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TAX EVASION IN OCCUPIED TERRITORIES

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[Text] It was 1 a.m. There was not a soul in the streets of Gaza. No one noticed, on that warm night of mid July, the two Border Patrol jeeps and the civilian car which made their way to the house of one of the well known gold dealers in the city. The senior member of the team, a veteran customs investigator, checked his watch. "Now," he said.

Their knocks disturbed the quiet. "Who is there?" a sleepy voice sounded in Arabic from the inside.

"Customs," replied the investigator.

After a few minutes, the trembling gold dealer emerged. "It is most likely a mistake," he said upon hearing the reason for the night visit. "I have no smuggled gold. All my merchandise is legal. Please come in. Take a look. Search all you want."

The search lasted 3 hours, corner after corner. In one corner, under a pile of junk, gold bars were found. A cursory investigation revealed that they were not marked properly. The rest of the night was spent by the Gaza merchant in the offices of the customs investigation division.

That night the customs officials went to homes and stores of other gold dealers in Ramallah, Nablus, Jannin and other cities on the West Bank. Their take -- 150 kg of unmarked gold. Thus a 2-year investigative project came to an end. The project entailed weeks of collecting data, surveillance and observations. One more Arab-Jewish "plot" to cheat the customs authorities has been uncovered.

Up to 2 years ago the gold market was wide open. Judaea, Samaria and the Gaza Strip were a magnet for enormous amounts of gold which was methodically smuggled into Israel, and from there to dealers and goldsmiths on the West Bank. Gold smuggling was a very lucrative business. Gold prices, in spite of world wide declines, have always been relatively high in Israel. On the West Bank prices were even higher. West Bank Arabs have for eons preferred to invest in "something real," such as gold and jewelry, rather than, for example, bank stocks. "Any family with any respect for itself," customs officials explain, "preferred to hoard gold and jewelry in their mattresses."

In the past 2 years customs officials have succeeded in making gold dealers mark their merchandise, so as to be able to identify its legal origin. Unmarked gold is, by law, confiscated. The phenomenon was of such concern to the customs authorities that even those who cross to Jordan over the bridges were made to mark their jewelry, so there would not be any question about its legality when they came back.

But the flow of smuggled gold to Judaea and Samaria was not completely stemmed. Even after that night operation considerable amounts of gold bars were still found at road-blocks. Only 3 weeks before this article was published, two gold bars were found in the upholstery of a car belonging to a Jannin gold dealer. It turns out that they were obtained from an Israeli source without reporting to the customs or tax authorities.

The wholesale smuggling of gold, via Israeli intermediaries, is but one way to exploit the special status of the territories for the purpose of tax evason. The tax authorities also know that Judaea, Samaria and the Gaza Strip have become a haven for tax evaders, for smugglers of foreign currency and for those who wish to "launder" illegal funds.

If there is a need for official recognition of the fact, it is to be found in drawers in the income tax offices and also in the prime minister's offices and in those of the general secretary of the Histadrut. For several months these respective drawers have contained a document known as the Tzarfati Committee report. The committee, headed by the deputy income tax commissioner, Avraham Tzarfati, devoted a separate section in its recommendations to the subject of tax evasion in the occupied territories.

"The black market," says the report, "is tied in with activities in Judaea, Samaria and the Gaza Strip. To date, although tax obligations for the territorries have been expanded partially, and the tax authorities have been empowered to implement them, they are still a haven for tax evasion. The implementing authority has been rendered impotent," so the report continues, "because of lack of manpower."

Until August 1979 Israelis who made their living in the territories were exempt from taxes. In that respect doing business in the territories was tantamount to doing business abroad. Tax liabilities only applied to income derived from or received in Israel. Yamit settlers who were not aware of the fact that they did not have to pay taxes received a refund.

Between 1976 and 1978, Israeli economic activiy in the territories increased. It was then that the Income Tax Act was amended, so that Israeli citizens and companies incurred a tax libability according to Israeli criteria. For individuals, it was decreed that even if they lived in the territories and derived their income there, their income would be considered as if it were generated in Israel. For companies the law is more complicated. According to attorneys Eli'ezer Tzuckerman (formerly deputy legal adviser for the Income Tax Division) and 'Imanu'el Gabai (formerly deputy Income Tax commissioner) it is incomplete and full of loopholes, wide open to tax evasion.

The law for corporations states that if they are indigenous to the territories--i.e., if they are active there and their owners live in the territories--their tax liability is according to Jordanian law, or 38.5 percent, payable to the income tax officer in the territories. Stockholders, on the other hand, are to pay their proportionate share to the income tax officer in Israel.

In order to evade taxes there are mother, daughter and grand-daughter corporations in the territories, all resident there. Thus, with a complicated scheme of transferring funds from one company to another--which cannot be detailed in this article--many corporations have managed to avoid legally paying their true share of taxes. The Income Tax Division is examining the chain structure of these companies, but things have not reached the point where they can be forced to pay their full share.

This is not the only loophole in the law, but legislation is not the main problem. The real problem is lack of funds and manpower.

"The tax potential in the territories is not fully exploited, although tax collection there has doubled in the last 2 years," says Shim'on Mizrahi, tax official in Judaea and Samaria. "The network of taxpayers is still incomplete and quite a few manage to slip through. Our weakness is particularly glaring when we have to locate tax evasion of Israelis in the territories. My people deal primarily with taxes from Arabs. Officials within the Green Line concentrate mostly on the immediate periphery. This is how the loophole is created. Jewish businessmen in the territories, in settlements or in industrial parks, fall through the cracks, so to speak. There is quite an opportunity here to evade taxes because of assessments and audits which are performed on these Jewish citizens."

One loophole, which has been very well taken advantage of by several Israeli companies, so it is suspected, is in the area of real estate. This has recently become particularly popular. There is currently an investigation going on into the dealings of one large Israeli real estate company active in Samaria. The deals were exposed due to cooperation between income tax and value added tax units in Judaea and Samaria.

The Income Tax Division showed the company as inactive--no reports on real estate deals ever reached the Division, not even balance sheets. But the company found it more difficult to bypass the value added taxes. Because of its nature, simple, easy to collect and not open to interpretation, it was easier to implement reporting for purposes of value added taxes. It thus happened that the routine exchange of intelligence between the two offices revealed large scale deals which had not been reported to the Income Tax authorities.

What followed was to be expected. Further investigation, as yet incomplete, revealed that stockholders also did not report their profits for income tax purposes. Initial estimates are that income of at least $250,000 has not been reported.

How was that accomplished?

Each land deal beween Arabs and Jews in the territories needs the approval of the civilian authorities there. These deals are usually not easily hidden from the income tax authorities. But when the buyer sells the land to a third party, usually an Israeli, the report has to go to the income tax offices within the Green Line. Because of lack of funds and manpower, explains Shim'on Mizrahi, in charge of tax collection in the territories, control in this area is very lacking. It is here that all the violations occur. In this particular case, the Value Added Division uncovered the fraud through a routine investigation.

How much evasion such as this takes place? How much capital is thus turned over? Shim'on Mizrahi and the income tax official have no clear answer. What is clear--and even the Income Tax Division admits it--is that there is a loophole through which big money can be made.

In order to close this loophole, two special supervisors are soon to be appointed by the Income Tax Division. Their job will be to deal only with Israeli companies in the territories. About 200 corporations are registered on the West Bank. More than half of them are real estate companies. The others deal in industry, transportation and commerce. The two can be expected to be very busy.

Construction is no less lucrative for tax evasion by Israelis in the territories. Only recenly the Income Tax Division found out about an Israeli company which won a bid to pave roads in Judaea and Samaria. Employing a sophisticated scheme, a real profit was turned into a paper loss. The funds remained within the company, with no taxes paid on the profits.

The fraud was worked out as follows: The job was subcontracted to an Arab company based in the territories. The local company received 90 percent of the income. The Israeli company was supposed to receive the remaining 10 percent in lieu of income tax not paid. But, falsified documents filed with the tax authorities reported payments to the Arab company which were 10 percent more than all income. The large payments were explained as "unexpected expenses incurred in the course of the project" (the Jordanian law is indeed very generous in allowing deductable expenses and it is therefore very easy to submit inflated bills). Thus the Israeli company showed itself as being in the red. The true profits were pocketed. The Arab contractor also profited because of the fictitious expenses allowed him.

Another Israeli firm, which contracted for construction jobs in one settlement, also showed suspicious generosity in paying its Arab subconractor. An investigation showed that its actual expenses were 70 percent lower than those showing in the receipts it submitted. The subcontractor, who was caught as a result of a routine investigation, was broken very easily. Now the investigation is concentrating on the books of the Israeli firm, too.

Not only construction companies work with subcontractors in Judaea and Samaria. Clothes manufacturers, small businesses, shoe factories and others have found out that it pays to work with an Arab subcontractor, because taxes for Arab workers are withheld at the rate of 25 percent at most (compared with 50 percent in Israel). "Utilizing the subcontractor method," says Shim'on Mizrahi, "it is much easier to report fraudulant figures. It is not at all unlikely that many Israelis are taking advantage of this so as to conceal their real profits. There are many Israeli firm that employ Arab subcontractors on the West Bank. Tax officials find it difficult to verify whether expenses are real or fictitious."

Another method, no less sophisticated, to outsmart the tax authorities was recently uncovered when an Israeli firm in the housewares business sold huge amounts of merchandi_ to an Arab firm in the territories at wholesale prices and with suspicious losses. The Arab firm resold the merchandise, at a profit, of course. Because of the lower tax rate applying to local companies as per the Jordanian law, the Arab intermediary was left with enormous profits. These profits were shared with the Israeli partner, who did not report them, because according to his books he was operating at a loss. The fraud, by the way, was discovered when an astute official suspected the balance sheet of the Israeli firm. The remainder was up to the Income Tax Division investigators.

One of the best known and most complex investigations that the customs offices conducted, against a well known Israeli importer, revealed a similar scheme. That importer sold smuggled merchandise in the territories on a large scale via an agent who was working under an alias. The agent distributed, in addition to merchandise, fictitious receipts bearing the name of a non existent person. Thus both he and the Israeli importer could enjoy untaxed income. The agent was found only after the Israeli importer, whose apprehension was well publicized, reported the name of his Arab accomplice.

This case--which is now in the courts--was not unique. There were more straw men like that Arab agent who distributed smuggled merchandise, originating in Israel, under false identities. Their apprehension is relatively difficult in the territories because of limited manpower. It should be pointed out, though, that because of unannounced road-blocks, recently employed by the tax authorities, it is almost impossible to transport merchandise in Judaea and Samaria without proper documents. Competition also lands, quite often, some nice results for the intelligence branch of the tax authorities.

The chief of customs and value aded taxes in the territories, Me'ir Yaffe, says that cooperation in smuggling merchandise to the territories is usually based on financing in the territories and on smuggling by Israelis. "In the last year millions of dollars' worth of smuggled merchandise was found in the territories. Recently there was a "plague" of containers full of rugs which were discovered in Nablus, Jannin and Gaza. Smuggled (or stolen) video cassette recorders and televisions have always been very popular on the West Bank. Those who do the financing are usually merchants who became rich under Israeli rule, and who make contacts with criminal elements in Israel. Established merchants do not deal, happily so, with stolen or smuggled goods."

But, the most prevalent method, so it is estimated, is that of forming concealed partnerships between Jews and Arabs. This method entails large profits, especially in agriculture, which is not taxable under Jordanian law.

Thus, for example, an Israeli farmer from the north recently formed an unofficial partnership with an Arab to establish a cattle ranch on the West Bank. That Arab was actually a straw man, whose sole function was to be the official proprietor of the business. The Israeli financed the whole project. The 75 percent of untaxed profits returned to him. His Arab partner received the rest, with no investment whatsoever.

Between 60 to 80 such partnerships were uncovered recently, especially in the construction industry, commerce and agriculture. Since agriculture is not taxable according to Jordanian law, it is also the most difficult to uncover. But even in other, taxable, industries such partnerships pay off because of the lower tax rates in Judaea and Samaria, according to Jordanian law.

[Box on p 16]

According to estimates, at least $40 million cross the Jordan bridges monthly into the West Bank. The sources of these funds are contributions to various oraganizations, support from relatives in Arab countries, loans and other sources. According to regulations of the civilian authorities, each Arab citizen in Judaea and Samaria is entitled to bring in $5,000 without having to declare anything.

"This money," says the official in charge of tax collection in the territories, "finds its way to the Israeli and West Bank black market. These funds are in addition to monthly salaries received by Jordanian officials in dinars. This is "good" money, non-taxable, because we are mandated to do so by the civilian authorities. The dinars are exchanged to shekels for day to day expenses. The dinars are returned to Jordan where they are exchanged for dollars, which return to the West Bank in the next round."

But there is something which causes even more concern: the smuggling of foreign currency from Israel to Switzerland, via Amman. "There is a flow of currrency from Israel abroad," says Mizrahi. "We have no idea what its true dimensions are. This is how this takes place: An Israeli goes to a money exchanger and hands over a large amount in dollars. He receives a check, where the amount is stated in dollars. The money, thus deposited with the money exchanger, is transferred to Amman, and from there, via a bank, it is deposited in Switzerland. Generally a whole month goes by before the circle is complete and the Israeli depositor can verify that his money is in Switzerland."

It is estimated that this is done by small and medium size businesses and even small time contractors. Cracking this circle is extremely difficult because of the degree of confidentiality maintained by both sides.

[Box on p 17]

Does an Israeli citizen, residing on the West Bank, have to pay income taxes, or is it that Israeli law does not apply there? According to internaional law the law that applies on the West Bank is the Jordanian law. When it comes to local Arabs no one disputes that the Jordanian law (along with some amendments implemented by the military authorities and later by the civilian authorities) applies. But when it comes to Israeli Jews, the law is open to interpretation.

One of the more interesting legal struggles on this issue was settled about 2 years ago by the Supreme Court. It was the appeal by the QPA Pladot Company of Qiryat-Arba regarding a lower court ruling that it is liable for income tax. The firm was accused, and found guilty, of not paying income taxes. It appealed, claiming that since Jordanian law applied in the territories, it could not be forced to file an income tax return in Israel.

But the Supreme Court, in a precedent setting ruling which to date serves the tax authorities, rejected the appeal and ruled that the firm did indeed have to file a return, even if it was not requested to do so. Moreover, the tax authorities have the right to enforce it and employ all the means at their disposal in order to collect the tax.

The Supreme Court ruled that although international law states that one country has no authority to enact tax laws in another country, Israeli citizens cannot be regarded as residing abroad, in this context. Judaea and Samaria, so it was stated, are occupied territories, and Israeli citizens residing there are affiliated with the State of Israel.

A similar struggle took place several years ago regarding the Finance Ministry's authority to collect value added taxes in the territories. The appeal was made by local merchants. At the end of a long and complicated legal debate, the court ruled that Israel has full autority to collect value added taxes in the territories, among others, because all revenues thus realized are spent on the local citizenry.

No wonder then, that politics has invaded the tax issue. The Finance Ministry has always been under pressure to apply Israeli rule to the territories. There were even Israeli firms, based in the territories, that because of political protest did not take advantage of the lower rates allowed them by Jordanian rule and preferred to pay taxes according to Israeli law.

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