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Abstract

This report aims at assessing the effect of sales tax and customs duties in Jordan on manufacturers of products that are inputs of another industry, and the disadvantages incurred thereby as a result of such taxes and duties vis-à-vis importers of such inputs.

Table of Contents

- FIRST: SALES TAX..... 9
 - 1- CHARACTERISTICS OF THE GENERAL SALES TAX: 9
 - 2- RATES OF SALES TAX: 9
 - 3- TAX IMPOSITION: 10
 - 4- TAX ON IMPORTED GOODS: 10
 - 5- EXEMPTION OF TAX: 10
 - 6- LOCAL INPUTS IN THE SALES TAX LAW: 10
- SECOND: CUSTOMS DUTIES 12
 - 1- CHARACTERISTICS OF THE CUSTOMS DUTIES: 12
 - 2- RATES OF CUSTOMS DUTIES: 12
 - 3- EXEMPTION AND DEFERRAL OF CUSTOMS DUTIES: 12
- Conclusions..... 16
 - REGARDING SALES TAX: 16
 - REGARDING CUSTOMS DUTIES: 16
 - REGARDING IMPLICATIONS OF TAX AND DUTIES: 17
- Recommendations..... 18
- Appendices* 20
 - Scope of Work: Specific Tasks of the Consultant(s) 20

Executive Summary

This report is a part of the USAID-funded AMIR Program's initiative to sponsor the establishment of the National Linkages Program as a component of the Jordan Upgrading and Modernization Program (JUMP). The objective of the National Linkages Program is to facilitate "backward linkages" in Jordan. Backward linkages are inter-firm relationships in which large firms purchase intermediate goods and services as its production inputs on a regular basis from one or more local small- or medium-sized enterprises (SME) in the production chain. Backward linkages have the potential to achieve the following.

- Generate additional economic activity
- Strengthen local SMEs through technology transfer and skills upgrading
- Give local SMEs a foothold in international markets
- Attract foreign direct investment (FDI) by offering an adequate local supply base

Some stakeholders have suggested that locally-produced manufacturing inputs are subject to sales tax, while the same imported inputs may be free of both sales tax and customs duties. For this reason, there is concern that local sourcing may be less attractive to potential clients of the National Linkages Program. It is important that the officers of the National Linkages Program clearly understand this matter before they contact potential clients and market the benefits of local sourcing.

Thus, the objective of this consultancy is to identify any impediments to local sourcing of production inputs due to tax policy and recommend measures to overcome them.

This report is heavily based on the readings and iterations of the Sales Tax Law No. (6) for the year 1994 [*hereinafter the Sales Tax Law*] and the Customs Law No. (20) for the year 2000 [*hereinafter the Customs Law*], as well as any supporting regulations, instructions and decisions, when found. The underlying objective for reviewing these legal tools was to determine the following:

- 1- Nature and type of such duties and taxes;
- 2- Definition and treatment of local inputs, if any;
- 3- Difference in applying taxes and duties to local versus imported inputs.

In addition, IBLAW conducted several meetings and phone calls with tax and customs specialists, both private and public sector representatives, in order to fully understand the tax collection and exemption procedures and details.

The report however intends to review the existing legislation and analyze any impediments therein, in the form of taxes and duties, which hinder the manufacture and local distribution of production inputs. Therefore any supporting communications and oral understandings are not brought about if they are not linked to a legal provision.

Jordan has recently adopted an aggressive initiative to support local manufacturers and industries in order to uplift and encourage them to export and benefit from the spectrum of international agreements to which Jordan is a party. It is no secret why any country

supports local industries in all means possible, hence, Jordan's efforts in this regard are commendable and constitute a step in the right direction for Jordan's economic well-being. The said initiative produced several key policy reforms in the field of tax and duty exemptions and facilities, including the recommendation to exempt from customs duties all production inputs imported from abroad. In addition, many articles in the Sales Tax Law and the Customs Law are found to foster local manufacturing by allowing the refund and/or deferral of duties until production is complete.

However, an argument was made that the support extended to the importation of inputs for manufacturing could have possibly had a negative impact on local manufacturers of the like inputs, whereby the importers of production inputs are given facilities that allow them to stand at a better position than direct manufacturers in the market. This is argued by the tax and other duties collected on local inputs as opposed to imported ones.

In this report, we will attempt to analyze the tax implications stipulated in the laws, and identify whether it is in fact a "legal" problem and that the disadvantages incurred by the local manufacturers is attributed to the tax and duty treatment under the Jordanian laws.

This report is divided into four sections; the first describes generally the concept and application of sales tax in the Jordanian laws and a preliminary assessment of what this entails. The second section does the same with the customs duties, while the third goes on to conclusions based on our analysis and the fourth aims to cover our recommendations.

Generally, the conclusions arrived at are as follows:

- 1- The Sales Tax Law does not differentiate between a final product and a production input, but rather defines taxable goods in general. Such taxable goods are governed as to tax amount applicable thereto or tax exemption therefore, pursuant to the tables annexed to the Law, or a Council of Ministers' decision.

Therefore, a factory importing products that are primary production inputs will pay the sales tax on such imports. Likewise, a factory manufacturing production inputs locally will account for the sales tax once it sells this production input to another factory, which means that the subject matter of the tax is the product itself, irrespective of the use made of it.

- 2- In all cases, both the importer factory and the local manufacturer are entitled to tax refund or tax deduction, where it is proved via their receipts and invoices that the products subject to tax were imported and/or sold as part of the production chain and that the tax was paid in advance to the Department. This entitles them to refund the tax paid (credited at the Department) or to deduct the amounts already paid thereby from the tax that they need to collect and remit to the Department.

As well, the Department has issued Instructions Governing the Collection, Remittance and Deferral of Tax No. (3) for the Year 2003. Under these Instructions,

the General Manager of the Department has the authority to approve the deferral of taxes due on the imported goods and services where the taxpayer is registered at the Department; is committed to submit declarations in due deadlines; is not charged with any offences for customs evasion; and where the imports are not for the purposes of carrying out an activity that is not subject to tax or is exempt from tax.

- 3- The Council of Ministers has an overriding authority to exempt any person, product or service from the sales tax, which allows for many exceptions to be under-passed from the imposition of tax. This is an important conclusion of indirect result, whereby it can be requested by the government, if and when it is affirmed that the tax collection on local inputs does harm the national productions and tend to favor imports in the face of national productions.
- 4- Customs duties are only imposed on imports and is applied at the border once the goods are about to be cleared and admitted within Jordan. National production is alternatively not subject to the customs duties and therefore, it seems that national production stands at a better footing than imports, in regards to the application of customs duties.
- 5- However, the Customs Law identified several mechanisms to temporarily suspend customs duties paid on the imports. These mechanisms are intended to encourage local industries to import production inputs while suspending the duty incurred thereon. Articles (133), (134) and (145) of the Customs Law specified above stipulate the details for availing from the refund mechanisms for importers for purposes of internal manufacturing or importers of inputs to production.
- 6- Moreover, the Council of Ministers, again, is entitles to totally exempted from customs duties as per its authority under Article (149/c) of the Customs Law. This statement was already argued and implemented on imports as the trend is to exempt all production inputs from customs duties.
- 7- Reading both laws and their supporting legislation indicates that little effect is found to impact cost as a result of the application of taxes and duties. On the contrary, legal provisions seem to favor national production on the account of importation, as this is supported by the argument that the sales tax is incurred by both importers and local manufacturers, while the customs duties (if paid) is only borne by importers.
- 8- For sales tax however, reading of the legislation at hand may suggest an advantage for importing manufacturers who enjoy this deferral facility in lieu of local manufacturers not entitled thereof and are obliged to pay the tax for their local purchases. Moreover, the Instruction on Collection, Deferral and Remittance of Sales Tax to the Department No. (3) for the year 2003 state that tax may be suspended for one month where the tax is due on local products, whereby allowing the taxpayer to withhold the cash flow that would otherwise

be frozen when paying the tax, even where a refund is granted. The same facility is allowed for importers, but with an additional advantage by removing the time limit on suspension. This could lead to a little more comparative advantage to the importers in comparison with local producers, who are time-bound to pay the tax one month after deferral, as opposed to importers who are granted unconditional deferral.

- 9- It seems that the major impediment to local sourcing of production inputs due to tax policy is the effect on cash flow for taxpayers where, even if entitled to refund, pay the tax and therefore, accounting for it and allocating cash in advance. This seems however to be a minor issue so long as the importers are also subject to the same terms and conditions for tax and duty collection and exemptions.
- 10- In all cases, we must note that it is important to rationalize the existing regime as it aims to strike a balance between the need to support manufacturing SMEs with the need to support importing industries. Thus, the legislation attempts to encourage local manufacturers to pursue their manufacturing processes even where the local market does not provide all necessary inputs, by importing basic inputs from abroad to use in local production- while duty and tax are deferred, especially where the taxes due are in such big amounts which unfeasibly exhaust the cash flow of the manufacturer.

Thus and at last, our recommendations are as follows:

- 1- This report was drafted as being heavily based on the reading of the relevant legislation while carrying out basic investigatory work and requesting assistance by some tax specialists. Thus, we recommend that -in order to fully understand the implication of taxes on local production- a more comprehensive investigation is carried out, whereby the feedback of the industry is sought and clearly tabulated regarding their comparative disadvantage as a result of the of taxation regime; as well as the percentage in which these taxes factor as a disadvantage, in comparison to other costs (cost analysis).
- 2- Where in fact, taxes and duties proved to be an impediment towards better networking opportunities for local input producers, the following can be sought:
 - Issue a decision by the Council of Ministers to exempt from sales tax any sales that are intended to be used as production input by a factory. This can also be carried out by giving factories a letter for good manufacturing practices which can be presented to sells of inputs in order t organize a tax-free invoice for the said manufacturer. Additionally, the Department can ensure safe application of this mechanism by posting bonds on such manufactures, under which they guarantee to dispose of inputs as such and not to sell as final products.

- For customs duties, and as it is already a practice to exempt incoming inputs, it is suggested to support this direction and encourage the full exemption of incoming inputs, while allowing a reasonable degree of competitiveness of local manufacturers through other fiscal exemptions and reduction of other costs such as electricity, water and labor requirements.
- 3- In case more details surfaced by the industry which indicate that the taxation regime is in fact distorting the local production due to major cash deficit resulting from the withholding of taxes by the Department where otherwise they would be utilized elsewhere more efficiently, we suggest that the articles already referenced in this report be revised and amended to allow for more effective mechanisms for refunds and deferrals of duties and taxes.

Assessment of Sales Tax and Customs Duties Legal Framework

FIRST: SALES TAX

The sales tax in Jordan is a general sales tax imposed on imported and local sales of services and goods. This tax is in principle borne by the end consumer, but is collected via a series of “intermediate” collectors who undertake to pay the tax and consequently charge customers thereof with the paid tax within the sale price.

The Sales Tax Law has defined the intermediate collectors of the tax in Article (2) thereof, which states that the taxpayer is any natural or juridical person who imports or sells a commodity and/or service subject to tax and who registered or is obliged to register with the Department [Income and Sales Tax Department].

1- CHARACTERISTICS OF THE GENERAL SALES TAX:

- **Indirect tax:** as the payment thereof ultimately falls upon the end consumer although not remitted thereby to the Department.
- **Territorial tax:** as it applies on the locally produced product and/or service as well as those imported from abroad when they have crossed Jordanian borders and sold therein.
- **Type tax:** calculated as per the type of the commodity or service and according to the tables annexed to the Sales Tax Law or issued by the Council of Ministers.
- **Value added tax:** imposed on each phase of the production cycle of any commodity or service whereby it is collected on the value addition to that commodity or service, being the increase of production value at each phase thereof. For example, the tax is imposed on the producer manufacturing and selling the product; the importer of a product; the wholesale trader and the retailer. This feature allows the taxpayer to recollect the tax already paid thereby during the value addition cycle.

2- RATES OF SALES TAX:

The General Sales Tax is paid in 16% of the value of all goods and/or services sold. However, other rates of the sales tax are imposed, as follows:

- Special tax imposed on certain goods and services, usually in high ratios in regards of the accessory nature of the goods.
- Lower or reduced ratios for basic commodities.
- 0% for certain goods and services.
- Exemption of certain goods and services from the general sales tax, whereby in this case, the goods and services are always exempt from sales tax

3- TAX IMPOSITION:

The sales tax is due upon the sale or supply of the goods or services. Sale is defined as the supply realized when goods are transferred from the supplier, or services performed thereby, to the benefit of the purchaser or recipient for a consideration. Sale shall be affected upon the fulfillment of any of the following, whichever earlier:

- The issuance of a tax invoice;
- The delivery of the good or performance of the service;
- The receipt of the value of the good or service whether wholly, partially or in installments.

4- TAX ON IMPORTED GOODS:

For imports, the sales tax is due upon clearance or customs acquittal of such imports, and upon the effectiveness of the customs duties, and shall be collected according to the procedures set out in the customs Law. Therefore, there are two case in which tax is due upon the importer:

- Upon customs clearance;
- Upon the first sale of the goods.

In this case, it is important to note that the legislator imposed sales tax on the importer in order to set the imported goods on an equal footing with the national products and therefore eliminating any favorable situation to the imports in lieu of the national production.

5- EXEMPTION OF TAX:

Exemption of tax is by virtue of law whereby certain commodities, services or persons are exempt from tax according to specific provisions in the law. For instance, purchases by the King, the counselor and diplomatic missions and international organizations are exempt from sales tax; as well as samples used for laboratory testing and personal items that do not bear commercial characters.

In closer perspective, the Council of Ministers has an overriding authority to exempt any person, entity, commodity or service from the sales tax pursuant to a decision it issues for this purpose, upon the recommendation of the Minister of Finance¹.

6- LOCAL INPUTS IN THE SALES TAX LAW:

Jurisprudence has defined production inputs to be any intermediate goods, whether raw or transformed, that are used in further production processes, and that either form a visible part of the final product components or are intrinsic therein by losing their original nature due to their processing within the manufacturing cycle.

As for the Sales Tax Law, Article (19/c) stipulates that any Registered person may, when accounting for the tax due to the Department, credit for the general sales tax that has been previously paid or charged on his purchases or imports of goods and

¹ Article (22/c) of the Sales Tax Law stipulates that the following are exempt from the sales tax: “Any goods, service or person approved by the Council of Ministers to be tax-relieved, wholly or partially, in certain cases and for justifiable reasons, shall be accordingly relieved upon recommendation of the Minister.”

services while he is registered, with the exception of those which are listed under Schedule (4) of this Law.

This provision entails that the legislator is allowing the taxpayer, after the calculation of the actual sales tax incurred thereon, to deduct from the tax due on his/its sales the amount already paid thereby for his sales or imports. This is called tax deduction and it refers to the amounts of tax deductible by the taxpayer where such tax has already been paid. Such deduction can also occur on those goods or services that are part of a production cycle for a good that is ultimately taxable.

However, it is important to note that the Sales Tax Law omitted the term “production inputs” in the recent amendments, whereas the earlier version of the law stipulated the following: *“Any Registered person may, when accounting for the tax due to the Department, deduct from the tax due thereon such amounts that has been previously paid or charged on commodity inputs and production requirements including spare parts for industrial machines that are used to manufacture a taxable commodity”*.

Additionally, the Deduction and Remittance of Sales Tax Instructions No. (4) for the year 2003 dictated that some conditions must be fulfilled to deduct the tax as follows:

- The taxpayer must acquire tax invoices or customs declarations in his name and the financial receipts thereof;
- That the goods and services for which tax is to be deducted are not among those listed in Schedule No. (4) annexed to the law which specifies the goods and services for which tax is not refundable or deductible.

The above mentioned entails that the registered person, whether an importer or purchaser, may deduct -in whole- the tax due on his purchases and imports, including the tax due on the services rendered thereto such as the legal consultancy and auditing services and telecommunication services as the fax and phone. These imports and purchases must however be substantiated with invoices and declarations detailing the tax. As well, the goods and services listed in Schedule (4) annexed to the law do not enjoy tax deductions and refunds.

To explain the concept, let us draw the following example:

A factory imported goods worth of 1000 JD. The general sales tax on these imports is 16%, hence the amount of tax to be collected is 160 JD. This factory has borne other expenses and costs for phones and transport for which a tax in the amount of 50 JD is accrued, to be added to his final calculation of the end price. Therefore the total amount of tax to be paid here is $160 + 50 = 210$ JD. If this factory sells the product at a price of 2000 JD, then the tax due on such sale is $2000 \times 16\% = 320$ JD. Ultimately, the taxes paid in advance, including taxes paid on imports and purchases, as well as the tax for the services and goods consumed during productions (like the tax and phone in our example) are all deducted when the tax is remitted to the Department. Therefore, the amount of tax to be paid in our example is $320 - 210 = 110$ JD.

Moreover, the Instructions on the Collection, Deferral and Remittance of Sales Tax to the Department No. (3) for the year 2003 state that tax may be suspended for one month where the tax is due on local products, whereby allowing the taxpayer to withhold the cash flow that would otherwise be frozen when paying the tax, even where a refund is granted. The same facility is allowed for importers, but with an additional advantage by removing the time limit on suspension. This could lead to a little more comparative advantage to the importers in comparison with local producers, who are time-bound to pay the tax one month after deferral, as opposed to importers who are granted unconditional deferral.

SECOND: CUSTOMS DUTIES

Customs duties are applied on imports to the kingdom at customs border. Jordan has recently reformulated its customs regime to bring it into compliance with the WTO requirements, during the process of acceding the WTO in 2000. the Customs Law was amended to include provisions related to customs valuation, rules of origin and border measures for protecting intellectual property rights. As well, the Customs Law has been revised several times in conjunction with the principles of the Kyoto Convention pertaining to customs formalities, in order to adopt best practices regarding customs collection, assessment and clearance.

1- CHARACTERISTICS OF THE CUSTOMS DUTIES:

In principle, the customs duties are collected: a) once, b) at the borders c) either as ad valorem rate (a percentage of the value of goods) or as fixed rate (a fixed amount/unit) or both ad valorem and fixed at the same time and d) on all imports. The deviation from this statement is that customs duties may be deferred or waived, or at times exempted from entirely. Also, the customs duties are not collected internally for local products, but collected only for imports to the kingdom.

2- RATES OF CUSTOMS DUTIES:

The customs tariffs are specified in the Customs Tariff Schedule annexed to the Customs Law. These tariffs are specified according to the nomenclature of products according to the Harmonized System (HS) Coding which assigns each product with a unique number. In turn, these numbers reflect a specific sequence by allocating the first 2 or 3 digits to the material in its raw shape, and then extending the number by additional digits according to the production processes occurring on the raw product.

The customs tariffs are a reflection of Jordan's commitments under the WTO, whereby reducing the rates applicable on imports are an indication of Jordan's gradual liberalization of tariffs until the full liberalization is achieved; the overriding principle within the WTO.

3- EXEMPTION AND DEFERRAL OF CUSTOMS DUTIES:

Jordan has in the last few years adopted a new industrial development initiative whereby it aims at supporting and encouraging national industries. One of the facilities granted for Jordanian manufacturers was the deferral of customs duties paid

on imports used in manufacturing (referred to as admission for manufacture), whereby duties are not collected on imports used as production inputs. This facility however is granted for manufacturers who are exporters and the duties are not collected only where the manufactured items are exported. As for the products put into the local consumption, their imported inputs are subject to the duties at the rates applied on their importation date, even where such duties were deferred. This understanding is based on the reading of the following articles:

Article 133: A- Duties and other fees and taxes on foreign goods may be suspended if the goods are brought into the Kingdom for manufacturing, completion of manufacturing, or repair, for subsequent export within a period of not more than three years. This shall apply regardless of whether the beneficiary therefrom is the exporter or the manufacturer.

C-Goods which enter the Kingdom according to the provisions of this Article, may be sold by one factory to another, provided the original import purpose is maintained.

Article 134: A- Materials imported for purposes of internal manufacturing may be put for local consumption upon the Director's approval, and subject to the legal conditions in effect.

B-Goods which are manufactured from materials imported for manufacturing purposes according to the provisions of Article (133) of this Law may be put for local consumption upon the Director's approval. The imported materials shall be subject to the customs duties and other fees and taxes at the rates effective at the date of entry of the materials, and assessed on the basis of the value of the material at the same date.

However, the Council of Ministers is entitled to grant a refund the duties levied on certain foreign materials which are used in the manufacture of national products when they are put into local consumption.

Article 145: A- The customs duties and other fees and taxes levied on certain foreign materials which are used in the manufacture of national products, shall be partly or wholly refunded upon re-export of such products. The said material shall be specified by a Minister's decision, upon the Director's recommendation, and in consultation with the Minister of Trade and industry.

B- The Customs duties and other fees and taxes shall be refunded, partly or entirely, or at a fixed, if the duties are levied on certain foreign materials which are used in the manufacture of national products. The said materials shall be specified by a Cabinet's decision and upon the Tariff Council's recommendation.

C- The Minister shall determine the following:-

1- The terms of [eligibility for] drawback.

2- The kind of fees and duties that shall be refunded and the rates or fixed amounts that are refundable for each material or each unit produced.

Additionally, the Instructions on the refund of Customs Duties and Other Taxes Levied on Foreign Materials Used in Manufacturing Local Production Upon Exportation- Instructions No. (12) for the year 1999 that are issued pursuant to the

Customs Law illustrate the procedures to be followed to request a refund of duties. Such instructions do not refer however to the mechanism for accepting the refund application or how will it be processed.

These Instructions lay down the following procedures for claiming a refund:

- Submit an application to secure the approval for the refund.
- Attach with the application a certificate of registration at the Ministry of Industry and Trade.
- Fill out the form regarding the information on the factory, including workers number, machinery, production lanes, materials for which a refund is claimed and factory address, in addition to other similar data.
- Application is submitted one and materials imported must be identified as entered under temporary admission status.
- Attach with the application a detailed explanation for the production formula and any technical details regarding production and manufacturing.
- Application for refund may be submitted within three years from the date of entry of products.
- A duly prepared customs declaration must be presented in order to grant the refund. Such declaration must indicate the refund application number.

Moreover, the Council of Ministers has an authority to exempt from customs duties any goods it deems appropriate². The Cabinet has already acted upon this authority and issued a decision to exempt numerous production input, wholly or partially, from the customs duties due thereon. This exemption was rolled out as a reduction of duties for some items, and then was expanded to cover a complete exemption of duties for almost all production inputs.

Ultimately, and by reading the literature and conducting further research, manufacturers have two ways to import production inputs; either by acclaiming the exemption where an import is a production input (specified by its corresponding HS code on the tariff schedule); or by applying for a refund under Article (145/b) of the Customs Law. In all cases though,

On another front, international bilateral and multilateral agreements regarding tariff liberalization also assist fundamentally in encouraging industrial activities by eliminating duties on products exchanged among member countries. In this respect, foreign products imported are subject to preferential duty rates and therefore, eligible for utilization in the local market at terms that are equal to, if not better, terms for using local inputs.

² Article (149/c) which states: The following shall be exempted from customs duties and other fees and taxes: c- What is decided to be exempt by the Council of Ministers upon the Minister's recommendation, provided that such recommendation specifies the conditions and procedures to be fulfilled to benefit from such exemption.

It is worth noting that the production formulas (equations) presented by a manufacturer play a significant role in identifying to the Customs Department, the types of processes and anticipated inputs and outputs of production, which all assists in specifying the production inputs required and therefore assist in encouraging the industry claim efficient and meaningful exemptions of duties.

Conclusions

REGARDING SALES TAX:

11- The Sales Tax Law does not differentiate between a final product and a production input, but rather defines taxable goods in general. Such taxable goods are governed as to tax amount applicable thereto or tax exemption therefore, pursuant to the tables annexed to the Law, or a Council of Ministers' decision.

Therefore, a factory importing products that are primary production inputs will pay the sales tax on such imports. Likewise, a factory manufacturing production inputs locally will account for the sales tax once it sells this production input to another factory, which means that the subject matter of the tax is the product itself, irrespective of the use made of it.

12- In all cases, both the importer factory and the local manufacturer are entitled to tax refund or tax deduction, where it is proved via their receipts and invoices that the products subject to tax were imported and/or sold as part of the production chain and that the tax was paid in advance to the Department. This entitles them to refund the tax paid (credited at the Department) or to deduct the amounts already paid thereby from the tax that they need to collect and remit to the Department.

As well, the Department has issued Instructions Governing the Collection, Remittance and Deferral of Tax No. (3) for the Year 2003. Under these Instructions, the General Manager of the Department has the authority to approve the deferral of taxes due on the imported goods and services where the taxpayer is registered at the Department; is committed to submit declarations in due deadlines; is not charged with any offences for customs evasion; and where the imports are not for the purposes of carrying out an activity that is not subject to tax or is exempt from tax.

13- The Council of Ministers has an overriding authority to exempt any person, product or service from the sales tax, which allows for many exceptions to be under-passed from the imposition of tax. This is an important conclusion of indirect result, whereby it can be requested by the government, if and when it is affirmed that the tax collection on local inputs does harm the national productions and tend to favor imports in the face of national productions.

REGARDING CUSTOMS DUTIES:

14- Customs duties are only imposed on imports and is applied at the border once the goods are about to be cleared and admitted within Jordan. National production is alternatively not subject to the customs duties and therefore, it seems that national production stands at a better footing than imports, in regards to the application of customs duties.

15- However, the Customs Law identified several mechanisms to temporarily suspend customs duties paid on the imports. These mechanisms are intended to encourage local industries to import production inputs while suspending the duty incurred thereon. Articles (133), (134) and (145) of the Customs Law specified above stipulate the details for availing from the refund mechanisms for importers for purposes of internal manufacturing or importers of inputs to production.

16- Moreover, the Council of Ministers, again, is entitled to totally exempted from customs duties as per its authority under Article (149/c) of the Customs Law. This statement was already argued and implemented on imports as the trend is to exempt all production inputs from customs duties.

REGARDING IMPLICATIONS OF TAX AND DUTIES:

17- Reading both laws and their supporting legislation indicates that little effect is found to impact cost as a result of the application of taxes and duties. On the contrary, legal provisions seem to favor national production on the account of importation, as this is supported by the argument that the sales tax is incurred by both importers and local manufacturers, while the customs duties (if paid) is only borne by importers.

18- For sales tax however, reading of the legislation at hand may suggest an advantage for importing manufacturers who enjoy this deferral facility in lieu of local manufacturers not entitled thereof and are obliged to pay the tax for their local purchases. Moreover, the Instruction on Collection, Deferral and Remittance of Sales Tax to the Department No. (3) for the year 2003 state that tax may be suspended for one month where the tax is due on local products, whereby allowing the taxpayer to withhold the cash flow that would otherwise be frozen when paying the tax, even where a refund is granted. The same facility is allowed for importers, but with an additional advantage by removing the time limit on suspension. This could lead to a little more comparative advantage to the importers in comparison with local producers, who are time-bound to pay the tax one month after deferral, as opposed to importers who are granted unconditional deferral.

19- It seems that the major impediment to local sourcing of production inputs due to tax policy is the effect on cash flow for taxpayers where, even if entitled to refund, pay the tax and therefore, accounting for it and allocating cash in advance. This seems however to be a minor issue so long as the importers are also subject to the same terms and conditions for tax and duty collection and exemptions.

20- In all cases, we must note that it is important to rationalize the existing regime as it aims to strike a balance between the need to support manufacturing SMEs with the need to support importing industries. Thus, the legislation attempts to encourage local manufacturers to pursue their manufacturing processes even where the local market does not provide all necessary inputs, by importing basic inputs from abroad to use in local production- while duty and tax are deferred, especially where the taxes due are in such big amounts which unfeasibly exhaust the cash flow of the manufacturer.

Recommendations

- 4- This report aims at providing preliminary assessment of the implications of the tax regime in Jordan on the national production carried out by small industries who are producers of inputs of another industry. This report was drafted as being heavily based on the reading of the relevant legislation while carrying out basic investigatory work and requesting assistance by some tax specialists. Thus, we recommend that -in order to fully understand the implication of taxes on local production- a more comprehensive investigation is carried out, whereby the feedback of the industry is sought and clearly tabulated regarding their comparative disadvantage as a result of the of taxation regime; as well as the percentage in which these taxes factor as a disadvantage, in comparison to other costs (cost analysis).
- 5- Where in fact, taxes and duties proved to be an impediment towards better networking opportunities for local input producers, the following can be sought:
 - Issue a decision by the Council of Ministers to exempt from sales tax any sales that are intended to be used as production input by a factory. This can also be carried out by giving factories a letter for good manufacturing practices which can be presented to sells of inputs in order t organize a tax-free invoice for the said manufacturer. Additionally, the Department can ensure safe application of this mechanism by posting bonds on such manufactures, under which they guarantee to dispose of inputs as such and not to sell as final products.
 - For customs duties, and as it is already a practice to exempt incoming inputs, it is suggested to support this direction and encourage the full exemption of incoming inputs, while allowing a reasonable degree of competitiveness of local manufacturers through other fiscal exemptions and reduction of other costs such as electricity, water and labor requirements.
- 6- In case more details surfaced by the industry which indicate that the taxation regime is in fact distorting the local production due to major cash deficit resulting from the withholding of taxes by the Department where otherwise they would be utilized elsewhere more efficiently, we suggest that the articles

already referenced in this report be revised and amended to allow for more effective mechanisms for refunds and deferrals of duties and taxes.

Appendices

Scope of Work: Specific Tasks of the Consultant(s)

Activity:	7339.2 Sales Tax Legal Assessment
SOW Title:	Assessment of Sales Tax Legal Framework for Enterprise Development
Modification:	Original
SOW Date:	13 December 2004
SOW:	Final
Task and Consultant:	D/Assessment of Sales Tax Legal Framework for Enterprise Development IBLA

I. Specific Challenges Addressed by this Consultancy

The USAID-funded AMIR Program is currently sponsoring the establishment of the National Linkages Program as a component of the Jordan Upgrading and Modernization Program (JUMP).

The objective of the National Linkages Program is to facilitate “backward linkages” in Jordan. Backward linkages are inter-firm relationships in which large firms purchase intermediate goods and services as its production inputs on a regular basis from one or more local small- or medium-sized enterprises (SME) in the production chain. Backward linkages have the potential to achieve the following.

- Generate additional economic activity
- Strengthen local SMEs through technology transfer and skills upgrading
- Give local SMEs a foothold in international markets
- Attract foreign direct investment (FDI) by offering an adequate local supply base

Backward linkage programs facilitate and enable such inter-firm relationships. A backward linkage program is defined as one that is

- Demand-driven by large purchasing companies,
- Selective in participation by and upgrading of SME supplier companies, and
- Oriented towards SMEs becoming accredited suppliers to large companies.

There is currently no backward linkage program as such operating in Jordan.

Some stakeholders have suggested that locally-produced manufacturing inputs are subject to sales tax, while the same imported inputs may be free of both sales tax and customs duties. For this reason, there is concern that local sourcing may be less attractive to potential clients of the National Linkages Program. It is important that the officers of the National Linkages Program clearly understand this matter before they contact potential clients and market the benefits of local sourcing.

II. Objective of this Consultancy

The objective of this consultancy is to identify any impediments to local sourcing of production inputs due to tax policy and recommend measures to overcome them.

III. Specific Tasks of the Consultant

Under this Scope of Work, the Consultant(s) shall perform, but not be limited to, the tasks specified under the following categories.

A. Background Reading Related to Understanding the Work and its Context

The Consultants shall read, but is not limited to, relevant sections of the following materials to understand fully the work specified under this consultancy.

1. AMIR Program. “Analysis and Recommendations for the Establishment of a Backward Linkage Program in Jordan” (May 2000)
2. AMIR Program. “National Linkages Program Design Update” (January 2004)
3. AMIR Program. “Analysis and Recommendations for the Establishment of a Small Enterprise Component in the National Linkages Program” (October 2004)
4. AMIR 2.0 Technical Proposal

B. Background Interviews Related to Understanding the Work and its Context

The Consultants shall contact personally, by e-mail, or by telephone the following individuals in order to fully understand the work specified under this consultancy.

1. Brad Fusco, ECI Component Manager, AMIR Program
2. Suhair Khatib, BDS Subcomponent Manager, AMIR Program
3. Other stakeholders, as necessary

C. Tasks Related to Achieving the Consultancy's Objectives

The Consultants shall use his or her education, considerable experience, and additional understanding gleaned from the tasks specified in A. and B. above to accomplish the following.

- Identify all laws and regulations related to sales tax and customs duties
- Determine the sales tax and customs duty treatment provided by those laws and regulations for the use of outputs from one local industry as inputs to another
- Determine the sales tax and customs duty treatment provided by those laws and regulations for the use of imported inputs by local industry
- Compare the two scenarios and identify any disadvantages to local sourcing present in the laws and regulations
- Provide recommendations to address those disadvantages

IV. Time Frame for the Consultancy

Unless otherwise specified in writing, the time frame for this consultancy is specified by the expenditure start and end dates shown in Annex C.

V. LOE for the Consultancy

The days of level of effort are allocated by location in Annex C.

VI. Consultancy Qualifications

The Consultant(s) shall have the following minimum qualifications to be considered for this consultancy:

1. *Educational Qualifications*

- Minimum of a Bachelor's degree in law.

2. *Work Experience Qualifications*

- At least five years of practical experience in the field of corporate law.