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The Hashemite Kingdom of Jordan

Improving the Design of the General Sales Tax, Customs Duties, and Tax Incentives for Investments

Ricardo Fenochietto and Gilbert Ménard

Technical Assistance Report | October 2016

INTERNATIONAL MONETARY FUND

F I S C A L   A F F A I R S   D E P A R T M E N T

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ABBREVIATIONS AND ACRONYMS

ASEZ	Aqaba Special Economic Zone
CIT	Corporate Income Tax
EFF	Extended Fund Facility
FAD	Fiscal Affairs Department
FAT	Financial Activity tax
FTAs	Free trade agreements
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GST	General Sales Tax
HS	International Harmonized System
IMF	International Monetary Fund
IT	Information technology
ITD	International Tax Dialogue
ISTD	Income and Sales Tax Department
JIC	Jordan Investment Commission
JIF	Jordan Investment Fund
JIL	Jordan Investment Law
JD	Jordanian Dinars
MENA	Middle East and North Africa
MFN	Most Favored Nation
MoF	Ministry of Finance
MSM	Micro simulation models
OECD	Organization for Economic Co-operation and Development
PIT	Personal Income Tax
PPP	Purchasing power parity
SST	Special Sales Tax
USAID	United States Agency for International Development
VAT	Value Added Tax
WEO	World Economic Outlook
WTO	World Trade Organization

PREFACE

In response to a request by the Minister of Finance, Mr. Omar Malhas, a technical assistance mission from the International Monetary Fund's (IMF) Fiscal Affairs Department (FAD) visited Amman from July 29 – August 8, 2016 to review policy aspects of the General Sales Tax, Customs Duties, and tax incentives in Jordan. The mission comprised Messrs. Ricardo Fenochietto (FAD and mission head) and Gilbert Ménard (external expert).

During its visit, the mission had several rounds of productive discussions with Messrs. Omar Malhas, Minister of Finance; Ezzedine Kanakrieh (Secretary General at the Ministry of Finance); Abdelhakim Shibli (Studies and Economic Policies Deputy Director); and other staff members of the Ministry. It also met with Messrs. Bashar Naser, Director General of the Income and Sales Tax Department; Mukhallad Omari, Secretary General of the Investment Commission; Qasem Al Zou bi, Director General of the Department of Statistics; Jehad Sawaqes, Assistant General Direct of Jordan Customs; Yousef-Al Shamali (Secretary General at the Ministry of Industry and Trade). The mission also met with several people working on the Fiscal Reform II project, funded by United States Agency for International Development (USAID).

The team acknowledges especially the support it received from Mr. Ezzedine Kanakrieh and his team in the preparation of the mission.

EXECUTIVE SUMMARY

Jordan has undertaken significant policy adjustments against a difficult external environment, rising socio-economic tensions, and high vulnerabilities. The economy has continued to perform favorably (economic growth averaged 2.75 percent in the period 2011–2015 despite a very difficult external environment). Nonetheless, significant challenges remain on the fiscal side. Gross public debt is about 94 percent of GDP, the combined public sector deficit reached 7.2 percent of GDP in 2015, while tax revenue has performed poorly in recent years. Since 2007, the tax-to-GDP ratio has dropped by 4.5 percent (from 20.4 percent to 15.9 percent in 2015). This was in part due to new tax exemptions and reductions of customs tariffs and General Sales Tax (GST) rates. To strengthen revenue collection, the authorities plan to address structural fiscal challenges through broadening tax bases and rationalizing tax incentives, which is a critical structural reform under the Extended Fund Facility (EFF) program that the Jordanian authorities have requested.[1]

The EFF aims at stabilizing public debt at about 94 percent of GDP in 2016, and then to gradually reduce it to about 77 percent of GDP by 2021. Medium-term fiscal consolidation will focus on revenue (equity-enhancing tax reform) and on prudent management of current expenditures. To underpin their fiscal consolidation efforts under the program, the authorities intend to rely primarily on simplifying and streamlining tax exemptions and broadening the income tax base. Committed to quickly overhauling the tax incentives framework – submission of a new framework to parliament is a mid-November structural benchmark under the new EFF – the authorities requested technical assistance to review indirect taxes (including tax incentives under the GST, customs duties) and corporate income taxes (CIT).

The Jordanian tax system is very complex. In addition to its revenue-raising function, it has to address multiple objectives such as reducing the price of food and attracting investments. Tax exemptions and reduced and zero rates are extensively applied in tariffs and GST; many tax incentives have also undermined the CIT base. More than a general tax system, the regime is a large collection of laws and regulations that establish differential treatment for multiple sectors, products, regions, or activities. The extensive use of preferential treatments results in a complex tax system that is difficult to administer and comply with, which and makes it prone to tax avoidance.

The GST plays an important role in Jordan's public finances. During the period 2010–15, GST revenues – including the Special Sales Tax (SST), which replaces excises in Jordan – has ranged between 46.6 percent and 49.5 percent of tax and nontax revenues. Higher revenues are critical for fiscal consolidation efforts and to reduce the public debt. There are two ways to do this. The first, used in the past, is to introduce small and sometimes distortionary patches (for instance, increasing the SST rates or non-tax fees). Doing so complicates the system without a definitive

[1] It is a three-year program, with access to 150 percent of quota (SDR 514.65 million, about US$ 720.4 million).

solution. The second is to solve the problem in an effective and efficient manner by eliminating the large number of reduced rates and exemptions under the GST. The mission strongly recommends the second option, which can increase revenue by 3.1 percent of GDP (about 70 percent of the current fiscal gap). It will also contribute to enhancing growth and notably simplifying the system (see the total list of recommendations in the table at the end of this summary).[2]

It is important to note that any improvement in GST revenue will not affect the competitiveness of Jordan economy. A well designed destination-based GST presents economic and collection advantages. A GST with a broad base (with only a few or no exemptions) and a single rate achieves neutrality with respect to investment and production decisions (particularly without having cascading effects). Unlike income taxes, a well-designed GST does not influence the forms or methods of doing business: GST for final consumers is the same for a product made in the corporate or non-corporate sector, with capital-intensive or labor-intensive technology, or for one made by integrated or specialized firms. The GST also ensures neutrality in international trade by zero-rating exports and by treating imports on a par with domestically produced goods (destination principle).

Recent empirical studies confirmed the economic advantages of the GST. They concluded that, after property taxes, the GST appears to be the least harmful of the major taxes in terms of economic growth. Regarding equity, studies conclude that the actual impact of GST exemptions or reduced rates on income redistribution is usually limited. In Jordan, as in other countries, individuals who are in the highest decile of the income distribution consume, in absolute terms, more exempt goods than do individuals who are in the lowest decile of the income distribution. Well-targeted social programs, in particular early intervention programs, have proved to be better tools in reducing poverty than GST exemptions that can be regressive.

The SST and its revenue could be also improved. Although not as complex as the GST, the SST system could be simplified by reducing the number of rates that apply to motor cars and its revenue could be increased by taxing non-alcoholic beverages – several countries have been successful in introducing sugar-based taxes on sodas and soft drinks. Jordan could follow this initiative. If the GST revenue is not improved enough, the government should also consider increasing the SST rates on cigarettes and oil products (in particular, diesel with its higher environmentally degrading emissions).

The tariff system could also be simplified. A first best option implies a revenue-neutral reform on customs duties to simplify the system with improved revenues from the GST. This includes reducing the number of tariff rates and the dispersion among them, and phasing-out most

[2] Gradual approaches include, for instance: (i) increase revenues by 2.2 percent of GDP by phasing-out all exemptions and differential rates and reducing the rate to 14 percent from 16 percent; or eliminating all exemptions and the zero-rating and limiting a reduced rate of 8 percent only to a short list of goods, which could represent an important portion of the consumption basket of the poor.

exemptions, except: products that come from countries with international agreements; goods that are used as inputs for exports; re-exports; and goods for basic needs, such as medicines. However, if revenue from the GST and SST cannot be improved enough (about 3 percent of GDP), a second best alternative should include the increase of the customs duties revenue – introducing a 3 percent rate on current exemptions with the exception of the above-mentioned special categories would increase revenue about 0.44 percent of GDP.[3]

Tax incentives for investment are also prevalent in Jordan. They include reductions or exemptions from the CIT, GST, and customs duties and are provided to a large number of specific industries and to designated economic zones (Development Zones and Free Zones). The report proposes the rationalization of tax incentives for investment, including the elimination of most preferential zero-rating of the GST; a reduction of the magnitude and imposition of sunset clauses to preferential CIT rates; and a reduction of the recourse to preferential customs duty exemptions. These measures will make the tax system simpler, fairer, and more stable while securing tax revenues, and will be more conducive to attracting investment in an effective and efficient manner. Alternative tax measures that may be considered to support investment in an efficient manner are also discussed.

The report also addresses governance issues related to tax incentives. The proliferation of tax incentive measures is in part due to deficiencies in the manner in which they are introduced and governed. A large number of tax preferences are contained in non-tax laws or are introduced in a discretionary manner, the responsibility of which does not rest with the Minister of Finance, who is otherwise responsible for tax policy and government revenues. The report recommends consolidating all tax provisions into tax laws under the authority of the Minister of Finance and reducing the degree of discretion in the granting of preferential tax treatment. It is also recommended to develop a framework to evaluate, in a systematic and transparent manner, the cost and benefits of tax preferences for investment.

[3] With an additional improvement from Most Favored Nation rates of 0.16 percent, the additional revenue would reach 0.63 percent of GDP (Table 13); the revenue gains would be about 1 percent of GDP if the rate for current exemptions were 6 percent instead of 3 percent (Appendix 2).

Recommendations of the Mission

		% of GDP (1)
	General Sale Tax	3.1
1	Separate the GST revenue from the SST revenue in the government statistics.	-
2	Establish a single threshold of JD 75,000.	-
3	Reduce the number of the GST rates to one or at least two.	0.9
4	Eliminate the GST zero-rate and maintain exemptions for only a very few group of goods.	2.2
5	Establish a monthly tax period for the GST and SST (it will yield 0.8 % of GDP one off)	+
	Special Sale Tax	0.3
6	Increase the SST on oil derivatives from 6 to 20 % if other measures of the report are not implemented.	0.1
8	Increase the rate on cigarettes to 0.52 cents per package and the SST on oil derivatives from 6 to 20 percent if other measures of the report are not implemented.	0.1
9	Simplify the motor rate structure in a revenue positive reform (unified the 16; 25; and 40 percent rates in only one: 35 percent).	+
10	Increase the SST rate on soft drinks from 0 to 20 percent.	0.1
	Customs Duties	0.7
	Reduce the number of MFN rates from sixteen to six (three for tobacco and alcohol and three for the rest) in a revenue neutral reform with the aim of simplifying the tariff system.	-
	If GST and SST revenue cannot increase enough (3 percent of GDP):	
11	- Slightly increase the tariff rates to raise revenue by 0.19 percent of GDP	0.3
12	- Tax exempted goods, except those that come from countries with FTAs, used as inputs for exports (including capital goods), re-exports, and goods for basic needs (such as medicines) at 3 percent.	0.4
	Tax Incentives for Investments	
	Short-term (2017)	
13	Impose a moratorium on the introduction of new tax incentives provisions and the expansion of existing ones in the JIL and any other non-tax law. Keep the moratorium in effect until the current tax incentives framework has been reviewed and streamlined.	+
14	Impose a moratorium on the granting of discretionary tax preferences though mechanism such as the Council of Ministers and under Article 8 of the JIL. Keep the moratorium in effect until the current tax incentives framework has been reviewed and streamlined.	+
15	Remove/phase-out GST concessions from the JIL and any other non-tax law. All taxpayers (including in DZs, special regions, etc. but excluding Free Zones) are to be subject to GST as defined in its Law. GST refunds on exports are part of the core GST and should not be affected by this recommendation.	+
16	Consider introducing GST payment delay mechanisms for some imported capital goods.	+
17	Impose time limits to new and existing CIT reductions in the Development Zones and for JNES, and IT and any other recipient of reduced income tax rates (say 5 years).	+
18	Remove the CIT exemption for enterprises operating in Free Zones after a ten-year transition period. Impose time limits to CIT exemption granted to new operations in Tax FZs to be aligned with the end of the 10-year phase-out period granted to the existing beneficiaries of the CIT exemption.	+
19	Remove CIT exemption and reductions for enterprises operating in the ASEZ after a ten-year transition period. Impose time limits to CIT exemption granted to new operations to be aligned with the end of the 10-year phase-out period granted to the existing beneficiaries of CIT exemptions and reductions.	+
20	Initiate discussions and exchanges with donor countries to define the actions to be undertaken to ensure aid projects are subject to tax (this recommendation supersedes the above recommendations for aid funded projects).	+
	Medium term (2018-2020)	
21	Subject to further revenue impact assessments, eliminate or scale back CIT incentives for new investment/activities in any of the tax preference framework (say no reduction at all or at most one reduced rate of no more than half the normal CIT rate subject to time limitation of 5 or 10 years).	+
22	Review custom duties exemptions provided in non-tax laws with a view to reduce or eliminate them in all investment frameworks except in Free Zones. This review should take into account revisions to the custom duties rates recommended in this report.	+
23	Move all tax incentive provisions into Tax Laws.	+
24	Repeal Article (8) of the Investment Law.	+
25	Give ultimate responsibility for tax incentives to the Minister of Finance.	+
26	Consider introducing a neutral investment incentive instrument in the Income Tax Law such as an investment allowance, investment tax credit, or accelerated depreciation available to all corporations on all investments.	+
27	Create, in the MOF a structure dedicated to the evaluation of tax expenditures with the mandate of developing a tax expenditure assessment framework. This structure could be part or a broader structure dedicated to the tax policy analysis.	+
28	Publish annually detailed tax expenditures estimates based on this framework.	+
	Total	4.1

(1) - implies neutral impact on revenue; + implies positive impact that could not be estimated by the mission.

I. IMPROVING GENERAL SALES TAX POLICY

1. **This section analyzes the General Sales Tax (GST) policy design in Jordan and discusses possible measures to improve its effectiveness and revenue**.[4] It briefly reviews international trends in GST policy with the aim of simplifying the tax, broadening its base, and identifying potential sources of additional revenues. The mission's main recommendation is to simplify the GST by phasing –out the number of rates – if possible to a single rate – and all exemptions.[5]

A. Good Practices in GST Policy

2. **In consumption taxation, the widespread practice is to apply a GST (VAT) supplemented by excises.** GST is a broad-based, multi-stage sales tax collected at each stage of the production and distribution chain after offsetting the input GST paid on purchases against the output GST received on sales. This collection mechanism avoids harmful cascading effects across the production and distribution chain. Excises are single-stage taxes usually applied at the production stage. While GST normally applies to all goods and services, excises apply to selected goods to reflect in prices the negative externalities that their consumption generates (e.g., cigarettes, oil derivatives, and alcohol).

3. **The GST has become one of the most important sources of government revenues around the world.** Today, more than 170 countries have adopted the GST. The combination of this tax and excises has replaced other consumption taxes, and only a small group of countries

Table 1. GST as Percent of GDP and of Total Tax Revenue, 2014

Region	No. of Countries	Percent of GDP						GST % Tax Revenue 1/
		Tax Revenue	PIT	CIT	GST	Trade Taxes	Taxes on Property	
Africa	45	16.3	2.0	2.7	4.5	4.1	0.2	27.5
Asia and Pacific	36	19.3	3.1	3.8	4.2	1.7	0.8	21.6
Europe	43	25.0	6.9	2.8	7.5	0.6	1.4	30.1
Mid East and North Africa 2/	15	18.4	2.6	4.3	5.1	1.7	0.6	28.0
America	34	18.8	2.3	3.2	6.0	2.5	0.9	32.0
Jordan 3/		15.9	0.8	2.4	7.0	1.2	0.4	32.5

1/ In the case of Jordan is the GST as percent of tax and nontax revenue.
2/ Includes only non-resource countries.
3/ The GST in Jordan does not include the Special Sale Tax (excises).
Source: Prepared by staff with data from WEO and IBFD.

[4] In this report the GST and the Value Added Tax (VAT) are used as synonymous.

[5] Well-targeted social programs have proved to be better tools to reduced poverty than GST exemptions that could be regressive.

maintains multi-stage turnover taxes or a single-stage retail sales tax. In terms of revenue, the GST represents about 28.0 percent of tax revenues in Middle East countries (Table 1).

4. **A well designed GST presents economic and revenue advantages.** A GST with a broad base (without exemptions or with only a few) and a single rate achieves neutrality to investment and production decisions (notably by not having cascading effects), and maximizes potential revenue collection. Unlike income taxes, a well-designed GST does not influence the forms or methods of doing business: GST for final consumers is the same irrespective of whether the product is made in the corporate or non-corporate sector; with capital-intensive or labor intensive technology; or whether made by integrated or specialized firms. The GST also ensures neutrality in international trade by zero-rating exports and by treating imports on par with domestically produced goods (destination principle).

5. **Empirical studies confirm the economic advantages of the GST.**[6] These studies concluded that, after property taxes, the GST appears to be the least harmful of the major taxes in terms of economic growth. These economic advantages of the GST explain in part the approach some countries have been adopting, namely increasing GST rates or improving based design by phasing-out exemptions. For example, reductions in labor taxes – including PIT and social security contributions– can be compensated in the short term by increases in GST rates, the so-called 'fiscal devaluation'.[7] The ultimate aim is to minimize the negative impacts on long-run growth.

6. **The actual impact of GST exemptions or reduced rates on income redistribution is limited.** Individuals who are in the highest decile of the income distribution usually consume, in absolute terms, more exempted goods than do individuals who are in the lowest decile of the income distribution. For instance, in Tunisia, while people in the fifth quintile of income distribution received 39.2 percent of the total benefit of GST exemptions, people in the first (lowest) quintile receive only 7.9 percent the benefit (Table 2).[8] The equivalent numbers for Morocco were 38.8 percent and 14.5 percent respectively. Similar conclusions would likely be reached for Jordan, because the top decile pays seven times more in indirect taxes than the bottom decile (USAID 2016). Moreover, people in the first quintile may have benefited less because a higher proportion of their consumption comes from their own production, or purchased from taxpayers under the threshold and exempted from the GST or in informal markets. This suggests that revenue from reducing GST exemptions and the rates can be more useful to support the poor; e.g., a well-targeted social program is better suited to improve

[6] Arnold, J. 2008; Arnold et al., 2011; and Acosta-Ormaechea, S., and Y. Yoo. 2011.

[7] Alesina, A. and Giavazzi, F., 2013, pp. 443-485.

[8] An OECD study (OECD, 2014) found similar results for low-VAT rates on food in 15 OECD countries and that the low VAT rates targeting to social or cultural objectives (e.g. restaurants and hotel accommodation) were regressive.

income distribution and protect the poor. In addition, a well-designed income tax is a better way to introduce progressivity in a tax system.

Table 2. Who Benefits from GST Reduced Rates and Exemptions?

Quintile	Colombia	Mexico	South Korea	Morocco	Tunisia
1	5.6	8.5	6.3	14.5	7.9
2	9.2	13.9	13.8	12.0	12.7
3	13.3	18.5	20.2	15.0	17.0
4	21.0	25.5	25.7	19.7	23.2
5	50.9	33.6	33.9	38.8	39.2
Total	100.0	100.0	100.0	100.0	100.0

Source: Colombia, estimated by the mission with data from tax department; South Korea: Park and Jung, 2014; México, Levy, Santiago. Redistribution effects of fiscal reform in Mexico: A Policy Proposal. Conference about Latin America organized by the Center for Research on Economic Development and Policy Reform Stanford University, March, 2002. University of Chicago Press, 2003. Morocco: Fouzi Mourji (2011); and Tunisia (Mansour, 2015).

B. The GST in Jordan: Revenue and Design

7. **GST (including the Special Sale Tax) is the main source of revenue in Jordan, accounting for 47.9 percent of tax and non-tax revenue**. GST revenue decreased from 12.1 percent of GDP in 2007 to 10.4 percent in 2015 (Appendix 1). The introduction of reduced rates and exemptions explains a great part of this decrease.[9] In comparing the performance of the GST over time and across countries, and to avoid the effect of the different GST rates, other measures are used: the coefficients of efficiency (C-efficiency) and productivity.[10] Both coefficients have also decreased in Jordan: the C-efficiency from 0.79 in 2007 to 0.67 in 2015 and the productivity from 0.75 to 0.65 (Figure 1). Without including the special sales tax (SST) revenue and refund to exporters GST efficiency is significantly lower (0.46 in 2015).

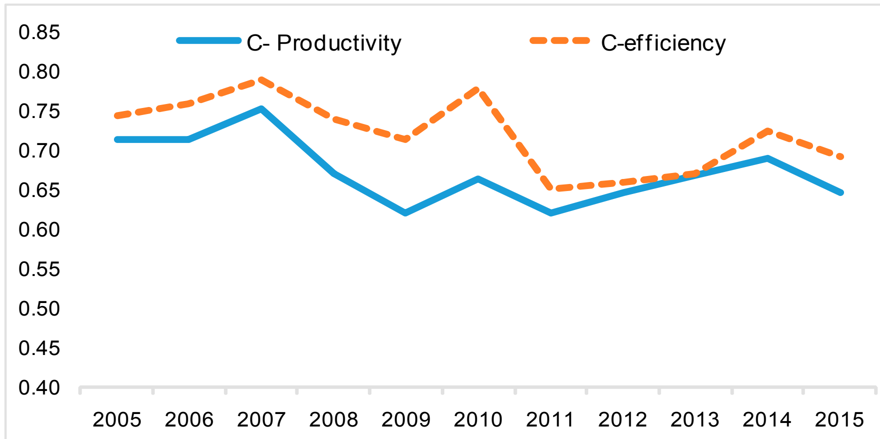
8. **Jordan's GST C-efficiency (0.67) is above the average of the region (Figure 2)**. However, this is in great part because the SST revenue is included with the GST revenue while in other countries revenue from excises is accounted separately. To compare the Jordanian GST

[9] There is no estimate of GST non-compliance in Jordan, therefore it is not possible to determine how much of this diminution can be assigned to an increase of the level of non-compliance.

[10] A common measure of GST performance is the ratio of its revenue to consumption (GDP) multiplied by the GST rate. This measure is commonly known as the C-efficiency ratio (GST productivity when the GDP is used instead of consumption). It represents the percentage of consumption (GDP) that each percentage point of the GST rate collects. The ratio is a useful tool in analyzing the performance of the GST within a country over time. A low ratio indicates erosion of the base (through either zero-rating or exemptions) and/or non-compliance. There is no estimate of GST non-compliance in Jordan.

revenue with the GST (or VAT) collection of other countries, the mission deducted the SST revenue and the GST refunds to exporters from the total GST-SST revenue.[11] Thus, the Jordanian

Figure 1. Jordan: GST Efficiency and Productivity



Source: prepared by the mission with data from WEO.

GST C-efficiency excluding the SST revenue and refund to exporters (now at 0.46) is significantly below the average of the group of countries of the region presented in Figure 2. This relatively weak performance is due in a great part to the high level of exemptions and reduced rates in Jordan; countries in Figure 2 with higher level of C-efficiency than Jordan (such as Israel and Georgia) have a shorter list of exemptions and only one rate (see next paragraphs). It is also worth noting that including the SST together with the GST revenue affects the transparency of the tax system and the comparison of revenue with that of other countries. It is recommended that Jordan accounts for the SST separately from the GST.

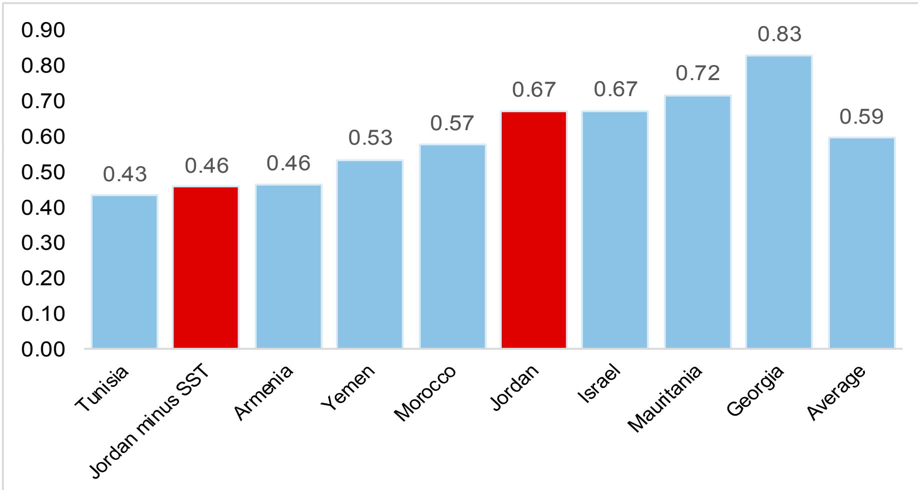
9. Complexity is the main characteristic of the GST in Jordan. The continued granting of exemptions and reduced rates (including zero-rating) has progressively narrowed its base, reduced revenue, and complicated controls by the tax administration. Rate reductions and exemptions began to increase in 2008 in response to the sharp increase in food and fuel prices. They continued after the 2009 global financial crisis with the aim of promoting some activities and regions (such as hotels taxed at a reduced rate of 7 percent in some regions of the country) or reducing the cost of inputs (intermediate goods, such as agricultural machinery and fertilizers).

10. While Jordan has weakened the GST by narrowing its base, the international trend has been toward the strengthening of GST (VAT). In Europe, several countries increased the GST rate in 2009 (Croatia and Lithuania, among others) or after the financial crisis (Spain, Ireland, Italy, and Montenegro). A few countries used the opportunity to reduce the Corporate Income Tax (CIT) rate (Finland). Outside Europe, several countries also increased the VAT rate: Japan from

[11] To estimate the SST revenues, the mission used the level of sales subject to the SST, which are accounted for separately. The level of SST revenues is not significantly different to that of the OECD countries (2.6 percent of GDP) and to that of a group of emerging countries in Latin America (1.8 percent of GDP).

5 to 8 percent (also reducing the CIT rate); Panama (from 7 to 10 percent in 2009); and Singapore (from 5 to 7 percent in 2007).

Figure 2. GST C-Efficiency in Selected Countries of the Region



Source: prepared by the mission with data from WEO.

C. Multiple Rates and Exemptions

11. Tax expenditures from GST exemptions and reduced rates (without including oil and its derivatives) reached about 3.1 percent of GDP (Table 3).[12] A large list of goods and services are exempted from the GST (Scheduled 3 of the GST Law), including selected food, power generation, aircraft, ships, and parts thereof, education, and health services (in addition, the Council of Ministers can exempt certain sectors or investment projects). The standard rate is 16 percent. In addition, multiple rates are in force:

- A reduced rate of 8 percent applies to a list of only five goods (construction steel bars of 5.5 mm or more; steel built and rolls imported by manufacturer as production inputs; etc.).

- Another reduced rate of 4 percent applies to a large list of selected 59 goods and services (i.e., kerosene and gas fuel; heaters; agricultural tractors and machinery; medicines; selected food; and books).

- A reduced rate of 7 percent applies on sales of services when being sold for consumption within development zones.

[12] Tax expenditures are defined as the revenue forgone from preferential tax treatments, relative to a reference tax system (or benchmark). Tax expenditures are discussed in the later part of this document.

- The zero-rating applies also to a large list of 59 goods and services: i.e., some specific, basic foodstuffs; supply used by the handicapped; machinery for pharmaceutical products and medicines; equipment used in renewable energy production; and several agricultural production inputs.[13] The zero-rating also applies to commodities necessary for production in 10 activities listed in the Article 4 paragraph b of the Investment Law (agricultural; hotels; call centers; air, sea, and railways transportation, etc.). Domestic zero rating is the main source of tax expenditures, accounting for 1.3 percent of GDP (USAID, Heredia, 2013).

Table 3. Jordan: GST Expenditure

	% of GDP
At customs by zero-rate and exemptions	0.5
Domestic Market due to zero-rate	1.3
Domestic Market due to exemptions	0.4
Subtotal	2.2
Tax expenditure for 4% rate (domestic market)	0.8
Tax expenditure for 8% rate (domestic market)	0.2
Total	3.1
Oil and derivatives	0.9
Grand Total (1)	4.0

Source: for zero rate and exemptions, Heredia 2013; for 4 and 8 percent: mission estimation with data from ISTD.

12. Exemptions and multiple rates have generated several problems in Jordan and most countries where they have been established:

- Efficiency loss because the exemption (or the differential rates) modifies the relative price of goods (in particular, if substitute goods receive a differential treatment). If the exemption applies on intermediate consumption goods, it causes cascading effects.

- Revenue loss because any exemption or rate below the standard highest rate, which is normally the highest (like in Jordan), creates a policy gap. It is only when goods and services are used in the intermediate consumption that GST reduced rates or exemptions do not result in foregone revenue.

- Loss of simplicity. More complex administration and compliance, in all types of procedures: bookkeeping, tax returns, audits, etc.

- Avoidance and evasion (create opportunities for deliberate misclassification).

[13] No tax is charged on the supply of an *exempt* good or service, and no input tax credit is provided for any tax paid in providing those supplies. Nor tax is also charged on the supply of a *zero-rated* goods or services, however, full input tax credits or refund are allowed.

- Scope for disputes in courts. Many goods and services are usually on the borderline between distinct categories. In the European Union and in Latin American countries, disputes have arisen in most items involving differential treatment; for instance, whether food is processed or not, whether simple operations such as drying or cutting fruit are considered processing and not exempt or subject to a reduced rate for unprocessed goods (Ebrill, L. et al, page 79).

- A precedent for other sectors to claim similar treatment, which could further undermine the GST design.

- Breaks in the GST chain thus introducing fragmentation in the taxation of consumption: domestic producers of exempted goods cannot recover the VAT of inputs (intermediate consumption) and as a result are at a disadvantage compared to external producers that can export the same product to other countries at GST zero rate. Then, domestic producers of these goods usually push to get the refund of the GST paid on inputs (implying domestic zero-rating). For this reason, the best practice is to restrict exemptions.

- The distributional impact of exemptions and reduced GST rates for food and necessities could be nil or very low (see Table 2 and discussion in paragraph 6). Using exemptions or reduced rates to reduce the impact of a GST on low-income households has not been a very effective tool to improve income distribution. To prevent the exemption (or the reduced rate) benefiting high income households, some countries have defined fine categories of exemptions within goods. However, this creates serious problems for the tax administration – for example, different treatment to different kinds of bread.

13. The initial theoretical policy argument in favor of multiple rates has been the inverse elasticity rule. According to this rule, to reduce distortions, higher rates should be applied to goods with inelastic demand and vice-versa to reduce distortions. However, the inverse elasticity rule is impossible to apply from the administrative and policy perspective. No country applies or has applied this rule, because it requires estimating the elasticity for most goods and services and it is impossible to administer the large number of differential rates that this system implies.

14. Only a few countries of the region have more than one rate (Table 4). Only one country (Egypt) of the fifteen included in this table has the same number of rates as Jordan. Notably, most countries (10 of the fifteen on Table 4) have restricted the VAT to one rate only. At 16 percent, the standard GST rate in Jordan is in line with the average level of countries of the region included in Table 4.

D. Reform Options

15. Reforming the GST system is essential for growth and fiscal sustainability. This section focuses on the feasibility of reducing GST expenditures. A GST without or lower exemptions and differential rates will notably simplify the system and bring many gains. First, the policy gap (revenue loss) due to rate differentiation and exemptions will be reduced (revenue could increase by about 3 percent of GDP). Second, this will notably help to administer the GST in a more effective manner, which would contribute to reducing avoidance and evasion.

Table 4. VAT Rates in Selected Countries of the Region

	Date VAT/GST Introduced	Standard Rate At introduction	Standard Rate Current	Other current rates
Algeria	Apr. 1992	13.0	17.0	7
Armenia	Jan. 1992	28.0	20.0	
Azerbaijan	Jan. 1992	28.0	18.0	
Egypt	Jul. 1991	10.0	10.0	5; 15; 20; 30.
Georgia	Jan. 1992	28.0	18.0	
Israel	Jul. 1976	8.0	17.0	
Jordan	Jan, 2001	13.0	16.0	0; 4; 7; 8.
Kazakhstan	Jan. 1992	28.0	12.0	
Kyrgyz Rep.	Jan. 1992	28.0	12.0	
Lebanon	Feb. 2002	10.0	10.0	
Morocco	Apr. 1986	19.0	20.0	7; 10; 14.
Tajikistan	Jan. 1992	28.0	18.0	
Tunisia	Jul. 1988	17.0	18.0	6; 12.
Turkmenistan	Jan. 1992	28.0	15.0	
Uzbekistan	Jan. 1992	30.0	20.0	
Unweighted average		21.1	16.1	
Average in:				
Africa		15.4	16.2	
Asia and Pacific		9.9	11.0	
Europe		16.5	20.6	
America		11.4	14.3	

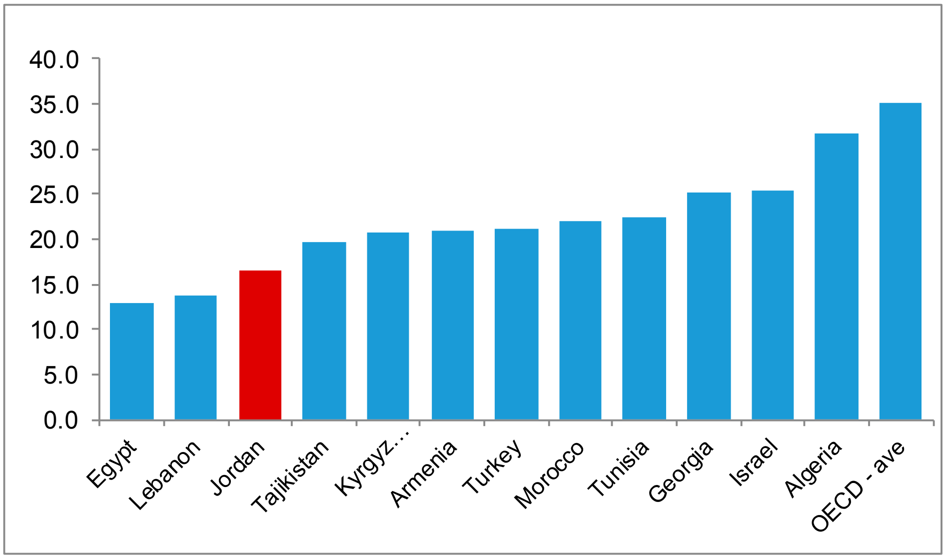
Sources: International Bureau of Fiscal Documentation, IBFD.

Food and agricultural products

16. Food and agricultural products represent the majority of goods exempted or taxed at zero rate. Despite the limited impact on income distribution of the GST exemptions and reduced rates, several countries exempt food and the agricultural products. Of thirty-three of the Organization for Economic Co-operation and Development (OECD) countries with a GST, twenty-four have established a preferential regime for agricultural products or food (reduced rate, exemption, or zero-rate). However, the tax system and structure in OECD countries are completely different from that of Jordan.

17. First, the bulk of the revenue is collected from direct taxes in OECD countries and from indirect taxes in Jordan (as in developing countries). For instance, while the PIT average revenue in OECD countries is 8.9 percent of GDP, it is only 0.5 percent in Jordan. This implies that the OECD countries have a margin to apply reduced rates in the VAT/GST, which Jordan does not have. In other words, if Jordan collected 4.5 percent of GDP from the PIT (only half of the OECD average), its tax revenue would not be one of the lowest of the region (Figure 3), its fiscal sustainability would not be at risk and as a result, it could consider granting exemptions from the GST without putting the fiscal framework at risk.

Figure 3. Tax to GDP Ratio in Selected Countries of the Region, 2014



Source: prepared by the mission with data from WEO.

18. **Second, the level of GST non-compliance is inversely related to the level of development.** While the level of non-compliance is equivalent to 15.9 percent of potential GST revenue in European countries (Bureau for Economic Policy Analysis, 2015), it is much higher among developing countries (In Latin America, it reached in average 31.0 percent). Jordan is not an exception; a rough estimate carried out by the mission situates the GST non-compliance at least slightly higher than the average in Latin America, more than double the level estimated for European countries. In others words, if Jordan's GST non-compliance were similar to that of the European countries (most of them belong to the OECD), GST revenue would be higher by about 2 percent of GDP, lessening the risks to the sustainability of its public finance from having GST reduced rates and exemptions.

19. **From the efficiency point of view, there is no argument to exempt from GST the agricultural products.** In addition to the revenue forgone, neutrality is also hampered (cascading effects are produced), and administrative difficulties introduced (particularly in the retail sector that sells taxed and untaxed products, creating noncompliance opportunities and difficulties in controlling compliance). Farmers are not able to claim any input VAT (and they have to charge VAT on their sales). This implies that producers would become overtaxed relative to other sectors of the economy and if farmers sell to intermediaries, the tax paid by them could also be exported. Under such a regime, to reduce the cumulative effect, different mechanisms have been established to offer some relief to farmers; for instance, like Jordan, several countries have exempted inputs from GST used in the agricultural sector, such as equipment, fertilizers, seeds, and so on. This has brought additional administrative and policy problems: the same piece of machinery (say a truck) is exempted for the agricultural sector but taxed if used for industrial purposes; pesticides and fertilizers are often exempted even though they are harmful to the environment (in Jordan they are taxed at 4 percent).

20. Options for eliminating the exemption for food should be considered, because they entail significant efficiency gains and additional tax revenue. As highlighted, this exemption implies a significant revenue loss. Income and Sales Tax Department (ISTD) staff explained to the mission that equity is the main reason for this exemption (to reduce burden for basic needs). However, as Table 2 shows, the exemption benefits the wealthier segments of the population more than the poor. In addition to revenue gains, taxing agricultural products will generate several efficiency benefits. At present, exempted agricultural products are used and acquired by agricultural-producer factories (including exporters), thus resulting in cascading effects.

21. Removing exemptions is not likely to affect small producers and preserve equity. It is also worth noting that the GST in Jordan is probably less regressive than usually thought.[14] If the exemption for agricultural products is eliminated, it is very likely that most of the small agricultural producers will remain below the GST registration threshold (see next section); and people in the first quintile of income distribution will either (i) consume their own production, (ii) buy in informal markets or (iii) to small sellers under the threshold. Therefore, their purchases are not subject to the GST.

Other item-specific value-added tax exemptions

22. Although the revenue impacts of eliminating other item-specific exemptions are much smaller, their necessity should be reexamined. It is important to regularly monitor them because they also complicate compliance and could create opportunities for noncompliance and also fraud. For instance, some exemptions complicate taxpayer liabilities (traders selling taxed and untaxed products must account separately for each), and are difficult to control. Others, such as sale of goods or provision of services by non-profit organization, may compete in the market with commercial entities that are subject to GST (for instance, with restaurants, etc.). This is a clear case for eliminating this exemption to avoid abuses—GST in several countries tax gross receipts of non-profit organization for those goods and services that compete with for-profit businesses in the market. Therefore, a systematic and detailed analysis of their cost and its publication should be considered—see further discussion in tax expenditure subsection.

Different Scenarios

23. In developing its recommendations, the mission considered the following objective: the sustainability of public finance and a potential trade-off between growth-enhancing tax policies and their distributional effects. The challenge of a tax system should always be to strike an acceptable balance between conflicting objectives while preserving the sustainability of public finances—which itself is a fundamental building block of a competitive economy.

[14] The system of indirect taxes (customs, excise and general sales tax) is relatively proportional over all deciles—that is households pay roughly the same proportion of their income in these taxes (approximately 11 percent).

24. Regarding equity GST differential treatments (reduced rates and exemptions) are not a good instrument for improving income distribution. The differential treatments usually benefit higher income consumers than people in the first quintile of income distribution, who, as it happens in Jordan, mainly purchase their food from small taxpayers (under the threshold and, therefore, are exempted from the GST) or in informal markets. Additionally, consumption of food of own production (also out of the scope of the GST) is higher among low income people. Well-targeted social programs (in particular early intervention programs such as school feeding programs or well-stocked public libraries), have proved to be better tools for poverty reduction than exemptions on goods that usually are regressive. Regarding efficiency and growth, the large number of exemptions and goods taxed at reduced rates notably affect the efficiency of the tax system. In addition, revenue loss from exemptions and reduced rates is significant (about 3 percent of GDP).

25. With these three objectives in mind, the mission analyzed different scenarios:

- On balance, the mission is of the view that the best option is a single GST rate equal to 16 percent. This implies phasing-out all exemptions and differential rate treatments (revenue gain of about 3.1 percent of GDP).
- Second best scenarios include:
  - The same measures but with a single rate of 14 percent (revenue gain 1.9 percent of GDP, taking into account a GST productivity of 0.62),[15] or

Table 5. Potential Revenue of Different Scenarios
Percent of GDP

GST expenditure (revenue forgone due to exemptions & different rates without oil)	3.14
Current GST Revenue without SST	6.83
Potential GST revenue without exemptions and diff. rates (without SST)	9.97
GST productivity (without SST), exemptions, and diff. rates	0.62
Potential revenue of different scenarios	
14 % rate without exemptions and domestic zero rate	1.90
13 % rate without exemptions and domestic zero rate	1.27

Source: prepared by the mission with data from ISTD.

  - Eliminating the reduced rates (including the zero-rate) and limiting exemptions only to a very few group of goods, which represents an important portion of the consumption basket of the poor (and others that could be laudable, such as supplies used by the handicapped, or have positive externalities, such as education and health).

[15] Current revenue (without SST) is 6.83 percent of GDP; if all exemptions and differential rates were phased-out, revenue would rise to 9.97 percent of GDP and GST productivity would reach 0.62.

E. Threshold

26. Starting in 2015, there are three GST thresholds: JD 10,000 for manufacturers of goods subject to a special GST tax rate; JD 30,000 for service industries; and JD 75,000 for manufacturers subject to the general tax and for traders.[16] Like Jordan, most countries have introduced special schemes for small taxpayers: in general, a threshold (of sales) under which small taxpayers are not liable for GST. These special schemes have two main—but related—objectives: (i) to reduce the cost of compliance for small taxpayers,[17] and (ii) to allow tax authorities to concentrate on monitoring large and medium size enterprises. The ceiling below, which entities are deemed 'small' for the purpose of these schemes, varies but generally it is a modest amount of turnover. The latter is generally considered to be the easiest proxy for size and/or capacity to comply with the tax system.

27. The objective of a special scheme should be simplification, rather than the reduction of the tax burden of small taxpayers. If small taxpayers in the simplified tax scheme enjoy a substantially lower tax burden than those in the general tax regime, they are not encouraged to transit to the general system. A lower tax burden also confers a competitive advantage compared to those businesses operating above the threshold. This can have very distortive effects, as taxpayers will have an incentive to manipulate their business activity to qualify for the lower tax burden, including by splitting up into several businesses that are ultimately controlled by the same person. Furthermore, the transition to the general system should be as smooth as possible so as not to involve steep increases in the total tax burden. Finally, a simplified tax system also facilitates voluntary compliance and could therefore help to reduce informality, but it is not the only tool to do so.

Number of Thresholds

28. Most countries have established only one threshold. Only a few countries specify different thresholds for different kinds of activity. The most common form of variation involves a lower threshold for services over other activities (for instance, Indonesia, Ireland, Jordan, and Argentina). More than a single threshold introduces administration and compliance complications, especially when taxpayers have more than one economic activity falling within separate thresholds. More than one threshold is also unusual compared to other countries of the region, which in general have only one (Table 6). To simplify the GST system, it is desirable that Jordan reduce the number of thresholds to only one or, two at most.

[16] Before 2015, four thresholds applied on the GST: JD 10,000 for manufacturers of goods subject to a special GST tax rate; JD 30,000 for service industries; JD 60,000 for manufacturers subject to the general tax; and JD 150,000 for traders

[17] When measured against sales or assets, compliance costs for small VAT taxpayers are significantly higher than for large and medium size businesses; see, for instance: OECD 2007.

Level of the Threshold

29. **A key consideration when designing a simplified system is to set a reasonable threshold**. Three effects should be considered when setting the GST registration threshold (Keen and Mintz 2004: (i) administrative and compliance costs (effect 1); (ii) revenue impact; and (iii) efficiency to the extent that those outside the GST net are conferred a tax benefit. Thus, while a relatively high GST threshold that leaves too many taxpayers outside the GST system may facilitate control, it may come at a high cost in revenue and efficiency. On the other hand, a very low threshold might be efficient but will be very difficult to control in practice and impose an undue burden on the smallest businesses.

30. **Setting too low a threshold can significantly compromise the administration of a GST**. This, together with the remarkable degree to which the GST collection is usually concentrated among a relatively small number of taxpayers (for instance, in Jordan 67.7 percent of GST domestic revenues are collected by 2.0 percent of taxpayers and 91.2 percent of the SST collections in 2015 come from only 16 taxpayers). Thus, the limited administrative capacity in many developing countries, lends support to setting a relatively high threshold, which reduces the number of GST registered taxpayers to administer (Ebrill, L., and others, p. 123).

31. **The GST registration threshold for manufactures and traders in Jordan is in line with international comparators** (Tables 6 and 7). It is 8.8 times the GDP per-capita (adjusted by purchasing power parity, PPP), slightly higher than the average of countries of the region (8.2 times). However, the lowest two thresholds (JD 10,000 for manufacturers of goods subject to the SST and JD 30,000 for service industries) are comparatively low. The information which would be required to estimate an optimal level of threshold in Jordan is not available.[18]

32. **In Jordan, the number of taxpayers under the GST was only 23,314 in 2015.** This is a comparatively low number (countries with similar level of population and GDP usually have about 60,000 taxpayers). This is in part because the level of the GST threshold was high until 2015 (JD150,000 for traders). In determining the level of recommended threshold for Jordan, the mission considered (i) an appropriate balance between revenue loss and simplification, and, in particular, (ii) what is needed to restrict the number of taxpayers to fit some given (limited) administrative capacity. Thus, the mission is of the view that the best alternative is to have only one threshold of JD 75,000.[19]

[18] In Keen and Mintz (2004), an optimal threshold is calculated as that level, which equates the additional administrative and compliance costs incurred by a small reduction in the threshold with the benefit of additional tax revenues by using the following formula: (Marginal value of public money x Administration cost) + compliant cost) / (Marginal value of public money-1) x (VAT rate x ratio value-added to sales).

[19] The increasing of the lowest two thresholds would reduce the number of GST taxpayers (today 4.5 thousand taxpayers are registered under the GST with a gross income lower than 30,000). This measure would not have a significant impact on revenues.

Table 6. GST Threshold in Jordan and Middle East and Central Asia Countries

Country	Threshold in 2016			Number of Thresholds
	Local Currency	US$	To Percapita GDP PPP/1	
Jordan - under SST	10,000	14,104	1.2	
Jordan - services industries	30,000	42,313	3.5	
Jordan - manufactures/ traders	75,000	105,783	8.8	Three
Egypt	150,000	19,018		Three
Algeria	130,000	1,291	0.1	Two
Armenia	58,350,000	118,684	14.7	One
Azerbaijan	200,000	129,032	7.4	One
Georgia	100,000	41,051	4.5	One
Israel	99,006	25,336	0.8	One
Kazakhstan	59,460,000	168,609	7.0	One
Kyrgyzstan	4,000,000	51,416	15.5	One
Lebanon	150,000,000	99,502	5.7	One
Morocco	500,000	51,530	6.9	One
Pakistan	5,000,000	47,169	9.8	One
Tajikistan	500,000	58,530	21.8	One
Tunisia	100,000	47,996	4.2	One
Turkmenistan	No threshold			No
Uzbekistan	No threshold			No
Simple average without Jordan		66,090	8.2	
Simple average without Jordan e Israel		75,803	8.9	

1/ Power purchasing parity (current international).

Prepared by staff with data from IBFD and WEO.

F. Tax Period

33. **Taxpayers pay GST on a two-monthly on odd and even basis in Jordan**. Monthly tax period is the practice in most countries. The two-monthly installments lead to a delay in tax collection by the ISTD, relative to monthly installments. The mission estimates that if the tax period changes to a monthly basis only for large taxpayers, cash revenue collection would have a positive one-off impact of 0.8 percent of GDP.

G. Comprehensive Value-added Tax Expenditure Analysis

34. **Tax expenditure reviews are important instruments to identify possible options for revenue mobilization and improve the quality and transparency of tax systems.** When the cost of tax exemptions delivered through the tax system is not scrutinized to the same extent direct budgetary expenditures are, tax exemptions tend to escalate over time as government and the society lose sight of their costs. As part of the budgetary process, it is good policy that in addition to discussing direct public expenditures, such as subsidies, education spending, health care expenditures, defense, etc.; the tax expenditures granted through exemptions and special treatments are also discussed. Tax expenditures are usually less transparent and less visible in the budgetary process and they are not subject to the same scrutiny as ordinary public expenditures.

Table 7. GST Threshold in Jordan and Countries by Income

Average in:	Threshold 2016 US$	Threshold 2016 GDP per capita PPP
Developed Countries	47,838.9	1.4
Emerging Economies	29,133.5	2.6
Developing Countries	58,029.8	6.8
Middle East and Central Asia	75,802.6	8.9
Jordan - under SST	**14,104**	**1.2**
Jordan - services	**42,313.2**	**3.5**
Jordan - manufactures and traders	**105,783.0**	**8.8**

Source: Prepared by staff with data from WEO and IBFD.

35. **The USAID has estimated total tax expenditures to be 7 percent of GDP, of which 3.1 percent belongs to the GST** (see Heredia-Ortiz 2011 and 2013). Despite the high level of tax expenditure in Jordan, there is no institutional process in the Ministry of Finance (MoF) to carry out a periodic, comprehensive analysis. It is important that Jordan starts doing this on a regular basis, and that this be included as a special chapter in the annual budget. The 2013 FAD mission highlighted the several steps that are required for a successful launch of an annual report of tax expenditures and recommended the creation of a dedicated unit in the MoF) in charge of tax policy matters to undertake this task (FAD 2013 provides a comprehensive guidance on undertaking tax expenditure analysis). The current mission ratified this recommendation.

Recommendations

- Separate the GST revenue from the SST revenue in government statistics.
- Establish a single VAT registration threshold of JD 75,000.
- Reduce the number of the GST rates to one or at most two.
- Evaluate the cost of GST tax expenditures as part of a comprehensive tax expenditure analysis, prepared in a systematic and periodic manner with an annual report to be included as a separate chapter of the budget.
- Eliminate the GST zero-rate and maintain the exemptions for only a very narrow group of goods and services.
- Establish a monthly tax period for the GST and SST.

H. Special Sales Tax

36. **As explained in the introductory section, in consumption taxation, the widespread practice is to apply a GST supplemented by excises.** While GST is a multi-stage tax (best practice without exemptions and with only one rate), excises are single-stage taxes usually applied at the production stage. Normally the GST should apply to all goods and services, and

excises should apply to selected goods to reflect, in prices, the negative externalities that their consumption generates. This includes cigarettes, oil derivatives, and alcohol (the Pigouvian prescription, Pigou, A. C.,1918). While in Jordan both taxes function together as in they are collected and accounted jointly, in most countries they function separately.

37. **Jordan imposes the SST (excises) on 22 categories of goods with either negative externalities, ease of taxation characteristics, or which are consumed mostly by high-income groups** (Schedule 1 of the GST Law).[20] The SST revenue reached 3.45 percent of GDP in 2015, which is comparatively high –the average in OECD countries is 2.6 percent of GDP and in developing and emerging countries of Latin America 1.5 percent). This is partially due to the high rates and number of goods reached by the SST to compensate for the loss of revenue from the GST exemptions and reduced rates (that is to say, an attempt to solve a distortion with another distortion).[21]

38. **The SST and its revenue could also be improved, but not significantly**. SST revenue is comparatively high; however, the mission explored the possibility of increasing its collection, if the GST revenue cannot be improved enough. Although not as complex as the GST, the SST system could be simplified, for instance, by reducing the number of rates that apply on motor cars in a revenue positive reform (Table 8). Non-alcoholic beverages could be taxed. Several countries have been successful in introducing taxes on sugar-based beverages and Jordan could follow this initiative. Taking into account the performance of this tax in other countries, the mission estimates that a 20 percent tax on soft drinks could yield in Jordan about 0.07 percent of GDP.[22]

39. **Oil and tobacco and their derivatives are always goods to consider in any revenue mobilization analysis** (mainly because the high negative externalities associated with them). The main constraint to raising the rate of these taxes is the recent increases. The fixed rate on cigarettes (JD 0.47 per packet) has been raised several times in the last three years (the last time on June 2015 from JD 0.42 to JD 0.47). However, taking into account how harmful cigarettes are

[20] Oil and its derivatives are exempted from the GST and taxed with the SST and excises (they are the only group of goods taxed with excises). The rates of the SST are: 18 percent for gasoline with 90 octanes; 24 percent for gasoline with 95 octanes; and 6 percent for the rest of the derivatives. In addition, oil derivatives are also taxed with excises at the following rates: gasoline: JD 75/ton; Kerosene: JD 75/ton; Diesel: JD 25/ton (yielding 0.61 percent of GDP in 2015).

[21] Tax expenditure was estimated in 1.1 for oil derivatives in USAID 2013 (for the rest of goods, 0.6 JD million, less than 0.01 percent of GDP: main exemptions come from the Investment Promotion Law, the Council of Ministers, and the Free Zones Law).

[22] Recent reviews of the literature indicate that a tax on sugar sweetened beverages may be a promising policy tool to address rising obesity prevalence and that price increases from a 20 percent tax may result in an average reduction greater than 30 kilojoules per person per day across populations in most middle income countries (Nakhimovsky, 2016).

to health the authorities should consider increasing the rate to at least JD 0.52 if the GST revenue does not improve enough (additional actions to control smuggling should be considered).[23]

40. Regarding oil products, the price of diesel, gasoline, and kerosene was increased by JD 0.0025 per liter in June 2016. However, and also if other measures are not taken to improve the fiscal stance, the government should consider excise rate increases on these goods again; in particular, taking into account: (i) the reduction of the price of oil in the last two years (which was passed-on to gasoline and diesel prices); (ii) the level of oil smuggling that is also under control (according to customs administration staff); and (iii) the rates are below the optimal level for a corrective tax[24]. The first product to consider should be diesel, which generates higher negative externalities than gasoline (the mission estimated that the increase of the SST rate on diesel from 6 to 20 percent would yield 0.1 percent of GDP).[25]

Table 8. SST Proposed Changes

Current Situation or Proposal	Proposed Rate	Impact on Revenue % of GDP
Cigarettes Pack of (20) cigarettes JD 0.47	0.52	0.10
Motor cars actually taxed at 16%; 25%; 40%.	35%	0.07
Soft drinks taxed at 0%	20%	0.05
Fuel derivatives taxed at 6% (diesel is more harmful)	20%	0.10
		0.32

Source: prepared by the mission with data from the MOF.

Recommendations

- Increase the SST rate on soft drinks from 0 to 20 percent.
- Simplify the motor rate structure in a revenue positive reform (unify the 16; 25; and 40 percent rates into only one rate of 35 percent).
- Consider increasing the rate on cigarettes to 0.52 cents per package and the SST on oil derivatives from 6 to 20 percent if other measures of the report are not implemented.
- Eliminate the GST exemption of oil and derivatives and reduce the rate of the SST with a positive impact on revenue of about 0.2 percent of GDP.

[23] The SST rates on tobacco and cigarettes should be reviewed to align them with those of customs duties (see next chapter).

[24] US$0.34 per liter of gasoline and US$0.31 per liter of diesel according to FAD estimates (see Parry et al 2015, pages 139–145).

[25] When considering increases to the SST on oil and derivative, consideration should be given to the fact that the burden on these products will increase if the exemption from the GST is phased-out.

II. CUSTOMS DUTIES

41. **This chapter deals with policy aspects of customs duties.** Its objective is to review tariffs, their revenue, exemptions, and duty relief regimes, and to analyze the feasibility of simplifying the system. The chapter also includes a brief introductory section describing the general principles under which a tariff system should be designed.

A. General Principles for the Design of a Tariff System

Tariffs as an Instrument of Protection

42. **Customs duties increase the domestic prices of goods on which they are imposed**. This effect of inward looking price protection, which benefits domestic producers of such goods, is the primary and main objective of tariffs. Thus, import-substitute industries benefit while consumers, exporters, and producers of non-tradable goods are adversely affected. As tariffs are levied on imports but not on domestically-produced goods, tariffs introduce a distortion driving the domestic allocation of resources to those activities with higher tariffs. The higher the number and level of tariffs the higher the misallocation of resources will be. Therefore, the number of tariffs should be low enough to avoid significant distortions. As resources tend to shift away from the production of exports, several countries (including Jordan) attempt to mitigate this effect by applying different mechanisms to relieve duties on imports used as intermediate inputs for the production of exports. Thus, some goods will or will not be taxed with customs duties depending on their final use. This generates many problems for customs control, in particular in developing countries with weak administrations, given the difficulty of verifying the final use of imports.

Trade Liberalization

43. **Trade liberalization means higher real income for citizens through access to a wider variety of goods and services at a lower price**. The optimal level of tariffs is obtained by offsetting benefits (industry protection and revenue) with economic social costs (misallocation of resources). Trade liberalization, which implies the reduction of tariff protection and other means, does not necessarily mean loss of revenue. Revenue may increase when trade liberalization comes with an improvement in customs procedures (Keen and Simone, 2004). Moreover, on many occasions, the reduction in tariffs comes along with compensatory measures and revenue does not go down, at least abruptly so. In the medium term, it is expected that collections increase with more revenue from GST and enhanced economic activity.

Tariffs as an Instrument to Mobilize Revenues

44. **Tariffs are also an instrument to raise government revenues**. In Middle East and North Africa (MENA) non-resource countries, customs duties revenues reached in average 1.7

percent of GDP in 2014.[26] However, the revenue-raising objective is better served by general taxes (such as the GST) that apply equally to domestic and imported goods and do not introduce distortions. Thus, a common feature of modern, efficient, and equitable tax systems is to use tariffs as an instrument of protectionism and general and neutral taxes as a means to obtain higher levels of revenue.

Simplicity and Transparency

45. A tariff system should be simple and transparent with uniform tariff rates. Tariff rates should be as uniform as possible, with little dispersion. Transparency of rates, customs procedures, and exemptions are crucial components of a tariff system. Transparent rules are needed to avoid misclassifications of goods and enhanced corruption. Nontransparent rules can increase the cost of business and create uncertainty and obstacles to trade. Simplicity of customs rules is not only a requisite for transparency but also for minimizing both the costs of complying and customs administration. Some features of a simple tariff system include but are not restricted to:

- Clear regulations and procedures;
- A small number of nominal tariff rates, without differentiation in the same categories of goods. A large number of rates provides opportunities for traders to misclassify imports into lower rate categories;
- Only a few, well-defined and controlled exemptions and duty relief schemes; a large number of exemptions could create scope for abuse and fraud, particularly those related to the final destination of goods after their nationalization.

B. The Jordanian Tariff System

Revenue

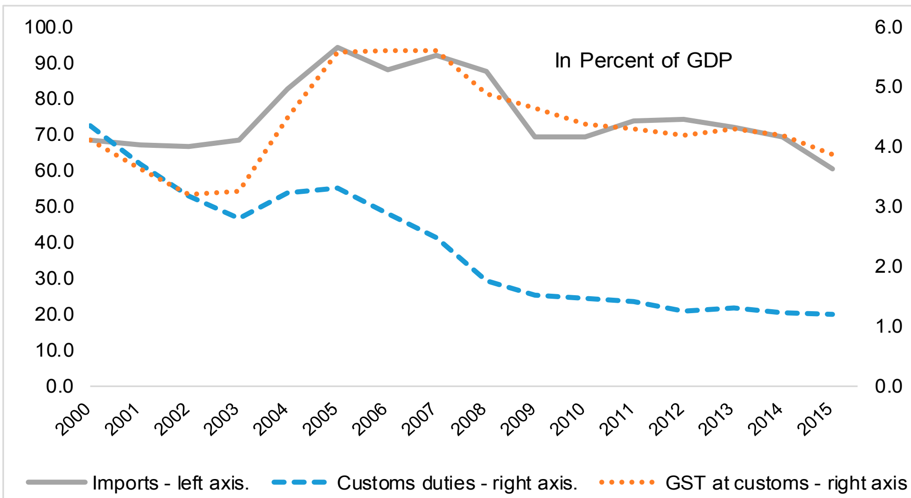
46. Jordan tariff revenues dropped from 4.3 percent of GDP to 1.2 percent between 2000 and 2015. This was mainly due to the decline of imports, the granting of exemptions, and the reduction in tariff rates (Figure 3). Following Jordan's World Trade Organization (WTO) agreement and other bilateral and multilateral free trade agreements (FTAs), the Government has progressively reduced tariff rates. As most of these agreements have already gone into effect, the decrease in the level of customs duties revenues due to FTAs will not be as significant in the coming years.

[26] In MENA countries, tariffs generated revenues, which were important to government budgets, and hard to replace when governments liberalized trade, either unilaterally or by entering into free trade agreements. Customs duties decreased significantly in MENA non-resource countries between 1990 and 2012 with reductions ranging from 2.5 percent of GDP in Tunisia to 9.4 percent in Egypt and Lebanon (Mansour, 2015).

Tariff Structure and Exemptions

47. This section reviews the current tariff structure and exemptions in Jordan to assess them against the principles analyzed in the previous section. The current Jordanian tariff structure is based on the international harmonized system (HS) of 1996, commodity description and coding system at the eleven-digit level with 5,500 different tariff lines or subheadings used in recording imports (Table 9).[27] The ad-valorem tariff rate structure in 2015 includes 16 Most Favored Nation (MFN)[28] rates ranging from 0 to 200 percent with an effective rate of 2.6 percent (defined as revenue collection as percent of imports of goods, excluding imports of services).

Figure 4. Jordan: Imports, Customs Duties, and GST at Customs



Source: Prepared by the mission with data from WEO and Ministry of Finance.

48. The Jordanian tariff system is complex, which derives from:

- The number of nominal rates (26 bound and 16 MFN)[29], which makes it easier for traders to misclassify imports into lower rate categories.

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[27] The number of most favored nation applied tariff lines is 7,673; the rate for 2,273 lines have not been yet defined.

[28] The MFN principle, which is included in the General Agreement on Tariffs and Trade (GATT), stipulates that countries should not discriminate between trading partners' goods; concessions accorded to one country's goods should be granted to the rest of the countries (no—discrimination). Article XXIV of the GATT allows departures from the MFN principle in regional and bilateral free trade agreements, provided these preferential (and discriminatory) agreements cover substantially all trade between the parties.

[29] According to Art. II of the GATT, each country shall accord to the commerce of the other contracting countries treatment no less favorable than that provided for in the appropriate Part of the Schedule annexed to this Agreement, which included the bound rates, usually higher than the rates the countries apply.

Table 9. Jordan: Tariff Rates

Number	MFN Rate	Tariff codes of 11 digit to which the rate applies	Percent of Total	Among others:
1	0	2814	51.2	Devices (systems) irrigation for agriculture;
2	5	315	5.7	Power generation systems using wind power parts; Gas turbines other parts; Of tungsten wires; Bars railways and trams of iron or steel
3	6.5	1	0.0	Grease and fat poultry birds extract, fresh, chilled;
4	7	201	3.7	Machinery components; solvents
5	10	266	4.8	Circular saws blade; pipes; tubes;
6	15	41	0.7	Parts and accessories for machines.
7	20	951	17.3	Parts and accessories for machines
8	25	54	1.0	Food other than staple.
9	30	815	14.8	Electrical and non electrical wires and cables plaited, twisted.
10	35	6	0.1	Orange and orange juice for certain period of the year.
11	40	1	0.0	Alcoholic preparations used in the beverage industry
12	45	5	0.1	Tobacco imported by factories as inputs to production
13	75	1	0.0	Tobacco smoking, though contained tobacco substitutes as an input to the production of the cigarette industry
14	150	17	0.3	Cigarettes containing tobacco substitutes (for domestic consumption); smoking tobacco that contained tobacco substitutes in any proportion.
15	180	1	0.0	Whisky least alcohol-gauge where about 80% by volume.
16	200	11	0.2	Other alcoholic beverages.
Total		5,500	100.0	

Source: prepared by the mission with data from Jordan Customs.

- The large number of exemptions (more than a half of the tariff lines, Table 9), which are always an area where customs are vulnerable to abuse, and reduced rates. Exemptions and reduced rates come from:

  - Special schemes with the aim of ensuring that goods in transit and those that will be exported or used as inputs of exports are free from tax.[30] These kinds of regimes require specific rules, and customs controls for the temporary entry of goods and enforces payments when the destination of such goods changes to the domestic market. Jordan has several free trade zones at Aqaba, Zarka, Dar'a on the Syrian border, Sahab, Al-Karak, Al-Karama and Queen Alia International Airport.

  - Trade agreements: Jordan has signed seven free trade agreements,[31] which granted zero rate for most goods imported from these countries (this means that there is no room for reduction of exemptions for goods that come from these countries).

[30] Countries have established different types of duty relief regimes; the most common are temporary admission regimes, drawback (customs duties refund), free trade areas (or free trade zones) and bonded manufacturing warehouses.

[31] (1) The Greater Arab Free Trade Area with 17 Arab countries under the Greater Arab Free Trade Agreement; (2) Jordan - EU Association Agreement, in addition to the Agadir Agreement between Egypt, Jordan, Morocco and Tunisia which aims at supporting further integration between these states and the Europe Union; (3) Jordan – U.S. FTA; (4) Jordan - Norway, Switzerland, Iceland and Liechtenstein under the European Free Trade Association (EFTA); (5) Jordan - Singapore Free Trade Agreement; (6), Jordan - Canada FTA; (7) Jordan - Turkey FTA. The coefficient of variation is the result of dividing the standard deviation of tariff line duty rates by the simple tariff line level average of all duty rates).

Table 10. Jordan: Tariff Structure, 2015

Chapter	Description	Most Favored Nation Rates					
		Number	Values	Min	Max	Mean	Standard Deviation
	Live animals and animal products.						
1 to 4	Live animals	7	0;3;5;10;20;25;30	0	30	13.3	11.7
5 to 15	Meat; fish, honey, eggs, coffee, cereals, oleaginous, fruits.	8	0; 5; 10; 15; 20; 25; 30; 35	0	35	17.5	12.2
	Prepared food, beverages						
16 to 21	Prepared food: cocoa and chocolates; cereals flour; fruits	7	0; 10; 15; 20; 25; 30; 40	0	40	20.0	13.2
22	Beverages, spirits, and vinegar	5	0;20;30;180; 200	0	200	86.0	95.8
23	Residues from food	5	0; 5; 10; 20; 30	0	30	13.0	12.0
	Tobacco; mineral products						
24 to 25	Tobacco; salt, sulfurs, stones	6		4	150	67.5	63.0
26	Ores, lag and ash	2		0	5	2.5	3.5
27	Mineral fuel	6	0; 5; 10; 20; 30	0	30	13.0	12.0
28	Products for chemical industries	2	0; 5	2	5	2.5	3.5
	Organic Chemicals						
29	Hydrocarbons, alcohols, and their halogenated; phenols	0	0	0	0	0.0	0.0
30	Pharmaceutical products;	2	0; 7	0	7	3.5	4.9
31	Fertilizers	4	0; 5; 20; 30	0	30	13.8	13.8
32 to 34	Coloring matter; cosmetic, perfumery and soap	4	0; 5; 7; 30	0	30	10.5	13.3
35	Albuminoidal substances, enzymes	4	0; 7; 30	0	30	11.7	16.1
36	Explosive, pyrotechnic	2	0; 7	0	7	3.5	4.9
37	Photographic; cinematographic and plastics goods	2	0; 7	0	7	3.5	4.9
38	Miscellaneous chemical products	5	0; 5; 7; 10; 20	0	20	8.4	7.4
39 to 40	Plastic, rubber and articles thereof	6	0; 5; 7; 10; 15;20	0	20	9.5	7.2
	Skins, leather and art. thereof						
41 to 42	Raw hides, skins, leather	4	0; 5; 10; 30	0	30	11.3	13.1
43	Fur skins and artificial fur	3	10; 20; 30	10	30	20.0	10.0
44 to 49	Wood, cork, straw, pulp, paper, printer books	7	0; 5; 10; 15; 20; 25; 30	0	30	15	10.8
50 to 56	Silk, wool; horsehair; cotton; textile fibers; man-made filaments and staples fibers; wadding;	4	0; 5; 10;20	0	20	8.8	8.5
57 to 63	Carpets; knitted of crocheted fabrics; clothing accessories.	5	0; 5; 10; 15; 20	0	20	10.0	7.9
64 - 73	Head gear, umbrellas, walking-sticks	6	0; 5; 10; 20; 25; 30	0	30	13.3	10.8
74 - 83	Cooper, nickel, lead, miscellaneous art of base metal, footwear, umbrellas, walking-sticks, etc.	7	0; 5; 10; 15; 20; 25; 30	0 4	30	15.0	10.8
84 - 85	Machinery, electrical equipment, televisions and reproducers, and Vehicles, railways, ships, aircrafts, musical inst., furniture	6	0; 5; 10; 15; 20; 30	0	30	13.3	10.8
	Total	16				16.2	65.1

Source: staff calculations from data provided by Customs authorities.

- Exemptions and reduced tariffs granted also by the Custom Law, the Investment Law, the Council of Ministers, or the free trade zones for several sectors for imported capital goods (see next chapter).

- The level of dispersion of nominal and effective rates. While the mission estimates the standard deviation from the mean of the unweighted nominal MFN rate is 65.1 for 2015

(Table 10), the World Trade Organization (WTO, 2015) estimated the coefficient of variation is 145 (Table 11). This mainly reflects the large number of exemptions and the tariff peaks for two groups of products: cigarettes and beverages. Dispersion is also high within broad categories of products. After tobacco and alcoholic beverages, prepared food has the greatest tariff (with particularly high rates of up to 200 percent for some products in the category of beverages, spirits, and special type of tobacco).

49. Despite a wide tariff rate structure, some Jordanian tariffs apply only to very few goods. Three rates apply to only one line (Table 9): (i) the 40 percent rate applies only to alcoholic preparations use in the beverage industry; (ii) the 75 percent rate applies only on some kind of tobacco used as an input to the production of the cigarette industry; and the 180 percent applies only on certain kind of whisky. Other rates, such as the 5 percent one apply to only a few lines. This shows that the number of rates could be reduced and the system simplified.

Table 11. Tariff Rates in Selected Countries of the Region

	Simple Average Rate		Maximum Rate		Number of Rates		Coefficient of Variation		Revenue % of Imports of Goods
	Bound	MFN	Bound	MFN	Bound	MFN	Bound	MFN	
Algeria		18.8		30.0		4.0		56.0	5.0
Armenia	8.5	3.7	15.0	10.0	9.0	3.0	83.0	116.0	3.8
Jordan	**16.2**	**10.2**	**200.0**	**200.0**	**26.0**	**16.0**	**92.0**	**145.0**	**2.6**
Kyrgyz Republic	7.5	4.6	141.0	132.0	50.0	22.0	72.0	111.0	4.9
Lebanon		5.7		326.0		161.0		204.0	3.4
Morocco	41.3	11.2	289.0	200.0	48.0	19.0	56.0	143.0	3.5
Tajikistan	8.1	7.7	278.0	278.0	184.0	30.0	84.0	78.0	3.4
United Arab Emirates	14.4	4.7	200.0	200.0	11.0	9.0	116.0	136.0	1.0
Average without Jordan	**13.3**	**6.5**	**153.8**	**122.0**	**50.3**	**29.9**	**68.5**	**88.5**	**3.0**

Source: prepared by staff with data from WTO 2015.

50. The high nominal tariffs in Jordan are not reflected in high collections by international comparison. While the MFN weighted average rate was 10.2 percent in 2014 Table 11), revenue collection reached only 2.6 percent of the value imports of goods (Table 12).[32] This shows the erosive impact of the large number of exemptions and preferential concessions, including those from FTAs. Broadening the base of the tariff will remove distortions and raise revenue or alternatively permit a reduction in the other tariffs. This will also reduce the dispersion in tariff rates, which will help to simplify the system and facilitates its control.

C. Toward a Simpler Tariff System

51. A first best option includes a revenue-neutral reform on customs duties to reduce the number of rates with an improvement of revenue from the GST.[33] This implies

[32] Revenue as percent of imports of goods is a better proxy of the customs duties effective rate than revenue as percent of total imports (which includes imports of services out of the scope of customs duties).

[33] As explained in the introductory section of this chapter, the revenue-raising objective of consumption taxes is better served by general taxes that apply equally to domestic and imported goods without distortions (such as the GST).

simplifying the tariff structure; reducing the number of rates and the high dispersion among them; and phasing-out exemptions (except: goods that come from FTA countries, are incorporated on exports, or for basic necessities, for instance, medicines). However, if revenues from the GST and the SST cannot be improved enough (by about 3 percent of GDP), a second best alternative should be to consider increasing customs duties revenues (the amount would depend on the extent to which GST and SST revenues could be increased).[34]

Table 12. Jordan: The Impact of Trade Agreements and Exemptions

Treatment	2014 - Imports		Revenue
	% of Total	JD Million	JD Million
FTAs	19.5	2,396.9	
Exemptions	56.4	6,926.2	
Oil and derivatives	12.4	1,520.4	
Regular MFN rates	11.7	1,439.0	302.9
Total	100.0	12,282.5	316.0
MFN weighted-average rate			21.0
Trade weighted average effective rate			2.6

Source: prepared by staff with data from Jordan Customs, 2014

52. The mission simulated different scenarios for a tariff reform using customs information for 2014. Tobacco, cigarettes, and alcohol are considered separately (like most countries, Jordan imposes a high burden on these goods with negative externalities and public health issues). A first revenue-neutral scenario maximizes simplification by having a single tariff rate of 3.2 percent. This rate would apply on all imports (including oil and derivatives) that do not come from FTA countries.[35] However, this would mean an abrupt reduction in the tariff for several products (among them, tobacco, cigarettes, and alcoholic beverages, Table 9); taxing inputs of exports; and, probably, an increase of the tariff for several goods over the bounded rates.[36] To avoid these problems, Jordan could adopt a simpler structure, such as that in Table 13, as a transitional regime:

- Six nominal MFN rates instead of the current sixteen, which include three rates 45; 75; and 200 for tobacco, cigarettes, and alcoholic beverages (if the treatment of these products does not change in accordance with recommendations in paragraph 52); and 5; 15; and 30 percent

[34] In the medium term, after simplifying the tariff system and improving the GST, Jordan could reduce even more the level of tariff rates according to a clearly specified timetable (which is consistent with growth-oriented trade liberalization).

[35] The rate would be 4 percent if it would not apply to oil and its derivatives.

[36] Only a few countries in the world, Hong-Kong, Macao, and East Timor, have only one rate.

for the rest of the goods. This combination would yield 0.19 percent of GDP (Table 13);[37] the increase in revenue would be only 0.26 if the 30 percent rate increases to 35 percent.

Table 13. Jordan: Option for Tariff Reform

Rate	In millions of JD				Additional Revenue	
	Current Situation		Proposal			
	Revenue	Imports	Rate	Revenue	JD	% of GDP
0 FTA	0.0	2,975.2				
0 other than FTA	0.0	7,119.0	3 (1)	116.6	116.6	0.44
Subtotal	0.0	10,094.2		116.6		
Pref FTA	11.2	113.4	Pref FTA	11.2		
5	2.1	41.1	5	2.1		
6.5	5.0	77.3	5	3.9		
10	5.4	53.7	15	8.1		
15	16.8	112.2	15	16.8		
20	93.1	465.3	30	139.6		
25	14.9	59.6	30	17.9		
30	117.1	390.4	30	117.1		
35	0.1	0.4	30	0.1		
40	0.0	0.0	30	0.0		
Subtotal	265.7	1,313.4		316.7	51.0	0.19
45	10.4	23.1	45	10.39		
50	0.0	0.0	45	0.01		
75	9.8	13.1	75	9.80		
150	3.2	2.1	200	4.22		
180	2.4	1.3	200	2.61		
200	3.1	1.6	200	3.12		
	28.8	41.2		30.2	1.3	0.00
Others	2.2	2.2		2.2		
Total	296.7	11,451.0		465.7	169.0	0.63

(1) The 3% rate applies on exemptions other than FTA; re-exports; inputs of exoports; and JD 700 million for medicines and basic goods.
Source: Prepared by the mission with data from customs.

- Taxing exempted goods (except those that come from FTA countries, used as inputs for exports, including capital goods, re-exports, and goods for basic needs, such as medicines and some foods) at 3 percent: this would yield 0.44 percent of GDP (at a rate of 6 percent

[37] In undertaking these simulations, the mission assumes no behavioral reactions from importers and consumers. They are static analyses that do not consider the elasticity of trade to tariff rates. Thus, the report assumes that import levels are not affected by tariff changes. Therefore, the estimations do not include the likely expansion of the demand for imports as a consequence of a rate reduction, as well as they do not consider the probable decline of this demand when rates increase. Since the analysis is static, it does not include the possible increase in revenue from other taxes due to the ensuing simplification and better allocation of resources.

revenue from eliminating these exemptions would be 0.90 percent of GDP and total increase of customs duties about 1.06 percent of GDP; see Appendix 2).[38]

- Restrict exemptions to those required by international agreements (diplomats), social objectives (NGOs and food), and special schemes for exporters.

Recommendations

- Reduce the number of MFN rates from sixteen to six (three for tobacco and alcohol and four for the rest) in a revenue-neutral reform with the aim of simplifying the tariff system.
- If GST and SST revenue cannot be increased by 3 percent of GDP:
  - Slightly increase the tariff rates to raise revenue by 0.19 percent of GDP as estimated in this report.
  - Tax exempted goods, except those that come from countries with FTAs, used as inputs for exports (including capital goods), re-exports, and goods for basic needs (such as medicines) at 3 percent (estimated impact 0.44 percent of GDP).

[38] The mission did not receive detailed information of imports (line by line according the eleven digits of the HS system with the MFN and the bound rates) to verify that level of the rates using in the simulation were higher than the bounded rates. This is unlikely to happen with most of the goods, in particular those exempted today and the mission proposed to tax at 3 percent. In all cases, the rates should increase in all cases until the bound level.

III. TAX INCENTIVES FOR INVESTMENT

53. **This section discusses tax incentives designed to promote investment in Jordan**. In order to better understand what this includes, as well as what it leaves out, it is useful to briefly review the various concepts associated with incentives. Below are brief definitions of tax incentives (within and outside core tax laws), investment incentives (tax and non-tax), and tax expenditures.

54. **Tax incentives are any special tax provisions granted to qualified investment projects or firms that provide favorable deviations from the general tax code**. They can take several forms such as tax holidays (complete exemption from tax), preferential tax rates in certain regions, sectors, for certain asset types, or targeted allowances (tax deductions or tax credits) for certain investment expenditures.

55. **Tax incentives can be further distinguished based on whether they are provided in the core tax laws or in special purpose non-tax laws**. For clarity we refer to tax incentives provided though special provisions in the core tax laws – Income Tax Law, GST Law, Customs Law, etc.– as tax law tax incentives, and to tax incentives provided in non-tax laws –Special Economic Zones Law, Investment Law, Development Zones Law, etc.– as non-tax law tax incentives.

56. **Tax expenditures are public expenditures delivered through the tax system**. The notion of expenditure implies a measurement of benefits provided through the tax system. This is generally achieved by defining tax measures that are considered to be departures from a benchmark tax system. Most departures from the benchmark system provide a reduction in tax compared to the benchmark and thus a benefit to the recipient and a corresponding cost to the government, that is, an expenditure. It is worth noting that departures that provide a less favorable treatment than the benchmark (for example a higher tax rate than the benchmark rate) result in a gain of revenue for the government or a negative tax expenditure.

A. Advantages and Disadvantages

57. **Governments often view tax incentives as a means to generate economic activity in sectors or regions identified as priorities**. Decisions to introduce and maintain tax incentives are also often motivated by competition considerations (if neighboring countries offer such incentives, not offering them may place the country at a competitive disadvantage). Tax incentives are also politically attractive. There is the perception that tax incentives are useful to kick start activity in a way that is easily visible to all. By their very nature, targeted tax incentives more easily meet demands of lobbies that are more focused on their own needs as opposed to policies that are designed to benefit the majority of economic agents.

58. **The cost of tax incentives is misunderstood.** There is a belief that the cost of incentives is illusory and that revenue foregone from an activity that would not have taken place without

the incentive is not really a cost or, where there is an acknowledgement that the measures entail a cost, that the direct and indirect incremental activities created, more than compensate for the cost of the incentive measure.

59. The potential drawbacks of tax incentives are well known:

- Tax incentives involve a loss of current and future revenues, which means that either taxes must be higher on other activities, or other spending reduced, or government borrowing increased.

- Tax incentives create opportunities for tax abuse and corruption. For example, through transfer pricing between related parties to ensure profits are made in exempt or low-taxed enterprises belonging to the same group.

- Regional incentives raise similar issues but can be justified for redistributive objectives, especially if sectoral incentives artificially direct economic activity. If they do not correct or address a market deficiency (such as the presence of externalities), they provide distorted information to economic agents with respect to the profitability of various economic endeavors. Where such incentives are permanent, they potentially lead to production choices that negatively impact the overall economic performance. Where they are provided over short time frames, they require costly reallocation of resources. It is, however, generally accepted that direct assistance to regions is more efficient than tax incentives.

- Export incentives raise trade issues. Tax incentives that result in a reduction of direct taxes on the basis of exports are substantially, similar to export subsidies could be in contravention of WTO rules.

- Tax holidays are one of the least desirable forms of tax incentive. Even when successful in attracting investment, their advantages erode over time as incentives are duplicated by other countries, often in the same region, and as taxpayers learn to arrange their businesses to extend the benefits of tax incentives (without generating incremental investment). Tax holidays also facilitates arbitrage and avoidance schemes. They tend to attract short-term "footloose" projects that quickly become profitable (to maximize the benefits from the holiday) and can easily be relocated when holidays expire.

- Tax incentives tend to be redundant; investments would be undertaken without tax incentives (see surveys below).

60. Tax incentives schemes are generally not very effective at attracting investment. Reviewing empirical evidence best assesses the relative merits of the positions of proponents of tax incentives and those advocating a more neutral tax policy approach. Since such empirical analysis is not available with respect to tax incentives in Jordan, information can be obtained from empirical evidence from other countries. The conclusions that can be drawn from such studies is although tax incentives may stimulate investment, the overall economic characteristics of the country, that is, its political stability, legal and regulatory frameworks, the quality of its infrastructures and labor, the stability of the macroeconomic environment, and the overall transparency of the tax law and administration are more important in attracting investment.[39]

61. **Surveys show most investors would have undertaken investments without tax incentives**. In a 2013 study on the impact of investment tax and non-tax incentives (James, 2014), the World Bank Group reported that 70 percent the investors surveyed in Jordan would have undertaken their investment without incentives and only 28 percent indicated that incentives influenced the level or their investments. The same report indicated that investors did not list incentives (tax or non-tax) as one of the most important factor influencing the decision to invest. The three most important factors cited by investors in Jordan were the investment climate,[40] the political stability and security, and the domestic market.

62. **A simple, transparent and stable tax system with few incentives and low tax rates is the best approach to attract investment in an effective manner**. Where tax incentives are used, they should be simple, transparent, broadly based and have the following characteristics:

- Target at the type of activity intended to be incentivized, for example, by placing greater emphasis on cost-based incentives (e.g., reducing the cost of investment) rather than profit-based ones.
- Contain as few regional and sectoral incentives as possible that only address exceptional situations.
- If used at all, income tax reductions should be limited to a short duration with no possible extension.
- No income tax holiday should be used in any preference scheme.
- No incentive related to value added taxation (GST in Jordan) should be provided in any preference scheme. Specific treatments should follow the principles of GST. Therefore, only exports and long-term investment projects should be exempted and to avoid relief schemes.[41]
- Incentive measures, as any other tax exemption, should be consolidated in tax laws.

[39] See, for example, Zee, Stotsky, and Ley (2002).

[40] Includes ease of import and export, availability of local suppliers, regulatory framework, adequate infrastructure, and the country's geographic position.

[41] Several countries have established duty relief regimes at customs with the aim of ensuring that goods in transit and those that will be exported or used as inputs of exports are free from tax. There are different types of duty relief regimes. The most common are temporary admission regimes, drawback, free trade areas, and bonded manufacturing warehouses. These kinds of regimes require specific rules, and customs controls regarding the temporary entry of goods and mechanisms to enforce payments when the destination of such goods changes to the domestic market.

- The ultimate and sole authority to enact or modify tax incentives should be with the Minister of Finance with adequate mechanisms to ensure interdepartmental consultations.
- There should be little or no discretion in the granting of tax incentives.
- The costs and benefits of an incentive scheme should be assessed ex-ante and ex-post, based on clearly stated assumptions and methodologies, and the assessments published on a regular basis (see discussion on tax expenditures below).

B. Tax Incentives in Jordan

63. This section discusses tax incentives for investments in Jordan and more specifically it focuses on non-tax law tax incentives.[42] Most investment incentives in Jordan that are not delivered through the core tax laws are contained in the Investment Law of 2014 (JIL). The Jordan Investment Law (JIL) resulted from the amalgamation of several previous laws that provided investment incentives, namely: The Investment Promotion Law No. 16 of 1995; the Investment Law No. 68 of 2003; the Development Zones and Free Zones Law No. 2 of 2008; the provisional Investment Promotion Law No. 67 of 2003; and the Development of the Investment Environment and Economic Activities Law No. 71 of 2003. These laws as well as some articles of the Economic Projects Development Law No. 71 of 2003 and the Industry and Trade Law No. 18 of 1998 were repealed with the introduction of the JIL.

64. Other laws provide tax incentives for investment, such as the Aqaba Special Economic Zone Law (ASEZ). There are also numerous other laws containing incentives but not necessarily investment incentives. These laws, which generally have a narrow application and are not necessarily aimed at incentivizing investment, are also not covered as they mostly are outside the scope of this report. These will not be discussed in this report. The mission decided to focus on the range of legal instruments that provide for tax incentives for investment given the expressed desire of the authorities to address tax preferences with a view to mobilize tax revenues.

65. The JIL incorporates three distinct sets of tax incentives for investment. Specific tax incentives are provided for some activities outside Free Zones and Development Zones; within Development Zones; and Free Zones. The JIL (Article 8) also stipulates that upon recommendation of the Investment Council, the Cabinet may grant any additional advantages, exemptions, or incentives to any economic activities, including small and medium enterprises, or any economic activities in a specific geographic area in the Kingdom, provided that the decision determine the conditions and procedures of their grant and to be published in the Official Gazette. The JIL (Article 9) also specifically grandfathers tax incentives obtained previously and

[42] Preferential treatments contained in the GST Law and the Customs Law were covered in the two previous chapters of this report.

also limits the ability to add-on tax incentives available under the JIL to previously obtained tax incentives.

66. For the purpose of the JIL, activities outside Development Zones and Free Zones are defined as follows:

- *Activities outside Development Zones and Free Zone eligible for tax incentives* include activities that transform materials into new products, lead to a change in the sub-tariff item in the harmonized customs system, or result in the value added specified under the existing legislation. Also eligible tax incentives are goods used in the activities that include agriculture and livestock, hospitals and specialized medical centers, hotels and tourist facilities, entertainment and tourist recreation facilities, call centers, scientific research centers and laboratories, artistic and media production, conference and exhibition centers, transport and/or distribution and/or extraction of water, gas and oil derivatives by using pipelines, air transport, sea transport and railways.

- *Development Zone*: Any area falling within the customs territory of the Kingdom declared as a Development Zone pursuant to the provisions of the JIL. There are currently 6 Development Zones under the authority of the Jordan Investment Commission (JIC) in Jordan. There are also numerous private or semi-public industrial zones corporations, which the JIC does not have full authority to oversee.

- *Free Zone*: Part of the Kingdom's territories that are defined and fenced by a separating barrier designated for the practice of economic and commercial activities including the storage of commodities. Free Zones shall be considered to be outside the customs range and the commodities and economic activities therein shall be treated for the purposes of implementation the provisions of the JIL as being outside the Kingdom. There are currently 8 public Free Zones in Jordan and approximately 30 private ones.

67. The ASEZ Law No. 32 of 2007 provides incentives to businesses registered within the ASEZ. The ASEZ is deemed a territory outside the perimeter of the Jordanian Customs territory and is not subject to customs legislation except as otherwise stipulated under the law. Goods manufactured in the ASEZ that have been transported into other parts of Jordan are treated as domestic products. No custom duties are levied and a reduced income tax rate of 5 percent applies except for the following sources of income, which are exempt from income tax: profits generated from capital; profits generated from the sale and purchase of land, real estate, shares and bonds; income from agricultural, gardening and afforestation investment in land; income generated from investments in poultry, cattle, fish or the breeding of bees; income generated from products manufactured by manual labor; and income generated from a concession or agreement granted by the government, which has been exempted under the terms of the concession or agreement.

68. Discretionary tax incentives for investment are also prevalent in Jordan. The Council of Ministers has discretionary powers to grant tax relief that are provided in many tax and non-tax laws. The Council of Ministers' members include officials from the MoF, the Customs Department, the ISTD, the Ministry of Industry, the Ministry of Planning, and others.

Table 14. Tax Incentives under the Investment Law of 2014

	Custom Duties	General Sales Tax	Income Tax
Development Zones	Exempt (most goods)	Zero-rated (goods) 7% (sevices offed in Zone)	5% on profits
Free Zones		Zero-rated (goods) Zero-rated (sevices offed in Zone)	0% on profits 0% income tax on foreign workers
Other Activities listed in*			
Schedule 1/A	Exempt	Zero-rated (production inputs)	
Schedules 1/B, 1/C, 1/D	Exempt	Zero-rated (production inputs, production requirements and fixed assets)	
Schedule 2	Exempt	Zero-rated (services)	
Schedule 3**	Exempt	Zero-rated (production goods)	
Investments in less developed areas* **			
Group A			100% reduction of tax for 20 to 30 years
Group B			80% reduction of tax for 20 to 30 years
Group C			60% reduction of tax for 20 to 30 years
Group D			40% reduction of tax for 20 to 30 years
Tourism industry******	Exempt	7% (services) Zero-rated (goods)	5% for 10 years
Projects falling under the Jordan National Employment Strategy (JNES)	Exempt	Zero-rated (goods and services)	5%
Information and technology services********	Exempt	Zero-rated (good and services)	5%

* Other activities are as those defined in Tables contained in Regulation 33 of 2015 and are located outside Development and free Zones

** Goods used in the following sectors: agriculture and livestock; hospitals and specialized medical centers; hotels and tourist facilities entertainment and tourist recreation cities; communication centers; scientific research centers and scientific laboratories; artistic and media production; conference and exhibition centers; transport and/or distribution and/or extraction of water, gas and oil derivatives using pipelines; air transport, sea transport and railways.

*** Except for establishments registered in Development or Free Zones; mining; electricity generation from non-renewable resources; exempt activity under the Income Tax Law and any activity benefitting from tax incentives under previous legislation

Group A includes the Northern Jordan Valley district, Deir Alla district, Southern Shunah district, Southern Jordan Valley district, Ruwayshid district, Northern Badiyah district, Northwestern Badiyah district, Azraq subdistrict, Jizah district excluding theboundaries of the municipality of New Jizah, Muwaqqar district excluding the boundaries of the municipality of Muwaqqar, and the Governorate of Aqaba excluding the Aqaba Special Economic Zone.

Group B includes the Maʿan governorate, Tafilah governorate, Karak governorate, and Ajloun governorate.

Group C includes Jerash governorate, Mafraq governorate, and Irbid governorate excluding the boundaries of the municipality of Greater Irbid.

Group D includes Madaba governorate, Balqa governorate, the governorate of the capital excluding the Secretariat of Greater Amman, Zarqa governorate excluding the boundaries of the municipality of Zarqa and the boundaries of the municipality of Rusaifah

**** These incentives are granted to hotels, tourist restaurants, theme parks and convention centres having economic activities in the following regions: Tafileh, Karak, Balqa, Jerash, Madaba, Ajloun, Irbid, Mafraq, Maan, Al Azraq, Ruseifa, Birin, Duleil, in addition to the capital's Jizah, Muwaqar, Qweismeh, Marka, Naur and Sahab. The list of tourist restaurants benefitting from these incentives will be identified based on standards to be jointly agreed upon between the Ministry of Tourism and the Jordan Investment Commission.

***** Comprising software development; mobile apps; website portals; digital content and electronic games; data processing; and IT learning and e-trainings.

Source: Prepared for the mission with data from Jordan Legislation.

69. **The JIL and supporting Regulations establish a three-level structure to manage investment incentives**. The activities related to the investment promotion and development of investment are managed by the Investment Commission, the activities of which are overseen by the Investment Council. A Technical Committee has also been created to provide advice and recommendations to the Investment Commission. The governance structure is summarized below.

70. **The JIL introduced an investment window mechanism in order to facilitate and accelerate the granting of investment licenses, including the incentive provisions.** This is done by eliminating all duplicative procedures and introducing a fast track approval mechanism through automation, introduction of time limits, and clearly defining agency accountabilities and responsibilities. The authorities indicated that the investment window is fully operational and that

considerable efforts are devoted to making it as efficient as possible (easier electronic access, non-paper based procedures, etc.).

Table 15. Governance Structure under the Investment Law of 2014

Entity	Composition	Main Role and responsabilities
Investment Council	Prime Minister (Chair) Minister of Industry, Trade and Supplies Minister of Finance Minister of Labour Minister of planning and international cooperation Chairman of the Investment Commission Central Bank Governor Chairman of Jordan Chamber of Industry Chairman of Jordan Chamber of Commerce Four private setor representatives	Submit to Cabinet recommendations on strategies, polices and draft legislation relating to investment Study the obstacles facing the economic activities, outline remedial courses and direct Commission towards appropriate mechanisms thereto Follow up on the implementation of plans and programs related to investment
Investment Commission	Chair (Nominated by Cabinet for a 4-year term) Secretary General Staff of the Commission	Formulate plans and programs to stimulate, promote and implement domestic and foreign investments Identify investment opportunities in Jordan Develop, regulate and monitor policies relating Free and Development zones
Technical Committee	Secretary General of the Investment Commission (Chair) Facilities and incentives director at the JIC (Deputy Chair) Director of the Investment Window Representative of the Ministry of Industry, Trade and supply Representative of Jordan Customs Representative of the Income and Sales Tax Department Representative of the Jordan Chamber of Commerce Representative of the Jordan Chamber of Industry	Determine the quantity of needed factors of production, fixed assets for dual purpose, and goods exempted from customs fees and subject to a zero GST tax rate Make recommendations to the chairman regarding goods, services and fixed assets subject to tax preferences and assess impact of tax preferences on the Treasury

Source: prepared by the mission with data from JIL and other pronmotion laws.

71. New tax exemptions were introduced recently in the context of the planned investments in Jordan by the Saudi Public Investment Fund. The Jordan Investment Fund Law No. 16 of 2016 (JIF) created a "Jordan Investment Fund" with a board of directors headed by the Prime Minister. The fund also includes four ministers as well as the chairman of Investment Commission, and three other members designated by the Council of Ministers. Saudi Arabia and Jordan also agreed to set up a Joint Coordination Council that will oversee Saudi investments. The JIF stipulates that the fund has the right to possess, invest in, and develop projects of the national railway network, the electricity inter-connectivity project with Saudi Arabia, the pipeline to transfer crude oil and fuel derivatives to the Jordan Petroleum Refinery Company and consumption and storage points. In addition, the cabinet may approve other projects based on the recommendations of fund's board of directors. Under the JIF, sovereign funds and Arab and foreign investment institutions are to establish a shareholding company or more to invest in development rights and in projects listed in the law and the company so created is exempted from all customs and stamps fees and any other fees or taxes, including GST, SST, and the income tax.

72. Thus, investment incentives have become widespread in Jordan. Not including the ad hoc incentives provided under discretionary provisions, there are currently six Development

Zones, 38 Free Zones, 4 different groups of less developed regions, and at least 12 sectors benefitting from tax incentives. Moreover, the JIL provides flexibility to add to this list in an unrestricted manner. Tax incentives have de facto become the norm and regions or sectors not benefitting from tax preferences could as easily be described as being singled out to be taxed more heavily.

73. Investment incentives are also complex and difficult to comply with and administer. For example, under the JIL, for each project undertaken under the Law, the Investment Commission, sometimes with the help of a Technical Committee, has to determine quantities of required goods, services and inputs eligible for tax preferences for the next three years and has to make and communicate such decisions within 30 days. Although the short time frame is motivated by the desire to minimize the delays faced by potential investors, the scope of this task will almost inevitably result in inadequate reviews of eligibility and limited control over tax exemptions. Besides, a rushed adjudication process would overlook open tax avoidance opportunities.

C. The Design and Governance of the Investment Incentives in Jordan

74. The introduction of the JIL improved the investment promotion framework. It reduced the number of laws under which tax incentives are granted and created a more cohesive set of measures, structures, and procedures to promote and support investment. The Investment Council and the Investment Commission provide improved governance structures to accompany the investment promotion and incentives framework. The Investment Commission has indicated to the mission that the investment window is fully operational and that considerable efforts are devoted to make it as efficient as possible (easier electronic access, non-paper based procedures, etc.).

75. However, the progress made with the JIL to streamline tax incentives has started to erode in recent years. Special provisions for tourism, IT technologies, employment, and for the Jordan Uranium Company listed at the bottom of Table 15 were adopted on June 21, 2016 thus expanding the list of activities eligible for investment tax incentives. There is ample room for improvement in both the design and governance of the investment incentives framework.

Design Issues

76. The JIL makes extensive use of zero-rating of the GST. Unlike one-time charges (such as custom duties) that add to the cost of investment, value added taxes such as the GST do not represent a permanent impediment to investment, as the GST paid on goods, services and production assets acquired are recovered when the goods and services produced by the investment are sold locally or exported. Only the value added by the enterprise making the investment will be subject to tax. The proliferation of zero-rated goods and services undermines the integrity of the GST – which works effectively when the chain and transactions is uninterrupted – and gives rise to opportunities for tax planning and tax avoidance. Zero-rated goods may be diverted from their intended uses and be liquidated on the domestic market thus resulting in loss of revenues to the government. Breaking the chain might also provide avoidance opportunities whereby GST tax credits are claimed but GST is never remitted to the government.

77. An alternative to zero-rating for some investment inputs imported could register the tax liability at the Customs but defer the payment of the GST. Such a mechanism is already in place for a limited number of importers with good compliance records with the Jordanian Customs. This short delay of two months is to ensure parity with domestic GST remittances which are done bi-monthly. Customs officials indicated that this mechanism operates well and that adequate communication and information exchanges exist between the Customs and the ISTD to ensure delayed remittances are integrated in the domestic GST system. A similar mechanism could be implemented for fixed assets imported when such assets are to be part of an investment project and when no domestic production of such assets exists. Such a mechanism would replace the zero-rating of the GST for capital goods. In the case of capital goods which are to be re-exported without further transformation in the free zones, the zero-rating of the imports could be maintained provided controls of the Free Zones are stringent enough to ensure these capital goods are in effect re-exported. In that respect, officials from the Jordanian Customs indicated to the mission that all Free Zones were fenced and that Customs officials were present at Free Zones access points to ensure compliance with the requirements of the Free Zones.

78. Income tax incentives are too generous and not always time limited. The recourse to tax holidays has been curbed under new investment incentive legislation. But there appears to be a developing trend to provide very low corporate tax rates (5 percent) without time limitations to businesses operating a wide range of business in Development Zones, as well as selected activities undertaken outside the zones. Such reduced rates were recently introduced for businesses operating the tourism and information technology (IT) sectors as well as projects falling under the Jordan National Employment Strategy and the Jordan Uranium Mining Company. Very low CIT rate not only have a direct impact on tax revenues but also provide opportunities for corporations to tax plan to reduce their overall tax liability (it will encourage domestic transfer pricing on a large scale). This is especially the case in countries like Jordan, which do not have detailed transfer-pricing legislation to prevent profit shifting between corporate entities that are part of the same group.[43] Simply stated, when low rates are provided to some corporations, there is an incentive to create and use a related entity within the enterprise eligible for the low rate, and to shift as much profits as possible to this entity from

[43] Article 20(d) of the Income Tax Law provides that: "If a person(s) who have mutual benefits in enterprise(s) concluded commercial or financial transactions between them and these enterprises, or among these enterprises, in a way different than what is being conducted in the market, and these transactions may reduce the profits subject to tax for any of them or of the enterprises, these transactions shall be ignored and the real profits shall be estimated according to the real market value of the transactions".

other parts of the corporate group subject to the higher corporate tax rates. The lack of time limitation makes this type of tax planning even more worthwhile.

79. Selective income tax reductions are not the most efficient way to incent investment. An income tax incentive targets the outcome of the investment. This approach has three major drawbacks. First, they introduce economic distortions because they require a selection of the sectors or regions benefiting from the tax reduction; second, profits may only be loosely correlated to investment thus reducing the effectiveness of such measures; and third they give rise to avoidance opportunities.

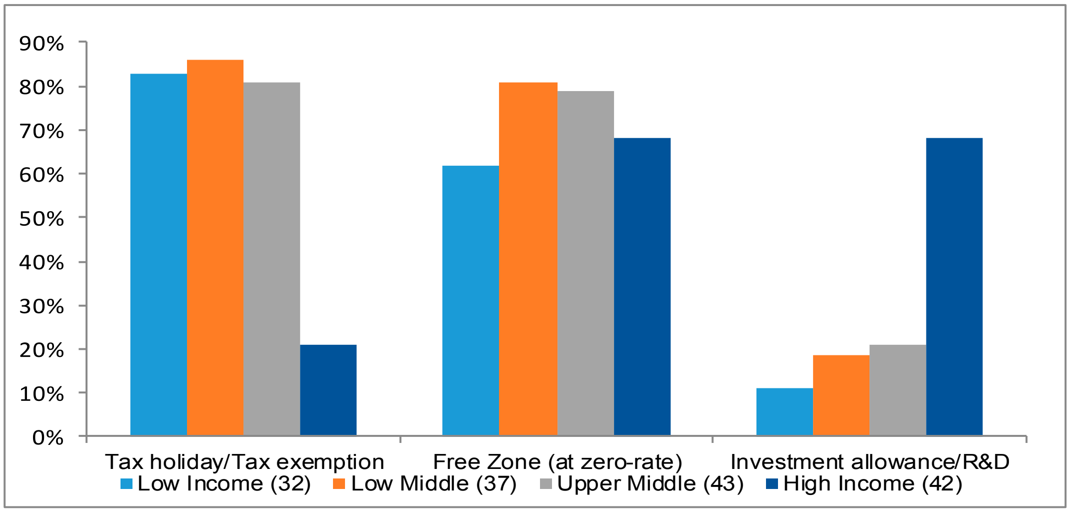
80. Non-discriminatory measures, which reduce the cost of investment, are preferable. For example, measures such as investment allowances and investment tax credits directly reduce the cost of investment (they are thus more effective) and are available to all investments. Both mechanisms are similar but not identical. An investment allowance reduces taxable income by a given percentage of the eligible investment. The value to the taxpayer of this reduction in taxable income will depend on the rate of tax – the higher the tax rate the higher the value. An investment tax credit reduces tax payable by a given percentage of the investment. The value of this benefit is unaffected by the tax rate. When there is a unique tax rate and this tax rate does not change, both approaches are equivalent. Where there are multiple tax rates (as is the case in Jordan) an investment allowance is a better approach to ensure the incentive is commensurate with the general level of taxation. Accelerated depreciation –which allows for a more rapid deduction from the CIT base of capital consumption relative to its true economic depreciation– could also be considered.

81. Many countries have granted tax incentives around the world. However, countries actually differ in the mechanisms they use. On the one hand, developed countries, usually use investment-related tax incentives measures to reduce the after tax cost of making an investment, and favorable tax treatment of research and development (R&D). On the other hand, developing countries usually offer broad tax holidays where companies are commonly exempt from the CIT and other taxes, such as property taxes and input and capital goods exempt from customs duties and VAT.

82. The lack of proper recognition of the cost and benefits of tax incentives has been instrumental in their proliferation. Jordan does not evaluate the cost of tax incentives when they are introduced nor do the authorities monitor their costs on an ongoing basis.[44] Such cost estimates are referred to as tax expenditures. The estimation and timely publication of tax expenditures is highly desirable for several reasons:

[44] In 2013 USAID published an assessment of tax expenditures in Jordan but the authorities do no themselves produce such estimates.

Figure 5. Tax Incentives by Level of the Income of the Countries



Source: prepared by the mission with data from James (2013). Between parenthesis the number of countries of each group.

- It ensures that the cost of policies delivered through the tax system is given the same scrutiny by policy makers as direct budgetary expenditures.
- It allows the monitoring of the cost of tax incentives that, unlike budgetary expenditures, are generally not capped.[45]
- It provides an ongoing assessment of the cost of individual incentives that may significantly change from year to year.
- It provides an estimate of the cumulative impact of incentives and their cumulative impact on tax revenues.[46]

83. Microsimulation models (MSM) using data from CIT returns are the most common tools used to measure corporate tax expenditures (including those related tax incentives for investments). An MSM is essentially a firm-level income tax calculator that allows the estimation of tax revenues under different tax parameters –for example a preferential rate scenario and a "normal or benchmark" rate scenario. The development of a MSM requires the building of databases that contain all information from taxpayers including those benefitting from various

[45] For example, the cost of a preferential rate of tax on a certain activity will depend of the magnitude of the activity without limit while a direct budgetary outlay to support the same activity would generally have a fixed maximum budgetary cost.

[46] It should be noted that as the cost of each tax measure is determined separately, assuming that all other tax provisions remain unchanged, the sum of individual tax expenditures does not provide an accurate measure of their combined impact.

forms of tax preferences.[47] The development of MSM also provides the capacity to undertake corporate income tax policy simulations and revenue forecasting. The development of a corporate tax MSM and the related dataset should be undertaken by the Department of Finance as a building block to a comprehensive tax expenditure assessment framework.

84. Benefits should also be evaluated when tax incentives are contemplated and, overtime, to ensure they continue to deliver the intended benefits. A comprehensive cost-benefit-analysis framework should comprise both direct and indirect effects of tax incentives – the latter are often overlooked in the analysis. Direct effects include, among others, the creation of jobs by the beneficiary, public revenue forgone by tax incentives (tax expenditure), additional administrative and compliance cost (of registration, rent seeking, etc.), distorted resource allocation, and scarcity of public funds (one currency unit of tax revenue has a higher social value than one currency unit of private income). Indirect effects usually comprise the creation of new jobs and investment (net of displacement) and the increase on tax revenue from new companies (or higher production).

Governance

85. The decision making process to enact tax incentives does not follow best governance practices. Countries that have been successful in attracting investment have generally adopted a holistic approach that places tax policy in the context of a broader national development strategy. It is common practice to have an interdepartmental adjudication committee with combined expertise that makes recommendations to the MoF about tax incentives. The latter should make the final decision to enact tax incentives and be responsible for their implementation through, or working closely with, the tax administration. Indeed, the Minister of Finance is best able to weigh different priorities while also keeping an eye on the cost of incentives. Where authority is outside the Ministry of Finance, special interests can easily dominate the general public interest.

86. Preferential tax treatment provisions are contained in many non-tax laws including the JIL. The transparency and accessibility of tax incentives are compromised when embedded in multiple pieces of non-tax legislation such as the JIL or the ASEZ Law. Tax incentives are for this reason best consolidated into the main body of the tax laws (Income Tax Law, GST Law and Customs Law). This reduces the likelihood of conflicting or overlapping provisions, which could create unintended distortions and uncertainty as well as revenue losses. Such an approach also signals to investors a degree of control over tax incentives and therefore of the stability of the tax system. In that respect, it is worth noting that the dispersion of tax incentive measures in non-tax laws is present only approximately 20 percent of middle and upper income countries compared to over 50 percent in lower income countries.

[47] When there is a large number of taxpayers, stratified samples can be used as a representation of the whole population.

87. **There should be no discretion to grant ad hoc tax preferences outside of the budgetary process**. Similar to the presence of tax incentives in non-tax laws, the degree of discretion varies with the income level of countries, with about 40 percent of higher income countries having such discretion in their laws compared to about 60 percent of lower income countries. It is difficult to eliminate all forms of discretion but the focus should be on eliminating the discretion to provide ad hoc specific tax preferences outside of the budgetary process.

88. **The revenue administration should be in charge of the implementation and enforcement of tax incentive schemes,** as it has the unique authority, expertise and experience necessary for the execution of the tax law of which incentives should be part. Where tax incentives are simple and unambiguous, they might be self-assessed by the taxpayer and subject to ordinary control and auditing procedures. Many incentive provisions, however, require some form of approval by the tax administration. When verifying facts, information or certification may be needed from other specialized government agencies or ministries. For the tax administration, documentation and publication of the decisions is a prerequisite to ensure transparency. This enables it to be held accountable by government and taxpayers. It also enables government (preferably the Ministry of Finance) to evaluate the costs and benefits of tax incentives.

Tax Incentives Related to Foreign Aid

89. **Foreign aid-funded projects are significant in developing countries and often provide opportunities for important strategic development to take place**. The recently announced initiative relating the investment by the Saudi Public Investment Fund is an illustration of such major assistance provided to Jordan. From a tax policy perspective, the systematic exemption of goods and equipment imported under projects and often the exemption from corporate and any other taxes in the context of aid-funded projects is not immutable (see Appendix 3). This practice, which causes destination misappropriation of exempt property and de facto promotes informal activities, should logically evolve. Indeed, as the relative share of direct budgetary assistance in official development assistance is increasing, the refusal to pay taxes on the part of donors is harder to justify, especially when a donor uses both instruments. The amount of direct budgetary aid can indeed be adjusted downwards by the taxes paid on projects.

90. **It is up to the Jordanian authorities to take the initiative to ask donors to reconsider such exemptions**. Some countries and international aid providers recently committed to paying taxes on the projects it funds. Based on these examples and on official pronouncements of the major donors (see Table in Appendix 3), talks could begin with donors and commitments be discussed from both donor and recipient sides.

Recommendations

Short-term (2017)

- Impose a moratorium on the introduction of new tax incentives provisions and the expansion of existing ones in the JIL and any other non-tax law (measures designed to limit the cost of incentives would not be subject to the moratorium). Keep the moratorium in effect until the current tax incentives framework has been reviewed and streamlined.
- Impose a moratorium on the granting of discretionary tax preferences through mechanisms such as the Council of Ministers and under Article 8 of the JIL. Keep the moratorium in effect until the current tax incentives framework has been reviewed and streamlined.
- Remove/phase-out GST incentives from the JIL and any other non-tax law. All taxpayers (including in Development Zones, special regions, etc.) are to be subject to GST as defined in the GST Law. GST refunds on exports are not considered to be tax incentives and therefore should continue to be allowed.
- Consider introducing GST payment delay mechanisms for some imported capital goods.
- Impose time limits to new and existing CIT reductions in the Development Zones and any other recipient of reduced income tax rates (say 5 years).
- Remove the income tax exemption for enterprises operating in Free Zones after a ten-year transition period. Impose time limits to CIT exemption, granted to new operations in Tax Free Zones, to be aligned with the end of the 10-year phase-out period granted to the existing beneficiaries of the income tax exemption.
- Remove income tax exemption and reductions for enterprises operating in the ASEZ after a ten-year transition period. Impose time limits to CIT exemption granted to new operations in the ASEZ to be aligned with the end of the 10-year phase-out period granted to the existing beneficiaries of income tax exemptions and reductions.
- Initiate discussions and exchanges with donor countries to define the actions to be undertaken to ensure aid projects are subject to tax (this recommendation supersedes the above recommendations for aid funded projects).

Medium term (2018–2020)

- Subject to further revenue impact assessments, eliminate or scale back CIT incentives for new investment/activities/registration in any of the tax preference framework with either no reduction at all or at most one reduced rate of no more than half the normal CIT rate, subject to time limitation of 5 or 10 years).
- Review custom duties exemptions provided in non-tax laws with a view to reducing or eliminating them in all investment frameworks. This review should take into account revisions to the custom duties rates recommended in this report.
- Move all tax incentive provisions into Tax Laws.

- Repeal Article (8) of the Investment Law.
- Give ultimate responsibility for tax incentives to the Minister of Finance.
- Consider introducing a neutral investment incentive instrument in the Income Tax Law such as an investment allowance, investment tax credit, or accelerated depreciation available to all corporations on all investments.
- Create in the MoF, a structure dedicated to the evaluation of tax expenditures with the mandate of developing a tax expenditure assessment framework, a key element of which would be the definition of a benchmark tax system. This structure could be part or a broader structure dedicated to the tax policy analysis and development section, which would also be part of the Department of Finance.
- Publish annually detailed tax expenditures estimates based on this framework.

D. Corporate Income Tax

91. As is the case with the GST, the CIT system in Jordan uses multiple rates.[48] Taking into account the reductions of tax payable, there are over ten statutory and "quasi-statutory" tax rates in Jordan. This is not aligned with international best practices, which would be to have one or at most two corporate tax rates. Table 16 summarizes the CIT rates in effect in Jordan including the reduced rates contained in the various tax preference frameworks.

92. Limited sectoral differences in CIT rates create economic distortions, but may bear some rationale. By taxing capital returns in one sector more heavily than in another sector, the tax system distorts the most productive investment allocation and thus hurts welfare and growth. Moreover, differential taxation can create problems if high-taxed activities can be jointly organized with low-taxed activities. For example, it might be beneficial for trading companies to engage in financial intermediation, as they will have a comparative advantage over financial companies, or Telecom companies can (and have in certain countries) engaged in quasi-banking activities which could be subject to a lower rate than applies to traditional banks. Therefore, a level playing field is generally desirable from the perspective of productivity and economic development. However, there can be circumstances that motivate a special tax treatment of particular sectors:

- Mining. Natural resource companies can generate a location-specific resource rent, which can be taxed without distortion. This may justify a special tax on mining.
- Banking. This sector may be different because it is exempt from GST. It renders the price of banking services for consumers lower and may cause a tax-induced overconsumption.

[48] This section is not intended to provide a complete assessment of the CIT system. The elements reviewed here (the rate(s) and transfer pricing provisions) are intended to complement the discussion on tax incentives for investment. The discussion draws heavily from and is consistent with what was contained in the IMF Technical Assistance report of 2013 (FAD 2013).

Special tax treatment under the income tax may help to offset this distortion. However, there are better ways of addressing it. For example, fee-based financial services may be taxed under the GST. Margin-based financial services may justify a so-called financial activity tax (FAT), which base consists of the total payroll and profit of a bank. The base of the FAT is broader than that of the CIT, allowing for a lower rate to generate the same revenue (see IMF 2010).

- Telecommunication. Entry to this market may be restricted due to the limited licenses to transmit signals over specific bands of electromagnetic spectrums. The entry restrictions can allow companies to generate monopoly profits. The government can reap part of these profits by special taxation. Most countries, however, reap the scarcity rent by auctioning the licenses, rather than by applying differential CIT rates. Hence, special taxation of some sectors can be defended, although it generally does not call for a special rate of CIT. Rather, alternative tax treatments are generally desirable. Differential CIT rates might, however, be a second-best solution as long as other instruments have not yet been developed.

Table 16. Corporate Tax Rates

Rate (%)		Additional information
Regular rates		
14	Industrial companies	
20	All corporations not subject to the 14, 24, or 35% rates	
24	Telecommunications, mining, electricity, financial intermediation, insurance and reinsurance, finance leasing, and financial services	
35	Banks	
Preferential rates		
0	Free zones	
5	Activities in Development Zones, IT services projects under under Jordan empolyment strategy, tourism, Jordan uranium mining Co.	
Reduction of tax payable (%) 1/		
100	Less developed area, Group A	Reductions do not apply
80	Less developed area, Group B	to corporations
60	Less developed area, Group C	benefitting from preferential
40	Less developed area, Group D	Income tax rates

1/ Reductions in tax in less developed areas apply to any industrial, professional, or tourism activity or any of the activities mentioned in article 4 (b) (4) of the Investme Law 2014, that is; agriculture and livestock; hospitals and specialized medical centers; hotels and tourist facilities entertainment and tourist recreation cities; communication centers; scientific research centers and scientific laboratories; artistic and media production; conference and exhibition centers; transport and/or distribution and/or extraction of water, gas and oil derivatives using pipelines; air transport, sea transport and railways.

Source: prepared by the mission with data from JIL; Income Tax Law; and other incentive laws.

93. The multiplicity of rates highlights the need for detailed transfer pricing rules. As discussed in in the previous section, Jordanian tax law does not contain detailed transfer pricing rules. In a system with multiple tax rates, this most likely results in the development of tax avoidance schemes to reduce corporate income tax through transfer pricing.

Recommendations

- Consider introducing a simple CIT rate structure, possibly limited to two rates –a standard rate and, if needed, a second rate for specific sectors earning extraordinary profits. Ensure revenue neutrality by introducing a financial activities tax on the banking sector and a review of the other fiscal charges on the telecommunication and mining sectors.
- Develop transfer-pricing regulations along the OECD guidelines.

Appendix 1. Tax Revenue in Jordan

Jordan tax revenue reached 15.9 percent of GDP in 2015. Non-tax revenue was 5.7 percent of GDP; in total, public revenue collection reached 21.6 percent of GDP this year. General Sale Tax (GST) was the main source of revenue, followed by taxes on income. GST collection accounted for 47.9 percent of tax revenues; taxes on income accounted for 14.9 percent of tax collection and customs duties represented only 5.5 percent of tax collection.

Jordan Tax and Nontax Revenue

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	Percent of total															
Tax and nontax revenue	25.9	26.0	24.5	23.0	25.7	28.3	29.2	29.5	25.5	24.5	22.7	20.5	21.5	21.5	23.0	21.7
Tax revenue	16.0	16.0	14.7	15.0	17.7	19.8	20.0	20.4	17.7	17.0	15.9	14.9	15.3	15.3	16.5	15.9
Taxes on income and profits	2.7	3.1	2.9	2.7	2.7	3.2	3.9	4.1	3.9	4.5	3.3	3.3	3.1	2.9	3.0	3.2
Taxes on foreign trade	4.4	3.8	3.2	2.9	3.3	3.4	3.0	2.6	1.8	1.6	1.5	1.4	1.3	1.4	1.3	1.2
Taxes on domestic transactions	8.6	8.9	8.3	9.1	11.3	12.8	12.8	13.4	11.6	10.6	11.1	10.3	10.8	11.1	11.6	10.8
General sales tax	7.7	8.1	7.5	8.3	10.2	11.5	11.4	12.1	10.7	9.9	10.6	9.9	10.4	10.6	11.1	10.4
Tax on real estate sale	0.9	0.8	0.8	0.8	1.1	1.3	1.4	1.3	0.9	0.7	0.5	0.4	0.5	0.5	0.5	0.5
Imports/Excises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.6
Nontax revenue	9.8	9.9	9.8	8.1	8.0	8.5	9.2	9.1	7.8	7.5	6.8	5.6	6.3	6.1	6.5	5.7
Fees	3.3	3.4	3.3	3.4	4.0	4.8	4.7	4.5	3.7	3.1	2.7	2.5	3.1	3.3	3.5	3.2
Enterprises	5.1	4.4	5.2	3.4	2.8	2.9	3.8	3.8	3.3	3.7	3.6	2.6	2.9	2.7	3.0	2.4
Others	1.4	2.2	1.3	1.2	1.2	0.8	0.7	0.8	0.8	0.7	0.5	0.5	0.3	0.1	0.1	0.1
	Percent of total															
Tax and nontax revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Tax revenue	62.0	61.7	60.0	65.0	68.7	70.0	68.4	69.1	69.4	69.5	70.1	72.8	70.9	71.4	71.6	73.5
Taxes on income and profits	10.4	11.8	11.8	11.7	10.5	11.2	13.2	13.8	15.2	18.5	14.7	15.9	14.6	13.3	13.1	14.9
Taxes on foreign trade	17.1	14.5	13.2	12.6	12.8	12.1	10.1	8.7	7.2	6.5	6.5	6.8	6.0	6.4	5.6	5.8
Taxes on domestic transactions	33.2	34.3	33.9	39.5	44.2	45.3	43.8	45.3	45.7	43.4	48.9	50.0	50.3	51.7	50.3	50.0
General sales tax	30.0	31.2	30.6	35.8	39.8	40.6	39.1	40.9	42.1	40.6	46.6	48.3	48.1	49.5	48.0	47.9
Tax on real estate sale	3.3	3.1	3.2	3.6	4.4	4.8	4.7	4.4	3.7	2.8	2.3	1.8	2.2	2.2	2.3	2.2
Imports/Excises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.6	2.8
Nontax revenue	38.0	38.3	40.0	35.0	31.3	30.0	31.6	30.9	30.6	30.5	29.9	27.2	29.1	28.6	28.4	26.5
Fees	12.9	13.0	13.5	15.0	15.6	16.8	16.1	15.4	14.5	12.6	11.8	12.2	14.4	15.5	15.1	14.8
Enterprises	19.6	16.9	21.3	14.6	11.0	10.3	13.2	12.8	13.1	15.1	15.7	12.6	13.5	12.5	12.9	11.2
Others	5.5	8.3	5.2	5.4	4.7	2.9	2.4	2.7	3.0	2.8	2.4	2.4	1.2	0.6	0.4	0.5

Prepared by staff with data from the Ministry of Finance

Appendix 2. Potential Revenue at Customs Taxing Exemptions at 6 percent

	JD Million	% of GDP
Exemptions	6,926.2	
Minus:		
Tobacco, alcohol	41.2	
Re-exports	790.2	
Imports used as inputs of exports		
-25% of exports of G&S	1,590.9	
Sensitive & bound (like medicines)	700.0	
Base	3,803.9	
Tariff 1%	38.0	0.15
Tariff 6%	228.2	0.90
Plus alcohol and tobacco	28.8	0.11
Plus MFN with 3 rates	316.7	1.25
Total		2.26
Current revenue		1.20
Additional revenue		**1.06**
Additional revenue with oil 6%		**1.41**

Source: Prepared by the mission with data from Customs.

Appendix 3. The Taxation of Aid

Today, major donors declare their readiness to finance projects including tax (see table on next page). They officially accept the idea of paying taxes, sometimes under certain circumstances, in particular that of applying "reasonable taxation". Despite this change in discourse, the status quo is often maintained, and projects financed by external aid exempted from duties and taxes.

Historically, donors insisted to qualify for exemptions. This practice has grown despite higher transaction costs for donors. The administrative procedures to benefit from the exemption prolong customs clearance time. Moreover, the mechanisms recommended over time by donors to better track exemptions (Treasury checks, lists, quotas) made them more stringent. Recipient countries, for their part, agree to grant such exemptions. In a context of low fiscal capacity, they represent the contribution of the recipient State in the financing of projects.

Several reasons explain this requirement by donors (International Tax Dialogue, 2006). The "unreasonable" character of the tax system (high tax rates, opacity of the legislation, abusive interpretation of statutes) and the ineffective management of public funds or the risks of diversion of funds in the recipient countries have prompted donors to request exemptions. Finally, if the amount of overall aid is fixed, the preference of donors tends to go towards the financing of projects that are targeted and therefore more visible. This form of aid is more conducive to the mobilization of aid, but has a higher risk in case of project failure.

Since 2004, the position of donors is changing. The change was initiated by the World Bank, which officially declared its acceptance to pay taxes provided they are "reasonable and non-discriminatory". International institutions have decided to reconsider their position within the International Tax Dialogue (ITD). The work carried out has resulted in the production of several documents, including draft guidelines for the tax treatment of assistance through funded projects (ITD, 2006; United Nations, 2007). This was to lead to a recommendation of the United Nations Economic and Social Council. The main gains from these exchanges were the recognition of changes occurring in the environment of international aid, openness in principle for the taxation of projects, but on a case-by-case basis, and the recommendation to foster discussions and exchanges between donor and recipient countries to define the actions to be undertaken both to tax the projects.

Position of Donor Countries Regarding Taxation of Aid

Aid Provider	Position regarding taxation of aid	Examples of Projects
Austria	Favorable	
Belgium	Favorable	
Bulgaria	Favorable	
Croatia	No	
Cyprus	No position	
Czech Republic	Favorable	
Denmark	Fovorable	Mali
Estonia	No	
Finland	No position	
France	Already implemented taxation of aid in some cases	AFD in Cameroun
Germany	No position	
Greece	No	
Hungary	No	
Ireland	Favorable	
Italy	No position	
Latvia	No position	
Lituania	Favorable	
Luxembourg	Favorable	
Malta	No position	
Netherlands	Favorable	
Poland	No	
Portugal	No	
Romania	Favorable	
Slovakia	No	
Slovenia	Already implemented taxation of aid	
Spain	No position	
Sweeden	No for now	
United Kingdom	No position	
European Union	Favorable	
World Bank	Yes if costs are reasonable	Introduction in 2005 of cost eligibility guidelines.
African Development Bank	Yes if costs are reasonable	Liberia
Asian Development Bank	Yes if costs are reasonable	In practive, applied in 7% of projects
USAID	No, bilateral negotiations	

Source: FERDI, IMF

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