

# Workshop Tax Reform for Lebanon

Issam Fares Institute- Thursday 25 January 2024  
(Karim Daher)

- **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 in whole and finalizing the still needed actions (Decree) + 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 implementing e-government and linking the public institutions through centralized systems or decentralized networks like the 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.
- 7) **Pursuing the recalcitrant through severe sanctions** → such as large fines (substantial enough to change the incentives), removal of license (for enablers like lawyers and auditors) and Name & Shame.



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

#### **Findings:**

Lebanese fiscal system → relies on indirect (regressive) 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 (worldwide taxation) → shift from a territorial regime to a residence tax regime without prejudice to the provisions of Double Taxation Treaties (DTT) → 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 → distinction between rented and non-rented residences → channel revenues derived from rents to the income tax and allocates the tax applicable to the owners residing in their homes to the local authorities as a property usage 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.
- Introduce and extend the use of earmarked taxes which increases the tax payers' knowledge of how taxes are channeled, which in-turn could increase taxpayers' vigilance over the efficiency of the service provided and influence for its improvement. .

## 6. Addressing tax avoidance and profit shifting in the context of the digital economy.

- 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 can:**

- ✓ 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 our trade & payments' balances;
- ✓ Develop the territory.
- ✓ Financial shortfall can be offset by the increased business performance and increased revenues and consumption capacity.
- ✓ Restore Lebanon to its central place as a financial regional platform (foundations, Family offices, etc.).





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

- The overall is to reassure the investor with long-term commitments, including the stabilization of tax burdens for a fixed period.
- Tax reduction or exemption from a sector or category of taxpayers can be offset by the increased business performance and increased revenues and consumption capacity that will re-establish definitely and by the imposition itself the basic equilibrium.
- Free zones are also interesting options for foreign investors → reduce taxation and get rid of complications and legislative and bureaucratic constraints.
- Several other promising activities may be supported in line with the recommendations of the McKenzie report and the outgoing government's recovery plan → renewable energy, recycling, cosmetics and perfumes, Green Buildings, prefab structures, ecotourism and Medical Tourism, environment or innovation, technology and telecommunication, etc.

