“Transparency Era: Combatting Money Laundering, Terrorism Financing and Tax Evasion and its Impact on Lebanon”

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International Taxation
Definition of Resident and Nonresident Taxpayer in Practice

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Background

The definition of resident:

- A matter of sovereignty in international taxation; and
- A cornerstone of the fiscal systems around the world.
- The residency issue more acute today owing to the Global Forum automatic exchange of information and transparency rules.
- Extension or limitation of the scope of the income taxation through the selection of one of the 3 current worldwide tax systems → territorial or residential or citizenship.
- Mitigation of advantages and limitations through hybrid systems→ personal and economic relationships.
- Major conceptual differences between tax systems lead to double taxation or no taxation.
- Cooperation between countries to eliminate or reduce → through DTTs or TIEA or multilateral tax treaties for transparency and exchange of information (MCA & MCAA) → common reporting standard (CRS).

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A- International Income Tax systems

Characteristic of a State's sovereignty → right to levy taxes on its citizens and/or residents and/or within the scope of its territory.

Taxation may be levied on worldwide income or on local sources:

Personal relationship (income tax):

	Individual	**Scope**
USA	Citizen/resident	Worldwide
France	Resident	Worldwide
UK	Resident/UK Domiciled	Worldwide
	Resident/Non UK Domiciled	UK Source

Economic relationship (i.e. Income from properties or activities within the Territory)

	Individual
USA (Foreigner/non-resident)	USA source
France (non-resident)	France Source
UK/Not Domiciled	Only UK Source

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1- Residential Taxation

- Most common taxation system in the world (177 countries out of 244).

- Residents taxed on worldwide (local and foreign) income / nonresidents taxed on local income.

- Worldwide income → wages, pensions, professional benefits, income from property, capital gains → notwithstanding any taxation or withholdings in other jurisdictions.

- Unlimited tax obligation with deductions or tax credits for foreign paid taxes on same revenues.

- Resident under such system means the person liable to tax by reason of his domicile and/or permanent residence and/or place of customary business or any other criterion of similar nature (more than 183 days of presence in the country).

- Difference in the United Kingdom (UK) between domicile (permanent home/domicile of origin) and residence → consequences on Inheritance Tax for properties or financial assets abroad.

2- Territorial Taxation

- Local generated income (local source) is taxed regardless the residence or the citizenship of the taxpayer.

- The source of income is determined for each kind of income as follows:

  - Professional or business income → where the services are performed.
  - Income from real estates and tangible properties → where the property is located.
  - Financing income (dividends, interests, etc.) → where the user or the beneficiary of the financing resides.
  - Wide system of withholding taxes → provide for great simplicity of administration.

3- Citizenship Taxation

- Applied by only two countries in the world: United States and Eritrea.

- Taxes the worldwide income of residents (whether citizens or not) and nonresident citizens.

- **Eritrea** taxes its nonresident citizens on their foreign income at a reduced rate of 2%.

- **United States** taxes its nonresident citizens on their worldwide income using the same marginal tax rates but with a foreign tax credit to mitigate double taxation.

- **Enforcement tactics** used by both countries to facilitate tax compliance → denial of passport to delinquent nonresident citizens + potential seizure of any accounts or assets held in the country.

- Eritrea uses also the harassment of relatives living within the country until the tax/penalties are paid.

B- Tax Treaties to eliminate or reduce double taxation or tax evasion

Double taxation problem arises when a resident taxpayer of a country, which applies the residency criterion (personal relationship), derives income from sources within another country (the host country) that applies Territorial criterion (economic relationship). Both assert jurisdiction → taxes levied twice on the same revenue.

1- Double Tax Treaties (DTTs)

• Double Tax Treaties between countries on a bilateral basis to prevent double taxation or non-taxation.

• Set in accordance with the model conventions on income and wealth drawn up by the Organization for Economic Cooperation and Development (OECD).
Also known under the title of tax information exchange agreements (TIEA).

• The provisions prevail over the internal laws.

• According to the OECD model tax treaties, a resident of a Contracting State means "*any person who under the law of that State is liable to tax therein by reason of his domicile, residence, head office or place of management (business), or any other criterion of a similar nature*".

“Tie breaker” clauses for resolving conflicts between residency rules of both Contracting States → alternative criteria:

- The permanent home; or
- The center of vital interests, taking into consideration the personal and economic links of the taxpayer (i.e. State with which his personal and economic relations are closer); or
- The habitual abode; or
- The nationality.

In this regard it should be noted that:

- “**Home**” means the place where the person or his family (spouse and children) usually live.
- “**Center of vital economic interests**” means the country where are implemented major investments or is located the center of professional activities or major income is generated.
- “**Permanent abode**” means a country (State) where the person spends more than 183 days within one year.

Inheritance tax

Real estate → in the Contracting State where it is located.
Tangible and intangible movable assets (currencies, securities, intellectual property rights, etc.) → the last residence of the deceased.
Exception: US citizen and resident alien decedents subject to the US estate tax on worldwide assets.

A- Multilateral Tax Treaties

Convention on Mutual Administrative Assistance in Tax Matters (**MAC**) → provide exchange of information in tax matters upon request to the widest possible extent (spontaneously) subject only to safeguards on confidentiality and limitations on use of exchanged information.

- MAC operates essentially as a giant multilateral TIEA.

- Parties (countries) must agree by separate bilateral instrument for automatic information exchange.

Multilateral Competent Authority Agreement (MCAA) → framework agreement designed to implement the automatic common reporting standard (CRS) on a multilateral basis → fully reciprocal.

- To become party to the MCAA, jurisdiction must also be party to the MAC.

- Exchange of information under the MCAA will be activated when both counterparties file Notifications with the OECD Secretariat.

- Under CRS → Financial Institutions (FIs) of each Member country report to their local competent authorities all accounts and related details pertaining to residents of other Member country.

- Objective → to expose the financial assets of non-residents so that they may be subject to tax by home revenue authorities.

- Criterion of residence turned out to be an essential issue at stake under MAC and MCAA.

I- <u>Lebanese Taxation System</u>

The current Tax regime is dependent on schedule taxes (*impôts cédulaires*) with separate and independent rules. Taxation's principles vary between each kind of taxes.

Lebanon resident	**Individual**
Active income (salary, commercial and professional activities)	Lebanon Source only
Passive income (revenues from foreign securities and debentures)	Worldwide
Income from properties (real estates)	Lebanon Source only

So far, residency was not specifically defined in the Lebanese laws → few regulations only (decree No 29/77) and basic circular (No 6170 dated 17/05/1996).

Recent new law, amending some provisions of the Code of Fiscal Procedures (to comply with the requirements of the Global Forum), provided a clear and undisputable definition:

(i) Resident legal entities, if:

- set up or registered in compliance with the Lebanese laws (include de facto corporation); or
- Head office localized in Lebanon.

(ii) Resident natural persons, if they:

- Have an office in Lebanon to undertake their activities; or
- Have a permanent home constituting an habitual abode for them or their family; or
- Spend in Lebanon more than 183 days (six months) within a twelve month period (does not include transit or stay for medical purposes).

Practically:

- Professional revenues remain taxable in Lebanon only if the income is generated in Lebanon.

- Conversely, incomes generated by residents or by expatriates abroad remain subject to foreign taxes.

- Nevertheless, incomes derived by residents from foreign movable capital are liable to Lebanese Taxes.

- Lebanese inheritance tax applies to the worldwide assets of the deceased resident, subject to bilateral treaties.

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Decree N° 3692 dated 22/6/2016 determines the mode of application of tax on nonresidents:

Clarified the meaning of two expressions at stake:

"**Location for undertaking the activity**": means a place that allows the taxpayer to perform his business for more than 6 months within a period of 12 months for public and private works and for a period exceeding 3 months within a period of 12 months for the other activities.

"Permanent and repetitive activity": means any person undertaking a taxable activity in Lebanon for more than one time within a period of 12 months (painter, consultant, etc.).

CONCLUSION

Despite globalization and expansion of multilateral tax treaties, States still enjoy fiscal sovereignty in the field of direct taxation notably for residents or local revenues → free to design their tax system in accordance with strategic policy objectives → attract investors and capital in circulation.