

**A Politician's Appraisal of Property Taxation:
Israel's Experience with the *Arnona***

Dan Darin
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Abstract

Throughout the world, governments are searching for better taxation systems than those we are familiar with to finance the activities of local authorities. Every known local taxation system includes some snag, drawback, or disadvantage to the individual or to the community. Land and taxation policy experts continually study and compare the existing systems, as well as proposals to ameliorate them.

In “A Politician’s Appraisal of Property Taxation: Israel’s Experience with the *Arnona*,” the system is first summarized for those are unfamiliar with this, the *arnona*, Israel’s unique form of local tax. The *arnona* has a tremendous effect on local authorities in the country, as it is by far their main source of income. In Tel Aviv, for instance, it provides nearly two-thirds of the city’s annual income. At first glance, the *arnona* seems to be a very non-sophisticated system, especially compared with the advanced CAMA [Computer Assisted Mass Appraisal] and/or the *ad valorem* property tax. However, upon closer scrutiny, the taxation scholar discovers several distinct advantages of the *arnona* system, and a potential for application in many other countries, once some of the disadvantages are overcome.

About the Author

Dan Darin was born 1939 in Tel Aviv. He studied architecture and has his own practice. He has designed numerous buildings. Together with his father, Haim Darin-Drabkin, Dan Darin was among the founders of the International Center for Land Policy Studies (ICLPS), which he has served in many roles, including editing and producing 40 issues of the ICLPS Newsletter. He has also has written extensively on land policy and taxation policy.

Dan Darin has been intensively involved in Israel's political scene since 1973. In 1989 he was elected to the Tel Aviv municipal council, and served as a member of the Local Committee for Building and Planning. In 1993, he became first deputy mayor in charge of planning, building, and infrastructure. In 1998, he returned to his private architecture practice.

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A Politician's Appraisal of Property Taxation: Israel's Experience with the Arnona

Introduction

Aung San Suu Kyi, Burma's Nobel prize-winning opposition leader, commented on the response of Burma's ruling generals to international sanctions: "I don't think dictators ever decide to give up. It is circumstances that decide for them."

Taxes, rates, charges, and levies, tend to behave in a similar manner. Unless pressure is exerted upon policy makers and politicians, taxation measures, like dictators, persist.

Since 1979, I have been involved in issues of land policy and taxation, in general, and with the Lincoln Institute of Land Policy, in particular. As an architect and planner, I am convinced that the only way to influence housing markets is by effecting changes in land markets. Such changes are difficult to make, as land is a commodity unlike any other in the general market.

For ten years, I had the privilege of serving on Tel Aviv's 31-member city council. For the first five years, I was the leader of the opposition. For the second five-year term, I was elected Tel Aviv's first deputy mayor in charge of planning, building, and infrastructure. During the entire ten years, I served on the *Arnona* Appraisal Committee, first, as a representative of the opposition and then as the committee head.

I discussed the *arnona* as a means to finance local authorities, in a paper, "*Arnona: The Israeli Form of Local Property Tax*," presented to the international conference on Property, Taxation and Its Interaction with Land Policy, organized by the Lincoln Institute of Land Policy and held in Cambridge, Massachusetts on September 22-28, 1991. Later, Joan Youngman and Jane Malme (1994) compared the Israeli experience with the *arnona* to other taxation systems in their *International Survey of Taxes on Land and Buildings*. The study was sponsored by the Lincoln Institute of Land Policy, the Organization for Economic Cooperation and Development, and the International Association of Assessing Officers, and published by Kluwer Law and Taxation Publishers.

Financing Local Authorities

The world is in search of a good system to finance the activities of local authorities. For some unknown reason, central governments decided that income tax and value-added tax (VAT) are good means to finance the needs of central governments. It was also decided, probably by the same bodies, that local authorities would find other taxes and charges as a means to finance their activities.

If the relationship between central and local governments was different, it might have been easy to enact a law for redirection of a set portion of the VAT and income taxes back to the localities where they were collected. However, due to the local authorities' desire for freedom from central government and central government's lack of desire for

financial commitments to local governments, an unwritten decision was taken, somewhere, that local authorities would seek financial solvency elsewhere.

Local authorities have invented different forms of taxation to finance their activities: property tax, domestic rates, council tax, community charges, development charges, betterment tax, land profit tax, land value increment tax, vacant land tax, annual site value tax, tax on sales profit, land transfer duties, sales tax, tax on residency in hotels, leisure tax, and many other measures. Each locality has adopted a form of taxation that is attractive to the administration and accepted by the population. The systems adopted remain in use until the population protests, because they have become too burdensome. After the revolt, the system is changed, altered, modified, or completely replaced by another form of taxation. Proposition 13 in California is one example; the poll tax in Britain is another. Israel has adopted the *arnona* system. It is used because its advantages outweigh its disadvantages and because the population, for now at least, accepts it.

Israel's Economic Strength

The *arnona* is a unique taxation system, quite different to taxation systems known in the western world. At first glance, it seems to be a very unsophisticated system, particularly in comparison with the advanced CAMA (Computer Assisted Mass Appraisal) *ad valorem* property tax.

The scholar might attribute this weird system to the state of development of the country. However, although Israel is a small country, its economy is very developed. Table 1 demonstrates Israel's economic situation, in relation to that of other countries.

In terms of the gross domestic product, Israel takes eighteenth place among the countries studied. However, in terms of per capita GDP, Israel stands in the seventh place. It shares the twelfth place, with Indonesia, as far as the growth of the GNP is concerned, and thirteen, at the moment, in terms of annual rate of inflation.

The Current Paper

In the current paper I begin with an introduction to the *arnona* taxation system, for those who are not familiar with it. In the first chapter, the *arnona* system is described: how it works, the *arnona* base; the factors that determine the rates (land use, location, type of premises, age of the construction); actuality of the system; the possibility of offering discounts; the appeal procedure; collection procedures; revenues and the costs of the *arnona*. This is followed by a discussion of different facets of the *arnona* based on my experience in the politic arena.

In chapter 2, I consider some political issues that relate to the essential nature of the *arnona*—its functionality and arbitrariness. In the affluent part of the city, the system is criticized for its progressive nature. The residents there propose to pay user charges. Residents of the less affluent part of the city don't want to hear about user charges and think that the affluent should be taxed more heavily.

Tel Aviv's *arnona* zones were defined in 1970. At present, the boundaries seem to be quite arbitrary and unjustified. However, the officials in the municipality prefer spot zoning to rethinking the whole issue.

Table 1: Economic Forecast for 1999

	Inflation (%)	GNP growth (%)	GNP (\$ per capita)	Population (millions)	GNP (\$ billion)
USA	2.4	1.6	32,616	272.3	8,848.4
Japan	-0.1	0.2	25,129	127.0	3,190.7
Germany	1.5	8	27,418	82.5	2,431.4
France	1.2	2.1	25,425	59.2	1,522.7
UK	2.7	8	23,478	59.3	1,450.6
China	6.0	7.0	779	1,250.0	978.3
Brazil	3.5	8.2	4,820	163.8	789.4
Spain	2.5	4	15,032	39.4	592.1
S. Korea	5.7	-2.3	6,135	46.8	287.0
Taiwan	2.9	4.8	12,074	21.9	264.7
Russia	80.0	7.0	2,466	146.6	239.7
Argentina	2.3	3.4	6,177	36.2	223.9
Turkey	64.7	4.1	3,159	65.7	207.5
Thailand	7.0	-0.1	2,135	61.7	131.7
Greece	4.0	3.2	11,739	10.6	124.0
Indonesia	15.9	2.3	590	208.2	122.9
Portugal	2.9	3.3	11,846	9.9	117.6
Israel	4.4	2.3	16,138	6.1	97.6
Egypt	4.6	5.1	1,386	64.5	89.5
Ireland	3.4	6.9	22,537	3.7	83.2
Malaysia	5.5	-2.1	2,772	22.7	63.0

Source: *The Economist* (reprinted in the Israeli daily *Ha'aretz*, December 21, 1998).

The issue of taxing premises according to their land use is problematic in an age of rapid technological changes. There is no linkage to wealth or income. Thus a diamond merchant in a small boutique might pay less than a supermarket, despite the fact that he earns more income, absolutely and relatively.

The arbitrary nature of the *arnona* is evident not only in the land-use *arnona* rates. The subjective nature of the system is also clearly reflected in the *arnona* imposed on nonresidential buildings. A few attempts have been made to resolve this issue. In 1981, a plan was formulated to introduce a local value-added tax on nonresidential land uses. The proposal was not adopted by any of the municipalities. In chapter 3, I describe the political debates in Tel Aviv Council's *Arnona* Appraisal Committee on this VAT proposal and other political efforts to improve the current system.

In chapter 4, I analyze the evolution of the relationship between the central government and the local authorities, which is highly relevant to the nature of the *arnona* as a means

to collect income for local governments. The present stage of this liaison is that the level of local taxation is determined by the central government, with Knesset (Israel's parliament) approval, and without the involvement of local governments. The government is more concerned with the state of the cost-of-living index than with the well being of the local authorities.

The government of Israel inherited the *arnona* system from the British, who ruled this part of the world as a consequence of the First World War, and modified it in 1970. This taxation system seems to have more advantages than disadvantages, and the population, at least for the time being, accepts it.

Chapter 1: The *Arnona* System

What Is the *Arnona* System of Taxation?

In their very important comparative work, Youngman and Malme (1994) noted that "Israel is unique in taxing all land and buildings using a geographic model that is not based on valuation" (p. 15).

The arnona is Israel's form of local property tax. It is imposed on residential and nonresidential properties, as well as occupied undeveloped land and agricultural land located within the jurisdiction of a local authority. The arnona is a very important factor in financing local authorities in Israel. In fact, most of the income of the local authorities in Israel is derived through this tax.

In Tel Aviv, for instance, the 1997 budget was NIS (New Israeli Shekels) 2,440 million (some \$610 million), of which:

NIS 1,362 million (\$340.5 million) came from *arnona*;

NIS 488 million (\$122 million) from other local charges;

NIS 305 million (\$76 million) from loans; and

NIS 285 million (\$71 million) from the national government, for services provided through the municipality.

That year, the *arnona* represented 55.8% of the city's annual budget, and accounted for 63.8% of its income.

The *Arnona* Base

The *arnona* is imposed on the property a person uses. The tax is not based on the value of the property. The *arnona* is a factor by which the size of the property (in square meters) is multiplied, to obtain the annual payment charged by the municipality for that given property for that given year.

In the fifty years of the existence of the State of Israel, there have been three methods to determine the *arnona*:

1. Until 1960, the *arnona* was based on the value of the property. Most of the apartments in the large cities were rented. The authorities saw the rent as the base of the value of the property. Thus, the *arnona* was determined as a percentage of the rent.
2. Between 1960 and 1970, the criteria for *arnona* on residential property was changed to the number of rooms for residential use and the area of the premises for nonresidential uses. The reason for the change was that at that time, a great deal of public housing was erected to absorb the new immigrants who had lived until then in temporary camps. This public housing became the dominant factor in the housing market. The number of apartments for rent, as a percentage of the total housing, diminished by the year.

Instead of formulating a different method for determining property value, it was decided to adjust the *arnona* according to the number of rooms in the apartment. The problem with such a system was its implementation. People added rooms and closed in balconies as their families increased. The authorities could not keep the registration of changes up to date. Naturally, most of those who made the changes never reported them to the authorities. The number of complaints about subsequent injustices increased.

On top of all this, there was a political outcry for change. If one person divided his apartment into three rooms and his neighbor divided an identical apartment into four, the latter paid more *arnona*. There were many politicians who argued that the current method of determining *arnona* discriminated against large families, who required more rooms because of their numerous children. Furthermore, in Israel, families with more children are usually relatively poor, as well. According to the prevailing *arnona* system at the time, it was they who paid the most *arnona*. A change was imminent.

3. Since 1970, *arnona* rates have been based on the measured surface area of all property. However, there is no law that determines the way to measure the surface area of the apartments.

In some municipalities, the area of an apartment includes a portion of the common space, such as staircases, lobby, bomb shelter, shared storage rooms, and the like. Other municipalities measure the apartments themselves, without the common area, but including the internal and external walls. The rest measure only the usable space: that is, the floor area only, excluding both external walls and internal walls. The surface area of an apartment measured by the first method is 14% larger than the same apartment measured using the second method. When comparing the third method with the first, the difference in size grows further, to 29%.

One problem that arises from this variety of measuring systems is that there is obviously no way to really compare the *arnona* rates of different municipalities. Furthermore, it is impossible to establish the “real” size of one’s apartment, because in addition to the *arnona* system of measurement, at least two other systems are applied: for building permits and for the properties registry.

In order to apply the change made in the 1970s regarding measurement of surface area, the local authorities had to invest in measuring all the properties in their jurisdiction. However, there were not enough professional surveyors around; consequently, unskilled laborers were used for the job. This led to many appeals. There are still people working in the *arnona* departments who remember the upheavals of those days. These officials love the system as it is and dread the introduction of any alteration because of their past traumas.

Determination of the *Arnona*

Thus, to sum up, the present *arnona* system, which was adopted in 1970, is imposed on buildings according to their use, on used undeveloped land, and on agricultural land (unused, undeveloped land is taxed by the national government). The property is measured by one of three methods. The *arnona* rate is determined by the combination of four criteria:

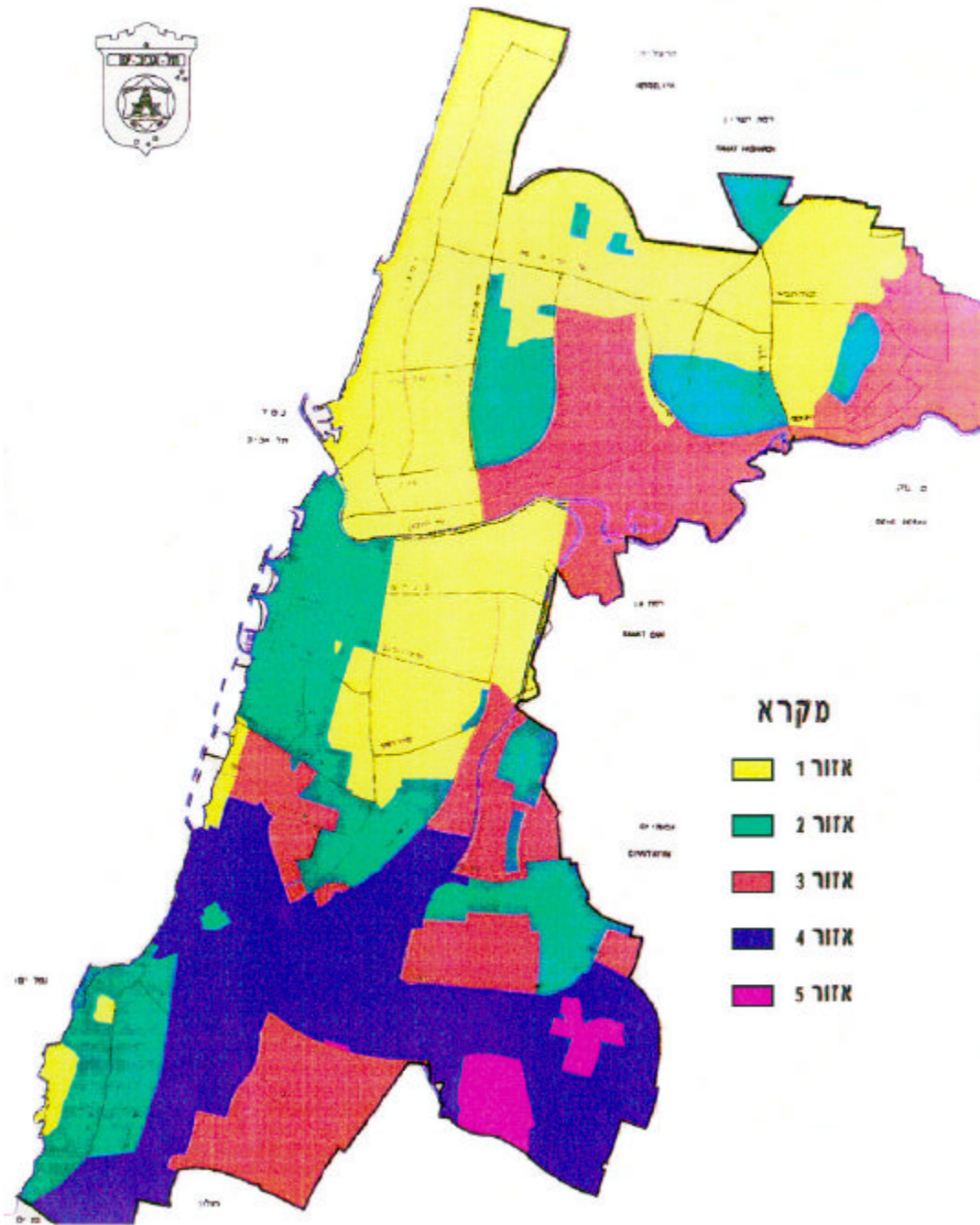
the actual use of the property (in contrast to its permitted use);
the location of the property in the municipality;
the type of property; and
the age of the property.

Land Use

There are basically two land uses: residential and nonresidential. Of the latter there are more than thirty categories, including:

- offices and commerce;
- warehouses;
- industry;
- hi-tech;
- banks;
- insurance companies;
- cultural institutions;
- schools;
- museums;
- artist studios;
- public market;
- cinemas;
- theaters;
- banquet halls;
- restaurants and coffee houses;
- department stores;
- swimming pools;
- country clubs;
- hotels;
- homes for the aged;
- embassies;

parking lots;
petrol stations;
and more.



The Division of Tel Aviv into 5 Residential Zones

- arnona zone 1 - yellow*
- arnona zone 2 - green*
- arnona zone 3 - orange*
- arnona zone 4 - blue*
- arnona zone 5 - red*

Location

Location is the single most important factor in this respect. Tel Aviv, for instance, has been divided into five zones for residential uses and five zones for nonresidential land uses: best, better, average, poor, and poorest. However, in practice, there are only three zones in Tel Aviv. *Arnona* zones 4 and 5 pay exactly the same rate. *Arnona* zone 3 pays almost the same as zones 4 and 5. Thus there are really only the best, the better, and the rest.

Type

In Tel Aviv, there are four types of residential uses in the best residential district, three types in the second-best residential district, and only one type in the other three districts. In zone 1, the highest-ranked district in Tel Aviv, where 25% of the residential units and 33% of the residential area are located, the residential units are divided into four types: (a) individual houses measuring over 110 square meters; (b) apartments larger than 180 square meters; (c) average apartments, measuring between 110 to 180 square meters; and (d) all other dwelling units. In zone 2, which encompasses 34% of the residential units and 33% of the residential area, the first two categories noted above are combined into one, and the other two brackets remain the same. In zones 3, 4, and 5, which account for 41% of the residential units and 34% of the residential area, there is only one residential category. Because of the low rate, there is no point in distinguishing among the different types, as is done zone 1.

In the nonresidential uses, the types of units vary according to land use. The only criterion for the division is size.

Age

There are seven age categories brackets for residential property and only three regarding the age of the nonresidential properties.

Once the actual use, the location, the type, and the age of the property have been determined, the rate can be calculated. (The way that the rate was initially set, in 1970, is not the concern of this paper. Since then there have been annual adjustments, generally based on the inflation. Occasionally, there are also increases in the real value of the *arnona*, as well.)

Implementation of the System

One of the interesting attributes of the *arnona* is its actual implementation. First, the user of the property, not the owner, pays the *arnona*. Second, the *arnona* is imposed on actual use, not permitted use. This is the source of one of the most long-standing conflicts between municipalities and residents. For instance, the user of an apartment that was leased for office use will pay the *arnona* rate applicable to office and commerce. The town and planning inspection section in the municipality may fine him for illegal use of the apartment as an office, and in many cases will evict him, by court order, even though

the same municipality charged and accepted *arnona* payments for office use. Thus the municipality operates simultaneously under two different and distinct laws: The Municipalities Order and the Planning and Building Law. The poor citizen is caught in the middle!

Setting the Annual Rate

The fiscal year in Israel begins on January 1. The members of the local councils determine the yearly rates of the *arnona* two months prior to this date. The power of the councilors is limited to determining the *arnona* within the limits—the minimum and the maximum increases allowed—that are set by the Knesset finance committee. This parliamentary committee debates and decides the *arnona* limits according to a proposal presented to them by the officials of the ministry of finance. Usually, the *arnona* is adjusted according to annual inflation alone, by linking the rate to the cost-of-living index. Sometimes the Knesset finance committee allows the local authorities in Israel to increase the *arnona* beyond the inflation. Each city council has the power to decide the level of the *arnona* in its jurisdiction, subject to the minimum and maximum increases set by the finance committee of the Knesset.

The yearly *arnona* is announced on the municipal billboards, where all the city residents can compare the rates. Personal bills are sent to each individual address.

Reductions in the *Arnona*

The *arnona* system takes social factors into account. Israeli law recognizes some seventeen different types of discounts related to the user's socioeconomic status, including reductions for senior citizens, newlyweds, invalids, high apartment density, new immigrants, soldiers, and the like. Only one category can be applied per user. The municipalities are entitled to add other discount categories, subject to the approval of the minister of interior.

Appeal Procedure

A person or a firm can appeal the determination of the *arnona* based on the measured size of the property, the location, the land use, and other criteria, or because the individual charged is not the actual user. The municipal director of *arnona* has 60 days to respond to such claims. Failure to respond within that time frame is considered as acceptance of the appeal.

If the person who submits an appeal is not satisfied with the response from the director of the *arnona*, he or she may appeal within 30 days to an appeals committee, comprised of three members nominated by the city council. The user or the director of the *arnona* has another 60 days to appeal to the district court if they are dissatisfied with the appeals committee ruling.



Announcement of Next Year's Arnona Rate

Municipal billboards with the poster detailing next year's *arnona*.

***Arnona* Payments and Collection**

The *arnona* can usually be paid by three means:

1. In advance for the entire year (the payer saves the link to the cost-of-living index and, in some local authorities, benefits from an additional reduction of a few percent);
2. In bi-monthly payments (billed periodically and linked to the cost-of-living index);
3. By standing order to the bank to honor the municipality's invoices (such payment is collected a month later than otherwise).

If the *arnona* is not paid on time, the municipality, with the signature of the mayor, is entitled to place a lien on the user's salary to pay the *arnona*. Another instrument for ensuring the payment of the *arnona* is the regulation that the change of property ownership may not be registered until the seller has remitted all debts on the property.

The municipality of Tel Aviv handles some 163,000 *arnona* accounts for residential use and some 53,000 for nonresidential uses. Every year some 20,000 to 25,000 accounts—about 10% of the total accounts—have to be handled individually (the first reminder is sent after failure to pay two bills). Last year, the city brought 4,000 cases—less than 2% of all the *arnona* accounts—to trial for refusal to pay despite several approaches.

If the municipality can not impound property or salary, and the debt is three years old or more and seems impossible to collect, the city council is entitled to write off the debt, subject to the approval of the ministry of the interior.

Revenues from the *Arnona*

The forecast for Tel Aviv's revenue from the *arnona* for 1999 is NIS 1,665.3 million (some \$406 million). Of this figure, 75.6%—NIS 1,258.9 million (\$307 million)—will come from nonresidential uses, and 24.4% (\$100 million) from residential uses. These calculations are based on an adjustment of 7.8% above the 1998 rates for the anticipated increase in the cost-of-living index for 1998.

Cost of Implementing the *Arnona*

The budget for the entire income department of the Tel Aviv municipality for 1997 was NIS 52,770 million, or \$13,250 million. This department administers all the income generated by the municipality. It is divided into five functions:

The income administration section is responsible for planning the income budget, supervising its execution, and for relations with the central government. It is staffed by 7 employees. The section budget is NIS 1,672 million, 3.2% of the total division budget.

The department services section is in charge of banks' clearinghouses and the collection of payments by telephone. It is staffed by 9 employees. The section budget is NIS 11,384 million, 21.6% of the division budget.

The *arnona* and water bill collection section deals with the *arnona* and water bills, accounting, legal services, and postage. It is staffed by 106 employees. The section budget is NIS 16,973 million (\$4,243,250), 32.2% of the division budget.

The section for collection of charges, levies, and payments for services is in charge of collecting payment for special municipal services other than the *arnona* (signposts, advertisements, education charges, etc.). It is staffed by 61 employees. The section budget is NIS 12,396 million, 23.5% of the division budget.

The assessments and billing section is responsible for inspection and registration of new premises and change of use in existing premises, and for updating all bills. It is staffed by 59 employees. The section budget is NIS 10,345 million, 19.5% of the division budget.

On the basis of this review of the specific sections, the cost of implementing the *arnona* system in Tel Aviv in 1997 was in the range of \$6 million. In the same year, more than \$378 million were collected in *arnona* payments alone—a ratio of one to sixty three. This ratio could be bettered by outsourcing some of the functions.

The Disadvantages of the *Arnona* System

If appraisal and valuation are considered to be an exact method for value-based determination of local tax rates, the *arnona* is very artificial. It is a very unjust system in which the equity issue plays no role.

The *arnona* system is not egalitarian compared to taxation based on the property value. Since the system disregards value, the equity issue can not be part of it. Nevertheless, people compare payments. The *arnona* system is not self-explanatory. Furthermore, it is very difficult to explain why, for example, a user of a stand-alone banquet hall pays different *arnona* rates than a user of a banquet hall located in a hotel. Similarly, why was Tel Aviv divided into five zones and not three?

Since each municipality determines its own *arnona*, neighboring communities may have utterly different taxation systems, which is incomprehensible. Moreover, the *arnona* is an insensitive taxation system, as it is based on only four components.

The major drawback of the *arnona* as a taxation system is the artificial way rates for nonresidential land uses are determined. There is no obvious reason why, in 1996, a bank paid NIS 526 per square meter annually, while the highest annual rate for offices was NIS 169, for a restaurant, NIS 193, and for the first 40 square meters of an industry NIS 130. How were these rates determined? Why? Was the difference based on their respective incomes? On the numbers of employees? Was it a response to a lobby in the Knesset? Who knows!

Those who consider equity, coherency, and transparency as the sole keys to a successful taxation system should stop reading this paper right here! In this respect, the *arnona* is a unique form of taxation, unlike any customary system of taxation. However, the *arnona* has its own specific advantages.

The Advantages of *Arnona*

The primary advantageous feature of *arnona* is that it collects more than 60% of the income of the Tel Aviv municipality. The other major asset is the amazing ratio between the sums collected and the cost of running the system - one to sixty three! Any property tax based on one form or another of property valuation will be much more costly relative to the amount collected.

Another important factor is the frequent adjustment of the *arnona* to the cost-of-living index. In Israel the rates are adjusted once a year, more or less according to this index. The bi-monthly bills are also adjusted according to the cost-of-living index. This means that increases are very moderate and gradual, and consequently, very easily adopted.

The designated task of *arnona* is to provide the means for municipalities to finance all the services they provide the residents. Linkage of *arnona* rates to the cost-of-living index assures the steady flow of income to the municipality even in a down-moving property market. This is the other asset of the *arnona*: in effect, it is impossible for revenues to drop in real terms. Those who are familiar with traditional forms of property taxation will appreciate these social and political advantages of the *arnona* system.

The more common property tax systems are based on periodic valuation of the property. In an upward-moving market, for instance, the length of several years between periods of reevaluation might result in major increases that are difficult to impose because of political considerations. By the same token, when a property evaluation takes place during a downward trend in the market, the local authorities are in real trouble. They face either decline in their income, or a need to increase the rate charged on property values in order to maintain a constant income. Either option will be very unpopular: the former with the officials, the latter with the population and the politicians.

The other asset of the *arnona* is the ease with which it can be modified. A municipal council may amend a part of the system, introduce a new discount, or make any other change it sees fit. The only condition for implementation is the approval of the minister of interior.

In conclusion, one can say that as a taxation system, the *arnona* works, although it is not equitable. How long the population will accept an inequitable system probably depends on the burden that the system imposes on that population. As long as it is acceptable to the populace, there will not be a revolution. If the burden will become too heavy, people will start questioning the nature of the *arnona* system.

Chapter 2: Political Issues Related to the *Arnona*

Politicians must address the question of *arnona* in three periods. The first time is during election campaigns, when general issues related to the tax are raised. The second time is at the end of every autumn, when the next year's rates are determined. The third and longest period is at any time in the course of the year, when residents solicit their preferred politician for assistance with domestic or business difficulties related to the *arnona*.

The Arbitrary Nature of the System

One of the basic criticisms of the *arnona* is that since it was originally introduced by the British, in 1934, it has evolved in such a manner that the inner logic of the system has been lost. The *arnona* is based on three or four criteria only: use, location, age, and type of property. These factors were selected quite arbitrarily. Each criterion affects the *arnona* rates, but it is impossible to explain their respective degrees of influence. Thus, despite its solid construction, the structure nevertheless seems alarmingly shaky.

The Base of the *Arnona* is Being Questioned

The *arnona* system was devised in the 1930s; it was amended in the 1970s, and has been adjusted ever since. In the past, the system was probably clear, simple, and undisputed. With the passage of time, residents and business people have become more experienced, more knowledgeable, and more aware of injustice. On top of it all, for the last 18 years, local papers have been published weekly. The militant ones are playing an increasingly important role in the municipality's affairs and in local elections.

Public grievances take front stage at election time. In Israel, a system of private "house meetings" has been developed. The different political parties ask supporters or sympathizers to invite relatives and friends to their homes for a relatively intimate meeting with a representative of the respective party, in case of general elections, or mayoral candidate, in the case of municipal elections. Between 20 and 50 people attend each such gathering. The host, with party funds, provides light refreshments. A typical house meeting will last between two and three hours. In such a forum it is possible to tackle serious issues more effectively than at public meetings, where the audience may be in the hundreds. Nowadays, there are hardly any public meetings. In a local election, the typical mayoral candidate will hold up to 100 such house meetings, sometimes two in the same evening.

The *arnona* comes high on the list of issues that voters opt to discuss during municipal elections, especially in the districts where residents pay the highest *arnona*. Their first and basic query is the one that questions the very nature of taxation based on property as a means to finance local authorities.

In every house meeting in Tel Aviv's *arnona* zone 1 (the highest paying *arnona* zone), the following questions regarding the *arnona* are certain to be asked:

“Does it cost more to collect the refuse in *arnona* zone 1 than in zone 5?”

“Does repairing one square meter of pavement cost more in zone 1 than in zone 2?”

“Do teachers get a higher salary in school in zone 1 than in zone 3?”

“To put it simply, I want to know why I pay such high *arnona* rates and get the same services as those who pay less *arnona*?”

“In short, I demand to pay for the services that I consume directly. So much for refuse collection, so much for street lightening, a charge for road improvements only when they are executed...”

The questions are simple, the answers are not. The residents are curt, impudent, and sometimes downright rude, as though the candidate himself devised the *arnona* system. Usually, those posing the questions hope to squeeze a promise from the candidate to reduce their *arnona*. (Hardly does he or she know, at that stage—unless he is an incumbent—that the local authorities are not allowed to reduce the *arnona* or allow discounts other than those specified by the ministry of interior. Of course, candidates can promise not to raise the *arnona* in the zone in question, but this will present trouble with residents in other *arnona* zones.)

These questions are asked quietly but the tone is on the rise. The next query, which usually follows swiftly, is already in an angry tone and reveals the knowledge underlying the first series of questions: “How come improvements in the poor districts are funded by the *arnona* collected from us? We demand that the *arnona* COLLECTED FROM US BE REINVESTED IN OUR DISTRICT ONLY!!!” Here the discussion is no longer polite, and the claims are no longer worded as questions. Quite often, an approving mutter, and sometimes even applause can be heard in the room.

Now, it is the politician’s turn to answer. He or she wants their votes, wants to answer in a manner that will please them. At the same time, any candidate knows that tomorrow there will be a house meeting in a poorer district, and the journalists present will inform their readers of any discrepancies between the answers in the two districts. Furthermore, inevitably, those present tomorrow will ask, “Why is all the income from the *arnona* invested in *arnona* zones 1 and 2, and not in ours?” How do they know? “Just open your eyes and you’ll see what our streets look like compared to theirs!”

At this stage, the politician has to explain the nature of Israel’s *arnona*, in particular, and the nature of property taxation system, in general. He or she has to explain this to an angry audience, and convince them that the *arnona* is a method that directly finances local authorities, and only indirectly supports local services. He or she has to appease them and say that there is no correlation between the *arnona* and the services they get, even though it is a local tax collected to finance the activities of the local authority. The public in the richer districts do not want to pay taxes. They want to pay only the share of the expenses incurred in their own neighborhood. Those in the poorer districts would like the *arnona* to be an even more progressive tax.

The problem of average politicians is that they understand the philosophical background to the *arnona*, or property tax for that matter, far less than those employed in the income division of the municipality. Nevertheless, even these employees would be unable to explain the essential nature and substance of the property tax. Why has taxation based on property been selected as the means for financing local authorities? What does the value of the property have to do with financing road improvement in another district? Where is the connection? The knowledgeable employees of the finance department will usually clap their hands together, look upward with indignity and murmur “but this is how it’s always been . . .”

If they encounter difficulties, what about the politician, who wants to please the crowd and be elected or even harder, reelected?

So the first problem related to the *arnona*, and maybe to every other form of property taxation, is that the wealthy public want to pay directly for services that they obtain from the local authority. Furthermore, in general, educated people do not accept that the value of a property or its location have any bearing on the amount of money an owner or a user should pay for services obtained from the community.

In other words, the base of property taxation as a means to finance the local authorities is being questioned. However, since they know that local authorities have to be financed somehow, as long as the financial burden is acceptable, they manifest their dislike to this form of taxation only every five years, at election time, when these matters are debated.

Determination of the Zones

When all is lost and the municipality’s employees fail to satisfy the town resident, and do not grant the requested discount in *arnona*, the latter call upon politicians as a last resort. They can not change the type of residential unit, as this is determined by the size of the apartment. Nor can they appeal the age of the building. The only factor that they think they can alter is the zoning.

“Come and visit me, look at my neighbors, and tell me if this is zone 2. I’m telling you, it should be zone 3 at the most, if not 4!” In order to pay less *arnona*, residents are ready to underestimate the value of their property, talk against their neighborhood, and insult their neighbors.

In 1970, Israel adopted the current *arnona* system. At that time, the *arnona* zones were determined. The city of Tel Aviv was divided into five zones for the purpose of the *arnona* for residential use and five *arnona* zones for nonresidential use (the divisions for the two uses differ).

***Arnona* Zone Changes for Residential Properties**

At present, the boundaries of the *arnona* zones seem to be quite arbitrary and difficult to justify. Many complaints are voiced about the inequality between different properties

within the same zone. In several cases, these have led to some fine-tuning. The finance department has proposed some 57 zoning changes for the approval of the Tel Aviv city council for the *arnona* rates for 1998. Of these, 50 were downgraded and 7 were upgraded. The changes are very particular in nature, and are identified by street addresses. There are several reasons for the different zone changes:

- In fifteen cases, the street on which the property is located is a traffic artery. The zone is the best zone, but a through road bisects it. Those living along the street were transferred from zone 1 to zone 2.
- In eleven cases, the properties are located in the best zone, but they are actually slums. These are units in detached houses that were originally part of Arab villages and remained after the 1948 War of Independence. Such buildings were constructed with very poor materials. The properties are designated for demolition, upon the approval of a new town plan for the area. The inhabitants in the dwelling units will be compensated.
- In nine other cases, the downgrading of one *arnona* zone was approved for residential units that were built for young couples. At the time of planning, political pressure ensured that young couples of moderate income could find affordable housing even in the best zones of the city. However, these apartments are small, and the buildings are not of the same quality as the other residential units in the best zone.



Residential Properties Located on the Main Route to Haifa

For many years, the Tel Aviv municipality granted a reduction in *arnona* to those who suffer from traffic noise. In 1993, the government abolished such discounts. The

municipality of Tel Aviv responded by spot zoning—lowering the *arnona* for those residents who suffer from traffic noise.



The New Givat Amal Project in Tel Aviv

A high-class residential project is being built in a prestigious area of Tel Aviv. The area is defined as *arnona* zone 2. When the project is completed, the municipality will grade it as *arnona* zone 1 (see the arguments regarding the classification of the Basle Tower on the following pages). However, some of the residential units in this neighborhood are actually slum units. The properties are located in houses left over from an Arab village that remained intact after the 1948 Independence War. They were spot zoned as residential *arnona* zone 3.

In seven cases, the properties are located on the boundary of a lower-ranked zone, and are influenced by this proximity.

And so on.

There are several reasons for the upgrading of properties for the *arnona* purposes:

- There is a process of spot zoning of new properties that were built in zones that are determined below the standard of the specific newly constructed building.
- Some properties have been upgraded because they are located on the boundary of a better-ranked zone.
- Properties in Old Jaffa that were rented to artists, who created beautiful galleries and studios in their residential units, were upgraded to zone 2, although the surrounding vicinity is designated as zone 4.

And so on.

Every year there is such a list of *arnona* zones changes. They are brought for approval to the annual city council meeting that discusses *arnona* matters. Consideration of each proposal involves a fight between the elected members of the city council and the finance department officials. The politicians try to help those who voted them in or those they hope will vote for them in upcoming elections. The officials' aim is to increase the city's revenues. Usually, the process of downgrading an area for *arnona* purposes is initiated by councilors, while upgrading of an area, or a new property, is generally based on a finance department recommendation.

***Arnona* Zones Changes for Nonresidential Properties**

The city has been divided into five *arnona* zones for nonresidential use, as it is for residential use. Here, too, the 1970 zone determination is somewhat obsolete. For the purpose of fine tuning, every year the finance department proposes some changes in the zoning of specific business properties. For the 1998 *arnona* rates, 42 zone changes in properties used for nonresidential purposes were approved by Tel Aviv city council. However, in contrast to the *arnona* zones changes made for residences, in the case of nonresidential properties, there were 35 zone upgrades and only 7 downgrades. Most of the upgrades were based on the location of the specified address in a shopping mall. Thus the factor of income is—albeit indirectly—taken into consideration. (In Israel, rents on property along commercial streets are lower than those in shopping malls. The malls' controlled environment and available parking space are part of the reason.)

There are political reasons for upgrading the *arnona* zoning of more nonresidential than residential properties. This trend might be attributed to the large number of business owners or users who do not live in the city and, as such, do not take part in municipal election. The other reason for the number of upgrades in nonresidential properties is probably related to the politicians' disinclination to be associated in the public eye with

business. Such a connection might suggest corruption, on the one hand, or socially unworthy ties, on the other hand. Consequently, we find politicians who may help a businessman change the *arnona* zoning of his residential property, while avoiding helping the same businessman change the zoning of his business, for fear of political damage.

To sum up this point, there is only one way to stop the process of some 100 *arnona* zone changes a year. After 20 years of accumulated experience, it would be appropriate to reevaluate the city's division into the five *arnona* zones, both for residential and nonresidential land uses. (The residential areas are essentially divided into four zones with regard to *arnona*, as zone 4 and zone 5 pay exactly the same *arnona* in all categories).

If such re-demarcation of *arnona* zones does take place, it seems logical to argue that a more self-explanatory zone definition would consist of three *arnona* zones only:

1. properties located in the best parts of the city;
2. properties located in the least attractive parts of the city;
3. the rest of the properties in the city.

Furthermore, if the *arnona* law is readjusted, it would make sense to include specification of the periods for reevaluating the *arnona* zone boundaries.

Spot Zoning: The Basle Tower Example

The notion of spot zoning is a new development in the *arnona* debate and probably an issue that will cause many sleepless nights for the purist advocates of the system. The necessity for spot zoning of individual buildings indicates some loss of confidence in the system, on the one hand, or its adaptable nature, on the other hand.

As noted earlier, there are four criteria for determining *arnona*: land use, zoning, the age of the structure, and the type of the unit. Take for example, however, the Basle tower. This building is located in Tel Aviv zone 2. One of the reasons for this zoning is that the area was developed before the Second World War, with typical houses of that period: 3- to 4-story buildings, on lots of 400-500 square meters, at a side distance of 5 to 6 meters and a back distance of 8 to 10 meters between buildings. In addition, prior to the construction of the Basle tower, there was an active open-air fruit and vegetable market and a very busy fire station in the center of the block.

The land was municipal land. The city decided to upgrade the whole area by clearing the market (the market vendors were paid compensation) and relocating the fire station. At the same time, the municipality initiated a change in the local master plan, to enable the construction of a 22-story residential tower, a large underground public parking lot, and a paved piazza. When the site was clear and the local and (later) district planning and building committees had authorized the new town plan, the Tel Aviv municipality tendered the land. The whole process, with its advantages and disadvantages, makes an

interesting story in itself, though it is beyond the scope of the present paper.



The Basle Tower

The Basle Tower was built in *arnona* zone 2. Note the quality of the tower and the residential buildings that surround it.

Upon completion of the Basle tower, the city finance department asked for authorization of spot zoning for the tower. This was approved in the yearly *arnona* debates, first by the city finance committee and later by the city council. Although the tower is located in a zone-2 area, they asked that the building itself be designated as zone 1. The proposal was accepted; it is politically easy to burden the rich.

However, the finance department's request and the council's subsequent approval of spot zoning is problematic for the *arnona* purists. For them, the real choice facing the decision makers should have been different. They should have decided either to upgrade the zoning of the entire district, from zone 2 to zone 1, as the removal of the market and the fire station has had its effect on the quality of the surroundings, or to designate the new tower as part of zone 2. The only difference between this building and its neighbors should have been the criterion of the age of the structure.

To upgrade the zoning—and raise the *arnona*—of the entire vicinity would have been politically unacceptable, as the removal of the market and the fire station did not significantly enhance the value of the apartments or change the income of those living in the district. On the other hand, the cost of the residential units in the Basle tower was higher than that of the average new building in zone 2. According to the *arnona* system, the finance department had no option but to consider the tower as a recently built residential building in zone 2.

The officials thought this option unjust. The difference between the value of the tower and that of neighboring properties would not have been reflected in the age-based differences in *arnona* alone. Naturally, they preferred to gain higher income for the municipality by upgrading the *arnona* zone for this single building. Politically, this was a far easier solution than raising taxes for a whole district. In this respect, both the officials and the politicians favored the more just solution, at the expense of the purity of the *arnona* system.

The process of spot zoning of the Basle tower demonstrates one of the main advantages of the *arnona* system: its flexibility and adaptability, and the possibility to react to events quickly. However, it also demonstrates a flaw in the system in its pure form. Since the zone boundaries were determined some 30 years ago, the need for spot zoning will increase in the future with the increased volume of new construction in old neighborhoods of the city.

Perhaps the solution to this conflict could be the determination of a new criterion - the state of the building—for each individual building in the city, taking into account the location and the age of the structure.

Renovated Buildings

For a long time, one of the problematic aspects of the *arnona* tax system has been the clause referring to the age of a renovated building. According to regulations, a building that has been renovated is considered a new building, as though it were built on the date of the renovation, and not the actual year of construction. The logic behind this was that

the age of a building represents its physical qualities; the newer the building, the better it is physically. The physical quality of a renovated building is better than a non-renovated building of the same age.

However, the owners of old buildings who renovated them and subsequently received higher *arnona* bills did not accept this logic. “First, we invest financially in the building, improving it. The environment gains; we lose money. In compensation for our financial efforts, we are punished and have to pay more *arnona*!”

Furthermore, in Tel Aviv, the municipality itself is involved in a massive renovation program. Some 1,500 buildings have been designated for preservation, forcing the owners to renovate them. These taxpayers also complain: “You are using the preservation program as a means to supplement the city’s income. You force us to spend money on our buildings and then you charge us higher *arnona* rates.”

The city accepted these arguments, especially when the discontent began to affect the renovation program. The municipality of Tel Aviv proposed a change in the *arnona* law in this respect, and in the 1994 State Economy Settlement Regulations, the Knesset eliminated the clause on redetermining the age of renovated buildings from the *arnona* law.

However, here again, the purity of taxation on property was violated. If the value of an old building increases after renovation, the tax on renovated properties should be higher than that on property constructed in the same period but not yet renovated. However, the *arnona* is by far more flexible as a taxation system, with greater capacity to absorb changes. The *arnona* employs some criteria from the theory of a property value, but not all the criteria that affect property values.



Ramat Aviv

Another example of *arnona* zone 2. Ramat Aviv was built in the mid-1950s.

The Determination of Land Use

The *arnona* on residential use follows a western logic. It is based on some components that determine the value of a property. In this respect, it belongs to the category of nonvalued property taxation systems. When the *arnona* is attached to nonresidential properties problems arise.

It is true that land use determines, in part, the value of a property. A building that in Bedford Square in London was once a private residence later became a school of architecture (I was lucky enough to study there), and in the future might be turned into an office building, like its neighbors. Nobody would suggest that the property value is the same for the three distinct land uses.

That notion underlies the determination of different *arnona* rates for different land uses. There are 33 different classifications of land uses, including:

- nonresidential properties, in general, that are not one of the following;
- industry;
- warehouses;
- hi-tech;
- banks;
- swimming pools;
- hotels;
- cinemas;
- performance and concert halls and theaters;
- dancing halls;
- banquet halls;
- restaurants and coffee houses;
- insurance companies and insurance brokers;
- stores over 201 square meters in area;
- department stores;
- parking;
- granaries;
- sports and leisure centers;
- artist studios;
- wholesale markets;
- gas stations
- homes for the elderly;
- government-supervised educational facilities (universities, public preschools);
- private educational facilities (the new private colleges, private preschools);
- museums;
- public institutions;
- hostels for students, new immigrants, and soldiers;
- hospitals and health clinics;
- embassies;
- and the like.



The Shalom Center

This is a major new project in Tel Aviv, comprising some 1,600,000 sq feet. The center demonstrates one of the controversies of the present *arnona*. Like many modern complexes, it houses many different land uses. The following have different *arnona* bases: offices and commerce, hi-tech, banks, insurance companies, cultural institutions, schools, cinemas, banquet halls, restaurants and coffee houses, department stores, spas, hotels, embassies, parking lots, petrol stations. The *arnona* per 1 sq. m. varies between NIS 25 for a school to NIS 690 for a bank. Yet these fifteen land uses are located in one complex!

It is only natural that a school should not pay the same *arnona* that a bank does. Nor should hospitals and hotels, or museums and shops be taxed the same rate. The only problem is how to determine how much to charge each land use.

How can one justify charging a private museum NIS 143.15 per square meter annually and a public museum, only NIS 106.65? How can this be compared to a bank, which pays NIS 690.03 per square meter annually!

Thus the assignment of *arnona* to different land uses is inherently controversial. In fact, the problem extends beyond the issue of different land uses. Charging different *arnona* rates to different categories within the same land use is a problem of yet another scale.

There are fifteen different *arnona* rates for hotels, based on the hotel ranking system (from 1- to 5-star hotels) and the *arnona* zones (there are hotels in three different *arnona* zones). The differences in the rates are substantial: a 1-star hotel in zone 3 (the lowest-paying category) will pay NIS 34.42 per square meter for the year 1999, while a 3-star hotel in zone 2 will pay NIS 50.92 per square meter for the same year, and a 5-star hotel in zone 1 will pay NIS 81.83 per square meter. The highest-grade hotel in the best district will pay 237% more than the lowest-grade hotel in a low *arnona* zone.

How accurate are these rates? What are they based upon? Do they reflect the hotel's income? The nightly charge per room? Basically, the accuracy and rationale of the rates do not matter, as long as the users of the properties do not complain!!!

Controversies Concerning Some Nonresidential Land Uses

Hi-Tech

For many years, the owners of hi-tech facilities complained, individually and collectively, about the *arnona* they were charged. Every year before the city council met to fix the next year's *arnona*, they would approach the leading politicians in the council. They argued that hi-tech was an industry in nature, simply with different means of production; however they were taxed like offices.

Those in charge of the Tel Aviv municipality income division argued that the interior furnishing, air-conditioning, degree of cleanliness, work hours, and type of work was more reminiscent of office work than of industry. Thus, hi-tech should pay the office rate of *arnona*.

The ferocity of the argument can be better understood in light of the differences in the *arnona* rates for office use compared with industrial use. The highest annual *arnona* rate for offices in 1998, for example, was NIS 212.80 (some \$52) per square meter, and the highest *arnona* rate for industry was only NIS 139.10 shekels (\$34) per square meter. The hi-tech industry argued that they were forced to pay 152.8% more than they should. That difference was right for the best locations. However, the cheapest rate for offices is NIS 92.23 (some \$22) per square meter per year and for industry, NIS 49.96 (\$12) per square meter per year, some 184% more than what the hi-tech leaders were ready to pay.

A compromise solution was reached in every city separately. In Tel Aviv, the 1997 rates were set, after long and controversial debates, at the same level as the *arnona* for general nonresidential use on ground-floor level (basically commerce or offices). This rate is higher than the rate for offices on other floors!

There are 12 different *arnona* rates for the general nonresidential use, based on four types of building in three *arnona* zones. The highest rate is NIS 231.04 (approximately \$56) per square meter per year, and the lowest *arnona* rate is NIS 92.23 (\$22) per square meter per year.

Since the above rate is higher than even the rate for offices, where is the compromise? It lies in the fact that the above rates are set only for the first 100 square meters. For the area above the first 100, the hi-tech user pays NIS 115.12 (about \$28) per square meter per year, regardless of zone or type of buildings, whereas offices pay the rates mentioned above.

What does this compromise have to do with the property value? It is a solution based on an oriental-style market bargaining!

The Printing Industry

This land use issue is similar to that of hi-tech, but in reverse. In the past, printing was a typical industry: noisy and dirty. Nowadays, the machines run much more quietly, and, since the introduction of computers in the industry, it is not dirty. City officials, in search of more income, initiated the change of their classification from industry to office use, which pay higher rates than the former. Not surprisingly, the owners of the printing presses maintained that they were by nature an industry and should remain as industry, despite the higher social status of offices. “You can’t pay the grocery bill with status, but you can with the money gained by downgrading printing to an industry...”

The moral of the story is clear, natural, and straightforward. The officials of the income division at the finance department will always classify a land use according to the highest possible rates, whereas the users of a property will argue for its classification according to the lower-paying land uses. In the absence of objective criteria in the *arnona* taxation system, this form of oriental bargaining will always prevail.

Banquet Halls

There are more than three important events celebrated in Jewish life; the circumcision, the Bar Mitzvah, and the wedding are the most important. The majority of Jewish Israelis celebrate these with a large group of guests, so that the celebration can not take place at home. For this purpose, there are banquet halls. Some are large halls in commercial centers or office blocks; some are stand-alone halls, and some are located in hotels.

The *arnona* imposed on banquet halls in hotels is at the rate for hotels. They do not pay separate bills. The hotel *arnona* includes all the hotel area, including, of course, the banquet hall. As noted earlier, there are fifteen *arnona* brackets for hotels depending on

the hotel ranking system (1 to 5 stars) and the location of the hotels in Tel Aviv in the *arnona* zones.

The highest *arnona* rate paid for a 5-star hotel located in nonresidential *arnona* zone 1 is NIS 81.83 (about \$20) per square meter per year. The *arnona* paid for a 3-star hotel located in *arnona* zone 2 is NIS 50.92 (\$12.5) per square meter per year. There are no banquet halls in other *arnona* zones.

In 1998, the stand-alone banquet halls paid NIS 194.39 (\$47.5) per square meter per year, 238% more than a banquet hall located in a 5-star hotel in the best zone, or some 382% more than a banquet hall located in a 3-star hotel in *arnona* zone 2.

This vast difference between stand-alone banquet halls and the same halls located in hotels induced the users of banquet halls to appeal to the municipality, later to the courts, and then to us, the politicians. They demanded that the *arnona* imposed on them be lowered to the level of *arnona* paid by banquet halls located within a hotel. For instance, in 1998, the stand-alone banquet hall users paid \$120,000 more for a 4,000-square-meter hall than the most elegant hall at the Hilton, for instance.

This difference affects costs. The hall owners argued that they could not charge their guests the difference or compete for events with the hotel banquet halls. In April 1995, the lawyer Mrs. Danon wrote to me arguing that the *arnona* imposed on banquet halls was too high:

1. The halls are very large—3,000 to 4,000 square meters.
2. More than 50% of the area is dedicated to toilets, kitchen, storage, etc.
3. It is unjustified that banquet halls in hotels pay far less *arnona*.
4. This dispute is not only with the municipality of Tel Aviv, but has been raised all over Israel.
5. The banquet hall users will eventually seek the help of the law.

The best thing that can happen to a politician is the threat to go to court. “If you want to go to court I can not stop you. On the contrary, I think it is a good idea. You should go to court and come back to me with the verdict.” The politician no longer holds responsibility for resolving the conflict. The dissatisfaction with a negative answer will be related to the court decision and not to the politician’s inability to change the course of events.

In early September 1995, I received a letter from another lawyer, Mr. Patt, appealing to me after the court decision, which was given on 2 July 1995:

1. Until recently, 36 banquet halls operated in Tel Aviv; now there are only 13. It is true that many banquet halls opened in towns on the periphery of Tel Aviv and in some kibbutzim, as well. But you, the elders of the city, should be aware that Tel Aviv’s residents have to leave the city for personal celebrations.

2. The *arnona* imposed on banquet halls in hotels is one-third of the *arnona* imposed on stand-alone banquet halls.
3. More than 50% of the space in the banquet halls is dedicated to service functions.
4. In nonresidential uses that require a large area, the *arnona* rates are regressive.
5. We want to continue to provide this service to the residents of the town. Please let us pay the *arnona* rates that are not contested and wait with the rest until the city council's decision.

To summarize Mr. Patt's appeal: "We failed in court. Please help us. God bless you!"

We did. On October 25, 1995, I received the predictable answer from Mr. Yelin, the city treasurer, regarding the banquet hall appeal, in general, and Mr. Patt, in particular:

1. The banquet hall users and their lawyers have already taken the Tel Aviv municipality to court, in 1993.
2. They lost in court and were forced to pay the *arnona* rates as imposed by the city council for the years 1993, 1994, and 1995.
3. In 1995, the city accepted the politicians' appeal and reduced the *arnona* rate for stand-alone banquet halls by 15%.
4. They should pay the full amount as the ordered or the municipality will appeal to the court.

Most important, the finance department also addressed the court and myself. The discrepancy between stand-alone and hotel banquet halls lies in the essence of how they are used. The *arnona* rate for banquet hall is a sort of an average between the different uses fulfilled by the hall: the banquet space itself and the services: toilets, kitchen, storage, etc. The *arnona* rate for hotels is a sort of an average, too. In a typical hotel, one finds storage, workshops, laundry, kitchen, restaurants, lobby, shops, offices, and the like, as well as residential quarters. Banqueting, a land use that consumes a lot of space, takes only a small portion of the total hotel space. The ratio between income-producing space and service spaces in hotels results in a lower average rate for the *arnona* in hotels than in stand-alone banquet halls.

I forwarded the treasurer's answer to Mr. Patt, the lawyer. I never heard from them again. I presume that they accepted the verdict, since essentially, they had no other option.

Sport Clubs

In Israel, as a rule, the sport clubs are public. Recently, privatization has reached this area, too, and some of the clubs are in the process of becoming private. The municipalities in Israel provide financial support, mainly to local teams that participate in the soccer and

basketball leagues. The support in the smaller towns stems from a wish to encourage civic pride and to enhance the local image in Israeli public opinion.

Beit She'an is a small town in the eastern Jezreel valley. Its population is about 30,000, composed mainly of families who originally immigrated from North Africa. There are no major industries in the town. Hi-tech is not present. Unemployment is high, some 13%. The town's main claim to national fame is Mr. David Levy, a town resident, who was minister for foreign affairs and deputy prime minister in the former Netanyahu and Shamir governments, and was recently appointed by Prime Minister Barak to head the foreign ministry in the present administration, as well. Another nationally recognized feature is Beit She'an's soccer team, which has taken part in the first league for the last five years, always struggling against demotion. Their fight against the more well-to-do teams from elsewhere in Israel has become famous; a successful movie was even made about their struggle for survival.

The financial support of sport teams in the "second-class" towns leads to pressure from the sport clubs and fans on the mayor, deputies, and city council members in larger cities. As there are many sport fans on the local voter lists, the local politicians are happy to succumb to this pressure.

The municipality of Tel Aviv supports each team that plays in the top soccer league to the tune of about \$160,000 per year (there are currently four such clubs); and basketball teams receive half that sum (there are two such teams). The total support per year for all sports clubs amounts to about \$1 million.

All financial allocations are subject to approval by the city council. Such allocations are always controversial. They are criticized in the local press, depending on the journalist's personal priorities. If he is a supporter of the arts, he will criticize the high allocations to sport. If she is a sports fan, she will complain that the two museums, the municipal theater, and the national opera receive about \$10 million from the Tel Aviv municipality annually, ten times more than the sport clubs do. The journalists and other sport fans argue that there are by far more people in the city that watch sport competitions than those who attend cultural activities. Yet others criticize the municipality for supporting sports clubs and the arts instead of investing the meager financial sources in better roads and sidewalk maintenance.

It is always politically advisable to support welfare cases and the poor; nothing else is a sure bet.

What does all this have to do with the *arnona*?

The sport organizations pay *arnona* on the buildings and grounds they use. For the land they occupy, they pay the rates for occupied terrain, about \$9 per square meter annually for the first 500 square meters, and \$6 per square meter thereafter. The size of a football ground and stands can be about 18,000 square meters. Comparison of the *arnona* they pay with the financial allocation reveals that a soccer team hardly receives any financial support from the municipality at all.

The officials of the soccer and other sports teams approached a few city council members for help. We knew that increasing the financial allocation would draw too much criticism. However, moderating the *arnona* rates would not really be noticed. So we opted to reduce the rates on occupied terrain used for sport purposes. However, the clerks in the income division suggested that this would be futile, since the officials at the ministry of internal affairs, who have to approve the annual *arnona* measures and the discounts given, would not accept the new *arnona* rates on occupied terrain used for sport purposes.

Our friends in the finance department suggested that the only real help that we, the politicians, could provide the soccer clubs was to reduce the price they pay for water. The soccer clubs use large quantities of water to maintain the lawns on the football pitches. The moral of the story is that you can change *arnona* rates for a specific land use (as in the case of hi-tech), if you relate to a national issue and not a local one.

One of the merits of the *arnona* system is its locality, agility, and adaptability. The need for government approval for every classification, zone change, change of rate, or discount is harmful to the nature of this taxation system. However, some vigilance is important as a watchdog against the politicians, who for short political gains might jeopardize a city's long-term income!

Office Use in Residential Apartments

The number of people living in the metropolitan area of Tel Aviv is on a constant rise. In 1972, 1.273 million people lived in greater Tel Aviv, 28.6% of them in the city itself. In 1996, the region housed some 2.539 million, a growth of 199%. Tel Aviv's population remained about the same, so that the city's share in the metropolitan area's population dropped to 13.7%. Yet, the number of those employed in the city grew to 328,600 in 1995, and continues to increase (there is now almost one employee per resident). Nearly two-thirds of the employees in Tel Aviv (63.6%) are daily commuters from the metropolitan region and even from further. The percentage of those employed in Tel Aviv is divided among the different economic branches:

- 15.4% in industry;
- 5.3% in construction;
- 20.5% in commerce, restaurants and hotels;
- 7.2% in transport and communication;
- 25.0% in financing and business services;
- 17.1% in public services;
- 7.7% in personal services;
- 1.8% in other categories.

Roughly 60% of those employed in Tel Aviv work in offices. Yet, the CBD of Tel Aviv has remained the same for many years, with very negligible addition of office space in new buildings. Since the demand for office use was not answered by the construction of new office blocks in the city, many residential apartments were converted into offices. The rent paid for offices in residential units were substantially lower than rents and maintenance costs paid in office blocks (the latter are three to four times more expensive). At the same time, the owner of a residential unit received higher rents for office use than for residential use. The owners and the tenants were better off. Furthermore, the process of conversion of apartments into offices led to less investment in office buildings. As a result, the invasion of offices into apartments spread into other parts of the city, as well.

The municipality of Tel Aviv was an accomplice to this process and acted in an uncoordinated manner, to put it politely. “Hypocritical” would perhaps be more accurate. The income division, guided by the Municipalities Order, imposed *arnona* on the actual use, overlooking the unauthorized use of apartments for office use, in breach of the Planning and Building Law.

For many years there was no law enforcement against the use of apartments in contradiction to building permits. For a long time, this breach of the law was undisturbed. The municipality encouraged the illegal conversion of apartments into offices by not charging the office users for breach of the planning and building law, while also increasing its income, as the *arnona* rates for office use are far higher than those for residential use. Since the local authorities did not force the issue, the owners of apartments had little incentive to apply for permits to change the designation of their property from residential to office use. The owners gained twice: they collected higher rents and did not have to pay betterment on the change of use and other charges involved in the process. The users found premises for their use at lower rates than they would have had to pay in office blocks. The income division in the municipalities gained higher income from the *arnona*. All actors were content.

In the late 1980s, three factors became prominent: First, Tel Aviv’s image had declined in comparison to Ramat Gan’s exchange district. Second, the center of the city looked like the CBD of other cities after dark, with no residents living there; and, third there was a very large wave of immigration from the former Soviet Union, who did not find enough empty apartments.

The combination of these factors encouraged the city council to combat the office invasion of residential units. In 1989, Town Plan N came into force. The plan determined where apartments may be converted into offices and where they may not. With the enactment of Plan N, the city’s legal department began charging office users in residential units and the apartment owners for illegal use of the premises. Those who were located in premises where Plan N permitted office use had to apply for a change-of-use permit.

The process was long and not inexpensive. First, the local committee for planning and building had to approve the requests for change of use. If the change was approved, the owners had to pay three different sums of money to the municipality: betterment charges, parking charges, and shelter charges. With regard to the first, the betterment issue in Israel

is the same as elsewhere (the owner pays 50% of the increase in the land value). As for the second, parking had to be provided according to the code (one space per residential apartment; one space for every 40 square meters of office use) or pay parking charges if they could not provide physical parking facilities. Shelter charges were collected if there was no legal shelter in the building. (The reason for collecting the charges was that the municipality would have to supply the missing facilities in the neighborhood, a claim that was hardly justified.) These charges created conflict between the owners and the users of the apartments in question. The owners wanted either to raise the rent or have the users pay part of the expenses.

On top of the expenses incurred by the apartment owners in the process of the change of use, the government also had a say in the effort to provide housing for the immigrants. Until then, property owners had to pay income tax on income derived from any source. Due to the pressure to supply accommodation for the new arrivals, the government decided that any income derived from renting apartments for residential use would be exempt of income tax. In contrast, the tax on income derived from residential units used as offices remained.

The process of enforcing the law regarding use of apartments, on the one hand, and the tax incentives, on the other hand, gave the city planning authorities the upper hand in the income division. However, the income division's loss of income would be temporary only; construction of new office buildings began in response to growing demand as offices were evicted from residential buildings.

The Income Factor and the *Arnona*

The *arnona* system for financing local government is divorced from any reference to the income or the wealth of the user of the property. Its attributes are physical in nature. These characteristics are the distinguishing differences between the *arnona* and the methods of financing local authorities that are more commonly applied in the western world: sales tax, value-added tax, or property taxation.

The disconnection of the tax system from the financial resources, wealth, or income of the user of a property is a potential source of misunderstanding with the municipalities. The complaints are in the order of:

“Why does a diamond dealer pay the same *arnona* per square meter as the owner of a grocery store? A diamond takes no space and the return per item is very high. You need to sell hundreds of loaves of bread and dozens of packages of cheese, etc., for the return of one diamond ring and you need a very large store. And yet they both are charged the same *arnona* per square meter!”

“A woman's dress, sold in a designer boutique, costs ten times more than a pair of men's underwear. Both require the same area. We pay the same *arnona* per square meter. Yet our return, by nature, is different.”

“I have a kiosk where I sell sandwiches. Next door there is a fine restaurant. We both pay the same *arnona* per square meter. How can you compare our businesses?”



Tel Aviv's Loss is the Ramat Gan's Gain

Two views of the Diamond Center in Ramat Gan. This neighboring town encouraged the building of new office blocks, when Tel Aviv enabled the invasion of residential units by offices.

When studying the issue of *arnona* from commercial enterprises, one finds that the 1998 rates in Tel Aviv stipulated the following:

- Users of shops under 200 sq. m. in *arnona* zone 1 pay NIS 231.04 (NIS 4.1 = \$1) per sq. m. annually.
- Users of shops over 201 sq. m. in the same zone pay NIS 236.81 per sq. m. annually.
- Users of small supermarkets or department stores under 200 sq. m. in *arnona* zone 1 pay NIS 231.04 per sq. m. annually.
- Users of supermarkets or department stores in the same zone pay NIS 236.81 per sq. m. annually for the first 1000 sq. m. They pay less—NIS 224.98 per sq. m. annually—for the area between 1001 and 1,500 sq. m. For the area above 1,501 sq. m., they pay even less—NIS 212.95 annually for every square meter.

The system does not differentiate between businesses. Basically, all pay the same *arnona* with only slight differences. The *arnona* for an average square meter is NIS 227.88 per sq. m. annually for a 2000-square-meter department store, compared to NIS 231.04 paid by the grocer next door (a difference of less than \$1).

During my ten-year tenure on the Tel Aviv council, very rarely did we grant a special rate due to the income factor! After the Gulf War, in 1992, the Tel Aviv Hotel Association appealed to then-mayor Lahat, for a reduction in *arnona* because of the influence on the hotel industry during and immediately following the war. Mr. Lahat accepted their reasoning and submitted a proposal to reduce the *arnona*, first to the finance committee, and then to the city council.

In 1995, the municipality embarked on an ambitious project to renew the infrastructure on an important local shopping street—Ha'ezel Street. The municipality invested NIS 22 million over a two-year period. The works included new drainage and water pipes, widening and changing the sidewalk, new street lighting, and more. At my initiative, we lowered the *arnona* charged the shopkeepers by 50% for this period of two years. Thus, we managed to gain their cooperation, despite the drop in income while the work was in progress. This discount needed the approval of the council finance committee, the city council, as well as the ministry of internal affairs.

According to the Israeli *arnona* law, there is no discount on *arnona* due to hardship in business. One can appeal to a specific municipal committee asking for a reduced *arnona* on one's residential unit, based on hardship on a personal level.

The grievances regarding the *arnona* imposed on business are naturally greatest during periods that are difficult economically. In time of economic crisis, another failure of the *arnona* emerges. The fines on not paying the *arnona* are not as severe as those imposed on failure to pay national taxes. Consequently, during an economic crisis, this is the last bill to be paid by users of nonresidential property.

Problems with Collection of the *Arnona*

As mentioned in chapter 1, in Tel Aviv, the municipality produces 163,000 demands for *arnona* from residential units and about 53,000 demands for *arnona* from nonresidential units—some 216,000 in total—a year. Some 80% are paid without any difficulty. About 20,000 to 25,000 bills require further personal handling in the form of reminders, admonitions, and warnings (after nonpayment of two bills). Every year, about 4,000 of the 216,000 (less than 2%!) are not paid and require legal procedures.

The majority of unpaid *arnona* bills belong to two distinct groups. The first group is the young residential renters. This social stratum is very mobile and changes location often. They sometimes forget to pay their *arnona*. They are easily traceable, as in Israel everyone is registered with the army. However, the local authorities are unable to enforce legal decisions in these matters, as the assets of this social group are negligible.

The second group, and by far the more significant as far as the city's income is concerned, is composed of limited companies. If such companies fail economically, they dissolve their companies and disappear. Because of the nature of the organization, it is impossible to persecute the individuals that compose these limited companies.

According to law, the city council has to approve the annulment of debts that can not be collected. There is an always a political uproar when these issues arise. The fury of the members of the city council rises each time, when they realize how much income is lost to the municipality and how helpless the system is against cynical tax dodging. There is always demand for more effective *arnona* collection. Yet the tools made available by law fall short of the task, especially in today's economic slump.

The law entails the closure of water supply if the users of a real property do not honor their water bills. A group of city councilors have proposed a resolution, which will require Knesset approval, enabling local authorities to prevent the supply of water to *arnona* evaders, as well. There are those on the city council that object to such drastic measures for residential use. They argue that those who do not pay *arnona* come from the poorer segments of society. On top of their small income, these families are usually religious or traditional and have numerous children to feed. These councilors persist in their opposition the closure of the water supply, arguing that the need for water use in nonresidential buildings is not of the same magnitude as in domestic use.

The other problem with the closure of the water supply to *arnona* offenders is that the punishment is not related to the offense. This contradicts the philosophy of western legal systems, and might lead to chaos. If someone causes a serious road accident, should the state confiscate his apartment?

Recognizing the anger of the majority in the Tel Aviv city council, this year, the directors of the city finance department tried another avenue. Without consulting the council first, the directors approached government officials at the ministry of finance, to sound out their reaction to an idea that would, logically, change the character of the whole *arnona* system. Their idea was to make the owners of the property responsible to the

municipality for payment of *arnona*. In other words, they suggested that *arnona* be imposed on the property owners rather than on the users. The government officials rejected the idea.

I believe that the government officials opted for the logical resolution. If you start changing the *arnona*, especially one of its significant cornerstones, and particularly in today's economy, the popular outcry would be great. It would lead to pressure to change other controversial aspects of the *arnona*. Furthermore, the ministry officials saved the directors a great deal of effort, as the politicians on the city council would have not accepted such a solution. As it is, the law for tenant protection has been a great burden on owners; in today's political climate, the new proposal had no chance of being approved at the Tel Aviv city council or the Knesset. Yet, the problem persists and every year the municipalities in Israel cancel uncollectable debts to the tune of tens millions of dollars.

Chapter 3: Political Debates Over Proposals to Improve the *Arnona*

The *arnona* rates for the coming year have to be approved by the city council finance committee and by the city council itself. Every year, the members of the city council raise issues related to the *arnona*. Tel Aviv's city council is very sensitive to the issue of the *arnona*, especially when the media is present at the debate. Usually they criticize the level of the increase as compared to the increase in the salaries that year. The salaries, like the *arnona*, are linked to the cost-of-living index. However, contrary to the *arnona*, salaries are linked to only 70% of the increase, and even this is not automatic, but only after a certain minimum increase in the index. And this is not the only issue.

The Inquiry Committee on the Structure of the *Arnona*

In 1994, while debating the *arnona* rates for 1995, diverse opinions were heard about this tax and its structure, as well as the level of *arnona* in Tel Aviv compared to other municipalities. Then-mayor Roni Milo proposed the establishment of a committee to study possible changes to the *arnona* system and reports its findings to the city council. Thus the Inquiry Committee on the Structure of the *Arnona* came into being. I was elected to head the committee, because of my involvement with this form of taxation and my position as the senior first deputy mayor.

Summary of the Committee Members' Interventions on the Proposal to Introduce Value-Added-Tax

The debate on the need to change the local taxation on business started at the end of the 1970s. There were many discussions at different levels of the political arena. In order to demonstrate the ferment in the committee, the following are the minutes of the committee meeting of March 26, 1995.

There was one item on the agenda: the proposal for a new local tax on business, namely, local value-added tax.

Mr. Beni Yelin, *the municipality's treasurer*: Declares that it is important to impose taxation on businesses not through the present system, but as a percentage of the value-added tax (VAT). At the same time, the local authority should maintain its economic independence from the central government.

Deputy Mayor Mordechi Yzhari, *member of the Religious Front (in Tel Aviv, the three religious parties—the national-religious, the Ashkenazi orthodox, and the Sephardic-orthodox—joined together to form one front. They held 4 out of 31 seats on the city council)*: Thinks that adopting the VAT will increase the municipality's dependency on central government. Therefore the present system is better, as it entitles the municipality to collect and control our taxes itself.

Councilor Haviva Aviguy, *of the Labor party (Labor held ten seats out of the 31 on the city council)*: Is in favor of the present system. Reminds the committee that there are businesses that do not pay VAT (non-profit organizations, for instance). Tel Aviv should not be part of the central government's counterbalance. Since Tel Aviv is economically strong, the state government will demand that the municipality consider the fate of the smaller and the weaker municipalities.

First Deputy Mayor Dan Darin, *member of Lev, a bi-partisan list (accounting for 5 of the 31 council members)*: Expresses concern that we are at the brink of a taxpayer revolt. The present system is an artificial system, lacking vertical as well as horizontal justice among users of equal properties. The advantage of the present system is the vast amount of money collected in relation to the small amount spent on expenses, with the accord of the taxpayers. Now that the *arnona* is becoming a burden, there is the danger of a revolt. Proposes that regarding nonresidential properties, the new system be linked to income or to turnover, but not to physical size of the business. A diamond dealer does his work in a relatively small area while his turnover is huge. Naturally, collection has to be local.

Deputy Mayor Eitan Sulami, *a member of the Likud Party (the Likud had 6 of the 31 seats on the council)*: Finds himself in a conflict. He is uncomfortable with the present system. An injustice exists, but income-wise, the present situation is the best for the municipality. If the municipality adopts the VAT system, the issue of paying for Dimona (a poor development town in southern Israel) may emerge. (In the same manner that the poor neighborhoods of cities demand that a larger portion of the *arnona* be directed to them, if there is one national pool of *arnona* from the whole country, the poor towns will employ similar tactics.)

Tel Aviv should not give up the decision-making mechanism. It should remain within the municipality. The committee should fight for the municipality's independence through the present system. Otherwise, the city will end up as the payers. In conclusion, he is in favor of changing the present *arnona* system, while I am afraid to lose the present income.

Mr. Meir Doron, *general director of the municipality*: The central government will not let the municipality run its own VAT system. The system will be operated by central

government and they will dictate the criteria. That is why Tel Aviv will end up on the losing side.

Mr. Eli Malachi, *director of arnona department*: The committee should remember that under the VAT system, a business that loses money does not pay taxes. Thus the municipality will lose income if it changes the present system to VAT. The present system ensures the centrality of Tel Aviv. Under the present system, a losing business will cease to exist as the user or the owner is exempt from paying *arnona* only for six months. There is no incentive for closing a failing business under the VAT system.

Ms. Niza Konshtok, *the municipality's legal advisor*: Claims that every few years the *arnona* issue is debated and nothing changes. When the Knesset legislated the State Economy Settlement Act, the municipality of Tel Aviv should have fought back. If the municipality does not succeed in the minor fights, it is ridiculous to speak about a major revolution. The present system functions well and there is no reason to change anything. She does not foresee any taxpayer revolt. We always overcome our difficulties. Pressures for changes will always be brought forward. It is up to the elected city council members to take a decision whether to succumb to pressures from the city merchants while increasing the municipality deficit. The State Economy Settlement Act caused injustice to Tel Aviv.

Mrs. Sima Freiman, *director of budgeting department*: Is in total agreement with Ms. Konshtok's arguments. She wants to emphasize a special issue concerning the adoption of the VAT system. When the municipality deals with firms that work nationally (supermarket chains, banks, etc.), there is no way to determine whether the added value took place in Tel Aviv. If the VAT system is adopted, Tel Aviv's share will probably be a percentage of the national VAT. First, there will be a fight about that percent and then, the government will dictate a system for returning the respective shares to the local authorities. It is reasonable to assume that the sum paid to local authorities will be based upon newly established criteria and Tel Aviv will not receive the amount it collects now.

Councilor Mordechi Virshovsky, *of Meretz (a leftist party, Meretz had 3 members on the city council of 31), a former MK of 17 years and Tel Aviv municipality's former legal advisor*: The legislators have no interest in these issues, including those Knesset Members who originally served in local government. The local authorities have always been confronted with hostility. The central government looks upon the local authorities as the bureaucracy that tramples the individual small citizen. The city councilors have to keep local authority independence and overrule any infringement from central government. Every document produced by this committee will become a dead letter if the committee members fail to use our party representatives in the Knesset to help the cause.

Councilor Michael Ro'eh, *also of Meretz*: Is not in favor of imposing VAT on business. In the end, the customers will bear the burden. The extra burden will create hardship. The committee members have to fight for the freedom of the shops and businesses and to define different new criteria to encourage business to diverge into other parts of the city. That is why the committee has to concentrate its work on new criteria for monitoring and regulating the location of business in the city.

Mr. Dan Darin: Summarizes the diverse opinions that were heard. In the next meeting, the conclusions of the National Committee for Local Authorities Affairs on the issue of *arnona* on nonresidential buildings, dating as far back as June 1981, will be presented. Beni Yelin, the city treasurer will present his ideas on the subject of the *arnona*. Shlomo Barzilai, director of the income division, and Eli Malachi, director of *arnona* department, will react to the proposal to impose VAT on businesses in Tel Aviv. They will also inform the committee about the stand of the Union of Local Authorities.

Also present, but not quoted in the minutes were Ms. Shelli Veil, the municipality's deputy legal advisor, and Mr. Shlomo Barzilai, director of the income division.

The Proposal for a Local Value-Added Tax: The Zanbar Report, June 1981

In 1980, the Knesset and the ministry of finance established the National Committee for Local Authorities Affairs, to study numerous problems that hampered the work of the local authorities in Israel. The following is an extract regarding the committee proposal to establish a new business tax:

The national VAT will constitute the base for the new local tax on business. For this purpose, the new tax will use the same definitions as the national VAT. It will be exactly the same law with different tax rates.

Every property user will pay the new local VAT on the base of last year's national VAT. Every municipality will determine the tax rate as long as it is no more than 25% of last year's national VAT. The local authorities will handle the collection of the local VAT. Every property user will have to declare his local VAT, based on the previous year's national VAT. The declarations may be compared with the actual payment of the national VAT. If found false, the local authorities will be entitled to impose heavy fines.

There will be a transition period of at least one year. For that period, the tax rate will be set arbitrarily at 5% in all the local authorities. It will give the local authorities the chance to study the income lost or gained as result of this new local VAT and the loss of the previous income tax systems.

Importers will be exempt from the new tax. They will pay tax on the added value (sales minus import value). Exporters will be exempt. Non-profit organizations do not pay national VAT, so the local authorities will be free to set up principles for their taxation.

New business will pay temporary local VAT in their first eighteen months, determined by the local authority.

Barzilai and Malachi's Reaction

At the conclusion of its meeting of March 26, 1995, the Tel Aviv City Council Inquiry Committee on the Structure of the *Arnona* requested a comment from those responsible for *arnona* collection regarding the proposal to introduce VAT on business. On 25 June 1995, Mr. Shlomo Barzilai, director of the income division, and Eli Malachi, director of

the *arnona* department in the municipality of Tel Aviv, handed the committee the following reaction.

Advantages of the general *arnona* system compared with the proposal for a local value-added tax

1. Economic autonomy

The principle of entitling a local authority to determine the level of the *arnona* rates and to collect them is worthy and desirable. *Arnona* is the main source of income for local authorities and as such should remain free from economic or political pressures or dependence on central government.

2. Business policy

Economic autonomy provides the local authority with a tool to determine urban economic policy through the definition of different *arnona* rates in different geographical localities.

3. Sharing the tax burden

Under the present system there is a balance and a common data base of the residential and nonresidential properties, public institutions, and occupied undeveloped land. The local VAT will address only nonresidential properties. It will be necessary to consider a new taxation system for the residential properties, public institutions, and occupied undeveloped land.

4. Economic stability

The *arnona* behaves like a taxation system that is not influenced by the economic market. The local authority knows how much it will earn from taxation and can plan and execute, even in times of economic crisis.

5. Business density

The principles of the present system create an incentive for unsuccessful businesses to close down and successful ones to open. This aspect of the tax system helps to maintain the centrality of Tel Aviv and the logical use of business premises.

6. Economic dependence

The global considerations of central governments do not necessarily coincide with the interests of local authorities. Taxation through VAT will harm the “strong” local authorities. Past experience demonstrates that central government responds to the pressures of “weak” local authorities at the expense of the “strong” ones. Furthermore, past experience guides local authorities not to trust central government in the domain of tax burden.

In the past, local authorities could tax leisure. (Owners of movie theaters and other leisure activities had to buy tickets from the municipality, which included the leisure tax. However, if not all the tickets were sold, the cinema proprietor returned the unsold tickets to the municipality and claimed a refund.). Because of the outcry from the ranks of the businessmen, central government has abolished the leisure and business taxes, with the promise to compensate local authorities for the income loss. Part of the promised compensation was the transfer of property tax (2% of the property value) from central government to the local authorities. The leisure tax was abolished but none of the compensating promises by the government took place. Local authorities must remember this lesson!

The Reaction of the Union of Local Authorities

On June 25, 1995 Mr. Shlomo Barzilai, director of the income division, and Eli Malachi, director of *arnona* department in the municipality of Tel Aviv, presented the committee with the reaction of the Union of Local Authorities, published on 21 December 1994. The following is the Unions' reaction:

- Israel's Union of City Treasurers met for several sessions in 1994 to debate and prepare the stand of the Union of Local Authorities towards the new proposal to introduce VAT instead of *arnona* on nonresidential properties. Basically, the concept of transferring part of the income generated by the national VAT to the local authorities and, in return, to reduce or abolish *arnona* imposed on the business sector by the local authorities, is not a novelty. The Zanbar Committee put such an idea forward in 1981. The following are some of the points agreed upon by those responsible for finances in local authorities:
- The Union of Local Authorities acknowledges the fact that there is a discrepancy between the *arnona* for residential use and the *arnona* for nonresidential uses. The reason for this stems from the fact that the central government did not honor its promise, in the early 1980s, that the local authorities would receive compensation through the mechanism of the VAT.
- The Union of Local Authorities is aware that the business-industrial sector pays higher *arnona* rates than the other nonresidential uses. Furthermore, the union acknowledges their complaint that this sector finances the services given to the whole population in any given settlement.
- The Union of Local Authorities proclaims that the *arnona* is a pure taxation system and not a sort of a repayment for given services (this proclamation has been confirmed in several court verdicts).
- Reducing the *arnona* rates in the business sector will end in reduction of the income of local authorities or extra burdening of other sectors. The Union of Local Authorities is of the opinion that the addition of a certain percentage to the national VAT could be the answer to the demand for reducing the *arnona* burden on the business sector. The reduction in *arnona* rates in that case would be through the non-

linkage of the *arnona* to the cost-of-living index. (The non-linkage would depend on the sums of money to be transferred to the local authorities from the VAT).

- The Union of Local Authorities suggests taking the chance of adopting this proposal, despite the bad experience that local authorities have had with the fulfillment of agreements reached with the central government. To avoid repeating past mistakes, the union demands the enactment of a special decree about the transfer of money collected through the VAT mechanism to the local authorities. Such an enactment is a prerequisite if this new concept is to become a reality.

The Reaction of Mr. Beni Yelin, Treasurer of the Municipality of Tel Aviv

The Tel Aviv City Treasurer continued to fight for the VAT cause. On 10 July 1995, Mr. Beni Yelin sent the members of the Inquiry Committee on the Structure of the *Arnona* the following summary of his position:

- In 1994, the real income of the municipality was eroded in comparison with the rise in the municipality costs, especially the increase in salaries approved by the government in collaboration with the minister of finance.
- The Knesset approved the increase of *arnona* for residential use by 4% above the cost-of-living index, to cover the expenses incurred by local authorities as a result of the central government policy.
- The Knesset did not approve such a rise in the *arnona* for nonresidential use. Since about 80% of the *arnona* collected in Tel Aviv is derived from nonresidential uses, Tel Aviv has suffered most compared to other local authorities.
- Tel Aviv does not only derive income from the nonresidential uses. The average municipal costs per business in Tel Aviv are the highest in the country. The costs include road and sidewalks, cleaning and maintenance, street lighting, inspection, etc.
- Thus Tel Aviv finds itself in a poorer financial position due to its metropolitan status. Therefore, it is to Tel Aviv's advantage that the business in the city be directly taxed on the basis of turnover, as elsewhere in the world.
- Thus, in the long run, the government of Israel has to allow Tel Aviv to establish business taxation as a function of business income. Such an action will solve Tel Aviv's deficit problem. In the short run, they should let us update the *arnona* on the nonresidential uses.

The Decision About the Introduction of VAT on Business in Tel Aviv

The Inquiry Committee on the Structure of the *Arnona* convened yet again on 17 December 1995 to formulate its decision on changing the structure of the *arnona* in Tel Aviv and introducing value-added tax on business. The following decision was drafted and presented to the city council:

1. The Inquiry Committee on the Structure of the *Arnona* held many discussions and deliberations about the structure of the *arnona* and examined the proposal to impose VAT on business. The committee reached the conclusion that the present system is far better than the proposed change, from the point of view of the independence of the municipality from central government. Accordingly, the committee passed a resolution not to change the structure of the *arnona* in Tel Aviv.
2. This sums up the work of the committee and with this, the committee has finished its task. However, if local problems with the *arnona* rise, the members of the city council are invited to approach the mayor, who will decide where they will be debated.

Proposals by Members of the Tel Aviv City Council for the 1996 *Arnona*

The yearly *arnona* debate is lengthy and unproductive. Usually, the members of the Tel Aviv City Council speak to impress the press, so that their proposals will be published in the paper. The proposals are not debated on the basis of their merit. They are more political manifestos. In November 1995, when the Tel Aviv City Council was debating the *arnona* for 1996, then-mayor Roni Milo decided to hurry up the proceedings. He suggested that all the proposals for bettering the *arnona* system for 1996 be brought forward and debated in the Inquiry Committee on the Structure of the *Arnona* in accordance with the committee resolutions. The following are some of those proposals.

Mr. Yosi Shperling (Labor party):

- The municipality will refrain from collecting *arnona* debts for elderly people who live in the poor districts, until the property is put up for sale. The property can be sold upon payment of the *arnona* debts.
- The municipality will determine minimum services as a base to determine *arnona* districts.
- *Arnona* on business will be imposed according to turnover and not related to physical size.

The Committee: The proposals are beyond the scope of this committee. The committee has rejected the idea to change the *arnona* on business.

Mr. Yakov Renner (independent):

- An increase of only 3.1% (rather than the proposed 8%) in *arnona* will be collected from the elderly in poor families and the government of Israel will be requested to pay the difference.
- A reduction in *arnona* will be granted to Tel Aviv inhabitants who live next to a source of noise, in the same manner that this reduction is granted to the inhabitants of *arnona* zone 1.

- The *arnona* zones will be re-determined.
- Further means will be developed to collect *arnona* from those who abstain from paying.

The Committee: The proposals are beyond the scope of this committee. The committee advises the future city council to adopt the proposal to reduce *arnona* for those who live near hazards.

Mr. Nasim Shaker (Arab list; entered the City Council upon Mr. Kabub's resignation):

- Income will be added as another criterion for establishing *arnona* for residential and nonresidential uses.
- The Ajami and the Heart of Jaffa quarters (both inhabited mainly by Arabs—D.D.) will be classified as *arnona* zone 5, rather than zone 2. New prestigious projects, such as Andromeda Hill or Shell on Sea, near Ajami, will be classified as *arnona* zone 1. New building projects constructed to ameliorate the living conditions of long-standing inhabitants of the area will remain classified as *arnona* zone 5.
- A special reduction in the *arnona* will be granted to inhabitants who live next to a source of noise. Such a reduction is granted to the inhabitants of *arnona* district 1.

The Committee: The proposals are beyond the scope of this committee. The committee advises the future city council to adopt the proposition about the reduction in *arnona* for those who live next to hazards. The changes requested in the *arnona* for the Ajami and Heart of Jaffa quarters are politically based and unjustified.

Mr. Haled Kabub (Arab list; resigned the Council to become a court judge):

- The *arnona* on hotels will be increased to the level paid by offices.
- The *arnona* on high-class homes for the aged will be increased.
- The *arnona* on painters' and sculptors' studios will be increased.

The Committee: The proposals are beyond the scope of this committee.

Mr. Michael Ro'eh (Meretz):

- The *arnona* on apartment-hotels will be increased drastically, to the level of businesses in residential districts.
- The *arnona* on businesses that cause nuisance to residential uses will be increased, while the *arnona* to the latter will be reduced.

The Committee: The first proposal is beyond the scope of this committee. The committee has already accepted half of the second proposal.

Mr. Mordechi Virshovsky (Meretz):

- A special *arnona* bracket will be created for art galleries. Their well-being is very important for the flourishing of artistic life in Tel Aviv.

The Committee: The committee chairman is of the same opinion, but the proposal is beyond the scope of the committee.

Mr. Shlomo Maslawi (Lev, and chairman of the Hatikva Neighborhood Committee)

- Business properties on Ha'ezel, Hanoach, and Abas streets will be reclassified (these streets are located in the Hatikva neighborhood—D.D.), from nonresidential *arnona* zone 1 to *arnona* zone 3.

The Committee: The requested changes in the *arnona* are political and unjustified.

Mrs. Haviva Aviguy (Labor):

- Charges will be pressed against the government for not paying the *arnona* on their premises.

The Committee: The proposal is simply a political statement.

Mr. Doron Sapir (Labor):

- The discount on *arnona* for residents over the age of 80 will be increased, from 25% to 50%.

The Committee: Last year, the city council adopted such a resolution, but the ministry of internal affairs did not approve the discount. Therefore, the committee considers the proposal as a political statement only.

Mr. Arieh Zuker (independent)

- It is astonishing that the finance and interior ministries have proposed a nationwide increase of the minimal residential tariffs by 11% and the maximum residential tariffs by only 8%. This is a discriminating act against the poor.
- The residential *arnona* to pensioners will be increased by only 3.1%, the exact increase of their pensions last year according to the rise in the cost-of-living index.

The Committee: This is a purely political statement by the only member of the opposition.

In November 1998, a new city council was elected. The new council decided (what a surprise) to set up an Inquiry Committee on the *Arnona*. The new committee chairman is the new first deputy mayor, Mr. Eitan Sulami, a member of the Likud Party (the Likud

now has only 4 members on the 31-seat council). Mr. Sulami was a member of the committee in the last term.

Chapter 4: Central Government Versus Local Authorities: The *Arnona* Conflict

General Background

The conflict between central government and local authorities is developing on many fronts. The history of the western world is comprised of conflicts over power between old regimes and those replacing them. The student of history might easily recall the wars of the feuds against the kings. Later, it was the king against the parliament. Following the industrial revolution, it was the bourgeoisie against the aristocracy, and later, the proletariat against the bourgeoisie. In the last 150 years, it has been the cities against the countryside and the conservationists against development. And these are just a few.

One of the emerging conflicts for the new millennium is that between central government and local governments. Central government is interested and responsible for national trends and processes, and cares less about local issues. Each local government is responsible to its jurisdiction and cares less about the national trends and processes. This is a global development. The state of conflict between central and local government depends on the age of the state and the phase of its development.

Israeli Background

In Israel this conflict is very acute. The country is highly developed. Its hi-tech industry and military complex are among the world's best. Israel obtained its independence 50 years ago. The national population is the size of a megalopolis - 6 million people.

The central government is responsible for education, welfare, and the absorption of new immigrants, among other duties. All these functions are carried out on a local scale. Thus, in actual fact, the local authorities perform them on behalf of the central government. One of the reasons for the local authorities' growing deficit lies in the fact that their expenses far exceed the income they receive from the central government for these activities.

The cities are in the "red." Mayors go on hunger strike against the central government. They cannot pay their employees' salaries. Their employees strike against them. Refuse is not collected. The stench and the rotting garbage are health hazards.

One of the reasons for the deteriorating state of the municipalities in Israel lies in the Municipalities Order. This order dictates the working of the local authorities and their dependence on central government. The Municipalities Order regulates the *arnona*—the income arteries and veins of the local authorities.

The system is originally British. While the region was under their mandate, as the outcome of the First World War and until 1948 (the Israel War of Independence), the

British enacted the Municipalities Order in this country. There is an anecdote told in Israeli local-authority circles: the British government formulated the Municipality Order because it did not trust the natives. According to the 1934 order, the local authorities are utterly dependent upon the ministers for internal affairs and for finance. The government of Israel, which came into power in 1948, adopted this non-trust notion immediately. The natives are still the same natives, though there are more of them. Although the governments are not the same, the mistrust between the central and local government still prevails.

The central government is more concerned with the state of the cost-of-living index than with the well-being of the local authorities. Every year the government, through the mechanism of the State Economy Settlement Act, fixes the floor and the ceiling, as well as the maximum growth rate, of the *arnona*. The *arnona* rate has nothing to do with the needs of the particular local authority. The authorization to raise the *arnona* level is basically the same for Tel Aviv (370,000 inhabitants); Be'er Sheva (160,000 inhabitants); Nazareth (an Arab town with 55,500 inhabitants); Ofaqim (a development town with 22,200 inhabitants); Abu Sinan (an Arab village with 9,600 inhabitants), and so forth.

The government and the Knesset do not take the different levels of infrastructure development into account. The government is not interested in the number and level of welfare cases in each respective locality. The education level in the schools is important to the parents and, as such, to local government, but less so to central government. Furthermore, the government has no concern with the number of commuters into or out of the cities, the number of employees in the city, whether there is a drainage system, the availability of street lighting, even the existence of roads in some cases, or any other criteria.

Since 1992, the central government has regulated the local authorities even more than ever. The *arnona* minimum and maximum level and the rate of growth are fixed by the State Economy Settlement Act. Every year's act begins with the same statement: "This Act amends different laws, postpones the commencement of some laws, or extends the validity of other laws, and formulates new regulations, in order to attain this year's national budget goals, reduce the deficit for the year 199-, and fulfill the economic policy goals." There is no mention of the well-being of the local governments. What about local governments' goals? Are there no municipal policy goals?

This situation is not affected by the fact that politicians, who belong to national parties, are to be found in the Knesset, in the municipalities, and in other local and regional authorities. Elections at all these levels are proportional. Most of the parties are represented both in the central and the local governments. The politicians in the Knesset make the laws that other members of their parties implement in the local authorities. One might expect some coordination or shared information between the politicians at the two levels. Yet none exists.

Basically, the MKs are less familiar with the workings of the municipalities. The Knesset committee for interior is less prestigious than the committee for defense, the committee

for finance, the committee for education, the committee for legislation, and the committee regulating the Knesset's work.

Paragraph No. 3 of the 1938 Municipality Order

In 1934, the British High Commissioner imposed the Municipalities Order. Paragraph no. 3(b) of that order exempted the government from paying *arnona* on buildings that it used.

General *arnona* shall not be imposed on any building or occupied land which are held by the government or by an individual or institution on behalf the government, and are used for the purpose of the government or for the purpose of that individual or institution. The properties will not be considered as used for those purposes, if the user is a government employee, paying rent for the use, directly or indirectly, as a deduction of his salary.

Hence, there were three conditions for the exemption of the government from the *arnona*:

- The property was held by the government, its institutions, or authorized individuals.
- The property was used for government purposes.
- Government employees did not use the properties for their private use.

In 1938, this law was amended to further specify the properties exempt from *arnona*. Land uses such as embassies, consulates, places of prayer, convents, hospitals, dispensaries, rest homes, schools, kindergartens, orphanages, and other such institutions were exempt from paying the *arnona*.

Paragraph 5(a) of this 1938 law stipulates that in spite of paragraph (3) to the 1934 Municipality Order, the government will not be exempt from paying *arnona* to those municipalities which the minister of interior has declared, after consultation with the finance minister, as "immigrants' settlements."

After 1948, the new Israeli government was happy to continue applying this 1934 Municipality Order with the 1938 amendments. Under this law, the state did not pay *arnona* in any place but Jerusalem. The Israel government did not mind paying *arnona* in Jerusalem, as their political aim was to strengthen the capital city.

The Tel Aviv City Council members protested for many years, to no avail, against this discrimination. In 1992, Mr. Mordechai Virshovsky was both a member of the Knesset and a member of the Tel Aviv city council. He managed to persuade the majority in the Knesset to omit, as of 1993, paragraph no. 3 from the 1934 Municipality Law and its 1938 amendments. The corrected law created a situation in which the government was not exempt from paying the *arnona* to the municipalities.

The municipalities celebrated. A new and lawful source of income had been granted. However, their joy was short lived.

In 1993, the finance ministry, faced with an annual payment of hundreds of million of shekels, introduced the State Economy Settlements Act (an annual law aimed at achieving the state's budget goals in that specific year). In paragraph 9(c) of the 1992 State Economy Settlements Act, the Knesset ruled that the minister for internal affairs and the finance minister, following the annulment of paragraph 3 to the 1934 Municipalities Law, will regulate the conditions by which *arnona* would be paid on properties used by the government or a corporation that has links to the government.

However, those ministers failed to formulate the regulations, and the annulment of paragraph 5 from the 1938 and paragraph 3 from the 1934 Municipality Law was postponed from 1993 to 1994, through the mechanism of the State Economy Settlements Act. In 1994, the ministers were busy and the annulment was postponed from 1994 to 1995, and again from 1995 to 1996, and so on and so forth. Today, in the summer of 1999, paragraph 3 of the 1934 Municipality Law, with the amendments of 1938, is still in effect, despite Virshuvsky's 1992 cancellation. The central government is still robbing the local authorities of income they deserve. This theft is carried out legally.

The controversy about the government avoiding paying *arnona* on its properties continued; in 1994, the legislators, as a compromise, specified that the government had to pay *arnona*. They accepted the rule but not the sums.

In paragraph 7(b) of the 1995 State Economy Settlement Act, the Knesset determined that the government would pay:

1. 10% of the *arnona* that would have been fixed otherwise, for properties used by the ministry of defense, the army, and their institutions.
2. 25% of the *arnona* that would have been fixed otherwise, for properties used for hospitals or public clinics.
3. 35% of the *arnona* that would have been fixed otherwise, for any other properties used by the government.

Until then, there had been an arrangement by which the government paid a charge for the refuse collection handled by the local authority. The ministers specified in paragraph 7(c) of the 1995 State Economy Settlement Act that the sum of the new *arnona* on properties used by the government will not be less than the refuse collection charge.

It seems that the principle of the government paying *arnona* on the properties it uses was resolved. However, the government paid very small sums of money compared to what it should. The government continued to exploit the Knesset members' ignorance about local matters, looking after its own interests at the expense of the local authorities.

The 1992 State Economy Settlement Act

Since 1992, the state has regulated the *arnona* even more than before. The attitude of not trusting the natives still prevails. Chapter D of the 1992 State Economy Settlement Act is dedicated to the local authorities. In paragraph 8(b), it is stipulated that the minister of internal affairs and the finance minister will distinguish among the different land uses of the properties and determine the method of calculating their area for the purpose of *arnona*.

Paragraph 9(a) determines that every tax year, the above ministers will fix the minimum and maximum *arnona*, according to land uses, and the proportions between the minimum and the maximum. The local authorities may impose their *arnona* on the different types of properties between the minimum and maximum *arnona*. These annual regulations must be approved by the Knesset finance committee.

Paragraph 9(b) puts some burden on the above ministers, as they are compelled to fulfill the above 60 days before the beginning of every fiscal year. I can not recall even one instance that the ministers abided by this part of the law. The reason that I do not recall any breach of the law by the ministers is that they quickly realized they had made a mistake by undertaking such an obligation. Paragraph 25 to the 1994 State Economy Settlement Act determined that despite paragraph 9(b), even if the ministers are late, the 1993 State Economy Settlement regulations shall remain valid.

In paragraph 9(c) there is another specification that was never fulfilled. According to this paragraph, the ministers have to regulate the conditions by which the government pays *arnona* on properties used by the government or by a corporation that has links to the government. As mentioned above, this part of the 1992 law was not fulfilled, either.

In paragraph 9(a)(1), the act stipulates a decree of a completely different nature, resolving one of the conflicts that prevailed between the municipalities and its residents. This paragraph stipulates that a city council will pay no more *arnona* on a renovated building than the amount the users paid prior to the renovation, in accordance to the year of construction of the building. However, if an area is added to the building during the renovation, according to paragraph 9(a)(2), the local authority is entitled to charge on the additional area, again according to the year of construction.

If a local authority does not impose *arnona* for a certain year, then according to paragraph 10, the previous year's *arnona* rates and periods of payments will prevail.

According to paragraph 11, the minister for internal affairs is personally entitled to allow a local authority to raise the *arnona* during the fiscal year, due to special circumstances.

Paragraph 12 takes away any strength that the elected members of municipalities had to influence the *arnona* according to local needs. The paragraph expropriates one of the powerful assets of city councilors—the right to decide upon reductions and discounts in the *arnona*.

In paragraph 12(a), it is stipulated that the ministers are entitled to grant a reduction to those who pay the entire annual *arnona* in one lump sum at the beginning of the fiscal year.

In paragraph 12(b), it is postulated that the minister for internal affairs will draft regulations to determine which reductions in *arnona* a local authority is entitled to grant and how much.

If paragraphs 12(a) and 12(b) were not clear enough, paragraph 12(c) concludes this 1992 State Economy Settlement Act, by emphasizing that a local authority council will not grant reductions and discounts on the *arnona* except according to the above paragraphs.

The 1993 State Economy Settlement Regulations (Part 1)

In the 1993 State Economy Settlement Regulations, the minister for internal affairs and the finance minister, with the approval of the Knesset finance committee, went a step further in squashing local authorities' tax autonomy. They determined, and thus dictated, the minimum and maximum *arnona* rates, in shekels per square meters, that can be charged on some land uses. These are presented in Table 2.

Table 2: Minimum and Maximum *Arnona* Rates—1993

Land-use	shekels per meter	
	Minimal <i>arnona</i>	Maximal <i>arnona</i>
Banks	150.00	700.00
Industry	8.00	70.00
Hotels	12.60	50.00
Residential	12.60	48.50
Occupied land	0.004	3.00

In paragraph 6, they prescribed that a local authority will impose the 1993 *arnona* as the sum for 1992 with the addition of 8%. The regulations explain how the local authorities are to handle the new regulations:

- If the new *arnona* is lower than the minimum *arnona*, the 1993 *arnona* for that land use will be in accordance to the new minimum *arnona*.
- In a local authority in which the *arnona* for 1993 for the above land-uses is higher than the maximum *arnona*, the 1993 *arnona* will be imposed in accordance with the maximum *arnona* allowed on these land uses in these regulations.
- If in any local authority, *arnona* was not imposed previously on any of the above land uses and the local authority would like to impose such an *arnona*, the local authority will impose only the minimum *arnona* for that land use.

- If the 1992 *arnona* on any of the land-uses was above the maximum *arnona*, the 1992 *arnona* will remain the same for 1993.
- If, however, the 1993 *arnona* for any of the land uses is below the minimum *arnona*, the local authority is entitled to impose the following:
 - The local authority is entitled to increase the 1992 *arnona* for banks by up to 16%, as long as the new sum is not above the minimum *arnona* allowed;
 - The local authority is entitled to increase the 1992 *arnona* for hotels and industrial buildings by up to 12%, as long as the new sum is not above the minimum *arnona* allowed;
 - The *arnona* on occupied land will be the 1992 *arnona* rate plus the 8%, even if the sum is above the minimum *arnona*, but as long as it is not above the maximum *arnona*.

These regulations detail further the transition from local control of the *arnona* to central government control. In paragraph 11, for instance, the regulations enable a local authority to grant a discount of up to 4% for payment of *arnona* in one lump sum at the beginning of the fiscal year.

The 1993 State Economy Settlement Regulations (Part 2)

Having intervened and taken over the right of the local authorities as far as determining the minimum and the maximum level of the *arnona*, the government and the Knesset went one step further. In the 1993 State Economy Settlement Regulations (part 2), they determined and stipulated the discounts and the reductions on *arnona* that a local authority may grant. With these regulations, the ministers and the Knesset finance committee eliminated the possibility of the locally elected representatives to influence the social content of their localities and initiate changes required by local needs.

For instance, in Tel Aviv, for several years we considered granting a substantial discount on *arnona* for young couples who emigrated from the prosperous northern quarters to developing neighborhoods in the south of the city. Similarly, in order to attract people to a relatively new pedestrian shopping street in the center of the Tel Aviv, the municipality initiated some activities. The local population found these too noisy for their liking and stopped the municipality's intervention through the courts. We, the politicians, thought of charging students who came to live in this area zero *arnona*. This would encourage the influx of a population that would appreciate the musical activities. We also initiated a discount in *arnona* rates to unmarried mothers. Finally, a discount on *arnona* was granted to those who lived next to environmental hazards.

All these local initiatives were stopped by the 1993 State Economy Settlement Regulations (part 2). In paragraph 2 to the 1993 regulations (part 2) the following deductions, reductions, and discounts from the *arnona* were prescribed:

- 1a. A reduction of up to 25% on the first 100 square meters of a property, for men over 65 years old and for women over 60 years old, if they receive a pension according to the national insurance (social security) criteria.
- 1b. A reduction of up to 100% on the first 100 square meters of the property, for men over 65 years old and for women over 60 years old, if they are entitled to a pension guaranteeing minimum income in addition to a pension.
2. A reduction of up to 80%, for disabled who are entitled to a monthly pension, in accordance with paragraph 127 of the National Insurance Law.
3. A reduction of up to 40% for disabled whose medical degree of disability is 90% or more.
4. A reduction of up to 66% on the first 70 square meters of the property, for the recipient of a pension, under the relevant categories, in the relevant laws: for a prisoner of Zion, for the families of people executed by the order of non-Israeli authorities, and for disabled persons persecuted by the Nazis. The reduction applies to the first 90 square meters if the recipient of the pension lives with four more members of the family.
5. A reduction of up to 90% for the blind, so certified in accordance with the 1958 Welfare Services Law.
6. A reduction of up to 90% of the first 100 square meters of the property, for immigrants for 12 months, beginning with registration in the population registry in accordance to the Repatriation Law.
7. A reduction of up to 70% for recipients of the following pensions: (a) guarantee of minimum income from the ministry for religious affairs, in accordance with the 1993 Budget Law; (b) payment in accordance with the 1972 Alimony Law; (c) a welfare pension in accordance to chapter 6 of the Insurance Law.
8. A reduction of up to 66% for the Righteous of the Nations (non-Jews who saved the lives of Jews in the Second World War) or their partners, as recognized by Yad Vashem (the Memorial Authority).
9. A reduction of up to 20% for single parents, in accordance with the 1992 Single Parents Law.

The 1993 State Economy Settlement Regulations (part 2) include provisions and conditions to establish a discount committee in the local authority. Such a committee is to be composed of three elected council members and four officials: the treasurer, the director of the welfare department, the director of the *arnona* department, and a legal advisor. The committee may award up to 70% reduction on the *arnona* for a needy user of a property. A needy person is defined as a user who had suffered exceptionally high expenses either because of prolonged medical treatment for him or herself or another

member of the family, or because of an event that caused a drastic reduction in his or her material financial condition.

There is no doubt that the 1993 State Economy Settlement Regulations (part 2) are formulated precisely. They are better defined than the local authorities would have prescribed and clearly linked to the different laws that prevail in Israel.

But what was wrong with the decision of the Tel Aviv City Council to grant a larger reduction, of 50% of the *arnona*, to those people who reached 80 years old? Or the reduction in the *arnona* granted to soldiers fulfilling their duty to the army? Or the reduction offered those who emigrate within the city to a developing neighborhood, as determined by the city council? Or the reduction for residents who suffer an environmental hazard (noise or the like)? Or the reduction for residents who live in an area where the physical infrastructure is incomplete?

The hidden agenda in the 1993 State Economy Settlement Regulations (part 2)—that of minimizing the power of the locally elected representatives to intervene in the taxation system—is being implemented effectively.

The 1994 State's Economy Settlement Regulations

The 1993 idea of determining the minimum and maximum *arnona* was accepted by the minister of internal affairs, the finance minister, and the Knesset members. They adjusted the minimum and maximum *arnona* for 1994 for the land uses that they determined in 1993 (see Table 3).

Table 3: Minimum and Maximum *Arnona* Rates—1994

Land-use	shekels per square meter	
	Minimal <i>arnona</i>	Maximal <i>arnona</i>
Banks	170.00	700.00
Industry	9.00	74.00
Hotels	14.00	65.00
Residential	14.00	53.50
Occupied land	0.004	3.00

They so enjoyed their revolutionary concept that they applied it to another five land uses, as shown in Table 4.

Table 4: Minimum and Maximum *Arnona* Rates—1994 (additional land uses)

Land-use	shekels per square meter	
	Minimal <i>arnona</i>	Maximal <i>arnona</i>

Offices and commerce	25.00	172.00
Light industry	17.00	100.00
Agricultural	0.0035	0.30
Parking	0.50	30.00
Other properties	1993 +10%	1993+12%



A Controversial Discount

Both buildings are located in *arnona* zone 1. One building faces the other. One of them is a residential block for young couples. The Tel Aviv municipality used to grant a discount for young couples. It was stopped by the 1993 State Economy Settlement Regulations (part 2). Who was right—the municipality or the government? (One should remember, though, that the reduction was given for the first 2 years only.)

The 1994 State Economy Settlement Regulations contains other paragraphs that make life even more complicated and less understood:

- The *arnona* for 1994 is set as the sum composed of the 1993 *arnona* and with the addition of 10.4 %, the rise in the cost-of-living index in that year.
- In paragraphs 7(a) and 7(b), it is specified that in relation to residential or any other use, the 1994 *arnona* will be the above new sum, or the new minimum *arnona*, the highest of the two, as long as the *arnona* is not higher than the maximum *arnona* set above.
- The *arnona* on non-built properties will be in accordance with paragraph 7(c). The 1994 *arnona* will be the new sum, whether it is higher or lower than the minimum *arnona*. However, it may not be higher than the maximum *arnona*.
- It is specified in paragraph 8(a), that despite what is written in paragraph 7, the 1994 *arnona* on occupied land will be in accordance with the new sum, even if it is higher than the maximum *arnona* set forth in the regulations.
- If, however, the new *arnona* for 1994 set on any property, other than residential use, is up to 15% higher than the minimum *arnona*, the local authority will set the *arnona* on those uses at the minimum *arnona* established for 1994.
- Paragraph 8(c) contains a specification regarding residential use. If the 1994 *arnona* is more than 15% lower than the minimum *arnona* for 1994, the local authority will have to charge the new sum for 1994 plus an additional of 15% in *arnona* on residential use.
- The reader might recall that the regulations for 1993 enabled local authorities to grant a reduction of up to 4% for payment of the *arnona* in one lump sum at the beginning of the fiscal year. For 1994, the Knesset finance committee was in an even more benevolent spirit. They specified in paragraph 11 that a local authority may grant a discount of up to 5% for payment of *arnona* in one lump sum, up to January 31, 1994.

The 1995 State Economy Settlement Regulations

The 1995 regulations are very similar to those of the previous year. The new *arnona* for 1995 will be the 1994 sum plus 13.8%. This percentage reflects the rise in the cost-of-living index between September 1993 and September 1994.

In paragraphs 5 and 6 of the 1995 regulations, a new table for the minimum and maximum *arnona* is published (see Table 5). These are the new *arnona* rates according to the different land uses:

Table 5: Minimum and Maximum Arnona Rates—1995

Land-use	shekels per square meter	
	Minimal <i>arnona</i>	Maximal <i>arnona</i>
Banks	205.00	7 35.00
Industry	11.00	81.50
Hotels	17.00	71.50
Residential	15.90	59.00
Occupied land	0.005	3.30
Offices and Commerce	30.00	189.00
Light Industry	21.00	110.00
Agricultural building *	0.16	22.50
Agricultural	0.0042	0.33
Parking	0.60	33.00
Other properties	1994 +10%	1994+14%

* New land-use

The 1995 regulations continue the pattern set in 1993 and 1994:

- In paragraph 7(a), it is specified that the *arnona* on residential use in 1995 will be the new sum or the new minimum *arnona*, the higher of the two, as long as the *arnona* does not exceed the maximum *arnona*.
- As if the addition of 13.8% in one year was not harsh enough, paragraph 7(b) determines that local authorities may add up to 4%, if they did not do so in the second half of the previous fiscal year. If a local authority did add on last year, but less than 4%, it may add up to the 4% to the *arnona*.
- The new 1995 *arnona*, then, will be composed of the 1994 *arnona*, plus 13.8% and a further 4% rise.
- In paragraph 7(c), it is specified that in relation to any land use other than residential, the *arnona* for 1995 will not be lower than the minimum *arnona* and not higher than the maximum *arnona*.
- In paragraph 7(d), the regulation deals with property that is not built up. In these cases, the *arnona* will be the 1994 *arnona* plus 13.8%, plus the 4%, as long as the total does not exceed the maximum *arnona*.
- Paragraph 7(e) even further complicates the regulations. According to this paragraph, despite the stipulation in paragraph 7(d), a local authority may, subject to interior ministry approval, impose *arnona* on non-built-up property at the sum of the 1994 *arnona* plus only 10%. However, the 1995 *arnona* must not be less than the minimum *arnona*.

- In paragraph 8(2) it is specified that despite paragraph 7, if the new sum for a property is lower than the minimum *arnona* by 20% or more, the local authority will charge the minimum *arnona* for 1995.
- Paragraph 8(3) deals with the *arnona* on nonresidential properties. If the sum of the 1994 *arnona* plus 13.8% is lower than the minimum *arnona* by more than 20%, the local authority will set the *arnona* for nonresidential property at the level of that sum plus the 20%.
- Paragraph 8(4) refers to homes for the aged. The *arnona* on this use used to be the same as for hotels. However, the 1995 State Economy Settlement Regulations specify that despite the calculations described above, the 1995 *arnona* for homes for the aged will not exceed the maximum *arnona*.
- Paragraph 11 allows local authorities to grant a discount of up to 5% for early payment of the *arnona* in one lump sum, by January 31, 1995.

The 1996 State Economy Settlement Regulations

The 1996 State Economy Settlement Regulations are very similar in character their predecessors since 1992, even though the minister of internal affairs was now Mr. Ehud Barak. The 1996, the *arnona* was set at the 1995 *arnona* plus 11%. In paragraph 5, the minimum and maximum *arnona* for the different land uses are set in the same manner as in the previous years, adjusted by about 11%.

- In paragraph 7(a)(1), it is specified that the 1996 *arnona* on a residential building will be the 1995 *arnona* plus 11% or the minimum rate, the higher of the two, as long as it does not exceed the maximum rate for residential use.
- In paragraph 7(a)(2), it is specified that the 1996 *arnona* on a home for the aged will be determined as in paragraph 7(a)(1), as long as the total does not exceed the rate imposed on a residential building in the same *arnona* zone.
- Paragraph 7(b) stipulates that the 1996 *arnona* on a nonresidential building will be no less than the minimum rate and no more than the maximum rate.
- In paragraph 7(c), the 1996 *arnona* on non-built up properties is determined as the 1996 sum plus 11.4%, as long as this is no lower than the minimum rate and no higher than the maximum rate.
- Paragraph 7(d) says that despite paragraph 7(c), a local authority may, upon approval of the interior minister, lower the *arnona* on non-built-up properties so determined by 10%. However, the new rate may not be less than the minimum rate.
- Paragraph 8(2) specifies that despite paragraph 7, if the new sum for a property is lower than the minimum *arnona* by 20% or more, the local authority may charge the minimum level of the *arnona*.

- Paragraph 8(3) deals with the *arnona* for nonresidential properties. If the sum of the 1995 *arnona*, plus 11%, is lower than the minimum *arnona* by more than 20%, the local authority may charge the *arnona* at that sum plus the 20%.
- In paragraph 9(a), the government introduces some new rules. Despite the specifications set forth in paragraphs 7 and 8 of the 1996 State Economy Settlement Regulations, a council may determine the 1996 *arnona* at any sum as long as it is not higher than the maximum rate in special circumstances:
 1. On residential properties, with the approval of the minister of internal affairs, as long as the new *arnona* is no less than the 1996 *arnona* or the minimum rate, the higher of the two;
 2. On nonresidential properties, with the approval of both the minister for internal affairs and the finance minister.
- Paragraph 9(b) permits the city council to change the classification of a use with the approval of the ministers for internal affairs and finance.
- In paragraph 9(c), the date of February 29, 1996 is set for submission of the requests specified in paragraphs 9 (a), 9(b) and 9(c), signed by the local authority.
- According to paragraph 9(d), the minister of internal affairs will notify the Knesset finance committee of any approvals of such requests.

Something has changed. It is specified in paragraph 12 that a local authority will be able to grant a reduction of up to 4%, rather than 5%, for payment of the *arnona* in one lump sum, up to January 31, 1996.

The 1997 State Economy Settlement Regulations

The 1997 State Economy Settlement Regulations are very similar to the previous years. The new *arnona* for 1997 will be the 1996 sum plus 11.4%.

In paragraphs 5 and 6 of the 1995 regulations, a new table for the minimum and maximum *arnona* is published. They are the same as in the previous year, adjusted by 11.4%.

- Paragraph 7 is the same as in the 1996 regulations, with one exception: the 1997 *arnona* can be higher than the maximum rate except in the case of homes for the aged and occupied land.
- In paragraph 9(a), the government sets up new rules. A council may determine the 1997 *arnona* at any sum, as long as it does not exceed the maximum rate, in special circumstances, namely on residential properties, subject to approval of the minister of internal affairs and the following two stipulations:

- a. If the local authority fixes the 1997 *arnona* at a rate lower than the 1996 sum plus 11.4%, it will not receive the interior ministry's 1997 balancing grant, as specified in the 1997 Budget Law.
- b. The new percentage increase for residential properties will not be less than the percentage increase on nonresidential properties.
- Paragraph 9(a)(2) specifies that the rate for nonresidential properties may also be raised. However, in this case, the local authority must obtain the approval of the finance minister, in addition to that of the minister for internal affairs.
- In paragraph 9(c), the date of February 28, 1997 is set for the above requests, which must be signed by the local authority's legal advisor in evidence of the compliance with the above paragraphs.
- The reduction for paying the *arnona* in one lump sum, by January 31, 1997, is the same as in 1996.

The 1998 State Economy Settlement Regulations

The 1998 regulations are very similar to those of the previous year. The new *arnona* for 1998 will be the 1997 sum plus 8.9%. In paragraphs 5 and 6 of the regulations, a new table for the minimum and maximum *arnona* is published. These are the new *arnona* rates according to the different land uses, as shown in Table 6).

Table 6: Minimum and Maximum *Arnona* Rates—1998

Land-use	shekels per square meter	
	Minimal <i>arnona</i>	Maximal <i>arnona</i>
Banks	291.00	891.70
Industry	15.60	106.70
Hotels	24.10	93.70
Residential	21.80	77.30
Occupied land	0.0074	4.40
Offices and commerce	42.80	247.60
Light industry	24.10	144.00
Agricultural building	0.22	29.50
Agricultural land	0.0062	0.44
Parking	0.90	43.20

The rest of the clauses follow the principles set forth in the previous years, with the exception of one clause, which will be discussed later.

Government Involvement with the *Arnona* Prior to 1992

A change in the attitude of the government towards the local authorities, as far as the *arnona* is concerned, can be traced to 1992. As described above, in 1992, Mr. Mordechai Virshuvsky, who at the time was both a Knesset member and a councilor in Tel Aviv, managed to obtain a majority in the Knesset to force the government to pay *arnona* on the properties they use. The State Economy Settlement laws and regulations have been described. To show the degree of the change in the government's attitude to the local authorities, the arrangements for the *arnona* between 1985 and 1991 are summarized:

- In 1985, paragraph 27a of the State Economy Emergency Settlement Law specified that a local authority could not charge higher *arnona* for 1986 than the *arnona* rate for 1985 plus 170% (please note that these were times of triple-digit inflation in Israel). This was the level of the increase in *arnona* that year, unless the local authority obtained the approval of both the minister for internal affairs and the finance minister for an even steeper rise.
- Paragraph 14(a) of the 1987 Economy Stability Law stipulates that a local authority will not charge a higher *arnona* than the 1986 sum plus 22%.
- In paragraph 14(b), the local authorities are warned to neither change the discounts nor the payment conditions of the *arnona*.
- Paragraph 14(c) permits the local authorities to raise the *arnona* more than in paragraph 14(a), subject to the approval of both the minister for internal affairs and the finance minister.
- In paragraph 1(a) of the 1988 General *Arnona* Law, the Knesset decided that a local authority could not charge *arnona* higher than the 1987 level. Paragraphs 1(b) and 1(c) of this law are the same as paragraphs 14(b) and 14(c) of the 1987 Economy Stability Law.
- For 1989, the content of the paragraphs were the same, but the name of the law was changed to the 1989 State Economy Settlement Law.
- In 1990, the regulations were again the same, but the law was again called the General *Arnona* Law.
- In 1991 there was a change. Paragraph 9(a) states that local authorities are entitled to raise the *arnona* for 1991. The new *arnona* was to be the 1990 sum multiplied by 3/4 and linked to the rise in the cost-of-living index between December 1989 and December 1990. In paragraph 9(b), the local authorities are forbidden to change the discounts in the *arnona*, except for the benefit of the payee. In paragraph 9(c), the local authorities are forbidden to collect *arnona* on other land-uses than in 1990.

However, according to paragraph 9(d)(1), the ministers have the right to mingle in local affairs and fix a lower *arnona* than specified in paragraph 9(a), though not lower than the

1990 sum multiplied by 3/4. Furthermore, according to paragraph 9(d)(2), the ministers are allowed to fix a higher *arnona* than stipulated in paragraph 9(a). They are allowed a change in the *arnona* reductions in contrast to paragraph 9(b). And, of course, the ministers, in contrast to paragraph 9(c), have the right to designate *arnona* to other land uses than in 1990.

In 1992 the attitude changed. Can one attribute this change to the vengeance of ministry of finance officials, in response to the Virshuvsky amendment? Or was the timing simply coincidental, the change in attitude toward local authorities in central government circles being completely independent of Virshuvsky's amendment? If this is the case, what did generate it?

Furthermore, the local authorities accepted the change without a fight. Why?

To begin with, as customary in the central government, the local authorities were not notified of changes in the making; second, they might not have been aware of the magnitude of the changes; third, they probably didn't realize the degree of independence they had lost. In any case, once it had been approved by the finance committee, all was lost.

The 1998 State Economy Settlement Regulations: Another Look

Why do we return to 1998 regulations? To add insult to injury, the ministry of finance and the Knesset finance committee decided to have some fun at the expense of the politicians in the local governments.

On November 10, 1998 the municipal elections were held throughout Israel. The ministries decided to include an unprecedented clause. On top of the regular addition to the *arnona* based on the rise of the cost-of-living index, they decided to authorize another increase. The local authorities that receive grants from the central government were now allowed to increase the *arnona* for hotels, industry, light industry, banks, insurance companies, offices, and commerce by another 5%, as long as they increased the *arnona* on the residential properties by the same amount. The municipalities that do not receive government grants could do the same, as long as the increase in the *arnona* on the residential land use was half the increase on the nonresidential land uses.

I do not recall one mayor who had the courage to anger his town's residents in that election year. In Tel Aviv, we declined the ministry of finance's benevolent generosity. Of course, the 1999 State Economy Settlement Regulations did not repeat this clause.

Conclusions

The mayors of towns and cities do change; in general, the central government's attitude towards the local government does not. Yet, I believe that this attitude must change.

There was once a revolution that began with the slogan "no taxation without representation." The elected members of the local authorities in Israel might rebel, one

day, under the slogan “no need for representation without the power of taxation.” This will happen when they realize and assimilate that the level of local taxation is determined by central government with the Knesset approval, without the consent of local governments, while they are the ones attacked by the residents for not fulfilling the needs of the local population. When they do rebel, it will not be the *arnona* alone that they seek to change.

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