How can a new tax system restore growth and equity?

A Diagnostic Review
of the Lebanese Taxation System &
Recommendations to Improve Fairness and Efficiency

In collaboration with

A report by *Financially Wise*

This report was prepared by Iskandar Boustany, Economist and PFM expert, with the contribution of Bassima Antonios, Tax expert and the former head of the large taxpayer's office at the Lebanese Ministry of Finance.

It was reviewed by:
Sabine Hatem, Senior Economist and Director of Partnership at the Institut des Finances Basil Fuleihan
Hassan Hamdan, Head of Strategic Planning and Risk Department at the Ministry of Finance of Lebanon
Francesca Mara Ricciardone, Senior Policy Advisor at the Open Society Foundation.

Contributed to the research Haifa Husseini and Sasha-Maria Sily.

Strategic guidance provided by Lamia Moubayed Bissat, President of the Institut des Finances Basil Fuleihan

Research coordination: Maya Bsaibes
Layout and design: Tonia Salameh
Communication editing: Jide Begdache

June 2023

www.financially-wise.org

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Acknowledgements

This study was made possible thanks to the financial support of the Open Society Foundation and to the contribution of the Institut des Finances Basil Fuleihan.

The content of this report was enriched by the contributions of the participants to the consultation meeting.

About this report

This report aims to assess the gaps and challenges in the current taxation scheme against fairness and efficiency criteria. It seeks to provide action-oriented recommendations and corrective measures and pave the way for more informed and evidence-based tax reform policies that would support Lebanon's recovery and help put the economy back on a sustainable path.

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List of Abbreviations

GDP	Gross Domestic Product
HR	Human Resources
IMF	International Monetary Fund
IOF	Institute of Finance
MOF	Ministry of Finance
PA	Public Administration
PIT	Personal Income Tax
CIT	Corporate Income Tax
VAT	Value Added Tax
SIGTAS	Standard Integrated Government Tax Administration System
TA	Tax Administration
TADAT	Tax Administration Diagnostic Assessment Tool
TIN	Tax Identification Number

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Executive Summary

Since 2019, Lebanon is mired in a series of compounded crises that drained the country's vital resources and led to the greatest economic depression in its history, plunging a sizable share of its population into severe poverty.

Inequality has reached unprecedented levels. Even prior to the crisis, the richest 10 percent received five times more income than the bottom 50% (Assouad, 2021).

To address rising inequalities, long-due reforms are needed, and the tax system stands at the core of these reforms, expected to meet multiple objectives, notably ensure fiscal sustainability, finance social spending, revamp the economy based on fairness and equity considerations, and restore a minimum level of trust between the citizens and the state.

This report presents a diagnostic review of the Lebanese taxation scheme and attempts to provide different scenarios for the way forward, by looking into: (i) the macroeconomic context, (ii) the legal framework, (iii) the human capacity, (iv) the system performance, (v) and the policy design.

<u>Main conclusions about the macroeconomic context:</u>

- Findings highlighted inadequacies between the macroeconomic context and the tax policy response, with the latter designed and implemented on an ad-hoc basis, with no anchor in a medium-term fiscal framework.
- The adoption of tax measures in silos created a **dysfunctional taxation regime with systemic adverse effects on fiscal sustainability, economic activity, and social justice**.
- **The taxation regime in Lebanon has been suboptimal and did not raise sufficient revenues over time**. The tax to GDP ratio decreased from an already low 15.1% in 2019 (IMF, 2021) to 6.6% in late 2021 (IMF, 2023).
- **Yet, tax revenues have always constituted the largest share of state revenues,** ranging between 69% and 83% of total revenues over the last decade, and further compromising fiscal sustainability.
- **The costs of insufficient tax collection have been significantly high, even prior to the crisis**. The costs, translated in terms of debt interests, and associated with an unraised tax value of 1% of GDP, varied between USD 34 million and USD 36 million between 2016 and 2019.
- **The costs of insufficient tax collection were even higher post-crisis and exacerbated by the adoption of ad-hoc tax measures.** For instance, revenue losses due to the mis-valuation of import taxes alone were estimated at 4.8% of GDP (IMF, 2023).
- In addition, **the only attempt to increase tax rates backfired.** Several measures were introduced in late 2017 and early 2018 aiming to increase tax rates. However, in the context of economic recession, these had a procyclical effect that led to a decrease in revenue collection by 1.8% and to a drop in VAT collection of 15.2% (MoF, 2020).
- In 2021, and **despite a spike in the collected VAT, the overall system started becoming further inequitable**.
- The increase in tax revenues in 2021 directly contributed to narrowing the tax to spending ratio gap. **However, this post-crisis fiscal improvement, driven by a spike in revenue collection, is neither sustainable nor expected to last.**

Main conclusions about human capacity and the tax administration:

- **The overall performance of existing staff across the tax administration decreased drastically** due to deteriorating working conditions, increased cost of living, loss of real income value and the systematic depletion of its skilled labor force since the outburst of the crisis.
- **The tax administration is at risk of running short on capacity in the medium term**, while its skilled labor is being recruited elsewhere. Talent depletion is expected to hamper the administration's capacity to resume properly work and to implement any reform as staff that were groomed and trained for years are leaving.
- **The administration's incapacity to perform its missions is expected to further undermine its relationship with taxpayers and heightens the risk of tax fraud and evasion**.

Main conclusions about systems and processes in place at the tax administration based on the findings of the Tax Administration Diagnostic Assessment Tool (TADAT):

- While the taxpayers' base is solid, the integrity of the taxpayer registry is **vulnerable to more informality, increased inaccuracy in data and information registry, and higher risks of cybercrimes due to the lack of automated verification and cross-check processes.**
- **Weak risk management allows for loopholes in the taxation system that favor specific categories of taxpayers at the expense of overall revenue collection**.
- **The capacity challenges that the tax administration was faced with prevented it from investing resources to support voluntary compliance, knowing that the latter is key to achieve greater fairness.**
- **Recurrent delays and the extension of grace periods for the filing and payment of taxes exacerbated inequality among taxpayers** in terms of cash management and of real tax paid at times of rapid currency devaluation.
- **In a context of weakened audit, the likelihood of under-paying or tax evasion has increased drastically, and indirectly penalized regular filers**. With the crisis, and due to the flight of civil servants, audit programs were no longer conducted on a regular and systematic basis. Coverage was therefore significantly reduced to target primarily high-risk taxpayers which are large taxpayers and corporations. **In terms of equal treatment, taxpayers today face different probabilities of being subject to audit**, with small taxpayers being more likely to attempt tax avoidance compared to large taxpayers.
- **Overall, tax dispute resolution is effective**; yet improvements in terms of timeliness and autonomy vis-à-vis the tax administration are necessary.

Main conclusions about progressivity gaps:

- **Evidence highlighted significant loopholes in the progressivity design of progressive taxes** including specific income taxes, inheritance tax, and property tax, generated largely by the lack of cumulative filing.
- **Non-residents are not subject to progressivity**.
- **Labor income and built property taxes are not cumulatively progressive.**
- Prior to the amendments brought by the 2022 budget law, **the devaluation of the national currency and co-existence of multiple exchange rates have reversed existing income tax progressivity.**
- The amendments introduced by the 2022 budget law have also reversed existing progressivity of the income tax, and **the gap was widened by the currency devaluation for a specific category of individuals.**
- Under the same amendments brought by the 2022 budget law, **tax discrepancy was accentuated across labor income tax categories.**

- **Inheritance tax was subject to systematic evasion.**
- **The VAT tax,** which is the main source of revenues for the Lebanese government**, is regressive on disposable income.**
- **Preferential treatments including deductions and exemptions are abundant** and tailored in favor of either specific sectors/industries or specific categories of taxpayers. For taxes covered by this study (income taxes, inheritance tax, built property tax, and the VAT), exemptions were granted for at least 135 categories of individuals and industries, and special deductions to at least 27 categories of individuals.
- **The excessive use of preferential treatments has a distortionary impact and widens the inequality gap across taxpayers and categories of taxpayers. It also makes it difficult for the administration to manage related procedures, complicates law enforcement, increases the risk and likelihood of discretionary implementation of the law, and heightens unfairness.**
- Standardizing the criteria for special treatments, including exemptions and deductions, is key to restore a minimum level of fairness.

<u>Recommendations</u>

In view of the assessment, the study attempted to provide a theoretical and practical framework for improving both the efficiency and fairness of the current taxation scheme and to initiate a dialogue around the pillars of reform.

Achieving fair taxation is a variable of the social contract in place in each country and of the authorities' abilities to reconcile taxation objectives with economical and societal developmental goals and ensure the tax burden is fairly distributed across society.

It usually starts by framing the fiscal role of the state including allocation, redistribution, economic growth, and stabilization into a clear strategy, that takes into considerations macroeconomic fundamentals.

Country examples from around the world confirm that there is no single approach to tax reform, but the Lebanese example appears as a distinctive case given the complexity of its political economy. Given current circumstances and the challenges hampering reform efforts, Lebanon can consider two possible paths going forward:

1. **A long-term scenario that would anchor reform into a national political and policy dialogue, and create fertile ground for rebuilding a taxation scheme geared towards more progressivity**, including unified taxes, wealth tax, earmarked taxes, targeted incentive packages, a more performant administration, better aware citizens, etc.
2. **The second option would be to implement corrective measures to stabilize the system in place on the short and medium terms.** Among these measures would be improving revenue collection, ending the capacity drain, upgrading policy design, standardizing procedures, and strengthening citizens' engagement.

While reforming the tax scheme is fundamental to forge a fairer society and support economic development, it is far from being a straightforward process. Change is often fraught with complexities, resistance, and unforeseen developments at the **political**, **institutional**, and **cultural** levels, that all stakeholders would need to identify carefully analyze and seek to address.

Introduction: Why is Tax Reform critical to Lebanon?

Why is Reforming the Tax System Critical for Lebanon?

Since October 2019, Lebanon has been witnessing a series of unprecedented crises that drained the country from its vital resources and led to the greatest economic contraction of its history, plunging a large share of its population into multidimensional poverty. The disorderly devaluation of the national Lira has devastated lives and impoverished millions. The rate of multidimensional poverty surpassed 80% of the total population (UNESCWA, 2021) while the unemployment rate reached 30% of the labor force, when the overall labor force participation rate revolves at around 43% (ILO, CAS, 2022).

Political disengagement and inaction in the face of rapid events have triggered a triple-digit inflation, compounded by a disorderly removal of subsidies, causing the purchasing power of the Lebanese people to deplete by more than 97 times compared to its initial value, while the country's level of indebtedness and shrinking foreign reserves have seriously undermined policy maneuver. Estimated GDP per capita has shrunk, reverting to its level in the mid-90s. The rapid erosion of real income has pushed the highly skilled workforce to emigrate, and deprived Lebanon of one of its more valuable resources for recovery: its talent base.

Inequality has remained at excessive levels for years. Even before the crisis, the richest 10 percent received five times more income than the bottom 50% (Assouad, 2021). This gap was exacerbated by a tax system that favored the banking sector, encouraged tax evasion, and concentrated wealth in the hands of the few. In the meantime, the ordinary taxpayer was subject to regressive taxation that hit the poorest.

For years, the political leadership have overlooked the obvious relationship between tax reform and poverty alleviation, inequality, and social exclusion, and underestimated the societal repercussions of a crippled social protection system, especially in times of crisis. Today, Lebanon has the opportunity to rethink its deficient model and transform it, with the objectives to revamp the economy, address inequality, ensure tax justice, and reform public financial management.

Lebanon therefore stands at a difficult juncture. In the absence of rapid and efficient reforms, the Lebanese economy could be mired in a never-ending crisis. Long-due reforms are needed to (i) achieve debt sustainability, (ii) secure financing for social and development spending, (iii) restore the viability of the financial system, (iv) unify the exchange rates and improve the external position of the economy, (v) strengthen PFM, and (vi) enhance governance and anti-corruption measures. Reforming the tax system is at the core of these measures, to ensure fiscal sustainability, finance social spending, revamp the economy based on fairness and equality considerations, and restore a minimum level of trust between citizens and the state.

Why is Introducing More Fairness to The Tax System Key to Achieve Sustainability?

Building a fair and effective tax system is a main challenge for modern societies faced by globalization, internationalization, human and corporate mobility, and by recurrent external macroeconomic shocks. Governments are more than ever concerned with widening socio-economic and gender inequalities, as well as with challenges brought by the rapid changes in international markets and national economies.

Reviewing tax policies and systems is not solely envisioned to collect more resources and finance the expansion of the state but is rather a tool that can serve to improve economic stability, enhance social harmony under a widely accepted social contract, and ultimately promote economic, social, and environmental sustainability.

How to Explore Fairness in Tax Policy?

The concepts of “fairness” and “fair taxation” are fluid. Their meaning, significance, and scope vary depending on the stakeholders. In general, “fair taxation” is understood as the extent to which the objectives of taxation policy are likely to meet economic and societal needs and expectations, while attempting to ensure an equitable distribution of the tax burden across the various stakeholders in society.

Yet, this definition is by no means either straightforward or completely objective. Therefore, any assessment of the taxation system against fairness, shall encompass the following key aspects:

- **Horizontal equity**, which goes beyond a unified income framework. The net wealth of individuals depends on many factors including personal status, assets, and liabilities. A fair system should adjust to such discrepancies through asset-based allowances, exceptions, and deductions.
- **Vertical equity**, relying on comprehensive progressiveness. The taxation scheme should be designed in a way to reflect the degree of fairness that the citizens have opted for, in addition to the level of state intervention through income re-distribution.
- **Income distribution** is key to consolidate societal cohesion, particularly in a country like Lebanon that faces recurrent crises, and where the state is more than ever called to directly support the less privileged through direct transfers, or indirectly by facilitating access to specific public services including education, healthcare, public transportation, etc.
- **Fair distribution of the tax burden**. A fair system should be able to deter the strongest player on the market from shifting the tax partially or totally to another economic actor and alter the tax outcome against fairness.

However, fairness does not always go hand in hand with efficiency. Most taxes create market distortion and might hamper economic growth. Excessive market distortion might shrink the size of the economy and subsequently decrease tax revenues. It might also discourage capital holders and investors from creating new businesses which would hinder the employment. Hence, it is important for policy makers and the tax administration to find an optimal trade-off between efficiency and fairness.

What Is the Aim of This Diagnostic Review and How Was It Conducted?

Given the above presented context, this report delivers an investigative review of the Lebanese taxation scheme in attempt to pave the way for the needed tax reform, recommending specific measures that would ensure greater fairness without further compromising the level of economic efficiency, competitiveness, and attractiveness.

The following study was based on a mixed-method approach. Five (5) pillars were identified and covered including (i) the macroeconomic context, (ii) the legal framework, (iii) the human capacity, (iv) the system performance, (v) and the tax policy design. The assessment was based on an extensive desk review in addition to a compilation of legal and administrative texts governing main taxes including income taxes, VAT, built property tax, and inheritance tax (cf. Compendium of Tax Laws and Regulations, Table 2). It also drew on insights provided by key informants and consultations with major stakeholders among CSOs, international organizations, tax experts and economists.

Chapter 1: Diagnostic Review of the Taxation System

Section 1: Macro-Fiscal and Policy Overview: A Decade of Contradictions

This section provides an overview of the macro-fiscal context in the country, with a particular focus on taxation. It investigates the state's tax revenues, their evolution over time, outcomes gaps, and attempts to understand how various factors such as governmental measures and reforms as well as economic and financial crises might have affected the administration's capacity to plan, predict and collect taxes.

Findings are mixed and highlight inadequacies between the macroeconomic context and the tax policy response, with the latter designed and implemented on an ad-hoc basis, with no anchor in a medium-term fiscal framework. The adoption of tax measures in silos created a dysfunctional taxation regime with systemic adverse effects on both fiscal sustainability and economic activity. The policy pattern produced intergenerational negative externalities and exacerbated injustice among the various social categories.

- **The taxation regime in Lebanon is suboptimal and does not raise sufficient revenues**. Despite a series of incremental reforms introduced to the system, notably between 2002 and 2008, and the progress made prior to the crisis (Table 1), tax revenue as a share of gross domestic product remained relatively low compared to other countries, notably oil importers or to OECD countries. This low level of taxes has restrained the administration's capacity to finance basic public services, and consequently to ensure fiscal sustainability and secure steady growth (Figure 1). In fact, the tax to GDP ratio in 2019 (15.1%) was close to the ratio of much poorer Egypt (14.2%), but way below countries that were marginally poorer, such as Morocco (28.4%) or Tunisia (34.3%). In addition, it was lower than the average of developing regions - including Emerging and Developing Asia (15.3%), Sub-Saharan African (15.6%), and Latin America and the Caribbean (17.8%). It was also significantly lower than the average of OECD countries (33.9%) (IMF, 2021) (Figure 2).

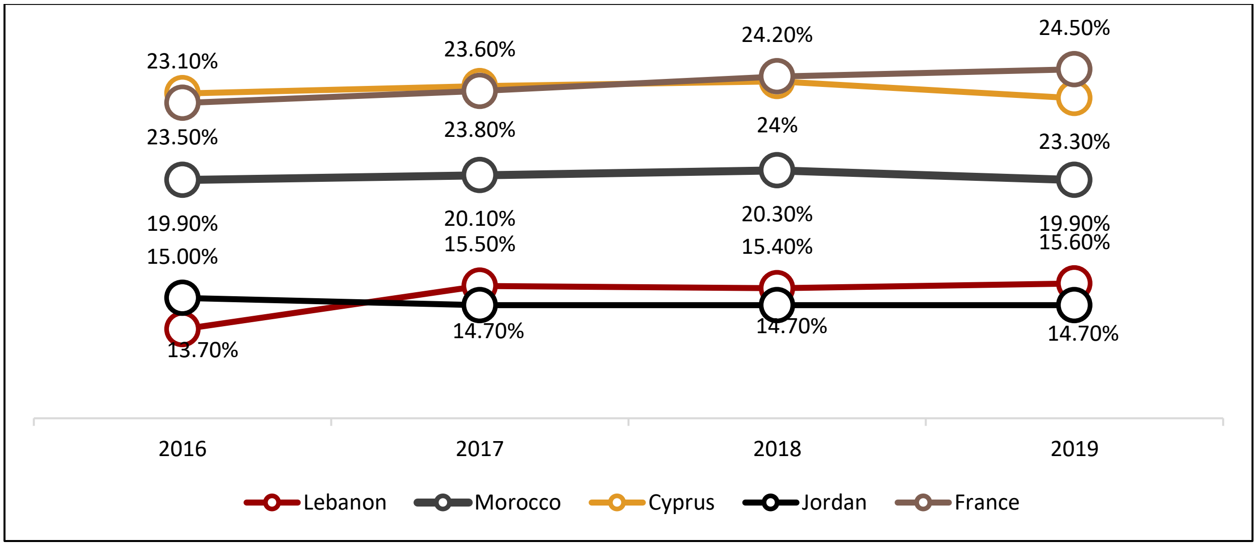
Table 1: Main tax reforms and measures introduced in Lebanon (2002-2022)

YEAR	REFORMS
2002	Introduction of the value added tax (VAT)
2003	Introduction of the tax on interest earnings (at 5%)
2008	Introduction of the tax procedures code
2017	Increase of the tax on interest earnings (from 5% to 7%) Introduction of the tax on real estate capital gains (up to 15%) Increase of the corporate income tax rate (from 15% to 17%) Increase of VAT (from 10% to 11%)
2019	Increase of the tax rate associated with higher income bracket (from 20% to 25%)
2020-2022	Tax on interest earnings temporarily set at 10%

Source: MoF, "Which Tax Policies for Lebanon? Lessons from the Past for a Challenging Future", Arab Reform Initiative (May 2021)

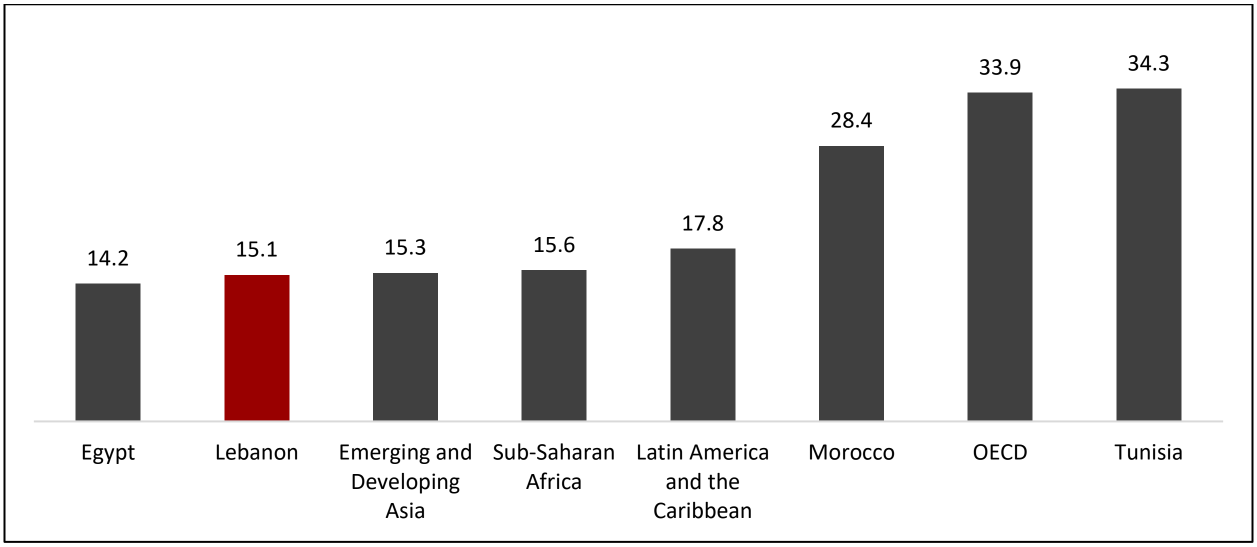
- Despite the gradual introduction of VAT between 2003 and 2005 and the significant growth of the economy at the time, tax revenues started increasing as of 2005, and reached a peak of 20.4% of GDP in 2009. However, the stagnation resulting from structural economic deficiencies and the war in Syria reversed this trend. Tax revenue to GDP dropped to a low of 14.1% in 2016, further fueled by the weakening of border controls.

Figure 1: Tax burden (Tax to GDP rate) - country comparison



Source: World Bank Data, 2022.

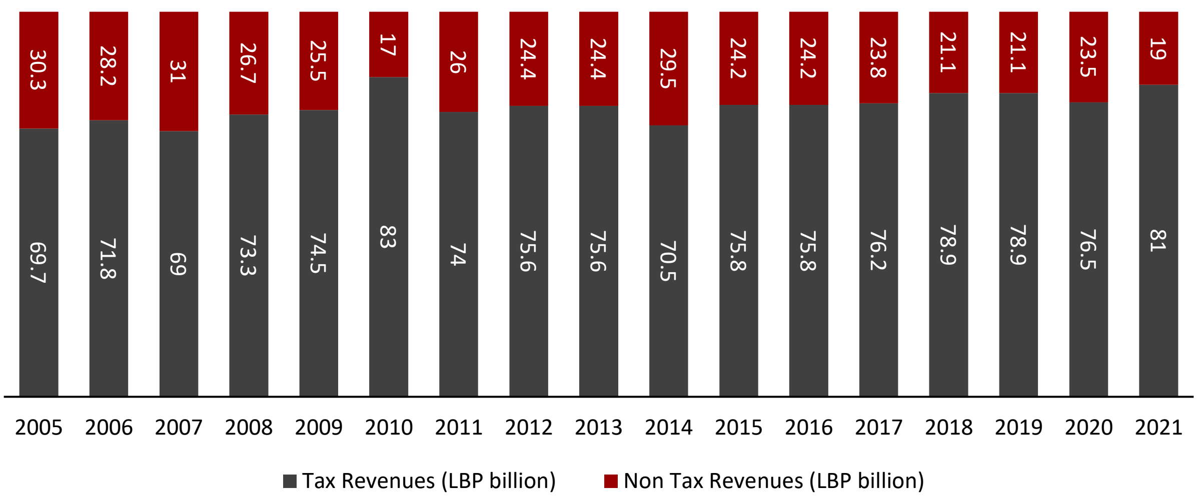
Figure 2: Tax revenue (Percent of GDP, 2019)



Source: IMF World Economic Outlook October 2021; OECD (2021) Revenue statistics in Africa.

Yet, tax revenues have always constituted the largest share of state revenues: this share ranged between 69% and 83% over the last decade, compromising further fiscal sustainability (Figure 3). Coupled with a low fiscal burden and high spending, this translated into recurrent and unsustainable fiscal deficits that built up into debt and led to the debt default in March 2020.

Figure 3: Evolution of tax and non-tax revenues (Percentage share)



Source: MoF, Public Finance Monitor 2022.

- **The costs of insufficient tax collection have been significantly high, even prior to the crisis**. The Lebanese Ministry of Finance has systematically reverted to debt to secure its financing needs while it could have arguably increased its general tax rate, minimized the tax gap, or introduced corrective measures. A quick simulation showcases the cost of uncollected taxes in terms of debt interests in the years preceding the crisis. The costs, translated in terms of debt interests, and associated with an unraised tax value of 1% of GDP, varied between LBP 51 billion and LBP 54 billion between 2016 and 2019 which was equivalent to USD 34 – 36 million (Table 2). Had Lebanon reached its potential in terms of tax to GDP rate, it could have saved billions of USD of debt interests and alleviated inter-generational inequity.

Table 2: The costs of unraised taxes

YEAR	GDP IN BILLIONS OF LBP	TAX TO GDP RATIO	YEARLY WEIGHTED AVERAGE INTEREST RATE OF DEBT IN DOMESTIC CURRENCY	ESTIMATED COST OF UNCOLLECTED TAXES OF 1% TO GDP VALUE* (LBP BILLIONS)
2016	77,105	13.7%	6.97%	53.74
2017	79,939	15.5%	6.70%	53.56
2018	82,764	15.4%	6.15%	50.90
2019	80,196	15.6%	6.47%	51.89

* The yearly weighted average interest rate was applied to 1% of the current GDP to estimate the cost of uncollected taxes
Source: MoF, Public Finance Monitor 2017-2021.

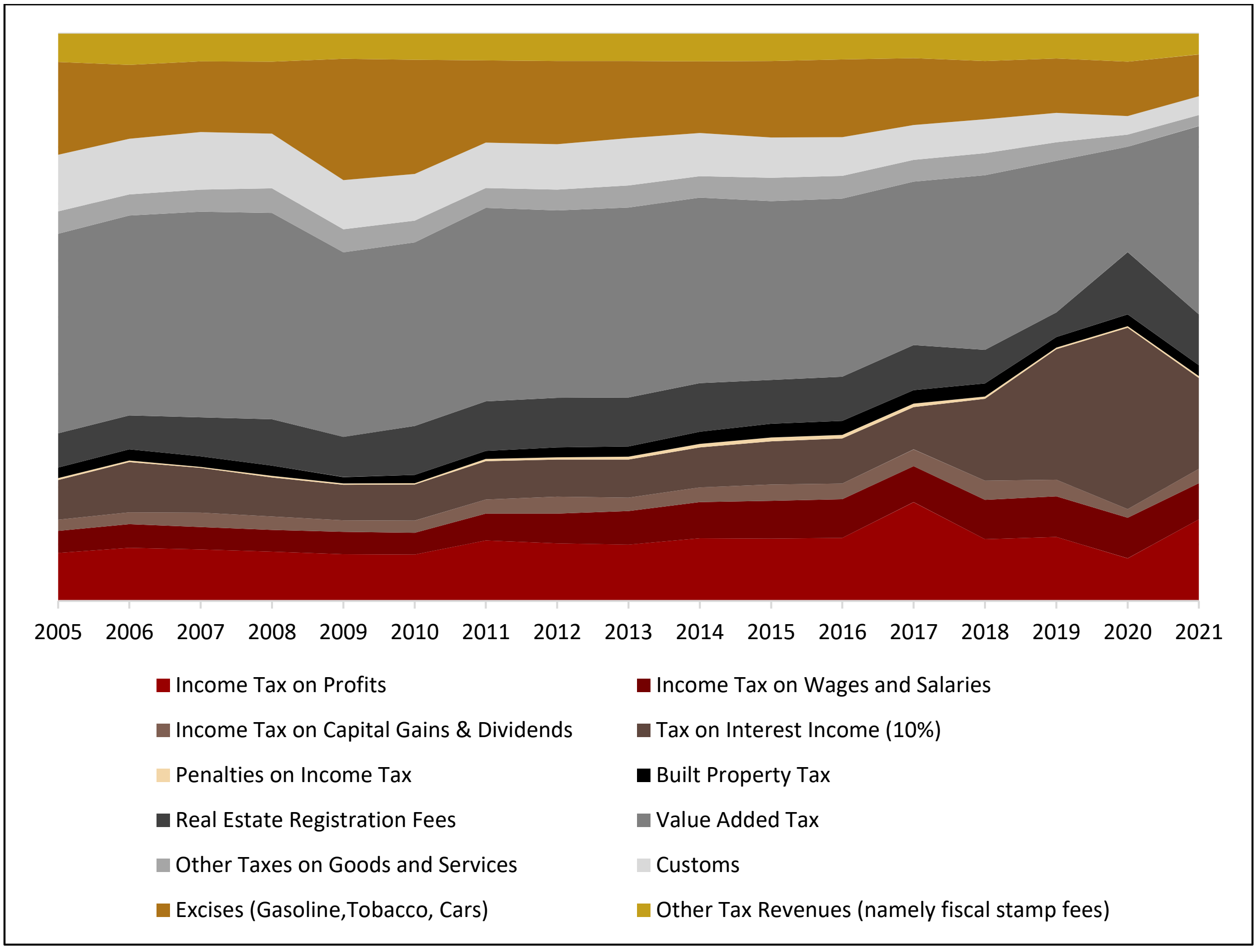
- **The costs of insufficient tax collection are even higher post-crisis and were exacerbated by the adoption of ad-hoc measures.** In 2020, the tax to GDP ratio dropped to 8.9% and further decreased in 2021 to reach a historical low of 6.6% (IMF, 2023), due to the economic contraction and rapid pace of devaluation, although the official exchange rate, used as a basis for tax calculation, was artificially maintained at its pre-crisis value. Revenue losses due to mis-valuation of import taxes alone was estimated at 4.8% of GDP (IMF, 2023). While policymakers were reluctant to introduce tax adjustment measures during the period of 2019-2022 to avoid social unrest, the public and military sectors saw their salaries being devaluated by more than 95%. The Lebanese government and following its decision to postpone the Eurobonds payment in March 2020, was no longer able to contract new debt on the market to secure its financing needs, except for specific loans from International Organizations. It therefore had to revert to money creation to finance the salaries and wages of public servants, which in turn fueled hyperinflation. To this date, the government has not secured sustainable financing sources to adjust the salary scale of public sector employees, whereas the private sector was quicker to put in place salary adjustments. Direct impact translated into societal injustice and the mass exodus of the most skilled civil servants, a dysfunctional public sector, and a loss of decades of accumulated technical expertise much needed to allow for the public sector and the country to recover.
- **The only attempt to increase tax rates backfired.** Several measures, showcased in table 1, were introduced in late 2017 and early 2018[1]. Measures that were ratified in Parliament resulted in a procyclical effect: While the initial intention was to collect more taxes, increasing tax rates during a recession led to a decrease in the level of collection from LBP 12,766 billion in 2018 to LBP 12,535 billion in 2019, equivalent to a drop of 1.8%. The VAT, which was the main source of tax revenue for the state, witnessed a drop of 15.2% over that same period (MoF, 2020). It is important to note that most likely, during economic recession or depression, the consumption of basic goods and services is the least affected, while the consumption of other goods and services is more elastic to revenue variation. As a matter of fact, in crisis, the share of VAT associated with the consumption of basic goods and services that compose the largest share of consumption in low-income households, is expected to relatively increase, rendering the VAT more regressive relative to the current income.
- **Despite an exceptional increase in the collected VAT, the overall system became further unfair**. During 2021, the VAT collection increased by 158%, disrupting the pattern in place.

Historically, the VAT has constituted the largest share of tax revenues in Lebanon, except in the year 2020 when the share of tax on interest income surpassed the share of VAT (Figure 4). This confirms that the government has been consistently relying on indirect taxes as its main source of financing. This trend is more likely to persist and even accelerate, due to multiple factors: (i) the VAT is the most elastic to price variation among all taxes, (ii) private consumption is expected to regain its pre-crisis level faster than the income level, (iii) the VAT is the most effective tax in terms of collection, (iv) the devaluation-hyperinflation cycle is still out of control.

[1] Only few of the fees and tax measures proposed by the tax administration were ratified.

Similar to other developing economies, Lebanon is relying on the indirect taxation of domestic and imported goods and services, thus producing a regressive impact that favors the wealthy who have the ability to save a higher proportion of their income and increases the tax burden on the poorest who see their share of taxed consumption relatively increasing fueled by hyperinflation. While more than half of the Lebanese population is believed to survive under the national poverty line (UNESCWA, 2021), it has become critical to revamp the VAT's structure and rates to reasonably target the consumption basket of households at the various rungs of the income scale.

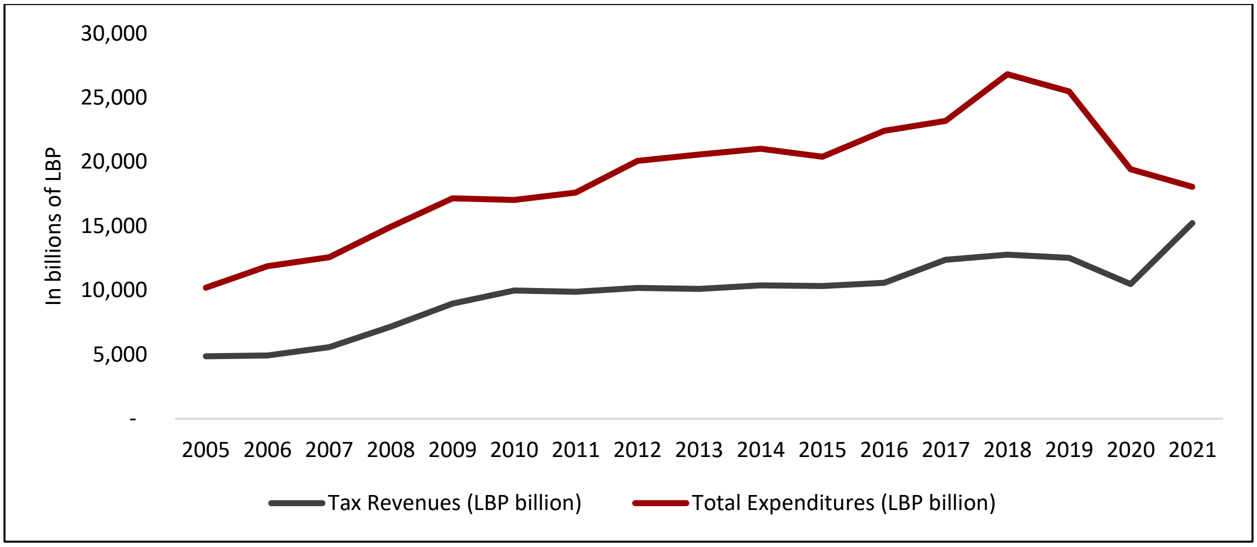
Figure 4: Evolution of tax revenues (Percentage, 2005-2021)



Source: MoF, Public Finance Monitor 2022

- **The increase in tax revenues in 2021 contributed directly to narrowing the tax to spending ratio gap** (Figure 5). **However, this post-crisis fiscal improvement, driven by a spike in revenue collection, is neither sustainable nor expected to last**. In fact, two main factors have led to an artificial drop in expenditures, and these are: (i) the suspension of payment of foreign debt interest at a time debt interests (local and foreign combined) constituted more than 30% of the overall budget expenditures prior to the crisis (IoF, 2021); (ii) the freeze to the salary scale of public servants and (iii) the increase in arrears not fully declared by the Government. Any adjustment of the salary scale is expected to drive the total expenditure to increase exponentially. To achieve fiscal sustainability on the medium term, the Government will need to simultaneously improve its revenue collection and level of spending in a way that can still guarantee a functional public sector.

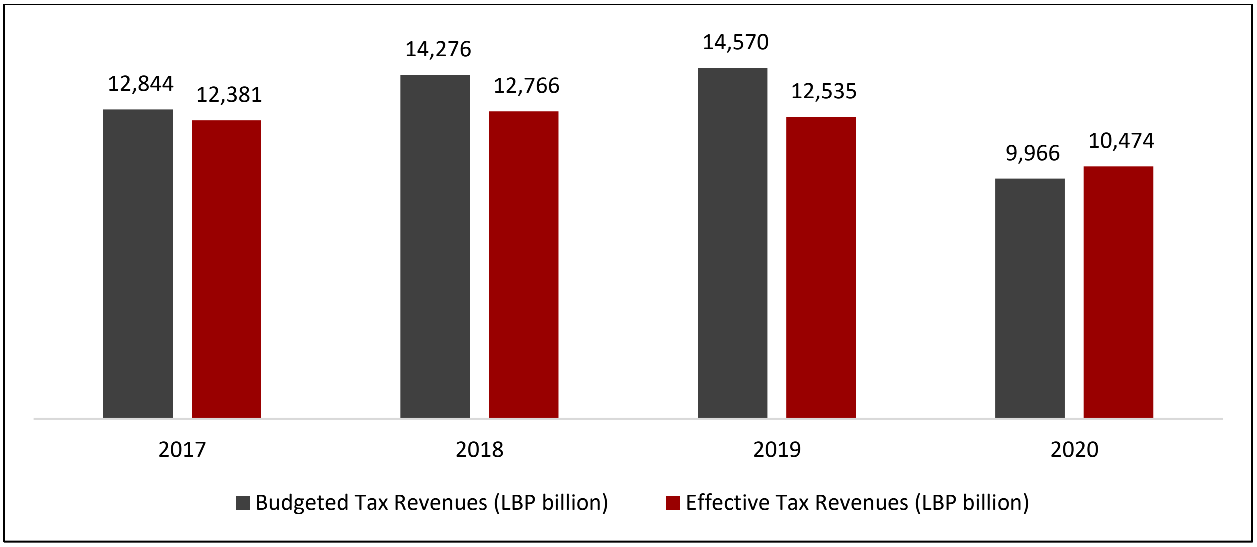
Figure 5: Evolution of tax revenues and expenditures (2005-2021)



Source: MoF, Public Finance Monitor 2022

- **Collection patterns also highlighted weak planning and forecasting capacity**. The MoF systematically tended to overestimate budgeted revenues and to underperform in collecting taxes (Figure 6). This observation underlines (i) the necessity to coordinate the design of tax policies across multiple functions at the Ministry of Finance, including the macro-fiscal forecasting and budgeting units, instead of limiting it to the tax administration, and (ii) to improve the forecasting models underlying budget assumptions and projections.

Figure 6: Effective and budgeted tax revenues (LBP billions)



Source: MoF, Public Finance Monitor 2021

In summary, the tax policy design and implementation did not produce the desired impact in terms of fairness and efficiency notably due to systematic discrepancies between the tax policy and the macro-fiscal context. This has further compromised fiscal sustainability and led to a dramatic revenue decrease while the country was facing the deepest economic crisis in its recent history, and consequent deterioration of public administration and institutions, among which the Tax Administration (TA). While the latter is expected to lead on the tax reform, it is undeniably enduring human capital losses and mass exit.

Section 2: Human Capital on Depletion Mode

This section looks at the current human capacity within the tax administration (TA) and investigates its ability to conduct reform and most importantly to enhance revenue mobilization and keep pace with the latest economic developments.

In fact, the TA is no exception to the public sector and has been facing a systematic depletion of its skilled labor force since the outburst of the crisis. The massive exit was primarily driven by the loss of purchasing power resulting from the currency depreciation, by immigration and by the search for better opportunities in Lebanon or abroad, whether in the private sector or in non-governmental organizations (Institut des Finances Basil Fuleihan, 2022).

In addition, civil servants are facing significant challenges that deteriorated their working conditions, such as (i) difficult access to the workplace due to increasing transportation costs, (ii) losing access to healthcare coverage, (iii) lack of office supplies, toners and other stationery given the administration's inability to secure the needed goods, (iv) offices not well maintained and cleaned due to the disruptions of maintenance services contracts; (v) the systematic shut down of systems after licenses expired, (vi) recurrent power cuts, etc.

On a parallel note, and since staff regulations opened the door for three-month unpaid leaves renewable once[2] and for longer leaves of absence depending on the specific bylaws of public institutions, a large yet not accurately estimated number of civil servants requested those leaves. Many left the administration for good; others took second jobs while waiting for the roll-out of a public sector rescue plan to decide if they would come back.

In what concerns the tax administration in particular:

- The overall performance of existing staff decreased drastically due to deteriorating working conditions in addition to tougher living conditions, exacerbated by the loss of real income value.
- It is expected to run short on capacity on the medium term, while its skilled labor is being recruited elsewhere.
- The administration is not being able to modernize tax policy and align it to international trends. For instance, it has not yet subjected multinational digital companies such as social media outlets to the Lebanese taxation scheme.
- It also lacks the capacity to produce the required reporting and to enhance transparency.
- It failed to adequately predict and prevent the materialization of institutional risks, such as the current exodus of human resources. Even though this was a systemic risk that materialized across the public sector, nevertheless, the MoF could have taken drastic mitigation measures to retain key staff to ensure the continuity of public service.
- As a matter of fact, talent depletion is expected to hamper the administration's capacity to properly resume work and implement reforms as staff that were groomed and trained for years are leaving. This means that years of investment in the capacity-building of staff were lost. Indeed, since the early 2000's, the tax administration benefited from continuous trainings in Lebanon (at the Institut des Finances Basil Fuleihan) and abroad, and from twinning and exchange programs. As such, intensive training and technical assistance have accompanied and facilitated the

[2] As per article 37 in Chapter 6 of the Civil Servants Code - Decree No. 112 issued on 6/12/1959.

introduction of major tax reforms such as the introduction of the Value Added Tax in 2002, and later of the Large Taxpayers Office (2005) and the new Tax Procedure Code as well as Lebanon's adhesion to the Standard for the Automatic Exchange of Financial Account Information in Tax Matters (2017).

- The deteriorating capacity of the administration is further undermining its relationship with taxpayers and heightening the risk of tax fraud and evasion. This marks a major drawback after having won, in 2007, the UN Public Service Award for "Taxpayer Service", an award recognizing the Ministry of Finance's work towards improving services delivered to taxpayers, their quality and timeliness, making it comparable to international standards (United Nations Office, 2007).

In the face of mass exodus, rising absenteeism, declining purchasing power, and skills' depletion, the Ministry of Finance would need to prioritize addressing the continued capacity deterioration of the TA and create the proper environment that would allow to restore the TA's operational performance and equip it with the needed competencies to fulfill its missions.

Section 3: An Underperforming Tax Administration

This section highlights the main challenges and gaps in the tax administration eco-system by examining the various aspects of tax management and procedures. It draws on the TADAT methodological approach to investigate seven different identified outcome areas (Reference table 3) (TADAT Secretariat, 2019) and provides valuable insights for enhancing the quality of the current administrative system and improve the efficiency and fairness of the tax regime in Lebanon.

Among the most challenging shortcomings identified, we cite:

- The poor coordination among tax units, leading to different practices and objectives.
- The poor coordination between tax and non-tax units.
- Staff shortages and the inefficient distribution of HR across the units.
- The lack of automation, including the full adoption of e-declaration and e-payment for all taxes and taxpayers.
- The multiplicity of non-integrated information systems, hindering data and statistics and affecting the quality of reporting and management.
- The lack of investment in modern equipment.
- Weak planning to ensure business continuity, especially when it comes to logistics and HR needs.
- The lack of a political will to implement reforms in the absence of a national strategy, thus reversing the progress previously achieved by the administration.
- The weak environment for efficient accountability.

Table 3: Performance outcomes with reference to the TADAT methodology

##	DESCRIPTION
OUTCOME 1	Integrity of the registered taxpayer base
OUTCOME 2	Effective risk management
OUTCOME 3	Supporting voluntary compliance
OUTCOME 4	On-time filing and payment of taxes
OUTCOME 5	Accurate reporting in declarations
OUTCOME 6	Effective tax dispute resolution
OUTCOME 7	Accountability and transparency

1. Integrity of the Registered Taxpayer Base

“All businesses, individuals, and other entities that are required to register are included in a taxpayer registration database. Information held in the database is complete, accurate, and up to date”.

The integrity of the taxpayer registry is key to ensure an equal treatment of all taxpayers and taxpayer categories. While the mechanism currently in place for taxpayers’ registration and the management of the taxpayers’ base is solid, yet the lack of automated verification and cross-check processes renders the system vulnerable to more informality, increased inaccuracy in information registry, and high risk of cybercrimes.

Table 4: Integrity of the registered taxpayer base - Summary table

STRENGTHS	WEAKNESSES
▪ The administration conducts a verification check to identify the existence or non-existence of an actual physical location for some activities that require a workplace, to limit the number of shell corporations that do not perform actual activities. ▪ Audit and compliance departments verify whether taxpayers are practicing any activity other than what they have registered for. They also verify the cessation of activity by cross-checking external information from the customs administration, commercial registry, syndicates, etc., and comparing it with submitted declarations. ▪ Taxpayers who cease work do not have their registration cancelled if they are still registered in the commercial registry: cessation of work is recorded in their SIGTAS register.	▪ There is no mechanism to avoid cybercrimes and forgery when issuing a tax identification number, since it is a serial number issued by the automated tax system SIGTAS. ▪ The process of matching and cross-examining external information (from the customs administration; land registry and cadastre; commercial registry; national social security fund; syndicates, etc.) with the declarations and data submitted by taxpayers is not automated, and in most cases, conducted manually via excel tables or even on paper. ▪ There is no systematic internal audit of the taxpayers' registry, and no external audit conducted for this purpose. Only quarterly reports on the evolution of the number of registered taxpayers are prepared. ▪ Taxpayers can access their registers online and edit limited options in their profile. Although in some cases, they must report modifications by means of a written form submitted to the competent administration, yet there is not systematic verification of the validity of the modified information.

2. Effective Risk Management

"Risks to revenue and tax administration operations are identified and managed effectively".

Weak risk management would allow for loopholes in the taxation system that favor specific categories of taxpayers at the expense of overall revenue collection. In Lebanon:

- The tax administration has established a risk management process to (i) identify risks based on specific sources of internal and external information, (ii) assess, (iii) rank, and (iv) quantify tax compliance risks.
- Yet, critical loopholes have significantly compromised the quality of the process in place. For instance, the tax administration did not have access to one of the major sources of external information that allows for accurate cross-examination, and that is the financial database of commercial banks, protected by the banking secrecy law. However, the banking secrecy law, which was originally established to improve the competitiveness of the economy and attract fresh capital, was rendered obsolete the moment Lebanon committed to the automatic exchange of information starting 2018, as financial flows of non-resident are automatically reported to their country of origin. Lately, the banking secrecy waiver removed legal obstacles, paving the ground for improved tax audit, but effective implementation is still not on track. Setting modalities on how to implement the waiver is necessary, yet it is dependent on the election of a new president and consequently the formation of a new cabinet.
- In result, systematic tax evasion was practiced by taxpayers over the years, and deliberately overlooked by the tax authority, notably on taxable inherited bank deposits and accounts. For decades, the certificate of inheritance rights provided by religious authorities was sufficient and acceptable to banks to transfer the ownership of accounts without the pre-approval of the inheritance tax department at the MoF. In pragmatic terms, this loophole benefited largely to large depositors, more than small and medium depositors, widening further the inequality gap.
- Another deficiency in risk management was its deviation from the requirements of tax compliance pillars (registering, lodging, reporting, paying). The tax administration did not invest enough efforts to promote compliance and tax awareness as part of its compliance plan.

Table 5: Effective risk management - Summary table

STRENGTHS	WEAKNESSES
▪ The tax administration collects and analyzes internal information to identify risks, in particular studies prepared in the central compliance department and in the compliance offices of the various tax departments, taxpayers' declarations, as well as the research and studies conducted in the tax departments. It also relies on the professional experience of auditors unveiling taxpayers' practices for tax evasion. The tax administration also reaches out to external sources (such as the customs authority, public administrations and institutions, commercial registry, suppliers and customers, syndicates, association of Lebanese industrialists, etc.) to develop its audit programs. ▪ The tax administration uses a risk grid to assess risks associated with each of the main taxes and selects the files to be audited. ▪ Audit and compliance reports are prepared and submitted on a regular basis. ▪ Draft laws and regulations to improve tax compliance are drafted and followed-up on.	▪ External sources used to identify compliance risk in respect to the main taxes do not include the data of financial institutions since the tax administration was not allowed to access such information under the banking secrecy law, until the amendment voted in 2022, that gave the tax administration the right to access bank accounts under specific conditions. ▪ The risk assessment process does not produce a systematic assessment for the compliance pillars (registering, lodging, reporting, paying). ▪ The tax administration does not systematically update its medium-term plan to prioritize field audits resulting from the risk assessment. ▪ Although risk mitigation activities are conducted as part of its compliance plan, the tax administration does not initiate wide-scale activities to improve the overall tax compliance or to promote tax awareness. ▪ Practices used to monitor and evaluate the handling of risks related to the filing of declarations and payment of taxes are not carried out based on a documented process or mechanism or according to standard evaluation criteria. ▪ Feedback received from the economic sectors is recorded, but no assessment is conducted to measure the impact of actions taken to address this feedback. ▪ Although there is a process to manage institutional risks (listing, probability of occurrence, impact, risk mitigation strategies, etc.), the administration was not able neither to predict nor to prevent the risks that have materialized following the economic crisis and the repercussions of covid-19 pandemic. Staff were no longer able get to work and the administration failed to meet the basic requirements for a proper work environment. ▪ The administration is witnessing significant staff exit, therefore draining its capacity to address mounting challenges.

3. Supporting Voluntary Compliance

"Taxpayers have the necessary information and support to voluntarily comply at a reasonable cost to themselves".

Supporting voluntary compliance is key to achieve greater fairness, as small taxpayers are more prone to commit errors during the filing and declaration processes and therefore more likely to be subject to fines compared to large taxpayers. Since the latter are mostly companies, they have both the obligation and the financial means to hire professional accountants and auditors while small taxpayers handle their tax duties individually.

- A quick observation of the MoF website highlights the lack of updated tax information to the public, rendering the filing process for small taxpayers lengthy, complex, and costly.
- Even though the range of information available on the website is abundant, it is not always made available in simplified terms, easy-to-understand by the public.

Table 6: Supporting voluntary compliance - Summary table

STRENGTHS	WEAKNESSES
▪ The taxpayers' obligations and information are published on the Ministry of Finance's website such as the deadlines for filing declarations and payment, forms, and guides prepared by the administration. ▪ The administration uses multiple channels to facilitate taxpayers' compliance, such as social media, mobile applications, relevant seminars, etc., as well as press releases and media interviews. ▪ The administration significantly eased the accounting burden on small taxpayers.	▪ Although most information related to the registration, filing of declarations, payment, and taxpayers' rights, is available and published, it is not updated on a regular basis. ▪ The call center established to answer citizens' inquiries or requests 24/7 is no longer active. ▪ The MoF disburses part of the tax fines collected during the fiscal year in the form of a bonus annexed to the salaries of the staff, thus creating a conflict of interest. ▪ The time taken to respond to taxpayers and tax intermediaries' requests is not monitored. No measure is being taken to improve the administration's response time. ▪ The administration does not collect feedback from taxpayers on a regular and systemic basis.

4. Timely Filing and Payments of Taxes

"Taxpayers file tax declarations and pay their taxes in full on time."

Recurrent delays and grace periods create room for inequality among taxpayers in terms of cash management and of real tax paid in times of devaluation.

- The timely declaration of corporate income tax (CIT), personal income tax (PIT), value-added tax, and tax on wages and salaries, is an indicator of the effectiveness of the mechanisms adopted by the tax administration to follow-up on taxpayers who fail to comply with the statutory due date (non-filers) for tax declaration, and of the level of ease in filling out and submitting declaration forms.
- Yet, the laxity in keeping the tax calendar has opened the room for unfairness towards regular tax filers, as non-filers have repeatedly managed to delay their tax filing. Such practices were excessively harmful in times of monetary crisis: as the currency devaluated, non-filers were paying relatively less taxes in real terms, and the state was bearing an increased opportunity cost in terms of real tax collection.

Table 7: Timely filing and payment of taxes - Summary table

STRENGTHS	WEAKNESSES
▪ 75% to 90% of taxpayers subject to corporate income tax fill their tax declaration on time. ▪ 95% of large taxpayers subject to corporate income tax fill their tax declaration on time. ▪ 75% to 90% of taxpayers subject to personal income tax fill their tax declaration on time. ▪ 75% to 90% of taxpayers subject to VAT fill their tax declaration on time. ▪ 95% of large taxpayers subject to VAT fill their tax declaration on time. ▪ 75% to 90% of taxpayers subject to income tax on salaries and wages have their tax declaration filed on time by their employers. ▪ 75% of main taxes are paid electronically via the banking sector or regular mailing services. ▪ Many taxes are being withheld at the source (e.g., income tax on salaries and wages, tax on dividends, tax on bank interests, tax on sums paid to non-residents, tax on profits resulting from service provision, management allowances or similar, or goods/royalties). ▪ The ratio of the VAT declarations for which due tax is collected to the total number of VAT declarations exceeds 90%.	▪ The publication of the tax calendar on the MoF website and its dissemination via regular and social media is not sufficient to encourage non-filers to comply. ▪ The administration's recurrent usage of legal buffers providing grace periods in specific cases gives a negative signal to non-filers who repeatedly abuse the system. ▪ The administration's recurrent deduction on penalties encourages the taxpayers not to declare and pay their dues. ▪ Although most of large taxpayers file their taxes electronically, however, the rate of e-declaration for small taxpayers whether subject to corporate income tax or personal income tax does not exceed 50%, noting that the number of small taxpayers is considerably high, and that the latter are not bound by the law to electronically file declarations. ▪ The payment in advance system is not mandatory by law. Choosing the method of payment rests on the taxpayer, increasing the risk of tax debts. ▪ The level of tax arrears is sizable and exceeds the minimum threshold set by the TADAT.

▪ The amount of the VAT collected on time makes up about 90% of the total amount collected.	▪ Not provided for by the law, old uncollectible debts are not written off. ▪ There is no systematic mechanism to separate uncollectible debts from collectible debts by order of priority, according to the volume of amounts or based on other criteria.

5. Accurate Reporting in Declarations

"Taxpayers report complete and accurate information in their tax declarations".

Ensuring the accuracy of tax declarations is key to guarantee a fair system. In a context of weak audit, the likelihood of under-paying or tax evasion increases drastically, thus penalizing indirectly regular filers.

- Prior to the crisis, the Tax Administration used to follow a systematic and standardized audit program to detect and deter inaccurate reporting. Tax departments used to set an annual audit plan based on the number of auditors, working days, and working hours required for each type of audit (desktop, directed or comprehensive), and covering all categories of taxpayers, while a separate plan was developed to cover large taxpayers.
- The plan was updated on a monthly and quarterly basis for the value added tax, and on quarterly basis for the income tax.
- Reports showing results for each type of audit, namely directed audit, field audit, and desk audit, were prepared on a yearly basis. Auditors used to conduct their audit under the supervision of senior auditors. Procedures followed during the audit were aligned to the comprehensive audit manual. Information was exchanged between the Directorate of VAT and the Directorate of Revenues, and sometimes joint audit programs were conducted.
- With the crisis, and due to the massive exit of civil servants, audit programs were no longer conducted on a regular and systematic basis. Coverage was significantly reduced to target high-risk taxpayers which are large taxpayers and corporations. In terms of equal treatment, taxpayers today face different probabilities of being subject to an audit, with small taxpayers being more likely to attempt tax avoidance compared to large taxpayers.

Table 8: Accurate reporting in declarations - Summary table

STRENGTHS	WEAKNESSES
▪ The tax administration has built a solid history of audit practice. ▪ Crosschecking is carried out with several official entities. ▪ Declarations and audit report results are achieved and can be easily accessed and reviewed.	▪ The crisis has significantly weakened the audit capacity built over the last decade, causing the administration to drop regular and systematic audit programs. ▪ In the context of human resources shortage across the administration, it is more likely that the audit programs, if any were to be conducted, would target mainly large taxpayers. ▪ The assessment of the audit programs' impact on taxpayers' compliance is irregular, random, and unsystematic (even prior to the crisis). ▪ No automated crosschecking is carried out. It is rather executed manually, either through excel or by accessing the concerned public entity's system. ▪ Crosschecking was not being carried out with the banking sector due to the banking secrecy law. ▪ The tax gap, resulting from inaccurate reporting, is not monitored, leading to the non-collection of large amounts of taxes.

6. Effective Tax Dispute Resolution

"The tax dispute resolution process is fair and independent, accessible to taxpayers, and effective in resolving disputed matters in a timely manner".

- There is an independent, workable, and graduated dispute resolution process established by law and all taxpayers have equally the right to resort to objection and appeal procedures.
- Overall, tax dispute resolution is effective; yet improvements in terms of timeliness and autonomy vis-à-vis the tax administration are necessary.

Table 9: Effective tax dispute resolution- Summary table

STRENGTHS	WEAKNESSES
▪ Taxpayers have the right to challenge the tax administration's decision. ▪ Objections are processed by an independent unit. ▪ If the dispute resolution outcome is not satisfactory to the taxpayers, they have the right to appeal to a specialized committee headed by a judge (affiliated to the Ministry of Justice). ▪ Taxpayers are also entitled to appeal the objections committee's decision to the State Council, considered as the supreme judicial authority. ▪ Information on the objection's rights and schedule is communicated to taxpayers.	▪ The appeal committee is not totally independent due to the presence of a tax administration representative on the committee. ▪ The statutory period for completing the objection review process in the Lebanese tax administration is set for six months, while the maximum period, according to international standards (TADAT) is of 90 days. ▪ The administration is not required to change the way it handles cases similar to cases lost and closed by the state council, since the latter's decisions are binding only in the case of objection.

7. Accountability and Transparency

"The tax administration is transparent in the conduct of its activities and accountable to the government and community."

Accountability and transparency are at the heart of good governance and key requirements to revive and establish a relationship of trust between citizens and the state. In a context of opacity, taxpayers are refrained from their right and duty to monitor, assess, and render the government accountable for its policy choices.

- Overall, the tax administration lacks transparency when it comes to the internal or external audit of its performance.
- Weaknesses listed under table 10, ranging from the lack of expertise to the quasi-nonexistence of two-ways communication channels with taxpayers, render the latter incapable of holding the administration accountable for its performance.

Table 10: Accountability and transparency - Summary table

STRENGTHS	WEAKNESSES
▪ Many reports related to taxpayers are saved on an internal system. User access is subject to specific parameters set by the administrator who has the capacity to alter access rights and controls. ▪ The departments of administrative affairs in the Directorate of Revenues and the Directorate of VAT supervise internal work and employees' compliance with processes, and prepare reports requested by the director.	▪ There is no internal audit unit within the tax administration. ▪ No annual internal audit plans are prepared. ▪ There are no specialized or trained teams to carry out internal audits. ▪ Reports are not archived in a professional way allowing for their review when needed. ▪ There is no code of conduct for the tax administration. ▪ Results of external audits are not published. ▪ Information and statistics are not saved systematically. ▪ No survey is conducted to capture the public's perception regarding the administration's integrity. ▪ Financial and operational performance are not made public. ▪ Tax administration's plans are not made public.

Section 4: Fairness and Efficiency Gaps Across the Board

This section attempts to identify the deficiencies and gaps compromising the quality of the taxation scheme and its design. It also looks at the various key amendments that occurred during the crisis and how they impacted fairness and equity considerations.

Evidence highlighted significant loopholes in the progressivity design among progressive taxes including specific income taxes, inheritance tax, and property tax, noting that the main reason behind attenuated progressivity is the lack of cumulative filing. It also suggested that standardizing the criteria for special treatments, including exemptions and deductions, is key to restore a minimum level of fairness.

1. Progressivity Gaps

- **Lebanon adopts a basic dual income tax scheme that levies a proportional tax rate on all net income generated by any type of capital, combined with progressive tax rates on labor income.** For instance, self-employed professionals and employees' income is subject to progressive taxation while corporate income is subject to flat taxation. While this study does not attempt to discuss either the validity or the efficiency of such a scheme, it highlights several loopholes that undermine the effectiveness of existing progressivity. Progressivity gaps were also captured under other categories of taxes such as built property taxes, inheritance tax, and VAT.
- **Non-residents are not subject to progressivity**. They are subject to a flat tax of 15% on their taxable income after applying a predetermined profit margin of 50% on all revenues. For decades, the tax administration has tolerated that non-registered self-employed professionals apply non-resident tax filing procedures (which does not require the taxpayer to have a TIN). For example, if an individual contractor is not registered in the MoF taxbase and does not have a TIN, the "employer" (whether an individual taxpayer or a registered company) had the possibility to withhold the equivalent of 7.5% (15% tax applied to 50% predetermined profit margin) of total revenues and pay it to the administration. The rationale behind this practice was to guarantee an income stream from the informal sector. However, this practice has allowed self-employed professionals to short circuit progressivity for taxable brackets equivalent and superior to the 7% rate.

  For instance, a registered self-employed professional (who reached a turnover above 100,000,000 LBP (sum of bracket 1 and bracket 2) before the end of the fiscal year, can ask its temporary "employer" or "contractor", when signing a new contract, to be declared as non-resident, and consequently pay a maximum tax rate of 7.5%. He/she is less likely to be cross-checked for multiple reasons: (i) he/she is among the small taxpayers therefore he/she is not on the priority list because of the low opportunity cost, (ii) when declared as non-resident, the TIN - which is a unique number for registered taxpayers- is no more useful for cross-checking, (iii) cross-checking using the name is very time consuming and inefficient.

Table 11: Self-employed professionals - Tax rates per Bracket - Amended

BRACKET NO.	BRACKET ASSOCIATED WITH YEARLY REVENUES (LBP)	RATE (%)
1	1-27,000,000	4
2	27,000,000-72,000,000	**7**
3	72,000,000-162,000,000	12
4	162,000,000-312,000,000	16
5	312,000,000-675,000,000	21
6	More than 675,000,000	25

Source: 2022 budget law

- **Labor income tax is not cumulatively progressive** among the different categories. As mentioned previously, labor income tax is progressive for self-employed professionals and for employees. For instance, if an individual is registered for multiple professions, the progressive tax is applied to the cumulative income generated by all professions. But for an employee that generates an income from another profession (e.g., university professor and part-time consultant), each source of income is taxed separately, and the taxpayer is expected to file the R8 declaration for the tax difference resulting from the double deduction only.
- **Prior to the amendments brought by the 2022 budget law, the devaluation of the national currency and co-existence of multiple exchange rates have reversed existing income tax progressivity.** The law stipulated for taxable amounts collected in foreign currencies to be converted to LBP based on the official exchange rate for tax filing. In between 2019 and 2021, income earners in fresh foreign currency filed and paid taxes on the basis of an exchange rate equal to 1507.5 LBP per dollar while the real value of their earnings was much higher. Technically, and over that period, labor income tax was applied on a regressive basis.

  For instance, if a self-employed professional "X" earned in 2021 a total of 45,000,000 LBP while self-employed professional "Y" earned a total 30,000 USD in foreign currencies, and after applying all deductions, both paid the same amount of annual tax, amounting to 300,000 LBP, while the real value of the total earned by "Y", based on an average of daily market exchange rate between 1/1/2021 and 31/12/2021, would be equal to 505,000,000 LBP, and be 11 times higher than "X"'s earnings.
- **The amendments introduced by the 2022 budget law also reversed existing progressivity on the income tax, and the gap was amplified by the monetary devaluation for a specific category of individuals**. The amendments stipulated that employees' income tax should be withheld on the basis of an exchange rate equal to 15,000 LBP per dollar and might be subject to further increase while the income brackets used to calculate the tax amount were not increased proportionally. As such, an individual "X" getting paid in USD would see its tax due increase as the local currency devaluates against the USD. For instance, an employee X (single) receiving a monthly wage of USD 2,000 would see its tax rate associated with the upper bracket increase from 7% to 11% (Reference table 12). On a positive note, corrective measures were foreseen in the 2023 draft budget to address the exchange rate gap; yet no significant results can be measured as the report was being written.

Table 12: Progressivity sensitivity to changes in the official exchange rate

FISCAL YEAR	ANNUAL REVENUE (USD)	OFFICIAL EXCHANGE RATE AS BASIS FOR TAX CALCULATION	EXCHANGE RATE ON THE BLACK MARKET	OVERALL TAX AMOUNT IN LBP/YEAR	REAL VALUE OF THE TAX AMOUNT (USD)	UPPER BRACKET IN LBP	RATE ASSOCIATED WITH THE BRACKET
2019	24,000	1,515	1,515	1,475,610	974	Between 15M and 30M	7%
2020	24,000	1,515	6,705	1,475,610	217	Between 15M and 30M	7%
2021	24,000	1,515	16,820	1,475,610	87	Between 15M and 30M	7%
2022	24,000	15,000	30,313	14,005,000	462	Between 30M and 60M	11%

Source: Author's calculations

Table 13: Different tax application to the same taxbase

FISCAL YEAR	PERIOD DESCRIPTION	WAGE EARNED IN USD	APPROXIMATE TAX WITHHELD (EQUIVALENT IN USD)
2019	Prior to the crisis	24,000	974
2020	Yearly average exchange rate on the parallel market: 6,705 LBP	24,000	217
2021	Yearly average exchange rate on the parallel market: 16,820 LBP	24,000	87
2022	Yearly average exchange rate on the parallel market: 30,313 LBP	24,000	462

Source: Author's calculations

- **Under the same amendment brought by the 2022 budget law, tax discrepancy was accentuated across labor income tax categories.** As shown in table 13, an employee "X" earning USD 24,000 a year would have to pay the equivalent of USD 462 in tax dues, while and a self-employed individual "Y" earning the same amount, would be technically exempted from paying taxes as he/she benefits from a 60% discount applied to profit.

- **Built property tax is not cumulatively progressive**, which means that progressivity is restrictively applied to each property and not to the cumulated real-estate portfolio of the owner. As shown in table 14, if each of the assets is own individually, the average tax to asset value would be progressive. But, if all properties are owned by the same individual, at some point, progressivity would be reversed and the average tax to asset value would decrease as the portfolio's size grows.

Table 14: Progressivity of the built property tax - Examples.

NO	ASSET VALUE (USD)	RENTAL (USD)	APPROXIMATE TAX (EQUIVALENT IN USD)	AVERAGE TAX TO ASSET VALUE
1	300,000	1,500	200	0.067%
2	550,000	3,000	900	0.16%
3	1,000,000	7,000	4,000	0.4%
TOTAL	1,850,000	N/A	4,920	0.26%

Source: Author's calculations

- **Inheritance tax was subject to systematic evasion**. Although the inheritance tax is designed to be progressive, part of the taxable amount, which is composed of bank accounts, was being transferred without the pre-approval of the inheritance tax department at the MoF, and consequently, was not taxed. As such, individuals who inherited large deposit bank accounts benefited extensively from this systematic tax evasion, thus flattening the progressivity of the tax.
- **The VAT, which is the main source of revenue for the Lebanese government, is regressive on disposable income.** Although, by nature, the tax rate is proportional and applied equally on consumption, households with lower income pay proportionally a higher share of their income as a tax on basic needs, since the marginal propensity to consume basic goods and services decreases when income increases. For instance, a household "X" with a net income of USD 1,000 would spend 30% of its income on food (USD 300), while a household "Y" with a net income of USD 20,000 USD would spend 15% of its income on food (USD 3,000). When applying the same VAT rate to both, household X, earning the lower income, would pay relatively more taxes compared to the higher-earning household (Reference table 15).

Table 15: Example of regressivity on the VAT

INDIVIDUAL	NET INCOME (USD)	PROPENSITY TO CONSUME FOOD (%)	CONSUMPTION (USD)	TAX APPLIED (USD)	TAX TO INCOME RATIO (%)
X	1,000	30	300	33	3.3
Y	20,000	15	3,000	330	1.65

Source: Author's calculations

2. Progressivity Levels

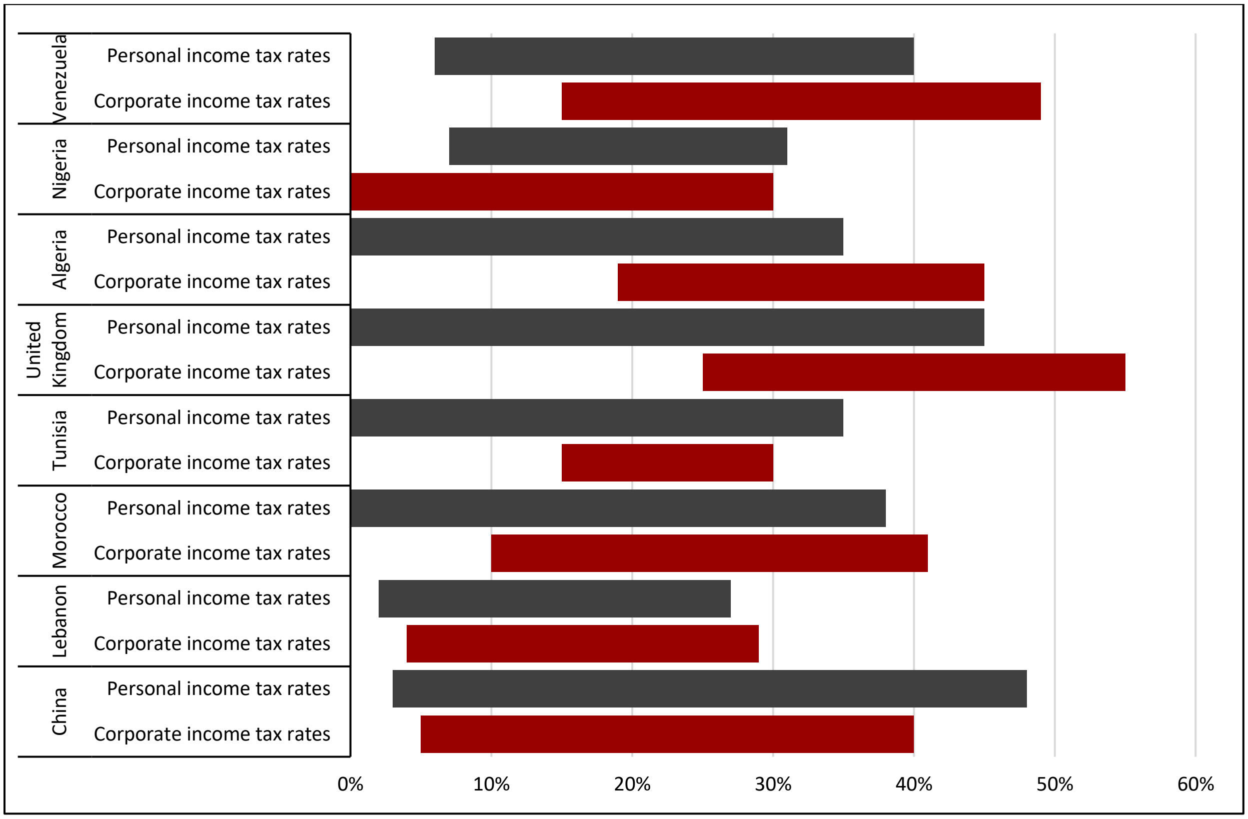
This sub-section discusses the challenges hampering the progressivity levels applied to income taxes. Inheritance tax and the built property tax were ruled out from the analysis since their main loopholes were outlined in the previous section.

- **Lebanon is among the countries with a narrow and low range of income tax.** The maximum rate applied to personal income tax associated with the higher income bracket (25%) is the lowest among the selected countries in figure no 7 while this rate reaches 45% in other countries. Also, the highest rate for corporate income tax (27%) is among the lowest among the same pool of countries, while it exceeds 50% in other countries (PWC, 2023).

- **The upper brackets could be further split, and tax rates consequently increased**. If the government is neither willing to introduce progressive taxation on corporate income nor increase current rates, to avoid a potential flee of capital that cannot be compensated by other competitiveness factors, it could, however end the excessively favorable income tax treatments such as (i) the exemptions related to taxation on holdings and offshore companies' dividends distribution, (ii) the exemptions related to capital gains generated from the sale of shares in joint stock companies, and others. Yet, taxing holding companies in full could be easily contested as double taxation.

- **While many would argue that the dual income taxation scheme, as mentioned previously, allows for a flattened progressivity, it does not technically prevent the implementation of a unified income tax that would at least enhance the progressivity of labor-generated income**. A unified income tax uses the taxpayer's aggregated income from all sources as a basis for taxation, which is the most objective criteria to assess the taxpayer's capacity to bear the tax burden. Fairness is only reached when progressive taxes are imposed on aggregated sources of revenues. This would allow savings in management and collection costs, but require a tax administration that has technical, administrative, and legal competencies, to be able to implement e-declarations and e-payments. The unified income tax may also be applied to households, leading to further equity.

Figure 7: Personal and corporate income tax ranges – Country comparison



Source: PwC, Worldwide Tax Summaries 2023

3. Preferential Tax Treatments

This sub-section investigates the scale and range of preferential treatments granted for specific categories of taxpayers or for specific sectors.

- **Preferential treatments including deductions and exemptions are tailored in favor of either specific sectors/industries or specific categories of taxpayers**. Yet, their excessive use makes it difficult for the administration to manage its taxation procedures, complicates law enforcement, increases the risk and likelihood of discretionary implementation of the laws, and heightens unfairness.
- The compilation exercise showcased in the Compendium of Tax Laws and Regulations, Table 1, has brought to light multiple observations.
- For all taxes covered by this study (income taxes, inheritance tax, built property tax, and the VAT), exemptions were granted for at least 135 categories of individuals and industries, and special deductions to at least 27 categories of individuals.
- 61% of exemptions and 50% of deductions were granted by laws.
- Income taxes were subject to more than 50 types of exemptions (41% of total exemptions captured by this study) governed by 25 different legal texts.
- VAT was subject to 32 types of exemptions.
- The industrial sector benefited from exemptions mainly related to income taxes.
- The education sector was exempted from corporate income tax and VAT.
- Religious organizations and clerics were exempted from the (i) built property tax, (ii) income tax on salaries and wages, (iii) income tax on profit from industrial, commercial, and noncommercial professions, (iv) and inheritance tax.

As clearly stated by the IMF, tax incentives were granted to specific form of companies (notably holding companies and offshore companies), sectors (including transportation, manufacturing, agriculture, tourism, IT, communication, and agro-industry), and regions in an excessive manner (IMF, 2023). Preferential treatments should be significantly tuned down by the tax administration, especially that a large number was assessed as ineffective, inefficient, and distortionary, and above all as a main driver for the widening inequality gap across taxpayers and categories of taxpayers.

However, the fragmented legal framework renders this task quite complex.

Table 16: Number of tax exemptions by sector

SECTOR/INDUSTRY	BUILT PROPERTY TAX	INCOME TAX	INHERITANCE TAX	VALUE ADDED TAX
AGRICULTURE		2		4
ALL SECTORS		13		
ASSET-BASED FINANCING AND SECURITIZATIONS		1		
AVIATION AND MARITIME NAVIGATION		1		
BANKING		5		2
BETTING GAMES AND LOTTERIES				1
COOPERATIVES		1		
CRAFT		1		
DIPLOMATIC FIELD		1		
DOMESTIC WORK		1		
EDUCATION SECTOR				1
ENVIRONMENT		1		
EXPORTS				2
FOOD				1
HEALTHCARE				3
IMPORTS				4
INDUSTRIAL SECTOR	2	6		
INHERITANCE			12	
INSURANCE		1		1
JEWELRY				1
MEDICAL SECTOR		1		
MILITARY		2		
OIL AND GAS				1
PARAMEDICAL SECTOR		2		
PRINTINGS				1
PUBLIC SECTOR		3		
REAL ESTATE		1		
RELIGIOUS ACTIVITIES		1		
SOCIAL PROTECTION		1		
TECHNOLOGY AND IT		1		
TRANSFER OF OWNERSHIP			1	
TRANSPORTATION				3

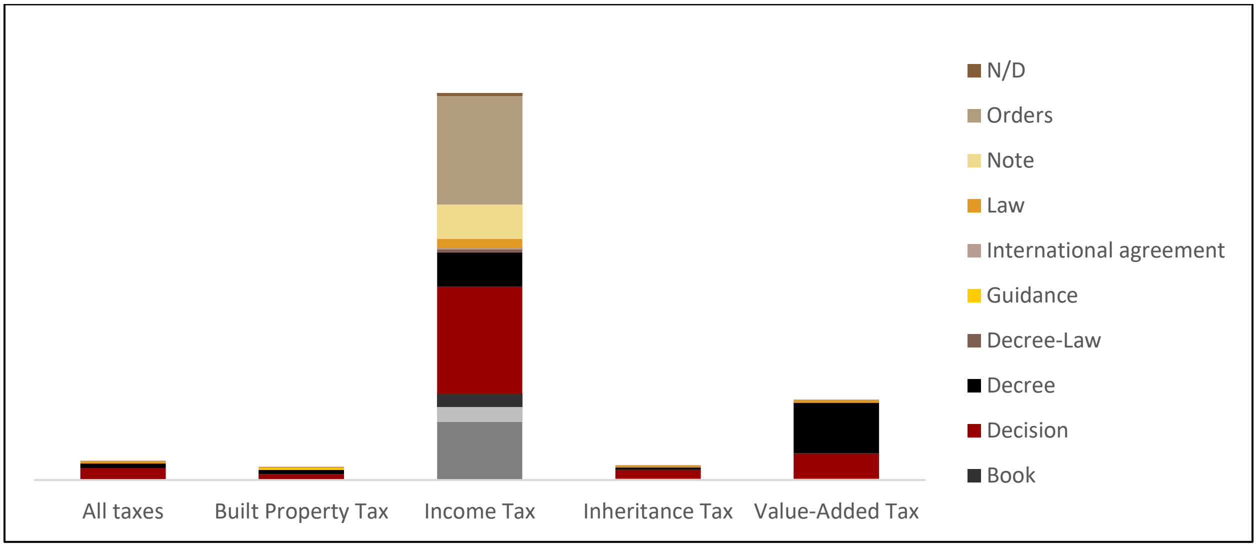
* This table might not be comprehensive

Section 5: A Fragmented Legal Framework

This section highlights the fragmentation in tax procedures and legal framework. It compiles all laws, decrees, decisions, amendments in budget laws, and other legal texts related to income tax, VAT, inheritance tax, and built property tax, pointing to shortcomings in the current framework.

- **The prevailing weak and fragmented legal framework is equally harmful to the taxpayer, the overall system, and the tax administration.**
- **A multiplicity of legal texts-350 different legal and administrative texts governing the above-mentioned four taxes, of which 258 are related to income taxes and 54 are related to the VAT alone-** (Figure 8) **govern tax procedures and numerous legal texts grant exemptions to various categories.** For instance, 55 exemptions to income taxes are granted through 33 different decree-laws and 22 others are granted through different laws. This fragmentation is largely detrimental to law enforcement and makes it extremely difficult for the administration to manage its tax procedures. It increases the risk and likelihood of discretionary implementation of the laws and heightens inequity.
- The ad-hoc amendments of tax rates, usually passed in the budget bill and contested on multiple occasions, have weakened the overall system, and reversed the progressivity of specific taxes.
- The overall low tax rates and numerous tax exemptions (cf. Compendium of Tax Laws and Regulations, Table 1) granted to encourage investments and the industrial sector have not paid off. Instead of improving the business environment, they have generated sizable opportunity costs in terms of tax collection.
- The issuance of tax amendments, through various legal channels, and based on circumstantial needs, with no anchor in an economic strategy or national sectoral plans, has substantially weakened the role and undermined the impact of tax policy.
- Ad-hoc amendments have also crowded out the desired impact of having a unified tax law that aimed to simplify tax procedures and address inconsistencies across the various laws.

Figure 8: Count of type of legal texts



Chapter 2 – Building a Better Taxation System for Lebanon

In view of the above assessment, this chapter attempts to provide a theoretical and practical framework to initiate the dialogue on how an enhanced or revamped tax system can help restore both growth and equity.

Section 1: What Makes a System Fair?

Attaining a fair taxation scheme depends on the social contract in each country. It is reached as far as the authorities succeed in reconciling taxation objectives with economical and societal developmental goals and ensuring that the tax burden is fairly distributed across the various categories in society. In general, advocates of tax fairness believe that taxes should be based on the individuals' ability to pay, while at the same time the government should be able to provide services that cater for the needs of society in ways that maximizes value for the money.

A system considered "fair" should be able to answer to the following questions:

- **Is the tax burden distributed evenly?** This question applies to all taxes (incomes taxes, sales taxes, property taxes, etc.), all sectors (education, healthcare, tourism, etc.) and every group of individuals. Policy making should be able to justify reasonable special treatments and their potential positive impact on the economy and society.
- **Are most citizens paying taxes and subject to a relatively fair burden?** The system should be designed as a whole and avoid granting exemptions on an ad-hoc basis. Income tax on wages should not be the main source of revenue for the state while other income taxes targeting corporate or self-employed professionals remain under exploited.
- **Is the administration ensuring fair implementation?** This relates directly to corruption practices and whether specific categories of taxpayers are reverting to political connections to bypass the system.
- **Could the tax system be more progressive?** This relates directly to the level of progressivity applied across different taxes, including the extent to which applied tax rates are high enough, and whether there are loopholes, including excessive exemptions, that limit or reverse progressivity.

Efforts to achieve more fairness in the taxation system (Mansour, Mitra, Carlo A., & Jewell, 2015) should be aligned with a clear vision of the fiscal role of the state including allocation, redistribution, economic growth, and stabilization. This justifies the call for a customized system design based on both the economic and social context and on the macroeconomic conditions of each country apart.

Ultimately, a sound system should be able to guarantee the core principles of taxation listed in table 17.

Table 17: Core principals of a taxation system

PRINCIPLE	ELABORATION
HORIZONTAL EQUITY	Taxpayers in similar conditions should pay similar amount of taxes
VERTICAL EQUITY	Taxpayers who are better off, should pay at least the same portion of income in taxes as those who are less well off
ADEQUACY	When the taxes provide enough to meet the basic needs of society
SIMPLICITY	When taxpayers understand the system better and reduces the cost of compliance, the system is easy to use avoiding forms and filing requirements
TRANSPARENCY	When taxpayers can easily know where their money is going and how it is used
ADMINISTRATIVE EASE	When forms are not complicated but can be easily went over, the state can tell if taxes are paid on time and correctly. The cost of collecting a tax should be very small in relation to the amount collected
FLEXIBILITY	Taxation systems should be flexible and dynamic enough to ensure they keep pace with technological and commercial developments
NEUTRALITY	Taxation should seek to be neutral and equitable between forms of business activities
EFFICIENCY	Compliance costs to business and administration costs for governments should be minimized as far as possible

Source: OECD, Addressing the Tax Challenges of the Digital Economy: Fundamental principles of taxation 2014

Section 2: What have Other Countries Done?

Country examples from around the world have shown that there is no single way of approaching tax reform and that it all depends on the political orientations of the government in place, the social contract, the macro-economic context, and other country-specific factors. What could be seen as reform measures in one specific country might be considered a deficiency in another.

Yet, one key conclusion is to be retained: framing the reform in a strategic vision and adopting a comprehensive approach is a requirement for success. For instance, when looking at their path for tax reform:

- Morocco's initial plan was to support the economy while improving fairness.
- Italy's main objective was to reduce inequality.
- Brazil wanted to promote tax neutrality. Had it implemented a comprehensive reform, it could have increased productivity and output growth.
- UAE's main objective was to reduce its reliance on oil revenues.

1. Enhancing Fairness in The Moroccan Tax System

Morocco identified three strategic reform areas back in 2013: (i) widening the tax base, (ii) reducing tax expenditures, (iii) and restoring a relationship of trust between the tax administration and taxpayers. Historically, the Moroccan tax system suffered from a narrow taxbase because of excessive exemptions and a large informal sector: almost 80% of corporate taxes were paid by only 2% of enterprises and 70% of revenues generated by income taxes were paid by wage earners. The VAT resulted in a large accumulation of refund credits. The Moroccan administration started introducing several reform measures in its 2014 budget law, among those: (i) taxing large agricultural enterprises, as a first step toward the full taxation of the sector, (ii) enforcing the taxation of self-employed and liberal professions to enlarge the tax base, (iii) and reforming the VAT regime and clearing the stock of VAT tax credits coupled with a reduction of inappropriate exemptions (Mansour, Mitra, Carlo A., & Jewell, 2015).

Morocco could have increased the beneficial impact of the reform with additional measures addressing inequalities through additional progressivity and supporting growth through more targeted production incentives and enhance revenue mobilization (International Monetary Fund. Middle East and Central Asia Dept., 2018).

2. Reforming Personal Income Tax in Italy

In 2021, Italy introduced several reform measures to simplify the tax system and enhance fairness although it was expected to result in narrowing the PIT base and in a drop of overall tax (Cammeraat & Crivelli, 2020). The reform included: (i) a reduction of the income tax brackets, (ii) a reduction of the marginal tax rates, (iii) an increase of tax credits for lower and middle -income and decrease for higher-income earners, (iv) the introduction of a single universal allowance to replace existing child tax credit and other benefits (e.g., child allowance).

Despite Italy adopting context-specific measures, tax reform was comprehensive and focused on lowering the burden on labor income, broadening the VAT base while abolishing reduced rates for goods and services consumed by wealthier households, updating the property valuation system, in addition to other measures.

3. Increasing Tax Rates in Brazil

In 2021, Brazil increased its tax rates on specific capital income, to promote neutrality in the tax system. As part of a comprehensive income tax reform, Brazil revised its taxation of income earned in financial markets to strengthen neutrality between different types of investments (Coelho, 2021). A key component of the reform was the introduction of a 15% withholding tax on dividends' distribution. Yet, the IMF issued a recommendation for a comprehensive tax reform that would eliminate, in addition to special CIT regimes, PIT deductions and consumption tax exemptions, with the aim to increase productivity and potential output growth, and lower overall income and geographic inequalities.

4. Broadening the Tax Base in Austria

In 2021, Austria introduced a tax on income from crypto transactions by which income derived from crypto currency sales was subject to a flat rate of 27.5% (equivalent to the capital gains tax rates). Income from crypto currencies includes the current income generated from crypto currencies as well as income derived from increases in realized values (Federal Ministry, Republic of Austria, Finance, 2023). The OECD is also developing a global tax transparency framework to facilitate the automatic exchange of tax information on transactions in crypto assets in a standardized manner (OECD, 2023).

5. Radical Change in the UAE

The United Arab Emirates announced a radical change in their tax system, introducing a generalized Corporate Income Tax as of mid-2023. This is a federal corporate tax on business profits that will enter into force in Q3 2023. The proposed CIT rate of 9% on taxable income above USD 100,000 is expected to apply to all activities in the UAE (KPMG, 2022).

6. Fundamental Tax Reforms Egypt

Egypt introduced fundamental tax reforms between 2005-2016 covering three major tax areas: (i) the modernizing of the income tax in 2005 with particular focus on encouraging self-tax commitment, strengthening trust between the tax administration and taxpayers, simplifying procedures, and automating the system; (ii) the introduction of a new property tax in 2008; (iii) and replacing the sales tax by a VAT in 2016. The 1st reform measure had a significant impact on state revenues and on the economy, with tax revenues skyrocketing the year after, steady increases in Foreign Direct Investment, and an improved business environment. The application of the VAT has also significantly increased the collection of consumption taxes and the overall tax revenues (Gamaledin Awad, 2019).

Section 3: What Can Lebanon Do?

The Lebanese example is a particular case given the complexity of its political economy. While today's dire circumstances might increase the appetite for reform, on the other hand, resistance to change remains high. Obstacles to reform come from inside and outside the administration, ranging from distrust in the state, vested interests, political cleavages, weakened administrative and HR capacity, and a poor governance system. Moreover, the crisis might have inflicted the tax administration with hardly reversible damages.

Reform measures should be designed and tailored to incentivize quick wins and create solid ground for a fairer and more efficient tax system. However, given current circumstances and the challenges listed above, questions as to the future of the tax system are numerous: To what extent can the Lebanese government design and tailor reform measures and expect positive outcomes without initiating an open dialogue with its citizens? How can any reform, regardless of its relevance, be consistent with citizens' aspirations for a fair and progressive society under the same old broken social contract? How can Lebanon design taxation reform without answering first questions related to the kind of state that citizens want?

This section does not intend to bring answers to these questions, but rather suggest a roadmap for the possible ways forward.

It would be recommended and more beneficial for Lebanon to follow a comprehensive approach to reforming its tax system (Reference table 18), yet it is believed that some measures are able to bring stability and reverse the downward trend of tax performance.

1. Scenario 1: Towards a revamped tax system and scheme

Scenario 1 is based on anchoring the reform into the political discussion. It consists of initiating simultaneously the political and the policy dialogue to create fertile ground for drastic changes.

Table 18: List of priority strategic actions (Scenario 1)

NO	STRATEGIC ACTION	PRIORITY	TIMELINE	STAKEHOLDERS
1	Initiating a national dialogue to forge a new social contract	High	Short term	All components of the society
2	Assessing the current capacity and urgent needs of the TA (Update software and new hardware, etc.)	High	Short term	MOF, TA, IMF
3	Setting a medium-term plan and concrete actions to rebuild the capacity of the TA	High	Short term	MOF, TA, IMF, IOF
4	Implementing the plan to rebuild the capacity of the Tax Administration	High	Medium term	MOF, TA, IMF, IOF, other Int' Org
5	Defining the pillars and features of a new taxation system in Lebanon (fairness, efficiency, transparency, optimal level of progressivity, distribution of tax burden, etc.)	High	Medium term	MOF, TA, IMF, the government, representatives of sectors, representatives of CSOs, etc.

NO	STRATEGIC ACTION	PRIORITY	TIMELINE	STAKEHOLDERS
6	Identifying and developing reform pillars and sequencing	High	Medium term	MOF, TA, IMF, the government, representatives of sectors, representatives of CSOs, etc.
7	Scheduling and implementing reform pillars	Medium	Medium to long term	MOF, TA, IMF, the government, representatives of sectors, representatives of CSOs, etc.

What could be the key features of a new taxation system in Lebanon?

- Building a system that is more reliant on progressive direct taxes and less reliant on indirect taxes.
- Introducing a unified income tax subject to progressive taxation **or** a dual income tax scheme with consolidated progressive taxes on all labor income and less progressive or flat tax on capital income.
- Introducing a wealth tax.
- Introducing “Sin Taxes” to increase the tax burden on activities that harm the environment.
- Setting “Earmarked Taxes” and increasing the spending allocated to social protection services.
- Designing incentive packages to support economic development and align with the new economic vision.
- Introducing competency frameworks and work behaviors codes (Ethic Chart) and adapting performance evaluation as modern methods to build a strong and capable administration.
- Building a culture of fiscally aware taxpayers and citizens.
- Embedding the use of artificial intelligence in the TA procedures to drive tax audits and data mining.
- Designing tax procedures to be user-centric and establish a one stop-shop model.

2. Scenario 2: Working in Silos

Scenario 2 consists of localized measures targeting the various aspects of the taxation system.

A- Implementing Immediate Corrective Measures

Immediate corrective measures are a must to avoid significant losses in terms of revenue collection and to narrow the widening inequality gap resulting from the monetary crisis.

- Adopting a unified and single exchange market rate as a basis for tax valuation would increase the tax collection by almost 5% of GDP (IMF, 2023) and eliminate inequalities and market distortion highlighted earlier in the study.
- Revising the nominal value of specific tax thresholds and brackets and indexing them to inflation, to ease the burden on small taxpayers (particularly the VAT, salaries and wages, and self-employed professional income tax) (IMF, 2023).

B- Ending the Capacity Drain

Ending the drain is a pre-requirement for recovery.

Table 19: List of priority strategic actions (Ending the capacity drain)

NO	MEASURE	EASE OF IMPLEMENTATION
1	Granting incentives to TA staff to secure work continuity and regularity.	Simple
2	Putting in place a training and redeployment plan to reduce the skills' mismatch across the tax administration.	Moderate
3	Enrolling the tax administration staff in continuous training to keep them abreast of international standards and good practices.	Simple
4	Setting and rolling-out a plan to combat tax evasion across the board (income taxes, VAT, inheritance tax, etc.)	Complex
5	Coordinating and cooperating with other administrations for cross-checking and verification including municipalities, the Directorate of Customs, the Directorate of Real Estate, import of used goods and scrap metal, information on real estate owners and commercial and non-commercial sales operations in addition to other stakeholders that can assist the TA in its work.	Moderate
6	Improving the automation and the integration of tax information systems, as a mean to improve the overall system performance.	Complex

Additional Measures:

- Improving policies and coordination mechanisms between all relevant tax departments.
- Nurturing dialogue and developing partnerships with public and private sector organizations (with Unions, Chambers of Commerce and Industry, Association of Lebanese Industrialists, Ministry of Economy, Directorate of Customs, - Directorate of Real Estate, Exporters, etc.).
- Developing simple "customer service" systems to ease and streamline the interaction between the tax and customs administrations, making it less arbitrary.

- Improving dispute resolution mechanisms and reducing favoritism, bureaucracy, and corruption.

C- Upgrading the Design

More progressive taxes with fewer exemptions would help the government finance immediate spending priorities and move towards more fairness (Verdier, et al., 2022).

Table 20: List of priority strategic actions (Upgrading the design)

NO	MEASURE	EASE OF IMPLEMENTATION
1	The transition towards more progressivity can be gradual and doesn't have to wait until a comprehensive reform is set to motion. For instance, the base of article 53 of the income tax law which stipulates that a person working multiple jobs, he/she must declare all sources of income generated by these jobs once per year, could be expanded to include all income sources (including title 3) in addition to the built property tax. It could be a first step to consolidate progressivity before engaging into a unified income tax.	Simple
2	Strengthening the progressive features of the PIT by applying higher rates on higher brackets.	Simple
3	Issuing decrees by the Council of Ministers to promptly operationalize the access of the Tax Administration to banking secrecy information to combat tax evasion and ensure tax compliance (IMF, 2023).	Moderate
4	Revising preferential treatments, specifically excessive exemptions benefiting capital income (cf. Compendium of Tax Laws and Regulations, Table 1).	Moderate
5	Applying comprehensive progressivity on property taxes and subjecting rental income to CIT.	Complex
6	Subjecting capital gains to CIT	Moderate
7	Adopting new secondary legislation to identify large taxpayers after hyperinflation.	Simple

Additional Measures:

- Granting tax incentives for foreign investments provided that the capital is foreign and that it does not conflict with the law on capital control.
- Granting tax incentives for the productive sectors including waste treatment industries, creative industries, and newly established industries that require substantial investments and that would potentially have a positive impact on the economy and boost recovery.
- Adopting multiple tax rates for VAT.
- Reviewing the declaration requirements for non-profit associations to facilitate their management and control, detect tax evasion associated for instance with salaries and wages, and ensure that their scope of work corresponds to the purpose for which they were established.
- Dismissing the normalization of tax settlements as a common practice during crisis unless it is associated with specific reform measures.

D- Smoothing the Procedures

Table 21: Priority actions (Smoothing the procedures)

NO	MEASURE	EASE OF IMPLEMENTATION
1	Adopting a simplified system for small taxpayers for VAT declaration and payment.	Moderate
2	Systemizing electronic filing and payment for all taxpayers.	Moderate
3	Facilitating and promoting electronic filing by self-employed professionals and issuing the necessary regulations to allow taxpayers' representatives to electronically file their clients' declarations. This would help improve the quality and accuracy of information made available to the tax administration.	Moderate

E- Improving Control and Audit

Table 22: Priority actions (Improving control and audit)

NO	MEASURE	EASE OF IMPLEMENTATION
1	Updating and expanding the tax administration database (related to the NSSF - the Trade Registry - the Directorate of Real Estate - the Ministry of Public Works, as well as other administrations such as the Public Procurement Authority, etc.).	Simple
2	Adopting automated processes to crosscheck information via an integrated system that sources information from various administrations including the Customs Administration, Land Registry and Cadastre, National Social Security Fund, Commercial Register, Public Procurement Authority, Stock Exchange, as well as to the banking sector, following the implementation of the amended Banking Secrecy Law.	Simple
3	Adopting a digital check procedure for TIN numbers to provide secure online access to the register.	Simple
4	Conducting investigations to detect unregistered businesses and individuals through the systematic use of third-party information and regular inspections of business premises and traders.	Moderate
5	Establish an internal audit function and train current employees on the new procedures.	Simple

Additional Measures:

- Conducting reviews (by the state oversight bodies) over internal audit operations and systems every five years at least, and record internal control policies, processes, and procedures in a special log for senior management.
- Documenting procedures and including filing-enforcement follow-up within a maximum duration of 21 days from the due date (for instance, contacting the taxpayers directly, considering the circumstances and the taxpayers filing history, issuing demand

notices, and issuing assessments of estimated tax liability and late filing penalty).

- Regularly updating the taxpayers' registry based on the results of non-filer enforcement.
- Improving the timely collection of withheld taxes.
- Regularly assessing the impact of audits on taxpayers' compliance
- Monitoring periodically the KPIs of the audit plan: (i) audit outcomes – assessments vs collection, (ii) inputs and time invested in each audit case, (iii) number of audit closures where additional tax is payable, (iv) number of audit closures without adjustments, etc.
- Monitoring periodically the cases of audit adjustments accepted without objection or appeal.
- Conducting narrative and quantitative analysis on compliance trends and anomalies detected by the audit and on the time taken to complete audits.
- Taking actions to address the recommendations of performance reports such as (i) improving future audit results, (ii) tracking audit closures against the audit plan, (iii) tracking the value of adjustments by audit types, etc.
- Routinely surveying audited taxpayers to assess the professionalism of audits conducted.
- Establishing an independent internal audit function that cooperates with the Anti-Corruption Commission and similar bodies and produces and publishes statistics related to integrity.
- Making sure an annual program of operational audits is conducted.
- Investigating, in collaboration with the Anti-Corruption Commission, the most serious cases of alleged corrupted conduct of tax officials.

F- Strengthening Citizens Engagement

Table 23: Priority actions (Strengthening citizens engagement)

NO	MEASURE	EASE OF IMPLEMENTATION
1	Designing public information campaigns and tools that can improve the public's understanding of taxes.	Simple
2	Reviewing the tax administration integrity framework and public relations campaigns based on the results of the surveys.	Moderate
3	Linking accountability to budget execution.	Moderate
4	Raising awareness and enhancing the collaboration with syndicates and the civil society to rebuild trust with the public sector.	Simple
5	Improving access to data and information and presenting tax information in a simplified manner.	Simple
6	Setting in place a mechanism for citizen engagement and participation in the decision-making process.	Complex
7	Enhancing the dispute resolution mechanisms.	Moderate

Additional Measures:

- Adopting a Code of Ethics that embodies the values, principles and guidelines provided for in Lebanese laws and regulations or international regulations related to ethics and integrity.
- Explicitly communicating the Code of Ethics and any updates there to the tax administration personnel.
- Producing and publishing strategic and operational plans prior to the entry into force of tax measures.
- Introducing feedback practices.
- Publishing the results of external audits.
- Documenting the compliance gap outcomes and follow-up on progress with the publication of periodic progress reports.
- Documenting the templates used and the methodologies followed.
- Documenting how compliance gap reports are being used to design interventions that would improve the accuracy of reporting.
- Improve the composition of the objections committee by amending the law in such a way that the MoF representative does not have the right to vote, but only the right to voice their opinion. The MoF representative shall be replaced by an accounting expert or tax expert, demonstrating high ethics, and independence.
- Putting in place a better objection management system to manage the large number of objections filed. TA can also coordinate with the State Council or other authorities that can help in explaining laws and texts, and provide the clarifications required.
- Granting the TA with the authority to deal with specific cases that require a quick intervention and to negotiate with concerned taxpayers based on a transparent procedure.

Concluding Remarks

Today, Lebanon stands at a critical juncture on the path to recovery. It has become imperative and urgent to understand and acknowledge the various **political**, **institutional**, and **cultural** challenges that stand in the way of reform.

While reforming the tax scheme is fundamental to forge a fairer society and support economic development, it is far from being a straightforward process. Change is often fraught with complexities, resistance, and unforeseen developments.

Shaking social inertia

One of the primary hurdles is resistance to change. People, whether in public institutions or citizens, are more likely to prefer the familiar or status quo over the uncertain. Whether because of the fear of the unknown, vested interests, or ideological differences, resistance can manifest itself in various forms, posing a significant challenge to the reform process. Overcoming this resistance requires effective communication, a robust coalition of supporters, and a compelling narrative that highlights the necessity and benefits of reform and ultimately a new social contract.

Breathing life into public administrations and institutions

Moreover, the complexity of the system under scrutiny adds another layer of challenge. Public administrations, among which the TA, are under great pressure to deliver and to lead the reform agenda, amidst quasi-absent political will. Securing financial and technical support to the public sector is a pre-requisite to ensure a minimum level of reactivity. Striking the right balance between transformation and stability requires meticulous planning and a thorough and nuanced understanding of the intricacies involved.

Creating a political momentum

Creating and sustaining a political momentum is the ultimate challenge in the context of Lebanon. Initiating reforms may be the easier part; but it is the political will and engagement that will give credibility, drive change, secure continuity, and ultimately maintain the moving-forward trajectory.

Annex – Consultations Meeting

The consultations meeting was part of the methodology. It was used to collect qualitative data and information on the various aspects of fairness and efficiency.

It was organized by *"Financially Wise"* and hosted by the "*Institut des Finances Basil Fuleihan*" on the 10th of May 2023. It gathered 13 high officials from 12 organizations representing public and private sectors, the donor community and CSOs.

Table 24: List of attendees to the consultation meeting

PARTICIPANTS	ORGANIZATION NAME	POSITION
CHAWKI BOU NASSIF	National Social Security Fund	Financial Director
KARIM DAHER	HBD-T law firm	Founding partner - Tax Expert
LAMIA MOUBAYED BISSAT	Institut des Finances Basil Fuleihan	Advisor to the Minister of Finance on Public Procurement Reform
YASMINE IBRAHIM	UNICEF	Social Policy Specialist
FREDERICO LIMA	IMF Office - Lebanon	Resident Representative
CARINE TOHME	The Lebanese Association for Taxpayers Rights - ALDIC	President
GINA CHAMMAS	Lebanon Certified Anti-Corruption Managers - LCACM	President
LINA TANNIR	AUB	Tax expert
JEAN TAWILÉ	The Lebanese Association for Taxpayers Rights - ALDIC	Economist
LEA YAMMINE	CESSRA	Co-director
MARIE-NOELLE ABI YAGHI	CESSRA	Co-director
OLGA JBEILI	ANND	Senior Research and Program Officer
AHMAD KAAKANI	Tanmia	CFO
RANIA BOU HANNA	Tanmia	Accounting Manager

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