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تجاوز

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Fiscal Policy Reform

**Designing a New Fiscal Framework for
Lebanon: A Crucial Step Towards Reform**

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About the Author

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In 2012, he was part of the US State Department's IVLP program for young leaders in the world. He ventured into politics early on and was one of the leaders of youth and student organizations between 2005 and 2008.

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The following policy brief is the result of a partnership between the Adyan Foundation (Adyan) and the Issam Fares Institute for Public Policy and International Affairs (IFI) at the American University of Beirut. The partnership consists of a project conducted under the name of the Tahawor (تجاوز) (US Embassy-funded) program, which aims to consolidate values-driven-human-centered reform dynamics.

As part of this project, IFI has organized three workshop sessions in January, February, and March 2024 to address fiscal policy reforms in Lebanon. The workshops were led by, respectively, Karim Daher¹ Mona Fawaz² and Sami Atallah³. These experts engaged in interactive discussions with MP staffers to highlight gaps in these policies and recommend reforms and address challenges upon their implementation.

The first element of the Tahawor program - addressing the economic compact of reforms - focused on the implementation of fiscal policies to generate revenue and income for state institutions in fairness and transparency. These reforms are essential for laying the groundwork for recovery plans from international financial institutions, and for attracting foreign investments, both of which are fundamental to revitalizing the Lebanese economy.

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2 Mona Fawaz is a Professor in Urban Studies and Planning and cofounder of the Beirut Urban Lab, a research center that specializes in working towards more viable cities, at the American University of Beirut

3 Sami Atallah is the Founding Director of "The Policy Initiative" think tank, who holds an MA in Quantitative Methods from Columbia University and a PhD in Politics from New York University

INTRODUCTION

Tax revenue in Lebanon has been significantly affected by the outbreak of the financial crisis in October 2019, given the currency devaluation and the existing loopholes that have been imposed on fiscal policy throughout the last decades. For this reason, fiscal reform is at the core of any future economic recovery policy program, which would allow spending on infrastructure and social sectors in Lebanon. For a country that has been struggling with dire economic conditions, Lebanon needs a deep restructuring of its public institutions, which are “currently inefficient, wasteful and vulnerable to corruption”⁴ and legislation to address the current fiscal policy challenges.

To address the ongoing fiscal crisis, it is necessary that reforms and policies be conducted with a more transparent and equitable vision than previous policies. Most of the fiscal policies adopted during the post-civil war period were considered to have weakened revenues by “favoring the affluent,” granting them unfair benefits and exemptions, notably in matters of built properties, which has also facilitated tax evasion.⁵

In fact, corruption and mismanagement are some of the main reasons that have caused the failure of fiscal policies in matters of poor tax collection and tax evasion negligence throughout the last three decades. Eventually, this failure was one of the main reasons that triggered the 2019 financial crisis, which led to currency devaluation, the collapse of the banking sector, widespread poverty, and unemployment.⁶

Moreover, adopting reforms will have to be followed by regulatory decrees that will allow them to be properly implemented. As discussed during the workshop sessions, the main obstacle confronting these reforms is the lack of trust from both taxpayers and international partners towards the government and public finance administration. Consequently, implementing new taxes remains a challenging feat without adopting structural reforms to the public institutions. Based on our observations, nevertheless, members of parliament from various blocs understood the importance of both adopting fiscal reforms and the need for foreign aid. This conviction could lead them to push for a more balanced and transparent taxation approach that could reassure their voters and also achieve the desired outcomes of this policy. Furthermore, their dedication to the program constitutes an important contribution to the reform process.

METHODOLOGY

Based on information provided by experts, and published reports, the policy brief took a qualitative approach. Meanwhile, the outcomes of the focus group sessions, which were aimed at addressing the issue of fiscal policy reform, where staffers of MPs actively participated and exchanged opinions, have also been considered for all the different opinions presented during these sessions. Hence, this brief is a reflection of published reports and the discussion of the experts participating in the workshops.

To address these reforms in-depth, the Issam Fares Institute for Public Policy and International Affairs (IFI) at the American University of Beirut organized three dialogue sessions on taxation policies, land fiscal policies, and public finance management respectively. The following policy brief reflects the main ideas discussed during these sessions to provide recommendations to Lebanese parliamentarians to overcome

4 “Lebanon’s Economic Crisis: A Ten Point Action Plan for Avoiding a Lost Decade”, Firas Abi Nassif, Edward Asseily, Bilal Bazzy, Hala Bejani, Amer Bisat, Henri Chaoul, Ishac Diwan, Haneen El Sayed, Ali El Reda Youssef, Saeb el Zein, Nabil Fahed, Philippe Jabr, Sami Nader, May Nasrallah, Paul Raphael, Jean Riachi, Nisreen Salti, Kamal Shehadi, Nasser Saidi, Maha Yahya, Bassam Yammine, and Gerard Zoueiri, 2020, A Citizen Initiative

5 “Lebanon, Technical Assistance Report On Putting Tax Policy Back On Track,” International Monetary Fund, Country Report No.238/, January 2023, <https://www.imf.org/en/Publications/CR/Issues/2023/01/Lebanon-Technical-Assistance-Report-on-Putting-Tax-Policy-Back-on-Track-528121>.

6 Dario Sabaghi, “How Lebanon was plundered by its own central bank,” DW, August 25, 2023, <https://www.dw.com/en/how-lebanon-was-plundered-by-its-own-central-bank/a-66613994#:~:text=Salameh's%20monetary%20policies%2C%20along%20with,sector%20collapse%2C%20and%20widespread%20poverty.>

their differences and advocate for long-due reform in these areas. The paper will discuss the recommended reforms of tax policies, followed by land fiscal policy and public finance management, and conclude with recommendations to MPs.

REFORMING TAX POLICIES

Combating Tax Fraud and Evasion

Proper revenue collection has always been a critical measure for governments to adopt. This has always been the case in Lebanon, however, it has become even more challenging in times of severe financial crisis, as the poverty rate has skyrocketed and more people are deprived of access to their most basic needs. Furthermore, it would seem almost impossible to enhance tax collection without implementing the necessary reforms to the fiscal system.

However, these proposed reforms are inefficient if they fail to be combined with genuine measures to combat tax evasion and the use of international tracking tools, such as the OECD Global Forum⁷ rules and framework. In this regard, Karim Daher notes that Lebanon should join these initiatives to gain access to valuable data regarding reportable accounts and assets owned by Lebanese tax residents. Such a mechanism would enable the Lebanese tax authorities “to automatically get all information regarding capital gains and interests earned in most of the world by local residents, and thus collect taxes on this income in accordance with Lebanese law.”⁸

In addition, leveraging new technologies such as data mining and implementing e-government systems are essential, and act as pathways to pursue non-compliant individuals, including imposing severe penalties such as significant fines and license revocations. Granting access to public beneficial ownership registers like companies, trusts, and real estate would enhance tracking efforts to combat money laundering and identify shell companies or corporate structures registered in offshore jurisdictions. Addressing modern tax evasion methods, such as collaborating with multinational companies like Uber and Airbnb that operate on the Lebanese soil, but which are taxable abroad, is also a crucial step.

Furthermore, these reforms cannot be sustained without creating a suitable environment, characterized by a transparent and accountable public administration with an effective mechanism for addressing corruption. The detrimental consequences of past malpractice would serve as a compelling incentive for various parliamentary blocs to reach a consensus and implement the necessary amendments. In addition to these reforms, amending Lebanon’s fiscal framework is an important milestone to reach before undertaking structural reforms, essential for the revival of the national economy and Lebanon’s future prosperity. Moreover, these measures cannot be implemented unless bank secrecy is lifted and other relevant laws are amended, so that instead of benefitting fraudsters, laws are realigned to their original purpose of attracting foreign deposits. Subsequently, a single tax identification number should be assigned to each resident, whether national or foreign, with the adoption of a “General Personal Income Tax” with progressive rates across all revenue streams within a global taxation framework⁹. This would incorporate all generated local and foreign revenues and pave the way to the adoption of a residence tax regime, where “residents of the country are taxed on their worldwide (local and foreign) income while non-residents are taxed on their local income.”¹⁰

7 OECD Global Forum, <https://www.oecd.org/tax/transparency/>.

8 Alain Bifani, Karim Daher, Lydia Assouad and Ishac Diwan, ‘Which tax policies for Lebanon? Lessons from the past for a challenging future,’ Political Economy Series, Arab Reform Initiative, May 28, 2021, <https://www.arab-reform.net/publication/which-tax-policies-for-lebanon-lessons-from-the-past-for-a-challenging-future/>.

9 ‘Lebanon Individual - Foreign tax relief and tax treaties,’ Worldwide Tax Summaries, <https://taxsummaries.pwc.com/lebanon/individual/foreign-tax-relief-and-tax-treaties>.

10 Karim Daher, ‘How to define a Tax Resident,’ 2016, ALDIC, <https://www.aldic.net/how-to-define-a-tax-resident/>.

The adoption of this regime will have to occur in accordance with double taxation treaties, which are “international agreements, almost exclusively concluded on a bilateral basis that aim to alleviate double taxation arising from cross-border activities.”¹¹ Such treaties have been signed by the Lebanese government and several countries.

All these measures underscore the necessity of unifying all the fiscal regulations and laws in a ‘General Tax Code’, a “collection of written laws gathered together, usually covering specific subject matter” to harmonize the laws and fiscal policies¹², which requires a legislative action to regroup the existing acts and laws into a new single law. Moreover, such amendments represent an important incentive for lawmakers to engage, in a second phase, in the process of deep fiscal reforms that would allow the broadening of the tax base and in a way that would benefit both the taxpayers and the government.

Fairness and Equity

Broadening the tax base, however, does not imply imposing new taxes on taxpayers who are already deprived of accessing their savings, and who suffer from the effects of the economic crisis. Such a concern has been reflected by several participants during the workshop sessions. On the contrary, reforming tax policies would bring fairness and equity to current regulations and laws, where unbalanced exemptions and disproportionate rates are being applied.

In this regard, a series of proposed measures by a group of experts were presented in a report published in 2021 as follows¹³:

- Increasing corporate taxes that benefit corporations from outdated exemptions and benefits, such as those rooted in the fiscal regime of 1959.
- Reforming the law on property tax, creating a distinction between rented and non-rented residences. Daher stated during his presentation that revenues accrued from rent would be included in the owners’ income tax, with taxes payable to local authorities if the owners were residing in their home, akin to a property usage tax.
- Amending the law on inheritance and gift taxes to address loopholes that have facilitated tax evasion and fictitious transactions, such as the improper transfer of property.
- Expanding the scope of the Value Added Tax (VAT) to encompass all economic activities, in turn reducing turnover thresholds for companies and equitably restructuring tax rates.
- Introducing an annual wealth tax on households with a net worth exceeding a defined threshold, in addition to their income taxes, to ensure a fair distribution of fiscal responsibilities and debt among citizens, while also incentivizing affluent individuals to invest.
- Implementing new taxes or raising existing tax rates on activities that are detrimental to health and the environment.
- Enforcing taxes on vacant houses, buildings, and lands to incentivize their use. The generated revenues from these taxes would contribute to establishing a special fund to foster habitat and sustainable development.
- Introducing new earmarked taxes to enhance taxpayers’ awareness of how their taxes are allocated. In turn, this transparency could foster increased scrutiny over the efficiency of public services and prospects for their enhancement.

¹¹ ‘Double taxation treaties and their implications for investment: what investment policymakers need to know, United Nations Conference on Trade and Development,’ 2024, United Nations, https://unctad.org/system/files/official-document/diaepcb2024d1_en.pdf.

¹² Alain Bifani, Karim Daher, Lydia Assouad and Ishac Diwan, ‘Which tax policies for Lebanon? Lessons from the past for a challenging future,’ Political Economy Series, Arab Reform Initiative, May 28, 2021. <https://www.arab-reform.net/publication/which-tax-policies-for-lebanon-lessons-from-the-past-for-a-challenging-future/>.

¹³ Alain Bifani, Karim Daher, Lydia Assouad and Ishac Diwan, ‘Which tax policies for Lebanon? Lessons from the past for a challenging future,’ Political Economy Series, Arab Reform Initiative, May 28, 2021. <https://www.arab-reform.net/publication/which-tax-policies-for-lebanon-lessons-from-the-past-for-a-challenging-future/>.

LAND FISCAL POLICY

Another important aspect of fiscal framework reform focuses on the need to adopt a more balanced and efficient land fiscal policy. In fact, Lebanon's predominant economic activity since the end of the Civil War in 1990 has revolved around the construction sector. In the wake of this -15year conflict and extensive damage inflicted on infrastructure, buildings, and historical sites because of the battles that took place in the country, it was inevitable for the government to create incentives to encourage the reconstruction effort.

Privileges and Exemptions

During the immediate aftermath of the war, tax exemptions were granted to developers building new properties, without consideration of overall urban planning and matters related to fiscal responsibility.

In fact, landowners and developers give minimal fiscal contributions due to various privileges they enjoy, either by exploiting legal loopholes or by using illegal techniques that enable them to engage in various forms of fiscal evasion. This issue is particularly worrying because of potential revenues that could be generated from the construction and real estate sectors, revenues from which public institutions have been deprived of over the last three decades. The exemption of vacant properties, "which ultimately discriminates in favor of idle resources and easing tax evasion" is a significant example of the squandering of resources.¹⁴

Another example is the tax imposed on land that does not reflect the real value of the properties, and where urban planning has been completely disregarded. In fact, legislation has granted disproportionate incentives to landowners, thereby hindering the public sector's ability to develop land properties.

All these issues were addressed during closed-door meetings under the theme of the 'Beirut Land Dialogues', from which several recommendations emerged and were subsequently published in a final report.¹⁵

The 'Betterment Contribution'

One of 'Beirut Land Dialogue' recommendations, as part of the 'Land Value Capture'¹⁶ session, focused on collecting taxes based on the value produced by public institutions such as parks and highways. In this case, properties that have experienced increased value due to betterment are subject to higher taxes in a scheme that is known as the 'Betterment Contribution.'¹⁷ These measures bring fairness to property owners who did not benefit from such improvements. Moreover, they enable the public sector to invest the revenue generated from this scheme into urban improvements or betterment initiatives without incurring additional debt.

In fact, a significant amount of money was lost "during the period of growth because many potential taxes were not collected at the moment of growth. One of the missing taxes was the betterment tax,"¹⁸ which has been incorporated into the Expropriation Law in 2006 with the amendment of Articles 37 and 53 of the previous 1991 expropriation legislation. However, these amendments have significantly restricted the law's initial intent and applicability, by defining the betterment contribution solely within the context of specific expropriation cases, making the collection and identification of such contributions challenging.

¹⁴ 'Lebanon, Technical Assistance Report On Putting Tax Policy Back On Track,' International Monetary Fund, Country Report No.238/, January 2023, <https://www.imf.org/en/Publications/CR/Issues/2023/01/Lebanon-Technical-Assistance-Report-on-Putting-Tax-Policy-Back-on-Track-528121>.

¹⁵ 'Beirut Land Dialogues: Pathways towards recovering the social value of Urban Land,' Beirut Urban Lab, Lincoln Institute of Land Policy, The Policy Initiative, Global Land Tool Network, UN Habitat's Arab Land Initiative, 2022. <https://beiruturbanlab.com/en/Details/873>.

¹⁶ Ibid

¹⁷ Ibid

¹⁸ 'Beirut Land Dialogues: Pathways towards recovering the social value of Urban Land,' Beirut Urban Lab, Lincoln Institute of Land Policy, The Policy Initiative, Global Land Tool Network, UN Habitat's Arab Land Initiative, 2022. <https://beiruturbanlab.com/en/Details/873>.

Furthermore, the law calculates the increase attributed to the “betterment contribution value” based on the area remaining from the expropriated land, rather than assessing the actual increase in “betterment value.” This approach “massively reduces the taxation value enforced on landowners who benefitted from nearby projects by 2 or 3 folds.”¹⁹

Moreover, a flagrant example of the negative impact of these limitations was experienced in Horsh Beirut - Beirut’s largest park - where “no expropriation was done” and where “consequently, although the value of land increased because of a public project, betterment taxation was not imposed” and where “developers benefitted enormously, they sold the view over the Park untaxed.”²⁰

Given these reasons, it is imperative to adopt new amendments to the expropriation law that would restore the original intent of the betterment tax and enhance its effectiveness. This entails reallocating and reinvesting the revenue generated from this tax into public works projects.

Valuation Standards

The above-mentioned amendments and reforms cannot be achieved without creating an enforcement mechanism, allowing taxes to be thoroughly collected according to a rigorous valuation system. This particular point has been raised by the Director General of Land Registration and Cadastre at the Ministry of Finance, Georges Maarawi, who highlighted the fact that the Valuation Committee for the Betterment Tax was an independent committee that conducted “valuations without a clear criterion that is unified with other sectors,” which created problems and disputes.²¹

Furthermore, reinstating a betterment tax should be supported by a clear valuation system that adheres to International Value Standards (IVS), which are adopted in more than 100 countries where valuers act according to defined rules. These standards are set by an international council, the International Valuation Standards Council (IVSC)²², which updates them regularly and provides valuers with a detailed scope of work to follow. Within this context, it is imperative for the legislator to act in accordance with the standards set by the council if they intend to implement them, knowing that “the requirement to depart from IVS pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other IVS.”

19 Ibid

20 Ibid

21 Beirut Land Dialogues: Pathways towards recovering the social value of Urban Land, Beirut Urban Lab, Lincoln Institute of Land Policy, The Policy Initiative, Global Land Tool Network, UN Habitat’s Arab Land Initiative, 2022. <https://beiruturbanlab.com/en/Details/873>.

22 International Valuation Standards, 2022, International Valuation Standards Committee, <https://www.ivsc.org/>.

PUBLIC FINANCE MANAGEMENT

It is very difficult to expect an efficient fiscal reform process that is not accompanied by similar reform to the public sector itself, addressing the lack of trust and transparency from which it suffers.

A report published in 2023²³ identified six dimensions for Public Financial Management (PFM) best practices as follows:

1. Budget credibility: The governments budget is realistic and implemented as intended, ensuring that actual revenues and expenditures align with the approved budget.
2. Transparency and comprehensiveness of public finances: Comprehensive and accessible information on PFM, including budget classification, government revenue and expenditure transparency, and published data on service delivery performance.
3. Policy-based budgeting: Preparation of the fiscal strategy and budget in line with government fiscal policies, strategic plans, and accurate macroeconomic and fiscal projections.
4. Budget execution: The budget is implemented with effective standards, processes, and internal controls to ensure resources are obtained and used as intended.
5. Accounting and reporting: Maintenance of accurate and reliable records, along with timely dissemination of information to meet decision-making, management, and reporting needs.
6. External scrutiny and audit: Independent review of public finances and follow-up on the implementation of improvement recommendations by the executive.

Financial Statement Transparency

As a result, MPs must advocate for a comprehensive and transparent financial statement, while considering factors such as the 2019 economic crisis and discrepancies arising from the multiple fluctuations and exchange rates. This should include an accurate reflection of the government's revenues and expenditures, including details regarding donations and funds allocated to support public institutions or to finance certain projects.

The current budget framework is not unified for the entire public sector. "Many activities are not fully disclosed, neither to the government nor to parliament. A unified budget does not mean that the finances of each entity are aggregated together. The important consideration is for budgets to be prepared in unison"²⁴.

Tax Revenue Allocations

Moreover, based on the data that would indicate accurate figures of government revenues and expenditures, the budget should be tailored to improving sectors that are vital for the recovery of Lebanon's economy. Taxes should be linked to a specific purpose, for instance, revenues from the betterment tax could be reinvested in infrastructure and public works. This approach would allow for the creation of project-based budget targeting priorities, while also enabling transparent tracking of expenditures. In Latin America, for example, "the legitimacy and the strength [...] is clearly tied to the capacity of demonstrating the link between what's being taxed and what's being constructed for the benefit of either the property or the community."²⁵

23 Wassim Maktabi, Sami Zoughaib, Sami Atallah, 'Lebanon's Public Financial Mismanagement', Konrad Adenauer Stiftung, The Policy Initiative, December 18, 2023, <https://www.kas.de/en/web/libanon/single-title/-/content/lebanon-s-public-financial-mismanagement>.

24 Mounir Rached, 'Workshop: Enhancing the Accountability & Transparency in the National Budget, Budget Coverage in Lebanon: Consequences and Recommendations,' The Lebanese Center for Policy Studies, 2012

25 'Beirut Land Dialogues: Pathways towards recovering the social value of Urban Land', Beirut Urban Lab, Lincoln Institute of Land Policy, The Policy Initiative, Global Land Tool Network, UN Habitat's Arab Land Initiative, 2022, <https://beiruturbanlab.com/en/Details/873>.

POLICY RECOMMENDATIONS

Based on the findings of the policy brief and the sessions dedicated to the fiscal compact of reforms, recommendations have been listed as follows:

On Taxation Policy:

- Assigning a single tax identification number to each resident, with the adoption of a 'General Personal Income Tax' with progressive rates across all revenue streams in accordance with the Double Taxation Treaties.
- Unification of all the fiscal regulations in a 'General Tax Code'.

On Land Fiscal Policy:

Reinstating the purpose of the Betterment Tax which has been incorporated into the expropriation law in a way that has significantly restricted the law's initial intent and applicability by defining the betterment contribution solely within the context of specific expropriation cases.

Issam Fares Institute for Public Policy and International Affairs

Inaugurated in 2006, the Issam Fares Institute for Public Policy and International Affairs (IFI) at the American University of Beirut is an independent, research-based, policy-oriented institute. It aims to initiate and develop policy-relevant research in and about the Arab world. The Institute aims to bridge the gap between academia and policymaking by conducting high quality research on the complex issues and challenges faced by Lebanese and Arab societies within shifting international and global contexts, by generating evidence-based policy recommendations and solutions for Lebanon and the Arab world, and by creating an intellectual space for an interdisciplinary exchange of ideas among researchers, scholars, civil society actors, media, and policy makers.

Adyan's Rashad Center for Cultural Governance

The Rashad Center for Cultural Governance is Adyan's Think-Do-Tank for policymaking and enhancement of cultural governance and diversity management. It is the newest expansion of Adyan's structure to respond to improved diversity management across political and educational public policies, legislation, and affairs. Since 2017, the center runs a variety of local and international projects that focus on advocacy and policy dialogue dedicated to improving private and public responses to arising challenges in the field.

