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The Impact of COVID-19 on Palestinian Income Tax

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Abstract

Income tax is considered a direct tax. It has been given special attention by all States and has occupied a prominent place in modern tax legislation for its financial, economic and social implications for the State. The aim of current study was to identify the impact of COVID-19 on income tax revenues. By analyzing previous studies and comparing income tax revenues for the year 2020 with previous years, it has emerged that the Coronavirus has had a significant negative impact on the Palestinian Authority income tax revenues for the year 2020. This led to the deterioration of the Palestinian economy, which is essentially fragile, exhausted and dependent on foreign aid. The Palestinian Authority was unable to cover the deficit, causing the Authority to borrow from abroad and in-house, resulting in a high proportion of the Authority's debt.

Keywords:Income tax, Coronavirus (Covid-19), tax evasion, Palestine

1. Introduction

Taxation is the primary resource for Governments in both developed and developing countries, in addition to being an important means for States to achieve their economic and social objectives; as it is of great importance in financing State public revenues and encouraging domestic and foreign investments(Alkhatib et al., 2020; Edwin, 2011). The concept of taxation has varied over the years, depending on changes in economic, social and political conditions, and taxation as defined by Al-Salameen et al., 2018 “is a compulsory deduction imposed by the State on natural and legal persons free of charge for the purpose of covering their public burdens, in order to achieve their economic, social and political objectives in accordance with a law or legislation”.

Taxes build the Government's capacity to provide security, meet basic needs and promote economic development (Abdul-Jabbar et al., 2020). Taxation is one of the main tributaries of the Palestinian Authority Budget, so the State must protect it so that it can provide the funds it needs to address its economic problems and achieve growth and prosperity for its citizens(Alkhatib & Maria, 2021). The State also seeks to ensure that tax is provided with appropriate social justice so that it can be accepted by the duty bearers (taxpayers), so they do not consider it as a burden or punishment, but rather willingly pay it as a contribution to the objectives of the State and to social loyalty among the members of society, within the framework of a successful tax policy adopted by the State(Farrar et al., 2017).

Tax revenue is one of the oldest ways to provide funds for government sustainability, and most governments rely on taxes to meet spending needs(Alkhatib, Abdul-Jabbar, Abuamria, & Rahhal, 2019; Kira, 2017). This means that taxes were the most realistic means of generating revenue by governments to finance their development projects (Tanzi & Zee, 2001).

Tax revenue is a real indicator of the effectiveness of government economic and financial performance (Torgler, 2005), and it has been revealed that there are many factors affecting the value of government tax revenues. One of which is tax evasion. In this regard, tax evasion is the most common and important challenge to tax administration(Alkhatib, Abdul-jabbar, & Marimuthu, 2018; Franzoni, 2000).

The Palestinian income tax contribution is very low compared to other countries, and the Palestinian Authority relies on taxes as one of its sustainable sources of income (Sarangi, 2016). Tax noncompliance poses a risk to the income of the Palestinian Government, which suffers greatly from tax noncompliance. The Alliance for Integrity and Accountability in Palestine estimated that USD 500 million is the annual loss of tax evasion (Coalition for Accountability and Integrity, 2018).

In addition, the income tax administration in Palestine is characterized by a high degree of tax evasion (Rahhal, 2017). Many countries around the world, developed and developing, are experiencing a high rate of tax evasion, with no 100% commitment by taxpayers to perform their tax obligations (McGee, Ho, & Li, 2008). Based on the above, there are many factors that affect the value of tax revenues, but the current study will address the Coronavirus as one of the important factors affecting income tax revenues in Palestine.

2. Literature Review

2.1. Income Tax

Income tax is a direct tax that has been given special attention by all States, and has occupied a prominent place in modern tax legislation because of its financial, economic and social implications for the State (Tanzi & Zee, 2001). Additionally, it is considered one of the most important types of taxation in developed countries due to the large number of investment institutions and the strength of their economy.

In the Palestinian context, where the Palestinian Authority was established in 1994 based on the Oslo Accords, Palestine has gone through several periods during which many tax laws have been applied. During the period of Israeli occupation, the Jordanian and Egyptian income tax laws were applied in the West Bank and Gaza Strip, with amendments in favor of the Israeli side, with the aim of destroying the Palestinian economic structure. In 2004, the first Palestinian Income Tax Law No. 17 of 2004 was passed by the Palestinian Legislative Council, a unified law for the West Bank and Gaza Strip, and was implemented on 1 January 2005. The Income Tax Act No. 17 of 2004 was also amended in 2008 by Act No. 2 of 2008; for the reason that the previous Act did not meet the objective for which it was set, which is to increase tax revenues and reduce tax evasion (Abdel-Karim, Said, & Abu-Hantash, 2015). In 2011, the Income Tax Act No. 8 of 2011 was passed and introduced numerous amendments, the most important of which was to change the currency of the Act from dollar to shekel (Income Tax Law in Palestine, 2011).

Based on the foregoing, tax evasion can be defined as illegal conduct used by the taxpayer to eliminate the payment of tax in whole or in part, which affects the State's proceeds (Alm, Martinez-Vazquez, & McClellan, 2016). Furthermore, tax evasion has a significant impact on the loss of government tax revenues (Pirttila, 1999). Similarly, Schneider and Enste (2000), emphasized that tax revenue losses reduce the capacity of Governments to provide public services, thereby impeding economic development. However, the challenge of tax evasion has limited the ability of governments to maximize the expected tax revenues to finance development projects.

2.2. Coronavirus (Covid-19)

The latest threat to global health is the ongoing outbreak of respiratory system disease, recently called Coronavirus Disease (Covid-19). Covid-19 was identified on December 1, 2019 and quickly found to be structurally linked to the virus that causes Severe Acute Respiratory Syndrome "SARS" (Anthony, 2020). It is a group of viruses that cause diseases to animals and humans and infect them with many respiratory diseases and acute severe syndrome, but Coronaviruses have caused a new virus called Covid-19. It first appeared in China in Wuhan City, and it turned into an epidemic all over the world. The reason it's so widespread and so fast is that the symptoms may not appear on the infected person in the case of COVID-19 until two weeks have passed. It is transmitted by touching objects on which droplets of the infected person may fall through sneezing or coughing, which has increased the speed of its spread (Rezeq, 2020).

2.3. Coronavirus and its Impact on Income Tax Revenues

One of the most serious shocks to the global economy at present is the outbreak of the Coronavirus (Covid-19), as all countries of the world were unable to confront Covid-19, leading to a global economic crisis from which no country, whether developed or developing, has been spared. In view of global interconnectedness between the economies of countries, this crisis has brought the world economy into a severe recession, causing major turbulence and shock that affected various sectors, leading to the collapse of global stock exchanges, and causing losses in millions of dollars worldwide (Shuraim, 2020).

The Palestinian economy is certainly not far from the shocks to the global economy. After many cases have been detected and confirmed as infected with this virus in the Palestinian territories, a series of strict precautionary measures have been taken to confront the outbreak and spread of the virus and to besiege it in the narrowest place. This has led to an increase in public expenditure as a result of increased government spending for the health care sector, as well as increased spending on personal protective equipment, examinations and diagnostic tests, in addition to more beds in hospitals and health centers, and the equipping of new field hospitals. It has also led to an increase in spending for the security sector as a result of the declaration of a state of emergency and the deployment of security forces in the governorates to follow up on the implementation of precautionary measures within the governorates.

The Palestinian economy is already exhausted in its structure and nature. It has been affected by many political and economic circumstances. It is the most economically affected by the Corona pandemic among the countries of the world; as it is a fragile economy subordinate to the Israeli economy. It has no national currency, its resources are controlled by the occupation, and its economy is heavily dependent on the aid of donor countries.

Under this pandemic, the Palestinian economy declined sharply by 12% during 2020, which led to a significant decline in tax revenues (Awad, 2020). As a result of the unexpected cost of the Coronavirus (Covid-19) to the Palestinian public treasury, which is already experiencing a marked and significant rise in the public budget deficit, the Palestinian Authority has resorted to external and domestic borrowing to cover its high expenditures (Helles, 2020).

Table 2.1 The Ratio of Income Tax to Total Government Revenues for the Years, 2017-2020

Year	Total Revenue (in million shekel)	Income Tax (in million shekel)	Income Tax as % of Total Revenue
2017	12880.2	970.1	8%
2018	12256.2	919.7	7.5%
2019	12383.2	775.2	6.3%
2020	11832.3	719.5	6%

Source: Palestinian Ministry of Finance (2017-2020)

The above table shows that the income tax revenue collection for the year 2017 to 2020 ranges from 6% to 8%, which means that the Palestinian income tax index is declining. We notice that the impact of the Coronavirus began in late 2019, with Palestinian income tax falling by 1.2% from 2018 and continuing in 2020, as it decreased by 0.3% from 2019. Palestinian Authority revenues declined sharply in May, as a result of its cessation of receipt of clearing revenues from Israel due to the Palestinian decision to cease coordination between the two sides, as well as the sharp decline in local collection caused by the Corona pandemic.

The revenue of the Authority has been reduced from 2019 to 2020 by approximately (550.9 million shekels). This decline is due to many reasons, mainly of which is the Coronavirus. As a result, imports from abroad have declined, and the Israeli occupation has deducted a large portion of the clearing. As the rate of proceeds from clearing is about USD 200 million per month, accounting for about 60% of total Palestinian revenue, which was seized by the occupation in May. This prevented the Palestinian Authority from paying salaries to employees and some establishments were shut down due to circumstances, and consequently the decline in Palestinian national income as a result of the disruption of more than two-thirds of its production capacity because of the declaration of the state of emergency, as well as the decline in the income level of companies and individuals (Mucif, 2020).

The closure led to a sharp decline in public revenues from local collection by nearly half, and the decline continued despite the gradual easing of restrictions starting from mid-May. This situation has led to a financial disaster owing to the inability of the Palestinian Authority to cover the deficit of more than USD5 billion, which can only be covered by aid from donor countries and borrowing from abroad. According to the budget, there are expectations that donor countries will provide about 45% of this deficit and the rest will be covered through borrowing (Mucif, 2020). A significant and clear decline in total revenues happened, at a time when the authority's expenditures on the health-care and security sectors are rising, leading to a large funding gap, widening over time and requiring funding from donor countries or through external and local borrowing, which increases the pace of public debt accumulation of public debt or reduces tax evasion.

According to World Bank estimates, the poverty rate in Palestine has risen to 30%, with about 1.4 million people suffer and live in poverty. The World Bank expectations indicate that the Palestinian economy had contracted by 11.5% over the past year, a significant difference from previous estimates of 7% contraction, under the influence of the Corona pandemic and the interruption of clearing funds. From the last third of March 2020 to 3 May 2020, the Palestine Stock Exchange closed its transactions, in compliance with the Palestinian Capital Market Authority's decision to suspend trading due to the spread of the virus, in addition to an 85% decline in Arab aid (Almarsad, 2021).

According to Ministry of Finance data, both crises of clearing and the Corona pandemic led to 70% decline in total revenue, accompanied by a half decrease in external assistance. In April 2020, the Palestinian Authority reached an agreement with the Palestinian Monetary Authority and banks to obtain a syndicated loan from local banks of USD 400 million, raising its debt to the banking system to about USD 2 billion by the end of July 2020. With the Authority reaching this ceiling of bank borrowing, it became difficult to obtain more bank loans. In addition, to rising local debt, the external debt also increased from USD 1.2 billion at the end of 2019 to more than USD 1.4 billion at the end of July 2020, with the withdrawal by the Palestinian Authority of a USD 250 million Qatari loan put in place by Doha at the disposal of Palestine in mid-2019. Loans are the primary engine of the economy, or at least parts of it, but this time their borrowing capacity appears to be running out (Alwafa,2020).

3. Conclusion

The Palestinian government relies heavily on taxes as one of its sustainable sources of income. However, tax evasion plays a significant role in the volume of those revenues, as there are many factors that affect tax evasion, which in turn negatively affects income tax revenues in Palestine. The current study examined one of the emerging factors, the Coronavirus, as one of the factors affecting tax revenues. The previous studies examining the impact of the Coronavirus on tax revenues in Palestine are very limited. The present paper provides a conceptual model in the context of Palestine and provides insight for tax researchers and tax authorities in particular to understand more about how Coronavirus affects tax revenues. However, the emergence of the Coronavirus has reduced the Government's ability to increase revenue generation. From the discussion of previous literature and statistics on this factor, it was found to have had a significant impact on income tax revenues.

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