ISSN Online: 3006-4708
ISSN Print: 3006-4694

SOCIAL SCIENCE REVIEW ARCHIVES
https://policyjournalofms.com

A Comparative Analysis of Tax Liabilities: Salaried Individuals Versus Associations of Persons (AOPs) Under Pakistan's 2025 Tax Regime

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DOI: https://doi.org/10.70670/sra.v3i3.1076

Abstract

This in-depth research article examines how Pakistan's Income Tax Ordinance, 2001, as amended by the Finance Act 2025, taxes salaried individuals and AOPs in different ways. The analysis reveals significant differences in tax rates, compliance requirements, and tax burdens among various classes of taxpayers who work for a salary, benefit from lower progressive tax rates, and have easier tax withholding. AOPs charge more and have more stringent rules for following the rules, especially if they have corporate members or make more than a certain amount. This paper examines these inequities through legal, economic, and equity lenses, utilizing Pakistan's tax documents and judicial precedents. The findings suggest that existing imbalances may lead to horizontal injustices and influence corporate structural decisions, necessitating a reassessment of policy to establish a more equitable and efficient tax system. It is suggested that the law be amended to make it easier to comply with the rules while ensuring that the government receives its revenue.

Introduction

In a fair tax system, everyone in the same situation should pay the same amount of tax, based on their ability to afford it. The 2001 Income Tax Ordinance, which mainly controls Pakistan's income tax system, contains varying rules for different taxpayers. Individual tax rates can be various. The new Finance Act 2025 modified the tax bands for individuals who work, but it retained the separate rules for Associations of Persons, which clarified these differences. It is essential to examine this difference from both scientific and legal perspectives to determine if it aligns with tax justice and economic efficiency.

Taxes don't just affect the government's bottom line; they also affect businesses' choices, investments, and markets. Pakistan's business climate and incentives to formalize are influenced by the fact that paid workers and AOPs (joint corporate ventures) are subject to different tax regimes. Law students and professionals must understand these disparities to inform tax planning, compliance guidance, and policy advocacy. The FBR is the main tax office in Pakistan. It enforces these laws to make it easier for taxpayers to follow them and to maximize profits, which often goes against fairness and administrative simplicity.

This legal analysis examines the amount of tax that people and AOPs owe under current law. This encompasses not only tax rates but also policy choices, compliance steps, legal interpretations, and the economic effects of these systems. The study utilizes the Income Tax Ordinance, 2001, as amended on July 31, 2025, official FBR publications, and globally recognized tax summaries to illustrate the changes of 2025.

The article is structured as follows: Section 2 sets up the conceptual framework and defines essential terms; Section 3 looks at the tax system for workers; Section 4 looks at how AOPs are treated; Section 5 compares systems; Section 6 looks at relevant court cases; and Section 7 ends with policy suggestions for making the tax system fairer and effective.

Conceptual Framework and Definitions

Salaried Individuals under the Income Tax Ordinance, 2001

The Income Tax Ordinance, 2001 generally defines "salary" as any payment an employee receives, such as wages, annuities, pensions, gratuities, fees, commissions, perks, and profits in place of or in addition to income. A salaried person is someone whose primary source of income comes from a job where they are controlled, dependent, and paid regularly. The Ordinance clearly states that salary is considered revenue from Pakistan if it is earned through work done in Pakistan, regardless of where the payment is made. This geographical link is what gives Pakistan the right to tax employment income.

The salaried individual category under tax law is crucial, as it possesses several unique characteristics. First, salaried people usually don't have as many ways to deduct their expenses as businesses do. This is because they can't claim costs they had to pay to obtain their income above certain legal limits. Second, the withholding tax system makes it easier for them to pay their taxes because employers deduct taxes at the source from salary payments. This system ensures that the exchequer receives regular payments and makes it more difficult for individuals to cheat. Third, people who work for a salary usually don't have the same freedom as businesses when it comes to timing revenue recognition, organizing transactions, or dispersing profits. This makes them the most open but also the most susceptible group of taxpayers.

Associations of Persons (AOPs): Legal Constitution and Tax Status

An Association of Persons (AOP) is a more complicated type of taxpayer under Pakistani law. The Income Tax Ordinance, 2001 says that an AOP is "a firm, a Hindu undivided family, any artificial juridical person, and any body of persons formed under a foreign law, but not a company." This term encompasses partnerships, professional firms, consortia, and other forms of collaboration where individuals or groups collaborate to generate revenue or conduct business. The most important thing about an AOP is that people work together for the same goal to make money.

The tax treatment of AOPs depends on whether they are legally separate taxable companies from their members. Section 92 of the Revenue Tax Ordinance, 2001 says that AOPs are taxed separately from their members. This means that the AOP alone is responsible for paying taxes on its own revenue. This separate entity method establishes a conduit principle, which means that income taxed at the AOP level is not taxed again when it is distributed to members. This stops double taxation in the economy. However, this conduit treatment is only available if certain conditions are met, such as AOPs with sales of more than PKR 300 million having to provide audited financial statements.

AOP taxation is challenging to understand because it involves a mix of various types of legal entities. For example, they are independent from each other in some ways but yet clear in others. AOPs are in the middle of the tax structure, unlike businesses, which have complete legal identity. There are unique requirements for situations involving corporate members, exempt revenue, and compliance failures. Due to this middle ground, AOPs have unique planning opportunities and compliance issues that distinguish them from both individual taxpayers and businesses.

Table 1: Key Definitions under the Income Tax Ordinance, 2001

Term Legal Definition Key Characteristics Tax Implications

A person who works for someone else and receives compensation for their work. Employer-employee relationship, regular payment, and few chances to deduct expenses Subject to progressive tax brackets, withholding at the source, and easier compliance

AOP, or Association of Persons Firm, Hindu undivided family, artificial juridical person, or group of people created by foreign law (not businesses) A collaborative element, a shared goal, and a goal of making money. Taxed as a separate company, the conditional conduit concept, and the possibility of higher rates

An individual, business, AOP, federal government, foreign government, or public international organization. A broad, all-encompassing definition establishes taxable capacity and jurisdiction.

Tax Regime for Salaried Individuals

Tax Slabs and Rates under the Finance Act 2025

The Finance Act 2025 introduced significant changes to the progressive tax brackets applicable to salaried workers. These changes helped low- and middle-income workers the most. The new structure, which goes into effect for the tax year 2025–26 (July 1, 2025 to June 30, 2026),