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Tax evasion in Lebanon: How much of a burden?

(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 Intemaitonal Trade	80	272
TOTAL estimated tax evasion	**1,130.0**	**1,722.0**

Source: BLOM Invest Bank

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Every national government sustains itself by raising money domestically, through taxes, and by borrowing. Hence, every population has its "potential to pay tax," which impacts the local authorities' revenue targets. Remaining gaps in the national budget are usually financed through borrowing from domestic creditors and foreign private or public institutions. Grants from international institutions may also be extended to selective economies that meet particular criteria.

However, 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 due 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. Other tax evasions in property tax and taxes on international trade (namely Customs) exist but less prominently.

Lebanon's Tax Evasion in Figures

Total tax evasion in Lebanon is estimated between $1.1 billion and $1.7 billion; however, many parameters crucial to identifying potential gaps in the administration of tax revenues remain "hidden," or buried in the country's informal economic activities. The evasion in these tax categories is compared to the tax evasion in the OECD and/or that of Latin America and the Caribbean. The form or amount of tax evasion are analyzed and quantified in terms of Lebanon's GDP, which stood at $49,459 million in 2015 according to the national accounts.

Tax on Corporate Profits Any registered enterprise in Lebanon was subject to corporate tax on profits at the flat rate of 15 percent, prior to October 2017 when the rate climbed to 17 percent, while the OECD's average rate is 29.33 percent among the block's seven largest economies. In its turn, the ratio of income tax on corporate profits in Lebanon to that in the OECD stands at 54 percent, which reflects the fact that the corporate tax revenues are also almost double in the OECD countries. Therefore, Lebanon does not seem to be severely evading taxes on corporate profits.

However, among the market players, banks in Lebanon paid 64.65 percent of total taxes in 2016, equivalent to $490 million out of the total $758 million collected in corporate revenues by the local authorities that year. The remaining 35.35 percent was paid by all "Other" (nonbank) enterprises. According to 2015's national accounts, financial services in Lebanon, namely banks, grasped 8 percent of the country's GDP, while 37.64 percent of the GDP is nontaxable because it's constituted of the tax exempt sectors: real estate (14.48 percent of GDP), health and social care (3.46 percent of GDP), education (5.26 percent of GDP), public administration (9.32 percent of GDP), administrative services (2.37 percent of GDP), and community services (2.75 percent of GDP).

Against this backdrop, the taxable GDP in Lebanon amounts to 63 percent of actual GDP, and the weight of banks climbs to 12.7 percent. 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 percent of total profit tax.

As a counterpart, in the OECD countries, banks and financial institutions constitute on average up to 6 percent of GDP, and the bloc's tax exemptions do not exceed 15 percent of GDP. Moreover, "other (nonbanks)" in the bloc pay the largest part of profit taxes, while banks contribute a bit more than their weight in GDP. Therefore, comparing Lebanon's "Other (nonbank)" 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 percent to 0.9 percent of GDP, equivalent to $400 million to $450 million.

Tax on Wages and Salaries

For both the public and private sector, taxes on W&S in Lebanon increase progressively from 2 percent to 20 percent. Alternatively, in the OECD, the weighted average tax wedge for the seven largest economies of the bloc stands at 39.95 percent, knowing 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. The comparison is challenging with OECD tax rates almost double Lebanon's. In turn, the average wage tax rate in LAC stands at 21.7 percent, close to Lebanon's 20 percent; yet, LAC generates 2.9 percent of GDP in returns from taxes on W&S given a GDP per capita of $8,156 in 2016 according to Federal Reserve Economic Data, while Lebanese tax payments constituted 0.94 percent of GDP. Adopting a conservative approach, the lag in Lebanon's returns from W&S is estimated at 0.8 percent to 1 percent of GDP, or the equivalent of $400 million to $500 million.

Property Tax

Real estate is a driver of the Lebanese economy constituting 14.48 percent of GDP. The real estate registration fees (composing 7.57 percent of total tax revenues) reached LL802 billion ($532 million) in 2016, up by 3.68 percent from 2015's. More recently, in H1 2017, registration revenues amounted to LL742.8 billion ($492.7 million), up from LL635.8 billion ($421.8 million) in H1 2016. However, the flaws in monitoring property tax encourage 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 Finance Ministry. However, 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.

Value Added Tax

VAT rates vary among countries. In Lebanon, the VAT stands at 10 percent (but expected to reach 11 percent by January 2018), compared to the OECD's 19.2 percent average VAT rate. With such a substantial difference in tax rates, Lebanon's VAT is compared to Australia's 10 percent and Switzerland's 8 percent, both countries being OECD members of comparable VAT rates. Lebanon's VAT returns amounted to 4.34 percent of GDP in 2016, while Australia's and Switzerland's respectively stood at 3 percent of GDP and 3.4 percent of GDP. Despite the higher revenues recorded, evasion from VAT exists in Lebanon, nurtured by the country's high consumption function which depends largely on worker's remittances. According to the latest national accounts, Lebanon's consumption to GDP ratio stood at 99 percent, almost double Australia's for instance, whose consumption reached 57.8 percent of GDP. Hence, evasion from the VAT in Lebanon is estimated between 0.5 percent and 1 percent of GDP, equivalent to $250 million and $500 million. It's also worthy noting that the rates of other non-VAT domestic taxes imposed on goods and services vary among different items and across countries.

Taxes on International Trade (customs and excises)

Lebanon's income from taxes on international trade amounts to 2.84 percent of GDP, whereas the LAC's totals 3 percent of GDP, while the OECD's is at 2.74 percent of GDP. The OECD member states include the countries within the "free trade" eurozone 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 percent of GDP, equivalent to a potential evasion of $80 million in international trade taxes.

In addition, taxes from Customs alone lag by 0.55 percent of GDP, equivalent to a potential tax evasion of $272 million. In fact, revenues from Customs in the LAC stand at 1.5 percent of GDP according to the OECD, while Lebanon's amount to 0.95 percent 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 percent in 2015, compared to 19.8 percent in the LAC according to the World Bank.

Ways Forward

In conclusion, Lebanon's total tax evasion is estimated at $1.1 billion to $1.7 billion, with the evasion being almost equally distributed among the four key tax components analyzed. 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 Customs, the Finance Ministry, et cetera) is also key.

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