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Myopic taxation

Lebanese still dealing with a fragmented system

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The package of tax measures recently signed into law and published in the Official Gazette was characterized by a lack of any fiscal and economic vision. It does not proceed from a well-designed tax policy addressing the various gaps and imbalances that characterize our fragmented and complicated set of taxes. As we all know, our tax system relies heavily on indirect taxes. Many sources of income are untapped, and there is no single overall income tax rate for individuals, as we are still living under the old-fashioned French “cedular” system of income tax, whereby each source of revenue is assessed and taxed separately with different rates. In fact, one of the most urgent tax reforms should have been to replace this old fragmented income tax system with a unified single rate applying by tranches to the total of all combined revenues for each individual. This is a system that could yield substantial amounts to the treasury, while making the life of taxpayers much easier, as just one tax return would have to be filed by them. It will also make life much easier for the Tax Administration Directorate.

As for the increase in VAT by 1 percent, this does not make much sense. It would have been more efficient to leave all essential goods at the rate of 10 percent, while creating a new rate for luxury goods at the level of 14 percent or 15 percent. The yield to the treasury would have been much higher, while for the poorer part of the population there would have been no increase in the price of essential goods. There is no doubt that the trade sector will take advantage of the 1 percent increase in VAT to raise prices by several percentage points, especially for goods imported from Europe, as the euro is on an ascending trend vis à vis the US dollar.

This increase in the VAT rate will also be amplified by the numerous increases in stamp duties, as well as in public notary fees. It should be noted here that most countries canceled stamp duties when they introduced a VAT system, but Lebanon did not, keeping old dating duties and excises taxes.

Missed opportunities

The increase in the tax rate for revenues of companies from 15 percent to 17 percent is not a bad measure, but it could have been raised up to 18 percent or even 20 percent, given the needs of the treasury to reduce the ever-increasing gaps in public finance, and to avoid future changes in the level of companies’ rate of taxation.

On the other hand, the increase in the tax on interests paid on deposits, or on state treasury bills in Lebanese lira from 5 percent to 7 percent, could have been advantageously replaced by a decline in interests paid by the treasury on its borrowings in Lebanese lira and US dollars, or by the decline in the central bank payment of high interests on the certificates of deposits it issues for subscription by local banks. In this regard, it is important to note that a 1 percentage point decline in interest rates paid by the state on its total debt of $75 billion, represents a decline in its annual debt service of $750 million, a huge amount indeed. It is also worth mentioning here that interest payments by the state on its public debt is the second largest item in budget expenditures, and therefore, there is a need to reduce the cost of servicing the debt. It would be preferable to reduce the present level of interest paid on Lebanon’s public debt, instead of increasing taxation on all deposits, either belonging to residents or to non-residents. After all, our national debt is being refinanced through an increase in deposits in the banking system accruing from the annual flow of emigrant remittances. Therefore, taxing interest revenues is not a very healthy measure. In any case, it would have been adequate to exempt small deposits from paying this tax.

As for the fines that the new law has imposed on those that have infringed the law on exploiting the state maritime domain, I do not believe that the treasury will collect large amounts of unpaid rents and fines. This is because the basis of the rents to be paid are still determined according to a 1992 decree by the then-government, which states the square meter value of rented land along the coast by region at prices that are no longer relevant, given how much real estate prices have been going up during the last few decades.

One should not be surprised by the heteroclite nature of all these tax measures, considering that for years successive Lebanese governments have had no vision or plan on how to reform Lebanese public finances, except for the short period of the Hoss Government in 1999-2000 which produced a detailed fiscal consolidation plan for 1999-2004. It might be time for Lebanon to seriously plan an escape from the vicious economic and financial circles the country has trapped itself in. Until such a plan emerges, we remain enclosed, increasing anxiety in public opinion about our economic and financial stability.