TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

MINIMUM ASSET TAX – PROPOSED MODEL FOR PAKISTAN

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408, CONTINENTAL TRADE CENTRE, BLOCK-8, CLIFTON, KARACHI
PH: +92-2135303293-6 | E-Mail: connect@tolaassociates.com | Web: www.tolaassociates.com

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Preamble

On the brink of formation of new Government after general elections, there are reports circulating in print and electronic media with respect to a possible Minimum Asset Tax model to be implemented in Pakistan to recover the economy after the formation of new parliament.

In this backdrop, we have inked this article for general public to understand the concept of Minimum Asset Tax, its (non) similarity with wealth tax and its possible features if implemented in Pakistan.

This model is much effective to eradicate the disparity in tax payments enjoyed by select few elites like agriculturists who enjoy sacred discriminatory exemptions against the working middle class of the country. However, the model may only be effective if implemented in its true spirit as envisaged in forthcoming article.

(Some excerpts of this article is also published in a leading newspaper, which may be accessed through https://epaper.brecorder.com/2018/08/17/21-page/733957-news.html).

1. Roots of Minimum Asset Tax

Minimum Asset Tax ("MAT") Scheme is a scheme first coined by legendary stock investor Warren Buffett to tax ultra-rich asset holders at 30%. The term was later referred as "Buffett Rule" by Ex-President United states of America, Mr. Barrack Obama.

Warren Buffett, publicly stated in early 2011 that he believed it was wrong that rich people, like himself, could pay less in federal taxes, as a portion of income, than the middle class, and voiced support for increased income taxes on the wealthy. He noted that he paid 17.4% of his taxable income in income and payroll taxes— "a lower percentage than was paid by any of the other 20 people" in his office. He stated that "the mega-rich pay income taxes at a rate of 15 percent on most of their earnings but pay practically nothing in payroll taxes." He proposed that tax rates be raised for taxpayers making more than $1 million.

The rule would implement a higher minimum tax rate for taxpayers in the highest income bracket, to ensure that they do not pay a lower percentage of income in taxes than less-affluent Americans. In October 2011, Senate leader Harry Reid proposed a 5.6 percent surtax on everyone making over a million dollars a year to pay for new stimulus provisions, but the change did not go through.

A White House statement released in January 2012 defined the rule as part of "measures to ensure everyone making over a million dollars a year pays a minimum effective tax rate of at least 30 percent ... implemented in a way that is equitable, including not disadvantaging individuals who make large charitable contributions." The White House also stated that "no household making more than $1 million each year should pay a smaller share of their income in taxes than a middle-class family pays."

The Buffett Rule was not in the President's 2012 budget proposal and the White House initially stressed it as a guideline rather than a legislative initiative. The rule, however, was later submitted for deliberation as US Senate Bill, *Paying a Fair Share Act of 2012*. On April 16, 2012, the bill received 51 affirmative votes, but was stopped by a Republican filibuster that required 60 votes to proceed to debate and a vote on final passage

2. Wealth Tax versus MAT

Wealth tax is a levy on the total value of personal assets and it is paid in addition to Income Tax. Whereas, under MAT model, all the assets of a person are taken into account to calculate a minimum tax rate at which a person should pay his tax liability. Infect MAT is minimum tax on individuals awaiting tax breaks to reduce their tax liabilities.

Wealth tax does not have any nexus with the amount of income tax paid. A person is required to pay a certain amount of wealth tax irrespective of the quantum of income tax paid. Whereas, MAT is the minimum amount of Income tax a person has to pay. If a person has paid lower income tax than the said limit, he will have to pay the differential amount. If the person has paid Income Tax more than or equal to the said limit, no MAT will have to be paid.

Example:

Wealth tax

Total Assets – Rs. 10,000,000
Wealth Tax Rate – 1%
Income Tax Paid/Liability – a) Rs. 90,000; b) Rs. 100,000; c) Rs. 130,000

In all the above cases, wealth tax liability shall be Rs. 100,000 (10,000,000x1%)

MAT

Total Assets – Rs. 10,000,000
Wealth Tax Rate – 1%
Income Tax Paid/Liability – a) Rs. 90,000; b) Rs. 100,000; c) Rs. 130,000

There shall be no MAT liability in cases (b) and (c). Whereas, in case (a), MAT liability shall be Rs. 10,000 (10,000,000x1% - 90,000).

MAT is a tool to fill the gaps created due to tax breaks between different sources of Income by mega rich as compared to those earning moderate incomes.

3. Wealth Tax in Other Jurisdictions

Current Examples

- British Columbia, Canada has implemented a tax on personal homes. The tax is in addition to regular property tax and begins at homes worth more than $3 million Canadian ($2.3 million US). The tax is 0.2% on the first million above the $3 million and 0.4% on any value above that. No recognition of mortgages, lien, or taxes due is taken into account.
- Argentina: It is named Impuesto a los Bienes Personales, on assets above ARS 800,000 (US$48,309.18), the annual rates are 0.75% for 2016, 0.50% for 2017 and 0.25% in 2018.
- France: Until 2017, there was a solidarity tax on wealth on any net assets above €800,000, if total net worth was €1,300,000 or more. Marginal rates ranged from 0.5% to 1.5%. In 2007. From 2018 onwards, it has been replaced by a wealth tax on real estate, exonerating all financial assets.
- Spain: There is a tax called *Patrimonio*. The tax rate is progressive, from 0.2 to 3.75% of net assets above the threshold of €700,000 after €300,000 primary residence allowance. The exact amount varies between provinces.
- Netherlands: There is a tax called *vermogensrendementheffing*. Although its name (*wealth yield tax*) suggests that it is a tax on the *yield* of wealth. It qualifies as a wealth tax, since the actual yield (whether it's positive or negative) is not taken into account in its calculation. Up to and including 2016, the rate was fixed at 1.2% (30% taxation over an assumed yield of 4%). From the fiscal year of 2017 onwards, the tax rate progresses with wealth. In addition to the *vermogensrendementheffing*, owners of real estate pay a tax called *onroerendezaakbelasting*, which is based on the estimated value of the real estate they own. This is a local tax, levied by the city council where the property is located.
- Norway: 0.7% (municipal) and 0.15% (national) a total of 0.85% levied on net assets exceeding 1,480,000 kr as of 2017. For tax purposes, the value of real estate assets is estimated to approximately 50% of the market value (25% if it is the taxpayer's primary

residence). The Conservative and Progress parties in the current government and the Liberal Party have stated that they aim to reduce and eventually eliminate the wealth tax.

- Switzerland: A progressive wealth tax that varies by residence location. Most cantons have no wealth tax for individual net worth less than CHF 100,000 and progressively raise the tax rate on net assets with a top rate ranging from 0.13% to 0.94% depending on canton and municipality of residence. Wealth tax is levied against worldwide assets of Swiss residents, but it is not levied against assets in Switzerland held by non-residents.

- Italy: Two wealth taxes are imposed. One, IVIE, is a 0.76% tax imposed on real assets held outside Italy. The values of such assets are determined by purchase price or current market value. Property taxes paid in the country where the real estate exists can offset IVIE. Another tax, IVAFE, is 0.15% and is levied on all financial assets located outside the country, including, so far as the language seems to imply, individual pension schemes such as 401(k)s and IRAs in the US.

Historical Examples of re-promulgation of wealth tax

- Iceland had a wealth tax until 2006 and a temporary wealth tax reintroduced in 2010 for four years. The tax was levied at a rate of 1.5% on net assets exceeding 75,000,000 kr for individuals and 100,000,000 kr for married couples.

  Some other European countries have discontinued this kind of tax in the recent years like Austria, Denmark (1995), Germany (1997), Finland (2006), Luxembourg (2006) and Sweden (2007). In the United Kingdom, property (real estate) is often a person's main asset, and has been taxed – for example the window tax of 1696, the rates, to some extent the Council Tax, and a new Mansion Tax proposed by some political parties.

4. History of Wealth Tax in Pakistan

Wealth Tax in Pakistan was first introduced vide Wealth Tax Act, 1963 which came into force on July 01, 1963. The rates of taxes ranged from 0.5% to 2.5% on net wealth exceeding Rs. 2.5 million. The Act was abolished through Finance Act, 2003.

It was said that the act was abolished to benefit a select few individuals to avoid their wealth tax liability which would have been accrued due to their status being changed into residents and due to their enormous wealth across the globe.

Later, vide Finance Act, 2013, an income support levy was introduced for tax years 2013 and onwards to charge tax at 0.5% of net moveable assets of individuals. However, the levy was repealed and ceased to exist subsequent to tax year 2013.

5. Proposed Model

As per the media reports, the new government is expected to introduce wealth tax in form of MAT. The gist of the scheme is to tax the citizens on the basis of fair market valuation of the assets held by them irrespective of their income generating capacity. The scheme is a tool to mitigate inequality of tax rates between ultra-rich and those who earn a tiny fraction as compared to those ultra-rich. A middle-class person having little or no assets end up paying more taxes, as compared to his assets, than the mega rich. (see Annexures A for Illustrations).

5.1. Salient Features of MAT

- All the assets, whether movable or immovable, may be subjected to MAT except for following:
  - Foreign Assets of a non-resident person.
  - Immovable assets up to 20 million held by senior citizens (age more than 60 years) not engaged in active business or profession.
  - Movable assets up to Rs. 2.5 million held by senior citizens.
  - Furniture, household utensils, wearing apparel, provisions and other articles (excluding jewellery and cars) intended for the personal or household use
  - One residential house owned and occupied by the assessee for purposes of his own residence
  - Books and manuscripts belonging to an assessee, not intended for sale
  - Any property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature in Pakistan
- Immovable properties may be valued at FBR notified rates. Whereas, FBR rates will be required to be updated to bring the values up to 80% of the market values. Rates for agricultural properties will also be required to be included in the FBR notified rates.
- For valuation of other assets, Valuation Table provided in Annexure C may be used:

- Taxes paid under Income Tax Ordinance, 2001; may be adjusted from Minimum Asset tax liability.

5.2. Income

The Business Dictionary defines income as 'The flow of cash or cash-equivalents received from work (wage or salary), capital (interest or profit), or land (rent). (http://www.businessdictionary.com/definition/income.html)

5.3. Resident Pakistani (Section 82)

As per section 82 of the ITO, an individual shall be a resident for a tax year if he is present in Pakistan for a period in aggregate amounting to 183 days or more in that tax year.

5.4. Major income types and rates in Pakistan

As per Income Tax Ordinance, 2001, Taxable Income is categorized as under (See Annexure B for details):

- Salary Income
- Business Income
- Income from Property
- Capital Gain
- Income under fixed tax regime
- Income from other sources

5.5. Agricultural Income Tax in Pakistan

Agricultural Income is being charged by provinces in respect of total agricultural income at the specified rates as under:

- Sindh – 5% to 15%
- Punjab – 5% to 15%
- Khyber Pakhtunkhwa – 5% to 17.5%
- Baluchistan – (Data not available)

6. Expected Rates

Minimum Tax Rates may range from 0.5% to 1% as under:

S. no.	Asset Value	Rate
1.	Upto 10 million	2%
2.	Next 40 million	1.75%
3.	Next 50 million	1.5%
4.	Next 400 million	1.25%
5.	Above 500 million	1.00%

7. Impediments

- **Legal** - Although MAT is a presumptive tax and is different from wealth tax as the wealth tax is in addition to Income Tax while MAT just provides a minimum tax rate to be charged on individuals based on their asset holdings, there may be arguments in legislative house that MAT is infect wealth tax. In such a circumstance, therefore, an amendment in the constitution will be required before introduction of MAT as Constitution of Pakistan does not provide for taxation on wealth of citizens.

- **Jurisdiction** - Similarly, the right to collect taxes on immovable properties are currently vested to provinces as per constitution of Pakistan, therefore, amendment in constitution to this effect will also be required to extend the same to federal jurisdiction.

- **Fair Market Values** - Prevailing FBR notified rates for valuation of immovable properties are highly disproportionate with their current market values. In most localities, the market values of properties are double the FBR rates. To remove the anomaly, FBR notified rates are required to be brought up to at least 80% of their real market values.

- **Agricultural Property** - Similarly, there are no FBR rates for agricultural properties in addition to their income being exempted from Income Tax Ordinance, 2001. This sector has been creating income tax rate disparity in Pakistan for decades and is one of the causes of lower tax rates on mega rich owning these properties. These properties are also required to be included in FBR list of notified rates to remove inequality.

8. Way Forward

To estimate the revenue generation from the model, a comprehensive study may be performed with the help of data available with Pakistan Bureau of Statistics with respect to dwelling houses, cultivated agricultural lands and investments. For equity investments, data of Central Depository Company of Pakistan may also be evaluated.

9. Conclusion

Introduction of MAT, after removal of above impediments, will enable eradication of income tax rate inequality and concentration of wealth enjoyed by elite class of the country and will contribute much needed additional revenues. Recent asset declaration scheme has resulted in 2.5 trillion fresh assets declared (unofficial sources), meaning that if only these declarations are accounted for and lowest MAT rate of 1% is used, this model may result in additional revenues of Rs. 25 Billion.

MAT serves as a negative reinforcer ("use it or lose it"), which coerces the productive use of assets. MAT also account for capital that is not productively employed. Thus, MAT can be viewed as a tax on potential income from capital. The idle assets are, therefore, put to use and invested in new ventures promoting investments and economic growth in the country.

Moreover, investment in commercial assets would create demand for labor, more financial resources in the hands of the poor and middle class would reduce their reliance on government delivery of social goods, such as improved educational opportunities for their children. That would promote social mobility, meaning more citizens would reach their full potential of productivity, thus improving the economy. Increased government revenue from MAT could be used to promote public investment in services like education, basic science research, and transportation infrastructure, which in turn improve economic efficiency. Increased government revenue from MAT coupled with restrained government spending would reduce government borrowing and so free more credit for the private sector to promote business. A strong, steadily growing economy could in turn increase tax revenues further, allowing for more deficit reduction, and so on in a virtuous cycle.

ILLUSTRATIONS

Annexure A

1. Salaried Person

S. No.	Asset Nature	Asset/Capital		Taxable Income	Effective Tax Rates	Tax
		Cost	FMV			
1.	Salary	-	-	3,000,000	4%	120,000
2.	Other Personal Assets	1,000,000	1,000,000	-	-	-
	Total	**1,000,000**	**1,000,000**	**3,000,000**	**-**	**120,000**

Effective Tax rate as a percentage of Fair Market Values of Assets = 12%

2. Business Individual

S. No.	Asset Nature	Asset/Capital		Taxable Income	Effective Tax Rates	Tax
		Cost	FMV			
1.	Capital (NTR)	10,500,000	10,500,000	3,000,000	4%	120,000
2.	Capital (FTR)	10,000,000	10,000,000	2,000,000	5%	100,000
3.	Personal House	1,000,000	6,000,000	-	-	-
4.	Other Personal Assets	1,000,000	1,000,000	-	-	-
	Total	**22,500,000**	**27,500,000**	**5,000,000**	**-**	**220,000**

Effective Tax rate as a percentage of Fair Market Values of Assets = 1.8%

3. Investor

S. No.	Asset Nature	Asset/Capital		Taxable Income	Effective Tax Rates	Tax
		Cost	FMV			
1.	Shares – Capital Gain	10,000,000	15,000,000	5,000,000	10%	500,000
2.	Deposits - Interest	10,000,000	10,000,000	1,000,000	15%	150,000
2.	Personal House	1,000,000	6,000,000	-	-	-
3.	Other Personal Assets	1,000,000	1,000,000	-	-	-
	Total	**22,000,000**	**32,000,000**	**6,000,000**	**-**	**650,000**

Effective Tax rate as a percentage of Fair Market Values of Assets = 2.03%

4. Business professional

S. No.	Asset Nature	Asset/Capital		Taxable Income	Effective Tax Rates	Tax
		Cost	FMV			
1.	Capital	1,000,000	1,000,000	5,000,000	10%	500,000
2.	Personal House	1,000,000	6,000,000	-	-	-
3.	Personal Car	2,000,000	2,000,000	-	-	-
4.	Other Personal Assets	1,000,000	1,000,000	-	-	-
	Total	**5,000,000**	**10,000,000**	**5,000,000**	**-**	**500,000**

Effective Tax rate as a percentage of Fair Market Values of Assets = 5%

5. Agriculturist Land Lords

S. No.	Asset Nature	Asset/Capital		Taxable Income	Effective Tax Rates	Tax
		Cost	FMV			
1.	Agricultural Property	1,000,000	10,000,000	100,000	-	-
2.	Personal House	1,000,000	6,000,000	-	-	-
3.	Personal Car	5,000,000	5,000,000	-	-	-
4.	Other Personal Assets	10,000,000	10,000,000	-	-	-
	Total	**17,000,000**	**31,000,000**	**100,000**	**-**	**-**

Effective Tax rate as a percentage of Fair Market Values of Assets = Nil

VALUATION TABLE

Annexure B

S. No.	Asset Type	Valuation
1.	Imported motor vehicles.	A-B A= CIF value plus the amount of all charges, customs-duty, sales tax, levies, octroi, fees and other duties and taxes leviable thereon and the costs incurred till their registration. B = a sum equal to 10% of the said value for each successive year up to a maximum of five years.
2.	Motor vehicles purchased from a manufacturer or assembler or dealer in Pakistan.	A-B A= The price paid by the purchaser, including the amount of all charges, customs duty, sales tax and other taxes, levies, octroi, fees and all other duties and taxes leviable thereon and the costs incurred till their registration. B = a sum equal to 10% of the said value for each successive year upto a maximum of five years.
3.	Used motor vehicles purchased locally.	Value determined in the manner specified in S.N. 1 or 2, as the case may be, as reduced by an amount equal to 10% for every year following the year in which it was imported or purchased from a manufacturer.
4.	Securities and shares traded on stock exchange.	Day-end price of the share or security quoted on registered stock exchange as on last day of relevant tax year and where no day-end price of such share or security is quoted on stock exchange on last day of relevant tax year, day-end price of the share or security quoted on a date nearest to last day of relevant tax year but not any date subsequent to last day.

S. No.	Asset Type	Valuation
5.	Securities and shares not traded on stock exchange.	Break-up value or face value, whichever is higher. Breakup value shall be the sum of paid-up capital, reserves and balance as per profit and loss account as reduced by the value of preference shares and divided by the amount of the paid up ordinary share capital.
6.	National saving schemes, postal certificates, bonds, securities and other similar investments in capital instruments not traded or quoted on stock exchange.	Face value.
7.	Gold.	Rupees 4500 per gram.
8.	Other precious stones and metals.	Market rate as on last day of relevant tax year or cost of acquisition, whichever is higher.
9.	Stock-in-trade.	Market rate as on last day of relevant tax year.
10.	Plant and machinery.	Actual cost of acquisition.
11.	Accounts receivable.	Actual cost of acquisition.
12.	Other assets.	Actual cost of acquisition.

S. No.	Asset Type	Valuation
13.	Prize bonds, cash and bank accounts including foreign currency accounts.	Face value.
14.	Foreign Assets	Fair Market Value as on last day of the relevant tax year.

MAJOR TYPES OF INCOME & RATES Annexure C

Income Type	Rate
• Salary Income	Rs. 0 to 15%
• Business Income	Rs. 0 to 15%
• Income from Property	Rs. 0 to 20%
• Capital Gain	0% to 15%
• Income under fixed tax regime	
○ Dividend income	7.5% to 15%
○ Prizes and winnings	15% and 20%
○ Exports receipts	1% of receipts
○ Commercial Imports	4.5% to 6%
○ Local Purchase of cooking oil or vegetable ghee by manufacturers	2%
○ Petrol Pump Operations	12%
○ CNG stations operations	4%
○ Commission or brokerage	8% to 12%
○ Sale of right to collect tolls	10%
○ Rent from machinery and equipment	10%
○ Interest Income	10% to 15%
○ Commission by stock exchange members	0.02%
• Income from other sources	Rs. to 15%