

Municipal Rate (Arnona) – Levying, Discounts and Regulation of Collection

Summary

General Background

1. The major source of self-revenues for the local authorities is the municipal rate or municipal property tax - in Hebrew: Arnona - which they levy on the property holders within their jurisdiction, according to their zoning classification and location. In 2012¹, the local authorities levied taxes in the aggregate amount of NIS 26 billion, which, after the grant of discounts and exemptions, accounted for some 71% of their total planned self-revenues for that year.
2. The Arnona rules are anchored both in primary legislation – i.e. British Mandate ordinances and Knesset laws; and in subsidiary legislation – i.e. regulations and orders instituted by the Ministers of Interior and Finance, as well as Arnona orders which the local councils update yearly.
3. In the framework of combating runaway inflation in the eighties of the twentieth century, the Economic Stabilization Law, 5745-1985 (hereinafter: "the Freeze Law") was enacted, which restricted the power of local authorities to decrease their deficit by raising Arnona rates, and transferred their power to increase them beyond a certain cap to the Ministers of Interior and Finance (hereinafter: "special approval").

Audit Actions

4. Between the months of October 2013 and February 2014, the State Comptroller's Office examined various aspects of the Arnona issue, including: levying of Arnona by the local authorities; grant of Arnona discounts to the eligible; monitoring and collection of Arnona debts; write-off of Arnona debts. The examination was carried out in 12 local authorities: seven municipalities – Beer Sheva, Bnei Brak, Haifa, Tirat Hacarmel, Afula, Nazareth and Acco; three local councils – Abu Snaan, Zichron Yaakov and Peki'in; and two regional councils – Hof Hasharon and Merom Hagalil. Complementary checks were carried out by the Ministry of Interior, in two of its districts – Haifa and Northern District, and by the Ministry of Finance's Budget Division. The findings of this report are based also on data and information gathered by the State Comptroller's Office through a questionnaire sent to all 257 local authorities in Israel.

Major Deficiencies

Deficiencies in Levying Arnona

5. The State Comptroller's Office did not find the system of logical arguments, reasons and justifications for the actual Arnona rates levied by the local authorities. Every local authority levies

¹ As of the audit completion date, February 2014, the data for 2013 have not yet been released.

Arnona by the incremental method, without examining the yardstick of needs required for funding its activities. Notwithstanding the government's decision passed already eight years ago to set up a public committee for Arnona reform, its recommendations have yet to be forwarded to the Ministers of Interior and Finance.

6. Many local authorities decided to add sub-classifications to the 12 principal classifications set out in the Arrangements in the National Economy (General Property Tax [Arnona] in the Local Authorities) Regulations, 5767-2007 (hereinafter: "Arnona regulations"), with some even defining numerous sub-classifications. Moreover, properties with the same zoning use were classified differently and properties used for one single purpose were split into several classifications. Such a situation resulted in the lack of uniformity among the local authorities in levying Arnona (municipal property tax) and in inequality among the payers of Arnona in respect of comparable properties.
7. Local authorities prescribed in their respective Arnona orders, rates that deviated from the provisions of the Arnona regulations, levying rates on properties within their jurisdiction based on different measurement methods and treating annexations and common properties differently, with some even charging rates based on a measurement method differing from that prescribed in their own Arnona order. Such a situation results in great disparities in the property tax rates charged by different local authorities, thereby creating inequality in the distribution of the tax burden among the property holders.
8. For many years some of the local authorities have not been carrying out a property survey, leading to the suspicion that this is causing them a loss of revenue and creating inequality in the tax burden imposed on the different property holders in their jurisdiction.
9. The large number of applications for special approval, granted wholly or partially by the Ministry of Interior – 92 applications in 2012 and 62 applications in 2013 – is inconsistent with the purpose of the legislation, effectively turning the exception into the rule. The Ministry of Interior's handling of some of the applications for special approval dragged on inordinately, to the point that some of the local authorities could not realize it during the relevant tax year.

Grant of Arnona Discounts Not in Accordance with Regulations

10. Local authorities granted different types of discounts, not in accordance with the provisions set out in the Arrangements in the National Economy (Discount on Arnona) Regulations, 5753-1993, and without sufficiently checking the eligibility of the applicants. They did not establish subsidiary tests for granting the discounts and did not cancel discounts for the eligible who had failed to settle their outstanding debt by the end of the tax year.
11. The Ministries of Interior and Finance did not establish a mechanism for updating the list of new immigrant cities, in accordance with objective and reliable criteria. The delay in handling the issue perpetuates a situation in which certain local authorities enjoy an increase in revenues from Arnona

(property tax) on state-owned properties, irrespective of the proportion of new immigrants in their population, and vice versa.

Deficient Monitoring of Arnona Debts and Collection

12. The audit presented a gloomy and worrisome picture regarding the local authorities' handling of the enormous amount of unpaid Arnona debts. At the end of 2012, these debts totaled NIS 27.5 billion, with the amount of debts for that year exceeding by over NIS 9 billion the local authorities' cumulative deficit and borrowing load combined. The weighted rate of Arnona collection in the local authorities for that year stood at 42%, and in 20 local authorities it was even lower than 10%.
13. In the absence of clear criteria, the local authorities adopted, each after its own fashion, different rules for defining Arnona debts, whose collection is uncertain, as "doubtful debts." At the end of 2012, some 62% of total Arnona debts owed the local authorities – NIS 17.0 billion – were defined as doubtful. The Ministry of Interior presented the Arnona debts in its annual statements without the doubtful debts, thereby embellishing the true picture regarding the scope of debts and giving the local authorities legitimization to treat the doubtful debts as bad debts which are uncollectible.
14. The audit uncovered many deficiencies in the processes of recording, monitoring and collection of Arnona debts by the local authorities. The statute of limitations on debts owed some of the local authorities expired due to the non-institution of proceedings for their collection. Local authorities discontinued or delayed collection proceedings against Arnona debtors within their jurisdiction, though no documents turned up showing the reasons for this, and despite the fact that they had engaged collection companies to handle the debtors.

Deficiencies in Arnona Debts Write-Off Process

15. The law and Arnona debts write-off procedure issued by the Ministry of Interior pose certain requirements with respect to approval of applications for write-off of Arnona debts. Likewise, they differentiate in this respect between a municipality, local council and regional council. The Ministry of Interior did not direct its districts to issue a procedure regulating processes for reviewing the applications. Local authorities wrote off bad debts and non-bad debts not in accordance with the law and debt write-off procedure, and without the approval of the Interior Ministry as called for.

Principal Recommendations

16. The Ministries of Interior and Finance should review the issue of Arnona imposition and rates, and work to establish an agreed upon, concise and "closed" list of classifications and sub-classifications and to limit the number of differential tax rate zones. Also, they should act to institute a uniform method for calculating the property area and limit the use of special approvals. They should seek to

carry out a general, methodical and progressive revision of the Arnona levying method to include all local authorities.

17. The Ministries of Interior and Finance as well as the local authorities should review the topic of Arnona discounts, rates and eligibility tests, with a view to creating uniformity and equality in this area. The Ministry of Interior should consider rounding up all the reasons for granting a discount under a defined and uniform number of categories where the discount rate and area of the eligible property are identical, and strive to achieve a fairer and more egalitarian system of granting Arnona discounts.
18. Given the enormous scope of Arnona debts, the local authorities should strive to collect them efficiently and effectively. A situation in which the local authorities increase the burden on the public through anomalous increases in the Arnona rates, instead of concentrating efforts and resources to claim the monies due them and collecting them from the debtors, is not a normative situation. Collecting the debts owed them will not only enable them to secure billions of shekels that are needed to provide better service to their residents, but will also contribute towards reduction of their deficits, proper administration and respect for the law.
19. The Ministries of Interior and Finance should endeavor to provide the local authorities with additional tools that will help them deal with the collection of Arnona debts. These actions should be backed by law and procedures that formalize and regulate issues of authority and responsibility.
20. The Ministry of Interior should engage auditors on its behalf to oversee the local authorities, and to ascertain that the provisions prescribed regarding the write-off of Arnona debts have been assimilated by them and are being duly implemented. In addition, the Ministry of Interior should also examine whether there is any point to the existing distinction made in the law's provisions between municipalities and local and regional councils, regarding their authority to write off bad debts.

Conclusion

21. **The audit uncovered substantive deficiencies and lack of uniformity in the method of levying Arnona by the local authorities, which stemmed in part from the effect of the Freeze Law. The mechanism of levying Arnona is both complex and cumbersome due to the multiplicity of classifications, rates and measurement methods, and is marked by non-uniformity and inequality. Deficiencies were also found in the system of granting discounts to the various property holders, and in the monitoring and collection of the enormous amount of Arnona debts – totaling as of the end of 2012 some NIS 27.5 billion. Other flaws revealed included the improper write-off of Arnona debts, and the absence of adequate oversight and control by the Ministry of Interior over the local authorities in this matter.**

22. **The Ministries of Interior and Finance were aware of the lack of uniformity, cumbersomeness and distortions characterizing the Arnona levying system in the local authorities, and over the years set up numerous committees to handle the matter. The most recent and comprehensive committee was set up in 2007; however, its recommendations were never submitted and discussed in any forum.**
23. **For years the matter has not been addressed seriously, and it is high time that the Ministries of Interior and Finance, in collaboration with the Ministry of Justice, carry out a profound reform to achieve a comprehensive and coherent resolution of the Arnona issue in the local authorities, inter alia, through the institution of regulations and initiation of legislative amendments.**