

Tax Collection Mechanism Back to Basics from Tax Bureaucracy to Tax Farming: The Case of Jordan

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Abstract

This research paper aims at reporting the current use of tax collection mechanism in Jordan. The data generated by two sources: primary and secondary sources that include interviews with senior tax employers to be able to have close look at the way of collecting taxes and the problems may face during processing tax collection. Jordanian economy is considered as developing economy and in regards to tax sector the administration costs is souring and the tax evasion rates is rising which makes the tax farming mechanism is fit to the Jordanian case to improve tax collection mechanism in Jordan. Tax farming has advantage and disadvantages but it will solve the problems exist in the Jordanian tax sector and the taxing authority can take tips and lessons from the tax farmers of the way they used in collecting taxes. By applying tax farming in Jordan, the tax collection may improve and may stop the tax evasion, which increase the government revenue rather than increasing the tax rates on the individuals who are not evading taxes in the short-run bases then creates new tax collection mechanism while using the tax farming to improve and evaluate the new tax collection mechanism. This approach lets the government test the new collection mechanism partially and let the other part of the tax farmers insure about the effectiveness and the efficiency of the mechanism. The researcher didn't cover the cost benefit of the tax farming mechanism and the effect of the tax farming on the future cash flow on the treasury which may need a feasibility study on implementing tax farming in Jordan.

Keywords: Collection Mechanism, Tax Collection, Tax Bureaucracy, Tax farming, Jordan

1. Introduction

Tax collection mechanism, which is the focus of this research paper, is the method used by a government to collect taxes imposed on citizens and business entities. This collection mechanism accompanied by rules and regulations set by the government to make sure that taxes are being collected correctly and fairly among citizens and business entities. It is commonly assumed that tax collection is an inherent function of a government historically governments commonly contracted with private agencies known as “tax farmers” to transfers its right of collection to private sectors in exchange for a certain fee. Jordan is facing problems arising from tax evasion and from calculating the proper amount due on the tax’s payers. The Jordanian income and sales tax department declared that there is a large proportion of tax evasion ranging between 55% to 65% of due tax amount, this as one of the purposes to conduct this research. Therefore, the purpose of this research paper is to explore questions about a government choice of tax collection between tax bureaucracy and tax farming to enhance their tax collection capacities to be able to make the tax receivable collection process effective and fair. The remainder of this research paper is organize as follows: The next section presents the theoretical framework and literature review. The third section describes the research methodology used. The fourth section presents the findings and the discussion of the analysis. The last section set out the summary and recommendations for this research paper.

2. Theoretical Framework and Literature Review

Tax is very old system that found and known firstly by the Egyptians and developed by many old countries such as Greece, Roman Empire, Great Britain, and Colonial America until it reached the tax model that is exist today.

Under the earliest taxing scheme in Great Britain an income tax imposed on the wealthy and office holder were a tax on movable property imposed on merchants. The first income tax suggested in the United States of America was during the war of 1812, which based on the British Tax Act of 1798 and applied progressive rates to income. In regards to tax and the evaluation of tax, Pava, (2014) states that income tax imposed on individuals and corporations. Individual income taxes, is computed based on the money earned. It usually called direct taxes because the burden is presumably on the person who pay it. Corporate income tax imposed on net profits and computed as the excess of cash received over allowable deductions. The history of tax in Jordan starts in issuing of tax law in 1933 and tax law number 50 in the year 1950 were the tax department established in 1951 according to the late law. The sales tax department established in 1994 and it became applicable in 2001. In 2004, the two departments were merge in a single department known as income and sales tax department. Irshed (2009) discusses the tax structure components in Jordan which is consists of direct taxes which are imposed on elements that have relatively attendance and stability, and indirect taxes aimed at reality and indirectly to load the taxes for spending on consumption and subordinate capital of the tax when trading. It could be argued that there is general consensus, that the tax be directly if it imposed on the income when generated or capital when owned, and are not directly if imposed on the income when spent. Although the diversity of taxes in Jordan represent low importance in terms of its impact on fiscal policy when compared with developed countries and reliance on direct taxes to finance government expenditure and this is contrary to social justice.

Generally, tax law is concerned only with the legal aspects of taxation not with its financial and economic or other aspects. Mclure Jr. (2009) explains a tax law as a body of rules under which a government has a claim on taxpayers asking them to transfer to the authority a rate of their income or property. The warrant to impose taxes is generally recognize as a right of governments. Neumark (2009) in his study about the economic goals of taxes recognized that the primary goal of a national tax system is to generate revenues to pay for the expenditures of a government as grow correspondingly. In the same view, Cox (2009) states that the general idea was that taxes should serve mainly to finance the government were the American economist Richard Musgrave sees the purpose of taxation is to differentiate between objectives of resource allocation, income redistribution, and economic stability. At the close of the 18th century, the income tax played different roles in different countries at different times to become an instrument of national policy to be able to achieve social reform through income redistribution. Then, the opinion has shifted away from the view that the income tax should uses for these purposes because of the costs involved were new tax terminology involved such as tax farming, which is the focus of this research paper. Tax farming refers to the way that a government would lease the right to collect taxes to private agents in exchange for a lump sum payment determined prior to collection. In the history of tax farming, Cosgel and Miceli (2006) review tax farming as an arrangement that the fixed rent type of a contractual agreement under which the collector would pay the government a fixed amount in exchange for the right to collecting the taxes and keep the residual after the taxes are collected.

Stella (1993) defines tax farming that a systematic tax administration problem in many developing countries has led to a search for radical solutions. One such proposed solution is tax farming which is a system wherein the right to collect taxes is auctioned off to the highest bidder. An analysis of the historical experience with tax farming shows that its purported administrative efficiency is largely illusory. Jang (2012) assumes that tax collection is an inherent function of the government and historically governments contracted with private agents known as tax farmers to enhance their tax collection capacities. Furthermore, Nably and Nugent (2014) argued that tax farming remain dominant in the periodic and inconstant markets and relevant for many reasons. First, these markets are very informal and formal accounts are rarely keep. Second, because of the infrequency and irregularity of their operations. Third, because every transaction is generally bargained separately and the information about realized prices and quantities is usually maintained as private information. Fourth, the fact that the tax rate specific to each item and often are specified in specific as opposed to terms, these differences raise the transaction costs of collecting the taxes in such markets.

3. Research Methodology

This research paper adapts two sources to be able to achieve its objectives: a primary sources including published articles and textbooks and secondary sources, which involves interviews with senior employers in many divisions such as evasion, legal affairs, and planning divisions in tax and sales department. These interviews expect to understand the tax history in Jordan, and the mechanism used to collect taxes and the problems may face in collecting these taxes.

4. Findings and Analysis

Based on both research sources adapted in this research paper there are problems much wider than the problem in tax law itself, which include tax assessors and the administration style. The tax law has been changing several times in the last fifteen years and the tax assessors are changing year by year but doesn't seem that the problems were solved after all of these changes in laws and the assessors. Some of the problems facing the Jordanian income and sales tax department are the tax evasion and the problem in calculating taxes on individuals that does not have a fixed source of revenue or does not have an accurate record to calculate taxes on them. The senior employers gave two reasons for evading taxes, the first one is people feeling that the value of the benefits they get is lower than the amount requested by the tax department and the second reason is people are feeling that there is an inequality because of the progressive rates of the taxes due on them. These problems attracted the researcher to have a deeper look inside the tax collection mechanism if any problems inside the mechanism and find a better way to manage the tax collections to increase the revenues from taxes including reducing the administration costs and the tax evasion rate. The tax collection mechanism used in Jordan is not clear. Then the self-judgment used to calculate taxes on people lacking clear statements, because self-judgment and the direct observation lead to a wrong judgment and it cause sometimes an inequality between people working in the same sector and have almost the same rate of income, which may reduce sometimes the income for the government.

Individual must submit their individual income tax form that includes their sales and purchases. If individuals do not provide their tax forms, or the information provided was insufficient or incomplete after it had been analyze and audit by tax department, they will be subject to one of the following two methods. The first one is the direct observation, which is consider the most effective way by assigning tax assessors to observe the sales for the two days in separated periods during the month. In this case, tax assessor take into consideration the unusual circumstances that may occur during the observation days. The second method is a self-judgment by auditing the form of the main supplier as a deal with the person who is inspecting him. The self-judgment of the assessors may be affect by many factors and any effect will cause a defect on the system and misleading to detect where the defect is coming from. Although the direct observation is consider as the most effective method but it is not a perfect method to detect the manipulation, almost 20% of the cases are being undetected and this is consider very costly and hard to apply on a wide range.

The researcher found that the tax evasion problem is not arising only from the tax law but from the collection mechanism itself, and this must be take into consideration because tax revenues are the main source of revenue to the Jordanian economy. The researcher found that tax farming fits the Jordanian case because Jordan can be consider as a developing country and tax farming fits well with the developing countries' economy, which is parallel with Nably and Nugent (2014) recommendations. The Jordanian economy is facing a big problem with taxes evasion and the way to minimize the tax evasion rates and the best way to minimize these problems is to adapt an effective tax collection mechanism called tax farming. Tax farming is a mechanism by which the government abandons the right of collecting taxes and gives the right of collecting taxes to the private sector through an auction and the higher bidder will have the right to collect taxes according to some rules that should know in advance for the bidder. One of the purpose of tax farming is to help government to impose control over tax sector on the long run which provide taxable profit to private sector that collect taxes and helps government to be able to collect its taxes properly by reduce tax evasion due to the fact that private sector as collector try to maximize its profit. In this case, the government can reduce the administration cost of the tax collection and the risk occurring from the collection and determine in advance the revenue from taxes.

To make the maximum benefit of this approach, the government first gives the private sector a large percentage of tax collection and then goes in a descending way to reach almost zero. In that time the government should carefully observe the tax farmers while they are collecting taxes, trying to learn from them to improve their collection mechanism and administrative skills due to the tax farmers' main goal is to generate more income and they will collect taxes in all possible ways. Tax farming mechanism is an efficient tax collection method because it provides the government with stable and fixed rate of revenue and solves the issue of the public tax collector under the bureaucratic tax collection system.

However, tax farming was not fully beneficial because it encouraged private sector collectors to exploit taxpayers to their expected return. Therefore, the US government applied in the 18th century the tax farming while they were improving and studying a bureaucracy mechanism.

At the 19th Century, the bureaucracy mechanism adopted and the tax farming mechanism reduced to reach the minimum rate and was only use for sectors that are hard to collect taxes from and to deal with. Tax farming in the Jordanian case will fit with the industry and commerce sectors especially small and medium firms that do not have enough records and do not have clear statement and they have a many ways to evade taxes. To maximize the benefit of tax farming approach in Jordan, the government must stay in touch with organizers of the financial reports of the tax farming to make sure of their credibility and to protect the citizens' rights on the first place to avoid the tendency of the tax farmers to abuse the taxpayer for collection taxes.

5. Summary and Recommendations

The tax collection mechanism used in Jordan is weak and need to be improved and developed and does not have enough guidelines for the collection of taxes on persons that does not have enough records. There are many problems arising from self-judgment and the direct observations were many factors affecting the decision of the assessors, which make their decision in most cases inaccurate. Jordanian economy is considered as developing economy and in regards to tax sector the administration costs is souring and the tax evasion rates is rising which makes the tax farming mechanism is fit to the Jordanian case to improve tax collection mechanism in Jordan. Tax farming has advantage and disadvantages but it will solve the problems exist in the Jordanian tax sector and the taxing authority can take tips and lessons from the tax farmers of the way they used in collecting taxes.

By applying tax farming in Jordan, the tax collection may improve and may stop the tax evasion, which increase the government revenue rather than increasing the tax rates on the individuals who are not evading taxes in the short-run bases then creates new tax collection mechanism while using the tax farming to improve and evaluate the new tax collection mechanism. This approach lets the government test the new collection mechanism partially and let the other part of the tax farmers insure about the effectiveness and the efficiency of the mechanism.

The researcher didn't cover the cost benefit of the tax farming mechanism and the effect of the tax farming on the future cash flow on the treasury, it only consider the effect of tax farming on the revenue for the government which may need a feasibility study on implementing tax farming in Jordan. There is also a window for further research to study the law and its effect of on the collection of tax mechanism.

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