Weaknesses in Palestinian Income Tax System: Reasons and Possible Remedies

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Abstract

Since 1994 the year of Palestinian Authority establishment, Palestinian public budget suffered from a large deficit which affects negatively on its financial power to pay its obligations. According to the budget of Palestinian Authority in 2010, income tax revenues represent about 3% of GDP and only about 8 % of total tax revenues. Therefore, this paper tried to discuss the main reasons behind the weaknesses in Palestinian income tax revenues in the view of tax administrators and tax officers using descriptive survey methodology by preparing a detailed questionnaire contain 26 paragraphs tried to find an interpretation to the problem of this study, this questionnaire distributed to a sample of 60 tax administrators were working in tax administrations in different cities of Palestine

Our finding shows that the main reasons behind weakness in Palestinian income tax revenues are due to the followings: weaknesses in income tax control system, low level of income in Palestine, lack of tax and nontax incentives.

Keywords: Weaknesses of Income Tax Revenues, Income Tax Burden, Palestinian Incomes Tax System

1. Introduction

Income tax revenue is one of most important income for national governments because of its valuable contributions in covering public expenditures. So, Palestinian Authority tried to introduce modern tax law and design procedures help them in increasing their revenues without breaking fairness principle of income tax. The first Palestinian income tax system has been issued in 2004 and entered to implementation on Jan.1, 2005, titled Tax Law 17\2004 (Abdulhamid, 2006).

Tax Law 17\2004 designed to achieve the fairness for both government and taxpayers; it was organized to keep government rights in collecting income tax revenues accrued during any tax year, at the mean time it was levied according to the social and financial power of taxpayers.

In this case and after implementing this law for more than 5 years, government revenues from income tax still suffered from a real weakness, the ratio of income tax revenue to GDP is about 3%. The main questions here are why Palestinian income tax revenues suffered from this weakness? Why it cannot keep government rights? Why the ratio of income tax revenue to GDP is low? This paper tried to answer these questions.

2. Palestinian Tax Administration

Palestinian Tax Administration consists of following departments:

- Income Tax Department (Individual and Corporate)
- Value Added Tax Department
- Excises and Customs Department
- Property Tax Department

All of mentioned departments are reported to minister of finance directly and each of them has a branch office in all of Palestinian cities (ministry of finance website).

2.1. Income Tax in Palestine

This section will discuss some of main articles of Act17\2004, after giving a brief history of Palestinian income tax system.

2.1.1. Brief History of Palestinian income tax system

In the earlier of 1940s British mandatory levied the first income tax law in the Palestinian territories, after withdrawing of British forces from Palestine, Jordan levied Jordanian income tax law on west bank while Egypt levied Egyptian income tax law on Gaza (Alawna,1992). Despite of Israeli occupation to west bank and Gaza areas they continued in levying the same tax laws with some adjustments issued by Israeli Civil Authority to comply these laws with their military orders. After establishment of Palestinian Authority in 1994 according to Oslo agreement, the same laws were continued in implementation with some reliefs and exemptions paired with reductions in tax rates. Since January 2005, the first National Income Tax Law which was issued by Palestinian Legislation Council (PLC) in 2004 has been implemented.

Palestinian Income Tax Law consist of 48 articles discussed all policies and procedures related to tax levying cycle for both individuals and corporations. This law stated corporate flat tax rate of 15%, while a progressive tax rates stated for individuals starting from 5% to 15% (Act 17\2004).

2.1.2. Income Tax Law: Main Issues

Act 17\2004 as the first Palestinian income tax law tried to build a new relationship between taxpayers and tax administration based on mutual confidence to cancel the previous visions toward tax evasion as a national action during occupation period. Therefore, Act 17\2004 minimize upper tax rate from 38.5% to 15% and increase tax exemptions for individuals. This section will summarize major Act 17\2004 articles:

- Residency is the main factor in defining taxpayers
- Accrual base has been adopted to determine taxable income
- Annual deduction of $7200 is given for all individual taxpayers
- Dividends and capital gains were exempted from income tax
- A progressive tax rates has been applied for individual taxpayers as following:

Table 1

Applied Income Tax Rates in Palestine

Individual Tax Brackets $	Tax Rates
1-10000	5%
10001-20000	10%
More than 20001	15%

Source: Palestinian income tax law Act17\2004

While flat tax rate of 15% is applied for corporation

3. Palestinian Income Tax Revenues

In this section, this paper is discussing the impact of income tax revenue in public budget and GDP of Palestine

3.1. Structure of Public Revenues in Palestine

Public revenues in Palestine consist of tax and nontax revenues while tax revenue represents about 50% of public revenue in 2010 and 65% of them are indirect taxes (Ministry of Finance Publications, 2010).

Table 2

Changes in Public Revenues through 2004-2010

Year	2004	2005	2006	2007	2008	2009	2010
Public Revenue $	954	1233	1148	1194	1486	1677	1988.8

Source: Ministry of Finance in Palestine, www.pmof.ps, 2011

Above table show the growth in public revenue during the period of 2004-2010 was reached about 108% which indicate to the improvement in physical policy of Palestinian Authority during mentioned period.

3.2. Development of Tax Revenues in Palestine

Palestinian Tax system consist from direct and indirect taxes, while direct taxes include property tax and income tax, indirect taxes include customs and excise from one side and value added tax from another side. In general, Palestinian tax revenues has been increased by 125% during the period of 2004 to 2010, table below will show the changes in total tax revenue and income tax revenue during 2004-2010

Table 3

Changes in Total Tax and Income Tax Revenues during 2004-2010

Year	Tax Revenues	Income Tax Revenues	% of Income Tax Revenues as Total Tax Revenues
2004	808	64	8%
2005	988	80	8%
2006	992	88	9%
2007	1098	77	7%
2008	1328	59	4%
2009	1491	99	7%
2010	1816	138	8%

Source: Ministry of finance in Palestine, www.pmof.ps, 2011

Above table shows that the income tax revenue represents only about 8% of total tax revenues which means indirect taxes such as value added tax and excises and customs is the main tax revenue of Palestinian Authority. The main reason behind the reduction in income tax revenue percentage during 2007 and 2008 is the political situation in West Bank and Gaza Strip as a result to the fighting between Palestinian political parties.

3.3. Income Tax Burden in Palestine

In spite of increasing in income tax revenue by 116% during the period of 2004-2010 but it still represent less than 3% of GDP, the following table will show the changes in income tax revenue as a percentage of GDP (income tax burden) during the period of 2004-2010

Table 4

The changes in income tax burden during the periods of 2004-2010

Year	Tax Revenues	Income Tax Revenues	Income Tax Burden	Total Tax Burden
2004	808	64	1.4%	17.7%
2005	988	80	1.7%	21%
2006	992	88	2%	22.5%
2007	1098	77	1.7%	24.2%
2008	1328	59	1.2%	27%
2009	1491	99	1.9%	28.6%
2010	1816	138	3%	39.5%

Sources: Ministry of finance in Palestine, www.pmof.ps, 2011

Palestinian Central Bureau of Statistics website, http://www.pcbs.gov.ps, 2011

The above table shows the percentage of income tax revenue to GDP (Income Tax Burden) has been doubled from 2004 to 2010 while the reduction in 2007 and 2008 was raised because the instability in the political situation in Palestinian Territories. On the other hand, the total tax revenue percentage to GDP has been raised more than double between the periods of 2004-2010 while it was about 17.7% in 2004; it was increased to 39.5% in 2010.

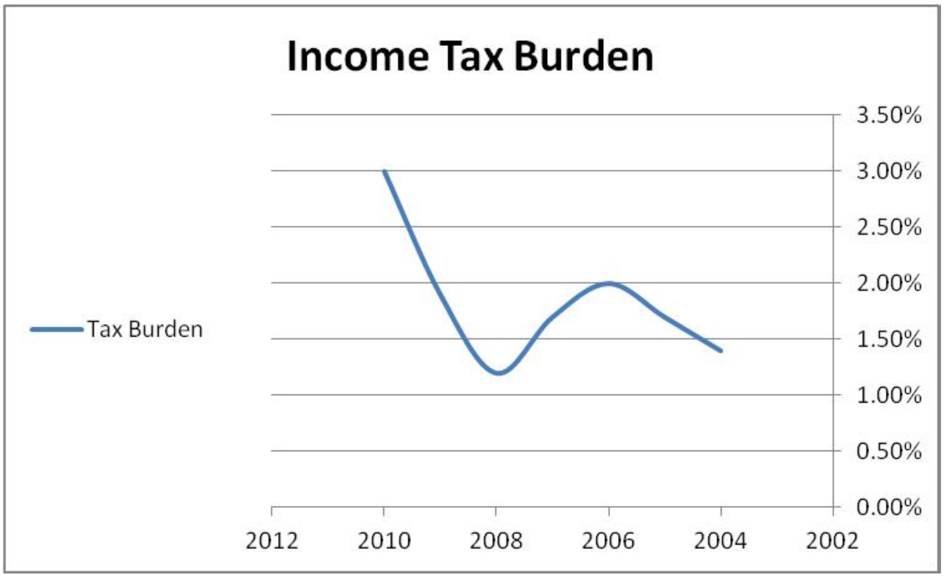
The composition of taxation in Palestine indicate that VAT is the main tax revenues in which represent about 32% of GDP while other taxes including (excises and customs, property and income tax) represent 7% of GDP, divided as following: excises and customs 3%, property taxes less than 1% and Income tax revenue 3%.

This unfair tax composition means consumption taxes, especially VAT play the main role in financing public expenditures which has negative effects on low income taxpayer.

In spite of this increasing in tax burden but it is still weak in comparison with the average of tax burden in OECD countries which was around 10% (OECD website, 2010).

Figure (1)

Income Tax Burden between 2004 and 2010



Ministry of finance in Palestine, www.pmof.ps, 2011

4. Conclusion:

The analysis of the questionnaire which was prepared and distributed to the administrators at Palestinian income tax authority discussing the reasons behind the low income tax burden in Palestine shows:

Weaknesses in income tax control and audit system is one of the main problems faced tax revenues because the lack of competence and skilled employees in tax auditing restrict the implementation of efficient control and audit plan to reduce tax avoidance and evasion

The second main reason was the low income level in comparison with developed countries, GDP per capita is less than $1300. This is because the instability of economic and political situation in Palestine.

Third, tax losses because inexistence of efficient plan to tax e-commerce transactions that was increased recently

Last, lack of tax and nontax incentives for taxpayers motivate them to comply with tax system and enhance their confidence in tax administration

5. Recommendations

Basing on the above results following recommendation could be adopted:

1. Using computerized tax system (e-tax system) and enhancing tax control and audit system with high skilled and well trained employees to overcome tax evasion problem. The computerized tax system (e-tax) will keep daily connection between taxpayers and tax administrators by submitting daily financial report to tax administration; this will be by providing electronic devices for each taxpayer connected with tax administration in his location
2. Spending more efforts to establish new relationship between taxpayers and tax administrators based on confidence by organizing meetings, distributing brochures and recruiting media campaign defining the importance of taxes and the obligations of taxpayers. In addition to, ministry of finance should motivate taxpayers to comply with tax system by adopting tax and nontax incentives such as:

- Offering addition tax deduction for taxpayers according to his annual consumption which proved by tax invoices or it could be cleared to tax administration during daily e-tax reports sending by taxpayers as mentioned above
- Offering facilities to clean taxpayers, clean taxpayers who are complying totally with tax system at all, these facilitation could take different shapes such as issuing VIP cards to facilitate their life in public community (governments, public companies, and border points), card holders have the priority in government services, respond their needs immediately with a real discount rate…etc.

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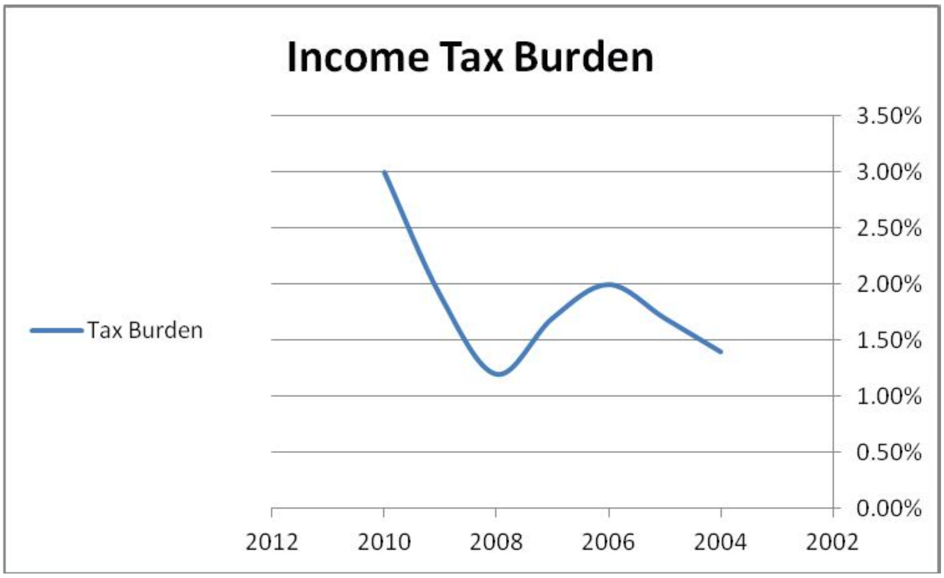

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