When Assets Become Liabilities! The Debate Over Taxing Defaulted Eurobond Provisions

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Lebanese banks are now facing a 17% tax on provisions they were instructed to set aside—ironically, to absorb losses from sovereign bonds the State itself defaulted on. In line with directives from the Banking Control Commission at the Central Bank, banks provisioned approximately 75% of their Eurobond exposure. Yet the government's decision to treat these provisions as taxable profits has sparked a wave of concern across the sector. What's at stake goes beyond the immediate tax burden. It calls into question how Lebanon accounts for its own default and sets a precedent that could deter banks from holding sovereign instruments going forward. Banks have until August 31 to comply with the new tax obligation, adding urgency to an already controversial decision.

The government's rationale hinges on applying the corporate profit tax rate to these provisions, effectively reclassifying them as taxable profits. But the provisions were not optional—they were mandated in response to the March 2020 sovereign default, which left banks holding deeply impaired assets. As of August 6, 2025, the BLOM Bond Index (BBI) recorded just 19.43 cents—an 81% haircut—underscoring the scale of the losses and the logic behind the provisioning.

The government appears to justify the tax by treating these provisions as hidden profits—claiming that banks merely shifted funds from one account to another, and that absent such provisioning, the amounts would have been subject to corporate tax. However, Dr. Fadi Khalaf, Secretary General of the Association of Banks in Lebanon (ABL), countered that **these provisions are not profits but an accounting reflection of the Eurobonds' collapse in value, and therefore should not be taxed.**

Banks have also questioned the logic of taxing provisions linked to sovereign obligations that are still in default. From the sector's perspective, it appears contradictory for the State to impose a tax on provisions stemming from liabilities it has neither serviced nor restructured. The government is taxing banks to raise revenues it may eventually use to repay those same banks on their Eurobond holdings. This circular dynamic underscores the dysfunction: banks are penalized upfront through taxation on defaulted debt, while any future repayment remains uncertain and heavily discounted. Therefore, Dr. Khalaf argued that the responsibility should fall on the Directorate of Revenues, not the banking sector.

Moreover, he warned that this approach weakens the appeal of holding Eurobonds, effectively incentivizing local banks to accelerate selling Lebanese Eurobonds to foreign entities at their currently discounted price— entities that, unlike domestic institutions, are not subject to such taxes. These losses compound the strain on domestic banks, deplete depositors' funds at these banks, and deepen the fragility of Lebanon's economy.

Adding to the complexity is the question of which exchange rate will be used to assess the taxable value of these Eurobond-related provisions. Lebanese Eurobonds total around $30 billion in outstanding face value, with the banking sector holding roughly one-third. Of that exposure, banks have provisioned approximately 75%, amounting to an estimated 7.5 billion in local dollars (Lollars). Applying the 17% corporate tax rate yields a potential tax liability of around 1.275 billion Lollars—aligning with Dr. Khalaf's warning of an up to a billion-dollar burden on the sector.

However, Finance Minister Yassine Jaber acknowledged confusion surrounding the issue, citing a study by the Tax Revenue Directorate that estimates the total value of all related operations at no more than $20 million. This discrepancy appears to stem from the exchange rate assumptions used in the government’s calculations. While the current official rate for Lollars is 15,000 LBP, our calculations suggest that the government applied the outdated 1,500 LBP rate—likely reflecting the rate in effect when most banks originally acquired the Eurobonds. Based on this assumption, the implied valuation becomes:

1.275 billion Lollars × (1,500 / 89,500) ≈ $21.4 million

This figure aligns with Minister Jaber’s estimate, suggesting that the government’s tax projections are based on historical—not market—pricing.

To settle the issue of who, when and at what rate these taxes should be paid, Dr. Khalaf proposed extending the tax payment deadline until the legal and financial status of the Eurobonds is clarified—potentially through the forthcoming Financial Gap Law, given that the banking restructuring law has already been enacted. In our view, this matter should be resolved within the framework of the anticipated IMF deal, which is expected to include a comprehensive restructuring of the government's debt, as the matter concerning the financial gap is expected to be resolved among banks, Banque Du Liban (BDL), and the government.

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