

Imposing a Value Added Tax on Fruits and Vegetables

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**Re: Imposing a Value Added Tax on Fruits and Vegetables –
In anticipation of the Knesset Finance Committee's Discussion on Wednesday
26.5.09**

As early as 1990 an attempt was made to cancel the 0% VAT rate on fruits and vegetables. As a result of fierce opposition and problems that were raised at the time concerning implementation, it was ultimately decided to leave the situation as it was. Today, after almost 20 years, the Finance Ministry is once again attempting to revoke the VAT exemption on fruits and vegetables. Additionally, the Finance Ministry suggests raising the VAT rate by 1% for a year and a half (from 15.5% to 16.5%), despite promises last year to lower VAT by 1%. However, these decisions would only take effect after preliminary approval by the Knesset Finance Committee, and currently, a majority in opposition to the measure is forming in the committee.

The Finance Ministry claims the assessed cost of the tax benefit that could have been collected on fruits and vegetables for fiscal year 2008 totals 1.6 billion NIS. However, the Finance Ministry calculations do not take into account possible shifts in economic behavior by tax-payers as a result of canceling the tax benefit. As a result of the change people would consume less fruits and vegetables, and therefore the total income of the state from the measure would be much smaller than anticipated.

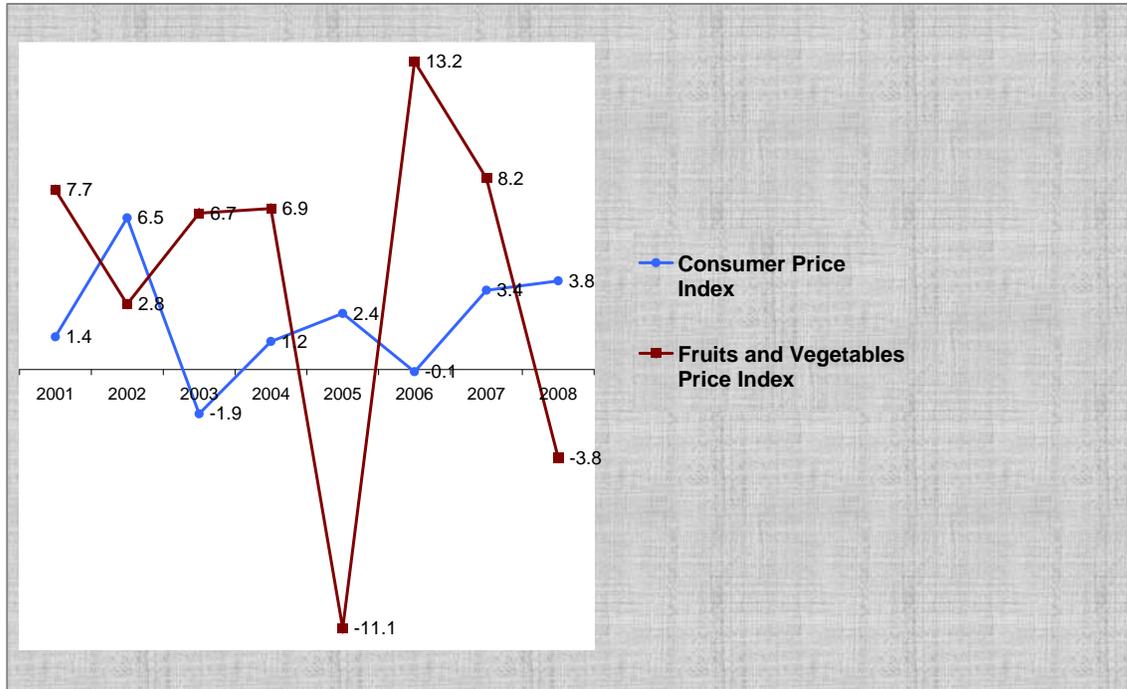
The tax benefit assessment method of the Finance Ministry is inaccurate and incomplete. This can be grasped from the Finance Ministry's own budget policy for 2008: "Tax benefit assessments suffer from high degrees of uncertainty... these assessments are made on partial data, lagging behind by a number of years... a possible decrease in fruits and vegetables consumption as a result of VAT imposition has not been taken into account."

Furthermore, in the budget policy for 2008, the Finance Ministry officials wrote that by canceling all tax benefits on governmental taxes, they could lower taxes both for individuals and companies. A theoretical decrease of 15% on individual taxes 4%, on corporate tax and 1% on VAT was mooted. Today, however, the Finance Ministry proposes solving the economical and fiscal problems in the opposite way: by increasing value added tax (VAT), and proposing to cancel benefits without a simultaneous decrease in tax rates on individuals and corporations.

Due to the fierce opposition, the Finance Ministry is considering providing benefits which would make the deal more palatable, such as discounts on public transportation and national insurance. In practice, instead of canceling the tax increase, the government attempts to expend with one hand what it raised with the other, and thus inflicts double damage upon the public. The tax hike provides a negative incentive to consume, harms the health of the poor and depresses employment in the food industry, while in addition, it also strengthens the bureaucracy that is expected to dole out subsidies as compensation for raising the tax.

Statistical data:

The percentage changes in the consumer price index in comparison with the fruits and vegetables price index for the years 2001-2008



An adaptation by the Jerusalem Institute for Market Studies of data from the Central Bureau of Statistics, 2001-2008, derived from: Consumer Price Index, by branches of economy, vegetables, fruits and crops, change in percentage – December vs. December.

From the above chart we can see that in most years, the trend of the price index for vegetables, fruits and crops is upward compared with the previous year, and the trend is disproportional to the more moderate upward (or even downward) trend of the Consumer Price Index. Taxing fruits and vegetables specifically, a branch where prices have increased most years, with an increase that is relatively higher than other products in the citizens' consumption basket, represents a double blow for consumers.

Additional data of the Central Bureau of Statistics (CBS) shows that:

- Families that earn less than 7,000 NIS a month expend some 250 NIS a month on fruits and vegetables, with the annual budget totals over 3,000 NIS. **The added burden of the proposed tax will add 16% to a family's expenses for fruits and vegetables.**

- Families with a lower income expend 3.5% of their income on fruits and vegetables, while higher income families expend only 1.5% of their income on fruits and vegetables. **Therefore, a tax on fruits and vegetables will mostly hurt lower income families.**

The opposition's stance:

- VAT is a regressive tax that mostly hurts the weaker classes. The Finance Ministry's decision to raise VAT in addition to the decision to cancel the exemption on fruits and vegetables is “hitting those who are already down”.
- The new tax package (raising VAT, imposing VAT on fruits and vegetables and more) is expected to cause a sharp increase of 1.8% in annual inflation. This is a one-time spike commencing with the last quarter of 2009.
- A third of fruits and vegetables are sold in open markets, where there is no practical way to fill in every receipt, and it is unfair to demand that stall owners fill in tax receipts. This is a measure that is difficult to enforce, and there are many ways to evade it.
- The price of raising fruits and vegetables changes often, which makes setting and registering the tax difficult. The cost of collecting the tax by suppliers will increase the base price, so consumers are hurt again.
- Stance of the supermarket chains: They are fiercely opposed, as they claim that the fruits and vegetables market increased in price over the last three years by 21%, as opposed to only 7.5 for the general index.
- The data of the Agricultural Planning Authority in the Ministry of Agriculture also shows that in March 2009 vegetables increased in price by 8.4%, as compared with only 0.5% for the Consumer Price Index.
- Many soup kitchens and institutions state that taxing fruits and vegetables is expected to add direct costs of roughly 400,000 NIS a year, with the VAT increase of 1% costing an additional 300,000 NIS.

- The Israel Pediatrics Association has also expressed its opposition to the Finance Ministry proposal as it not only hits the public in the pocket but it is also detrimental to the health of children.

The Treasury's Reply:

On the one hand, the Treasury claims that despite the attempt to make things easier for the weaker classes they are determined to impose VAT on fruits and vegetables, as it is a distorted exemption created due to historical circumstances, and today 80% of fruits and vegetables are sold by regular businesses which pay VAT. However, due to the harsh criticism and pressure from Knesset Finance Committee members, at the last committee discussion the Finance Minister hinted that he is willing to reconsider the matter if alternative solutions that do not breach the deficit target of 6% of the GDP can be identified.

The Spokesperson for the Finance Ministry, Shlomi Shefer, concedes that low-income recipients are the ones hurt the most by the proposed tax. According to Accountant-General Shuki Oren: "The fruits and vegetables VAT issue is part of the ministry's original plan, and we are looking for ways to compensate the weaker classes. The VAT raise issue is more of a financing issue, and will last for only for a year and a half."

Therefore, the Treasury is considering alternatives that benefit the weaker classes and compensate for taxing fruits and vegetables, such as cheaper public transportation and benefits in national insurance payments for lower-income households. Another measure the Treasury is considering instead of taxation is raising the stipend for the fifth child, or alternatively increasing stipends in a linear fashion (equal increase for each child).

Conclusions:

- **The government intends to dole out with one hand a large portion of what it rakes in with the other.**

- **This is a double blow**, as raising taxes, and the price rises in the wake of the tax, causes **a negative incentive to consume – harming the health of the poor and depressing employment in the field**, at a time of employment difficulties.
- **These steps will only strengthen the existing bureaucracy**, as the government will provide subsidies for transportation or increased stipends, two items that distort other branches and increase the power of the government, increasing dependence on the government rather than attempting to strengthen the independence of the citizenry.
- Studies by the Treasury show that lowering taxes is appropriate and will encourage the economy's growth. On more than one occasion the Prime Minister has been quoted in this vein. Despite this, the opposite has been decided upon. **Imposing a regressive tax will harm the weaker classes, private consumption and the economy's growth, and runs contrary to government promises.**
- **The assessments of the Finance Ministry are faulty and inaccurate.** The Finance Ministry claims that 1.6 billion NIS could be added to the budget by imposing taxes on fruits and vegetables. But it itself admits that the calculations do not take into account possible changes in the economic behavior of tax payers as a result of the benefit's cancellation. **As a result of the change people will consume less fruits and vegetables, so that the total intake will be less than predicted.**
- **We should learn from larger and better countries who are going the opposite route:** In England, for example, not only food is exempt from VAT, but also medicines, equipment for the disabled, books and many other branches. Many countries have also totally exempted small businesses from VAT payments.
- While it is true that according to KPMG data, the average VAT rate in the European Union totals about 20%, outside the union the picture is different – in developed countries 17-18%, in South America around 14%, and in the Asia-Pacific region, less than 11%. **It should be noted that the total tax burden in Israel is high by any standard, as well as the bureaucratic burden on businesses, and we should strive to change these trends.**

- **The VAT collection method causes the country's consumers and businesses, as well as its officials, a number of severe problems:** businesses need to pay VAT to the state before receiving the money, which means they are effectively loaning the country money. If the deal is cancelled, they must struggle to get their money back. It would be easy to solve part of the VAT collection problem, if the date of VAT payment would change and become the date the business receives the cash. **Instead of increasing VAT percentage, action should be taken to change the collection method.**