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DIRECT TAXES

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BY

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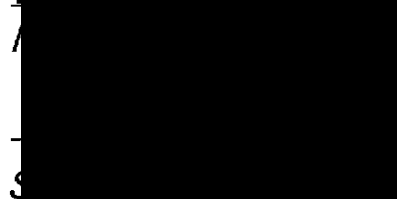
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DEDICATION

**TO ..
MY MOTHER
&
MY FATHER
WITH MY DEEP LOVE**

Acknowledgement

I would like to express my indebtedness to all those who cooperated in this research .

I'm particularly indebted to Dr. Abdallah Dah who, by his advice, cooperation, and continued guidance, has supervised the research through to completion . I also extend my sincere appreciation and gratitude to Dr. Hussin Hejase for his assistance and encouragement .

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Abstract

The purpose of this study of the Direct Taxes in Lebanon is three fold : first, and chiefly, to give a description of what direct taxes are ; secondly, to assess the latest tax reforms in regard with government deficit, fiscal discipline, and national debt; and thirdly, to evaluate the fiscal tax system from the stand point of fiscal adequacy and effects on income distribution and production .

As a background, it has been found appropriate to give a brief history of the development in the economy since the Pre-Independence Period. Also, a good deal of information concerning fiscal adjustment like public debt, budget deficit, and reconstruction programme were presented . And, a survey was conducted on 32 respondents to test the different views and suggestions with respect to recent tax reforms, so as to have a package of certain hints and notes on our tax system in general .

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Chapter I

Introduction : Taxation, Budget Deficits, and National Economy

1.0 Introduction

This research project is concerned with the latest direct-tax reforms in Lebanon : how we got into them, how they affect us, and what they tell us about our social, urban, economic character, history, and future . As might be expected, there are no simple explanations, solutions, or lessons . The tax reforms of 1994 and 1995 were introduced as a solution of the increasing budget deficit and national debt . Knowing that taxes in Lebanon constitute about 86 % of the ordinary receipts, in 1994 amounted to L.L.2,245.765 billion¹ , it may be useful at this point to spell out in the following paragraphs how the tax reforms play a role with the budget deficit and national economy .

1.1 General Background

1.1.1 Pre Independence Period

Economic development began to shape the structure of the Lebanese economy at the beginning of the 19th century . A primary feature of this structure was the role of Beirut as a service entrepôt between the industrialized countries and the Mashriq, with services centered around land and sea transport, international trade, banking, insurance, education, health, tourism, and technical and scientific services . The 1943 National Pact divided political powers along confessional lines, and this trend was also followed in the fields of social and

(1) " Al - Malyia Al-Aama ", Mohammed Awada and Abed Al-raouf Kteash, Beirut, Dar AlKhouid, 1994 (p:481)

economic development . A number of significant economic measures took place following the independence , the most important of which were ² :

- i- The severing of monetary relations with France in 1940, which granted Lebanon the freedom of administering its public funds, monetary conversion, and capital movements in the country .
- ii- The abolition of customs and monetary union with Syria in 1950, and the division of " common interest " between the two states (railroads, the Tobacco Monopoly, Custom Authority) . This allowed the Lebanese state to pursue a policy of free monetary financial and commercial exchange, and strict monetary policy .
- iii- The Banking secrecy law of 1956 .
- iv- A series of bilateral agreements concluded by the Lebanese state at the beginning of 1950s with various Arab countries, such as Iraq, Libya, Jordan, and Gulf states .
- v- Lebanese efforts at establishing a number of mechanisms to redistribute wealth to different social groups, regions, and sects .

1.1.2 The 1943-1975 Period

An important economic development took place between 1943 and the 1975 . Many regional incidents such as the Arab-Israeli war of 1948 and the rise in oil revenues in the Gulf countries led to a number of trends in the Lebanese economy during that period ³ :

- a- Rapid growth in national income, including a four-fold growth between 1950 and 1970, and fifty percent growth from 1970 to 1975 .
- b- Faster growth in service activities: the increase in the share of services as a portion of national income from 63% in 1950 to 70% in 1975

(2) " The Beirut Review " , Ghassan Tueni, Beirut : Lebanese Center for Policy Studies , 1993 (p:98)
(3) Ibid (pp: 101-102)

- c- ' Externally- oriented ' growth motivated by the needs of foreign (regional) markets, particularly in services, industry, trade, and the export of labor; meanwhile, the share of remittances in terms of national income rose from 5.4% in 1951 to almost 30% in 1975 .
- d- A tendency towards a more equitable distribution of the benefits of economic growth .

In general, the 1943-1975 period was characterized by a decline in the economic and social differences among the Lebanese, across the abroad . Yet this mostly positive assessment should not blind us to the negatives in Lebanon's socio-economic situation prior to 1975 . This includes externally oriented growth, insufficient growth in agriculture , manufacturing, and unfair income distribution in social, regional, and sectarian terms . These negatives, however, did not constitute the main character of economic development; in reality, their sharpness increased with the gradual disappearance of the state during the wars and occupations after 1975 .

1.1.3 Post 1975 Period

During the civil war period 1975-1990, Lebanon's productive capacity has been drastically reduced. Over 25 percent of the manufacturing sector was forced to cease production, and those remained in business were ,on average, only working at 25 percent of their production capacity . Most small manufacturing units were located in East Beirut and many were destroyed due to the heavy shelling which began at the end of January 1990 and continued for over four months . Throughout the civil war, Lebanon remained an exporter of fruit and vegetables, mainly to the Arab world. It's worth mentioning here that one third of lebanese land is cultivated with 400,000 hectares . Of this, 25% is irrigated . During that period, the government receipts had drastically decreased because it was seized by the milicheits, and the tax revenue went down to the extent that the general receipts represented about 10 or 15 percent of the general

expenditure⁴ . Also, the general public debt had increased from L.L.322million in 1974 to L.L. 12 trillion in 1982 to L.L.980 trillion in 1989 ⁵ . The ratio of expenditure to gross national product has kept on increasing and reached 45% by mid 80s ⁶ . With the gradual end of war, the state began to rebuild itself . It reactivated the Council for Development and Reconstruction (CDR) , authorizing it to prepare a plan for rebuilding infrastructures and providing an economic recovery .

1.2 Budget Deficit and Fiscal Policy Dilemma

The debt is very high and has been accumulating due to high deficits of the past 20 years of civil war and the very ambitious reconstruction programme, which is scheduled to run from 1993 until 2002 under Hariri's leadership . Such deficits go back to fiscal and monetary practices that have been missed during the war .

Such an argument is clear in Tables 1.1 and 1.2 . Since 1990, presidents , cheered on by fashionable economists , have taken the decisions of reconstruction and economic recovery that have accumulated into today's huge imbalances . Unwilling or unable to find the resources to pay the bills for the combined geopolitical and domestic ambitions, the Lebanese government has developed a perennial tendency towards fiscal deficits .

(4) " The Public Sector and the Private Sector in the Arab World ", Beirut: The Arab Unity Studies Center , 1990 (p:608)

(5) Ibid

(6) Ibid (p:609)

Table 1.1

<i>Key Indicators</i>	<i>unit</i>	<i>Lebanon</i>				
		<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
Population	m	2.66	2.67	2.90	2.70	3.78
GNP	\$bn	3.35	3.20	2.60	3.27	2.90
GNP per capita	\$	1,150	1,100	960	1,200	1,075
Inflation	%	155	80	**-	50	*100
Exports	L.Lbn	*253	*236	*330	*490	*938
Imports	L.L.bn	968	*1,114	*1,762	*3,476	*7,101
Balance of trade	\$m	1,771	221	**-	** -	** -
Exchange rate	LLper\$	409.2	496.7	695.1	928.2	1,712.8

Source : The Middle East Review 1995 (p:58)

*estimated figure

** unavailale data

Table 1.2
Budget Performances
1989-1995
(LLBn)

	1989	1990	1991	1992	1993	1994	1995*
Expenditures	528	778	1,196	2,219	2,957	5,089	3,187
Revenues	64	126	522	1,059	1,855	2,245	1,886
Deficit	464	652	674	1,160	1,102	2,847	1,931
Deficit (% of expenditures)	88	84	56	52	37	56	50.6

*Until September 15

Source: *al-Safir* (Beirut)

This maybe put off the day of reckoning if there is fiscal discipline and activist government intervention . The need for fiscal discipline is represented either by reducing waste and inefficient government spending or by increasing tax revenues but not necessarily the tax rate . The need for government intervention is represented by investing to build infrastructure and expanding basic services . If Lebanon is to develop rapidly and overcome the problem of overpopulation, economic development should become a major element of government policy .

Government intervention is needed in irrigation, drainage, forestation, hydro-electric power generation, geological surveys, experimentation in new crops, extension services, search for and participation in new industries, and establishment of industrial schools . However, the government should be very careful to the inherent limitations which are low productivity, poor performance, and lack of consensus on economic and social aspects .

Development activities, require that a substantial part of the national income be saved. However, savings could be increased only if income increases and/or, consumption decreases . Here a dilemma emerges. the national income cannot increase before some development is achieved . On the other hand, consumption could not appreciably decrease, as this would involve a reduction in efficiency .

This dilemma could be resolved with the help of the outside world . In fact some foreign capital is necessary, especially in the early take-off stage of development, so that it will proceed without much strain on domestic resources . However, the main part of the financial resouces required has to come from the country itself .

Domestic financing requires that voluntary and forced savings be increased and hoarding mobilized . Fiscal policy can play an important role in this respect . For increasing voluntary saving and mobilizing hoardings, with least adverse effects on efficiency and investments in the private sector, several measures may be used by the government :

First, it could float a public debt by offering attractive rates of interest . The future cost of servicing such a debt should not make the government reluctant to offer high rates of interest . For if the public debt is invested in remunerative government undertakings or in development projects conducive to a rapid increase in real income, the public revenue will become adequate to finance the debt .

Second, it could participate in establishing savings and investment banks or encourage them by subsidies . The pooling of savings in such banks will help tremendously the private sector in playing its role in economic development .

Third, it could exempt from the income tax profits reinvested in fixed capital . Such a measure, besides encouraging savings, will direct them into productive channels .

fourth, it could encourage the corporate form of business organization by abolishing progression in taxation of corporation profits, and by relieving corporations from the tax on authorized capital and the stamp duty on issue of shares . Since corporations help to pool individual savings of varying amounts and from all sources into productive undertakings, growth of the corporate form of an organization increases the role that the private enterprise can play in economic development . Besides, corporations can help directly in increasing productivity, because they can adopt efficient machinery and technological and managerial skills that are too costly for other forms of business organization .

Induced savings may be inadequate to finance economic development if not helped by forcing saving, that is by imposing new taxes and increasing the rates of the existing ones . However, such measures should be applied most carefully .

What should be taken into consideration when financing development by compulsory ways is the strong adverse effect that some taxes have on efficiency and on investments in the private sector . Forced saving could be achieved with least adverse effect on efficiency and on the desire to invest by three ways . First the government could unify the income tax and raise the progression of its rate . Secondly, it could increase the progression in the rates of the succession tax . Thirdly, it could raise customs duties on luxury goods and articles of type and quality produced locally . Other taxes on consumption should be avoided, especially during the early stages of development, for such taxes, besides

reducing efficiency among the masses, weaken the inducement to invest by reducing consumption .

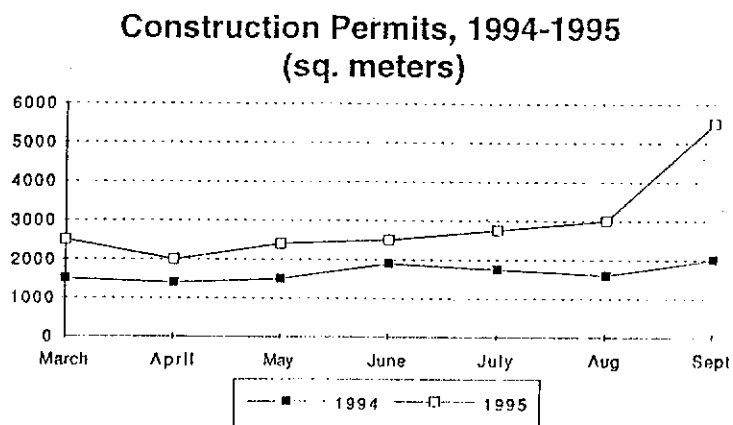
Besides endeavoring to increase and mobilize financial resources, the government should see that these resources are channeled into economic development projects of greatest urgency and productivity . In order to intensify the cumulative and self-generating nature of economic development, it should give particular attention to activities which are conducive to a more rapid increase in real income. Here again, fiscal policy can play its role through differential tax rates, exemptions, and subsidies, designed to encourage investments in the most desirable projects and discourage undesirable utilization of financial resources .

In conclusion, it should be emphasized that, though considerable improvement has taken place in the fiscal system of Lebanon, there is still a wide field for further improvement in the taxation system, in tax administration, and in public expenditure management . There is also great need for a fiscal policy designed to mitigate business fluctuations and to bring about a more rapid economic development .

1.3- Reconstruction Programme

The programme is budgeted at \$10bn in direct costs, with an additional \$2.9bn in finance charges ⁷. Of this, foreign loans and grants make up \$7.6bn, with the balance of \$5.3bn anticipated from budget surpluses. However, some estimates have put the total cost nearer to \$18bn⁸. The largest allocation (\$2.8bn) is for expenditure on transport, followed by electricity repair and rebuilding (\$1.8bn) and education (\$1.13bn) ⁹. The construction permits is clear in the graph below.

The January 1994 public offering of shares in Soldaire, the property company responsible for redeveloping the Centre of Beirut, was heavily over-subscribed; it raised \$921 million, almost \$300 million more than expected or needed ¹⁰. The reconstruction programme is overseen by the CDR ¹¹. The CDR's goal is to restore Lebanon's GDP to its pre-civil war (1974) level by 1995, and to double real GDP per capita during the ten year period 1992-2002. The works programme is known as "Horizon 2000" ¹².



Source: Order of Engineers

(7) "Lebanon", Anthony Griffin, *The Middle East Review*, 1995 (p:58)

(8) *Ibid* (p:58)

(9) *Ibid* (p:58)

(10) "Beirut Bourse Reborn", Josh Martin, *Business and Finance*, July August 95, (p:22)

(11) "Lebanon", Anthony Griffin, *The Middle East Review* 1995 (p:22)

(12) "Lebanon lures international finance to pay for reconstruction" Josh Martin, *Business and Finance*, July / August 1995, (p:18).

1.4 Economic Recovery

The Lebanese economy seems to be recovering from low base . Estimates for 1993 put the country's growth rate at 7 percent, with forecasts for 1994 ranging between 8 and 10 percent as shown in Table 1.3 . However, according to figures released by Bank Audi, the Lebanese economy grew by 6% in the first six months of 1995 ¹³ . While the growth rate is moderate when compared to the more optimistic forecasts earlier in the year, it is relatively optimistic at a time of sluggish consumption and high interest rates . The growth rate does, however, conceal more severe problems faced by the lebanese economy, including the continued expansion of the budget deficit, a growing domestic and foreign debt burden, and increasing pressure on the pound . While the pound has continued to gain ground in the first eight months of 1995, this has come at an increasing high cost of declining foreign currency reserves at the Central Bank . In the central bank's May report, foreign exchange has further declined, reaching \$1.6bn by late August, reflecting continuing uncertainty vis-à-vis the pound's stability ¹⁴ .

(13) " The Lebanon Report ", No.3 Fall, 1995 (p:14)

(14) Ibid

Table 1.3

1994 Principal Economic Indicators *

	Dec. 31,92	Dec. 31,93	Dec. 31,94
GDP growth rate estimate (%)	4	7	8
Inflation rate estimate (%)	131	8.8	12
Exchange rate (LBP/USD)	1,838	1,711	1,647
Balance of Payment (USD million)	54	1,170	1,130
Total Exports (USD million)	510	470	560
National Debt (LBP billion)	5,698	6,381	10,577
Net Foreign Assets (USD million)	6,739.2	8,726.4	9,566.8
Total Assets in commercial banks (LBP billion)	14,634	18,809	24,285
Deposits in commercial banks (LBP billion)	12,760	16,460	21,288
Beirut Port (No. of ships)	3,054	3,328	3,359
Beirut Airport (No. of passengers)	1,043,562	1,294,239	1,438,298
Construction permits (thousand of sq.m)	10,745	9,424	12,993
Electricity production (million of KW/h)	4,033	4,164	4,548

* official report from Banque du Liban Et D'Qutre-Mer.

1.5 Slow Fiscal Adjustment

Fiscal adjustment is concerned with the public income, public expenditure, and public debt including the balancing of the budget and the economy as a whole . That is, it is not possible to pass a complete judgement upon any operation in public finance without balancing against one another both sides of the operation, the effects of raising, and the effects of the spending, of the public revenue . It is idle to speak of the " burden of taxation " regardless of the corresponding public expenditure as will be shown in the following section .

1.5.1 Budget Deficit

The expansionary fiscal measures adopted by the government for the purpose of reconstruction resulted in an increase in the government budget deficit from LBP 1,234billion in 1993 to LBP 2,961 billion in 1994 ¹⁵ . As percentage of GNP, the budget deficit is showing an upward trend that may eventually result in higher levels of interest rates .

Total revenues collected by the government in 1994 increased by 39% , an increase from LBP 1,792bn in 1993 to LBP 2,242bn in 1994 ¹⁶ . Tarrifs collected on imports of goods and services remained the major component of revenue standing at 36% of total revenues . The new tax structure implemented in January 1994, in the hope of increasing tax revenues by increasing the tax base, has yet to show probable significant effect on tax collection .

On the expenditure side , spending by the government increased by 86% in 1994, reaching LBP 5,203bn ¹⁷ . Servicing the public debt constituted 28.6% of total expenditure ; 2.5 percentage points higher than the previous year ¹⁸ .

The expanding budget deficit has continued to be a burden to economic growth . Mr. Sanioura, minister of finance, revealed that the budget deficit was 51%, considerably higher than the 44% expected in the 1995 budget ¹⁹ .

(15) " Lebanon " , Anthony Griffin , The Middle East Review , 1995 (p:58)

(16) Ibid

(17) Ibid

(18) Ibid

(19) Ibid

1.5.2 Public Debt

The expanding domestic debt continues to slow economic growth . Bank Audi estimated that the net domestic debt grew by 6.9% in the third quarter of 1995 to reach L.L.8,651bn . Meanwhile , the Central Bank estimated the foreign debt at \$1.24bn by the end of september , 1995 ²⁰ .

1.6 Future Prospects

During the past years of 1992,1993,1994, and 1995, the prevailing general political stability and the economic policies followed by the government led to a wave of confidence which contributed to a relative stability in the monetary sector and has stopped the inflation / depreciation spiral of the past . The value of the lebanese pound was strengthened, inflation was kept under control, balance of payments registered a sizeable surplus, and the dollarization process was turned around .

The ratio of the deficit to total expenditure , however increased from 38.5% in 1993 to 55.2% in 1994 ²¹ . Besides, the projected budget deficit figures by the Ministry of Finance show an increase in the ratio of debt to GDP until the year 1999, where it is expected to reach 91% . Efforts, however, are being made by both the government and the Central Bank to stabilize the path of public debt . The new tax structure, the improvement in tax collection process, and the activity are all expected to increase government revenues, leading to a reduction in the

(20) " The Lebanon Report " No.4 , Winter, 1995 (p: 16)

(21) " Lebanon " , Anthony Griffin , The Middle East Review , 1995 (p:58)

budget deficit . These have reduced corporate and personal taxes to 10% ²² . Tax collection has been non-existent since the beginning of the civil war when top taxation rates were 43% (personal) and 35% (corporate) . The tax reforms were seen not only as a means to stimulate payment and collection, but also as a stimulus to private investment to distribute wealth and enhance productivity .

In this stage, and before conveying the basic purpose of this study, it is natural and practical to set the general basic concepts of taxes .

1.7 What are Taxes ?

The average citizen looks upon taxes as a burden and consequently tries to evade it if possible . If there were a better understanding of the purposes and the uses of taxation, citizens would have a more kindly attitude toward being taxed .

The basic things to clarify are the objectives of taxation which are the followings :

- a- raise revenue .
- b- change the distribution of income .
- c- make the recipients of certain benefit pay the cost of generating those benefits.
- d- change people's behavior like to discourage smoking by making it more expensive.
- e- try to minimize the cost of running the tax system and enforcing the collection of taxes .

(22) Ibid

The second thing to clarify is to distinguish the tax from other forms of charges . Taxes are ,in a sense, a method of distributing wealth . Without government, our present economic system could not operate . In as much as government helps our economic society to operate, it must share in the fruits of production . Someone has to pay the expenses of operating the government. Clearly, those who benefit from the use of government agencies must pay for these services ²³ .

Taxes are imposed, directly or indirectly, by the citizens of a city or a country . A tax, after it is imposed, requires a compulsory contribution to be made to the government in payment for services for the common good ²⁴ . Taxes, therefore, have no specific application to special benefits conferred on individuals . They are for the common good , and they are compulsory .

This definition distinguishes taxation from other payments of other charges. For example, a postage stamp pays for a service , but its use is not compulsory unless the service is desired . Citizens who violate laws have to pay fines as penalties . The fines are compulsory but they are not taxes ; They are penalties .

1.8 Direct and Indirect Taxes

As noticed, taxes are classified as direct and indirect . This distinction is not entirely accurate . A direct tax is one that is levied upon a particular group of persons or organizations without the possibility of the cost of tax being passed

(23) " Business Economic Problems " , H.G.Shields and W. Harmon Wilson , Washington : South-Western Publishing Company . 1994 (p:363)

(24) Ibid (p:364)

on to others ²⁵ . An indirect tax is one that is levied upon a group of individuals or organizations but can be passed on indirectly to others ²⁶ .for example, a tax on real estate is usually considered to be a direct tax because it must be paid by the owner of the real estate . Nevertheless, the tax on real estate can be passed onto the renter by charging higher rent . From this point of view, it may be considered as an indirect tax .

After presenting the relation among budget deficit, national decline, and taxation as well as differentiating between direct tax and indirect tax in general, it may be useful at this point to spell out that the main issue in this project is direct taxes in specific . So, the coming paragraphs will talk about the need, purpose, and construction of the project .

1.9 Need of the Project

Nowadays, the direct tax issue is a hot subject in Lebanon . Some economists argue that direct taxes and specially income taxes should go back to 43% as it was before the reform in order to distribute wealth from the rich people to the poor . Others believe that income taxes should be even lower than 10% in order to encourage domestic and foreign investment . In fact there are different opinions, views, and suggestions . This project is, therefore, going to tackle and sum up these opinions, views, and suggestions for the sake of evaluating the socio-economic implications of such tax reforms .

(25) Ibid (p:366)

(26) Ibid

1.10 Purpose of the Project

The purpose of this project is to assess the implications and incidences of recent direct tax reforms . The primary objective is to study the effects on income distribution and productivity to seek the means that best achieves our social ,urban ,economic character , history, and future .

1.11 Construction of the Project

As could be noticed, Chapter one was an introductory presentation about direct taxes . Chapter two will illustrate the issue in depth in reference to the literature that dealt with the topic, and chapter three will state the methodology used in this research . Next, Chapter four states the study findings and analysis of results . Finally, Chapter five states the major limitations and recommendations .

CHAPTER II REVIEW OF LITERATURE DIRECT TAXES

2.0 Introduction

Taxes are levied for revenue or regulation . Taxes levied for the first purpose come under the taxing power of the government. Those levied for the second purpose come under the government's right of police power .

Direct taxes , as grouped in the budget , include the Buildings Tax , Income Tax , Succession and Gift Tax , Private Vehicles Tax , Forests Tax , Land tax , and Improving Tax .

The fiscal importance of these taxes put together is bearily evident as shown in Tables 2.1 and 2.2 . In fact, estimates of 1995 put Lebanon's direct taxes between 10% and 20% of the total government revenues . However, in the United States of America direct taxes represents 85% of government revenues²⁷ . This may be attributed to five main reasons as follows . First of all, the yield of the land tax is actually insignificant, due, partly, to the fact that the assessment of net yield was far lower than the actual , and, partly, to the low rates of this tax ²⁸. Second, the income tax is a tax on separate incomes, which decreases considerably the yield of progressive income taxation²⁹ . That is there is a tax on salary, a tax no bond, and a tax on corporate profit and not a tax on the total income . Third, the rates of the income tax are not progressive enough at the upper-income brackets . Fourth, the yield of the inheritance and gift tax is very low, partly, because of the very low rates of the tax, and partly because of the low allowing secrecy of bank deposits, which helps tremendously the concealment of liquid assets³⁰ . Fifth, imposition and collection of most direct taxes are much neglected in rural areas³¹ .

(27) Quoted speech by Mr. Ghassan Deibi at BUC Jebail in October 18th, 1995

(28) " AL-Malyia AL-Aama", Mohammed Awada and Abed AL-Raouf Kteash, Beirut: Dar AL-Khould, 1994 (p:485)

(29) Ibid (p:602)

(30) Quoted speech by Mr. Ghassan Deibi at BUC Jebail in October 18th , 1995

(31) " The Fiscal System of Lebanon " , Raja S.Himadeh, Beirut : Khayati Beirut, 1961 (p.23)

Table 2.1
Fiscal Importance of Direct Taxes
1956-1958
(In Thousands Lebanese Pounds)*

kind of tax	1956		1958		1958	
	% of tax revenue	% of total revenue	% of tax revenue	% of total revenue	% of tax revenue	% of total revenue
Building Tax	4.6	3.94	5.37	4.65	5.58	4.64
Land Tax	.35	0.3	.32	.28	.40	.33
Income Tax	12.20	10.46	12.23	10.58	11.78	9.79
Succession & Gift Tax	0.65	0.56	0.38	0.32	.62	.52
Private Vehicles Tax	1.96	1.68	1.91	1.66	1.98	1.65
Forest Tax	.15	.13	.13	.12	.15	.13

* Source : Quoted from " The Fiscal System of Lebanon ", Raja S.Himadeh, Beirut : Khayati Beirut,1961 (P.24)

Table 2.2
Fiscal Importance of Direct Taxes
1967-1970*

Kind of Receipts	Budget 1967 (L.L.)	Budget 1968 (L.L.)	Budget 1969 (L.L.)	Budget 1970 (L.L.)
Part 1				
Direct Taxes & Duties of Similar Nature				
Section 1				
Building Tax	36,847,268	41,189,261	42,134,104	47,000,000
Income Tax	63,219,455	62,606,123	61,075,541	63,000,000
Succession & Gift Tax	2,987,426	3,629,113	2,576,195	4,500,000
Private Vehicles Tax	10,822,905	15,667,679	15,639,887	17,000,000
Forest Tax	201,316	124,447	48,568	200,000
Land Tax	36,850	17,239	46,226	-
Total of Section 1	114,115,222	123,233,864	121,520,524	131,700,000

* Source : " Al - Malyia Al-Aama ", Mohammed Awada and Abed Al-raouf Kteash,Beirut,Dar AIKhould, (p:478)

Table 2.3
Direct Taxes*

Type no.	Description	Expected Receipt (L.L.) 1994
1	Building Tax	60,000,000,000
2	Income Tax	200,000,000,000
3	Succession&Gift Tax	45,000,000,000
4	Private Vehicles Tax	55,000,000,000
5	Forests Tax	250,000,000
6	Land Tax	Pending
7	Improving Tax	Unnoticed

* Source : " Al - Malyia Al-Aama ", Mohammed Awada and Abed Al-raouf Kteash, Beirut, Dar AlKhould, (p.533)

After presenting the fiscal importance of direct taxes in general, it is important to state each type of direct taxes in particular as shown in Table 2.3 .

Table 2.3 represents four points which are the followings :

(1) The income tax is levied on all incomes except those from buildings and which are subject to the Buildings and Land Tax respectively and those exempted by law³² . The incomes subject to the Income Tax are divided into three categories as will be elaborated in Income Tax section .

(2) The tax on capital is levied on Succession & Gift Tax and Private Vehicles Tax³³ .

(3) knowing that there are no important points or comments and data on Private Vehicles Tax, and Forests Tax, there will be no illustration on them in this project .

(4) It is clear that the Land Tax exists only in the Budget of 1967 till 1969 and it is pending from 1959 till now . In fact, the Land Tax is applied only by law and not by practice .

So, what will be studied are the remaining five types of taxes .

(32) " AL-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Kteash. Beirut, Dar Al-Khould 1994 (p:534)

(33) Ibid (p: 482)

2.1 Building Tax

2.1.1 Historical Review

When the buildings tax was unified in 1922, it was made 12% of the gross rental value of all buildings and that of all lands used for commercial or industrial purposes³⁴ . A deduction of 1000 Lebanese piasters of the rental value of buildings belonging to the same owner or owners in the same district was allowed before the application of the tax . The rental value was fixed on the basis of a declaration made by the proprietor . New buildings were exempted for a period of three years .

The above buildings tax was replaced in 1935 by another one based upon the rental value as assessed by tax commission³⁵ . In 1945 the tax was revised and its basis become the actual instead of the assessed rent , and the rate was made 8 1/3 percent of the actual rent . In June 1959 it was revised again . And, in August 1st , 1994 a Legislative Decree No. 366 replaced the previous one and adjusted it by a tax less progressive as will be presented in the following section .

2.1.2 Basis and Rates

The tax is based on the gross returns of the property as shown in the contract of rent that must be registered in the municipality concerned . In case of buildings having central heating or air conditioning system , an elevator, a reservoir, and a residing janitor , 18 percent of rent is deducted before the tax is applied . The rate ranges as follows³⁶ .

(34) Ibid (p:493)

(35) Ibid

(36) Ibid (p: 513)

<u>Returns Brackets</u>	<u>%</u>
(1) below L.L. 20,000,000	4
(2) 20,000,000 - 40,000,000	6
(3) 40,000,000 - 60,000,000	8
(4) above 60,000,000	10

2.1.3 Exemptions

The following property is exempted from the tax³⁷ :

- (1) Buildings used for commercial or industrial purposes that are subjected to another tax known as income tax
- (2) Property used as hospitals, clinics, orphanages, or schools provided it is not rented
- (3) Property owned by municipalities or public institutions when it is used for public interest and does not yield any income
- (4) Government property
- (5) Property owned by foreign states if used as offices by their diplomatic or consular delegations or as residences for the heads of such delegations on the condition that similar exemption is accorded to the lebanese government by the foreign state concerned
- (6) Property used for religious purposes provided it is not rented
- (7) Buildings used for agricultural activities provided they are not rented

(37) Ibid (pp: 499-505)

- (8) Cemeteries and adjoining service buildings belonging to religious or philanthropic institutions unless such buildings are rented
- (9) Buildings having bricks get 50% of income tax payment as an exemption for 10 years on condition the exemption does not exceed \ L.L 500,000 \
- (10) The buildings tax is totally exempted if the building is ruined
- (11) Each owner or partner occupying a certain unit building can get 2 millions of the taxed returns as a deduction . Also, 50% of the taxed returns that exceed 2 millions are deducted on the condition that the taxed revenues does not exceed 4 millions
- (12) The tax payment is stopped if the owner announces that the building is not rented or not bringing returns after finishing it

2.2 Income Tax

The income tax is levied on all incomes except those from buildings and land . The incomes subject to the Income Tax are divided into three categories³⁸ :

- i. Profits from industrial, commercial, and non-commercial enterprises .
- ii. Salaries, wages, and pensions
- iii. Income from movable capital including interest and dividends of all sorts .

Receipts from the Income Tax amounted in 1957 to L.L.22,212,333³⁹ . This amount represented 12.23% of tax revenue and 10.58% of total revenue that year .

2.2.1 Tax on Profits of Industrial, Commercial, and Non-commercial Enterprises

The tax on the profits of industrial, commercial, and non-commercial enterprises is levied on the profits of these enterprises, including handicrafts and profession, and on the profits of any other activity not subject to tax on income⁴⁰ . All persons real or legal are subject to this tax on the basis of their profits realized in Lebanon .

(38) " Al-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Kteash, Beirut: Dar Al-Khould 1994 (p: 534)

(39) "The Fiscal System of Lebanon ", Raja S. Himadeh, Lebanon:khata's Beirut ,1961 (p:35)

(40) " Al-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Ktash, Beirut: Dar Al-Khould 1994 (p: 535)

The following income recipients are exempted⁴¹ :

- a) Educational institutions
- b) Hospitals, orphanages, asylums, and relief institutions, provided they receive patients free of charge
- c) Sanatoriums and mental disease hospitals
- d) Consumers cooperatives, syndicates and agricultural cooperatives that do not have a commercial purpose
- e) Agriculturists who sell their own land or cattle production, provided that such production is not exposed in sale stores or processed
- f) Airways and sea transport concerns, provided in the case of foreign enterprises reciprocal treatment is given by their countries to Lebanese concerns if such concerns exist
- g) Public enterprises that do not compete with private enterprises
- h) Tourists institutions
- i) Industrial institutions whose incomes are not taxed up to ten years starting from the date of production. This is done to encourage investment
- j) Invested incomes in industrial institutions

(41) *ibid* (pp: 539- 543)

2.2.1.1 Basis

The taxable income of all enterprises subject to the tax is either the actual net profit, the assessed net profit, or the estimated net profit⁴² . The following categories of enterprises are compulsorily taxed on the basis of their actual net profit as shown in their balance sheets and income statements⁴³ .

- (a) Corporations, partnerships, whether collective or commandite, consumer cooperatives, syndicates, and agricultural cooperatives subject to the tax (i.e. having a commercial purpose);
- (b) Branches of the above mentioned establishments when their head office is outside Lebanon ;
- (c) Industrial firms with the exception of handicrafts ;
- (d) Banks, bankers and persons undertaking discount operations ;
- (e) Importers, exporters, wholesale or semi-wholesale dealers, commission merchants, agents of manufacturers or business firms ;
- (f) Retail dealers that employ more than four persons ;
- (g) Drugs and chemical ware-house ;
- (h) Exploiters of gambling clubs and houses ;
- (i) Exploiters of first and second class hotels ;
- (j) Exploiters of first and second class theaters and cinemas ;
- (k) Printing presses and publishers ;
- (l) Grindmills, not run by water or mill ; and
- (m) Lessors of equipped establishments .

(42) Ibid (p: 561)

(43) Ibid (p: 562)

Other categories of enterprises, except insurance and savings concerns, transport enterprises, petroleum refineries, and public work contractors, may also, upon their request, be taxed on the basis of the actual net profit.

By actual net profit it is meant the total returns subject to this category of the income tax minus all charges and expenses necessary for the running of business⁴⁴.

The following expenses are not deductible⁴⁵.

- a) Interest on capital and expenses that lead to an increase in net worth of the business ;
- b) Taxes paid or due to a foreign country ;
- c) Losses sustained by the taxpayer in enterprises run outside the lebanese territories ;
- d) Expenses that the taxpayer cannot prove that he has sustained in respect of business outside Lebanon ;
- e) Personal expenses including amount drawn by the enterpriser or the partner from the business as a salary ;
- f) Representation allowances that do not exceed 30% of the salary of an employee ; and
- g) Extraordinary taxes and personal fines .

To determine the taxable income of persons who are taxed on the basis of their assessed profits, the total receipts are taken as a base and multiplied by the coefficient appropriate to the category of the enterprise as it is fixed in a decree issued by the Minister of Finance and based on the report of a commission of five experts, appointed by him⁴⁶.

(44) Ibid (p:550)

(45) Ibid (pp : 560-561)

(46) Ibid (p:561) .

Total receipts are defined as the total returns resulting from all the operations that the taxpayer has actually undertaken during the preceding year⁴⁷ . Such returns include, specially , proceeds of sale of goods (of any kind), rent of such goods, commission, interest, and brokerage . People who are exempted by the Commercial Code from keeping books are taxed on the basis of estimated net profit as fixed by a special commission appointed by the Minister of Finance⁴⁸ .

2.2.1.2 Rates

a) companies of persons : (sole proprietorship, partnership, limited partnership, participating companies)

1.a.-Exemption : They are stated in the table below .

Table 2.4
Exemption Criteria⁴⁹

Marital Status	yearly exempted amount L.L.
Single	3,000,000
Married + no children	4,500,000
Married + 1 child	4,800,000
Married + 2 children	5,100,000
Married + 3 children	5,400,000
Married + 4 children	5,700,000
Married + 5 or more children	6,000,000

(47) Ibid (p:561)

(48) Ibid (p:577)

(49) Ibid (p: 600)

The conditions allowing the exemption for each child are as follows:

- 1- The child should be a male with an age less than 18 years or up to 25 years if he is studying at the university ;
- 2- The child is disabled and does not have work ; and
- 3- for females, they should be single, divorced, or widowed .

2.a.- Rate : After allowing the appropriate deduction, Table 2.5 shows the rates applied⁵⁰ .

Table 2.5

<u>Income Bracket (L.L.)</u>	<u>%</u>
Up to 7,500,000	3
7,500,000 - 18,750,000	5
18,750,000 - 37,500,000	7
Above 37,500,000	10

b.- Companies of Capital : (joint-stock company, limited partnership by shares, and companies with changeable capital)

1.b.- Exemption : Companies of capital do not get benefit of the marital exemption but their partners do get it as it is presented in the Table 2.4 before⁵¹ .

2.b.- Rate : The rate is 10% of the total income , but it is 5% when the company's transactions are concerned with constructing buildings and setting apart the apartments or selling them⁵² .

(50) Ibid (p: 602)

(51) Ibid

(52) Ibid (p: 603)

c. Holdings companies :

1.c.- Exemptions: Income is not subject to income tax . What is subject to tax is the capital⁵³ .

2.c.- Rate ⁵⁴:

<u>Capital Bracket (million)</u>	<u>%</u>
Up to 50	6
50 - 80	4
above 80	2

- There is a condition that the total tax should not exceed 5 millions .
- Returns from renting institutions inside Lebanon are subject to 25% as a tax
- Returns from offering management services to institutions inside Lebanon are subject to 12% as a tax
- Returns from interests on offering loans to companies taxed on its income are subject to a tax of 5%
- There is a capital gain tax on improving the assets of the company, which amounts to 6%
- There is also a tax on salaries, wages, and benefits of board of directors as will be discussed in part 2.2.2.

d.- Off-Shore companies :

1.d.-Exemption :-

- Its income is not subject to the Income Tax
- If there is a foreign employee, 30% of his salary is exempted from the tax on salaries, wages, and pensions⁵⁵ .

2.d.- Rate :

- It is subjected to a tax amounted to one million L.L.⁵⁶
- A capital gain tax of 6% on the fixed assets⁵⁷ .
- A tax on salaries and wages except the 30% for the foreign employee as has just been mentioned⁵⁸ .

(53) Ibid (p: 604)

(54) Ibid (p: 605)

(55) Ibid (p: 608)

(56) Ibid

(57) Ibid

(58) Ibid

2.2.2 Tax on Salaries, Wages, and Pensions

This tax is levied on these incomes - which include also compensations, indemnities, and allowances - paid in the lebanese territories from a public fund to residents and non-residents and from private funds to residents or else to non-residents for services rendered in Lebanon⁵⁹ .

The following incomes are however exempted⁶⁰ :

- a) Allowances received by the clergymen for religious services
- b) Salaries and allowances received by the members of foreign diplomatic or consular services and their foreign personnel when such an exemption is reciprocated
- c) Salaries and allowances of military people of allied countries
- d) Pensions of disabled persons retired from government service, public services, or private institutions in accordance with pension laws
- e) Life allowances and temporary compensations granted to victims of labor accidents
- f) Wages of agricultural labor
- g) Wages of servants in private houses
- h) Salaries and wages of nurses and maids in hospitals, orphanages, asylums, and similar institutions
- i) Indemnities paid for dismissal from work in accordance with the law
- j) Family indemnities

(59) Ibid (p: 610)

(60) Ibid (p: 611)

2.2.2.2 Basis

The tax is based on the net yearly returns of the taxpayer⁶¹. These are determined by subtracting from the taxpayer's gross receipts, in money or in kind, any deduction made on account of pension funds, and any allowance given to the taxpayer to cover expenses that are incurred in fulfilling the service for which the salary, wage, etc. is paid⁶².

2.2.2.3 Rates

Each person is allowed a deduction on his marital status as presented in Table 2.4 before.

Taxpayers who have at the sametime an income subject to the tax on the profits of industrial, commercial, and non-commercial enterprises are not entitled to this deduction. After allowing the appropriate deduction, the tax rates are shown in Table 2.6.

Table 2.6⁶³
Tax Rates Applied

<u>Taxable Income Bracket (millions)</u>	<u>%</u>
On portion not exceeding 5	2
5 - 15	3
15 - 25	6
25 - 75	8
On portion exceeding 75	10

(61) Ibid (p: 612)

(62) Ibid

(63) Ibid (p: 614)

2.2.3 Tax on Income from Movable Capital

The tax on income derived from movable capital, i.e., debts and equities, is levied on interest on bonds, interest on mortgages, interest on ordinary debts, interest on deposits and current accounts, dividends and all similar returns including lottery prizes to securities and bonus shares when such incomes are derived in Lebanon or received by a resident in Lebanon⁶⁴.

The following returns are, however, exempted⁶⁵:

- a) Dividends distributed by Lebanese corporations from profits that were subject to the tax on incomes from enterprises.
- b) Repayments to stockholders and creditors if such amounts are not taken from the profit and loss or reserve account
- c) Repayments to stockholders and creditors by a concessionary company when the reason for such payments is its obligation to deliver free of charge at the end of its concession all its equipment to the government.
- d) Interest on savings deposits
- e) Interest and returns from current accounts accruing to the government, municipalities, and public institutions, and to foreign diplomatic and consular bodies in Lebanon provided such exemption is reciprocated.
- f) Interest on lebanese government bonds.

(64) Ibid (p: 614)

(65) Ibid (p: 617)

For the purpose of assessment and collection of the tax, the income from movable capital is divided into four groups⁶⁶:

- 1- Income from Lebanese stocks and bonds .
- 2- Income from foreign stocks and bonds .
- 3- Income from mortgages .
- 4- Income from debts and deposits .

The tax rate is 5% of the gross returns⁶⁷ .

2.2.4 Evaluation

The income tax applied in Lebanon seems to be the result of an arbitrary attempt to make a simplified version of an income tax of the type applied in France . There, the incomes from different sources are taxed separately at proportional rates varying inversely with the personal efforts needed in each source of income and directly with the certainty of the income derived from each of these sources⁶⁸ . An additional progressive tax is then applied on the aggregate income of each real person after allowing an exemption varying with the personal status of the taxpayer . In an effort to have a similar tax with the features of the income tax in France, the Lebanese financial authorities drafted an income tax that taxes incomes from different sources separately with progressive rates on some sources of income and uniform rates on others.

The financial authorities in Lebanon seem to be unaware yet of the fact that the application of progressive taxation to separate incomes from different sources results in lack of uniformity and is therefore unjust .

(66) Ibid (pp: 620-621)

(67) Ibid (p:620)

(68) "The Fiscal System of Lebanon ", Raja S. Himadeh, Lebanon:khata's Beirut ,1961 (p:45)

It discriminates especially against persons who draw all or most of their income from one source, and in favor of persons drawing income from several sources . An example will make this clear . Suppose that X and Z have an income of L.L. 27,000,000 each . Suppose X derives all his income from salary, while Z (a physician) derives L.L.12,000,000 from salary and L.L.15,000,000 from private medical practice . Neglecting exemption, X will pay as a tax on his income L.L. 1,160,000 $(\frac{5,000 \times 2}{100} + \frac{10,000 \times 3}{100} + \frac{10,000 \times 6}{100} + \frac{2,000 \times 8}{100})$; while Z will pay only L.L. 910,000 $(\frac{5,000 \times 2}{100} + \frac{7,000 \times 3}{100} = 310,000)$ and $(\frac{7,500 \times 3}{100} + \frac{7,500 \times 3}{100} + \frac{7,500 \times 5}{100} = 600,000)$. Thus, though X and Z have equal incomes , and though the rates applied on income from professions are made higher than the rates applied on salaries, X who derives all his income from salary pays L.L. 250,000 more than Z who derives more than two-third of his income from profession . This injustice would not occur if the tax is applied on the total income of each person . Besides, the separate progressive taxation of income from different sources has the disadvantage of making a person venture in more than one kind of occupation (trade and agriculture for example), in some of which he may have little competence, in order to evade a part of the tax .

A second defect is that the income rates range up to 10% in order to attract investment . But this is considered small because it won't be enough to face the upward trend of the budget deficit . That is , it should be more progressive up to 20 or 25 percent as been suggested by the economist Ghassan Deibi in a lecture at BUC Jubail in October 18,1995.

2.3 The Succession and Gift Tax

It is a direct tax that is levied on all rights and all movable and immovable property that pass to others by inheritance, will, gift, waqf, or by any other way that does not involve compensation⁶⁹. That tax was established by the law of December 21, 1951. It is a tax on the capital value of the property and not on the income earned from the property, and it takes place once there is a death or another legal incident that causes the transfer of the property. Movable property existing abroad that is transferred from a Lebanese residing in Lebanon, is also subject to the tax, unless it is proved that a similar tax has been levied on it outside⁷⁰.

2.3.1 Basis

2.3.1.1 Basis of Tax on Inheritance

The inheritance tax is levied on the net value of the share of each heir. The following elements of estate are, however, exempted: pensions, indemnities, securities exempted from tax by law, collection of books, and etc., and furniture up to an assessed value of L.L. 40 millions⁷¹. The following deductions from the value of each share are made before the tax is levied⁷²:

- i- L.L. 40 million for parents and husband or wife .
- ii- L.L. 16 million for a sister or a brother .
- iii- L.L. 28 million for other heirs .

(69) " Al-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Kteash, Beirut: Dar Al-Khould 1994 (p: 633)

(70) Ibid (p: 635)

(71) Ibid (p: 638)

(72) Ibid (pp : 638-639)

As to children , the deductions are as follows :

- a- L.L. 24 million for disabled descendent .
- b- L.L. 1.6 million for a married son plus L.L. 8 million for each son under the legal age up to an assessed value of L.L. 40 million .

2.3.1.2 Basis of the Tax on Gifts ⁷³

The tax on gifts is levied on all rights and property that are donated after the deduction of any obligations there on . Benefits from insurance are treated as gifts if the beneficiary is not a legal heir . Donations and contributions made from public funds are however exempted . Also, gifts amounted to L.L. 1.6 million are exempted. Moreover, gifts amounting to L.L. 100 million and made for philanthropic institutions or an educational, technical, or sport society are exempted .

2.3.1.3 Basis of the Tax on Bequests

Bequests are treated for taxation purpose like inheritance if the beneficiary is a legal heir. Otherwise, they are treated like gifts ⁷⁴ .

2.3.1.4 Basis of the Tax on Awquaf

The tax on awquaf is levied on the share of each beneficiary from the revenue of awquaf, with the exception of the founder . An amount of L.L. 1.6 millions from the share of each beneficiary is exempted ⁷⁵ .

(73) Ibid (p: 639)

(74) Ibid

(75) Ibid

2.3.2 Rates ⁷⁶

There are two kinds of rate : one is progressive and the other is fixed . The first is given in Table 2.7 which ranges between 3 and 33 percent . They are applied on the net share of the beneficiary after making the deductions already mentioned . The rates vary according to the degree of relationship of the beneficiary to the deceased or donator . The latter is 0.5 % on inherited parts after deducting L.L. 40 million of all inherited parts which are considered as obligations to be paid .

Table 2.7
Succession Duty Tax in % ⁷⁷

Category of taxpayers L.L.million	1 Husband Wife	2 Parents	3 Ancestors Brothers/Sisters	4 Uncles, Aunts, Nephews,Nieces	5 Other taxpayers
Up to 30 .	3	6	9	12	16
From 30 to 60	5	9	12	16	21
from 60 to 100	7	12	16	21	27
Over 100	10	16	20	26	33

(76) Ibid (pp: 647-649)

(77) Ibid (p: 648)

2.4 Land Tax

This tax was known as the " Land Werko", which was assessed on the capital value of land⁷⁸ . The land tax which in 1955 replaced the old one taxes was suspended in 1959 for a period of five years, mainly for the purpose of cultivation⁷⁹ . But it is still suspended up till now . This tax is levied on the owner of land . However, in case of long-term lease or exploitation right the tax is levied on the lease holder or explioter⁸⁰ .

Receipts from this tax amounted in 1957 to L.L.582,567 accounting only for 0.32 percent of tax revenue (81) .

2.4.1 Basis and Assessment ⁸²

The tax is based on either the assessed average net return of the property or on the actual net return as declared to the Finance Authorities concerned .

As to taxation on the basis of assessed net return , the tax law established seventeen categories of land, which are classified as irrigated or unirrigated salikh and as irrigated or unirrigated groves . The average net return of each of these categories is assessed from the 1st of March by a central committee of five experts . The assesment of the net returns of each category serves as the tax base for a period of five years, after which period a new assesment is undertaken . However, revision can be made whenever there is a change exceeding 20% in the estimated average return of a given category . Also the category determined for a given piece of land can be changed if there is a change in the character of land or in the kind of plantation .

(78) Ibid (p: 485)

(79) Ibid

(80) Ibid

(81) " The Fiscal System of Lebanon ", Raja S. Himadeh, Lebanon:khata's Beirut , 1961 (p:48)

(82) " Al-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Kteash, Beirut: Dar Al-Khould 1994 (pp: 488-490)

As to taxation on actual net returns, they are determined by deducting from the gross returns all expenditures incurred in the exploitation of the land , including : cost of seeds, plants, fertilizers, and insecticides; depreciation of building and machinery used; interest on borrowed capital; expenses of ploughing, sowing, planting, supervision, control of pests and disease, harvesting, and picking , etc .

The actual net return is compulsorily taken as a base when the lands of a single taxpayer are, according to the assesment considered to yield more than L.L 25,000 yearly . Taxpayers whose lands are considered to yield less than this amount would be taxed on the basis of the actual yield if they asked for it and are prepared to keep the necessary accounts . Otherwise the tax will be based on estimated returns .

Lands that are considered building lots are taxed on the basis of their capital value . In Beirut, the capital value per square meter of each subdivision of a district is determined in an appendix of the Land Tax Law . Outside Beirut eight categories are established as shown in Table 2.8 , and the category of building lots in each village or city is determined by the same local committee that determines the category of agricultural lands . The capital value is assessed on the basis of the minimum square meter value of the land of the category concerned . The assessed capital value of building lots serves as the basis of the tax for a period of five years . However a revision can be made if there is a change of more than 20 percent in the value . Agricultural lands that are not exploited are taxed on the basis of their area .

Table 2.8
 Categories of Building Lots Outside Beirut
 Established by the Land Tax Law

Range of Assessed Square Meter Value	Category Number
Lebanese Piasters	
1 - 250	1
251 - 500	2
501 - 1000	3
1001- 1500	4
1501- 2000	5
2001- 3000	6
3001- 5000	7
above5000	8

2.4.2 Rates ⁸³

For the purpose of taxation of cultivated agricultural lands, the net yearly income of a taxpayer from such lands is determined, and a progressive tax is applied after certain deductions are made . A bachelor is allowed a deduction of L.L. 1,800; a married person who has no children L.L. 2,400, and a married person having children L.L. 3,000 . Taxpayers who benefit from similar deductions in the computation of any other direct tax are not entitled to these deductions .

(83) " Al-Malyia AL-Aama ", Mohammed Awada and Abed Al-Raouf Kteash, Beirut: Dar Al-Khould 1994 (pp: 490-491)

Table 2.9 shows the rates applied to total taxable income from cultivated agricultural lands :

Table 2.9
Rates on total taxable income

<u>Brackets</u>	<u>%</u>
on the part that does not exceed L.L. 5000	2
5,001 - 15,000	3
15,001 - 25,000	6
25,001 - 35,000	8
35,001 - 50,000	10
50,001 - 75,000	15
75,001 - 100,000	20
100,001 - 200,000	25
on the part that exceeds L.L. 200,000	35

The tax on agricultural lands, which are not exploited, and the tax on building lots are not progressive. The rate on the former is 25 piasters per 1000 square meters , and on the latter 2 per thousand of the assessed selling value .

2.4.3 Exemptions ⁸⁴

The land Tax Law exempts from taxation: public property; non-agricultural land not belonging to the class of building sites; forest lands; gardens adjacent to buildings, not exceeding 1000 sq.meters ; land belonging to schools, free clinics, hospitals for mental disease and tuberculosis, orphanages and aslyums, provided such lands are not rented; land belonging to hospitals which depend for support upon philanthropy and receive free patients, provided the land is not rented; and pasture lands .

(84) Ibid (p: 487)

In order to encourage improvements on the land, the Land Tax Law provides also for substantial temporary exemptions . Swamps that are dried by their owners and uncultivable lands that are made cultivable by improvements are exempted for the first five years following the completion of the works. New orchards are exempted for a period varying between two and fifteen years depending upon the kind of trees planted .

Unirrigated land changed into irrigated land by its owner or exploiter is taxed for the first five years after completion of improvement on the basis of the assessed return of its previous category . Unirrigated 'salikh' land converted by improvement into a higher category is similarly treated, unless it is exempted as mentioned above .

2.4.4 Evaluation

The Lebanese Land Tax is rather unique in its kind . It is neither a tax on the ownership of land nor a tax on both income derived from agriculture, but it seems to be a tax on both income from land ownership and income from cultivation⁸⁵ . Being based on the net income from land (actual or assessed), this tax cannot be considered a tax on land ownership as its name implies. On the other hand, it cannot be considered as a tax on income from land cultivation because it is levied on the owner, who may not be the cultivator .

Two facts , however, show that the lebanese land tax is intended to tax, at the same time both land ownership and income from agriculture.

(85) " The Fiscal System of Lebanon ", Raja S. Himadeh, Lebanon:khata's Beirut , 1961 (p:53)

First, in the preamble of the tax project law, there is the following statement: " The government did not want to divide the land tax into two taxes, one on property, based on rental value, and the other on agricultural profits ... but tried its best to find a tax that falls on the average income from land ..." Secondly, the land tax does not allow the deduction of the rent of land from taxable income in calculating the net actual return⁸⁶ .

This attempt to tax income from land ownership and income from land cultivation together is open to serious criticism . To apply one single tax on both land ownership and on income from agriculture, and collect it from the landowner, can only be justified when the owner of the land is himself undertaking its cultivation⁸⁷ .

(86) Ibid (p: 54)

(87) Ibid

2.5 Improving or Amelioration Tax

It is a direct tax imposed on plots that gain more value as a consequence of constructing public utilities besides them⁸⁸. It does not regard the personal sites of the plot owner, and it is a progressive tax.

2.5.1 Rates and Exemptions

The tax rate starts on improving parts that exceeds 5 times the minimum salaried workers. Details are shown in Table 2.10

Table 2.10⁸⁹

<u>Minimum Salaried workers times Bracket</u>	<u>%</u>
5 - 25	10
25 - 50	20
50 - 100	30
Above 100	40

In the last bracket, the tax amount should not exceed $\frac{1}{4}$ of the value of the plot⁹⁰. It is clear that improving parts that are below 5 times the minimum salaried workers are exempted from taxation. Also, 25% of the improving tax amount is exempted if the plot needs to be set apart⁹¹.

Finally, at the end of this chapter and after presenting each type of direct taxes, it is certainly that the prime objective of taxation is to raise revenue and to distribute income. At this point, it is a good idea to illustrate an economic principle that confirms such an objective. This principle is known as ability-to-pay principle.

(88) Ibid (p : 657)

(89) Ibid (p: 661)

(90) Ibid

(91) Ibid (p: 662)

2.6 Ability-to-Pay Principle ⁹²

This principle is concerned only with raising revenue, and it focuses on a fair way to accomplish this. This view looks at taxation as largely distributive in nature and seeks to make redistributive conform to certain principles. It has two specific equity principles. One is horizontal and the other is vertical. The first one says that equals should be treated equally. The second says that those who are better off should pay more in taxes than those who are not as well off.

As to the horizontal equity principle, nobody is against that equals should be treated equally under the tax system. But there will be a problem of defining and specifying equity. For instance, if income is used as the base for measuring equity, the argument is to tax those with the same income by the same amount. However, many practical problems arise in implementing this principle. One is the treatment of different-sized households. Should a family be treated as a group of individuals with income for each equal to the total family income divided by the number of family members? Another problem arises in terms of individual choice. For instance, what if one earns income by investing inherited wealth while the other must work very hard? What about people who have very high medical expenses?

In practice the attempt to maintain horizontal equity can be extremely complex because it is hard to have agreement on what constitutes equality.

As to the vertical equity, its axiom is that those with more income should pay more in taxes since there is greater ability to pay. Such an axiom is virtually unopposed.

(92) "Public Finance and Expenditure in a Federal System," Werner Z. Hirsch and Anthony M. Ruffolo. Florida: Harcourt Brace Jovanovich Inc. 1990 (p.350)

But the question is how much more should be paid in taxes . The concepts of progressive and regressive taxes were developed to help address this issue . That is, if tax payments go up faster than income, the tax is called a progressive tax. If the tax payments go up less rapidly than income, the tax is called regressive tax. It should be clearly understood that many regressive taxes would meet the ability-to-pay criterion . For instance, if someone earning \$5,000 paid \$500 in taxes while someone earning \$10,000 paid \$800 in taxes, the tax would be regressive . This tax would indeed require that the person with the higher income would pay the higher tax. On the other hand, there is much disagreement on how much the tax system should be progressive . Or, how much income redistribution should take place. One would argue that the marginal dollar of income is worth less to the rich person than it is to the poor person . This has been ruled out in modern economic theory, and there is no general principle that says how much progressive it should be.

In conclusion, as it's been clear that Chapter 2 illustrated the literature review of direct taxes, there is a need for seeking out the opinions of the economists on the direct tax reforms . This will be done by the methodology used in the following chapter .

CHAPTER III

Research Design and Methodology

3.1 The Basic Research :

This study has been conducted to assess the implications of lower tax rates on government revenues, fiscal discipline, and national debt in Lebanon .

Moreover, the study also attempts to examine the various factors that are most likely to be associated with successful features of the Direct Tax System like the impact of direct tax system on income distribution and production .

3.2 Sources of Information :

A field survey was conducted to test the purpose presented above . The survey sample covered economic experts, government officials, and financial managers as well as financial auditors . Questionnaires along with follow-up interviews were used as a major technique to gather data concerning the taxation procedures and the respondent satisfaction with these procedures .

The respondents were gathered from four main places or sources :

- 1- Ministry of Finance
- 2- Chamber of Commerce and Industry
- 3- Lebanese University
- 4- Lebanese American University (L.A.U)

3.3 Survey Design :

The questionnaire and follow-up interview were used to collect data from people daily exposed to the process of handling tax features .

The questionnaire was developed to measure factors affecting lower tax rates . The instrument included four sections . It contained six questions on Demographic Characteristics, seven questions on effects of Direct Tax System on Distribution, eight questions on effects of Direct Tax System on Production, and three questions on specific impacts of tax rate reduction (See appendix A for a sample of the questionnaire) .

Forty questionnaires were distributed, 8 of which were unreturned. The response rate was 80 percent. The process involved meeting with the respondents, explaining the nature of the study, clarifying any questions, translating the questions into Arabic sometimes, and picking up the completed questionnaire .

As to the type of response, in the first section, multiple choice and fill in the blanks types were used . In the second section, Likert Scale type was used ranging from strongly agree to strongly disagree . In the third section, Likert Scale and Direct questions were used . Finally, in the fourth section, Likert Scale ranging from extremely high to extremely low and Direct questions were used .

3.4 Research Variables :

The proposed factors that influence Direct Tax System are chosen on the basis of their perceived socio-economic importance .

3.4.1 Demographic Variables :

It is section one which provides information about each respondent's age, sex, educational level, origin of degree, field of focus, and job experience .

3.4.2 Effects of Direct Tax System on Distribution :

This measure is used to assess whether the present direct tax system should be adjusted so as to be more progressive in order to distribute income from rich to poor . That is, it is to seek if a progressive tax system reduces the inequality of income .

3.4.3 Effects of Direct Tax System on Production :

This measure is used to assess whether by lowering income tax to 10%, productivity is encouraged and investment is enhanced . Also, it is to seek the effect on efficiency, economic activity, and economic stability and to know the factors that determine foreign direct investment .

3.4.4 Specific Impacts of Tax rate reduction :

This measure reflects directly the impact of tax rate reduction on government deficit, fiscal discipline, national debt, incentive to work, and incentive to save . For instance, if the impact on government deficit is extremely high, this means that it is positive so that more revenues will be generated as a result of the reduction and the deficit will be lower .

3.5 Data Analysis :

Responses were analyzed using the facilities of the statistical package SPSS (Statistical Package for Social Sciences) . Using this facility, a descriptive analysis was used to investigate the relationship between the variables of demographic, distribution, production, government deficit, fiscal discipline, and national debt . To achieve this, the frequencies, crosstabulation, and correlation facilities were used .

Having identified the design and the methodology of this research, the variables to be included, and the analysis tools to be used, it is an important step now to list the findings and the implications of the study . This is in fact the objective of the following chapter .

CHAPTER IV

Research Findings and Analysis

Direct taxes are not only a source of revenue to the government, but also a tool to distribute income and enhance productivity. So, when there is a tax reform, implications and incidences emerge and affect the socio-economic situation. This has been the basic study as mentioned in Chapter One.

After presenting the methods followed and tools used for analyzing the data collected for this study, it is the intent of this chapter to present the findings and analyze them. That is, this chapter intends to test the views and suggestions regarding tax reforms in the light of the result obtained and the findings analyzed.

4.1 Profile of Respondents

The respondents included in the study, as was mentioned in Chapter Three, formed an 80 percent response rate and the size of the sample upon which the study was conducted was 32 respondents. Respondents surveyed by this study belong to different functional areas (Management, Economic, Finance, Accounting, Marketing, Money and Banking, Faculty of Law, and other) and work in organizations operating in finance and taxation (Ministry of Finance and Chamber of Commerce and Industry).

Concerning the respondents' general characteristics, of the 32 respondents, 31.3% were females and 68.8% were males. The ages of the respondents ranged between 46 and 55 years. As to the educational level, 65.6% of the respondents held BS degree, 12.5% held MS degree, and 15.6% held PHD degree. Moreover, 28.1% of the respondents had an experience between 5 and 6 years and 50% had over 8 years of experience. This shows that this sample is highly educated as well as experienced. These characteristics are shown in Table 4.1 which presents the profile of the respondents.

Table 4.1
Profile of Respondents

Characteristic			
	<u>range</u>	<u>frequency</u>	<u>%</u>
Age:	19-25	3	9.4
	32-35	3	9.4
	36-45	9	28
	46-55	13	40.6
	56-65	2	6.3
	Above 65	2	6.3
Mean 3.438	Median 4.00	Mode 4	
Sex :		<u>frequency</u>	<u>%</u>
	Male	22	68.8
	Female	10	31.2
Educational level :		<u>frequency</u>	<u>%</u>
	Intermediary	0	0
	Trade School	2	6.3
	BS	21	65.5
	MS	4	12.5
	PHD	5	15.6
Field of Focus	Management	5	15.6
	Economic	2	6.3
	Accounting	11	34.3
	Finance	6	18.8
	Marketing	5	15.5
	Money and Banking	1	3
	Others	2	6.2
Job Experience	0 to 1 yr.	2	6.3
	1 to 2 yrs	3	9.4
	3 to 4 yrs	2	6.3
	5 to 6 yrs	9	28
	over 8 yrs	16	50

4.2 Effects of Direct Tax System on Distribution

The use of taxation for the purpose of reducing the inequality of income was considered by the classical economist to sacrifice progress for social considerations ⁹³. Though redistributive taxation has, in general, always been praised on the grounds of social justice and though it has been admitted that taxing the rich more than the poor reduces the total real burden on tax payers, such taxation was condemned by the classical economist who considerer it as a hindrance to the accumulation of capital .

However, contemporary economists contest classical thought on this question . " In as much as depression and unemployment and indeed long term stagnation can now be traced to inequality of income distribution, redistributive measure commend themselves not merely on the grounds of social justice, but permanently on the grounds of economic reason "⁹⁴ .

4.2.1 Income Tax Base

In Lebanon, direct taxes are based on the separate incomes and not on the total income . That is, if a person earns income from planting a land, renting a building, and getting a salary, his tax will be considered on separate incomes as Land Tax, Building Tax, and Income Tax . So, such tax base is not calculated on the whole basket of incomes although higher income bracket will be obtained and thereby more tax revenues will be generated if the total income base is considered .

(93) E.F.Schumacker, " Public Finance- Its Relation to Full Employment", Economics of Full Employment, Oxford Institute of Statistics. Basil Blackwell , Oxford, 1994, (p.9)

(94) Ibid (p.91)

In fact, the majority of the respondents, 84.4%, disagree on the idea that direct taxes should be on the total income and not on the separate incomes . This goes back to the factor of resisting change of the present situation to avoid higher income bracket . Or, it could be due to the difficulty of resetting up the tax departments and administrations to go along with new tax base .

4.2.2 Taxing The Rich More Than The Poor

It is a commonsense that the rich should be taxed more than the poor to reduce the total real burden on taxpayers . In fact, 56.3% of the respondents agree on such suggestion . This confirms that the tax system should be utilized as a tool of income distribution . The remaining 43.7 % of the respondents, who disagree on such taxation, are considering it as a block to the formation and accumulation of capital .

4.2.3 A Progressive Tax System Versus A Regressive One

Economically speaking, a progressive tax system reduces the inequality of income while a regressive one accentuates it . 93.8% of the respondents agree on this statement . What to know next is whether the Lebanese tax system is regressive or progressive . First, 93.8% of the respondents agree that the progressivity of the direct taxes should increase in order to distribute income from rich to poor .

Second, 78.2 % agree that the extremely tendency of the indirect taxes in Lebanon is not compensated by any substantial progressive tendency in the direct taxes . This is true because the majority of tax revenue is obtained from indirect taxes sine it is more easily and quickly collected than direct taxes . Consequently , the tax system in Lebanon is greatly regressive, and to support this 97.9% of the respondents agree on that . Thus, the inequality of income is more available with the regressiveness of tax system .

4.2.4 Relationship between (EFFDIST) and Demographic Variables

i- As for the EFFDIST1 which states that direct taxes should be on the total income and not on separate incomes , there exists variability along with age, sex, job experience, source of degree, and field of focus as shown in Table 4.2 . First, a significance level of 0.0056 occurred upon testing the relationship between EFFDIST1 and age using the Chi-square analysis . Moreover, a significance level of $0.0062 < 0.05$ was obtained upon testing the variability of this variable along the sex of the respondent by using the same test . In addition, using Chi-square analysis , a significant level of 0.0090 was obtained between EFFDIST1 and job experience . Also, by using the correlation analysis, a P level of 0.030 occurred between EFFDIST1 along with the source of degree, and 0.030 P level with the field of focus .

As could be noticed from these findings listed in Table 4.3, that the attitudes towards the stated requirement of EFFDIST1 have variability

along age, sex, job experience, source of degree, and field of focus . By this, it can be concluded that such items affect the respondents' attitude towards EFFDIST1 .

Table 4.2
Crosstabulation and Correlations

Crosstabulation: EFFDIST1 by AGE				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
39.618	20	0.0056	0.063	28 OF 30 (93.3%)
Crosstabulation: EFFDIST1 by Sex				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
14.35504	4	0.0062	0.313	8 of 10 (80%)
Crosstabulation: EFFDIST1 by JOBEXP				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
43.40040	24	0.0090	0.031	33 of 35 (94.3%)
Correlations:				
	AGE	SEX	SDEGREE	FIELD
EFFDIST1	.6674	-.5180	.3836	.3836
	P=.000	P=.002	P=.030	P=.030

ii- The relationship between (EFFDIST4) and Demographics : EFFDIST4 states that " wage earners and salaried people who belong to the poor and middle classes are the least able to evade the income tax, since the tax on their incomes is deducted at the source by the employer." Using the correlation analysis, P levels of 0.034, 0.019, 0.019, 0.0090 were obtained between EFFDIST4 and educational level, job experience, source of degree, and field of focus respectively as shown in Table 4.3

Table 4.3
Correlations

Correlations:				
	EDLEVEL	SDEGREE	FIELD	JOBEXP
EFFDIST4	-.3756	.4129	.4129	.3491
	P=.034	P=.019	P=.019	P=.050

As could be concluded, that since the educational level has a negative sign, this means that as the respondent is highly educated as he will agree with the stated statement EFFDIST4 . However, as this respondent has more experience , he\she will disagree on this statement .

iii- As for the relationship between EFFDIST5, which states that the progressivity of direct taxes should increase in order to distribute income from rich to poor, with age, sex, source of degree, and field of focus, this relation was tested using the Chi-square analysis . The results showed p-levels of 0.0010, 0.0011, 0.0309, and 0.035 respectively and were listed in Table 4.4 . Based on this, we can say that there is variability in EFFDIST5 along these variables .

Table 4.4
Crosstabulation

Crosstabulation: EFFDIST5 by AGE				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
29.67606	10	0.0010	0.125	16 of 18 (88.9%)
Crosstabulation: EFFDIST5 by Sex				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
13.5408	2	0.0011	0.625	4 of 6 (66.7%)
Crosstabulation: EFFDIST5 by SDEGREE				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
22.6439	12	0.0309	0.063	20 of 21 (95.2%)
Crosstabulation: EFFDIST5 by FIELD				
<u>Chisquare</u>	<u>D.F.</u>	<u>Significance</u>	<u>Min E.F.</u>	<u>Cells with E.F. < 5</u>
27.6439	12	0.035	0.067	20 of 21 (95.2%)

iv- Relationship of EFFDIST6 and EFFDIST7 with demographics:
EFFDIST6 states that the extremely regressive tendency of the indirect taxes in Lebanon is not compensated by any substantial progressive tendency in the direct taxes .
EFFDIST7 states that the tax system in Lebanon is greatly regressive, thus accentuating considerably the inequality in the distribution of income and the inequality in the economic welfare derived from income .
There is variability in EFFDIST6 along job experience at a significance level of 0.0074 using the Chi-square analysis , and in EFFDIST7 along the sex of the respondent at a significance of $0.0220 < 0.05$ accepted level . However, EFFDIST6 and EFFDIST7 do not have significant relations with the other demographic variables .

4.3 Effect of Direct Tax System on Production (EFFPROD)

4.3.1 Labor, Capital, and Efficiency

Such indirect taxes on commodities which are considered necessities by workers reduce income necessary for consumption or investment . This decreases the efficiency of workers because they will have more expenditure on commodities and less income . 78.2% of the respondents agree on that the regressiveness of the Lebanese tax system tends to reduce the efficiency of the employees both in the present and in the future .

It is often argued that taxing the poor, who are anxious to consume, rather than the rich, who are willing to save, increases the rate of capital formation necessary for efficient production . This is a double fallacy because capital includes human beings as well as material equipment .

Much spending especially by and on behalf of the poor, makes an addition, through the increase of efficiency, to human capital. Much consumption in short is really investment. On the other hand much saving, particularly in times of depression, makes no addition to material capital because it fails to find its way to investments.

4.3.2 Investment Incentives Versus Economic Blocks

It's been said that the government lowers direct taxes and especially income taxes to encourage foreign investment. A highly progressive income tax may be said to weaken the inducement to invest by reducing the net rate of profit, but such a reduction is expected to be far inferior to that which results from the decrease in demand produced by the regressive indirect taxes. 62.5% of the respondents disagree that the decrease of top personal and corporate taxes from 43% and 35% respectively to 10% promotes efficient and large scale production. In fact, the majority are with the view that income tax in Lebanon can be made more progressive without adverse effect on the incentive to invest. On the other hand, the majority agree that the excessive dependence on indirect taxes has adverse effect on economic activity. 75.1% agree that the reliance on indirect taxes reduces the income left in the hands of masses for consumption, thus reducing induced investment spending. Moreover, half of the respondents agree that economic activity would be better off if the tax system rests on more progressive inheritance and income taxes.

4.3.3 Relationships between effect of direct tax system on Production (EFFPROD) and demographic variables'

There occurred no variability in all statements of EFFPROD along demographic variables at a significance level of 0.05 . This means that no matter what the age, sex, educational level, source of degree, and field of focus of the respondents are, this will not affect their attitude towards EFFPROD .

4.4 The effect of tax rate reduction and political stability upon foreign direct investment

Interesting findings were shown by those two effects, for 59.4% of the respondents agree on that the tax rate reduction is not the only determinant of foreign direct investment . However, 100% of them agree that political stability constitutes the only determinant of foreign direct investment . So, the majority of them did not take into consideration the factor of maximizing profit as a determinant of foreign direct investment . This may be due to the Israel war that took place during April, one month before filling the questionnaire .

4.5 Impact of tax rate reduction upon government deficit (GD), fiscal discipline (FD), and national debt (ND)

The majority of the respondent agree that GD, FD, and ND are highly affected by the tax rate reduction .

One may say that as tax rate is reduced, budget deficit increases because the collection of tax revenue will be lower and thereby there will be low supply of revenues to cover the national debt . But, this is not the case in Lebanon since as tax rate decreases, tax revenue increases from 4 billion to 25 billion as estimated in the Ministry of Finance . This could be accounted for the collection process becomes better and for the tax being low, so most businesses offer their statements for tax purposes .

As for the various relationships between the impact of tax rate reduction upon fiscal discipline and the educational level of the respondent , a significance level of 0.0411 occurred using the Chi-square analysis . This means that there is variability in the variable along educational level . Moreover, significant levels of 0.0224, 0.0440, and 0.0421 were obtained between impact of tax rate reduction upon national and educational level, field of focus, and source of degree respectively . By this, we could say that the respondents' educational level, field of focus, and source of degree affect his attitudes towards the impact of tax rate reduction upon national debt .

4.6 Applicability of supply-side model in Lebanon

Half of the respondents agree that the supply-side model has adequate applicability in Lebanon while the other half do not . This could be interpreted by the fact that the coming accurate results are not clearly viewed by the respondents . Thus they are uncertain about the present situation .

As for the variability in the respondent's attitude towards the adequate applicability of the supply-side model along demographics, the significances that occurred along the educational level, field of focus, and the source of degree were 0.0015, 0.0070, and 0.0067 respectively . These were obtained by using the Chi-square analysis . We could conclude that those demographics affect the respondents' attitude towards the supply-side model in Lebanon, although they seem uncertain about its applicability .

As the research findings were analyzed, the immediate step is to summarize the conclusions and recommend certain hints related to tax reforms . This will be the intent of the following chapter .

CHAPTER V

Conclusions and Recommendations

5.1 Summary of Major Findings

In order to judge the effect of the tax system on the redistribution of income, it is necessary to determine whether it is progressive or regressive and the degree of the progression or regression. 93.8% of the respondents agree on that a progressive tax system reduces the inequality of income; a regressive one accentuates it. However, since the marginal utility of income diminishes rapidly as income increases, and since the inequality in economic welfare derived from income, that is desirable to reduce, only a substantially progressive tax system can be considered really redistributive and desirable; a mildly progressive tax system may accentuate inequality in economic welfare rather than decrease it.

The Lebanese tax system rests mainly on indirect taxes, which account for two-thirds of tax revenue as reported from Marwan Iskander. This high proportion of indirect taxes is due partly to wide taxation of articles of general consumption, and partly to very high taxation of some necessities, such as kerosene and benzene, and of customary necessities, such as tobacco and liquors; only essential physical necessities are exempted from taxation such as wheat, flour, meat, and cheese. Emphasis seems to be placed, therefore, on deriving as large a revenue as possible, with little consideration to the effect of such policy on income distribution.

Direct taxes are either not progressive or, for the most part, mildly progressive and most of the respondents ask to increase its progressiveness. Progression of the succession tax is very mild.

Moreover, it should be noted that direct taxes are more strictly applied on the poor than on the influential rich . Wage earners and salaried people are the least able to evade the income tax, since the tax on their incomes is deducted at the source by the employer . Thus it appears that the relative mild progression provided in the law of some of the direct taxes is, for many people, further reduced in practice .

The extremely regressive tendency of the indirect taxes in Lebanon is thus not compensated by any substantial progressive tendency in the direct taxes .

Considering the above features of direct and indirect taxes, it must be concluded that the tax system in Lebanon is greatly regressive, thus accentuating considerably the inequality in the distribution of income and, more so, the inequality in economic welfare derived from income .

Moving to the effects of tax system on production, these can be considered under three headings : effect on efficiency, effect on economic activity, and effect on economic stability .

i- Effect on efficiency : The regressiveness of the Lebanese taxation system tends to reduce the efficiency of the labor class both in the present and in the future. Although the indirect taxes are imposed in general on commodities which do not contribute to health and efficiency, and in some cases on commodities that are considered harmful to the health such as tobacco and alcoholic drinks, they still have an adverse effect on efficiency . This is because taxation of commodities, that are considered by workers as conventional necessities increases the expenditure upon them and reduces the amount of income that can be spent on necessities, such as food, shelter, medicine, and education .

ii- Effect on economic activity : In Lebanon, the excessive dependence on indirect taxes, levied mainly on articles of general consumption, has a powerful adverse effect on economic activity . The

regressiveness of the tax system, for which these taxes are mainly responsible reduces the income left in the hands of the masses for consumption, thus reducing the inducement to invest, employment, and activity in general .

Economic activity would be better off if excise taxes, specially those on necessities are decreased and the tax system is made to test on more progressive inheritance and income taxes, and on high customs duties on luxuries and articles of type and quality produced locally .

iii- Effect on economic stability :The fiscal system in Lebanon should be considered inflexible for two reasons : first, indirect taxes, largely on necessities, form the main source of public revenue. The inelasticity in the demand for necessities makes the money burden of indirect taxes vary substantially less than variation in national income . Secondly, since direct taxes are , on average, only mildly progressive, variation in the money burden of these taxes are only slightly more pronounced than variation in national income . Consequently, direct taxes fail to compensate for the adverse effects of indirect taxes on economic stability .

5.2 Recommendations

From this study, the following recommendations are obtained :

1- In Lebanon, direct taxes are not highly progressive, so that they should be more progressive to face the increasing budget deficit and to have counterbalance with indirect taxes if it is made less on necessities .

2- The Lebanese tax system rests mainly on indirect taxes . There should be considerations to the effect of such policy on income distribution and not thinking only of how to get revenue .

3- The rich should be taxed more than the poor .

4- Lowering the tax rate does not enhance productivity or investment since there are more important factors like maximizing the profit, elasticity of demand, and political stability .

5- Income tax can be made more progressive without adverse effect on the incentive to invest .

5.3 Limitations

There are three limitations for this study which are the followings:

1- The weak knowledge of English language of some respondents constituted an obstacle . A special effort was made to explain the content of the questionnaire by interviewing them for about 10 to 15 minutes .

2- The sample size is relatively a small one

3- Missed item in the demographic variable like working industry which is worth to be mentioned since the majority of the respondents belong to finance and economic industry .

One could say that after the occurrence of the certain answers by the respondents, further research is recommended in order to seek for other factors that influence the economical status in Lebanon .

APPENDIX

" A "

**Assessment of Direct Tax System
in Lebanon**

Dear Respondent,

This questionnaire is designed to assess the implications of lower tax rates on government revenues, fiscal discipline, and national debt in Lebanon . Your opinion is of high importance to this study. Your responses will be treated with complete confidentiality and will be discarded after data analysis is completed .

Your time and effort are highly appreciated. Thank you for your cooperation .

Yours sincerely,
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I. Demographics

- Please answer the questions below by checking the box that best fits your answer .

1. Age :

- | | |
|--------------------------------|-----------------------------------|
| <input type="checkbox"/> 19-25 | <input type="checkbox"/> 46-55 |
| <input type="checkbox"/> 26-35 | <input type="checkbox"/> 56-65 |
| <input type="checkbox"/> 36-45 | <input type="checkbox"/> Above 65 |

2. Sex :

- | | |
|-------------------------------|---------------------------------|
| <input type="checkbox"/> Male | <input type="checkbox"/> Female |
|-------------------------------|---------------------------------|

3. Level of education completed :

- Intermediary school
- Trade or vocational school
- University - BS
- University - MS
- University - PHD
- Others specify _____

4. Origin of degree _____

5. Field of focus _____

6. Job experience:

- | | |
|---------------------------------------|---------------------------------------|
| <input type="checkbox"/> 0 to 1 year | <input type="checkbox"/> 5 to 6 years |
| <input type="checkbox"/> 1 to 2 years | <input type="checkbox"/> over 8 years |
| <input type="checkbox"/> 3 to 4 years | |

II. Effects of Direct Tax System on Distribution:

Please read each statement carefully, and put X in the square you think that best describes the statement (Note that S.A = Strongly Agree; A= Agree; U = Uncertain; D = Disagree; S.D = Strongly Disagree).

	S.A	A	U	D	S.D
1. Direct taxes should be on the total income and not on separate incomes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The rich should be taxed more than the poor to reduce the total real burden on tax payers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. A progressive tax system reduces the inequality of income while a regressive one accentuates it	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Wage earners and salaried people who belong to the poor and middle classes are the least able to evade the income tax, since the tax on their incomes is deducted at the source by the employer	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. The progressivity of direct taxes should increase in order to distribute income from rich to poor .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. The extremely regressive tendency of the indirect taxes in Lebanon is not compensated by any substantial progressive tendency in the direct taxes .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. The tax system in Lebanon is greatly regressive, thus accentuating considerably the inequality in the distribution of income and the inequality in economic welfare derived from income	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

III. Effects of Direct Tax System on Production :

	S.A	A	U	D	S.D
8. The regressiveness of the Lebanese tax system tends to reduce the efficiency of the employees both in the present and in the future .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Top personal and corporate taxes have decreased from 43% and 35% respectively to 10% . This promotes efficient and large scale production	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. The excessive dependence on indirect taxes has adverse effect on economic activity .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. The reliance on indirect taxes reduces the income left in the hands of masses for consumption, thus reducing induced investment spending .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Economic activity would be better off if the tax system rests on more progressive inheritance and income taxes .	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. The income tax in Lebanon can be made more progressive without adverse effects on the incentive to invest, if investment, whether for replacement or expansion, is made deductible from taxable income	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. Tax rate reduction is not the only determinant of foreign direct investment .	<input type="checkbox"/> Yes <input type="checkbox"/> No				
15. Political stability is the only determinant of foreign direct investment	<input type="checkbox"/> Yes <input type="checkbox"/> No				

Please read each statement carefully, and put X in the square you think that best describes the statement (Note that E.H = Extremely High; H = High; N = Normal; L = Low; E.L = Extremely Low).

	E.H	H	N	L	E.L
16. How do you think the impact of tax rate reduction upon the followings :					
- Government deficit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
- Fiscal discipline	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
- National debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. How do you think the impact of low tax rate on :-					
- incentives " to work "	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
- incentives " to save "	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. The supply-side model has adequate applicability in Lebanon .					
	<input type="checkbox"/> Yes		<input type="checkbox"/> No		

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