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by Camilo Martinez

The Iraqis are fostering, with the help of the international community, an institutional and legal framework for the new order. One of the vital elements of that framework is a functioning, just, and reliable tax system that can respond to the many demands on the public purse in a country set to reconstruct its infrastructure.

This article analyzes what has already been done to put in place a new tax system for Iraq and addresses some choices for the future.

We start with the new interim Iraqi Constitution, of which article 18 is probably the shortest article, and perhaps the most reassuring, simply proclaiming, “There shall be no taxation or fee except by law.” With that, the Coalition Provisional Authority (CPA) validated the country’s constitutional tradition going back to the first constitution of the then recently unified Kingdom of Iraq of March 21, 1925, article 11 — “No tax may be imposed except in accordance with law, the provisions of which shall apply to all classes of the people.”

Away from the rarified air of constitutional law, the new government had to recognize that it would be almost impossible to enforce taxation, in all its latitude, amid the chaos of the first months after Saddam’s removal. The CPA decided in September 2003 to suspend all taxes of the ancien régime from the day Saddam was removed to the end of 2003, except for the following:

- tax on luxury hotels and restaurants;
- tax on the transfer of real property;
- tax on the sale of cars; and
- excise tax on petrol.

Taxation could still operate in those few, manageable areas.

Luxury hotels and restaurants were a small, easily tapped universe catering to the influx of foreigners brought over by coalition members, relief agencies, and news organizations. The sale of real property and cars depended on public registration of deeds for legal certainty. The excise tax on Iraq’s main export item was the most obvious and perhaps the most easily enforceable of all sources of tax revenue.

The CPA decided that individual and corporate income tax for 2004 and subsequent years would not exceed 15 percent, reduced from the previous 40 percent maximum tax bracket.

At the beginning of 2004, the CPA decided to prolong the suspension of all taxes with the exception of the aforementioned taxes until March 31, 2004, and introduce a more generous progression of individual taxes and allowances. As a result of
the changes, some individuals will pay one-fifth of what they used to on the same income, comparing
the old and the new rates and allowances tables. Reductions of 70 percent are not uncommon.

With the passage of political authority from the CPA to Premier Iyad Alawi’s government, that new design was maintained. Although it seems, *prima facie,* (to be cynical) an attempt to pander to the masses by heralding the new government with lower taxes or (to be optimistic) to promote productive investment at a time of reconstruction with lower taxes, it could disguise a grander design.

Most countries draw the bulk of their tax revenues from individual and corporate income taxes as well as from indirect taxation — typically (general) sales tax or value added tax. Iraq, however, has never had indirect taxation worthy of that name and is now dramatically reducing individual and corporate income taxes.

That could mean a deliberate decision to rely more heavily on the excise tax on petrol because the other taxes could not possibly meet the country’s tax revenue needs. If that is the case, there are important repercussions — taxation in Iraq will go far beyond Iraq’s borders.

An excise tax on such a vital and strategic natural resource as petrol, sold all over the world, will go one step past just “exporting” taxes (something most textbooks in economics would advise against) and will, in effect, “internationalize” the tax burden of Iraq, sending abroad the bill for the country’s internal needs.

At that point, we would have a delicate political and financial balancing act. On one side, the excise tax on crude oil is bound to help maintain the commodity’s high prices, and on the other side, lower internal taxes may help reduce social unrest, which would translate into a much-needed political stability that could ultimately dictate lower prices for crude oil in international markets.

Time will tell the outcome.