

Taxes and Social Justice

Policy Brief

JORDAN



Towards Fair Tax Policies in Jordan

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Introduction

The Jordanian economy suffers from many structural imbalances embodied by the chronic and persistent deficit in the public budget and the high rates of poverty and unemployment. This situation has resulted from successive Jordanian governments adopting specific economic options based on a set of principles: liberalizing the Jordanian economy, privatizing state-owned enterprises, liberalizing foreign trade, liberalizing prices, lifting subsidies on goods, including commodities, and implementing austerity policies on basic rights and services such as education, health, labor and social welfare, in addition to adopting unfair taxation policies that have deepened social inequalities and contributed to poverty expansion. This was coupled with a delay in the progress towards strengthening the course of democratic transition, weakening some constitutional institutions, whether executive, legislative or supervisory and weakening law respect and enforcement. Therefore, the scope of tax evasion widened weakening the chances of building social balances between the various components of the society and the Jordanian State. Social dialogue tools have been weakened by the absence of representatives of vulnerable social classes and groups from the poor and lower segments of the middle class.

Imbalances have deepened over the past years due to the political and security crises in Syria and Iraq, which resulted in closing the borders in face of goods and people between Jordan and the most important economic partners, Iraq and Syria.

Moreover, the large waves of refugees who entered Jordan from Syria over the last six years have contributed to increasing pressures on the Jordanian economy, leading to increased burdens on basic services such as education, health, the labor market, transportation, etc., which already had major problems. All these factors led to a decline in GDP growth rates at constant prices of 2.0% in 2016, compared to 2.4% in 2015, and 2.8% in 2014 ¹.

As part of the restructuring programs for the Jordanian economy, which Jordan has been implementing since 1989 in close coordination with the International Monetary Fund (IMF), these programs included plans and policies for the so-called «reform of the tax system», where indirect taxes, such as general sales taxes, special taxes, etc., have been expanded. The consumption tax was replaced by the general sales tax, and many changes were made to the essence of tax policies, as progressive tax policies were not adopted effectively, and effective tax collection tools from taxpayers and evaders were not developed. The features of the tax system remained in place without any fundamental reforms contributing to social justice and alleviating social inequalities.

The importance of preparing this paper stems from the importance of the role played by tax policies as one of the most important tools for the distribution of wealth and the achievement of social justice among the various components of the society, as well as their developmental role in

¹ Ministry of Finance, Government's financial bulletin, July 2017

driving the economy and its impact on the lives of families and individuals. Moreover, the tax policies applied in Jordan suffer from significant imbalances. In fact, tax revenues as a percentage of GDP are low and do not exceed 15.5%. Plus, income tax revenues do not exceed 4% of GDP², which is a very low percentage compared to most countries in the world, where these revenues range between 8% and 10%. As for the rates of indirect taxes such as general sales taxes, special taxes and customs duties, these are high compared to most countries in the world, with rates at about 10%. Therefore, those who bear the tax burden are the poor and middle-income segments of the society.

Tax justice is when individuals accept relatively willingly to pay the tax, and usually individuals do not wish to pay the tax unless they realize that they contribute to covering the various expenses of the State that they benefit from, that their share in paying the tax commensurate with the contribution of each individual to the society according to his income, and are convinced that their individual contributions will ultimately affect their income only to the extent that they affect the income of others. Tax justice is an important condition for social and economic justice; however, it is not enough because other conditions must be met, mainly the way of spending tax revenues. Tax justice is linked to the principle of capacity to pay, and is divided into two types: horizontal justice and vertical justice³.

2 Ibid

3 نصر عبد الكريم، النظم الضريبية في عدد من الدول العربية من منظور العدالة الاقتصادية والاجتماعية، تموز، ٢٠١٧

Horizontal tax justice is achieved when taxpayers with equal conditions in terms of income and family size (for example) pay the same amount of taxes. As for vertical tax justice, it is achieved when people in different economic circumstances are treated differently in terms of taxes, so individuals who are in a better economic situation pay higher taxes than those whose economic conditions are lower ⁴.

Tax revenues generally come from two main sources: direct taxes, which include income and wealth taxes, and indirect taxes, including value added tax, general sales tax, special taxes and customs duties.

For the purpose of preparing this paper, the fairness criteria of tax systems can be summarized according to three principles: progressive taxation in terms of direct taxes, which include income and wealth taxes, the differentiation in indirect taxes, which include the general sales tax (Jordan case), special taxes and customs duties, in addition to the balance in the structure of direct and indirect tax revenues.

Problematic

Despite successive Jordanian governments' declarations that they intended to reform the tax system to increase its efficiency, these reform measures have not contributed to removing the fundamental distortions of the system. The size of tax revenues as a percentage of GDP is still weak, and has even fallen

⁴ Ibid

to around 22% ten years ago to 15.5% in 2015. The levels of tax evasion remain very high; the government has estimated it at about 700 million dinars annually. In addition, income tax revenues do not exceed 4% of GDP. Furthermore, the expansion of indirect taxes (general sales taxes, special taxes and duties of all kinds) further deepened social inequalities, expanded the size of the poor, and caused more pressure to the poor and some segments of the middle classes. In light of this reality, this paper will analyze and examine tax policies in Jordan as per the degree to which they achieve social justice.

The tax is a State's right imposed on society members who are able to pay it. It is collected by the executive authority through its competent bodies with a view to redistributing it in the form of services and rights that the State commits to provide to the society, such as health, education, transportation, defense, security, State's administrative bodies, etc. It also aims at achieving many goals related to the economic and social interests of the State and society. Through tax, governments manage the spending of tax revenues fairly so as to achieve social justice and reduce social inequalities. Tax is also used to achieve social, economic and political stability.

As the various literature of political economy points out, the power of the executive authority to collect and manage the tax of various kinds is closely linked to the levels of accountability of the executive authority by the society and other relevant State institutions, whether parliaments or civil society, or any other framework where the executive authority is accountable for how to collect and spend tax revenues, and

thus making the government accountable for its various policies, which can only be achieved within the framework of a democratic political system.

Analysis of problematic elements:

In order to find out more about the different aspects of the policy paper, this section will review the most important features of the tax system in Jordan, to clarify its imbalances and their effects on social justice. The various features of the tax system and related policies will be reviewed under the perspective of the system's ability and policies to reduce class disparities and social inequalities, and through the three criteria mentioned in the introduction to assess the fairness of the tax system. In this context, the features of the Jordanian tax system are the following:

1. The weak implementation of progressive taxation in terms of direct taxes, which include the income tax: Economic literature confirms that the emphasis on progressive taxation in terms of direct taxes, especially the income tax, according to the multitude and diversity of social segments' income, is one of the most important criteria of fair tax systems. The Jordanian Constitution stipulates that the principle of progressive taxation ⁵ should be applied. The upward trend contributes to reducing social inequalities. It is a means of achieving economic development, attracting investments and creating greater job opportunities for a large category of individuals and citizens.

⁵ Jordanian Constitution of 2011, article 111.

In fact, one of the basic principles of the fair tax system is to take into account the ability of taxpayers to pay, the need not to increase imposition, the personal cases of taxpayers, and to impose taxes in line with their financial means to avoid the problem of tax evasion.

According to this criterion, the income tax applied in Jordan is almost progressive (or distorted) because it adopts three narrow brackets that do not take into account the disparity in individuals' incomes. The size of exemption reaches 12 thousand dinars for the natural person and 12 thousand dinars for his dependents, in addition to exemptions for treatment and education expenses, the benefits of housing loans and Murabaha, and technical and legal services up to a maximum of four thousand dinars annually ⁶.

According to the law, the tax rate on progressive income brackets is 7% for every dinar for the first ten thousand dinars after the exemption, 14% for every dinar for the following ten thousand dinars and 20% for every following dinar ⁷. These brackets are too narrow to reflect the disparity in the incomes of the different components of the society, which deepens social inequalities, as there is no differentiation between those with very high and medium incomes. Therefore, tax brackets that are subject to progressive taxation are supposed to be five or seven, to make a distinction between taxpayers paying the income tax whose annual income exceeds

⁶ Income tax law number 34 of 2014, Official Gazette, article 9-A 1 & 2

⁷ Income tax law number 34 of 2014, Official Gazette, article 11-A

54,000 dinars, for that it is unfair to adopt a 20% threshold for the taxable income, and would be fairer to increase it to higher levels and higher tax deduction rates. It is also unfair to start with 7% for the first bracket, which is a high rate inciting tax evasion.

2. The expansion of indirect taxes and lack of differentiation, including the general sales tax (Jordan case) and customs duties. The vast majority of goods and services are subject to similar tax deductions. The majority of goods are subject to a 16% general sales tax rate, which is a very high percentage compared to general sales taxes and/or value added taxes, and few goods are subject to lower general sales tax rates, whereas the goods that are not subject to the general sales tax are very limited. At present, the government is discussing the possibility to impose a 16% rate on all goods and services, which would violate the principle of tax justice. This is in addition to the high levels of special taxes on certain basic commodities such as oil derivatives (23-46%), telecommunications, as well as special taxes on cigarettes and other commodities that the government considers as luxury goods. Customs duties, which are cut off on a wide range of goods, especially cars, that are essential for citizens due to the absence of an efficient public transportation system, can be added.

3. The significant decrease in direct tax revenues, mainly from the income tax, as its relative importance is low in comparison with tax revenues in general. These are not more than 30% as mentioned above, and not more than 4% of GDP, knowing that this percentage decreased in the last ten years from 4.5%

to 3.6% ⁸. This decrease is due to several reasons such as the weak law enforcement, which led a large number of taxpayers to evade paying their due taxes. This applies to the income tax and the general sales tax, in addition to the lack of the effective application of the principle of progressive taxation as mentioned earlier. This affects the principle of tax justice among individuals according to the difference in income and social classes, regardless of their income levels and ability to pay their due taxes, as well as between institutions according to their different incomes.

4. The imbalance in the structure of direct and indirect tax revenues; the tax system in Jordan is mainly based on indirect tax revenues. In general, it is biased to indirect taxes; data indicate that indirect taxes, especially the general sales tax, became the main source of government revenues, after its relative importance increased from 10.6% during 1985-1988 to 45.8% in 2009-2012. Moreover, the percentage of indirect taxes increased from 61% in 2009 to 69% of the total tax and non-tax revenues in 2012, exceeding 70% of the total tax revenues, compared to 30% of direct tax returns. When compared to global rates, which are close to 50% for direct taxes and 50% for indirect taxes, the picture is even clearer.

It is common knowledge that fair taxes are direct (income tax) and progressive taxes, as they are paid by those who can do so, while indirect taxes are considered unfair taxes because they are deducted on consumption and in equal proportions without taking into account income inequalities.

⁸ Ministry of Finance, public finance reports, different issues, 1990-2017

This deepens social inequalities, reduces the aggregate demand for goods and services, and thus puts reverse pressure on economic growth rates.

5. The increasing tax evasion; tax evasion means that the taxpayer does not pay wholly or partially the due tax, using methods that violate the provisions of the tax system, by means of cheating or fraud⁹. Tax evasion in Jordan, including the income tax and the general sales tax, reaches about 700 million dinars annually, according to official statements. Tax evasion is mainly due, as mentioned elsewhere in this paper, to legal, political, economic and social reasons. The weak law enforcement as a result of weak political reforms plays a key role in the development of centers of influence that government institutions cannot approach and subject to laws. In addition, tax collection government agencies are inefficient and ineffective, both in terms of procedures and/or the staff themselves.

Alternative policies and recommendations:

In light of the analysis of the problems faced by the tax system – the most important of which were presented above – this policy paper will present a set of alternative tax policies and recommendations, some of which are overlapping, which we believe will contribute to reforming the tax system in Jordan towards greater justice and efficiency:

⁹ الخطيب، خالد شحادة، الأصول العلمية والعملية في المحاسبة الضريبية، ط ١، دار حامد، عمان - الأردن، ٢٠٠٨، ص ٢٤

1. In order to apply more effectively the principle of progressive taxation stipulated by the Jordanian Constitution in Article 111, which is one of the most important criteria of fair tax systems, we recommend the need to increase tax brackets to 5-7 spaced brackets, instead of only three, starting from a lower ceiling, i.e. from nine thousand dinars per capita annually and 18 thousand for the family (individual's dependents) annually, while preserving the exemptions provided for in the current law, amounting to four thousand dinars annually. Tax rates on the progressive income brackets shall start at 3% and then increase according to annual income rates. This proposal will also reduce tax evasion and expand the base of taxpayers who are subject to the income tax.
2. In order to increase income tax revenues as a share of total tax revenues in general and as a proportion of GDP, and to balance direct and indirect tax revenues, we recommend the adoption of an equal income index for these two types of taxes when tax policies are drawn up, stopping the expansion of indirect taxes, and increasing direct taxes.
3. In order to reduce the tax burden on middle and poor social classes and achieve differentiation in indirect taxes, which include the general sales tax and customs duties, we recommend reducing the general sales tax rate to 10% instead of 16% and reducing the special tax rates on many commodities such as oil derivatives and telecommunications. We also recommend exempting basic goods and services from the general sales tax to become accessible to the majority of citizens of poor and middle classes. This would alleviate poverty, increase the aggregate demand for goods and services, and thus accelerate economic growth.

4. In order to limit aggravated tax evasion in all its forms, wholly or partially, we recommend the need to increase the efficiency of the department of income tax and general sales tax and to promote political reform efforts that would strengthen and enforce the rule of law. We also recommend implementing the invoicing system that would oblige taxpaying companies and individuals to disclose their financial transactions, as well as tightening sanctions on tax evaders.

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- Jordanian Constitution of 2011, article 111.

- Income tax law number 34 of 2014, Official Gazette, article 9-A 1 & 2

- Income tax law number 34 of 2014, Official Gazette, article 11

- الخطيب، خالد شحادة، الأصول العلمية والعملية في المحاسبة الضريبية، ط١، دار حامد، عمان - الأردن، ٢٠٠٨، ص ٢٤.

