Macroeconomic overview

The introduction of VAT Law\(^1\) in Lebanon is one of the major structural measures the Ministry of Finance has undertaken in the last decade or so towards the modernization of the revenue administration.

The VAT implementation in 2002 was seen as a major success generating 5.1% of GDP in 2005 and 5.4% of GDP in 2007\(^2\). Today, VAT represents an important source of revenue for the Lebanese Government, with a percentage of VAT collected to the total GDP in the order of 5.9 per cent (projected to yield LBP 2,758 billion (US$1,839 million) for the 2009 budget proposal). Furthermore, VAT (for the 2009 budget) represents 33.5% of all taxes collected, consolidating the fact that it represents an influential component with regards to tax revenues.

Despite the efficiency of the VAT system and the substantial revenue it yields, it did not reduce in a significant manner the budget deficit that it is still raising, so far reaching the level of LBP 6,000 billion (US$4 billion) based on the proposed budget for 2010. As the International Monetary Fund’s recent mission in Lebanon concluded, even if ‘Lebanon’s economy has largely eluded the impact of the global crisis and performed remarkably well, reflecting a confidence boost from regained political stability and prudent macroeconomic management, vulnerabilities remain very high overall, in particular the public debt burden.’\(^3\)

In this context, the acting Minister of finance took in charge the difficult task of drafting the budget for 2010. With a public debt reaching LBP75,000 billion (US$50 billion), Lebanon is in need for more financial resources that may be found by the implementation of the main proposals of the Paris III donors conference held in 2007 where Lebanon presented a reform program aiming primarily at ‘stimulating growth, creating employment, and putting Lebanon’s large public debt on a downward trend.’\(^4\)

\(^1\) Law No. 379 dated 14/12/2001
\(^2\) Ministry of Finance publication, Reform at the Ministry of Finance – a clear vision leading the way, 2005 – 2008 and beyond
\(^3\) International Monetary Fund, Lebanon—2010 Article IV Consultation Mission, Mission Concluding Statement – 9 June 2010
\(^4\) Reform Program presented by the Lebanese Government at the Paris III Donors Conference in 2007
One of the proposed measures was the increase of the VAT rate to 12% and over the medium term to 15%, but this measure was not included in the current proposed budget. The VAT rate increase does not seem to be well perceived by many segments of the Lebanese society and across its political spectrum.

It is important to note that Lebanon is built up on a free economy market where prices are not regulated and with practically no control on inflation. Consequently, an increase of 2 per cent would not necessarily be without adverse effect. In practice, this means that suppliers of goods and commodities along with the providers of services will probably cease the opportunity to increase their pricing benchmarks, notably before any VAT rate increase, something that will affect the final consumer who will accordingly be obliged to reduce his consumption and limit his expenses because the margin of his income will get narrower.

There is also a common fear, reinforced by some studies recently conducted, that an increase in VAT rate will have an adverse impact on poverty. As mentioned in some surveys\(^5\), the percentage of the Lebanese population living below the extreme poverty line may go from 3 per cent to 6.6 per cent due to the implementation of a VAT rate increase, and that people who live in “extreme poverty” are defined earning less than $USD 2 per day and being unable to meet basic food and non-food needs.

Along these lines of arguments, a 5% increase in VAT as mentioned at the Paris III Conference would carry about 9% of the Lebanese into extreme poverty. The survey shows that number of people living at or under the “upper poverty line” defined as earning between $USD 2.4 and $USD 4 per day – would also be expected to increase from the current rate of 28% of the Lebanese population to approximately 31%.

Nevertheless, one can’t look at the distributional impact of VAT in isolation but it needs to be put in the context of the tax system as a whole. In this respect, the Ministry of Finance has been undertaking for more than 10 years major steps towards reforming the tax system in view of addressing economic and financial concerns. Other sources of taxation should be looked at in order to widen the tax base and limit exceptions. This would have the effect of enhancing voluntary compliance and ultimately generating additional revenue.

Furthermore, the VAT Law itself has addressed those social and distributional concerns in exempting goods and services that constitute most of the low income household spending (food, butane, education, …). These exemptions are proper to mitigate the impact of an increase in VAT rate on those who reached the poverty line.

According to a study published by the Lebanese Economic Association (LEA) on January 2010\(^6\), if the share of each main exemption category in household’s total expenditure is higher for poorer than richer households then the exemption can be considered to be well targeted i.e. somewhat progressive as the share of household’s budget spent on exempted food items declines as households get richer. For example spending on exempted food items represents on average almost 14% of overall household’s budget with a share much higher for the poorest(almost 18% of spending) than the richest ones (9.2% of spending). On the other hand spending on books and education is highly regressive as a direct implication of higher spending of richer Lebanese households on private education, while spending on health which is significant for all households (almost 7% of their budget )does not change much with household’s welfare status.

Even if not implemented yet, the increase in VAT rate is being a recurrent debate as it is seen as an important source of revenue. If it has to be implemented, the government would need to mitigate the adverse impact on extreme poverty and poverty overall by more effective social spending for example

\(^5\) Reference to the study:
\(^6\) ‘The poverty and equity implications of a rise in the VAT: a microeconomic simulation for Lebanon’, Nisreen Salti and Jad Chaaban, May 2009
and as mentioned earlier it is of utmost importance to ensure that the consumer rights are protected to avoid any prices increase before the implementation of a new VAT rate.

The Government’s focus should also be on improving the economic growth by maintaining certain fiscal regulations that will allow GDP rate to increase up to 8% as foreseen. The general economic growth will generate more activities generating more revenues to the budget and could allow the government to increase easily the VAT by setting future budgets without causing social disruptions.

Moreover, there should be more efforts put at activating the economy by stimulating productive sectors (such as tourism, promote domestic output for agriculture and industrial sectors, amongst others…), something that will lead to increase overall VAT revenues because of the increase of consumption, for example when stimulating tourism and the industrial sector.

Last but not least, budgetary solutions may not only be related to immediate taxation but also in attracting investment and creating projects. Efforts are being made in this sense towards enhancing the investment climate to align it with regional and international best practice with a clear objective to create jobs and promote balanced and sustainable economic opportunity.

**Scope of tax**

The Lebanese VAT is a tax on domestic consumption, based on the invoice credit mechanism. It is levied on every stage of the production and distribution process being “neutral” to taxpayers (no cost to business) and ultimately levied on consumption.

It did not replace any existing general consumption tax but it did abrogate some specific indirect taxes applicable as of 2002:

- 5% tax on restaurants and hotels
- Duties on non-alcoholic beverages
- Cement duties
- Duty on the value of advertisement fees broadcasted by television
- Municipality duties charged on water, electricity and telecommunications

The VAT system in Lebanon is largely inspired from the EU model (6th directive) and draws upon systems from other recent VAT jurisdictions like Singapore and Switzerland for example.

Even though the Lebanese VAT system is designed in a way to address specific policy objectives, we can say that it is in large part aligned with VAT international best practice and its features ensure the neutrality of the system.

The table below shows the main features of the Lebanese VAT system tested against the OECD criteria defined in the context of the Ottawa Framework conditions:

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Description</th>
<th>Key results</th>
<th>Lebanon</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplicity and certainty</td>
<td>Taxation should be clear and simple to understand so that taxpayers can anticipate the tax consequences of a transaction, including knowing when, where and how the tax is to be</td>
<td>Easy to implement and to apply Limited need for litigation High voluntary compliance</td>
<td>Yes</td>
</tr>
</tbody>
</table>
Implementing a VAT system in Lebanon was considered as a decisive step in the context of financial and economic reform undertaken by the government and it aimed at enhancing the business climate and contributing to economic growth. It also introduced new aspects of a modern tax administration based on self-assessment of tax, function based administration, streamlined compliance requirements, integrated collection function… which were replicated in the Large Taxpayer Office (LTO) created in May 2005, and in the proposed reorganization of the tax administration.

As shown, the VAT system has proved to be very efficient so far in terms of revenue generating and in this context, the government intention⁷ to increase the VAT rate from 10% to 12% and over a medium term to 15% has not materialised yet and as mentioned earlier it seems there is no political consensus on the matter.

**Taxable persons and permanent establishment⁸**

**Definition**

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⁷ Based on the Reform Program presented by the Lebanese Government at the Paris III Donors Conference in 2007
⁸ According to articles 3 to 5 of the VAT law
The taxable person is every juridical or physical person that supplies goods and/or services in Lebanon, irrespective of nationality, or residence, although special rules apply on supplies made by non-residents.\(^9\)

To qualify as a taxpayer under Lebanon’s VAT regime each entity has to meet the following requirements:\(^{1}\)

- A natural or juridical person
- Performs taxable supplies of goods and services (including zero-rated supplies)
- In the course of an independent economic activity
- Achieves a total turnover covering four successive quarters that exceeds LBP 150 million (US$100,000)\(^{10}\)

The turnover is defined as being the total value of the taxable transactions (excluding VAT), zero-rated transactions and exempt transactions. While some jurisdictions measure the threshold against the capacity to generate VAT the Lebanese system measures it to the economic capacity and not only to the taxable turnover. This results in enlarging the VAT population as it is enough to undertake one taxable transaction to become a taxable person provided the other conditions of the law are met.

**The threshold**

The threshold was initially set at LBP 500 million (US$333,333), one of the highest threshold applied worldwide, in application of the 90-10 rule according to which 90% of the potential revenues would be generated by 10% of the businesses. The idea was to limit the number of registered business to ease the VAT administration and limit its cost. This corresponded to 5,000 registered businesses generating an average of LBP 993 billion (US$662 million).

In view of mitigating the adverse effect of a high threshold that could result in some cases in distorting the neutrality of VAT, the threshold was lowered several times and is currently set at LBP 150 million (US$100,000). This resulted with having 27,629 companies registered in 2009 generating an average of LBP 2,800 billion (US$1,867 million).

The table below shows the change in VAT threshold over the years with corresponding revenues generated:

<table>
<thead>
<tr>
<th>VAT Revenues Per Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Threshold (LBP Million)</td>
<td>500</td>
<td>500</td>
<td>225</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>VAT Revenues (LBP Billion)</td>
<td>993</td>
<td>1,361</td>
<td>1,763</td>
<td>1,693</td>
<td>1,660</td>
<td>2,003</td>
<td>2,584</td>
<td>2,889</td>
</tr>
</tbody>
</table>

The lowering of the threshold did not prove to be a decisive measure. The additional revenue generated is definitely not proportional to the additional number of registered businesses, and the cost of administration has undoubtfully increased with a higher compliance risks since the additional businesses are mostly medium taxpayers carrying potential higher risks.

In the same view of preserving competitiveness and being neutral to businesses, the law entitled the person whose turnover was between LBP 150 million and 500 million to opt to be a taxable person. Currently this option is allowed irrespective of the level of the threshold.

\(^{9}\) Refer to article 40 of the VAT Law (No 379 dated 14/12/2001)

\(^{10}\) The threshold was initially set at LBP 500 million and there was an optional registration threshold set at LBP 150 million
**Persons out of the VAT scope**

Like many other VAT jurisdictions, the Lebanese VAT system treats the supply of land as being out of the VAT scope. It is to note that the transfer of land is subject to a registration fee of 6% of the transfer value. The VAT Law also treats public bodies as being out of the VAT scope when they act within their public authority capacity. However, in the case where public bodies act outside this capacity then they become taxable like any other person would.

This is a common practice to keep the public bodies outside of the VAT system when providing non-commercial services. This treatment gave rise to a number of issues around the transaction classification (act performed within the public authority capacity or not) as well as VAT deduction entitlement for public bodies performing both taxable and out of scope supplies.

Out of the VAT scope does not mean that public bodies are relieved from paying input VAT. This issue has been questioned by public bodies as they were traditionally exempt from all taxes. The VAT Law has been amended accordingly to clarify that no one was exempt from paying VAT due on a taxable supply (neither exempt nor zero-rated) unless otherwise stipulated in the VAT Law. It is to note that the input taxed treatment has a zero impact on revenue for the Government since the public bodies reflect this additional cost in their budget.

**Related persons**

In Lebanon there is no VAT Group as such. In order to prevent businesses from splitting and keeping their turnover below the threshold, the law stipulates that the total turnover achieved by related persons who perform similar or related transactions or activities in different businesses or establishments shall be aggregated. In case the overall turnover of the related companies is above LL150 million, each of the related entities shall be considered as a taxable person and will to fulfill the VAT obligations separately.

The main difficulty was to define the criteria according to which the entities are considered as being related and the regulations refer to administrative, financial and organisational control. Additionally, the activity of a holding company is considered to be related to the activities of its related companies if it is necessary and complementary to those activities.

It is to note that turnovers of foreign related entities shall not be added to the aggregated turnover of the Lebanese entities.

**Permanent establishment**

Lebanon’s VAT regime does acknowledge permanent establishments, branches and similar concepts. Although there is no clear definition for permanent establishments in the local legislation it is usually defined in the context of Double Taxation Treaties.

Regarding branches and head office transactions within the same country and cross border, the former type of transaction is not considered as a supply for VAT purposes since the branch is not considered as a separate legal entity; the latter, however, is considered as a supply for VAT purposes.

The taxable base between branches and head offices is deemed to be the consideration that the supplier of goods or services has or will collect for supplying these goods and services.

Taxable cross border transactions between related entities should be performed respecting the arm’s length principle. In Lebanon, the Tax Procedure Law (entered into force on 1 January 2009) sets general anti-abuse provision that entitles the tax administration to re-assess the value of a transaction.

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11 According to article 60 of the VAT Law
12 Law no 44 dated 14/11/2008
between related parties, as it would have been performed between two independent entities dealing at arm’s length.

It is important to state that matters relating to transfer pricing and the arm’s length principle are still at a very early stage in Lebanon, hence there is a lack of clear guidelines on how to apply transfer pricing valuation methodologies and the implementation details have not been issued yet.

**VAT rights and obligations**

The person who meets the taxable person definition has to fulfill specific obligations and enjoys specific rights stipulated under the VAT Law.

The tax procedure law has streamlined the taxpayers’ rights and obligations across all taxes for an increased transparency and accessibility. This codification is in line with the latest trend over the last decade, which encourages tax authorities to ‘define and publicise taxpayers’ rights and obligations so that taxpayers have confidence in the fairness and equity of the tax system’.

The obligations of the taxable person may be summarised as follows:

<table>
<thead>
<tr>
<th>Obligations</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>To register</td>
<td>Within 2 months starting the last day of the quarter where the conditions for being taxable are available</td>
</tr>
<tr>
<td>To issue VAT invoices</td>
<td>Issue an invoice, or other document serving as an invoice in respect of all goods and services supplied to another person</td>
</tr>
<tr>
<td>To file VAT return</td>
<td>To file periodical returns within 20 days from the end of the VAT period</td>
</tr>
<tr>
<td>To pay VAT due</td>
<td>Payment should be done to any of the accepted private banks or its operative branches in Lebanon, in a single payment, within 20 days from the end of each VAT period, covering the taxable transactions performed during that period, after deducting the amount of deductible tax</td>
</tr>
<tr>
<td>To keep books and records</td>
<td>Retain the records, invoices and other accounting documents to enable the VAT administration to ascertain the VAT liability for a 10 years time limit starting the end of the calendar year through which the tax was due</td>
</tr>
<tr>
<td>To give access and information</td>
<td>The VAT administration is entitled to full and free access at all reasonable times to any kind of information (including electronic information), documents, goods, and any other property regarding the taxable person, to ensure the correct collection of tax due</td>
</tr>
</tbody>
</table>
| To de-register    | • Within 2 months from the end of the calendar year that follows the year where the conditions for being taxable ceased to be available  
• Within 2 months from the date of cessation of activity |

The table below shows some of the rights of the taxable person as stipulated under local legislation compared with an illustrative taxpayers’ charter drawn by the OECD based on experience in a number of OECD countries.

<table>
<thead>
<tr>
<th>Rights</th>
<th>Corresponding rights in the TPL</th>
</tr>
</thead>
</table>

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13 According to article 35 of the VAT Law and provisions of the TPL
14 According to article 35 of the VAT law and provisions of the TPL
15 Fiscal Blueprints – A path to a robust, modern and efficient tax administration, EU Commission – Taxation and customs union, 2007, 47-52
16 GAP 002 Taxpayers’ rights and obligations, OECD Centre for Tax Policy and Administration, Paris, 2003
Right to be informed, assisted and heard
- Right to be treated with respect and objectivity
- Right to ask the tax administration to show the documents that constituted the basis of the assessment
- Right to be present at a field audit and be notified of its results and reasons for the tax assessment
- Right to present explanations to the tax administration regarding the computation and payment of the tax due
- Right to be notified with the audit results, and request statements or summaries relating to tax returns and documents already filed

Right to appeal
- Right to object a decision made by the tax administration in accordance with the provisions of the law

Right to pay no more than the correct amount of tax
- Right to benefit from legal tax concessions or deductions as well as from waiver of penalties
- Right to amend tax returns

Right to certainty
- Right to be provided with returns, publications, and related guides free of charge – Right to get an advanced ruling

Right to privacy
- Right to request the competent officials to produce their identification card and a decision on the basis of which action is undertaken before proceeding with the examination or audit
- Right to have an audit performed at the business premises

Right to confidentiality and secrecy
- Right to confidentiality with respect to information provided to the tax administration

### Taxable transactions

**Definition**

Taxable supplies comprise:

- Supplies of goods and services in Lebanon by a taxable person for consideration
- Self supplies of goods and services
- Import by any person

A supply of goods is defined as the transfer by the taxable person of the right to dispose of goods (tangible movable or immovable) as an owner:
- For consideration
- No need for a physical transfer of possession
- No need for the legal transfer of the property title (sell it, manage it,…)

A supply of services is defined as any transaction that does not constitute a supply of goods (catchall definition).

It includes:
- The transfer of intangible property
- The obligation to refrain from an act or to allow an act

Imports and acquisition of services from abroad are considered to be other types of taxable supplies. Concerning importation, VAT becomes chargeable at the point when customs duties become due.

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17 According to article 2 and articles 6 to 12 of the VAT law
All supplies of goods and services are taxable (at the standard rate of 10 per cent or at zero rate), except where specifically exempt under the VAT Law.

Transactions that touch both the business and the private spheres of an entrepreneur are treated with no difference under Lebanon’s VAT regime. For example, when goods/things pass from the business to the private sphere or if business assets are used for private purposes then they are taxable under the self-supply provisions to the extent that related input VAT has previously been deducted.

**Place of taxation rules**

VAT is based on the destination principle according to which imports are taxable and exports are zero-rated. The place of supply rules determines where the supply is considered as taking place and if the supply takes place in Lebanon then the VAT law applies.

The place of supply rules under the VAT law are as follows:

The place of supply of goods is:

- Where the goods are located, or
- Where transport starts if the goods are supplied with transport

The general rule for the place of supply of a service is where the service is used. There is an assumption that if either the supplier or the recipient is established in Lebanon, the service is considered to be used in Lebanon.

Exceptions:

- The place of supply of services connected with immovable property is where the property is located (e.g. real estate agent, rental, legal services)
- The place of services connected with tangible movable property is where the services are performed (e.g. repair of a car, renting of vehicles)

There is no differentiation in the place of supply rules between B2B and B2C transactions.

**Illustrative example:**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>VAT treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>A business supplier located in Country A makes a supply to a customer in Country C. The supply is somehow connected to immovable property in Lebanon</td>
<td>According the place of supply rules, supply made by A is connected to an immovable property located in Lebanon and thus the place of supply is Lebanon</td>
</tr>
</tbody>
</table>

Lebanon has not implemented a ‘use and enjoyment’ rule to be able to consider the place of supply as being in Lebanon for VAT purposes where the place of supply would be outside Lebanon under the general rules.

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18 According to articles 13-14 of the VAT Law
VAT rates, exemptions and zero-rate\textsuperscript{19}

The VAT system in Lebanon is broad based with almost all supplies subject to VAT at one single rate of 10%. Lebanon has adopted a single rate structure to make it easier and less costly for the taxable persons to comply with the VAT Law as well as for the tax administration to control the correct application of the Law. It facilitated a lot the accounting keeping and reporting and ensured an effective self-assessment system relying more and more on voluntary compliance.

The single rate structure avoided the argument over the classification of goods and services under various rates as well as the political pressure that entailed risks of increasing the number of differentiation measures, which would have eroded the tax base.

The VAT scope may be summarised as follows:

<table>
<thead>
<tr>
<th>Standard Rate</th>
<th>Reduced Rate</th>
<th>Zero Rated</th>
<th>Exempt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most goods and services supplied in Lebanon or imported into Lebanon</td>
<td>N/A</td>
<td>Exports of goods and services</td>
<td>Supplies of certain goods that are considered as basic needs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Supplies related to international transport of goods and persons</td>
<td>Certain activities in the public interest as well as activities that are difficult to tax under VAT (see table below)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Supplies in connection with projects funded from foreign sources</td>
<td></td>
</tr>
</tbody>
</table>

In Lebanon the exemptions are compulsory, no taxpayer could opt out or opt for an exemption.

To better understand why some supplies of goods and services are exempt from VAT, it’s worth mentioning the background of these exemptions:

- The main argument supporting the exemption is of economic nature with the aim of keeping certain industries totally outside the VAT system in order to preserve its competitiveness (e.g. real estate sector which could not bear a 10% VAT)
- There’s the social dimension justifying some of the exemptions e.g. supply of basic food (milk, bread, etc…), medicines, health and education
- Some sectors are exempt because the output it is too difficult to tax under VAT such as for example the financial services sector
- Other ad hoc exemptions that were introduced for various economic reasons

Exemption means that:
- No output VAT is charged
- No input VAT is deductible/recoverable

\textsuperscript{19} According to Articles 10 to 21 and Article 25 of the VAT law
As shown in the table below, “the Lebanese VAT law exempts basic food and social items such as education and health services, medicine, books, and public transport, which make the bulk of low-income household consumption of goods and services (it is estimated that about 60% of their consumption is exempt from the VAT). In this regard, the VAT could be seen as a progressive tax on income spent due to the fact that the goods and services exempted from the VAT represent a relatively smaller portion of spending by high-income households'.

On the other hand, exemptions raised some difficulties in terms of classifying goods and services covered under the exemption and in relation to the calculation of the proportional deduction where taxable persons are performing both taxable and exempt supplies.

The exemption also means that input VAT is not deductible / refundable and therefore it raised the issue of additional cost related to input VAT. This effect has been mitigated for some exempt industries, which were granted a relief through a VAT partial recovery system.

Exempt supplies of goods comprise:

<table>
<thead>
<tr>
<th>Exempt supplies of goods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Livestock, poultries and agricultural alimentary in their raw state</td>
</tr>
<tr>
<td>Books and similar publications, newspapers, magazines</td>
</tr>
<tr>
<td>Bread, flour, meat and fish, milk and yogurt, sugar, salt, vegetable oil, baby’s food, macaroni, borghol…</td>
</tr>
<tr>
<td>Drugs and pharmaceutical products</td>
</tr>
<tr>
<td>Gas for domestic consumption</td>
</tr>
<tr>
<td>Precious and semi-precious stones</td>
</tr>
<tr>
<td>Medical and agricultural tools and equipment</td>
</tr>
<tr>
<td>Boats and yachts owned by non-Lebanese</td>
</tr>
<tr>
<td>Means of air transport for goods and passengers</td>
</tr>
<tr>
<td>Supply of gold to the Central Bank</td>
</tr>
<tr>
<td>Postal stamps and bank notes</td>
</tr>
</tbody>
</table>

Exemptions at import:

<table>
<thead>
<tr>
<th>Exemption at import</th>
</tr>
</thead>
<tbody>
<tr>
<td>All goods and services mentioned above</td>
</tr>
<tr>
<td>Personal luggage, household equipment and specimen with no value</td>
</tr>
<tr>
<td>Transactions in connection to the Presidency of Republic, UN Organizations, political and consulate, military privileges, donations granted to public administration and institutions</td>
</tr>
<tr>
<td>Military vehicles, weapons and ammunitions</td>
</tr>
</tbody>
</table>

Exempt activities comprise:

<table>
<thead>
<tr>
<th>Exempt activities</th>
<th>Scope of the exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical services</td>
<td>Services offered by medical doctors or medical professionals and hospitalisation</td>
</tr>
<tr>
<td>Education</td>
<td>Educational services provided by recognised educational institutions</td>
</tr>
<tr>
<td>Insurance and reinsurance</td>
<td>Insurance and reinsurance services provided by recognised insurance companies Medical and hospitalisation coverage provided by mutual assistance funds and</td>
</tr>
</tbody>
</table>

Reform Program presented by the Lebanese Government at the Paris III Donors Conference in 2007
Banking and financial services | Services provided by authorised banks and financial institutions. Covers all services that only authorised banks are allowed to perform.
---|---
Non-profit organisations | Activities undertaken for non-profit purposes, except when exempting such repeated activities is likely to create a distortion of competition with taxable businesses.
---|---
Real estate property | Sale of real properties and residential letting.
Collective transport | Collective transportation by buses or cars (so called ‘service’) excluding taxis.
Betting and gambling and lotteries | Betting in chance games with possibility to win prizes (cash or in kind).
Farming activities | All activities necessary to the supply of the agricultural products by the farmer provided the products are supplied in its raw state or with basic transformation.

Zero-rate applies on exports of goods and supplies of international transport of goods and services. It applies to the supply of goods or services to or within the customs zones, or from the customs zones to outside Lebanon.

Zero-rate applies as well on the supply of services used outside the country. This area of international services has proven to be hard to monitor and the ‘use’ of the services outside the country is not always clearly determined and gives rise until today to a lot of questions.

Zero-rate means that:
- Output VAT is charged at 0%, and
- Input VAT is fully recoverable.

**Illustrative example:**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>VAT treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company X established in Lebanon sells a printing machine company Y established in France. Company X shall export the machine to France and install it in company Y’s premises</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>A lawyer established in Lebanon giving legal advice to a company established and operating in Oman</td>
<td>Zero-rated, since the service is considered as being used abroad</td>
</tr>
<tr>
<td>A supplier supplies goods from Lebanon to a free zone</td>
<td>Zero-rated</td>
</tr>
</tbody>
</table>

**Taxable amount**

The taxable amount is the consideration paid or payable by the recipient for the supply made by the supplier.

If the final price is undeterminable between the different parties involved on the date of the supply, VAT is calculated based on the expected value of the supply and is recalculated once the final price is determined.

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21 According to article 23
If the taxable amount is lower than cost to related parties, meaning that if a taxable person sells goods or services to related parties or employees at a price that is lower than the market price of the good or service, then VAT is calculated based on the cost, and not on the selling price.

If the taxable amount is lower than the market price, then VAT is calculated based on the price agreed upon between the two parties. Doing this could infringe with the arm’s length principle, hence it should be done on the condition that the difference between the price set by the parties and that the market price is not greater than the discounts given by the taxable person in the normal course of business.

In case of a lack of a sale price usually used by the taxable person, the market value is use.

Additional payments (e.g. transportation costs, fees, voluntary payments, customs duties) are also included in the calculation of the taxable amount.

If the taxable amount is not expressed in the Lebanese national currency (Lebanese Pounds), it should be converted using the official exchange rate at the date VAT becomes chargeable.

Deductions

General principle

VAT, in Lebanon, is based on invoice credit mechanism and thus cascading is avoided under the Lebanese VAT legislation.

Thanks to the input VAT deduction mechanism, no matter how many taxable persons intervene in the production and distribution of a particular good or service, the total amount of VAT collected will always be the same.

Although VAT is imposed and collected by registered taxable persons on their supplies at each stage of the production and distribution, the deduction mechanism will prevent any cascading effect (tax on tax) since every registered taxable person will be able to recover the input VAT charged on his purchases of goods and services.

The taxable person is entitled to deduct from the VAT he is liable to pay for a specific VAT period, the whole deductible VAT for that same period. This means that the full amount of input VAT can be deducted immediately, and not through some kind of depreciation over time. Nevertheless, input VAT deduction on fixed assets may be adjusted in case of change in use over time.

VAT paid or payable is deductible, to the extent that it relates to taxable or zero-rated supplies.

Compliance requirements

In order to be deductible, VAT does not need to be paid, it must be due by the taxpayer (paid or payable). In order to exercise the right to deduct, the taxable person must hold:

- An invoice for the goods or services acquired from another taxable person including all the information required under the VAT Law
- Import documents issued by the competent authorities, proving the import and the payment of the tax.

Mixed supplies

---

22 According to articles 27 to 32 of the VAT Law
As mentioned earlier, VAT is not deductible on exempt supplies (although there is a special refund scheme for some exempt activities).

Where a taxable person performs both supplies which give the right to deduct input VAT (i.e. taxable and zero-rated supplies) and supplies which do not give the right to deduct input VAT (i.e. exempt supplies), that person is entitled to deduct input VAT that is attributable to the former supplies only.

The Law stipulated for two methods to calculate the amount of deductible input VAT when performing mixed supplies:

- Direct allocation, or
- Proportional deduction

The direct allocation method is used when it is feasible for a taxable person, through direct allocation, to determine what amount of input VAT relates to taxable and zero-rated supplies and what amount relates to exempt supplies.

When direct allocation is not feasible, the proportional deduction method is to be used, where a proportion of deduction (pro-rata) is used to determine the amount of deductible input VAT. The pro-rata is the ratio of supplies that give the right to deduct and total supplies (including exempt supplies). VAT charged on such supplies is excluded from the calculation of the pro-rata.

**VAT refund**

The refund is a key feature of the VAT system that entitles the taxable person to claim excess input VAT. This is applicable in the cases where input VAT for a given period exceeds output VAT due for the same period. It is especially true for exporters that are zero-rated.

The excess input VAT for a given period is normally carried forward to the next period with the possibility to claim the input VAT refund on a yearly basis. This has allowed the tax administration to monitor the refund mechanism smoothly and address some of the risks associated with it.

In order to ease the cash flow of taxable persons, the VAT Law has been amended\(^\text{23}\) to allow the taxable person to claim the input VAT refund on a bi-yearly basis. It is to note that special arrangements are made for qualified exporters that are entitled to a quarterly refund.

The refund mechanism has been quite efficient with no major delays. This is also due to the fact that for the first time in 2001 a tax law has introduced a deadline that obliges the tax administration to refund the tax credit within 4 months from the date of the claim subject to a late payment interest of 0.75% monthly. This has been reinforced in the TPL and the late payment interest applies on any tax refund claim ed by the taxpayer.

From an audit strategy perspective, and in view of mitigating some of the risks associated with the voluntary compliance and refund mechanism, the tax administration relied extensively on pre-refund audits especially at the first stages of implementation. This allowed the tax administration to build taxpayers’ compliance history and identify high risks cases to focus on. In this context and in order to ease the government cash flow, the TPL has allowed the tax administration to offset any tax credit against VAT and other tax liabilities, to ensure that the claimant has no tax arrears before refunding the VAT.

The taxable person may request the refund of excess tax within 4 years starting from the end of the year where the right to deduct has arisen (year following the business year).

**Special schemes**\(^\text{24}\)

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\(^{23}\) According to Article 30 par 2 of the VAT Law as amended by Budget Law No 583 dated 23/04/2004

\(^{24}\) According to Chapter 18 of the VAT Law
Refund to exempt sectors

As mentioned earlier, there is a special refund scheme that allows full input VAT recovery on fixed assets and current expenses with regards to some exempt activities:

<table>
<thead>
<tr>
<th>Industry</th>
<th>Input VAT recovery on fixed assets</th>
<th>Input VAT recovery on current expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing of medicines</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Manufacturing of exempt alimentary products</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Hospitalisation and medical laboratories</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Education</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Non profit organizations</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Manufacturing of pharmaceutical products</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Manufacturing of papers used in writing, printing, newspapers and printing ink</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Manufacturing of books, newspapers magazines and all exempt publications</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Collective transport of persons</td>
<td>√</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Refund to foreign taxable persons

Lebanon allows foreign businesses to claim a refund of VAT paid in Lebanon to acquire goods or services directly and clearly connected to the purpose of their visit to Lebanon, where the purpose of the visit to Lebanon is to hold or participate in conferences or exhibitions.

Foreign businesses include any person, natural or juridical, foreign or Lebanese, resident abroad, who has a tax or commercial registration number in the country where it operates or in which it resides and who does not have a real or elected establishment in Lebanon.

This scheme differs from the foreign VAT refund implemented in Europe based on the EU 8th VAT Directive, in a sense that the foreign business should not carry out any activity (taxable or non-taxable) in Lebanon.

This scheme is not very effective and very few claims are made with this regards due to the limited scope of application and to the fact that usually it is the Lebanese agent of the foreign business who bears the cost of such visits and claims related input VAT as per the VAT Law conditions.

Tourist refund

VAT refund is applicable on goods, exceeding LL 150,000 per store per day to foreigners or Lebanese nationals residing abroad so long as their visit does not exceed three consecutive months.

For tourist refunds there are procedures to take into account, such as:

- Upon exit from Lebanon, a tourist should submit the refund request to the offices handling VAT refunds and should demonstrate the goods for which he is requesting refund
- The customs authorities check the goods and their conformity with the supporting invoices and stamp the refund requests accordingly
The VAT refund procedures are handled by a private company that is authorised under a specific agreement with the Lebanese Government. The private company is entitled under this agreement to withhold a fee from the tourist for handling the refund request.

*Refund for diplomats and international organisations*

Following international convention, diplomats and international organisations may claim the VAT paid on purchases of goods and services designated exclusively to be used for the execution of their official duties in Lebanon.

*Illustrative example:*

- X is an international organization granted tax exemption in Lebanon.
- Rabih is the son of consul of Bahrain, who is not a permanent resident in Lebanon and is a holder of a diplomatic card.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>VAT treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>X repaired the elevator installed at their offices in Downtown, Beirut</td>
<td>Refundable, since VAT on repairs of buildings owned by diplomatic bodies is refundable</td>
</tr>
<tr>
<td>Rabih renovates the windows in his house</td>
<td>Non-refundable, the renovation works for individuals are non-refundable</td>
</tr>
<tr>
<td>Rabih invited his friends on his birthday to a club in Beirut</td>
<td>Non-refundable. VAT on restaurant bills and purchase of alcoholic drinks is non-refundable</td>
</tr>
<tr>
<td>Samer, the Lebanese manager of X, who has been living in Lebanon for 20 years, purchased an oven for his house</td>
<td>Non-refundable. Samer is Lebanese, therefore he does not meet the conditions</td>
</tr>
<tr>
<td>X purchased an office photocopier</td>
<td>Refundable. Office photocopier is an equipment used to undertake the activity of the organization</td>
</tr>
</tbody>
</table>

*Jewellery*

This sector benefits from a special scheme where VAT is charged on the profit margin. As jewellery is a major industry in Lebanon and subject to strong regional competition with countries without VAT or with a VAT exemption, there was a decision to simplify the VAT system and apply a special scheme. The profit margin has been determined in agreement with the jewelers syndicate at 8% and 12% for jewellery with precious stones.

*VAT liability*\(^{25}\)

Generally, taxable persons who are registered or required to register under the VAT law are liable for VAT. In some cases, the recipient of a taxable supply may be liable to VAT under the reverse charge provision. Accordingly, services acquired from outside Lebanon by a recipient residing in Lebanon are subject to reverse charge i.e. the non-resident does not have to appoint a representative as he is performing the services abroad. The recipient is any person taxable or not who is acquiring the service from abroad. The person acquiring the service from abroad, shall declare the amount of the VAT due on this service and pay it to the tax authorities.

\(^{25}\) Article 33 of the VAT Law
Illustrative example:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>VAT treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Media company located abroad provides a client located in Lebanon with a Media campaign</td>
<td>This transaction is considered as an acquisition of services subject to VAT at 10% under reverse charge</td>
</tr>
</tbody>
</table>

VAT compliance requirements

VAT registration and de-registration

Every taxable person has to register with the VAT Department within 2 months from the last day of the quarter where conditions of taxability are fulfilled.

Upon registration, the tax administration gives the taxable person a unique Tax Identification Number (TIN) covering all taxes. The TIN should be used on all documents issued by the taxable person.

He has to cancel his registration:

- within 2 months from the end of the calendar year that follows the year where conditions of non-taxability are fulfilled, or
- within 2 months from the date of cessation of activity

For entities not established in Lebanon who perform a taxable activity in Lebanon (i.e. occasionally involved in chain supplies in Lebanon) are required to register directly or through a VAT representative irrespective of the turnover achieved.

VAT registration form:

<table>
<thead>
<tr>
<th>Lebanese Governor</th>
<th>Value Added Tax</th>
<th>Ministry of Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>K1-1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Application for registration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1- Taxability</td>
<td>□ Mandatory □ Optional</td>
<td>Registration number (at the Ministry of Finance)</td>
</tr>
<tr>
<td>2- Details</td>
<td>Company Name / Institutions, Trade Name, Commercial Register Number…</td>
<td></td>
</tr>
<tr>
<td>3- Address</td>
<td>Region, Street name, Po Box, Telephone and fax numbers, E-mails…</td>
<td></td>
</tr>
<tr>
<td>4- Date conditions are fulfilled to comply with VAT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Was the company registered before?</td>
<td>□ Yes □ No</td>
<td>Reason for cancellation of registration</td>
</tr>
<tr>
<td>5- Type of activity</td>
<td>6- Import / Export</td>
<td>Do the company Import? □ Yes □ No</td>
</tr>
<tr>
<td>Sort them by importance</td>
<td>Do the company Export? □ Yes □ No</td>
<td>Rate of export to sales</td>
</tr>
<tr>
<td>Sale amount of exported goods in the last 4 quarters</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7- Turnover number</td>
<td></td>
<td>The turnover amount for the last four quarters:</td>
</tr>
<tr>
<td>Turnover amount for the period ending</td>
<td></td>
<td>Quarter 1 from to LL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Quarter 2 from to LL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Quarter 3 from to LL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Quarter 4 from to LL</td>
</tr>
</tbody>
</table>

According to article 35 to 39 of the VAT law and to the provisions of the tax procedure law
VAT return

The VAT system is based on self assessment according to which the taxable person has to calculate its VAT due and declare and pay it to the VAT Administration. The VAT Law introduced for the first time the principle of self assessment as a legal principle without the need for the tax administration to systematically issue adjusted tax assessments.

Every taxable person has to file a VAT return within 20 days from the end of each VAT period including the amount of VAT refundable, if any. It is to note that under the VAT Law, the VAT period is a monthly period, with authority given to the Minister of Finance to change this period and make it quarterly. Accordingly, a quarterly VAT period has been adopted since the VAT implementation date until today. There have been some talks about adopting a monthly VAT period for large taxpayers in order to improve the VAT collection but this is not yet implemented.

The tax procedure law has introduced specific provisions in relation to tax returns that take into consideration specific circumstances of the taxpayers. Accordingly, taxpayers are given the possibility to amend their VAT returns without any penalty in case the amendment is filed within 30 days and provided the difference resulting from that amendment does not exceed a reasonable amount (the law states 10% of the total tax due). Moreover, the law allows taxpayers to request a deferral of the deadline for filing tax returns in case of difficult circumstances.

The law also separates the deadline for filing the tax return from the deadline for payment of the tax due which leads to accepting that the taxpayer may file the return without paying in specific circumstances; in this case, only the late payment penalty would apply.

VAT return form:

<table>
<thead>
<tr>
<th>Lebanese Government</th>
<th>Value Added Tax</th>
<th>Ministry of Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>K 2-</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Tax declaration**

1- Details
Company Name / Institutions, Trade Name, Commercial register #

2- Address
Region, Street name, Po Box, Telephone and fax numbers, E-mails...

3- Tax calculation

<table>
<thead>
<tr>
<th>Sales subject to VAT</th>
<th>Gross Revenue</th>
<th>Tax due</th>
<th>Deductible Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exempted sales with right of deduction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exempted sales</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales of fixed assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales returns</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Purchases and charges
Total subject to VAT for the same period

<table>
<thead>
<tr>
<th>Amounts to be paid LL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total amount to be paid</td>
</tr>
<tr>
<td>Deduct: deductible tax from previous period</td>
</tr>
<tr>
<td>Other deductions</td>
</tr>
<tr>
<td>Net to be paid</td>
</tr>
<tr>
<td>or deductible amount to be reported</td>
</tr>
</tbody>
</table>

4- Details of some purchases for the period

Impoted purchases
Local purchases
Fixed assets purchases subject to VAT

<table>
<thead>
<tr>
<th>Amounts LL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impoted purchases</td>
</tr>
<tr>
<td>Local purchases</td>
</tr>
<tr>
<td>Fixed assets purchases subject to VAT</td>
</tr>
</tbody>
</table>

5- In case the Ministry of Finance needs elaboration on any subject relating to this application, please contact

Name
Rank
Tel:
**VAT invoices**

Other measures are put in place in Lebanon to facilitate tax collection, one of the most relevant examples being the obligation for each taxable person to issue VAT invoices for each supply they undertake. Additionally, there is an obligation to keep proper books and records.

The VAT invoice requirements are standard based on the EU 6th VAT Directive:

- The name, address and registration number of the supplier of goods or services at the MoF
- The name and address of the person for the interest of whom the invoice has been issued
- The description of the supply of goods and services
- The serial number and date of the invoice
- The amount of discounts granted
- The due amount for the supply of goods and services
- The tax chargeable with the applied tax rate (10% or 0%)

Under the Lebanese legislation and due to a large number of cash businesses, the VAT Law has stipulated for the possibility to apply for the issuance of cash receipts instead of VAT invoices in order to ease the compliance requirements and align with the specific operating models. In the same view of aligning VAT rules with the business specific requirements, the VAT Law also entitles a taxable person who deals on a periodical basis with the same recipient to issue periodical VAT invoices.

**Penalties**

In case of non-compliance with the law, then two types of penalties may be imposed on the taxpayer:

- Administrative penalties for the violation of the tax obligations
- Criminal penalties in case of fraud

The initial penalties were very high to enable enforcing the VAT legislation. Those penalties have been decreased and are now streamlined in the TPL. It is to note that the Minister of Finance has the authority to waive penalties up to a certain percentage and it has been a common practice to exercise this authority.

<table>
<thead>
<tr>
<th>Violation</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late or non submission of the registration request - Late or non declaration of cease of activity</td>
<td>Joint Stock Companies: LL2,000,000; Limited Liability Companies, partnerships and establishments exempt from tax: LL 1,000,000 Individuals and others: LL 300,000</td>
</tr>
<tr>
<td>Penalty for late or non payment of taxes</td>
<td>1.5% for withholding taxes &amp; VAT – 1% for all other taxes</td>
</tr>
</tbody>
</table>

27 Provisions of the Tax Procedure Law
<table>
<thead>
<tr>
<th>Non notification of modification of information</th>
<th>Joint Stock Companies: LL 200,000; Limited Liability Companies, partnerships and establishments exempt from tax: LL 100,000; Individuals and others: LL 50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incorrect tax return</td>
<td>20% of difference between tax declared and tax due; Minimum penalty: Joint Stock companies: LL 750,000; Limited Liability Companies, partnerships and establishments exempt from VAT: LL 500,000; Individuals and others: LL 100,000</td>
</tr>
<tr>
<td>Violations related to invoices</td>
<td>If no invoice issued: penalty = 2% of the transaction value If no tax number or other formal information: penalty = 0.5% of the transaction value</td>
</tr>
<tr>
<td>Invoices, books and records in form not affecting substance - or obstruction of tax procedures</td>
<td>50% of the undeclared tax; Minimum penalty: Joint Stock companies: LL 750,000; Limited Liability Companies, partnerships and establishments exempt from VAT: LL 500,000; Individuals and others: LL 100,000</td>
</tr>
<tr>
<td>Responsibility of persons supposed to withhold tax</td>
<td>5% of the due tax / month; Minimum penalty: Joint Stock companies: LL 750,000; Limited Liability Companies, partnerships and establishments exempt from VAT: LL 500,000; Individuals and others: LL 100,000</td>
</tr>
<tr>
<td>At import and export</td>
<td>Depends on the import legislation</td>
</tr>
<tr>
<td>Omission of information from return not affecting taxable base</td>
<td>Joint Stock Companies: LL 200,000 per declaration; Limited Liability Companies, partnerships and establishments exempt from tax: LL 100,000 per declaration; Individuals and others: LL 50,000 per declaration</td>
</tr>
<tr>
<td>Late or non submission of tax return - omission to submit audit reports</td>
<td>5% of value of tax due / month; Not exceeding 100% of the tax. Minimum penalty: Joint Stock Companies: LL 750,000; Limited Liability Companies, partnerships and establishments exempt from tax: LL 500,000; Individuals and others: LL 100,000</td>
</tr>
</tbody>
</table>

It is possible for other parties than the taxable person to be held jointly and severally liable for the VAT and the penalties due such as the VAT representative. The partners in an unlimited partnership may also be held jointly and severally liable.

It is interesting to note that the TPL has introduced the liability of the CEO’s or heads of boards who may also be held jointly and severally liable in case of intentionally not complying with the VAT obligations. This must be proven by a court decision.
Administrative issues

VAT audit
As explained earlier, the VAT system is based on self-assessment and the taxable person has to calculate the tax due and declare and pay it to the VAT administration. The VAT administration has the right to control the correctness of the declaration and may perform desk verification or field audits and may issue additional assessments. When performing its duties, the tax administration may request from any third party, supplier or client of the taxable person, to supply information concerning amounts received from or paid to the taxable person.

The tax procedure law has introduced a new approach to tax compliance with the concept of the tax control based on risk analysis criteria. This is in line with the effort deployed at the Revenue Department to put in place a new audit strategy based on risk analysis criteria, with new audit techniques and procedures. It is to note that the tax administration is working on an integrated approach to tax audits across taxes. This is true for VAT and income tax in the context of the large taxpayers who are administered under a separate department (large taxpayers’ office).

Those efforts constitute an important step aiming at reducing the workload of the tax administration and ensuring more transparency to the audit process. A recent OECD study revealed that despite ‘tax audit and verification activities represent a major investment of revenue body resources, (...) the value of verification results represents less than 4% of annual net revenue collections.’ In Lebanon, additional income tax revenues resulting from verification represents less than 29% of the total tax revenue, which is still low compared to the large efforts put into verification by the tax Department.

In this context, it is worthy to note that Lebanon is looking at its strategy for voluntary compliance, which is a trend in a number of jurisdictions that have started to intensify efforts to have an efficient strategy for voluntary compliance, and may want to look at the latest developments in some countries that introduced voluntary compliance programs in partnership with the taxpayers (e.g. Australia, Netherlands, UK, and Canada).

The tax procedure law also introduced rules to enhance the transparency around the tax audit. This includes:

- The possibility for taxpayers to actively participate throughout the whole control process and to have access to information and evidence gathered by the tax administration
- The taxpayer must be notified of certain details of an upcoming tax audit at least 15 days before the audit is initiated. The details include: the date of the commencement of the audit, the books and records to be prepared for the review of the tax administration, the tax periods to be covered by the tax audit
- The control at the taxpayer premises should not last more than 6 consecutive months to oblige the tax administration to perform its duties as quickly as possible and reduce to a maximum extent the burden on the taxpayers
- Tax authorities are obliged to notify the preliminary results of the control undertaken to have the taxpayer’s feedback before issuing the final assessment. This helps at reducing scope for errors and potential disputes and objections. The notification of the audit results gives taxpayers another chance to interact with the tax administration and enables them to provide clarifications or new evidence that may impact the tax administration’s assessment.

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28 In accordance with the provisions of the tax procedure law
29 Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2008)
**Advance rulings**

In light of those changes and the increasing need for certainty and transparency, the TPL introduced the possibility for the taxable person to apply for an advance ruling asking the VAT administration to clarify how the VAT Law would apply with regards to specific transactions.

The application should meet the following requirements:
- The request relates to a concrete transaction
- The transaction has not been completed yet
- The taxable person has to provide details of the transaction
- The tax administration may ask for additional information

The tax administration should answer in writing within 2 months and the ruling is binding to both parties if complied with. A fee of LBP 2 million (US$1,333) is applicable.

It is to note that even before the TPL was enacted, the VAT Department has always responded to taxable persons' requests and queries through a fully dedicated team. This is being replicated for all taxes and has been reflected in the TPL.

**Statute of limitation**

The tax administration has 4 years to collect its rights. The period is calculated from the end of year that follows the current business year (6 years for taxable persons who did not register before the tax administration when the registration was obligatory).

The taxable person may request the refund of excess tax within 4 years starting from the end of the year where the refund right was created (year following the business year).

The tax administration can exceed the statute of limitations in cases where a profit or revenue has been proven by a court order, arbitration or inheritance clearance. The extension is limited till the end of the calendar year following the end of the year in which the tax administration was notified of such event.

**Objections and appeals**

The taxable person has the right to object to the tax administration decision/assessment within 2 months. The VAT Department must give a feedback within 6 months or the objection will be considered as being received. Again, this measure has first been introduced by the VAT Law and is now replicated in the TPL for all taxes. It reinforces the fact that the introduction of the VAT system has been as a testing laboratory for modern tax administration measures before being generalised to all taxes.

The decision of the VAT Department may be appealed to the “appeal commission” within 2 months. The commission should resolve the appeal within six months. The decision of the appeal commission can be appealed to the Council of State within 1 month.

The objection must conform to the following formal requirements:
- A written formal request signed by the concerned person stating the arguments and the details of the request.
- Copies of the documentary proof on which the objection is based should be attached to the request.
The VAT Department must notify the taxable person of the results of the objection in written and it should state the motives of the decision.

The Appeal commission has to notify its decision to the taxable person and the VAT Department within 30 days.

The Appeal before the State Council is subject to a guarantee deposit equivalent to 5 per cent of the appealed amount. If the State Council approves the appeal, the guarantee will be used to pay the amount of VAT due, if any, and the excess is paid back to the taxable person.

In case the appeal is partly or fully accepted, the taxable person has the right to claim the overpaid tax with the interest due on this amount.

The procedural rules in Lebanon apply both to resident and non-resident taxpayers.

Late payment penalties still apply during the objection period provided that the period does not exceed 12 months starting the date of submitting the objection to the tax administration.

In case the objection was partly or totally accepted, taxable persons who already paid the due amounts can get:

- A refund for the extra amount paid
- The interest due on this balance

E-taxation

The tax procedure law has introduced the e-taxation principles. It enables taxpayers to file electronic returns, pay the amount of tax due electronically and keep and archive books and records in an electronic format.

International tax practice shows that technology is playing an increasing role in contributing to achieve an efficient tax system. It is an essential tool towards reducing compliance costs for taxpayers and administrative burden on tax authorities.

The system for e-filing is currently being tested and in its way to be generalized. No details of application have been issued yet.

It is worthy to note that Incentives should be given to taxpayers to encourage them use this e-facility knowing that it can only remain optional at this stage or at least applicable to large taxpayers who have IT capacity.

Anti-avoidance rules and transfer pricing

According to the VAT Law provisions, the taxable amount in B2B transactions shall be the price of the supply even if it’s below the fair market value provided that this price does represent a normal discount. If the transaction is between related parties, the taxable amount shall not be less than the cost price.

A general anti-abuse provision has been introduced with the tax procedure law, which enables the tax authorities to re-assess the value or the nature of a transaction according to its substance and not only to its legal and formal aspect. This principle has been discussed at length in tax theory as ‘substance over form’ principle.

Tax authorities are also entitled to adjust the price and terms of a transaction occurring between related persons, to the price and terms of a similar transaction that would have been undertaken between persons at arm’s length.
Conclusion

So far the Lebanese VAT system has been successfully implemented and generates substantial revenues for the government. Nevertheless, this revenue generating ability has to be balanced with the need to address businesses concerns and needs in order to create a true ‘win-win’ for governments and taxpayers alike.

To achieve its objectives, the Lebanese VAT system should continue to enhance its system through a constructive and engaged dialogue with taxpayers.

In a recent conference, the OECD and European Commission\textsuperscript{30} set the following VAT trends for the years ahead:

- VAT is likely to maintain its key position and could become even more central as the world emerges from recession
- The economic efficiency of VAT should be improved: countries should modernise their VAT systems to keep pace with economic and technological changes
- VAT compliance should be eased for businesses: tax administrations should provide business with clarity and certainty and compliance costs should be minimised without putting the fight against fraud at risk

It is essential for Lebanon to keep pace with these trends and try as much as possible to align with international best practice and standards to ensure a neutral, efficient and competitive VAT system.

\textsuperscript{30} Lucerne Conference held in September 2009 where 25 OECD countries, the European Commission and 5 non-member countries were represented