Laws, Rules, and Tax Regulations Relating To Foreign Investment In Lebanon

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Research Topic

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CHAPTER I

A. Introduction

Lebanon is one of the smallest countries in the Middle East, one of the most densely populated and also one of the poorest in natural resources.[1] Lack of space and the mountainous nature of the country make agricultural development difficult. For these and other reasons, the Lebanese people were historically oriented toward trade. After the end of World War I, Lebanon's economic structure underwent significant changes and by 1950 the services sector dominated the Lebanese economy. Between 1950 and 1975, Lebanon enjoyed a period of relative political stability which was accompanied by rapid economic growth.

Over the years, Lebanon has developed into an economic and financial center which served the Arab region until 1975. This growth has been tied to the growth of commercial banking in the country.

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1. Marwan Iskandar and Elias Baroudi, The Lebanese Economy (Beirut: Middle East Economic Consultants, 1984), p. 209.

In the early 1960's, Lebanon was able to absorb large numbers of Egyptians, Syrians and Palestinians. Skilled Lebanese have regularly emigrated to various Arab and African countries. Remittances to their families in Lebanon have helped cover the current account deficit of the balance of payments.

In 1983, and after the partial withdrawal of Israel, Lebanon hoped to secure a large portion of the funds required for reconstruction from foreign loans and grants. A change in political expectations took place in that year. By April, many domestic and foreign political problems emerged.

By the beginning of 1984, the economy which had not been given time to recover from the destructive effects of the Israeli invasion faced greater difficulties than in any time in the previous nine years. Thirty percent of the labor force was estimated to be unemployed; agricultural and industrial production and exports were at a very depressed level.

On the other hand, industry suffered from a sharp decline in export opportunities and from production interruptions because of shortage of power and materials, particularly after the closure of Beirut port in early February, 1984.

The Lebanese banking sector, despite the continuing hostilities has continued to grow after 1975.[2]

A_1. Factors Leading to the Prosperity of the Banking sector in Lebanon

Many factors have led to the prosperity of the banking sector. These factors are the economic , social and political environment which have made Lebanon an important financial center in the Middle East.

1. The liberal Environment

Lebanon has a free and liberal economic, social and political environment. These characteristics help in the development of various

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2. Ibid., p. 325.

sectors of the Lebanese economy. The Lebanese banking sector is a vital sector in the economy and has benefited from this environment. In 1948, the Lebanese government ended the control which had been imposed since 1941 by the French authorities on foreign exchange.[3]

The adoption of a system of free currency exchange played an important role in attracting foreign capital to the Lebanese market and strengthened the purchasing power of the Lebanese Pound, the L.L.

In general, the Lebanese economic history is characterized by limited government intervention and the absence of a clear strategy of development. Overall it would seem safe to say that Lebanon's successful performance took place due to "laissez faire" attitude as well as a limited government intervention strategy.

However, in the last years of war, i.e. up to 1990, this limited intervention was perhaps not a conscious policy on behalf of the government as much as one dictated by political events. By the

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3. Legislative Decree No. 13053 of 15 Nov. 1948.

closing years of the war, the various military organizations had taken over the many functions of government.

2. The Geographic site

Lebanon has been described by historians as "The gate to the East". Lebanon has a very important geographic location. This location made Beirut a significant port of connection between the east and the west, a center for international trade and an ideal environment for the practice of banking activities in the Middle East. The environment helped in the creation of a highly skilled, innovative, and qualified personnel.

3. The Political Environment

The instability of the political situation in neighbouring Arab countries had a positive influence on the development of the banking sector in Lebanon. After 1948, because of the Israeli occupation of Palestine, many wealthy palestinians left their country and came to Lebanon. A similar migration of Egyptians occurred after the downfall of the monarchy in Egypt. This led to the transfer of huge amounts of Arab funds to the Lebanon.

4. The Arab Oil Revenues

The oil wealth in the Arabian Gulf and the inability of these countries to absorb all the revenues generated from selling oil mainly as a raw material led to the accumulation of large surpluses in the balance of payments. The Lebanese economy was one of the beneficiaries of these surpluses with Arab investors concentrating their investments until 1975, mainly in the banking and real estate sectors.

5. Tourism and Emigration

Until 1975, Lebanon was considered a a major center for tourism in the Middle East, attracting tourists from the USA, Europe and mainly the Gulf countries. In addition to tourism, the emigration of a large number of Lebanese citizens to the Gulf and to Africa generated a volume of income and remittances and a balance of payments surplus.

A2. Recent Trends in Foreign Investments in Lebanese Banking Sector.

The Banking sector remained largely unaffected by the unstable situation in Lebanon until the early eighties. In 1983, and as a consequence of the Israeli invasion, the banking system was not only confronted by the civil strife and political instability, but also by a stagnant economy.

Banking activity declined and the problem of bad debt in many banks portfolios became more serious resulting in many banks incurring substantial losses.

1. The accumulation of bad debt:

Many banks and a large number of commercial and industrial concerns were caught in the fighting and suffered huge losses in their offices, plant and equipment. They were, accordingly, in no position to meet the financial obligations to banks. This caused a rise in the proportion of debt in the portfolios of most commercial banks.

2. The slow down in import - export activity:

The sharp drop in import - export activities had a serious effect on commercial banks in Lebanon since the issuing of letters of credit and guarantees constituted a major and highly profitable aspect of their operations.

3. Excessive competition

The number of commercial banks operating in Lebanon is large relative to the size of the market. This concentration did not represent a problem in the period up to the early eighties. However, this situation changed in 1982-1983. The general slow-down in economic activity forced banks to increase competition in order to maintain their share of the declining volume of banking activity.

4. Lack of safe local investment outlets

In the period 1982-83, a period of continuing strife and political uncertainty, banks faced difficulties in locating safe and profitable investment in the private sector.[4]

A3. Criticism of the Lebanese Economic System

The Lebanese economic literature provides many criticisms of the Lebanese model over the following two points:-

1. The Lebanese economy is potentially very unstable; and
2. Income is unequally distributed in Lebanon and the government's limited intervention in economic activity was often viewed as a failure.[5]

Despite all the criticism mentioned above, there is no evidence that Lebanon's economic problems were necessarily the outcome of its economic system. However, the economy in post-war

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4. Marwan Iskandar and Elias Baroudi, The Lebanese Economy 1982-83, Op. cit., pp. 207 -209.

5. Emile Chiab, The Export Performance of a Small Open Developing Country, The Lebanese experience, 1979 , p. 35.

Lebanon can not start to recover from its depressed state unless a broad degree of political stability is re-established.

A4. Foreign Investment and the Lebanese Economy

Prior to the civil war which started in 1975, the majority of foreign investors who had drawn interest in Lebanon as a good investment prospect were motivated by the open door policy which encouraged the participation of private local and foreign capital in economic development plans.

Investments in Lebanon are classified into three main types:- local investment, Arab investment, and foreign investment.

Table 1 clearly shows that during the civil war period only domestic investments by Lebanese nationals took place and at a declining rate in dollar terms. In 1974, these investments amounted to 1 059 million dollars by 1988, this investment had declined to 3.399 million dollars. As for the total lack of foreign participation in investments in Lebanon and the minute investments conducted by

Arab nationals in the period 1975-1990 the reasons are obvious: lack of security and political instability.

From this table, it is clear that the development of Lebanese investments can be divided historically into two stages, one before 1982 and the other after it. The reason for this division is the Israeli invasion which was responsible for the breakdown in the Lebanese economy.

The first stage was characterized by an increase in the volume of investments $ 1059 million in 1974 to $ 1417 million in 1982, the period after the Israeli invasion showed a decline in the investment rate causing a severe dis-equilibrium in the Lebanese economy. These investments declined to a trickle of only $ 3.4 million in 1988.

Development of Investments in Lebanon

between 1974 - 1990

Year	Domestic Investment by nationals in million L.L.	In million US $	Domestic Inv. by Arabs in million L.L.	In million US $
1974	2435	1059	0.9	0.39
1975	2936	1208	8.1	3.33
1976	2488	849	-	-
1977	2579	860	-	-
1978	3349	929	-	-
1979	3980	1222	-	-
1980	4660	1279	-	-
1981	4940	1068	-	-
1982	5398	1417	-	-
1983	7373	1343	-	-
1984	6610	744	-	-
1985	3487	193	10.9	0.60
1986	3296	38	-	-
1987	2189	4.81	1.0	0.22
1988	1801	3.398	8.9	0.02
1989	No	-	No	No
1990	No	-	No	No

Source: <u>Chamber of Industry and Commerce</u>

In conclusion, despite the Lebanese war, Lebanon continued to encourage foreign investors to invest. However, as confirmed by the investment statistics, these attempts failed to materialize.

In the post-war period, Lebanon needs to cultivate and develop the existing climate for investors. For Lebanon continues to preserve and possess the elements needed for attracting foreign investments which include:-

1. The human wealth and the open door policy which combined to maintain the economy during the war years;
2. The industrial, commercial, educational and medical projects which are open to Lebanese and foreigners alike;
3. The governments open policy and national laws and rules regulating foreign investment in Lebanon;
4. Its location and long established trading relations in the region, which extends its market size far beyond its limited domestic size;
5. Tax exemptions, and
6. Economic stability.

B. Scope and Methodology:-

The scope of this research is to study the rules, laws and tax regulations relating to foreign investment in Lebanon. The methodology by which information was gathered depends mainly on published studies and official publications.

C. Need for the Study:-

The need for this study stems from the very basic fact that there is no recent research conducted in this field.

D. Statement of the Study:-

Do law, rules and tax regulations relating to foreign investment have a positive, negative or no effect?

E. Purpose of the Study:-

Purpose of the Study:-

Foreign investment in Lebanon witnessed several changes during the last decade. This was in part the consequence of the war.

The primary objective of this research is to assess whether in the existing conditions of normality and stability the country's regulations support the transfer and in-flow of funds for investment purposes into Lebanon. The Study discusses regulations relating to companies in general and banks in specific. It also investigates and assesses tax laws which have a bearing on international flow of funds and foreign investments in Lebanon.

CHAPTER II

What is Foreign Investment

This chapter defines foreign investment, its determinants, motives and benefits.

I. Foreign Investment

Countries that are unable to generate enough funds to support their economic growth usually look for foreign resources of funds. The United States, during the period 1935 - 1960 relied on foreign savings to push its development forward as well as before World War I and the Communist Revolution.

The legal aspect of investment needs special attention as long as the volume of foreign capital flowing to developing countries depends on the effectiveness of legal machinery to attract and protect investment.

A. Determinants

Why do firms invest abroad? The answer to this question is of relevance in appraising foreign investment in developing countries for two reasons. First, for determining the areas into which foreign investment is likely to flow and, secondly, for determining the minimum acceptable terms on which the foreign investor will be likely to come to the host country.

A world characterized by perfect competition would miss direct investment; the foreigner would always be at a disadvantage in comparison with local competitors in the host country because of the costs of overcoming economic and/or cultural-social differences. The foreigner must therefore possess some advantages which make it possible for him to overcome these costs and high rate of return on certain investment. In case of market imperfection, in either product of factor markets, external or internal economies in production, the foreigner is at an advantage because of his ability to internalize the market with local competitors. This would provide a rationale for foreign investment occurring.[6].

Overseas investments are of two kinds: direct and indirect.

Indirect foreign investment occurs when investors buy shares and debentures that can be liquidated at market value within a short time.[7]

On the other hand, direct investment involves control of an undertaking and may take the form of a branch. Investors may acquire part or all the equity of an existing company with the aim of controlling or sharing control over production, research and development. Foreign direct investment involves a long term commitment in which capital funds will be kept for a long time.

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6. Deepak Lal, Appraising, Foreign Investment in developing Countries, (Heinenen; London, 1975), p.19.

7. Kinder A. Nemir. Arab Banking Facing up Arab Investment Abroad, (Lebanon: Union of Arab Banks, 1989), p. 196.

Foreign direct investment constituted 8 percent of the total foreign savings flows entering developing countries in 1983; a sharp drop from its 24 percent in 1960. Foreign investment may not only include equity finance, but also large amounts of loan finance, management expertise, modern technology and technical skills.[8]

The in-flow of foreign capital into a developing country may not only raise the productivity of a given amount of labour but may allow a larger labor force to be employed as well.[9]

Domestic consumers may also benefit from direct foreign investment if the investment is cost-reducing in a particular industry; consumers of the product may gain through lower product

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8. H.G. Johnson, "LDC Investment: The Road is Paved with Preferences", Columbia Journal of World Business, Jan. - Feb., 1968), pp 17 - 21.

9. Ibid., p. 39

prices.[10] But if the investment is product-improving or product innovating, consumers benefit from better quality products or new products.

For many countries, taxes on foreign profit constitutes a large portion of government revenue.[11] The fiscal benefit derived from foreign investment is evident from the fact that the share of government revenue in the national product of countries that have received substantial foreign investment is higher than in most of the other low-income countries. Most of the significant contributions of foreign investment comes from external economies. Direct foreign investment brings to the recipient country not only capital and foreign exchange but also managerial ability, technical personnel, technological knowledge and innovations in products and production techniques.

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10. John Stopford. The World Directory of Multinational Enterprises 1982-83. (Detroit; Gale Research Company, 1982), p.2

11. Ibid., p. 12.

One of the greatest benefits to the recipient country is the access to foreign knowledge that private foreign investment may provide, knowledge that helps overcome the managerial gap as well as the technological gap. Private foreign investment may also serve as a stimulus to additional domestic investment in the recipient country. This is especially likely through the creation of external economies.

Against these benefits must be set the costs of foreign investment to the host country. These costs may arise from special concession offered by the host country, adverse effects on domestic savings, deterioration in the terms of trade and problems of balance of payments adjustment.

To encourage foreign enterprise, the government of the host country may have to provide special facilities, undertake additional public services, extend financial assistance or subsidize inputs. Tax concessions may also have to be offered.

B. Motives For Direct Foreign Investment

Many surveys and case studies that were conducted indicate that the motivation for making direct foreign investments are based on strategic consideration of five main types:-

1. Market seekers
2. Raw Material Seekers
3. Production efficiency Seekers
4. Knowledge seekers
5. Political safety seekers[12]

There are many motives for foreign direct investment:-

a. Behavioral Motives

A study of behavioral aspect showed two sets of motives; one arose from a stimulus from the external environment and the other from a stimulus

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12. Aharoni. The Foreign Investment Decision Process. (Boston: Harvard Graduate School of Business Admit. Division of Research, 1966), p. 265.

within the organization on the basis of personal biases, needs and commitments of individual and groups.[13]

b. Economic Motives

The benefits and purposes of this investment can be summarized as follows:

1. it represents an alternative outlet for excess capital that may not be profitably invested in the home country;
2. it provides a potential for superior financial return particularly with the use of sophisticated leverage techniques;
3. it allows risk diversification including economic, industrial, and political risk,

and 4. it permits the exploitation of skills, experience and resources associated with the investor's own business.[14]

C. Benefits of Foreign Investment

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13. Ibid., pp 79-88.

14. Ibid., p. 272.

The most commonly stated objectives of foreign investment are those of job creation, transfer of usable technology and skills and earning of foreign exchange. Moreover, many host countries seek foreign investment to help promote regional development objectives and to increase domestic tax revenues.

1. Employment Expansion

Some observers maintain that displacement of local firms by multi-nationals may actually reduce local employment.

There is a growing body of evidence that developing - country firms employ more labor intensive practices than their developed country counterparts even though the volume of their investments remains relatively small. Their investments are more heavily concentrated in relatively labour - intensive industrial undertakings such as textiles and simple consumer goods.

2. Technology Transfer

The second major benefit expected from foreign investment is the transfer of technology and skills. Many huge foreign firms are a potentially rich source of valuable information about new technology, new processes, new marketing methods and managerial approaches. If this information can be transplanted to host countries, material increases in growth and productivity can result over the long term. The type of capacity required for successful transfer of technology depends on the nature of the investment project.

3. Foreign Exchange Benefits

The third objective of foreign investment is to save and earn foreign exchange. The treatment of foreign exchange earnings of the companies is some what similar, for in this period the non-mining sector of the economy was running large and increasing balance of payments deficits which contributed to a crisis in 1966. The official rate of exchange did not at this time reflect the true value of the economy of foreign exchange.

4. Other Indirect Effects

A number of writers have identified a diversity of indirect effects of private overseas investment. A large number of these are really a variant of the political effects. Political fears of host countries about private overseas investment relate not only to the possibility of economic pressure exercised by foreign powers through their foreign companies, but equally to the fear of the possibility of direct subversion by foreign powers to protect the local interests of their companies in the host country. These fears are essentially left for the leaders of developing countries to assess, and are likely to differ from country to country, depending large part upon the factors in each case.[15]

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15. Deepak Lal. Appraising Foreign Investment in developing Countries, (Neineman; London Educational Book Ltd, 1975), p. 273.

The second set of indirect effects is suggested to be associated with private overseas investment in developing countries is the effect on income distribution and consumption patterns.[16]

The in-flows and outflows on the capital account of the balance of payments associated with the foreign investment is very important as a measure of the real income or balance of payments effect of private overseas investment.[17] There is also the internal rate of return of capital flows associated with the project which is calculated and then compared with the appropriate social opportunity cost of capital in the host country. This will be valid only if the difference between the POI and a domestic alternative was in the form of financing the project.[18] Then the IRR of the

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16. Paul Streeten, Costs and Benefits of Multinational Enterprise in less Developing Countries (October, 1973), pp 8-9.

17. Ibid.

18. Ibid.

capital flow associated with POI alternative will give the costs of foreign financing and as long as the social cost (opportunity) of domestic financing are equal to or greater than this IRR, the foreign alternative will be more desirable.[19]

This chapter surveyed the relevant literature relation to foreign investment. The following chapter presents rules, laws, and tax regulations relating to foreign investment in Lebanon.

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19. Ibid., p. 35.

Chapter III

Laws, Rules and Regulations relating to Foreign Investment in Lebanon

This chapter deals with rules, laws and regulations relating to foreign investment in Lebanon. The first part deals with banking and commercial laws while the second is concerned with tax laws.

I. Banking and Commercial Laws

A. Banking Laws

1. Establishment of New Banks

Article 128 of the Code of Money and Credit was modified by Legislative Decree No. 77 of 27 June 1977, whereby the authorization of the Central Council of the Central Bank was required for establishing any new Lebanese bank and the opening of a branch of a foreign bank. This authority must be obtained before undertaking the formalities of registration and publicity provided by Order No. 96 of 30 January 1926 and article 29 of the Code of

Commerce.[20] The Central Council of the Central Bank grants new licenses if it sees that it serves the public interest.[21] The Council has discretionary authority to give or to refuse the license of any new bank.

2. Capital Requirements

a. Requirements Prior to May 23, 1991:

Before May 9, 1977 every bank (Lebanese or foreign) intending to engage in banking activities in Lebanon was required to pay a minimum capital of LL 3 million. The Bank of Lebanon was entitled to require banks to raise the initial capital up to LL 5 million. After May 9, 1977, every bank (Lebanese or foreign) was required to raise its minimum capital to LL 15 million, seven million five hundred thousand of which should be paid before the beginning of its activities and blocked with the

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20. Code of Money and Credit, Article 130, as amended.

21. Ibid., Article 131, as amended.

Lebanese Treasury.[22]

b. Requirements As of May 23, 1991:

According to Article 1 of law No. 99 dated May 23, 1991, every new bank is required to allocate minimum capital, the value of which is determined by the Central Council of BDL, a ratio of which would have to be blocked in an interest free account lodged with the Lebanese Treasury. The determination of the value of this ratio is also left to the discretion of BDL Central Council.[23]

c.

It should be noted that every bank operating in Lebanon is required to set up a reserve fund by setting aside 10% of its net profit for that purpose. If a bank incurred a loss so that its capital is reduced, it has to reconstitute its

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22. Ibid., Article 132.

23. Official Journal No. 46 dated 04-11-1991, Article No. 132

capital within a period of one year.[24] No bank can reduce its capital.[25]

3. Bank Shares

All bank shares must be registered shares.[26] At least one third of the total shares of any bank formed in Lebanon must be held by Lebanese individuals.[27] Decree No. 126 of the Code of Money and Credit states "only firms set up as joint-stock companies shall be authorized to carry on the banking profession in Lebanon." However, foreign banks can operate even if they don't have the form of a corporation, provided that they are considered banks in their country of origin. The Central

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24. Ibid., Article 134.

25. Ibid., Article 133.

26. Ibid., Article 132.

27. Law No. 32 dated Feb. 11, 1991 which amended Decree No. 87/83

Council refuses authorization of any transfer of shares if it leads to the ownership by non-Lebanese of more than two-third of the shares of the bank.[28] Article 1 of Legislative Decree No. 87 of September 16, 1983 states that if non-Lebanese want to participate in the formation of a new bank, the Central Bank will approve their application if their countries allow Lebanese citizens to participate in the formation of banks in their respective countries. Thus, the approval of the Central Council is based on the principle of reciprocity. Reciprocity principle is also applied to foreign banks that want to establish branches in Lebanon.

B. Commercial Laws

Many companies set up branches and agencies outside their home country. Lebanon, because of its strategic commercial location, used to tempt foreign companies to have branches in Lebanon.

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28. *Ibid.*, Article 3.

Foreign corporations and limited partnerships by shares are obliged, before setting up any branch in Lebanon, to present an application to the Ministry of Trade and National Economy mentioning the name of the company, its location and capital. This application should be accompanied by a copy of the company's articles of association.

In addition, foreign companies of all kinds that open a branch in Lebanon must register in the commercial register.

In principle, there are no restrictions imposed on foreigner to invest in Lebanese corporations or limited liability companies. The capital of limited liability companies could consist wholly owned by non-Lebanese. However, the managing director of such a company should be a Lebanese citizen or a foreigner having a Lebanese work permit.

The quasi-totality of the capital of a Lebanese corporation could consist of foreign investments. The only restriction derives from the fact that the majority of the members of the board of directors of a corporation should be Lebanese nationals. The law requires that a member of the board of directors of a corporation should own a minimum number of shares to be determined by the articles of association of the corporation. Since these articles may fix the minimum number of two shares only, the percentage of Lebanese participation in a Lebanese corporation could be reduced to a symbolic number of shares.

However, Lebanese laws have imposed certain restrictions on the ownership of shares in Lebanese companies dealing with banking (which was discussed already, public utilities, commercial representation (agencies) and ownership of real estate).

Public utilities

Article 80 of the Commercial Code requires that at least one-third of the capital of companies dealing in public utilities should be Lebanese.

Commercial representation (agencies)

With respect to commercial representation, Legislative Decree No. 34 of 1967, as amended, indicates that the attitude toward foreign business activities in Lebanon is restrictive. A commercial representative must be a Lebanese citizen and have a commercial office in Lebanon.[29]

Where the activities of commercial representation are performed by partnerships or limited liability companies, the majority of the partners and every signatory for the business must be Lebanese. The majority of the capital must be Lebanese owned.

In the case of a corporation, all shares must be registered. The majority of the capital must be owned by Lebanese nationals, who must also occupy the following positions: two thirds of the Board; the Chairman General Manager.

Ownership of real estate

Decree No. 5131[30] permits non-Lebanese companies and individuals to acquire real estate not exceeding ten thousand meters without authorization on condition that

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29. Ibid., Article 34

30. Commercial Code, Article 80.

1. If it is a limited liability company, the majority of its shares should be owned by Lebanese.
2. In the case of a corporation, one third of the shares should be registered shares owned by Lebanese.

Due to the importance of corporations and limited liability companies as vehicles for foreign investments the main features of these companies shall be discussed here-below. Finally, it should be noted that the Lebanese Government issued two legislative Decree in 1983 pertaining to the off-shore company and holding company for the purpose of attracting foreign investors to Lebanon by reducing taxes on these companies to a minimum. The two companies shall also be discussed here-below.

The Corporations in accordance with Legislative Decree No. 54 issued on June 16, 1977, it is no longer necessary to obtain a presidential decree in order to form a corporation. Notarization of the company's states by a notary public is, however, required. All amendments to the states must be also notarized. A minimum capital of LL 30,000,000 is required. A legal reserve must be established by the directors. Ten percent of the annual profits should be transferred to reserves until it is equal to one-third of the company's capital.

All shares must have a par value and be subscribed in full.

The Board of Directors must consist of at least three and not more than twelve members. The majority should be Lebanese nationals. The Board is elected from shareholders owning a minimum number of shares determined by the company's articles of association.

Limited Liability Company

A limited liability company is governed by Legislative Decree No. 35 of 1967. The company is required to register in the register of commerce. It must be formed by not less than three persons.

The minimum capital of LL 5 000 000 should be paid in full upon formation of the company.

Limited liability companies may not engage in insurance, savings, and banking operations.

Holding Companies

Legislative Decree No. 45 of 1983 permits the establishment of a holding company which must take the form of a corporation and is subject to the same rules as a corporation.

The activities permitted to holding companies are:

1. The acquisition of shares in Lebanese or foreign corporations and limited liability companies which have been already formed or are in the process of formation.[31]
2. Taking part in the management and administration of companies in which it owns shares.
3. Granting of credit to subsidiary companies which may issue bonds up to 5 times the value of its capital and reserve.[32].
4. The acquisition of trade marks, patents and similar rights.

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31. Legislative Decree Law No. 45 of 1983, Article 2.

32. Article 122.

5. The acquisition of fixed and movable assets provided that such assets are reserved for use by holding company.

On the other hand, A holding company must not acquire share-holding of more than 40% in more than two companies operating in the same industrial, commercial or non-commercial field in Lebanon.[33]

A holding company's head office must be in Lebanon. The company must also keep its accounts and records in the country. The annual general meeting must be held in Lebanon not latter than 5 months after the end of the financial year. Board meetings may be held outside if permitted by the articles of association. The nationality requirements for the board of directors is only 2 Lebanese individuals on the board. The chairman of the board does not need a work permit if he is foreign. At least, one resident Lebanese auditor must be appointed but it is not necessary to appoint a second auditor.[34]

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33. Article 4

34. *Ibid.* Article 5.

The company's capital may be dominated in a foreign currency. The only information which need to be published is its annual balance sheet and the names of its directors and auditor.

Offshore Company

An offshore company is governed by Legislative Decree No. 46 of 1983. It must be in the form of a corporation.

Offshore companies are prohibited from undertaking industrial, banking, insurance and commercial activities in Lebanon. An offshore company should meet the following requirements:-

1. It must register in the commercial register. Upon its registration, it must present a guarantee from a Lebanese bank;
2. Only two Lebanese individuals need to be appointed as director and chairman of the board;
3. At least one resident Lebanese auditor must be appointed;

and, 4. It may keep its accounts in Lebanese or foreign currency and must publish its annual balance sheet and the names of its directors and auditors in the special register.

II. Tax Laws

The basic Lebanese tax structure has remained unchanged since the enactment of the Income Tax law in 1959 which have been subject to minor amendments.

A. Income

All persons, whether individuals or legal entities are subject to an income tax on their earnings derived in Lebanon. The types of income subject to taxation are:-

1. income on commercial profits
2. salaries, wages, and pension payments, and
3. income from movable capital

1. Tax on commercial and non-commercial profits

Business income is an income or profit derived from trade. Progressive rates are applied to net business income realized by both Lebanese and foreign companies. Individuals and partnerships not limited by shares are subject to the following rate of business income tax:-

on the first	LL 100 000	6%
on the next	LL 100 000	9%
	LL 100 000	12%
	LL 200 000	15%
	LL 250 000	19%
	LL 500 000	23%
	LL 500 000	27%
	LL 750 000	31%
	LL 1 250 000	35%
	LL 1 250 000	40%
	LL 2 500 000	45%
amount over	LL 7 500 000	50%[35]

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35. Paragraph 1 of Article 32 of Income Tax Law, 1990.

Companies and partnerships limited by shares are subject to a flat rate of 26% on their business income.[36]

2. Taxes on Salaries, wages and pension payments

Minimum salaries are exempt from income tax. Individuals or partnerships not limited by shares are subject to progressive rates. See Table below:-

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36. Law No. 27/80, Article 133.

Taxable Income

On the first	LL	450 000	2%
on the second	LL	750 000	3%
	LL	1 050 000	4%
	LL	1 350 000	6%
	LL	1 650 000	8%
	LL	1 950 000	10%
	LL	2 250 000	13%
	LL	2 700 000	16%
	LL	3 150 000	19%
	LL	3 750 000	22%
	LL	4 500 000	25%
	LL	5 250 000	28%
Over	LL	28 800 000	32%

- The official minimum daily wage rate earned by daily workers is tax exempt.

3. Tax on business income from movable capital

Income from movable capital is taxable in Lebanon if it is derived in Lebanon. If earned in the course of business, income from interest and dividends is taxed on the basis of lump sum profits at the rate of 12% of gross receipts.

Income from movable income includes the following items:-

a. Interest on bank deposits

b. Interest paid to creditors and debentures holders

c. Fees of the members of board of directors in corporations

B. Property Tax

Built up property is assessed on a tax basis of the average net return of the property, after deducting expenses at a flat rate of 11 percent in addition to a progressive rate ranging between 3-23 per cent.

C. Social Security Contribution

Social Security contributions must be paid by both employees and employers. Foreigners are subject to all social security contribution except those for end-of-service benefits.

The contribution are as follows:-

Contribution	Employer's Contribution	Employee's
Sickness, maternity	11%	2%
Family allowances	7.5%	-
End of service	8.5%	-

D. Holding Company

The profits of holding companies are exempt from income tax and distributed dividends are exempt from the tax on movable capital.[37]

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37. Official Journal No. 26 dated 30-06-1983.

However the following taxes are imposed:-

1. interest arising from loans to companies operating in Lebanon which is subject to the tax on movable capital.
2. Capital gains resulting from sales of company's fixed assets, and holding in Lebanese companies which are subject to a 12% income tax in addition to surtaxes bringing the all-in-tax rate to 14.214%[38]
3. Sums received from companies operating in Lebanon for the use of patents and similar rights are taxed at 25%.

Holding companies are subject to an annual tax of 6% of their capital plus their reserve if they do not exceed LL 50 million, 4% for amounts range between LL 50 million and LL 80 million and 2% for amounts exceed LL 80 million provided the total annual tax should not exceed LL 5 000 000.[39]

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38. Ibid.

39. Law No. 89 dated 1991, Article 39.

E. Offshore Company

Profits of an offshore company are exempted from tax on business income. The dividends paid by the company are exempt from the tax on movable capital. They are instead subject to an annual tax of 1 000 000 LL.

~~Capital gains realized by the company on fixed~~ assets in Lebanon are subject to tax at the rate of 12% plus surtax bringing the-all-in-tax to 12.214%. Foreign employees are granted an exemption of 30% of their salary as representation allowance.

Tax Exemption

All individuals, institutions and companies are' subject to tax laws. Due to certain reasons, certain exemptions are allowed due to social, educational, economic or national aims.

The Lebanese tax legislator dealt with some of these said exemptions in Legislative Decree No. 144/59, Article 5..

These exemptions could be permanent or for a limited period.

I. Permanent Exemptions

These exemptions are related to certain groups as well as to specific institutions which are:

1. educational institute.
2. hospitals, orphanages, benevolent asylums and similar institutions such as mutual assistance centres (if profit-making, within the limits of their net profits resulting from contributions from public or private funds and subsidies, and, if non-profit making, fully exempt).
3. lunatic asylums and tuberculosis sanatoria.
4. consumers' co-operative companies, trade unions and agricultural cooperatives of a non-commercial nature.
5. agricultural investors, provided the product of their lands, the cattle they raise and the produce of the cattle are not put-up for sale in the appropriate market, or sold after transformation.

6. local sea and air transport companies and foreign sea and air transport companies in whose home countries Lebanese companies enjoy a reciprocal treatment.
7. Public institutions which don't compete with private establishments.

II. Limited Exemptions

A. Exemptions related to industry:

The exemption applies to industrial companies who invest in new equipment which increase productivity; construction of houses for their own employees provided that the houses remain the company's property for 12 years and the annual rent does not exceed 15 percent of the employees' annual salary including non-cash benefits.[40]

If all the conditions are met, the amount set aside to cover the investment from yearly net income up to a maximum of 50 percent of that income is exempt from income tax for four years. The percentage of income eligible for the exemption is

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40. Decree No. 27 of 1980.

raised to 75 percent if the investment is made in a region designated by the government for development.

Decree No. 27 of 1980 provides for a ten year tax holiday for industrial companies established in 1980 or later provided that the total exempted income during the period of exemption does not exceed the value of the total investments before depreciation at the start of production.

B. Exemptions relating to specialized banks

The aim of these exemptions is to encourage the establishment of specialized banks.[41]

- Banks with long and short term credits are exempt from income tax for seven years

starting form the date of its establishment.[42]

- Interests of certificate deposits are also exempt.[43]

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41. Legislative Decree of 1977.

42. Legislation Decree No. 144 dated 12-06-1959.

– Starting from the eighth financial year, specialized banks will be subject to profit tax.

III. Exemption from the tax on movable capital

The following items are exempt from the tax on movable capital:-

1. amounts paid in reimbursement of creditors or shareholders provided they are not taken from the profit or loss account or from reserves.
2. amounts reimbursed to shareholders and creditors in concessionary companies even though they are taken from reserve funds or profit and loss accounts when this is warranted by the obligation to surrender installations to the State, free of charge, at the expiry of a concession;
3. interest on saving accounts.

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43. Ibid.

4. interest and revenue of current accounts opened at banks in the name of the Government, municipalities and public institutions and also foreign diplomatic and consular corps in Lebanon subject to reciprocal treatment;

and 5. income from bonds issued by the treasury of the Lebanese government.

IV. <u>Exemption from income tax as an attempt of encouraging certain companies to operate in Lebanon</u>

A. Exemption relating to holding companies and offshore

The profits relating to holding companies and offshore companies are exempt from the business income tax and the distributed dividends are exempt from the tax on movable capital.

V. Other Exemption

In addition to the exemptions discussed above, the following are also tax exempt:-

1. Local sea and air transport companies and those foreign sea and air transport companies whose country of origin gives Lebanese companies reciprocal treatment are exempt from business income tax.
2. Bank free zone interest paid to non-residents on their deposits and savings accounts in foreign currencies is tax free[44], provided that:-
   - the depositor gives the bank an authority in which he agrees that his account may be inspected by the chairman and members of the banking control committee when necessary;
   - the bank keeps the accounts benefiting from tax free interest in special and separate accounting records.
   - the accounts are maintained in the books of local bank's head office or the foreign bank's main branch in Lebanon.

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44. Decree No. 9976 of April 1977

3. Allowances paid to religious ministers for performance of religious rights are also exempt from income taxes.
4. Subject to reciprocity, salaries and allowances of ambassadors of foreign states and their foreign staff are exempt from income taxes.
5. Any local or foreign goods that come in or come out of "free zone" are exempt from all taxes and customs[45].
6. Salaries and wages of military men and wages of agricultural labor are exempt from income taxes.
7. Lebanese corporations and limited liability companies are not taxable on dividends from shares in other Lebanese joint-stock and limited liability companies.

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45. Decree No. 15747 dated 13-03-1964.

8. Decree No. 127 of 1983 introduced a six year exemption from business profit tax for every factory established in a village and from existing industry which moves from the industrial and coastal areas.

Chapter IV

Evaluation of Rules, Laws, and Tax Regulation Governing Foreign Investment in Lebanon

The previous chapter presented the rules, laws and tax regulations governing foreign investment in the commercial and banking sector in Lebanon. From the discussion so far, one can conclude that the decline in the volume of activities of foreign banks and companies was not due to these rules, but was mainly due to the political instability in Lebanon which made the operation of foreign companies and banks very difficult.

The aim of this chapter is to evaluate the present laws in the context of prevailing security and political stability after the termination of the Civil War in 1990. Accordingly the chapter is divided into two broad sections which isolate the positive and negative effects of firstly, the legal structure, and secondly, the tax structure.

A. The Legal Framework

As we have seen, there are many legal incentives that encourage foreigners to invest in Lebanon. These incentives are outlined in the table below.

a. Banking Sector

1. No regulations on the transfer of funds	**Positive Elements** There is no restriction on the in-flows and outflow of funds which plays a positive role in attracting foreign funds to Lebanon.
2. No restriction on foreign exchange and currency transfer	According to Decree No. 13532 dated 05-11-1948 and 8300 dated 17-05-1952 There are no foreign exchange and transfer regulations imposed on foreigners and lebanese alike.

3. Relatively low Tax rate	Lebanon in comparison with other countries is characterized by law tax rates which support the in-flow of funds for investment to Lebanon. Deposits of non-residents foreign currency are exempt from tax; and capital investment in industrial projects are exempt from tax for a period of five years.
4. The Banking Secrecy Law	Banks are prohibited from disclosing information about their clients. This law strengthens the confidence in the Lebanese banking sector.
5. Free Zone	All imported goods located in the free zone are tax exempt.

6. Airline and shipping companies are tax exempt	Local sea and air transport companies and those foreign sea and air transport companies whose country of origin give Lebanese companies reciprocal treatment are exempt from income tax.

7. Bank Shares	Decree No. 32 issued on February, 11, 1991 states that one-third of the total shares of any bank must be held by Lebanese individuals. This encourages foreigners to invest in the lebanese banking sector.
8. National Institute for guarantee of Investment	The objective of this institution is to guarantee new investments against war risks.

Negative Elements

1. Profits of branches of foreign banks are subject to tax	Foreign banks have to pay profit distribution taxes on profit whether it distributed dividends or not.
2. Reciprocity treatment could be negative or positive	Reciprocity treatment could be negative and positive in the sense that it either encourages or discourages foreigners to invest in Lebanon.

On the positive side, the legal framework provides the bank secrecy law, the bank free zone within banks, the foreign ownership of a majority of bank shares, and the free transfer of capital and the independently floating exchange regime to which Lebanon has historically been adhering.

Starting with the banking secrecy law, all Lebanese banks and branches of foreign banks are subject to the dictates of the law issued on September 3, 1956 which prohibits banks from disclosing information related to the accounts of their customers. Upon the request of customers, banks may also open numbered deposit accounts. All bank employees and their auditors have to sign a statement affirming their compliance with this law. Moreover, all the central bank's banking control commission's staff, who are entrusted with the examination of bank accounts, also have to declare under oath, before a court judge their with holding of any information they may come across in the course of their duty which may lead to the disclosure of the identity of creditor accounts. In fact, the law does not allow BCC examiners access to the identity of creditor accounts. The dictates of this law are, however, lifted if the owner of such bank accounts is involved or implicated in bankruptcy court procedurings.

The strict application of the banking secrecy law led to an increase in foreign confidence in the Lebanese banking sector. A good example of the effectiveness of this law occurred during the Israeli invasion of Lebanon in June 1982; the Mossad inquired about the accounts of some Palestinian depositors from the branch managers of several banks operating in Saida. The bankers called the branch manager of Bank of Lebanon in Saida who called BDL's head office.[46] International contacts were set into motion and the problem was solved without allowing a break of the secrecy

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46. Some advocates of this law, such as Mr. Adnan Kassar, Chairman of Fransabank emphasize that "Lebanese banks are more secretive than banks in Switzerland Euromoney, May 1983, p. 107

law.[47]

Creating a bank free zone within banks can also play a positive role in increasing the volume of activities of foreign banks operating in Lebanon. Decree No. 9976 of April 1977 which provided for creating such a zone exempted bank liabilities to non-residents in foreign currency from reserve requirements, deposit insurance fees and taxation. Such exemptions have effectively created out of the Lebanese money market a Euro-currency center much the same as any internationally unregulated center such as that of London and Bahrain. But unlike these countries, this market has the added advantage of attracting deposits which may well but not necessarily be invested in the Lebanese domestic market.

Decree No. 32 dated Feb. 11, 1991 which amended Decree No. 87/83 such that one-third of the total shares of any bank must be held by Lebanese individuals is in all likelihood going to play an important role in attracting foreign funds to the

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47. Tom Mc. Girk "How the Banks Kept their Door Open" Euromoney, May, 1983 pp 107-113.

banking Sector. According to this decree, foreigners can own a majority of up to two-thirds of a bank's shares. Such an acquisition is, however, subject to the approval of BDL's Central Council which takes into account the principle of reciprocity. This principle, should the Central Council decide to invoke, may be used to shut off future acquisitions by foreigners of shares in Lebanese banks. The reason for this is the fact that most nations emphasize national ownership of their domestic banking systems. This principle may well constitute in future one of the major stumbling blocks to the participation of European Community member countries in the Lebanese banking sector.

In addition to what has been mentioned, Lebanon is one of the 28 countries which operates a system of independently floating exchange rates. This system plays a positive role in encouraging in-flows of funds for investment in Lebanon. Foreigners may transfer capital from abroad into Lebanon and vice-versa without any restriction. This freedom of capital transfers dates to November 5, 1948 when Decree No. 13532 was issued. This Decree confirm that there are no foreign exchange and currency transfer regulations imposed on foreigners. This long history of upholding the freedom of currency transfers, extending over a period of more than 40 years, is responsible for the generation of surpluses in Lebanon's balance of payments' accounts even during the years of the Civil War.

b. Commercial Sector

Lebanon, by virtue of its strategic commercial location, used to tempt foreign companies to open branches or to establish a partnership or a company in Lebanon.

According to Lebanese legislation, foreign firms possess an independent legal entity in Lebanon by which they can practice commerce, raise court cases, deal with cases and make profit. Moreover, foreigners may participate in industrial activities.

All types of foreign companies wishing to operate in Lebanon need to register in the commercial register if they are commercial companies, individuals involved in industrial activities must register in the Chamber of Commerce and Industry of Beirut.

Foreign investors may participate in all commercial activities in Lebanon other than banking as discussed above.

However, there are two main restrictions to these activities, the first relates to the commercial representation of foreign firms and the second to ownership of real estate.
These restrictions were outlined previously.

B. Taxes

Tax policy is also an important factor that helps in attracting foreign funds to Lebanon. Tax rates applied in Lebanon are generally modest and in some respects even attractive in comparison with internationally applied rates. A branch manager of a Lebanese bank having a majority of foreign ownership said that during the Lebanese 1974-1984 war, the bank was obliged to open a branch in Paris to follow its clients who emigrated and had set up business concerns in Paris in addition to Beirut. The taxes in France were comparatively high, but the bank was obliged to open that branch in order not to lose its clients.[48]

In addition to the favourable banking and commercial laws, taxes play a very significant role in supporting the in-flow of funds for investment to Lebanon through tax exemptions provided by the Lebanese legislator.

One of these tax exemptions was provided by Decree No. 3018 of 1972 which is connected with Industrial Promotion. According to this Decree, a six year tax holiday under certain conditions.

Decree No. 27 which amended Decree No. 3018 provides for a ten year tax holiday for industrial companies established in 1980 or later under certain conditions. Moreover, Decree No. 127 of 1983 introduced a six year exemption from the business profit tax for every first factory established in a village and for existing industries which more from the industrial to a

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48. Anis Khatib. The Theory of Banking Regulation in Lebanon. MBA, unpublished project AUB, 1984.

rural area on condition the rural area should be 300 meters or more above sea level and one kilometre or more from the sea front.

In addition, certain social and economic entities are exempt from business income taxes. These include educational institutes, hospitals, orphanages, local sea and air companies in whose home countries, Lebanese companies enjoy a reciprocal treatment.

The profit of holding and offshore companies are also exempt from the business income tax and the distributed dividends of both types of companies are exempt from taxes on movable capital as well.

Furthermore, the taxation system in Lebanon encourages foreign investments especially for the fact that Lebanon levies taxes on profits realized in Lebanon only and waives taxes on profits realized in the course of conducting business outside Lebanon. This system is accordingly tailored to harmonize domestic taxes with foreign country taxation laws in order to avoid double taxation in Lebanon. In fact, Lebanon has succeeded to reach agreement with France to avoid double taxation between the two countries.

On the other hand, there is one factor that might have a negative effect on foreign investments especially in the banking sector. The reason for this is that branches of foreign banks are taxable on their dividends whether they distributed dividends or not.

Chapter V

Conclusion

This research investigated the effect of the Lebanese laws, rules and regulations governing foreign investment. The importance of this study derives from the fact that some of these rules, laws and tax regulations play a positive role in encouraging foreign investments in Lebanon. The Banking Secrecy Law, the free foreign exchange system, and the relatively low tax rates, are considered important factors that attract foreign funds to the Lebanese financial and commercial sector.

Despite the positive role of these regulations foreign investments have been declining since 1983 due to political instability.

To maintain and enhance Lebanon's financial role, especially in the period following the civil war, the Lebanese government and the Bank of Lebanon should maintain security and political stability through:

- maintaining social and economic stability
- stabilizing foreign exchange currency fluctuation
- rehabilitating the country's economic priorities.
- building up of specialized financial institutions for extending credit facilities directed to the productive sectors.
- and finally supporting the role of the Arab International Fund for the reconstruction of Lébanon as well as finding other local and international sources of funds to finance economic development projects.

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