

CHAPTER XIV

THE FISCAL POLICY OF THE GOVERNMENT

THE GOVERNMENT'S revenue from taxes rose from IL. 673 million in 1957 to IL.777 million in 1958—an increase of 15 per cent, somewhat exceeding the 13 per cent rise (at current prices) in national income.

The principles underlying Government fiscal policy in the year under review conformed to those of 1957: Additional income tax allowances were granted, the Defence Levy imposed on incomes to finance security expenditure was abolished, indirect tax rates were somewhat raised and customs duties continued to be imposed on imported raw materials, so as to reduce the gap between domestic and import prices.

Despite the considerable improvement in tax collection, the share of income tax revenue within total tax revenue declined from 38.6 per cent to 35.8 per cent. Taxes on property and business transactions, fees and licenses constituted the same proportion of total revenue as in 1957. The share of taxes on expenditure, however, rose from 48.1 per cent to 51.3 per cent.

1. CHANGES DURING THE YEAR

In view of the continuous growth in public expenditure and the inadequate increase in private saving, it was again necessary to raise tax rates in 1958.

As in 1957, however, only indirect taxes were raised.¹ The possibility of raising direct tax rates did not appeal to the authorities, which even desired to reduce these taxes—particularly those on income.

Reductions in taxes on income were granted on the assumption that tax rates in the country (including the "Defence Levy") were exceptionally high as compared to many other countries,² and that this usually obstructed the collection of the real amounts due, weakened the will to work, and adversely affected private and business savings.

As in previous years, the raising of indirect tax rates took into account the limitations of this kind of taxation. The most important of these limitations are:—

(1) The linking of wages to the index. Collective wage agreements in Israel

¹ Indirect taxes are here defined to include taxes on expenditure and taxes on transactions, fees and licenses; direct taxes are defined as taxes on income and property.

² The comparison is made on the basis of the official rate of exchange and income levels of relevance in Israel.

stipulate that wages be increased according to the rise in the consumer price index. The imposition of a tax on any commodity within the consumption basket raises its price, thus causing wages to rise and defeating the purpose of the tax, which is to reduce the purchasing power of individuals.

(2) Essential commodities, such as certain foodstuffs, medical supplies, and articles used for educational, cultural and religious activities, should not be taxed.

(3) The encouragement of certain economic branches and the promotion of investments, precluded the taxing of materials used in agriculture and of agricultural and industrial machinery.

(4) Costs of collection. The cost of collecting taxes on a large number of commodities, the production of which is spread over many enterprises, is very high.

In view of these limitations, it is not possible to impose low tax rates on a wide basis, the tendency being towards imposing higher duties on a limited number of items, so as to facilitate collection.

(1) *Reductions in taxes on income*

The "Defence Levy" imposed in April 1956 on the incomes of individuals and companies, in order to finance special defence outlays, was abolished on 1st April, 1958. As a result, taxes paid by individuals in all income brackets were lower (see Table XIV-1). Another concession, reflected in Table XIV-1, was that the additional cost-of-living allowance paid as from 1st July, 1958, at the rate of 3.6 per cent of wages, up to a maximum of IL.18 per month, was free of income tax.

TABLE XIV-1

*Annual Income and Income Tax of Employees, by Marital Status,
1957/58-1958/59
(IL.)*

Annual income	Income tax			
	unmarried persons (under 30)		married + 2 children	
	1957/58 ^a	1958/59	1957/58 ^a	1958/59
1,500	65	25	—	—
3,000	492	357	155	80
4,800	1,175	902	697	516
6,000	1,701	1,346	1,176	900
9,600	3,990	3,294	3,152	2,574

^a Including the "Defence Levy".

SOURCE: Office of the Director of Inland Revenue, Ministry of Finance.

Corporate income tax rates, including the "Defence Levy", were lowered from 53 to 46 per cent.

Besides the exemption granted on 1st July, 1958, as regards the cost-of-living allowance, the deduction allowed for the fourth and every additional child was increased, and the grant to wage earners for travel to and from their place of work, as well as the professional literature grant paid to certain categories of academic workers, were exempted from tax. It should be noted that these concessions reflect the tendency to alleviate the income tax burden, apparent ever since 1954/55.¹

Table XIV-2 compares income tax rates paid by married wage earners with two children on equivalent real incomes during selected years—1953/54, 1955/56 and 1958/59. Real incomes in 1955/56 and 1958/59 were calculated by inflating the 1953/54 income by the rise in the average annual consumer price index. On the basis of this calculation, it would seem that in both 1956/57 and 1957/58, tax rates—expressed either in percentage of real income or in absolute amounts paid—declined steadily in all income brackets (see Table XIV-2).

TABLE XIV-2
*Income Tax as a Percentage of Real Fixed Income,
1953/54, 1955/56, 1958/59*
(Employee, married, with two children)

1953/54			1955/56			1958/59		
income (IL.)	amount of tax (IL.)	percentage of tax	real income ^a (IL.)	amount of tax (IL.)	percentage of tax	real income ^b (IL.)	amount of tax (IL.)	percentage of tax
1,800	24	1.3	2,063	—	—	2,405	—	—
3,000	428	14.3	3,438	310	9.0	4,008	279	7.0
3,600	688	19.1	4,126	515	12.5	4,810	511	10.6
4,800	1,440	30.0	5,501	1,067	19.4	6,413	1,058	16.5
6,000	2,310	38.5	6,876	2,004	29.1	8,016	1,765	22.0
7,200	3,188	44.3	8,251	2,939	35.6	9,619	2,588	26.9
9,600	5,039	52.5	11,002	4,764	43.3	12,826	4,476	34.9

^a Nominal income in 1953/54 is multiplied by 1.146—the rate of increase in the average annual consumer price index between 1953/54 (205) and 1955/56 (235): $\frac{235}{205} = 1.146$.

^b Nominal income in 1953/54 is multiplied by 1.336—the rate of increase in the average annual consumer price index between 1953/54 (205) and 1958/59 (274): $\frac{274}{205} = 1.336$.

¹ Tax rates were lowered and larger deductions and exemptions were allowed already prior to 1954/55. They were, however, expressed in a lower percentage of tax on nominal incomes—not necessarily on real income: Indeed, at certain income levels and family status, the rates on real income were actually increased.

Despite these allowances, however, income tax rates are still high in Israel in comparison with many countries.

Another important concession, granted on the 1st April, 1958, retroactive to the 1st April, 1955, was the possibility to revalue equipment and machinery used in industry, agriculture and transport. The revaluation of imported equipment is based on the exchange rate of foreign currency, while locally-manufactured equipment is revalued according to a graded scale based on its year of production.

(2) *Tax allowances to encourage saving*

Approval has been granted to saving schemes instituted by banks, the interest on which is to be income tax free, and to bond issues of various institutions, the interest on which is to bear a maximum tax of 25 per cent.

However, this method of promoting saving involves small amounts only. Of the IL. 87 million worth of new securities sold in 1958, purchases by individuals accounted for only IL. 13 million, while the balance of private persons' deposits within the framework of the banks' saving schemes rose by IL. 26 million.

(3) *Indirect taxes*

(a) *Customs duty on raw materials.* In 1958, the imposition of duties on imported raw materials continued. Customs and other imposts were imposed on non-ferrous metals (the dominant rates being 30 to 40 per cent), on cork and wax powder (35 per cent), on paper and cardboard (28 to 67 per cent), on materials for the ceramic industries (30 per cent) and on chemicals (30 per cent). These taxes, which came in the wake of the more or less total liberalization of the imports of these goods from qualitative control, were meant to make them more expensive, so as to prevent any possible waste of raw materials being caused by the low exchange rate for imports.

It was hoped that the imposition of these taxes would leave the local prices of the raw materials concerned at their pre-liberalization level, as importers' profits had been high when import licenses were controlled. The new duties thus replaced the excess profits of importers.

(b) *Higher foreign travel tax.* The foreign travel tax on tickets purchased in Israel currency was raised from 33 $\frac{1}{3}$ to 40 per cent. In the year under review, a tax was also imposed—for the first time—on tickets received as presents from abroad. Such tickets are now taxed at the rate of 20 per cent, or 15 per cent if the return fare is paid in foreign currency.

(c) *Higher revenue from equalization funds.* In 1958, import prices were—on the average—7 per cent lower than in the preceding year. As a result, more revenue accrued from the price differential on imported goods covered by arrangements for price stabilization, such as fuel, fodder and foodstuffs. Revenue from the equalization funds and from other imposts rose from IL. 24 million in 1957 to IL. 47 million in 1958.

On the other hand, revenue from customs duties on imports not included in the framework of the equalization funds declined, as these goods are usually taxed *ad valorem* rather than at a fixed rate.

(4) *Taxes raised chiefly for fiscal reasons*

The following relatively moderate increases were made in indirect taxes:

(a) *The grey market.* The grey market comprises commodities—or raw materials for their local production—for which importers are allocated foreign currency, for the purpose of absorbing purchasing power by the imposition of high duties on them. In many cases, allocating foreign currency to imports for the grey market caused the restriction of trading in these goods by new immigrants, sailors and returning residents, who in the past used to bring them into the country and sell them here at high profits.

TABLE XIV-3
Grey Market Imports and Tax Revenue
(thousands of IL.)

<i>Commodity</i>	<i>c.i.f. value of imports</i>	<i>Revenue from taxes^a</i>	<i>Percentage of tax</i>
Sugar	1,229	5,498	447
Rice	1,073	3,415	318
Fish	245	757	309
Green coffee	1,085	4,649	428
Other foodstuffs	943	3,789	402
Alcoholic drinks and cigarettes	107	631	590
Refrigerators ^b	2,969	13,078	440
Miscellaneous	658	2,569	390
<i>Total</i>	8,309	34,386	414

^a Including customs duty, purchase tax and special compulsory payments.

^b The value of imports refers to parts for the local manufacturing of refrigerators. Revenue from taxes comprises, in addition to customs duty, the taxes imposed on the assembled refrigerators. These taxes total 57 per cent of the retail price of refrigerators.

In 1958, the following goods were sold on the grey market: Rice, sugar and coffee (intended for free sale in addition to rations), dried fruit and spices, fish, alcoholic drinks, cigarettes, lighters, motor-cycles, electric shaving machines, as well as commodities manufactured locally from imported parts—such as refrigerators, record changers and air conditioners. The import duties on these goods ranged between 300 and 600 per cent.

In December 1958, restrictions on imports of motor cars were abolished (except for sizes assembled locally), and taxes at rates ranging from 300 to 400 per cent were imposed.

Tax rates on commodities imported for the grey market and the revenue accruing from them are shown in Table XIV-3.

(b) *Other tax increases.* During 1958, taxes were raised on cooking gas, cooking gas appliances and containers, expensive petrol heating stoves, small commercial vehicles, timber and calculating machines. Taxes on some locally-manufactured commodities, such as expensive cigarettes, alcoholic drinks and cars, were also raised.

All these tax increases affected commodities not considered essential. Moreover, the taxes imposed were easy to collect and did not affect the consumer price index in effect at the end of 1958.

(5) *Correction of anomalies*

(a) *Higher taxes on Diesel vehicles.* The high tax imposed on petrol and the fact that solar fuel used in agriculture is tax-free, led to the more extensive use of Diesel engines and their substitution for petrol engines. Though the consumption of fuel might have been expected to increase as the economy developed, during the last four years petrol consumption has been steadily declining at the rate of 1 per cent per annum, whereas the number of Diesel-propelled vehicles—and thus the consumption of solar oil—have shown an upward trend. The shift from petrol to solar not only causes losses to the Treasury, but is also economically undesirable. The real cost to the economy of the use of Diesel engines is higher, but individuals prefer them in view of the high tax on petrol (this does not apply to buses, or to Diesel-trucks of 9 tons and over). In order to lessen the divergence between individual and national economic interests, and increase the revenue from petrol, the Government last year raised the import duties on Diesel engines for taxis, as well as the license fees for Diesel vehicles.

(b) *Standardization of purchase tax rates.* In an attempt to apply the principles of progressive taxation to indirect taxes as well, it is customary in Israel to tax cheap, widely-used commodities at a low rate, or even exempt them entirely, and tax expensive goods—considered to be luxuries—at high rates. Sometimes, the same class of goods was taxed at two or more different rates, according to price. This tended to disrupt production: Producers refrained from manufacturing goods for sale at prices close to the upper limit of the cheaper, low-tax quality and the lower limit of the more expensive, high-tax quality, since in this range even a small rise in price is followed by a considerable increase in tax. Moreover, high tax rates on expensive manufactures discourage the production of better-quality goods and cause tax evasions. To remedy all these distortions, the graded tax rates on textiles, fountain pens, ball pens, sports equipment, toys and games were standardized.

(6) *The protection of local production*

In 1958, protective taxes were imposed on a limited number of commodities, such as motor-scooters imported by new immigrants, cutting tools, winding wires, bicycle brakes and various chemicals. The protection of local production gen-

erally takes the form of prohibiting the import of commodities the local output of which is regarded as sufficient.¹

The protective tax is thus only of secondary importance. Yet, it should be borne in mind that, in an increasing number of cases, customs duties originally imposed for purely fiscal reasons assume the role of protective tax when the commodity concerned begins to be produced in the country. Iron rods, rice and sugar are cases in point demonstrating this.

2. TAX REVENUE

Table XIV-4 shows the revenue from taxes in 1957 and 1958. Some of this revenue was not included in the Ordinary Budget.²

Total tax revenue (*less* taxes on purchases of Government offices and National Institutions exempted from tax up to the end of 1957) reached IL. 747 million in 1958 as against IL. 643 million in the preceding year,—an increase of 16 per cent (see Table XIV-5). However, the real increase³ in 1958 was only 13 per cent, a rate roughly equal to that of 1957 and 1956, but lower than in the fiscal years 1954/55 (17 per cent) and 1955/56 (31 per cent⁴).

The percentage share of tax revenue within national income and private income is given in Table XIV-5.

Between 1957 and 1958, revenue from taxes on income rose by 7 per cent, from taxes on property—by 15 per cent, from taxes on expenditure—by 23 per cent (mainly due to equalization funds and compulsory payments), and from fees and licenses—by 12 per cent.

During the last two years, the share of taxes on expenditure within total tax revenue rose from 48.1 to 51.4 per cent, while that of taxes on income declined from 38.6 to 35.8 per cent. The share of taxes on property remained unchanged, at about 2 per cent, and that of taxes on transactions, fees and licenses at about 11 per cent. The smaller proportion of taxes on income is due to the slower increase in revenue from income tax and from the "Defence Levy" than in other taxes. Taxes on income yielded only 5.5 per cent more in 1958 than in 1957, while total tax revenue rose by 16 per cent.

¹ However, imports by new immigrants, sailors and returning residents also compete with local products.

² Revenue from National Insurance, war risk insurance, equalization funds and certain compulsory payments is not included in ordinary tax revenue. Revenue from radio license fees was excluded from the ordinary budget as of the 1st April, 1957.

³ Obtained by dividing revenue by the index of output costs.

⁴ The fiscal year begins in April and ends in March. As some of the data refer to calendar years, the comparisons are not strictly valid for two reasons: (a) Revenue collected during the fiscal year is usually higher than that collected during the corresponding calendar year, owing to the continuous rise in incomes; (b) The revenue collected during the last quarter of the fiscal year (i.e., between January and March) varies considerably, but always exceeds 25 per cent of the total annual amount due, owing to time lags in collection.

TABLE XIV-4

Revenue from Taxes and Compulsory Payments, 1957-1958
(thousands of IL.)

	1957		1958		percent- age increase from 1957 to 1958
	thousands of IL.	percentage of total taxation	thousands of IL.	percentage of total taxation	
<i>Taxes on income</i>					
Income tax and "Defence Levy"	236,981	35.2	250,012	32.2	5.5
Inheritance tax	576		1,000		
Land betterment tax	1,089		1,023		
National Insurance contributions (employees and self-employed)	21,223		25,984		
<i>Total taxes on income</i>	259,869	38.6	278,019	35.8	7.0
<i>Taxes on property</i>					
Urban property tax	3,406		4,656		
Rural property tax	1,224		905		
War risk insurance tax	11,613		12,534		
<i>Total taxes on property</i>	16,243	2.4	18,095	2.3	11.4
<i>Taxes on expenditure</i>					
Customs duty	113,545	16.9	127,424	16.4	12.2
Fuel tax	40,879		53,594		
Excise: Tobacco	28,331		31,223		
Alcoholic Beverages	11,165		13,990		
Cement	27,073		29,014		
Tires and miscellaneous	2,554		2,521		
Purchase tax	54,994		68,311		
Foreign travel tax	4,716		6,871		
Entertainment tax	4,233		3,243		
Equalization funds and compulsory payments	24,320		46,534		
Indirect security stamp on expenditure	11,858		15,432		
<i>Total taxes on expenditure</i>	323,668	48.1	398,157	51.3	23.0
<i>Taxes on transactions, fees and licenses</i>					
Stamp tax	5,391		6,033		
Driving licenses and vehicle licenses	7,062		8,533		
Court fees	4,756		5,972		
Radio licenses	1,364		1,438		
Land registration fees	3,654		3,881		
Other license fees	2,655		3,239		
National insurance contributions from employers	43,564		47,066		
Indirect security stamp	5,062		6,373		
<i>Total taxes on transactions, fees and licenses</i>	73,508	10.9	82,535	10.6	12.3
<i>Total revenue</i>	673,288	100.0	776,806	100.0	15.4

SOURCE: Office of the Director of Inland Revenue and the Accountant-General, Ministry of Finance.

TABLE XIV-5

*Tax Revenue as a Percentage of National and Private Income,
1954/55-1958*

Year	Total tax revenue ^a (millions of IL.)	Increase in incomes compared to previous year (in per cent)		Percentage of nominal increase in income tax revenue as compared to previous year	Percentage of tax revenue	
		nominal	real ^b		within national income	within private income
1954/55	324	40	17	58	22	20
1955/56	457	41	31	28	26	24
1956/57	561	23	14	17	27	25
1957	643	23 ^c	14 ^c	16	27	24
1958	747	16	13	14	27	25

^a Excluding revenue from taxes on purchases of Government departments and National Institutions.

^b The real increase is calculated on the basis of the annual rise in output prices. This rise totalled—from 1953 to 1954—19.6 per cent; from 1954 to 1955—7.3 per cent; from 1955 to 1956—8 per cent; from 1956 to 1957—8 per cent and from 1957 to 1958—2.5 per cent.

^c Increase in revenue during the fiscal year 1957/58 as compared with 1956/57.

SOURCE: Office of the Director of Inland Revenue (Ministry of Finance), Central Bureau of Statistics and Bank of Israel.

In general, all types of revenue registered increases, the sole exceptions being the rural property tax, the land betterment tax and the excise on tires. In all three cases, the lower yields were due to the fact that for special reasons the 1957 revenue from these taxes was exceptionally high. Entertainment tax revenue declined only on paper, as since August 1958 this tax has been levied by the local authorities, which have to transfer part of the amounts collected to the Ministry of Finance. As a rule, revenue increase is due to the widening of the tax base (as a result of higher prices and incomes and of the population growth), improved tax collection and, in some cases, higher tax rates.

Income tax and the "Defence Levy" yielded IL. 250 million in 1958 as against IL. 237 million in 1957, though the "Defence Levy" was abolished as from 1st April, 1958.¹ Income tax revenue (excluding the "Defence Levy") rose from IL.200.2 million in 1957 to IL.229.1 million in 1958. This 14 per cent increase—despite the larger exemptions granted, the concession concerning the revaluing of equipment, and the exemption of the additional cost-of-living allowance accorded employees as from July 1958 (self-employed earners were granted the same exemption)—was due to the higher income level and to improvements in assessing and collection methods. As income tax rates remained unchanged, income tax revenue increased less rapidly than total tax revenue. If the "Defence Levy" be included with income tax, the percentage increase is even lower.

¹ Some arrears on account of the "Defence Levy" remained to be collected after this date.

Despite improved collection methods, the fact that—unlike other taxes—income tax rates have not been raised since 1955/56, reduced the proportion of income tax revenue to total tax revenue (see Table XIV-5). It should also be noted that the accelerated collection of arrears during any given year increases revenue during that year, but reduces the future revenue reserves.

Customs duties. Revenue from customs includes compulsory payments on imports and revenue accruing from the discontinuation of the special exemption granted to the Government, the National Institutions and non-profit institutions. (For 1957, an amount of revenue equal to the special exemption has been imputed.) These sources yielded IL. 127 million in 1958, as against IL. 114 million in 1957. This 12 per cent increase was caused by the higher rates of duty and the expansion of the grey market.

Fuel tax. Most of the revenue from this item accrues from petrol. Petrol consumption by the non-governmental sector remained virtually unchanged in the last two years, but it may be assumed that, were it not for the restrictions imposed on vehicles at the beginning of 1957, when the closing of the Suez Canal to navigation caused a petrol shortage, consumption would have been higher in 1957 and shown a decrease in 1958. The decline in 1958 was caused by the shift to Diesel-propelled vehicles due to the high tax imposed on petrol. The substitution of kerosene for petrol as a motor fuel was not reflected in petrol consumption, being checked by the order published on 15th December, 1957. Fuel tax revenue increased owing to the larger purchases of the governmental sector, the higher tax on cooking gas and the substitution of a fuel tax for part of the equalization fund dues. The last-mentioned step did not affect consumer prices or total Government revenue, since it caused a parallel reduction in income from the equalization fund.

Purchase tax revenue rose from IL. 55 million to IL. 68 million—an increase of 26 per cent. This was due not only to bigger consumption and higher tax rates, but also to improved collection methods and the prevention of tax evasion. New systems of control were introduced, adapted to the special conditions under which the various commodities are produced and marketed. In addition, tax rates were standardized and tax collection was transferred to the raw materials stage.

Abolition of the special exemption. The revenue from customs duty, fuel tax and purchase tax includes amounts levied on purchases by Government departments, the National Institutions and non-profit organizations. Up to October 1957, most of these bodies' purchases were tax exempt. To facilitate comparison, imputed receipts from these institutions have been included in the 1957 tax revenue appearing in Table XIV-4. Indirect taxes due from the above-mentioned public bodies are estimated to total IL. 30 million per annum.

The special exemption was abolished so as to oblige these public bodies to estimate their purchases on the basis of market prices, thus preventing waste, particularly of foreign currency. For as long as their imports were duty free,¹

it seemed cheaper to import than buy locally. The results of this new arrangement will only be felt in 1959/60, when Government departments and the institutions concerned will be compensated by a fixed annual grant. In 1958, the taxes paid on their purchases were refunded, and consequently the abolition of the exemption had no effect.

The indirect "Defence Levy" and security stamps. In theory, both the direct and the indirect "Defence Levy" were abolished on the 1st April, 1958. In practice, however, the indirect levy was partly included within the existing tax framework (albeit with some minor concessions) and partly converted into the security stamp of 1958/59. The same procedure was followed with regard to other former security stamp duties. Those parts of the "Defence Levy" and security stamp dues, which were not included in existing taxes, combined to form the "Security Stamp" of 1958/59.

Facilities for taxpayers. In certain cases, the Government assists persons owing income tax or purchase tax by arranging bank loans for them, which may be repaid in instalments. According to this arrangement, the entire amount owed is considered to have been paid and the collection is made by the bank. This does not constitute an expansion of credit, but the transfer of tax collection from the Government to the banks. Consequently, official figures of revenue from income tax and purchase tax, as given in Table XIV-4, are overstated, exceeding actual revenue by IL. 10 million in 1957 and by IL. 7 million in 1958. In addition, the Treasury permits purchase tax to be paid some months after it is due. The delay varied from branch to branch, but averaged 3 months in 1958. This concession was made because producers often give credit to their clients on the whole price of their merchandise, including the tax. The Treasury also advises banks to grant credit for some weeks to wine producers, who are obliged by law to pay taxes upon removing merchandise from stock. Such credits are granted during the two peak seasons for the consumption of alcoholic beverages—the spring and autumn festivals.

Another cause of discrepancy between the due of a tax and its actual collection is the time required for assessment purposes. In the case of income tax, self-employed persons and companies pay advances based on previous assessments, the balances being paid upon the final computation of the tax. These advances are usually smaller than the amounts actually owed. During the period April–December 1958, some 60 per cent of income tax payments by self-employed persons were on account of the current year, 14 per cent on account of the previous year, and the rest for former years.

As regards customs duty, however, the importer clearing his goods through customs usually deposits an amount exceeding the actual duty, the balance being refunded to him with the final account.

¹ Most of the institutions concerned dispose of foreign currency funds resulting from donations from abroad.