

# Lebanon: Technical Assistance Report on Putting Tax Policy Back on Track



# LEBANON

## TECHNICAL ASSISTANCE REPORT ON PUTTING TAX POLICY BACK ON TRACK

January 2023

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**Washington, D.C.**

## **Lebanon**

# **Putting Tax Policy Back on Track**

Shafik Hebous, Svetlana Cerovic, Michael Keen, Lydia Sofrona, Nate Vernon, and  
Christophe Waerzeggers



**Technical Report**

**November 2022**

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## GLOSSARY

AEOI	Automatic Exchange of Information
BDL	Banque du Liban
CIT	Corporate Income Tax
CoCG	Code of Conduct Group
CoM	Council of Ministers
EDL	Électricité du Liban
EFF	Extended Fund Facility
ESSN	Emergency Social Safety Net
ETR	Effective Tax Rate
EU	European Union
FAD	Fiscal Affairs Department (of the IMF)
GDP	Gross Domestic Product
IDAL	Investment Development Authority of Lebanon
IPZ	Investment Project by Zone
IMF	International Monetary Fund
IPZ	Investment Project by Zone
LBP	Lebanese Pound (or Lira, the currency of Lebanon); the official rate is USD1 = LBP 1,510. The market rate is about USD1 = LBP 38,000 as of September 2022.
LEG	Legal Department (of the IMF)
MoF	Ministry of Finance
MoE	Ministry of Energy
OECD	Organisation for Economic Cooperation and Development
PDC	Package Deal Contract
PIT	Personal Income Tax
QDMTT	Qualified Domestic Minimum Top up Tax
R&D	Research and Development
TSEZ	Tripoli Special Economic Zone (TSEZ)
USD	U.S. Dollar
VAT	Value-Added Tax
WHT	Withholding Tax
WTO	World Trade Organization

## PREFACE

At the request of the Deputy Prime Minister Mr. Saadeh Al Shami, a team from the IMF Fiscal Affairs Department and Legal Department conducted a mission in Beirut during September 12-23, 2022, to assist the authorities in reviewing tax policy. The mission comprised Shafik Hebous (mission head), Svetlana Cerovic (MCD), Michael Keen (FAD expert), Lydia Sofrona (LEG expert), Christophe Waerzeggers (LEG), and Nate Vernon (FAD).

The mission held discussions with Deputy Prime Minister Mr. Saadeh Al Shami and the Ministry of Finance (MoF) led by the Minister of Finance Mr. Youssef Khalil, including Mr. Georges Maarrawi (Director General), and Mr. Louay el Hajj Chehade (Commissioner General). The mission also held discussions with the Minister of Economy Mr. Amin Salam, the Minister of Industry Mr. Georges Boujikian, the Minister of Energy and Water Mr. Walid Fayad, and the Governor of the Banque Du Liban Mr. Riad Salameh. The mission also met with officials from the Lebanese Customs Administration.

The mission team held meetings with representatives of the private sector (including banks and law firms); the Association of Banks in Lebanon (ABL); the Chamber of Commerce, Industry, and Agriculture; the Regie Libanaise des Tabacs et Tombacs; the Investment Development Authority of Lebanon (IDAL); and civil society organizations. The mission also met with representatives of the World Bank.

The mission team would like to express its sincere thanks to the authorities for the constructive discussions and to Ms. Sabine El Corm and Ms. Claudine Karaki for the excellent organization throughout the mission, facilitating access to data, and the informative discussions.



## لبنان إعادة السياسة الضريبية إلى المسار الصحيح

### ملخص وافٍ

انخفضت الإيرادات الضريبية في لبنان إلى أقل من النصف بين عامي 2019 و2021، على خلفية أعمق أزمة اقتصادية منذ نهاية الحرب الأهلية. وما لم تُتخذ الآن تدابير ضريبية نشطة، فمن المرجح أن يستمر انخفاض الإيرادات في 2022 و2023، مما يسفر عن تداعيات حادة - بخلاف الدخل الضائع (ومن ثم تدهور المؤسسات العامة) - تتسبب في تقويض تصاعدية النظام الضريبي وتفاقم عدم المساواة والتشوهات.

ويحدد هذا التقرير خيارات إصلاح السياسة الضريبية لوقف نزيف الإيرادات الآن وفي المدى القريب والانتقال إلى نظام ضريبي أكثر كفاءة وفعالية وشمولاً في المدى المتوسط. ويركز التحليل على ضرورة اعتماد رؤية شاملة للنظام الضريبي تسترشد بها الإصلاحات وتوازن بين المفاضلات المختلفة، بدلاً من المنهج المجزأ القائم على تدابير مخصصة وغير منسقة - وكذلك ضرورة اعتماد منهج استراتيجي متسلسل للخروج العاجل والقوي من المصاعب الحالية. ورغم عدم تعمق هذا التقرير في التفاصيل، فمن الضروري تقييم أثر التدابير الموصى بها على أكثر الفئات ضعفاً واعتماد تدابير للإنفاق التعويضي حسب الحاجة (وهو ما قد يشمل توسيع "شبكة الأمان الاجتماعي الطارئة" (ESSN)).

### جزمة تدابير فورية

**تصحيح التقييم الخاطئ:** ينبغي استخدام سعر صرف سوقي موحد في كل التقييمات للأغراض الضريبية. وفي الفترة الانتقالية على المدى القصير، يمكن استخدام مؤشر قريب بدرجة معقولة، مع الاقتراب من سعر الصرف السوقي بالتدريج. فسعر الصرف المخصص للتقييم الضريبي ليس المقصود منه (ولا ينبغي) أن يكون خيار السياسة الضريبية أو أن تكون له قيمة مخصصة لتحديد سلفاً. ونوصي بقوة بعدم اعتماد سعر صرف أدنى من سعر منصة "صيرفة" أو أي قيمة مطلقة تتحدد سلفاً للأغراض الضريبية. ومن المقدر أن التقييم الخاطئ للجمارك ورسوم الاستهلاك والضريبة على القيمة المضافة على الحدود - بسبب استخدام سعر صرف محدد سلفاً قدره 1,507 ليرة لبنانية (مقارنة بسعر السوق البالغ حوالي 38 ألف ليرة لبنانية اعتباراً من 22 سبتمبر/أيلول 2022) - يتسبب في خسارة إيرادات تعادل 4,8% من إجمالي الناتج المحلي في عام 2022. ونورد في الجدول أدناه تفصيلاً لعناصر التكلفة.

**التصحيح لمراعاة التضخم المرتفع:** ينبغي إعادة تحديد رسوم الاستهلاك وحدود التكاليف ذات القيم الاسمية وربطها بالتضخم. وقد أدى عدم إعادة تحديد رسوم الاستهلاك (ولا سيما على المحروقات) إلى خسارة في الإيرادات قدرها 0,8% من إجمالي الناتج المحلي، مما وصل بمجموع الإيرادات الضائعة (بسبب عدم الاستجابة لانخفاض سعر الصرف وارتفاع التضخم) إلى 5,6% من إجمالي الناتج المحلي في عام 2022. وينبغي العودة بحد التكاليف بضريبة القيمة المضافة إلى مستوى ملائم لتخفيف التكاليف الإدارية وتكاليف الامتثال. وينبغي أيضاً تعديل شرائح ضريبة دخل العمل وربطها بالتضخم وإعادة العمل بالجدول الأصلي الذي يتسم بتصاعد متوسط المعدلات الضريبية، ومعالجة التقويض المستمر للعدالة الأفقية والرأسية. وفي كل الحالات، ينبغي أن يكون ربط الضريبة بمؤشر أمراً تلقائياً.

2023	2022	
خسارة الإيرادات المقدرة بسبب التقييم الخاطئ على الحدود (% من إجمالي الناتج المحلي)		
0,6	0,7	الجمارك
0,6	1,4	رسوم الاستهلاك
2,3	2,7	الضريبة على القيمة المضافة
3,5	4,8	الجمارك + رسوم الاستهلاك + الضريبة على القيمة المضافة
خسارة الإيرادات المقدرة الناجمة عن ضياع القيمة الحقيقية لرسوم الاستهلاك المحددة (% من إجمالي الناتج المحلي)		
0,8	0,8	رسوم الاستهلاك
4,3	5,6	التكلفة الكلية

المصدر: حسابات خبراء صندوق النقد الدولي (على النحو المفصل في الملحق الأول والقسم 2 من هذا التقرير).

**وقف المعاملة التفضيلية المفرطة فيما يتعلق بالضريبة على عائدات رأس المال:** يؤدي فرض ضرائب أقل مما ينبغي على الموسرين، ولا سيما غير العاملين مقابل أجر، إلى إضعاف الإيرادات وتقليص دور السياسة الضريبية في إعادة توزيع الدخل وتقويض المعنويات الضريبية. وينبغي إلغاء الإعفاءات التالية لسد تلك الثغرات: (1) ضريبة الاقتطاع من المنبع على توزيعات الأرباح للأفراد من الشركات القابضة أو الأوفشور؛ و(2) الكسب الرأسمالي من مبيعات الأسهم في الشركات المساهمة؛ و(3) الكسب الرأسمالي من بيع العقارات المخصصة لأغراض غير السكن الرئيسي. وينبغي أيضا معالجة أوجه القصور في ضرائب الشركات، بما في ذلك عن طريق: إلغاء المعاملة الضريبية التفضيلية لعائدات التصدير (بما لا يتسق مع معايير التجارة الدولية المعمول بها)؛ وإدخال الكسب الرأسمالي للشركات ضمن القاعدة الضريبية لدخل الشركات (بدلا من إخضاعها للضرائب على نحو منفصل).

**إطلاق إمكانات الضرائب العقارية:** يتعين القيام على الفور بإلغاء الإعفاء الممنوح للعقارات الشاغرة – الذي يؤدي في نهاية المطاف إلى التمييز لصالح الموارد المعطلة وتيسير التهرب الضريبي – باعتبار ذلك خطوة ضرورية لتحقيق الإمكانيات الكاملة للضرائب على العقارات المبنية. وينبغي أن يكون هذا الإجراء جزءا من جهود أكبر في الإطار الزمني الفوري إلى القريب من أجل تحسين جودة نظام تقييم العقارات والحفاظ على اتساق القيم العقارية مع المعايير السائدة.

### تدابير المدى القصير

إعادة بناء النظام الضريبي اللبناني عملية مستمرة. وفي عام 2023، ينبغي أن تركز الإصلاحات على ما يلي:

**إعادة ضريبة القيمة المضافة إلى ما كانت عليه من كفاءة كبيرة:** كان استحداث الضريبة على القيمة المضافة في عام 2002 مثالا حيا على إمكانية تحقيق نجاح كبير في إصلاح النظام الضريبي اللبناني. وللنهوض إلى مستوى التحديات الضريبية الجارية، ينبغي تعزيز تصميم ضريبة القيمة المضافة عن طريق تدابير على المدى القريب لتقليص الثغرات الحالية في الامتثال وفي السياسة. وتشير التقديرات إلى أن اعتماد تدابير معتدلة نسبيا – دون رفع معدل ضريبة القيمة المضافة – يمكن أن يحقق إيرادات إضافية مقدارها 1% من إجمالي الناتج المحلي. ومن بين التوصيات المحددة لتوسيع قاعدة ضريبة القيمة المضافة إلغاء الإعفاء المشوه الذي تحظى به مستلزمات الإنتاج في قطاعات محددة وقصر استحقاقات رد الضريبة عموما (قدر الإمكان) على مؤسسات الأعمال المسجلة في ضريبة القيمة المضافة عن طريق إلغاء نظام رد الضريبة للسائحين، بين أمور أخرى.

**استخدام رسوم الاستهلاك بصورة أفضل:** رسوم الاستهلاك هي طريقة كفوة لتخفيض التلوث، حيث تحقق مزايا بيئية ملموسة وإيرادات كبيرة، مع تأثير محدود على الأسعار. ومن المقدر أن فرض رسم على استهلاك الديزل يزداد من 0,10 دولار في 2023 إلى 0,25 دولار للتر في 2025 يؤدي إلى زيادة الإيرادات بنسبة 1,5% إلى 3% من إجمالي الناتج المحلي. وفي حين أن الضريبة على الديزل هي الأولوية وينبغي تطبيقها في الأجل القريب، فإن رسوم استهلاك البروبان والبولتان يمكن أيضا إدخالها في التشريع بصورة تدريجية تلقائيا دون اشتراط الحصول على موافقة أخرى من البرلمان.

**سد الثغرات وتحديث ضريبة دخل الشركات:** تماشيا مع أفضل الممارسات الدولية، ينبغي فرض ضريبة على أصحاب المهن الحرة في نظام الأرباح الحقيقية وباستخدام ضرائب الاقتطاع من المنبع على المدفوعات التي يتقاضوها مقابل خدماتهم. وينبغي إلغاء النظم المطبقة على شركات الأوفشور والشركات القابضة (التي لم تعد تتماشى مع المعايير الدولية)، والحوافز المهدرة للموارد التي يتيحها نظام الضريبة على دخل الشركات.

### المدى المتوسط

ينبغي استكمال الإعداد لتدابير المدى المتوسط في عام 2023 حتى يتسنى إدخالها حيز التنفيذ في 2025/2024. ولتحسين نظام ضريبة الدخل، يتعين وضع قانون جديد لضريبة الدخل يحل محل القانون القائم الذي أصبح غير صالح للتطبيق. وينبغي أن يسعى القانون الجديد إلى ضمان الحياد الضريبي بين مصادر الدخل والأشكال القانونية، وحماية القاعدة الضريبية بترسانة من القواعد الحديثة لمكافحة التحايل الضريبي، والنص على حوافز ضريبية قائمة على التكلفة تتسم بالكفاءة والفعالية. وينبغي الاستمرار في صقل الضريبة على القيمة المضافة عن طريق إجراءات من بينها إلغاء الإعفاء الحالي على الديزل وتحسين تصميم القواعد المطبقة على المعاملات العابرة للحدود.

### ملخص التوصيات

## التوصيات الفورية

<ul style="list-style-type: none"> <li>• استخدام سعر الصرف السوقي (مع إمكانية استخدام سعر منصة "صيرفة" أثناء الفترة الانتقالية) بشكل موحد في كامل النظام الضريبي لأغراض التقييم.</li> <li>• ينبغي ربط الأحجام الاسمية بمؤشر التضخم.</li> </ul>	<p><b>التقييم</b></p>
<ul style="list-style-type: none"> <li>• استخدام سعر الصرف السوقي (مع إمكانية استخدام سعر منصة "صيرفة" أثناء الفترة الانتقالية) بشكل موحد لتقييم الواردات لأغراض الضريبة على القيمة المضافة</li> <li>• إعادة القيمة الحقيقية لحد التكاليف بضريبة القيمة المضافة إلى نحو 75 ألف دولار.</li> <li>• اعتماد نظام الربط التلقائي بالتضخم (ربما فيما يتجاوز قيمة قياسية معينة) عند إرساء حد التكلفة وغيره من قواعد ضريبة القيمة المضافة القائمة على القيمة الاسمية حالياً.</li> </ul>	<p><b>الضريبة على القيمة المضافة</b></p>
<ul style="list-style-type: none"> <li>• إعادة رسوم الاستهلاك المحددة إلى قيمها الحقيقية السابقة على الأزمة.</li> <li>• اعتماد نظام يربط رسوم الاستهلاك المحددة ربطاً تلقائياً بمؤشر، بما في ذلك نطاقات الشرائح الضريبية (ربما فيما يتجاوز مستوى قياسي محدد).</li> <li>• مثلما هو الحال مع كل رسوم الاستهلاك الأخرى، اعتماد نظام يربط رسوم استهلاك المحروقات بمؤشر (ربما فيما يتجاوز مستوى قياسي محدد).</li> </ul>	<p><b>رسوم الاستهلاك</b></p>
<ul style="list-style-type: none"> <li>• التعديل التلقائي لشرائح ضريبة الدخل تبعاً للتضخم.</li> <li>• تمكين الإدارة الضريبية من الوصول إلى المعلومات المصرفية ذات الصلة.</li> <li>• البدء في تلقي معلومات في إطار المنتدى العالمي عن الحيازات الخارجية للمقيمين اللبنانيين لاستخدامها في الأغراض الضريبية.</li> <li>• إدخال الكسب الرأسمالي المتحصل من بيع الأفراد للأسهم في الشركات المساهمة ضمن القاعدة الخاضعة للضريبة.</li> <li>• إلغاء إعفاء توزيعات الأرباح للأفراد من الشركات القابضة والأوقشور من ضريبة الاقتطاع من المنبع.</li> <li>• جعل الإعفاء من ضريبة الكسب الرأسمالي على بيع الأفراد للعقارات مقصوراً على مسكن رئيسي واحد.</li> <li>• إلغاء المعاملة التفضيلية لعائدات التصدير في إطار ضريبة دخل الشركات.</li> <li>• إلغاء المعدلات المخفضة لضريبة دخل الشركات التي تُمنح عن الأرباح المعاد استثمارها، دون تطبيق الإلغاء بأثر رجعي.</li> <li>• إخضاع الكسب الرأسمالي للشركات لمعدل الضريبة المتعارف عليه بالنسبة لدخل الشركات.</li> </ul>	<p><b>ضرائب الدخل</b></p>
<ul style="list-style-type: none"> <li>• استخدام سعر الصرف السوقي في كل ضرائب المعاملات العقارية المقومة بالدولار (أو غيره من العملات الأجنبية).</li> <li>• إلغاء الإعفاء التلقائي من الضريبة العقارية الممنوح للعقارات الشاغرة والمعاملة التفضيلية للعقار الثاني.</li> <li>• توسيع نطاق رسوم التسجيل لتشمل تحويلات الأسهم التي تستمد قيمتها في الأساس (50% أو أكثر) من العقارات بشكل مباشر أو غير مباشر.</li> </ul>	<p><b>الضرائب العقارية</b></p>

## التوصيات للمدى القريب

<ul style="list-style-type: none"> <li>• فرض ضريبة على مدخلات القطاعات أو الأنشطة المعفاة المنصوص عليها في المادة 59.</li> <li>• إنهاء العمل بنظام رد الضريبة للسائحين.</li> </ul>	<p><b>الضريبة على القيمة المضافة</b></p>
<ul style="list-style-type: none"> <li>• استحداث رسم على استهلاك الديزل وزيت الوقود بقيمة 0,25 دولار للتر وإعادة رسوم استهلاك البنزين والكيروسين إلى مستويات ما قبل الأزمة بالدولار الأمريكي.</li> <li>• يمكن تطبيق هذه الضرائب تدريجياً على مدار ثلاث سنوات، ولكن ينبغي تجنب الحاجة لموافقة لاحقة من البرلمان.</li> </ul>	<p><b>رسوم الاستهلاك</b></p>
<ul style="list-style-type: none"> <li>• إخضاع أصحاب المهن الحرة لنظام الأرباح الحقيقية واستخدام ضريبة تستقطع من المنبع على ما يتقاضونه من مدفوعات.</li> <li>• إلغاء نظم شركات الأوقشور والشركات القابضة، مع السماح للمكلفين الحاليين بغلق منشآتهم دون ضرائب.</li> <li>• استحداث قاعدة لتقييد الفوائد، مع إعطاء إعفاء محدود لترتيبات القروض القائمة.</li> <li>• تقوية قواعد الإقامة للأفراد والشركات.</li> </ul>	<p><b>ضرائب الدخل</b></p>

<ul style="list-style-type: none"> <li>• استحداث تعريف للمنشأة الدائمة وتعريف شاملة للأطراف المرتبطة بها.</li> <li>• تقدير الإيرادات الضائعة من خلال النفقات الأساسية لضريبة الدخل (والضريبة على القيمة المضافة).</li> </ul>	
<ul style="list-style-type: none"> <li>• تبسيط نظام تقييم العقارات بين مستويات الحكومة والهيئات المشتركة في تحقيق تقييم عقاري موحد.</li> </ul>	<b>الضرائب العقارية</b>

### التوصيات للمدى المتوسط

<ul style="list-style-type: none"> <li>• فرض ضريبة أشمل على معاملات الممتلكات غير المنقولة، بما في ذلك العقارات السكنية الجديدة.</li> <li>• إلغاء الإعفاء من ضريبة القيمة المضافة الذي طُبق مؤخراً على النيزل.</li> <li>• تشديد الإعفاءات على الصحة والتعليم.</li> <li>• فرض ضريبة أشمل على الخدمات المالية القائمة على الرسوم.</li> <li>• تحسين تصميم القواعد العابرة للحدود.</li> </ul>	<b>الضريبة على القيمة المضافة</b>
<ul style="list-style-type: none"> <li>• مراجعة المعاملة الضريبية الضمنية لمنتجات التبغ، في ضوء مستهدفات الإيرادات والصحة.</li> </ul>	<b>رسوم الاستهلاك</b>
<ul style="list-style-type: none"> <li>• إخضاع دخل الأفراد من الإيجارات لضريبة الدخل.</li> <li>• استحداث نظام مبسط لمؤسسات الأعمال التي يقل دخلها عن حد التكلفة بضريبة القيمة المضافة.</li> <li>• جعل نظام الأرباح الحقيقية إلزامياً لكل دافعي ضرائب دخل الشركات، ومؤسسات الأعمال التي يتجاوز حجم أعمالها حد التكلفة بضريبة القيمة المضافة، وكل من يسجل طوعاً لهذه الضريبة.</li> <li>• توحيد جداول المعدلات الضريبية على الأجور وأنشطة الأعمال للأفراد.</li> <li>• إجراء مراجعة دقيقة لحوافز قانون الاستثمار وإصلاحها، وتبديلها بحوافز قائمة على التكلفة ببررها تحليل واضح للتكلفة والعائد.</li> <li>• البدء في نشر تقارير النفقات الضريبية بانتظام.</li> <li>• استحداث قواعد قوية بشأن مصدر الدخل، وقواعد للشركات الأجنبية الخاضعة للسيطرة، وقواعد للتسعير التحويلي، وقاعدة للتحويلات الخارجية غير المباشرة، والنظر في وضع قاعدة لمكافحة التحايل الضريبي في إطار إصلاح قانون ضريبة الدخل.</li> </ul>	<b>ضرائب الدخل</b>
<ul style="list-style-type: none"> <li>• تحسين جودة نظام تقييم العقارات والحفاظ على قيم العقارات في مستوى متوافق مع الاتجاهات السائدة.</li> <li>• النظر في توسيع قاعدة ضرائب العقارات المتكررة لتشمل الأراضي غير المبنية.</li> </ul>	<b>الضرائب العقارية</b>

## EXECUTIVE SUMMARY

**Lebanon’s tax revenue more than halved between 2019 and 2021, in the face of the deepest economic crisis since the end of the civil war.** Without taking active tax measures now, the decline in revenue is likely to continue in 2022 and 2023 with severe ramifications, beyond foregone receipts (and consequent deterioration of public institutions), in undermining the progressivity of the system, and in aggravating inequality and distortions.

**This report identifies tax policy reform options to stop the drain on Lebanon’s tax revenue in the immediate and near-terms and to move toward a more efficient, effective, and inclusive tax system in the medium-term.** The analysis emphasizes the need for a holistic view of the tax system to guide reforms and balance the trade-offs, rather than a piecemeal approach with ad hoc uncoordinated measures—and for a strategic, sequenced approach to developing a rapid and powerful emergence from current difficulties. Though not developed in detail in this report, it will be critical to assess the impact of recommended measures on the most vulnerable and adopt compensating spending measures as needed (including, potentially, through the Expanded Social Safety Net; ESSN).

### A Package of Immediate Measures

**Correcting mis-valuation.** A single market exchange rate should be used for all valuations for tax purposes. For a short-term transition, an index that is reasonably close, and converging, to the market exchange rate can be used. The exchange rate for valuing taxes is *not* meant to (and should not) be a tax policy choice or set at some *ad hoc* preset value. Adopting a lower rate than the Sayrafa or any preset value in absolute amount for tax purposes is strongly recommended against. The mis-valuation of customs, excises, and VAT at the border—due to the use of the predetermined exchange rate of LBP 1,507 (compared to the market rate of about LBP 38,000 as of September 22, 2022)—is estimated to cause a loss of revenue of 4.8 percent of GDP in 2022. This cost is decomposed as in the table below.

**Correcting for high inflation.** Specific excises and thresholds that are set in nominal values should be reset and indexed to inflation. Failing to reset the specific excises (mainly on fuel) has led to a loss of revenue of 0.8 percent of GDP, bringing the total forgone revenue (from the lack of response to the depreciation and inflation) in 2022 to 5.6 percent of GDP. The VAT threshold should be restored to an appropriate level to ease administrative and compliance costs. Employment income tax brackets should be adjusted and indexed to inflation to reinstate the original schedule of increasing average tax rates and address the continuing damage to both horizontal and vertical equity. In all cases, indexing should be automatic.

	2022	2023
<i>Estimated revenue loss from mis-valuation at the border (% GDP)</i>		
Customs	0.7	0.6
Excises	1.4	0.6
VAT	2.7	2.3
<i>Customs + Excises + VAT</i>	4.8	3.5
<i>Estimated revenue loss from the lost real value of specific excises (% of GDP)</i>		
Excises	0.8	0.8
<b>Total cost</b>	<b>5.6</b>	<b>4.3</b>

Source: IMF staff calculation (as detailed in Appendix 1 and Section II of this report).

**Ending excessively favorable capital income tax treatment.** Under-taxation of the affluent, mainly non-wage earners, weakens revenues, the role of tax policy in income redistribution, and tax morale. The following exemptions should be repealed to close loopholes: (i) the withholding tax on dividend distributions to individuals from holding and offshore companies; (ii) capital gains from the sale of shares in joint stock companies; and (iii) capital gains from the sale of real property for other than the primary residence. Shortcomings in corporate taxation should also be addressed, including by: eliminating the preferential tax treatment for export earnings (inconsistent with current international trade standards); including corporate capital gains to the corporate income tax base (rather than taxing them separately).

**Unlocking the potential of property taxation.** As a critical step toward reaching the full potential of the built property tax, the exemption of vacant properties—which ultimately discriminates in favor of idle resources and easing tax evasion—should be abolished immediately. This measure should be a part of greater efforts, in the immediate- and near-terms to improve the quality of the property valuation system and keep property values current.

### Near-Term Measures

**Rebuilding Lebanon’s tax system is a continuous process. In 2023, reforms should focus on:**

**Making the VAT great again.** The introduction of the VAT in 2002 is a living proof of the possibility of highly successful tax reform in Lebanon. To rise to the ongoing tax challenges, the VAT design should be strengthened by near-term measures to lower the compliance and policy gaps. Estimates suggest that—without raising the VAT rate—relatively moderate measures can yield extra revenue of 1 percent of GDP. Specific recommendations to broaden the VAT base include removing the distortionary exemption of inputs into specified sectors and generally restricting entitlements to refunds (as much as possible) to VAT registered businesses by abolishing the tourist refunds scheme, inter alia.

**Making better use of excises.** Excises are an efficient way to reduce pollution, generating marked environmental benefits and significant revenue, with a modest impact on prices. An excise on diesel that increases from USD 0.10 in 2023 to USD 0.25 per liter in 2025 is estimated to raise 1.5 to 3 percent of GDP in revenues. While the tax on diesel is the priority and should be

introduced in the near-term, excises on propane and butane could also be phased-in automatically in the legislation without requiring further parliamentary approval.

**Closing loopholes and modernizing the corporate income tax (CIT).** In line with international best practices, professionals should be taxed in the real profits’ regime and with the use of withholding taxes on payments to professionals for services. The regimes of offshore and holding companies (that no longer conform with international standards), and wasteful CIT incentives should be abolished.

### Medium-Term

**Preparation for medium-term measures should be completed in 2023**, for them to enter into effect in 2024/2025. Upgrading income taxation requires a new income tax law to replace the existing outdated one. The new law should strive to ensure tax neutrality across income sources and legal forms, protect the base with an arsenal of up-to-date anti-tax avoidance rules, and incorporate efficient and effective cost-based tax incentives. Finetuning the VAT should continue by, among other things, removing the exemption on diesel and improving the design of the cross-border rules.

### Summary of Recommendations

#### *Immediate Recommendations*

<i>Valuation</i>	<ul style="list-style-type: none"> <li>• Use the market exchange rate (possibly using the Sayrafa rate during a transition period) uniformly in the entire tax system for valuation.</li> <li>• Nominal magnitudes should be indexed to inflation.</li> </ul>
<i>VAT</i>	<ul style="list-style-type: none"> <li>• Use the market exchange rate (possibly transition using the Sayrafa rate) uniformly to value imports for VAT purposes</li> <li>• Return the real value of the VAT threshold to around USD 75,000.</li> <li>• Adopt automatic indexation to inflation (perhaps beyond some trigger value) of the threshold and other VAT provisions that are specified in nominal terms.</li> </ul>
<i>Excises</i>	<ul style="list-style-type: none"> <li>• Restore specific excises towards their real pre-crisis values.</li> <li>• Adopt automatic indexation of specific excises, including bracket ranges (perhaps beyond some trigger level).</li> <li>• As with all other excises, adopt automatic indexation of the fuel excises (perhaps beyond some trigger level).</li> </ul>
<i>Income Taxes</i>	<ul style="list-style-type: none"> <li>• Adjust the income tax brackets for inflation automatically.</li> <li>• Enable the tax administration to access relevant banking information.</li> <li>• Start receiving and acting upon information on offshore holdings on Lebanese residents for tax purposes through the <i>Global Forum</i> framework.</li> <li>• Include capital gains from the sale of shares in joint stock companies by individuals in the taxable base.</li> </ul>



	<ul style="list-style-type: none"> <li>• Abolish the WHT exemption for dividend distributions to individuals from holding and offshore companies.</li> <li>• Limit the exemption from the capital gains tax of gains from the sale of real property by individuals to one primary residence.</li> <li>• Abolish the preferential CIT treatment for export earnings.</li> <li>• Abolish reduced CIT rates for reinvested profits, with grandfathering.</li> <li>• Subject corporate capital gains to the standard CIT rate.</li> </ul>
<i>Property Taxes</i>	<ul style="list-style-type: none"> <li>• Use the market exchange rate for all transaction taxes on property transaction that are denominated in USD (or other foreign currencies).</li> <li>• Remove the built property tax exemption for vacant properties and the preferential treatment for the for second properties.</li> <li>• Extend the registration fee to transfers of shares that derive their value primarily (50 percent or more) directly or indirectly from real property.</li> </ul>

*Near-term Recommendations*

<i>VAT</i>	<ul style="list-style-type: none"> <li>• Tax inputs into the exempt sectors or activities specified in Article 59.</li> <li>• End the tourist refunds scheme.</li> </ul>
<i>Excises</i>	<ul style="list-style-type: none"> <li>• Introduce an excise on diesel and fuel oil of USD 0.25 per liter and restore excises on gasoline and kerosene to pre-crisis levels in USD terms.</li> <li>• These taxes could be phased-in over three years but should avoid the need for subsequent parliamentary approval.</li> </ul>
<i>Income Taxes</i>	<ul style="list-style-type: none"> <li>• Subject professionals to the real profits regime and use a WHT on payments to professionals.</li> <li>• Eliminate the offshore and holding companies' regimes, with existing taxpayers allowed to unwind their structures without tax.</li> <li>• Introduce an interest limitation rule, with limited grandfathering for existing loan arrangements.</li> <li>• Strengthen residence rules for individuals and corporations.</li> <li>• Introduce a PE definition and comprehensive related party definitions.</li> <li>• Estimate revenue foregone from key income tax (and VAT) expenditures.</li> </ul>
<i>Property Taxes</i>	<ul style="list-style-type: none"> <li>• Streamline the property valuation system between the different levels of government and agencies involved to achieve a single property valuation.</li> </ul>



*Medium-term Recommendations*

<i>VAT</i>	<ul style="list-style-type: none"> <li>• Tax immovable property transactions, including in new residential property, more comprehensively.</li> <li>• Remove the recently introduced VAT exemption on diesel.</li> <li>• Tighten exemptions for health and education.</li> <li>• Tax fee-based financial services more compressively</li> <li>• Improve the design of the cross-border rules.</li> </ul>
<i>Excises</i>	<ul style="list-style-type: none"> <li>• Review the implicit tax treatment of tobacco products, in the light of both revenue and health objectives.</li> </ul>
<i>Income Taxes</i>	<ul style="list-style-type: none"> <li>• Subject rental income of individuals to income tax.</li> <li>• Introduce a simplified regime for businesses below the VAT threshold.</li> <li>• Make the real profits regime compulsory for all CIT payers, businesses with turnover in excess of the VAT threshold, and all who register voluntarily for the VAT.</li> <li>• Unify the rates schedules for wages and business activity of individuals.</li> <li>• Thoroughly review and reform Investment Law incentives and replace by cost-based incentives that are warranted by explicit cost-benefit analysis.</li> <li>• Start regular publication of tax expenditure reports.</li> <li>• Introduce strong source rules, CFC rules, transfer pricing rules, an offshore indirect transfers rule and consider a GAAR as part of the ITL reform.</li> </ul>
<i>Property Taxes</i>	<ul style="list-style-type: none"> <li>• Improve the quality of the property valuation system and keep property values current.</li> <li>• Consider broadening the recurrent property tax base to unbuilt land.</li> </ul>

# I. INTRODUCTION

**1. Lebanon is living through dire economic circumstances.** The 2019 banking turmoil was followed by a significant fall in the value of the Lebanese Pound (LBP) and the sovereign default in March 2020 (the first in Lebanon’s history). With the outbreak of the COVID-19 pandemic and the devastating explosion in the Port of Beirut in August 2020, economic contraction continued with negative growth of 48 percent between 2018 and 2021.<sup>1</sup> The tax-GDP ratio dropped from its pre-crisis level of 15.5 percent to 6.6 percent in 2021 (**Figure 1**), its nadir since the end of the Lebanese civil war in 1990. Inflation reached 211.4 percent in May 2022. In this highly troubled context, in early 2022 Lebanon and the IMF reached a staff-level agreement on comprehensive economic policies that could be supported by a 46-month Extended Fund Facility (EFF) arrangement equivalent to about USD three billion.

**2. Without immediate actions, the decline in government revenue is likely to continue.** Even pre-crisis, tax revenue in Lebanon was lagging behind its regional and income-level comparators. For example, in the largely pre-crisis year 2019, Lebanon’s tax-to-GDP ratio (at 15.5 percent) was lower than that of Jordan, Morocco, Tunisia, or the average of emerging and developing economies (**Figure 1**). This period has also seen a marked share in the composition of revenues. Since 2004, the share of income taxes in total revenue in Lebanon increased from 12 to 30.3 percent, particularly due to taxes on interest income that reached almost 17 percent of total revenue in 2019 (3.2 percent of GDP). However, in 2022, with the downfall in interest on bank deposits, the yield from this tax is expected to be almost completely eroded. VAT, excises, and tariffs remain important at 30.3 percent of total revenue in 2019. However, their share in total revenue has been declining in the last decade—and, moreover, receipts have been on a steep downward trajectory since 2019, due in large part to mis-valuation of the tax base (to be discussed in the next section). Non-tax revenues are also significant, standing at 20 percent in 2019 and predominantly comprising dividends from the wholly state-owned telecom sector (nine percent of total revenue)<sup>2</sup> and administrative fees.

**3. Lebanon entered the economic crisis already with one of the world’s most skewed income and wealth distributions toward the affluent.** Pre-crisis, the top 10 percent earned 55 percent of national income in Lebanon (Assouad, 2021). In 2019, around 18 percent of households earned below the monthly minimum wage of LBP 675,000 (LFHLCSS, 2019). The million people demonstrations in October 2019—triggered by a proposed monthly tax of USD 6 on using WhatsApp—is a reminder of the need to raise revenues through a holistic tax reform that supports income redistribution and balances the trade-offs; rather than a piecemeal approach with *ad hoc* uncoordinated measures.

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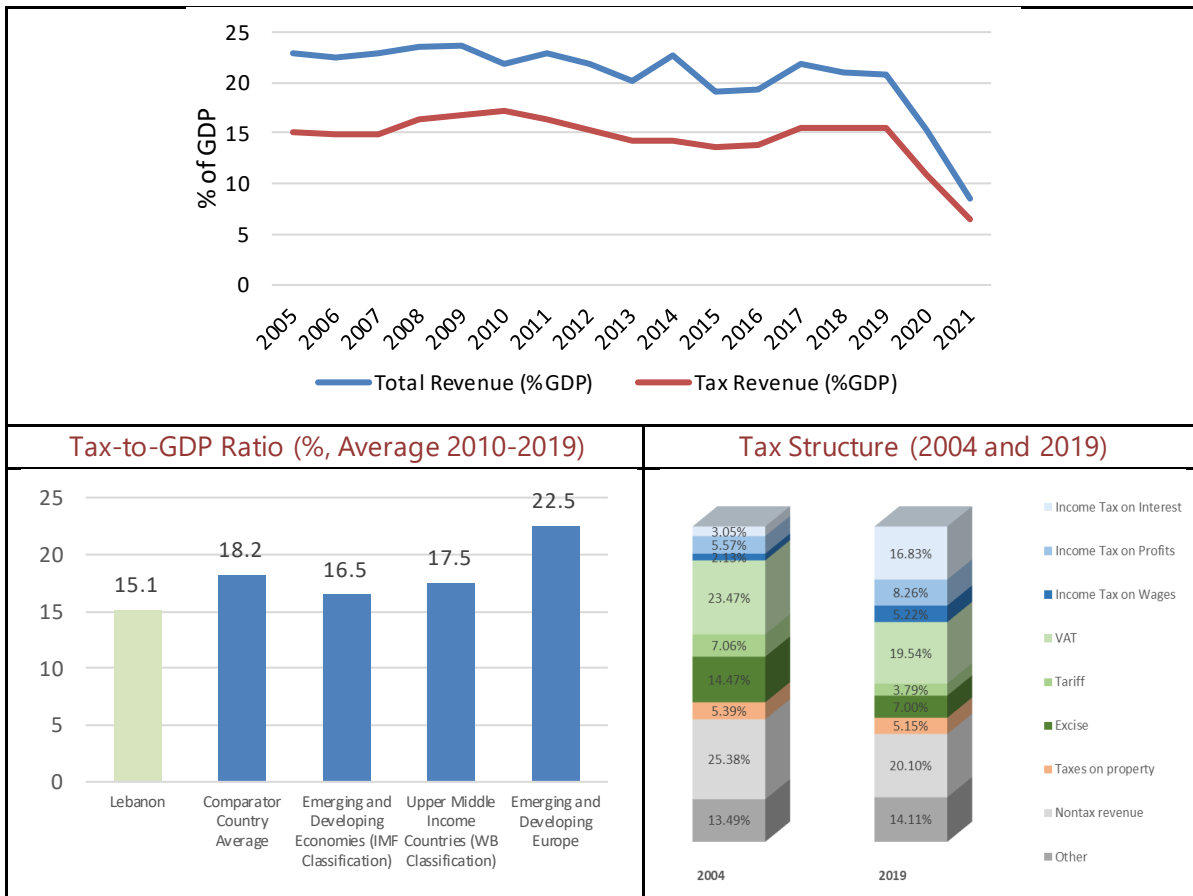
<sup>1</sup> In 2018, GDP was USD 64.4 billion versus USD 42.2 billion in 2021.

<sup>2</sup> Further detail on the telecom sector is in Appendix 2.

**4. Reversing the downward trend in tax revenue and improving the entire tax policy design are thus critical elements of the overall needed reforms for Lebanon to steer its way out of the crisis and modernize its economy.** This report presents a holistic view of taxation in Lebanon to: (i) identify immediate and near-term tax measures to support revenue and crisis recovery in an inclusive manner; and (ii) set out options for medium-term reforms to reduce structural deficiencies and upgrade the capability of the tax system to raise revenue in a growth-friendly manner, redistribute income, and respond to international tax developments.

**5. The structure of the report is as follows.** Section II sets out the profound effects of exchange rate mis-valuation. Sections III and IV review the value-added tax (VAT) and excises respectively, while Section V identifies options to reform personal and corporate income taxes. Section VI briefly looks at property taxes.<sup>3</sup>

**Figure 1. Tax Revenue and Structure in Lebanon**  
Trend in Lebanon's Total Revenue and Tax Revenue (% of GDP)



Sources: IMF staff calculation. Notes: in the right lower panel "Other taxes" include "passenger departure taxes", car registration fees, and stamp fees, inter alia. Non-tax revenues are mainly dividends from the telecom and fees. Grants are negligible in Lebanon's public budget.

<sup>3</sup> On issues of administration, see IMF (2016, 2018, 2022b). IMF (2004, 2005, 2010) remain relevant on tax policy.

## II. LEBANON'S CRISIS AND TAXATION

### A. Framing the Problem of Mis-Valuation at the Border

6. The disparity between the market ('parallel') exchange rate and the predetermined 'official' exchange rate—exceeding a multiple of 25 as of September 2022—has caused significant problems in the tax system, notably:

- **An immense loss in tax revenue, estimated at 3.6 percent of GDP for 2023 (Figure 2):** Customs, excises, and VAT are mis-valued at the border because they are imposed on imports using the predetermined exchange rate of LBP 1 = USD 1,507 rather than the market rate (about LBP 38,000 per USD 1 in September 2022), implying a base value of less than five percent of the tax base at the market rate. This mis-valuation of the tax base leads to a direct loss in revenues from customs and excises of 0.64 and 0.63 percent of GDP, respectively (Table 1). In the case of VAT, in principle, mis-valuation at the border could be offset to some degree by collection through the domestic VAT chain, but in practice this is not happening leading to a massive leakage in VAT revenue reaching almost 2.3 percent of GDP (Table 1; Figure 2).<sup>4</sup>
- **Regressive consequences impacting:**
  - *Vertical equity* (average tax rates should increase with the earned income): Nominal tax brackets for employment income significantly shifted down in Lebanon, leading to a bracket creep whereby low salaries/wages earned in LBP are subjected to the top employment income tax rate of 25 percent (almost from the first "market" dollar); and
  - *Horizontal equity* (those with the same income should pay the same tax): There is now a severe differential tax treatment favoring those who are paid salaries in US dollar over those who are paid in LBP, as the same real amount would be effectively subjected to two *different* tax rates. For instance, an annual salary of USD 25,000 would face an average tax rate of 0.3 percent or about 23 percent depending on whether it is paid in USD or in LBP, respectively. Note that some salaries must be paid in LBP (notably for public servants) while others have the liberty to earn in USD.
- **Distortions:**
  - *Nullifying policy tools:* With the dwarfed tax/tariff liability, the policy objective, whatever that may be, is no more reflected in the tariff and tax rates.

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<sup>4</sup> Expectations that the mis-valuation will eventually be corrected appear to have triggered a large volume of imports (particularly of vehicles and other durables) to benefit from the tax giveaways while they last. Imports have increased by 34 percent (or nearly USD three billion) in the first seven months of 2022. A similar result is seen for non-fuel imports, meaning that this increase is not driven by higher fuel prices.

- *Inconsistency in the tax system:* Valuation is done differently across taxes (including at the border and for income taxation) and across taxpayers—causing much incoherence. To name one example, imported capital goods are now valued for VAT at the border differently from their values on firm financial and tax accounts (including for depreciation purposes). And the lack of clarity—including from legal uncertainty—means that the same tax items can be recorded differently by taxpayers.
- *Administration and compliance complications:* The diminished real thresholds for VAT registration and inclusion in the Large Taxpayers Unit (LTU) tend to increase administrative costs while tax uncertainty and taxpayers' confusion will have raised compliance costs.

**Table 1. Revenue Foregone Due to Mis-Valuation of the Tax Base of Imports (% of GDP)**

	2020	2021	2022	2023
Loss of revenue, assuming the Sayrafa exchange rate	0.72	2.27	4.18	3.10
Loss of revenue, assuming the market exchange rate	1.27	3.66	4.86	3.58

Source: IMF staff calculation (see Appendix 1).

## B. Framing the Problem of High Inflation

**7. While distinct from the problems of mis-valuating the tax base, relatedly, high inflation adversely affects revenue and efficiency.** Specific excises, tariffs, and other charges that are set in LBP, have lost their real values (which, in addition to the direct impact on revenue, further reduced the VAT base into which they enter and nullify their intended policy impact). Moreover, especially in a very high inflation environment, the time difference between when collection actually takes place, and the corresponding date of the taxable event reduces the real value of tax receipts (the 'Tanzi effect'). Inflation also exacerbates distortions from the corporate income tax (CIT), by reducing the real value of depreciation allowances and encouraging finance by borrowing rather than through equity. Further, incentives to comply are eroded as fixed penalty amounts become meaningless.

## C. Correction of Mis-Valuation and for High Inflation

**8. Evaluation for tax purposes—whether at the border (customs, excises, and VAT) or for income taxes—should be at the same *market* exchange rate.** The exchange rate for valuating taxes is *not* meant to (and should not) be a tax policy choice or some *ad hoc* preset value. In contrast to Lebanon, most countries do not face such a discrepancy at the outset when the official exchange rate is de facto equal (or at least close) to the market rate.

**9. During 2022-2023, the 'Sayrafa'<sup>5</sup> rate can be transitionally used for valuation for tax purposes, with the prospect that it will converge to the market rate (IMF, 2022c).** At 29,000 LBP per 1 USD, the Sayrafa rate has been higher than the official exchange rate but remained below the market rate (by about LBP 9,000 as of September 2022). Valuation of imports using the Sayrafa rate would still fail to recover 0.5 percent of GDP of revenues (from VAT, excises, and tariffs) compared to the market rate. Adopting a lower rate than the Sayrafa or any preset value in absolute amount for tax purposes is recommended against, in the strongest possible terms. Reiterating, using the market exchange rate is a *correction* of the current improper valuation practice. If tax policy intends to mitigate a possible pass-through to the retail prices of necessary food products and medicine, then the rates of tariffs could be revisited. However, the VAT should maintain a uniform rate (Section III. B) while, as discussed further in the next section, redistribution to low-income households is ideally, and feasibly, achieved using targeted spending measures.

**10. Specific taxes and charges (that are set in nominal values) should be indexed to inflation.** In this regard, discussions about the levels for the VAT threshold, specific excises, and employment income tax brackets are in Sections III. C, IV. B, and V. C, respectively. The Tanzi effect can also be mitigated by automatic indexation (perhaps beyond some threshold inflation rate) of specific taxes, as well as other tax provisions (relating, for instance, to penalties) that are specified in LBP terms. Further measures include introducing, for example, quarterly installments of annual income taxes (IMF, 2004; IMF, 2018) and withholding on professional services (V.E).

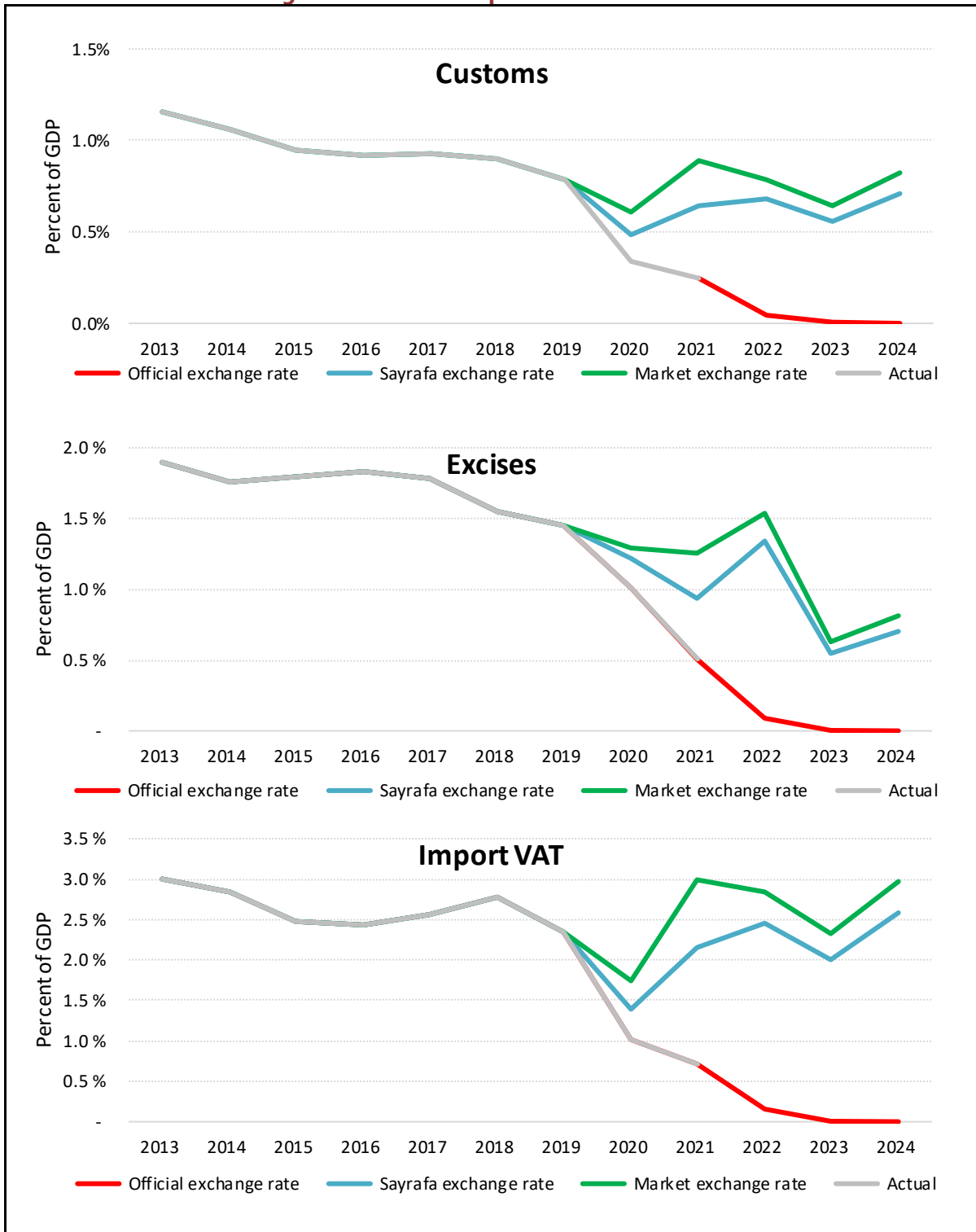
### Recommendations

- *Immediately:*
  - Use the market exchange rate (possibly using the Sayrafa rate over a brief transition period) uniformly in the entire tax system for valuation.
  - Index nominal magnitudes to inflation, perhaps beyond some threshold rate.

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<sup>5</sup> The Sayrafa rate is adopted by the Banque Du Liban (BDL), and is ambiguously linked to the trading volume in the 'Sayrafa platform' that is accessible to money transfer companies and banks.

**Figure 2. Revenue Impact of Mis-Valuation**



Source: IMF staff calculation based on data from Lebanese Customs Administration. See Appendix 1. Note: the relatively high revenue gain in 2022, as compared to 2023, reflects the increase in imports-to-GDP caused by the documented anticipation effect in 2022 and the expected lag in 2023's imports. This is especially relevant for excises applied to vehicles, as vehicle imports saw a disproportionately large increase in 2022.

## III. VAT

### A. Current Situation

#### Background and Design

**11. The VAT continues to be Lebanon’s main source of tax revenue.** Introduced in 2002, the VAT stands as a marker of successful tax reform in Lebanon in modern times and continues to be the single most important contributor to total tax revenue (**Figure 1**).

**12. The VAT adopts the basics of good VAT design,** most prominently a single positive rate—raised to 11 percent in 2017 from 10 percent at introduction—that is imposed on (in principle) all goods and services whether imported or domestically supplied, with a crediting and refund mechanism to relieve supply chains from VAT and enable the tax burden to fall on final consumption. It further features a zero percent rate on exports to relieve consumption abroad from the VAT base in accordance with the destination principle. The VAT Law also generally adopts a clear drafting style.

**13. However, there remains ample room to improve the VAT two decades following its implementation.** The rest of this section delves deeper into the anatomy of the Lebanese VAT and its performance, while the following section discusses areas for improvement.

#### The Performance of the VAT

**14. Even before the current crisis, the revenue yield of the VAT was low—and in decline (Figure 3).** From a peak of nearly six percent of GDP in 2008, VAT revenue has steadily declined to 4.1 percent in 2019, the last pre-crisis year, before plummeting to less than two percent in 2020 and 2021. And that pre-crisis yield is far below the average 6.7 percent of GDP achieved by comparators.

**15. The low revenue yield partly reflects a relatively low standard rate of VAT.** It is a great strength of the Lebanese VAT that there is only a single positive rate. At its current rate of 11 percent this is notably lower than in all comparators (**Figure 4**). This partly explains the comparatively low level of VAT revenues. But, both before the 2017 rate increase and after an revenue boost that followed (visible in Figure 3), revenue has been in decline even at a constant standard VAT rate. The modest standard rate alone does not explain the increasing weakness of VAT revenues.

**16. More fundamentally, the poor and worsening performance of the VAT reflects significant structural weaknesses in design and implementation.** A standard indicator capturing both the extent of compliance and the breadth of coverage of the VAT is ‘C-efficiency’: the ratio of VAT revenue actually collected to the revenue that would be collected if compliance were perfect and all consumption taxed at the standard rate. For an idealized VAT—a single rate on all consumption, perfectly enforced—C-efficiency would be 100 percent; that standard is

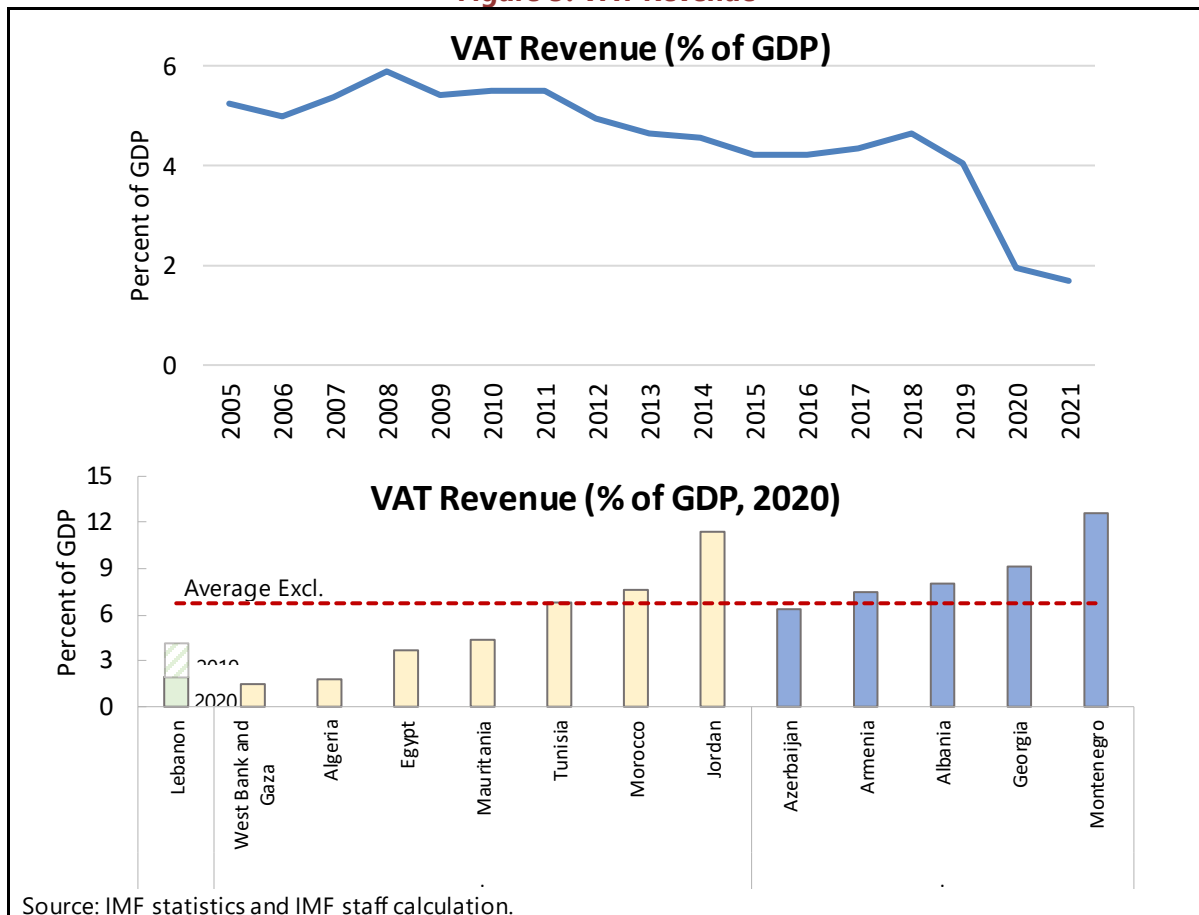


rarely achieved of course, but serves as a benchmark.<sup>6</sup> Three features of the state of, and developments in, C-efficiency in Lebanon stand out (**Figure 4**):

- **C-efficiency has been in decline for many years.** From a peak of around 57 percent in 2008, it stood at around 33 percent in (largely) pre-crisis 2019. The 2016 'RA-GAP' report of the IMF (IMF 2016) points to a decline even before that, from around 2008.
- **Even at its pre-crisis level, C-efficiency is low relative to comparators,** where it averages around 47 percent.
- **The fall during the crisis has been precipitate,** to about 14 percent in 2020.

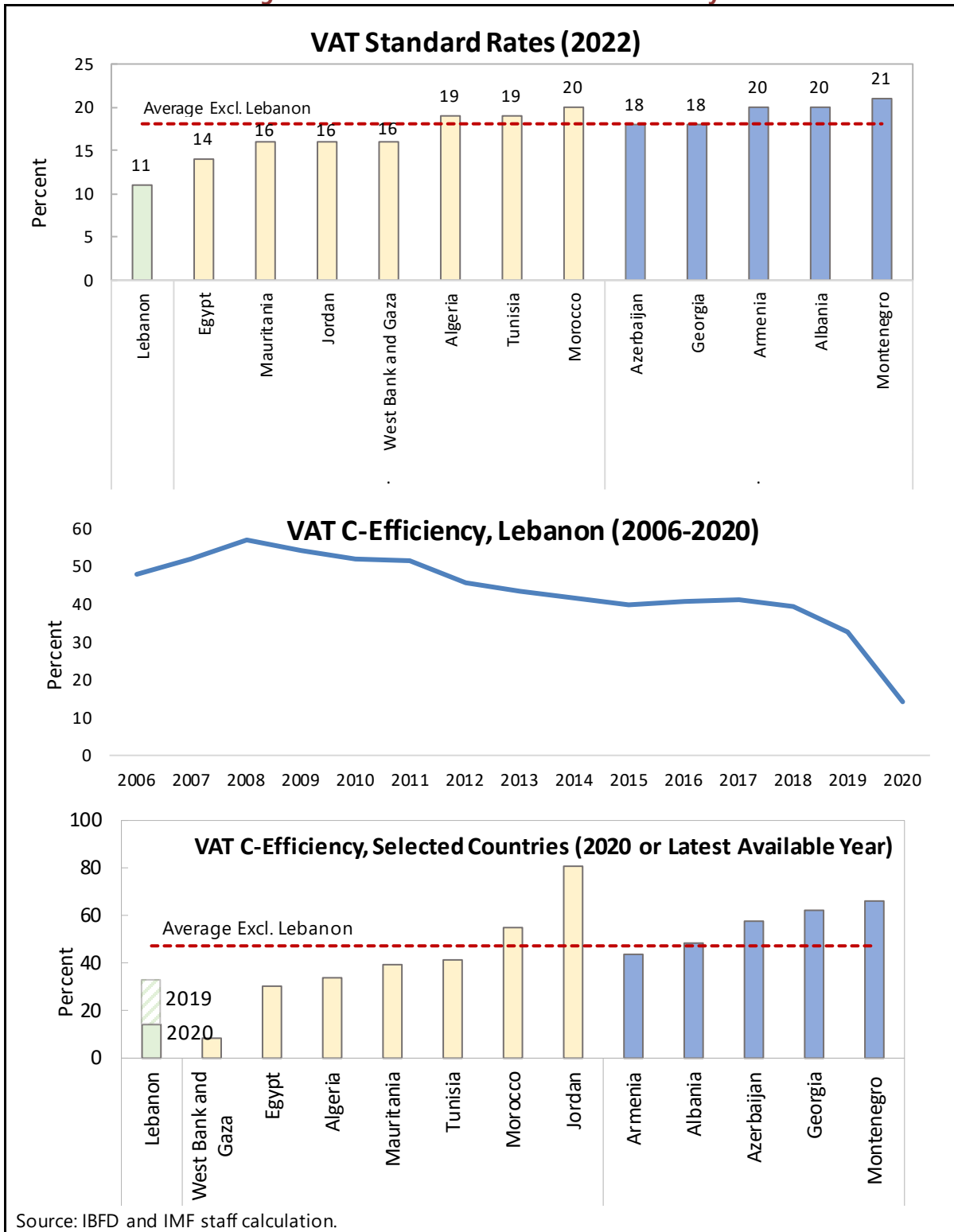
**17. Importantly, the decline in C-efficiency cannot be fully explained by a generalized fall in consumption:** that would be expected to reduce the numerator and denominator of C-efficiency by roughly the same proportion. Part of the explanation may lie in a shift of consumption towards items taxed at relatively low rates; this effect alone, however, is unlikely to explain a good deal of the collapse.

**Figure 3. VAT Revenue**



<sup>6</sup> Further discussion of C-efficiency is in Ebrill and others (2001).

Figure 4. VAT Standard Rates and C-Efficiency



18. This poor performance in C-efficiency reflects sizable weaknesses in both policy design and administration, of roughly similar magnitude. C-efficiency—equivalently, the ‘VAT

gap' between actual and potential revenues—can be decomposed into two parts: a 'policy gap' that reflects deviations of the base from all consumption, and a 'compliance gap' that reflects less than complete compliance with the system in place. IMF (2016)<sup>7</sup> finds that in Lebanon the policy gap accounted for about 55 percent of the total gap, a little more than half of which could be recovered by limiting special treatment within the VAT to what are in effect 'standard' in all VATs (such as the exemption of financial services).<sup>8</sup> A compliance gap' of 45 percent accounted for the rest. IMF (2016) also found the relative importance of the policy gap to be increasing (up from 50 percent in 2008). This trend may have continued—for example with the extension of Article 59 provisions (see below)—but there is no compelling reason to suggest a very marked change.

**19. At present, as discussed in Section II, there is significant erosion of VAT revenue from the mis-valuation of imports at the 'official' exchange rate.** Use of an over-valued exchange rate for the LBP to value imports results in an undervaluation, in LBP terms, of the import VAT base and so directly jeopardizes ultimate VAT revenue. Indirectly, moreover, it further erodes revenue by weakening incentives to be VAT-compliant further down the VAT chain. And there is a further mis-valuation effect on VAT revenues since customs and excise charges enter the VAT base: their undervaluation thus amplifies the effect operating through the undervaluation of imports themselves.

## **B. Improving the VAT**

**20. Both immediately and in the near term, there is scope to substantially increase revenue from the VAT while strengthening its fundamentals**—and, combined with other measures, securing fairness concerns. Increasing revenue is an immediate priority, though in ways that support rather than undermine the task of rebuilding its effectiveness over the medium term—and with attention to cushioning any adverse impact on the vulnerable, including through accompanying spending measures.

### **Gains from Removing the Mis-Valuation of Imports**

**21. The most immediate (and urgent) way to increase VAT revenue is by removing the massive distortion from the use of an artificial exchange rate to value imports.** The effect, it is not hard to believe, can be substantial: an individual importing a car with a market price of USD 30,000, for instance, would pay USD 3,300 if the standard rate were applied to its real value; in fact, however, they will pay only around USD 130.<sup>9</sup>

**22. In principle, the fractional nature of the VAT—collection and crediting throughout the production chain—can dampen the impact of misvalued import on final VAT revenue.**

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<sup>7</sup> IMF (2016), Table 12. That analysis extends only until 2013 but remains informative.

<sup>8</sup> This means, in the terminology of IMF (2016), eliminating the 'expenditure gap.'

<sup>9</sup> Calculated as  $0.11 \times 30,000 \times (1,507/38,000)$ . Even this leaves the gain through reduced customs and excise aside.

Assessing the ultimate revenue impact of under-collection is made somewhat complex for the VAT because import VAT, unlike customs and excises, is not necessarily a final tax. For the VAT, under-collection at import stage would not make any difference to final LBP VAT revenue if the import were purchased by a compliant taxpayer entitled to credit or refund of VAT on their acquisitions (and final sales are made at market prices in LBP): any reduction in the VAT paid by the importer would then be exactly offset by a reduced credit or refund to the purchaser. There is an effective understatement of LBP VAT revenue, however, to the extent that the import is acquired by a final consumer or firm that is VAT-exempt (whether *de facto* or *de jure*), since the import VAT then remains final. Incidentally, and continuing the example in the previous paragraph, this is also the case in relation to cars, as VAT on cars is levied only at the border without further taxing and crediting in the distribution chain.

**23. In practice, there is little sign that reductions in import VAT have tended to be offset by increased payments inland (Figure 5).** It is hard (without access to individual returns) to assess the proportion of import VAT that is credited further down the production chain. Historically, however, *changes* in import VAT have not been offset by opposite changes in VAT collected inland:<sup>10</sup> prior to 2019, reductions in import VAT were accompanied about one-for-one with reductions in total VAT collections. And between 2019 and 2020, domestic collections fell even more than import VAT. Experience in the following year was quite different—increased inland collection more than offset the continued reduction in import VAT—but the interpretation of this remains unclear.<sup>11</sup>

**24. Mis-valuation may also be weakening compliance with the VAT, leading to under-collection of VAT on final sales.** A key feature of the VAT is that the payment of the tax on inputs provides some incentive to declare final sales, and pay output VAT, in order to recover that input tax. For this reason, effective collection of VAT on imports is critical. There is thus good reason to be concerned that the reduction in the real value of input VAT on imported goods implied by the use of the official exchange rate is seriously weakening that incentive, with the consequence that domestic VAT may also be undermined (perhaps with some gain from the undervaluation being passed to final consumers).<sup>12</sup> The proportion of credits/refunds claimed against output tax declared by taxpayers is also a key indicator for audit and compliance risk management—an indicator that is severely distorted by this mis-valuation. While the scale of any such effect on compliance is unknown, it can only increase the revenue gain from eliminating the mis-valuation at the border.

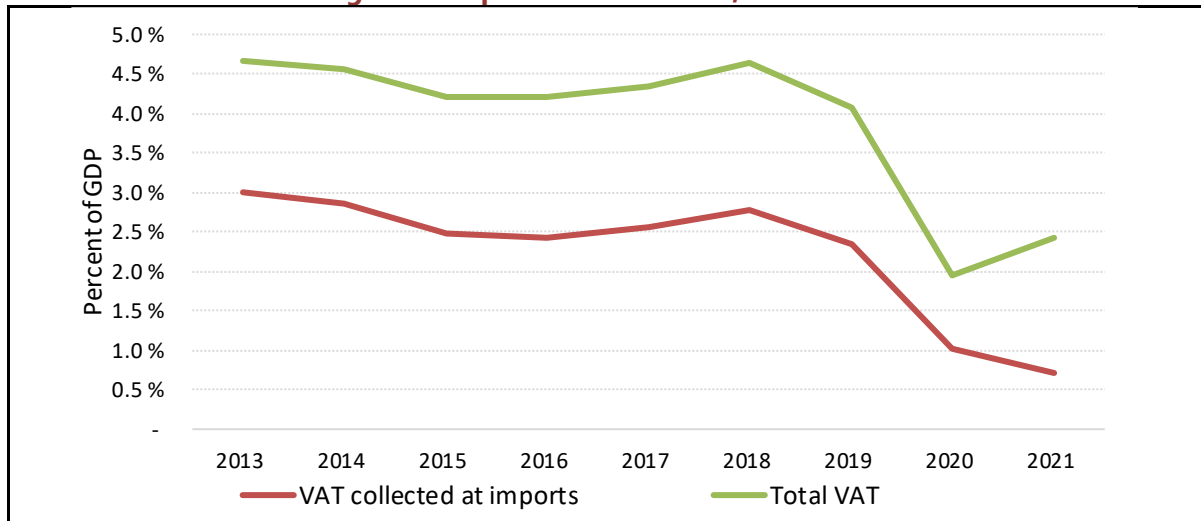
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<sup>10</sup> 'Inland' or 'domestic' VAT is the excess of final VAT collections over import VAT.

<sup>11</sup> It partly reflects, for instance, a reduction in VAT refunds; the unwinding of COVID-19 and related tax measures—which further complicate the assessment of all recent figures—may also play a role.

<sup>12</sup> This effect is likely strongest when the importer sells directly to final consumers, but collusion throughout a longer VAT chain may also result in artificially low input VAT being passed to the final seller, so having the same effect. The continued use of the official exchange rate also for (some) domestic B2B sales in USD would further enable this (following a ministerial decision based on consumer protection legislation B2C sales must be declared at the market exchange rate).

**Figure 5. Import and Total VAT, 2013-2021**



Source: Data from MoF.

**25. The revenue gain from revaluing to the current market rate would be around 2.6 percent of GDP in 2022.**<sup>13</sup> This would reflect not only the direct effects of revaluation but also any indirect effects through both the worsening of compliance it has led to and the mechanical understatement of the VAT base through the impact of mis-valuation on customs and excises.

### Gains from Improving the Structure of the VAT

**26. While the gain from adjusting the valuation of imports can be realized immediately, further measures into the near- and medium-terms can provide much needed additional revenue.**<sup>14</sup> Some core strengths of the VAT noted above provide a good basis upon which to build.

**27. Additional revenue of around 1.7 percent of GDP could be raised, without increasing the standard rate, by raising C-efficiency from its pre-crisis level to the comparator average.**<sup>15</sup> And even this is only moderately ambitious: a decade or so ago, C-efficiency in Lebanon was regularly well above that comparator average.

<sup>13</sup> Details of this calculation are in Appendix 1.

<sup>14</sup> While it makes no difference to overall revenue, the allocation of part of the net VAT paid on telecoms—ten points out of eleven (corresponding to the previous standard rate)—lacks a clear rationale, and appears to be a holdover from arrangements when the VAT was introduced. Clearly though this cannot be reformed without considering the financial implications for the municipalities, for whom this is an important source of finance.

<sup>15</sup> For this calculation: C-efficiency is  $E^C \equiv \frac{R}{\tau C}$  where  $R$  denotes VAT revenue,  $\tau$  the standard rate of VAT and  $C$  aggregate consumption. This can be rewritten as

$$E^C = \left(\frac{R}{Y}\right) \left(\frac{Y}{\tau C}\right),$$

where  $Y$  denotes GDP. Holding constant the standard rate and assuming the ratio of consumption to GDP,  $C/Y$ , to be unchanged, the change in the ratio of VAT revenue to GDP consequent on an increase of  $\Delta E^C$  in C-efficiency is:

**28. Achieving this will require actions to reduce both the compliance and/or the policy gap**—which, as discussed above, contribute in roughly equal parts to the overall ‘VAT gap’: the amount by which the revenue that would be raised if the standard rate were applied perfectly to all consumption exceeds actual VAT collections. A reasonable estimate of potential VAT revenue—the current standard rate, applied to all consumption and perfectly enforced—might be around eight percent of GDP in ‘normal’ times.<sup>16</sup> This implies a current VAT gap, comparing pre-crisis 2019 with those ‘normal’ times, of around 3.9 percent of GDP. To close this:

- **Measures for narrowing the compliance gap are suggested in the 2016 ‘RA-GAP’ and 2018 TADAT assessments (IMF 2016, IMF 2018).** The focus of this report being on policy, administrative issues are not pursued further here. But they are evidently critical for progress in both short- and longer terms: again, benchmarking to pre-crisis 2019, reducing the compliance gap by around one-third would raise revenue of close to 0.6 percent of GDP.<sup>17</sup>
- **Eliminating ‘non-standard’ provisions could raise revenue by around 1 percent of GDP,** given the estimate in IMF (2018) that these account for around half of the policy gap.<sup>18</sup>

**29. Specific base-broadening measures—including the elimination of non-standard measures—that would better serve the revenue and other objectives of the VAT include:**

*In the near term:*

- *Taxing inputs into specified exempt sectors or activities.* Under the current VAT law (Article 59) businesses and organizations in specified exempt sectors or engaged in certain exempt activities<sup>19</sup> are entitled to full refund of input tax (and so effectively zero-rated)—and this is so whether or not they are otherwise required to be registered for VAT. Both the type of expenditure (capital versus current) and the sectors/activities eligible for full refund have gradually expanded over time. Eliminating these refunds would improve the revenue productivity of the VAT by input-taxing these sectors and activities in line with standard practice, with their output continuing to be exempt from VAT. Exports from these sectors—for instance of agricultural products and foodstuffs—would of course continue to be zero-rated.

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$$\Delta\left(\frac{R}{Y}\right) = \frac{R}{Y} \left(\frac{\Delta E^C}{E^C}\right).$$

With  $\frac{R}{Y} = 4.1$ ,  $E^C = 0.33$  and  $\Delta E^C = 0.47 - 0.33$ , this gives  $\Delta\left(\frac{R}{Y}\right) = 1.74$ .

<sup>16</sup> IMF (2016, Table 6) put the average for 2009–2013 at around 7.5 percent of GDP, since when the standard rate has increased from 10 to 11 percent.

<sup>17</sup> Calculated as  $(3.9 \times 0.5)/3$ .

<sup>18</sup> Calculated as  $3.9 \times 0.5 \times 0.5$ .

<sup>19</sup> These include the manufacturing of medicines, pharmaceuticals and other health and hygiene related products, exempted foods, paper and other printing materials; public transport; health care; education; and non-profits.

Refunds claimed by these activities amounted to 0.14 percent of GDP in 2019, though only around one-quarter are recorded as paid.

- *Removing the tourist refunds scheme and further restricting refunds to VAT registered taxpayers only.* The policy justification for providing VAT refunds to tourists is weak in ordinary times,<sup>20</sup> and removing it is unlikely to have any negative effect on the attractiveness of Lebanon as a tourism destination. Current data on refunds under this scheme are not available to the mission, but IMF (2010) puts the amount for 2003-9 at 0.5-0.7 percent of all VAT. More generally, consideration should be given to further restrict VAT refunds to VAT registered businesses only; for instance, there appears to be scope to reduce refunds to diplomats to what is internationally required.

In the medium term:

- *Taxing immovable property transactions more comprehensively, including new residential property.* Currently only inputs into construction and non-commercial rents are taxable, with the latter only raising net VAT revenue when paid by non-VAT taxpayers.<sup>21</sup> This implies that the value added by property developers remains largely untaxed, while there is ample evidence that their profits are currently undertaxed (for example, the net profit percentage for the application of the lump-sum regime to private contractors is 15 percent, and 10 percent for civil engineers). A more comprehensive approach to taxing immovable property under the VAT in line with good practice would be to:
  - Tax all supplies of non-residential property whether by way of sale or lease—except for unimproved land; this would remove the current non-neutral treatment between sales (exempt) and leases (taxed); and
  - Tax all first sales of new (including substantially renovated) residential property, while any subsequent sales and leases of residential property would remain exempt. To cushion the impact on the lower end of the property market a concession (such as a 50 percent reduction of the VAT base) could be provided to new homes below a specified value. A reform of this nature should be considered in conjunction with reviewing existing transaction and capital gains taxes on immovable property (Section V. D) and property taxes (Section VI).
- *Tightening exemptions for health and education.* Both sectors are currently largely VAT exempt, while also benefiting from exemptions on certain key inputs or related supplies (such as medicines and pharmaceutical products, books, purchased immovable property). While it is not uncommon for countries to exempt health and education when provided publicly—or

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<sup>20</sup> IMF (2010).

<sup>21</sup> Individuals (such as in the case of hotels) and VAT exempt businesses and organizations, but only if not entitled to Article 59 refunds (see above). While commercial rents paid by the public sector are subject to VAT, these amounts merely represent budgetary transfers.

at subsidized prices—private health and education services are increasingly included in the VAT net. Imposing VAT on private health care providers also has the added benefit of introducing a level of formalization that would enable more comprehensive taxation of professionals in this sector and strengthen compliance (Section V. E).

- *Removing the recently introduced VAT exemption on diesel.* The VAT (and customs and excise duty) exemption for diesel (gas oil) currently appears to largely benefit the private electricity generators, as price subsidies are gradually being removed and the BDL is gradually ceasing to supply fuel importers with USD at the Sayrafa exchange rate. Imposing VAT on diesel will raise revenue to the extent that purchasers are exempt<sup>22</sup> (and so not claim credit or refund—also incentivizing private generators to formalize); this, however, is not known with enough confidence to allow a quantitative estimate.
- *Taxing fee-based financial services more compressively.* Services by financial institutions that require to be licensed by the BDL are exempt from VAT. Conversely, transactions that are connected to those core activities are taxable (financial leasing, advisory services, letting of property including safe deposit boxes).<sup>23</sup> While it is common practice to exempt margin-based banking services such as lending, consideration should be given to tax more comprehensively all explicit financial fees and commissions earned by banks.<sup>24</sup>
- *Improving the design of the cross-border rules.* While the VAT generally (and appropriately) adopts the destination principle in its cross-border application, the current rules to achieve this result—in particular in relation to services—are no longer in line with international best practice.<sup>25</sup> As the authorities work towards introducing new rules to more effectively tax e-commerce including under the VAT, they should take the opportunity to also improve the design of the current rules in particular as they relate to services to ensure competitiveness of Lebanese providers on the world market as well as leveling the playing field on the home market.<sup>26</sup>

**30. Increasing the standard rate would raise relatively little and worsen the structural problems of the VAT.** In the relatively normal circumstance of 2019, a one-point increase in the standard rate would raise only around 0.37 percent of GDP.<sup>27</sup> The modesty of this amount reflects the imperfections of design and implementation discussed above. The distortions and inequities that result from the effective base-narrowing would be amplified by increasing the standard rate: it would be asking more, for instance, from those who are already compliant with,

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<sup>22</sup> Or not part of the public sector.

<sup>23</sup> It was reported to the mission that in 2019 banks accounted for 4.9 percent of all VAT receipts.

<sup>24</sup> IMF (2010).

<sup>25</sup> Article 14 of the VAT Law (place of supply of services) is insufficiently granular to provide clear and predictable rules with respect to the international trade—both inbound and outbound—of services. See OECD (2017).

<sup>26</sup> The draft e-commerce law prepared by the authorities does not currently achieve this and is not in line with international best practice.

<sup>27</sup> With VAT at 11 percent and collection of 4.1 percent of GDP, this rough estimate is calculated as  $0.01 \times (4.1/0.11)$ .



and receive no favorable treatment from, the current VAT system. The single, modest positive single rate of the Lebanese VAT is a strength that should be built on.

**31. It is important—and becoming increasingly feasible—to protect the most vulnerable against any adverse effects of changes to the VAT.** With 20 percent or more of the population projected to be in extreme poverty,<sup>28</sup> it may be necessary and would certainly be appropriate to allocate some part of the additional revenue raised by any VAT (or other consumption tax) changes to compensate the most vulnerable for any adverse effect—how much will depend of course, of the nature of the change,<sup>29</sup> and require some analysis. Precisely how such protection can best be delivered goes beyond the scope of this report, but the Emergency Social Safety Net (ESSN; also known as AMAN) appears potentially capable of delivering compensation to those in most need. Building on the National Poverty Targeting Program and with support from the World Bank and World Food Programme, this aims to deliver uniform cash payments (plus support for schooling) to 176,000 families living in extreme poverty.<sup>30</sup> The mission understands that around half of these families are now registered for the scheme, with plans for a rapid increase. With continued expansion,<sup>31</sup> the ESSN provides a potentially powerful instrument for ensuring that revenue-raising measures do not merely have no harmful impact on the poorest but—as is an ultimate purpose of tax reform—leaves them better off.

## Recommendations

- *Immediately:*
  - Use the market exchange rate (possibly transition using the Sayrafa rate). uniformly to value imports for VAT purposes—as discussed in Chapter II.
- *In the near term:*
  - Tax inputs into the exempt sectors or activities specified in Article 59 of the VAT Law.
  - End the tourist refunds scheme and explore ways to further restrict refunds to VAT registered persons only.
- *In the medium term:*
  - Tax immovable property transactions, including new residential property, more comprehensively.
  - Remove the recently introduced VAT exemption on diesel.
  - Tighten exemptions for health and education.
  - Tax fee-based financial services more compressively.
  - Improve the design of the cross-border rules.

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<sup>28</sup> World Bank (2012) projects around 22 percent to be in 'extreme poverty' (defined by the World Bank as living on less than USD 1.90 per day).

<sup>29</sup> As discussed in the next section, returning the VAT threshold to a reasonable level would tend to benefit the less well-off.

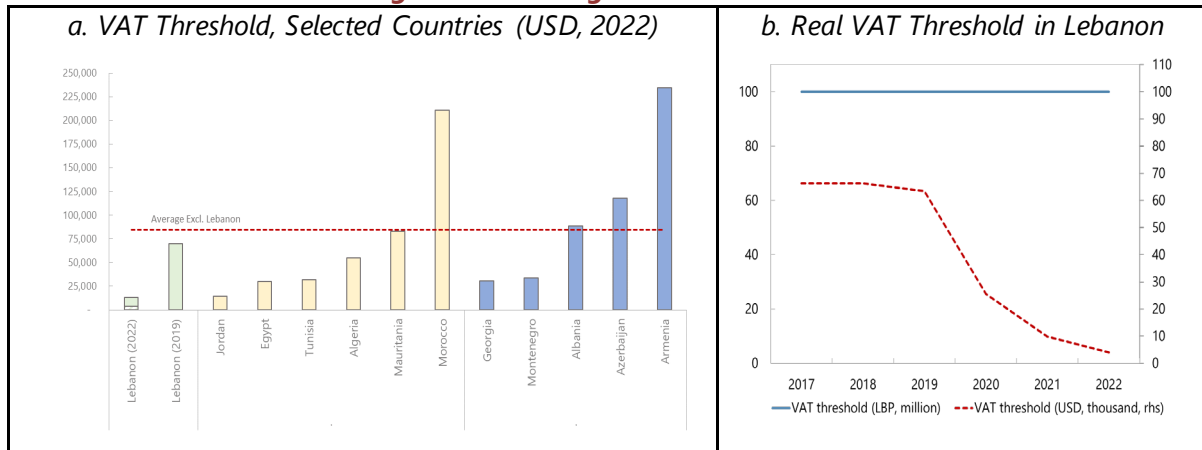
<sup>30</sup> Eligible households are identified by proxy means-testing, with common per-person (USD 20 per month, for up to 6 people) and per-family (USD 25) amounts, with support also provided for schooling in age group 13-18; payment is by pre-paid card. See World Bank (undated) and World Bank (2022).

<sup>31</sup> Even with full coverage, on current plans the ESSN would cover only half of those in extreme poverty (World Bank, undated).

## C. The VAT Threshold and Inflation

**32. Inflation has very substantially eroded the real value of the VAT threshold (Figure 6).** At LBP 100 million, the threshold level of turnover at which registration for the VAT becomes obligatory was for many years equivalent to around USD 75,000; while somewhat below the comparator average, this is higher than in several other countries in the region. At the market exchange rate, however, the threshold is now well below USD 10,000.

**Figure 6. VAT Registration Threshold**



Source: IBFD and IMF staff calculation. Lebanon's threshold for 2022 is separately calculated using the official average exchange rate and the parallel market exchange average rate (dashed green).

**33. It may be tempting to take advantage of the unplanned increase in the number of VAT payers brought about by inflation and maintain the low real threshold at its new level...** Wide inclusion of even small enterprises in the VAT system also has the appeal of easing the distortion and inequity that is created by having businesses subject to VAT competing with others that are not.

**34. ...but the balance of considerations creates a strong case for returning the VAT threshold towards its pre-crisis real value.** Against the advantages of a low threshold must be set the additional compliance costs that it imposes on enterprises and the additional burden imposed on the tax administration. In striking the right balance between the pros and cons of a low threshold in Lebanon's circumstances, two considerations stand out. One is that revenue to be gained from the smallest businesses is very limited: in 2020/21, for instance, that smallest 75 percent of active taxpayers<sup>32</sup> accounted for less than 10 percent of all VAT revenue (Table 2). The other is that the additional effort required of the tax administration to identify and control very small taxpayers would detract from other and more urgent tasks that they face at a critical moment for the rebuilding of the wider tax system. Effort will be required not only to monitor them but also in policy formation, since simplified rules would need to be developed for their engagement in the VAT to be manageable for both the businesses themselves and the

<sup>32</sup> Over 30 percent of all registered taxpayers are recorded as inactive. The issues around deregistration are discussed in IMF (2018).

administration. The balance thus points towards a substantially higher real threshold than now. By way of (very rough) illustration, the second column of **Table 2** translates the turnover ranges into USD equivalent, at a rate of USD 1 = LBP 12,000. This suggests that returning the threshold to its previous level of around USD 75,000 would eliminate three-quarters of taxpayers while preserving more than 90 percent of VAT revenue.

**Table 2. VAT by Range of Turnover, 2020/21**

Ranges of turnover		Percentages of:	
In million LBP	In USD /1	Active VAT payers	VAT paid
Over 100,000	Over 8.3 million	0.44	43
50,000-100,000	4.2-8.3 million	0.50	10
20,000-50,000	1.7 to 4.2 million	1.26	11
10,000-20,000	830,000-1.7 million	1.85	8
5,000-10,000	417,000-830,000	3.11	7
1,000-5,000	83,000-417,000	14.74	12
100-1,000	8,300-83,000	35.70	8
Less than 100	Less than 8,300	42.28	1

Source: Ministry of Finance. Notes: 1/At an exchange rate of USD 1 = LBP 12,000.

**35. Setting an appropriately high VAT registration threshold also improves the progressivity features of the VAT.** Small traders—from whom poorer households are more likely to buy basic food and necessities, especially in non-urban areas—would then be outside the VAT net. Excluding them from the VAT tends to benefit either their customers, to the extent that the effect is passed on in lower prices, or the traders themselves, to the extent that it is not. In either case, it tends to be the relatively poor that benefit.<sup>33</sup> Small (or start-up) businesses operating below the VAT threshold should continue to be able to opt for registration to maintain their competitiveness domestically (in the business-to-business sector) or internationally (to access refunds for exports).

**36. Automatic adjustment of the threshold to inflation would avoid similar difficulties arising in future.** A one-off adjustment of the LBP value of the threshold would leave the risk of further adjustment becoming necessary if inflation were to continue at a significant rate for some while. A better strategy is to index the threshold to domestic inflation, which would ensure such adjustment without any need for distinct legislative approval, provide taxpayers with greater certainty, and avoid unplanned increases in the burden on the tax administration. To avoid frequent small changes, the automatic adjustment might apply only when the increase in the general price level has exceeded some trigger value.

<sup>33</sup> Empirical evidence suggesting that this effect can be sizable is in Bachas and others (2020). This effect would, however, be somewhat mitigated by the adoption of a modest turnover tax on those below the threshold recommended in Section V.E.

**37. Other provisions in the VAT law and regulations that are also specified in nominal terms, and practices that imply long collection lags, also require adjustment and indexation.** The minimum penalties for failure to register or file (timely) returns of LBP 2 and 5 million,<sup>34</sup> for instance, are now (at around USD 60 and 150) minimal. Especially (though not only) in times of high inflation the requirement to pre-pay only 8 percent of a disputed tax amount<sup>35</sup> can be an invitation to appeal. Beyond legislation, as mentioned in Section II, practices that imply significant lags between the determination of a nominal liability and its payment also imply an erosion of real revenue: this would include the excessively long period for resolving tax disputes in Lebanon that is highlighted by IMF (2018).

### **Recommendations**

- *Immediately:*
  - Return the real value VAT threshold to around USD 75,000.
  - Adopt automatic indexation (perhaps beyond some trigger value) of the threshold and other VAT provisions that are specified in nominal terms.

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<sup>34</sup> Article 48.1 and 48.2 of the VAT law.

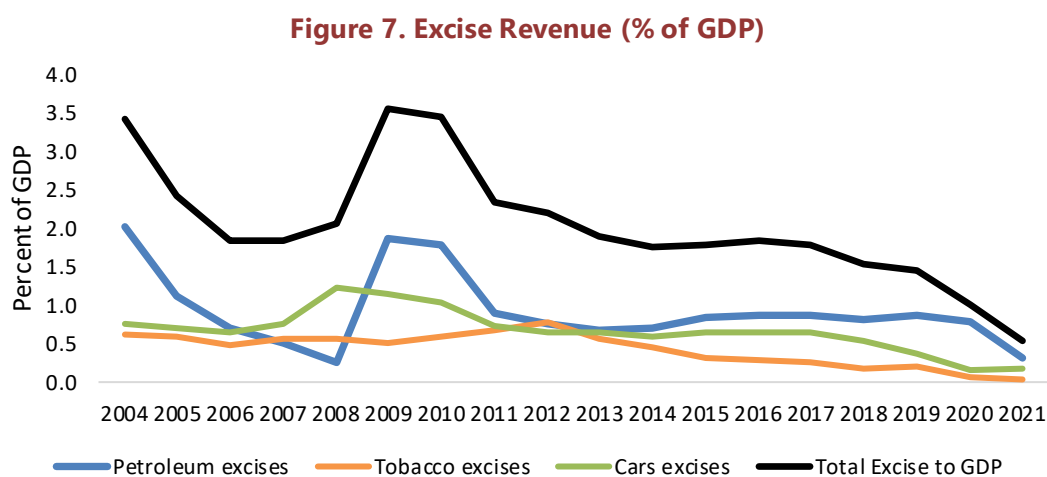
<sup>35</sup> Article 50.3 of the VAT law.

## IV. EXCISES

**38.** This section addresses current issues relating to the excises: taxes, that is, on particular commodities which apply to both imports and domestic production.

### A. Current Situation

**39.** Revenue from the excises in Lebanon has been in decline for a decade and has plummeted during the crisis. Following an upward spike around 2010,<sup>36</sup> excise revenue decreased from around 2.3 percent of GDP in 2011 to 1.5 percent in pre-crisis 2019; and then fell precipitately to 0.5 percent of GDP in 2021 (Figure 7).



Source: Data from the MoF.

**40.** Within this declining total, the excises on petroleum and cars have become increasingly dominant. Over the 5 years prior to the crisis, they accounted for 80-85 percent of total, with 45-60 percent from petroleum alone. Revenue from tobacco has been dwindling, while that from alcohol (and others) has long been less than one percent.

### B. Dealing with Inflation

**41.** The real values of the excises (and customs duties) levied in specific form have been massively eroded by inflation—to negligible amounts. Table 3 shows the specific components—elements, that is, which are specified as LBP amounts per unit of product—of the major excises,<sup>37</sup> along with their USD value at both the ‘official’ rate, which might be taken as an indication of their ‘intended’ real value prior to depreciation and inflation, and at the current ‘market’ exchange rate. In real terms, the specific excises are now negligible: the excise on

<sup>36</sup> This apparently reflected the easing of a cap on petroleum prices.

<sup>37</sup> Tobacco excises are entirely ad valorem. A full description of the major excises is in Appendix 3.

unleaded gasoline, for instance, has fallen from 16.5 cents per liter to less than one cent; that on the cheapest category of used car from nearly USD 3,000 to less than USD 200.<sup>38</sup> Since excises enter the base of the VAT, there is a further effect, beyond the reduction of the excise itself, in reduced VAT revenues (see III.B).

**42. The revenue loss from the reduction in the real value of the excises is potentially in the order of 0.8 percent of GDP.** This is the shortfall of expected revenues in 2022 from those in 2019—that will also doubtless reflect declines in compliance and perhaps changes in consumption, but revenue in earlier years was significantly higher than in 2019.

**Table 3. The Erosion of the Excises**

Description of good	Specific excises				Ad valorem excises Rate (% on CIF)
	Base	Rate	USD, official rate	USD, market rate	
Fuel					
Gasoline, 95-98 octane, unleaded	liters	249.5	0.165	0.0091	-
Gasoline, leaded	liters	592.5	0.392	0.0022	-
Kerosene	liters	17	0.11	0.0006	-
Diesel and fuel oils	NA	-	-	-	-
Cars					
Cars, used: CIF value up to LBP 20 mln	per car	4.5 mln	2,982	164	-
Cars, used: CIF value above LBP 20 mln					45
Cars, new: CIF value up to LBP 20 mln					15
Cars, new: CIF value above LBP 20 mln					45
Alcoholic beverages					
Beer made from malt	liters	180	0.12	0.01	-
Wine, vermouth, spirits from grapes, and other fermented beverages	liters	600	0.40	0.02	-
Spirits, liqueurs, cordials	liters	1,200	0.80	0,04	-

Source: Lebanese Customs Administration.

**43. There can be good policy reasons to use specific taxation.** Ad valorem excises—ones specified as a proportion of the price—have the merit of maintaining their real value in times of inflation, since the nominal amount of tax they imply simply rises with the product price. Specific excises do not have this feature, but (also leaving aside here issues of administration) are nonetheless often an appropriate policy instrument. This is so when their purpose is in part to correct adverse health, environmental or other effects associated with the consumption of some commodity, serving to incentivize firms and consumers to take account of those costs in their

<sup>38</sup> For cars, there is an additional (though presumably no more intended) effect, acting in the opposite direction, towards higher real taxation, through the reduction in the real value at which higher rates of ad valorem taxation apply: for new cars, for instance, that rate now rises from 15 to 45 percent not at around USD 13,000 but at USD 600.

purchase decisions. Since the damage to local air quality from fossil fuel consumption, for example, depends on the amount of fuel burnt, not on the price paid for it, the corrective tax should vary only with the amount burnt and not with its value. Similar arguments are commonly applied to alcohol excises. This does not mean that excises should only take specific form: the objective of policy may be not only to correct for adverse effects but also to raise revenue from goods in relatively inelastic demand, for which some ad valorem component may be appropriate.<sup>39</sup> It does mean, however, that it is important to maintain the real value of specific excises in the face of inflation.

**44. The near-term remedy is to restore the specific excises to their intended real values and index them automatically to inflation**, which seems set to continue at significant rates in Lebanon for some time. As discussed in connection with the VAT in section III, the simplest way to do this is to index the specific excises<sup>40</sup> automatically to inflation, perhaps with adjustment only when inflation exceeds some threshold level.

**45. Beyond restoring them to pre-crisis values, it will be appropriate to reconsider the level of the key specific excises.** While this applies to all of the excises—there is a case, for example, to relate alcohol excises to alcohol content—we focus here on just two: those on petroleum products, most importantly, and on tobacco.<sup>41</sup>

## Recommendations

- *Immediately:*
  - Restore specific excises towards their real pre-crisis values.
  - Adopt automatic indexation of specific excises, including bracket ranges (above some threshold level of inflation).

## C. Petroleum Products

**46. Fuel demand has increased significantly in the past five years, with health, economic, and balance of payment costs (Figure 8).** It is estimated that annual air pollution costs from fuels equal one to three percent of GDP in Lebanon, or roughly USD 0.24 and 0.04 per liter of diesel and gasoline respectively.<sup>42</sup> These costs are due to lost productivity, health care costs, and premature death caused from the inhalation of particulates that are released when fuels are burned.<sup>43</sup> Additionally, gasoline and diesel are significant elements in the current balance of payments crisis and have made up 8 to 25 percent of GDP over the past 10 years

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<sup>39</sup> On the appropriate balance between specific and ad valorem taxation more generally, see Keen (1998).

<sup>40</sup> And the threshold value at which the ad valorem rate applies to cars changes.

<sup>41</sup> The discussion of other structural issues in IMF (2010) and IMF (2012) remains relevant.

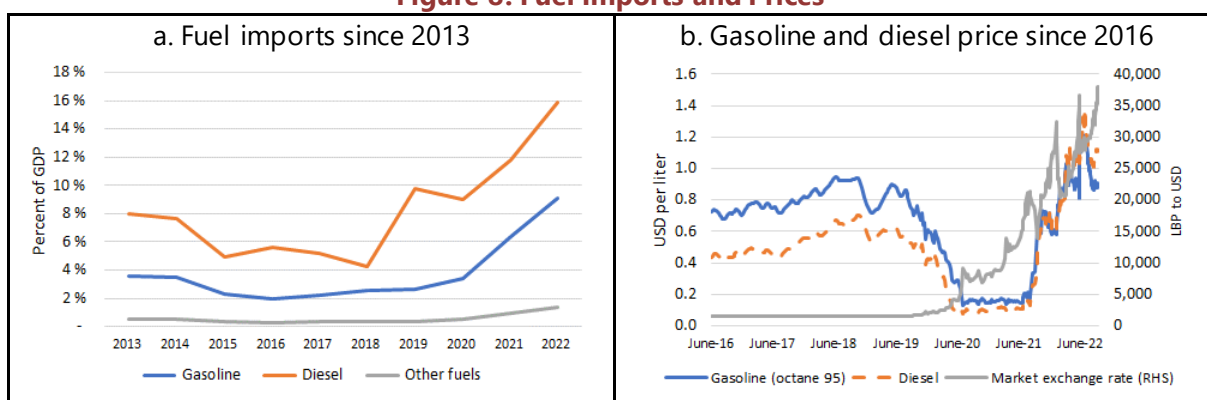
<sup>42</sup> Parry and others (2021) MOE and others (2011).

<sup>43</sup> The studies may underestimate costs since they were undertaken prior to the increased use of diesel-powered generators located with cities, which is particularly harmful for health.

(Figure 8). The increasing demand is partly driven by subsidies for diesel and gasoline<sup>44</sup> (which were phased out between late 2021 and September 2022, Figure 8) and the reliance on diesel-powered electricity generators to make up for the limited electricity supply from Électricité du Liban (EDL).

**47. Excise taxes are an efficient way to reduce pollution.** By increasing the cost of goods that pollute, excises cause households and firms to consider the societal cost (both the direct financial cost and that of pollution) when making consumption and input choices. This results in pollution only occurring when the benefits to the polluting firm or consumer exceed the societal cost, causing a reduction in pollution, incentivizing improvements in energy efficiency and switching towards non-polluting alternatives, such as renewable energy, and, in the process, raising revenue. From all these perspectives, the current absence of any excise (or customs duty) on diesel is a major concern.<sup>45</sup>

**Figure 8. Fuel Imports and Prices**



Source: Lebanese Customs Administration and IPT. Note: imports of diesel include fuel oil, and prices are converted to USD using the market exchange rate.

**48. The introduction of an excise on diesel should be an immediate priority, generating marked environmental benefits and significant revenue, with a modest impact on prices.**

An excise that gradually increases from USD 0.10 in 2023 to USD 0.25 per liter in 2025 is estimated to raise 1.5 to 3 percent of GDP in revenue (assuming that imports are half of the 2013-2019 annual average to account for reductions in economic activity). The combination of excise and VAT would increase diesel prices 15 percent above current levels for households and by 1-5 percent for firms since (registered) firms can recover their input VAT (Figure 9). Prices of products that use diesel as an input, such as electricity, may increase but at lower rate than the diesel for firms (1-5 percent) since diesel would only make up a portion of the good and services' production cost. While the tax on diesel is the priority and should be introduced immediately, excises on propane and butane could also be phased-in as these are polluting fuels, and the lack of an excise leads to overconsumption.

<sup>44</sup> Subsidies were provided through exchange rate support to importers and regulated retail prices.

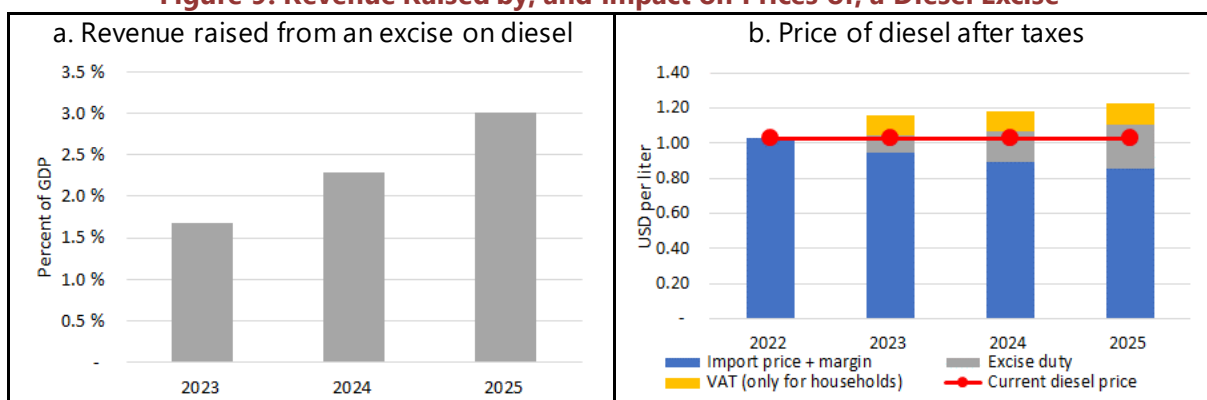
<sup>45</sup> As discussed above, such a corrective tax is best imposed in specific rather than ad valorem form.



**49. The diesel excise could be phased-in over 3 to 4 years.** Phasing in the tax provides households and firms with time to adjust, although the price increase will be much lower than that imposed by the recent subsidy removal. If it is phased-in, the legislation should be drafted so that the tax automatically increases until it reaches the target level of USD 0.25 per liter and not require annual parliamentary approval for each subsequent increase.

**50. The gasoline and kerosene excises should be restored to their pre-crisis levels in USD terms, and all fuel excises should be indexed to inflation going forward.** The gasoline excise on unleaded octane (grade 95-98) was USD per liter 0.165 and kerosene was USD 0.011 prior to the exchange rate devaluation (see Table 3 above for the pre-crisis excise levels for other fuels).<sup>46</sup> Indexing to inflation, perhaps with adjustment only when inflation exceeds some threshold level, will avoid the erosion of excises in the future.

**Figure 9. Revenue Raised by, and Impact on Prices of, a Diesel Excise**



Source: IMF staff calculations. Note: the falling import costs are due to the forecasted decline in global crude oil costs, using a forecast from the IMF World Economic Outlook.

**51. Combining these fuel taxes with targeted support for vulnerable households and firms can be, on net, progressive:**

- *Households:* The wealthy are the primary consumers of fuel and electricity in Lebanon, with the top 25 percent by income consuming 55 percent of fuels and 38 percent of electricity, compared to only 6 and 16.5 percent consumed by the poorest 25 percent, respectively (MoE, UNDP 2015a). Energy subsidies are not well-targeted support measures for the poor, making them an inefficient social support tool. Instead, targeted cash transfers—as discussed above in connection with the VAT—or in-kind transfers of essentials are inherently more effective,<sup>47</sup> with a particular need in this context for investment in public transportation to provide cheaper and more efficient transportation alternatives.
- *Firms:* Electricity is a significant cost for energy-intensive industries, with currently a strong dependence on diesel generation for power. The excise would marginally increase the cost of

<sup>46</sup> Since diesel is more polluting, there is a rationale for maintaining a higher rate on diesel.

<sup>47</sup> Amaglobeli and others (2022).

electricity, and there may be merit for some temporary support for the most vulnerable firms. Any support should target firms with liquidity and solvency issues caused by the excise increase (in order to reduce the likelihood of providing support to inefficient companies), be time-limited (because companies need to adapt over time), follow a transparent and non-discriminatory selection process, and be clearly accounted for in the budget.

**52. These fuel excises would be a significant step towards meeting Lebanon’s international commitments to address climate change (Box 1).**

**Recommendations**

- *Immediately:*
  - Restore excises on gasoline and kerosene to pre-crisis levels in USD terms.
  - As with all other excises, adopt automatic indexation of the fuel excises (above some trigger level).
- *In the near-term:*
  - Introduce an excise on diesel and fuel oil of USD 0.25 per liter.
  - The tax could be phased-in over three years, with the legislation providing automatic increases to the tax until it reaches USD 0.25 per liter without requiring parliamentary approval for each subsequent increase.

**Box 1. Lebanon’s Climate Commitments and Policies**

Under the UNFCCC framework, Lebanon has committed to reducing greenhouse gas (GHG) emissions by 20 percent below business-as-usual levels by 2030, or by 31 percent if adequate international resources are provided. There is also a commitment to increase renewable energy use for heating and electricity generation to 16.5 and 30 percent, respectively. While Lebanon is not a large contributor to climate change, accounting for only 0.07 percent of global emissions, its commitments align with the international norms of coordination and burden-sharing in mitigation emissions and reducing warming, which could have significant economic impacts in Lebanon (MOE and others, 2015b).

Currently, there are no clear policies to support mitigation efforts. Regulatory improvements to the electricity system (IRENA 2020) and taxes on fossil fuels, such as the proposed excises on diesel, would be a positive and important step. The proposed reform of EDL tariffs to cost-reflective levels is also crucial to improve the company’s financial credibility as an electricity provider and generate funds to support investment in renewable energy.

**D. Tobacco products**

**53. There is no excise on domestic tobacco products as such.** They are taxed instead through a 48 percent tax on imported raw tobacco (5 percent customs duty and 43 percent excise). Imported cigarettes are subject to 5 percent customs duty and an ad valorem tax

(equivalent to a tariff) of 108 percent: this serves, in effect, to provide protection to domestic production.<sup>48</sup>

**54. Since all profits from domestic tobacco products accrue to the government, it is immaterial for total revenue how much of the price to the consumer is labelled ‘tax.’** The production and pricing of domestic tobacco products is under the sole control of the *Regie Libanaise des tabacs et tombacs*, which transfers its revenue (net of operating costs) to the government.<sup>49</sup> The government’s receipts from domestic production thus comprise VAT and charges on imported cigarettes and raw tobacco plus the profits of the Regie. The latter have been a steadily increasing share of the government’s take from tobacco since around 2011; at around USD 180 million in 2019, they accounted for about 75 percent of the total. Simply calling part of the price charged to the consumer “tax” would affect the labelling of receipts from the sector but not its total.

**55. There are, nonetheless, important (tax-like) policy issues in setting tobacco prices.** At present, prices seem to be set by applying some mark-up to costs of the Regie: though not labelled as such, that mark-up is equivalent to a tax. The current policy objectives in setting these implicit tax rates on tobacco products, however, are unclear. It may be that they are set with some combination of concerns of revenue (through the impact on the Regie’s profits), affordability, and perceived risk of leakage to smuggling in mind. Health considerations, however—a primary concern of tobacco tax policies in most countries—do not seem to be a significant consideration.

**56. From a health perspective, some observers have felt that tobacco prices—and hence the implicit excises—were too low prior to the crisis.** Heavy taxes on tobacco products can be rationalized in terms of both ‘externalities’ (reducing the damage that smoking does to non-smokers) and ‘internalities’ (discouraging people from starting to smoke, so removing the self-harm they will later suffer given the difficulty of quitting). With such considerations in mind, observers coming to the issue from a health perspective have been critical of Lebanon’s policy in this area.<sup>50</sup>

**57. A near-term review of implicit tobacco tax policy would be appropriate, including in the light of smuggling issues and current market innovations.** The prospect of significant inward smuggling sets some constraint on how high implicit taxes can be set—but some degree of smuggling is perhaps inevitable, and the smuggling is at present outwards;<sup>51</sup> ultimately,

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<sup>48</sup> There are also ad valorem excises of 30 percent on water pipe tobacco and of 35 percent on cigars, cheroots and cigarillos.

<sup>49</sup> The Regie is not subject to corporate income tax, which of course makes no difference for the government’s total receipts from the sector.

<sup>50</sup> Toacconomics (2022), for example, gives Lebanon the lowest possible score in terms of ratio of cigarette prices to per capita real income (higher values being judged preferable from the health perspective). And WHO (2020) reports Lebanon as having the second highest prevalence of smoking in the Eastern Mediterranean.

<sup>51</sup> This reflects low implicit taxes, the use of the official exchange rate being immaterial in this context.

control of the borders by customs is key. This review might also consider the implications for tax design of other market developments, notably the emergence of e-cigarettes of various kinds, which raise new issues from both revenue and health perspectives.

### **Recommendation**

*In the medium term:*

- Review the implicit tax treatment of tobacco products, in the light of both revenue and health objectives.

## V. INCOME TAXES

### A. Key features of the Income Tax System

**58. Lebanon's income tax system has features of a dual income tax system.** Employment income is taxed using a progressive rate structure with a top marginal rate of 25 percent, whereas capital income is generally subject to a flat tax rate that depends on the income source.<sup>52</sup> Specifically, the tax rate on interest income is currently 10 percent (it was temporarily raised from its standard rate of 7 percent for three years from August 2019, but later extended to the end of 2022). Generally, realized capital gains are taxed at 15 percent (even if considered business income). The standard CIT rate is 17 percent. Dividends are taxed at 10 percent but are exempt if distributed by 'holding companies' or 'offshore companies' (each of these types of companies represents a separate preferential CIT regime as discussed in Subsection F below). Business income of the self-employed is subject to a progressive rate structure that is slightly different from the tax scale for employment income. Rental income is taxed under a separate schedule under the 'built property tax'. A summary of the key features of the income tax system is presented in Appendix 5.

**59. Three different regimes apply for the taxation of business profits:**

- Under the *real* (or 'actual') regime (*base du bénéfice réel*), tax is charged on actual profits. This real regime is compulsory for specified categories of taxpayers, including joint stock companies, partnerships, banks, industrial undertakings, importers, and retail traders employing more than four persons. Most other taxpayers (subject to certain exceptions) may elect (irrevocably) to be taxed under this regime.
- The *lump sum regime* (*bénéfice net forfaitaire*) applies to certain commercial activities and professions, and it is not based on a turnover threshold. For these, taxable income is calculated by applying the tax rate to a percentage of turnover (set by a Minister of Finance Decision for each class of activity). The lump-sum regime is mandatory for establishments operating in the following sectors: insurance,<sup>53</sup> savings, maritime, land, air navigation, oil refining, and public works; it is optional for non-corporates with fewer than five employees. The activities subject to this regime are numerous and extend to various sectors of economic activity (MoF Decision 283 of 2020). See **Box 2** for an overview of this regime.
- All others are taxed by the *estimated profits regime* (*bénéfice estimé*): their estimated profits are fixed (for a 3-year period) by a committee comprising representatives of the Ministries of Finance, Economy and Industry, and of the private sector.

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<sup>52</sup> The income tax law divides income into three categories: Profits from industrial, commercial, and non-commercial professions; salaries, wages and pensions; and revenues from movable capital.

<sup>53</sup> The taxable base for insurance companies is determined as a fixed percentage of the premium income, depending on the category of the insurance.

## Box 2. Distortions and Inequities under the Lump Sum Regime

### The lump-sum regime creates distortions as effective taxation significantly differs across economic sectors.

The net profit ratio applied to each sector varies between 1 and 50 percent (Table 4). For example, if a lawyer and a public works contractor both have actual profit margin of 25 percent and are subject to the CIT rate of 17 percent, the lawyer pays an effective tax rate (ETR) of 34 percent and the public works contractor pays 10 percent. In a more extreme scenario, a taxpayer with a low realized profit margin compared to its assumed profit margin could face tax rates exceeding 100 percent (for example, a doctor that has had to purchase medical equipment). In some ways, the option to (irrevocably) file under the real profits regime mitigates these differences and makes the lump-sum function as a maximum tax of 17 percent or an ETR that follows from the progressive rate schedule for professionals. However, this raises fundamental questions about the benefits of the lump-sum regime in the broader tax system. Overall, the lump-sum system creates a strong bias towards sectors with low margins relative to the assumed net profit ratio used to determine their taxable income.

### The variation in ETRs across sectors creates revenue leakage and reduces incentives to comply.

Taxpayers can lower their effective tax rate substantially and relatively easily by misreporting their economic sector, complicating enforcement especially of small taxpayers. Also, high effective tax rates create an incentive to underreport turnover (or profit), even if the taxpayer correctly reports their sector. In addition, the procedure for the determination of net profit rates raises governance concerns (as discussed in subsection F).

**Table 4. Lump-sum Regime – Net Profit Determination Rates for Select Sectors**

Activity/Industry	Assumed net profit margin (percent)	Effective tax rates (under various realized profit margins)		
		5	25	50
Lawyer	50	170.0	34.0	17.0
Accounting and tax consultancy activities	35	119.0	23.8	11.9
Medical practice activities	50	170.0	34.0	17.0
Engineering	30	102.0	20.4	10.2
Life insurance	5	17.0	3.4	1.7
Public works, operation of power stations	15	51.0	10.2	5.1
Air transportation	10	34.0	6.8	3.4
Maritime and road transportation	15	51.0	10.2	5.1
Oil refining	15	51.0	10.2	5.1
Private generators	30	102.0	20.4	10.2
Trade in cars, wholesale of phones	15	51.0	10.2	5.1
Secured transaction activities	1	3.4	0.7	0.3

Source: IMF staff calculation and summary based on Decision 283 (2008) and Decision 59 (2014). Note: the effective tax rate (ETR) is calculated as the tax payable divided by realized profit, with tax payable equal to the assumed profit margin × the tax rate (17 percent, assuming those are not taxed as free professionals). For example, a lawyer that earns an actual profit margin of 25 percent pays an ETR of 34 percent because their tax payable is 8.5 percent (50 percent × 17 percent), while its profit is 25 percent. 8.5 divided by 25 is equal to 34 percent.

## B. A New Better Income Tax Law is Needed

**60. The current income tax law (ITL) is outdated and should be fully replaced by a better income tax law in the medium-term.** The ITL was written in 1959 and has been subject to a series of amendments through various subsidiary legal instruments with different legal

standing, leading to inconsistencies and complexities.<sup>54</sup> The ITL lacks basic definitions and concepts, such as the concepts of residence and permanent establishment (of particular importance in relation to inbound and outbound investment), and capital income items, leading to ambiguity, arbitrary interpretation, and difficulty in obtaining advance rulings. The logic behind the criteria for the application of the above-mentioned three business tax regimes is not based on the (in)ability to produce accurate books (for example, approximated based on turnover), but is rather based on the nature of the business. Importantly, the incoherence of taxation under different categories of income and regimes creates loopholes and leaves room for abuse. There are no up-to-date anti-tax avoidance rules. Overall, fully addressing the structural issues that arise from the current ITL would require a completely new draft of a modern ITL. The new law should be guided by clear tax policy objectives. The medium-term income tax measures proposed through this report could be introduced in the new ITL.

**61. However, a few necessary measures to modify the ITL in the immediate to near-term are discussed below.** To the extent possible within the limitations of the existing ITL, immediate to near-term measures should aim at reducing non-neutralities in treatment across different sources of income and taxpayer, in order to close loopholes, strengthen progressivity, simplify income taxation, and enhance revenue. Given existing administrative challenges, it is recommended to maintain features of a dual income tax system, with a progressive rate on employment income and an appropriately set uniform flat tax rate on all capital incomes combined with measures to tackle loopholes in the taxation of businesses.

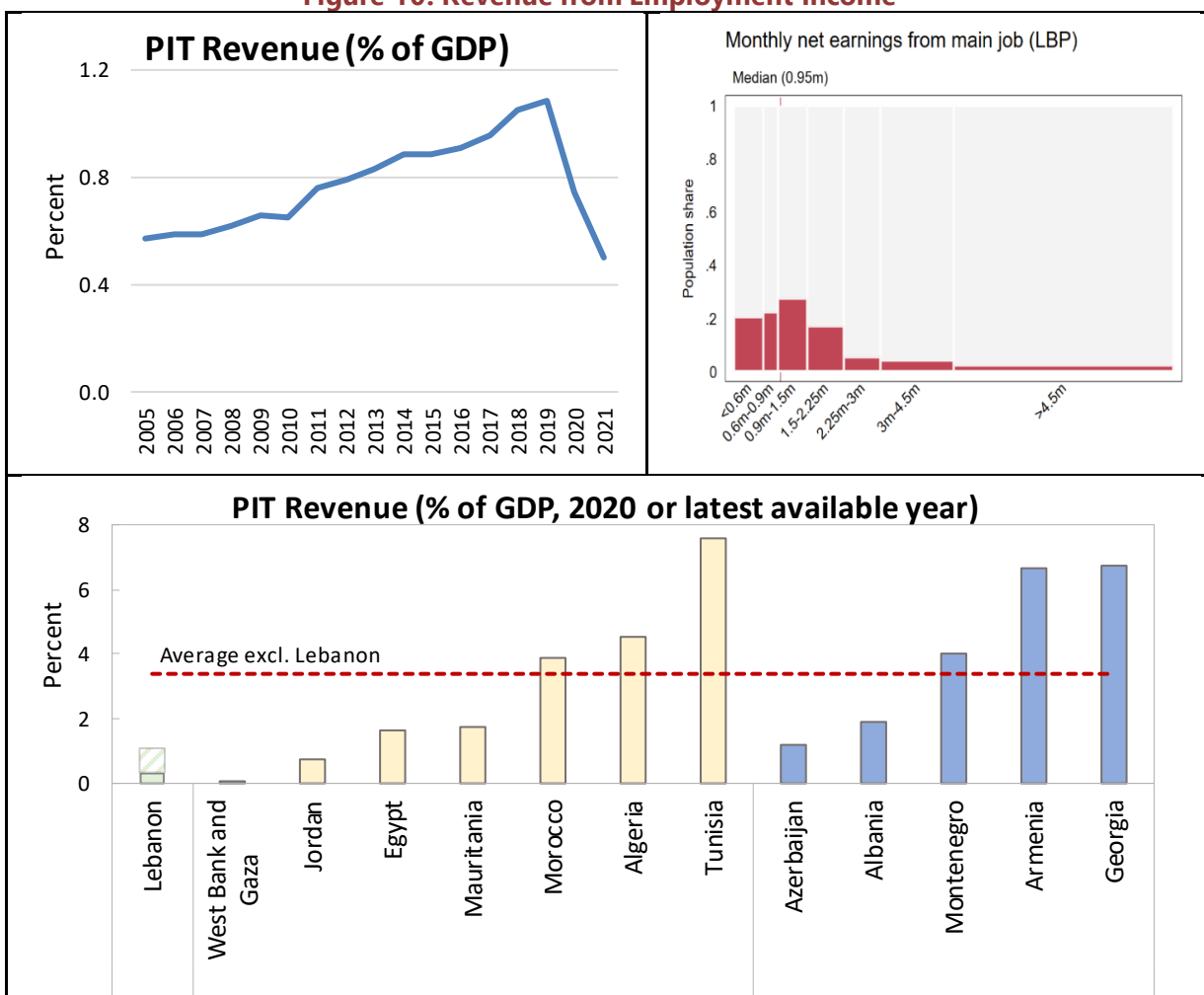
### C. Improving Employment Income Taxation

**62. An upward trend of tax revenue from employment income before the crisis reached 1.1 percent of GDP in 2019, but in 2021 revenue dropped to 0.5 percent of GDP (the lowest level since 2004, Figure 10).** Even at its peak, revenue from individual taxation (excluding the tax on interest) was lower than in comparators (Figure 10) indicating room to enhance revenue. Appendix 4 displays the current tax brackets and rates. Before 2019, there were 6 brackets with tax rates ranging from 2 to 20 percent. In a recent move to enhance progressivity, Article 23 of the Budget Law 2019 added a seventh income tax bracket to the employment income scale with a top rate of 25 percent on income exceeding LBP 225 million. However, even before this change, survey results suggest that less than 1 percent of employees could have fallen into the old top income bracket that initially started at LBP 60 million (Figure 10). Also, less than 8 percent reportedly earned more than LBP 2.25 million a month. As a general caveat, survey results tend to underestimate earnings at the top of the distribution.

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<sup>54</sup> These include Council of Ministers Decrees, Decrees (by the PM or Ministerial), Ministerial Decisions, Ministerial Circulars and General Director Decisions (which are in the area of administrative guidance).

**Figure 10. Revenue from Employment Income**



Source: IMF staff calculation using IMF statistics and Labor Force and Household Living Conditions Survey 2018-2019.

**63. The immediate priority is to appropriately reset the income brackets, to be automatically indexed for inflation to support revenue and equity.** The new top annual income bracket (introduced in 2019) starting at LBP 225 million corresponded to about USD 150,000 prior to the crisis, but now is less than USD 6,000. Also, the first zero-tax bracket for income not exceeding LBP 6 million has *de facto* disappeared (standing now at less than USD 160 of annual income). As discussed in section II., mis-valuation adversely affected horizontal equity (those earning salaries in dollar now pay less tax on the same amount of real income than those earning in LBP) while high inflation adversely affected vertical equity (as real tax paid may be higher for someone with lower income) and , for some, caused real tax paid to increase even at unchanging real income—the so-called bracket creep or ‘cold progression’. The crisis therefore significantly undermined the progressivity of the tax system and immediate inflation adjustment is needed for both the employment income tax schedule and business income tax schedule on both horizontal and vertical equity grounds. It is considered best practice to automatically adjust



the income tax brackets if inflation exceeds some level. Resetting the brackets would increase (decrease) revenues from salaries earned in USD (LBP).

**64. As the economy recovers, tax brackets and rates should be reconsidered.** And the existing two progressive tax schedules (the one for employment income and that for business income) should be also unified. The exact calibration of the tax scale will depend on the accompanying tax reforms but should generally aim at fulfilling the revenue need while striking a balance between equity and efficiency.

## **D. Improving Capital Income Taxation at the Individual Level**

**65. The main pitfalls in the taxation of capital in Lebanon are blunt exemptions and pervasive arbitrage opportunities for business taxation.** The discussion throughout the rest of this section set out the main issues and options for reforms.

**66. Capital income taxation for individuals should be expanded to include:**

- *Capital gains from the sale of shares in joint stock companies.* Under ITL Art. 73, sales of shares in joint-stock companies (*société anonyme libanaise*) by individuals are not included in the taxable base.<sup>55</sup> In addition to equity concerns and violating tax neutrality, this exemption also creates an important loophole in real estate transfers. Structuring sales of shares in companies that derive their value from real estate enables circumventing the 15 percent capital gains tax that is imposed on real estate sales by individuals (see below). Therefore, as an immediate step this exemption should be abolished.
- *Dividends distributed by holding and offshore companies to individuals.* As discussed in subsection F and summarized in Appendix 6, these companies benefit from exemptions from the CIT and the withholding tax (WHT) on dividends, *inter alia*. As an immediate step to support revenue and progressivity, the WHT exemption on dividends distributions to *individuals* from these types of companies should be eliminated. For further discussions, see subsection F.
- *Limiting the exemption from capital gains from the sale of real property by individuals to one primary residence.* Currently capital gains from real estate sales from individuals are taxed at 15 percent, while the law provides for an exemption from the tax on capital gains for up to two primary residences (ITL Art. 45.2.b.).
- *Rental income.* Rental income from immovable property is not taxed if the property is not part of the business assets of the individual. This exemption should be repealed, as in

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<sup>55</sup> Under the Lebanese Code of Commerce (Legislative-decree No. 304 of 24/12/1942), the main business forms that may be registered are joint-stock companies, limited liability companies, companies with variable capital, partnerships, and joint-ventures. The authorities informed that the term “shares” used in ITL Art. 73 does not include “stocks” in joint stock companies.

principle all sources of capital income should be taxed. This medium-term reform should be considered in conjunction with the reform over the medium term of the built property tax (Section VI).

**67. The tax authorities should be able to access relevant banking information.**

Information is critical for tax compliance, in particular for enforcing capital taxation, and for strengthening governance. Lifting bank secrecy is needed for inshore information for tax purposes. To be able to tax offshore capital income of Lebanese residents, however, it is also important for Lebanon to start receiving information from abroad through the full implementation of automatic exchange of information (AEOI) standards. While Lebanon is committed to the *Global Forum* and AEOI and has taken relevant implementation measures,<sup>56</sup> in practice the mission understand that it is only sending but not receiving cross-border information due to technical IT issues (including access to a qualified server) and awaiting fulfilling the needed requirements by the competent international body to qualify for receiving information.

## **E. Taxation of Business Income (other than under the CIT)**

### **Taxing Professionals**

**68. The current tax treatment of professionals—lawyers, doctors, architects and the like—is, and is perceived to be, a fundamental source of unfairness in the Lebanese tax system.** The lump-sum regime applies by default to most free professionals. This provides an opportunity for evasion by well-to-do people who are perfectly capable of complying with the bookkeeping requirements of the real regime. This problem is a difficult one, and not unique to Lebanon—but experience elsewhere shows that progress can be made.

**69. Taxation of business income for the self-employed should be reformed, in the medium-term, as follows:**

- *Taxpayers who are manifestly capable of adequate bookkeeping should be subject to the real profits' regime.* Free professionals such as doctors, lawyers, and accountants, as well as a significant range of traders should not be under the lump-sum regime.
- *Transitioning to the real profits' regime should be complemented by a WHT on payments to professionals for services rendered to companies and public entities.* This WHT should be creditable against final tax liability. To ease administration, the WHT is proposed to be applied when the payor is a business or public sector entity. Other design options for the

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<sup>56</sup> The Council of Ministers has adopted the Decree No.6327 of May 4, 2020, ratifying the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS/MCAA).

introduction of such a WHT include whether to set a threshold and apply different rates depending on the type of services rendered.<sup>57</sup>

- *As part of the broader ITL reform, the rates schedules for wages and business activity of individuals should be unified. At the same time, comprehensive rules for the deduction of business expenses need to be designed.*

## Improving Taxation of Small and Micro Businesses

### **70. Most of the revenue from businesses is collected from relatively large companies.**

While data is not available for the income tax, VAT payments are concentrated at the top of the turnover distribution (**Table 2**), with 67 percent paid by the largest four percent of companies. This and general experience with countries in the region suggests that income tax collection from very small businesses is currently very low.

### **71. The absence of a simplified regime for small businesses (below the VAT registration threshold) encourages informality and increases administrative and compliance costs.**

Therefore, it is considered best practice to adopt a simplified regime in line with international best practices. One popular practice is a turnover tax.

### **72. A turnover tax with a uniform rate on businesses with an annual turnover below the VAT threshold should replace the income tax.**

- *Threshold:* The choice of the threshold should balance the number of taxpayers in the standard regime and the need to lower compliance and administrative costs. Most countries apply the simplified regime to businesses below the VAT thresholds (and who have not opted to be VAT registered). This would work in Lebanon if the current VAT threshold is updated to reflect the erosion of the threshold due to inflation, as discussed and recommended in Section II.<sup>58</sup> For example, if threshold would result in around 75 percent of businesses falling under this simplified turnover regime (**Table 2**).

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<sup>57</sup> For example, in Greece a 20 percent (non-final) WHT applies for professional and management fees rendered to businesses by individuals; a 3 percent (non-final) WHT applies to construction services and an 8 percent (non-final) WHT to all other services rendered to public entities by either individuals or businesses. In Egypt, a 3 percent (non-final) WHT (referred to as 'deduction') applies for service fees rendered by businesses and individuals to public entities, joint stock companies, free zone entities, and a series of other entities (depending on activity). In *Indonesia*, fees for technical, management, construction, consulting services, legal services, accounting services, design services, waste management services and cleaning services to residents are subject to a 2 percent (non-final) WHT.

<sup>58</sup> If the VAT threshold is not updated, then a small business registration threshold of around USD 75,000 (and linked to inflation) could be used. However, this is strictly inferior to returning the VAT threshold to pre-crisis USD levels and aligning the small business regime threshold with that of the VAT, especially since cost and turnover information automatically collected as a VAT taxpayer support compliance with and administration of the standard business income tax regime.

- *Rate:* The uniform rate of the presumptive tax should be moderate, e.g., 2 to 3 percent, in line with international best practices.
- *Uniform rate:* Profit margins may vary across businesses and economic sectors. However, main objective of this presumptive regime is to be as simple as possible. Thus, multiple rates create complexity and avoidance opportunities and therefore should be avoided. Avoiding a low tax in the simplified regime is also warranted in order to encourage firms to grow.
- *Setting the rate:* some countries allow a deemed cost deduction before applying the turnover tax. However, a lower rate on the entire turnover yields identical outcomes. The issue is not concerning the value of deemed cost deduction (which can be zero) but the rate of the tax. For example, suppose the tax rate is 5 percent applied on turnover after deemed deduction of 50 percent. This is equivalent to 2.5 percent applied on total turnover. Many countries, such as Rwanda, Seychelles, and Uzbekistan, apply a rate of between 1.5 and 5 percent with a threshold between USD 50,000 and 120,000. **Table 5** presents international examples of thresholds and rates of presumptive tax regimes.
- *Sectors included:* The SME regime would apply to all sectors of the economy that are subject to the income tax, with the only eligibility criteria being business turnover, with the exclusion of certain, clearly defined business activities (professional services and corporate entities, see below). This is important to ensure that the SME regime is simple to administer for government and comply with for businesses and avoids creating loopholes.
- *Exclusion of corporate entities and professionals:* legal persons and individuals providing professional services—such as lawyers, accountants, and physicians—should not be taxed under the presumptive regime even if they fall below the turnover threshold. These businesses attain relatively high margins and the compliance costs with the standard tax regime is relatively small. Also, corporates should always be in the standard regime even if in the startup phase there are little revenues (below the threshold).
- *Exclusion of microbusinesses:* These microbusinesses, e.g., below an annual turnover threshold, for instance around USD 5,000 can be subjected to a moderate flat registration fee. Again, with the threshold denominated in LBP and indexed to inflation.
- *Opting into the real profits' regime.* Those below the VAT threshold should be entitled to make a voluntary election to pay both the VAT and the real income tax, subject to meeting book-keeping conditions and restrictions on the ability to switch between regimes. In any case, the opportunity to rebut, or to opt into the real regime should be tightly prescribed.

**Table 5. Selected International Presumptive Tax Rates**

Country	Sales threshold (USD)	Presumptive tax rate (%)	CIT rate (%)
Algeria	255,000	5	19
Armenia	274,922	5 (trading), 3.5 (production)	18
Azerbaijan	346,000	4 (in Baku), 2 (outside Baku)	20
Belarus	584,246	5	18
Latvia	45,600	15 (includes payroll tax)	20
Mauritania	810,000	3	25
Rwanda	55,000	3	30
Seychelles	74,000	1.5	25
Uzbekistan	120,000	4	15

Source: Wei and Wen (2019). Updated using IBFD.

## Recommendations

- *Immediately:*
  - Adjust the income tax brackets for inflation automatically.
  - Enable the tax administration to access banking information.
  - Start receiving and acting upon information on offshore holdings on Lebanese residents for tax purposes through the *Global Forum* framework.
  - Include capital gains from the sale of shares in joint stock companies by individuals in taxable base.
  - Abolish the WHT exemption for dividend distributions to individuals from holding and offshore companies.
  - Limit the exemption from capital gains from the sale of real property by individuals to one primary residence.
- *In the near term:*
  - Subject professionals who are manifestly capable of adequate bookkeeping to the real profits regime.
  - Complement the transition to the real profits regime with a WHT on payments to professionals for services rendered to companies and public entities.
- *In the medium term:*
  - Subject rental income of individuals to income tax.
  - Introduce a simplified regime for businesses below the VAT threshold. The real profits regime should be compulsory for all businesses with turnover in excess of the VAT threshold, and all who register voluntarily for the VAT.
  - Unify the rates schedules for wages and business activity of individuals.

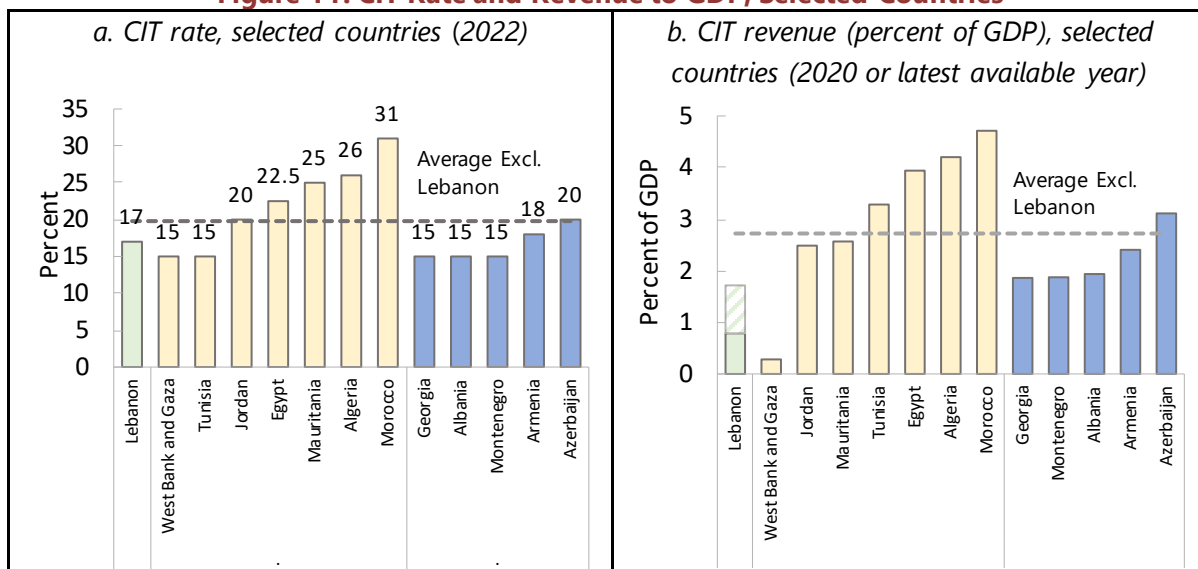
## F. Corporate Income Taxation<sup>59</sup>

### Current Situation

#### 73. CIT revenue is below comparators, largely because the CIT base is eroded by widespread tax incentives, loopholes, and the lack of modern anti-tax avoidance rules.

Revenue collected prior to the crisis was below two percent of GDP, compared to an average of around three percent for comparator countries, and collapsed to 0.8 percent of GDP in 2020 (Figure 11). Part of this decline is attributed to the decreasing profitability of banks, contributed about 50 percent of total CIT from 2010 to 2020. The CIT rate, at 17 percent, is below the average of comparators. Corporate capital gains are taxed at 15 percent. The CIT offers minimum and maximum capital allowances of between 8 and 25 percent for most cost categories; investors' choice within this range must be notified to the tax administration. And as discussed below, tax incentives are pervasive while the existing anti-tax avoidance framework is rudimentary.

**Figure 11. CIT Rate and Revenue to GDP, Selected Countries**



Source: IBFD and IMF staff estimates.

### Tax Neutrality

#### 74. Corporate capital gains should be included in the CIT base and hence taxed at the standard CIT rate, eliminating a minor but potentially costly distortion.

75. Through the CIT, inflation tends to raise the cost of acquiring investment goods and to encourage debt finance. The first effect arises because inflation erodes the real value of depreciation allowances when, as in Lebanon (and as is commonplace), these are based on the historic cost at which assets were acquired. Through this route, inflation raises the tax-inclusive

<sup>59</sup> Specific issues concerning the CIT treatment of banks, in particular the tax treatment of non-performing loans and other financial assets, will need to be carefully considered in light of any restructuring of the financial sector and depend on the form and timing of any such restructuring; they are therefore not further discussed here.

cost of investment. The second effect arises from the ability to deduct not only real interest payments but the part of interest payments that simply compensates for inflation.<sup>60</sup> Interest deduction always reduces the real cost of debt finance and favors it over equity finance (the costs of which are not deductible)—the point is that it does so even more at higher inflation rates. In terms of the overall impact on investment, the two effects act in opposite directions; but where firms are strongly constrained in their ability to borrow, as seems likely to be the case in Lebanon for some time, the first—adverse—effect seems likely to dominate.

**76. Measures can be taken to limit both of these effects, by:**

- **Allowing companies to choose any depreciation in the current range without explicit notification.** For the medium-term, consideration should be given to temporarily allowing largely tax-free revaluation of assets (as was done in 1994).<sup>61</sup>
- **Adopting some form of interest limitation rule,** which for this purpose should apply generally, and not only to loans between related parties. Such rules are discussed further below as an anti-avoidance device.

### **Strengthening the CIT Base: Reforming Tax Incentives**

**77. Tax incentives are provided through a generous array of tax and non-tax legislation.** The ITL, the Investment Law, and several special laws provide tax incentives to certain company forms (notably holding companies and offshore companies), certain sectors (including transportation, manufacturing, agriculture, tourism, IT, communication, and agro-industry), and certain regions (see Appendix 6). Incentives are also provided for exports, in the form of a reduced CIT rate, and to new investment financed by retained earnings.

### **Offshore and Holding Regimes**

**78. There is extensive use of offshore and holding entities as vehicles for financial and, likely to a lesser extent, management activities.** As of 2019, over 3,000 holding and 6,000 offshore companies were active in Lebanon with only 1,961 and 8,538 employees, respectively. This corresponds to roughly one employee per active entity, indicating that they generally operate as financial conduits rather than actively managing investments or providing other services. In 2019, holding companies earned USD 190 million and held USD 3.2 billion in fixed assets, while offshore companies earned USD 1.5 billion with USD 1.9 billion in fixed assets. Applying the CIT and WHT on dividends, to these profits would raise USD 430 million in revenue

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<sup>60</sup> To illustrate, take the extreme case in which the real interest rate is zero; since lenders only require to be compensated for inflation, the nominal interest rate is then equal to the rate of inflation. When that inflation rate is zero, so too is the nominal interest rate; and hence the tax deduction is also zero. At any positive inflation rate, however, the positive nominal interest rate means that the deduction now becomes positive even though the real interest cost is zero.

<sup>61</sup> ITL Art. 46.

(or one percent of GDP), assuming that the profits would remain in these entities, or others in Lebanon, if taxes were applied.

**79. Both offshore and holding company regimes operate as aggressive tax shelters and should be abolished.** Both regimes have been introduced by way of special laws.<sup>62</sup> Under these frameworks, both types of companies are exempt from CIT and WHT on dividends and enjoy several other tax incentives. These exemptions provide a tax shelter for companies and individuals to channel domestic or cross-border income through distribution of dividends, including to resident shareholders, effectively tax-free. For example, under current rules, nothing prevents a group from diverting a substantial part of the profits of its affiliates to a holding company, through management fees, royalties or similar related party arrangements; this is further exacerbated by the absence of interest limitation and proper transfer pricing rules. The holding companies' exemption on interest for long term loans creates an important loophole. Offshore companies are an efficient vehicle to channel domestic source income abroad; also to escape inheritance taxes, since offshore company shares are exempt from transfer and inheritance taxes and all related fees.<sup>63</sup>

**80. Moreover, offshore and holding company regimes are no longer in line with international norms.** Both regimes provide for a very low lump sum annual tax and qualifying companies are expressly excluded from several substance requirements of the BEPS project and the EU Code of Conduct Group (CoCG) (Appendix 6). The French Supreme Court, for instance, recently ruled that a Lebanese offshore company, which is exempted from the CIT but subject to a lump sum tax, is not regarded as a resident of Lebanon for the purpose of the France—Lebanon tax treaty and therefore must be denied treaty benefits.<sup>64</sup> In the broader region, Morocco's offshore companies regime, for instance, was identified by the EU CoCG group and Code of Conduct Group (CoCG) as a harmful tax regime and has been closed to new entrants as of 1 January 2019.<sup>65</sup> Thus, as a first step, the offshore company regime should be abolished (with grandfathering of existing structures)<sup>66</sup> in conjunction with the introduction of substance requirements for holding companies. In the medium term, a new income tax law should include a

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<sup>62</sup> Legislative Decree No. 45/1983 for holding companies (amended by Law No. 772 of 2006) and Legislative Decree No. 46/1983 for offshore companies (amended by Law No. 19 of 2008).

<sup>63</sup> In lieu of the holding company regimes, a participation exemption system should be introduced to avoid cascading the tax on related-party dividends distribution, subject to certain requirements. Currently inter-company dividends are exempt from CIT (ITL Art. 9) but upstream dividend distributions are subject to 10 percent WHT (ITL Art. 72/2).

<sup>64</sup> Conseil d'État 20 mai 2016, [no 389994](#), Société Staff and Line.

<sup>65</sup> The Morocco offshore regime has been abolished through the Finance Law 2019 No 80-18 and closed to new entrants as of 1 January 2019. <https://data.consilium.europa.eu/doc/document/ST-7549-2019-INIT/en/pdf>

<sup>66</sup> No new companies should be permitted to enter the offshore and holding company regimes. The status of existing companies in those regimes should be phased out (over a few years), thereby future profits/dividends of these companies would only be taxed under the standard CIT regime after the end of the phase-out/transition period.



participation exemption regime (for related parties) and the holding company regime should be eliminated.

## **ITL and Investment Law Incentives**

**81. The Investment Law (No. 360 of 2001) provides generous tax holidays, while the ITL provides reduced CIT rates for retained profits (Art 5/2) and for industrial exports (Law 248 of 2014).**<sup>67</sup> The Investment Development Authority of Lebanon (IDAL) reports having provided incentives to 82 projects under the Investment Law, which together have invested USD 1.7 billion, since 2003. Almost all investment has occurred in tourism (USD 1.1 billion), industry (0.4) and agriculture (0.2). IDAL estimates that annual revenue forgone has averaged only around USD 24 million over 2003-09. The mission did not receive data on the use of incentives under the ITL, but their take-up was reported to be low.

**82. Existing tax incentives are ineffective, inefficient, and distortionary:**<sup>68</sup>

- *Ineffective* because they are a poor tool to target research and development (R&D) activities (and investment cost more broadly). Reduced CIT rewards only success, but successful outputs are a function of many nonrelated R&D inputs that are not characterized by market failure. Reduced CIT rates tend to be important for potentially important investments that may not be successful quickly. In this sense, they create a bias towards short-term projects with low upfront costs (most of which are 'footloose'). Moreover, the tax relief is not connected to the level of investment while proportional to the amount of qualifying income—i.e., two projects may generate the same income, thereby receiving the same benefits from the reduced CIT rate, despite having different levels of inputs/investments. Additionally, evidence suggests that non-tax factors (such as the rule of law and the quality of the public infrastructure) are more important for attracting real investment of multinationals. For these companies, minimum taxes in the headquarter country can be triggered if the tax is too low abroad, and, under the new international tax landscape, may be subjected to a global minimum tax (subsection H. ). In this sense, tax holidays in Lebanon can simply generate tax revenues to other countries without creating any attractions for the investor.

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<sup>67</sup> Under the ITL, new investments of industrial companies financed by retained earnings are exempt from up to 50 percent of their CIT liabilities for a period of up to four years, provided that such investments are made for the acquisition of new industrial equipment or the construction of housing facilities for the personnel and do not exceed the original investments made. In areas designated 'development zones', up to 75 percent of a company's tax liabilities may be exempt (ITL Art 5/2). A second incentive is provided under ITL Art. 5/2, in the form of a 10-year tax holiday for industrial companies; however, this is perhaps outdated as it is linked to the production of products not produced in Lebanon before January 1, 1980.

<sup>68</sup> A comprehensive overview of experience with tax incentives, and appropriate policy in this area, is provided by Platform for Collaboration on Tax (2016a,b).

- *Inefficient* as they result in greater foregone revenue since they provide tax benefits to projects even after the recovery of capital costs; and
- *Distortionary* for the allocation of factors of production since they discriminate across sectors.

**83. Tax incentives should be reformed, as follows:**

- I. **Tax holidays under the Investment Law and reduced CIT rates on retained profits should be abolished.** Instead, considerations can be given to introducing well-designed cost-based tax incentives (such as accelerated depreciation) that are better targeted at real investments than profit-based incentives. To preserve credibility and avoid possible disputes, existing holidays should be grandfathered.
- II. **Preferential tax treatment for exports should be immediately removed to align with international standards and avert distortion.** The 50 (or 75) percent reduction in the CIT for industrial exports (Law 248 of 2014) discriminates against some productive investments by favoring specific sectors or industries. Since income tax incentives cannot be linked to export performance under World Trade Organization (WTO) rules, this incentive is most likely incompatible with WTO rules and jeopardizes Lebanon’s aspirations to join the WTO.

**Governance: Transparency of Tax Incentives and Beyond**

**84. Cost-based incentives, if introduced, should be provided exclusively in the ITL and uniformly applied to all qualified investments with no room for discretion or other interfering laws.** Box 3 outlines a recommended governance framework for tax incentives.

**85. Beyond inefficiency and ineffectiveness, existing tax incentives are vulnerable to weak governance.** Now, concerns stem from key issues, summarized as follows:

- *Tax incentives are not consolidated in tax legislation.* Tax incentives are found in the ITL, the Investment Law and special laws (notably offshore and holding company regimes, the Tripoli SEZ, and incentives for industrial exports).
- *Several incentives are not administered by the MoF.* Investment Law incentives are administered by the Investment Development Authority of Lebanon (IDAL), with prior approval from either to the Council of Ministers (CoM) or the Prime Minister, depending on regime chosen. Offshore and holding companies are registered in the Commercial Register.
- *There is wide discretion in the granting and administration of incentives.* The Investment Law grants the authority to award both incentives schemes<sup>69</sup> on a discretionary basis, including with respect to the quantum of the incentives provided. The so-called “mixed” projects (projects that only partly engage in the qualifying activities) can apply for the Investment Law

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<sup>69</sup> The Package Deal Contract (PDC) scheme and the Investment Project by Zone (IPZ) scheme.

incentives on a “pro-rata” basis—the requirements for and compliance with which would be difficult to monitor. The Investment Law also allows for other qualifying sectors to be determined by a CoM Decree.

- *There is no regular estimation and publication of the revenue forgone from tax incentives.* Estimating and publicly reporting tax expenditures to accompany the public budget are key for transparency purposes and guiding the public debate. Therefore, it is important to build capacity in tax analytics at the Ministry of Finance to conduct relevant estimations, policy simulations, and cost-benefit analyses.

**86. Existing discretion in the application of the law must be minimized and should be reviewed in the new ITL.** There are many areas where the law is applied on a discretionary basis. In the case of income tax, examples include: (i) depreciation rules, where the taxpayer may choose the applicable rates from a range (ITL Art 7(7)); (ii) determination of lump-sum profit and estimated profits regimes by Committees, including on an *ad hoc* basis for estimated profits (ITL Art. 27); (iii) non-deduction of expenses based on a rule referring to customary practice (ITL Art. 7(12)); and (iv) determination of the tax base for capital gains on shares on the basis of auditors’ reports or, alternatively, general assembly or Board of Directors resolutions (ITL Art. 73).

## Recommendations

- *Immediately:*
  - Abolish preferential CIT tax treatment for exports.
  - Abolish reduced CIT rates for reinvested profits, and all tax holidays, while grandfathering existing ones.
  - Subject capital gains to regular CIT rate.
- *In the near term:*
  - Eliminate the offshore and holding companies’ regimes, with existing taxpayers allowed to unwind their structures without tax.
  - Identify a small number of tax expenditures and prepare on an annual basis an estimate of the revenue foregone from the provision of such expenditures.
- *In the medium term:*
  - Subject all CIT taxpayers to real profits regime.
  - Thoroughly review and reform Investment Law incentives, and replace by cost-based incentives, complementing with a cost-benefit analysis, as part for the ITL reform.
  - Start publishing annual tax expenditures reports.

### Box 3. Improving Tax Transparency of Incentives

**Transparency is necessary to provide accountability and reduce opportunities for rent seeking and corruption.** Government decision-making processes, policies, and administration should be subject to scrutiny and evaluation, to enable authorities to be held accountable for their actions and remedial action can be taken when necessary. Specifically in respect of tax incentives and other forms of preferential tax treatment, these should:

- *Be clearly prescribed in law and as much as possible consolidated in the tax law.* This reduces the likelihood of conflicting or overlapping provisions and inter-agency jurisdictional conflicts, which could create distortions and uncertainty.
- *Have clear and transparent eligibility criteria based on rules rather than discretion.* Qualifying criteria should be clear, simple, specific, objective, and apply automatically so as to reduce discretion afforded to officials for granting or approving incentives creating opportunities for rent seeking.
- *Be under the ultimate and sole authority of the MoF,* where relevant based on input and views of other stakeholders within the government.
- *Be subject to effective and transparent administration and evaluation.* Their fiscal costs should be reviewed annually as part of a tax-expenditure review which is made public. In this respect, the MoF should keep records of the estimated cost and the actual cost of all CIT concessions and publish these figures in the form of a tax expenditure budget. Cost-benefit analysis, especially (but not only) in the case of new incentives is also important to inform policymaking and the public.
- *Be based on clearly stated policy objectives and time-limited, renewable only if the policy objectives are being met at reasonable cost.* Experience suggests that ineffective or excessively costly incentives can easily become embedded in the 'normal' tax system.
- *Be monitored by the tax administration,* including through compliance and enforcement action where needed when conditions are not or no longer met.

### Solidarity Charges

**87. In exceptional crises, some countries embarked upon temporary additional levies aimed to fall particularly on excess profits or the income of the more affluent (known as solidarity charges or excess profits taxes).** The rationale (beyond revenue which may not be sizable in Lebanon at this juncture) is the importance of social cohesion during temporary major crises, while recognizing that these taxes do not address the structural efficiency, fairness, or revenue raising capacity of a tax system. There are various design options. Preferable are those that fall on economic rent (Hebous and others, 2022), but surcharges on income are relatively straightforward to implement and have been used recently, e.g., in 2011/12 in Australia and Japan to deal with natural disasters. In Japan, for instance, the surcharge on the CIT was 10 percent applied for two years, while on individual income, the surcharge rate was 2.1 percent, and it will apply until 2037.

## Recommendations

- Consider temporary moderate-income surcharges.

## G. Protecting against Erosion of the Income Tax Base

**88. It is critically important to protect the tax base against common base erosion strategies by strengthening the legal framework consistent with current international norms.**<sup>70</sup> Apart from their revenue impact, this would also assist in promoting tax certainty for investors. Areas of particular concern include:<sup>71</sup>

- *Residence and permanent establishment definitions.* There is no definition of ‘resident’ in the ITL. The current residence definitions for companies and individuals are included in Law 60 of 2016 and in the definitions section of the TPL, although the two frameworks are inconsistent.<sup>72</sup> The current residence tests for individuals do not adequately cover individuals who have significant and personal economic ties to Lebanon. The residence tests for companies, based on the registered seat principle, are also inadequate. Most jurisdictions treat a legal person as a resident of a jurisdiction for tax purposes, even if incorporated or established under foreign laws, as long as its place of control and management is in that jurisdiction, i.e., key management and commercial decisions necessary for the business are made in that jurisdiction. This would be done through place of effective management rules. Importantly, there are no provisions in the ITL that define permanent establishment (PE) or exit tax rules.
- *Strong source rules.* The ITL lacks a comprehensive set of rules for income and payments that are considered to be sourced in Lebanon.<sup>73</sup> These rules are necessary especially in a territorial system since the exemption of foreign business activity from domestic taxation creates many

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<sup>70</sup> Lebanon is currently not a member of the OECD/BEPS Inclusive Framework.

It is noted that the Petroleum Tax Law No. 57 of 2017 includes thin capitalization rules, residence and PE definitions, and a transfer pricing framework. The mission has not reviewed the Petroleum Tax Law for consistency with current international tax rules.

<sup>71</sup> Issues of detailed drafting are not taken up here, but support can be sought from the IMF.

<sup>72</sup> According to Law No. 60/2016 (amending Law No. 44 “Tax Residency in Lebanon”), an *individual* is considered tax resident in Lebanon if one: (i) has a place of business in Lebanon; (ii) has a house in Lebanon permanently available to one’s family members (i.e., the spouse and dependent children); or (iii) is present in Lebanon for more than 183 days in any given 12-month period. The 183 days will not include days spent in transit at the International Airport Beirut, or in Lebanon, if the stay was solely for the purpose of undergoing a medical treatment. The TPL definition provides for a 120-day test and does not include the transit or medical treatment exemptions. A *company* is considered a resident in Lebanon if it has (i) been established according to the Lebanese laws; (ii) been registered according to the Lebanese laws, or (iii) a place of business in Lebanon.

<sup>73</sup> For example, that income borne by an employer resident in Lebanon, or rental amounts, license fees and royalties borne by a person residing in Lebanon or by a PE in Lebanon are considered Lebanon sourced income. ITL Art. 3 contains a very basic source rule: “The tax shall be imposed in the name of natural persons and corporate entities, residing in Lebanese territory or abroad, on sum of all profits they realize in Lebanon”.

opportunities for base erosion. These should be complemented by comprehensive definitions on interest, dividends, royalties, and service fees.

- *Interest limitation rules.* There are no interest limitation rules in the ITL. ITL Art. 7(3) provides for unlimited interest deduction on loans contracted with third (related or unrelated) parties; however, the authorities informed the mission that currently a general non-deductibility rule relying on customary practice is used to deny interest deductions (ITL Art. 7(12)).<sup>74</sup> Interest limitation rules in line with current international best practices to limit the deduction of excess interest should be introduced as a priority.<sup>75</sup> Such rules can also help counter the inflation-induced incentive to debt finance noted earlier.
- *Proper transfer pricing rules.* The transfer pricing framework is segmented and inconsistent. ITL Art. 15 provides a basis for transfer pricing adjustments for cross-border transactions. The arms' length principle is found in TPL Art. 10(2), along with a very basic definition of related parties that only refers to direct control situations (not specifying any holding percentages), without any mention to indirect or common control situations, or to degrees of kinship for individuals. MoF Decision 368/2002 contains another definition of related parties for VAT purposes (further to VAT Law Art. 60(2)). Existing transfer pricing rules do not seem to apply to transactions between non-residents and their PEs in Lebanon, or between residents and their PEs outside Lebanon, or to domestic transactions with entities in special zones or otherwise benefiting from a tax holiday.
- *CFC rules.* Base erosion may also arise as a result of Lebanese resident taxpayers shifting income into a foreign subsidiary in which such taxpayers have controlling interests. The ITL does not include CFC rules, which would be particularly important as some items of foreign source capital income (dividends and interest) are subject to taxation on a worldwide basis.
- *An Offshore Indirect Transfers Rule.* A common international tax planning practice to avoid tax on gains derived from the disposal of assets or properties in a jurisdiction is to transfer shares of foreign companies that hold such assets or properties directly or indirectly through an interposed entity, i.e., offshore indirect transfers. As part of the broader ITL reform, an offshore indirect transfer's rule should be adopted, with consideration given to the types of

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<sup>74</sup> Art. 7(12) ITL "Representation allowance exceeding 10 percent of the employee's basic salary, and any salaries, wages, and other expenses that exceed the limits of what is customarily required to engage in commerce, industry, or an occupation."

<sup>75</sup> There are various options for designing interest limitation rules, typically a debt-to-equity ratio or a ratio of net interest to EBITDA, with special rules for banks and financial institutions, and possibly the application of a *de minimis* threshold. In Lebanon, such a rule already exists in the Petroleum Tax Law, providing for a debt-to-equity ratio of 1:1.5. Most countries in the broader region limit interest deductions using similar designs, including: Jordan, Egypt and Turkey that currently apply a debt-to-equity rule. EU countries, including Greece and Cyprus, apply an EBITDA rule (implementing the EU Anti-Tax Avoidance Directive).

assets that ought to be covered and structured to take account of Lebanon’s existing tax treaty network.<sup>76</sup>

- *A General Anti-Tax Avoidance Rule (GAAR)*. There is no GAAR in the ITL or the TPL. A GAAR can be included in domestic tax legislation as a provision of “last resort” against tax avoidance practices that are not otherwise targeted by specific integrity rules like those listed above—and which can be designed to apply to all taxes not just income tax. Where the GAAR is invoked, the tax administration has the power to cancel a particular tax benefit or assess a different (increased) tax liability against the taxpayer in circumstances where the course of action taken by a taxpayer is so blatant, artificial or contrived that it is only explicable by the desire to obtain a relevant tax benefit. Introducing a GAAR requires careful consideration to ensure that it is designed and applied in a measured, even-handed and predictable way. This is because a rule of this nature is less rules-based and more discretionary in its application.<sup>77</sup>

## Recommendations

- *In the near term:*
  - Strengthen residence rules for individuals and corporations.
  - Introduce a PE definition and comprehensive related party definitions.
  - Introduce an interest limitation rule, with limited grandfathering for existing loan arrangements.
- *In the medium term:*
  - Introduce strong source rules, CFC rules, transfer pricing rules, an offshore indirect transfer’s rule and consider a GAAR as part of the ITL reform.

## H. The Global Minimum Tax

**89. Lebanon will need to be attentive to developments in international corporate taxation—even if it remains outside the Inclusive Framework.** Major changes to the international tax system are now a real prospect, following the agreement in October 2021 of around 140 countries in the G20-OECD led ‘Inclusive Framework’ to follow a ‘two pillar’ approach. Pillar 1 aims to reallocate part of the profits earned by the very largest and most profitable multinationals to countries in which they make final sales. Likely more relevant to Lebanon is Pillar 2, which aims to set a global minimum effective tax rate. Since this may be imposed unilaterally by participating countries on their affiliates operating abroad, this will affect Lebanon even if it remains outside the Inclusive Framework.

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<sup>76</sup> Platform for Collaboration on Tax (2020).

<sup>77</sup> Waerzeggers and Hillier (2016).

**90. The minimum tax is intended to top up to 15 percent the tax<sup>78</sup> paid on the ‘excess profits’ of in-scope entities,** these excess profits being the amount by which financial profits exceed a ‘carve-out’ (also known as ‘substance-based income exclusion’) calculated as fixed fractions of turnover and tangible assets.<sup>79</sup> While many important considerations arise, three are especially important for Lebanon. First, the tax applies only to entities that are a part of multinational groups with global annual turnover of over € 750 million. This threshold is low enough to likely include some hotel chains, oil companies and others now active in Lebanon—and the expectation is that the threshold will fall over time. **Table 6** suggests that there are at least 100 or so entities active in Lebanon that will be potentially subject to the minimum tax. Second, a nominal CIT of 17 percent does not ensure that effective rates, which, for the purposes of Pillar 2 are calculated relative to financial profit, will exceed 15 percent: tax deductions will generally reduce taxable profits below financial (as of course will tax holidays). Third, any top up tax due may be collected unilaterally by the country in which the parent of the entity in Lebanon is resident.<sup>80</sup>

**91. The amount of revenue at stake may be significant.** **Table 6** reports information from Country-by-Country Reports, which report on the activities of multinationals that meet the size test for inclusion in Pillar 2. The information is incomplete, and subject to much qualification, but suggestive, nonetheless. One puzzling feature is that, contrary to expectations, the effective tax rates in many cases exceed the statutory rate of 17 percent: the reason for this is unclear. Existing tax incentives, for example, decrease the effective tax rate below the statutory one. And indeed, the effective rate is less than the critical 15 percent for the single most profitable source of investment in Lebanon, the US, as well as on sizable profits from India, and from Italy. Topping these up to 15 percent, the additional tax payable would be around USD 5.5 million, which is a 17 percent increase in the total tax payable by all entities in the table.<sup>81</sup>

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<sup>78</sup> ‘Tax’ here means primarily CIT but includes also withholding taxes charged on the entities’ receipts.

<sup>79</sup> For more detail, see IMF (2022a) and UNCTAD (2021); the model rules, and discussion, are in OECD (2021, 2022). Recent tax changes in the US, not entirely consistent with the Pillar 2 proposal, have complicated policy discussions; for brevity, they are set aside here.

<sup>80</sup> Through the ‘Income Inclusion Rule’.

<sup>81</sup> These figures take no account of the carve out which would reduce the additional tax payable. If the top up were only to an effective rate of 13 percent, for instance, the revenue at stake falls to 11 percent of the current total.



**Table 6. Entities in Lebanon In-Scope of Pillar 2—An Overview**

Residence country	No of entities	Profit before income tax	Income tax accrued, 2017/1	Effective tax rate
Denmark	8	2,496,241	867,927	35%
France	60	65,812,674	13,967,202	21%
Germany	13	27,441,341	6,533,277	24%
India	2	16,491,101	1,401	0
Italy	4	2,057,540	97,825	5%
Japan	3	2,590,281	607,104	23%
Mexico	1	-	-	-
South Africa	1	961,635	166,931	17%
Switzerland	9	20,149,336	3,922,596	19%
United States	-	68,809,296	7,455,632	11%

Source: Country by Country Reports, available at OECD statistics. Note: /1 Except 2016 for Mexico. All countries except France, Italy, and Mexico exclude sub-groups with negative profits, with sub-groups defined as subsidiaries of a single MNE parent company.

**92. It will be correspondingly important to pre-empt any top up tax on Lebanese entities that would otherwise accrue to foreign governments.** Since companies care only about how much tax they pay, not who they pay it to, allowing effective rates on these companies in Lebanon to fall below 15 percent will simply result in other countries receding more tax revenue.

**93. How this might be done will require close attention.** There are several options. Measures might include either increasing the CIT rate to a level that is expected to be sufficient to raise the effective rate to 15 percent in most cases, and/or a minimum effective rate of 15 percent of financial profit—measures that might be adopted for all companies, or just for those in scope. These would be major changes, and require close analysis before acting, in terms of both their economic impact (on investment, not least) and legality (to ensure, for example, that they are accepted by others as bringing tax up to the minimum where they currently benefit from a commitment to a lower rate of tax such as a tax holiday). The simplest alternative would be to adopt a ‘Qualified Domestic Minimum Top up Tax’ (QDMTT), which the model rules for Pillar 2 allow for as a means by which source countries can precisely levy the top up tax themselves.<sup>82</sup> It is not clear, however, that other countries would accept this as implementing the top up so long as Lebanon is not a member of the Inclusive Framework. If they do not, the top up tax would become an additional charge on the investor (because the investor will be subject to the minimum tax by the headquarter country despite the top up tax in Lebanon).

**94. The planned global minimum would have particular implications for tax incentives.** For in-scope companies, the advantage of a tax holiday would be largely eliminated.<sup>83</sup> Where commitments have been made to offer incentives for some years, pre-empting may require renegotiation—which companies may be willing to accept, if it is immaterial to their overall tax

<sup>82</sup> For a low-taxed investor, application of the QDMTT is preferable to simply paying an effective tax rate of 15 percent, because the carve out under the former excludes some part of profit from topping up.

<sup>83</sup> The ‘largely’ is because the presence of the carve out means that not all of the profit excluded by the holiday would be subject to topping up.

liability. How significant a concern this should now be in Lebanon is not clear. What is clear, however, is that the global context in which tax policies to attract investment need to be formulated appears set for significant transformation.

**95. It is intended that the minimum tax apply from some time in 2023 or 2024.** There is thus some urgency to considering its implications for Lebanon, and the appropriate policy response. The first step in doing so is to take stock of precisely which entities in Lebanon will be in scope of the minimum tax, and of the effective tax rates they pay.

## VI. PROPERTY TAXES

**96. Property taxes represent an important share of tax revenue.** Revenues from property taxes have averaged around 1.5 percent of GDP over the last ten years,<sup>84</sup> driven by two decades of a dynamic real estate market buoyed by foreign capital including from the Lebanese diaspora. Moreover, since the onset of the 2019 crisis, real estate has generally been perceived as a safe haven asset, further drawing investment into the real estate market—increasing the share of revenues from property taxes to 14 percent of total tax revenues.

**97. Taxation of property encompasses several taxes and fees collected by the central government and municipalities, including:**

- 1) *Property registration fee*, a transaction fee on the transfer of ownership of real estate. It is the largest component of state revenues from property taxes and is imposed at a rate of 5 percent of the transaction value, with a reduced rate of 2 percent for commercial real estate.<sup>85</sup> However, transfers of shares that derive their value primarily from real estate (i.e. shares in a real estate holding company) are not subject to the registration fee that would have applied had the property been transferred directly—enabling tax planning. Property transaction contracts are mostly denominated in USD, while conversion to LBPs for tax purposes is done at the official exchange rate (see Section II).
- 2) *Built property tax*, a recurrent tax levied by the state on the estimated annual rental value of built property, at progressive rates from 4 to 14 percent. The exemption threshold is LBP 20 million per property up to two properties per owner. An additional municipal tax of 5 or 7 percent on the rental value is imposed on housing and non-residential properties respectively. Vacant properties are exempt from built property tax. The rental value for tax or registration purposes is determined separately by the central government, municipalities, and the Directorate General of Land Registry and Cadastre, potentially leading to different tax values set by each jurisdiction. Valuation criteria are non-transparent and rental values are not regularly updated.

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<sup>84</sup> Revenues from certain fees (including stamp duties) are not included in this estimate, given that those are reported under other tax revenue with no sufficient breakdown.

<sup>85</sup> Additional transaction fees of around 0.8 percent include 0.3 percent in stamp duties, 0.25 percent in municipality fees, and 0.2 percent in other legal fees.

3) *Inheritance and gift tax* is levied when property is transferred by inheritance or gift. The tax is levied at varying rates depending on the value and relationship between the deceased (or grantor) and the recipient(s) of the property, with tax rates ranging from 3 to 45 percent of the property value.

**98. Removing the exemption for vacant properties from built property tax should be an immediate priority.** The exemption complicates the system, burdens a weakened tax administration, incentivizes misreporting, and undermines revenue yield. Indeed, a recent study<sup>86</sup> suggests that around 50 percent of reported vacant properties in Beirut Municipality are in fact occupied. The exemption is also regressive, given that unoccupied properties are likely second homes or investment properties, the ownership of which is highly concentrated at the higher level of the income distribution. Eliminating the exemption of vacant property would mobilize additional revenue both at municipal and central government levels (with a rough estimated yield of around 0.3 percent of GDP).

**99. Other immediate measures should include expanding the built property tax base and reducing tax avoidance through property holding structures.** The preferential treatment for the for second properties should be removed as it is more likely to benefit the wealthier segments of the population.<sup>87</sup> Also, transfers of property should be subject to the same registration fee, irrespective of whether the property is transferred directly for instance by way of sale, or indirectly by instead transferring the shares in the entity that—directly or indirectly—owns the property. The latter tax planning technique through the use of property holding structures is also more likely to benefit the better off.<sup>88</sup>

**100. Improving the property valuation system over the medium term is key to a more efficient and equitable property tax framework.** The two most common approaches for assessing property value are capital (or market) assessment and annual rental value assessment (currently used in Lebanon).<sup>89</sup> While both methods can result in similar estimated values, capital value assessment is preferred in markets with frequent sales transactions that can be objectively observed. Irrespective of which of two methods above are used, valuation criteria should be clear and transparent to avoid discretionary approaches by the valuers, ensure consistent treatment among taxpayers, and preserve the credibility of the valuation system. Once a sound valuation system is in place, it is important to update it on a regular basis to reflect current market values of properties. Levying recurrent property tax on an outdated rental value, in addition to reducing its revenue yield, undermines fairness of the system. For example, owners who keep the property

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<sup>86</sup> Beirut Urban Lab (2020).

<sup>87</sup> See Section V on limiting the capital gains exemption to one primary residence.

<sup>88</sup> IMF (2010)

<sup>89</sup> An alternative sometimes suggested is a 'self-assessment' system, under which owners are invited to declare a value for the property, with the government having the right to buy it (perhaps for later auctioning) at that price. This in principle provides an incentive to declare the true market value. Such a scheme has reportedly been used with some success in Bogota (Colombia), but remains essentially untested in practice: it requires, for instance, that the government at least has a sense of the true market value and may not be corruption-proof.

longer may end up paying lower taxes due to an outdated valuation, compared to new owners whose property was recently valued. However, setting up a robust property valuation system requires time, including to build a reliable database for property transactions. As a very short-term solution the authorities could continue with the existing valuation while, but property transactions valued in USD should be converted for tax purposes using the market exchange rate (Section II).

**101. In the meantime, centralizing or unifying the existing valuation system would go some way towards streamlining the property tax process.** The current system with multiple valuation processes is complex and represents a significant administrative burden both for taxpayers and tax administrations. While it is not uncommon for the property tax base to be shared between local and central governments, the valuation process should be streamlined to produce a single valuation for all tax purposes. In practice, the following options exist for determining the primary institution/agency responsible for property valuation: 1) national government, 2) dedicated national government agency, 3) local government, 4) combination of the above, or 5) a private agency. In Lebanon, valuation at central government level seems preferable, given that capacities are likely to be more constrained at local government level.

**102. As part of broader review of taxes on transfers and holdings of property, consideration should be given to extending the recurrent property tax to both land and buildings.** The recurrent property tax only applies to built property, while land is only implicitly taxed insofar as its value is derived from a property built on it. The value of unbuilt land, however, remains untaxed, except when subject to a transaction (i.e., registration fee). Consideration could be given in the medium term to broaden the recurrent property tax to unbuilt property to reduce distortions and increase the potential tax base.

## Recommendations

- *Immediately:*
  - Use the market exchange rate for all transaction taxes on USD (or other foreign currency) denominated property transactions.
  - Remove the built property tax exemption for vacant properties and apply the tax to all but one principal residence property per owner.
  - Extend the registration fee to transfers of shares that derive their value primarily (50 percent or more) directly or indirectly from real property.
- *In the near term:*
  - Streamline the property valuation system between the different levels of government and agencies involved to achieve a single property valuation.
- *In the medium term:*
  - Improve the quality of the property valuation system and keep property values current.
  - Consider broadening the recurrent property tax base to unbuilt land

## Appendix 1. Calculation of the Revenue Impact from Mis-Valuing Imports

**103. Estimating the revenue impact of correcting the mis-valuation of imports required data from various sources** (Figure 2). Customs values in USD and tax rates for customs, excises, and VAT were downloaded from the Lebanese Customs Administration website, and combined with data on the various exchange rates (official, Sayrafa,<sup>1</sup> and market), GDP (from Central Administration of Statistics for actuals, and IMF sources for 2022 to 2024 estimates), and actual revenue collections up to 2021 (from country authorities).

**104. The steps to estimate import levels assuming no mis-valuation in 2020-2022 (to correct for the anticipation effect), imports for 2023-2024, and revenue under the various scenarios are listed below.**

- *Imports for 2020-2022:* imports as a share of GDP using the Sayrafa and market exchange rates were adjusted downward to remove the anticipation effect for 2020-2022, under the assumption that the anticipation effect was driven by mis-valuation (in other words, imports to GDP would be at pre-crisis levels if not for mis-valuation of imports for tax purposes). This assumption aligns with anecdotal evidence from discussions with stakeholders and the fact that imports as a share of GDP greatly increased to 70-110 percent when assuming Sayrafa and market exchange rates. The downward adjustment was calibrated so that the average imports to GDP for 2020-2022 (70-110 percent prior to adjustment) match that of the 2017-2019 (38 percent).
- *Imports for 2023-2024:* it is assumed that imports-to-GDP is below historical levels in 2023 (reflecting both the lag in imports of durables following the anticipation effect seen in 2020-2022 and import-substitution due to the economic slowdown and rising cost of imports from currency depreciation) and then returns to historical levels in 2024. There is an additional downward adjustment for vehicles since the anticipation effect was especially large (for example, vehicle imports in 2022 are estimated to be around 400 percent of pre-crisis levels relative to GDP, compared to 250 percent for non-vehicle imports).
- *Revenue estimates:* imports are converted from USD to LBP using the various exchange rates, and revenue is estimated by simply applying tax rates to the customs values in LBP and quantities.

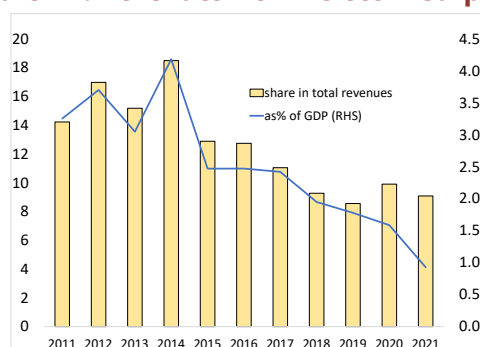
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<sup>1</sup> Since the Sayrafa exchange rate was not available in 2020, it is assumed to be 80 percent of the market rate, which is roughly the different between the two rates in 2021-2022.

## Appendix 2. Telecommunications Sector

**105. The telecom sector contributed 12.4 percent of total revenues on average during the last decade.** It has been the second largest revenue-generating component in the budget, after VAT.<sup>2</sup> However, transfers from telecom surpluses reached their peak in 2014 (at 4 percent of GDP) and since then have been declining (**Figure 12**).

**Figure 12. Revenues from Telecom Surpluses**



Source: MoF data.

**106. The telecom sector is state-owned and since May 2020 fully operated by the government,** with three providers: Ogero, a state-owned and state-run company that operates landline services. The other two companies are Alfa and Touch; both are mobile operators that used to be controlled by two foreign companies under rolling licenses. In May 2020, the Lebanese government took back control of both companies in preparation for re-tendering the contracts, and since then the Ministry of Telecommunications has been operating the service.

**107. Revenues generated both from landline and cellular services belong to the state,** while the two private companies receive annual management fee in return for operating the networks. The contract with mobile operators used to stipulate that they pay collected revenues to the government in USD irrespective if collected in LBP, while revenues from Ogero were collected and transferred in LBP. As such, revenues from telecom surpluses were also a significant source of foreign exchange (FX) for the budget. Revenues would be transferred to the Ministry of Telecommunications, which, after deducting for operational and capital expenses, transfers the remaining surpluses to the state treasury. With three telecommunication providers and no legitimate competition in the market, an increase in mobile and internet penetration over years allowed this sector to be a major source of revenues for the state. Significant decline in telecom revenues in recent years is to a large extent a result of an ongoing economic crisis. Fast depreciating national currency and related increasing maintenance and operational costs left the sector with notably smaller revenues to be transferred to the budget. Reportedly, poor regulation and auditing of the sector also contributed to large inefficiencies.

<sup>2</sup> 10/11 of net VAT revenue collected from telecom services is distributed to the municipalities as compensation for municipal taxes repealed when VAT was introduced in 2002 (Article 55(2) of the VAT Law).

### Appendix 3. Excise Rates by Product

HS code	Description of good	Specific excises			Ad valorem excises
		Base	Rate (LL)	Rate (USD, official)	Rate (USD, market)
<i>Alcoholic beverages</i>					
2203	Beer made from malt	Liter	180	0.12	0.01
2204-2207, 2208.2	Wine, vermouth, spirits from grape, other fermented	Liter	600	0.40	0.02
2208.30-70	Sprits, liqueurs and cordials	Liter	1,200	0.80	0.04
<i>Tobacco</i>					
2401.10-30	Raw or semi-processed tobacco and refuse				48
2402.10	Cigars, cheroots, cigarillos				35
2402.20-90	Cigarettes containing tobacco, other				108
2403.11	Water pipe tobacco				30
<i>Fuels</i>					
2701	Coal	NA	0	0.00	0.00
2710.12.13	Gasoline > 98 octane, unleaded	Liter	241	0.16	0.009
2710.12.14	Gasoline, 95-98 octane, unleaded	Liter	249.5	0.17	0.009
2710.12.15	Gasoline, 90-95 octane, unleaded	Liter	279.5	0.19	0.010
2710.12.20-40	Gasoline, leaded	Liter	592.5	0.39	0.002
2710.12.50	Jet fuel	NA	0	0.00	0.00
2710.19.10	Kerosene	Liter	17	0.11	0.0006
2710.19.20-30	Diesel and fuel oils	NA	0	0.00	0.00
2711.12-19	Liquid gases, including natural gas, propane, butane	NA	0	0.00	0.00
<i>Vehicles</i>					
8703.21.30-8703.24.30	Cars, used: CIF value up to LL 20 mln		4,500,000	2,982	164
	Cars, used: CIF value above LL 20 mln				45
8703.21.90-8703.24.90	Cars, new: CIF value up to LL 20 mln				15
	Cars, new: CIF value above LL 20 mln				45
8703.40.90, 8703.60.90	Electric and hybrid, new				15

Source: Lebanese Customs Administration

## Appendix 4. Tax Rates on Employment and Business Income of Individuals

Tax Rates on Business Income			Tax Rates on Employment Income		
Taxable income (LBP million)		Rate (%)	Taxable income (LBP million)		Rate (%)
Up to	9	4	Up to	6	2
9	- 24	7	6	- 15	4
24	- 54	12	15	- 30	7
54	- 104	16	30	- 60	11
104	- 225	21	60	- 120	15
Over	225	25	120	- 225	20
			Over	225	25

Source: Income Tax Law of 1959. Note: These rates are applicable after 'family deductions' (including deductions for children) of a maximum of LBP 12.5 million (ITL art. 31). For pension income, the tax bands are the same as for employment income; however, as of 1 August 2019, the tax rates are halved. Brackets and deductions were adjusted upwards in the 2022 budget law (that was passed after this IMF mission took place).



## Appendix 5. Key Features of the Income Tax

Lebanon Overview of key income tax features				
Issue	Personal income tax		Corporate income tax	
<b>Income category and rates</b>	Employment and business income are subject to different schedules Wages and salaries income: 25% top marginal rate (art. 58). Exemptions: art. 47 Business income: 25% top marginal rate (art. 32) Family allowances (art. 31) Real profits, lump-sum or estimated regime (depending on type of business and business activity) Income from movable capital income is business income if effectively connected to business activity (art. 8 & 70) 15% municipality surtax on commercial, industrial and non-industrial professions (art. 33)		Real profits or lump-sum regime (depending on business activity) Capital gains and capital income are taxed under different schedules Real profits or lump-sum regime (depending on business activity) Standard CIT rate: 17% Special regime for petroleum companies: Petroleum Tax Law No. 57 of 2017 Art. 11: mandatory real profits regime Art. 44: mandatory lump-sum profits regime Exempt entities: art. 5	
<b>Type of tax system</b>	<b>Residents</b>	<b>Non-residents<sup>1</sup></b>	<b>Residents</b>	<b>Non-residents</b>
	Partly territorial Only interest and dividends are taxed on a worldwide basis (art. 77)	Territorial	Partly territorial Interest and dividends are taxed on a worldwide basis (art. 77)	Territorial
<b>Capital gains</b>	15% Real estate CG phased out at a rate of 8%/year if sale of real estate is not business income Gains from the sale of up to two primary residences are exempt (art. 45.2.b) Rental income from land and built real estate taxed (at 15%) only if business income (art. 8) Sales of shares in joint stock companies are not included in the taxable base (art. 73) 0% WHT - The income is declared with the annual tax return (for all taxpayer categories)	Same as residents	15% (art. 8) Optional revaluation of fixed assets every five years - 'betterment profit' taxed at 10%/15% (on conditions) - art. 45	Same as residents

<sup>1</sup> Taxation of non-residents is subject to tax treaty rates.

<b>Issue</b>	<b>Personal income tax</b>	<b>Corporate income tax</b>	<b>Issue</b>	<b>Personal income tax</b>
<b>Dividends</b>	10% final WHT, including foreign source dividends (art. 9 & 72 bis)	10% final WHT	10% final WHT, including foreign source dividends (art. 9 & 72 bis) Domestic dividends are deducted from income for CIT purposes Branch remittance tax: 10% No participation exemption for foreign subsidiaries (art. 9)	10% final WHT
<b>Interest</b>	10% final WHT (art. 69) Some payments subject to 7% (increased to 10% until 1.8.2022 – subject to extension)	Same as residents	10% final WHT (art. 69) Some payments subject to 7% (increased to 10% until 1.8.2022 – subject to extension) Regular business income for banking and financial institutions (WHT creditable against final tax liability) – art. 69/second	Same as residents
<b>Royalties/Service fees</b>	Taxed as business income 0% WHT	7.5% final WHT (art. 42)	Taxed as business income 0% WHT	7.5% final WHT (art. 42)
<b>Rental income</b>	Not included in the taxable base if not effectively connected with a business (real estate taxed through built property tax)	Same as residents	Taxed as business income (17%) – art. 8)	Same as residents

## Appendix 6. Main Tax Incentives Regimes

### Offshore companies

<b>Legal framework</b>	Legislative Decree No. 46 of 24 June 1983, amended by Law No. 19 of 5 September 2008
<b>Activities</b>	<ul style="list-style-type: none"> <li>• To engage exclusively in business transactions outside Lebanon, including negotiation and signing of contracts and agreements to be executed outside Lebanon or in free zones</li> <li>• Banking, financial and brokerage activities to be executed outside Lebanon</li> <li>• Participation in Lebanese or foreign companies and granting of loans to foreign companies in which the offshore company owns at least 20 percent of the share capital</li> <li>• Carrying out maritime transport activities</li> <li>• Preparation of studies or undertaking consulting services for use abroad</li> <li>• Opening of credits and borrowing from banks and financial institutions residing abroad or in Lebanon to finance their activities and transactions</li> <li>• Rental of offices in Lebanon and acquisition of real estate necessary for the company's activities</li> <li>• Prohibited activities are industrial activities, banking, insurance holding activities and any commercial activity undertaken in Lebanon other than the permitted activities. They are also prohibited from earning any revenue from fixed or movable property in Lebanon and from rendering services to establishments situated in Lebanon. They may, however, receive interest on their Lebanese bank accounts</li> </ul>
<b>Tax incentives provided</b>	<ul style="list-style-type: none"> <li>• CIT exemption (capital gains derived from the sale or transfer of Lebanese-situs fixed assets are subject to the regular 15 percent rate)</li> <li>• WHT on dividends exemption</li> <li>• Annual LBP 1 million lump-sum tax</li> <li>• Exemption from stamp duties on overseas business contracts signed in Lebanon</li> <li>• Foreign employees are granted an exemption of 30 percent of their salary as representation allowance</li> <li>• The offshore company shares are exempt from transfer and inheritance taxes and all related fees</li> </ul>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• Licensing by the Commercial Registry (Min. of Justice)</li> <li>• Established as joint stock companies and obliged to keep proper accounts, prepare annual financial statements and submit tax returns</li> <li>• Special rules: <ul style="list-style-type: none"> <li>- Accounts may be kept in Lebanese or foreign currency.</li> <li>- Two Lebanese individuals need be appointed as directors; the chairman of the board does not need a work permit if he is a foreigner and not resident in Lebanon</li> <li>- At least one resident Lebanese auditor must be appointed but it is not necessary to appoint a second auditor</li> <li>- The company need only publish its annual balance sheet and the names of its directors and auditors in the special register</li> <li>- It can be formed by a sole shareholder, natural person or legal entity, Lebanese or foreign</li> </ul> </li> <li>• Compliance monitored by the tax administration</li> </ul>

## Holding companies

<b>Legal framework</b>	Legislative Decree No. 45 of 24 June 1983, as amended by law No. 772 of 11 Nov 2006
<b>Tax incentives provided</b>	<ul style="list-style-type: none"> <li>• CIT exemption</li> <li>• WHT on dividends exemption</li> <li>• Interest exemption for long-term (more than 3 years) loans to companies operating in Lebanon</li> <li>• Capital gains participation exemption if holdings in Lebanese companies more than 10 percent and for more than 2 years</li> <li>• Management fees charged to Lebanese subsidiaries of the holding company are taxed at 5 percent, provided that such fees do not exceed 2 percent of the revenues of the subsidiary</li> <li>• Income from the lease of patents and trademarks to companies in Lebanon is taxed at the rate of 10 percent</li> <li>• Annual lump sum tax on the value of the company's capital plus reserves up to a maximum of LBP 5 million</li> </ul>
<b>Activities</b>	<ul style="list-style-type: none"> <li>• Participation in Lebanese or foreign companies, management and granting of loans to companies operating within Lebanon in which the holding company owns at least 20 percent of the share capital</li> <li>• Acquisition of patents, concessions, registered trademarks and any other reserved rights, and leasing them to Lebanese or foreign establishments</li> <li>• Acquisition of movable and immovable property for use exclusively in its administrative operations</li> </ul>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• Registration as shareholding companies in the Commercial Registrar (Min. of Justice)</li> <li>• Established as joint stock companies and obliged to keep proper accounts, prepare annual financial statements and submit tax returns.</li> <li>• Possibility of having their share capital, accounts and balance sheets in foreign currency</li> <li>• Right to publish only the balance sheet of each financial year, the names of the members of its board of directors and the auditors in the special register</li> <li>• Exemption from the following requirements: <ul style="list-style-type: none"> <li>- To have Lebanese nationals as members of their Boards of Directors and for the Chairman of the board to hold a work permit if he is a non-Lebanese national not residing in Lebanon</li> <li>- To maintain the company's head office, together with its legal registers and documents, in Lebanon</li> <li>- To hold board meetings and general assemblies, abroad (apart from the annual assembly)</li> <li>- To appoint at least one initial Lebanese auditor resident in Lebanon for a 3-year period and an additional auditor</li> <li>- The obligation to register in the General Trade Register in conformity with the provisions of the Code of Commerce, as well as at the Court of First Instance of Beirut</li> </ul> </li> <li>• Compliance monitored by the tax administration</li> </ul>

### Incentives For Large Scale Projects: The Package Deal Contract (PDC) Scheme

<b>Legal framework</b>	Investment Law (Law 360/2001)
<b>Activities</b>	In the following sectors: Industry, Agriculture, Agro-food, Tourism, Information Technology, Telecommunication, Technology, Media and other sectors specified by a decree issued by the Council of Ministers based on a proposal of the President of The Council of Ministers  It is possible for the company to engage in other activities. In this case, the tax incentives are awarded pro-rata to profits or transactions corresponding to the above activities
<b>Tax incentives provided</b>	<ul style="list-style-type: none"> <li>• CIT exemption for up to 10 years</li> <li>• Dividends exemption for up to 10 years</li> <li>• Exemption from land registration Fees</li> </ul> <p>The exemptions are granted based on investment size, sector of operation and number of jobs created</p>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• Approval by Council of Ministers decision</li> <li>• Administered by the IDAL</li> </ul>

### Incentives For SME Projects in Specific Zones: The Investment Project By Zone (IPZ) Scheme

<b>Legal framework</b>	Investment Law (Law 360/2001)
<b>Tax incentives provided</b>	<ul style="list-style-type: none"> <li>• CIT exemptions up to 100 percent for a period up to 10 years</li> <li>• Dividends exemptions up to 100 percent for a period up to 10 years</li> </ul> <p>The exemptions are granted based on investment size, sector and geographical location of the project (3 zones)</p>
<b>Administration</b>	<ul style="list-style-type: none"> <li>• Approval by Prime Minister decision</li> <li>• Administered by the IDAL</li> </ul>

### The Tripoli Special Economic Zone (TSEZ)<sup>1</sup>

<b>Legal framework</b>	Law No 18 dated of 5 September 2008
<b>Tax incentives provided</b>	<ul style="list-style-type: none"> <li>• CIT exemptions (subject to minimum capital and number of employees conditions)</li> <li>• VAT, customs duties, and excise taxes exemptions, for all inputs, machinery, and equipment needed, provided the equipment and supplies stay within the boundaries of the TSEZ</li> <li>• Income tax exemption for all salaries of employees</li> <li>• An exemption from land and property taxes for all buildings of businesses inside the TSEZ</li> </ul>

Source: IDAL website and IMF staff compilation.

<sup>1</sup> The authorities have informed that this regime is not active yet.

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