# Tax Evasion in Lebanon: How Much of a Burden?

BLOMINVEST BANK

***Every national government sustains itself by raising money domestically, through taxes, and by borrowing from local parties or external lenders.*** *As such, every population has its "potential to pay tax", which in turn impacts the local authorities' revenue collection target every year. Any remaining gap(s) in the national budget is usually financed through borrowing, whether from domestic creditors or from foreign private or public institutions. Foreign aid in the form of grants from some international institutions may also be granted to selective countries if their economies meet particular criteria.*

***To-date, there is no elaborate study nor sufficient data to conclude exactly how much tax revenues the Lebanese government is being deprived of every year.*** *This can be attributed to imperfections in the tax networks and in the monitoring of all market players operating in the country's various economic activities. Nonetheless, estimations can be made based on a number of domestic parameters and analyses of international benchmarks.*

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## Taxes and Governments

**Tax evasion is a form of moral hazard.** Entities that are fully-informed about their tax duties tend to evade them, as the government's effective tax network is jeopardized by structural and man-made factors: weak corporate governance, poor scrutiny of enterprises' operations, corruption among tax or political officials, citizens' habit of evading taxes owing it to cultural problems or unclear collection systems. In Lebanon, tax evasion seems to be primarily constituted of evasions from the Income tax on corporate profits, on wages and salaries, and Domestic taxes on goods and services- namely the Value Added Tax (VAT). Other tax evasions in Property tax and Taxes on international trade (namely Customs) exist but less prominently.

**Total tax evasion in Lebanon is estimated between $1.1B and $1.7B**. The different tax categories prone to tax evasion in Lebanon are compared to those in the OECD and/or Latin America and the Caribbean (LAC). The evasions are also quantified in terms of Lebanon's GDP, which stood at $49,459M ($49.46B) in 2015 according to the latest available data from CAS. However, many parameters crucial to identify potential gaps in the administration of tax revenues remain 'hidden', or buried in the country's informal economic activities.

**Tax Revenues Breakdown: Evasion and Potential for Improvement**

| Comparative Table: Tax Revenues 2015 /2016 (in percent of GDP) | | | |
|---|---|---|---|
| | Lebanon | OECD average | Latin America & The Carribean (LACs) |
| **TOTAL TAX REVENUE:** | **14.21%** | **34.30%** | **22.80%** |
| **Taxes on Income, Profits, & Capital Gains, of which:** | **4.04%** | **11.60%** | **6.20%** |
| *Income Tax on Profits of corporates* | 1.53% | 2.82%* | *3.30%* |
| *Income Tax on Wages and Salaries* | 0.94% | 8.78% | 2.90% |
| **Property Tax** | **1.64%** | **1.82%*** | **0.80%** |
| **Domestic Taxes on Goods & Services, of which:** | **5.06%** | **10.76%*** | **11.20%** |
| *VAT* | 4.34% | 6.60% | 6.00% |
| **Taxes on International Trade** (includes: Customs & Excises|) | **2.84%** | **2.74%** | **3.00%** |
| *Customs* | 0.95% | 0.1%* | 1.50% |
| *Excises* | 1.89% | *2.64%** | 1.50% |
| Other Taxes | 0.63% | *0.2%** | N/A |
| *Sources: Data on Lebanon, Ministry of Finance; OECD & LACs data: OECD statistics, 2017* | | | |
| *Data not available for 2015, so avg. over 5 years calculated. | | | |

## A. Tax on Corporate Profits

**The evasion of Lebanese corporates from taxes on profits is minimal.** Any registered enterprise in Lebanon was subject to corporate tax on profits at the flat rate of 15%, prior to October 2017 when the rate climbed to 17%, while the OECD's average[1] rate is 29.33%. In its turn, the ratio of income tax on corporate profits in Lebanon to that in the OECD stands at 54%, which reflects the fact that the corporate tax revenues are also almost the double in the OECD countries. Therefore, Lebanon does not seem to be severely evading taxes on corporate profits.

**However, banks in Lebanon paid 64.65% of total corporate taxes in 2016, while "Other" enterprises pay less**. Banks paid the equivalent of US$490M out of the total $758M collected in corporate revenues by the local authorities in 2016. The remaining 35.35% was paid by all "Other" (non-bank) enterprises, which reveals room for improvement. According to 2015's national accounts, financial services in Lebanon, namely banks, grasped 8% of the country's GDP, while 37.64% of the GDP is non-taxable because it's constituted of the tax exempt sectors: Real estate (14.48% of GDP), Health and social care (3.46% of GDP), Education (5.26% of GDP), Public Administration (9.32% of GDP), Administrative Services (2.37% of GDP), and Community services (2.75% of GDP).

Against this backdrop, the taxable GDP in Lebanon amounts to 63% of actual GDP, and the weight of banks climbs to 12.7%. Even though the share of banks in taxable GDP is higher than their share in total GDP, they are still paying a large share of 64.65% of total profit tax.

[1] The "Combined corporate income tax rate" figures for the 7 largest economies of the OECD are averaged and used for this study: US, UK, Germany, France, Italy, Spain, and Japan.

**As a counterpart, in the OECD countries, banks contribute a bit more than their weight in GDP, while "other (non-banks)" pay the largest part of profit taxes.** Banks and financial institutions in the OECD constitute on average up to 6% of GDP[2], and the bloc's "other (non-banks)" contribute most to profit taxes. Moreover the bloc's tax exemptions do not exceed 15% of GDP.

**Therefore, corporate tax evasion exists in Lebanon in the order of $400M to $450M.** Comparing Lebanon's "Other (non-bank)" contributions to profit taxes to the OECD's, we deduce that tax collections from "Other" Lebanese enterprises can be improved, as tax evasion exists in the order of 0.8% to 0.9% of GDP, equivalent to $400M to $450M.

**"Other enterprises" in Lebanon include non-banks, of which approximately 92% are SMEs.** Around 92% of the companies in Lebanon are small to medium-sized firms (SMEs) and the authorities' efforts to collect these taxes may cost more than the firms' actual total payment on profit taxes. Moreover, such businesses tend to submit falsified statements on their profits. Despite the local government's efforts to conduct spot checks and audits on the activity of enterprises all over Lebanon, companies to date - particularly operating in the informal market- still manage to present false financial statements by which they evade taxes or reduce their tax payments. These are hard to estimate though as some may be registered or not, while others operate only regionally or on a very small scale.

**Investing in an inclusive taxation network may boost revenues from tax on profits in the long run.** In this context, an initial investment for a more efficient tax network that can include these SMEs in the taxation mechanism may be costly at first. Nonetheless, on the long-run, the Lebanese authorities could reap multiple benefits and boost public revenues from corporate taxes on these businesses.

### B. Tax on Wages and Salaries (S&W)

**Comparing tax rates on S&W in Lebanon and the OECD is challenging, as the OECD's rate is almost double.** For both the public and private sector, taxes on S&W in Lebanon increase progressively from 2% to 20% as per the corresponding income brackets, while the OECD's weighted average[3] tax wedge stands at 39.95%. Moreover, the OECD's GDP per capita reaches highs of $42,098 as per 2016's OECD data, while Lebanon's GDP per capita amounts to $11,900.

**Nonetheless, taxes on S&W in the LAC stand at 21.7%, revealing a tax evasion ranging between 0.8% to 1% of GDP in Lebanon's revenues from tax on W&S.** The average wage tax rate in the LACs stands at 21.7%, close to Lebanon's 20%. Nevertheless, LAC generates 2.9% of GDP in returns from tax payments on W&S, while the Lebanese lag behind constituting 0.94% of GDP. Moreover, the GDP per capita in the LACs according to FRED (Federal Reserve Economic Data) stands at $8,156 in 2016, while Lebanon's $11,900 GDP per capita is higher. Therefore, adopting a conservative approach throughout the report's findings, the lag in revenue settles at an estimated 0.8% to 1% of GDP, equivalent to $400 to $500M.

[2] Luxembourg's FIs constitute the largest portion, 27% of OECD's GDP; but considering it's a small economy, it's excluded from the region's averaging used in this research. The USA holds 7% & Switzerland 9%, while all the FIs of all remaining member states each stand at 5% to 6%.

[3] The OECD defines "tax wedge", as the total taxes on labour income paid by employees and employers, minus family benefits received, as a percentage of the labour costs of the employer. The weighted average is that of the tax wedges in the 7 largest economies of the OECD used earlier.

**In addition, income taxes on S&W in Lebanon are shadowed in the informal labour market.** According to previous studies conducted by Blom Invest, the Lebanese labour market is characterized by a high degree of "informality", with an 'informal' labour market defined as one where, "*explicit and registered work contracts and/or social security coverage for workers on the job [are absent]"* as per the International Labour Organization (ILO). Thus, the evasion from income taxes on S&W may be linked to the fact that, "*[…] 50% of the working age population works in informal jobs*" according to Haneen Sayed, Human Development Coordinator for Lebanon, Jordan and Syria and co-author of the World Bank 2013 Miles Report.

**An influx of cheap and undeclared labour into Lebanon post-Syrian War invaded Lebanese enterprises.** Since the onset of the 2011 Syrian Crisis, the workforce in Lebanon comprises of Lebanese nationals competing with Syrian refugee-workers who settle for significantly lower incomes. When the average monthly salary of a Syrian refugee stands at LBP 418,000 (around US$280), the minimum wage of a Lebanese worker is LBP 675,000 (US$450). Hence, local employers were granted a leeway to hire cheap labour, knowing Syrian workers do not need a work permit and most of them remain undeclared to the local authorities. By doing so, domestic enterprises end up evading from the fees of registering employees.

**"Other" local enterprises declare employee salaries to be lower than the real salaries to evade social security fees.** In Lebanon, employers bear 22% of the social security costs of every employee. As a result, declaring lower salaries becomes a common practice amid the lack of tight governmental monitoring. In fact, approximately 43% of Syrians take on informal positions in industrial and semi-skilled jobs, like carpeting, welding, repairmen, mechanics, handicraft, and food processing according to the ILO. Yet, knowing that most Lebanese enterprises (SMEs) hire less than 10 workers, the wage bracket tackled is the low bracket, which is the main reason why revenues from tax on S&W in the LACs also remain higher.

### C. Property Tax

**The flaws in monitoring property tax in Lebanon encourage dealers not to record transactions or to underestimate their value.** Real estate is a driver of the Lebanese economy constituting 14.48% of GDP. The RE registration fees (composing 7.57% of total tax revenues) reached LBP 802B ($532M) in 2016, up by 3.68% from 2015's. More recently, in H1 2017, registration revenues amounted to LBP 742.8B ($492.7M), up from LBP 635.8 ($421.8M) in H1 2016. However, the imperfect monitoring of property tax encourages dealers not to record transactions or to underestimate their value to reduce the tax burden. In fact, the main market players are RE agencies, but also a number of RE brokers working within the 'informal' market, with no corporate office. As such, their business transactions most probably slip the official declarations to the Ministry of Finance.

**However, compared to the OECD and LAC, the evasion potential from property tax in Lebanon is marginal.** Following the conservative approach, the gap between the ratio of income from property tax in Lebanon to income from property tax in the OECD is almost nil, while Lebanon's revenues from property tax exceed those of the LAC. Thus, the evasion potential from property tax in Lebanon remains marginal.

### D. Value Added Tax (VAT)

**The performance of Lebanon's VAT revenues is compared to countries with an equivalent tax rate.** VAT rates vary among countries. In Lebanon, the VAT stands at 10% (but expected to reach 11% by Jan.2018), compared to the OECD's 19.2% average VAT rate. With such a substantial difference in tax rates, Lebanon's VAT is compared to Australia's 10% and Switzerland's 8%, both countries being OECD members of comparable VAT rates. As such, Lebanon's VAT returns amounted to 4.34% of GDP in 2016, while Australia's and Switzerland's respectively stood at 3% of GDP and 3.4% of GDP.

**Despite Lebanon's higher VAT revenues relative to its comparables, evasion from the VAT exists, nurtured by the country's high consumption function.** Lebanon's consumption function depends largely on worker's remittances among other factors. According to the latest national accounts, Lebanon's consumption to GDP ratio stood at 99%, almost double Australia's for instance, whose consumption reached 57.8% of GDP. Hence, evasion from the VAT in Lebanon is estimated between 0.5% and 1% of GDP, equivalent to $250M and $500M.

**Evasion from VAT may also still exist in discrete forms**. Consumers pay the VAT on purchased goods, but the end recipient of VAT payments may not pay it or submit it fully to the government thereby jeopardizing collected taxes. It's also worthy to note that the rates of other non-VAT domestic taxes imposed on goods and services vary among different items and across countries, which makes their comparison less reflective on the reality of the country's public revenues from tax.

### E. Taxes on International Trade (Customs and Excises)

**Comparing Lebanon's income from taxes on international trade to the LAC's helps estimate that tax evasion is equivalent to $80M.** Lebanon's income from taxes on international trade (customs and excises) amounts to 2.84% of GDP, whereas that in the OECD stands at 2.74%of GDP and the LAC's at 3% of GDP. The OECD member states include the countries within the 'free trade' Euro Zone area where members do not pay customs duties among each other. Thus, the returns from international trade taxes in this study compares Lebanon's to the LAC's, and estimates the revenues lag by a 0.16% of GDP, equivalent to a potential evasion of $80M in international trade taxes.

**As for taxes from Customs alone, the study estimates tax evasion at $272M.** Taxes from Customs alone lag by 0.55% of GDP, equivalent to a potential tax evasion of $272M. In fact, revenues from Customs in the LAC stand at 1.5% of GDP according to the OECD, while Lebanon's amount to 0.95% of GDP. The gap may be attributed to the undervaluation of imports in Lebanon. Furthermore, the tax base in Lebanon is larger, as the ratio of imports of goods to GDP stood at 34.9% in 2015, compared to 19.8% in the LAC according to the World Bank.

## Lebanon's Tax Evasion in Figures and Ways Forward

In conclusion, Lebanon's total tax evasion is estimated at $1.1B to $1.7B, with the evasion being almost equally distributed among the four key tax components analyzed as per the below table. Because of imperfections in the tax networks and the lack of thorough monitoring of all market players, no exact figures can be drawn. Nonetheless, improving tax collection necessitates large efforts from the government. The coordination among the different public entities administering taxes (like the customs, the ministry of finance, etc.) is also key.

*Wrap-Up: Lebanon's Tax Evasion in Figures*

| *(in US$ millions)* | Lower Bracket | Higher Bracket |
|---|---|---|
| Income Tax on Corporate Profits | 400 | 450 |
| Income Tax on Wages and Salaries | 400 | 500 |
| Value Added Tax | 250 | 500 |
| Tax on International Trade | 80 | 272 |
| **TOTAL estimated tax evasion** | **1,130.0** | **1,722.0** |

Note:
Ranges used for calculation of lower and higher brackets are explained in the report and summarized below:

- Tax on corporate profits: 0.8% to 0.9%
- Tax on salaries and wages tax: 0.8% to 1%
- VAT: 0.5% to 1%
- Customs: 0.16% to 0.55%

*Source: BLOM Invest Bank*

## For your Queries:

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