

The Reasons of Tax Evasion in Palestine: View of Tax Managers in Income Tax Department

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Abstract

Tax evasion phenomena is one of the most challenges faced the physical stability of Palestinian government. Lack of tax revenues caused annual high deficit in the public budget. This study aims to explore the causes of tax evasion phenomena in the view of income tax managers in Palestine. For that a questionnaire of 37 paragraphs has been developed and distributed to employees of income tax administration in west bank of Palestine. Then SPSS software has been used for statistical analysis. Depending on statistical study the main causes of income tax evasion in Palestine are due to: economic agreement between Palestine and Israel (Paris protocol), lack of detailed applicable control plan in tax administrations, inefficiency of some employees in tax administration and complicated procedures in tax collection. This study offered several recommendations to deal with causes mentioned above.

1. Introduction

Tax is the most important resources for governments to finance their public expenditures specially in countries such Palestine because of lack in natural resources, so tax evasion and avoidance have a high negatively affect on government powerful to meet its obligation.

The public budget of Palestine depends on taxes in financing its expenditures, 90% of public budget sourced from taxes while 17% of them come from income tax revenues and the rest amount come from indirect taxes such as VAT and Customs (ministry of finance website).

The annual deficit of Palestinian public budget reached in 2012 to 1400 million USD; this means the government should investigate the causes of this deficit and the best methods to reduce it (ministry of finance website).

One of the main reasons of the deficit in public budget is weaknesses in Palestinian income tax revenues which represent only 3% of GDP (Rahhal, 2012). General Accountant of Ministry of Finance in Palestine Mr. Yusef Zomour declared that tax evasion in Palestine reached to 500 million USD in 2011, (Alhayat newspaper, 2011), this is interpret clearly the main reason of weakness in Palestinian income tax revenues.

This study try to explore the causes of this high percentage of tax evasion in Palestine in the view of income tax administrators by developing a questionnaire disseminate for income tax administrators either who works in the headquarter of income tax administration which located at the building of finance ministry or who works in the branches of income tax department in different cities of west bank.

2. Literature review

2.1. Tax Evasion VS Tax Avoidance

Tax is defined as contribution of householders in financing public goods and tax compliance is enforced by the law, while planning to reduce tax payment or taxpayer's failure to comply with their tax obligations is defined as tax evasion or tax avoidance. Distinguishing between tax evasion and avoidance is subject to tools used in reducing tax payments, if taxpayers sheltered by tax law items or adoption accounting methods accepted by tax legislations to reduce tax liabilities tax avoidance or legally tax evasion will be introduced, while illegally tax evasion is breaking intentionally tax legislation (Franzoni, 1998).

Tax evasion and tax avoidance involve similar taxpayer behavior and are each undertaken in pursuit of the same broad aim: to minimize or to eliminate tax liability. They are factually similar, but legally distinct. Tax evasion is illegal. It consists in the willful violation or circumvention of applicable tax laws in order to minimize tax liability. Tax evasion generally involves either deliberate under-reporting or non-reporting of receipts, or false claims to deductions. This conduct is legally straightforward to identify; a taxpayer has committed tax evasion only if he or she has breached a relevant law. Indeed, evasion ordinarily involves criminal fraud. Tax avoidance is not illegal. Rather, it is the act of taking advantage of legal opportunities to minimize one's tax liability. (Prebble and Lincoln, 2012)

A study of tax evasion in Armenia [McGee, 1999b] summarized the reasons of evasion by two main issues: 1) the lack of a mechanism in place to collect tax 2) the widespread opinion that the government does not deserve a portion of a worker's income.

Both of them will effect negatively on government powerful to meet its obligations because of tax gap between expected tax revenues and tax compliance by taxpayers or distancing statutory taxes from effective payments (Franzoni, 1998)

2.2. Reasons of Tax Evasion

Growth of tax evasion phenomena could be resulted from various reasons some of them related to tax system while other related to taxpayers (Cohn, 1998)

2.2.1. Tax Evasion Reasons Related to Tax system

- a. Lack of efficiency in tax employees in implementing tax audit plan

- b. Corruption in tax administration
- c. Complicated of tax collection procedures
- d. Weaknesses in tax legislations could facilitate tax evasion and avoidance

2.2.2. Tax Evasion Reasons Related to Taxpayer

- a. Ethics of Taxpayers
- b. Lack of taxpayers awareness toward importance of tax payments
- c. High tax burden which called economical reasons of tax evasion

2.3. Decision to evade

Compliance with tax law means (Franzoni, 1998):

- I. True reporting of tax base (true revenues and true expense)
- II. Correct Computation of tax liability
- III. Timely filling the tax return
- IV. Timely payment of amount due

Not-compliance with one of above points means tax evasion is done. Most evaders either do not declare their liability at all or declare it only in part.

2.4. Ethics of Tax Evasion

From past centuries, different views have emerged on the ethics of tax evasion. First view, in all circumstances tax evasion is always, or almost always unethical. There are basically three underlying rationales for this belief. One reason is the belief that individuals have a duty to the state to pay whatever taxes the state demands. This view is especially prevalent in democracies, where there is a strong belief that individuals should conform to majority rule. (McGee, 2005)

The second rationale for an ethical duty to pay taxes is because the individual has a duty to other members of the community. This view holds that individuals should not be freeloaders by taking advantage of the services the state provides while not contributing to the payment of those services. A corollary of this belief is the view that if tax dodgers do not pay their fair share, then law abiding taxpayers must pay more than their fair share.

The third rationale is that we owe a duty to God to pay taxes, or, stated differently, God has commanded us to pay our taxes. This view holds no water among atheists, of course, but the view is strongly held in some religious circles. (McGee, 2005)

Second view adopt the thought of there is no duty to pay taxes because the state is illegitimate, a mere thief that has no moral authority to take anything from anyone. The state is no more than a mafia that, under democracy, has its leaders chosen by the people. This view insists that there is no such thing as a social contract according to this position. Where there is no explicit agreement to pay taxes there also is no duty. All taxation necessarily involves the taking of property by force or the threat of force, without the owner's permission. Thus, it meets the definition of theft. Stated as an equation, TAXATION = THEFT. A corollary equation is that FAIR SHARE = 0. (McGee, 2005)

View Three holds that tax evasion may be ethical under some circumstances and unethical under other circumstances. This view is the prevalent view, both in the literature and according to the present survey. (McGee, 2005)

The articles by Cohn [1998], Tamari [1998], Smith and Kimball [1998] and Ahmad [1995], insist that all religions Jewish, Christians and Islam considered tax evasion unethical action should be ended.

3. Income tax in Palestine

This section will discuss some of main articles of Act 8\2011, after giving a brief history of Palestinian income tax system.

3.1 A 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).

President of Palestinian Authority issued a new income tax order has law enforceable in 2011 this law titled Act 8/2011, the main changes in this law that Act 8/2011 adopted Israeli Currency (Shekel) for taxing Palestinian income, in addition to other changes in tax rates, exemptions...so on.

3.2 Income Tax Law: Main Issues

Act 8\2011 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 8\2011 minimize upper tax rate from 38.5% to 20% and increase tax exemptions for individuals. This section will summarize major articles of Act 8\2011:

- Residency is the main factor in defining taxpayers
- Accrual base has been adopted to determine taxable income

- Annual deduction of 30000 shekel is given for all individual taxpayers
- capital gains were exempted from income tax
- A progressive tax rates has been applied for individual taxpayers as following:

Table 1. Applied Individual Income Tax Rates in Palestine

Individual Tax Brackets Shekel	Tax Rates
1-40000	5%
40001-80000	10%
80001-125000	15%
More than 125000	20%

Source: Palestinian income tax law Act8/2011

Table 2. Applied Corporate Income Tax Rates in Palestine

Tax Brackets (Shekel)	Tax Rates
1-125000	15%
More than 125000	20%

Source: Palestinian income tax law Act8/2011

Dividends were taxed of 10% and interest on saving accounts taxed for 5%

3.3 Palestinian Income Tax Revenues

In this section, this paper is discussing the impact of income tax revenue in public budget and GDP of Palestine. 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, 2013).

Table 3. Changes in Tax Revenues through 2007-2013

Year	2007	2008	2009	2010	2011	2012	2013
Total Revenues (Million Shekel)	5216	5551	6230	7021	7321	7989	8230
Income Tax Revenues (Million Shekel)	297	227	381	531	614	771	994
% of Income tax Revenues to Total Revenues	5.7%	4.08%	6.1%	7.6%	8.4%	9.7%	12.1%
% of income tax revenues to GDP	1.7%	1.2%	1.9%	2%	1.8%	1.9%	2%

Source: Ministry of Finance in Palestine, www.pmf.ps, 2014

Palestinian Central Bureau of Statistics website, <http://www.pcbs.gov.ps>, 2014

Above table show the growth in public revenue during the period of 2007-2013 was reached about 58% which indicate to the improvement in physical policy of Palestinian Authority during mentioned period, at a meanwhile the income tax revenues has been increased by 234.6%. Despite this increasing in income tax revenues, the percentage of income tax revenues to GDP increased by 0.3% only. Which means the increasing in income tax revenues is reflecting the increasing in GDP not reduction of tax evasion

4. Methodology

After reviewing the literature of tax evasion a questionnaire of 37 statements was prepared and 27 copies was distributed to managers of income tax administration in all cities of Palestinian territories governed by Palestinian Authority. Using a five-point Likert scale, the respondents should answer the questionnaire by choosing the appropriate point from strongly agree to disagree

This survey tries to examine the causes of tax evasion in Palestine which they are grouped in following main reasons:

1. Weaknesses in control procedures of Tax units
2. Inefficiency of tax staff at income tax department
3. Economic agreement with Israeli government
4. Weaknesses of tax legislations
5. Complicated of tax collections

4.1 Survey Analysis

Table 4. The Scores of Main Causes of Tax Evasion

Cause of Tax Evasion	Mean Score	Standard Deviation
Weaknesses in control procedures of Tax units	3.66	0.60
Inefficiency of tax staff at income tax department	3.12	0.78
Economic agreement with Israeli government	3.86	0.72
Weaknesses of tax legislations	3.48	0.37
Complicated of tax collections	3.03	0.81

Table (4) indicate that all mentioned causes of tax evasion in Palestine have been accepted by respondents, while economic agreement with Israeli government was classified as a main cause of tax evasion with a score of 3.86, this followed by weaknesses in control procedures with score of 3.66, then weaknesses of tax legislation with 3.48, followed by inefficiency of tax staff at income tax department with 3.12, while complicated of tax collection was the last cause with score of 3.03.

Table 5. Statements Scores of Weaknesses in control procedures of Tax units as a cause of Tax Evasion

#	Statement	Mean Score
1	Lack in number of tax staff	3.19
2	Rarely of routine visits to taxpayers working place	3.56
3	Weakness in coordination between different tax departments	3.74
4	In efficiency in implementation of control procedures	3.26
5	Weakness in coordination between tax departments and other government units	4.19
6	Weaknesses in control and audit plans	3.78
7	Unsystematic of audit plans	3.56
8	Weaknesses in coordination between tax departments and public institutions	3.78
9	Lack of motivation for households to share in tax control	4.15
10	No electronic links between tax departments and taxpayers to activate daily control	3.48
Average of Weaknesses in control procedures of Tax units as a cause of tax evasion		3.66

Table (5) indicate that two reasons are dominate in this cause of tax evasion Weakness in coordination between tax departments and other government units with score of 4.19 and Lack of motivation for households to share in tax control with score of 4.15 while less important reason was lack of tax staff with score of 3.19

Table 6. Statements Scores of economic agreement with Israeli government as a cause of Tax Evasion

#	Statement	Mean Score
1	Not compliance to economic agreement by Israel	3.48
2	Economic agreement restrict Palestinian government in determining tax rates	3.67
3	Israeli occupation restrict the powerful Palestinian tax departments in implementation of tax audit plans	4.22
4	Difficulties in auditing of business contract has an Israeli party	4.19
5	Difficulties in imposing income tax on Palestinian workers in Israel	3.78
Average of Economic agreement with Israeli government as a cause of tax evasion		3.86

Table (6) indicate that restriction of Israeli occupation reduce the Palestinian government in implementation of tax audit plans with score of 4.22 followed by auditing difficulties of business contract has an Israeli party with score of 4.19

Table 7. Statements Scores of Inefficiency of tax staff at income tax department as a cause of Tax Evasion

#	Statement	Mean Score
1	Staff of tax departments have no academic qualifications	2.15
2	Lack of experience	2.74
3	Lack in training courses to improve employee performance	3.48
4	Difficulties in understanding of tax legislation	2.96
5	Lack of financial and non-financial incentives	4.07
6	Lack of updating to developments in tax and accounting fields around the world	3.33
Average of Inefficiency of tax staff at income tax department as a cause of tax evasion		3.12

This table shows that lack of training courses and lack of incentives are the main reasons for the inefficiency of tax staff.

Table 8. Statements Scores of Weaknesses of tax legislations as a cause of Tax Evasion

#	Statement	Mean Score
1	Lot of tax legislations	3.52
2	No adoptions for tax awareness in tax laws	3.52
3	Difficulties in understandings of tax law articles	3.44
4	Some of law articles could facilitate tax evasion unintentionally	2.52
5	No implementation to articles of tax evasion punishments	4.11
6	No activation to special court of tax evasion crimes	4.07
7	Lack of cooperation between police and tax departments in the field of tax evasion crimes	3.85
8	Some of tax article are unclear	3.33
9	No incentives to taxpayers who paid their obligations	3.48
10	Lack of fairness in following tax items	
i	Tax rates	2.85
ii	Exemptions	2.89
iii	Deductions	3.15
iiii	Discounts	3.00
Average of Weaknesses of tax legislations as a cause of Tax Evasion		3.36

In table (8) weaknesses in implementation of punishment towards tax evaders could be the main reason for tax evasion followed by lack of cooperation between different tax departments and units in the fighting tax evasion crimes. Finally, lack of tax incentives offered to taxpayers to comply with their tax liabilities could push to evade from income tax.

Table 9. Statements Scores of Complicated of tax collections as a cause of Tax Evasion

#	Statement	Mean Score
1	Tax collection policies and procedures are not clear	2.96
2	Lack of depending on audited financial statements to assess tax obligations	3.04
3	Times of tax payments is too late	2.85
4	Manual tax assessing in order to use software	3.26
5	Limitations in tax payment method (cash payment)	3.30
6	Imposing tax depends to understandings between tax staff and taxpayers rather than complete implementation to tax law	2.78
Average of Complicated of tax collections as a cause of Tax Evasion		3.03

Table (9) indicates that this cause is less important than other causes; the high score was 3.3 only for limitation in tax payment method. The only way to pay tax liabilities is cash payment, the cause is followed by using manual system to assess imposed tax in order to use software and electronic devices for simplifying tax assessment and to give more accurate value in shorter time which could reduce the cost of tax assessment.

5. CONCLUSION

The Palestinian budget suffers from a huge deficit because of weaknesses in tax revenues especially in income tax revenues which represent less than 3% of GDP. The main reason of this weakness was tax evasion which was estimated by 500 million dollars annually.

This study tried to explore the main causes of tax evasion in Palestine in the view of income tax administration. Regarding to the views of questionnaire respondents, the main causes of tax evasion in Palestine belonged to following causes: economic agreement between Palestine and Israeli government, weaknesses in implemented concrete control plan by tax administration, lack of efficient staff employed in tax administration and complicated tax collection procedures because of weaknesses in tax legislations.

Ministry of finance incorporation with other units in Palestinian governments should spent more efforts in designing and developing concrete plan to fight tax evaders and to minimize tax evasion effects. One of main urgent steps should be adopted by Palestinian government is canceling or adjusting the economic agreement with Israel to give Palestinian government the freedom in implementing tax control plan in B and C areas which they are still occupied by Israeli military authority .

Department of general revenues in ministry of finance should develop their employed staff by sending them for international courses to increase their skills in detecting tax evasion actions and to develop their styles in dealing with taxpayers.

Developing IT networks between different tax administrations from one side and between taxpayers and tax administration from other side, therefore, tax administration should have to look for e-tax model, which links taxpayers with tax administration directly by sending daily taxpayers transactions to tax administration for controlling purposes

Establishing an awareness campaign of taxpayers about the negative effects of tax evasion on Palestinian economic stability by organizing conferences, lecturers and mass media and they should employed religion men to identify the position of religions from tax evasion and the ethics of tax evasion. In addition to, tax administration legislations should adopt new policy to motivate taxpayers to comply with tax law and to increase taxpayers self control

In the field of punishments and penalties, Palestinian government should activate tax court from one side and implement all punishments and penalties adopted by tax law from other side.

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