INTERNATIONAL MONETARY FUND

Fiscal Affairs Department

الجمهورية اللبنانية

مكتب وزير الدولة لشؤون التنمية الإدارية

مركز مشاريع ودراسات القطاع العام

Republic of Lebanon

Office of the Minister of State for Administrative Reform

Center for Public Sector Projects and Studies

(C.P.S.P.S.)

Lebanon: The Association with the European Union and its Revenue Implications

A. M. Abdel-Rahman, Thomas Helbling, Erik Andersen, and Percy Kierstead

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1. Introduction

The Minister of State for Financial Affairs of Lebanon, requested technical assistance from the IMF to review the tax system and its administration. The request aims broadly at: (i) assessing the budgetary impact of the forthcoming association agreement between Lebanon and the European Union (EU); and (ii) suggesting measures to compensate for the revenue loss that would result from establishing a Free Trade Area (FTA) between the EU and Lebanon. The agreement stipulates inter alia that customs duties and other charges having the same effects on imports originating in the EU will be dismantled over a transitional period of 12 years.

The request reflects the Lebanese authorities' concern about the fiscal impact and the welfare benefits and costs of the FTA. In view of these concerns, the authorities are scrutinizing the implications of the association on the Lebanese economy.[1] Disagreement has already been expressed with the criteria used by the EU as a basis for allocating financial assistance among associated states. These criteria consist of the per capita income and the population size of the associated countries. The Lebanese authorities favor the per capita imports from the EU as a better indicator of the benefits and costs of the association and consequently as a basis for financial assistance from the EU. They also added the relative importance of the budget deficit which is the highest among the associated countries.

In response to the request for technical assistance, a mission led by Mr. A.M. Abdel-Rahman, member of the panel of fiscal experts, visited Beirut from November 17 to December 3, 1996. The mission comprised Messrs. Thomas F. Helbling, economist (MED), Erik Andersen and Percy Kierstead, both members of the panel of fiscal experts, and Mrs. Susana Otero, administrative assistant.

The mission reviewed the recent tax reforms to assess their contributions to tax revenue and tax administration enforcement In addition, major duties and taxes were analyzed with a view to broaden the tax base, introduce necessary new taxes, strengthen tax administration, and eventually raise additional revenue, not only to offset the revenue loss to result from the contemplated FTA with the EU but also to reduce further the budget deficit.

The mission was received by the Minister of State for Financial Affairs and worked closely with his advisor, Dr. Basil Fuleihan. It benefited from the efficient collaboration of the Lebanese authorities and wishes to thank in particular Dr. Nadim Munla, the Economic Advisor of the President of the Council of Ministers; Dr. Nasser Saidi, First Deputy Governor, Bank of Lebanon; Dr. Habib Abu Saker, Director General of Finance; Dr. Issam Haballah, President of the Higher Council of Customs; and their staff.

[1]The Lebanese delegation was led by the Ministry of Foreign Affairs and comprised representatives of the Ministries of Finance, Economy and Trade, Industry, and Agriculture, as well as the Central Bank.

At the request of the Minister of State for Financial Affairs and by his arrangement, the mission met with the association of banking and insurance enterprises, as well as the representatives of industry to obtain their views on the effects of the association with the EU.

This report replaces and completes the aide-mémoire which was prepared to serve as a basis for discussion during the mission's concluding meeting with the Minister and his senior advisors. Because earlier reports had already tackled important policy aspects of the principal taxes and duties and their administration, this report concentrated on the issues that bear directly on the association agreement and the measures that would compensate for its revenue loss. It is organized as follows: Section 2 contains the missions' findings and conclusions. Section 3 reviews recent changes of the Lebanese tax system, while Section 4 summarizes the implications of the association agreement on taxation of imports and the necessary changes that could be introduced. Sections 5 deals with taxes on goods and services, which have the potential to generate additional revenue. The tax administration is examined in Section 6, which does not however cover customs administration.

2. Conclusions and Recommendations

Conclusions

Recent developments in the tax and tariff structure

Over the last four years, the Ministry of Finance has been engaged in reforming the tax system, reconstructing its institutions, and modernizing its administration. Revenue mobilization has been a primary goal of these reforms to finance the reconstruction requirements and to minimize the adverse effects of the sizable budget deficits on the flow of private and international capital and investments.

Starting in 1993 and in accordance with the goals of economic development and stabilization, a number of tax and tariff reforms were introduced, with technical assistance under the project UNDP/WB/IMF "Revenue Enhancement and Fiscal Management." The 1993 reform of taxes on income and profits aimed primarily at: (i) reducing the high nominal rates to encourage investment and to improve taxpayers' compliance; and (ii) modernize the administration of this tax. The 1995 tariff reform simplified the tariff structure by consolidating the many additional charges and duties into the principal tariff and making its rates fewer and lower. It eliminated virtually all quantitative restrictions and unified customs and exchange rates at the prevailing market level. The reform of excises, especially those on tobacco, cigarettes and petroleum products, was the third pilar of the reforms of the 1990s, which contributed significantly to tax revenue.

The outcome of the reform efforts is reflected in an increase in the tax ratio from 9.3 percent in 1993 to about 15 percent in 1996, although their full impact remains to be reached.

Tax and tariff administration

Tax and tariff administrations have been reformed to complement the structural reforms and to facilitate the procedures of assessment and collection. In 1994 an amnesty program was introduced to encourage taxpayers to liquidate their tax liabilities incurred during the 1970s and 1980s, and to reduce the burden on the Revenue Department of identifying and assessing nonfilers.

The Customs Department has started computerizing its operations in 1995. It has also reinforced the valuation techniques, which in principal are based on the Brussels definition of value (BDV), by collecting information about the transaction value of imports, in anticipation of adopting the WTO/GATT code of valuation.

The association agreement with the EU

Lebanon is an associate state of the Euro-Mediterranean association and in the process of negotiating an FTA with the EU. The authorities are assessing the implications of the association, with due concern about the budgetary impact, as well as the costs and benefits to the economy. The association is expected to have far-reaching consequences, especially on the revenue structure, in view of the dominant size of imports of EU origin. About 50 percent of Lebanon's imports originate in the EU and they generate a proportional share of revenue from duties and taxes on imports. Based on the data provided by the High Council of Customs, and without taking into account the dynamic effects to result from the association, the revenue loss to result from dismantling the duties on imports from the EU could amount to about 4.2 percent of GDP. Lebanon does not have a general sales tax (GST) which is the conventional means to compensate for the revenue loss from customs duties, although a simplified general sales tax has been on the agenda of tax reform for the last two or three years. Moreover, the Lebanese revenue institutions, despite recent improvements, continue to be adversely affected by the events of the 1970s and the 1980s, and the budget deficit has been exceptionally high following the reconstruction efforts. The conclusion of an association agreement only adds to the urgency of additional revenue measures.

Recommendations

The mission sought to identify measures in light of the reforms of the last three-four years and the commitments under the association that would minimize the revenue loss following the dismantlement of customs duties. Meanwhile, some recommendations aim explicitly at improving the revenue structure and generating additional revenue irrespective of the outcome of the association.

Duties and taxes on imports

To minimize the revenue loss that may result from the association with the EU, it is recommended that:

- Separate excises from customs duties, because of their fiscal nature, in order to avoid the possibility of a strict application of Article 12 of the draft agreement that requires equal dismantlement of customs duties of fiscal or revenue nature along with pure and simple customs duties that are usually of a protectionist nature.

- The separation of excises from the tariff should not preclude their collection at the stage of importing for administrative convenience. This however would require that excises be equally levied on locally produced goods and on imports.
- The timetable for tariff reduction as suggested in the draft association agreement could be modified to concentrate the initial reductions on the high tariff rates rather than eliminating the minimum tariff rate of 2 percent.

- The 5 percent rate should be considered as a minimum tariff rate to be applicable across the board on all imports, including those with EU origin. The suggested minimum, subject to agreement with the EU, should remain unchanged during the transitional period.

- The high tariff rates of 100 percent, 80 percent, 50 percent, and 40 percent could be eliminated leaving the rate of 35 percent as the overall tariff binding level. Specific binding for each tariff item should be avoided because it could add unnecessary complexity and require detailed negotiations.

- The future of the Tobacco Monopoly (Régie) should be assessed in view of the requirement of the draft association agreement that no discrimination in procurement and marketing should be allowed between the nationals of Lebanon and those of the EU.

- Decide on whether and when the valuation code of WTO/GATT could be introduced in replacement of the BDV. The Harmonized System (HS) introduced by the 1995 tariff reform could be used as a basis for trade classification with EU without the combined nomenclature as required by the EU.

- The rule of origin as provided for in Article 14 may be too restrictive to encourage exporting manufactured goods to EU. In their negotiations, the authorities could seek relaxing the conditions to qualify as Lebanese origin.

Taxes on goods and services

- The mission reiterates the 1994 recommendation to introduce a simplified GST to be levied equally on imports and locally produced goods. A GST is gaining in urgency in view of the contemplated revenue loss from customs duties that can hardly be compensated for from existing taxes and duties and/or improvement in their administration.

- The GST is the conventional method to meet the requirement of nondiscrimination between locally produced goods and imports of EU origin, as stipulated in Article 21 of the draft association agreement.

- The concern about the administrative difficulties that may arise following the adoption of a GST is overestimated by its advocates. Recently produced data suggest that exceptionally few large taxpayers contribute the largest share of turnover--about 6 percent of taxpayers produce 75 percent of total turnover, while 57 percent of small and medium taxpayers produce only 2 percent to 3 percent of total turnover, respectively (Table 14). The mission judges that the GST can be effectively implemented within a period of no more than 24 months, but the preparatory work should start as early as possible.

- The adoption of the proposed GST should be accompanied by a tariff reform which should adjust the customs rates to reflect (i) the reduction in tariff rates on goods originating in EU, (ii) the separation of excises from customs duties, (iii) the availability of revenue from the GST which will be levied on all imports irrespective of their origin, and (iv) the minimization of the origin of imports as a factor influencing the overall burden of import taxation from third countries and eventually the redirection of trade.

Tax administration

- The majority of the 1993 mission's recommendations are being implemented by the Canadian project. Work has already started on training tax auditors, establishing a large taxpayers unit (LTU), introducing a comprehensive survey of taxpayers, introducing a taxpayer's identification number, and computerizing the operations of the Revenue Department. The mission reviewed with the Canadian team their plans for accomplishing these tasks and concluded that when fully implemented overall tax administration should be enhanced.

- A policy decision is urgently needed to start the enactment and the administration's preparations of the GST. Since the administrative arrangements for establishing an LTU have been initiated, completion should be a prerequisite for the administration of a GST.

- The development of the LTU, which will cover all taxes paid by large taxpayers, must be integrated with the planning for the GST to ensure that the unit will be fully operational and prepared to assume responsibility for GST administration when the tax is introduced.

- The ratio of actual collection of taxes on income and profits to their assessment is very low, suggesting the need to improve the quality of assessments and acceleration of the collection of the tax arrears.

- A functional organization of the Revenue Department headquarters, with divisions responsible for legislation, tax planning and studies, computer systems and procedures, and statistics and planning, would enhance the efficiency and effectiveness of the department.

- Efforts to implement the recommendations made by earlier Fund missions and with the assistance of the Canadian Team should be enhanced. These efforts would facilitate modernizing the Revenue Department and reenforcing procedures for assessment and collection.

Revenue effects

The revenue effects of the association and the mission recommendations vary depending on the measures to be introduced. In the absence of measures that could be introduced independently of the association and irrespective of its outcome, the revenue loss would amount to 4.2 percent of GDP. Should the authorities separate the excises from customs duties, introduce the proposed GST, increase the minimum tariff rate to 5 percent, eliminate the top rates of 100 percent, 80 percent, 50 percent, and 40 percent, the outcome could be an increase in tax revenue of 0.4 percent of GDP (Table 13). The mission reiterates the separation of excises and the adoption of the GST as necessary measures to improve Lebanon's revenue structure and to reduce the budget deficit. No additional revenue that would be generated from improved tax administration and/or higher economic growth has been included in the mission's calculations.

3. The Tax System and its Recent Developments

Over the last three-four years, the Lebanese authorities have embarked on a number of fiscal reforms to mobilize revenue and to strengthen public expenditure management. Additional revenue is urgently needed to meet the dual objectives of financing the reconstruction of the country and enhancing its financial stability. On the revenue side, the tax system has been reviewed, and measures for the reform of the major categories of taxes and duties were proposed.[2] Special emphasis was placed on duties and taxes on imports and principal excises in view of their capabilities of generating the urgently needed additional revenue in the immediate future and their relative ease of administration. The possibility that Lebanon will establish a free trade area with the EU requires the reassessment of the overall strategy of tax revenue mobilization that takes into account the substantial fiscal implications of the agreement in the context of the current tax system and the large budget deficits.

Lebanon's tax ratio (total tax revenue as a percentage of GDP) increased from 9.3 percent in 1993 to 11.1 percent in 1995 (Tables 1-3 and Charts 1 and 2). The 1996 and 1997 budgets project further increases in the tax ratio to 14.9 percent and 13.2 percent, respectively. Despite the increase in the country's tax efforts, budget deficits continue to be, by international standards, significantly large suggesting that expenditure is increasing at a higher rate than that of tax revenue. The projected increase in the tax ratio for 1996 and 1997 does not reflect revenue effects of new tax measures. Rather, they are based on the assumption of higher rates of economic growth and better enforced tax administration. The budget deficits ranged from a low of 9.2 percent of GDP in 1993 to a high of 21.8 percent of GDP in 1996. To reduce the deficit, the authorities have to continue their efforts to mobilize revenue and/or curtail expenditure.

The recent improvements in the tax revenue mobilization are primarily the result of the customs reform in 1995. The decline in the share of taxes on income and profits reflects the combination of : (i) changes in the relative importance of other categories of taxes, mainly import duties, and (ii) the revenue effects of the 1993 reform of these taxes which reduced the nominal rates to encourage the flow of international capital and direct investments and to improve the voluntary compliance by taxpayers. While the share of taxes on goods and services ranged from a minimum of 2.1 percent in 1995 to a maximum of 2.5 percent in 1993 and 1994, this share does not reflect the actual contribution of this category of taxes to total tax revenue, especially since 1995. The 1995 tariff reform that simplified customs administration incorporated the principal excise duties in the tariff. Therefore, the revenues from these excises, which are significant, as Table 4 suggests, have been recorded as revenue from Customs.

[2] For details of these reforms, see "Liban: L'Imposition des revenus et des bénéfices et sa réforme" by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and P. Kierstead, 1993; "Lebanon: Taxation of Goods and Services and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and R. Sandre, 1994; and "Lebanon: Review of Selective Tax and Customs Issues," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and M. Zarnowiecki, 1995.

Table 1. Revenue Developments, 1993-97
(In billions of LL)

	1993	1994	1995	Budget[1] 1996	Budget[1] 1997
Taxes on income and profits	232.9	267.9	294.9	515.0	505.0
Taxes on income	200.9	239.6	228.2	350.0	375.0
Taxes on inheritances	26.0	21.2	53.2	40.0	50.0
Taxes on property	6.0	7.0	13.5	125.0	80.0
Taxes on goods and services	325.4	380.5	385.6	460.0	567.0
Excises	115.0	127.0	90.6	60.0	65.0
Cement tax	6.5	21.6	20.0	25.0	25.0
Excises on alcoholic beverages [2]	2.3	7.6	9.0	10.0	10.0
Excises on tobacco[2]	...	...	...	25.0	30.0
Excises on fuel[2]	106.1	97.8	61.6	...	...
Passenger departure tax	13.8	27.5	33.7	40.0	40.0
Real estate fees	177.0	197.4	222.0	275.0	275.0
Other indirect taxes[3]	19.5	28.6	39.3	85.0	187.0
Taxes on foreign trade	661.4	791.4	1,320.0	1,800.0	1,800.0
Import duties and charges	661.4	791.4	1,320.0	1,800.0	1,800.0
Other taxes[4]	...	...	...	280.0	280.0
Total tax revenue	1,219.7	1,439.8	2,000.5	3,055.0	3,152.0
Nontax revenue[5]	635.3	801.8	1,032.5	970.5	948.0
Total revenue	1,855.0	2,241.6	3,033.0	4,025.5	4,100.0
Memorandum items:					
GDP	13,121.6	15,305.0	18,027.6	20,529.8	23,945.5
Budget deficit[6]	1,214.0	3,138.0	3,309.0	4,481.0	...
In percent of GDP	9.2	20.5	18.4	21.8	...

Source: Ministry of Finance, Banque du Liban, and mission calculations.

[1] Budget estimates.
[2] Since July 1995, excises on imported petroleum products, tobacco and cigarettes, and alcoholic beverages have been incorporated in customs duties.
[3] Includes fiscal stamp taxes until end-1995.
[4] Includes fiscal stamp taxes from 1996 onward.
[5] Including capital revenues from 1996 onward.
[6] For details of expenditure and budget deficit, see the most recent Report on Economic Developments "Lebanon - Economic Recovery, Stabilization, and Macroeconomic Policies", SM/94/207 and the most recent Statistical Appendix SM/96/99. Figures for 1996 are preliminary mission estimates.

Table 2. Revenue of Major Categories of Taxes as a Percent of Tax Revenue, 1993-97
(In percent)

	1993	1994	1995	Budget 1996	Budget 1997
Taxes on income and profits	19.1	18.6	14.7	16.9	16.0
Taxes on goods and services	26.7	26.4	19.3	15.1	18.0
Duties and taxes on imports	54.2	55.0	66.0	58.9	57.1
Other taxes	...	...	...	9.2	8.9
Total tax revenue	100.0	100.0	100.0	100.0	100.0
Memorandum items:					
Nontax revenue as a percent of tax revenue	52.1	55.7	51.6	31.8	30.1
Tax revenue as a percent of total revenue	65.7	64.2	66.0	75.9	76.9

Source: Ministry of Finance and mission calculations.

Table 3. Revenue of Major Categories of Taxes as a Percent of GDP and their Buoyancies, 1993-97

(In percent)

	Tax/GDP Ratios					Buoyancy [1]	
	1993	1994	1995	Budget 1996	Budget 1997	1993-95	1993-97
Taxes on income and profits	1.8	1.8	1.6	2.5	2.1	0.7	1.2
Taxes on goods and services	2.5	2.5	2.1	2.2	2.4	0.5	0.8
Duties and taxes on imports	5.0	5.2	7.3	8.8	7.5	2.7	0.6
As a percent of imports	7.7	8.5	12.1	16.6	14.7	...	...
Total tax revenue	9.3	9.4	11.1	14.9	13.2	1.7	1.0
Nontax revenues	4.8	5.2	5.7	4.7	4.0	1.7	-0.1
Memorandum items:							
Buoyancy of duties and taxes levied on imports with respect to imports	...	...	...	...	...	3.6	1.1

Source: Ministry of Finance and mission calculations.

[1] The buoyancy is measured as the relation between the percentage change of revenue and the percentage change of GDP. A distinction, however, must be made between buoyancy and elasticity of revenue as the latter gives an accurate idea of the responsiveness of different taxes to changes in GDP. The elasticity has to be measured after eliminating or adjusting for the revenue effects resulting from discretionary tax measures. Because of data constraints, it was not feasible for the mission to estimate the elasticity.

Table 4. Revenue (Customs and Excises) from Excisable Goods and their Allocation by Origin, 1996 [1]

(In billions of LL)

	Value of Imports			Combined Revenue			Revenue from Excises as Percent of Combined Revenue	Effective Rates (in percent)	
	Total	EU	Other Countries	Total		Customs Excise		Customs	Excises
Alcoholic Beverages	18.3	15.1	3.2	13.4	4.3	9.2	68.4	23.2	50.2
Tobacco and cigarettes	257.9	13.4	244.5	77.4	9.7	67.7	87.5	3.8	26.2
Petroleum products	388.2	201.1	187.1	206.1	28.3	177.9	86.3	7.3	45.8
Cement	53.1	39.0	14.2	13.3	4.0	9.3	70.1	8.0	17.0
Cars	661.3	328.0	333.3	144.4	108.3	36.1	25.0	16.3	5.5
Total excisable goods	1,378.8	596.6	782.2	454.7	154.6	300.1	66.0	11.2	21.8
Other imports	7,264.3	3,690.4	3,573.9	819.8		- -	- -	11.3	- -
Total all imports	8,643.1	4,287.0	4,356.1	1,275.0	974.3	300.1	23.5	11.3	3.5

Source: Mission calculations based on data provided by the authorities which cover the period January 1 - September 30, 1996.

1 Following the 1995 tariff reform, excise duties on the above mentioned commodities items which are levied equally on locally produced goods and their imported counterparts have been incorporated and collected at the stage of imports. This procedure aims at facilitating the administration of excises by collecting their principle share on imports without the lengthy procedures of assessment and collection.

2 Revenue from excises estimated on the basis of a comparison of 1995 values before and after the incorporation of excises into the tariff.

Chart 1. Distribution of Tax Revenue in Percent of GDP, 1993-97

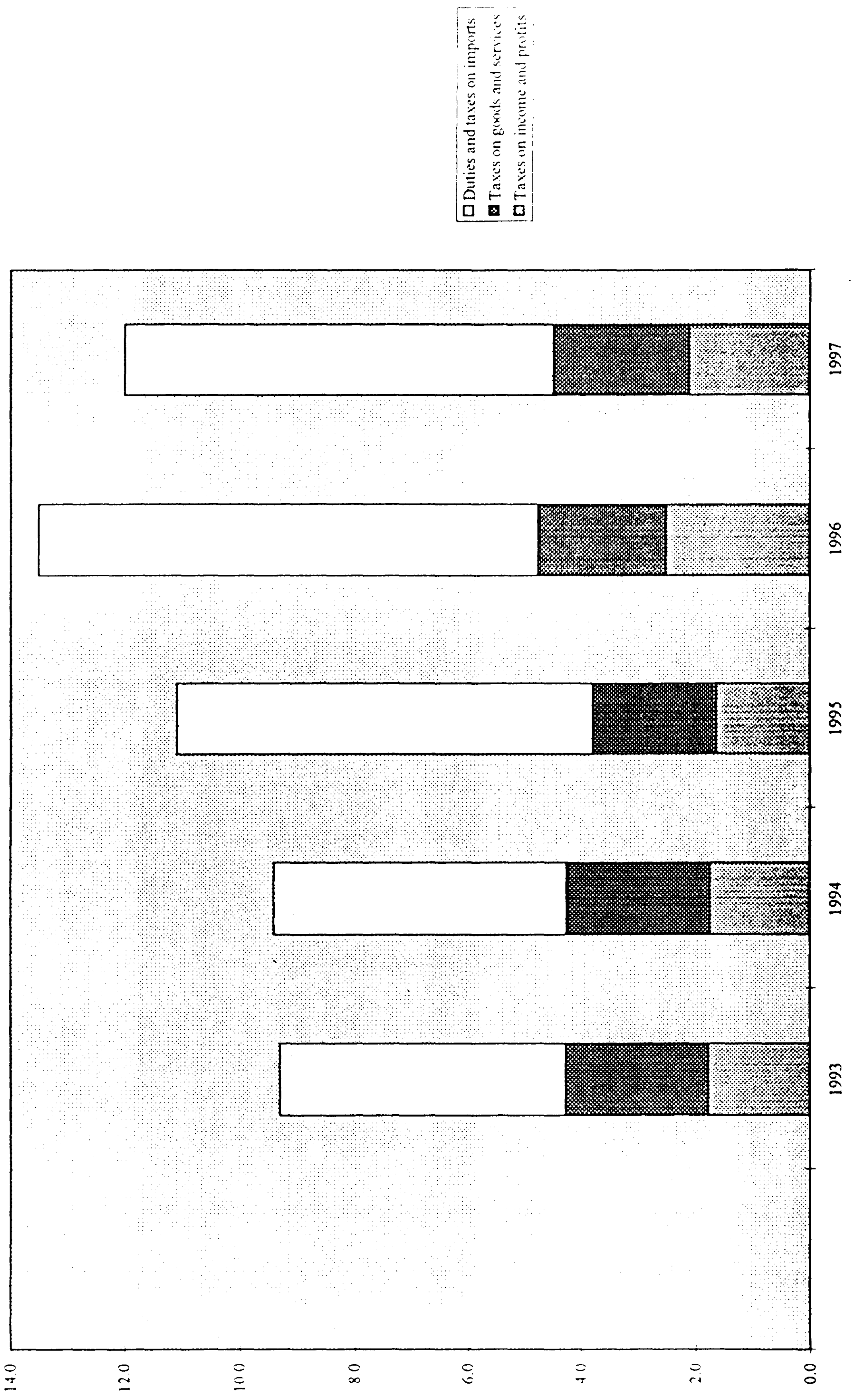
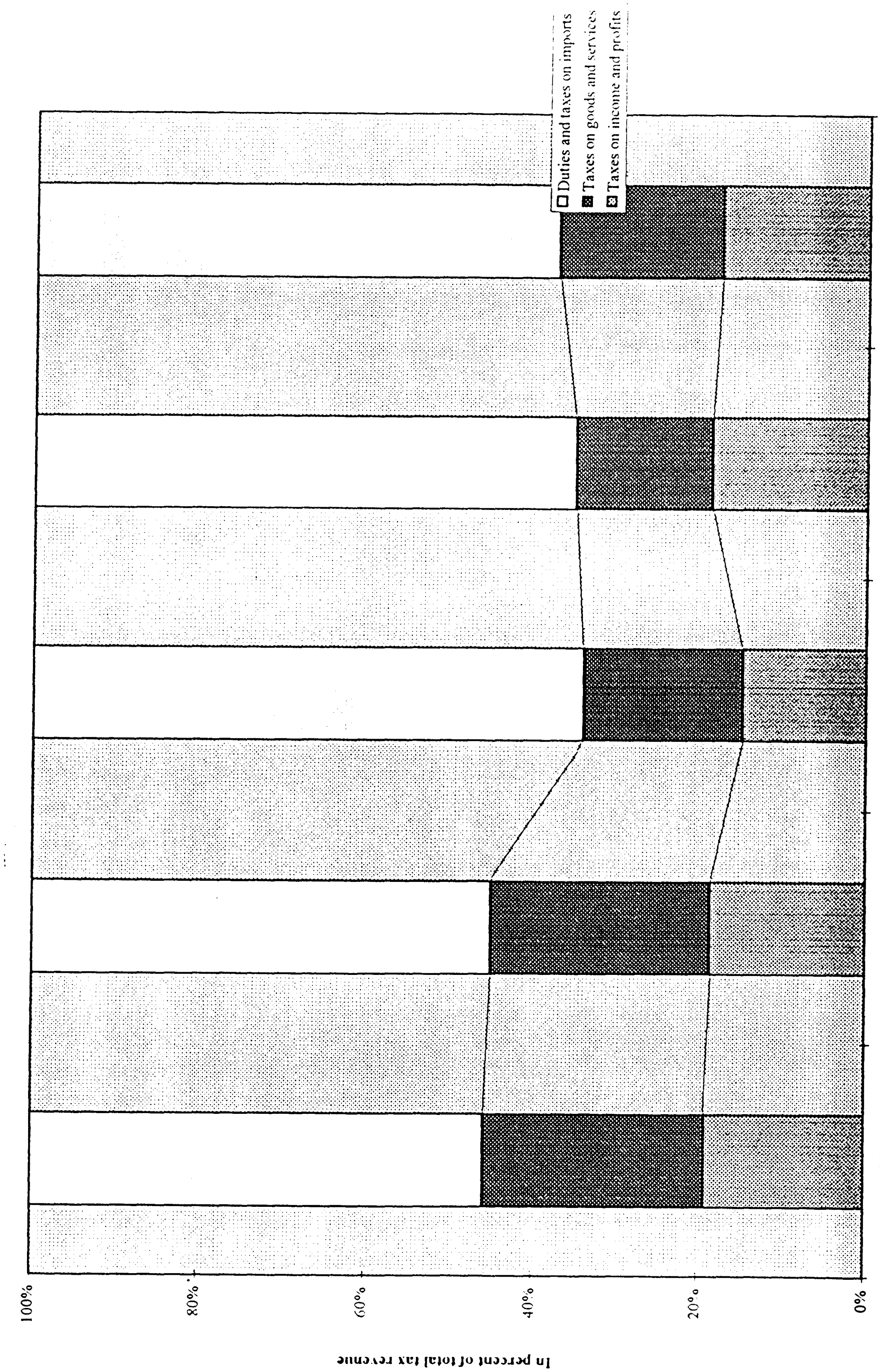


Chart 2. Structure of Tax Revenues, 1993-97



For 1993-95, the tax revenue registered a buoyancy ratio of 1.7, reflecting the net favorable revenue effects of major reforms introduced during this period and the improvement in the tax administration (Table 3). The projected decline for the period 1993-97 confirms the absence of major tax measures to be introduced in connection with the budgets of the last two years. The following discussion deals with the buoyancy of the major categories of taxes and duties.

Taxes on income and profits

Despite the progressive rates of these taxes, they registered over the 1993-95 period a buoyancy ratio of less than unity, although it is expected to reach 1.2 for the period 1993-97. Because of the lack of detailed data, it was not feasible to calculate the elasticity of these taxes. In addition, they have been subject to a major reform in 1993, which adopted the following measures: (i) the reduction in the nominal rates of corporate profits from 26 percent to 10 percent and from 15 percent to 5 percent for dividends and on other corporate distributions; (ii) the top marginal rates of individual income taxes were reduced from 32 percent to 10 percent for wages and salaries, and from 50 percent to 10 percent for individual business profits; (iii) the adoption of an amnesty program that added 9,700 taxpayers; and (iv) speeding up the payment of taxes withheld at source that previously were paid at the time of filing the declaration by withholders. In addition to these reform measures, the administration of these taxes is being strengthened and the Government expects an increase in their yield. The net effects of these measures that push in different directions cannot be quantified and therefore the interpretation of the tax buoyancy and the conclusion should be pursued with caution.

Duties and taxes on imports

This category of taxes registered the highest buoyancy ratio for the period 1993-95, reaching 2.7, reflecting the considerable favorable revenue effects of the 1995 tariff reform. This buoyancy ratio was also favorably influenced by the temporary increase in imports to meet the requirement of reconstructing the economy and its infrastructure. These imports and their share in GDP are likely to fall once the productive capacity of the Lebanese economy is reinstalled. The duties and taxes on imports were reformed in 1995, aiming at strengthening the customs tariff as a policy instrument, increasing its yield, simplifying its structure, and facilitating its administration. Customs revenues therefore almost doubled between 1994 and 1995, despite the relative decline in the share of imports in GDP. It should be noted that the high buoyancy ratio of duties and taxes on imports for the period 1993-95 reflects the once-and-for-all effects of the 1995 tariff reform, which can only be expected to have led to a sustained, one-time increase in the ratio of customs revenue to GDP. With an association agreement with the EU in the making, customs duties on imports originating in the EU are expected to be dismantled over the transitional period, and therefore the buoyancy of these duties is expected to decline.

Taxes on goods and services

During the period 1993-95, a number of measures with significant revenue effects were introduced. The excises on tobacco and cigarettes were raised to 30 percent, and the prices of petroleum products were also raised a number of times to narrow the gap with the international prices. Despite these developments, this category of taxes registered the lowest buoyancy ratio (0.5) during the period 1993-95. This is attributed to the collection of principal excises at the stage of importing and recording their revenue with that from customs duties as already explained. The low buoyancy ratio should reflect, among other things, the absence of a GST which is among the principal tax revenue sources in both developed and developing countries.

Comparison of Lebanon's tax system with other associated countries

Table 5 compares the revenue structure of Lebanon with that of some associated countries. Conclusions to be reached from this comparison need to be interpreted with care in view of the particular differences of tax policies in different associated countries, as well as differences in the efficiency of the institutions in charge of tax and customs administration. The comparison reveals the following factors which could bear directly on the association effects and on the size of the revenue loss from customs duties.

- Lebanon and Algeria have the lowest tax ratio despite the fact that their per capita income is not necessarily among the lowest. The low tax ratio suggests in itself the feasibility of mobilizing additional tax revenue.

- Lebanon generates the largest share of tax revenues from duties and taxes on imports reaching 66 percent, to be compared with 9.2 percent in Malta and 11 percent in Israel. With due recognition to the fact that revenues from principal excises are recorded in this category, Lebanon is expected to face a relatively large loss of tax revenue from this source which has to be compensated for by other sources.

- The Lebanese tariff, as reformed in 1995, seems to adhere to the contemporary norms of restructuring tariffs as the rates have become fewer and lower. Quantitative restrictions have been virtually removed and replaced by the tariffs which seem to be oriented toward revenue rather than protection.

- With the exception of Syria, Lebanon has the lowest share of tax revenue generated by taxes on goods and services. Both countries do not levy GSTs and this could add to the difficulties to be confronted within the process of replacing the loss from customs duties with a GST, which has to be introduced, implemented, and reinforced before reaching its full capacity of revenue mobilization.

- Taxes on income and profits generate in Lebanon the lowest share of tax revenue suggesting the possibilities for mobilizing additional revenues from these taxes.

Following the 1993 income tax reform, Lebanon is concentrating on tax administration as the means of raising revenues. Despite the importance of improving tax administration and taxpayers' compliance, their contribution to increased revenue cannot be substantial, especially in view of the large revenue loss expected from dismantling the customs duties on imports from EU.

- Lebanon has fewer public enterprises than any other associated country and cannot exercise the option of using privatization proceeds to facilitate the adjustment of the tax system to the revenue losses implied by the association agreement.

- Lebanon's public finances are characterized by a budget deficit that is much larger than in any other associated country. The need to compensate for revenue losses from the elimination of duties and taxes on imports from EU countries adds further urgency to the already pressing requirement to mobilize revenue to minimize the possibilities of aggravating budget deficit, which could nullify the objectives of the trade liberalization.

Table 5. Tax Structure of Certain Associated States, 1995

(In percent of tax revenue)

Country and Year	Taxes on Income and Profits: Total	Individuals	Corporations	Taxes on Goods and Services	Duties and Taxes on Imports	Other	Tax Ratio (In percent of GDP)	Buoyancy Tax Revenue (1990-95)
Lebanon,	14.7	...	...	19.3	66.0	--	11.1	...
Algeria	23.0	13.3	...	42.8	31.4	2.8	11.8	0.87
Cyprus	33.0	23.4	9.6	47.1	12.4	7.5	18.4	1.75
Egypt	35.8	4.1	31.7	27.3	20.7	16.2	17.0	1.14
Israel[1]	45.9	33.4	12.5	39.1	10.6	4.4	31.6	1.05
Jordan	20.0	8.1	11.9	43.3	34.6	2.1	16.4	1.25
Malta, 1994	57.1	15.8	16.5	33.7	9.2	...	27.9	...
Morocco	27.4	18.6	8.9	52.2	20.4	2.4	21.0	1.72
Syria,	26.1	4.5	21.6	4.0	14.3	55.6	18.2	1.86
Tunisia	19.2	...	...	27.5	30.6	22.7	25.1	1.12
Turkey	39.9	30.4	9.5	39.7	17.9	2.5	14.2	1.25

Source: Mission calculations on the basis of the most recent data available (1995) unless it is indicated otherwise.

[1] Distribution of revenue from taxes on income and profits between corporations and individuals is estimated on the basis of 1994 data.

4. Taxation of Imports and the Implications of the Association Agreement

The 1995 tariff reform

The tariff reform of 1995 was a major step toward tariff simplification and transparency and it remains the basis of Lebanon's import taxation and its policy.[3] The reform reduced the tariff rates from 31 to 10 with a minimum of 2 percent. It eliminated all exemptions other than those for the armed forces and according to international agreements. The reform also eliminated the many additional duties and charges and consolidated them in the tariff. It put an end to a multitude of import duties and charges, each of which used to have its own rate structure and patterns of exemptions and exclusions. The appreciated "customs dollar" which was used in calculating the dutiable value of imports in Lebanese Pounds was eliminated and therefore customs and market exchange rates have been unified.

The consolidation of additional duties and charges coupled with rate reduction lowered the combined number of tariff rates from 72 to 12 and tariff items from 2,200 to 1,750. The revenue effects of the reform, despite rate reductions, have been quite favorable. Revenue generated by import duties increased from 5.2 percent of GDP in 1994 to 8.8 percent in 1996. The average effective tariff rate (import duties as a percent of total imports) also increased from 8.5 percent in 1994 to 15.6 percent in 1996 (Table 6). In addition, the Customs Department has started computerizing its operations, and for the first time since 1977 data on imports and their revenue are available without any delay. The significant increase in revenue yield is attributed mainly to the elimination of exemptions and the application of a minimum rate of 2 percent on virtually all imports.

The major limitation of the reform has been the consolidation of the principal excise duties levied on locally produced goods and imports into the customs duties. The consolidation aimed at collecting these excises at the stage of importing to strengthen the administration and to reduce the lengthy procedures of assessment and collection. The 1995 technical assistance mission had already underlined the adverse effects of this consolidation on the structure of the tariffs and equal taxation of locally produced goods and imports. It suggested the separation of customs duties from excises and emphasized that separation would not preclude the collection of excises at Customs to reinforce the entire tax administration.[4]

To conclude, the 1995 tariff reform has resulted in a simplified, transparent tariff with favorable revenue effects. It also reinforced trade liberalization as virtually all quantitative

[3] For more details of this reform, see "Lebanon: Taxation of Imports and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and P. Kierstead, 1993.

[4] For details, see "Lebanon: Review of Selective Tax and Customs Issues," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and M. Zarnowiecki, 1995.

Table 6. Evolution of Import Duties and Taxes, 1993-97
(In billions of LL)

	1993	1994	1995	1996[1]	Budget 1997
Value of imports	8,545.6	9,309.1	10,897.6	11,524.1	12,204.0
Duties and taxes on imports	661.4	791.4	1,320.0	1,800.0	1,800.0
Duties and taxes on imports as a percent of tax revenue [2]	54.2	55.0	66.0	58.9	57.1
Duties and taxes on imports as a percent of imports	7.7	8.5	12.1	15.6	14.7
Duties and taxes on imports as a percent of GDP	5.0	5.2	7.3	8.8	7.5

Source: Mission calculations based on data provided by the authorities.

[1] Import projections based on data for the first nine months.

[2] Following the 1995 tariff reform, revenue from principal excises has been incorporated in revenue from customs duties.

restrictions were removed and replaced by tariff duties. Lebanon does not discriminate against imports according to their origin, although it has not yet joined the World Trade Organization (WTO). It has concluded a number of trade agreements with some Arab countries that provide tariff concessions on a reciprocal basis.

The implications of the association agreement

Lebanon signed the Euro-Mediterranean Association which has political, economical, social, and financial objectives.[5] In the economic area, the association agreement aims, inter alia, at the establishment of an FTA. The agreement, once it is concluded, will eliminate customs duties and other charges having the same effect on imports of EU origin over a 12-year transitional period.

[5] The Associated States are Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Palestinian Authority, Syria, and Tunisia.

The authorities are quite concerned about the implications of the agreement on public finance, trade direction, employment, and eventually the economic development of Lebanon. The agreement will replace the trade agreement of 1978 with the EU which remains in effect.

The 1978 agreement allows exports of Lebanese origin exemption from EU customs duties. These trade advantages are granted under the Generalized System of Preference (GSP) and do not require reciprocal treatment. The association agreement departs considerably from the 1978 agreement as it requires reciprocal treatment for exemptions from customs duties. It is to be noted that under the Yaoundé convention, the European Community (EC) required exemption for imports of EEC origin in African associated countries from "customs duties."[6] The condition of reciprocity was abandoned, however, under the Lomé convention in 1975 and was extended to Lebanon along with many other developing countries under the GSP.

The association agreement is based to a large extent on those already signed by Morocco, Tunisia, and Israel without adequate consideration to the particular circumstances of Lebanon. These circumstances include: (i) the liberal and transparent nature of the Lebanese tariff in comparison with those in most associated countries, leaving limited scope for further liberalization, (ii) the predominant fiscal role of the Lebanese tariff, and the particular structure of the Lebanese economy which is characterized, among other things, by relatively high per capita imports, a large share of which consists of imported industrial goods. It is estimated that the per capita imports from the EU amount to US$2,000 per year. These factors would make the magnitude of the revenue loss resulting from the elimination of customs duties much larger than in any other associated country. In addition, the customs duties as incorporated in the tariff include, for administrative reasons, fiscal elements (excises) which are of particular revenue importance. Article 12 of the draft agreement stipulates that customs duties of fiscal nature should be eliminated in the same way as protective duties. The application of this article could have far-reaching consequences on the revenue from customs duties and it could, in the absence of adequate corrective measures, aggravate the budget deficit which is already at a critical level.[7]

The contribution of the agreement to the economic development of Lebanon and its welfare depends primarily on the flow of international capital and its investment in the

[6] The Yaoundé Convention provides, in its Article 3(1), that: "Products originating in the Community may be imported into each Associate State free of customs duties and charges having equivalent effect." In its Article 3(2), it specifies that: "Each Associated State may, however, retain or introduce customs duties and charges having equivalent effect which are necessary to meet their development needs or which are intended to contribute to their budgets." The application of a two-column tariff would make it possible to grant exemptions from customs duties originating in the EU, while safeguarding certain fiscal revenue. However, the association agreement does not authorize such a solution, even if this had been accepted by the EEC in the Yaoundé Convention.

[7] For a detailed discussion of duties of fiscal nature, sometimes referred to as revenue duties, and their treatment under Free Trade Areas reference is made to Curzon Price, V. "The Essentials of Economic Integration," (New York: St. Martins' Press, 1974). It was noted that some European countries (Switzerland) in their negotiations with EFTA retained their revenue duties for a variety of reasons, including administrative convenience. Other member countries of EFTA were allowed to continue to collect excise duties at the frontier if that was what they used to do. Finally, some other countries argued that governments are reluctant to change their tax laws unless there are compelling reasons to do so.

manufacturing and service sectors. Exports of industrial products to the EU are not expected to be significant because the agreement does not give additional incentives, other than those already available under the 1978 system. The business community hopes that the agreement, which is bilateral between EU and each associated country, would encourage regional trade among Mediterranean associated countries through removal of tariff and other trade barriers. There is also a growing concern among some associated countries about the net contribution that may result from the agreement. These countries feel that the agreement will succeed in reducing the size of import competing sectors, but it may do little to encourage exports and foreign investment.[8]

Fiscal impact of the agreement and suggested compensatory measures

According to Table 7, imports of EU origin amounted to about 50 percent of imports in 1996, and the correspondent share of import duties was 51.3 percent, while the average tariff rate on imports from the EU is 15.2 percent to be compared with 14.7 percent for all imports. The origin of imports is therefore not an important a factor influencing the tariff burden.

The agreement requires that all duties and taxes with an equivalent effect on import from the EU be eliminated over a transitional period of 12 years. During the initial negotiations in 1996, a provisional timetable for the tariff dismantlement was proposed (Table 8). Under the assumption that the share of imports originating from the EU and their share in GDP remain constant during the transitional period, this timetable permits the calculation of the gross revenue loss on the basis of 1996 data only. The loss increases gradually to 1.3 percent of GDP over the first eight years before it accelerates during the remaining four years, reaching 4.2 percent of GDP at the end of the transitional period (Table 9).

To compensate for the revenue loss after adjustment for excises with fiscal elements which will continue to be significant, the mission suggests: (i) maximizing the revenue to be collected from customs duties during the transitional period without the risk of being in conflict with the agreement, and (ii) introducing the GST which has been on the agenda of the Lebanese tax reform since 1994. The mission is not suggesting reform measures for taxes on income and profits as the 1993 reform that came into effect in 1994 has not yet achieved its full impact. It would be counterproductive to engage in new reform measures in view of the very short time that has elapsed since the last major reform. Meanwhile, the authorities are contemplating modernization of the administration of these taxes by training tax auditors and improving their knowledge and professional skills, computerizing the operations of the Revenue Department, and establishing an LTU responsible for auditing taxes levied on large taxpayers or withheld by them from employees' salaries and wages. The program of tax

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[8] See "The proposed free-trade agreement between Lebanon and European Union countries," by Iskander Moukarbel, Association des banques du Liban, 1996, and "Preferential Trade Arrangements: The Traditional and the New" by Robert Z. Lawrence, Working Paper No. 6, The Egyptian Center for Economic Studies, 1996.

Table 7. Distribution of Imports by Tariff Rates and Origin, 1996

Tariff Rates	In billion LL		Percentage Share in Total		Share	In billion LL		Cum. Share in Percent		Effective Tariff	
	Total	EU	Total	EU	EU	Total	EU	Total	EU	Total	EU
0	221.7	0.6	2.6	--	0.3	--	--	--	--	--	--
Min-Max [1]	411.0	256.0	4.8	6.0	62.3	362.0	216.6	28.4	33.2	88.1	84.6
2	2,032.1	1,199.4	23.5	28.0	59.0	39.4	23.8	31.5	36.8	1.9	2.0
5	1,075.6	502.1	12.4	11.7	46.7	47.4	22.8	35.2	40.3	4.4	4.5
10	1,956.4	1,034.7	22.6	24.1	52.9	189.6	99.7	50.1	55.5	9.7	9.6
15	826.1	335.0	9.6	7.8	40.6	120.4	48.8	59.5	63.0	14.6	14.6
20 [2]	1,084.5	524.1	11.7	11.3	48.3	223.4	109.3	77.1	79.7	20.6	20.9
25	334.4	133.5	3.9	3.1	39.9	83.5	33.3	83.6	84.8	25.0	25.0
30	611.4	237.2	7.1	5.5	38.8	172.3	70.6	97.1	95.6	28.2	29.8
35	75.8	56.6	0.9	1.3	74.6	25.8	19.5	99.2	98.6	34.0	34.4
40	0.5	0.5	--	--	93.8	0.2	0.2	99.2	98.7	39.8	39.8
50	0.8	0.5	--	--	68.3	0.3	0.2	99.2	98.7	43.9	41.1
80	11.2	10.5	0.1	0.2	93.6	9.0	8.4	99.9	100.0	80.0	80.0
100	1.7	0.3	--	--	17.4	1.1	0.2	100.0	100.0	65.6	73.8
Total	8,643.0	4,291.0	100.0	100.0	49.6	1,274.5	653.4	...	...	14.7	15.2

Source: Mission calculations based on data submitted by the High Customs Council and limited to the period January 1-September 30, 1996.

[1] Goods taxed at alternative rates (ad valorem or specific) to generate the maximum of revenue.
[2] Includes imports of cars.

Table 8. Timetable for Tariff Dismantlement by Tariff Rates According to the Draft Agreement of Association, 1996[1]

(In percent)

Tariff Rates	Tariff rate at the beginning of year												
	1	2	3	4	5	6	7	8	9	10	11	12	13
2[2]	2.0	2.0	--	--	--	--	--	--	--	--	--	--	--
5	5.0	5.0	5.0	5.0	5.0	4.6	4.2	3.8	3.4	2.7	2.0	1.0	--
10	10.0	10.0	10.0	10.0	10.0	9.2	8.4	7.6	6.8	5.4	4.0	2.0	--
15	15.0	15.0	15.0	15.0	15.0	13.8	12.6	11.4	10.2	8.1	6.0	3.0	--
20	20.0	20.0	20.0	20.0	20.0	18.4	16.8	15.2	13.6	10.8	8.0	4.0	--
25	25.0	25.0	25.0	25.0	25.0	23.0	21.0	19.0	17.0	13.5	10.0	5.0	--
30	30.0	30.0	30.0	30.0	30.0	27.6	25.2	22.8	20.4	16.2	12.0	6.0	--
35	35.0	35.0	35.0	35.0	35.0	32.2	29.4	26.6	23.8	18.9	14.0	7.0	--
40	40.0	40.0	40.0	40.0	40.0	36.8	33.6	30.4	27.2	21.6	16.0	8.0	--
50	50.0	50.0	50.0	50.0	50.0	46.0	42.0	38.0	34.0	27.0	20.0	10.0	--
80	80.0	80.0	80.0	80.0	80.0	73.6	67.2	60.8	54.4	43.2	32.0	16.0	--
100	100.0	100.0	100.0	100.0	100.0	92.0	84.0	76.0	68.0	54.0	40.0	20.0	--

Source: Mission calculations based on data provided by the authorities.

[1] The latest edition of the Draft Association Agreement is of September 1996. It is understood which has been temporarily suspended to evaluate the benefits and costs from the Association.

[2] The Draft Agreement provides for the elimination of the minimum tariff rate of 2 percent following two years of its signature. It also provides for a five year grace period for other rates' reduction.

Table 9. Customs Revenue Loss Implied by Tariff Dismantlement According to the Draft Agreement of the Association, 1996

(In billions of LL)

Tariff Rates	EU Imports 1996	Customs revenues in year 1	2	3	4	5	6	7	8	9	10	11	12	13
2	1199	24.0	24.0	--	--	--	--	--	--	--	--	--	--	--
5	502	25.1	25.1	25.1	25.1	25.1	23.1	21.1	19.1	17.1	14.0	10.0	5.0	0.0
10	1035	104.0	104.0	104.0	104.0	104.0	95.2	87.0	79.0	70.4	56.0	41.4	21.0	0.0
15	335	50.3	50.3	50.3	50.3	50.3	46.2	42.2	38.2	34.2	27.1	20.1	10.1	0.0
20 [1]	524.1	113.2	113.2	113.2	113.2	113.2	96.4	88.1	80.0	71.3	57.0	42.0	21.0	0.0
25	134	33.4	33.4	33.4	33.4	33.4	31.0	28.0	25.4	23.0	18.0	13.4	7.0	0.0
30	237.2	71.2	71.2	71.2	71.2	71.2	66.0	60.0	54.1	48.4	38.4	29.0	14.2	0.0
35	57	20.0	20.0	20.0	20.0	20.0	18.2	17.0	15.1	14.0	11.0	8.0	4.0	0.0
40	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0
50 [2]	204	199.2	199.2	199.2	199.2	199.2	183.3	167.3	151.4	135.4	108.0	80.0	40.0	0.0
80	11	8.4	8.4	8.4	8.4	8.4	8.0	7.0	6.4	6.0	5.0	3.4	2.0	0.0
100	0.3	294.0	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.0
Total Customs Revenue from EU		648.3	648.3	624.4	624.4	624.4	567.0	518.0	468.2	419.0	333.0	246.4	123.2	0.0
Memorandum Items:														
Implied Gross Revenue Loss [3]		--	--	-24.0	-24.0	-24.0	-82.0	-131.0	-180.2	-230.0	-36.0	-402.0	-521.1	-648.3
As a percent of Total Customs Revenue		--	--	-1.9	-1.9	-1.9	-6.4	-10.3	-14.1	-18.0	-24.8	-31.5	-41.2	-50.9
As a percent of Total Revenues		--	--	-0.8	-0.8	-0.8	-2.7	-4.3	-6.0	-7.6	-10.5	-13.3	-17.4	-21.5
As a percent of GDP		--	--	-0.2	-0.2	-0.2	-0.5	-0.9	-1.2	-1.5	-2.1	-2.6	-3.4	-4.2

Source: Mission calculations based on data submitted by the High Customs Council and limited to the period of January 1- September 30, 1996.

[1] Includes imports of cars of which imports from EU generated customs revenues of LL 74,989 million.

[2] Includes imports of some petroleum products which are taxed at ad valorem tariff rates of 50 percent, but which are assessed according to the max-min valuation procedure. See footnote 1 of Table 7. The tariff reduction schedule for the effective tariff rate of these product follows the draft proposal.

[3] The gross revenue loss is the maximum loss to result from the application of the tariff reduction schedule to EU imports under static conditions and without the introduction of prior measures (measures that can be introduced independently of the Association).

administration modernization is in its early stages, but there are indications that it will contribute to a survey of taxpayers and enforced assessment and collection. In view of the large size of the revenue to be compensated for due to the association, and the modest increases achievable through improved tax administration, it would be more productive to concentrate on taxes on goods and services and customs duties. Furthermore, the authorities continue to emphasize lower tax rates on income and profits as a mean to improve the entire tax administration.

Measures to mobilize revenues from customs duties

In addition to the proposed GST which will be levied when adopted on imports, irrespective of their origin, the mission suggests the consideration of the following:

Separation of excises from customs duties

Table 4 illustrates the revenue generated from the principal excises that are currently recorded with customs duties despite their fiscal nature. In view of their significant revenue, they should be separated from the customs duties as a safeguard against the possibility of being eliminated in accordance of Article 12 of the association agreement. This separation could have been introduced with the 1995 tariff reform, for structural improvement and assurance that locally produced goods are equally treated with imports. The separation should reveal the real revenue loss which is unnecessarily inflated. This measure should not change the burden of duties and taxes on excisable goods (imports and local production). It is, however, a necessary precautionary measure to guarantee that there will be no unnecessary revenue loss from this important source that can hardly be compensated for. The 1995 technical assistance mission had already argued, for policy and administration purposes, against the complete consolidation of excises into the customs tariff duties for the following reasons:

-- The coordination of future changes in excises on locally produced goods and on imports cannot be implemented because excises on imports no longer exist as separate duties.

-- The consolidation gives the impression that locally produced excisable goods are discriminated against, because the record of payment of the equivalent of these excises on imports has already disappeared in the process of consolidation. This may bring pressures from local producers to eliminate excises levied on their production.

-- The consolidation deviates from the widely accepted principle of separating the role of the tariff from that of GSTs and excises. The tariff is increasingly recognized as the sole instrument for protection. In Lebanon, despite the importance of the revenue the tariff generates, this importance has to be reduced in favor of excises and a GST.

Once the revenue from excises is separated from total customs revenue, as recommended by the mission, the actual revenue loss shown in Table 9 would decline from 4.2 percent to 2.7 percent of GDP (Table 4 and Table 13).[9]

Increases in the excise rates

The mission is fully aware of the effective measures introduced over the last two to three years to mobilize revenues from the principal excises, mainly those on tobacco and petroleum products. The mission suggests that prices charged for these excisable goods be periodically reviewed to generate additional revenue from this important source. Such a review would ensure that the relative importance of excise duties as a source of tax revenue would not be eroded by inflation and that they would generate as a minimum an increase equivalent to the increase in the rate of government expenditure. Despite the recent increased revenue from excises (Table 10) the mission feels that further increases can be generated from these excises, irrespective of the outcome of these agreements.

Table 10. The Budget Revenues from Tobacco and Cigarettes, 1993-96
(In billions of LL)

Year	Transfer	Customs	Total
1993	13.6	6.5	20.1
1994	9.3	7.6	16.9
1995	34.4	54.0	88.4
1996 [1]	30.6	90.0	120.6

Source: Based on data provided by the authorities.
[1] Data limited to the period January 1-September 30, 1996.

Changes in the timetable of tariff dismantlement

The draft agreement of September 1, 1996 suggests: (i) the elimination of the 2 percent tariff rate two years after the agreement comes into effect, and (ii) the progressive reduction of the remaining rates after a grace period of five years and over seven years, which brings all customs duties from EU imports to zero by the end of the transitional period (Table 9). As an alternative to this timetable, the mission suggests the following formula: (i) consolidation of the minimum rate of 2 percent into the 5 percent rate which, as a new minimum, should be levied on all imports, including those of EU

[9] The calculations of the revenue effect of the agreement are on a static basis. No attempt has been made to calculate changes in the imports from EU following the reduction of customs duties. Equally, the trade diversion from third countries into Lebanon to benefit from tariff reductions has not been taken into account.

origin during the entire transitional period, as suggested in Table 11;[10] (ii) elimination of the top rates of 40 percent, 50 percent, 80 percent, and 100 percent and limitation of the highest tariff rate to 35 percent; and (iii) progressive reduction of tariff rates starting after five years of grace (Table 11). Lowering the top rates does not seem to have a significant revenue impact as imports subject to these rates and their correspondent revenues do not exceed 1 percent (Table 7). On the other hand, increasing and generalizing a minimum tariff rate at 5 percent tends to protect revenue and minimize the differences between the tariff burden on imports from the EU and the rest of the world (Table 12). Table 13 compares the revenue effects of tariff dismantlement as incorporated in the Agreement with those from the mission's recommendations.

The basis of customs duties reduction

According to the draft agreement tariff rates as of January 1, 1997 should serve as the basis for customs duties reductions. This date is no longer applicable in view of the suspension of the negotiations with the EU. The question to be decided is the tariff level binding and its form. Given the Lebanese tariff rate structure, the mission judges that a tariff rate (after separating excises from customs duties) of 35 percent represents a reasonable binding level for all tariff items. An overall binding commitment is preferable to specific tariff items, which would require detailed negotiations and could add unnecessary rigidities in case of the need for changing some tariff items.

State monopolies

In contrast to many associated countries, Lebanon does not have important state monopolies which should be privatized over five years from the effective date of the agreement. The tobacco monopoly (Régie) needs to be privatized, after a transitional period, to achieve complete competition between Lebanon and the EU. The requirement could enhance the Ministry of Finance's efforts to control the Régie, public its accounts after being audited by an independent auditor, and increase its contribution to the budget in the form of increased excises or transfers.

Tariff nomenclature

The 1995 tariff reform introduced the harmonized system (HS) which is the same for the EU but with further differentiations known as the "combined nomenclature." The draft agreement stipulates that the combined nomenclature be the basis for classifying goods in trade between Lebanon and the EU.

[10]Depending on the outcome of the negotiations, the suggested minimum rate of 5 percent could become a permanent element of the tariff.

Table 11. Timetable for Tariff Dismantlement by Tariff Rates According to Mission's Proposals
(In percent)

Tariff Rates	Tariff rate at the beginning of year												
	1	2	3	4	5	6	7	8	9	10	11	12	13
2 [1]	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	...
5 [1]	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	...
10	10.0	10.0	10.0	10.0	10.0	8.8	7.5	6.3	5.0	3.8	2.5	1.3	...
15	15.0	15.0	15.0	15.0	15.0	13.1	11.3	9.4	7.5	5.6	3.8	1.9	...
20	20.0	20.0	20.0	20.0	20.0	17.5	15.0	12.5	10.0	7.5	5.0	2.5	...
25	25.0	25.0	25.0	25.0	25.0	21.9	18.8	15.6	12.5	9.4	6.3	3.1	...
30	30.0	30.0	30.0	30.0	30.0	26.3	22.5	18.8	15.0	11.3	7.5	3.8	...
35	35.0	35.0	35.0	35.0	35.0	30.6	26.3	21.9	17.5	13.1	8.8	4.4	...
40 [2]	40.0	40.0	40.0	40.0	40.0	35.0	30.0	25.0	20.0	15.0	10.0	5.0	...
50 [2]	50.0	50.0	50.0	50.0	50.0	35.0	30.0	25.0	20.0	15.0	10.0	5.0	...
80 [2]	80.0	80.0	80.0	80.0	80.0	35.0	30.0	25.0	20.0	15.0	10.0	5.0	...
100 [2]	100.0	100.0	100.0	100.0	100.0	35.0	30.0	25.0	20.0	15.0	10.0	5.0	...

Source: Mission calculations based on data provided by the authorities.

[1] The mission suggests that the minimum tariff rate of 2 percent be consolidated in the rate of 5 percent which should remain unchanged during the transitional period.

[2] The mission also proposes that the top high rates of 100 percent, 80 percent, 50 percent, and 40 percent be eliminated after the fifth year following the signature of the agreement.

Table 12. Customs Revenue Loss Implied by Tariff Dismantlement According to the Mission's Proposals, 1996

(In billions of LL)

Tariff Rates	EU Imports 1996	Customs revenues in year 1	2	3	4	5	6	7	8	9	10	11	12	13
5	1701.5	85.1	85.1	85.1	85.1	85.1	85.1	85.1	85.1	85.1	85.1	85.1	85.1	--
10	1034.7	103.4	103.5	103.5	103.5	103.5	90.5	77.6	64.7	51.7	38.8	25.9	12.9	--
15	335	50.2	50.2	50.2	50.2	50.2	44.0	37.7	31.4	25.1	18.8	12.6	6.3	--
20 [1]	524.1	113.2	113.2	113.2	113.2	113.2	91.7	78.6	65.5	52.4	39.3	26.2	13.1	--
25	133.5	33.4	33.4	33.4	33.4	33.4	29.2	25.0	20.1	16.7	12.5	8.3	4.2	--
30	237.2	71.1	71.1	71.1	71.1	71.1	62.3	53.4	44.5	35.6	26.7	17.8	8.9	--
35	56.6	19.8	19.8	19.8	19.8	19.8	17.3	14.9	12.4	9.9	7.4	5.0	2.5	--
40	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	--	--	--	--	--
50 [2]	203.5	199.1	199.1	199.1	199.1	199.1	183.2	167.2	151.3	135.4	107.5	79.6	39.8	--
80	10	8.4	8.4	8.4	8.4	8.4	3.7	3.1	2.6	2.1	1.6	1.0	524.1	--
100	0.3	0.3	0.3	0.2	0.3	0.3	0.1	--	--	--	--	--	--	--
Total customs revenue from EU		684.2	684.2	684.2	684.2	684.2	607.2	542.9	478.5	414.1	337.8	261.5	173.3	--
Memorandum items:														
Implied gross revenue loss [3]		35.9	35.9	35.9	35.9	35.9	-41.2	-105.5	-169.9	-234.2	-310.5	-386.8	-475	-648.2
As a percent of total customs revenues		2.8	2.8	2.8	2.8	2.8	-3.2	-8.3	-13.3	-18.4	-24.4	-30.4	-37.3	-50.9
As a percent of total revenues		1.2	1.2	1.2	1.2	1.2	-1.4	-3.5	-5.6	-7.8	-10.3	-12.8	-15.7	-21.5
As a percent of GDP		0.2	0.2	0.2	0.2	0.1	-0.3	-0.7	-1.1	-1.5	-2.0	-2.5	-3.1	-4.2

Source: Staff calculations based on data submitted by the High Customs Council and limited to the period of January 1- September 30, 1996.

[1] Includes imports of cars of which imports from EU generated customs revenues of LL 75.0 billion.

[2] Includes imports of some petroleum products which are taxed at ad valorem tariff rates of 50 percent, but which are assessed according to the max-min valuation procedure. See footnote 1 of Table 7. The tariff reduction schedule for the effective tariff rate of these product follows the draft proposal.

[3] The gross revenue loss is the maximum loss to result from the application of the tariff reduction schedule to EU imports, under static conditions and without the introduction of prior measures (measures that can be introduced independently of the association).

Table 13. Revenue Effects of the Association Agreement and the Mission's Recommendations, 1996 [1]

(In percent)

	Year after association agreement becomes effective												
	1	2	3	4	5	6	7	8	9	10	11	12	13
Revenue loss according to association [2]	--	--	-0.2	-0.2	-0.3	-0.6	-1.0	-1.3	-1.7	-2.2	-2.9	-3.7	-4.2
Revenue effects of mission's recommendations													
Separation of excises from customs duties	--	--	--	--	--	0.1	0.2	0.4	0.5	0.7	0.9	1.2	1.5
Minimum tariff rate of 5 percent	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.1
Introduction of a GST[3]	--	--	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Change in tariff dismantlement schedule	--	--	--	--	--	0.2	0.2	0.1	--	0.1	0.1	0.3	--
Net revenue impact (mission proposal)	0.3	0.3	3.1	3.1	3.0	3.0	2.8	2.5	2.1	1.8	1.4	1.1	0.4

Source: Mission calculations based on information and data provided by the authorities.

[1] See also Table 9 for details of the calculations.

[2] The gross revenue loss is the total loss that would result from the association agreement according to its current draft and without any prior or compensatory measures, some of which fall entirely within the jurisdiction of Lebanon and can be introduced independently of the association agreement.

[3] The probable revenue effects of the GST are based on the work of earlier missions (see "Lebanon: Taxation of Goods and Services and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and R. Sandre, 1994.

The adoption of the additional differentiation may be an unnecessary burden to Lebanon, especially in the early stage of the agreement. Lebanon could continue using its current harmonized system as a basis for classification. This has already been agreed upon with Israel (Article 6 of the EU-Israeli agreement).

Valuation and rules of origin

Currently Lebanon applies the Brussels Definition of Value (BDV) as a basis for valuation, although some efforts are being undertaken to move to the GATT valuation. According to the draft agreement valuation and origin should be based on the WTO (GATT) code. The Lebanese delegation should consider its position in this respect and decide whether and when to accept the obligations of the WTO. The principal difference between the BDV and WTO (GATT) is that under the BDV the basis for valuation is the price the imported good would fetch on the open market, not necessarily the invoice price. This allows Customs to reassess the value of goods when it is understated. The WTO (GATT) uses the transaction price and relies on the invoice value as the main rule, but with the possibility of applying different value under specified circumstances. Customs therefore have wider powers under the BDV to challenge declared values.

Article 14 of the proposed protocol on the definition of origin lays down the traditional prohibition of drawback, and the use of suspensive customs systems. The Lebanese products made by raw material or semifinished goods imported from third countries with the payments of customs duties will be disadvantaged compared with goods produced in other countries with a zero tariff rate on raw material or other inputs. The Lebanese business community judges that Article 14 would restrict exports of manufactured goods to the EU, the encouragement of which is the core of the agreement.

Nondiscrimination between locally produced goods and imports of EU origin

Article 21 of the draft agreement prohibits all measures of domestic fiscal nature that may result directly or indirectly in discrimination against products of EU origin. The obligation under this article can be effectively met by adopting the already suggested GST. The GST is deemed to be levied equally on imports and locally produced goods which meet the obligation of nondiscrimination. In addition, the credit mechanism of the GST, which allows the GST paid at earlier stages in production or distribution as a deduction from the final payment of the GST, should maximize in neutrality and efficiency.

5. Taxes on Goods and Services

Background

Lebanon does not have a broad-based tax on consumption and has historically relied for its major sources of tax revenue on customs tariffs and selective excises. While these taxes have accounted for the major share of tax revenue, and have increased in relative importance since the tariff reform of 1995, the consumption of domestically produced goods and of services has, to a large extent, remained a small source of government revenue in relation to other countries in a comparable position.

The Government placed the taxation of goods and services on its reform agenda in 1994 due to concern with the budget deficit, and the technical assistance of February 1994 recommended the adoption of a GST. [11]

The mission's recommendation for the adoption of a GST was based on its finding that the plethora of indirect taxes being utilized to tax consumption were producing an extremely low revenue yield by international standards. Further, the experience of other countries, many in the region, has been that a GST can become the principal source of government revenue.

During 1993-95 the Government's reform efforts concentrated on taxes on income and profits, duties and taxes on imports, and selected excises. The 1993 reform of taxes on income and profits aimed to improve voluntary compliance and the attraction of international investment. The reform of the import duties and excises was enhanced in view of its potential revenue capacity and relative ease of administration. Under these conditions the adoption of a GST was given a lower priority in the reform.

One of the goals of the association with the EU is to establish an FTA between Lebanon and the EU under which imports of EU origin will be duty free after a transitional period. For this reason, should Lebanon sign the agreement it must phase out its customs tariffs on imported EU goods over a 12-year transitional period. As these customs tariffs are currently a principal and very important source of the Government's revenue it is imperative that a source of revenue be identified which will compensate for the loss.

[11] "Lebanon: Taxation of Goods and Services and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and R. Sandre, 1994.

The current situation regarding adoption of a GST

In view of the pending loss of revenue from customs tariffs once the association agreement is signed, the mission carefully reviewed the current relevance of the 1994 mission's recommendation for the adoption of a GST especially since general sales taxes are the usual means of compensating for revenue lost from customs duties. The mission concluded anew that the taxation of consumption through a GST is the most viable method for providing the Government with a principal source of revenue and for compensating for the revenue which will be lost if the association agreement is signed.

Although there is potential for additional revenue mobilization through improved administration of direct taxes, the resulting revenue will be inadequate to compensate for the substantial loss from customs duties.

The mission confirms the major conclusions of the earlier mission:

- The current aggregate tax base is too narrow and numerous consumer goods and services are not taxed.

- The current taxation of goods lacks consistency and equity.

- Amendment of tax rates tends to be by product and cumbersome to achieve.

- Harmonization of the taxation of imports and their locally produced counterparts is absent.

- Taxpayers are inefficiently identified.

- Audits are insufficient and the quality is poor.

In view of these factors the mission reconfirmed the 1994 recommendation. It recommends that the Government adopt a GST as a means of mobilizing the revenue needed to compensate for the customs tariff revenue, which will be lost if the association agreement with the EU is signed, and as a means for mitigating the budget deficit.

The simplified GST

The mission determined that despite the 1994 mission's recommendations and the detail contained in its report, the concept of a GST is poorly understood within the Ministry of Finance. This misunderstanding also extended to the leaders of finance, business, and industry with whom the mission met. Generally the GST was seen as a form of additional excises on selective products and related cumbersome administration.

During the course of many meetings the mission explained that the tax is a novelty to Lebanon. It is levied on all imported goods, where the tax is collected by the Customs Department prior to the release of the goods, and on domestically produced goods. The tax is simplified in its domestic administration by establishing a turnover threshold which is sufficiently high to render liable for the tax only the largest enterprises. These enterprises will account for the major portion of the aggregate turnover of all enterprises, are relatively small in number, and have the ability to comply. Cascading of the GST is overcome by providing an input credit for GST paid at all earlier stages including importing. All exports are taxed at a zero rate of GST, nevertheless the input credits are provided for GST paid at earlier stages and overpayments are promptly refunded.

Goods which are essential for consumption of the mass of low-income citizens are exempted from the tax at all stages.

The rate of GST is determined by the fiscal goal of its implementation. It is easily calculated by determining the relevant factors such as the aggregate value of taxable imports, the aggregate turnover of domestic taxpayers to be subject to the tax, and the value of re-exports and of domestically produced exports that are always exempt. GST rates have tended to fall in the range of 5-15 percent, but a reasonable degree of research of data which can be assembled will lead to the establishment of an appropriate rate for Lebanon.

Administration of a GST

The administration of a GST is simplified by limiting its application to taxable imports (exempting essential goods) and to the small number of large enterprises which account for the major portion of taxable domestic turnover. (See Table 14 and comments in Section 6 under "Can the Revenue Department administer a general sales tax?")

The tax is collected by the Customs Department on taxable imports before the goods are released. The value on which the tax is based is the customs value plus import duties and excise taxes when applicable, but excluding the GST itself. The Customs Department provides importers with certification of payment of the GST and this serves as the basis for claiming input credits when imported raw material or goods are re-exported, resold as finished goods domestically, or exported.

The tax is usually paid on domestic sales on a monthly basis. A simple declaration is filed on which GST collected from customers is reported and input credits for GST paid at earlier stages to Customs on imports or to domestic suppliers is claimed as an offset. Credit is also claimed for inputs to exported goods which are taxed at a zero rate.

The administration of the GST on domestic transactions is simplified, as has been mentioned, by limiting the taxpayer population by a turnover threshold which is sufficiently high to encompass only the relatively small number of large enterprises, which account for the major portion of domestic turnover. This subject is discussed in more detail in Section 6 on tax administration, which recommends that a special LTU be established by the Revenue Department to administer all taxes of large enterprises. Table 14 indicates that 6 percent of the enterprises account for 74.4 percent of the turnover. This small number of enterprises suggests that with careful planning administration of a GST is manageable.

6. Tax Administration

Background

The mission reviewed the present status of the Revenue Department's administrative capacity. This review aimed at: (i) assessing the Department's ability to administer the proposed GST should the Government adopt it as a means for revenue mobilization, and (ii) determining the revenue potential of the existing taxes, mainly taxes on income and profits, through improved administration.

Earlier Fund technical assistance missions had reviewed, with varying degree of details, the tax administration and its emerging problems. They made recommendations for improving the efficiency and effectiveness of the Revenue Department to reduce the devastation effects experienced during the 1975-1992 civil war.[12] In connection with the proposed GST, the potential problems were analyzed. To facilitate the adoption of this tax and to ensure its effectiveness, an action plan, including the establishment of a large taxpayer unit to administer the GST, were detailed.[13]

The mission's review included, inter alia, (i) assessing the authorities' response to earlier recommendations and identifying the measures they introduced and those being planned with respect to each of the earlier recommendations, and (ii) examining the current situation as these factors relate directly to the ability to implement the GST in a timely fashion. The core of the 1993 reform which concentrated on taxes on income and profits were: (i) emphasizing tax administration as a means of combating the fairly wide spread noncompliance with the tax laws, and (ii) generating additional revenue through lower tax rates which were expected to improve taxpayers' compliance and eventually improve the entire tax administration.

Policy measures to improve taxpayers' compliance

To improve taxpayers' compliance and to encourage the flow of private investment and capital, the 1993 tax reform substantially reduced the number of taxable brackets on taxes on income and profits. These reductions became effective in 1994. Concurrently, a conditional amnesty was granted to taxpayers who did not file their tax declarations. The condition of the amnesty was that the nonfilers identify themselves and pay a fixed amount for each year of noncompliance, in lieu of taxes on income and profits which should have been assessed and collected. To implement this reform, the authorities

[12]"Liban: Le système fiscal et sa reconstruction," prepared by Messrs. A.M. Abdel-Rahman, M. Rached, G. Walton, and C. Grandcolas, and Mrs. T. Papavassiliou, July 1992; and "Lebanon: The Taxation of Income and Profits and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and P. Kierstead, July 13, 1993.

[13]"Lebanon: Taxation of Goods and Services and its Reform," prepared by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and R. Sandre, April 1994.

are in the process of modernizing and improving the tax administration with bilateral assistance from the Canadian International Development Agency (CIDA).

Reduction of taxable brackets and their rates

For individual taxpayers with income from salaries and wages the number of taxable brackets and tax rates were decreased from 13 to 5. The minimum rate of 2 percent remained unchanged, but the maximum rate was reduced from 32 to 10 percent.

For individual taxpayers with commercial, industrial, and professional profits the number of taxable brackets and tax rates was decreased from 12 to 4. The revised minimum rate is 3 percent and the maximum is 10 percent to be compared with 6 percent and 50 percent, respectively. The tax rate on income from movable capital was reduced from 15 percent to 5 percent. The corporate profits tax was reduced from 26 percent to 10 percent, but without the minimum of 1 percent of the turnover that was recommended by the 1993 mission.

The conditional amnesty

The 1993 mission had been advised by the authorities that noncompliance with the tax laws was widespread. They quoted the results of limited surveys to identify nonfilers which had been carried out, as well as the positive revenue mobilization which was being experienced from the reinstated audit activity as evidence of the level of noncompliance.

The authorities emphasized that a major reason for noncompliance with the requirement for filing tax declarations was the concern of nonfilers that the tax law rendered them liable for all years for which they had not filed declarations. Under the prevailing circumstances, that meant that most would be liable for taxes not paid during a period stretching back to 1975.

Under these conditions, the 1993 mission recommended an amnesty according to which nonfilers for years prior to 1989 would be granted exemption from penalty. The exemption was, however, to those who voluntarily registered and obtained a taxpayer identification number.

In 1994 the amnesty was implemented, although not in line with the missions' recommendations. Instead of granting complete exemption for the war years the authorities required the payment of LL 118,000 for each year for which a declaration was not filed. Based on data during the mission, 9,272 taxpayers took advantage of the amnesty but only 2,000 were actually unknown to the Revenue Department.

The 1993 recommendations and their implementation

The bilateral technical assistance project from CIDA is playing an important role in implementing the earlier Fund recommendations that fall mainly in the tax administration area. The CDN$ 5 million project is of three years duration beginning from June 1996. A contract for the project has been awarded to the consulting firm of CRC Sogema, which has experience with projects of this type in countries in Africa and the Caribbean.

This project is viewed by the mission as being sufficiently important to the future of revenue mobilization, including the implementation of the GST.

The following is a summary of the principal recommendations made by the 1993 technical assistance mission to improve tax administration and the authorities' response:[14]

- Lebanon mount a major taxpayer registration program and issue each individual and corporate taxpayer a taxpayer identification number (TIN). The characteristics of a TIN and the principal elements of legislation governing the TIN were outlined.

- A project team be assembled to implement the registration program.

- The registration program be the subject of a high profile publicity campaign.

- Given the high level of non compliance the registration program be backed up by a broad program of taxpayer identification (a comprehensive survey) to be conducted by the Revenue Department.

- The Revenue Department be reorganized to improve its capacity to operate effectively. The recommendation described a conventional functional organizational structure.

- A large taxpayer unit be established which would be responsible for all taxes paid or withheld by these large enterprises.

- Sufficient additional staff be added to support improved administration.

- A training program be developed and implemented.

[14] "Lebanon: The Taxation of Income and profits and its Reform," by Messrs. A.M. Abdel-Rahman, C. Grandcolas, and P. Kierstead, July 1993

- The taxpayer identification be computerized in the near term and in the mid term be expanded to the processing of tax declarations and payments, accounting and follow up of stop filers and collection of tax arrears. Also that the computer system be developed to support the selection of the most high potential taxpayers for audit.

- Policies, procedures and work flows be simplified and improved and an operational manual created.

- The collection of tax arrears be transferred from the Treasury to the tax administration.

- Gathering and exchanging information be improved including the redesign of tax declarations to gather the data necessary to support computerization and to provide fiscal planning and management information.

- A general tax law should be introduced to codify the many tax laws and their amendments.

- A global income tax system replace the present schedular system.

The mission reviewed the project plan and the progress already attained. The following is a summary of the achievements under this project:

- A national taxpayer registration campaign has been designed and was planned to be implemented by February 1, 1997. The campaign will allow taxpayers six months to voluntarily register. A law will be passed to oblige taxpayers to register. The plan includes substantial publicity, waiving of penalties which might otherwise apply to non/stopfilers and heavy penalties for failure to register. Registration guides and application forms are being designed as well as the TIN.

It is also planned to issue all individual taxpayers, including employees with income from salary and wages who do not file a declaration, with a TIN. Employees are being included because it is suspected that many enterprises withhold taxes from the salaries and wages they pay but do not remit them to the Treasury. Despite the validity of this argument, the mission is against the registration of wage earners who do not have other sources of income. Their number is exceptionally large as they represent the vast majority of taxpayers and to require their registration would increase unnecessarily the burden on the Revenue Department, without proportional improvement in tax revenue or tax administration. A second "business number" will be issued to both incorporated and unincorporated enterprises. The business number will have single digit annexes which identify the tax type to which a given transaction applies, (i.e., employee income tax deductions, profits tax, withholding tax, property tax, etc.). This numbering system is consistent with that used by Revenue Canada.

- A comprehensive taxpayer survey to supplement the registration campaign has been planned and is under way. Information has been obtained from several major sources which will assist in the identification of business and professional taxpayers. To date information has been obtained from Customs on importers and from the computerized records of the electricity and telephone companies to identify other enterprises. Staff are presently collating this information and eliminating corrupt data.

While there are as many as 200,000 taxpayers carrying on business and professional activities, only 55,000 currently file tax declarations. For example, 7,500 corporations file but the information gathered indicates the existence of 35,000 corporations. Similarly, the information identifies 25,000 professionals whereas only 12,500 individual, partnership, and professional enterprises file declarations.

The next step is for tax inspectors to visit all of the suspected nonfilers to confirm the accuracy of the information. If active businesses or professions are being operated they will be registered and tax declarations obtained.

- In preparation for setting up an LTU, a training program in accounting and auditing has been implemented. Earlier in 1996, 100 new auditors were recruited by the Revenue Department, all with university degree in accounting. The 60 with the highest potential were identified through a series of interviews and tests conducted by the project team. An initial group of 25 auditors have been given six weeks of concentrated accounting and auditing training, and the 23 who passed the tests are ready to be assigned to the LTU. A second group of 25 was planned to have received similar training in January 1997 and those that pass will also be assigned to the LTU.

Only new auditors will be assigned to the LTU to ascertain the selection of the most qualified staff in the unit. Additional training and specific audit of specialized industry groups and tax types are planned for July 1997. This training will be conducted by experts drawn from Revenue Canada and Revenue Quebec as will be the training material. It was planned that the LTU will begin operating no later than January 1997. The criteria for selecting the taxpayers has been agreed with the Minister, the first 23 auditors to be assigned are trained and the accommodation and equipment, (i.e., offices, furniture and office supplies) are in place.

The selection criteria for large taxpayers includes turnover, profit, taxes paid, and number of employees. Due to the political sensitivity associated with being identified as a large taxpayer and thereby falling under the jurisdiction of the LTU, the Minister directed the "stratification" of the selection criteria across the main industry groups to assure broad coverage. He will also select the first 100 taxpayers to be transferred to the LTU. These taxpayers' files will be drawn from the Beirut and Mount Lebanon regions. As the law requires that taxpayers must be assessed by their regional offices the Minister is staffing the LTU with this requirement in mind.

Five experienced and competent senior auditors have been assigned to the LTU to supervise the new staff. It was understood that in 1997 an audit supervisor will be assigned to coach all LTU staff. At the time of his retirement he was in charge of Revenue Quebec's underground economy investigation unit and seems to be well qualified for the LTU assignment.

Indications are that the LTU selection criteria will identify approximately 1500 taxpayers. However, if the LTU is to administer the GST, as the mission has suggested, it appears that the size of the unit will need to be expanded.

The data in Table 10 indicate that 6 percent of taxpayers account for 74.4 percent of turnover. Based on 55,000 tax filers this indicates the existence of approximately 3,300 fairly large taxpayers, more than double the number planned for the LTU. Possibly the "stratification" of the selection across main industry types eliminated some of the larger taxpayers in favor of the diversification or one of the other criteria, such as taxes paid or number of employees, caused some large taxpayers (based on turnover) to be eliminated. However, if the LTU is to play a key role in the administration of the proposed GST, as the mission recommends, the number of taxpayers assigned to the LTU will need to be increased. Also, the LTU's planned maximum staff of 50 will need to be increased to account for the increased number of taxpayers and the added responsibility for the GST. An enhanced training program will also be required.

- Policies, procedures, and workflows are planned to be re-engineered to modernize, simplify and streamline them. This is endorsed in view of the fact that present procedures are 40 years old, with many changes being introduced. An operational manual is planned. Tax declarations are to be simplified and redesigned to facilitate computerization of the data needed to produce assessments, account for assessments and payments, issue stopfiler notices and collection letters. Development of taxpayer guides is also planned. Definition of terms used in the law will be developed to reduce as much as possible misinterpretation. Preliminary work has begun but will be finalized by a team of two accountant/auditors and two business analysts who will be brought from Canada, and a lawyer to be locally recruited.

Proposals will be made to allow for: (i) the filing of tax declarations and payment of tax at the same location and time; (ii) corporations to file financial statements at the time of filing the tax declaration rather than three months later; (iii) provide appropriate tax declarations for holding companies which are subject to special rules; (iv) require all exempt taxpayers to file declarations to prove their exemption; (v) new taxpayers to file opening balance sheets to disclose net worth and asset valuation; and (vi) globalize the tax system. The analysis to support these proposals is well advanced.

- The computerization of the Revenue Department will be accomplished by utilizing a system developed by the consulting firm, CRC Sogema, for use in similar projects in African and Caribbean countries. It is known as "Standard Integrated Government Tax Administration System" (SIGTAS). It is based on Revenues Canada's operational systems and operates on an Oracle platform. It is adaptable to Lebanon's needs.

- The project plan recognizes the Fund's recommendation that responsibility for collecting additional tax assessment is to be transferred from the Treasury to the Revenue Department. However, if this does not occur the computerized cashiering and accounting system for taxes can be installed in treasury offices.

- The reorganization of the Revenue Department is not included in the project plan as a specific element.

As the mission understands the plan, it anticipates the development of all of its components; such as policies, procedures, work flows and computer applications, on functional lines. After testing the completed work by a pilot unit attached to the LTU, implementation in the regions will be carried out by an implementation task force. Throughout the whole process Revenue Department counterparts will work closely with the consultant's project team members to assure the transfer of knowledge.

However, the headquarters consists only of the Head of the Revenue Department and a support staff of less than 10 and the regions are not organized on functional lines but are organized by tax type. For this reason it is possible that when the project is completed, and the experts leave Lebanon, neither the Headquarters nor the regions will be able to sustain or further develop the systems and procedures which the project has put in place. The mission brought this matter to the attention of the authorities and it will be followed up by forthcoming missions.

The project as planned addresses all of the Fund's earlier missions' recommendations, except for the functional organization of the Revenue Department. The project's progress is being closely monitored by the Minister, who initiated it, and by the consultants, CRC Sogema, as well as CIDA.

If the project proceeds according to its plan, the LTU should be capable of administering the proposed general sales tax within the 18-24 month period needed to plan for and implement the tax, provided the staff is increased to an appropriate level and adequate training is provided.

It is not possible to quantify the revenue increase which might be derived from improved administration of existing taxes as this depends on a number of factors, such as the size of the tax gap, the effectiveness of the improved administration, and the political will to support the enforcement of the tax laws. However, the present administration continues to suffer from the unfavorable effects of the events of the 1970s and 1980s and therefore contributes to the present malaise. It therefore follows that a greatly improved tax administration, if fully supported politically, will mobilize additional sustained revenue from the existing taxes.

Under these conditions, it is necessary that further technical assistance under the UNDP/IMF program should be designed to complement the Canadian bilateral aid and to avoid overlapping and/or duplicating efforts.

Identified problems

- There continues to be a substantial lack of reliable data necessary to formulate policy measures and/or decisions for planning and managing tax administration programs. The current available data are scattered, they are collected and maintained by each of the five regional tax offices and their Treasury counterparts. At the Revenue Department headquarters, there is no central planning, and therefore no staff is charged with data collection and their analysis. Similarly, there is no central register of taxpayers to provide data on the number of taxpayers by region or size of enterprises based on such factors as turnover, profits, numbers of employees, and industry type.

The computer system to be installed under the Canadian bilateral assistance program will address most of the data needs, but there will remain the need for a planning and analysis unit to ensure the effective collection and utilization of the data for policy formulation and effective administration.

- The Revenue Department's headquarters consists only of its Head and a support staff of less than 10 personnel. As noted above it is not organized on functional lines with divisions responsible for effecting change and functional management. It therefore lacks the facility to develop such essentials as administrative policy, tax programs to be delivered by its regional offices, and to monitor program delivery to assure efficiency, effectiveness, and even-handed delivery. This weakness prevents the department from reacting to and redirecting its scarce resources to areas of the economy where the highest return in the form of increased revenues might be realized. The overall staff of the Revenue Department has not, as yet, reached its 1975 level of 500, presently standing at approximately 400. An evaluation of the number and type of staff needed to assure effective operation needs to be carried out.

- The Revenue Department has not been assigned responsibility for collecting tax arrears as was recommended by earlier missions. This responsibility remains with the Treasury which has been ineffective in controlling arrears (only 30 percent of assessments are collected). Based on the experience in many countries, it has been found that when revenue departments have the responsibility for collecting their assessments they have a vested interest in pursuing effective collection. In addition, their assessments tend to be more accurate and reasonable.

- Throughout the period 1994-1996, revenues from the taxes administered by the Revenue Department have remained almost static in real terms and their relative importance and buoyancy has diminished sharply (Tables 2 and 3) notwithstanding the substantial reduction in tax rates and the conditional amnesty, both of which were implemented in 1994. It may be too early to judge the success of these measures in improving voluntary compliance. The present number of tax filers (55,000, which excludes salary and wage earners who do not file) is very low considering the population and pace of economic activity. In addition:

- The conditional amnesty identified only 2,000 taxpayers who were unknown to the Revenue Department.

- Only small numbers of new taxpayers voluntarily register each year, although the Canadian project, as related to the implementation of a national taxpayer registration campaign, suggests a taxpayer population in the range of 200,000.

- Officials report that the audit of tax declarations yields increases in tax in the range of 33 percent of declared amounts, which they categorize as small due to the shortage of auditors and the limited skills and lack of training of the audit work force.

- Only approximately 30 percent of assessed taxes are collected.

It follows that the only course of action available to improve compliance with the tax laws and improve revenue performance is to improve the enforcement capability of the Revenue Department. However, once improved its enforcement programs will need strong political support if they are to be effective.

- Despite the fact that the adoption of a GST was recommended by the 1994 mission as a means of mobilizing revenue in view of the increasing budget deficit, no planning or analysis related to the potential implementation of the tax had been initiated by either the Ministry of Finance, the Revenue Department, or the Customs Department. The mission found that many officials were unaware of the recommendation that a GST be adopted and those who were aware poorly understood the details and advantages of a GST. As far as it can be ascertained the Ministry of Finance and the Revenue Department have no policy position on the GST, its coverage and its concepts, and in particular the credit mechanism. This absence of planning and analysis has not only prevented the Ministry of Finance government from considering the extraction from consumption of additional revenues needed to ameliorate the pressing problem of the budget deficit, but has now placed it in a very serious position vis-à-vis quickly adopting the tax as a means of compensating for the revenue to be lost from customs tariffs following the signing of an association agreement.

Can the Revenue Department administer a GST?

Given the fact that until June of 1996 (the arrival of the Canadian technical assistance), little was done to improve the administrative capacity of the Revenue Department, the mission addressed the question of whether or not Lebanon would be able to effectively administer a GST. As well, the period of time which would be needed to prepare the administration following a decision to proceed was considered.

As a first step in considering this question, the mission undertook the identification of the potential taxpayer population which would become liable for a GST in a simplified form. In addition, the experience of other countries suggests that the administration of a GST becomes less demanding if its domestic application is limited, by means of an appropriately high threshold, to only the largest enterprises operating in the country which account for most of the taxable turnover. For Lebanon, a major share of tax revenue is expected to be generated by the GST on imports. The Customs Department will remain responsible for the GST on imports.

To accomplish the identification of the large enterprise population, the mission reviewed data from a statistical sample of taxpayers being used for a study undertaken by the Ministry of Finance. The mission utilized the data to establish the turnover reported by taxpayers covered by the sample and stratified it into turnover brackets where it was aggregated.

Data incorporated in Table 14 reveals that 6 percent of the largest taxpayers account for 74.4 percent of the turnover. This suggests approximately 3,300 large taxpayers based on 55,000 filing declarations. The mission believes that a further breakdown of the turnover bracket LL 501-1,000 billion would identify a further small number of taxpayers who would account for the largest portion of the turnover of that bracket.

The mission therefore concludes that the taxpayer population which would become liable for a simplified form of GST is not large, likely in the range of 3,300-3,500, and could be managed by the Revenue Department if the administrative reforms presently under way are successfully implemented.

A planning team will be required to update the 1994 timetable for the implementation of the GST, to complete research on an appropriate threshold, to establish the GST rate(s), to prepare the draft law, to design the declarations and other forms, to prepare policies and procedures, to determine staff requirements, and to regularly brief the Minister and his senior officials on progress, problems, and related issues. In view of the urgency of introducing the GST, these preparatory actions should be completed within a period of no more than 24 months. Coordination with the Canadian project will be critical as the GST planning must be consistent with the progress of the development of the LTU. Strengthening of the Revenue Department's headquarters through the addition of strong and knowledgeable managers, with clearly defined functional responsibilities, is also a prerequisite to success.

Table 14. Distribution of Business Taxpayers by Turnover, 1992-94 [1]
(In billion LL)

Turnover Brackets	Number of Taxpayers			Turnover			Number of taxpayers (Percent)			Turnover (Percent)		
	1992	1993	1994	1992	1993	1994	1992	1993	1994	1992	1993	1994
-100	660	747	776	24.7	27.7	30.4	37.6	30.5	27.4	0.9	0.3	0.3
101-500	558	723	853	142.6	178.0	213.5	31.8	29.5	30.1	5.1	1.7	2.0
501-10,000	484	845	1,033	952.5	1,928.2	2,431.2	27.6	34.5	36.5	34.0	18.1	23.3
10,001-100,000	50	119	153	1,222.0	3,280.0	4,195.0	2.8	4.9	5.4	43.6	30.7	40.2
100,001-more	3	15	17	463.4	5,265.4	3,571.3	0.2	0.6	0.6	16.5	49.3	34.2
Total	1,755	2,449	2,832	2,805.2	10,679.0	10,441.1	100.0	100.0	100.0	100.0	100.0	100.0

[1] Based on a statistical study undertaken by the Ministry of Finance. Data are based on filed declarations.