The Jordanian New Tax Law

What is Needed?

July 2018

منتدى الاستراتيجيات الأردني
JORDAN STRATEGY FORUM

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The Jordan Strategy Forum (JSF) is a not-for-profit organization, which represents a group of Jordanian private sector companies that are active in corporate and social responsibility (CSR) and in promoting Jordan's economic growth. JSF's members are active private sector institutions, who demonstrate a genuine will to be part of a dialogue on economic and social issues that concern Jordanian citizens. The Jordan Strategy Forum promotes a strong Jordanian private sector that is profitable, employs Jordanians, pays taxes and supports comprehensive economic growth in Jordan.

The JSF also offers a rare opportunity and space for the private sector to have evidence-based debate with the public sector and decision-makers with the aim to increase awareness, strengthening the future of the Jordanian economy and applying best practices.

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1. Background

Everybody knows that the Jordanian economy faces a multitude of socio-economic challenges. These include weak and unstable growth, high unemployment rates, and deteriorating public goods and services. In addition, the monthly income of 85.2% of all Jordanians who are subscribed to the Social Security Corporation is less than JD 700.

The challenges facing the national economy must have been instrumental in the June 2018 demonstration on the streets of Amman and other parts of the country. The 2018 withdrawn Tax Law that was submitted by the government of His Excellency Hani al-Mulki was the “straw that broke the camel’s back”.

In response to the demonstrations, His Majesty King Abdullah II entrusted Dr. Omar al-Razzaz to form a new government. His Majesty has tasked the government with a myriad of objectives. These include launching a national dialogue whose objective is to deliver a new tax law that achieves growth and justice, and enhancing the quality of public goods and services (education, healthcare, and public transport).

This position paper, published by the Jordan Strategy Contribution (JSF), is a modest contribution whose aim is to contribute to the on-going national dialogue about the new tax law to be submitted by the government of Dr. Razzaz.

In section 2, we outline the main characteristics of a good and modern tax system. In section 3, we provide some observations about public finance in Jordan (spending and revenues), and the need for greater fiscal revenues. Based on the characteristics of good tax systems, we evaluate the current (2014) tax law. Based on this evaluation, we provide some recommendations. Finally, in section 4, we conclude.

2. Characteristics of Good Tax Systems

The JSF argues that any tax law should be guided by 5 main principles:

A. **Fair:** The tax burden should be fair. Those whose incomes are high should bear more burden than the poor. Also, those whose incomes are equal, should pay the same amount of tax. To be fair, the tax system must not be dominated by indirect taxes (sales).

B. **Transparent and Simple:** The law should not be complicated. It should be simple enough to safeguard the taxpayer against any possible exploitation of tax authorities and experts. A Tax payer should be able to assess their tax liabilities independently and in a straightforward manner.

C. **Diversified:** A good tax system should be guided by the principle of diversity. There should not be a single or a few taxes that dominate government tax revenues. For any reason, a decrease in tax revenue from a dominant source would jeopardize public finance.

D. **Elastic:** The tax law should be elastic. When national income increases, the law should result in higher tax to GDP ratio (sufficient tax elasticity). If income tax is progressive, and the tax revenues are not dominated by one or few sources (sales tax), sufficient tax elasticity would be realized.

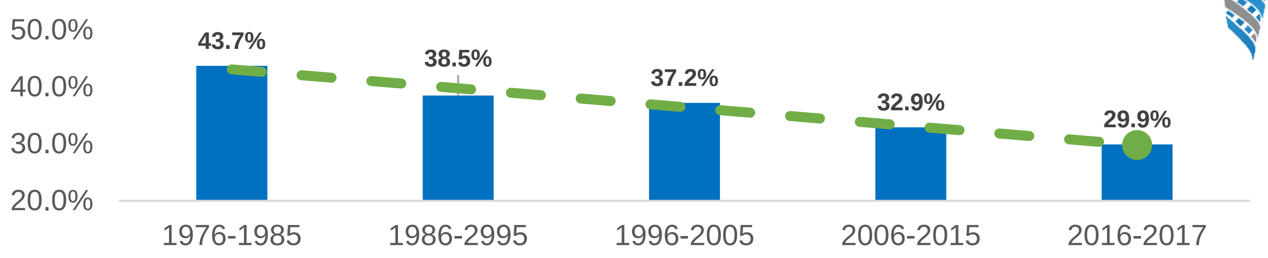
E. **Sufficient:** The law should yield “adequate” amount of financial resources for the government so that it becomes able to perform its increasing welfare and developmental activities. The provision of **“sufficient”** and **“efficient”** public goods and services (i.e. health, transport, education, and others) results in inclusive real economic growth.

3. Public Finance in Jordan

Public finance deals with tax revenues, spending programs, budget procedures, macroeconomic stabilization policy and procedures, and public debt management. The subject matter of public finance in Jordan must remain, for several reasons, at the top of the agenda by the government.

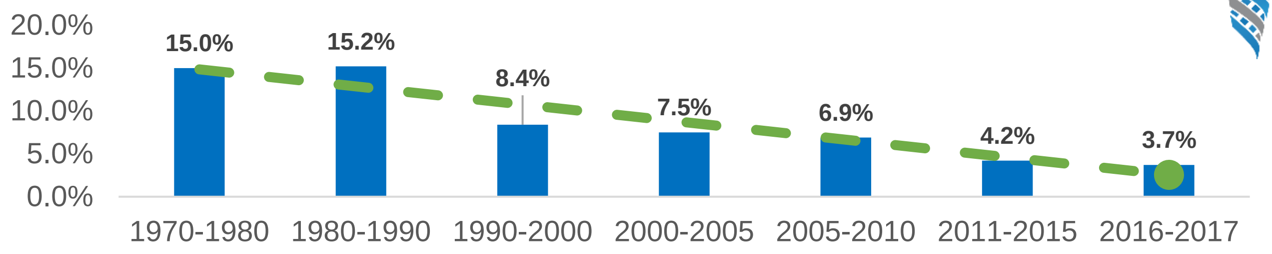
First, total public spending to GDP ratio has fallen from 43.7% (1976-1985) to 29.9% (2016-2017). **Adding what the municipalities and local councils has spent in 2016-2017 would increase total spending to 32.3% of GDP.** Notwithstanding the fact that there is always room for improving public spending efficiency, these ratios (29.9% or 32.3%) are lower than that in, to name a few countries, Turkey (37.0%), USA (40.4%), Estonia (42.3%), Poland (42.6%), and France (56.8%)!

Figure 1: Total Public Spending to GDP Ratio



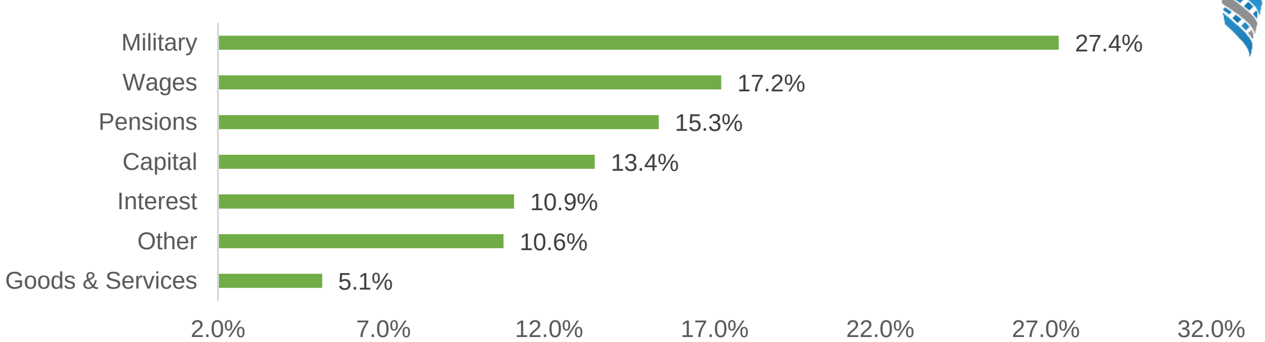
Second, the decrease in total public spending was largely due to its capital component. Relative to GDP, capital spending decreased from 15.0% (1970-1980), to **3.7% in 2016-2017! This decrease must have had negative implications to the provision of public goods and services in terms of sufficiency and efficiency!**

Figure 2: Capital Spending to GDP Ratio

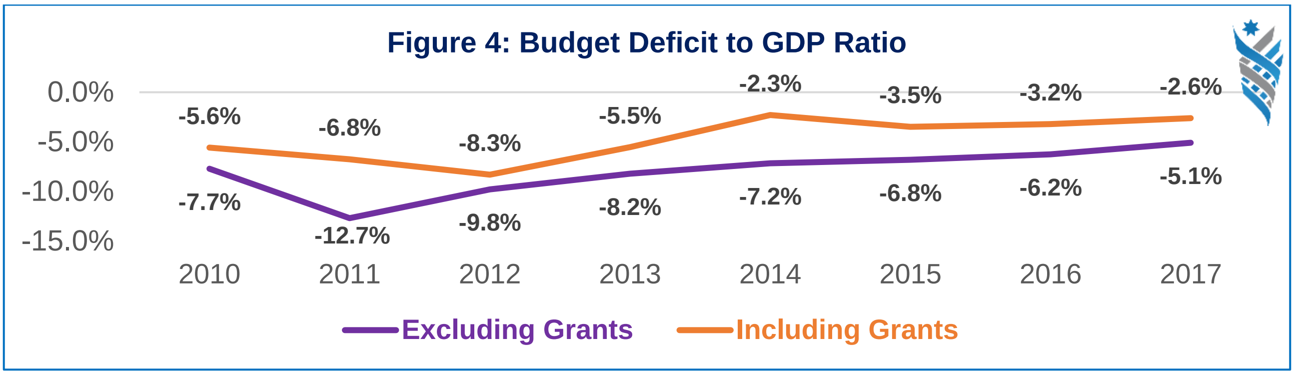


Third, few spending items account for a large proportion of total public spending. During the period 2015-2017, the military, public wages and pensions, interest payment on public debt, and the purchase of goods and services accounted for about 90% of total public spending.

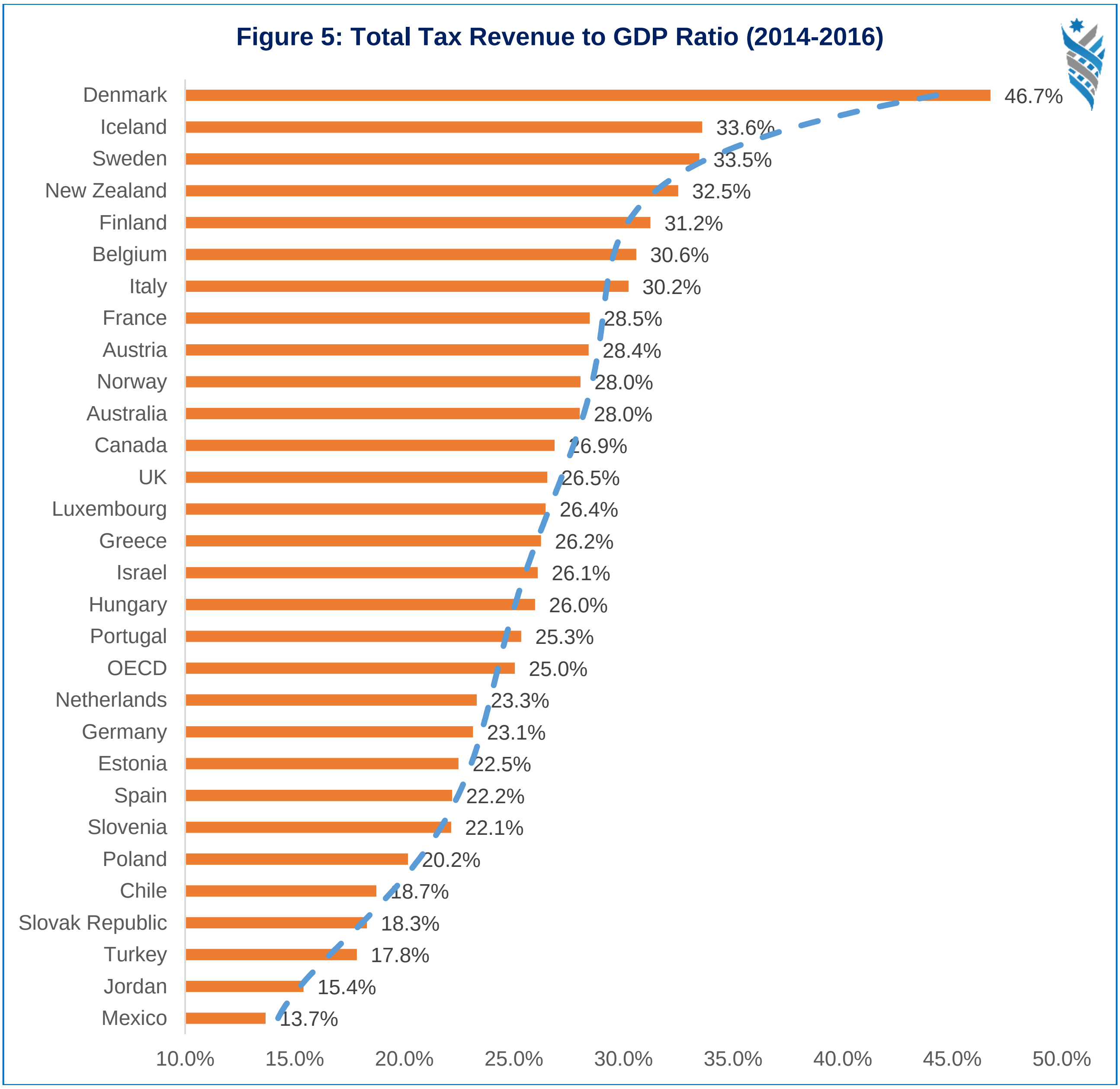
Figure 3: Main Components of Total Public Spending (2015-2017)



Fourth, notwithstanding the fact that total public spending is relatively low, with or without grants, consistent budget deficits is the norm.



Fifth, the tax effort in Jordan is relatively low. Indeed, total tax revenues to GDP ratio (2014-2016) in Jordan was equal to 15.4%. In Mexico only, this ratio is lower (13.7%).



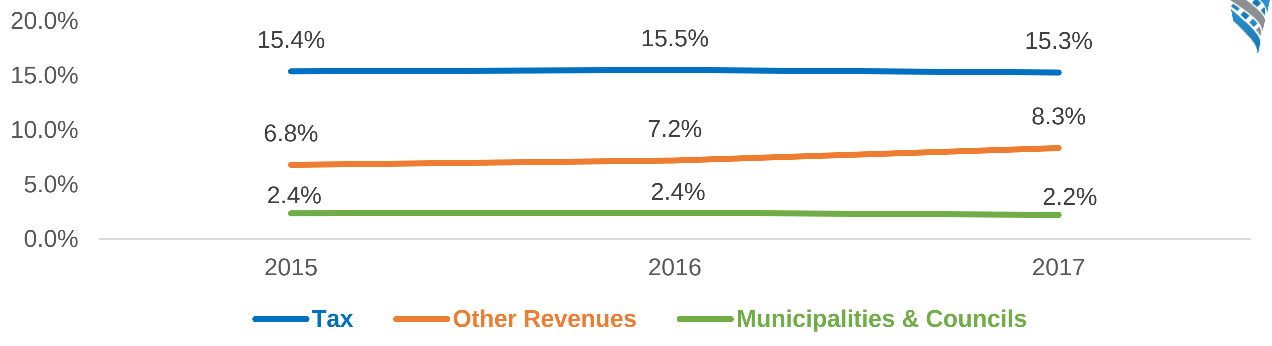
Sixth, relative to the tax revenue to GDP ratio in Jordan, it is useful to note two observations:

(1) Non-tax revenues to GDP ratio was equal to 6.8%, 7.2%, and 8.3% in 2015, 2016, and 2017 respectively.

(2) Total revenues of all Jordanian municipalities and local councils were equivalent to 2.4%, 2.4%, and 2.2% of GDP in 2015, 2016, and 2017 respectively.

(3) If we add the three sources of income (taxes, non-tax revenues, and revenues of municipalities and councils), total public revenues would become close to 26% of GDP. However, this ratio is still relatively low because in the OECD countries, non-tax revenues to GDP ratio constitute about 12% - 15% of GDP.

Figure 6: Tax and Non-Tax Revenues to GDP Ratio



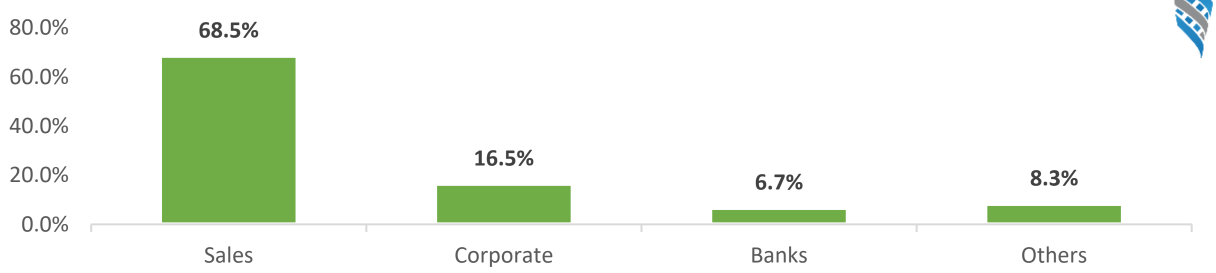
Based on the above-mentioned observations, we argue that there is always room to improve public spending efficiency. However, total tax revenue to GDP ratio, and total public revenues to GDP ratio in Jordan are relatively low. More fiscal revenues are needed to at least, the reverse the downward trend in capital spending.

4. The Current Tax Law: Test of Tax Principles

A. Is the Tax Law Fair?

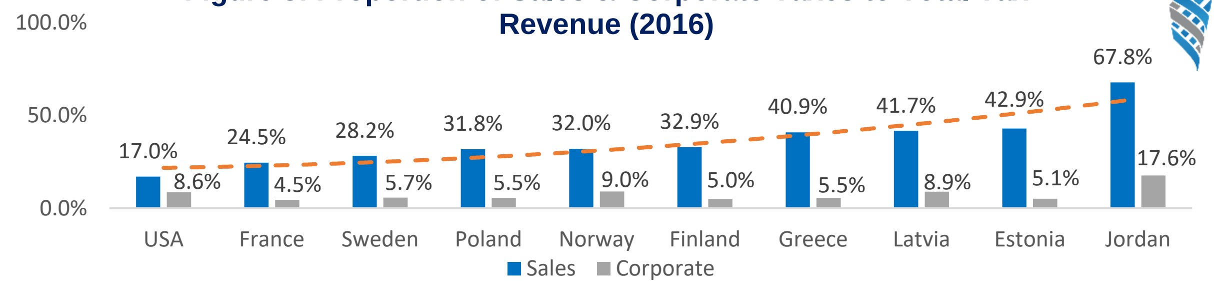
The current system is not fair. The contribution of sales tax towards total tax revenue is relatively high (about 69%). This implies that the poor contribute, as a proportion of their income, more taxes than the better-off.

Figure 7: Composition of Tax Revenues (2014-2017)



The current tax system is not fair. The corporate sector in Jordan contributes about 17.6% of total tax revenues. This ratio is relatively high. In addition, the fact that the banking sector accounts for about 65% of the taxes paid by all listed companies makes the system unfair. Banks pay more taxes because they are more profitable, but it is not fair to impose on them higher tax rate than other sectors.

Figure 8: Proportion of Sales & Corporate Taxes to Total Tax Revenue (2016)

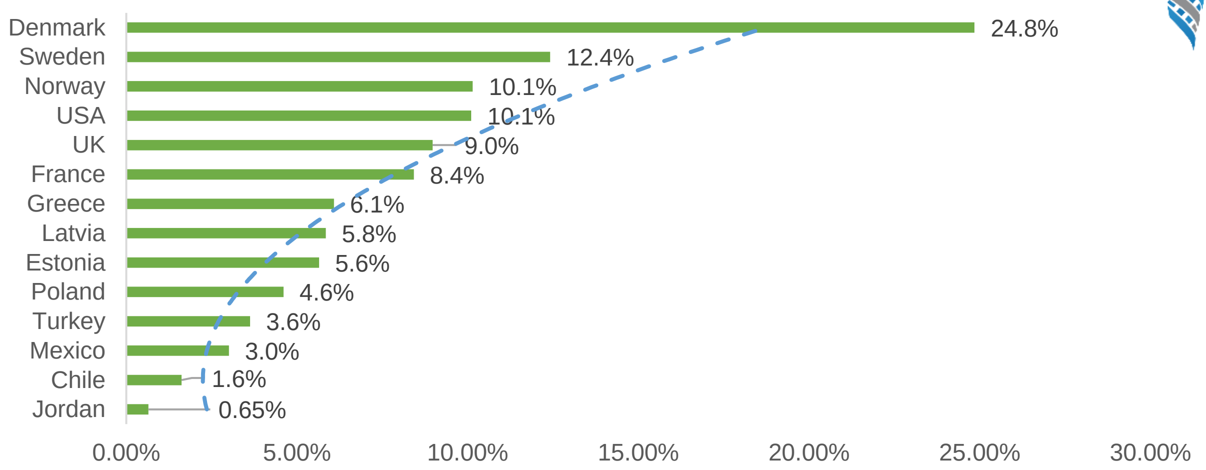


The current system is not fair. Given the low income of salaried individuals, it is unbelievable that they contribute to the treasury more than the private sector does (professionals and SMEs)! There is probably no accurate registration of the total number of private sector businesses (professionals and SMEs) outside the listed and large companies. However, the Department of Statistics estimates that this sector is composed of 147,767 and 157,852 in 2012 and 2014 respectively. Assuming that this sector is composed of 150,000 businesses, the 2017 tax figure implies that, on average, each business has paid JD 440 a year only (JD 66.1 million / 150,000)!

Income Tax Paid (JD Million)	2015	2016	2017
Salaried Individuals	111.5	118.7	129.8
Private Sector (Professionals & SMEs	95.4	75.2	66.1

To put this observation into its international perspective, private individuals in Jordan (salaried individuals and professional and SMEs) contribute very little towards tax revenues compared to other countries!

Figure 9: Private Individuals Tax to GDP Ratio (2012-2016)



B. Is the Tax Law Transparent and Simple?

The current system is not transparent and simple. Any new law should clearly differentiate between tax and non-tax revenues. Also, the current law is not simple because it has experienced frequent changes, involves too many taxes, and sets different tax rates on different sectors.

C. Is the Tax Law Diversified?

The current system is not diversified. In 2014-2017, sales tax revenues constituted about 69% of total tax revenues. Also, the banking sector accounts for about 65% of the taxes paid by all listed companies.

D. Is the Tax Law System Elastic?

The current tax system is not elastic. The long-run tax elasticity is equal to 1.09. This means that when real GDP grows by, for example, 5%, tax revenue to GDP ratio increase by 0.45% [5 * .09 = 0.45]. The main reason for this "inelasticity" is the fact that the system is not well-diversified.

E. Does the Tax System Provide Adequate Finance to Government?

The current system does not provide the government with sufficient financial resources to perform its duties. The currently existing tax effort (tax to GDP ratio of around 15%), is relatively low. Whilst the efficiency of public spending can always be improved, total public spending to GDP ratio in Jordan is relatively low because tax revenue to GDP ratio is equally low!

5. Recommendations

For several reasons, the subject matter of public finance in Jordan must be at the top of the agenda by the present government. **Based on the observations raised in this paper, the JSF recommends the followings:**

A. The current law requires households whose income is greater than JD 24,000 to pay 7% on the first JD 10,000, 14% on the second JD 10,000, and 20% on the income greater than JD 44,000 a year. For individuals (single) whose income is less than JD 12,000 a year, the current law exempts them from paying income tax. We recommend broadening the tax base, there is nothing wrong with reducing the existing tax thresholds. However, any changes in these tax rates must be professionally well-explained to the public at large.

B. Some heavy investment in the tax department on personnel, and where possible, on technology, must be carried out to improve tax collection in efficiency and amount of taxes collected. This aspect is critical in increasing tax revenues from the professionals and SMEs. If managed well, this sector would provide the treasury with sizeable revenues (fiscal space). Also, it would result in a greater level of diversification in the tax system.

C. For two reasons, there is nothing wrong with keeping the current sales tax as is. First, the average citizens has already become used to the existing rates. Second, reducing the sales tax rate would not necessarily result in significant decreases in consumer prices.

D. Where possible, different tax rate on different sectors should be avoided. This creates imperfections in the allocation of resources.

E. Following the adoption of the new tax law, the government must accurately reflect the state of public finance in terms of classifying the sources of revenues. If a revenue source is "TAX", it should be classified under "TAX REVENUES".

F. The law should not be complicated. It should be simple enough to safeguard the tax payer against the "exploitation" of tax authorities and experts. Improving the tax legal procedures is a priority.

G. To avoid any misunderstandings or even manipulations, the government must be extremely professional in making the average Jordanian citizen understand **the contents of the New Tax Law and their implications.** Anecdotal evidence shows that Jordanians think they pay tax a lot more than what they actually do (Tax Illusion)! This is due to several reasons including the number of tax items, frequent changes in the tax law, and the hitherto existing poor provision of public goods and services.

H. Finally, and within the context of all the above-mentioned recommendations, the JSF stresses that many **"miscellaneous", and important issues** about the currently existing tax law can be suggested. These include:

1. Should the new law include dividend tax, capital gain tax, permanent establishment tax, digital tax, integrated invoicing system, and transfer pricing? If yes, there should be clear definitions to all of them.
2. Should the new law re-consider property tax that is currently based on the estimated rent value?

"Successful state-building demands political leadership with a vision of tax as delivering a 'national purpose' that actual and potential taxpayers will support (and pay for). The tax system component of the state-building effort must explicitly link to a national strategy for promoting economic growth".

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