A RECONSIDERATION OF THE LEBANESE INCOME TAX

By

Ramzi E. Maluf

A Thesis submitted in partial fulfillment for the
requirements of the degree Master of Arts
in the Economics Department of
the American University
of Beirut
Beirut, Lebanon
October, 1963

A C K N O W L E D G E M E N T

This thesis was written under the supervision of Professor Paul Klat to whom I am indebted for invaluable assistance and advice. He is not however, to be considered responsible for any shortcomings or opinions expressed in this dissertation.

R.E.M.

A B S T R A C T

While the Lebanese Tax System has come a considerable way from its recent essentially medieval structure inherited from the Ottoman Empire and perpetuated by the French Mandate it is still short of meetings the financial requirements of the Lebanese Government as well as of ensuring an equitable distribution of the tax burden.

These shortcomings of the tax system have more than ever before been highlighted by the recently gained awareness of the Lebanese Government of its crucial role in the social and economic development of the country.

Given the present shortage of revenue as reflected in the successive budgetary deficits, as well as the recognized inequities in the present tax system, a number of suggestions and schemes for reform, most of which are centered around the abolishment of the income tax and its replacement with other taxes, were made by various individuals.

While these suggestions were refuted by many, who, though recognizing the shortcomings and abuses of the present income tax, advocate its reform and its maintenance as an essential part of the tax system, no attempt was made to present a comprehensive scheme for the reform of the Income Tax.

Our main contention in this dissertation is that a salutary solution to the present fiscal predicament can only be found in a reform of the system of income taxation, and with that as an objective an attempt is made to explore the possibilities of reform through a critical evaluation of the main features of the Income Tax.

It is of crucial and fundamental importance that in any attempt to remedy the present situation all the relevant factors should be comprehended in their full significance and in their true relation to one another, for only in this way can the problem be fully understood in its various bearings, and a solution be arrived at that is satisfactory to the requirements of justice and economic growth.

TABLE OF CONTENTS

TABLE OF CONTENTS

L I S T O F T A B L E S

" Those who would be in the vanguard of civilization must go to the bottom of the matter, and in so doing they will gain theoretical and practical knowledge."

Lorenz Von Stein

"On Taxation"

A RECONSIDERATION OF THE LEBANESE INCOME TAX

CHAPTER I

THE DEVELOPMENT OF THE LEBANESE FISCAL SYSTEM

A. INTRODUCTION

The main features in the evolution of the Lebanese fiscal system over the last century have been largely determined by the three different political stages and their concomittant social and economic conjunctures through which the country passed in this period.

The first stage started in 1861 with the institution of the Autonomous Province of Mount Lebanon within the Ottoman Empire and ended with the outbreak of the First World War. The second stage started in 1920 with the institution of the French Mandate and the unification of Lebanon, and ended in 1943 with the accession of the country to independence. The third stage covers the period of independence.

Each of these phases left its distinctive mark on the fiscal system of its respective times. The first period was characterized by a stagnant quasi feudalistic primary economy which ironically enough was not only reflected in a medieval fiscal system, but was largely anticipated by it. For, on the institution of the Province of Mount Lebanon a tribute was imposed

on it which was to be levied by the means of a seemingly immutable tax structure based on a population census and revenue valuations carried in 1861 which, for the lack of adequate provisions for subsequent revision, were apparently expected never to alter.

The second period was one of unification and gradual awakening from a protracted slumber which was slowed in the economic sphere by currency troubles and the depression of the thirties, but was again brought to an abrupt activation by the outbreak of the Second World War. The fiscal system in this period was progressively unified and adapted through a slow process which was stepped up in the early years of the War.

The third stage started with the accession of the country to independence in a boom period which contributed substantially to the modernization of the structure of the economy. At the outset of this period the national government, in the flush of early independence and pressed by the accompanying conglomeration of events created by the new economic and political developments, undertook a reform of the system of direct taxes which culminated in the introduction of an income tax, the reform of the built property tax and a draft law for a new land tax which was subsequently enacted together with an inheritance tax.

In this Chapter an account will be given of the fiscal system and its evolution under each of the above mentioned stages.

B. The Ottoman Period

Under the Ottoman Empire and after the year 1861, present day Lebanon was divided into two parts ; one part formed the Autonomous Province of Mount Lebanon, the other part comprised the Wilaya of Beirut and a section of the Wilaya of Damascus.

1. The Tax System in Mount Lebanon

The Province of Mount Lebanon enjoyed a privileged autonomous political and fiscal system provided for by the Protocols of 1861 and 1864 signed between the Great Powers[1] and the Ottoman Empire. In accordance with this system Mount Lebanon had to pay to the Sultan a fixed due in the form of a tribute imposed as a lump sum on the whole province. This tribute which was known alternatively under the names "mal-miri", "mal-mahdoud", or "mal-makt'u", amounted to 35,000 gold Turkish pounds and was supposed to meet the expenses of administering the Province and maintaining public services.[2] The collection of the "mal-miri" was carried by means of two direct taxes ; a capitation tax (mal-a'nake) and a real property tax (mal-amlake).

It was preconcerted that the capitation tax was to yield one third of the "mal-miri", and accordingly after a population census was carried in 1864 the sum of the tax was allotted or

---

1. Austria, France, United Kingdom, Prussia, Russia.

2. Elias A. Gannagé, La Réforme des Impôts Directs au Liban et en Syrie, (Catholic Press, Beirut, 1947), p.283.

assigned among Lebanese villages on the basis of their male population between the age of 15 and 60 years. Being levied on a collective village basis in accordance with a census which was never revised, this tax created over the years much injustice due to the simple fact that some villages diminished in population (many substantially so due to emigration) while others increased.

The real property tax, which was to yield two thirds of the "mal-miri", was allotted among property owners in accordance with a once for all estimate of the annual gross income they derive from each piece of property they owned. Thus in effect, this tax or levy was apportioned among existing pieces of property neglecting completely the particular circumstances of the owner and creating gross injustice due to the fact that a new piece of property e.g. a building, automatically escaped the tax and any decrease or increase in the revenue derived from a piece of property was not taken into consideration.

To meet rising expenses the administration of Mount Lebanon found it necessary later to impose additional taxes which were not provided for under the 1864 arrangement. Some of these taxes were :

Road Tax or Poll : this was introduced in 1889 to meet expenses of building and maintaining roads ; it was imposed on every male between the age of 15 and 60 years at the rate of 5 Turkish piasters per annum and was collected on a collective village basis.

Animals and Nomads Tax (Aghnam) : this was imposed at the annual rates of 2.50 Turkish piasters per sheep, 2 piasters per goat, and 15 piasters per nomad.[1]

Built Property Tax : this tax was introduced in 1908 and was imposed only on new built property i.e. property not taxed by virtue of the real property tax. The rate of the tax was 2% of gross annual estimated rental value.[2]

2. The Tax System in the Wilaya of Beirut

The territories of the Ottoman Empire with the exception of Mount Lebanon were divided into administrative units called Wilayat. These Wilayat were subject to the Ottoman tax system which was uniformly applied in all of them with only slight differences in detail.

Being interested in the territories which form present day Lebanon an account will be given of the tax system prevalent between the years 1910 and 1918 in the Wilaya of Beirut.

Direct taxes which were imposed on land produce, property and other external manifestations of wealth were the main sources of revenue. The most important of these were :

The Tithe or Osher :[3] this was a tax on the gross produce

---

1. Ibid., p.286.

2. Amin Mouchawar, Notice sur les Impôts et les Taxes au Liban, (Imprimerie de Saint Paul, Harissa, 1934), p.8.

3. See George Hakim, "Fiscal System of Syria", in Economic Organization of Syria, Ed.Said B. Himadeh (American Pressi, Beirut, 1936), pp.345-346 ; also Raja S.Himadeh, The Fiscal System of Lebanon, (Khayat, Beirut, 1961), p.2 ; Gannage, op. cit., pp.272-275.

of miri[1] land and as its name indicates it had originally consisted of 10% of the harvest, however, after a series of surcharges for the benefit of the agricultural bank, public education, and military equipment, the rate was brought to 12.5% by 1889.

Payment of the tax was to be made either in kind or in money equivalent ; thus, in order to assess the tithe it was necessary to determine the quantity of the crop and to fix the price.

The Tithe was levied on a collective village basis, that is, the unit of taxation was the village and not the individual farmer. Collection was usually carried out through a system of tax-farming, according to which the right to collect the tax in each village was auctioned off to the highest bidder, who was thus given the right to collect the tax from the peasants.

Built Property Tax :[2] up to 1910 the built property tax was regulated by the Law of July 24, 1886. According to this Law, the tax was based on the capital value of buildings and the rates ranged from 5 to 10 per thousand, depending on the material of construction and whether the building is rented or not, plus a surtax of 11% of the tax. The tax was assessed in accordance with an estimate of the capital value of buildings carried in 1872, which in principle had to be revised every five years but actually was never revised.

---

1. Miri land is land in which the right of use is in the hands of individuals, but the title invested in the state.

2. See Gannagé, op. cit., pp.264-266.

In 1910 a new built property tax law was promulgated. This provided for a tax on the gross estimated rental value of buildings without any deduction for maintenance and the rates were :

12% of rental value on constructions made of stone ;

9% of rental value on constructions made of wood[1] or used as mills or factories.

Added to this was a surtax of 60% of the tax on built property in the city of Beirut and 41% of the tax on built property in other parts of the Wilaya.

Due to the fact that the application of the new tax had to be postponed until an estimate of the rental value of buildings was carried it was only by 1912 that it was put into effect in the city of Beirut and later on in other parts of the Wilaya.

The Land Werko :[2] this was a property tax assessed on the capital value of land. The capital value of all land subject to this tax was determined by a general valuation made in 1887 which in principle had to be revised every five years but in fact was not. Thus up to 1920 lands were still taxed on the basis of a valuation carried in 1887.[3]

The rate of the Werko varied according to whether or not the land paid the tithe. Land that was subject to the tithe paid a tax of 4 per thousand of its value, and land that was not subject to the tithe paid a tax of 10 per thousand of its capital value.

---

1. Mouchawar, op. cit., p.3.
2. See Hakim, op. cit., pp.354-355 ; also Gannagé, op. cit., pp.268-271.
3. Hakim, op. cit., p.355.

A surcharge which was increased from 6% of the tax in 1887 to 65% of the tax in 1914 was added to the tax.[1]

Animals Tax or Aghnam : this tax was originally conceived as a tithe payable in kind and imposed on the "living produce of land". However, during the last quarter of the nineteenth century it was developed into a tax payable in money at rates varying with the type of animal. These rates were between 1888 and 1918 as follows :

4 Turkish piasters per sheep or goat ;

10 Turkish piasters per horse, camel or head of cattle and

5 Turkish piasters per hog.

To these rates was added a surcharge of 36% of the tax.[2]

Roads Tax or Poll : this tax was introduced and earmarked for the purpose of building and maintaining roads. According to the Law of February 6, 1890 every male between the age of 18 and 60 years had to pay 16 Turkish piasters per annum or work on the roads for four days.[3] In 1906 the rate was raised to 20 Turkish piasters per annum.

The Tamattu' Tax : this tax was introduced by the Law of November 30, 1914 and remained in application in Lebanon with only minor alterations upto 1944 when it was replaced by an income tax.[4] The Tamattu' was the nearest thing to an income tax as yet

---

1. Mouchawar, op. cit., pp.22-23.
2. Gannagé, op. cit., pp.276-277.
3. Ibid., pp.279-280.
4. Ibid., p.408.

introduced to the fiscal system of the Ottoman provinces. It was intended as a tax on commercial and industrial enterprises, the professions and on salaries, and to that extent it was a tax on the source of income rather than on income or the person receiving the income. Each source of income was taxed separately and a person deriving income from two or more occupations had to bear the tax on each one separately.

With a few exceptions the Tamattu' did not attempt to reach income directly but rather indirectly through rough but convenient indices ;[1] only in the case of salaries and wages, and income of public utility companies was actual income taxed.

The Tamattu' comprised four forms of impositions :

The First involved public utility companies, insurance companies, contractors and concessionaires, and employees. These were taxed on the basis of their income according to the following schedule :[2]

---

1. R. Himadeh, op. cit., p.5 ; and Hakim, op. cit., p.363.
2. Mouchawar, op. cit., pp.43-45 ; and Hakim, op. cit., p.364.

T A B L E I

Tamattu' on the Basis of Actual Income

Taxpayer	Basis	Rate
1. Public utility companies (railways, tramways, electricity, telephone, sea transport, water companies, etc.)	Net profits to be distributed as dividends and interest among stock and bond-holders.	5%
2. Insurance companies other than life.	Annual total premiums cashed.	2%
3. Life insurance companies.	Amount of insurance carried.	2‰
4. Contractors and concessionaires for governmental organizations.	Amount of contract or concession.	3%
5. Employees (public and private) including those receiving pensions.	Total salary and allowances after deduction of T.p.2,000.	3%

The Second involved commercial and industrial enterprises and the professions. These were taxed on the basis of the rent of the premises in which the business or profession was exercised. The rate of tax was proportional and varied with the type of business or profession as shown in the following table :[1]

---

1. Mouchawar, op. cit., pp.39-41 ; and Hakim, op. cit.; p.364.

T A B L E II

Proportional Tamattu' Tax on the Rent of Business Premises

Taxpayer	Basis	Rate
Class 1. Banks and credit institutions.	Rent of Business Premises.	20%
Class 2. Transportation companies, commission houses, contractors, engineers, lawyers, dentists, physicians, etc.		15%
Class 3. Wholesale merchants, jewelry and antique shops.		12%
Class 4. Retail shops of hardware, clothing, furniture, etc.		10%
Class 5. Retail shops of food, charcoal, etc.		8%
Class 6. Workshops, factories, mills, printing presses, and warehouses.		5%

The Third again involved commercial and industrial enterprises and the professions, but consisted of a variable tax based on the number of persons employed by the enterprise concerned and the means,[1] and instruments used in carrying on the trade or industry. The tax also varied with the importance and size of the town in which the trade, industry or profession were carried.[2]

---

1. By 'means' it was meant to include all sorts of vehicles.

2. Mouchawar, op. cit., p.42 ; Hakim, op. cit., p.365 ; and Gannagé, op. cit., p.413.

The Fourth involved a group of professions to which the above indices could not apply and therefore were not taxed under the preceeding categories. These included engineers, doctors, lawyers, dentists, masons, etc. The tax was fixed as a lump sum varied with the profession and size of the town in which it was carried.

During the First World War surtaxes totalling 70% of the normal tax were super imposed on the Tamattu'. These were intended as a form of war contribution, as well as to meet budgetary deficits.

Thus, up to the outbreak of the First World War, the system of indirect taxes applied in the territory of present day Lebanon was essentially medieval and not only rooted in religious tradition but also in an economic structure that had scarecely altered over a period of centuries.[1]

In many instances these taxes took the form more of a levy than a tax and were perhaps most oppressive when collected through a system of tax farming.

The three main characteristics of the system of direct taxation were : the 'real'[2] nature of the taxes ; the exclusive reliance on property and external manifestations of wealth as a basis of taxation ; and the proportionality of the taxes.

---

1. Kurt Grunwald, Government Finances of the Mandated Territories of the Near East, (Palestine Economic Society, Tel-Aviv, 1932), p.15.

2. A real tax as opposed to a personal tax is a tax on things rather than on persons, on the product of the property rather than on the person of the property owner.

As far as the property taxes were concerned the system was one of taxes on things rather than on persons, on the product of the property rather than on the person of the property owner. In other words these taxes looked at the source of revenue rather than at the recipient of the earnings, and abstracted from the personal situation of the taxpayer. Moreover, being imposed on estimated value or gross product of a property, no allowance was made for expenses of cultivation or of maintenance.

The reality of the taxes entailed as a corollary the availment of external manifestations of wealth as a measure of taxable capacity under the Tamattu' Tax. The criterion here again was impersonal and related to the source of income rather than to the person subject to tax.

Finally, the rates of all the taxes were proportionate thus completing the requisites for a fully consistent impersonal and real system.

C. The French Mandate

The period of the French Mandate over Lebanon started in 1920 and ended in effect in 1943.

The main political developments of the earlier part of this period were the proclamation of the State of Greater Lebanon in 1920 and the subsequent declaration of the Lebanese Republic in 1926. These steps lead to the final unification of the territory of present day Lebanon and to the suppression of the political autonomy of Mount Lebanon.

The first step taken by the French authorities in the fiscal field was the preparation for fiscal 1921 of a single general budget, "Budget Général des Gouvernements de la Syrie et du Liban",[1] which was a combined statement of revenues and expenditures for the Lebanese and Syrian states. However, realizing that this practice might compromise the autonomy of Lebanon this system was abandoned in 1922 in favour of separate state budgets supplemented by two budgets for "common interests". One of these budgets was for revenues, the Budget des Recettes àRépartir (Budget for Distributable Revenues), and the other for expenditures, Budget des Fonds de Concours (Budget for Contributory Funds), which included the contributions of the separate states for some common expenditures.[2]

In 1928 the latter two budgets were unified to form a single budget known as the Budget for Services in the Common Interest of the States.[3] The common services included customs ; tobacco monopoly ; quarantine ; concessions; railways ; general security; gun powder monopoly and other minor services. The revenues for this budget were secured from duties and fees imposed by the services concerned. The expenditures were effected for the maintenance of native troops, the service of the Ottoman Public Debt, the Administration of Customs, and a share of the civil expenditures of the Mandate.

---

1. High Commissioner's Ordinance No.662, January 28, 1921 in Recueil des Actes Administratifs du Haut Commissariat de la République Française en Syrie et au Liban, 1921.

2. High Commissioner's Ordinance No.1179/8 of December 31, 1921, loc. cit..

3. Ordinance No.1945 of May 12, 1928.

According to Law No.751 of March 2, 1921 passed by the High Commissioner, the separate budget for the Lebanon was to derive its revenues from the system of direct and indirect taxes and duties which was prevalent in what was previously the Wilaya of Beirut and which was hence forth to be applied uniformly over the whole country.[1]

Thus in 1921 the fiscal autonomy and tax system of Mount Lebanon were theoretically suppressed in favour of a unified country wide system. However, in practice, the tax system was not finally and completely unified except in 1933.

The slow process of unification proceeded hand in hand with a reform of the adopted Ottoman tax system which however did not venture beyond the modification of rates ; the clarification of the tax base ; and a more elaborate codification of the tax laws. This unification was mainly introduced in four stages :

The first took place in 1921 with the unification of the Aghnam or animals tax and the Road Tax.

The second in 1922 with the unification of the Built Property Tax.

The third in 1923 with the unification of the Tamattu'. This was accompanied by the abolition of the old Capitation Tax applicable to Mount Lebanon.

The fourth in 1933 with the introduction of a "unified land tax". This tax replaced the "mal-miri" property tax of Mount Lebanon as well as the Werko or land tax and the Tithe of the Wilayat.

---

1. Gannagé, op. cit., p.322.

During the same period the system of indirect taxes and duties was also progressively unified : the salt monopoly in 1926 ; the tobacco monopoly in 1930 ; and a new tax on benzine and inflamables introduced in 1928.

Starting with 1934 Lebanon experienced for the first time a unified and comprehensive tax system. During this period direct taxes were the main source of revenue for the ordinary state budget, while the budget of Common Interests derived its revenue from indirect taxes and duties the most important of which were custom duties.

The main direct taxes during the period 1934-1943 were the following :

Built Property Tax : this was instituted by the Law of December 15, 1930 and remained in application up to 1943. The tax was assessed on the gross rental value of buildings as determined by a commission of estimators. The rate was a proportional 8½%, plus a maximum of 3% for the benefit of municipalities. Constructions made of wood or earth were allowed an abatement of 25% of rental value. The basic rate was increased to 10% in 1940. Here again no allowance was provided for maintenance and the tax was imposed with utter disregard to the particular situation of the owner of the property.

The Unified Land Tax : established by the Law of August 12, 1933, this tax replaced the old Land Werko, the "mal-miri" land tax of Mount Lebanon, and the tithe. The three of which were accordingly abolished.

This tax was an allotment or assigned tax, the amount to be collected from it was fixed in advance at L.L.S.404 thousand (this was subsequently reduced until it became L.L.S.151 thousand in 1937)[1] and was apportioned among villages. Thus, the unit of taxation was the village and not the farmer or land owner.

In 1940, Legislative Decree No.37, of March 26, instituted a new land tax which was similar in most respects to the previous one. The amount to be collected was fixed at L.L.S.410 thousand and was again allotted among villages. However, the distribution of the tax among land-owners within each village was to be carried in accordance with a schedule which classified lands into categories according to use and estimated productivity and layed down a separate rate for each class of land. The latter provisions were definitely a step forward in the development of land taxation. However, even such a slight improvement proved difficult for practical application and soon the new tax was abandoned and the "unified land tax" reinstituted.

Aghnam Tax : of all taxes inherited from the Ottoman period this tax underwent the least transformation during the Mandate.[2] The rates of the tax varied slightly over the years and in 1943 were as follows :

PL.S. 135 per sheep or goat, PL.S. 200 per camel,

PL.S. 300 per head of cattle, and PL.S.400 per hog.

---

1. Ibid., p.388.

2. Ibid., p.392.

Roads Tax : this tax was again essentially unaltered during the Mandate except for the rate which in the thirties was PL.S.125 per male inhabitant between the age of 18 and 60. This tax was repealed in 1939.

The Tamattu' Tax : the Tamattu' was integrally adopted by the French Mandate and was by 1923 uniformly applied over the whole Lebanese territory. On the whole this tax underwent only minor amendments during this period which were confined to modifications of rates, a revision of estimated rental value of premises on which the proportional tax was based, and alteration of the basis of assessment with respect to currency which was changed first from Turkish piasters to Egyptian piasters and then to Lebanese and Syrian piasters.[1]

Thus, the period of the French Mandate while it dawned with the unification of Lebanon and its gradual subordination to a uniform tax system, was not characterized by any far reaching fiscal reform. The French administration adopted the Ottoman tax system in force in the Wilayat, and adapted it to the new social conditions by introducing minor amendments and modifications which seldom however made radical departures from the adopted system. The most prominent reforms introduced in this period were : a more elaborate codification of the tax laws ; a more clear and practical definition of the tax base ; and a more effective method of tax assessment.

---

1. See Mouchawar, op. cit., pp.47-58.

All direct taxes remained, as under the Ottoman regime, essentially real in nature imposed on property and external manifestations of wealth without any regard to the particular individual conditions of the taxed. It was still a system of taxes on things rather than on persons, on the product of property rather than on the person of the property owner, it abstracted from the personal situation of taxpayers, and made no allowance for expenses of cultivation, maintenance, or indebtedness.

D. The Second World War and Early Years of Independence

With the advent of the Second World War and the accession of Lebanon to independence, the need for tax reform became more pressing than ever before.

The interruption of world trade due to the outbreak of hostilities, encouraged the growth of a diversity of light national industries to replace commodities which could no longer be imported from abroad. This industrial development was, among other things, sustained by a swollen purchasing power created by the expenditure of allied troops stationed in the area.

A parallel development was the expansion of both the trade and services sectors catering to the needs of the allied troops and the expanding wealthier class.

The effects of the War were, however, not confined to a basic modification of the structure of the economy as a result of the unprecedented growth of the industrial, trade, and services sectors ; they also inevitably caused a relatively great expansion in

monetary circulation and a concomitant inflation in prices which was intensified by the absence of effective government control and widespread speculation and profeteering.

These developments were not without grave social consequences. A deterioration ensued in the purchasing power of the masses and of the fixed income groups who were in no position to share in the new prosperity ; on the other hand, traders and industrialists reaped unprecedented profits.

As a concomitant to these developments in the private sector were the obligations created in the public sector by the accession of the country to independence in 1943 and the transfer of a number of public functions to the Lebanese Government among which were internal security and the army. These functions necessarily entailed a larger outlay on the part of the Government and therefore accentuated the need for greater revenue. Another additional claim on the already strained resources of the Government was the purchase of public utilities from the French. Moreover, because of the inflation, the Government had to raise the wages and salaries of its employees which thus claimed a larger portion of government expenditure.

Cramped by an essentially inelastic revenue system, especially with respect to direct taxes, the Government soon found itself unable to meet its rising expenditure requirements.

As far back as 1941 it was realized that new sources of revenue were urgently needed and, not unexpectedly, evidence pointed in the direction of the enriched traders and industrialists

as providing the best subject of taxation, both for considerations of justice and yield.

Since the outbreak of the War these classes were making significant profits and amassing large fortunes which were the envy of other classes as well as the Government. Therefore, it was found fair enough to ask them to make an additional contribution towards meeting the rising costs of Government.

It was soon decided that a tax on war profits should be imposed and a law providing for an "Extraordinary Contribution on Exceptional or Supplementary Profits Realized Since the War" was prepared and promulgated.[1] This law was to come into effect in 1944 but was retroactive affecting profits earned since January 1, 1940.

As its name suggests this "contribution" was to be provisional and to be levied on "exceptional or supplementary profits", which were defined as net annual profits in excess of "normal profits". Normal profits being defined as net profits realized during the year 1939.[2]

Once supplementary or exceptional profits were determined, an abatement of L.L.7,500 was allowed and the balance was taxed according to the following schedule :[3]

---

1. Legislative Decree No.NI/245. Official Gazette No.4042 of 11 November, 1942.

2. Ibid., articles 1, 5, 6 and 11.

3. Ibid., article 17.

	Rate of tax
On taxable supplementary profits not exceeding L.L.20,000	15%
On the portion of taxable profits comprised between :	
L.L.20,000 and L.L.40,000	20%
L.L.40,000 and L.L.75,000	25%
On the portion of taxable profits exceeding L.L.75,000	33%

The special interest of this "contribution" lies in the fact that in principle at least, it was the most advanced tax yet to be introduced in Lebanon in the sense that it confirmed most closely to modern criteria of taxation.

It was the first tax in Lebanon, (i) to recognize the net concept in determining taxable profits ; (ii) to recognize actually realized revenue (not estimated) as a tax base ; (iii) to be progressive ; (iv) to require personal declarations or tax returns from all those concerned.

However, while all this was in principle a step forward, in practice the contribution proved to be a step backward. Its introduction at a time when no income tax existed was actually putting the cart before the horse. Its effective application required an administration as competent as that required for an income tax. More particularly, the problem of determining exceptional or supplementary profits, which would have been relatively easier had there been an income tax, proved insurmountable.

Finding itself in no position to effectively enforce the new tax, the Government brushed aside its provisions and decided

to conclude agreements with associations of merchants and industrialists in accordance with which these associations were to pay the sum of L.L.6 million to the Government[1]. In turn they undertook to collect this sum from members on an allotment basis arrived at by general agreement. The Government also concluded particular agreements with individual large companies in accordance with which they were to pay specified sums to cover their share of the contribution.

The revenues secured through these agreements were but a small fraction of what the contribution was originally expected to yield.

Although in practice this contribution proved to be a failure, it did in fact as already mentioned, serve an important purpose by introducing several new modern concepts of taxation into the Lebanese tax system and thus proved a stepping stone to bolder reforms and more particularly to the introduction of an income tax.

Moreover, the contribution was no more than a transient tax which was to end as soon as the war was over, and therefore, it was soon felt necessary to introduce new and more permanent reforms on the tax system which will ensure greater revenue in the future as well as conform to the newly recognized concepts of equity.

---

1. See Law of October 9, 1944, Official Gazette No.41 October 11, 1944, article 1.

Thus, on June 24, 1943 a new reformed built property tax was promulgated and was followed on December 4, 1944, after a period of controversial discussions and elaboration, by an income tax. This in turn was followed by the presentation to Parliament of a draft bill for a new land tax to replace the old Unified Land Tax. However, the new tax was not ratified by Parliament except on December 20, 1951 and on the very next day it was followed by a Gift and Inheritance Tax.

Thus ended in 1951 a period of transformation and reform of the Lebanese tax system from a relatively medieval system inherited from the Ottoman Empire to a more modern system, which although by no means perfect, was more in conformity with the requirements of an emerging modern state.

E. Recent Reforms of the Tax System and the Main Direct Taxes

In 1958-1959 the spirit of tax reform was again in the air ; however, very little came out of it and most direct taxes were just rewritten in a revised form.

In 1962, as will presently be indicated in detail the Buildings Tax was basically amended.

An account will now be given of the Buildings Tax and the Land Tax.[1]

---

1. A good account of the Gift and Inheritance Tax is given in Raja S. Himadeh, The Fiscal System of Lebanon, op. cit., pp.59-65.

The Buildings Tax : this tax was established by Legislative Decree No.55/ET, of June 24, 1943, was revised by Legislative Decree No.145 of June 12, 1959[1], and was finally replaced by a new tax imposed by the Law of September 17, 1962[2] which will come into effect starting with 1964.

We shall first review the tax which was in effect for the past twenty years and then consider the basic amendments introduced by the Law of September 17, 1962.

The original tax was an impersonal proportional tax levied on all built property including land adjoining them and not exceeding an area of 1,000 square meters. It was also levied on non agricultural land used for any commercial or industrial purpose.[3]

The tax was assessed on the gross returns of the built property as appeared in the lease that must be registered in the municipality concerned, or, in case there was no lease, as estimated by a commission of three experts whose recommendations are binding.[4]

In the case of buildings having central heating or air condition, an elevator, and a residing janitor, ten per cent of the rent was deducted before the tax was applied.[5]

---

1. Collection of Legislative Decrees on Direct Taxation, (Sader Press, Beirut, 1960).
2. Supplement to Official Gazette No.38 of 19.9.1962, pp.1506-1532.
3. Legislative Decree No.145, loc. cit., article 2.
4. Ibid., articles 10, 15, 16, 17 and 19.
5. Ibid., article 5.

The rate of tax was 1/12 of the gross rental value, or 8-1/3 per cent. To this was added a surcharge not exceeding 3 per cent of the gross rental value for the benefit of municipalities.[1]

The following property was exempted from tax :

1. Government property.
2. Property owned by municipalities or public institutions when it is used for public interest and does not yield any income.
3. Property used for religious purposes provided it is not rented.
4. Cemeteries and adjoining service buildings belonging to religious or philanthropic institutions unless such buildings are rented.
5. Property used as hospitals, clinics, orphanages or schools provided it is not rented.
6. 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.[2]
7. Buildings used for agricultural activities provided they are not rented.
8. Buildings having a yearly rental value that does not exceed L.L.120.[3]

The improvements in this building tax over the tax prevailing before 1943 were confined mainly to questions of detail and it therefore remained essentially real and impersonal in nature. The main improvement was the availment of actual return as evidenced

---

1. Ibid., articles 8 and 9.
2. Ibid., article 3.
3. Ibid., article 8.

by the lease as a basis for assessment instead of complete reliance on estimation which cannot escape from being arbitrary.

The main defect of the tax remained the fact that it was based on gross rental value of buildings with no regard whatsoever to depreciation, repairs, and maintenance expenses.

The Buildings Tax introduced by the Law of September 17, 1962 is to be levied on the net real or estimated annual returns of built property.[1]

Net returns or revenue is defined as gross revenue, which includes all revenue derived from the built property concerned, less such expenses as are allowed for in the Law.[2]

These deductible expenses include only outlays which according to the lease are effected by the owner of the building on behalf of the tenant or tenants. They are the following :

1. Subscriptions and cost of using the phone ; and cost of water, electricity and gaz if evidenced by bills issued by the company or authority concerned.
2. Taxes due from the tenant to the Government or municipalities.
3. Cost of the following general services rendered in buildings by the owner at his expense :[3]
   - Operating lifts,
   - Central heating or air conditioning,
   - Hot water supply,
   - Residing janitor.

---

1. Law of September 17, 1962, loc. cit., article 24.
2. Ibid., articles 26 and 27.
3. Ibid., article 27.

The following expenses are not deductible :

1. Interest incurred on the capital invested in the building.
2. Expenses incurred for the purpose of maintenance or improvement of the building.
3. Indemnities paid for tenants for leaving a dwelling.
4. Any other expense which does not involve a direct service rendered to tenants.[1]

The new Buildings Tax is a multiple tax providing for a proportional tax of 8% of net annual returns not exceeding L.L.20,000[2], supplemented by a progressive tax on returns exceeding L.L.20,000 and accruing to a single person or company from property owned in Lebanon.

The progressive tax schedule is the following :[3]

	Rate of tax
On the portion of taxable returns comprised between :	
L.L. 20,000 and L.L. 50,000.	3%
L.L. 50,000 and L.L.100,000.	5%
L.L.100,000 and L.L.200,000.	8%
L.L.200,000 and L.L.400,000.	11%
On the portion of taxable returns exceeding L.L.400,000.	15%

To these rates is added a surcharge for the benefit of municipalities which should not exceed 3% of the tax in case the

---

1. Ibid., article 29.
2. Ibid., article 55.
3. Ibid., article 56.

proportional tax is applicable and 10% of the tax in case the progressive tax is applicable.

Additional exemptions, deductions or allowances provided for under the new tax are the following :

- Buildings owned and utilized by political parties, syndicates, associations and institutions which do not aim at profit are exempted from tax.[1]
- Dwellings occupied by their owners and whose rental value does not exceed L.L.500 are exempted from tax.[2]
- Dwellings occupied by their owners and whose rental value does not exceed L.L.1,000 are allowed a deduction of L.L.500.[3]
- Dwellings purchased by instalment by the lower income groups are exempted from tax for a period of 10 years.[4]
- Corporations of all sorts are allowed a deduction of 25% of the tax.[5]

Thus we observe that some basic amendments to the taxation of built property has been introduced by the new tax.

In the first place it has adopted the concept of net revenue and allowed for the deduction of operating costs. However, it still excludes depreciation and cost of maintenance.

In the second place it has introduced some essentially personal elements into the tax, namely progression and the exemption

---

1. Ibid., article 8.
2. Ibid., articles 52 and 53.
3. Ibid..
4. Ibid., article 11.
5. Ibid., article 56.

of dwellings purchased by the lower income groups and dwellings occupied by their owners and whose rental value does not exceed L.L.500. On the other hand, it still does not allow minimum personal and family deductions which is unjustifiable in view of the fact that such deductions are allowed under the Income Tax and the Land Tax.

An important defect of the tax which it has in common with the Land Tax and the Income Tax emanates from the inequity that results from the separate application of progressive taxes on incomes derived from different sources. This will be discussed in detail under Chapter V.

The Land Tax : this tax was established by the Law of December 20, 1951[1] and was to come into effect starting with January 1953. However, in 1952 its application was postponed until January 1955. In 1959 and after four years of application, it was suspended again for a period of five years which was to end in 1963[2] but was later extended till 1966.

The suspension of the Land Tax was proclained to reflect the desire of the Government to encourage agriculture ; however, it was also due to the fact that the tax was proving too difficult to apply effectively and was yielding negligible revenue.

The Land Tax classifies lands into three main categories : (i) cultivated land ; (ii) uncultivated land ; (iii) building lots. Each of these categories is taxed separately at a different rate or rates.

---

1. Supplement to Official Gazette No.52, December 26, 1951, Land Tax Law.

2. Legislative Decree No.107, June 12, 1959.

The imposable person is generally the owner, however, in the case of a long-term lease or exploitation right the tax is levied on the lease holder or exploiter.

(i) Cultivated Land : the tax on cultivated land is based either on the actual net return or on estimated net return.

Actual net returns are determined by deducting from the gross returns all expenditure incurred in the exploitation of the land, including : cost of seeds, plants, fertilizers and insecticids; depreciation of buildings and machinery ; interest on borrowed capital ; expenses of ploughing, sowing, planting, harvesting and picking, etc.[1]

The tax is compulsorily levied on the basis of actual net income when the revenue from the land of a single taxpayer exceeds L.L.25,000. Taxpayers whose lands yield less than this amount would be taxed on the basis of actual return if they so desire and are prepared to keep the necessary accounts.[2]

In all other cases the tax is assessed on the basis of an estimate of net annual income which is carried by a committee of five experts and is revised every five years.[3] The estimate is based on a schedule which classifiesland into seventeen categories depending on whether the land is irrigated or not and according to use, productivity per 1,000 square meters, location and crop rotation.[4]

---

1. Land Tax Law, loc. cit., article 11, quoted in R.Himadeh, op. cit., p.50.
2. Land Tax Law, loc. cit., article 12.
3. Ibid., articles 7 and 9.
4. Ibid., article 8.

After allowing an initial deduction of L.L.1,800 for a bachelor, L.L.2,400 for a married person with no children, and L.L.3,000 for a married person with children, the following rates are applied to total taxable income from cultivated lands :[1]

2% on the part which does not exceed L.L.5,000.
3% on the part between L.L. 5,001 and 15,000.
6% on the part between L.L. 15,001 and 25,000.
8% on the part between L.L. 25,001 and 35,000.
10% on the part between L.L. 35,001 and 50,000.
15% on the part between L.L. 50,001 and 75,000.
20% on the part between L.L. 75,001 and 100,000.
25% on the part between L.L.100,001 and 200,000.
35% on the part that exceeds L.L.200,000.

(ii) Uncultivated Agricultural Land : this is taxed on the basis of area at the rate of 25 piasters per 1,000 square meters.[2]

(iii) Building Lots : these are defined to include all non agricultural land that can be used for building as well as lands within the city of Beirut.[3] These lots are taxed on the basis of an estimate of their market value at the rate of 2 per thousand of the assessed value.

The Land Tax Law exempts from tax the following categories of land : public property ; forest lands, gardens, adjacent to

---

1. Ibid., article 38.
2. Ibid..
3. Ibid., article 20.

buildings and not exceeding 1,000 square meters ; land belonging to schools, hospitals, orphanages and asylums provided such land is not rented ; land beloning to hospitals which depend upon philanthropy and receive patients free of charge, provided the land is not rented ; and pasture lands.[1]

In order to encourage land improvement and development, the tax provides also for substantial temporary exemptions. Swamps that are dried by their owners and uncultivable lands that are made cultivable by improvements are exempted from tax 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.[2] Unirrigated land changed into irrigated land by its owner or exploiter is taxed for the first five years after completion of the improvement on the basis of the assessed return under its previous category.[3]

While the Land Tax has gone a long way from preceeding similar taxes in the adoption of modern concepts of taxation such as net revenue and the provision for production and development costs, as well as the recognition of the personal element with all that it entails, such as progression, personal and dependency allowances and differentiation ; it still has a number of defects the most important of which are its complicated and cumbersome structure, and its gross confusion between income derived from

---

1. Ibid., article 2.
2. Ibid., article 40, quoted in R.Himadeh, op. cit., p.53.
3. Ibid., article 19.

ownership of land and income derived from agriculture or cultivation. The latter confusion has made it neither a tax on land ownership nor a tax on agricultural income, but rather an amalgam of both which has nothing to commend except legislative expediencey.[1]

---

1. For a good account of the inequities resulting from this treatment see R.Himadeh, op. cit., pp.52-55.

CHAPTER II

THE LEBANESE INCOME TAX : GENERAL CONSIDERATIONS

A. The Inducements

The conjuncture created by the Second World War and its repercussions on the Lebanese economy together with the accession to independence in 1943 and the persistent increase in Government outlay which this entailed, lead, as we have seen in Chapter I, to the realization by the Lebanese Government of the need for tax reform which will not only increase public revenue, but also insure greater equity in the distribution of the burden of taxation.

Perhaps the most important combination of events which contributed to the conclusive recognition in Lebanon of the concept of justice in taxation as a necessary concomitant of any modern tax system, were those created by the economic disruptions of the Second World War which gave rise to a wide disparity in the distribution of income between the richer and poorer classes and brought to the forefront the problems of social and economic inequalities.

Drawing on the experience of France, the Lebanese Government decided first to introduce a kind of war profits tax which,

as we have seen, proved a complete failure as its French counterpart of 1914. However, this war profit tax through the new concepts in taxation which it introduced into the Lebanese tax system, though in a purely statutory form, paved the way for the final adoption of what has become generally recognized as the ultimate form of a remunerative and equitable tax in a democratic country, namely the income tax.

With the state of mind of the Government, the businessmen, and the enlighted public finally set for the introduction of an income tax, there ranged a controversy which lasted for nearly one year on the type and form of income tax to be introduced. A number of advocates of different systems presented draft Laws of their projects which drew heavily upon one or the other of the income tax systems prevalent in western countries.

B. The Alternative Income Tax Projects

In order to give an idea of the alternative projects presented we shall now give a brief account of each.[1]

1. The Himadeh Project

Mainly of American inspiration, Professor Himadeh's project provided for a general personal income tax levied on the whole income of a person. According to it, gross income for the purposes of the tax was to consist of the following :

---

1. See Gannagé, op. cit., pp.50-58.

a) Profits from commercial and agricultural enterprises ;

b) Wages and salaries ;

c) Pensions ;

d) Interest on loans, mortgages, saving and current accounts and other debts ;

e) Dividends, prizes and annuities ;

f) Rent from buildings and land intended for building ;

g) Income from agricultural exploitation.

Net taxable income was arrived at after deducting all costs incurred in the normal operations of business including cost of maintenance of capital, rent, depreciation, interest paid, other direct taxes paid during the year and other specified deductions such as personal and family allowances.

The tax was mildly progressive with rates for real persons ranging between 3% and 15% depending on the income bracket.

A noteworthy and commendable feature of this project was its separation of the tax rate structure applicable to corporations from that applicable to individuals. Corporate income according to it was to be taxed at a uniform proportional rate of 10% without allowing any deductions as in the case of real persons.

2. The Soubirou-Pouey Project

General Soubirou-Pouey, Controller General of the finances of the French Army in Syria and Lebanon, prepared and presented his project at the request of the Syrian and Lebanese Governments.

Eclectic in nature, this project was of French and Egyptian inspiration and retained as well some features of the Tamattu' Tax.

It provided for a schedular income tax supplemented by a licence tax. The latter was essentially a modified version of the Tamattu' tax, and took the form of a trade licence tax or occupational tax on business and the professions based mainly on external manifestations of wealth. It provided for three forms of impositions :

a) A fixed fee varying with the nature of the profession ;

b) A proportionate rate on the rental value of commercial, industrial or professional premises ;

c) A fee varying with the real volume of business or business turnover.

The schedular tax which was to be imposed over and above the licence tax in the case of commercial and industrial enterprises and the professions, provided for three categories of taxable income namely : income from industrial, commercial and non commercial enterprises ; income from wages and salaries ; and income from movable capital. While each of these categories was to be taxed separately, the same progressive rate scale with rates ranging between 4% and 12% was applied to the first and second categories. A simple proportional rate was applied to the third category.

Real persons were allowed a deduction of L.L.1,000 annually under the commercial and non-commercial enterprises schedule, and L.L.45 monthly under the wages and salaries schedule irrespective of their family status.

Corporations were subject to the same rate scale as individuals but were allowed no deduction.

3. The Salem Project

This project was essentially of French inspiration, and like the French Income Tax it provided for a schedular tax supplemented by a complementary tax on aggregate income. It varied however in one important respect from its French counterpart, and that is in providing for progressive schedular rates whereas the French tax provides for proportionate rates.

Income subject to tax was classified into three categories namely : income from industrial and commercial enterprises ; income from wages, salaries and the professions ; and income from movable capital. Each category contained the description of the income items falling under it, the deductions allowable and the applicable rates.

Essentially discriminatory in nature, as all schedular income taxes are, this project provided for two different progressive rate scales and one proportional rate. Thus income derived from industrial and commercial enterprises was to be taxed at rates ranging between 4% and 10% ; income from wages, salaries and the professions at rates ranging between 3% and 7% ; and income from movable capital at a flat rate of 5% of gross income. An initial deduction of L.L.600 was allowed for a single person and L.L.300 for each dependent.

The complementary tax was to be levied on the aggregate income of real persons after allowing a deduction of L.L.12,000 for a single person, L.L.15,000 for a married person and L.L.2,000 for each child. The rates to be applied were the following :

	Rate of tax
On taxable income not exceeding L.L.25,000.	3%
On the portion of taxable income comprised between L.L.25,001 and L.L.100,000.	5%
On the portion of taxable income exceeding L.L.100,000.	7%

Under this project as under the Soubirou-Pouey project, external manifestations of wealth were to play an important role in the determination of income, thus tainting the tax with impersonal and real criteria related more to the source of income rather than to the person subject to tax. To this extent both projects tended to perpetuate an essentially rudementary and crude concept of income which at best could lead only to very rough approximation and consequently result in an inequitable tax.

4. The Government Project

The Lebanese Government, on its part, entrusted the Ministry of Finance with the preparation of an Income Tax Project Law.

This was duly completed in 1944 and was adopted by the Government which subsequently presented it to Parliament for consideration.

For over three months the Parliamentary Finance Committee was engaged in the consideration of this project as well as the other three projects which were presented to it through individual deputies. Early in its deliberations however, it came to the conclusion that the Government's project was the most "practical and convenient" of the four and therefore concentrated on it.[1]

---

1. Lebanese Government, Parliamentary Debates, Fifth Legislative Session, 1944-1945, Meeting of November 16, 1944, p.21.

In the course of these deliberations a number of amendments and alterations, exclusively confined to questions of detail, were introduced on the original draft law. Among these, were the reduction of the maximum rate of tax for commercial and industrial enterprises from 24% to 15% ; the increase of the personal and family deductions allowed to persons deriving income from wages and salaries ; and the increase of the rate applicable to income from movable capital from 5% to 7%.[1]

The Parliamentary Finance Committee reported to Parliament on its findings in its meeting of November 16, 1944, and suggested, after an exposition of the aims, purposes and functioning of the Law, that it should be adopted.[2]

The Law itself was presented to Parliament for final ratification in its meeting of November 21, 1944, and was duly ratified on the same day. It was subsequently published in the Official Gazette of December 6, 1944, and was to become effective as of January 1, 1945.

The income tax provided for by this project was again mainly of French inspiration and was clearly "the result of an arbitrary attempt to make a simplified version of the income tax applied in France."[3] In effect, it adopted neither the system of a general income tax, nor that of a schedular income tax, and the most that can be said of it in this respect, is that it is a tax on

---

1. Ibid., pp.22-23.
2. Ibid., p.24.
3. R. Himadeh, op. cit., p.45.

certain specified categories of income depending on their source.

This is particularly so since it deliberately excludes income from built property and income from land, both of which are taxed separately under the Built Property Tax and the Land Tax. Moreover, within the Income Tax itself, the dichotomy in the taxation of various categories of income is very close to being complete.

The Lebanese Income Tax does in this respect contain a flagrant misconception of the essence and purpose of an income tax which is no other than taxing persons according to income. To draw therefore a distinction among kinds of "income", gains, or receipts according to source, is to make the income tax lose much of its raison d'être.[1]

Income taxes are levies upon persons, not upon specific parts of the social income ; their proper objective is that of imposing equitable relative levies upon individuals, not that of reaching somehow every item of income.[2]

In so far therefore as the Lebanese Income Tax deviates from these basic principles and confuses between income from things (including human labor) and income to persons, it cannot be fully termed an income tax.

Incomes subject to tax are classified into three categories. Each of these categories is taxed separately and contains the

---

1. Henry C. Simons, Personal Income Taxation, (Chicago; University of Chicago Press, 1938), p.152.

2. Ibid., p.134.

description of the income items falling under it, the deductions allowable and the applicable rates.

The first category comprises profits from industrial, commercial and non-commercial enterprises ; the second category comprises wages, salaries and pensions ; and the third category income from movable capital including dividends and interest.

Minimum exemptions differing with the family status of the person concerned are allowed to those deriving income from sources falling under the first two categories. No such exemptions are allowed to corporations or to income falling under the third category. Originally these exemptions were of the magnitude of L.L.1,200 for a single person, L-L-1,500 for a married person and L.L.1,800 for a married person with children ; however, these were increased in 1950 to L.L.1,500, L.L.2,400, and L.L.3,000 respectively.

Two different progressive rate scales are applied to the first category, one on profits derived from commercial and industrial enterprises, and one on incomes derived from professions, handicrafts, and other non-commercial enterprises. Originally there was a discontinuity of progression in the first of these scales at a rate of 15% for an income over L.L.50,000, and in the second scale at a rate of 12% for the same income. After a number of amendments however, the last of which was in 1949, progression was brought to a maximum rate of 42% for an income over L.L.750,000 derived from an industrial or commercial enterprise, and to a rate of 37% for the same slice of income derived from a non-commercial enterprise.

Under the second category, concerned with the taxation of income from wages, salaries and pensions, a single set of progressive rates is applied. By the law of 1944 these rates ranged between 3% for an income of L.L.2,400 and 8% for an income over L.L.24,000. In 1945 a new set of progressive rates was introduced with rates ranging between 2% for an income not exceeding L.L.4,800 and 10% for an income over L.L.48,000.

Under the third category one single proportionate rate is applied. This was originally 7% of gross income but was subsequently increased to 10%.

An important feature of the Lebanese Income Tax is that individuals and companies liable to tax are made subject to an essentially similar treatment with the same progressive rate scale being applied to corporate as well as to individual income.

It is worth noting, before concluding this preliminary discussion, that in 1959 a complete revision and redrafting of the Income Tax was undertaken. Curiously enough however, no important reform or amendment came out of this revision. This can only be ascribed to either one or more of the following reasons : an apathetic indifference to the obvious shortcomings of the Law; a purposeful intent on their perpetuation ; ignorance ; or simply to that inherent characteristic of human nature to overrate difficulties of change.

Only two alterations in the revised income tax are worth mentioning. One is the introduction of a "system" of taxation

according to estimated income under the first category.[1] The other is the introduction of a capital gains tax on the sale of business assets.[2]

The first item is obviously a step backward. To introduce a system of outright estimation into an income tax that has been in application for nearly fifteen years is no more than giving statutory recognition to rudementary practices which defeat the purposes of an equitable tax.

The second item, though formulated in ambiguous terms, is in principle a commendable step forward towards the possible introduction of a more comprehensive capital gains tax.

In the following Chapters, a detailed critical analysis of the salient features of the Income Tax will be undertaken.

---

1. Collection of Legislative Decrees Related to Direct Taxes and Duties (Beirut; Sader Press, 1960), Legislative Decree No.144 of June 12, 1959, articles 24 to 27.

2. Ibid., article 45.

CHAPTER III

CHARGEABLE PERSONS AND EXEMPTIONS

A. Those Liable to Tax

Income tax is payable upon the chargeable income of all persons pysical or corporate.[1] Having regard to the legal definitions the following are liable to tax :[2]

a) Any individual.

b) Any company.

c) Any cooperative society with commercial aims.

d) Any association.

e) Any society of persons whether corporate or not corporate.

The practical significance of the various categories of taxable persons is however different, and actually individuals and companies are those primarily liable to be taxed[3] be they residents or non-residents on income realized in Lebanon.[4]

---

1. Ibid., article 3.
2. Ibid., articles 2, 4, 5, 69 and 119.
3. Ibid., article 4.
4. Ibid., articles 3, 46 and 69.

B. Those Chargeable With the Payment of Tax

The liability of those upon the income of whom income tax is payable is a result of their being subject to the following obligations :

a) Answerable for all matters required to be done by virtue of the Income Tax Law for the assessment of the income and for paying the tax chargeable thereon.

b) Assessable.

c) Chargeable with the payment of the tax, i.e. liable to pay tax.

On principle, all these obligations are to be fulfilled by those liable to pay tax themselves. In the case of corporate bodies this means that the manager or other representative officer of the corporate body shall be answerable for doing all such acts as are required by virtue of the Income Tax Law including the payment of the tax.[1]

In the case of a "société en nom collectif" and a "société en commandite simple", every partner has to fulfil the obligations and is individually liable to tax on his share of the profits.[2] However, such bodies are considered liable for all taxes charged in the name of each partner.[3]

There are a number of cases, in which besides, or in the place of, those upon the chargeable income of whom the tax is

---

1. Ibid., article 39.

2. Ibid., article 35.

3. Ibid..

charged, other persons will have to fulfil the obligations emanating from the liability to pay tax.

Thus, for example, in case of a sale or transfer of business, the buyer as much as the seller is liable and chargeable for taxes due upon the income of the year of assessment as well as for tax due on past years.[1] This rule also applies to heirs of deceased persons.[2]

Chargeable to tax and answerable for all matters required to be done by virtue of the Income Tax Law are liquidators,[3] receivers,[4] and persons charged with trusteeship on behalf of incapacitated persons,[5] as well as representatives of any person physical or corporate.[6]

Persons effecting payments to non-residents who, according to the rules and regulations of the Income Tax Law, are chargeable, are personally responsible to deduct and forward such taxes to the treasury.[7]

All employers be they individuals, companies, institutions,

---

1. Ibid., article 38.
2. Ibid..
3. Ibid., article 29.
4. Ibid..
5. Ibid., article 10.
6. Ibid., article 39, and Legislative Decree No.147, June 12, 1959, article 34 (Law Regulating the Collection of Direct Taxes).
7. Legislative Decree No.144, op. cit., articles 41, 42 and 43.

societies,[1] or public bodies ;[2] who pay wages, salaries, pensions, or compensations in money or in kind,[3] are required to deduct and forward to the treasury the taxes due in accordance with the provisions of the Income Tax Law on any such payments made to their employees.[4] Any employer who fails to do so is held personally responsible for any unpaid taxes.[5]

Any person or company who undertake the payment in Lebanon of dividends, interest on bonds, mortgages, deposits or current accounts, and any other payments or returns on movable capital as are provided for under Article 69 of the Law, are required to deduct and forward to the treasury taxes due in respect of such payments.[6] All such persons are held personally responsible for any delinquency in the payment of such taxes.[7]

The provisions of the Income Tax Law concerning the obligations of some persons on behalf of others do not, however, cause a change in the provisions about the taxability of those who are

---

1. Ibid., article 63.
2. Ibid., article 64.
3. Ibid., article 52.
4. Ibid., article 63.
5. Ibid..
6. Ibid., articles 75, 77, 78, 81 and 89.
7. Ibid., articles 76 and 81.

originally taxable. They do not relieve the original taxee from any obligation, not from the formal and definitely not from the material one, since article 40 under the first category and article 66 under the second category specifically provide, that "whosoever is responsible to pay the tax on behalf of an original taxee has the right to recuperate any such payments from the funds he holds or may hold for account of such a person."[1]

The only purpose of these provisions is to assure the orderly administration of the Income Tax, particularly in respect of withholding tax or deduction at the source, and also in those cases in which, for some reason or another, the person liable to be taxed cannot personally be assessed or cannot comply with the administrative clauses of the Law in respect of returns or other obligations.

Thus, the person primarily liable is not relieved from his liability by the mere fact that he belongs to a class of persons on behalf of whom a form of trustee or agent is assessed.

C. Those Whose Income is Exempt from Tax

In all countries in which income tax exists, there is a series of cases in which the conditions for an imposition of tax are actually given, yet on the ground of special provisions, the income is exempt from tax. These exemptions are based partly on the peculiar character of the kinds of income concerned and partly on the fact that the payment would not be in the public interest.

---

1. Also provided for under Legislative Decree No.147, loc. cit., article 34.

Generally, income may be exempt from tax on the basis of who gets it, the use to which it is put, its source, or its amount.

More specifically, exemptions are motivated by the desire to protect the minimum of subsistence, to simplify administration, to remove the state itself from the purview of taxation, to subsidize institutions and activities which perform a public service even though privately owned, and to encourage certain business or other activities deemed desirable.[1]

1. Exemption to Protect the Minimum of Subsistence

Any scheme of taxing incomes has to provide an answer to the question whether all incomes are to be taxed, however small; and if not all incomes, what is to be the standard by which the exemption of the smallest incomes is to be determined. The conceptions of progressive taxation raise the question in its most obvious form, for as compared with other taxpayers enjoying more substantial incomes, the capacity to pay of a person with an income insufficient to provide the means of subsistence is non-existent.[2]

Since the introduction of the income tax there has been a universal recognition of the fact that no income tax should be levied upon any income which is insufficient to provide its owner with what he requires for subsistence.

---

1. Tax Exemptions, Symposium Conducted by the Tax Policy League (New York ; Tax Policy League, 1939), p.6.

2. Royal Commission on The Taxation of Profits and Income, Second Report, (London ; Her Majesty's Stationary Office, Cmd. 9105, 1954), p.48.

As an outcome of this, an important class of tax exemption in every country arises from an attempt on the part of legislators to avoid imposition of taxes on what it is generally considered a subsistence minimum. If any person has an income so small that under given circumstances is barely adequate for personal maintenance, then the state is justified in exempting that income from tax.[1]

What is needed therefore is some provision that could be related to the idea of minimum subsistence. It is obvious that the requirements of subsistence for this purpose can be understood in widely different terms. They may involve "an income sufficient for bare subsistence ; or an income large enough to equip and sustain a healthy and efficient citizen ; or an income sufficient in addition to provide conventional comforts and luxuries usually enjoyed by the working class."[2]

It cannot, however, under any circumstances, be suggested that there is a need to be precise in delimiting the concept of subsistence for practical application. The purpose can perhaps best be served by adopting something that corresponds roughly to the second suggestion of the Royal Commission namely, "an income large enough to equip and sustain a healthy and efficient citizen." The actual figure chosen will, of course, vary with time and place.

If subsistence is to be of determining consideration in fixing an exemption limit it would logically follow that the scheme must provide different exemptions for different personal circumstances,

---

1. Tax Exemptions, op. cit..

2. Royal Commission On the Taxation of Profits and Income (London; His Majesty's Stationary Office, Cmd.615, 1920), para. 242.

for the income needed respectively by the single, the married, and the married with children, cannot be expressed by the same figure.

It must be pointed out in this respect, that the exemption limit need not be confined to the idea of minimum subsistence, but it must at least be fixed at a level that is high enough to prevent the tax impinging upon what is required for subsistence.

Under the Lebanese Income Tax, tax exemptions take the form of a fixed amount of income which by the Law of 1944 were fixed at L.L.1,200 for a single person, L.L.1,500 for a married person and L.L.1,800 for a married person with children.

These figures were revised upwards in 1950 due to the belief that they no longer coincided with what can be considered as minimum subsistence. The new figures are L.L.1,500 for a single person, L.L.2,400 for a married person, and L.L.3,000 for a married person with children.

It can readily be observed from these figures that no exemptions are allowed for dependents other than a spouse and children. This completely ignores the not uncommon possibility of a single or married person having other dependents e.g. young brothers or sisters and mother in case the father is dead, or even the father himself in case he is old or incapacitated. Moreover, the exemption for a married person with children does not take into consideration the number of children.

While this exemption scheme can be justified on grounds of practical expediency and as being a way to circumvent the possibility of fraudulent claims for dependents, such justification does not make it any more equitable and as long as it is perpetuated it will be a source of injustice.

Considering the effects that a normal inflationary tendency would have over a period of thirteen years in bringing within the scope of the tax individuals whose real income did not increase, or perhaps decreased, as well as the not unreasonable assumption, that in a country like Lebanon which has experienced over the past decade a period of rapid growth and change an upward valuation of the ingredients that go into "minimum subsistence" is to be expected, a further upward revision of the minimum exemptions is advisable.

2. Exemption to Simplify Administration

The exemption of small incomes from tax is not confined to the purpose of protecting a minimum of subsistence or of "preventing the taxpayer with little income from being called on to make an excessive contribution, in the light of other taxes he bears to the support of the state",[1] but is also designed to simplify and make less costly the administration of the income tax. The implication here is that the imposition of the tax on a large number of small taxpayers will be too cumbersome and the revenue so realized not commensurate with the required expenditure in money and effort.

3. Exemptions of Private Institutions and Activities Performing Public Functions

One class of tax exemptions more or less uniformly provided for in most income tax laws concerns private institutions performing functions which in their absence would have to be undertaken by the public sector. The most common instance of such private agencies performing public function is charitable, educational, and to a lesser extent, health institutions. It is commonly accepted that if,

---

1. Tax Exemptions, op. cit., p.7.

in the absence of a private enterprise, taxation would be necessary in order to discharge a needed function, "the state may properly subsidize the institution which performs the service".[1] A common method of subsidy, though a very crude one, is through tax exemption.

Under the First Category, the Lebanese Income Tax Law provides for the exemption from tax of educational institutions, sanatoriums, mental illness hospitals, and hospitals provided they receive patients free of charge.[2]

The condition of receiving patients free of charge as a basis for exempting hospitals from tax is at best a very crude one. At least some minimum in relation to capacity should be set. However, since the control of such a rule will be difficult, it is better suggested that all privately owned hospitals, i.e. hospitals owned by a single or a number of doctors as against hospitals owned by institutions, should not be exempted from income tax since they are a business concern as any other.

4. Other Exemptions

Exemptions aiming at the encouragement of certain forms of activity are granted to consumers cooperatives, syndicates and agricultural cooperatives that do not have a commercial purpose. Also to agriculturists who sell their own land produce, cattle or cattle produce, provided such produce is not exposed in stores, or processed.[3]

---

1. Ibid., p.17.
2. Legislative Decree No.144, loc. cit., article 5.
3. Ibid..

Exemptions for the sake of convenience and depending on reciprocity are granted to foreign airways and shipping companies.

A number of other exemptions are also granted under the Second and Third Categories of the Income Tax.

Under the Second Category the following incomes are exemptd :[1]

a) Allowances received by the clergymen for religious services.

b) Pensions of disabled persons retired from Government service, public services, or private institutions in accordance with pensions laws.

c) Life allowances and temporary compensations granted to victims of labor accidents.

d) Wages of agricultural labor.

e) Wages of servants in private houses.

f) Salaries and wages of nurses and maids in hospitals, orphanages, asylums, and similar institutions.

g) Indemnities paid for dismissal from work in accordance with the Law.

h) Salaries and allowances received by members of foreign diplomatic or consular services and their foreign personnel when such an exemption is reciprocated.

i) Salaries and allowances of military personnel of allied countries.

Under the Third Category the following returns are exempted :[2]

a) Dividends on stocks of Lebanese corporations if the profits for such distribution are derived from income already subjected to tax in accordance with the First Category.

b) Repayments to stockholders and creditors if such amounts are not taken from the profit and loss or reserve account.

---

1. Legislative Decree No.144, loc. cit., article 47.

2. Ibid., article 71.

c) Repayments to stockholders and creditors, by a concessionary company even though taken from the reserve or profit and loss account when the reason for such payments is the obligation to deliver free of payment at the expiry of its concession all its installations to the Government.

d) Interest on savings deposits, if it does not exceed one thousand pounds per year.

e) Interest and returns on current accounts accruing to the Government, municipalities, and public institutions, and to foreign diplomatic and consular institutions provided such exemption is reciprocated.

f) Interest on Lebanese Government bonds.

5. Exemptions of New Industrial Enterprises

In addition to the specific exemptions from income tax and as an incentive to investment in industrial enterprises, under the Law of February 5, 1954[1] new industrial enterprises established within five years of the enactment of the Law may be exempted from income tax for a period of six years on the recommendation of the Minister of Economy and after consultation of the Council for Planning and Economic Development, if they fulfil the following conditions :

a) The enterprise must be unlike any already in existence in Lebanon and contribute to the expansion of the national economy.

b) Capital invested in Lebanon must exceed L.L.1 million.

c) The annual wages paid to Lebanese employees and workers must exceed L.L.100,000.

In 1959 the application of this Law was prorogated for another five years.

This device for encouraging new investment by granting freedom from income tax for a specified period of years has

---

1. Lebanese Government, Official Gazette No.6, February 10, 1954, pp.59-60.

invariably been criticized by economists and fiscal theorists.

It is generally conceded that tax measures are at best blunt instruments for the specific channelling of investment. This is apparent in the fact that they allow for exemptions from tax all those who fall into the category defined by the law regardless of whether or not they would have engaged in the favoured enterprise even without the tax concession.

In other words, the system is not selective in its effects[1] and, apart from a possible psychological effect when first introduced, it will provide little stimulus to the pioneering firm[2] making no important taxable profits within the relevant exemption period.

On the other hand, for the very successful firm the incentive is adequate without tax freedom, and the system merely extends to it a quite unjustified immunity[3] as well as reduce the volune of public investment that could be undertaken without inflation.[4]

Thus, before proposing the use of tax incentives to promote investment, a showing must be made that this is in fact the most direct and most effective method, and the Government must examine the extent to which the tax exemption can in fact bring about the desired results. Incentive taxation must therefore "be predicated on estimates and expectations of decisions which investors are

---

1. Higgins Report (Typescript), 1960, p.75.
2. Ursula K. Hicks, Public Finance, (Cambridge; Nisbet, and Cambridge University Press, 1958), p.307.
3. Ibid..
4. Higgins, op. cit., p.75.

supposed to take as a result of the improved tax situation offered them."[1] Moreover, the loss of revenue suffered as a result of granting such tax incentive constitutes a reminder that a price must be paid for their use in the promotion of investment.

A further important consideration to be taken into account, is the fact that tax factors are only part of the over all set of conditions which determine the decisions of investors. In many instances, investors decisions may be made before even reaching considerations of the tax factors involved. This is particularly so in the case of foreign investors where the factors that decisively swing the balance are economic prospects in the widest sense, political security , and facilities for the repatriation of dividends, and if necessary capital.[2] An appreciation of tax factors as such will therefore necessitate "an examination of the relative impact of non-tax factors which are likely to guide investors in other directions than those which they would follow if they were motivated only by the desire of minimizing their tax burdens."[3]

Given these considerations, if a system of tax exemptions is still to be applied the crux of the problem will turn on the tax arrangements after the holiday period has expired. If the customary tax on profits with depreciation allowances is then imposed (so that

---

1. United Nations, The Effects of Taxation on Foreign Trade and Investment, (United Nations, Lake Success, New York, 1950), p.7.

2. Hicks, op. cit., p.308.

3. The Effects of Taxation on Foreign Trade and Investment, op. cit., p.7.

five year old machinery is effectively treated as new) then a profitable industry would benefit considerably and substantial revenue may be sacrificed.[1] If however, this is not done and only a definite carry forward of losses is allowed, as is the case in Lebanon[2], the firm may be worse off than if the straight line method of depreciation with indefinite carry forward of losses had been allowed, instead of the tax holiday.[3]

A more effective and equitable way of providing incentives to new investment through temporary tax freedom is the system of accelerated depreciation.[4] According to this system a more rapid write-off of new investment in plant and equipment would be allowed. More specifically, the rate at which new investment is amortized would be left to the discretion of the firm concerned. Thus, if sufficient profits are made in one year to write-off the entire new investment, and the firm chooses to do so, it should be accorded this privilege.[5] Any subsequent profits would, however, be taxed at the current rates, and no further write-offs would be permitted until more new investments were made.

Under this system profitable enterprises which do not need tax incentives to make investment in them attractive, would be accorded tax freedom only for short periods, while less profitable undertakings would be accorded tax freedom for long periods.

---

1. Hicks, op. cit., p.307.
2. Carry forward of losses is limited in Lebanon to a period of three years. Legislative Decree No.144, loc. cit., article 16.
3. Hicks, op.cit., p.307.
4. See Hicks, op. cit., pp.305-306; and Higgins, op. cit., pp.76-77.
5. Higgins, op. cit., p.76.

In other words, "the system of accelerated depreciation means freedom from income tax for the investor for a period long enough for him to recoup his capital once but not for a longer period than that.[1]

A final consideration, peculiar to foreign investors, is the complication created by the taxes imposed by the country of origin. If no double taxation agreement exists between the two countries concerned, the foreign investor may be seriously deterred by having to pay the two taxes aggregatively. However, even if such an agreement exists ; under which the usual practice is that the tax of the capital importing country is credited against the tax of the capital exporting country, that is, the firm pays the whole of the tax of the country with the lower rate, which is usually the capital importing country, and the balance to the country with the higher rate or capital exporting country ; a reduction or elimination of the tax by the capital importing country would benefit solely the capital exporting country by reducing the credit it would have to allow.

Thus, where capital exporting countries offer such tax credits, capital importing countries having lower tax rates have small reason to add further incentives since tax reductions or exemptions on their part would give no advantage to the foreign investor but would merely result in reducing the credit allowance which is made by his home government.[2]

---

1. Ibid..

2. The Effects of Taxation on Foreign Trade and Investment, op. cit., pp.47-48.

Thus, capital importing countries which wish to give tax incentives to foreign investors operating under a tax credit system must obtain a reduction in the exporting country's taxes before a reduction in their own taxes can do more than reduce the tax credit loss of the capital exporting country or else the concessions it offers may be in vain.

CHAPTER IV

THE BASIS OF ASSESSMENT

A. The Temporal Basis of Assessment

The mechanism provided for by the Income Tax presupposes that in the course of the year of assessment not only the returns be furnished,[1] but also the assessments be made and collection of tax be performed.[2] Consequently, the temporal basis of assessment cannot be the year of assessment itself, but a period which is already concluded before the beginning of the year of assessment.

Under Article 6 of the Income Tax Law, it is specifically provided that the basis of assessment shall be "the year immediately preceeding the year of assessment even though the source of income may have ceased to exist during or before the year of assessment."

In the case of enterprises following with the consent of the Ministry of Finance an accounting year different from the calendar year, the period of assessment for which declarations should be presented is "the period of twelve months on the basis of which the last balance sheet was prepared."[3]

---

1. Ibid., articles 13, 17 and 52.
2. Ibid., articles 28, 30 and 34.
3. Ibid., article 14.

This system by which the profits of the preceeding year shall represent the definite basis of assessment, is infringed by one exceptional provision which predicates that in case the taxee should discontinue his trade or profession he should within a period of one month present to the tax authorities his income tax return together with other necessary statements on the basis of which he will be charged with the tax.[1] Thus in the event of cessation of business the basis of assessment is the year of assessment itself.

However, in case a taxee should possess another source of income than the one that was discontinued he must within a month give notice of the cessation of the one concerned and, in due course, incorporate the income derived from that source in his regular annual income declaration from the continued source.[2]

Thus in effect the Law prescribes the substitution of the year of assessment for the preceeding year only when a person ceases to possess a source of income that is taxable under the First Category.

In the case of new enterprises formed during the year preceeding the year of assessment, the tax is assessed on income earned from the date of starting business until December 31 of the year preceeding the year of assessment.[3]

B. The Local Basis of Assessment

The Lebanese Income Tax is essentially territorial in its

---

1. Ibid., article 29.

2. Ibid..

3. Ibid., article 14.

application, applying to income arising from sources within Lebanon as respects residents,[1] citizens and non-residents.

The jurisdictional base of the tax under the First and Second Categories is the relationship of income or expense to a Lebanese source or economic activity. The citizenship or residence of the taxpayer are immaterial factors on the application of the tax.[2]

The statutory rule under the First Category is that the tax is applicable to income realized in Lebanon or derived from a Lebanese source by any person physical or corporate whether resident or not.[3] To this effect also, the rule under the Second Category is that salaries, wages, pensions, compensations and indemnities paid in Lebanon to residents or non-residents for services rendered in Lebanon are taxable.[4]

As a result of the territorial base of the Income Tax, Lebanese subsidiaries of foreign enterprises, no matter what form they take, are taxable only on income realized in Lebanon to the complete disregard of their foreign operations.[5] Losses incurred by such enterprises outside Lebanon are not deductible from income

---

1. According to Article 10 of Decree No.2931 K of March 23, 1945 regulating the Application of the Income Tax Law, a resident in Lebanon is defined, as any person physical or legal Lebanese or foreigner who has a place of residence, owns an enterprise, or has a place of business in the country.

2. Legislative Decree No.144, loc. cit., articles 3 and 46.

3. Ibid., article 3.

4. Ibid., article 46.

5. Ibid., articles 7 and 15.

earned in Lebanon,[1] and taxes paid or due to foreign Governments on income arising in Lebanon are also not deductible.[2]

In order to curb attemps for tax evasion by such enterprises through a transfer of profits to head offices or subsidiaries - as the case may be - by intentionally raising or lowering the price of goods or services exchanged between them, the Law allows the Income Tax Administration, in case it suspects such attempts, to assess such enterprises on estimated profits which could be determined through comparison with other similar establishments operating in the country.[3]

Persons or companies realizing an income in Lebanon but having no office or place of business in the country are taxed in a particular way provided for under Articles 41, 42 and 43. According to Article 43, net chargeable income of such companies is assessed at 10% of gross income realized in Lebanon, and net chargeable income of such persons at 50% of gross income. The applicable rate is a flat 10%. The deduction of tax and its forwarding to the treasury is an obligation on those residents who effect payments to non-residents.

A further important consequence of the territorial base of the tax, is that income received by Lebanese citizens or residents (individuals or companies) from sources outside Lebanon, is not subject to tax. The implications of this rule in a country where

---

1. Ibid., article 7.
2. Ibid..
3. Ibid., article 15.

a considerable amount of income is derived from foreign sources will be discussed under Section D of this Chapter.

An important exception to the territorial rule, which adds to the hybrid nature of the Lebanese Income Tax, is the application of the residence rule in the taxation of income from movable capital,[1] and particularly in the taxation of income from foreign bonds and securities.[2] Thus, income from such holdings accruing to a resident in Lebanon is taxable, and in case it is cashed in Lebanon it is the obligation of the intermediary who effects the payment to deduct the tax and forward it to the treasury.[3] On the other hand, if it is cashed outside Lebanon through an intermediary or otherwise, it is the obligation of the person receiving the income to declare the amount received and pay the tax to the treasury.[4]

C. Treatment of Deductions Under Territorial Rule

In spplying the territoriality principle to allowable deductions the income tax is explicit on two points : (1) that all taxes and duties paid or due to foreign governments on income realized in Lebanon or on any transaction connected with that income are not deductible.[5] (2) that all losses incurred by head offices, branches or subsidiaries, located outside Lebanon are not deductible.[6]

---

1. Ibid., article 69.
2. Ibid., article 77.
3. Ibid., article 78.
4. Ibid., article 82.
5. Ibid., article 7.
6. Ibid..

However, on the question of costs and expenditures incurred outside Lebanon, the Law is less explicit and rather ambiguous. Thus, while no territorial rule is laid for costs and expenses which may be deducted, the rule under the section concerned with non deductible expenses is that costs and expenses which the taxee does not prove that he has sustained in respect of his participation in business outside Lebanon are not deductible.[1]

This negative way of dealing with a delicate question is very unsatisfactory and gives rise to a wide degree of conflicting interpretations which can only complicate the law and contribute to its ineffective and inequitable application.

The rigorous and sound application of the territorial rule to deductions should be based on the relation of the expense to income realized in the country rather than to the place of the expense. In other words, the place where the cost or expense was incurred should be of no consequence, and deductibility should be based on the relationship of the expense to Lebanese operations, regardless of the place where the expense was incurred. Thus, deduction should be explicitly allowed for any expense (otherwise allowable) which is connected with and properly allocable to income taxable in Lebanon.

For the sake of expediency and the restriction of uncertainty, specific statutory allowances for certain expenses occuring abroad and made deductible because of their relationship to Lebanese income could be embodied in the Law.

---

1. Ibid..

One difficulty with the rule of relationship and allocation referred to here, is the administrative problem posed by expenses incurred abroad by a business with branches or activities in both Lebanon and other countries. In case such a business incurs expenses outside Lebanon which it claims are properly allocable to Lebanese income, difficulties may arise in checking those expenses or their allocation. For convenience, any such claims should be made subject to the taxpayer's proving both the expense and its allocation in accordance with specific rules established by law.

D. Possible Shift to World Wide Income Rule

Is the application of the territorial rule as the main base for income tax jurisdiction in Lebanon the most expedient system or is it too limited in scope as respects the income of Lebanese residents ? Should not Lebanon tax its residents on all of their income whether from Lebanese or other sources ?

Under the residents approach a Lebanese resident receiving any income from foreign sources would be subject to Lebanese tax. Since the present income tax already provide for the taxation of residents on income from movable capital, the resident rule will still have to be applied to income from commercial, industrial and non-commercial enterprises, to wages and salaries, and to rent. Thus, a Lebanese corporation with a branch outside Lebanon would become liable to tax on the income of that branch as well as on income realized in Lebanon, and a resident businessman realizing income from a trade or other operations outside Lebanon would be liable to tax on that income.

If this approach were adopted, that is, if the territorial rule were abandoned, some recognition should be given to any foreign income tax that may be incurred on income from sources outside Lebanon. Such recognition could appropriately take the form of an allowance of a credit for the foreign income tax paid against Lebanese tax on the income from the foreign country, as is done by most countries following the residence rule.

A country generally decides to go beyond a territorial rule and reach all the income of its residents for one or more of the following reasons : to increase its revenue ; to encourage investment at home by withdrawing the incentive to invest abroad that may result from non-taxation of income from foreign investment ; to achieve equity in the treatment of its residents by reaching all income they receive regardless of sources.[1] An added factor may also be that of administration, "since the world wide income rule makes unnecessary the determination of the question whether the income does or does not arise within the country."[2] The administrative complications that arise under the world wide rule from the application of the foreign tax credit are less serious than any that arise under the territorial rule.

While no accurate estimate can be given of the amount of income received by Lebanese residents (individuals and companies) from abroad, it is doubtless true that such income is by no means negligible if not considerable. The largest source of foreign income

---

1. Carl S. Shoup, The Fiscal System of Venezuela, (Baltimore : John Hopkins, 1959), p.157.

2. Ibid..

at present is that derived from neighboring Arab countries by Lebanese traders and companies e.g. contracting companies, consultants, and traders who buy goods in foreign countries and sell them in the Arab countries without these goods passing through Lebanon or by being reexported through the Free Zone.

It can be asserted from personal experience in the banking business and from interrogations of businessmen engaged in the latter form of trading operations, that these operations carried by Lebanese traders or traders resident in Lebanon are considerable. The main countries involved are the Gaza Strip, Jordan, Kuwait and Iraq. The Gaza Strip is in most instances used only as a stage for goods which are ultimately destined to the United Arab Republic.

There are also in Lebanon a number of so-called base companies which have been established to control foreign operating subsidiaries or branches mainly in Arab countries, and to receive income from such foreign sources. Some of these companies conduct operations in Lebanon as well.

While the abandonment of the territorial rule would make the Lebanese Tax rule no longer suitable for the base company operations or others of a similar nature, yet, it should be clearly realized that the selection of Lebanon as a center and base for such operations in the Middle East has not been so much motivated by the territorial tax rule as by a multitude of other factors such as : greater security, free trade, freedom from exchange control, relative abundance of trained personnel, good communications, and the fact that Beirut has been a long established financial and commercial center.

A reconsideration of the territoriality rule in favour of the residence rule will thus undoubtedly widen considerably the tax base thus potentially increasing the remuneration of the tax without jeopardizing to any appreciable extent the pivotal position of Lebanon as a base for trading and other operations in the Middle East.

Equity considerations are also on the side of a residence rule. No justification can be given to the exclusion from tax of a large number of Lebanese residents who are more than anybody else enjoying the unique advantages presented by the Lebanon in this part of the world.

It is therefore suggested that in case any major revision of the Income Tax is to be undertaken the residence rule should be seriously considered as an alternative to the present territorial rule.

E. Some Problems of Non-Residents

The above discussion relates only to residents, it does not involve non residents who would continue to be governed by the principle of territoriality and hence would be subject to tax only on income from a Lebanese source. Undoubtedly, such a rule will give rise to problems of law and administration and it is important that the Tax Administration be alert to recognize these problems and situations, and to state what, in its opinion, is the applicable rule in each case, so that taxpayers can guide themselves accordingly. It is necessary to continually explore troublesome situations in order to develop an appropriate rule for the determination of the

sources of particular items of income. In other words, the present territorial rule and any future residence rule could, in the interests of certainty and tax consequences desired, be buttressed by specific rules prescribing the source and taxability of particular items of income. In addition to these problems, the Administration must also be vigilant to assert and collect tax in situations where income is being derived by non-residents from Lebanese sources. Thus, scrutiny could be given to the activities of foreign concerns selling goods in Lebanon through agents to ascertain if they are properly paying tax.

At the present stage and as an aid to the collection of tax from non-residents, the adoption of a special flat rate for certain types of income going abroad, supported by withholding of tax at the source as provided fro under Articles 41, 42 and 43 of the Income Tax Law is commendable. However, it is doubtful to what extent these provisions are being really applied at present.

As an enforcement measure, it may be suggested that the payer of such incomes should not be allowed a tax deduction for amounts paid to non-residents unless he shows that he has withheld on those amounts the required tax.

CHAPTER V

THE STRUCTURE AND SCALE OF PROGRESSION

A. The Rate of Tax

Under the present system, as already indicated, all income subject to tax is classified into three categories. Each category is taxed separately and contains the description of the income items falling under it, the deductions allowable, and the applicable rate or rates scale.

1. Tax on Profits of Industrial, Commercial and Non-Commercial Enterprises

Under the first category concerned with the taxation of profits of industrial, commercial and non-commercial enterprises, the tax is levied on the net yearly profit actual or estimated after allowing the following personal and family deductions : L.L.1,500 for a single person, L.L.2,400 for a married person, and L.L.3,000 for a married person with children. In case a person is taxed on his estimated profits the deduction allowable is L.L.2,400 irrespective of his family status.[1]

After allowing the appropriate deductions the following two separate sets of progressive rates are applied one for industrial and commercial enterprises, the other for non-commercial enterprises :

---

1. Legislative Decree No.144, loc. cit., article 31.

	Commercial & Industrial Enterprises	Other Enterprises
On the portion of chargeable income not exceeding L.L.5,000	5%	4%
On the portion of chargeable income comprised between :		
L.L. 5,001 and L.L. 15,000.	7%	5%
L.L. 15,001 and L.L. 25,000.	9%	7%
L.L. 25,001 and L.L. 35,000.	13%	10%
L.L. 35,001 and L.L. 50,000.	17%	13%
L.L. 50,001 and L.L. 75,000.	22%	17%
L.L. 75,001 and L.L.100,000.	27%	22%
L.L.100,001 and L.L.250,000.	32%	27%
L.L.250,001 and L.L.750,000.	37%	32%
On the portion of chargeable income exceeding L.L.750,000.	42%	37%

A surtax of 10 per cent of the amount of the tax is added for the benefit of municipalities[1] and a temporary surtax of 3 per cent on the part of the tax that exceeds L.L.1,000 for the benefit of the Reconstruction Fund.[2]

Curiously enough, the law does not determine how the tax should be computed for persons deriving part of their income from commercial or industrial enterprises and part from other sources belonging to the first category.

---

1. Ibid., article 33.
2. Law of April 9, 1956, article 11, Official Gazette No.15, 1956.

In practice, the taxation of such persons has differed considerably depending on the tax inspector concerned as well as on the degree of mutual agreement between him and the taxpayer.

One method, is to tax first the income derived from commercial or industrial enterprises then the tax on the income from other sources is computed starting by the bracket or fraction of the bracket following that which the income from the first source has reached.[1] In other words, the income derived from a commercial or industrial enterprise is first taxed at the rates applicable to it, then the income from a non-commercial enterprise is taxed starting with the marginal rate applicable to the bracket or fraction of the bracket following that which the income from the first source has reached.

Thus, a single person earning L.L.50,000 from a commercial enterprise and L.L.25,000 from a non-commercial enterprise will be taxed as follows :

Bracket of Taxable Income	Rate of Tax	
L.L. 3,500	5%	
L.L.10,000	7%	
L.L.10,000	9%	
L.L.10,000	13%	
L.L.15,000	17%	
L.L.25,000	17%	(Marginal rate applicable to the slice of non-commercial income between L.L.50,000 and L.L.75,000).

1. Himadeh, op. cit., p.39.

Another method that has been followed is to compute the tax on the aggregate of the income derived from both the commercial or industrial enterprise and the non-commercial enterprise on the basis of the rate scale applicable to commercial and industrial enterprises.

Still another method which results from the fact that one income may be taxed on the basis of "real income" and another on the basis of "estimated income", is to tax each income separately according to the rate scale applicable to it depending on whether it is derived from a commercial or industrial enterprise or from a non-commercial enterprise.

The negligence on the part of tax authorities to lay down specific rules to govern such cases has thus resulted in confused and arbitrary practices on the part of tax inspectors which put a premium on corruption and result in gross inequity as between one taxpayer and the other with the same amount of income.

2. Tax on Salaries, Wages and Pensions

Under the second category concerned with the taxation of salaries, wages and pensions, the same personal and family allowances as under the first category are permitted with one additional provision concerning day laborers who are allowed an exemption of L.L.8 per day irrespective of their family status.[1] Taxpayers engaged in taxable activities under the first and second categories can benefit only once from these deductions.

---

1. Legislative Decree No.144, loc. cit., article 59.

After allowing the appropriate deductions the following rate scale is applied :

On the portion of chargeable income not exceeding L.L.4,800.	2%
On the portion of chargeable income between L.L. 4,801 and L.L. 8,400.	3%
L.L. 8,401 and L.L.12,000.	4%
L.L.12,001 and L.L.24,000.	5%
L.L.24,001 and L.L.36,000.	6%
L.L.36,001 and L.L.48,000.	8%
On the portion of chargeable income exceeding L.L.48,000.	10%

3. Tax on Income from Movable Capital

The tax on income 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 stock dividends.[2]

For the purpose of assessment the following sources of income are differentiated :

1. Income from Lebanese stocks and bonds.
2. Income from foreign stocks and bonds.
3. Income from mortgages.
4. Income from loans and deposits.
5. Income from forfeitures resulting from lapse of time.

---

1. Ibid., article 58.
2. Ibid., article 69.

The rate of tax on the first four groups is a flat 10 per cent of the gross returns, while on the fifth group it is 50 per cent.[1]

B. The Structure of a Progressive Tax

It can be noticed that the arrangement of the rate scale under the first and second categories of the income tax is progressive and is based on the bracket system, i.e. a system of progressive rates being applied to successive slices of income. In other words, the effective rate of tax upon the income of the individual taxpayer, i.e. the amount of tax that he pays divided by the amount of his total income, increases as the income increases. By this means the burden of tax is so distributed that the owner of the larger income contributes a larger portion of it in tax than the owner of the smaller income. A clear picture of how this system operates is given in Tables III, IV and V. These tables indicate the marginal rates, the effective rates, and the actual tax payments of persons who are single, married without children, or married with children.

The tax burden however, is adjusted not only by variations of the rate, but also by the grant of allowances in respect of certain categories of personal circumstances that affect the tax-paying capacity of individual taxpayers ; as well as by a differentiation between earned income on the one hand and investment income on the other.

---

1. Ibid., article 90.

T A B L E III

Effective And Marginal Rates of Income Tax

Commercial & Industrial Enterprise

Total Income L.L.	Marginal Rate of Tax %	Single Person			Married & no children			Married with children		
		Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %
1,500	-	-	-	-	-	-	-	-	-	-
2,000	5	500	25	1.2	-	-	-	-	-	-
2,400	5	900	45	1.8	-	-	-	-	-	-
3,000	5	1,500	75	2.5	600	30	1.-	-	-	-
5,000	5	3,500	175	3.5	2,600	130	2.6	2,000	100	2.-
6,000	7	4,500	225	3.7	3,600	180	3.-	3,000	150	2.5
10,000	7	8,500	495	4.9	7,600	432	4.3	7,000	390	3.9
20,000	9	18,500	1,265	6.3	17,600	1,184	5.9	17,000	1,130	5.6
30,000	13	28,500	2,305	7.7	27,600	2,188	7.3	27,000	2,110	7.-
40,000	17	38,500	3,745	9.4	37,600	3,592	9.-	37,000	3,490	8.7
50,000	17	48,500	5,445	10.9	47,600	5,292	10.6	47,000	5,190	10.4
60,000	22	58,500	7,570	12.6	57,600	7,372	12.3	57,000	7,240	12.1
70,000	22	68,500	9,770	13.9	67,600	9,572	13.7	67,000	9,440	13.5
80,000	27	78,500	12,145	15.2	77,600	11,902	14.9	77,000	11,740	14.7
90,000	27	88,500	14,845	16.5	87,600	14,602	16.2	87,000	14,440	16.-
100,000	27	98,500	17,545	17.5	97,600	17,302	17.3	97,000	17,140	17.1
110,000	32	108,500	20,670	18.8	107,600	20,382	18.5	107,000	20,190	18.3
150,000	32	148,500	33,470	22.3	147,600	33,182	22.1	147,000	21,990	22.-
200,000	32	198,500	49,470	24.7	197,600	49,182	24.6	197,000	48,990	24.5
250,000	32	248,500	65,470	26.2	247,600	65,182	26.1	247,000	64,990	26.-
300,000	37	298,500	83,895	27.9	297,600	83,562	27.8	297,000	83,340	27.8
500,000	37	498,500	157,895	31.6	497,600	157,562	31.5	497,000	157,340	31.5
750,000	37	748,500	250,395	33.4	747,600	250,062	33.3	747,000	249,840	33.3
800,000	42	798,500	271,320	33.9	797,600	270,942	33.9	797,000	270,690	33.9
1,000,000	42	998,500	355,320	35.5	997,600	354,942	35.5	997,000	354,690	35.5

T A B L E IV

Effective And Marginal Rates of Income Tax

Non Commercial Enterprise

Total Income L.L.	Marginal Rate of Tax %	Single Person			Married & no children			Married with children		
		Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %
1,500	-	-	-	-	-	-	-	-	-	-
2,000	4	500	20	1.-	-	-	-	-	-	-
2,400	4	900	36	1.5	-	-	-	-	-	-
3,000	4	1,500	60	2.-	600	24	.8	-	-	-
5,000	4	3,500	140	2.8	2,600	104	2.1	2,000	80	1.6
6,000	5	4,500	180	3.-	3,600	144	2.4	3,000	120	2.-
10,000	5	8,500	375	3.7	7,600	330	3.3	7,000	300	3.-
20,000	7	18,500	945	4.7	17,600	882	4.4	17,000	840	4.2
30,000	10	28,500	1,750	5.8	27,600	1,660	5.5	27,000	1,600	5.3
40,000	13	38,500	2,855	7.1	37,600	2,738	6.8	37,000	2,660	6.6
50,000	13	48,500	4,155	8.3	47,600	4,038	8.1	47,000	3,950	7.9
60,000	17	58,500	5,795	9.6	57,600	5,642	9.4	57,000	5,540	9.2
70,000	1 7	68,500	7,495	10.7	67,600	7,342	10.5	67,000	7,240	10.3
80,000	22	78,500	9,370	11.7	77,600	9,172	11.5	77,000	9,040	11.3
90,000	22	88,500	11,570	12.8	87,600	11,372	12.6	87,000	11,240	12.5
100,000	22	98,500	13,770	13.8	97,600	13,572	13.6	97,000	13,440	13.4
110,000	27	108,500	16,395	14.9	107,600	16,152	14.7	107,000	15,990	14.5
150,000	27	148,500	27,195	18.1	147,600	26,952	18.-	147,000	26,790	17.9
200,000	27	198,500	40,695	20.3	197,600	40,452	20.2	197,000	40,290	20.1
250,000	27	248,500	54,195	21.7	247,600	53,952	21.6	247,000	53,790	21.5
300,000	32	298,500	70,120	23.4	297,600	69,832	23.3	297,000	69,640	23.2
500,000	32	498,500	134,120	26.8	497,600	133,832	26.8	497,000	133,640	26.7
750,000	32	748,500	214.120	28.5	747,600	213,832	28.5	747,000	213,640	28.5
800,000	37	798,500	232,545	29.1	797,600	232,212	29.1	797,000	231,990	29.-
1,000,000	37	998,500	306,545	30.6	997,600	306,212	30.6	997,000	305,990	30.6

T A B L E V

Effective And Marginal Rates of Income Tax

Wages, Salaries and Pensions.

Total Income L.L.	Marginal Rate of Tax %	Single Person			Married & no children			Married with children		
		Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %	Taxable Income	Amount of Tax	Effective Rate %
1,500	-	-	-	-	-	-	-	-	-	-
2,000	2	500	10	.5	-	-	-	-	-	-
2,400	2	900	18	.75	-	-	-	-	-	-
3,000	2	1,500	30	1.-	600	.12	.4	-	-	-
4,000	2	2,500	50	1.25	1,600	32	.8	1,000	20	.5
6,000	3	4,500	90	1.5	3,600	72	1.2	3,000	60	1.-
8,000	3	6,500	147	1.8	5,600	120	1.5	5,000	102	1.3
10,000	4	8,500	208	2.1	7,600	180	1.8	7,000	162	1.6
12,000	4	10,500	288	2.4	9,600	252	2.1	9,000	228	1.9
14,000	5	12,500	373	2.7	11,600	332	2.4	11,000	308	2.2
20,000	5	18,500	673	3.4	17,600	628	3.1	17,000	598	3.-
24,000	5	22,500	873	3.6	21,600	828	3.5	21,000	798	3.3
30,000	6	28,500	1,218	4.1	27,600	1,164	3.9	27,000	1,128	3.8
36,000	6	34,500	1,578	4.4	33,600	1,524	4.2	33,000	1,488	4.1
40,000	8	38,500	1,868	4.7	37,600	1,796	4.5	37,000	1,748	4.4
45,000	8	43,500	2,268	5.-	42,600	2,196	4.9	42,000	2,148	4.8
48,000	8	46,500	2,508	5.2	45,600	2,436	5.1	45,000	2,388	5.-
50,000	10	48,500	2,678	5.4	47,600	2,588	5.2	47,000	2,528	5.1
60,000	10	58,500	3,678	6.1	57,600	3,588	6.-	57,000	3,528	5.9

CHART I

MARGINAL AND EFFECTIVE RATES OF TAX
SINGLE PERSON DERIVING INCOME FROM
COMMERCIAL & INDUSTRIAL ENTERPRISE AND NON COMMERCIAL ENTERPRISE

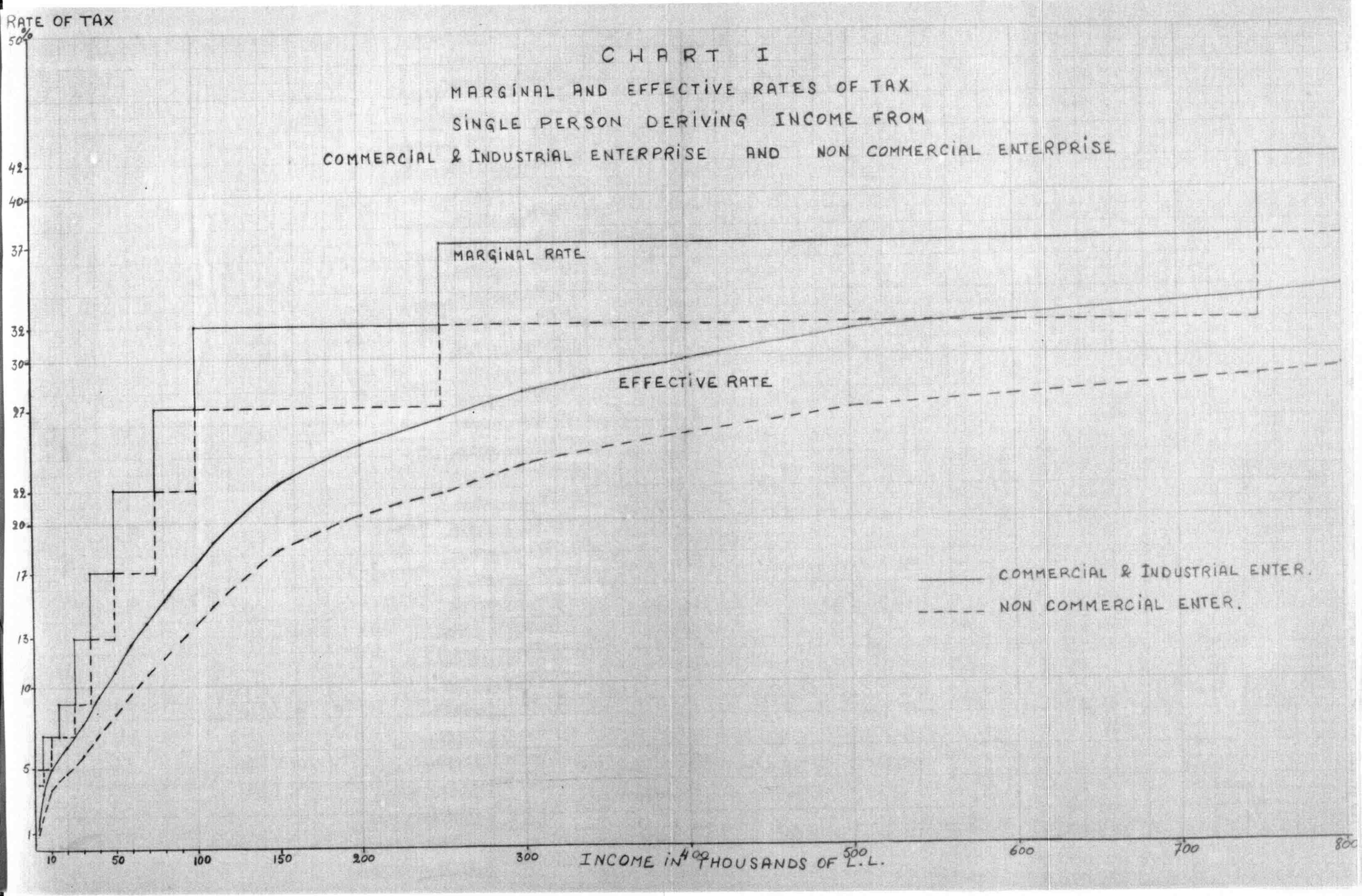


CHART I

MARGINAL AND EFFECTIVE RATES OF TAX
SINGLE PERSON DERIVING INCOME FROM
COMMERCIAL & INDUSTRIAL ENTERPRISE AND NON COMMERCIAL ENTERPRISE

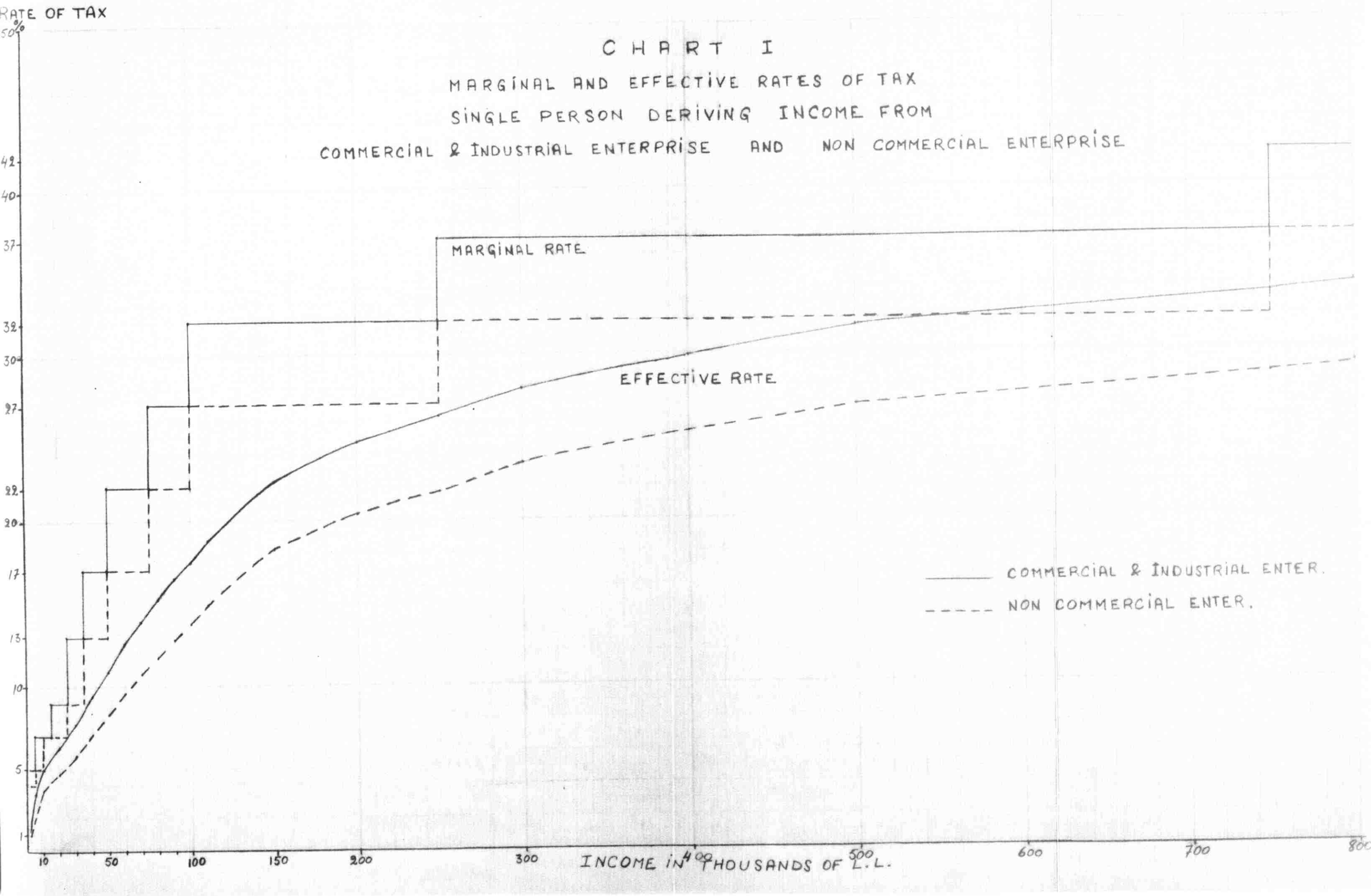
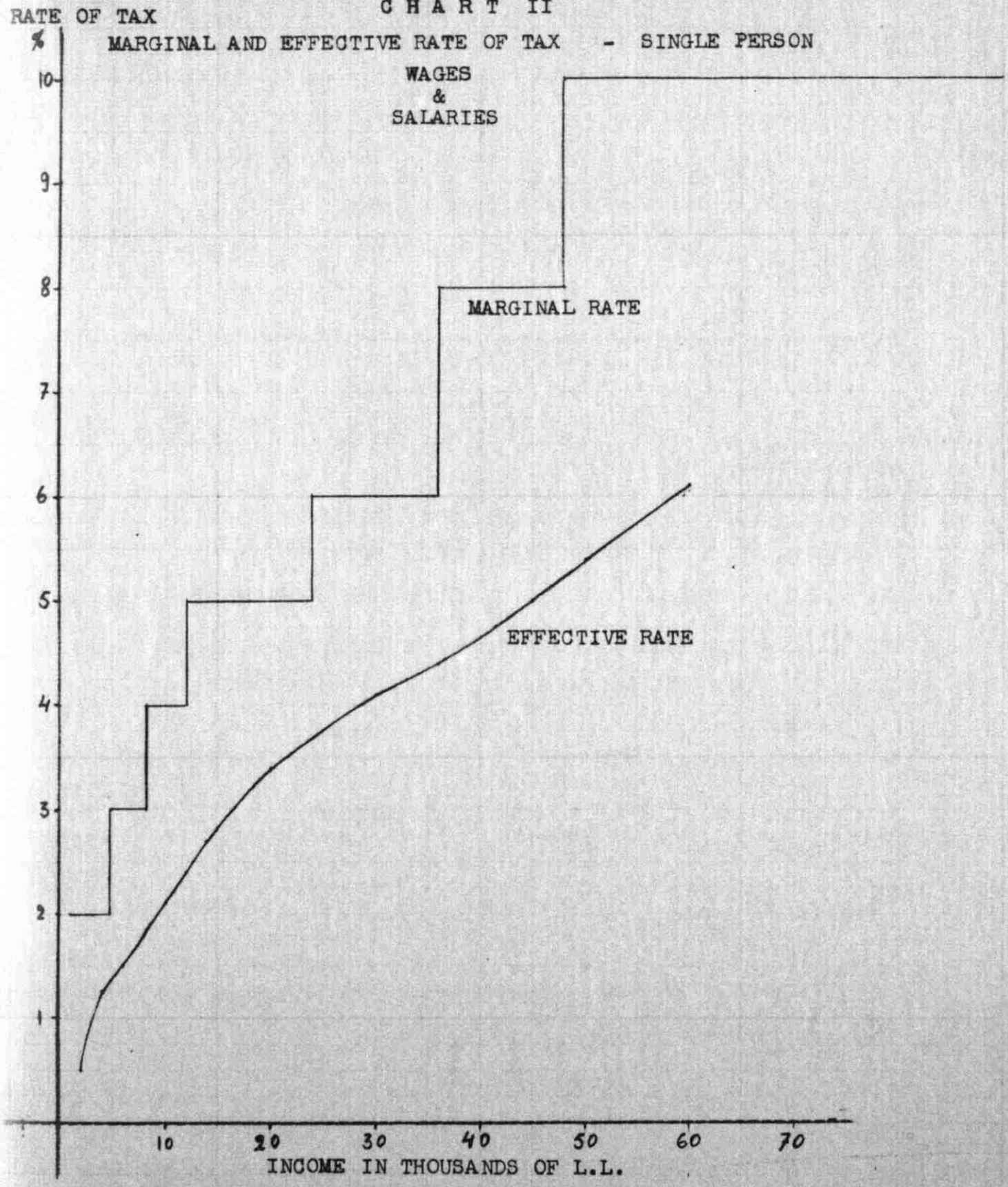


CHART II

MARGINAL AND EFFECTIVE RATE OF TAX - SINGLE PERSON



The ultimate question to be considered therefore in a review of the distribution of the burden of taxation, is the amount of tax borne by a particular individual with a particular income and particular personal circumstances in relation to other individuals with different levels of income and different personal circumstances. It is usual to employ the term "graduation" to describe the operation of the personal allowances and the progressive scale, and the term "differentiation" to describe the effect of distinguishing between earned and investment income or between income according to effrt. Each of these instruments is used in an income tax to relate the amount of tax borne by one taxpayer to the amount of tax borne by another.

While in our subsequent discussion it was found necessary to consider the form and incidents of each instrument by itself in order to evaluate it and see how it can be modified in a revised income tax, the fact that its effects are not ultimately to be considered in isolation but only as contributing to determine the amount of tax and the effective rate of tax that each individual has to bear through the operation of all the instruments combined is not to be neglected.

C. The Basis of Progressive Taxation

Before attempting to analyze the extent to which the present distribution of the burden of the Income Tax is satisfactory or not, it is advisable to establish a point of view about the basis upon which the principle of progressive taxation rests.

While it is plain that progression is not the only possible scheme of tax distribution, yet, it has, for various reasons, been adopted as a basic feature of all income taxes applied in the world and the progressive character of the income tax is nowadays taken for granted.

The case for progressive taxation has been argued upon the basis of a number of technical propositions construed on notions of benefit, sacrifice, ability to pay, or economic stability. While undoubtedly these distinctive arguments have their merit, they are by no means uncontroversial, and a case for progression confined to them will prove to be an uneasy one.[1]

The case is believed to have stronger appeal when progressive taxation is viewed as a means of reducing economic inequalities.[2] In fact progression cannot be defined meaningfully without reference to its redistributive effect on wealth or income. It would seem therefore, that any consideration of progression must at some time confront the issue of equality, which in itself is perplexing and controversial.

In its narrower application to the income tax as such, a generally accepted argument for progression is that it merely compensates for the regressivity of other taxes in the overall tax system. Its function in this view is to make the total burden from taxes, if not slightly progressive, at least proportionate to the

---

1. See Walter J.Blum and Harry Kalven, Jr., The Uneasy Case for Progressive Taxation, (Chicago : The University of Chicago Press, 1953).

2. Ibid., p.104.

incomes of taxpayers.[1]

A tenable proposition is that the application of any principle must be controlled by the general sense of fairness, and while the rule of fairness was not invariably on the side of progression, it can well be asserted that in the present state of public opinion, progressive taxation is needed in order to conform with the notions of equitable distribution that are widely, almost universally, accepted.

The case for progression must, therefore, be rested on the case against inequality. In other words it must be rested "on the ethical or aesthetic judgement that the prevailing distribution of wealth and income reveals a degree of inequality which is distinctly evil."[2]

Such a view however, takes account only of the distributional effects of progression which is but one side of the problem. The degree of progression in a tax system, it may be argued, does, after a certain point, affect production and the size of the national income available for distribution. Thus in its extreme the problem may become one of choice between more progress or more justice both of which will prove costly luxuries - costly, above all in terms of each other.[3]

The real problem of policy under such circumstances will thus develop into one of weighing the one set of effects against the other.

---

1. Ibid., p.5.
2. Simons, op. cit., pp.18-19.
3. Ibid., p.24.

Under the present tax set-up, this conflicting problem of choice involving the progression of the tax system, cannot be said to occur in Lebanon for the overall incidence of the present tax system is anything but steeply progressive if not positively regressive.

D. The Scale of Progression

As already stated, the graduation of scale under the Income Tax takes the form of charging successive slices of income at increasing rates of tax. The first slice of every income is exempt by the personal and family allowances, the succeeding slices are charged at rates ranging between 5% and 42% for incomes from commercial and industrial enterprises, between 4% and 37% for incomes from non-commercial enterprises, and between 2% and 10% for incomes from salaries, wages and pensions. The effect of the system, as illustrated in the accompanying graphs and tables, is that the effective rate of tax rises gradually from 1.25% of an income of L.L.2,000 accruing to a single person from a commercial or industrial enterprise to a rate of 35.5% of an income of L.L.1 million accruing from the same source (see Table III).

The equivalent effective rates for incomes accruing from a non-commercial enterprise range from 1% of an income of L.L.2,000 to 30.6% of an income of L.L.1 million (see Table IV). The effective rates for incomes accruing to a single person from a salary, wage or pension, range from 0.5% of an income of L.L.2,000 to 6.1% of an income of L.L.60,000 (see Table V).

The following features of the rate structure require particular attention :

In the first place it will be noticed that for incomes from industrial, commercial and non-commercial enterprises the starting rates rise fairly steeply over a narrow range of income in the lower end of the scale and much more smoothly over a wider range of incomes in the upper end of the scale. This distortion is the result of the extreme narrowness of the initial brackets which soon give way to much wider brackets at higher income levels.

In other words "there is an incongruity between the progressiveness in the tax rates and the progression in size of income brackets,"[1] the increase in size of bracket moves slower than the increase in tax rates in the lower brackets, whereas in the higher brackets it moves faster than the increase in tax rates.[2]

A direct outcome of this is that the tax scale is steeply progressive over a narrow range of lower incomes and much less progressive over a wide range of higher incomes, thus, in effect, favouring higher incomes as against lower and middle incomes, and proving to be less truly progressive than it may appear to be on first sight. This peculiar characteristic impairs the equity of the tax and decreases its expected redistributive effects.

Some examples from the accompanying graphs and tables will help give a concrete picture of these observations.

---

1. Higgins, op. cit., p.61.

2. Himadeh, op. cit., p.47.

From Table III it can be noticed that the effective rate of tax of a single person deriving his income from a commercial or industrial enterprise rises steeply from nil for an income of L.L.1,500 to 6.3% of an income of L.L.20,000 whereas it rises by only 3.1% (9.4 - 6.3) between an income of L.L.20,000 and an income of L.L.40,000. Furthermore, it can be noticed that the effective rate rises steeply to 16.9% of an income of L.L.90,000, whereas it is only at an income of L.L.800,000, where the effective rate is 33.9%, that another equal rise in the effective rate is attained.

The same phenomenon can be observed in Chart I where it can be noticed that the pertinent effective rate curve is very steep over the range of income between L.L.1,500 and L.L.10,000, slightly less steeper over the range of income between L.L.10,000 and L.L.110,000, and considerably smoother thereafter.

This phenomenon is also apparent in the scale applied to income from salaries, wages and pensions, though in a less accentuated manner. From Chart II it can be noticed that the effective rate curve rises quiet steeply up to an income of L.L.14,000 and considerably less steeply thereafter.

The second feature to be observed is that for all sources of income, but especially for salaries and wages, there is a marked discontinuity in progression. No justification can be thought of for the fact that progression under the latter category stops at an income of L.L.48,000 when it is obvious that a wide group of executives earn salaries either in money or in kind, considerably in

excess of this sum.[1]

Moreover, while progression under the category concerned with the taxation of income from industrial, commercial and non-commercial enterprises does actually stop at an income of L.L.750,000 however, for a considerably wide range of income between L.L.250,000 and L.L.750,000, there is a marked discontinuity of progression which has nothing to commend and leads to a considerable reduction of progression at upper income levels.

If, as it is believed, there is no ideal rate of progression that can be demonstrated by formula, the minimum requirement for a system of progression to be defensible on some grounds, is that it should confirm to some general rule of fairness or notion of justice in the distribution of the burden of taxation in a sense that is akin to the propositions propounded in the preceeding section and on which the whole idea of progression rests.

A second prerequisite for a consistent system of progression, is that it should achieve as nearly as possible a smooth progression at all levels of income.

As demonstrated, and as will presently be established in respect of some of its other aspects, the present system of progression does not confirm to these minimum requirements. Therefore, if any reform of the Income Tax is to be undertaken, there is every reason to give primary importance to the scrapping of the present

---

1. A recent draft bill for the amendment of the Income Tax proposes the extension of progression for income from wages and salaries up to L.L.100,000.

cumbersome, arbitrary,overlapping, inconsistent, and inequitable multiple progressive rate structure in favour of a single schedule to be applied to all personal income from whatever source.

E. Personal Allowances

If the progressive rate structure of an income tax may be said to recognize that a man's "capacity to pay" tax varies with the level of his income, the personal allowances carry this conception of varying capacities to pay into another field and recognize that, if equal relative sacrifice is what it is sought to achieve, the same tax bill may represent very different sacrifices for two persons with equal incomes according to differences in their respective personal situations.[1] A man with L.L.5,000 a year and a wife and two children to support out of it is less able to bear a given amount of taxation than a single man with the same amount of income.

Under a system using the deduction from income method of allowances by which a fixed amount of income is deducted from a person's income subject to tax, the operation of allowances provide as well an exemption limit. Thus, allowances will in effect have a double part to play in the system : at once to create effective exemption limits for taxpayers in the lowest ranges of income, and at the same time to afford the required measure of differentiation between taxpayers at all levels of income.

---

1. Royal Commission, Second Report, op. cit., p.45.

It is generally believed, that there are disadvantages in using the same instrument to perform this double task. The major disadvantage lies in the fact that "the function of an instrument of exemption is not the same as the function of an instrument of graduaction".[1] An exemption limit, as already stated (supra p.53) while it need not be confined to the idea of minimum subsistence, must usually be fixed at a level "that is high enough to prevent the tax impinging upon what is required for subsistence."[2] On the other hand, an allowance that is given at all levels in recognition of particular personal circumstances has no real connection with subsistence. Its purpose is not to provide a taxpayer with a tax-free allowance of the cost of keeping himself, in the case of the single personal allowance, or of the cost of keeping himself and his wife, in the case of the marriage allowance, since living expenses should be found out of the whole income after it has paid tax rather than out of that part of the income which is not subjected to tax. A personal allowance is primarily a means of ensuring progressiveness in the effective rates of taxation, as well as a method of differentiation between people with the same income but different family circumstances. There would be little meaning therefore in basing the amount of the personal allowance upon a standard of subsistence which had no practical meaning upon the actual standard of living.[3]

---

1. Ibid., p.49.
2. Ibid..
3. Ibid..

With this in mind let us now examine the system of allowances in application under the Lebanese Income Tax.

Here the method of granting personal and dependency allowances takes the form of "deductions from income". In so far as these deductions have already been discussed in their role as exemptions under the section concerned with the latter, this section will be confined to a consideration of allowances in the extent to which they contribute to the degree of progression and differentiation in the Income Tax scale.

The deduction from income method of allowances, although adopted by many countries, is criticized as theoretically unsound. This is so because under a graduated income tax it modifies the tax of a person subject to higher rates to a greater absolute extent than it does that of a person subject to only minimum rates.[1] If the range in rates, for example, is from 1 to 15 per cent and the allowance is L.L.1,000, the value of the allowance to a person subject to the minimum rate is L.L.10 ; the value to a person subject to the maximum rate is L.L.150.

Another alternative method of income tax allowance which is more favoured on theoretical and practical grounds provides that the initial allowance shall be credited against the computed tax rather than against the taxpayer's income. Thus, if the tax is computed on the entire net income of every taxpayer and each person is then relieved of L.L.25 of tax, the money value of the relief

---

1. Tax Exemptions, op. cit., p.48.

to each class of taxpayers will be precisely the same whether his income is great or small.

Put in different terms, the deduction from tax method of allowances is one under which the tax liability of each taxpayer is calculated on his entire income and then allowances in the form of flat amounts varying with the family status or number of dependents of the person concerned are deducted from the tax liability itself.

The decided advantage of this method over the deduction from income scheme, is that it provides for equal benefits in amounts of tax saved to taxpayers in the same family circumstances at all levels of income.

In addition to this superiority on grounds of equity, the deduction from tax scheme of allowances has the additional advantage of permitting an easier method of computing the tax liability. The taxpayer simply calculates tax on his total income at the rates indicated by the rate schedule and then deducts from this tax the credit to which his family status entitles him.

An example will make this clear. Assuming that the allowances granted under this scheme in the form of credits to be deducted from tax are as follows :

Personal allowance - single person. L.L.80.

Wife..... L.L.50.

Each child or other dependent..... L.L.30.

Assuming further that the first three rates of tax in a scale of progression are as follows :

	Rate of Tax
Income not exceeding L.L.5,000.	5%
Income comprised between : L.L.5001 and L.L.10,000.	7%
L.L.10,001 and L.L.20,000.	10%

etc.

Under this scheme the tax liability of a person with an annual income of L.L.10,000 will, irrespective of his family status, be calculated as follows :

Slice of Income	Rate	Amount of Tax
L.L.5,000.	5%	250
L.L.5,000.	7%	350

Total tax liability before allowances L.L.600.

Once this figure is arrived at, the appropriate allowable deductions are substracted from it. Thus, the tax liability of a single person will be L.L.600 - L.L.80 = L.L.520 ; of a married person L.L.600 - L.L.80 - L.L.50 = L.L.470 ; and of a married person with one child L.L.600 - L.L.80 - L.L.30 = L.L.440.

A third advantage of this system is that it can permit a cleavage between the double tasks accorded to allowances under the deduction from income method. Thus, a general exemption limit could be set at, for example, L.L.2,500 , and any income in excess of this sum will be subject to the normal rates of tax. The tax liability will then be reduced by the appropriate allowances.

Another advantage, as will be seen in the following section, is that it would allow the incorporation of the scheme of income differentiation into that of allowances.

F. Income Differentiation

Income differentiation or earned income relief, or differentiation in favour of income that requires a greater amount of personal effort, is in essence a form of differentiation between two types of income namely, income from work and income from capital.

It is based on the idea that, if a given amount is to be raised by taxation, the burden of that sum is more faily distributed if a pound of earned income is treated as not being the taxable equivalent of a pound of investment income.[1]

The differentiation in favour of earned income is based particularly on the fact that, in general, it has less stability of source than investment income and its receipt does depend, as the other's does not, upon the receiver being available to give services in exchange for it. It does not accrue without the contribution of his own effort, and the prospects of its accrual are therefore affected by such circumstances as age, sickness, or other disability.

The relief or differentiation is thus intended as an allowance in recognition of the fact that the recipient of earned income needs to save a portion of his income for retirement, or as a reserve in case of illness, in a way in which the recipient of investment income does not.

Furthermore, it has been held, that "there is an element of expense involved in obtaining remuneration from work that is not

---

1. Royal Commission, Second Report, op. cit., p.67.

2. Ibid., p.79.

present in the obtaining of income from investment and at the same time cannot be completely allowed for by deductions for expenses in tax assessment."[1]

In other words, the performance of work involves a real cost in the form of effort, weariness or merely sacrifice of leisure, whereas the ownership of property involves no such real cost.

In addition to this, the property owner has an advantage in comparison with the man who lives on a wage or salary since he has not only an opportunity for making capital gains, which in the absence of a capital gains tax go uncharged, but also has a suitable hedge against inflation.

Having presented the case for earned income differentiation, we shall now consider the pertinent legislation in the Lebanese Income Tax.

In its report to Parliament on November 16, 1944[2] laying down the main features of the proposed income tax law and advocating its adoption, the Parliamentary Finance Committee had roughly this to say in justification of the division of the Income Tax into three separately taxed categories ; "the main reason that leads the Government to divide the income tax into three separate categories, is that such division permits the Financial Aurhorities, to apply to incomes from different sources rates that differ with the amount

---

1. Ibid., p.67.

2. This report was incorporated into the preamble to the first Income Tax Law.

of personal effort needed in each of these sources,"[1] in such a manner that income which needs a greater amount of personal effort is less heavily taxed than other income.[2]

This statement should in all probability have a sort of counterpart in some French legislation on the income tax where it could well be advanced in support of applying to incomes from different sources proportionate rates that differ with the amount of personal effort needed in each of these sources. In the particular Lebanese case however, it was certainly availed of out of imitation and for lack of other justification for a system which does in fact contradict this declared purpose.

In its application of progressive taxation to separate categories of income depending on their source, the Lebanese Income Tax, has created an anomalous distortion whereby, a person deriving his income wholly from one source, say a salary, is in many instances, more heavily taxed than a person earning the same amount of income but deriving it from more than one source e.g. from a salary and commercial enterprise or a salary and profession. This is so, inspite of the fact that a marked difference exists in the scale of progression applied to incomes from different sources.

Thus, while in principle it is intended at favouring earned income, this separate taxation does implicitly discriminate against

---

1. Himadeh, op. cit., p.46 ; and Lebanese Government, Parliamentary Debates, Session of 1943-44 Meeting of November 16, 1944, p.22.

2. Ibid..

persons who draw their income from one source and favours a reliance on different sources of income.

Some examples will make this clear.

Referring to Tables III, IV and V, we notice that :

1. A single person earning L.L.30,000 a year distributed as follows :

		Tax Liability
From a commercial enterprise	L.L.10,000	495
From a profession.	L.L.10,000	375
From a salary.	L.L.10,000	208
His total tax liability will be :		L.L.1078.

On the other hand, a person earning L.L.30,000 a year from salary pays a tax of L.L.1218, i.e. L.L.140 in excess of the former.

2. A single person earning L.L.40,000 a year distributed as follows :

		Tax Liability
From a profession	L.L.20,000	945
From salary.	L.L.20,000	673
His total tax liability will be :		L.L.1618.

On the other hand, a person earning L.L.40,000 from salary pays a tax of L.L.1868, i.e. L.L.250 in excess of the former.

Thus we note that in the two examples, persons deriving all their income from salary are more heavily taxed than persons deriving half or two thirds of their income from a commercial enterprise or a profession.

It should be pointed out that an absolute tax advantage for a person deriving a certain income from different sources as against a person deriving it from one source cannot be expected at all levels of income.

Another outright contrariety to the declared policy of taxing "more heavily incomes that need less effort than those that need more effort" is the treatment of income from movable capital which, by any standards, needs the least amount of effort and is as certain as any income can be. Yet, the rate applied to it is a simple proportionate one of 10 per cent.

A mention should also be made in this respect of the separate taxation of income from built property at the flat rate of 1/12 of the rental value of 8-1/8 per cent (11-1/3 % including a 3% tax for municipalities) which was in effect in Lebanon up to 1963 and will only be replaced by a progressive tax starting with 1964.[1] This treatment had nothing to commend in the presence of a progressive income tax on wages and salaries. On the same grounds, no justification can be advanced for the present exemption of agricultural income from tax.

The statement of policy by the Parliamentary Finance Committee which was incorporated into the preamble to the first Income Tax Law was therefore a vain justification for what in actual fact has vitiated the whole idea of differential treatment of earned income.

---

1. See Law of September 17, 1962, Supplement to Official Gazette No.38 of 19.9.1962.

If differentiation in favour of earned income, or differentiation between incomes from different sources on the basis of personal effort needed in each, is desired, it can readily be obtained without resort to a distorted system.

In case a schedular system is favoured for one reason or another, then a more faithful adoption of the type of income tax applied in France (with proportional rates applied to each schedule and an additional progressive tax on aggregate income) would well be commendable. However, if as it is more advisable, a general income tax is resorted to with one schedule applied to all personal income then income differentiation would most appropriately be allowed for in the same manner suggested for personal and family allowances namely, in the form of a flat amount deductible from tax. Thus, persons deriving their income from specified sources, say a wage or salary, which are considered to require a greater amount of personal effort, would, for example, be allowed a deduction from tax of L.L.20 over and above the personal and family deductions allowable.

CHAPTER VI

THE TAXATION OF COMPANIES AND DIVIDENDS

A. Similar Treatment of Individuals and Companies

Under the present law, no fundamental difference exists between the individual liable to tax and the company liable to tax in respect of the taxability of incomes, the ascertainment of the chargeable income, and the assessment. In so far as the former two items are discussed under separate chapters we shall dwell in this chapter exclusively on the third, namely assessment.

The most conspicuous feature of this essentially similar treatment is the subjection of companies, in their capacity as legal persons, to the same progressive rates applied to real persons. The only variation in this respect, arises from the fact that companies are not allowed any of the minimum exemptions or deductions granted to individuals.

This system is certainly an outcome of utter neglect of the significant difference between the nature of the income of individuals and that of corporate bodies, and a misconception of the idea and purpose of progression.

The similar treatment of individuals and companies for the purpose of income taxation would be understandable perhaps, in an economic society in which corporations were exclusively family-owned and family-managed, or otherwise very closely held. Consequently, under such circumstances, an individual would, speaking generally, be taxed the same whether his wealth was in the corporate form or in individual ownership.[1]

Such a support for the present structure however, does not exist, since it necessarily falls once a number of corporations change from closely held, family-owned and family-managed affairs to a large organization in which ownership is no longer closely held.

Although, at the present time, the large majority of companies in Lebanon are of the "société en nom collectif" and "société en commandite" type, which are usually owned by a small number of individuals, often members of the same family, yet, the income of such companies is by specific provision fully integrated with the taxation of individual income.[2] As an outcome of this, the unfavourable consequences of the subjection of corporate income to the same progressive rates applied to individuals fall exclusively upon companies of the "société anonyme" type which, by any standard, are least amenable to a family or closely held type of business organization.

---

1. The Fiscal System of Venezuela, op. cit., p.112.
2. Legislative Decree No.144, loc. cit., article 35, (see following section).

B. The More Favoured Position of Closely Held Companies

A peculiar feature of the present system is the implicit more favourable treatment accorded to closely held companies of the "collectif" and "commandite" type as against the "société anonyme".

This phenomenon is an outcome of the subjection of corporate income to a progressive rate scale while at the same time adopting the system in accordance with which the income of closely held companies is fully integrated with the taxation of individual income.

According to the latter system the income of closely held companies, namely of the "collectif" and "commandite" types, must for tax purposes be split among the owners each of whom is then separately taxed on the basis of his own share.[1]

This splitting of income under the present Law, creates an essentially inequitable and distorted practice by which the "collectif" and "commandite" companies have a net tax advantage over the "société anonyme", in such a manner, that a company of the former type realizing the same amount of profits as a company of the latter type will in effect, pay a much smaller proportion of it in tax.

An example will help make this clear :

Suppose a company of the "collectif" type composed of five associates with equal participation, each of whom is married and has children, makes a net profit of L.L.250,000.

This profit will be divided equally among the 5 associates each getting L.L.50,000 out of which a deduction of L.L.3,000 is

---

1. Ibid..

allowed, the balance of L.L.47,000 being taxable income.

The tax liability of each associate will be determined as follows :

Slice of Income L.L.	Marginal Rate of Tax	Amount of Tax L.L.
5,000	5%	250
10,000	7%	700
10,000	9%	900
10,000	13%	1,300
12,000	17%	2,040
L.L.47,000	Total Tax Liability	L.L.5,190

Each associate will thus incur a tax liability of L.L.5,190. The five associates will therefore incur a total tax liability of L.L.29,950.

On the other hand, a "société anonyme" with a considerable number of shareholders and making a net profit of L.L.250,000 will incur a total tax liability of L.L.65,950 (see Table VI).

From these figures it can be observed that a company of the "collectif" type making L.L.250,000 in profits pays L.L.40,000 (65,950 - 25,950) less than a "société anonyme" making the same amount of profit.

In addition to this, it should be borne in mind that closely held companies and individuals are in a better position than a "société anonyme" to make use of fraudulent means and tricks for tax evasion.

It should be pointed out in this respect that the splitting of income method for the taxation of closely held companies is most

TABLE VI

Marginal and Effective Rate of Income Tax
Corporate Profits.

	Marginal Rate %	Amount of Tax	Effective Rate %
5,000	5	250	5.-
15,000	7	950	6.3
25,000	9	1,850	7.4
35,000	13	3,150	9.-
40,000	17	4,000	10.-
50,000	17	5,700	11.4
75,000	22	11,200	15.-
100,000	27	17,950	17.9
150,000	32	33,950	22.6
200,000	32	49,950	25.-
250,000	32	65,950	26.4
300,000	37	84,450	28.2
400,000	37	121,450	30.1
500,000	37	158,450	31.7
750,000	37	250,950	33.4
800,000	42	271,950	34.-
1,000,000	42	355,950	35.6

appropriately made use of by tax systems characterized by a double rate structure namely, a progressive rate scale for personal income and a proportional rate for corporate profits. Recognizing the infinite ways by which wealthy individuals may escape the full impact of the progressive rate structure by resorting to the intricacies of closely held companies, which would otherwise be taxed at a simple proportional rate, and discerning a close indentity between the income of such companies and that of their owners, a splitting of income is therefore aptly insisted upon.

Thus, in effect, the splitting of income method is usually used to discriminate against - not in favour of - closely held companies which would otherwise be taxed at a proportionate rate and could be availed as a means for tax evasion by wealthy individuals and families.

C. The Case for Separate and Proportionate Taxation of Corporate Income

Any satisfactory basis of taxation for corporate incomes must acknowledge the significant difference between the nature of the income of individuals and that of corporations.[1]

The distinguishing quality of true money income is that it is at the free disposal of the individual to whose benefit it accrues. So far as corporate profits are distributed as dividends they assume this quality by being transmuted into personal incomes, and to that extent they should become subject to the tax scale, preferably

---

1. See Royal Commission, Final Report, op. cit., pp.15-17 and pp.345-346.

progressive, laid down for personal income. So far as they are not thus distributed they retain their own distinctive quality as "a corpus of funds" separate and apart from the current flow of personal income,[1] and to that extent should be treated differently.

Moreover, the adaptability of the income tax to the individual case, according to the principle of capacity to pay, emphasizes "the essential difference between personal income, each under the control of an individual, and corporate profits, as earnings of an impersonal venture which may or may not be turned into personal incomes."[2]

If for tax purposes personal incomes are accepted as the prime measure of capacity to pay - a measure that is modified in its application by a number of adjustments such as personal and family allowances, earned income differentiation etc. - there is no tenable corresponding concept of relative capacity to pay that is valid for the undistributed profits of companies. Moreover, considerations of equal sacrifice and reduction of economic inequality advanced in support of progression do not apply to comparisons between large and small corporations.

Furthermore, considerations of economic efficiency undoubtedly favour the levying of a tax at a rate or schedule of rates that is independent of the total profits earned by the corporation. There certainly is "little point in penalizing bigness as such" in a time when "technological progress has carried with it a tendency for efficiency to increase with size in many fields of production."[3]

---

1. Ibid., p.345.
2. Ibid..
3. Higgins, op.cit., p.61.

Thus penalizing bigness may become a means of penalizing efficiency.[1]

This, however, does not conclude the case against the progressive taxation of corporate income.

It may be argued for instance, that a system of concurrent progressive taxation of personal income and proportionate taxation of corporate income will lead to certain inequities. The individual proprietor of a business, under such a system, is liable to be assessed at progressive rates of tax on the whole of the profits earned by him irrespective of the portion he may retain for the purpose of strengthening and expanding his undertaking. In other words, his saving through the medium of his business is effected out of income that has borne the full burden of a progressive scale of tax.

On the other hand, a corporation will be in a position to set aside out of profits whatever amounts are necessary or advisable for the maintenance and expansion of its business without incurring a progressive burden of tax. Thus, it is argued, a company will be in a position to operate as a medium through which the whole body of its equity shareholders are enabled to achieve a measure of saving out of profits in respect of which only a proportional rate of tax has been paid.[2]

This indirect benefit of incorporation, while it cannot be ignored, is in fact restricted to the company as such and cannot be assumed to accrue to individual shareholders except in a very closely held company. The saving is achieved on behalf of the shareholders

---

1. Ibid..

2. Royal Commission, Final Report, op. cit., p.17.

as a whole, the money is in most instances outside the control of any one individual shareholder and it is certainly not directly at his disposal as free personal income.

While it is true on the other hand, that a regular course of investing retained profits must normally have an influence on the rate of long-run appreciation in share values, and therefore on their realisable value ; this connection is by no means automatic and, at any time, very undertain to justify the notion that the shareholder's ability to dispose of part of his holding gives him the power to enjoy in his own hands a spendable income equivalent to his share of the undistributed profits.[1]

The fact is, that the amount of capital gains which particular individuals make on particular shares depends on their timing of purchase and sales, and not on the amount of undistributed profits during any particular period. Furthermore, in the case of successful companies the growth in market capitalisation resulting from the growth in earnings and dividends may greatly exceed the growth in the companies' reserves through the continued ploughing back of profits.

Moreover, it can readily be observed from a scrutiny of stock price fluctuations that the amount of distributed profits or dividends tend more directly to influence in the short run the market value of a share rather than the amount of undistributed profits that are ploughed back into the business.

---

1. Ibid..

In the light of the foregoing it may well be concluded that "it does not seem possible to find a satisfactory basis of taxation for corporate profits by any line of reasoning that would treat companies as if they were the same sort of taxpayers as individuals."[1] The distinction of quality between personal incomes and corporate profits needs therefore to be clearly recognized and firmly embodied in the tax system.

In the absence of any clear guidance from principles of fiscal equity, the rates of tax on corporate profits as such must be expected to be determined primarily by the current need for revenue and the requirements of current economic policy whose objects it may be hoped to achieve by changes in the impact of taxation.

Thus, for example, a policy of favouring company investment must, to be consistent, be accompanied by a favourable tax treatment of undistributed profits.

Taking into consideration the present stage of development of the Lebanese economy, and the advisability of favouring corporate investment in view of the advantages that this form of organization appears to offer for the formation of capital and the adoption of efficient business practices, it is advisable, with respect to the corporate rate structure, to have two rate brackets. An initial rate of say 15% for profits of up to L.L.75,000, and a rate of 25% for profits in excess of this.

---

1. Ibid..

Among other things, such a corporate rate structure that is not bound tightly to the individual rate structure has the inportant advantage of providing greater flexibility in formulating tax policy. Thus, if economic or revenue conditions warrant, any rate or rates that it might be found advisable to apply to corporate incomes, may be changed without having to face the serious obstacles that the present structure offers.

D. The Taxation of Dividends.

The amount which a company distributes as dividends need not always be identical with the amount of its chargeable income ; it is left to the discretion of the company to distribute either exactly the amount of the chargeable income for any particular year, or more, or less. A company may, if it thinks fit, refrain altogether from distributing a dividend, and to that extent no question of taxation of dividends will arise. On the other hand, it may distribute an amount exceeding the chargeable income of the respective business year by adding profits accumulated from previous years in the form of reserves, or capital in the form of the release of assets.

Under these circumstances, the Lebanese Income Tax has opted for the taxation of all forms of receipts derived from stocks[1] irrespective of their origin or the name bestowed on them.[2]

---

1. Legislative Decree No.144, loc. cit., article 69.

2. Ibid..

The only exception to this rule is granted to payments intended for the reimbursement of creditors or share holders if they are effected from other than reserves or the profit and loss account.[1] In other words, if they are effected out of capital i.e. from the proceeds of a sale of capital assets which effectively leads to an equivalent reduction of the capital of the company.[2]

It should be pointed out in this respect, that the proceeds of a sale of a capital asset are exempted from tax only in so far as they do not exceed the capital value of this asset as appeared before its sale in the books of the company after allowing the appropriate depreciation. Any amount realized in excess of this, whether distributed to shareholders or retained by the company, is taxed at a proportional rate of 10 per cent.[3] In other words, a capital gains tax is applicable in this instance.

In all other cases payments made by companies to shareholders in the form of dividends or any other form are taxable. This applies to payments made out of profits or reserves for the purpose of reimbursement or amortizement of stock, founders shares or other obligations before the termination of business ;[4] and to distributions out of profits or reserves which are made in the form

---

1. Ibid., article 71.

2. Legislative Decree No.2941/K of March 23, 1945, article 40. (This states, that all reimbursements or amortizement of stock should lead in the statutes of the company and under the liabilities to a corresponding reduction of the company's capital).

3. Legislative Decree No.144, loc. cit., article 45.

4. Ibid., article 69.

of stock dividends or any other form such as bonuses, or extras.[1]

In all these instances the tax is assessed on the basis of auditor's reports, decisions of assembly of stockholders, decisions of board of directors, and other relevant evidence.[2] The rate applicable is a flat 10 per cent of gross returns.

A provision which requires particular attention is that of the taxation of stock dividends in the same manner as money dividends.

Technically speaking, this question is one of definition and therefore should, strictly speaking, be treated under the following chapter. However, since this section is concerned with dividends in general it may as well be treated here.

A company, as we have seen, can distribute dividends either from its current income, or from accumulated reserves, or from both. In any of these instances it puts part of its income at the immediate disposal of its shareholders thus, unequivocally, creating a taxable income on their part.

On the other hand, a company may chose to incorporate part or all of its accumulated reserves into its capital thus augmenting it. In other words, it capitalizes its reserves, and simultaniously issue and distribute to its shareholders, free of payment, the equivalent of this capital increase in common stock.

What, it may be asked, does make of these so called stock dividends an income or equivalent of income upon the basis of which

---

1. Ibid..

2. Ibid., article 73.

a tax may be justified ?

The predominant opinion is definitely against the treatment of stock dividends as income.

In the first place, the distributed stock cannot be said to have increased neither the actual nor the realisable income of a shareholder. Not the actual, since they definitely do not add to his current disposable income ; and not the realisable since the value of the new share plus that of the old share (assuming for simplicity's sake that one additional new share was given for each old share i.e. a one hundred per cent stock dividend), will under no circumstances exceed the value of the old share.

An example will make this clear : a company with a capital stock of L.L.1,000,000 divided into one thousand shares of L.L.1,000 each and reserves of L.L.1,000,000 will have a total net worth of L.L.2,000,000. Since each share represents an equal proportionate ownership of the net worth, the equity per share will be L.L.2,000. If the company decides to capitalize its reserves by issuing an additional one thousand shares which will be distributed free of payment to its shareholders, this would in effect, in a simple accounting sense, require the transfer of L.L.1 million from the reserve or surplus account to the capital account. However, since both of these accounts are the essential constituents of the net worth, there will not result any alteration in it. On the other hand, since the number of shares has doubled the equity per share will now be only L.L.1,000.

In the second place, by the capitalization of reserves which otherwise would have ultimately been distributed, shareholders will, for all practical purposes, be forgoing a possible future income rather than receiving one. Therefore, to tax them on an income which they have actually forgone is absurd.

Given this evidence it is no wonder that under most systems of income taxation, including the American and British systems, stock dividends are not subject to tax.

It is suggested therefore, that stock dividends should not be treated as income and consequently should not be taxed as such.

E. Withholding Tax on Dividends and the Issue of Double Taxation

The provisions on the taxation of dividends are formulated in a manner that compels companies to deduct the tax and forward it to be treasury within a month from the declaration of dividends.[1] Companies are at the same time authorized to recuperate the tax from shareholders upon payment of the dividends.[2]

This withholding system has the double advantage of simplifying collection and curbing evasion.

Another intention governing the withholding of tax from dividends, is that while the company is made liable to pay the tax on both distributed and undistributed profits, no double taxasion of the same income should occur.

---

1. Ibid., article 74.

2. Ibid., article 75.

Thus, the law provides that taxes paid by companies in accordance with the provisions for the taxation of dividends shall be deducted from their tax liability under the provisions for the taxation of company profits.[1]

The double obligation on the part of companies to pay the tax on profits, as well as on dividends, necessitates a clear separation for tax purposes between the distributed and the undistributed portion of profits particularly if double taxation is to be avoided.

In practice, this would necessitate for its implimentation the adoption of either one of two alternative systems :

The first would allow the company to deduct its distributed profits from its total profits and then subject the undistributed portion only to the company profits tax. This method is known as the deduction to corporation or dividend deduction method.[2]

The second would allow the company to credit the tax paid on distributed profits or dividends against its tax liability on the whole of its realized profits.[3]

In Lebanon, the second system was adopted with one modification, namely, that instead of a credit against tax a refund from tax is allowed. In other words, the company has to pay first the tax on dividends which is due one month after such dividends are declared, then it has to pay the tax on all of its profits, and then

---

1. Ibid., article 9.
2. The Fiscal System of Venezuela, op. cit., p.117.
3. Gannagé, op. cit., p.179.

tax paid in respect of dividends is refunded by the tax authority.

An example will help make this clear : suppose a company realizes a profit of L.L.100,000 out of which it decides to distribute L.L.25,000. It will have first to withhold and pay tax on L.L.25,000 at the rate of 10%, which amounts to L.L.2,500. Then it will have to pay tax at the progressive rate scale on the whole of its profits ; this, as can be observed from Table VI amounts to L.L.17,950. The tax authority will then refund the sum of L.L.2,500 paid on account of dividends, and thus the company will in effect have paid a tax of L.L.15,450 (17,950 - 2,500).

In the event that, as suggested, a separate proportionate tax on corporate income and a general personal income tax with a single schedule applied to all income from whatever source are adopted, it would still be desirable to avoid double taxation of corporate profits and to make use of a system of withholding in the taxation of dividends.

This however cannot be achieved through any of the preceeding methods. It would require, in addition to a system of withholding tax, the adoption of a system of credit against tax to be allowed to a shareholder for the amount of corporate tax on his dividend. This method would in effect regard the corporate tax as a withheld tax.[1]

Thus, assuming that the corporate profit tax is a flat 25%, the company would be required to pay tax on the whole of its

---

1. The Fiscal System of Venezuela, op. cit., p.117.

income and in case it distributes dividends, to deduct from the amount of the dividend tax at the rate of 25%. Moreover, the company would be required, upon payment of dividends, to furnish each shareholder with a certificate setting forth the amount of the dividend paid to him and the amount of tax which has been deducted. When such dividend is included in the chargeable income of the shareholder, the tax which the company has deducted would be set off for the purposes of collection against the tax charged on his chargeable income.[1] In other words, when the tax payable by the shareholder has been ascertained on the basis of his personal return he is credited with the amount which the company has deducted according to the furnished certificate as if he himself had paid this tax. The amount of income tax payable by him is then reduced by the amount deducted by the company, and if he himself is not liable to pay tax at all, or if the amount of tax payable by him is less than the deducted amount, the appropriate amount of the deduction is refunded to him.

The overall administrative advantage of this credit to shareholder method, lies in the fact that it involves little compliance and avoidance risk for the government. The full corporate tax is obtained through the company and the relief from double taxation would depend on the shareholders initiative.

The only risk would lie in the non reporting of part or all of dividends by taxpayers whose rate of tax is greater than the credit allowed, while those with rates below the credit would do so and thereby obtain a refund.

---

1. Moses, op. cit., p.172.

This risk however, can be considerably diminished by the requirement that companies should upon distribution of dividends, submit to the tax authorities a list of the names of shareholders together with the amount of dividend paid to each.

CHAPTER VII

THE ASCERTAINMENT OF CHARGEABLE INCOME

A. The Definition of Income

The concept of taxable income which has gained increasing acceptance among economists and fiscal theorists is that of total accretion.[1] Income is defined as the increase or accretion in one's power to satisfy his wants in a given period in so far as that power consists of (a) money itself, or, (b) anything susceptible of valuation in terms of money.[2] In other words it is "the money value of the net accretion to one's economic power between two points of time."[3]

Personal income thus connotes the exercise of control over the use of society's scarce resources and implies estimate of consumption and accumulation.[4] Since the relation of the income concept to the specified time interval is fundamental, its measurement implies allocation of consumption and accumulation to specified periods.

---

1. Richard A.Musgrave, The Theory of Public Finance, (New York : McGraw-Hill, 1959), p.165.

2. Robert Murray Haig, "The Concept of Income-Economic and Legal Aspects," Readings in the Economics of Taxation, (Homewood, Illinois : Irwin, 1959), p.59.

3. Ibid..

4. Simons, op. cit., p.49.

Put in different terms, personal income is the sum of (1) the market value of rights exercised in consuption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.[1] It is "merely the result obtained by adding consumption during the period to 'wealth' at the end of the period and then subtracting 'wealth' at the beginning."[2]

Accordingly, all accretions to wealth are included in whatever form they are received or from whatever source they accrue. These include factor earnings such as rent, interest, profits and wages as well as capital gains, inheritances, gambling profits and any kind of windfall irrespective of whether they occur at regular or irregular intervals, and whether they are realized or not.[3] Similarly, all diminutions of wealth are allowed for, whether they take the form of wear and tear, technical obsolecence, capital loss, or any other form.

By the incorporation of all accretions to wealth whether realized or not, this definition of income conflicts with the conventional accounting practice according to which, income is recognized only when gains are converted into cash. It is only at this time that a gain or loss is recorded in the income statement. An exception to this general principle is however made with regard to depreciation charges. Here, a loss of value is charged against

---

1. Ibid., p.50.
2. Ibid..
3. Musgrave, op. cit., p.165.

certain assets on the basis of a presumptive schedule, assumed to reflect their decline in value over the period of useful life.

This accounting procedure is designed essentially to record current costs and receipts and to measure profits from current business operations. The emphasis is on the income statement, and the balance sheet is adapted accordingly. Since the income statement is designed to show profits from current operations only, it does not record all changes in value during the period. Accordingly, assets must be carried at cost in the balance sheet. Gains or losses from changes in their value, other than wear and tear, which is allowed for by presumptive depreciation, cannot be recorded until they are realized.[1]

Thus, while strictly speaking the calculation of income - which in the rigour of an economist's definition is regarded as a result imputed to particular periods - demands complete revaluation of all assets and obligations at the end of every period, the accounting practice has, in order to avoid the requisite value estimates, adopted the realization criterion as a practical expedient.

A good defence of the realization rule can certainly be made in pragmatic terms, but it should clearly be recognized that the problem here becomes one of practical expidiency and of administring an income tax based on valuation and not of definition.

---

1. Ibid., p.166.

The ideal solution therefore, would, among other things, require the taxation of capital gains upon their accrual realized or not. A practical solution would be to tax them upon realization. A compromise solution could however be adopted in accordance with which revaluation may be required at set intervals only, e.g. a period of five or ten years, and a tax imposed on capital appreciation whether realized or not.

It must certainly be expected that in the practical workaday world full of imperfection administrative and pragmatic considerations would not permit drastic adherence to the general concept of income (accretion) as formulated above. Modifications must be made in this concept to fit it for use as an item of net taxable income, due regard being given to the limitations imposed by the actual conditions under which the law must function.

Such modifications, however, must be regarded merely as "concessions made to the exigencies of a given situation", and the legal concept should not depart in any fundamental fashion from the economic concept.

Given therefore the practical devices of accounting and tax legislation which contemplate a rough approximation to income, it is important that taxable income under a law that purports the taxation of income should approximate as nearly as practicable true net income. How close an approximation is possible depends upon the perfection of the environment in which the tax must live.

Since close approximation is the most that can be hoped for, it is important to have a consistent theoretical concept which will act as a normative standard on the basis of which it is possible

to "criticize and evaluate merely practicable procedures and to consider fruitfully the problem of bettering the system of presumption".[1]

Indeed the importance of a broad - though perhaps "impractical" - conception of income "in terms of which existing and proposed practices in income taxation may be examined, tested, and criticized,"[2] cannot be overestimated. It is therefore advisable that any reform of the Lebanese Income Tax should be preceeded by a full comprehension of the economic concept of income outlined in this section.

B. The Taxable Income Generally

There are systems of taxation in which only those kinds of income expressly listed are taxable, so that, even if it is established that certain receipts are income, their taxability is not yet decided upon.

In England, only an income which is contained in one of the five schedules to the Income Tax Act, can be taxed. To this effect, it is stated in the Final Report of the Royal Commission on the Taxation of Profits and Income That "one of the basic conceptions of the tax code, is that referability to a defined source is essential to permit of a receipt being categorised as income,"[3] and

---

1. Simons, op. cit., p.106.
2. Ibid..
3. Royal Commission, Final Report, op. cit., p.8.

that "since the tax code identifies income by a process of classification, a receipt, to constitute income, must be capable of being referred to one of those classes."[1]

With other systems of taxation the taxability of a receipt is established when the receipt is generally found to be an "income" ; these systems either give a general definition of income which includes a mention of the various kinds of taxable receipts e.g. the United States system ; or, relying on a schedular system, they give a specified list of the different items of income included under each schedule and, in the anxiety not to exclude some class by inadvertence or omission, they add a comprehensive "sweeping up" clause which purports to include every kind of income not explicitly specified.[2]

The Lebanese Income Tax follows this latter method. Thus, after expressly listing as taxable under the first category incomes of industrial, commercial and handicraft establishments, and incomes of the liberal professions, without however attempting to define these ; it adds a clause to the effect that all gains not falling under any of the foregoing items and not charged by virtue of any other schedule or tax on income are taxed in accordance with the provisions of this category.[3]

The last paragraph of article 2 however, goes further than this by expressly and unequivocably stating, that no income is to be exempted from tax except by express provision of the Law.

---

1. Ibid..
2. Moses, op. cit., p.65.
3. Legislative Decree No.144, loc. cit., article 2.

These provisions are, in essence, duplicated under the third category concerned with the taxation of income from movable capital. Thus, here again, after giving an itemized specification of all taxable receipts, a clause is added to the effect that the tax on movable capital is imposable on all other returns from capital that are not subject to another tax on income and are not explicitly exempted from tax.[1]

Thus, in order to determine the liability to pay tax, two criteria must be ascertained :

a) That a return arising to a person is income.

b) That this income arises either from sources expressly listed or from any other source not charged in accordance with other taxes on income and not exempted by express provision of the law.

C. Taxable Income Under the First Category

Net taxable income under this category is defined as total actual returns or receipts less all charges and expenses necessarily incurred in the operation of the business[2] and, within limits set by the law, all contributions to officially recognized philanthropic, social, educational and sport institutions.[3]

The law gives a detailed list of all deductible expenses as well as a list of non deductible expenses. The former comprise in effect, expenses which are recognized by conventional accounting

---

1. Ibid., article 70.

2. Ibid., article 7.

3. Ibid..

practice.

The following expenses are not deductible :[1]

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 on income realized in Lebanon.

c) Losses sustained by the taxpayer in enterprises run outside Lebanon.

d) Expenses that the taxpayer cannot prove that he has sustained in respect of participation in business outside Lebanon.

e) Personal expenses including amounts drawn by the owner or owners from the business in the form of salary.

f) Representation allowances that do not exceed 30 per cent of the salary of an employee.

g) Extraordinary taxes and personal fines.

After adopting such a definition of income, which substantially coincides with the conventional accounting concept of income, the tax code reverses its course and ceeds considerable ground where this rule becomes inaplicable. Realizing that most medium sized and small business enterprises do not keep the necessary records and accounts which are a prerequisite for the application of this concept, the tax code resorts to other methods of determining taxable income which are based on pure presumption.

Thus, in effect, the taxable income of enterprises subject to tax is either the actual net profit, the presumptive profit, or the estimated profit.

---

1. Ibid.,

1. Enterprises Taxed on the Basis of Actual Net Profit

A necessary prerequisite for an enterprise in order to be taxed on the basis of its actual net profit is that it should keep a complete system of accounts. The Law specifically mentions the following categories of enterprises to be compulsorily taxed on the basis of their actual net profits as shown in their income statements and/or balance sheet :[1]

a) Corporations ; partnerships, whether of the "collective" or "commandite" type; consumers cooperatives ; syndicates and agricultural cooperatives with commercial aims.

b) Branches of the above mentioned establishments in case their head office is outside Lebanon.

c) Industrial firms and establishments with the exception of handicrafts.

d) Banks, bankers, exchange dealers and persons undertaking discount operations.

e) Importers, exporters, wholesale or semi-wholesale dealers, commission merchants, agents of manufacturers or business firms.

f) Retailers who employ in their business more than four persons.

g) Owners of drug and pharmaceutical ware-houses.

h) Exploiters of gambling establishments.

i) Exploiters of first and second class hotels.

j) Exploiters of first and second class theaters and cinemas.

k) Printing presses and publishers.

l) Grinding mills, not run by water or wind.

m) Lessors of equipped establishments.

---

1. Ibid., article 11.

Other persons and enterprises, except insurance and savings concerns, transport enterprises, petroleum refineries, and public works contractors,[1] may also, upon their request, be taxed on the basis of actual net profit.[2]

To the extent that the provisions under this rule are rigorously applied its shortcomings are essentially confined to those that are intrinsically characteristic of conventional accounting practice which although not devoid of arbitrary rules, could, within limits set out in section A of this Chapter, well be relied upon for a close approximation of true income.

2. Enterprises Taxed on the Basis of Presumptive Income

The general method followed in determining the enterprises or professions which are to be charged on the basis of presumptive income is one of elimination. Thus, the law provides that taxpayers not charged on the basis of actual net income or estimated income are to be charged on the basis of their presumptive income.[3]

Persons charged in accordance with this method have to submit an annual return in which they should give one global figure representing their total or gross receipts for the year from whatever source and for whatever service.[4]

Total receipts are defined as the total returns resulting from all operations actually undertaken by the taxpayer during the

---

1. Ibid., article 44.
2. Ibid., article 12.
3. Ibid., article 17.
4. Ibid..

year preceeding the year of assessment. Such returns include proceeds of sale of goods of any kind, rent of such goods, fees, commissions, interest and brokerage.[1]

The only record of their business operations that these taxpayers are required to maintain, and against which assessors may roughly verify the accuracy of the global figure given in the declaration or return of income, is the daily journal.[2]

In order to determine taxable income, the total receipts so declared are taken as a base and multiplied by a coefficient appropriate to the category of the enterprise. This coefficient is fixed in a decree issued by the Minister of Finance and is based on a report of a commission of five experts appointed by him.[3]

These coefficients are supposedly taken to represent what it is believed is the proportion of net profits to total receipts in a given enterprise or profession. Thus, for example, the coefficient for a hair dresser for men is 35%, that for an engineer is 50%, and that for a pharmacist is 11%. In other words, it is presumed that 35% of the gross receipts of a hair dresser, 50% of the gross receipts of an engineer, and 11% of the gross receipts of a pharmacist, constitute net taxable income.

At present there are no less than 180 classified enterprises and professions with coefficients ranging from 1/4 per

---

1. Ibid., article 18.
2. Ibid., article 20.
3. Ibid., articles 21, 22 and 23.

thousand to 85%.

Once taxable income is determined, and after allowing the appropriate deductions, the relative rate scale is applied depending on whether the person concerned is engaged in a commercial or industrial enterprise or in a non-commercial enterprise.

Having given an account of the presumptive method of taxing income, let us examine its merits and demerits.

On theoretical grounds it has no merits whatsoever, its adoption abandons from the start any attempt at assessing the true income of persons in accordance with carefully defined methods and favours an arbitrary procedure that is at best very crude.

More important still, its conception of income is essentially the result of a confusion between income and turnover. The resulting tax is more akin to a turnover tax than to an income tax. Strictly speaking however, it is a hibrid of both, for it taxes a predetermined proportion of a given turnover on the assumption that it represents net income.

A blatant shortcoming of such a system is that no matter what the total receipts of an enterprise are it may well have an overall net loss for the year. Therefore, to assume that a predetermined portion of the receipts of an enterprise represent net taxable income is to commit a gross misconception.

On practical grounds this procedure could perhaps be defended as having been, on the introduction of the Income Tax, a practical expedient in an environment where the keeping of accounts was by any standard scanty. It was applied by the French Income Tax and therefore it was thought convenient for Lebanon.

In actual operation however, this system of presumption has proven to be the most cumbersome, complex and inequitable part of the Income Tax. It has given rise to the widest degree of corruptibility among tax inspectors and to rampant collusion between them and taxpayers based on bribery.

Moreover, it has created the complex tasks of an extensive classification of all enterprises and professions subject to the presumptive income tax and of determination of the most appropriate coefficient that is to be applied to each. Obviously such a procedure if it is to achieve any degree of accuracy it would be so demanding as to prove prohibitive. Thus, it has given way to a procedure that is at best arbitrary.

As for the classification that has been adopted, it is by no means comprehansive and is in many instances overlapping. Thus, for instance, even though the Law specifically mentions public contractors as necessarily taxed on the basis of their presumptive income no coefficient has been laid for them. Tax inspectors have therefore, in this instance and other similar ones, been using their discretion, and it has been understood from conversation with accountants that in this particular case some inspectors are applying a coefficient of 10% others a coefficient of 5%.

The classification and coefficients are also in many instances overlapping. Thus in the case of an engineering and contracting enterprises there arises the confusing problem of determining the applicable coefficient. The coefficient for engineering being 50% and that for contracting "conventionally" either 5% or 10%.

Another case is that of an enterprise engaged in the sale of radios, record players and records ; or electrical appliances, radios and record players. The coefficient applicable to enterprises engaged in the sale of electrical appliances is 18%, of radios and record players 8%, and of records 15%.

What, it may be asked would be the coefficient applied to the total receipts of such enterprises ?

The law does not determine any, and in practice the solution depends on the whim of the tax inspector and on the degree of collusion between him and the taxpayer.

It has been understood from conversations with accountants and businessmen, that in the case of a tax inspector having his first contact with a taxpayer he would usually either insist upon applying the highest coefficient, or on the apportionment of the income among the various constituent activities with the pertinent coefficient being applied to each portion. After further contacts however, a more favourable arrangement to the taxpayer is usually agreed upon.

If any suggestion is to be made regarding this system of presumption, it would be for its complete scrapping. Perhaps no other piece of legislation could be formulated in such a manner as to actually put a premium on dishonesty and to inherently encourage the arbitrary practices, the tax immorality, the bribery and inequity that this system has given rise to.

It is certainly advisable that the law should encourage and in many instances request more enterprises to keep a comprehensive system of accounts so that many of those now taxed on the

basis of their presumptive income would be taxed on their actual income.

As for the others, it would be advisable to introduce in their case a detailed income tax return which would show various sorts of receipts and expenditures classified in a manner that would make it easy to trace their genuineness in any subsequent check by the tax authority. The filing of such returns would be made imperative upon all persons concerned. A simple system of control on any deliquency would be to number the returns and upon distributing them inserting the name of the person concerned against the number of the particular return handed to him. Any person failing to hand in his return would then be easily traced.

3. Enterprises Taxed on the Basis of Estimated Profit

Enterprises and persons not required by the Commercial Code to keep any sort of accounting records are taxed on the basis of their estimated net profit.[1] This estimation is carried by a special commission appointed by the Minister of Finance and in each individual case is to remain effective for a period of three years after which it should be revised.[2]

In carrying its estimation the commission concerned may rely on any available information regarding the taxpayer concerned, on external manifestations of his wealth, and may even accord him an audience.[3]

---

1. Ibid., articles 10 and 24.
2. Ibid., articles 25 and 27.
3. Ibid., article 26.

This method is one of the crudest, if not the crudest, that could be devised for the determination of taxable income and to that extent it has no merits whatsoever. It is therefore advisable that the keeping of a minimum of accounts in the form of a journal should be made imperative for every enterprise, and that the system of a classified income tax return be also applied to this category of taxpayers.

D. Taxation of Capital Gains

Gains and losses from transactions in investment assets present one of the most prominent and most controversial issues of income taxation. Much has been said and written to justify their inclusion or exclusion from taxation, and yet this polemic is no where to being conclusively settled.

It is one of the basic notions of the economic concept of income, depicted in the first section of this Chapter, that capital gains and losses whether realized or not should be included in full as elements of income.

It is held, that since capital gains increase a person's taxable capacity by increasing his power to spend or save there is no reason why they should not be taxed as ordinary income ; and that "since capital gains are not distributed among the different members of the taxpaying community in fair proportion to their taxable incomes but are concentrated in the hands of property owners their exclusion from the scope of taxation constitutes a serious discrimination in tax treatment in favour of a particular class of taxpayer."[1]

---

1. Royal Commission, Final Report, op. cit., p.365.

The economically correct time to tax a capital gain, as already observed, would be when it occurs. Thus, strictly speaking, such taxation would require complete revaluation of all assets and obligations at the end of every period. As a practical expedient however, the realization criterion must be adopted if the taxation of capital gains is to be considered as a viable measure at all. The criterion for creating liability would therefore be the bare fact of realization of a property or investment asset at a net price greater than the cost of acquisition.

One of the problems that confront any practical application of the treatment of capital gains as taxable income and which is a direct outcome of the realization criterion, is that profit which accrues in the year of realization has no true relation to the income of that year unless the appreciation in the value can itself be found to have occurred wholly in that year. However, if the property sold has been held for a period of years, there is no reason why this should be so. In actual fact there may have been a steady increase in value spread over the whole period or, more reasonably, there may have been rises and falls during the years that the period covers.

Thus, in a system of progressive rates, to treat the whole profit as a part of the income of the year of realization and so to tax it at the marginal rate or rates of the taxpayer concerned would seem unjust. Consequently there has to be superimposed upon the idea of treating capital gains as taxable income a structure of provisions for taxing gains on property acquired before the current year at special abated rates,[1] or for averaging the gains

---

1. Ibid., p.29.

over the years during which the property was held.

A second practical problem of an equitable tax on capital gains results from the logical necessity of a symetrical relief for losses with all the complications that this may entail.

Still another crux is found in the treatment of reinvestment of capital gains. Many of these gains on realization occur to individuals or institutions for whom the act of realization is merely a prerequisite for a change of investment or replacement. The proceeds of sale being intended for acquiring a new asset.

It is contended by some that such problems create "formidable fiscal difficulties" for an equitable tax on capital gains,[1] and that "a tax on capital gains, if put into operation, cannot be expected to prove a tax of simple structure or one that would be free from a number of rather arbitrary solutions of its various problems".[2]

While the latter argument has some truth, it is not believed that it would hold its own before evidence in favour of taxing capital gains particularly under a well developed system of income taxation. Capital gains form an essential constituent of income and are an important source of wealth particularly in the upper income groups. Moreover, their exclusion from tax creates an important loophole which can be used as a means for tax evasion by the conversion, in various ways, of income into capital gains.

---

1. Hicks, op. cit., p.216.

2. Royal Commission, Final Report, op. cit., p.31.

The practical and equitable application of a system of progressive taxation of income that includes capital gains would require that such gains be computed by substracting from the sales price of an asset the total of the following : the cost of the asset plus any expenditure relating to it which were properly capitalized, and less any depreciation allowed or actually deducted, plus any expenses incurred on the sale of the asset.[1]

In view of the progressive rate structure, and to avoid taxing in the year of sale a gain that may be attributable to several years, the taxable income from the sale could be spread over the length of time the taxpayer had held the asset.

Another device for tackling with this problem would be to tax only a percentage of the gain, the percentage varying according to how long the asset has been held.[2] Thus, for example, one hundred per cent of the gain would be taxable if the asset has been held for not more than one year ; 80 per cent, if it has been held more than one year but not more than two years; 60 per cent, if it has been held for more than two, but not more than five years ; 40 per cent, if it has been held for more than five, but not more than ten years; and 20 per cent, if it has been held more than ten years.

As for capital losses, they would be computed in the same manner as gains and would be allowed only against capital gains and

---

1. The Fiscal System of Venezuela, op. cit., pp.164-165.

2. Simons, op. cit., p.160.

not against ordinary income. Thus the net of the gains over the losses would be taxed and an excess of losses over gains in a given year would not be deductible in that year from other income but would be permitted to be carried forward as an offset against the taxpayer's future gains.

In the event of reinvestment, a full rebate of tax would be allowed in case the proceeds of sale of an asset are spent on acquiring a new one within a specified period.

From the above, it could well be deduced that the effective and equitable application of such a system would by no means be an easy task and would therefore very much depend on the accompanying circumstances. In other words, it would depend on the environment in which it is expected to operate and particularly on the expertise of the revenue authorities.

Given the present state of affairs in Lebanon it would require a good deal of temerity to propose that such a system be adopted. Its exclusion however, does not mean that any tax on capital gains should be excluded. On the contrary, there is much to be said in favour of a simplified, separate and proportional capital gains tax particularly on transactions in buildings and land which, at present, constitute a considerable area of exempt accretions to wealth.

Such a tax would, in the first instance, mitigate the gross unfairness of a tax which, while taxing at progressive rates income from salaries, wages and similar steady returns from work, allows considerable income from speculative transactions in real

estate to go untaxed. Another advantage of such a tax, is that it would stem speculative investment in real estate which causes funds to leak away from possible productive investment into mortgages, land speculation, and luxury buildings.

Under the present Law, only gains from the sale of business assets are taxed. Thus, after allowing for decennial revaluation of business assets, the Law provides for the taxation of any capital gains at a proportionate rate of 10%. Taxpayers may however claim a refund of tax if they prove that they have reinvested in their business the proceeds of such a sale within three years of their realization.[1]

While the provisions of this capital gains tax are very crude and would require much elaboration in case they are to be equitably and effectively applied, they could well be developed and extended to include transactions in buildings and land.

Some of the shortcomings of the present provisions are : first, they do not lay any rules for revaluation of assets thus leaving it to the discretion of the businessman to follow the system he wants with all the possibilities of over or under estimation and therefore of evasion that this would entail. Second, the law is not explicit on whether liability arises by the simple fact that appreciation in value is detected through revaluation or whether it is confined to actual realization.[2]

---

1. Legislative Decree No.144, loc. cit., article 45.

2. A recent draft bill for the amendment of the Income Tax explicitly provides for the taxation of capital gains on fixed assets only upon realization.

CHAPTER VIII

ECONOMIC AND SOCIAL POLICY AND THE ALTERNATIVES IN TAXATION

A. Tax Reform and Economic Policy

A significant position regarding taxation and tax reform is properly a derivative, or a subordinate part, of a broader position on general questions of economic policy. Taxation is only a small element in the structure of rules and conventions which constitute the framework of our existing economic system ; and problems of taxation can be clearly apprehended only as phases of the broad problem of modifying this framework in such a manner as to make the system more efficient and more secure.

Those who reject revolutionary upheavals as a means to progress particularly as represented in some neighboring Arab countries, must recognize and analyze the shortcomings, the weaknesses, and ungratifying features of the system as it now stands. They must determine which of its faults most urgently need correction and which are most easily amenable to correction. Finally they must ascertain what kinds of measures are appropriate in each case. Thus, one's position regarding taxation can hardly be stronger than one's position on economic policy generally.

Sound proposals for tax reform imply sound conception of the role of taxation changes in some larger scheme ; they imply sound insights as to what tax reform may properly undertake to accomplish, and which urgent problems may best be dealt with along other lines.

Tax reform must therefore form part of a general framework of economic and social policy to which any progressive government must be committed, and whose objectives must be translated into some sort of specific goals to be attained within a given period of time. There certainly will be room for much debate about what are to be regarded as attainable goals even among those who agree on the national objectives. However, the debate on general objectives can best be brought from generalities to earth if specific targets are set for such activities as economic development, public education, social security, etc.

The rule for guidance in formulating any such economic and social policy must be found with reference to a standard that represents the consensus of opinion of the society in question, to the habits, customs and ideals, the degree of culture and civilization attained, and the economic status of the society in question.

As far as principles of taxation are concerned these must reflect the aims of the country's economic and social policy, and to that extent must vary from time to time with the progress in economic and social evolution, should conform to existing ideals and standards of society, reflect the prevailing conceptions of equity, and at the same time conform to the political conception upon which they are based.

With the preceeding in mind, and adopting the notion that "public finance in a modern state starts with a given expenditure plan, and the authorities adjust their revenue by means of taxes and other resources, to match the expenditure",[1] let us examine the expenditure requirements of the Lebanese Government in the light of its social and economic objectives.

B. A Program of Economic and Social Development

One of the major economic problems of Lebanon is the problem of sustaining economic growth particularly by the development of the lagging sectors of the economy, namely the agricultural and industrial sectors.[2]. It is also one of achieving a wider diffusion of prosperity and a more equitable distribution of income in order to mitigate the present social and economic inequalities, thus ensuring the maintenance of social and political stability, which are indispensable if the present liberal and democratic system is to be preserved.

---

1. Hicks, op. cit., p.14.

2. For a detailed consideration of this problem the reader is referred to :
   - Yusif A.Sayigh, "Lebanon : Special Economic Problems Arising from a Special Structure", Middle East Economic Papers, (American University of Beirut, 1957).
   - Albert Badre, "Towards New Economic Horizons", Les Conférences du Cénacle, No.34, March 1960.
   - Higgins Report.
   - Marwan Iskandar, Social Security for Lebanon, (Dar Altaliah, Beirut, 1962).

From a revision of declarations and policy statements by the Government over the past few years, one can clearly discern an awareness of this problem coupled with a declared intention of coping with it. In many instances, the Government has laid down policy objectives and even specific programs and plans whose implementation would go some distance towards solving this problem.

Some of these plans are the following :

- The Social Security Plan which was prepared in 1959 and became law in August 1963, and which is conservatively estimated to cost the government about L.L.15 million annually.[1] This is associated with a social development program concerned mainly with rural areas which was prepared by the IRFED mission and which is estimated to cost about L.L.8 million annually.

- The Program for public overhead capital investment to encourage overall economic development . This program was originally laid down by the Five Year Project for Economic Development prepared by the council for Economic Planning and Development in 1958 and was estimated to cost over L.L.150 million annually, excluding the Litani Project and some other projects already under way.

A revised plan calling for investments amounting to L.L.450 million over a period of 5 years starting in 1962 was enacted into law by Legislative Decree No.7277 of August 7, 1962. This plan includes mainly irrigation and potable water, roads, and electricity projects.

---

1. Iskandar, op. cit., p.57.

- The plan for the amelioration and expansion of the port of Beirut. This will cost in the neighborhood of L.L.50 million and is already under way. Legislative Decree No.9543 of May 23, 1962 calls for an initial expenditure of L.L.16 million on this project over the years 1963, 1964 and 1965.

- The governmental city which is already under construction and which will have an initial cost of L.L.22 million. Legislative Decree No.9544 of May 23, 1962 provides for the expenditure on this project of L.L.10 million in 1963, L.L.8 million in 1964 and L.L.4 million in 1965.

- The International Fair of Tripoli. The Law of December 14, 1962 provides for the expenditure on this project of L.L.8 million in 1964 and L.L.4 million in 1965.

- A program for spreading free and compulsory elementary education.

- A program of public housing for the lower income groups.

From a simple aggregation of the preceeding figures it can be perceived that the achievement of the governments' objectives would require an additional expenditure of over L.L.100 million annually over the coming few years.

When it is realized that the Government incurred over all deficits in its ordinary and extraordinary budgets of L.L.26.7 millions in 1956, L.L.38.6 millions in 1957, L.L.46.3 millions in 1958[1], and of L.L.75 millions in 1959[2], as a result of which

---

1. Himadeh, op. cit., p.103.

2. Higgins, op. cit., p.21.

the Reserve Fund which is used to finance development projects has been largely depleted, it can readily be observed that the tax system as it now stands is inadequate to meet the increase in expenditure which the implementation of the governments objectives would require.[1] Therefore the Government is faced with the necessity of having to increase tax revenue.

Taken to its logical consequence however, the governments objectives imply the intention of achieving a wider diffusion of Lebanese prosperity, in other words, of achieving some redistribution of income through the fiscal process. Accordingly, if any increase in tax intake is required it necessarily must be obtained from the upper income groups. To impose an additional tax burden on the same income groups who are expected to benefit from the government program would defeat the whole purpose of the program.

On the other hand, in the development program, industrialization and agricultural improvement are given primary importance. Therefore, a consistent program would require that tax policy should be designed to avoid impeding investment in productive enterprise.

Put in a nut shell, our conclusion would be that any increase in tax revenue would have to be obtained through either one or more of the following alternatives : an increased taxation of luxury imports for the upper income groups ; a more effective application and enforcement of present direct taxes ; a reformed income tax on the lines suggested in our preceeding chapters; a surmise income tax which would replace the present tax ; or an expenditure tax which would replace the income tax altogether.

---

1. A minor overall budgetary surplus was realized in 1960 but this was a result of curtailment of expenditure on necessary projects rather than of a disproportionate increase in revenue.

C. Increased Taxation of Luxury Imports

The Government has already gone some way over the past two years in increasing import duties on such luxury items as alcoholic beverages, arms and munition, certain grades of textiles, cigarettes, and ready made furniture. However, there is definitely a limit to the sums that could be collected through such taxation.

In the first place, the demand for such luxury items except perhaps tobacco, is usually very elastic and there will be a limit beyond which an increase in the tax would result in a disproportionate increase if not actual diminution of revenue due to the resulting decrease in demand.

In the second place, it should be borne in mind that one of the most important industries of the Lebanon, and one that still has much potentialities for development is tourism. A necessary requisite for a tourist country is the availability of luxury items at reasonable prices. Therefore if Lebanon is to develop this industry it cannot afford neglecting this side of the matter.

D. Effective Enforcement of Present Direct Taxes

Tax evasion in Lebanon has been variously estimated at any where between 50 and 75 per cent.[1] To be on the conservative side it shall be assumed that the lower figure is the more accurate one.

Taking into consideration the fact that between the years 1956 and 1961 an average of L.L. 36 million was collected from direct taxes, it can be assumed that a very strict application of the

---

1. Higgins, op. cit., p.50 ; and Joseph Chader, Al-Jaridah No.2102 of 3.11.1959.

existing direct taxes would ensure an additional revenue of between thirty and forty million pounds annually.

While this will still be short of meeting the additional requirements in tax revenue, a more important consideration is the fact that, as already pointed out, existing direct taxes and particularly the income tax are defective, inequitable, and bear within them the cause of their ineffective application. Therefore, effective enforcement must necessarily be preceeded with their basic reform.

E. The Controversy Over Abolishing the Income Tax

Starting in 1959 there ranged in Lebanon a strong controversy between advocates of the abolishment of the declaratory income tax and its replacement with a surmise income tax or an expenditure tax and those who while recognising the shortcomings and abuses of the present tax advocate its reform and its maintenance as an essential part of the Lebanese Tax System.

This controversy was initiated by a project prepared and presented by Mr. Joseph Chader calling mainly for the substitution of a surmise income tax for the declaratory income tax.

Basically this conflict reflected different assessments of the possibility of administering and enforcing a declaratory income tax in Lebanon and the position represented by the Chader plan was a vehement refusal of any sort of declaration on the part of taxpayers.

The arguments presented in favour of abolishing the income tax were the following :

First, with the extent of evasion existing, the income tax is not only yielding insufficient revenue but is actually regressive rather than progressive in its incidence.

Second, the elimination of the income tax would be an important factor in attracting foreign enterprises to Lebanon.

The suggested replacement taxes were the following :

1. A surmise income tax assessed by the tax authority on the basis of rent paid for office, shop or factory. This tax was also to vary with the type of business, industry or trade according to a detailed schedule of classification.[1] Enterprises occupying premises whose rental value does not exceed L.L.1,000 were to be exempted from tax.

2. A tax on liberal professions imposed in a lump sum and varying between L.L.100 and L.L.2,000 per year.[2]

This tax and the preceeding one were estimated to yield about L.L.20 million annually.[3]

3. A tax on imports ranging between 3% and 10% of their value and varying with the extent ot which the good in question is considered to be a necessity or luxury.[4] This tax was estimated to yield about L.L.6 million.

---

1. Commerce du Levant No.923 of 17.7.1963.
2. Ibid..
3. Commerce du Levant, No.922 of 13.7.1963.
4. Commerce du Levant No.923.

4. A tax on the transfer of immovable property to be imposed on the basis of the following schedule:[1]

	Rate of Tax
For property valued at less than L.L.50,000.	3%
For property valued between L.L. 50,000 and L.L.100,000.	4%
L.L.100,000 and L.L.250,000.	6%
For property valued at over L.L.250,000.	8%

This tax is estimated to yield L.L.4 million annually.

5. A tax on privately owned cars ranging between 4% and 10% of their value and which is estimated to yield L.L.15 million annually.[2]

F. Evaluation of Arguments for Abolishing the Income Tax

a. Tax Evasion

There can be no doubt that the income tax as presently formulated, administered and enforced is extremely inequitable and may well be regressive in its incidence. This has already been pointed out in detail in our preceeding chapters.

While evasion is widespread and may exceed 50% of the total tax liability it is particularly rampant among the self employed and non-corporate enterprises. Exact annual figures on the extent of evasion are difficult to obtain and may well be nonexistent.

---

1. Ibid..

2. Commerce du Levant No.922 of 13.7.1963.

However, the Higgins Report embodied the following figures for the year 1958. In that year only 842 professional people submitted returns at all, they reported a total income of L.L.7.3 million or an average of only L.L.8,600. On this income they paid a tax of only L.L.229,000 or about 3% of the reported income. Less than one-quarter of the medical doctors in the country submitted returns. The 242 submitting returns declared an income of just over L.L.2 million, or an average of L.L.9,999. Only 168 lawyers declared their incomes, and reported an average income of less than L.L.7,000. National income estimates, on the other hand, indicate that the aggregate income of this group in 1958 exceeded L.L.100 million. It seems safe to say therefore, that the evasion in this group of income earners approaches 90%.[1]

On the other hand, some 34,700 non-corporate enterprises submitted returns for 1958. Of these, just under 12,000 were subject to tax. These 12,000 enterprises reported a total income of just over L.L.100 million, or an average profit of just over L.L.8,000. On these earnings they paid L.L.16.7 million in tax, or about 16% on the average. There were 281 national corporations submitting returns, reporting a total profit of L.L.8.8 million on which a tax was paid of L.L.2.4 million, or more than 25%. Since non-corporate enterprises plus national corporations together earned over half the national income, their gross receipts in 1958 must have exceeded L.L.600 millions, of which at least L.L.100 millions must constitute profits to the enterprises. Thus, it is

---

1. Higgins, op. cit., p.64.

clear that here too the evasion is on a very great scale perhaps 75%.[1]

From the preceeding it can readily be observed that the arguments for the abolishment of the income tax based on the extent of evasion are well founded.

b. Income Tax Yield

As already repeatedly pointed out the yield of the income tax is only a shade of what it should be, and while in absolute terms it has tended to increase rather gradually over the past twelve years, as can be observed from Table VII, in relative terms its contribution to total revenue has tended to diminish averaging on the whole not more than 10%.

---

1. Ibid..

TABLE VII

Income Tax Yield in Thousands of L.L. and as a Per Cent of Total Revenue

Year	Yield	% of Total Revenue
1946	5,672	7.7
1950	10,107	12.1
1951	11,315	10.7
1952	13,546	10.-
1953	15,664	11.2
1954	17,495	11.1
1955	16,302	9.1
1956	20,066	10.5
1957	22,212	10.6
1958	22,149	9.8
1959	20,884	8.4
1960	23,084	7.3
1961	27,481	8.7

Thus from the view point of fiscal adequacy and measured by what it could potentially yield the present income tax is certainly inadequate.

c. The Income Tax and Foreign Investment

It has been estimated by those advocating the abolishment of the income tax that this move will attract to Lebanon foreign capital in the neighborhood of L.L.500 million.[1]

While one cannot refute nor confirm this figure it can readily be observed that in itself it has no meaning. The abolishment of the income tax might well attract to Lebanon this sum or any other sum in the form of bank deposits of which Lebanese banks already have considerable amounts. The important question to consider is whether these sums would be invested in productive enterprise.

Although it is asserted by advocates of the abolishment of the income tax that this is what will actually happen, their case is a very weak one and has already been refuted in detail under Chapter III.

There are many considerations to be taken into account by any potential foreign investor other than tax considerations and these may well offset the benefits of the latter. Even excluding these considerations however, much will also depend on the type of taxes which will be introduced to replace the revenue loss through the abolition of the Income Tax. This will presently be discussed.

G. Evaluation of Suggested Replacement Taxes

a. A Surmise Income Tax

In their determined rejection of any sort of declaratory

---

1. See Joseph Chader, Al-Amal No.4205 of 5.12.1959.

income tax to which they ascribe the shortcomings of the present system, some of the advocates of the abolishment of the income tax have suggested its replacement with a surmise income tax.

No argument could be advanced in favour of this tax except perhaps administrative expediency. Even if honestly and effectively enforced this tax would be far from being equitable, imposed as it is on such a rough index of income as rent of business premises.

An enterprise may well be paying a hundred thousand pounds in rent, or any sum for that matter, and yet may be losing money for any particular period. Therefore to tax it on the income it is presumably supposed to have made during that period is absurd.

On the other hand, since one of the basic arguments for abolishing the income tax was that such a step would be an important factor in attracting foreign enterprise to Lebanon, it cannot be seen how the substitution of a surmise income tax which it is claimed will yield nearly as much revenue as the present tax, can on any grounds sustain that argument.

It would seem therefore that the adoption of a surmise income tax would prove to be a step backward rather than forward. It is certainly more advisable that if external indices are to be made use of they should be used as "keys to tax evasion rather than as a basis for determining tax liability."[1]

b. An Expenditure Tax

Among advocates of the abolishment of the income tax are those who have suggested its replacement with an expenditure tax

---

1. Higgins, op. cit., p.69.

which they claim will be more equitable, more remunerative, and will provide a strong incentive to saving and investment.[1]

While certainly a strong case can be made for taxing expenditures rather than income particularly in an underdeveloped country, one cannot help but adopt the conclusion of Professor Nicholas Kaldor who is the major advocate of an expenditure tax.

After exposing the many advantages of an expenditure tax as compared to an income tax of the kind prevailing in advanced countries, Kaldor concludes that "a progressive personal expenditure tax is by no means a simple or easy form of taxation to administer,[2] ... it would undoubtedly be a more complicated tax than the present type of income tax and would make greater demands on the taxpayer as well as on the Revenue officials in checking it."[3] Moreover, he adds that an expenditure tax "could only be gradually adopted and could only be successfully employed in a civilized society possessing both a highly efficient tax administration and a reasonable standard of discipline in the tax paying public."[4]

It should be clear from the foregoing that the replacement of the present income tax with an expenditure tax could only lead to greater confusion. There is nearly twenty years accumulated experience in administering the income tax in Lebanon, and much more than that in other countries whose experience could well be drawn

---

1. Commerce du Levant No.678, March 8, 1961.
2. Nicholas Kaldor, An Expenditure Tax, (Allen & Unwin, London, 1955), p.188.
3. Ibid., p.222.
4. Ibid., p.188.

upon. There is no such experience concerning the expenditure tax ; and therefore to embark on unexplored territory particularly in matters of taxation could well prove risky.

c. Taxes on Transfers of Immovable Property and on Privately Owned Cars

Given the present need for substantial increase in government revenue these taxes or any other special levies can only be welcomed as expedient sources of additional revenue. Under no circumstances however can they be considered as adequate alternatives for an income tax; neither for revenue purposes nor for equity considerations.

Moreover, the extent to which such levies can be imposed is very limited particularly in a free economy due to the direct and immediate curbing impact that they produce on the item or sector concerned. Thus unless it is government policy to control, direct or convert a certain activity, expenditure or resource, the recourse to such levies must necessarily be restricted.

H. A Reformed Income Tax

It should be emphasized that while fully recognizing the present inadequacy in tax administration and enforcement machinery one cannot help but reject the idea of the elimination of the income tax simply because it has not been effectively administered and enforced. Such a step would only reflect an outright confession of defeat on the part of the Government, so far as the introduction of a modern and progressive tax system is concerned. Moreover, it would inevitably delay the effort to build up the personnel and

the proposed amendment of the income tax entrenches more than ever the system of direct estimation of income carried by tax inspectors with respect to certain categories of taxpayers, with all that it entails in collusion between taxpayers and tax inspectors.

Since tax reform however is a gradual evolutionary process one may still hope for a greater understanding of the issues involved and the gradual elimination of errors and shortcomings of tax legislation in the light of suggested reforms.

I. The Secret Bancaire and the Income Tax.

Perhaps the greatest obstacle in the long run for an equitable enforcement of an income tax would be the secret bancaire which was introduced in Lebanon by the Law of September 3, 1956, and reenforced by the Code of Money and Credit promulgated on August 1, 1963.[1]

It is here suggested that since the declared purpose behind the introduction of the secret bancaire as proclaimed by its most ardent proponents is to make Lebanon "a refuge for foreign capital thus increasing the number of banks, the volume of deposits and the importance of Beirut as a financial center,"[2] Lebanese nationals should be excluded from the privilege of opening secret bank accounts with what it entails in immunity from investigation by tax inspectors.

---

1. See articles 150 and 151 of the Code of Money and Credit.

2. Reymond Eddé, Al-Jarida No.1520 of 13.12.1957 and Pierre Gemayel, le Commerce du Levant No.672 of 15.12.1961.

No justification can be given for the extension of such a privilege to nationals except as a convenient loophole for tax evasion. If however, such a system cannot be worked out for one reason or another, then the secret bancaire should be abandoned in so far as the tax inspectors are concerned.

CONCLUSION

Given the revenue requirements of the Lebanese Government in the years ahead, and its newly gained awareness of its social and economic role, the need for tax reform has become more pressing than ever before.

While there will always be an important place in a good tax system for indirect and strictly impersonal taxes there is decisive evidence that points to the income tax not only as the proper source of those necessary revenues which cannot be provided by the few good impersonal taxes but also as an important instrument of fiscal and social policy.

However, with the present shortcomings in income tax legislation and inadequate enforcement machinery one is tempted to plead fervently in favour of fundamental reforms which seem crucially important for the immediate future.

The essential purpose of an income tax is that of a remunerative reasonable relative taxation of persons, and if that purpose is lost in a paraphernalia of confusing legislation, an apathetic and resigned attitude to obvious abuses by tax inspectors and

taxpayers alike, and of dishonest concessions to disguised demands for avoidance opportunities, then the income tax will never occupy its proper place in our fiscal system.

Along the lines of recent amendments there is only limited scope for improvement and therefore a gradual shift to more substantive reform is emphatically recommended.

If Lebanon cannot build an abundantly productive system of equitable personal taxes, as an indispensable part of a program for preserving a democratic, free enterprise system against the trend in this part of the world to absolute and irresponsible political authority, then that undertaking is simply hopeless.

B I B L I O G R A P H Y

BOOKS

1. Adler, John H. ; Schlesinger, Eugene R. ; and Olson, Ernest C. Public Finance and Economic Development in Guatemala, (Stanford, Stanford University Press, 1952).

2. American Economic Association, Readings in The Economics of Taxation, (Homewood, Illi., Irwin, 1959).

3. Black, Duncan, The Incidence of Income Taxes, (London, Macmillan, 1939).

4. Blum, Walter J., and Kalven, Harry Jr., The Uneasy Case for Progressive Taxation, (Chicago, The University of Chicago Press, 1953).

5. Brown, Harry Gunnison, The Economic Basis of Tax Reform, (Columbia, Mo., Lucas Brothers, 1932).

6. Brownlee, O.H., and Allen, Edward D., Economics of Public Finance, 2nd. edn., (New York, Prentice-Hall, 1954).

7. Buehler, Alfred G., Public Finance, 2nd. edn., (New York, McGraw-Hill, 1940).

8. Colm, Gerhard, Essays in Public Finance and Fiscal Policy, (London, Oxford University Press, 1955).

9. Dalton, Hugh, Principles of Public Finance, 4th. edn. (London, Routledge & Kegan Paul, 1954).

10. Gannagé, Elias A., La Réforme Des Impôts Directs au Liban et en Syrie, (Beirut, Catholic Press, 1947).

11. Green, William Raymond, The Theory and Practice of Modern Taxation, (New York, Commerce Clearing House, 1933).

12. Goode, Richard, The Corporation Income Tax, (New York, John Willey, 1951).

13. Groves, Harold M., Trouble Spots in Taxation (Princeton, Princeton University Press, 1948).

14. Groves, Harold M., Financing Government, 5th.edn., (New York, Henry Holt and Co., 1958).

15. Grunwald, Kurt, The Government Finances of the Mandated Territories in the Near East, (Tel-Aviv, Palestine Economic Society, 1932).

16. Henderson, James M., Introduction to Income Taxation, 2nd edn., (Rochester, N-Y., The Lawyers Cooperative Publishing Co., 1949).

17. Hicks, Ursula K., Public Finance, 2nd edn., (London, Nisbet and Co. and Cambridge University Press, 1958).

18. Himadeh, Raja S., The Fiscal System of Lebanon, (Beirut, Khayat, 1961).

19. Himadeh, Said B., Ed., Economic Organization of Syria, (Beirut, American Press, 1936).

20. Kaldor, Nicholas, An Expenditure Tax, (London, Allen & Unwin, 1955).

21. Lewis, W. Arthur, The Theory of Economic Growth, (London, Allen & Unwin, 1955).

22. Magill, Roswell ed., Lectures on Taxation, Columbia University Symposium, (New York, Commerce Clearing House, 1932).

23. Magill, Rosewell, Taxable Income, (New York, Ronald Press Company, 1936).

24. Mills, Mark Carter ; and Starr, George W., Readings in Public Finance and Taxation, (New York, Macmillan, 1932).

25. Mouchawar, Amin, Notice sur les Impôts et les Taxes au Liban, (Harissa, Imprimerie Saint Paul, 1934).

26. Moses, S., The Income Tax Ordinance of Palestine, (Jerusalem, Tarshish Books, 1942).

27. Musgrave, Richard A., The Theory of Public Finance, (New York, McGraw-Hill, 1959).

28. Musgrave, Richard A. ; and Peacock Alan T., Editors, Classics in the Theory of Public Finance, (London, Macmillan, 1958).

29. Pigou, A.C., A Study in Public Finance, 3rd edn., (London, Macmillan, 1949).

30. Rao, V.K.R.V., Taxation of Income in India, (Calcutta, Longmans, 1931).

31. Seligman, Edwin R.A., Essays in Taxation, (London, Macmillan, 1909).

32. Seligman, Edwin R.A., The Income Tax, 2nd edn., (New York, Macmillan, 1914).

33. Seltzer, Lawrence H., The Nature and Treatment of Capital Gains and Losses, (New York : National Bureau of Economic Research, 1951).

34. Shoup, Carl S., et. al., The Fiscal System of Venezuela, (Baltimore, Johns Hopkins, 1959).

35. Simons, Henry C., Personal Income Taxation, (Chicago, The University of Chicago Press, 1938).

36. Tax Institute, Capital Gains Taxation, (New York, Tax Institute, 1946).

37. Tax Institute, Income Tax Administration, Symposium (New York, Tax Institute Inc., 1948).

38. Tax Policy League, Tax Exemptions, Symposium, (New York, Tax Policy League, 1939).

39. Wallich, Henry C. and Adler, John H., Public Finance in a Developing Country, El-Salvador, (Cambridge, Mass., Harward University Press, 1951).

40. Westen, Stephen F., Principles of Justice in Taxation, (New York, Columbia University Press, 1903).

OFFICIAL AND OTHER PUBLICATIONS

41. Lebanese Republic, Official Gazette, 1940-1963.

42. ———— Budget of the Lebanese Republic, 1940-1963.

43. ———— Closed Accounts of the Budget, 1940-1960.

44. ———— Bulletin Statistique Trimestriel.

45. ———— Collection of Legislative Decrees Related to Direct Taxes, (Beirut, Sader Press, 1960).

46. ———— Parliamentary Proceedings, 1942-1946.

47. ———— Five Year Plan, Ministry of Planning, (Beirut, Sader Press, 1958).

48. ———— Annual Reports of the Council of Planning and Economic Development, 1954-1958.

49. United Kingdom, Report of the Royal Commission on the Income Tax, Cmd. 615, (London, His Majesty's Stationary Office, 1920).

50. ———— Royal Commission on the Taxation of Profits and Income, First Report, Cmd. 8761, (London, Her Majesty's Stationary Office, 1953).

51. ———— -do- Second Report, Cmd. 9105, (London, 1954).

52. ———— -do- Final Report, Cmd. 9474, (London, 1955).

53. United Nations, The Effects of Taxation on Foreign Trade and Investment, (New York, 1950).

54. U. N. R. W. A., Quarterly Bulletin of Economic Development No.13, Government Budgets of Middle East Countries, (Beirut, 1956).

55. Beirut Chamber of Commerce and Industry, The Economy of Lebanon and the Arab World, Nos.36, 51, 54, 55, 66, 74, 76, 99 and 103.

UNPUBLISHED STUDIES

56. Higgins Report (Typescript), 1960.

57. Salim, Khalil I., Lebanese Tax System (mimeographed study).

58. Sayigh, Yusif A., Economic Development of Lebanon its Prospects and Problems (typescript), Baltimore, 1955.

59. Economic Research Institute, Business Legislation in Lebanon, American University of Beirut, (Beirut, 1954).

ARTICLES

60. Tuéni, André, "The Budget and Tax System of Lebanon", Les Conférences du Cénacle, (Beirut, 1950).

61. ———— "Fiscal Reform in Lebanon", Les Conférences du Cénacle, (Beirut, 1952).

62. Badre, Albert, "Towards New Economic Horizons", Les Conférences du Cénacle, (Beirut, 1960).

63. Sayigh, Yusif A., "Lebanon : Special Economic Problems Arising from a Special Structure", Middle East Economic Papers, American University of Beirut, 1957.

64. Himadeh, Said, "The Reform of the Lebanese Tax System", Al-Abhath, Vol.11, Beirut, 1958.

65. Shihab, Jamil, "Administration of Public Funds in Lebanon", Al-Abhath, Vol.10, Beirut, 1957.

NEWSPAPERS

66. Le Commerce du Levant, 1959-1963.

67. Al-Jarida, 1959-1961.

68. Al-Amal, 1959-1961.

69. Al-Hayat, 1959-1960.