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THE INCOME TAX LAW IN JORDAN

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Hani M. Abu-Jabarah
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INTRODUCTION

Problems and Issues

Few, if ever found, countries like Jordan which depend to a considerable extent on foreign sources of funds in the form of aid to support its economic existence. Local revenue sources in Jordan provide only about 70 per cent of the total resources of the government, with the other 30 per cent coming from foreign aid. The government, therefore, claims that the revenue system is not sufficiently productive of funds and more strict measures should be introduced to generate more local revenues. Jordanian citizens, on the other hand, always maintain that they contribute to the domestic government revenue more than their incomes allow. They claim that taxes, which are imposed upon them, constitute a heavy burden. It is the prime objective of this studyto examine such statements.

For our examination of such a problem, it is rather difficult to study all facets of government revenues. It is essential, therefore, to be selective on the part of the writer. Since the tax system constitutes the heart of the government revenue sources, the writer finds it convenient to study the income tax in order to pass a value judgment concerning the adequacy of the revenue system in Jordan. It is assumed, therefore, that income taxation policy is a representative of the revenue system.

Moreover, if Jordan wants to cope successfully with the serious problem of heavy dependence on foreign aid, it should develop its economic resources. A general requirement for growth in Jordan, as well as in all countries, is the creation and mobilization of capital resources for investment in productive plant. In the private sector of the economy, capital resources are created by individual and business saving from income, i.e., by not spending for consumption purposes. In the public sector, savings are forced upon the public by the imposition of taxes, i.e., tax payments by individuals and business are savings from private income largely at the expence of consumption. It follows, therefore, that private savings as a proportion of income can be increased only by a reduction in the amounts of income used for consumption purposes, whether this reduction is more or less voluntary, or forced by taxation. It is an objective of this study also to analyze the role that income taxation can play in this respect.

Summary of the Study

Since income tax policy is determined by the legal structure that was formulated to fulfill the requirements of a sound income taxation system, the writer selected the Income Tax Law in operation in Jordan to be analyzed and evaluated. In the first chapter, however, the economic environment of Jordan is studied. The basic economic sectors are analyzed to identify the specific features of the Jordanian economy. It has been shown that, generally speaking, the economy is mainly an agricultural one. In this chapter also, a detailed analysis of the revenue structure is given in order to realize the importance of income taxation as a source of governmental revenue. The role of the public sector in the economic setting is emphasized to indicate the urgent need of revenue by the government to participate actively in the process of economic development.

In the second chapter, the structural aspect of the Income Tax Law is analyzed. Undoubtedly, emphasis was concentrated on the weak spots of the law, to indicate the necessary improvements needed to be incorporated into the law. In this chapter, the claims of both the government and the taxpayers are examined. For this purpose, an interesting and a pioneering study of the distribution of the income tax burden in Jordan is introduced. Such a study questioned the often claimed objectives of social justice and equity in income taxation policies.

In the third chapter, the administrative aspect of the law is analyzed. It is to be understood, at the outset, that no description is given to the actual administration of the income tax as represented by the Income Tax Department. Instead, the operational basis of the administrative aspect of the Income Tax Law is examined. The scope and the space limitations of this study did not allow the writer to extend his study to a detailed description of the Income Tax Department operations. In this chapter, however, an emphasis is put on the mechanizm by which the tax is reported, assessed, and collected.

Finally, the fourth chapter examined the various impacts of the law on the economic growth and stability of Jordan. Its effects on saving, investment and corporate business are given. Such a study is important to know whether the Income Tax Law as it is structured encourages or discourages economic development in Jordan. This is important because it is generally contended that there is a conflict between revenue productivity and development encouragement in income tax policy. It is shown that Jordan Income Tax Law encourages rather than discourages private savings and investments. It does not, however, play a dominant role in the economic development of Jordan. In the last chapter, the conclusions of the study are given. These conclusions have lead the writer to propose a series of suggestions in order to change some aspects of the law.

Procedure

This study depended mainly on the writer's analysis of the Income Tax Law. To support his conclusions, however, the writer accumulated some of the available and relevant statistics from the different government agencies, and especially from the Income Tax and the Statistics Departments. Many interviews with some businessmen and taxpayers were undertaken. To complete the picture, some interviews have been held between the writer and some of the government officials who are working or had worked in the Income Tax Department.

The writer has referred to the theoretical writings on the tax literature and compared it with the income tax policy in Jordan, whenever the need arose. This procedure has been followed to see the extent of conformity or deviation of the income tax practice in Jordan from the theoretical situation. The writer, however, being mindful of Jordan's stage of development, has referred mainly to the literature written on the underdeveloped economies.

Difficulties

Although the statistical data available on the subject were sufficient in some respects to reach fair conclusions, limitations have been faced throughout the study, which were imposed by some shortage of the statistics. One important fact is that the writer did not find any officially published statistics on income taxes in Jordan. He, therefore, tried to secure these statistics by personal contact with the Income Tax Department. At the beginning, the Department manifested very secretive behaviour and it refused to disclose to the writer any statistical facts. It was only after several months, and through a high official executive, that the Department showed a cooperative response when approached.

It is to the writer's amazement that many of the basic data were not compiled in an organized form in the Department. The writer, therefore, was obliged to spend a long time in compiling the relevant statistics from the first-hand records. Many employees, however, were highly cooperative and answered some illustrative questions.

Another difficulty that faced the writer was the lack of some analytical statistics. To give an example, it was not possible to get the breakdown of the saving and investment figures, so that we would be able to know the ratios of savings which come from low and high income groups. The extent and the amount of tax evasion were not available by any means. Such statistical limitations, therefore, introduced an obstacle for having a more elaborat analysis of income taxation in Jordan.

One important point concerning statistics in Jordan is the fact that there is always a time lag between their publication and dates. At the time they are officially published, their importance would diminish. For instance, the national accounts and statistics of 1966 and 1967 have not yet been published. This fact obliged the writer to limit his studies up to 1965 only.

Finally, a difficulty has been introduced by the recent political circumstances which happened in Jordan. The Kingdom was divided into two parts in June 1967. Until this moment the more economically prosperous part (the Western Bank of Jordan) is occupied by foreign forces. The future is not definitely certain. The economic conditions might, therefore, substantially change. The writer, however, ignored these recent political developments and continued his study on the assumption of the former situation in Jordan. This was necessary to avoid all and any unpredictable consequences of the future.

CHAPTER I

THE ECONOMY OF JORDAN

Background

To relate income taxation to the general economic setting within which the Income Tax Law is operating, it is of prime importance to study the basic economic features of Jordan. The economic setting in which Jordan operates, however, has been affected by the vast problems arising from the events of 1948. Within few months, Jordan's population increased almost three-fold without a corresponding increase in resources.

Jordan at present comprises the former Transjordan, which became an independent state in 1946, and that portion of Palestine which remained in Arab hands after the 1948 events. At the time of the 1961 Census, Jordan population was about 1.8 million of whom 45 per cent were under 15 years of age, with a yearly rate of increase about three per cent.[1]

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[1] General Union of Chambers of Commerce, Industry, and Agriculture of the Arab Countries, The Arab Economic Report (Beirut: Albayan Press, 1965), p. 7.

On the favorable side of the economic achievements of Jordan is the remarkable growth in the Gross Domestic Product (GDP) despite Jordan's shortage of natural resources. Appendix (1) shows that the GDP has grown from JD 85.17 million in 1959 to JD 150.95 million in 1965, at an average increase of 10.6 per cent per annum.[2] Another favorable economic condition in Jordan is the more or less maintained stability in prices.[3] This is an encouraging factor for economic development.

On the unfavorable side there are three major problems. First, the balance of trade is weighted heavily against Jordan. In 1965, receipts from exports of goods were JD 9.91 million and payments to imports of goods amounted to JD 55.77 million.[4] This shows that receipts from goods exported were about 17 per cent of imports. Out of domestic expenditure of

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[2] Jordan Department of Statistics, The National Accounts and Input-Output Analysis, 1959-1965 (Amman, 1966), p. 3.

[3] Jordan Department of Statistics, Statistical Yearbook. (Amman: Department of Statistics Press, 1966), p. 584.

[4] Central Bank of Jordan, Third Annual Report (Amman: National Press, 1966), p. 57.

JD 202.62 million on consumption and capital formation in 1965, almost 27 per cent was spent on imports of goods.[5] The result has been heavy dependence upon external sources of funds to offset trade deficit.

The second problem is that despite considerable increases in recent years, per capita income remains low. In 1964 and 1965, the Gross Domestic Product averaged about \$ 204 and \$ 220 per person respectively.[6] These figures place Jordan as an underdeveloped country according to Higgins' definition of underdeveloped countries as, "... those with per capita incomes less than one quarter of the United States or roughly less than \$ 500 per year."[7] Associated with low per capita income are low productivity of labor among those who are working and the high proportion of those who are too young for the labor force or are unemployed.

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[5]Jordan Department of Statistics, <u>The National Accounts</u>, p. 2.

[6]<u>Ibid.</u>, p. 73.

[7]Benjamin Higgins, <u>Economic Development</u> (New York: W.W. Norton and Co., Inc., 1959), p. 6.

The third problem is the level of unemployment. The 1961 Census showed that seven per cent of the working force were seeking work.[8] The Census, however, indicated that ten per cent of the male population whose ages ranged between 15 and 64 years were economically not active. This raised the unemployment ratio to 16.3 per cent, which is the real and the disguised unemployment.[9]

Having in mind these realities about Jordan economy, we turn to a summarized study of the basic sectors of the economy.

Basic Economic Activities

<u>The Agricultural Sector</u>.--Agriculture is one of the most important sectors in the Jordan economy. According to the 1961 Census, while providing employment for 35.3 per cent of the labor force, agricultural net income for the same year amounted

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[8]Jordan Development Board, <u>The Seven Year Program For Economic Development 1964-1970</u>, (Jerusalem: The Commencial Press, 1965), p. 4.

[9]Jordan Development Board, <u>A Study Of The Human Force of the Organized Institutions</u> (Amman, 1965), p. 12.

TABLE 1

DISTRIBUTION OF LABOR FORCE IN JORDAN

Economic Activity	No. of Employees	Percentage
Agriculture & Forestry	137,757	35.3
Mining	9,186	2.4
Industry	32,746	8.4
Construction	40,159	10.3
Electricity & Water Supply	1,572	0.4
Trade	31,356	8.0
Communication, Transportation & Warehousing	11,899	3.1
Services	53,525	13.7
Undetermined Activities	71,778	18.4
TOTAL	389,978	100.0

Source: General Union of Chambers of Commerce, Industry, and Agriculture of the Arab Countries, <u>The Arab Economic Report</u> (Beirut: Albayan Press, 1965), p. 7.

to only 22.82 per cent of the Gross Domestic Product.[10]

It would be helpful at this point to review the 1961 Census distribution of labor force among different economic activities. It is clear that agriculture alone was in 1961 absorbing more than one-third of the labor force, while earning about one-fifth only of the GDP for the same year. There is no one indicator that the picture has changed to any considerable extent since 1961. In 1965, for example, agriculture accounted for 22.6 per cent of the GDP and it averaged 22.4 per cent per year of the GDP for the three years 1963, 1964, and 1965.[11]

Table (2) summarizes the agricultural income and expenditure for a period of seven years. It is apparent that the agricultural income has grown during the seven-year period to a considerable extent. However, although the growth has been about 228 per cent between 1959 and 1965, the agricultural income is still

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[10] Jordan Department of Statistics, The National Accounts, p. 3.

[11] Jordan Department of Statistics, The National Accounts, p. 3.

TABLE 2

SUMMARY OF AGRICULTURAL INCOME AND EXPENDITURE

J.D. MILLION

	1959	1960	1961	1962	1963	1964	1965
Crops & Forestry							
Gross Income	11.73	10.95	23.27	15.40	16.26	28.03	25.50
Cost	1.62	1.70	2.24	2.22	2.14	2.41	2.45
Net Income	10.11	9.25	21.03	13.18	14.12	25.62	23.05
Livestock							
Gross Income	9.03	7.39	6.44	8.69	9.11	9.83	13.22
Cost	4.06	2.02	2.17	0.97	1.15	1.31	1.86
Total Net Income	15.08	14.62	25.30	20.90	22.08	34.14	34.41

Source: Jordan Department of Statistics, The National Accounts, and Input-output Analysis 1959-1965 (Amman, 1966), p. 17.

low and fluctuates in an unpredictable manner. It has jumped in 1961, for example, to JD 25.30 million as compared to only JD 14.62 million and JD 20.90 million in 1960 and 1962 respectively. Again, in 1964 it has risen to JD 34.14 million from that of 1963 income of JD 22.08 million - an increase of JD 12.06 million, which is 59.2 per cent of 1963 income.

This considerable fluctuation is explained by many factors. Jordan depends mainly on rainfall in its cultivation of land. Since the quantity of this rainfall is not the same every year, the quantity of the rain-fed crops, therefore, fluctuates accordingly. From the following classification of cultivable land, one can easily see that the irrigated land is insignificant (13 per cent of the rain-fed land) if compared with the rain-fed land.

The problem is not only that the rainfall is irregular, but it also falls in small quantities. Most parts of the country receive less than 400 millimeters (16 inches) of rainfall per annum. Although this quantity of rain suffices to cultivate in one season considerable volume of crops, it does low and fluctuates in an unpredictable manner. It has jumped in 1961, for example, to JD 25.30 million as compared to only JD 14.62 million and JD 20.90 million in 1960 and 1962 respectively. Again, in 1964 it has risen to JD 34.14 million from that of 1963 income of JD 22.08 million - an increase of JD 12.06 million, which is 59.2 per cent of 1963 income.

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TABLE 3

AREA OF CULTIVABLE LAND

	Dunums
Irrigated	759,000
Rain-fed	5,615,880
Fallow	3,908,685
Total	10,283,565
Unexploited	2,716,435
Grand Total	13,000,000

Source: Jordan Ministry of Information, Department of Education & Guidance, The Agricultural Sector (Amman: Hashemite Press, 1965), p. 5.

Another factor which hinders the growth of the agricultural sector is the system of land tenure. Jordan agriculture is mainly in the hands of small land-owners. From table (4) it appears that 59.45 per cent of the agricultural land is held by small holdings where each holding does not exceed 49 dunums. Naturally, these holdings are mainly owned or leased by small farmers who cannot afford to modernize their methods for lack of capital to mechanize farm production. Hence, we find that manual farming predominates in cultivating the agricultural land. Productivity, therefore, is very low and consequently the agricultural income is also low.

TABLE 4

DISTRIBUTION OF LAND BY SIZE OF HOLDING

Dunums	Number of Holdings	Percentage
Less than 10	26,708	22.49
10 - 49	43,899	36.96
50 - 99	21,332	17.96
100 - 199	15,456	13.01
200 - 499	9,028	7.60
500 - 999	1,687	1.42
1000 - 1999	421	0.35
2000 - 4999	178	0.15
5000 - 9999	45	0.04
10000 - and more	22	0.02
TOTAL	118,776	100.00

Source: Jordan Ministry of Information, The Agricultural Sector (Amman: Hashemite Press, 1965), p. 6.

A third reason for a fluctuating and low agricultural product is the narrowness of the Jordanian market. If in a year the agricultural product is relatively high, the prices would decline to an extent that it would reduce the positive effects of high productivity. This problem of marketing the agricultural product could have an adverse effect on the initiative of small farmers.

Realizing the agricultural problems which result from scarcity and irregularity of the rainfall, the government considered a number of irrigation projects to increase the cultivated land and agricultural productivity. The most important project of these is the East Ghor Canal. The construction of the first stage of this project started in 1958, and in 1964, the third stage was completed. Presently, about seventy kelometers of the Canal have been constructed and 120,000 dunums of cultivable land were put under exploitation.[12]

Industrial and Mining Sectors.-- The indust-

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[12] Jordan Ministry of Information, Department of Publications, The Economy of Jordan, Its Size and Growth (Amman: Hashemite Press, 1966), p. 33.

rial sector is relatively weak in the economy of Jordan. In 1961 it accounted for only 8 per cent of the GDP, while it was providing employment for 10.8 per cent of the labor force. Income, however, has averaged 9.7 per cent of the GDP per year for the three years 1963, 1964 and 1965.[13] Furthermore, the Department of Statistics found in 1965 through an economic survey, that the total number of the industrial establishments was 6,838 employing 37,094 workers.[14]

A striking feature, therefore, of the Jordanian industry is the fact that most of its firms are small and hence operate on a modest scale. In the industrial survey of 1965, it was found that only 595 firms out of 6,838 were engaging 10 employees or more. Moreover, it was found that only 69 firms were producing a yearly output of JD 50,000 or more. The total value of production of these firms amounted to JD 20,264,000.[15] These facts

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[13] Jordan Department of Statistics, The National Accounts, p. 3.

[14] Ibid., p. 66.

[15] Ibid., p. 67.

imply complete absence of large scale operations, and thus a low efficiency in the industrial sector in general. This might explain the fact that the government has legalized the monopoly of some industries and prevented the importation of their products in order to protect them against foreign competition.

Jordan has two main obstacles to industrial development. First, it suffers from a shortage of local raw materials. Jordan lacks coal, oil and water power, and possesses only a few industrial raw materials. Transportation costs, among others, preclude any industrial expansion requiring cheap power, imported raw materials, and overseas export markets. Second, Jordan has a small domestic market. With a low per capita income coupled with a small population, it is not to be expected that Jordan's industry would develop on a very large scale. Other handicaps for industrial development are shortage of capital and lack of technical know-how.

At present the only mineral resources being commercially exploited are phosphate, marble, and salt, of which the latter two are quite small in value. In 1965, phosphate alone has accounted for 31 per cent of total Jordan goods exports.[16] Potash has favorably passed the scrutiny of technical and feasibility studies. The plan has been put to produce and export at least 500,000 tons of potash per year worth JD 5.36 million starting in late 1970.[17] In addition to phosphate, potash, and marble, there are a number of other possible mineral resources. Deposits of copper, manganese, iron, sulphur, radioactive minerals, and bituminous rocks are known in various parts of Jordan. Of these copper, manganese, iron and sulphur have attracted most attention and detailed investigations of some of these mineral deposits have been initiated. In order to achieve a significant improvement in the balance of payments position, Jordan places heavy reliance on the production and exportation of minerals. To these industries, therefore, capital should be channeled. It is understood that the industrial sector in Jordan is starving for capital.

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[16] Central Bank of Jordan, Third Annual Report, p. 59.

[17] Jordan Development Board, The Seven Year Program, p. 192.

A special problem in Jordan is the tendency for potential capital funds to flow into elaborate and expensive housing, thereby being devoted to luxury consumption of a sort which to the individual often seems to be investment. But if classified as investment, it is unproductive, because it contributes nothing to real productivity in the economy. In 1965 for example, the total private expenditure on capital formation amounted to JD 17.44 million and on resendential housing construction amounted to JD 7.42 million which is 42.5 per cent of total capital formation.[18]

Trade and Services Sectors.--When studying Jordan Gross Domestic Product, one fact draws the attention of the observer, which is the important role played by the trade and services sectors. As table (5) indicates, the goods-producing sectors (including agriculture, manufacturing and mining, and construction) did not contribute on average more than 36.9 per cent per annum to the GDP in the years 1963, 1964, and 1965. The trade and services, however, averaged 47.7 per cent per year of the

[18] Jordan Department of Statistics, The National Accounts, pp. 6-7.

GDP for the same years (including transport, trade, banking, dwellings, and services.) If we consider the government sector as a service rendered by the government to the public, this percentage then rises up to 62.2 per cent. This is a sufficient indication that the economy of Jordan is presently oriented towards trade and services.

Trade is a major source of national income and it is only surpassed by agriculture. Its contribution to the GDP has slightly declined from 21.2 per cent in 1959 to 20.9 per cent in 1965. This decline, however, has been only in relative terms and not absolute. In 1959, the income from trade was JD 18.01 million as compared to JD 31.43 million in 1965 - an increase of 74.5 per cent (see appendix 1). Moreover, the services income has jumped from JD 7.78 million to JD 12.83 million - an increase of 65 per cent between 1959 and 1965.

It is interesting at this point to note that while the goods-producing sectors income was 30.4 per cent of the GDP in 1959, it rose to 38.6 per cent in 1965. The trade and services sectors, therefore, contributed about 69 per cent in 1959 as

TABLE 5

GDP DISTRIBUTION AMONG ECONOMIC ACTIVITIES

IN PERCENTAGES (AT FACTOR COST)

	1963	1964	1965	Average for the three years
1. Agriculture	19.0	25.2	22.6	22.4
2. Manufacturing & Mining	9.0	9.3	10.8	9.7
3. Construction	5.2	4.0	5.2	4.8
4. Electricity & Water Supply	0.8	0.8	1.2	0.9
5. Transport	10.9	9.0	8.3	9.4
6. Trade	22.5	20.7	20.9	21.3
7. Banking & Finance	1.1	1.1	1.4	1.2
8. Dwellings	7.9	7.3	7.1	7.4
9. Public Administration & Defence	14.9	14.4	14.1	14.5
10. Services	8.8	8.2	8.4	8.4
	100.0	100.0	100.0	100.0

Source: Jordan Department of Statistics, The National Accounts, and Input-Output Analysis, 1959-1965 (Amman, 1966), p. 3.

compared with 59.2 per cent in 1965.[19]

[19] Jordan Department of Statistics, op.cit., p. 3

This simply means that the relative importance of the goods-producing sectors is rising at the expence of trade and services. The increase in the proportion of income from the goods-producing sectors is mainly attributable to agriculture, where its contribution to the GDP rose from 17 per cent in 1959 to 22.6 per cent in 1965.[20] From an economic view point, this is a healthy sign, and if the trend could be maintained in the future, as Jordanian planners hope, it will have a positive effect on the economy.

Our analysis remains incomplete unless we relate these findings to the employment distribution. According to 1961 Census, it was found that the goods-producing sectors were employing about 56.4 per cent of the labor force, while their income was only 34.5 per cent of the GDP for the same year. This is in contrast with 24.8 per cent of the labor force employed by the trade and services sectors and earning an income of about 65 per cent of the 1961 GDP.[21] It is needless to comment that

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[20] Jordan Department of Statistics, The National Accounts, p. 3.

[21] Ibid.

these facts reveal symptoms of maldistribution of income among the different economic activities in Jordan.

The goods and services account has shown a continuous deficit in Jordan's balance of payments. In 1964 and 1965 this deficit amounted to JD 24.45 million and JD 26.83 million respectively. In 1959, however, the deficit was JD 31.58 million.[22] This drop is attributable to the fact that exports of goods and services have increased by 142 per cent between 1959 and 1965, while imports of goods and services have increased by 53 per cent only.

Government Revenues and Expenditures

Local Revenue.--Table (6) summarizes the domestic government revenue. It is clear that the domestic receipts have increased persistently during the seven-year period. The percentage increase between 1959 and 1965 was about 100 per cent, or an average annual increase of 16.6 per cent. By components of the total, the various categories show

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[22] Central Bank of Jordan, Third Annual Report, p. 57.

TABLE 6

GOVERNMENT DOMESTIC REVENUE

JD MILLION

	1959	1960	1961	1962	1963	1964	1965
1. Income from property and entrepreneurship	1.80	2.00	2.03	6.94*	3.66	3.34	3.87
2. Indirect taxes	8.36	8.86	9.27	10.28	11.39	13.43	16.66
3. Direct taxes	1.48	1.68	1.92	1.98	2.31	2.51	3.10
4. Other current transfers from households	2.36	2.36	2.75	2.65	3.04	3.53	4.49
Total domestic revenue	14.00	15.90	15.97	21.85	20.40	22.81	28.12

Source: Jordan Department of Statistics, The National Accounts and Input-Output Analysis 1959-1965 (Amman, 1966), p. 9.

Note that the figure for 1962 is unusually high since it includes a large exceptional payment of JD 3.68 million for previous years' arrears following a new agreement with the Trans-Arabian Pipe Line Company.

the following average annual percentage increases:

Property & enterpreneurship:		19 per cent
Indirect taxes	:	16.5 per cent
Direct taxes	:	18 per cent
Other transfers	:	14.7 per cent

Indirect taxes include customs and excise duties, trade and import licences, revenue from posts, telephones and telegraphs, and the national guard tax. While the direct taxes category includes income taxes, social welfare tax, land tax, animal tax, and taxes on land and buildings. The indirect taxes were 59.2 per cent of total domestic revenue in 1965 while the direct taxes amounted to only 11 per cent in the same year.

If taxes are defind broadly to include indirect as well as direct taxes, the tax system is found to be heavily oriented toward indirect taxes (taxes normally shifted through a price change to someone other than the original payer). In 1965, for example, the direct taxes accounted for only 15.6 per cent of total taxes, while the indirect taxes accounted for 84.4 per cent of total taxes. According to Bird and Oldman, the country is heavily dependent on indirect taxes, which account for nearly 70 per cent of total tax revenue.[23]

This proportion of indirect taxes is very high, and it is a typical characteristic of countries at Jordan's stage of development. A nation which places such a heavy dependence upon imports, because its resources for primary production are limited, its industries relatively undeveloped, and its living standards are heavily subsidized by foreign aid, will tend to draw a large proportion of its domestic revenues from customs. In 1965, customs receipts amounted to JD 7.9 million which is about 48 per cent of indirect taxes and 38 per cent of all taxes.[24] A second explanation why Jordan places such a heavy dependence on indirect taxation is the fact that it is easier to impose and administer than direct taxation.

Foreign Revenue.--The following table presents a summary of total government current revenue from both domestic and foreign sources. The foreign

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[23] R.Bird and O. Oldman, Readings on Taxation in Developing Countries (Baltimore: The John Hopkins Press, 1964), p. 60.

[24] Jordan Ministry of Finance, Law of General Budget (Amman: Department of Statistic Press, 1966), p. 16.

TABLE 7

SUMMARY OF GOVERNMENT CURRENT REVENUE

JD MILLION

	1959	1960	1961	1962	1963	1964	1965
1. Total domestic Revenues	14.00	15.90	15.97	21.85	20.40	22.81	28.12
2. Budget support (U.S. and U.K.)	16.69	16.52	16.52	15.39	13.28	14.51	11.83
3. Budget support loan from abroad	---	---	---	---	---	5.00	---
Total current revenues	30.69	31.42	32.49	37.24	33.68	42.32	39.95

Source: Jordan Department of Statistics, The National Accounts and Input-Output Analysis 1959-1965 (Amman, 1966), p. 8.

revenue is a budgetary aid received from the United States and British governments. In 1964, however, a loan from Kuwait Government for the specific purpose of supporting the budget occured.

The importance of foreign grants and loans is evident from the table. Yet it is pretty obvious that the absolute as well as the relative magnitude of this foreign source of revenue was declining during the seven-year period. In 1959, it was JD 16.69 constituting 54.3 per cent of total current revenue, while the corresponding figures for 1965 were JD 11.83 and 30 per cent. It is expected that the budget-support will continue to fall since the United States is following a tighter policy in its aid program in order to relieve the pressure on its balance of payments.[25]

The implications of foreign aid and its continuous reduction are serious. First, it reveals a basic weakness in the economy of Jordan, namely, its heavy dependence upon external sources of revenue and hence it carries with it an element of un-

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[25] Guenter Reiman and Edwin Wigglesworth, The Challenge of International Finance (New York: McGraw-Hill Book Co., 1966), p. 114.

certainty as to future revenue. It implies that this source of foreign revenue will continue only if the political framework within the country will remain unaltered. Second, it implies that the government should contemplate a major increase in its domestic revenues to replace the anticipated reduction in foreign revenues. The ideal solution for the government is to try to increase its total revenue from taxation and especially direct taxation. As it will be shown in the following chapters, there is a room to increase the government revenue from income tax. Since Jordan faces a chronic problem of trade deficit in its balance of payments, it is hoped that its imports will be maintained at the same level or slightly increased during the coming few years. This implies that indirect taxes are not expected to increase to any considerable extent to replace the reduction in foreign aid.

Government Recurring Expenditures.--Budget expenditures for a period of seven years are given in table (8). It is evident that the recurring expenditures were increasing from one year to another, except for 1964 when they were less than 1963 expenditures. It is worthwhile noting that while

TABLE 8

GOVERNMENT RECURRING EXPENDITURES

JD MILLION

	1959	1960	1961	1962	1963	1964	1965
General administration	2.23	2.46	2.42	2.48	3.07	2.84	2.92
Defence	16.01	16.30	16.75	16.15	18.57	16.61	19.78
Justice and police	2.10	2.30	2.15	2.71	2.84	2.67	2.85
Education	2.36	2.60	2.64	2.97	3.27	3.53	3.72
Health services	0.80	0.91	0.98	1.16	1.13	1.12	1.14
Social Welfare services	0.12	0.12	0.13	0.12	0.14	0.18	0.19
Communication	0.41	0.41	0.42	0.44	0.53	0.69	0.88
Other services	1.26	1.32	1.48	1.50	1.57	1.89	2.11
Pension payments	0.22	0.56	0.88	1.22	1.49	1.78	2.11
	25.41	26.98	27.85	28.75	32.61	31.31	35.70
Less employee's pension contributions	0.48	0.54	0.52	0.83	0.88	0.56	0.57
Total recurring expenditures	24.93	26.44	27.33	27.92	31.73	30.75	35.13

Source: Jordan Department of Statistiés, The National Accounts and Input-Output Analysis 1959-1965 (Amman, 1966), pl 10.

the recurring expenditures have increased during the seven-year period about 40 per cent, the domestic revenues have increased about 100 per cent during the same period. Moreover, it will be noted that while in 1959 the recurring expenditures surpassed the domestic revenues by JD 10.93 million (24.93-14), in 1965 the difference was only about JD 7 million. This shows that the gap is becoming narrower between domestic revenues and recurring expenditures. However, until the gap completely disappears, Jordan will remain unable to support by its own resources ordinary recurring expenditures, and not to mention its disability to finance the capital expenditures. From mere comparison between table (7) and table (8) it will become evident that only in 1962 domestic revenues were sufficient to cover defence expenditures while prior to that year army expenditures alone exceeded the government's domestic receipts.

Furthermore, direct taxes constitute only about 9 per cent of recurring expenditures, while indirect taxes comprise about 47 per cent of these expenditures. This is another indication that Jordan, like most other developing countries, relies more heavily on indirect rather than on direct taxation in covering its ordinary recurring expenditures.

Capital Expenditure.--The government capital expenditure does not follow a certain pattern. From table (9) it is apparent that it fluctuates from one year to another. Usually, current revenue exceeds current expenditure, and hence the government saves on current account.[26] The capital transfers from abroad comprise payments made by the United States Government in respect of various economic development projects plus the proceeds of sales of some foodstuffs received from the U.S. as aid. It includes also cash grants for development purposes from West Germany and Arab countries. The expenditure on fixed capital (equipment and construction) includes Aqaba Port development, East Ghor Canal, rehabilitation of the Hejaz Railway, together with certain development and extraordinary expenditures which are more akin to capital formation than consumption expenditures. These latter include expenditure on agricultural extension ser-

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[26]Current Expenditure includes recurring expenditures plus current transfers to households plus current transfers to rest of world.

TABLE 9

COMPOSITION OF GOVERNMENT RESOURCES AND CAPITAL EXPENDITURE

JD MILLION

	1959	1960	1961	1962	1963	1964	1965
Current revenue	30.69	31.42	32.49	37.24	33.68	42.32	39.95
Current expenditure	25.81	27.36	28.58	29.93	33.87	33.53	37.89
1. Saving on current transactions	4.88	4.06	3.91	7.31	-0.19	8.79	2.06
2. Capital transfers from abroad	2.62	3.67	2.74	2.82	3.17	6.29	8.64
3. Foreign loans	0.50	1.50	0.50	1.56	0.47	0.95	2.34
Total resources available for capital expenditure	8.00	9.23	7.15	11.69	3.45	16.03	13.04
4. Expenditure on capital formation	5.04	4.46	5.47	8.06	7.16	5.97	10.35
5. Loans, grants & investment in private sector	0.48	0.66	0.31	0.59	0.51	0.67	1.59
Total expenditure on capital formation & investment in private sector	5.52	5.12	5.78	8.65	7.67	6.64	11.94
Surplus (-Deficit)	2.48	4.11	1.37	3.04	-4.22	9.39	1.10

Source: Jordan Department of Statistics, The National Accounts and Input-Output Analysis 1959-1965 (Amman, 1966), p. 11.

vices, tourism development, and other technical assistance activities.[27]

Loan, grants, and investment in the private sector comprise net loans made to the agricultural sector, net loans to local industry, grants made to industrial cooperative societies, and investment by the government in local enterprises by means of share purchases.

It is interesting to note that the government savings totaled JD 30.82 million during the seven-year period, while capital expenditure amounted to JD 51.32 million for the same period. This means that 60 per cent of the government capital expenditure during the seven-year period was financed by its own savings and 40 per cent from foreign sources. This is a typical characteristic of the development process in developing countries where their economic expansion cannot but be subsidized from outside. Jordan would have not been able to accomplish its growth in the GDP during the past decade without having been dependent on foreign grants and loans.

[27]Jordan Department of Statistics, The National Accounts, p. 55.

As I hinted previously, foreign aid cannot be assumed to continue flowing into Jordan for the long-run. The solution is to try to move Jordan into self-sufficiency. This solution carries with it the implication that domestic revenue should grow in the coming years in order to increase savings. Jordan, therefore should try to enhance its economic development by increasing its capital expenditure and thus generating more internal income. During the seven-year period (1959-1965), for instance, the total capital expenditures were about 25 per cent of recurring expenditure and 19 per cent of total expenditures. Moreover, the capital expenditures in 1965 were 6 per cent of the GDP. This is a low ratio in a country badly in need of developing its economic resources like Jordan. The reason for this is implicit in the extremely low levels of income and saving which serve as the source of capital formation.

The Economic Role of the Government

Government Participation in Economic Activities.--The agricultural, industrial, trade, and services activities are mainly the realms of the private sector in Jordan. The government, however, realized that the private sector would not be capable to assume the full responsibility required for developing the economy, for a multiple of reasons. First, the private sector lacks the capital required for long-term investment. Since the per capita income in Jordan is low and hence a high proportion of the people are expected to be living on subsistence level, we find that the propensity to consume is very high and, therefore, the propensity to save is low. In 1965, for example, the propensity to consume was 92 per cent.[28] This is an indicator that the private sector cannot finance all capital expenditure required for the development process. Of JD 29.38 million spent on capital formation in 1965, the private sector was able to contribute out of its savings JD 17.44 million only, which is about 60 per cent, and the net had to be financed by the government.[29]

Second, there are some activities having

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[28] Jordan Department of Statistics, The National Accounts, p. 5.

[29] Ibid., p. 7.

the characteristics of public utilities where the requirements for fixed capital are significant in magnitude and hence the private sector would not be able or willing to own and run such activities. The government, therefore, took the initiative to wholly own and run these activities. To give only few examples, I would mention such institutions as railways, Aqaba Port, water supply, and East Ghor Canal.

A third factor for the active participation of the public sector in the economic activities of Jordan is the legal monopoly. Some local industries were given monopolies in order to encourage their establishment and growth. Such legal monopolies were introduced by the government to protect the local small industry from foreign competition and hence secure the domestic market for its production. In order to encourage the private sector to invest in such growing industries, the government therefore took the lead and invested in them. Thus we find that most firms which are given legal monopolies are mixed in their equity and management composition. The cement, phosphate, petroleum refining, tanning, and steel industries are only few examples where the public and private sectors are participating together in both ownership and management.

It is worth mentioning here that the government has acquired untill December 31, 1964 equity ownership in about twenty domestic corporations in the industrial, trade, and services sectors, where its total investment in these corporations amounted to JD 5.745 million constituting 28.5 per cent of the total capital of these corporations.[30] By such investments, the government believes that it can have direct influence over planning, pricing, marketing and production activities of the basic industries. Moreover, the government would be in a better position to harmonize the activities of the different economic sectors in order to facilitate the process of economic development.

Furthermore, to achieve its objectives, the government has participated in creating a number of specialized institutions for long-term financing.

The most important of these are: the Jordan

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[30] Jordan Ministry of Information, Department of Publication, The Economy of Jordan, p. 37.

Development Bank, the Industrial Development Bank, and the Agricultural Credit Corporation. The government owns 10 per cent of the first bank's capital and it extends loans mainly to the agricultural sector. Moreover, it owns one-third of the second bank, while it wholly owns the Agricultural Credit Corporation.[31]

Government Attitude Toward Local and Foreign Investment.--Jordan, similar to other developing countries, cannot reach the stage of higher standards of living and hence raise its rate of economic growth without increasing the productive resources of the country. With propensity to save (0.08), and limited natural resources, it is rather natural to find that the level of investment is low in Jordan. In 1965, for instance, the private investment represented 10 per cent only of the national income.[32] In contrast, the ratios of private saving and investment are 15 and 18 per cent respectively of national income in the advanced countries.[33]

[31]Jordan Ministry of Information, Department of Publication, The Economy of Jordan, p. 77.

[32]Jordan Department of Statistics, The National Accounts, p. 3.

[33]Bird and Oldman, Op.cit., p. 5.

Realizing this fact, and being aware of the fact
It is essential to stimulate all potential factors
that in the process of development/of production
to participate, the government has tried to create the favorable legal environment for investment. For this purpose, it has issued in January 1967, the "Investment Encouragement Law."

The encouragement for investment is given in the form of exemptions from taxes, customs, and excise duties. The law exempts the fixed assets of any productive project from customs duties or any other taxes when they are imported.[34] Moreover, the profits of the projects are exempted from income and social services taxes for the first six years. The land and buildings of the projects are also exempted from land and building taxes. The exported products of the project are exempted from production and exportation excise duties for a period of six years. Furthermore, after the first six years elapse, The Council of Ministers has the right to exempt 25 per cent of the net profits, from income and social taxes if such amounts are used (a)

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[34] Jordan Ministry of National Economy, Investment Encouragement Law (Amman: Aljamel Press, 1967), p. 8.

in the improvement, extention or increasing the productive capacity of the project, (b) in establishing dwelling houses for the employees of the project, and (c) in establishing buildings for health, education or entertainment services for the employees.[35]

To attract foreign capital and to encourage domestic savings, the law provides for the exemption of interest earned on deposits in local banks from income and social taxes. In addition, the income which is generated from investing in the public debt securities (such securities have not been issued yet) and the interest paid on foreign loans which the government borrows, or paid by the local banks on foreign loans, are all exempted from income tax.[36]

Finally, the law stipulates that the government guarantees the equal treatment of foreign and local capital, so that both will enjoy the same tax exemptions. Moreover, profit and interest which

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[35] Jordan Ministry of National Economy, *op. cit.*, p. 10.

[36] *Ibid.*, pp. 8-9

are generated in Jordan by foreign capital are transferable abroad without any restriction. But concerning the transference abroad of the invested foreign capital, the law allows it to be transferred in three yearly equal installments, provided that the first installment will be transferred after two years of the operation of the project in which this capital was invested.[37]

This law reflects the pressing need of Jordan for capital. The government, however, seems to be responding positively, at least from a legal view point, toward such need. By the "Investment Encouragement Law", the government has appealed to potential resources which would have been ready to undertake promising opportunities in Jordan. All the above mentioned facilities which are given for investments, are at the expense of domestic government revenue. Yet, the government forgoes such returns in order to cope with the problem of Jordan's shortage of productive resources.

The Seven-Year Plan of 1964.--The government of Jordan seems to be convinced that the count-

[37] *Ibid.*, p. 11

ry's economic problems could not be solved if the machinery of the economy is left to operate haphazardly. With these problems in mind, the government realized that flexible long-range planning is necessary for the achievement of Jordan's economic objectives. It has, therefore, produced the "Seven-Year Program, 1964-1970". Since the scope of this study does not warrant a detailed discussion of all the plan, I shall limit myself to the discussion of the domestic revenue, the part with which this study is mostly concerned. The goals of the plan have been established by the government in the following order of importance:[38] (1) major reduction in the external balance of trade deficit and such reduction in dependence upon budget support as Jordan may be able to sustain; (2) an increase in per capita income at as rapid a rate as possible, consistent with goal one; (3) and a reduction in the level of unemployment. It is apparent that to move Jordan as rapidly as possible toward economic self-sufficiency is the overall goal of the Seven-Year Plan. The means of achieving this goal are pro-

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[38] Jordan Development Board, <u>The Seven-Year Program</u>, p. 11.

vided in the capital formation programs of the various sectoral plans. Table (10) shows the government revenue and expenditure during the seven-year period. It reflects that domestic revenue must be increased from about J.D. 22.8 million in 1964 to JD 35.3 million in 1970 as a necessary part of the process of moving toward economic independence. Increasing the government domestic revenue is necessary, (a) to offset the reduction in budget support, (b) to channel some of the increased purchasing power of the private sector into investment as well as to prevent an undue rise in imports of consumer goods with a consequent worsening of the trade deficit, and (c) to permit necessary increases in recurring and capital expenditures.

To achieve such increases in domestic revenue, the planners stressed the importance of tax revenue. The program calls for an increase in tax revenue as a proportion of national income. Moreover, the program, calls for the imposition of new income tax law to include incomes mentioned in the existing law, in addition to the presently exempted incomes from agriculture, animal husbandry, horticulture, shares, divedends, capital gains and investment from

TABLE 10

GOVERNMENT REVENUE AND EXPENDITURE DURING THE SEVEN-YEAR PLAN

JD MILLION

	1964	1965	1966	1967	1968	1969	1970
1. Domestic Revenues	22.8	26.9	28.1	29.6	30.9	33.1	35.3
2. Budget Support	18.6	12.8	12.0	11.0	10.0	8.0	6.0
3. Total current revenues	41.4	39.7	40.1	40.6	40.9	41.1	41.3
4. Recurring Expenditures	34.6	35.8	36.7	37.7	38.7	39.8	41.0
5. Capital funds required	11.8	14.8	24.9	34.8	30.8	24.7	20.1
6. Surplus on current a/c	6.8	3.9	3.4	2.9	2.2	1.3	0.3
7. Development grants	3.3	6.6	8.4	6.8	3.5	3.5	3.5
8. Sales of short and long term bonds to private sector	--	--	0.2	0.5	0.9	1.5	2.0
9. Foreign Borrowing	1.7	4.3	12.9	24.6	24.2	18.4	14.3

Source: Jordan Development Board, The Seven-Year Program for Economic Development of Jordan 1964-1970 (Jerusalem: The Commercial Press, 1964), p. 35.

abroad.[39] Ideally, the tax program for the Seven-Year Plan is designed to discourage productive activity and investment as little as possible, to reduce luxury consumption as much as possible, to be economical to collect, and to provide incentive for foreign investors.

The major domestic revenue source, i.e., customs receipts, will cease to grow as the limit on imports and the shift in imports to exempted items required by the Program take place. Reducing the growth in customs collections means that other revenue sources must be found to replace the declining budget support and pay for the costs of the Plan.

If the tax program is successfully implemented, it means that the domestic revenue will increase by about JD 15 million between 1963 and 1970, while the recurring expenditures will increase by about JD 9.5 million. This means that at the end of the program, domestic revenue would have grown to an extent that it will allow more funds to be

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[39]Jordan Development Board, The Seven-Year Program, p. 52.

applied for capital spending. In 1963, recurring expenditures exceeded domestic revenue by JD 11.3 million. At the end of the Program, however, the difference would become JD 6 million only. At the time being, all indications show that domestic revenue is growing as rapidly as it was projected, if not better. In 1965, for example, domestic revenue amounted actually to JD 28.12 million while it was forecasted to reach JD 26.9 million only. Whether the tax program has been so far as successful as the planners wanted it to be, will be manifested in the following chapters. But it is safe to say at this point that until the present moment, no new tax law has been enacted to replace the existing law as it was proposed in the Plan.

CHAPTER II

THE INCOME TAX LAW: HISTORY AND ANALYSIS

Background

A Brief History.--Until the passage of the Income Tax Law No. 50 in 1951, applying to all Jordan, the income tax had a dual history. One part was the Transjordan income tax, which was introduced in a primitive form in 1933, amended in 1936, and replaced by a new law in 1945.[1] The other part was the Palestine income tax. It was introduced in 1941 by the British Government on the pattern of a model law circulated by the Colonial Secretary. Then in 1947, on the basis of six years' experience, it was replaced by a specific law, the Income Tax Law No. 13 of 1947.[2]

After the partition of Palestine in May, 1948, and even after the formal joining of Central Palestine and Transjordan to form the Hashemite

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[1] Alaudin S. Nammare, A Brief History and Development of Income Tax in Jordan (Amman; the Income Tax Department, 1964), pp. 7-8.

[2] Ibid., p. 9.

Kingdom of Jordan in April 1, 1950, the two laws were still applied separately until 1951. But on April 1, 1951, the two laws were replaced by a single law, Income Tax Law No. 50, applying to all Jordan. This law was then replaced by Income Tax Law No. 12 of 1954 which offered some reductions in the income tax.[3] In 1964, however, a new law was formulated, known as Income Tax Law No. 25 of 1964, to replace the 1954 law.[4] This law is still in force. Our discussion, therefore, will concentrate mainly on the 1964 law. By and large, the Jordan income tax law today is patterned after the Palestine law based on the British approach to income taxation.

Guidelines For Tax Policy in Jordan.--In general, there are three broad requisites for a good tax system which fiscal authorities should have in mind as they assume the responsibility of providing for the financial needs of government. First of all, taxes must produce adequate amount

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[3]*Ibid.*

[4]A.S. Nammari, *op.cit.*, p. 10.

of revenue if they are to be effective as fiscal instruments. It is sometimes difficult to determine in advance precisely what constitutes adequacy in this connection, especially in a country like Jordan which depends heavily on foreign aid to enable it to meet annual outlays. But it is clear, as seen in Chapter I, that total domestic revenues should be in excess of at least government recurring expenditures. If steps were to be taken in this direction, the financial position of Jordan would be strengthened as moves are made to increase the productivity of the tax system.

Another established requisite of a good tax system is equity in the distribution of burdens imposed.[5] Few will argue against justice and fairness in taxation, but honest differences prevail with respect to the meaning of the terms. Students of taxation are in quite general agreement, however, that the principles of benefits received and ability to pay have roles to play in the quest for justice in taxation.

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[5]H.A. Silverman, Taxation: Its Incidence and Effects (London: Macmillan and Co., Limited, 1951), p. 68.

Everyone is presumed to receive some benefits from the government. For that reason a case can be made for a tax system which requires a certain contribution to the support of the public authority on the part of each person who is a beneficiary. There are many individuals, however, whose financial resources are so limited in amount that any tax levied on them would result in a burden too heavy to be borne. It is generally agreed, therefore, that those who are barely able to sustain themselves should not pay taxes even though they do gain some benefits from government.[6]

In a few cases involving direct tax levies, the benefits-received principle can be applied quite effectively. The company income tax, for example, is often defended on grounds that the corporation, as an entity, is a creation of government and receives many benefits from the public authority and thus should pay a special tax.[7] It is evi-

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[6]Joseph Scherer and James Pate, Public Finance and Fiscal Policy (Boston: Houghton Mifflin, 1966), p. 165.

[7]E.C. Alvard and Others, How Shall Business Be Taxed? (Chicago: LiHle and IVES Co., 1937), p. 35.

dent, however, that this principle of taxation has quite limited application.

The ability-to-pay principle is more generally accepted and its use more staunchly defended than the benefits-received principle in the search for justice and equity. It is commonly believed that net income is a reasonably satisfactory measure of one's ability to pay taxes, and that the possession of wealth adds to ability.[8] In the final analysis, taxes are paid out of income, either directly or indirectly. For that reason, levies on income are widely used throughout the world, mainly because they make possible the application of the ability-to-pay principle.[9] Taxes on net income, together with levies on inheritences and estates, and to a much lesser degree on property, are examples of revenue measure geared to the ability-to-pay idea. The rates levied on incomes, inheritences, and estates are usually progressive, i.e., they increase as the base increase, since it is believed

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[8]H.A. Silverman, op.cit., p. 71.

[9]Roy Blough, The Federal Taxing Process (New York: Prentice-Hall Inc., 1962), p. 382.

that the utility of a unit of money declines as the number of units in possession increases.[10] There is no satisfactory way to measure in an exact manner the utility of money for purposes of income taxation, but progressive rates are nevertheless thought to be in keeping with the ability-to-pay principle.

Finally, a tax system should function in such a way that the repressive effects on the operation of the economy are at a minimum.[11] Each tax, whether direct or indirect, reduces personal incomes by transferring funds to the public treasury. This may have the effect of decreasing consumption or saving, or both, on the part of income recipients. A reduction in saving will cause the supply of available investment funds in private hands to decline. Taxes do not diminish the flow of money, of course, since the funds shifted to government are kept in use. But they may discourage individuals in their efforts to save, to invest, and even

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[10]A. Musgrave, The Theory of Public Finance (New York: McGraw-Hill, Inc., 1959), p. 52.

[11]J. Stamp, op.cit., p. 75.

to consume.[12] The fact that the government spends the tax receipts is not in itself a sufficient reason for concluding that taxation, as a transfer operation, has no repressive effects. Taxes may be deterrents, and it is highly important that public officials recognize this possibility in order that attempts may be made to minimize the ill effects.

The Income Tax as a Growing Source of Revenue

In discussing the income tax as a source of additional revenue, the writer is mindful of three aspects of the problem: (1) the automatic growth of revenue from income taxation as the Jordan economy develops and income expands; (2) the potential increase in taxes from changes in the law to broaden the base of the tax; (3) the potential increase in collections through better enforcement.

The second as well as the third points will be elaborated, at some length, in the latter sections of this chapter and in the following chapters.

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[12]E. Rolph and G. Break, Public Finance (New York: The Ronald Press Co., 1961), pp. 35-38.

In this section, however, I shall concentrate on the first point.

The Automatic Growth of Revenue From Income Taxation.--Table (11) presents the income tax revenue for a period of eight years. It is obvious that the taxes experienced a continuous growth over the period. Moreover, it is to be noted that the increase was not steady but fluctuated to a considerable extent. This might reflect the inadequacy of the collection system where the administrative enforcement determines the magnitude of the collections from the assessed taxes. When a strict policy is followed, it seems that the collected taxes would be higher. This point, however, will be discussed fully in a subsequent section of the following chapter.

The increase in 1965 (27.6 per cent) draws the attention of the observer. The explanation for this sudden increase might lie, among other factors, in the fact that the economy witnessed a boom in 1964. The incomes were relatively high (See appendix) and, hence, the assessed tax in that year was also high. The tax on 1964 incomes was

TABLE 11

JORDAN INCOME TAX REVENUE

Year	Income Tax (JD)	Percentage Increase	As a Percentage of Total Taxes	As a Percentage of Domestic Revenue
1959	806,634		8.2	5.6
1960	907,831	12.5	8.6	5.7
1961	995,449	9.6	9.9	6.3
1962	1,197,549	20.0	9.8	6.0
1963	1,375,573	15.0	10.2	7.0
1964	1,410,986	2.5	9.0	6.2
1965	1,800,554	27.6	9.1	6.5
1966*	1,904,180	5.7		

Source: Calculated from the Income Tax Department records, which were given personally to the writer.

*Note : The figures for total tax and domestic revenue for 1966 have not been published yet by the official authorities. For this reason, it was not possible to compute the income tax as a percentage of both total tax and domestic revenue for that year.

assessed and collected in 1965. Although Jordan's income tax still plays a modest role as a source of revenue, yielding on average for the eight-years period under study only about 9.5 per cent of total taxes and 6.2 per cent of domestic revenue, it is particularly well suited to capturing for the government a fair share of the expanding income from its development program, rather than letting it be dissipated in additional consumption. Yet, the income tax constantly encounters the charge that it interferes with private development investment both by reducing the supply of private investible funds and by discouraging the incentive to invest.[13]

Jordan applies a progressive income tax rate. This kind of income taxation is widely recognized as the most effective instrument in the revenue system.[14] For example, for each increase of 1 per cent in national income, it is estimated that the United States federal income tax-yield increases by between 1.4 per cent and 1.6 per cent.[15] In contrast, bet-

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[13]H.A. Silverman, op.cit., p. 169.

[14]Harold Groves, Financing Government (New York: Henry Holt and Co., 1954), p. 32.

[15]Harold Somers, Public Finance and National Income(Philadelphia: The Blakiston Co.,1949), p. 487.

ween 1959 and 1965, the Jordan GDP increased by 76 per cent while the income tax revenue increased by 123 per cent during the same period.[16] This means that for each increase of 1 per cent in the GDP, Jordan income tax yield increased by 1.6 per cent. In other words, the revenue elasticity or "built-in flexibility" of this tax is very high. (Property taxes and general sales taxes, by contrast, have been found to increase by only 1 per cent in yield for each 1 per cent increase in national income.)[17] This high revenue elasticity, therefore, is the effect of the progressiveness of the tax. This fact strengthens the writer's belief that income taxation should be given a special attention from public officials in Jordan in order to reap the rewards of growth. The income tax is, to be sure, the best available tax to tap large incomes and accumulated fortunes which accompany economic growth. Much of the ultimate source of income in Jordan out of which fortunes are being amassed, is derived from liberal foreign aid; it is not only

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[16] Jordan Department of Statistics, The National Accounts, p. 3.

[17] Somers, op. cit., p. 490.

appropriate but extremely important for the sake of general justice to tap this wealth through progressive taxes. In the absence of any direct tax on wealth like estate or inheritance taxes, as the case is in Jordan, the burden of reducing extreme inequalities falls on the income tax. Through this tax, some of the enrichment of a fortunate few that accompanies rapid development is shared with the population as a whole in the form of various government programs. It is the writer's belief that the Jordan income tax revenue has not yet reached its optimal limit. From the following analysis, it will be shown that this type of tax is still possessing potential increases without doing irreparable damage to the economy if the existing loopholes in the law are closed.

Structural Analysis of the Income Tax Law

Personal Income Tax

In the distribution of tax burdens, the official legeslative bodies have taken cognizance of the requirement of Article 3 of the Jordanian Constitution, which states:

> "In imposing taxes, the Government should adhere to the principle of progressive taxation, while at the same time ensuring equality and social justice. Taxation should not exceed either the paying ability of the tax-payer or the financial needs of the Government."[18]

The income tax offers Jordan its best opportunity for meeting the constitutional requirement of progressive taxation. Throughout the world, it is recognized that a comprehensive tax on income, with appropriate family allowances and progressive rates, more closely meets the ideal of social justice in taxation than any other form of tax.[19] Those who defend the Jordan progressive income tax maintain that it passes the test of equity. They claim that it is equitable, both in the sense of horizontal equity, i.e, that people in equal economic circumstances should be taxed equally, and in the sense of vertical equity, e.e, that people in unequal circumstances should be taxed according to the progressiveness principle whereby a larger proportion of income is taken the higher the income.[20] It is

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[18]Hashemite Kingdom of Jordan, <u>Jordan Constitution</u> (Amman, The Army Press, 1950), p. 6.

[19]H.Groves, <u>op.cit</u>., p. 36.

[20]Hashemite Kingdom of Jordan, <u>Report of the Royal Fiscal Commission</u> (Amman, 1960), pp. 64,65.

one objective of the present study to put this statement under careful scrutiny.

Jordan income tax embraces all forms of income in a "global" or "universal" tax. It pools the different forms of income for each taxpayer into a single total, taxable under a single schedule of rates. Many writers prefer this type of income taxation as against the schedular income tax which splits income into different segments taxable at different rates without regard to the total income and family status of the taxpayer.[21] Added to this, progressive taxation has the advantage that it adjusts each year to the taxpayer's current economic status, rising as income rises, falling as income falls, and stopping when income stops.

Personal Income Tax Rates and Family Allowances.--Article 24 of the income tax law sets out the schedule of tax rates upon the chargeable income of any person other than a company as follows:[22]

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[21] Bird and Oldman, op.cit., p. 185.

[22] Hashemite Kingdom of Jordan, Income Tax Department, The Income Tax Law Number 25 of 1964 (Amman, 1964), p. 25.

Taxable income (in JD)	Rate
Not over 400	5 per cent
Over 400 but not over 800	7 per cent
Over 800 but not over 1,200	10 per cent
Over 1,200 but not over 1,600	15 per cent
Over 1,600 but not over 2,000	20 per cent
Over 2,000 but not over 2,400	25 per cent
Over 2,400 but not over 2,800	30 per cent
Over 2,800 but not over 4,000	35 per cent
Over 4,000 but not over 6,000	40 per cent
Over 6,000 but not over 8,000	45 per cent
Over 8,000	50 per cent

In addition to this income tax, every taxpayer is required to pay 10 per cent of his income tax as Social Welfare Surtax. This tax is also collected by the Income Tax Department. According to the Social Services Tax Law No. 89 of 1953, the revenue of this tax is allocated by the Ministry of Social Affairs and Labor for charitable and educational purposes.[23]

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[23] Hashemite Kingdom of Jordan, The Official Gazatte Number 586 (Amman: Army Press, 1953), p. 246.

Article 14 assigned the personal and family deductions (exemptions) deductible from net income in arriving at chargeable income subject to tax, as follows:

Basic Family Allowances	JD
Residence allowance (for each taxpayer)	150
Wife	100
First child	25
Second child	20
Third child	15
Fourth child	10
Maximum family exemptions	JD 320

Furthermore, Article 15 allows a general deduction of 15 per cent of the resident taxpayer's total taxable income, to a maximum of JD 200, if the individual has employment income or pension income.

In addition, the taxpayer may deduct from taxable income: travel and subsistence expenditures without specific limitation, entertainment expenses to a maximum of JD 150; university education charges of up to JD 200 per student; dependency or non-related child maintenance cost up to JD 50; and up to 25 per cent for charitable contributions. He may also credit against tax 5 per cent, to a maximum of JD 8, of life insurance premiums paid or pension fund contributions made.[24]

It is evident that the law treats the income of individual residents sympathetically. One might find justification in exempting JD 200 of the taxable income for educating a student in a university, since Jordan is in need of such an investment. Moreover, the JD 8 credit against tax for life insurance premium or pension fund is also justified by the objectives of stimulating security and savings. But generally speaking, personal exemptions from tax represent sources for diminishing the tax revenue. In particular, the deductions of 15 per cent of total taxable income, travel and subsistence expenditure without specific limitations, and entertainment deductions, might be sources of abuse on the part of taxpayers and hence reduce unjustly their taxable income. It is always maintained by the Income Tax Department officials that such a loop-

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[24]Income Tax Law of 1964. Articles 9, 11 and 15.

hole in the law is actually used by many taxpayers who present fictitious transactions to the Assessing Officers.[25] This happens because the law does not determine the proof required for the allowance of the exemptions. The law also does not place a ceiling on subsistence and travel expenses. If it is fair to allow family allowances and some other deductions, one wonders what justification is given to allow the 15 per cent of taxable income up to a maximum of JD 200 as a general deduction over and above other personal exemptions.

Moreover, the upper individual income brackets can profit most from the benefits available under the law, namely, the personal, family, and general deduction allowances. The withdrawal of these allowances has the effect of lowering the top "slice" of income subject to the tax, so that, under the law's progressive rates, tax is saved at a relatively higher rate than on incomes in the lower brackets. For example, an allowance of JD 150 is worth JD 7.5 of tax to the taxpayer whose taxable

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[25] Kassem Rusan, Income Tax Department, A Study of Jordan Income Tax Law (Amman: 1964), p. 11.

income does not reach beyond the first bracket (taxed at 5 per cent). But for a taxpayer in the 40 per cent bracket, the same JD 150 exemption relieves him of JD 60 of tax. It seems that the law is self-defeating at this point. In principle, the income taxation should be a tool for equitable treatment, horizontally and vertically, and a tool for more equitable distribution of wealth and income. To give all taxpayers, regardless of the level of their incomes, a uniform exemption in terms of tax, instead of relieving the wealthy taxpayer of larger amount of tax per exemption than the poorer man, is prefered. This might be accomplished by converting the personal exemptions into equivalent tax credits at the lowest bracket rate.

Furthermore, once the tax applies, the rate of tax on individual income, marginally and effectively, rises more steeply in the first seven brackets, due to their relatively narrow income bands (JD 400) than in the last four (from 5 to 30 per cent marginally, and 5 to 16 per cent effectively, on the first JD 2800 as against a maximum of 50 per cent marginally, and of 32.1 per cent effectively at the JD

8000 level)[26] This convex nature of the law's individual rate schedule, pursuant to which incomes in the seven low steps of that eleven-bracket scale are subject to a relatively higher tax than those within the last four, discriminates against such lower incomes.

<u>Burden Distribution of Income Tax</u>.--It appears desirable, at this point, to review the actual impact of the tax on all income brackets. This leads us to an interesting analysis of the distribution of income tax burden among different groups of taxpayers. Such a distribution is presented in Table (12). When reviewing the distributional information presented by the table, one is struck by the following points: (1) The heavy concentration of taxpayers in the very lowest income groups. About 86 per cent of taxpayers other than companies are in the lowest income group (below JD 400). Taking those under JD 800 of taxable income, we find that about 94 per cent of

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[26]The effective tax rate is equal to the ratio of tax liability to net income. Thus, the tax liability on an income of JD 2800 is JD 448 and the effective rate is $\frac{448}{2800} = 16$ per cent.

TABLE 12

PERCENTAGE DISTRIBUTION OF INCOME TAX BY

INCOME GROUPS FOR THE YEAR 1965

(excluding limited companies)

Income Group (JD)	Percentage of Taxpayers	Taxable Income(JD)	%	Tax Assessed (JD)	%
Less than 400	85.7	6,596,329	42.9	329,077	24.6
401 - 800	8.7	2,829,195	18.4	156,513	11.7
801 - 1200	2.4	1,506,854	9.8	101,667	7.6
1201 - 1600	1.2	1,076,324	7.0	90,965	6.8
1601 - 2000	0.8	784,178	5.1	81,601	6.1
2001 - 2400	0.5	553,538	3.6	70,899	5.3
2401 - 2800	0.3	415,153	2.7	62,873	4.7
2801 - 4000	0.2	338,273	2.2	60,197	4.5
4001 - 6000	0.1	307,521	2.0	53,509	4.0
Over 6000	0.4	968,692	6.3	330,416	24.7
Total	100.0	15,376,057	100.0	1,337,717	100.0

Source: Calculated from the Income Tax Department records.

taxpayers is accounted for. (2) As the table shows, the picture changes materially for taxable income and tax assessed. The bottom group below JD 400, accounts for only about 43 per cent of taxable income and about 25 per cent of tax assessed, while the over JD 2800 groups (which are considered of high income-earners), account for 10.5 per cent of the taxable income and 33.2 per cent of the assessed tax. (3) The table reflects the maldistribution of incomes in Jordan. It tells us that 86 per cent of taxpayers account for only 43 per cent of taxable income while 0.7 per cent of taxpayers account for 10.5 per cent of taxable income. (4) The JD 1,337,717 of tax assessed against persons other than companies represents about 9 per cent of the total taxable income of JD 15,376,057.

These figures strongly suggest that the present income tax in Jordan is by no means a crushing burden. They also appear to support the observation that much income must be escaping the tax. Since only 0.7 per cent of all taxpayers have incomes over JD 2800 and are taxed, while 85.7 per cent of taxpayers whose incomes are below JD 400 are taxed, one is safe when saying that there is much more tax-compliance, i.e, tax-loyalty, on the part of low income-earners than on the part of high income-earners. It seems that this might be a reflection of the social system in Jordan, where the high income group has privileges over other citizens, gained by their social and political influence. This supports the opinion that the income tax in Jordan has not yet reached its potential.

Furthermore, it seems that income taxation in Jordan did not function effectively as a redistributive tool of wealth and income. Since income and wealth in Jordan are not distributed fairly and equitably among citizens, reliance on income taxation should be considerably higher to redistribute incomes and wealth more equitably among all classes. The overall tax rate in 1965 was only about 9 per cent of net income. This is definitely a very low rate for wealthy taxpayers. Moreover, it is certainly a low rate in relation of the benefits received by Jordan residents. If one remembers that elementary as well as secondary education, health, police and many other services are given free of any charge by the government, it would be safe to comment here that the overall 9 per cent income tax rate is a light burden. Furthermore, it might be an index of the tax non-compliance on the part of Jordan residents.

Taxable Income

The Income Tax Law of 1964, defines "Chargeable Income" as, the aggregate amount of the personal income from the sources specified in Article 5, remaining after allowing the appropriate deductions and exemptions under this law. It would be proper at this stage to enumerate the sources of income which are considered to be subject to income taxation.

Article 5 paragraph 1 (a) subjects to tax the profits or gains from any trade, business, profession or vocation, or from any separate transaction or deal in the nature of trade or business. It is clear that gains arising from the disposition of capital assets are not subject to tax. In this latter respect, the law could easily subject to tax capital gains from the sale of real or personal property, if determined to be in the nature of trade or business gains.

Paragraph 1 (b) taxes profits or gains from employment, including the estimated annual rent of any quarters, boards, or residences, or any other allowance. Moreover, paragraph 1 (c) includes as taxable income the net annual rent of owner occupied residences.

Paragraph 1(d) subjects to tax interest or discount earned, and paragraph 1 (e), pension annuity. In paragraph 1 (f), rents from real property as well as royalties, premiums, and other profits arising therefrom, represent taxable income. Paragraph 1 (g) subjects to tax profits or gains arising from any property other than real property. Paragraph 1 (h) includes as taxable income compensation received in respect of any trade mark design, patent or copyright, subject to a spreading out of this income over a period longer than a year as the Assessing Officer shall allow. Finally, Article 5 paragraph 1 (i) subjects to tax profits or gains arising from any other sources not covered by paragraphs (a) to (h), if not exempted under this or any other law. The law is not clear concerning the nature of these sources of the profits or gains so subject to tax.

Paragraph 2, provides that any sum realized under insurance against a loss of profits shall be taken into account in the ascertainment of gains or income. The law here is also not clear about the types of insurance falling under this paragraph and the risks intended to be covered therein.

It is interesting to note that paragraph 6 attributes to the husband, for purposes of tax, the income of a wife living with him. What constitutes taxable income in this case should be explained, particularly where there are trust arrangements or other prenuptial contracts.

Further, Article 6 states that tax shall be charged, levied and collected for each year of assessment upon the chargeable income of any person for the year immediately preceding the year of assessment notwithstanding that the sources of income may have ceased before or during the year of assessment.

Income Exempted From Tax

From the sources reviewed and the personal interviews of the writer with some high officials in the Income Tax Department, it seems that there is a universal agreement that the income tax in Jordan did not reach its potential.[27] The income tax, it is always said, have not been too productive of revenue, a basic objective of Jordan taxation policy. Any income, therefore, exempted from tax, should be justified by reasonable and positive effects on the economy as a whole, In this respect, a question arises concerning the advisability of not taxing the currently exempted incomes.

Capital Gains Exemption.--By a capital gain it is meant a financial gain resulting from the sale of a capital asset at a higher price than was paid for it.[28] Capital gains, therefore, are measured by the difference between the sale price of an asset and its "basis"; the latter is usually the acquisition price of the asset minus net allowances, if any, during the interim for depreciation.[29] The

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[27] The writer interviewed the Director and several high officials of the Income Tax Department.

[28] Philip Taylor, The Economics of Public Finance (New York: The Macmillan Co., 1953), p. 350.

[29] H. Groves, op.cit., p. 169.

gain usually arises out of an appreciation of capital value, and creates in the hands of the receiver a clear capacity to pay tax.

One characteristic of many of the so-called capital transactions is that they are irregular, as opposed to the more recurring forms of income, such as salaries, and business income. Of course, there are persons who regularly deal in capital assets, such as real estate salesmen or stock brokers, and the income of such persons is not substantially more irregular than that of many wage-earners. Hence, in one sense, the question comes down to whether occasional income should be treated any differently from recurring income. In another sense, the question corresponds somewhat to distinguishing between business and non-business income. Obviously, we cannot go into them here. Suffice it to say that there are no compelling reasons, from a theoretical point of view, why capital gains should be treated differently from other forms of income, since, a unit of capital gain commands precisely the same economic power for a consumer as a unit of any other type of income.

The practical argument advanced against the taxation of capital gains as ordinary income rests upon the notion of "income realization."[30] This results from the fact that under most tax systems, including that of Jordan, income is only taxed when it is realized. Yet, since the amount realized upon the sale of an asset frequently represents the appreciation in value of the asset over a substantial number of years, the gain which is thus realized in one year is really attributable to several years. Without some special provision, the gain will all be taxed in the year of receipt, and because of the progressive nature of the tax structure the gain will thus be taxable at a higher rate rather than if it had been taxed each year as it accrued. Therefore, it is said by advocates of a preferential lower rate for capital gains, that unless such a lesser rate is introduced or capital gains are exempted altogether from tax, an inequity will be created, since taxpayers with capital gains will be taxed more severely than those with more regularly occurring income.[31]

There are several answers to this argument. To begin with, the problem of irregular income is a

[30] H. Groves, op.cit., p. 170.

[31] H. Groves, op.cit., p. 172.

general one, not restricted to the recipients of capital gains. Authors, for example, frequently receive large sums in the year in which they initially publish a book, but then receive little or no income for a long period of years. The problem is simply one aspect of the difficulties inherent in an annual system of accounting.[32] Moreover, the tax payment often suffered by persons realizing capital gains is frequently offset by the choice which such persons have with respect to the time at which they wish to realize their gains. Thus, if a taxpayer anticipates a gain upon the sale of an asset, he can often wait to realize it in a year when he has less taxable income and he will thus have an advantage not enjoyed by other taxpayers.[33] Fianally, and most significantly, the proper remedy for this admitted evil is not the complete exemption of capital gains, or their subjection to a lower tax rate, but a more limited cure adapted to the disease. That is to say, some sort of averaging over time for capital gains is needed to elimi-

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[32] Bird and Oldman, op.cit., p. 238.

[33] Ibid., p. 240.

nate significant lumping.

Turning now to the specific case of Jordan, we find that under the present Income Tax Law of 1964, capital gains are not subject to income taxation. This is a serious gap in the law which permits tax escape of profits arising out of activities making little or no contribution to Jordan's economic development. Particularly, in the case of residential land holding and construction, every effort must be made to divert resources to more productive channels. In recent years, luxurious residential construction has been one of the country's principal investments, and residential buildings have an extremely high capital to output ratio (more than 9).[34] Channeling investment funds away from residential construction into industrial enterprise is a precondition for the success of industrialization in Jordan which, as seen in Chapter I, is an important requirement. Income taxation should be an effective instrument in effecting such a change.

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[34]The Royal Fiscal Commission, <u>op.cit</u>., p. 88.

Moreover, by extending capital gains exemption to companies, they are encouraged to realize tax-exempted profits, arising from the sale of such companies. This gap in the law opens the opportunity for companies, and especially the closely-held ones to retain their profits, so that the assets appreciate in value. When such an appreciation is significant, the owners materialize it by selling the appreciated assets, thus enjoying the privilege of capital gains tax-exemption.

Subjecting capital gains to taxation would make at least some contribution to the stated objectives of income taxation in Jordan. To surmount the objection of "income realization", percentage reductions in the includible amount of gain in the taxable income might be made according to the length of time the capital asset has been held. An example of such a reduction might be as follows: if the asset is held less than one year, 100 per cent of the gain is includible; if held over one, but less than three years, 80 per cent is includible; if held over three, but less than 6 years, 60 per cent is includible; if held over 6 years, 50 per cent is includible. These declining percentages recognize that it would be unfair to tax at full progressive rates in one year the capital gains which have been accruing over a period of years.

To be fair, if capital gains are taxed, capital losses shall also be deductible from capital gains, and only on bona fide sales, and may be carried forward against capital gains for a period of time, such as 6 years.

Agricultural Income Exemption.--Article 8 paragraph I (m) states that:

> "There shall be exempt from tax the income accruing to any person from agriculture, husbandry, afforestration, or horticulture, including the income from processing products through simple hand work."35

As it was shown in the previous chapter, the agricultural sector is important in the economy of Jordan, though its income is still low. It has contributed in 1965 about 22.8 per cent of the GDP.[36] Moreover, from table (1) it appears that the agri-

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[35] Income Tax Law of 1964, p. 10.

[36] Jordan Department of Statistics, The National Accounts, p. 3.

cultural sector absorbs about 35 per cent of the working population. This means that those who are engaged in farm production are privileged over non-agricultural income-receivers. Furthermore, the exemption means that the agricultural sector is subsidized by the government.

This exemption is a typical characteristic of underdeveloped countries. In this respect, the United Nations' Report on the world social conditions in 1963 states that, the fiscal practices in underdeveloped countries have favored agricultural income recipients. It reports that income derived from the land has been subject to low rates or has been exempted totally in Iraq, Jordan, Syria and Turkey.[37]

Pursuing the principle that income from all sources should be pooled into a single total if a proper measure of ability to pay for progressive tax purposes is to be attained, one finds the

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[37] United Nations, Department of Economics and Social Affairs, 1963 Report on the World Social Situations (New York, 1963), p. 78.

exemption of income from agriculture to be an anomoly. A considerable amount of agricultural income would fall below the exemption limits. But in a significant number of cases income would be chargeable to taxpayers from this source who are already chargeable on income from other sources and, hence, are escaping tax on part of their incomes. The net agricultural income in 1965, for example, amounted to JD 34.31 million.[38] If we assume that only 50 per cent of this income is taxable, this means that about JD 17 million will be a gross taxable income. Moreover, if we assume that family and personal deductions will reach 50 per cent also, this would leave about JD 8.5 million as net taxable income.[39] Applying the overall tax rate of about 9 per cent, it will appear that about JD 765,000 of revenue were foregone by the government. It is clear that this serious gap in the tax law defeats two important objectives of income taxation in Jordan, namely, equitable treatment of all taxpay-

[38]Jordan Department of Statistics, <u>The National Accounts</u>, p. 17.

[39]These estimates are based on the assumptions of Mr. Arafat, the former Assistant to the Income Tax Director, in his book, <u>Income Tax Evasion in Jordan</u>, p. 39.

ers and revenue productivity.

One can find no justification for subsidizing the agricultural sector at the expense of other productive sectors. Jordan, like other developing countries, is badly in need of developing the industrial sector. By favoring the agricultural sector and taxing the industrial profits, capital is induced to be diverted from industrial enterprises. To minimize the dependence on foreign importation and in order to realize a more favorable balance of trade, the industrial sector should be developed. It is true that some exemptions in this sector might be given by the Investment Encouragement Law, but these exemptions are given for only a limited period of time.

Furthermore, the law exempts the income accruing from processing products through simple manual work. The law is not clear whether this exemption includes only the agricultural manual production, or whether it extends also to manual trading income. The exemption of manual farm processing, however, would encourage investors to preserve their obsolete and retarded methods of production. It would be more remunerable for both the producer and the treasury as well, if these methods were modernized by mechanization.

From this analysis, it seems to be urgent to place the agricultural income, a major source of revenue in Jordan economy, on an equal footing with other taxable incomes. On the other hand, inclusion of agricultural income in the tax base would allow the deduction of agricultural losses against taxable income from other sources. This deduction, therefore, provides tax stimulus to take investment risks in agricultural undertakings.

Other Exemptions.--There are some other exemptions that the law permits. The most important of these are three: income from sources outside of Jordan, income of any pension fund, and income of cooperative societies.

Firstly, income received by persons in Jordan from sources outside Jordan is not included in the present tax base. The present law (Article 5) taxes income of any person accruing in or derived from the kingdom. This implies that part of the income of taxpayers is excluded from the tax base, thus running counter to the principle of ability to pay. The current law, therefore, discriminates against those taxpayers who take risks in Jordan.

This serious loophole in the law encourages investors to seek opportunities abroad. Including such income in the tax base may, therefore, have the advantage of discouraging export of capital and thereby put more funds at the disposal of domestic enterprises. In such a case, full credit would be granted for taxes paid abroad (but not exceeding the Jordanian tax due on such income), so as to avoid any and all double taxation.

Secondly, Article 8 paragraph 1 (f) exempts the income of any pension, or saving fund from income tax. Furthermore, under Article 9 (f), an employer may deduct from his taxable income any sum he pays as an annual contribution to a pension, or saving fund. It is obvious that the purpose of this exemption is to encourage savings. The law, however, does not specify the conditions under which such funds would be created. This might encourage employers to create such funds and, hence, escape tax on some of their income. It is said that several such funds are operating in Jordan, some employer created.[40]

The law, therefore, should work out carefully the conditions which such funds must meet to qualify for this exemption, having in mind in particular that employer created funds could serve as vehicles for diverting taxable into non-taxable income.

Thirdly, Article 8 paragraph 1 (d) exempts the income of cooperative societies from dealings with its members (including dividends paid to its members from such dealings), and as well from dealings with non-members, if the Minister of Finance shall be satisfied that this is consistent with the public interest.

This exemption might stimulate many individuals to establish such cooperative societies. It is said that some members initiate societies for their private dealings and after a period of time they start to deal with non-members, thus realizing a profit. They could easily secure the ministerial

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[40] J. Costa, Tax Review, Jordan Income Tax Law No. 25 of 1964 (Amman, 1966), p. 21.

order to exempt their income. If the law wants to be more fair, it should not allow the dividends arising from non-members dealings to be exempted. Moreover, if such members deal with the outside world, they would pay more for their transactions. They, therefore, are rewarded when dealing with the cooperative society. Their savings are repaid to them in the form of exempted devidends. Hence, there is no reason why they should be rewarded in the form of tax exemption, when they deal with non-members.

Further, the law does not specify how the society shall maintain its accounts. In particular, clearly identified should be the accounts of its dealings with its members and, separately, with its non-members. This separation is preferred because the Minister might not approve the exemption of non-members dealings. In such a case the identified accounts can be easily assessed for tax purposes.

Tax on Company Profits and Dividends

Article 25 paragraph (1), states:

> "The tax upon the chargeable income of any company shall be charged at the rate of 250 fils on every Dinar of the chargeable income

> thereof, and the tax so collected shall be considered final and cannot be refunded or set off under any of the provisions of this law."[41]

In addition, Article 8 (1) (t), stipulates:

> "There shall be exempt from tax the income of any dividends distributed by a company which paid the income tax according to Article 25 (1) of this law..."[42]

It is clear that the company tax rate on unearned income is a flat 25 per cent, with dividends exempt. The effect of this tax is to make attractive the forming of a company by those individuals who have an annual taxable income in excess of JD 4880 (the point at which the effective rate of tax for individuals reaches 25 per cent). Thus, an individual having non-corporate taxable income, other than earned income, in excess of JD 4880 could, by incorporating, hold his tax liability to 25 per cent. He could also, if he had himself paid a salary carrying an effective rate under 25 per cent, further reduce his tax liability.

Assume, for example, that an individual has a taxable income of JD 12,000, consisting of JD 3000

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[41] Income Tax Law, of 1964, p. 25.

[42] Ibid., p. 11.

as net salary (after deducting the maximum JD 570 allowed for personal and family and general deduction allowances) and JD 9000 as corporate profits, distributed as tax-free dividends. The tax on the salary would be JD 518 (approxiamtely 17.3 per cent), while the tax paid by the corporation would be JD 2250 (25 per cent), for a total tax of JD 2768 (approximately 23.2 per cent). The tax on this same income, if conducted as a sole proprietorship, would have been JD 4568 (38.07 per cent). The difference, incident to a change from the individual to the corporate form of doing business, would be JD 1800 (approximately 64 per cent). It is said that a number of taxpayers are taking advantage of this tax loophole.[43]

It is pretty obvious, therefore, that company dividend distributions which putatively would be subject to tax at rates equal to or above the 25 per cent company rate, enjoy preference over those which, if taxed would be subject to tax rates below 25 per cent rate. This provides a deterrent to the channelling of small savings into company shares.

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[43] G. Arafat, op.cit., p. 89.

To illustrate, we refer to the law which says that the tax which is deducted and withheld at 25 per cent rate is considered final and cannot be refunded or set-off against any tax from other sources of income. This is a bias against the small share holder whose income usually does not exceed the first or second lowest bracket and if the law allows the tax to be refundable, he would be refunded. This would be the case, if the law permits the dividend to be grossed up with other sources of income and taxed within the proper bracket and then the tax withheld by the company would be deducted from the due tax. On the other hand, the shareholder whose income falls in the top bracket would pay more tax if a set-off of the tax withheld is allowed in the law. The following example will clarify the point. Assume that an assessee has an income of JD 8320 from his own business and JD 1000 as dividends. If no set-off is allowed, i.e. in accord with the present law, the tax is calculated as follows:

Taxable income	-	JD 8320
Family deductions	-	320
Net Taxable income	-	8000
Income tax due	-	JD 2568

While if set-off is allowed, the income tax would be calculated as follows:

Taxable income	-	JD 8320
Add dividends	-	1000
Total		9320
Deduct family allowance	-	320
Net taxable income	-	9000
Assessed tax	-	JD 3068
Deduct the tax withheld	-	250
Income tax due	-	JD 2818

From the above example, it is clear that the high-income taxpayer has saved JD 250 of tax, taking advantage from the fact that the present income tax considers the tax withheld by the company as final and cannot be refunded or set off. Such a gap in the law has its repurcussions on small investors, while it constitutes an economic stimulus for wealthy investors. It is worthy to note here, that the Income Tax Law of 1954 allowed the company tax withheld to be set off and refunded, thus benefiting the small shareholder.[44]

Undoubtedly, the purpose of exempting compnay dividend income is to avoid double taxation. It is argued by some that, since the corporation

[44] Hashemite Kingdom of Jordan, The Official Gazette Number 695 (Amman, 1954), p. 13.

pays a tax on its earnings, the stockholders should not be subject to an additional tax (or at least not a full tax) on these same earnings when they are distributed to him as dividends.[45] The corporate tax is merely a device for collecting at the source and, once the tax is collected in this manner, it should absolve the stockholder from all or at least part of his personal responsibility toward the government.

On the other side of the argument, it is contended that the corporation is very definitely a legal entity separate and distinct from its stockholders. This distinct-entity doctrine is often used to the advantage of the corporation, as for example, in the matter of limited liability.[46] Why should not this same doctrine now be applied to the disadvantage of the corporation? Furthermore, the corporation's tax may be regarded as a business tax and justified by the benefits business as such receives from the government. In that event, it is

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[45] Richard Goode, The Corporation Income Tax (New York: John Wiley & Sons, Inc., 1951), p. 25.

[46] R. Goode, op.cit., p. 26.

not illogical to include dividends in the measure of the personal tax paid by stockholders.

Moreover, in some cases, especially in the public utility field, corporations largely pass on their taxes to the consumer.[47] In this case the stockholder escapes both the direct and indirect burden unless dividends are included in his taxable income. Finally, since the corporate tax treats all stockholders alike in the indirect burden it imposes upon them, it is only by taxing the individual that a suitable differentiation may be made in making the progressive rates applicable to them.

One striking fact in Jordan, is the strong inclination to distribute corporate profits as dividends. It is reported that at the present time from 80 to 85 per cent of profits are paid out in the form of dividends.[48] The result is that the companies rely more on outside financing than on in-

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[47] H. Groves, op. cit., p. 174.

[48] Royal Fiscal Commission, op. cit., p. 92.

ternal financing for their expansion.

In view of the bad need for more revenue, on the side of the government, and for equity purposes among taxpayers, it seems that the present system of company taxation falls short of its objectives. A change in such a system is desired to check the tendency for high dividends distribution, to have more equitable treatment for all classes of shareholders, to prevent the inclination to convert from one form of business to another, and to secure more revenues for the government, without having adverse consequences on the economy as a whole.

Finally, as it is well-known, that any income tax law has in its construction both structural and administrative aspects. To be constructive, an income tax law should have effective operational bases in both aspects. After we have analyzed the basic features of the structural set-up, we turn now to an analytical study of the administrative aspect of the Jordan Income Tax Law.

CHAPTER III

THE ADMINISTRATIVE ASPECT OF THE INCOME TAX LAW

Background

The Income Tax Law is administered and put into operation by the Income Tax Department. The latter is a separate division of the Ministry of Finance. The Department is made up of five main sections comprising a Headquarter and four District Offices. The Headquarter office is headed by the Director of Income Tax, while the District Offices are each headed by an Assessing Officer in charge. The larger District Offices are organized in sub-sections according to the categories of assessees dealt with. These categories are: (1) General assessees which include limited companies, other corporate persons, and individuals, other than government and other employees; (2) Government and Army employees; (3) Other employees.

It was repeatedly emphasized that additional domestic revenues are needed to strengthen

Jordan's position both internally and externally, and that the income tax should contribute a fair share of these added revenues. One important instrument to accomplish such an objective is through more effective administrative enforcement. The tax administration should be strongly reinforced to assure the taxpayer evenhanded treatment under the law and to provide government with an increased flow of income tax revenues. One indicator, among other things, of the importance of the administrative enforcement of the income tax policy is the magnitude of the income tax in arrears. Such arrears are given in table (13), and they represent the unpaid portion of the assessed and due income tax.

From the Table, it is apparent that the unpaid income tax is growing in both absolute and relative terms. The tax in arrears is indicative of two problems. On one hand, it reflects a tax non-compliance of Jordan taxpayers. On the other, it indicates the urgent need of more administrative enforcement to be more productive of revenues.

TABLE 13

INCOME TAX IN ARREARS* (JD)

Year	Income Tax	Penalty	Total	Percentage (excluding Penalty) 1952 - 100
1952	4,254	1,522	5,776	100
1953	9,014	1,840	10,854	212
1954	5,310	1,975	7,285	125
1955	3,761	570	4,331	88
1956	7,587	1,278	8,865	178
1957	10,672	1,650	12,322	251
1958	14,183	2,456	16,639	333
1959	18,792	2,591	21,383	442
1960	23,090	2,633	25,723	543
1961	33,014	4,060	37,074	776
1962	28,855	4,071	32,926	678
1963	42,646	3,392	46,038	1002
Totals	201,178	28,038	229,216	

Source: Income Tax Department records.

* The figures exclude the tax in arrears of government and other employees.

Actually, the Assessing Officer is considered to be the most important personality in charge of applying and implementing the income tax regulations and policies. For this reason, we should scrutinize his role and then study the other important administrative procedures in the income tax law.

Powers Conferred on Assessing Officers

The Assessing Officer is the key Income Tax Department official in respect of the application of the tax to taxpayers and withholding agents. Whenever a question of proof is raised, it is he who must be satisfied with the proof adduced. By article 35 he requests taxpayers to submit tax returns. Under Article 53, he has the duty of assessing or reassessing these returns, or making an arbitrary assessment when no such return is filed. Article 56 requires him to serve on the taxpayer the assessment he makes. By Article 59 he may permit the tax to be paid in installments.

It is obvious that the authorities delegated, by law, to the Assessing Officer are excessive. When he assesses the tax, it is only his honesty which determines its fairness for both government and taxpayers. If his personal tendencies and inclinations enter as determinant factors instead of objectivity and justice in assessing the tax, he may become a medium of imposing injustice and corruption on citizens. The law does not create more than one channel through which the assessment of tax passes, in order to have a check on the Assessing Officers performance. Once an Assessing Officer assesses a tax, the law does not permit a fellow Assessing Officer to assess it once more and independently. Furthermore, the advantage of installment payments of the assessed tax might be granted to some taxpayers and others may be deprived of this right. It is only the Assessing Officer who should be satisfied to allow such installment payments. If one realizes that no interest payments are due on such deferred installments, the importance of the Assessing Officer in this respect becomes clearer.

Moreover, the law does not stipulate when these payments should be settled.

Under Articles 26 to 29, he is charged with responsibility in respect of the collection of tax withheld. He also is the officer who hears and decides on administrative appeals (objections) taken by taxpayers against his assessments in order to have their assessed tax reviewed (Article 56), and who serves the appealing taxpayer with the court decision (Article 57).

It is apparent that the law has a serious administrative defect regarding the administrative appeal. Since the Assessing Officer is the one who assesses the taxable income, a higher officer should be charged with the authority of deciding such appeals. There is no doubt that he will have a bias toward his own initial assessment. Alternatively, he may, under some external pressure, contradict himself and adjust his previous judgement. Thus, it is the shortcoming of the law which opens the opportunity for this self-contradiction and bias.

Furthermore, the Assessing Officer is empowered to enforce the application of delay penalties (Article 61), which he has authority to reduce or cancel should they fall below JD 50. He also has to enforce the law for the collection of tax revenues (Article 64), the bringing of suit for the collection of the disputed tax before the Income Tax Court (Article 64), and determining the right of a taxpayer to a refund of tax (Article 66).

The Assessing Officer under the law thus seems to dominate tax operations in the Income Tax Department. He may carry out his duties independently and without regard to line authority or the action of his fellow Assessing Officers, subject however to such restraints as the circulars may impose. Insofar as the Director's autho rity over the Assessing Officer may be concerned, this appears to be minimal under the law.

Income Reporting

Under Article 35 paragraph 1, the Assessing Officer may, at any time require any person within thirty days after service of a written notice, to submit a tax return in respect of his taxable income and tax due. Presumably, the notice, and as well the returns, are on printed forms tailored to taxpayer requirements.

Nevertheless, the law does not permit the taxpayer wholly to rely on Assessing Officer action in respect of his income reporting responsibility. By Article 35 (2), if he receives no Assessing Officer request to file a return, he must, however, file such a return by June 1 of each year, showing his income and tax due.

Furthermore, Article 68 (1) says that every person who fails to submit the return provided for in Article 35, shall be liable to a fine not less than JD 10 and not in excess of JD 20 for each month or part thereof during which the failure occurs.

The fines of this Article appear to be excessive in nature, and may even be confiscatory, since the tax assessed may run well below the penalty applied. For this reason, it is said by some Income Tax Officials, that no fine was actually levied on taxpayers for mere failure to submit their returns.[1] Had the fines been more moderate in nature, the compliance would be much better on the part of taxpayers, simply because in such a case the fine would be applicable. Table (14) presents the statistical

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[1]G. Arafat, <u>op.cit</u>., p. 61.

TABLE 14

INCOME TAX FILING RETURNS

Details	Assess-ment year, 1963	Per-centage	Assess-ment year, 1964	Per-centage
Returns issued	13,647	100	40,646	100
Returns filed	5,804	43	14,370	35
Returns not submitted	7,843	57	26,276	65

Source: Income Tax Department records.

facts concerning taxpayers filing returns. It is clear that taxpayers do not have a real tax-loyalty. This might be explained by the fact that the administrative enforcement is not strict in applying the provisions of the law. When 57 and 65 per cent of the issued returns are not submitted again to the Department, it means, among other things, that taxpayers do not have tax-compliance. This non-compliance might be the result of inefficiency on the side of the Income Tax Department.

Another reason which might explain this high percentage of non-reporting of incomes by taxpayers, is found in the ignorance of taxpayers. Given the law's complexities, the taxpayer could well have found a proper determination of income subject to tax and net taxable income not easy. Improved taxpayer reporting could largely be effected without change in the law, if Department assistance were provided to taxpayers in the preparation of their returns. Such assistance could, in the period between the close of a taxpayer's fiscal year and the returns filing date, and at locations convenient to the taxpayer, be in the form of making available to him Department personnel expert in the determination of taxable income. The taxpayer, therefore, would be enabled to consult with the experts either by telephone or in person, for assistance in preparing his tax return. The Department could also undertake information and education programs, designed to obtain taxpayer cooperation generally and for understanding the law and its operation. These techniques may create a favorable environment for more taxpayers compliance and they also might facilitate the job of the Assessing Officers.

Tax Assessment

When a taxpayer deliveres a return pertaining to him, Article 53 stipulates that the Assessing Officer may: (1) accept the return and make an assessment accordingly; (2) determine to the best of his judgment the amount of the chargeable income of such person and assess the amount of tax accordingly, if he has reasonable grounds to believe that the return is incorrect; (3) or accept the return provisionally, and require payment of tax due under that return without prejudice to his right to determine later on the income of that taxpayer. Moreover, the Article says that where a person has not delivered any return and the Assessing Officer is of the opinion that such person is liable to tax, he may, according to the best of his judgment, determine the amount of the chargeable income of such person and assess the due tax on that person accordingly. Under Article 56, the Assessing Officer must serve notices of assessments (tax bills) on assessees who, in turn, by Article 59, must pay their tax or the first installment thereon within thirty days thereafter unless they make an administrative or judicial appeal from that assessment.

The law is thus generally neutral as between the Assessing Officer and the taxpayer action in respect of computing and payment of tax, although the Assessing Officer may be said to have a command position, due to his responsibility for taxpayer compliance. The system of self-assessment, however, is introduced for the first time in the current law. In practice, therefore, whether due to unfamiliarity with this technique, to the law's concern with preciseness in establishing tax, or to administrative and taxpayer preference, it is believed that the taxpayer takes his lead from the Assessing Officer in tax assessment.[2]

Yet it seems clear that the taxpayer must in the return set forth his chargeable income. In so doing it would not be unlikely for him to have made, but not submitted, a computation of his tax. Obviously, in such case, he could as easily have made that computation on the return.

On the other hand, the Assessing Officer must independently compute the tax for all received

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[2] J. Costa, op.cit., p. 7.

returns, regardless of whether the taxpayer has also made such a computation. In difficult cases, the Assessing Officer, to arrive at taxable income, could be seriously burdened, which, given the thirty day period usually allowed for assessing the tax, could lead to inaccuracies in assessment or delays beyond the assessment period. It seems obvious that the thirty-day period is inadequate and should probably be extended.

Again, it is apparent that the Department should extend its assistance to taxpayers, in order to relieve the Assessing Officers from some of the pressure. A self-assessment system, pursuant to which the taxpayer combines proper declaration of taxable income with, if required, Department assistance in the preparation of the return, computation of due tax on the return, and payment of tax on or before the return filing date. It would seem to be a sound alternative to the present Assessing-Officer system, and productive of greater revenue. The Department would have as much information, if not more, to work on from the assistance so provided to the taxpayer before the filing date. Moreover, it could collect its tax on that date and not thirty days or more later, and could be expected to protect itself against taxpayer's failure to declare proper taxable income.

Concerning the right of the Assessing Officer to investigate taxpayers, Article 28 held this right to investigate employers regarding salaries, pensions, or wages. Furthermore, Article 37 held the right to examine the taxpayer's books and records. The authenticity of such books and records, if the taxpayer shall carry more than one set of accounting books, and does not submit to the Assessing Officer inspection the true set of accounts, cannot simply be questioned. The law, therefore, should provide for the Assessing Officer the right at least to inspect the taxpayer's bank records, and in line with the provisions of Article 28, to extend his inquiry to third persons with financial relation, among other things.

It is fair to comment here, that the current law has the basic grounds of a self-assessment system. By taking into consideration the above mentioned shortcomings, the present system of tax would be of a higher quality in application.

Reviewing Procedures of the Assessed Tax

The law gives taxpayers more than one channel through which they can have their tax assessmnets reviewed. One review procedure is administrative, then there are two judicial reviews, and finally an executive review.

Firstly, Article 56 (2) provides that if any person desires to object against an assessment he shall be entitled to object by notice in writing to the Assessing Officer requesting him to review and revise the amount of tax assessed upon him. Such a taxpayer is required to submit his objection within fifteen days from the date of receipt of the notice communicated to him. Further, Article 65 (5) says that in reviewing the case, the Assessing Officer may confirm, reduce, increase or abolish the assessment in that case.

The weakness of the law concerning this administrative review is apparent. It is the same Assessing Officer who is entitle d to review the case. This would make him exposed to pressures. He might be tempted by rich taxpayers, especially if he is not granted any extra material compensation for his highly sensetive position, as the case is in Jordan. On the other hand, the Assessing Officer might insist on his firstly determined assessment, thus having a bias in favor of his initial judgment. It would be better if the law frankly provided for only a higher executive to review the administrative objection.

Secondly, Article 57 (1) stipulates that a court called "Income Tqx Apeal Court" shall be formed within the establishment of the Ministry of Justice. To this court shall be referred all income tax cases which the law allows to be judicially appealed. Again, the court can reduce, increase, confirm or abolish the assessment in that case. If the taxpayer, however, is not satisfied by the court decision, Article 57 (8) permits him to review his case once more by a cassation. His case is liable to cassation only if the amount of tax assessed by the Assessing Officer exceeds JD 100 before making any set-offs.

Finally, Article 54 gives the right to the Minister of Finance or the officer authorized by him to review any assessment within five years of the return filing date. The Minister or the officer so authorized may call for the record of any proceeding taken by the Assessing Officer and he may cause an enquiry as he may deem fit, and may also issue any orders he may deem fit in respect of that case.

This provision of the law provides the taxpayer with a means for reopening a closed case, either before or after he has exhausted his administrative and judicial appeals from the original assessment. Moreover, Article 54 (3) gives the taxpayer the right to take a further judicial appeal, if the Minister's order shall increase the tax.

Such an executive review would seem to be unnecessary, the taxpayer having recourse to three other reviews of his case, with any bias arising in the administrative review being subject to correction through the independent considerations of tax and cassation courts. It could also be that a call for an executive review could conceivably embarass the Minister, should the taxpayer be a powerful figure in the country promoting a case having little or no merit. In any event, the taxpayer's exercise of such a right could lead to delays of five years or longer in the making of final decisions and the payment of tax. This delay, coupled with the fact that no interest payment is required on the disputed tax, would explain the high ratio of objections submitted by taxpayers.

Table (15) reflects the awareness of taxpayers of their right to have their assessments reviewed. They try to benefit from the channels opened by the law. In 1963, for example, 43 per cent of the assessments were protested. This high percentage would imply, among other things, an added job for the administration to perform. It, thus, involves a loss of efficiency on the side of Income Tax officials. Instead of assessing new cases, they are occupied by reviewing the already assessed cases. Moreover, there were 663 and 754 cases in 1963 and 1964 respectively, as disputed objections. Actually, they represent a loss of revenue to the treasury during the period of dispute. The law requires the taxpayer to pay only 50 per cent of his assessed tax and he pays the balance, free of interest, when the objection is finally settled (Article 60). Since no interest payment is required, many taxpayers are taking advantage of this loophole in the law and thus, submitting objections to delay payment of taxes. It is said that about 95 per cent of the objections submitted in 1964, had their assessed tax reduced.[3] This would be a sufficient reason for taxpayers to be induced to submit objections and have their cases reviewed. The 95 per cent might be an indication of an inefficient income Tax Administration in Jordan. It indicates that, either the original assessment was made with negligence on the side of the Assessing Officer, or unhonorable ways are followed in settling the objections.

Collections and Refunds

The income tax in Jordan is collected by two ways: one way is the collection of tax at the source by withholding, and the other is the collection of tax directly from the taxpayer.

The phrase "collection at the source" is used to describe the method of collecting taxes from the payers of income rather than from the payees. Collection at the source offers the advantages of

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[3] G. Arafat, op.cit., p. 61.

convenient payment, minimum delinquency and minimum avoidance. Third parties usually have no interest in defeating the claims of the government.

By Article 26 (1) every company is entitled to deduct from the dividends paid to any shareholder income tax at the rate paid or payable by the company upon the income from which such dividend is paid (25 per cent). By Article 27, the payer of interest shall therefrom deduct ten per cent and then submit to the Assessing Officer an account of the amount so deducted. Under Article 29, any employer responsible for paying any chargeable income shall at the time of payment deduct tax from the amount payable at such rates as may be prescribed. Finally under Article 29, payment of mortgage interest or any other taxable income by a resident to a non-resident is subject to a 20 per cent tax by way of withholding. All withholdings are payable within thirty days.

All other taxpayers are entitled to pay tax directly on their behalf. Where an assessment notice shall have been served, tax is due, pursuant to Article 59, within thirty days after such service. This tax, however, may be paid in installments if the Assessing Officer agrees to such an arrangement. Further, Article 60 subjects a taxpayer to a fifty per cent deposit of the finally assessed tax, if a notice of assessment shall not have been served before the first day of June of any year of assessment, or if such notice has been served but has been objected, or appealed or taken to cassation[1] The "finally assessed tax" is held to mean the tax due for the last year of assessment on which the tax became due for payment. Under Article 63, the tax in dispute pursuant to an administrative or legal appeal, once determined, likewise falls due thirty days after the service of an assessment notice.

It is rather obvious that the law is relatively strict in treating the incomes of employees, shareholders, and interest receivers. The law, on the other hand, is lineant in its treatment with other income receivers. The first group pay their tax as they receive incomes and they are not permitted to pay by installments. The second group are privileged by the installments payments. Moreover, the latter pay fifty per cent of their tax, if no notice is served by the first of June. Apparently, they are not thereafter required to pay the balance of the tax, until they are served such an assessment notice, at which time they must either pay the balance due or take an objection. The fifty per cent deposit encourages taxpayers to lodge an objection, or appeal, or cassation, since they are by law given grace periods free of tax. These taxpayers are, therefore, privileged over those whose tax is withheld. It seems that the law, at this point, has parted with the principle of equity among taxpayers, a basic objective of all income tax laws. It would be a better alternative if a one hundred per cent deposit of tax not in dispute is required by the first of June or date of assessment whichever first occurs.

Regarding overpayment of income tax, Article 66 says that if it is proved to the satisfaction of the Assessing Officer that any taxpayer for any year of assessment has paid tax, by deduction or otherwise, in excess of the amount with which he is properly chargeable, such person shall be entitled to have the amount so paid in excess refunded. The law does not permit the payment of any interest to taxpayers on their tax over-payments. If the law, however, were amended to provide for interest payments on disputed tax, it could presumably be expected to provide for payment of interest on over payments of tax. This is important for the sake of fairness in treating the taxpayers equally.

Offences and Penalties

Article 61 (1) sets out the penalties applicable to delays in the payment of tax when due. The penalties ranges from 10 per cent of the due tax if the period of delay is six months or less, to 25 per cent if the period of delay is twenty four months or more. The Assessing Officer, however, may, for reasons acceptable to him, reduce or cancel this penalty if its value is less than JD 50. The Director may also, upon the recommendation of the Assessing Officer, reduce or cancel the penalty in the cases when they are over JD 50.

It is rather desirable to penalize the citizen who does not show a social loyalty to his society by paying his tax. As a beneficiary from various government's services, he is entitled to contribute to such services. Furthermore, it is for the purposes of fairness and justice among all taxpayers, that the government should penalize those who manifest tax non-compliance. But it seems that the law is lineant at this point. It gives both the Assessing Officer and the Director the right to reduce or cancel the penalty without determining the circumstances under which such executives can use this right. Any observer familiar with the Jordanian administrative environment, could easily conclude that such a provision in the law shall be abused, for the disadvantage of the treasury. Obviously this forgiveness provision, if actually materialized, discriminates against those who pay the tax when due. An additional point of interest in this respect is the fact that no interest is required on the tax delayed.

Moreover, under Article 67, willful evasion or attempt to evade the tax, through submitting incorrect returns or false books, accounts or records, subjects the taxpayer to imprisonment for up to six months or a fine of not less than JD 25, plus an amount of double the difference between the tax assessed and the tax giving rise to the offense. It is to be noted that Article 71 permits the Director to make a compromise on any act committed contrary to Article 67 before judgment and he can stop any proceedings in the Courts. Again, the law does not specify the standards and conditions to be applied in effecting such a compromise. It is clear that the law is not efficient in imposing its penalties on those assessees who do not comply with its provisions. It is sufficient here to mention the statement of the former Assistant to the Director of the Income Tax Department who had a long service, that no taxpayer was brought to the court for a period of fourteen years, although many fictitious and incorrect returns were submitted.[4]

From our analysis, it seems clear that the law, as designed, has operational bases which potentially may hinder rather than advance efficient administration. Administrative enforcement needs a better formulation of the tax provisions. It was shown that, structurally as well as administratively, the law, as it is, has many loopholes. These gaps create inequitable treatment among taxpayers, reduce the government revenue, and lower the morale of taxpayers by creating tax non-compliance.

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[4]This statement appeared in the book of Mr. G. Arafat, Income Tax Evasion in Jordan (Amman: Dar El-Kutub, 1965), p. 103.

Having this legal background in our minds, however, we turn now to the study of some impacts of the Income Tax Law, in order to evaluate it as an economic tool.

TABLE 15

TAX ASSESSMENTS AND OBJECTIONS

Details	Year (1963)	Percentage	Year (1964)	Percentage
Taxable Assessments	16,209		21,243	
Submitted objections	5,447	100	5,740	100
Settled objections	4,784	88	4,986	87
Unsettled objections	663	12	754	13
Ratio of submitted objections to assessments		43		32

Source: The Income Tax Department records.

CHAPTER IV

ECONOMIC IMPACT OF THE INCOME TAX LAW

Background

It is not easy to specify the exact role and impact of income taxation on Jordan's economic development. True, it is easy to accept the principle that Jordan, in its search for equity and revenue, should not push its income tax too far as to impede domestic and foreign investment or encourage the flight of domestic capital abroad. On this point, all are likely to agree. But it is most difficult to measure or appraise the force of income taxation as an impediment to developmental investment relative to other factors governing the tempo of Jordan's development. It is sufficient here to mention such factors as, the availability of natural resources, the availability of technical knowledge and skills, the political stability, and the extent of existing and potential markets, to realize that it is rather difficult to reach a fair conclusion concerning the exact impact of income taxation.

Another factor which might complicate our analysis of the income tax impact on the economic environment is that, no tax can be considered and evaluated in isolation. Appraisals of the tax climate for investment must take the total range of taxes, and not just the income tax, into account. By doing so, we would be more precise in our generalizations. Undoubtedly, the scope of the present study does not allow such a full consideration to be effected.

It is important to point out these facts at the start, to ensure a balanced approach to thinking about the economic impact of the income tax. Moreover, these facts would serve the end of assigning to the income tax its rightful role rather than a dominant role in the structure of incentives for productive investment in Jordan. To be effective, however, and where other conditions are favorable to private investment, the income tax must not put roadblocks in its path. It is apparent, therefore, that income taxation in Jordan faces the problem of compromising between the two objectives of revenue productivity and economic stimulus. As it was pointed out through the previous chapters, Jordan badly needs both, more domestic revenue and better economic development. The country cannot sacrifice the one at the expense of the other.

At this stage, the question arises whether the income tax in Jordan is effective in pushing savings and investments in the positive direction. If it is effective, one can justify the exemptions and deductions which the Income Tax Law allows to encourage these ends. But if the income tax is only a marginal factor in this respect, there would be no reason for giving generous exemptions and allowances and, hence, deprive the treasury of some revenue. Again, it is essential here to emphasize that it is not easy to measure with great precision the exact role of income taxation relative to other factors. Our analysis, therefore, will examine the question that, if other factors are favorable, what impact does the Income Tax Law have on Jordan's economic development?

Impact on Saving

Before examining the special case of Jordan's Income Tax Law attitude toward saving, it would seem desirable to review the theoretical impact of income taxation on private savings.

Income Tax and the Extent of Savings.--There is obviously an inverse relationship, in the purely physical sense, between a high income tax and the level of savings.[1] The very fact that a taxpayer has to hand over a larger amount of his income to the government than he did formerly, means that, unless his income has kept pace with the increased tax, he has a smaller balance to devote to expenditure on his personal and business requirements, including the amount to be set aside as savings. It is known that the percentage of income saved is by no means constant, but that it increases in general at a faster rate than the total income. Conversely, when incomes go down the ratio of savings diminishes in more than proportionate degree.[2]

Actually, there is a psychological as well as a physical effect, but, on account of conflict-

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[1]Raja J. Chelliah, Fiscal Policy in Underdeveloped Countries (London: Allen and Unwin, 1960), p. 67.

[2]Richmond Prest, Public Finance in Theory and Practice (London: Weidenfeld, 1960), p. 145.

ing tendencies, one cannot be too certain of the ultimate result. On one hand, a high income tax may discourage a taxpayer from saving the customery amount, even though he has the physical ability. After weighing the net future returns against the satisfactions he might derive from present consumption, he may decide in favor of the later.[3] On the other hand, there are many people who may wish to accumulate a certain capital sum during their working life in order to provide for their declining years, or for their dependents in the event of their early death. Under conditions such as these, a high income tax may have the effect of cutting down the current expenditure on consumable goods rather than the amount set aside as savings.[4] Indeed, if the income were not too small, it might stimulate the recipient to save even more than before. This is so because continued taxation at the same rate would involve a reduction in the net return in later years. Some writers believe in a stimulus of a different

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[3] Ibid., p. 148.

[4] American Economic Association, Readings in the Economics of Taxation (Washington: American Economic Association, 1959), p. 48.

kind. They contend that a reduction in the income of successful businessmen is likely to serve as an incentive to further effort and accumulation.[5] They believe that every raising of the income tax rate would probably be followed by increased efforts to increase incomes out of which to pay the increased tax.

This view of taxation, however, does not appear to command much support by most writers. It is generally accepted that high income tax has an adverse effect upon savings.

Income Tax and the Form of Savings.--The effect of a high income tax on the savings of individuals naturally varies with the amount of the respective incomes. Such savings as come from the lower income-brackets are not likely to be seriously curtailed. The people in this class are more likely to economize on their ordinary expenditure than to cut down their savings, for in these classes the incentive to provide for old age and for dependents is very strong.[6] They are more concerned with

[5] Bird and Oldman, op.cit., p. 253.

[6] K. Butters and J. Lintner, Effect of Federal Taxes on Growing Enterprises (Boston: Harvard University, Division of Research, 1965), p. 14.

making their position secure than with obtaining the maximum immediate return from their incomes.

In the upper-brackets of income the effect of the tax is more severe. As is well known, the greater part of national saving comes from the comparatively high income classes, and it is these who contribute the major share of the income tax revenue (see table 12). The physical capacity to save is naturally reduced, and so to some extent isthe will to save. Different from the taxpayers in the lower income classes, they look to their investments not merely to give them security, but also to enrich them in the near future.[7] A high income tax, which may reduce the net return by anything up to a half is, therefore, very liable to restrict the portion of current income that is saved.

Moreover, the attitude of a taxpayer to saving is determined largely by the nature of his economic activity. If he is an employee or a professional, his policy will be influenced by considerations such as those mentioned above. But if

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[7] *Ibid.*, p. 17.

he is a businessman working on his own account, or a partner in a partnership, he will tend to hold a different view of the necessity of saving. He will be influenced, of course, by the personal factors, but in addition he will have to consider the needs of his business. New capital may be required from time to time, and he will find it preferable as a rule to provide the amounts out of the current earnings of the business than to depend on outside sources.[8] Thus, the incentive to save is stronger among businessmen than among professional and other people with a similar income.

Impact of the Income Tax Law on Saving.-- It was shown in table (12) that the income tax in Jordan has a light burden on taxpayers. The statistical facts indicated that 85.7 per cent of taxpayers pay only 5 per cent of their net incomes as income tax. Moreover, the overall tax rate, which is about 9 per cent, is also not a heavy burden, It is safe, therefore, to conclude that , generally speaking, the Income Tax Law encourages taxpayers to save. The published statistics, however, do not

[8]Butters and Linter, op.cit., p. 22.

indicate from what classes of income-earners does the bulk of saving come. In this respect, there is a statistical limitation concerning the form of savings. Here, it is not possible to conclude whether private savings come mainly from low or high income-brackets.

Turning to the specific provisions of the Income Tax Law, we find that Article 8 (2) exempts the interest payable on any loan guaranteed by revenues of the government from income tax. Article 32 gives to the taxpayer a setoff against the tax due equivalent to 5 per cent of the annual premium of a life insurance or annual sum paid to any pension, saving, or other similar funds. Moreover, according to Article 9 (f), an employer may deduct from his taxable income any sum he pays as an annual contribution to a pension or saving fund. Under Article 8, the income of such funds is exempted from income tax. In addition, and as it was pointed out in chapter II, the income of any cooperative society is exempted from income tax according to Article 8 (d). Furthermore, the law exempts from tax the income of any dividends distributed by a company which paid the income tax.

Obviously, these exemptions are incorporated into the law in order to induce savings. These provisions, coupled with the generous personal allowances and deductions, reflect the awareness of the Income Tax Law of Jordan pressing need for stimulating saving to provide the capital needed for economic development. The failure of the law to tax incomes from sources outside Jordan, however, would encourage domestic savings to fligh abroad. This gap, therefore, might defeat the purpose of the law to encourage private savings.

It is apparent that the law provided the favorable legal framework for the income recipients to save. If savings, however, were for any reason relatively low, it is because average incomes in Jordan are low. Table (16) presents the savings of the private sector for a period of seven years. These statistics show that savings do not follow a certain pattern, and they fluctuate from one year to another. Moreover, the low level of the private savings indicates that the income tax is not a determinant factor in affecting savings. The average of the private savings for the seven-year period is 8 per cent of the national income, while it is

TABLE 16

SAVING OF PRIVATE SECTOR

JD MILLION

Year	Savings	As A Percentage of GNP
1959	2.70	2.7
1960	6.99	6.6
1961	12.68	9.9
1962	11.06	8.9
1963	5.42	3.9
1964	19.37	12.0
1965	19.56	10.8

Source: Jordan Department of Statistics, The National Accounts and Input-Output Analysis (Amman, 1966), p. 5.

about 15 per cent in the advanced economies.[9]

[9] Bird and Oldman, op.cit., p. 5.

Impace on Investment

In our search for the effect of income taxation upon investment, we should differentiate between two stages. The first stage is the effect of income tax on formation of new enterprises, and the second is its effect on expansion and taking more investment during the life of the enterprise.

Effect of Income Tax on New Investment.--
There is a general contention among most of the writers on the tax literature that the founders of small, independent enterprises seldom give detailed consideration to taxes in deciding whether to undertake their ventures.[10] This conclusion was asserted by the writer during the course of this study. The writer interviewed about 70 businessmen to study the income tax impact on their decisions to start their businesses. Only 10 showed awareness of the income tax position when they were considering the establishment of theit businesses. The rest were mainly interested with security and rate of return.

Jordan Income Tax Law gives several concessions and tax exemptions in order to encourage new

[10] R. Mikesell, Private and Government Investment (Oregon: University of Oregon Books, 1962), p. 173.

investments. Article 8 (p) exempts from tax the income exempted under the Investment Encouragement Law in force. Such exemptions were mentioned in Chapter 1. The most important of these is the exemption of the profits of the newly established projects from income tax for the first six years. Such a tax concession would stimulate potential investors to assume the risks usually attached to new enterprises. This exemption is coupled with the provision of Article 11 (1) which allows any person to set-off against his taxable income any loss incurred during the year preceeding the year of assessment. If such a loss exceeds his taxable income from all sources, Article 11 (2) allows this loss to be carried forward for the next six years in succession, until it is set-off in full. If, however, his taxable incomes during the six years were insufficient to cover the loss, the taxpayer will be liable to income tax on his taxable income starting from the seventh year after the loss has been incurred. It is clear that the loss set-off and its carry-forward advantages, stimulate both the new as well as the already established investments.

By allowing full loss deductions, privately assumed risks are reduced and hence the investment is made more attractive. This is a significant inducement for investment in Jordan, and hence it positively affects the process of economic development, if other factors do not work as detterent for risk taking.

Effect of Income Tax on Business Expansion.--Business enterprises, which we may now examine can be classified into two groups: small private concerns and large private businesses. The owner of a small business usually fall in the lower income tax ranges. It is unlikely for such a businessman to let the tax act as a deterrent on his investment. This is so because the utility of each unit of money is very high and he is reluctant to lose more than he can help.[11] Moreover, the rate of progression does not affect him very considerably since the government will take less than one half of every extra dinar he earns. Such a businessman, therefore, will be disinclined to restrict his activities because of a higher tax. It is worth noting here, and

[11]Butters and Linter, op.cit., p. 43.

as it was mentioned in Chapter 1, that most of Jordan enterprises are of modest sizes.

The owners of a large private business, however, will be more liable to limit their enterprises, especially in the more speculative branches of their activity.[12] Where an investment involves the risk of heavy loss, and any gains are certain to be seriously cut down by taxation, the investor may decide against the particular hazard.

Effect of the Income Tax Law on Investment.-- The Income Tax Law legislator is aware of Jordan need to invest every available dinar in productive opportunities to realize its economic development. The law, therefore, provides economic incentives to stimulate investments.

Article 9 provides that for the purpose of computing the taxable income of any producer, there shall be deducted from this income the following items: (a) interest on capital borrowed by the investor to finance his business; (b) rent paid by him on land or buildings occupied for producing the

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[12] *Ibid.*, p. 44.

income; (c) the replacement cost of any equipment or machinery to replace an obsolete equipment;[13] (d) any sum expended for repair of equipment, premises or machinery employed in the enterprise; (e) bad debts incurred as a result of conducting the business; and (f) the depreciation of buildings, machinery, plant or furniture used by the enterprise. Where, however, the profit in any year falls short of covering any of the above mentioned depreciation allowances, the amount of this depreciation will be added to the amount of depreciation allowance for the following succeeding years.

These deductions, coupled with Article 11 provisions of full loss set-off and loss carry-forward for the next six successive years, minimize to a considerable extent the risks attached to some investments. By giving full allowance for replacement costs of obsolete machinery and equipment, the law induces investors to modernize their methods of

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[13]The Income Tax Law defines the replacement cost as equivalent to the cost of the equipment or machinery replaced after deducting from that cost the total depreciation which has occurred by reason of exhaustion or wear and tear and any sum realized by the sale thereof, or the cost of the new machinery, whichever is less.

production. Such an inducement would imply more efficiency on the part of the enterprises. The possibility remains, however, that the producer might get rid of efficient machinery and replace them by new and equally efficient equipment. This might happen if he is interested in just new and modern machinery, without giving enough consideration to pure efficiency.[14] In such a case the law would operate as a motivating force for wasting part of the country's resources, a thing which Jordan cannot stand.

Furthermore, the law exempts from income tax interest paid to foreign investors on their capital. The income of such foreign capital is also exempted from income tax for the first six years in succession if invested in Jordan (Article 8 (9)). As indicated in Chapter 1, the aim of the law is to attract foreign investment, realizing the shortage of domestic capital. This stimulation (at some cost to government in terms of lost tax revenue) might be justified also in terms of the technical and managerial knowledge which private foreign investment

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[14]Richmond Prest, Public Finance in Underdeveloped Countries (London: Weidenfeld, 1962), p.240.

bring together with the capital invested.[15]

It is apparent that the law treats the invested capital sympathetically. But it is still not easy to measure with any degree of precision the real impact of such tax allowances and concessions. It was pointed out that many businessmen did not consider seriously the income tax treatment when they organized their businesses. But the writer found, through his interviews with some businessmen, that at a later stage of development, these businessmen became aware of the favorable tax treatment accorded to their investments by the Income Tax Law. This treatment frequently acts as a positive stimulus to investment. The law, therefore, does not stand as an obstacle in the path of developmental investment when other factors are favorable. But the question remains whether the advantages that really accrue to the economy from such investment tax concessions justify the revenue foregone by the government. Until this moment, there is no statistical data to assign to the income tax its exact

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[15] Peggy Richman, Taxation of Foreign Investment Income (Baltimore: The Johns Hopkins Press, 1963), p. 59.

effect.

Impact on Corporate Business

We have discussed in Chapter II the treatment of the Income Tax Law for the company income and dividends. It was shown that the law encourages high-income taxpayers and, as well, it discriminates against low-income taxpayers. In this section, an analysis of the impact of the income tax on the corporate business is given.

Effect of Income Tax on Corporate Formation.-- In later years, the corporation form of business organization has realized more importance in the Jordan economy. Recently, many corporate industries were formed which prooved to be effective in Jordan economic growth.[16] To give examples, it is sufficient to mention some of the main industries which are being conducted as corporations. Such industries are: the cement, tobacco, phosphate, tanning, textiles, petroleum refining, commercial banks, plastics, dairy food, and drug industries. These

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[16] Ali T. Dajani, The Industry of Jordan, 1967 (Jerusalem: Greek Convent Press, 1967), p. 19.

industries needed, relatively speaking, large capitals to be undertaken. Such funds could not be supplied by few businessmen. It was through the corporate form of business that several contributions were pooled into a single capital to start promising industries.[17]

The Income Tax Law gives several inducements to corporate formation. According to Article 8 (q) it exempts all corporations from income tax for six years. After the lapse of the six years, the Council of Ministers can relieve 25 per cent of the income of any corporation from income tax.[18]

Since the corporation is subject to a flat tax rate of 25 per cent (Article 25), the law encourages high-income recipients to incorporate. All taxpayers whose income exceeds JD 4880 will be subject to a rate higher than 25 per cent. By incorporating, they hold their income tax to be equal only to this lower flat rate.

On the other hand, the law discourages low-

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[17] Ibid., p. 22.

[18] Jordan Ministry of National Economy, Investment Encouragement Law, p. 9.

income earners to enter the corporate business. Most probably, they will be subject to a rate lower than 25 per cent, in case they do not incorporate. The law, therefore, works as a deterrent for low-income recipients to channel their savings into corporations.

Furthermore, the law exempts the dividends paid by corporations from any income tax (Article 8 (t)), This is a significant stimulus for savings to be invested in corporations. Once the corporation pays 25 per cent of its income as tax, the dividends paid out to stockholders will not be included in their taxable income. This would encourage some investers to transfer their capitals from non-corporate to corporate enterprises. Moreover, all non-corporate enterprises which pay tax more than 25 per cent of their incomes, will be induced to transfer their businesses to corporations.

Finally, the law induces speculators to enter corporations as stockholders for only a certain period of time. When they find that their shares have been appreciated in value, they sell them at the market without paying any tax on the capital gain thus realized. This is so because the law does not subject capital gains to income taxation.

From the above analysis, one can easily conclude that, generally speaking, the Income Tax Law encourages the formation of corporations. It goes without saying that such a form of business is continuously appraised as an efficient tool in the national economy.

Effect of Income Tax on Corporate Financing.-- Corporations usually need, from time to time, some capital to finance their development and expansion programs. They resort to either external financing, by incurring debts, or to internal source of funds from retained earnings. Generally speaking, corporate taxes restrict the growth of corporations by the limitations they place on the amount of capital available to such companies.[19] This restrictive effect of corporate taxes on the availability of capital is understandable in two senses. First, corporate taxes directly reduce the amount of net income, and hence the amount of retained earnings available for expansion. Secondly, corporate taxes, by reducing the potential profitability of new dev-

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[19]United Nations, Fiscal Commission, Corporate Tax Problems (New York: Economic and Social Council, 1963), p. 57.

elopments and by making them more risky, will cause the terms on which corporations can obtain outside capital to deteriorate.[20] In many cases, less favorable terms will be equivalent to a reduction in the amount of capital which can be obtained from outside sources.

Retained earnings are an especially important source of funds for business expansion, since expansions will be undertaken only if they can be financed from retained earnings. For instance, management may be unwilling to weaken its control position and its freedom of action by acquiring new equity capital. It may also be unwilling to incure the risks and restrictions involved in borrowing funds.

In the case of Jordan, the corporate income tax rate is not prohibitive. Since it is a 25 per cent flat rate, it does not exert any adverse effect on high earnings. That is to say, the income tax does not increase as the corporation's profits increase. In contrast, the company tax rates in some neighbouring countries are as follows: in Lebanon,

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[20] *Ibid.*, p. 64.

the rate is progressive ranging between 5 and 42 per cent, in Iraq it ranges from 10 to 30 per cent, in Syria from 8.5 to 49 per cent, in Sudan from 12 to 40 per cent, and in Egypt it is a flat rate of 40 per cent.[21] Jordan, therefore, compares favorably with these countries, a fact which implies that it does not place, from a theoretical point of view, a severe restrictive limitation on the availability of funds necessary for expansion. This is coupled with the generous tax concessions and exemptions that the law gives to corporations which reduce their tax liability, and especially in the early years of their establishment.

Moreover, dividends paid out to stockholders are not includible in their taxable income and, hence, they are tax exempt. This would imply that the stockholders are indifferent concerning the distribution of profits as dividends or retaining them in the company for reinvestment. The dicision whether to distribute dividends or retain the profits depends on other financial factors such as the urgent need for

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[21] Harvey Perry, Taxation and Economic Development in Ghana (New York: United Nations, 1965), p. 78.

consumption on the side of the stockholders and the anticipated rate of returns on the invested retained earnings. The practice so far, however, was in favor of excessive distribution of earnings as dividends. As previously mentioned, 80 to 85 per cent of company profits are paid out as dividends.[22] The Jordan Companies Law No. 14 of 1964, however, requires all companies to retain each year 10 per cent of their net profits as "obligatory reserve", until this reserve is equal to the company's capital stock.[23]

As a matter of fact, Jordan corporations depend mainly on external financing for their expansion. They have not, until this moment, issued bonds to borrow from the public. Instead, they depend on commercial banks for their borrowing.[24] They are encouraged to do so because the law allows the interest paid on borrowed capital to be deducted, when computing the corporation's taxable income (Article 9 (1) (t)). This would reduce their tax liability.

The Jordan Income Tax Law, therefore, induces

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[22] Royal Fiscal Commission, op. cit., p. 92.

[23] Hashemite Kingdom of Jordan, The Official Gazette number 1757 (Amman: The Army Press, 1964), p. 530.

[24] Jordan Central Bank, Economic Research Department, The Seasonal Bulletin (Amman: Labor Co-operative Society Press, 1967), p. 39.

corporations to depend on external rather than on internal financing. In conditions of a tight money market, corporations might find that this sort of financing is not easy to materialize.

Impact on Economic Stability

In our analysis of the income tax impact on economic stability, we should study its impact on the general level of prices. If the income tax affects prices at all, however, it does so in either of two ways. It is either shifted directly by the producer to his customers, by the simple addition of the equivalent of the tax to the basic price, or it reacts upon prices in an indirect pattern by affecting conditions of demand and supply.[25]

It can easily be proved that it is in only exceptional circumstances that the money burden of the income tax can be directly shifted from the seller to the buyer in the form of higher prices. This is the case because, as it is well known, the price

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[25] M. Kubniski, Public Finance for Stability and Growth in an Underdeveloped Economy (Amesterdam: International Bureau of Fiscal Documentation, 1961), p. 197.

of a commodity tends, under conditions of competition, to equal the unit cost of production of the marginal firm. This firm, being on the borderline between profit and loss, is not required to pay income tax, and is liable, therefore, to undersell any other firm which attempts to shift the tax on its profits to its customers.[26] Under conditions of monopoly the transmission of the tax is no more applicable, for it is presumed that the seller is already exploiting this advantage to the full and charging the utmost that the market will bear.

To pass to the reactions on the side of demand, it might appear that the forces tending in the direction of a rise in prices are counteracted by the opposite set of forces tending to bring about a reduction. If a high income tax diminishes the private sector's spending power, it would be more likely to result in a fall rather than a rise in prices.[27] Actually, however, there would not neces-

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[26] Jack Heller and Kenneth Kauffman, Tax Incentives for Industry in Less Developed Countries (Cambridge, Mass.: Harvard Law School International Program in Taxation, 1963), p. 552.

[27] Jack Heller and Kenneth Kauffman, op.cit., p, 569.

sarily be any reduction in the volume of demand regarded as a whole. Much of the revenue would flow back to the beneficiaries of the public services and expenditures. Moreover, the bulk of the government purchases has to be taken into account. The aggregate demand would seem, therefore, to undergo a change, not so much in its volume as in its composition.[28]

To enter in any detail upon a discussion of the likely effects on the prices of particular kinds of goods would take us too far from the present subject. The reduced purchasing power of the well-to-do taxpayer might result in fall in the price of luxury articles. Whether the lower prices would be permanent would depend largely on the conditions governing their costs of production. Possibly, when sufficient time had elapsed, the curtailed supplies would result in higher prices than before.[29] On the other hand, an increased spending power given to the low-income groups might, for the time, cause the

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[28] Ibid., p. 571.

[29] Benjamin Higgins, Economic Development: Principles, Problems, and Policies (New York: W. Norton and Co., Inc. 1959), pl 234.

prices of necessaties to go up, although ultimately, if competition were effective and hence the supply were elastic, the prices might fall even below their former level. Whether in fact the spending power of these classes showed a net increase as a result of these transferences would depend upon many circumstances, notably the elasticity of the supply of goods and services, the level of employments and the pattern of the public expenditure.[30] If, for example, there is a situation of full employment, the government subsidized the wages of those already in employment by an extension of the social services, the demand for necessaties would in aggregate go up, and the prices might follow suit. On the other hand, in a situation of unemployment, if the revenue was used largely for maintaining those out of employment, the aggregate demand for necessaties might still be below the normal because, presumably, the spending power given to the unemployed would be less than that of their normal income, if they were employed. The prices, therefore, might not go up.

From such reasoning, the impact of taxation appears to have more bearing upon relative prices

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[30] Benjamin Higgins, op.cit., p. 261.

than upon the price level in general. In other words, the prices of certain classes of commodities may show considerable variations, yet the index number of prices as a whole may remain fairly stable.[31]

As a matter of fact, the income tax in Jordan did not cause a problem of economic instability. Actually, and as it was mentioned in Chapter 1, inflation and economic instability are not at present major problems in Jordan. Internal government borrowing is not known today. This means that the monetary system in Jordan is not highly effective, because the government cannot directly increase or decrease the quantity of money supplied through changes in the government credit instruments. Furthermore, since speculation is of small significance in Jordan, and mainly limited to real estate, the general price level tends to be stable, with the exception of rent, which follows the movement of the prices in the real estate. Until Jordan's economic conditions and monetary institutions change substantially, however, the problem of rising prices will probably be confined to specific sectors like

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[31] M. Kubinski, <u>op.cit.</u>, p. 210.

housing and other construction materials and resenditial land where intensified demand, or in some cases, short supply force prices up. The income tax, therefore, appears to command no dominant role in stabilizing the economic conditions in Jordan.

Likewise, cyclical fluctuations in the usual sense are not a current problem in Jordan.[32] Large chronic unemployment, especially as related to the refugee population, is a serious problem. But this problem is not very amenable to income tax policy action, except insofar as a carefully differentiated customs policy can help promote favorable conditions for substituting domestic industry for foreign sources of production and supply. The income tax enters here mainly on the incentive side.

To conclude this chapter, one is on the safe side in commenting that the Income Tax Law does not seem to play an important role in Jordan's economic growth. The law, however, encourages more than discourages the process of development, when other factors are favorable. The economic environment is, to be sure, influenced by other factors which are considered to be more determinative of economic development and growth.

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[32] Royal Fiscal Commission, <u>op.cit</u>., p. 71.

CHAPTER V

CONCLUSIONS AND SUGGESTIONS

Conclusions

In the light of our brief analysis of the economic environment of Jordan, and referring to our analysis of the Income Tax Law, we may summarize our conclusions in the following points. It is of prime importance to emphasize that the following conclusions are not intended to be a summary of the arguments presented in the previous chapters. Alternatively, these conclusions are the highlights of the analysis and they cannot be, in any case, a substitution of the analytical reasoning which preceded them.

(1) Jordan economy depends heavily on external sources to subsidize it. It was through excessive foreign financial aid that Jordan could sustain its economic existence. Jordan, therefore, must take the necessary developmental steps to move toward economic self-sufficiency.

(2) Although the income tax revenue in recent years

has continuously contributed larger amounts of funds to government domestic revenue, it did not yet realize its potential limit. The government revenue, therefore, can be increased from income taxation without causing irreparable damage to the economy, or retarding the economic growth of Jordan. This increase can be achieved by closing the loopholes in the law, by widening the tax base and hence including as taxable income some of the presently exempted incomes, and by improving the administrative aspect of the law.

(3) The Income Tax Law treats the income of taxpayers sympathetically. It grants excessive exemptions and deductions. The upper income brackets can profit most from the benefits available under the law, not only in respect of the exemptions and exclusions from tax, but as well from the personal, family, and general deduction allowances. The subtraction of these allowances has the effect of lowering the bracket of income subject to the tax. Under the law's progressive rates, therefore, tax is saved at a relatively higher rate than on incomes in the lower brackets.

(4) Non-Company taxable income at the lower end of the progressive rate scale carries a relatively higher tax burden than if falling at the upper end (refer to the individual tax rates on page 66).

(5) The capital gains exclusion from tax has a preferred tax position over taxable income. Thus, the exclusion from tax of speculative and other capital gains, in addition to providing an avenue of escape for potentially substantial tax, ordinarily benefits the investing class, which normally does not come from the lower income groups. The interesting conclusion is thus reached, whereby earned income (salaries and professional fees), which in some tax systems is favored over unearned income and in others given comparatively neutral treatment, is subject to a progressive tax rate rising to 50 per cent, while unearned income is given an option to be taxed at a 25 per cent rate under the corporate device, and at a zero rate for capital gains.

(6) The agricultural income exclusion from the tax discriminates against other sources of taxable income. This exclusion would make the engage-

ment in the agricultural sector more attractive to the working population than engagement in the industrial and other productive sectors. It has been shown in Chapter 1 that productivity and income are low in this sector. Not less important than this, is the fact that, by exempting the agricultural income from tax much revenue is lost by the treasury.

(7) The non-taxation of income received from sources outside of Jordan, means that some income is escaping tax. Furthermore, the law thus encourages the flight of capital outside the country.

(8) Company dividend income, by reason of its tax-exemption, enjoys a tax advantage over taxable income.

(9) As proved in Chapter II, the company income, which is taxed at 25 per cent, fares better than non-company income effectively taxed above that rate. All non-company incomes which are in excess of JD 4880 (the point at which the effective tax rate reaches 25 per cent), therefore, would be at a disadvantage if compared with the company income.

(10) The administrative provisions in the law have operational bases which potentially may hinder rather than advance good administration. Some of the more important of these appear to be: virtual autonomy of the Assessing Officer, reliance on Assessing Officer assessments of tax, the right of the Minister of Finance to review any assessment within five years of the return filing date, inequitable delay penalties, and the excessive criminal penalty for failure to file a return.

(11) By withholding the tax due from only some taxpayers (employees and stockholders) as the income is earned, and collecting the tax due from other taxpayers (businessmen, professionals, etc.) during the year following the year in which the income is earned, the Income Tax Law discriminates against the former taxpayers. Moreover, the law encourages some taxpayers to have tax non-compliance by delaying payment of the tax due. The law opens several channels for taxpayers to have their assessments reviewed and hence, intentionally, delay payments without paying any interest.

(12) The income tax does not seem to command a dominant role in the scale of incentives for economic development in Jordan. Yet, it seems that the law encourages, rather than discourages, such economic growth when other relevant factors are favorable. This kind of inducement is given by excessive and generous concessions and tax-exemptions. This would mean that the government loses some revenue in order to stimulate both domestic and foreign investments.

(13) It thus appears that the Income Tax Law as structured, falls short of the often stated desirable objectives of reasonably equitable treatment among taxpayers similarly situated, taxing according to ability to pay through a progressive rate schedule, and effecting a better redistribution of wealth and income from the higher to the lower income groups. Under these circumstances, the legal structure appears to have some bias toward regressivity. Moreover, the income tax seems not to have been sufficiently productive of revenue, a basic ob-

jective of income taxation. This fact might be a reflection, among other things, of the limitations in the law.

Suggestions

To bring the income tax into closer conformity with the goals of equity, revenue adequacy, administrative feasibility, and consistency with economic growth objectives, the writer finds it to be essential that some substantive changes in the Income Tax Law should be introduced. A series of changes in exclusions, deductions, exemptions, and rates are here suggested.

One should keep in mind that the task of balancing the different objectives is not easy. The most difficult task of all is to provide incentives for productive private investment without undermining the equity and progressivity of tax. It would be too easy to riddle the income tax with special concessions and reductions in the name of business incentives and economic development. Indeed, carried to an extreme, such a process could easily turn the income tax from an instrument of justice, imperfect though it may be at present, into an instrument of special privilege. This would run directly counter to the test of social justice and progression in taxation.

The writer strongly believes that, by a fair compromise, the causes of equity and economic development can be harmonized in tax policy, The suggestions which follow are intended to achieve this end, partly by making the income tax more inclusive of all facets of ability-to-pay, partly by amending the form of personal exemptions and the schedule of rates, partly by taxing income from speculative and non-developmental investment, and partly by improving the administrative aspect of the law.

Change in Form of Personal Allowances.--It has been shown in Chapter II that under the present form of the personal exemptions, the tax value of the deduction is much greater for taxpayers in the upper brackets than for those in the lower brackets. To give all taxpayers, regardless of the level of their incomes, a uniform exemption in terms of tax it is suggested that the personal allowances be converted into equivalent tax credits at the lowest bracket rate (assuming a change is introduced in the rate as it is suggested below) as shown in the following computation. This would ensure more equitable treatment among all taxpayers:

Family Allowances	Present Deduction from Income (JD)	Suggested Credit Against Tax (at 4%) (JD)
Residence allowance	150	6.0
Wife	100	4.0
First child	25	1.0
Second child	20	0.8
Third child	15	0.6
Fourth child	10	0.4
Maximum family exemptions	320	12.8

The deductions for university education and for dependency or non-related child maintenance cost should also be computed in the same manner.

Moreover, it is suggested that the general deduction of 15 per cent (up to JD 200) from the employment or pension income is altogether removed from the law. Limitations on travel and subsistence expenses to produce the income, and annual contributions to pension funds are recommended to be incorporated into the law.

Revision of Individual Income Tax Rates.--In view of the greater burden which is carried by the lower end of the rate structure, the writer suggests the following revision of the scale. The proposed rate structure moderates the income tax burden in the middle brackets and at the same time serves the principle of progressive taxation by raising the top rates of tax (compare with the present tax rates on page 66).

Proposed Individual Tax Rates

Taxable Income (in JD)	Rate
Not over 400	4 per cent
Over 400 but not over 800	7 per cent
Over 800 but not over 1200	10 per cent
Over 1200 but not over 1600	15 per cent
Over 1600 but not over 2200	20 per cent
Over 2200 but not over 2800	26 per cent
Over 2800 but not over 3600	32 per cent
Over 3600 but not over 4500	38 per cent
Over 4500 but not over 5500	44 per cent
Over 5500 but not over 6500	50 per cent
Over 6500	56 per cent

It will be noted that this proposal reduces the lowest bracket rate, but leaves unchanged both the rates and the brackets for taxable incomes up to JD 1600. Then, it both widens the brackets and reduces rates on taxable income from JD 2200 to JD 4500. From JD 4500 it raises the bracket rates of tax, to a top rate of 56 per cent above JD 6500.

To compare the impact on effective rates (ratio of tax liability to net income before family allowances) of both schedules, the following computation is presented. The effective income tax rates are computed for a married couple with two children (JD 295 family allowance).

Effective Tax Rates

Net Income (JD)	Present Rates	Proposed Rates
400	1.3%	1.1%
800	3.4	2.9
1200	4.9	4.5
1600	6.5	6.2
2200	9.5	9.3
2800	12.8	12.3
3400	16.2	15.2
4000	19.1	17.9
5000	27.5	22.2
7500	29.3	31.4
10000	34.2	37.6

The reduction in the effective rates of tax would be recommended for several reasons. Firstly, it would induce the taxpayers to pay their taxes promptly and it would also minimize their tendency toward tax-evasion. This would result in improved tax-loyalty on the side of the taxpayers. Secondly, it is hoped that the reduction in the tax revenue would be more than compensated by the inclusion of the presently exempted sources of income as it is proposed in this chapter. Thirdly, it has been shown in table (12) that the last two brackets are, relatively speaking, highly productive of the tax revenue. The tax rates for these two brackets are higher in the suggested change. This, therefore, would partly compensate for the reduction in the rates of other brackets.

Inclusion of Capital Gains in the Taxable Income.--It has been shown that the exclusion of capital gains from the taxable income is a serious gap in the law which permits tax escape of some sources of income. This exclusion, therefore, implies inequitable treatment of all sources of income. It is suggested that capital gains be includible in the taxable income. The includible amount of gain, however, might be reduced according to the length of time the capital asset has been held. This reduction is recommended in order to emphasize the fact that it is not fair to tax fully in one year the gain which accrued in many years. To recapitulate what has been suggested in Chapter II, percentage reduction in the amount of capital gains to be included in the taxable income could be as follows: if the asset is held less than one year, 100 per cent of the gains is includible; if held over one year, but less than three years, 80 per cent is includible, and so forth.

If, however, capital gains are taxed, capital losses should be deductible from capital gains. Like other losses, it is suggested that such a loss be carried forward against capital gains for a period of six years in succession.

Inclusion of Agricultural Income in the Taxable Income.--The writer strongly suggests the inclusion of income arising from agriculture in the taxable income. This recommended treatment would be in conformity with the principle that income from all sources should be pooled into a single total if a proper measure of the ability to pay for progressive tax purposes is to be attained. On the other hand, if the agricultural income is included in the tax base, it is recommended that agricultural lossess be deducted against taxable income from other sources.

This would provide an inducement to take investment risks in the agricultural sector.

Taxation of Income From Sources Outside of Jordan.--By excluding income received by persons in Jordan from sources outside Jordan from the tax base, the law is running against the principle of ability to pay. Moreover, in order to discourage the export of capital, it is suggested that the law be amended to include the income received by Jordanians from outside Jordan in their taxable income.

Moreover, unless a policy is adopted to encourage the migration of labor outside Jordan, the income from employment abroad should be subject to tax also. The feasibility of encouraging or discouraging employment abroad cannot be discussed at length here, since it is beyond the scope of this study. To avoid double taxation, however, the law would allow full credit for taxes paid abroad.

Tax on Company Profits and Dividends.--The writer suggests that the company profits and the dividends received by stockholders be treated separately. It is recommedded, therefore, that the present rate of 25 per cent on company profits be kept and dividends be taxed at a lower rate, such as a 10 per cent rate.

This change would be suitable to Jordan from several points of view. First, it would reduce the incentive to distribute profits as dividends rather than retaining them for reinvestment in the company or undertaking new productive ventures. Second, added revenue would be obtained for government without excessive burdening of taxpayers in absolute terms nor relative to levels prevailing in most neighbouring countries. Thirdly, the benefits received from operating in the form of a company would be recognized by the tax on the entity as such. This would imply the taxation of dividends separately to comply with the principle of ability to pay. An objection to this suggestion might be that it involves greater burden on small stockholders. The answer is that the majority of the investing class usually comes from the upper income groups. The writer assumes that Jordan is not an exception to this fact, especially in the absence of statistics in this respect to indicate otherwise.

Administrative Amendments.--Weaknesses in the administrative aspect of the law can be easily corrected to improve its functioning framework. It is suggested that the law should make it clear that the powers conferred on the Assessing Officer under the law, should be subject to the supervision and direction of the Director of the Income Tax Department. The line authority would be more emphasized in the law in order to give taxpayers more assurance of equal treatment. By having the Director as a reference to whom their complaints can be referred, taxpayers would have more confidence in the Department.

Moreover, since the taxpayer receives ample administrative and judicial review protection, the availability of a Minister of Finance review unduly burdens that executive and interferes with the assessment of tax, and delays the collection thereof. The omission of this Ministerial right from the law, therefore, is suggested. This would prevent the possibility of reopening a closed case within five years.

The inequities inherent in the application of delay penalties could be eliminated if an amendment to Article 61 were made. It is recommended that this Article should provide for tax payment delays to be calculated at the average commercial bank rate of interest, and as well to be subject to a fixed percentage penalty, no part or all of which could be forgiven. Presently, the Assessing Officer and the Director have the right to relieve taxpayers from payment of delay penalties. This would create inequitable treatment, since the forgiveness provision discriminates against the taxpayers who duly pay their tax liabilities.

Furthermore, the excessive nature of the criminal penalties applicable to taxpayers who fail to file returns calls for amelioration. The law should be amended in order to moderate these penalties.

Finally, the law should be reexamined with a view to making self-assessment an effective tool for the assessment and collection of the tax. This would require the Income Tax Department to render more assistance to taxpayers in the preparation of their returns. Such a procedure might have the outcome of improved repotting of taxable income, more prompt payment of tax, and concomitant increases in revenues.

It seems that this Chapter should not be concluded before asserting the fact that the above mentioned suggestions should be taken as a unity. It would be inconsistent, for example, to moderate the tax rates without widening the tax base by including as taxable incomes the presently exempted sources of income. Even if some of the suggestions appeared to be impractical, the fact remains that the Income Tax Law as it is calls for reconsideration to fulfil its objectives in a more efficient way.

APPENDIX

INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT

JD MILLION AT CURRENT FACTOR COST

	1959	1960	1961	1962	1963	1964	1965
I.a) Crops and forestry	10.11	9.25	21.03	13.18	14.12	25.62	23.05
b) Livestock	4.97	5.37	4.27	7.72	7.96	8.52	11.36
	15.08	14.62	25.30	20.90	22.08	34.14	34.41
2.Manufacturing & Mining	6.23	6.89	8.83	8.06	10.62	12.53	16.22
3.Construction	4.66	4.50	4.50	6.15	6.12	5.45	7.87
4.Electricity & Water Supply	0.66	0.69	0.67	0.74	0.93	1.03	1.68
5.Transport	10.70	11.12	12.64	12.53	12.77	12.03	12.60
6.Wholesale & retail trade	18.01	19.57	24.28	23.63	26.43	28.01	31.43
7.Banking and finance	0.80	0.87	1.27	1.46	1.35	1.51	2.11
8.Ownership of dwellings	6.30	7.13	8.01	8.58	9.39	9.93	10.69
9.Public Administration & defence	14.95	15.79	16.74	17.06	17.61	19.70	21.41
10.Services	7.78	8.26	8.63	9.51	10.37	11.19	12.83
Total Gross Domestic Product at factor cost	85.17	89.44	110.87	108.62	117.67	135.52	150.95

Source: Jordan Department of Statistics, The National Accounts and Input-Output Analysis, 1959-1965, p. 3.

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