WEBINAR
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What Tax Policy for Lebanon? Lessons from the Past for a Difficult Future

How to improve effectiveness?
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- **Priority fiscal objectives of any recovery plan** → bringing down the current account deficit and achieving debt and financial sustainability.

- **Outcomes of this process** → increase of public resources by enhancing revenue collection → i.e. strengthening tax compliance and applying efficient and fair taxes.

- **Limits & cautions**: not to undermine efforts to revive the national economy and finance sustainable development.

- **International community**: aid flows will not be granted unless Lebanon strengthens its revenue raising capacity based on better designed tax systems and stronger revenue institutions.

- **Easiest way to increase revenues** → focus on easy-to-collect taxes (VAT, customs duties and selective high-yielding excise taxes) or increase corporate tax → regressive and very far from the desired objective of fairness and equity → will undoubtedly lead to the same disaster and tragic outcome of the financing of salary scale three years ago.

- **Key question**: how to improve effectiveness of any new tax policy or tax reform?

1. Prior economic impact assessment:

- Proceed to a prior economic impact study to hedge against the adverse effects of any inappropriate tax measure;
- Establish a yearly report → traces the evolution of measures in comparison with initial projections and the observed results.
- Encrypt the direct shortfalls of any measure (growth, employment, balance of payments).

2. Improve revenue collection by broadening the tax base and combatting tax evasion:

Implies a broad consensus on several measures and steps to be adopted.

1) **Broadening the tax base by a gradual orientation and incorporation of the informal sector into the formal economy** → awareness (financial literacy) + promote tax ethics and communication + simplified legal device + social coverage.
2) **Set limits to the arbitrary discretion of the tax authorities** → improve and enforce sanction regime.
3) **Tackling several loopholes in the current tax system** → abandoning the schedule taxes + lifting the bank secrecy + amending the notification procedures + apply the tax identification number for each resident, whether national or foreigner.
4) **To broadly resort to the new technology** → implementation of algorithms and computer interface links (Data mining) as well as blockchain technology in order to highlight the flaws and to pursue the recalcitrant.

5) Open access to the public beneficial ownership registers (companies, trusts, real estates, cars, boats, etc.) → better tracking of money laundering and shell companies or corporate structures registered in offshore jurisdictions.

6) Simplify and improve the existing regulations and procedures → short tax forms + fair and well-balanced procedures + efficient and fast administrative organs for conflicts resolution and tax disputes.

3. Review the fundamentals of the tax system and adopt more efficient taxation.

Findings:

Lebanese fiscal system → relies on indirect taxes and biased towards rentier-based activities.

The current regime of schedule taxes adopted in 1959 excludes important revenues and assets from the tax base and facilitates tax evasion and tax abuse.

Measures:

- Adoption of the General personal Income Tax on the whole revenues with progressive rates → incorporate to the tax base all the generated local and foreign revenues → deductions or foreign tax credits for taxes already paid abroad.
- Tax harmonization through the regrouping of disparate fiscal provisions in a General Tax Code.
- Reform of the Law on property tax → channel revenues derived from rents to the income tax.
- Amendment of the Law on inheritance and gift taxes → address loopholes and vulnerabilities and close gasps facilitating tax abuse and fictive transactions.
- Extend the scope of the VAT to all the economic activities + lower thresholds + reorganize its rates fairly.

4. Impose a tax on wealth.

Wealth inequality has been shown to be higher than income inequality.

Impose an annual tax (between 0.5 and 3%) on households with a net worth above a defined threshold and that on top of their income taxes. It will:

- Contribute to apportion the burden of the loss and debt fairly between the citizens;
- Encourage the wealthy to dissipate their fortunes by spending the money in productive investments.

5. Expend the use of earmarked taxes.

- Introduce new taxes or increase rates of current taxes on activities that are harmful to health and prejudicial to the environment (such as careers and cement factories).

- Apply a kind of "*jugatio terrena*" tax (Diocletian) on empty and vacant houses, buildings and lands to stimulate their use → allocate proceeds to a special fund promoting habitat and sustainable development.

- Adopt a special regularization (amnesty) for income derived by Lebanese residents from foreign movable assets (interest, dividends, arrears, bonds, etc.) in order to avoid discretionary tax control and assessment → fixed percentage (3 to 5%) of the whole capital → affect and allocate proceeds to the sovereign fund or dedicated deposit recovery fund.

<u>6. Addressing tax avoidance and profit shifting in the context of the digital economy.</u>

- Digitalization turned out to be at the same time a chance to combat tax fraud and evasion and a **loophole that facilitate the same** → harmful and unfair competition between multinational digital firms (GAFAM, Uber and Airbnb) and local actors and disrupting the ability of Lebanon to raise resources → both indirect and direct taxation are affected.

- BEPS Inclusive framework (Action 1) addresses this tax challenges and submit several proposals.

- Lebanon may proceed in the meantime on standalone basis but in a concerted manner → (i) tax such value where consumer resides and value is created; or (ii) create a taxable threshold with the allocation of profits based on fractional apportionment.

7. Revenues generated by the development of international cooperation and exchange of information in tax matters.

Global Forum (CRS) rules and framework → allow the transfer of valuable information on reportable accounts and assets held by Lebanese tax residents → will enable the tax authorities to:

- ✓ perceive taxes on movable revenues and estates of Lebanese residents located abroad;
- ✓ tackle aggressive tax planning and optimizations that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

8. Shifting from counterproductive and unfair tax incentive to efficient and useful tax incentives.

Findings:

- Generally implemented to encourage specific economic activities and promote underdeveloped geographical areas as well as to attract foreign direct investments (FDI) → contribute to the balance of payments' equilibrium and strengthen revenues with a view to redistribute wealth in the economy.

- In Lebanon, tax incentives have been found to be (i) obsolete and outdated; (ii) used and carried out in a manner which undermines the intention of the tax law (i.e. taxpayer has misused or abused the law).

- Incentives must necessarily be coupled with other key factors: (i) political stability; (ii) transparent and accountable public administration; (iii) flexible labor code; (iv) quality of the infrastructure; (v) and adequate dispute resolution mechanism.

8-1 Counterproductive tax incentives and exemptions:

- **Tax exemptions on real estate activities** → led to surplus (hub) and inadaptability (inappropriate product range) → sector crisis with devastating effect since the real estate sector has always been a key driver of economic growth in Lebanon.

- **Permanent exemption of educational institutions** (article 5 of the Income Tax Law) → resulted in a departure from its original aim (combat illiteracy) and led to multiplications of fake institutions and decrease of education’s level.

- **Permanent exemption of maritime and aerial transportation companies (MEA)** → created a monopolistic situation and unlawful competition → unjustified increase of travel and transport rates.

- **Exemption of Investment banks and Medium and long term credit banks** (Decree-Law No.50/1983) → exemption from corporate tax (17%) during the seven first financial years and thereafter up to a ceiling of 4% of the paid-up capital.

- **Exemption of shares' transfer in Lebanese joint stock companies (SAL)** → led to tax avoidance and abuse notably in the real estate sector.

- **"Package Deal" of the Law No. 360/2001 promoting investments (IDAL)** → has been taken out of context and unfairly infringed and misused to lower tax burden.

8-2 Well-targeted tax incentives as regulatory and stimulation tool.

Well-targeted tax incentives and well selected productive activities (McKenzie report)

- ✓ Stimulate private investment and enhance productivity and growth;
- ✓ Ensure efficient public investment, especially in infrastructure;
- ✓ Favor research and development (R&D);
- ✓ Attract foreign capitals (FDI) to create jobs, bring in foreign exchange and stabilize both trade's & payments' balances;
- ✓ Develop the territory.
- ✓ Financial shortfall can be offset by the increased business performance and increased revenues and consumption capacity.