INTERNATIONAL MONETARY FUND

Fiscal Affairs Department

Lebanon: Taxation of Goods and Services and its Reform

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Introduction

At the request of the Minister of State responsible for Financial Affairs of Lebanon, an International Monetary Fund technical assistance mission examined the taxation of goods and services and proposed measures for improving its yield and strengthening tax administration, particularly by introducing a simplified general sales tax. This request reflects the authorities' concern with the budget deficit, despite the recent improvement, and its negative effects on flows of private capital, investment, and Lebanon's overall financial equilibrium.

In response to that request, a technical assistance mission led by Mr. A. M. Abdel-Rahman, a Headquarters-Based Consultant, visited Beirut February 10-25, 1994. The mission also included Mr. Christophe Grandcolas, a Headquarters-Based Consultant, and Mr. Robert Sandre, a member of the Fund's panel of fiscal experts.

The mission was received on several occasions by the Minister of State and his senior advisors. It was able to work in close cooperation with the Tax and Customs Directors and their staff. Given that in Lebanon many taxes are collected by offices outside the Ministry of Finance, the mission met with the Minister of Telecommunications, the Minister of Industry and Petroleum, the Director-General of Electricity of Lebanon, and the Management Committee of the Tobacco Authority. The mission expresses its sincere thanks for the productive cooperation it received from the authorities.

This report contains the mission's conclusions and recommendations. It complements the aide-mémoire submitted to the authorities before the mission's departure. Section 1 deals with a summary of recent developments in Lebanese taxation, the urgent need for the introduction of a general sales tax (GST), and a synopsis of the conclusions and recommendations. Section 2 analyzes the present taxation of goods and services and its limitations. Section 3 defines a strategy for strengthening the administration and a schedule of tasks in preparation for the introduction of the turnover tax. Section 4 deals with the taxation of specific goods and excise taxes.

The mission discussed its work with Mr. Hendrik van der Kloet, United Nations Coordinator and UNDP Resident Representative, particularly concerning long-term technical assistance needs in the areas of customs, tax, and financial administration and on the possibility of mobilizing resources for such technical assistance.

1. Summary of Conclusions and Recommendations

Recent developments in Lebanese taxation

To finance the needs of both reconstruction and security, fiscal policy and the strengthening of its administration have become the principal instruments of government policy and strategy.

Following the efforts made to control expenditure and improve tax administration, the budget deficit was reduced. In 1993, revenue financed approximately 60 percent of expenditure, compared with 44 percent in 1992.

Despite this improvement, however, the budget deficit remains significant. Further efforts are required to mobilize additional resources and limit future government expenditure. Reducing the budget deficit is still the most effective way to ease inflationary pressures and their negative effects on flows of private capital and investment.

The lack of detailed statistics, particularly on national income, remains an obstacle to the conduct of an in-depth review of recent developments in government finance. Estimates cannot be made of the elasticity ratios of major categories of taxes and duties. Despite the recent reduction in the budget deficit, government finance still face numerous problems, and structural reforms need to be introduced. In the last two years, the Government initiated a series of tax reforms covering practically all duties and taxes.

In 1993, a tariff reform was completed, with the aim of strengthening the customs tariff as an instrument of fiscal policy, simplifying its structure, and facilitating its administration. The number of rates was thereby reduced to ten, a minimum of 2 percent was introduced, and all additional duties and taxes were incorporated into the proposed tariff. Meanwhile, revenue from import duties and taxes increased significantly in 1993 (more than 100 percent) because of the adjustment of the exchange rate applied by Customs, even if this adjustment still does not align the customs rate with the market exchange rate (the "customs rate" is LL 800, compared with a market rate of LL 1,700). The Customs Administration has started computerizing its operations, and for the first time since 1977, statistics are now available without delay on imports, exports, and revenue.

In 1994, taxes on income and profits were the subject of a reform, whereby the tax burden was reduced on professional profits and personal income. High with respect to income and profit taxes, the rates were reduced in order to encourage flows of capital and investment. In spite of this, the improvement in revenue seems limited and slow. The authorities are fully aware of these limitations and are therefore seeking to mobilize additional revenue through the taxation of goods and services.

The need to introduce a general tax on goods and services(GST)

Despite the multiple duties and taxes contained in its system of indirect taxes, Lebanon does not have a broad-based tax on consumption. There are, however, numerous excise duties and other indirect taxes on excisable goods, especially petroleum products, alcohol, and cement.

Revenue from these taxes are, by international standards, extremely low, particularly for tobacco and cigarettes, which generally contribute a significant portion of the revenue in most countries. In Lebanon, in spite of the existence of a Tobacco Monopoly in a monopoly position, the national budget receives almost nothing of the proceeds from the marketing of these products.

In many countries, the general sales tax has emerged as the main source of revenue. Most Arab countries (except for the oil-producing Gulf States) apply a general sales tax that contributes approximately 5-7 percent of GNP. Syria, which is the only exception, is considering establishing such a tax.

It seems that for the immediate future, no significant revenue is expected following the reform of duties and taxes on imports, and taxes on incomes and profits. All that remains, therefore, for mobilizing the additional revenue, that is critically needed for reducing the deficit, is to tax the consumption of goods and services.

Current taxes on goods and services do not provide the expected revenue, in spite of their potential and the fact that they are relatively easy to administer.

A well-designed general sales tax could provide an aggregate base, with exemptions limited to essential goods consumed by low-income groups of the population. This makes it possible to have a relatively low rate and the credit mechanism for taxes paid at earlier stages. The credit mechanism encourages taxpayers' compliance and facilitates administrative cross-checking. Such a tax can compensate for the decline in income and profit taxes as a result of indexation and rate reductions. The economic effects of this tax should be positive, insofar as it encourages savings by taxing only consumption.

The authorities are considering introducing a general sales tax as of July 1, 1995. This requires detailed planning and rigorous preparation of the various tasks that are necessary for its efficient administration.

Summary of conclusions

An analysis of the indirect taxes revealed their insignificant yield and the complexity of their administration. The major limitations are as follows:

- The presence of a wide variety of duties and taxes assessed by various offices with different collection procedures. Apart from this complexity, their yield is insignificant by comparison with the yields produced by the same taxes internationally;

- The aggregate tax base is narrow, to the extent that numerous standard consumer goods and services are exempt. While water is taxed at 10 percent, hotels and restaurants, even first-class ones, are exempt;

- The only services taxed are electricity, water, telephones, and telecommunications. They are collected by those providing the services, on behalf of the municipal governments, at the rate of 10 percent. In fact, it seems that these taxes are remitted to the Treasury or the Central Bank by the providers of services, instead of being transferred to the municipalities;

- The taxation of goods and services lacks consistency. For example, the posting of advertisements in public places and at roadsides is subject to a very old tax that has been in existence since 1932, whereas the same service in the newspapers or on television, although more significant in terms of a tax base, is exempt;

- Most of these duties are specific and insensitive to changes in product prices or consumers' income. For their yield to be maintained, each duty has to be changed thus requiring legal provisions that take time and sometimes are difficult to introduce;

- There is no harmonization between the taxation of goods produced locally and their competing imported goods. A large number of duties collected only on imports and not on local products were merged in the context of the new tariff. It is also significant that there are no formal, organized relations between the Tax and Customs Departments;

- The laws and their amendments are available neither to civil servants nor to taxpayers;

- The indirect taxes office responsible for administering excise duties suffers from the lack of adequate qualified personnel and equipment. The recent departure of several qualified, experienced civil servants, who will be difficult to replace immediately, could affect the implementation of the structural reforms. Owing to the frequent use of specific rates, the Administration has to carry out physical audits that will requires the presence of collectors at each plant. The lack of qualified, experienced staff, even to conduct simple physical controls, encourage lax administration and leads to reduced revenue;

- Collections and their procedure are split up among various offices and ministries;

- Taxpayers are inefficiently identified;

- Delinquent taxpayers are inefficiently monitored;

- Data processing resources are rudimentary; and

- Tax audits are insufficient and ineffective.

Summary of recommendations

The mission's main recommendations concern immediate and short-term measures.

- The immediate measures are those that lend themselves to application without major changes in tax administration. They are designed to increase revenue and rationalize the structure of the main excise duties. Increase revenue from these excises will also make it possible to set a lower rate for the GST; and

- The short-term measures concern the legal and administrative aspect of the proposed GST. In view of the present state of the Lebanese tax administration, the GST cannot be immediately introduced. The prescribed action plan provides for the necessary preparatory stages which would facilitate its introduction and ensure its efficiency once it is introduced.

It must also be noted that both the immediate and short-term measures proposed need to be closely coordinated with the reform of taxes and duties on imports because imports represent the bulk of the GST tax base (approximately 80 percent). The GST rate may require changes in the tariff rate to reach an acceptable overall tax burden (customs duties, GST, and excises) on imports.

Immediate measures

- Petroleum products

On the basis of discussions with the Minister of Industry and Petroleum and considering the current price of petroleum products, the mission feels that market conditions are favorable for an increase in sales prices.

It is therefore recommended to:

- raise the retail prices of all products by 20 percent;

- introduce a 20 percent ad valorem customs duty on all products;

- adjust the value of the excise duty (specific rate) collected by the Department of Customs to the difference, for each of the products, between the new selling prices and the other components in the structure of prices; and

- transfer to the Customs Department the responsibility for collecting all duties and taxes on petroleum products. These duties and taxes should be collected before the products leave the depots or refineries, that is, before the products are released for consumption.

- Tobacco and cigarettes

Whatever the importance of the other objectives fulfilled by the Tobacco Monopoly, its tax functions (the collection of duties and taxes) should be given the top priority. The Monopoly's raison d'être is the collection of taxes on tobacco and the transfer of its profits to the central government. Its other roles (employer, producer assistance) are secondary and should not obscure the collection of duties and taxes. It is therefore recommended to:

- introduce an ad valorem tax of 10 percent on the sales prices of products marketed by the Monopoly or 23 percent on imported goods;

- review the report of the independent auditor recently appointed by the Minister and have the Monopoly introduce double-entry accounting. Balance sheets, trading accounts, and other accounts should also be submitted to the authorities spontaneously and at more regular intervals;

- define precisely, and as soon as possible, the proportion of the Monopoly's profits be transferred to the central government. Moreover, consider the possibility that the Monopoliy be liable for the business profits tax; and

- withdraw the Régies' monopoly of importation and marketing if it fails to meet its tax obligations.

- Alcoholic beverages

- Introduce an ad valorem excise tax of 10 percent, in addition to the current specific duty; and

- Replace the old presumptive (forfaitaire) method of determining the tax base for products manufactured locally by a method based on the actual production of alcohol.

- Cement

Replace the current specific duty by an ad valorem duty of 10 percent of the selling price.

- Services

The 10 percent tax collected on behalf of the communes should be allocated to the central government budget. The municipalities should be financed by budgetary transfers. These services should be subject to the GST when this tax is introduced at the 10 percent rate.

Short-term recommendations (adoption of the GST)

Despite the importance of the immediate measures proposed in terms of revenue and administration simplification, they do not change the current tax structure. For the introduction of the GST, the essential administrative and legal measures need to be outlined, and the various steps of an action plan for their implementation should be carried out.

- Major aspects of the GST

The achievement of the maximim of the benefits expected from the GST (yield and neutrality) is conditional on the definition of its base and the level of its rate. It is therefore recommended that:

- the GST have as wide a base as possible. If the base is narrow owing to exemptions, a higher rate would have to be selected, and this would encourage evasion. The GST should be applied to all goods and services, except for a very limited number of explicitly exempt goods.

The GST should be applied equally to both locally manufactured goods and their competing imported goods.

The tax base for services should also be as broad as possible, and the GST should be applied to all services except those expressly exempt, such as banks, insurance, and other financial services.

For imports the base should be equal to the dutiable value as determined for customs purposes increased by customs duties and excises. The GST on imports should be collected by the Customs Department along with other duties and taxes on imports before the taxable products are released.

- The GST should preferably have a single rate of 10 percent of the selling price excluding the tax. This choice of the 10 percent rate was influenced by the fact that water and other essential services are already taxed at 10 percent.

- Exports will be exempt.

- In order to avoid "cascade" effect, the GST paid at earlier stages (customs, suppliers) will be credited against the amount of the tax to be collected on sales. Tax credits should be as general as the tax itself and should be applied to both goods or services and investment. This could facilitate the modernization of Lebanese industry and help in the replacement of old equipment with more modern ones.

- The adoption of the GST does not mean that excise taxes on selective goods should not be retained to guarantee more revenue. For goods subject to excise duties, the tax base for GST purposes will include these excises.

- The liability for the tax will be limited to those taxpayers duly registered, and who have a turnover in excess of the threshold (this could provisionally be set at LL 1 billion). These taxpayerswill be liable irrespective of their position in the production and distribution cycle. Indeed, if the taxation threshold is set at that level initially, the number of persons liable will be limited and the tax administration will be able to control the taxpayers adequately. This threshold can be modified later, depending on the progress made by the Administration and the need for revenue.

- Tax administration measures

The GST will be a novelty and perhaps one of the main pillars of the Lebanese tax structure. Its introduction requires detailed planning and preparatory tasks specified in the attached schedule (see the timetable of measures recommended, phase 2).

The following recommendations are aimed at facilitating the introduction of the tax and strengthening the efficiency of its administration:

- A special pilot unit under the authority of the Tax Department should be created as soon as possible. It will be in charge of the GST (preparatory work and future management). It should be led by an experienced official and provided with qualified, motivated staff and the necessary equipment.

- The tax should be paid automatically on a monthly basis by taxpayers to the tax office (pilot unit), which alone will be responsible for its collection, using a single printed form (tax return, payment).

- This new unit should coordinate its work closely with the Customs Department and the Direct Taxes Office. For this, reliable tax identification numbers have to be established. These numbers should be unique to respective taxpayers, replacing the present multiple identification numbers. They should be assigned gradually, starting with those liable for the GST and continuing with other taxpayers.

- Immediate action will be taken against delinquent taxpayers (nonfilers, those submitting returns without payment), with the help of appropriate expeditious procedures.

- The computerization of the GST unit (or pilot unit) should be flexible, complete, and consistent.

- Owing to the novelty of the concept introduced by the GST, the auditing of this tax will not be general. Instead, the principle of specific, frequent, expeditious, and targeted audits will be applied.

- Revenue effects

The revenue effects of the aforementioned measures are potentially very important, as shown by the mission's estimates, summarized in Table 1.

Table 1
Revenue Effects of Recommendations 1/

I. Immediate Measures

Type of Measure	Description	Expected effect (LL billions) in annual base	Reference to report (page)
1. Petroleum: Reform of the petroleum tax structure and introduce a 20 percent increase in retail prices	- Introduction of a 20 percent ad valorem customs duty on all products - Introduction of a specific tax at rates tailored to each product	212	41
2. Tobacco: Restoration of minimum taxation on tobacco with standard retail price increases of 10 percent	- Introduction of a 10 percent ad valorem tax on local production and 23 percent on imports (to take account of the rate of the customs exchange rate)	35	44
3. Alcoholic beverages: Increase taxation of alcoholic beverages.	- Introduction of a 10 percent ad valorem tax	10	45
4. Cement and construction materials: Increase taxation on construction materials.	- Introduction of a 10 percent ad valorem tax on all materials to replace the specific tax on cement	40	45

II. Short-term Measures

Type of Measure	Description	Expected effect (LL billions) in annual base	Reference to report (pages)
5. Introduction of a general sales tax (GST)	- Broad aggregate taxable base - Adoption of a threshold to limit the number of taxpayers and facilitate their monitoring. The proposed threshold could range between LL 0.5-1.0 billion turnover. - Exemptions to be limited to essential goods (agriculture, milk, food, etc). - A single tax rate is proposed (preferably 10 percent). - A tax credit to be allowed for registered taxpayers. - Refunds for exporters.	Not assessed because of lack of detailed data. The authorities are of the opinion that this tax could generate additional revenue of 2-3 percent of GDP.	20 et seq.

1/ The revenue effects to result from improved administration, could not be quantified but they are expected to be positive.

Timetable of measures recommended

Scheduled dates in an action plan for improving tax administration and reforming indirect taxation, through the introduction of a GST.

Phase 1: Immediate measures

Timing

A. Reform significant excise duties

1. Petroleum products

a. Introduction of a 20 percent ad valorem customs duty for all "black" and "white" products

Immediate

b. Adjust the specific tax collected by the Customs Department, as the difference between the new selling price, plus 20 percent for all products, and the preceding ad valorem tax
c. Eliminate all other duties and taxes, including stamp duties, port taxes, and the tax collected at the Tax Department (Indirect Taxes Division)
d. Customs to collect all duties and taxes on products, when they are released to the market and without delay
e. Restore all petroleum depots to customs control

2. Tobacco

a. Introduce an ad valorem tax of 10 percent of the sale price of local products and 23 percent of f.o.b. prices at the current exchange custom rate

Immediate

b. Speed up the audit of the Tobacco Monopoly
c. Restore the Rules of Commercial Accounting for the Monopoly

3. Alcohol

a. Add to the specific rate a 10 percent ad valorem element on all imported or locally manufactured alcoholic beverages — Immediate
b. Review the method for determining the tax base for wines and spirits — January 1, 1995

4. Cement

- Replace the current specific tax with a 10 percent ad valorem tax — Immediate

5. Services: Water, Electricity, Telephones

- Allocate the 10 percent service tax to the central government's budget and discontinue all earmarking of revenue from these services to municipalities

Immediate

Timetable of measures recommended (continued)

B. Strengthen tax administration

1.	Update Customs computer files by incorporating importers' identification numbers and taxes paid	1994
2.	Continue registering those liable for taxes at the Tax Department (using the conditional amnesty and increasing investigations)	Beginning May 1994
3.	Improve the financial situation of tax officials (application of the new system of allowances)	Beginning May 1994
4.	Create a specialized unit and prepare a plan for the professional training of employees	Beginning May 1994
5.	Increase tax audits significantly (briefing memorandum, programming, statistical monitoring)	Beginning May 1994

Phase 2: Introduction of the General Sales Tax (GST)

1.	***Establish a committee responsible for monitoring the GST project***	June 1994
2.	***Legislation and regulation***	
	- Establish working hypotheses: rates, thresholds, etc.	June-September 1994
	- Simulate the expected results	June-September 1994
	- Draft the decree introducing the tax	July-September 1994
	- <u>Adopt and promulgate the law</u>	<u>By December 31, 1994</u>
	- Draft the regulations, implementation circulars	By April 30, 1995
3.	***Create the GST pilot unit***	
	- Appoint persons responsible for the pilot unit	November 1994
	- Define the organization of the pilot unit and its place within the Tax Department	By January 1995
	- Provide office space and computer equipment	January 1995
	- Appoint employees and officials of the pilot unit	February 1995
	- Appoint collectors	February 1995
4.	***Operations***	
	- Introduce taxpayer identification numbers (TIN) to be used by Customs, Tax, and Treasury Departments	Nov.-December 1994
	- Define the procedure for the GST registration of enterprises and assigning tax identification numbers	January 1995
	- Define the procedure for submitting GST returns and making payments	February 1995
5.	***Forms***	
	- Design and print forms for registration, tax returns, and payments	April 1995

Timetable of measures recommended (concluded)

6. Computerization

- Define the structure and the equipment required	December 1994
- Purchase and install the equipment in the appropriate offices	February 1995
- Develop and test the software for assigning tax identification numbers	March 1995
- Start the registration of enterprises and the assigning of tax identification numbers	May 1995
- Develop ways for monitoring delinquent taxpayers	June 1995
- Develop accounting and statistical data	July 1995
- Develop audit techniques	August 1995

7. Information

- Seminars for briefing the staff of all Ministry of Finance directorates	September-December 1994
- Prepare a GST guide and manual	By March 30, 1995
- Prepare a guide and a manual on registering enterprises and assigning tax identification numbers	By April 30, 1995
- Consumer information	April-September 1995
- Draw up a manual on GST auditing	By end-August 1995

8. Publicity

- Publicity for the registration of enterprises and the assigning of tax identification numbers	May-June 1995
- Publicity for the GST application	May-June 1995

9. Professional training

- Identification of special actions for the GST and planning	January 1995
- Preparation of courses	February-June, 1995
- Professional training courses (registration, processing of returns, posting of receipts, collection action, GST auditing)	April-September 1995

10. Application of the GST

- Providing registration forms	April 1995
- Registration and assigning of tax identification numbers	Beginning May 1995
- Visits to enterprises	May-July 1995
- Providing forms for returns/payment	June 1995
- <u>Entry into force of the GST</u>	<u>July 1, 1995</u>
- Initial returns and first payments	August 1995
- Identification of defaulters and first computerized reminder notices	September 1995
- Initial action against delinquent taxpayers and audits	October 1995

2. Taxation of Goods and Services and its Administration

Inherited from old laws that have never been updated consistently, taxation of goods and services is characterized by its complexity, inflexible specific rates requiring frequent adjustments to keep pace with prices, insignificant tax revenue, and inefficient, poorly coordinated administration shared by the various departments and offices.

Taxation of goods and services is complex and inefficient

A plethora of indirect duties and taxes for insignificant yields

The Tax Department (Indirect Taxes Division) is responsible for the assessment, collection, and auditing of numerous indirect taxes, the principle of which are shown in Table 2.

Table 2
Indirect Taxes Collected by the Tax Department

(In billions of LL)

	1992	Percentage of total indirect taxes	1993	Percentage of total indirect taxes
Petroleum products	78.4	74.6	106.1	73.5
Stamps	8.6	8.1	14.7	10.1
Bets	0.4	0.4	0.7	0.5
Travel (departure taxes)	11.8	11.2	12.8	8.8
Cement	4.2	3.9	6.5	4.5
Non-alcoholic beverages	0.9	0.8	1.9	1.3
Alcoholic beverages	0.1	0.1	0.2	0.1
Clubs	0.5	0.4	1.3	0.8
Videos, pinball, car clubs		0.0		0.0
Salt				0.0
Total indirect taxes	105.0	100.0	144.3	100.0

Source: Ministry of Finance and the mission's calculations.

Taken together, the total indirect taxes collected by the Tax Department (i.e., LL 144.4 billion in 1993) represent 13 percent of tax receipts. However, four excises (petroleum, cement, stamp duties, and departure taxes) account for more than 92 percent of the total.

A number of these excises could be eliminated, as their collection cost is certainly greater than their yield (taxes on salt, on playing cards). It might be useful to strengthen others, either to increase tax revenue or for reasons of social or environmental policy (taxes on gambling, on alcoholic beverages). Still others can be introduced (taxes on tobacco).

In addition to these indirect taxes collected by the Tax Department, however, there are indirect taxes collected by Customs and municipal governments (sometimes in addition to other duties and taxes).

With respect to public services, the inventory of taxes is even more complex. 1/ It is difficult to (a) study the mechanism for determining tax bases because of the inclusion of services taxes in the price determined by public authorities, (b) identify the beneficiary from these taxes, the revenue of which may go the the central government or municipalities, and (c) determine the administration responsible for the assessing and collecting of these taxes which could be the Ministry of Finance, other ministries, or the Tax Department.

To name but one example, Customs collects indirect taxes on exports and imports, which are then transferred to the Treasury, with respect to:

- playing cards,
- salt,
- film censorship,
- alcohol and alcoholic beverages,
- tobacco (special taxes),
- sugar (on behalf of the Ministry of Economy),
- oil seeds and oil fruits (on behalf of the Ministry of Economy and Commerce),
- radio and television sets (on behalf of the Post Office), and
- fruit exports (on behalf of the Office of Fruits).

However, the new customs tariff has provided for the consolidation of all these taxes into the proposed duty. 2/

Some goods are relatively undertaxed

- Petroleum products

1/ Water, electricity, and telecommunications.

2/ This new tariff, which was formulated according to the recommendation of the 1992 IMF technical assistance mission has not yet been put into effect.

The average rate of taxation on petroleum products consumed locally is 20 percent of the selling price. This average rate of taxation and the retail selling prices of petroleum products are among the lowest in the world.

- Tax on cement

The average rate of the tax on cement is even lower (approximately 6 percent of selling prices). However, the amount of taxes are not necessarily fully paid, given the low technical level of tax officials assigned to audits.

- Tax on beer

In spite of a recent increase in the specific rate its incidence on the consumer remains insignificant (less than 3 percent).

- Taxes on alcoholic beverages (arak, wines, alcoholic beverages)

These specific excises and taxes 1/ combine numerous tariffs (rather low, although recently increased) and entail complex administration that is inefficient, given the limited staff. Their yield is insignificant (LL 202 million), whereas quantities released for consumption are relatively high (1,000,000 liters for arak and 1,700,000 liters for wine). In conclusion, the tax burden on this sector (less than 3 percent) is particularly low. Moreover, the system of collective presumptive taxation (forfait), whereby production volumes that are to serve as tax bases are determined with wine-growers after harvesting, is ill-defined, archaic, and likely to encourage tax evasion, which is very widespread in this sector of activity.

- Stamp duty

It is current practice in Lebanon to affix movable stamps to documents and contracts and to apply a proportional tax of 3 per 1,000 on numerous agreements. This has an incidence that is far from negligible (nearly LL 15 billion in 1993). Stamp duty management is, however, complex, as the use of stamping machines is still rare. In addition, audits in enterprises reveal numerous irregularities that tend to prove that these taxes are underreported.

- Tax on travel abroad

Efficiently collected by airlines and shipping companies. The taxable event is the sale of tickets for departures from Lebanon. This tax yields significant revenue (nearly LL 13 billion in 1993) and its administration raises no particular difficulty.

- Taxes on entertainment (cinemas, theaters, videos, night clubs, etc.)

These traditional taxes cause no difficulties, and their yield is significant (LL 2.4 billion in 1993).

1/ In addition to a fixed business license tax paid at the beginning of each year (variable depending on the type of goods sold), wholesale or retail merchants must pay specific excises, namely LL 200 per liter of arak, LL 200 per liter of wine, LL 750 per liter of whisky less than 12 years old, and LL 2,000 [per liter] of whisky more than 12 years old.

Significant exemptions of goods and services 1/

In most countries, tobacco is the subject of indirect taxes generating high yields. This is not the case in Lebanon. Similarly, services such as electricity, water distribution, and telecommunications are totally exempt from central government taxes, whereas the central government's contribution is particularly high in the financing of their infrastructures. Even if taxes are collected on behalf of local governments, the problem of the exemption of these public services is a long way from being solved.

The current level of exemption is even less justified, because of the national reconstruction effort, which requires the use of the country's taxable capacity. To this effect, arrangements have to be found to raise revenue provided that the consumption of essential goods by the poor remains untaxed.

Undertaxation of consumption and the overlooking of unimportant potential taxable capacity

Even if indirect taxes collected in Lebanon, which affect only a very limited number of goods and services, are passed on by producers and retailers in sales prices, it is clear that the sizable share of consumption is exempt.

Such an arrangement is seldom encountered internationally. Indeed, any consistent tax system is based on three essential sources: imports, revenue, and consumption.

By ignoring this third source of tax revenue (consumption), Lebanon is depriving itself of a tax source that is essential and, in addition, well accepted to the extent that its impact on prices is moderate.

Weaknesses of tax administration

To be fully effective in a tax system based on declaration, a tax administration should collect taxes spontaneously and without lags between assessment and collection. It should send out reminder notices promptly to defaulters, regularly audit returns, and, in par, maintain accurate records of tax bases. From these angles, the Lebanese tax administration has considerable shortcomings, although efforts have been recently made to improve its functioning.

Limited administrative capacities

Compared with the situation prior to the events, the current tax administration is characterized by:

- a significant decline in real remunerations of tax officials. At around US$200 per month, the remuneration of a senior official in a central government office is clearly not enough to provide even a modest standard of living in Beirut. This situation does not favor initiative and explains the

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1/ In light of their importance, a special chapter is devoted to an examination of the excises on petroleum products, cement, alcoholic beverages, and tobacco.

rapid staff turnover and the limited appeal of government employment for university graduates. To address this major difficulty, arrangements have just been made to introduce a system of supplementary allowances based on increased tax revenue resulting from audits; and

- a no less significant decline in the number of persons employed, at a time when the work involved is singularly complicated in light of the ongoing national reconstruction.

Out of the 500 jobs created at the Tax Department, only half have been filled.

The situation is worse for the Division of Indirect Taxes. This office is staffed by a recently appointed office manager, assisted by eight controllers. Before the troubles, there were many more staff members, that is, 49 persons, including 18 assistant controllers responsible for performing field audits of taxpayers (see Table 3).

Table 3
Distribution of the Tax Department Officials by Grade

	Organic Law	1992	1994
Office Manager	1	1	1
Senior Controllers	4	0	0
Controllers	20	6	8
Observers (Assistant Controllers)	18	7	1
Administrative Staff	5	2	0
Aides	1	1	0
TOTAL	49	17	10

Source: Tax Department

With its staffing now so limited, this office alone will not be able to supervise the introduction of the GST. Moreover, employees of the office have greater facility with physical audits of goods taxed at specific rates than with auditing accounts or invoices. Yet, this latter type of audit (in the field) is what is required for the GST and the expansion of ad valorem rates.

The mission therefore takes the view that in its present form, the Indirect Taxes Division is not equipped for being given the task of implementing this suggested reform.

In addition, this office does not have material administrative resources (not enough cupboards and filing cabinets, no performance indicators centralizing results, and obviously no microcomputers), whereas with a small team, it deals with nearly 15 percent of central government revenue.

Collection dispersed among various departments and offices

In Lebanon, the administration of excise duties and indirect taxes are entrusted to the Tax Department. This department does not look after collections, which are the responsibility of the Treasury Department. What is more, a portion of the indirect taxation falls outside the purview of the Ministry of Finance and goes toward the financing of budgets other than that of the central government.

The complexity of this organization leads to a fragmentation of functions and responsibilities, a proliferation of payment "windows," poorly defined administrative relationships, and a dispersal of tax documentation (tax files, collection files, the cross-checking base). This situation is exacerbated by the fact that there has been insufficient computerization of operations and by the virtual absence of a taxpayer identification number. It is difficult to coordinate the various offices (especially customs and taxes) in the present structure.

The indirect taxes office's internal relations and its connections with the collector's office (by revenue schedule) are particularly hidebound. Taxpayers are therefore obliged to make numerous trips, and the personal intervention of the office manager is required for countersigning most formal communications.

The collections situation is therefore made worse. The Treasury Department is incapable of keeping track of the situation with respect to outstanding assessments remaining for collection.

Inefficient taxpayer identification

Efficient administration is judged inter alia by its capacity of promptly identifying (surveying) those liable for different taxes and, once this identification is complete, for reacting with similar promptness to remaining assessments to be collected. This need is all the more crucial in Lebanon, since taxpayers compliance is traditionally lax, and the extremely long period of civil war has no doubt helped to foster an environment in which some may feel that they can avoid tax obligations with impunity.

During its 1992 and 1993 missions, the IMF recommended that the authorities initiate a large-scale registration program, so that those liable could be located and each assigned a tax identification number (TIN). This was to be done in tandem with the tax amnesty campaign.

Despite the efforts already made, the situation is still extremely worrisome. About 50 percent of taxpayers remain unidentified and those for whom a file exists their returns were submitted irregularly. This state of affairs is attributable to the lack of field staff resources (survey workers) assigned to the Tax Department and of a taxpayer identification system, either in computer files managed by Customs 1/ or in the documents managed manually by tax offices. The very idea of establishing an identification system to facilitate the introduction of a tangible cross-checking base conflicts with special provisions. 2/ However, in most advanced countries such bases exist and

1/ The present Customs file does not include the identities of transactors. Only data useful for the establishment of foreign trade statistics are recorded. Names of importers are not entered in the computer.

2/ In Lebanon, banking secrecy is instituted as an absolute rule.

are even used daily, so as to allow for minimal tax auditing. 1/ In Lebanon at this time, there is no identification system reliable enough to be used. At best, there are trade registration numbers. But a single enterprise can have several such numbers. 2/

Insufficient reminder notices to delinquent taxpayers

It is crucially necessary in a tax system based on declarations to monitor the submission of returns and dispatch timely reminder notices to those who are late. If a taxpayer does not comply with reminders sent to him, action should be taken by the office immediately for the automatic taxation of unreported tax bases, the automatic forwarding of tax assessments to the accountant responsible for the collection, and the automatic initiation by the latter of appropriate enforcement measures, together with lateness penalties.

The tax offices were unable to provide the mission with enough statistical data on these points to permit a precise evaluation of performance. It seems that this aspect of the work does not escape the employees' vigilance, but the rate of delinquency is very high, especially for direct taxes (certainly close to 20 percent for companies taxed on an itemized basis and well above this in the case of sole proprietorships).

Lack of data processing resources

Before the events, the Tax Department had its data processing center which was destroyed. At present, all administrative tasks are done manually, at a time when staffing is at low levels. This observation is particularly important with respect to the Indirect Taxes Division.

The situation is better at the Customs Department, but the computerization system that has just been introduced is still only for statistical centralization purposes and provides no help in the processing of customs operations.

Inefficient and partial tax audits

On-site inspections are performed both by the indirect taxes offices (especially with respect to stamp duties) 3/ and by the income and profit taxes office. Programming is done by the office manager, and concerns primarily major enterprises. Matters under investigation by controllers and supervised by senior controllers entail the recovery of large amounts of arrears. It is true that the accounting records submitted are generally irregular and unsuitable for accounting for the amounts reported. At the direct taxes office, audits resumed in 1993, as recommended by the Fund's 1992 mission, but they are still insufficient compared with the large number of cases. 4/

1/ For example, the common base of those liable for the VAT in all the countries of the European Union is accessible to financial administrations and even to economic transactors.

2/ There are five trade registers in Lebanon, and during the troubles, enterprises were able to register elsewhere without canceling their registration numbers in Beyrouth. There was no checking or "cleaning up" of the registers.

3/ However, the elimination of supervisor positions in cement plants and breweries, has led to a considerable reduction in the number of field audits.

4/ Whereas nearly 60,000 enterprises have been identified by the Chamber of Commerce, annual auditing capacities are for no more than 1,500 cases.

Table 4
Field Audit Results

Year	Number of Audits	Reminders in taxes and penalties (LL million)
1991	not available	1 278
1992	750	25 499
1993	1 000	43 699

Source: Tax Department (Direct Taxes Division).

In addition, the actual collections resulting from these audits are not known and are probably rather small, insofar as the significance of the reminders is disproportionate to the current taxpaying possibilities of taxpayers, given the excessive length of the statute of limitations. 1/

It is also noteworthy that once assessed taxes are designated for collection, they can be contested by appeal before the courts. To date, however, few such cases have been recorded.

Finally, the accounting records of major enterprises that are liable for excise duties (petroleum corporations) are never audited on site by staff of the Indirect Taxes Division.

1/ For persons not identifying themselves to the tax office on the occasion of the tax amnesty, audits can go back, without limits on duration, to the beginning of the taxable activity.

3. Toward a General Sales Tax

Principle characteristics of a general sales tax

In spite of the disadvantages faced by the Lebanese tax administration, it is not feasible that consumption or sales remain outside of the tax system indefinitely.

Before such a reform is initiated, however, decisions must be made on the options and necessary choices. Such choices must be based on the major principles applicable in such matters, concerning the tax base, the rate of tax, tax relief for investment, and the shifting of the tax incidence to the final consumer.

Coverage, exemptions, and special cases

- Coverage

The application of the tax to all economic activities is recommended, in order to achieve the greatest degree of neutrality and to facilitate having a lower rate. Therefore, commercial and industrial activities, services, and imports should be taxed.

Making services liable to the GST from the outset, particularly public utilities, water, electricity, and telephones, will be a major step forward. The mission notes that public utilities (water, electricity, and telephones) already include a 10 percent municipal government tax and that it would be possible to convert this tax into a general sales tax as applied to services without increasing the burden.

Enterprises with a turnover below the threshold will be exempt (a possibility of choice can be offered). Initially, this will limit the number of taxpayers targeted by the reform, in order to facilitate its introduction and then its administration.

- Exemptions

Exemptions should be limited. Experience suggests that the larger the exempted goods and services, the most likely the rates of the tax tend to be higher. In addition, the sale of exempted goods does not entitle the enterprise to benefit from the credit of the tax made at earlier stages. It therefore bears a heavier tax burden. The general sales tax is neutral when its coverage is as wide as possible.

Traditional exemptions relate to:

- livestock, agriculture, fishing, and wild game products re-sold in their original state without being extensively processed;

- real estate operations subject to registration taxes;

- operations relating to tax stamp duties issued by the government;

- essential goods, according to a list that is as restricted as possible;

- education services;

- health services; and

- international transportation.

• Special cases

- Banking, financial, and insurance services

Given the special procedures involved in determining the value added in these sectors, it is recommended to exempt them from the GST.

- Public utilities

All public utilities should be subject to the GST.

- Imports

For imports, the tax base is equal to the c.i.f. value, plus any other expenses and taxes (especially including customs duties and excise taxes), excluding the GST itself.

- Exports

Taxable goods exported by those liable for taxes will qualify for the application of the zero tax rate. For the taxpayer, the application of this rate is equivalent to an exemption, without loss of rights to deduct the GST (in contrast to an outright exemption).

- Hydrocarbons

For petroleum products, a specific study should be carried out, leaning toward the introduction of the GST in the price structure, alongside customs duties and excises. This study can draw on the mission's recommendations in Section 4.

Effect on prices

The adoption of a general sales tax will have effects on prices, even if it is difficult to quantify them owing to the absence of statistics and the fact that no rate has been fixed to date. The mission believes that this effect will not be very important, because of the following factors:

• The GST will be no more inflationary than any other tax that would yield the same revenue;

• If it generates additional budgetary revenue, the effect will be deflationary, unless indexation measures are adopted (a wage increase);

• The choice of the time for implementing the tax is important: for example, it is easier to introduce a tax at a time of disinflation;

• The exemption of essential goods, even in a limited number, would reduce the price effects especially for low-income groups;

• For consumers of water, electricity, and telephones, there should be no increase if the GST initially replaces the local government tax, at the same rate as is suggested;

• Sound taxpayer information, coupled with effective application of the credit for taxes paid at earlier stages, and temporary price controls are likely to minimize any price increases;

• The existence of significant profit margins in retail trade and the prevelance of strong competition also represent a powerful brake on inflation; and

• For products deemed sensitive, the introduction of the GST will be associated with a revision of the customs tariff, to arrive at an accepted overall burden.

The rise in prices is definitely difficult to gauge precisely, but it is expected to be insignificant. This may be attributed to the possibility of following appropriate economic and financial policies that would minimize the inflationary pressures to follow the adoption of a GST.

Setting a taxation threshold

Based on the 1992 study, updated in 1994, on the distribution of enterprises by turnover bracket, as well as the limited administrative capacities, the mission recommends setting a threshold for the GST that is high enough initially to limit the number of taxpayers to be administered. The mission feels that the minimum threshold for the GST should be an annual turnover of LL 1 billion. 1/ This is a preliminary estimate that still needs to be refined.

The study is based on a sample of 4,271 companies taxed on the actual basis (régime réel) and filing their tax returns in Beirut, Mount Lebanon, and Tripoli (see Table 5).

This study shows that 13 percent of the enterprises make nearly 75 percent of the turnover in the sample. At the national level, those enterprises recording a turnover of more than LL 1 billion are few in number, probably totaling less than 1,000. This small number of taxpayers will facilitate the introduction and then the administration of the tax by a small, competent team at the Tax Department (pilot unit).

1/ These are estimates that are subject to revision following an analysis of the studies updated for 1994 and particularly of the data base of industrial enterprises being established at the Ministry of Industry and Petroleum with UNIDO assistance, which should be available in October 1994.

Table 5

Distribution of Corporations (Stock Companies (S.A.) and Private Limited Liability Companies (S.A.R.L.)) by Turnover 1/

(In billions of LL)

Turnover bracket	Cumulative number of enterprises	Percentage	Cumulative turnover	Percentage
> 1 Billion	566	13	2 872	73
> 500 Millions	1 574	37	3 521	90
> 100 Millions	3 097	73	3 875	99
> 0	4 271	100	3 932	100

Source: Tax Department.

1/ Results, 1993, excluding banks and insurance companies, for Beirut, Tripoli, and Mount Lebanon.

Enterprises with turnover below the threshold will be exempt from the tax, without any presumptive (forfait) system which is sometimes costly in terms of manpower resources for very small yields. Being exempt from the GST does not mean that the enterprises in question are not subject to tax. They will, indeed, be subject, like all economic transactors (including those in the informal sector) to the GST paid when making purchases or imports. Only their own value added will not be taxed. The foregone tax revenue is too insignificant to mobilize the needed administrative capacities. In the medium term, the taxation threshold could be lowered in consecutive phases, with a view to the gradual expansion of the population subject to taxation.

The merits and setting of a single rate

As this is a new tax, arrangements to facilitate its introduction and administration should be made. If a high threshold limits the number of taxpayers, the adoption of a single rate could also facilitates the administration of this tax, for both taxpayers and the administration. 1/

1/ For example, of the 34 countries that have introduced a VAT since January 1, 1990, twenty-five--or more than three quarters--apply a single rate.

- Merits of a single rate

Multiple rates:

- complicate the forms for periodic tax returns enormously and increase data processing entries and the likelihood of errors;

- require special accounting arrangements, in order to provide a breakdown of taxpayers' sales and stocks at the various rates;

- increase verification problems and encourage the emergence of steadily accumulating real or notional credits; and

- erode the tax base, leading to the fixing of a standard rate that is higher for a given level of revenue.

For certain essential goods and in order to avoid any price increases, the mission prefers the adoption of exemption measures, rather than a low rate provided that exempted goods remain limited.

- Setting the rate

For rate setting purposes, the mission recommends that account be taken of the following considerations:

- the revenue target (the amount of revenue to be generated from the GST); and

- evaluating the results of simulations to be performed in order to determine the tax base.

A simple macroeconomic analysis should take special account of the value of imports (except imports of specially exempt goods). In fact, given the high proportion of imports in Lebanese consumption, the major portion of the tax will be collected at this level. As tariff rates were fixed without reference to this tax, which will affect the bulk of goods, the mission suggests, for sensitive products that the tariff be reviewed to reach an acceptable overall tax burden. The value added of enterprises liable for tax (those with a turnover above the threshold) and the value of their exports could be usefully estimated, to be respectively added to and deducted from the value of previous imports. This method leads to a theoretical GST base. Dividing the target revenue by this adjusted tax base will produce the rate sought.

- Any enterprise-by-enterprise microeconomic analyses in search of a rate are bound to fail (they cannot serve to determine possible price increases).

<u>On a practical level, the mission recommends that the authorities perform a macroeconomic and tax simulation on the basis of a 10 percent single rate.</u>

Tax Credits and accounting obligations

In order to avoid cascade effects, the main characteristic of the GST is the credit mechanism which allows deducting one tax from the other ("tax-on-tax"). Accordingly, taxpayers will be authorized to deduct from the tax collected from their customers, intended for transfer to the Tax Department, the tax paid in customs or to other suppliers of goods and services, who are themselves taxpayers.

The introduction of the credit mechanism should be conditional on the administration's strengthening its supervision of compliance with invoicing requirements. Only expenditure that has generated the delivery of an invoice by an entity liable for the GST may qualify as deductible expenditure. The law on the GST should contain all necessary information with respect to accounting requirements.

Each invoice should contain the following information:

- date issued;
- continuous, chronological serial number;
- name, address, and tax identification number (TIN) of the supplier;
- name, address, and tax identification number of the customer;
- description and quantity of the merchandise sold;
- unit price and total price before tax; and
- invoiced GST.

The original invoice is kept by the purchaser. A copy is kept by the seller. The accounting documents (purchases and sales logs) should make GST auditing possible. Operations should be recorded on the basis of amounts before tax.

The credit should be generalized as much as possible with a few exceptions and no delay for its implementation. Initially, under certain conditions, exporters will obtain refunds of the GST on their purchases. In a second phase, the refund of unused tax credits might be extended to all taxpayers, depending on progress made in the administration of this tax.

Appropriate penalties and sanctions

In the recommended GST the taxpayer legally liable plays a collector role vis-à-vis other taxpayers. Accordingly, the penalties for failure to remit the tax must be exemplary, realistic, and above all, nonnegotiable.

In the case of estimated taxation for the failure to register with the tax office, provision must be made for denying taxpayers the right to benefit from the credit for taxes paid at earlier stages. Similarly, penalties limited to 50 percent for underreporting or failure to report after a reminder has been issued are justified. 1/ But these penalties must be strengthened if tax evasion is discovered

1/ Currently, the penalties applied in Lebanon seem to be insufficient for direct taxes (10 percent) and excessive in the case of indirect taxes (e.g., 10 times the tax for stamp duty).

and must entail exemplary and punitive damages (temporary closure of the enterprise, debarment from government contracts, etc.). 1/

Tax evasion, as an offense, should be introduced into the penal code.

Action plan for the introduction and administration of the GST

The weaknesses noted in the organization and operation of the tax administration require a short- and medium-term plan of action based primarily on collection and audit of the prospective General Sales Tax (GST).

Despite the constraints on Lebanon's Tax Administration, the mission believes that a gradual and selective self-assessed approach, will enable the service to achieve solid improvement in a relatively short time.

In order to accord clear priority to the introduction of the GST, the action plan recommended is intentionally confined to three areas of particular strategic importance:

- The GST must be administered by a team of officials who are highly motivated and efficient, organized as a pilot administrative unit. Over time, the methods and procedures used by this unit with respect to the GST and excise duties will be extended to taxes paid automatically by the same enterprises (at-source withholdings on wages), then to direct taxes, and ultimately to smaller enterprises.

- GST assessment, collection, and audit must be conducted in accordance with new methods, involving simplified procedures requiring moderate, but consistent computer support; severe deterrent action will be taken against taxpayers in arrears, tax avoiders and defrauders;

- Training and improving the technical knowledge of the staff charged with the GST unit and of all the officials in the Tax Department, should be re-examined with a view to achieving a more efficient administrative apparatus that rewards performance and penalizes mediocre performers more severely. A special group of highly qualified staff should be nominated and charged with the unit.

Establishment of a pilot unit

The statistical information provided to the mission shows a high degree of concentration in the tax base as few taxpayers pay significantly a large share of the tax (see Table 5).

In a situation characterized by scarce resources, this concentration is a very significant asset that can be turned to best advantage, administratively speaking, by setting up a small team of officials to work on the largest cases. The pilot unit is the forerunner of a tax office organizational structure that handle all tax matters. The tax administration and structure could be modernized over four successive phases:

- Phase 1, 1994-95: setting up a pilot unit for controlling and collecting the GST and excise duties;

1/ An identical provision is in the process of being prepared with regard to the collection of electricity bills.

- Phase 2, 1996: expanding the jurisdiction of the pilot unit to administer other taxes paid automatically (withholding at source on wages, etc.);

- Phase 3, 1997: further expansion by taking on responsibility for direct taxation, the pilot unit thus becoming an "office with responsibility for major enterprises;" and

- Phase 4, 1998: distribution to all other offices of the experimental methods related to phases 1-3 to administer, at the district level, taxation in respect of medium-sized enterprises.

The experience of other countries shows that such action makes the rapid adoption of modern management techniques feasible (computerization of operation, collection, and audit tasks). The amount of tax revenue very quickly shows the effects of significant progress, since the taxpayers concerned (less than 1,000) alone account for almost 75 percent of domestic tax revenue. Lastly, such action makes possible a gradual improvement in the audit and collection techniques used by all tax administration offices.

The pilot unit must include (1) a cell for collecting taxes and monitoring delinquent taxpayers, (2) an audit team, responsible for auditing new taxpayers, (3) a team for carrying out cross-checks, with responsibility for detecting nonreported activities, and (4) a management cell responsible for maintaining records and electronic data files.

All the officials assigned to this unit must be chosen carefully, with priority given to skills, motivation, and dynamism. (Table 6 gives a suggested organization chart for the pilot unit.)

The number of staff assigned to the pilot unit, under the supervision of a Department Head, should in principle be about 25, including those to be responsible for collection.

Transfer of collection to the Tax Department

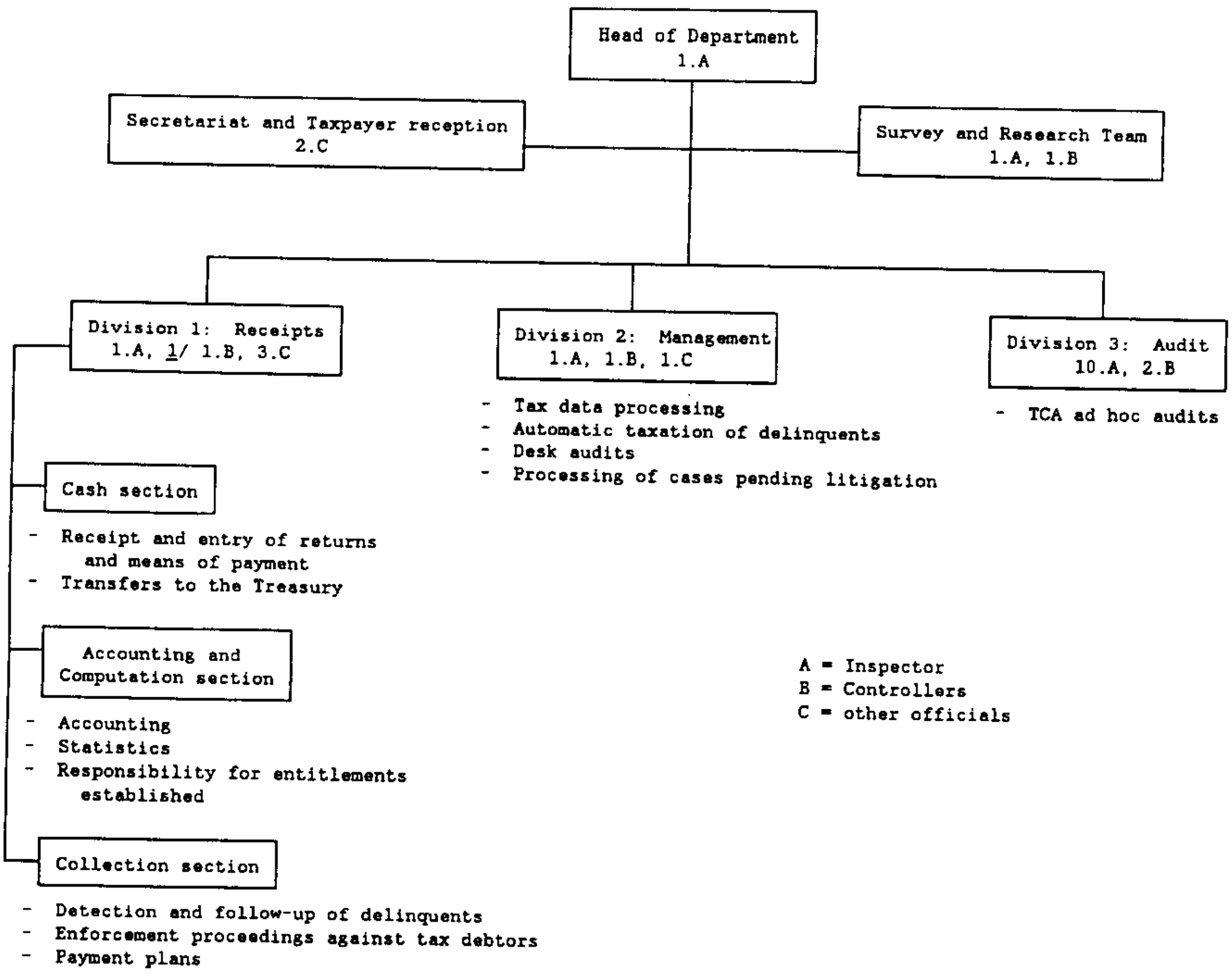
Collection of the GST will be entrusted to the pilot unit which will include a special section for this task. The mission recommends monthly collection. Tax returns and payments will be made using a single form to be lodged with the tax collection office in the first two weeks of the following month (see model form in Appendix 2).

Efficient collection is a decisive factor in obtaining efficient performance with respect to tax revenue. In this respect, retaining an organizational structure inherited from the era preceding independence is a handicap that considerably weakens the tax administration. Splitting collection and assessment authority between two separate directorates of the Ministry of Finance leads in practice to wasted resources and a dilution of responsibilities that are hardly compatible with implementing the tax reform program. This observation, which holds valid regardless of the nature of the taxes currently collected, clearly takes on heightened significance with the introduction of the GST.

Table 6

Organization Chart for a Pilot Unit to Administer the GST

(Beirut)



1/ Tax collectors seconded from the Treasury.

To date, no country that has inherited this particular type of organizational structure for collection has risked dividing the responsibility for collection and assessment when a GST-type tax was introduced; this is true of France, where the General Department of Taxes is responsible for all aspects of administering and collecting indirect taxes of this nature. Combining collection and assessment in the same department means that monthly obligations can be monitored effectively and immediate action taken against delinquent taxpayers.

Taxpayer Identification Number (TIN)

The main, new feature of the GST is the tax credit that allows for deducting, on a "tax-on-tax" basis, the tax paid at earlier stages, either at the time of importation or at the time of local purchase. In return for this advantage, the tax administration must be able to verify the tax deducted. Tax evasion will be preventable only by means of an effective cross-checking system, based on simple data-processing methods, and well-organized coordination between Customs and the Tax Department.

Furthermore, on the question of a tax withheld in respect of third parties, periodic transfers must be audited closely and reminders issued as soon as the submission deadline expires. In this case, too, <u>a simple computerized system makes it possible to detect delinquent taxpayers immediately and take action against them, after the taxpayers liable to the GST have been identified</u>. Thus, the GST requires strict monitoring of taxpayers, made all the more simple by the fact that the number of taxpayers will be limited in the beginning. However, all this will be possible only if taxpayers are identified on an accurate and reliable basis.

For this reason, the mission recommends embarking upon the specific identification of taxpayers, <u>for tax purposes</u>, by establishing, in common with Customs and the Tax Department, an <u>individualized identifier</u>, or taxpayers identification number (TIN). This identification number, formerly invariable for a given enterprise (regardless of its activity or address) must include the following characteristics:

- it should be numerical, sequential, and include a check digit 1/

- it should be unique and unchangeable (regardless of the number of the enterprise's branches or offices);

- it should be common to Customs, Treasury, and Tax Departments (this should be sufficient enough; the quest for a common identification number with other offices, ministries, or departments inevitably delays and complicates its design, and ultimately could be prejudicial to tax considerations);

- it should appear on tax and customs declarations, invoices, and business records of taxpayers liable for tax. (The absence of an identification number shall be grounds for disallowing tax credits or debarring taxpayers from government contracts.)

1/ Six digits, including one check digit, should suffice for Lebanon.

The mission considers it fundamentally important for all enterprises subject to the GST to register with the tax office (pilot unit) in the first instance. In this way, it will be easy to ensure that all registered taxpayers have filed their returns and made their monthly payments. This registration formality, which is obligatory and free of charge, should be phased in gradually in order to be feasible and efficient, and should entail the following stages:

- registration of enterprises subject to the GST first, that is, those whose turnover exceeds the threshold (1994-1995);

- registration of all importers, irrespective of their turnover;

- registration of other commercial and service-providing enterprises (1997).

Only those invoices issued by registered suppliers will benefit from the credit of the GST paid at earlier stages.

Consequently, the registration exercise entrusted to the pilot unit of the Tax Department will encompass, as a priority matter, the 1,000-1,500 enterprises liable for the GST. It must be carried out in the three months preceding the introduction of the GST and be accompanied by media advertising. Dissemination of a special notice specifying the conditions for registration, the modalities for use, and the implications of the tax identification number (TIN) is strongly advised. 1/

Keeping track of delinquent taxpayers

Strengthening administrative efficiency with respect to the GST will depend on the administration's ability to react immediately to situations involving delinquency or payment default. In addition, the mission recommends faxing 2/, where possible, all procedural documents to enterprises not in compliance. Lastly, estimated tax assessments and other enforcement measures are to be implemented within the legally established timeframe. Close attention will have to be paid to this matter by the Chief of the pilot unit, and needless to say, by the appropriate echelons of the Tax Department.

Computerized task processing

Computerization of the pilot unit will be on a very small scale. Installation of 4 PCs should be enough to process the following modules:

- a taxpayer registration module (issuance of tax identification numbers);

- a collection form (accounting and centralization of receipts, posting to the accounts, Treasury paying-in slips, payment plans, etc.);

1/ A very effective penalty for nonregistration is the permanent loss of the right to credit the tax paid at an earlier stage (Customs, suppliers) from the time the tax was established up to the discovery or late registration of the enterprise. A model GST registration declaration, needed for assigning the tax identification number is shown in Appendix 1.

2/ Use of fax machines for procedural documents shall be legalized in the law establishing the GST. This will make it possible to deal efficiently with address problems.

- a detection and follow-up of delinquents form (initialling of accounts, identification of delinquent taxpayers, issuing reminder notices and lists of automatic tax assessments to be performed);

- an audit assistance form (making it possible to identify inconsistencies, on the basis of various parameters, and to incorporate the cross-checks provided by the Customs Department, inter alia);

- a management assistance form (making it possible to publish activity performance results and all management statistics).

(See Table 7, the plan for computerizing the GST taxpayer file.)

Using this computerization plan, the procedure for processing tax returns 1/ becomes very prompt and efficient. After the taxpayer has filed his return and payment has been recorded, the return is immediately called up on the screen. It is then included in the GST file which is examined on a regular basis by the audit team which uses the audit-assistance computer form for programming cases to be audited. This form, which will incorporate customs data, will also include several parameters capable of exposing tax evasion (bad credit reports, inconsistent data in comparison with those from other enterprises operating in the same sector of activity, etc.).

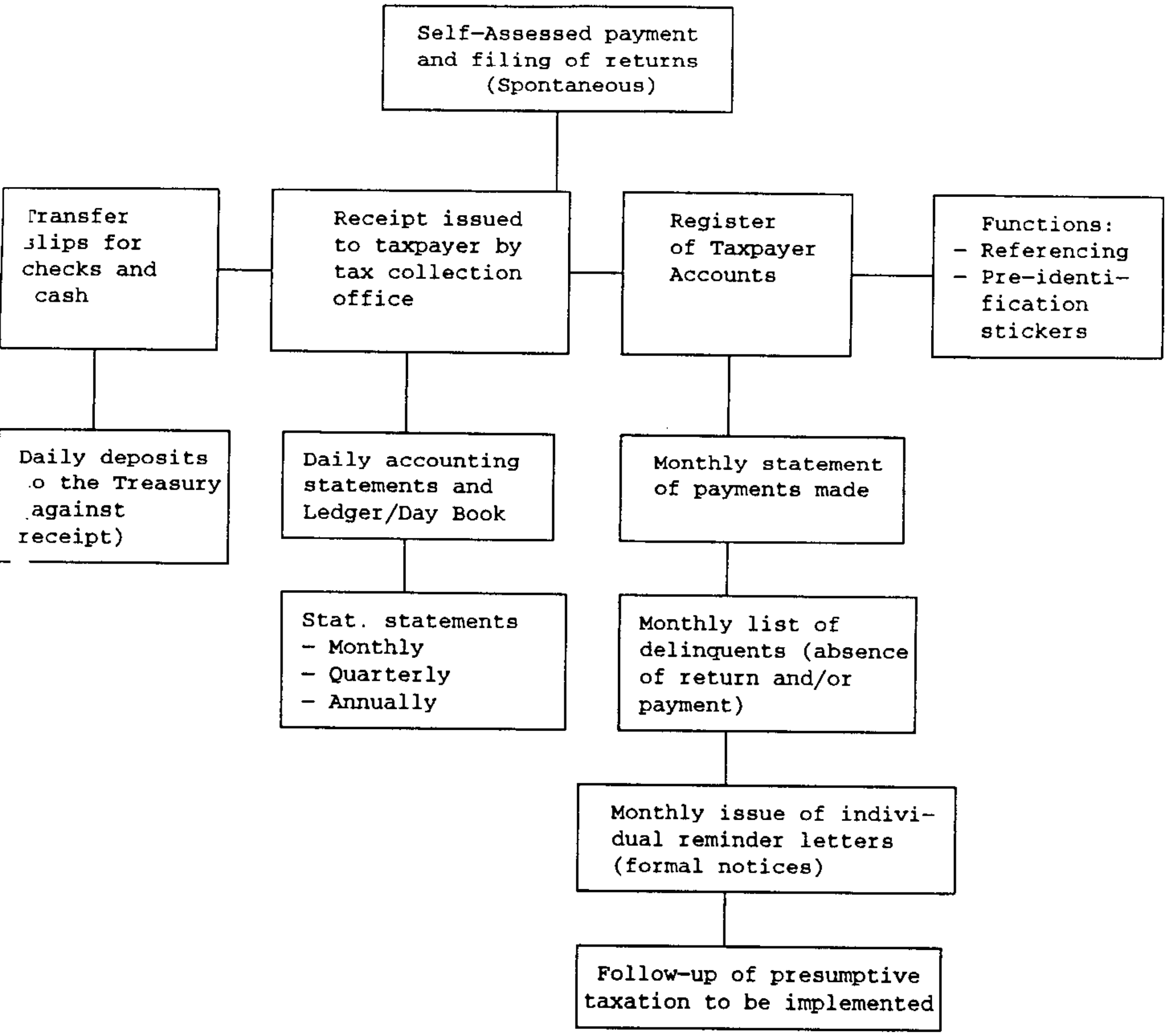
New audit methods and coordination with Customs

The pilot unit audit team will carry out a number of specific, targeted audits requiring only limited time on site (maximum 1-2 days). It may reasonably be expected that a team of 10 auditors will be able to audit all the taxpayers affected by the GST at least every two years. It is less by recovery of large amounts of arrears (often not recovered) and far more by increasing the frequency of audits in an expanded group of enterprises that improvements can be obtained in reporting behavior. The methodology of the ad hoc audit, which will be standard practice in the pilot unit, could also serve as a model for other audit structures (direct taxes team), and it should be made clear that the traditional methods should be reserved only for exceptional cases of tax evasion.

Before putting these new methods in place, a training program for auditors needs to be conducted and a guide to the new arrangements will be distributed. This guide will describe the essential investigations (verification of profit margins and, by sampling, examination of stock records). The decision for field audits will be the responsibility of the Tax Director, with priority given to taxpayers with arrears. An effort will be made to seek a balance in frequent audits between the various sectors of the economy and the size of turnover.

1/ Compare the model proposed in Annex 2. The computer system will make it possible to preprint the permanent components of the return (name of the enterprise, GST code, etc.), whether on a sticker, or on the tax return itself.

Table 7
Plan for the Computerization of the Taxpayer Register



The activities of the cross-checking team, which is an important function of the pilot unit, will be directed toward discovering nonreported activities. In this connection, systematic research should be conducted at all the organizations that have information of one sort or another, on the business affairs of enterprises (Chamber of Commerce, Customs, social security, courts, etc.). Particular importance will be attached to the use of information pertaining to occasional importers identified by Customs. In this respect, the Customs Department should be fully involved in the process of introducing the GST because it will compute and collect the largest proportion of the tax by virtue of its very broad base and small number of exemptions. Almost all imports will be subject to the GST and part of it, that is, that paid by taxpayers liable on their later transactions.

Procedures of customs clearance should be modified so that the GST can be computed. It is equally important that customs officials be informed of the provisions of the GST.

Coordination between Customs and the Tax Department is essential for verifying GST deductions declared as having been paid in Customs. This coordination should give rise to a systematic information-swapping plan, which is computerized, and based on the National Tax Identification Number (TIN). Since the GST is applicable both domestically and at the time of importation, Customs must pay special attention to exemptions that are not identical. Computation by Customs must be carried out for all imports including those exempt from customs duties but subject to the GST. The value of goods exempt from GST must be computed in order to determine the foregone revenue.

Coordination between Customs, Treasury, and Tax Departments

Since the GST paid is immediately deductible, through the credit mechanism the event given the right to deduct the tax should be defined clearly. To minimize possible discrepancies between Customs computations and actual collections, the mission recommends:

- requiring payment of the GST before the release of goods, and denying extending the benefit of temporary release (crédits d'enlèvements éventuels) to the GST;

- requiring proof of assessment and payment to support the credit.

This assumes that Customs shows separately the GST collections at the time of importation and issues a receipt. Computer system support, however small-scale, is essential for establishing correct links.

A special link will be established between the Tax Department and the Treasury to handle the daily transfer of the collection made by the pilot unit.

A motivated team to ensure a successful introduction of the GST

The date for implementing the new GST must take account of two major constraints:

- the preparatory tasks for introducing the tax itself, and

- the work needed for strengthening different stages of tax administration, namely those of auditing, collection, and other important procedures.

The recommendations already formulated take into account the essential features required for managing the collection and auditing of a GST-type tax. They may be summarized as follows:

- establish a pilot unit for the largest enterprises, which alone are initially liable for the new tax,

- register and identify the taxpayers involved,

- design a single payment form,

- establish appropriate computerized processing,

- implement an appropriate collection procedure, and

- carry out frequent, short, but targeted audits.

After taking the essential factors into account, the mission considers that the earliest date for successful introduction of the GST would be July 1, 1995, if the recommendations formulated are implemented by the deadlines that have been set. In particular, the law on the introduction of the GST should be promulgated at least six months before its entry into force, that is, December 31, 1994 for implementation on July 1, 1995.

This deadline gives Lebanon more than 15 months to draft the relevant legislation and organize the necessary consultations. In particular, this period of time should be used to strengthen the operational efficiency of the administration, which is indispensable for controlling the planned tax. This will also make it possible to bring the various preparatory tasks to a successful conclusion.

Appointment of a team responsible for the GST project

A permanent working group for developing the GST should be nominated immediately and officially. This group should be headed, if possible, by the person who will later be responsible for the pilot unit, which will have full responsibility for administering the GST. This team, with its permanent links to the Tax Director and the Office of the Minister of Finance, will have about six individuals to cover all the aspects of the reform. The team leader should be assigned to this project on a full-time basis and released from all other activities.

The functions of this team will include:

- general coordination and tax policy issues (team leader),

- organization and choice of staff, premises, office equipment, furniture, etc. (1 official),

- legislation, circulars, GST manual, seminars for taxpayers and consumer information (1 official),

- operational implementation and establishment of procedures (registration, reporting, payment, audit), publication of manuals, staff training, visits to enterprises, Customs/Taxes/Treasury coordination (2 officials, 1 of whom from Customs),

- choice of computer sites and equipment, development of applications (1 tax official and 1 programmer analyst).

As the work progresses, these numbers can change. Customs should participate in the work from the beginning for introduction of the tax on imports and to maintain the links that will be necessary for supervising the tax later (improving the files on foreign trade, joint research with the Tax Department for the individualized identification of those liable for tax).

Professional training of officials

The team put in place will conduct specialized training of officials of the Pilot Unit and of Customs. Manuals and guides are essential for ensuring that consistent decisions are taken within the Tax and the Customs Departments.

Planning and potential participation will focus on other training in the:

- Ministry of Finance (officials from the Minister's office, interested in tax policy issues, the Treasury, Customs, and from Budget); and

- financial heads of other ministries.

The training of pilot unit officials will focus on economic and policy aspects of the reform, registration procedures, preliminary visits to enterprises, monitoring delinquent taxpayers and issuing reminder notices, actions related to collection, enterprise accounting and audit in accordance with the new guidelines. In view of the current deficiencies in tax controls and the relatively high risks linked to introduction of the tax, it is essential to improve audit performance and post-audit collection, without overlooking the small and medium-sized enterprises that are significantly involved in underreporting of turnover.

A "public relations" cell

The team for developing the GST will work also in close consultation with business sectors and their representatives, and exchanges of information shall take place at each stage prior to the reform to obtain their consensus, which is indispensable for the success of the reform: draft law, forms, procedures. Consequently, it will be appropriate to organize seminars for those who deal with Customs, accounting firms, CEOs, etc.

At the same time, the "public relations" cell will design and distribute brochures and leaflets to consumer organizations and the media (press, television).

Furthermore, as recommended by earlier IMF missions, it is essential to consolidate all tax laws and their amendments into a general Tax Code. The Code should be distributed widely to tax officials and taxpayers in order to facilitate their compliance and efficient application.

To carry out these various tasks (legal aspects, computerization, training, information), the team for developing the GST, then the pilot unit, could benefit from possible bilateral or multilateral technical assistance.

An implementation plan

Tasks for execution have been summarized and presented in the timetable of recommended measures, phase 2 above.

4. Taxation of Special Products (Excise Duties)

The introduction of the GST does not necessarily preclude the levying of excise duties because of the additional tax revenue they may generate and also for environmental, health, and energy policy reasons. The application of the GST in addition to excise duties is the norm in all the countries where the tax is instituted.

Tobacco, alcohol, petroleum products, and cement are among the widely consumed goods traditionally subject to these duties. A special analysis of the taxation of these products was conducted, as they offer the possibility of an immediate increase in revenue. The administration could also become more effective by strengthening this taxation as a prelude to introduction of the GST.

Petroleum products

Observations: Arbitrary price structure and dissipated and diminished tax yield

- Arbitrary price structure

The price structure is based on a "world price" arbitrarily defined for each product (see Table 8). Though these "world prices" were substantially increased in 1993, they are calculated on the basis of the customs exchange rate which is equivalent to LL 800, as opposed to the market exchange rate of LL 1,700.

The following are added to the "world price":

- a variable excise duty of 4-18 percent, depending on the product;

- a stamp duty (3 per mil),

- a port tax (3.5 percent),

- a specific customs duty, except on "black" oil products (diesel oil, DDO, fuel oil).

The price structure is set by the Ministry of Industry and Petroleum with the collaboration of the Ministry of Finance.

The fixed sale prices, among the lowest in the world, have not been adequately adjusted to avoid possible increase in the minimum wage and to reduce inflationary pressures. But, because of competition, prevailing prices are often lower than the fixed prices, inflationary pressures. This is a result of inconsistencies in pricing policy in general, and energy product pricing in particular; electricity prices tripled in 1993. So the increase in duties and taxes on petroleum products would not necessarily lead to a proportional increase in prices actually charged at the pump.

Table 8
Petroleum Products Price Structure, February 1994

(in LL/100 liters, unless otherwise indicated)

	Super 98	Super 92	Unleaded	Petroleum	Diesel Oil	DDO	Fuel Oil	TOTAL 1/ billions
1. World price	26 900.0	25 430.0	26 200.0	29 662.6	27 736.2	27 736.2	15 543.0	750
2. Domestic ad-valorem tax*	4 842.0	4 577.4	4 716.0	2 669.6	2 496.3	2 496.3	621.7	106
3. Stamp and port taxes*	429.5	343.6	343.6	530.5	429.5	429.5	285.0	11
4. Specific customs duties*	5 000.0	5 000.0	5 000.0	882.3	0.0	0.0	0.0	88
5. Distribution fees	354.0	354.0	354.0	95.0	178.0	0.0	20.0	8
6. Delivery charges	660.0	660.0	660.0	660.0	660.0	562.5	700.0	19
7. Resale margin	3 814.5	3 635.0	3726.4	1 500.0	1 500.0	0.0	0.0	79
TOTAL Price/retail/hl	42 000.0	40 000.0	41 000.0	36 000.0	33 000	31 224.5	17 169.7	1 061
Price of 20-liter barrel	8 400.0	8 000.0	8 200.0	7 200.0	6 600.0	6 245.0	3 434.0	
Price per liter in LL	420.0	400.0	410.0	360.0	330.0	312.0	172.0	
Price $/US gallon US$ 1 = LL 1 700	0.93	0.88	0.91	0.80	0.73	0.69	0.38	
Amounts sold in 1993 thousands of hl	2 400.0	15 000.0	80.0	560.0	9 200.0	1.0	1 930.0	29 171.0
Taxes levied LL/h	10 272.0	9 921.0	10 060.0	4 082.0	2 926.0	2 926.0	907.0	
Total taxes in billions of LL 1/	25.0	149.0	1.0	2.0	27.0	0.0	2.0	205.0
% taxes/sale price	24 %	25 %	25 %	11 %	9 %	9 %	5 %	20 %

Source: Ministry of Finance and calculations by the mission.

1/ The total is obtained by multiplying by the amounts sold in 1993.

- Dissipated and diminished tax yield

The yield for 1993 from the various taxes on domestic consumption of petroleum products is estimated at LL 205 billion (see Table 9). This represents about 17 percent of tax revenue.

Table 9
Domestic Oil Taxation, 1993
(In billions of LL)

Ad valorem excise duties	106.
Specific customs duties	88. 1/
Stamp and port taxes	11. 1/
	205.

1/ Mission estimates.

The yield is dissipated and low because of:

- Insufficient customs control

Though Customs does effectively "operate" (supervise) the port and certain warehouses, it does not physically monitor deliveries of petroleum products, particularly products delivered under exemptions.

No duties are payable on released goods from the customs area by the 15 distributors licensed by Customs. Distributors declare the destination of their goods and the tax treatment (taxable or exempted), but without being checked when the goods leave the warehouse. Some warehouses "managed" directly by the Ministry of Industry and Petroleum (Zouk for electricity) have no customs guarantee. There is no customs clearance or payment of taxes for petroleum products delivered to Electricité du Liban.

- Little or no tax control

A single officer in the Tax Department is responsible for checking declared payments of excise duties (financial tax) by distributors and issuing payment orders for these taxes with the Treasury.

Distributors have 20 days on average to declare the amounts released for consumption (up until 1993, they were given over two months). A late filing penalty of 1 percent per day is applied. However, insufficient and poorly trained staff prevent the Tax Department from verifying the movements of these products or the distributors' accounts. Only the declarations filed by the distributors are subject to formal checks.

- Inadequate monitoring of exemptions

The army, National Guard, UN, embassies, and international airlines are exempt from excise duties but these exemptions are not rigorously monitored. The National Guard and embassies receive refunds or compensation rather than direct exemptions.

Though the "black" petroleum products delivered to Electricité du Liban (EDL) (1 million metric tons of fuel oil) are taxable, they are released without payment of customs duties or taxes. Payment is deemed to take place when the petroleum ministry receives a price which includes these taxes. Available information suggests that neither the Ministry nor EDI transfer any taxes to the Tax Department. 1/

- Disparate and complex collection procedures

- Specific customs duties are paid once a week according to a summary statement submitted by licensed distributors. The warehouse from which the goods are released approves the declaration and payment is made to the main cashier located away from the warehouse.

- The same payment procedure applies to stamp and port taxes.

- Ad valorem excise duties are paid to the Treasury based on distributors' declarations approved by Customs, verification and preparation of the payment orders by the Tax Department (Indirect Tax Office). This duty is paid on average 20 days after the goods have been released for consumption.

The lags between assessments and collection increase the entire cost of tax administration, prolong unnecessary delays in payment which could have unfavorable effects on the entire public finance especially under inflationary pressures and finally make control more difficult.

Recommendations: Increase the supervisory role of the Customs, increase taxes, and implement the GST

- Short-term measure:

(1) Resumption by Customs of its supervisory role

It is recommended that Customs be fully responsible for collection and monitoring the circulation of these goods. Customs duties and taxes should be paid at the same time as the goods are released for consumption when they leave the warehouses or refineries. No extended payment periods should be granted. 2/ Each time goods leave the warehouse, they should be subject to clearance and immediate payment of all taxes. This will make it possible to simplify administration, reduce taxpayer obligations, and improve control.

Distributors will be required to file only one declaration when they take the goods from the warehouse, with a single administration (Customs). The method of one declaration per withdrawal is easily compatible with the data processing systems currently available to licensed distributors. 3/ All arrears and delays will be eliminated because it will be impossible to take

1/ The Ministry of Industry and Petroleum imports and distributes petroleum products directly on behalf of Electricité du Liban.

2/ Distributors make deliveries to retailers c.o.d. or with payment due no more than 24 hours later.

3/ The 85 or so unlicensed distributors file declarations for each withdrawal along with the immediate payment. The computerization of customs services will make it possible to further improve the effectiveness of this procedure, which is recommended as of now.

goods out without payment. Both the value and volume of exemptions will be monitored by Customs, both by recipient and by product.

To prevent fraud, it is strongly recommended that the two refineries and all the warehouses be put under strengthened customs supervision. In particular, the warehouses supplying EDL should once again be placed under customs supervision, have the original taxes reapplied, and customs declarations drawn up for each withdrawal, irrespective of the type of importer (whether private or ministries). No public or private entity should have the ability to import petroleum products and release them for consumption without Customs clearance.

(2) Increase in taxation

The prices of petroleum products in Lebanon are among the cheapest and therefore the least taxed in the world. The level of taxation is less than 25 percent of the sales price for gasoline, 11 percent for oil, 9 percent for diesel oil, and 5 percent for fuel oil; being 20 percent on average. One immediate measure would be to gradually increase the taxes on these products. This could be done by:

(a) Converting specific customs duties into ad valorem taxes at a rate of 20 percent for all goods.

(b) Instituting an excise duty to be collected by Customs along with the ad valorem customs duty, to bring tax collection up to the desired level (i.e., the difference between the new sales price for each product and the total of the other items in the price structure).

(c) Eliminating stamp duty, port tax and the variable financial tax of 4-18 percent, by merging them with the specific tax described above as it is suggested under the proposed tariff.

Hence, with a retail price increase of 20 percent for all products (which would still be among the cheapest in the world after this increase), the fiscal gain would amount to LL 212 billion, that is, 103 percent of current oil tax revenue. The new price structure is given in Table 10 below.

The new, more condensed structure (5 items instead of 7, as delivery charges are incorporated in distributors' margins), contains only two tax components, one ad valorem and the other specific, both should be paid at Customs when the products are released for consumption.

- Medium-term measure: application of the general sales tax (GST)

In the medium term it is recommended that the GST also be levied on petroleum products for the reasons given above.

The introduction of the GST into the price structure of petroleum products will make it possible to lower production costs for producers subject to the tax by making it deductible for certain products (diesel oil, DDO, fuel oil) used in manufacturing, but not for products used in transportation. This deductibility of the GST increases its economic neutrality, improves the position of the real sector vis-à-vis the informal sector, which is incapable of benefiting from tax credits and reduces the cost of investments.

Table 10
Petroleum Product Price Structure with 20 Percent Price Increase

(In LL per hl unless otherwise indicated)

	Super 98	Super 92	Unleaded	Petroleum	Diesel Oil	DDO	Fuel Oil	TOTAL billions
1. World price	26 900.0	25 430.0	26 200.0	29 662.6	27 736.2	27 736.2	15 543.0	750
2. Customs 20 % 1/	5 380.0	5 086.0	5 240.0	5 932.52	5 547.24	5 547.2	3 108.6	150
3. Specific tax 2/	13 292.0	12 835.0	13 020.0	5 350.0	3 979.0	5 754.0	1 228.0	267
4. Distributor margin	1 014.0	1 014.0	1 014.0	755.0	838.0	562.5	720.0	27
5. Retailer margin	3 814.5	3 635.0	3 726.4	1 500.0	1 500.0	0.0	0.0	79
TOTAL Retail price	50 400.0	48 000.0	49 200.0	43 200.0	39 600.0	39 600.0	20 600.0	
Price of 20 l barrel in LL	10 080.0	9 600.0	9 840.0	8 640.0	7 920.0	7 920.0	4 120.0	
Current price per barrel	8 400.0	8 000.0	8 200.0	7 200.0	6 600.0	6 245.0	3 434.0	
Taxes levied in LL/hl	18 672.0	17 921.0	18 260.0	11 282.0	9 526.0	11 301.0	4 337.0	
Total taxes in billions of LL 3/	45.0	269.0	1.0	6.0	88.0	0.0	8.0	417
% taxes/sales price	37 %	37 %	37 %	26 %	24 %	29 %	21 %	
Additional taxes collected after reform - billions -	20.0	120.0	1.0	4.0	61.0	0.0	7.0	212

Source: Mission calculations.

1/ Customs duties at a uniform rate of 20 percent of the world price.
2/ The specific tax in this instance is the difference between the retail price and the other lines of the price structure.
3/ The total of taxes collected is obtained by multiplying these unit prices by the amounts sold in 1993.

To this end, the 15 licensed distributor companies would also have their margins subject to the GST. They will therefore bill the GST to manufacturers for bulk deliveries of petroleum products. The retailers, too numerous to supervise, should not initially be subject to the GST unless their turnover exceeds the threshold. The gain for manufacturers resulting from the deductibility of the GST, and based on the rate of that tax, could far surpass the possible price increase. To prevent a price increase, it would be enough to deduct all or part of the new GST from the excise duty proposed above.

A specific tax is justified by the need to forecast budget revenue with some certainty, irrespective of changes in world prices. Ad valorem taxes, however, (customs duties and GST) provide some flexibility in price setting and the pass-through of a portion of the changes in international prices to consumers.

Tobacco and the Role of the Tobacco Monopoly (Régie des T[illegible]

The main role of the Régie des Tabacs, established **in 1935, was** [illegible] for the Government duties and taxes on tobacco, which **represented a sub**[illegible] revenue. Before 1975, this share accounted for 10 percent of **government re**[illegible] Since 1990, the Régie has regained its importance. The **importance of the R**[illegible] by its 1993 budget reaching about LL 600 billion, or the **equivalent of 1/3 of** [illegible] revenue for that year. 1/ That notwithstanding, the Régie's **contribution, in its differ**[illegible] customs duties, indirect taxes, direct taxes, and transfers to the State **budget is very sm**[illegible] the margin permitted is 25 percent higher than the f.o.b. price with an **additional US$15 p**[illegible] of 500 packs for imported cigarettes, customs duties are 2.3 percent of the f.o.b. **price (in Cu**[illegible] dollars). The Régie has always been exempted from the business profits tax. **The Régie has three** main and three subordinate activities:

- To export "oriental" tobacco leaves and support agricultural production of tobacco. **While** production is subsidized exports are in deficit.

The Régie buys locally and exports about 2.5 million kg of tobacco leaves. They are purchased at US$6 per kg and resold on the international market at US$5 per kg, representing a loss of US$1 per kg. This constitutes a subsidy for tobacco farmers, some of whom are located in the southern part of Lebanon. Despite this subsidy, the production of more profitable vegetables and fruits has replaced tobacco production, which has fallen from 12 to 2.5 million kg.

- The Régie produces local cigarettes which are unpopular judging from the substantial decline in turnover in 1993. The production system is reportedly outmoded and in need of investment. Meanwhile, the 2,000 employees are not very productive and represent a handicap to any possible restructuring.

- Despite making sizeable profits on imported cigarettes, taxation is almost non-existent and half of the cigarettes are smoked outside of Lebanon. The Régie has a strong monopoly, it imports almost 1 million cartons of cigarettes with a turnover of more than LL 350 billion from resales.

Despite the profits accruing from the latter activity, estimated at LL 41 billion, the Government receives almost nothing. Stamp and customs duties are insignificant (less than LL 3 billion per year based on a rate of 2.3 percent of the f.o.b. price, calculated at the customs exchange rate). The price of a pack of foreign cigarettes, set by ministerial decree, is LL 1,028, that is, US$0.56, one of the lowest in the world. It nevertheless includes a 5-percent margin for the retailer and a 1.7-percent margin for the wholesaler. But there is nothing for the state budget in the form of taxes, although cigarettes are a widely consumed item, and usually subject to excises. The fear of creating distortions in the present commercial circuits for the benefit of foreign competition should not deter taxation. Based on the mission's discussions it was concluded that there was a margin for the immediate institution of an ad valorem tax at the relatively low rate of 10 percent. The sale price of one carton would rise from US$282 to US$310. This limited increase (US$28 per carton, i.e. a new price of US$0.66 or LL 1,130 per pack instead of

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1/ The breakdown of the turnover by sources traced by the mission accounts for only LL 437 billion. The discrepancy of LL 163 billion between the two sources, Report of the Government Commissioner and the Régie des Tabacs, is still unexplained.

LL 1,028), would result in a new price of LL 35 billion a year and the government would gain. Furthermore, there are often instances in which cigarettes are sold at LL 1,200 a pack, with additional retail markups taking the place of taxation.

Excise taxes should be collected by Customs when the cigarettes and tobacco are released for consumption, irrespective of the time lag before resale. As Customs uses the special dollar rate and the f.o.b. price instead of the sale price, and in order to maintain an ad valorem tax rather than a specific tax, a rate of 23 percent would have to be applied in order to maintain the same level of revenue. Of course locally manufactured cigarettes would bear the same excise, but at the rate of 10 percent on the retail sales price, withheld by the Régie and remitted monthly to the Tax Department.

If the impact is across-the-board, that is, an increase of 10 percent in all prices--in addition to the 3-percent hike in November 1993--there would be no major consequences after the first few weeks. The increase would still be insufficient to change the present commercial channels, especially those involved in border trade.

- Owing to the lack of transparency in the accounts kept by the Règie (balance sheets and trading accounts), the results announced cannot be verified. The absence of a legal profit allocation mechanism is not conducive to the type of management the Government desires. The recent voluntary remittance of US$5 million cannot hide the fact that no taxes were paid on the product itself or on the Régie's previous profits.

In conclusion, the mission recommends: (1) the institution of an ad valorem tax at a rate of 10 percent on locally manufactured cigarettes and 23 percent on imports; (2) immediate auditing of the Régie's accounts by an independent auditor, to assess the possibility for assessing and collecting government taxes. The Régie should be back on track for achieving its initial objective of collecting tax revenue for the State budget; (3) elimination of the Régie's monopoly of cigarette imports if the Régie proves incapable of fulfilling its fiscal role; 1/ and (4) the application of the GST to tobacco over and above the excise duty, when it is introduced.

Liquor and alcoholic beverages

The mission recommends the following:

- An additional 10-percent ad valorem tax on the top of all specific excises on liquor, wine, and beer imported or locally produced. The current taxes, even after the suggested increase, are derisory in comparison with other countries as Lebanon remains at the bottom of the ladder for this type of taxation. In addition, numerous irregularities are evident (regarding arak production, in particular).

- Elimination of the presumptive methods in determining amounts of taxable wines. This method is based on an annual presumptive (forfaitaire) estimate per producer region. This should be replaced by a system based on actual production on the basis of which excise duties would be paid.

1/ See 1992 report, Lebanon: the tax system and its reconstruction, page 32.

Cement

The construction sector is booming in Lebanon. In addition to the reconstruction of buildings destroyed during the civil war, the Government initiated a policy of major public works: railways, highways. It would appear that considerable profits are being and will continue to be concentrated in this sector, which should contribute more to Lebanon's government finance. The specific tax on cement imported or produced locally--LL 6,000 per metric ton--represents, at best, 6 percent of the corresponding sales (based on a price of US$60 per metric ton of "black" cement and US$150 a ton of "white" cement). Luxury construction materials, particularly marble, are not taxed at all.

- The mission recommends the replacement of the specific tax on cement with a 10-percent tax on all construction materials: cement, marble, etc. This tax will be collected on imports by Customs and by the Tax Department in the case of local production.

Other Utilities

- Electricity

The Lebanese electricity company (Compagnie d'Electricité du Liban), which has a monopoly of electricity distribution, collects a service tax of 10 percent added to its billings which, in principle, is entirely allocated to the municipal governments. No taxes are levied by the Central Government. The company does not, however, make any direct payments to the Treasury on its fuel oil supplies. All its fuel oil is purchased through the Ministry of Industry and Petroleum, which imports directly. The standard price set by the Ministry includes the price of the product itself, transportation and storage costs, and duties and taxes. 1/

The billing rate of the electricity company in proportion to its production costs rose from 35 percent in 1992 to 106 percent in 1993. The collection rate was about 50 percent in 1993. The expected doubling of this revenue in 1994 (LL 260 billion as opposed to LL 130 billion) is not indicative of an improvement in the efficiency of the EDL's collection department, considering that electricity rates went up by 350 percent as of November 1, 1993.

The introduction of the GST in the medium term must include the electricity supply. This should not be exempted, so as to obtain the largest possible base for the GST and hence the tax rate most conducive to achieving revenue targets.

The 10-percent tax levied for the benefit of the municipal governments should henceforth be allocated to the State budget alone. In 1995, it might be useful to convert this tax into the GST when the latter is introduced. The budgets of the municipal governments should be funded by the State budget and not by earmarking taxes to them.

1/ No trace of remittances of duties and taxes by the Ministry of Industry and Petroleum to the Ministry of Finance could be found because, according to the Finance Ministry, these amounts should have been directly paid by the EDL to the Directorate of Taxes. Unremitted taxes amount to some LL 4.65 billion for 1992 and LL 6.58 billion for 1993, according to the Directorate of Taxes.

The collection rate--a mere 50 percent--is so low that an improvement in the efficiency of the company's collection department would make it possible to introduce the GST without a rate increase. On the contrary, the possibility of reducing the tax billed at the medium voltage rate would lower production costs for manufacturers. (System of crediting the tax paid at earlier stages.)

Finally, the mission recommends:

- allocating the current 10-percent tax to the national budget only;

- extending the GST, when it is introduced, to the consumption of electricity. It should be incorporated into the price charged for electricity;

- allowing manufacturers to deduct this tax;

- compensating for necessary rate increases with improvements in bill collections.

• Telephone

No indirect taxes are levied on telephone services (telephone, fax) apart from the 10-percent service tax collected to the benefit of the municipal governments. The Ministry of Telecommunications deposits all its revenue with the Central Bank, but sometimes makes "advances" to the municipal governments to be deducted from their tax revenue allocations.

In this case also, the allocation of the yield of this tax to the municipalities should be stopped and the tax revenue in its entirety go to the national budget. This tax could also be converted into the GST in 1995.

The recommendations made for electricity also apply to telephones and water.

Appendix 1
Declaration for the GST

NIF/TIN
Taxpayer Ex-N°
SCIFE Ex-N°

NAME OF TAXPAYER

01 Last Name | 02 First Name | 03 Second Name

04 Form | 05 Corporate Name

06 Trademark

07 Full address of company head office

08 Business | 09 Business Code | 10 / Telephone/Fax

11

12

13

Address of other offices

17	Day	Month	Year

Effective date of tax liability

Last quarter	14	
Last year	15	
Projections for the next 12 mths	16	

Amount of turnover

I, the undersigned, ..., having the authorization to declare the liability of the above-cited enterprise, hereby vouchsafe that this declaration is sincere and request registration for the GST.

Signature

FOR OFFICIAL USE ONLY

18

Inspection Code

19	Day	Month	Year

Registration Date

20

Application denied

DECLARATION REC'D ON BY

Appendix 2
Monthly GST Return

MINISTRY OF FINANCE
Department of Taxes

DATE STAMP

Return regarding business from the month of 199
(to be filed by the 15th of the following month)

I. IDENTIFICATION

Tax identification number (NIF)

Last Name and First Names or Corporate Name ....

Other designations / Trademark ....

Address : Head office .... FAX No. ....

Other offices .... TEL No. ....

II. TURNOVER BEFORE TAX		Amount before GST			
			Taxable local sales	3	
			Total t/o before GST	4	
Local sales exempted	1		Self delivery	5	
Export sales	2		Taxable TOTAL (3+5)	6	

III. DEDUCTIONS		GST deductible
Credit carried over from previous month	7	
Deductions on goods not constituting fixed assets, on fixed asset services, and on services		
• Deduction on imported goods and services	8	
• Deduction on goods and services purchased locally	9	
GST deductible on goods constituting fixed assets	10	
Regularizations: • additional deductions requested with mandatory supporting attachments (+)	11	
Regularizations: • rebates due with explanation (-)	12	
TOTAL (7 + 8 + 9 + 10 + 11 - 12)	13	

IV. NET GST		
Gross GST (GST rate x line 6)	14	
Deductible GST (line 13)	15	
Net GST due (lines 14-15)	16	
Credit to be carried forward (lines 15-14)	17	

V. PAYMENT (must be submitted with return)

amount of payment (in letters)

form Cash ☐ Check ☐

Bank

FOR OFFICIAL USE	FILER
Receipt No. Penalty Reason Amount paid	At.................. on .... Signature and seal

Republic of Lebanon
Office of the Minister of State for Administrative Reform
Center for Public Sector Projects and Studies
(C.P.S.P.S.)

الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام