

VAT EVASION IN LEBANON: CASES AND MAIN CAUSES

Rana Ismail

American university of Science and Technology
RAI10009@students.aust.edu.lb

Faisal Nsouli

American university of Science and Technology
fnsouli@aust.edu.lb

Wafic Rihan

Lebanese University
dr.waficrihan@hotmail.com

—Abstract —

The Value Added Tax (VAT) is a very important source of treasury revenues in Lebanon. It was initially introduced in Lebanon in order to reduce the budget deficit and help contain the debt. However, VAT evasion growth in Lebanon is leading to significant VAT revenue losses because of its size and frequency.

In this paper, we will highlight the contribution of VAT to the treasury revenue. In addition, our research has led to figure out the most significant VAT evasion cases and the way tax payers evade paying their required VAT or try to have an illegal refund. From these tax evasion cases, we will pinpoint the main causes of such evasions and propose solutions to limit as much as possible VAT evasion in Lebanon.

Key words: *VAT, contribution of VAT, evasion cases, illegal refund, causes of evasion.*

JEL Classification: H26.

1. INTRODUCTION

VAT is a tax on national consumption. This tax is paid by the consumer on transactions of goods and services. Studies and analyses made the Ministry of Finance realize the need to increase tax revenues in order to help reduce the budget deficit, contain the increase in public debt, finance several

development projects and rebuild the infrastructure. It was also indispensable to reform the tax system through the reconsideration of indirect taxes, the modernization of the tax administration and the introduction of a unified income tax system in preparation to the participation in free trade agreements, WTO.

Since the tax burden in Lebanon is still relatively low, considering that direct and indirect taxes constitute about 13% of the GDP whereas it constitutes between 20 and 40% in other countries, one of the policy options available was the introduction of the value-added tax, a tax system already adopted by many countries around the world. In Lebanon the value added tax was introduced by the law No. 379 dated 14/12/2001. A general tax on consumption that imposes a unified rate of 10% on all goods and services whether produced locally or imported from foreign countries with certain exemptions. It is a consumption tax that does not affect unspent income or savings. A tax that represents an important source of revenue for the government and is “expected” to generate more than 3% of GDP, which contributes to contain the increase in public debt. (Rihan W., 2001).

The opportunities for VAT evasion in the single market, which are potentially trade-distorting as well as revenue-eroding, have led the European Commission and various economists to call for measures to repair the break in the VAT-chain by imposing VAT on interstate exports in the country in which the exports originate (exporter rating), and by allowing this VAT as a credit (and refund, if required) against the VAT payable on the importer’s supplies in the importing member state. Due to the novelty of VAT legislation in Lebanon, the studies and analyses of the methods of evasion and other illegal recovery of taxes are still scarce. It was found through Web search that studies conducted in some countries that implement VAT law around the world, dealt with cases of VAT evasion and suggested ways and mechanisms to control it as much as possible, as well as develop and improve the existing legislations or issue new ones.

In this paper, a preliminary study of the Lebanese legislation on the Value Added Tax shows the importance of the collection of VAT in the Lebanese treasury revenue. Unfortunately, there will always be some taxpayers who will try in many ways to evade paying the required VAT. Up on our research, we will pinpoint several cases of VAT evasion and illegal recovery. From these tax evasion cases, we will identify the main causes of such evasions and propose solutions to limit as much as possible VAT evasion in Lebanon.

2. LITERATURE REVIEW

Although many studies have been made on tax compliance, very few have examined compliance, or rather noncompliance, primarily from the perspective of ethics. Most studies on tax evasion look at the issue from a public finance or economics perspective, although ethical issues may be mentioned briefly, in passing.

(Brederode, 2008:31) published a study which dealt with tax evasion in some EU countries and he stressed and explained the issue of what is called “Carousel Fraud” that affects negatively EU revenues. VAT fraud is an issue of growing concern for the tax authorities in EU countries, because of its size and frequency, the increased sophistication of the fraud schemes and inherent difficulty of combating it, and its financial significance. The value added tax is a significant part of the total revenue for the EU member states, accumulating to 13 to 22 % of the total annual revenue and is charged at standard rates varying between 15 and 25 % on most goods and services across the EU.

(Gebauer et al., 2007:1) published a study in Germany about tax evasion and methods to control it. In his study, they stressed that the German State Treasury sustained significant losses due to VAT evasion. They also discussed the newly established reform models, and their ability to reduce the VAT evasion and prevent the decrease in revenues in the European Union. In the course of his discussion of the three models of reform, they mentioned that, apart from the usual types of VAT evasion caused by transactions without invoices, input-tax reimbursements based on forged invoices, the so-called Carousel fraud appears to have recently been playing an important role for the tax revenues. Carousel fraud works in such a way that intra-Community EU companies supply and purchase goods and services and this leads at the end to a fraudulent retention of VAT revenue. (Gebauer et al., 2007:1.)

A study carried out in Nigeria (Fagbemi et al., 2010:1) on tax compliance, including VAT, shows that the level of tax evasion is clearly affected by the low ability of tax administration officials to enforce tax liabilities and by corruption. 90% of the surveyed taxpayers believe that tax evasion is an ethical matter. A study carried out in Portugal by Iglesias and Tavares (Tavares et al., 2010) suggested that attributions of tax evasion had two independent dimensions the confidence in the Fiscal Justice and confidence in the efficiency of tax evasion control. This study (Tavares et al., 2010) reports on a research conducted in

initially in Spain using the same causal attributions used in the Portuguese research.

Another study conducted in Turkey (McGee et al., 2011:1), regarding ethical attitudes to tax evasion, showed similar results to the studies conducted in Nigeria and Portugal. The aforementioned McGee et al. study found that tax evasion is more likely to be viewed as justifiable if: the tax administration officials are corrupt, tax funds wind up in the pockets of corrupt politicians, or the tax system is perceived as being unfair.

3. CONTRIBUTION OF VAT IN LEBANESE REVENUES

The main reasons for the implementation of the value added tax were to contribute in redressing the economy by enhancing revenue, reducing the deficit and containing the debt on one hand. On the other hand, it will allow Lebanon to better integrate into the global market place by getting prepared to trade agreements such as WTO, EU and Arab Trade Union.

According to data from the Treasury Department, VAT represents an influential component with regards to tax revenues. VAT constitutes around 25% of the Lebanese total revenues (Fig 1) for the past three years. In addition, the Customs collect circa 70% of the total VAT revenues (Fig 2). Despite the tremendous VAT evasion and illegal recovery cases, VAT is significantly increasing between 2005 and 2011 to reach around 1.5 billion dollars (Fig 3).

Figure-1: Tax Revenues Distribution (2009-2011)

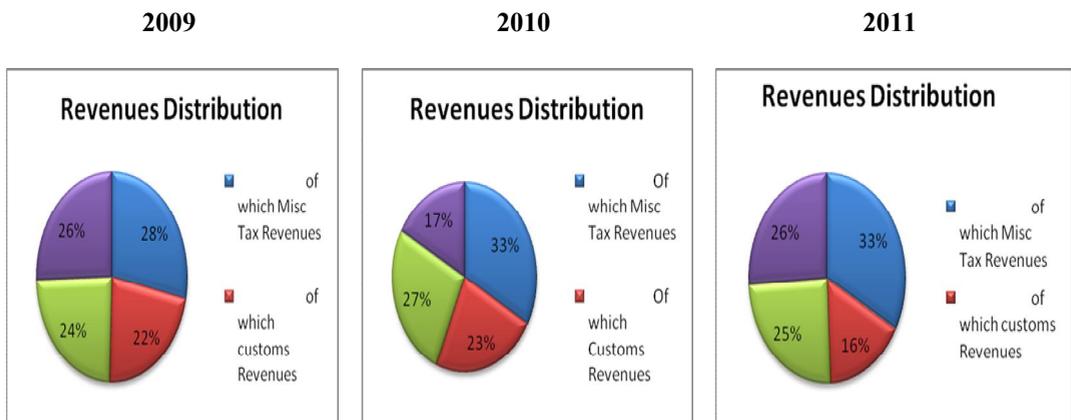


Figure-2: VAT Collected by Customs

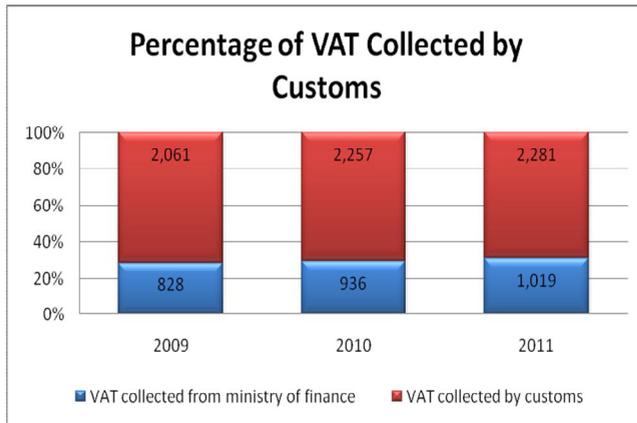
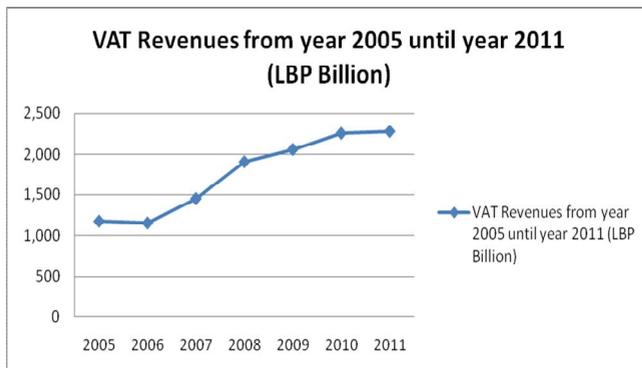


Figure-3: VAT Revenues (2005-2011)



The cases of tax evasion and illegal recovery are not usually published in periodicals or circulated in the media, because of the privacy of tax processes between the tax authorities and the taxpayers and professional confidentiality (Article 44 of Law No. 379/2001 and its amendments). It was thus imperative, in order to access the aforementioned cases, to conduct fieldwork with officials in VAT collection and derivating processes (recovery, exemption ...). The two main references here are the Customs Authorities and the VAT Directorate at the Ministry of Finance. Regulators in the Central Inspection Board and the competent judicial authorities also have a role to play in the investigation of such violations, which deprive the state treasury of a part of its tax revenues.

4. VAT EVASION AND ILLEGAL RECOVERY CASES

Conducting such a field study - of an academic nature and done within the codes of procedures required in the public administrations - was not an easy matter. It might indeed raise the reservations and anxiousness of a number of employees as to the objectives, purpose and results of the study.

The Staff's response was mixed, be it positive or negative. We were though able to interview a couple of dozen present officials and former experts in the Customs Administration and the VAT Directorate as in the Ministry of Finance.

Through the field study, we were able to single out several cases of VAT evasion and illegal recovery; however no sufficient information or data were available for us to determine the percentage of financial losses the treasury incurs, the annual frequency of such cases or the number of violators caught.

After studying the tax evasion cases and illegal recovery, we were able to bring out the following:

- 1 - Making "off the books" sales (without issuing invoices), declaring the sale of less goods than those on which VAT was already paid. Therefore, claiming that the collected tax is inferior to the paid tax, and exercising the "right" of recovery of the balance brought forward: Under-reported sales that do not reflect the real activity of the trader.
- 2 - VAT taxable trader reporting sale of goods at a lesser than the true value of goods. Therefore, exercising the right of recovery of the balance brought forward: Under-evaluated sales that do not reflect the real activity of the trader.
- 3 - VAT taxable trader exercising a commercial activity outside the scope of his registered activities in the trade register for which he charges VAT and does not remit it to tax administration: Hiding undeclared commercial activity.
- 4 - Smuggling of goods across the border, illegally selling them on the national market and possibly charging VAT: Tax avoidance, illegal commercial activity and unfair competition.
- 5 - Creating smokescreen companies with fake identities, fake addresses and fictitious business transactions. Such companies register voluntarily for the VAT tax under the false pretext of exercising business operations. The said companies then file for VAT recovery on the basis of fictitious invoices. Such "invoice mills"

exploit the practical impossibility of crosschecking every invoice against evidence that earlier tax has been paid: Falsification of documents and unlawful recovery.

6 - A car dealer recovering the VAT tax difference although he charged it to the end consumer. The difference results from the evaluation of the car at the Customs at a higher value than its actual selling price. The tax administration returns the difference to the car dealer, provided it does not to exceed 20% of the VAT tax - which was calculated on the basis of the customs value plus all the fees. There are no legal texts confirming the legality of such recovery.

7 - Conspiracy in issuance of fictitious bills of sale between a company that buys from unregistered suppliers (who do not pay VAT tax and do not declare it), and a company that sells to consumers who pay VAT tax (consumers do not ask for recovery or deduction.) Conspiracy to hide the VAT tax charged by the first company from a third company that eventually exported the goods and recovered VAT (the case of scrap dealers): The State pays VAT tax instead of collecting it.

8 - Falsification of the declaration of goods at import - value or number - and re-export, to unlawfully recover higher VAT tax upon export.

9 - False declarations upon recovery to benefit from VAT tax exemptions on certain goods for a personal use - the goods not being for a personal use. For example: Personal furniture.

10 - Purchase of goods and payment of VAT tax, then selling the said goods on the local market and recovering the VAT charged upon the purchase. Then forging a false customs declaration of the export of the said goods, and filing a VAT tax recovery under the guise of exportation.

11 - Dual invoicing in tourism, hospitality and services where the full VAT tax is charged, but only part of it is remitted to the Treasury (an invoice understating the value and another invoice containing the higher amount.)

12 - Loose interpretation of the fiscal legislature on the subject of tax exemptions for donations to the communities. Large quantities of goods are imported in the form of donations to the communities, and they are therefore exempted from tax.

In order to combat VAT tax evasion and unlawful recovery, it is necessary to conduct a thorough analysis of the potential loopholes in tax legislation and regulations, and discuss the procedures in the operations of the VAT tax and Customs administrations, to come out with proposals aimed at combating this

phenomenon and reducing its negative consequences on the state revenues.

5. MAJOR CAUSES OF VAT EVASION

The main violations we encountered were as follows:

- Violations under an indirect legal cover resulting from loopholes in the legislation.
- Violations of the provisions governing the VAT tax resulting from the bad ethics of a number of taxpayers, and perhaps made easy by the follow-up gaps in inspection and audit.
- Poor implementation of the legislative texts and bad interpretations of the tax legislator's intent resulting from confusion, ambiguity or the incapacity of the administration to provide a sound interpretation of the law.

6. RECOMMENDATIONS

In the course of our analysis of the VAT tax evasion cases, the following suggestions are offered to combat these phenomena, or at least, try to limit them:

- Revision and reform of related articles, sections and provisions of the legislation on value added tax to avoid any uncertainty or ambiguity, and to fill the gaps through which illegal transactions are carried out, thus resulting in substantial losses to the Treasury.
- Reinforcing the tax administration with highly efficient and sufficient human resources as well as highly developed technical means, while emphasizing the need for a better coordination between the concerned administrations.
- The implementation of rules and regulations defining the proper mechanisms to activate control, inspections and audit in the offices and on the field, to reduce VAT evasion and illegal recovery.
- A number of dealers declare that a big number of cars remain unsold. For this reason, the best solution is to make use of "NAR" and "NAJM" systems to detect and match the data of imported cars (number, type, structure number,...) with the data related to the value of cars in the local market (number, type, structure number,...).
- Putting forth clear texts that clearly show cases of exemptions and their objectives on the basis of limiting instead of expanding them.

- Marking or coding the process subject to exemption in the information system to prevent collusion and repetition of the same operation for one case within time limits.

7. CONCLUSION

Through the field study we reached the following conclusions:

1 - VAT tax evasion cases remain limited, in comparison with requests for illegal recovery, which represents the highest percentage of losses for the state revenues. Therefore, the tax administration concentrates its efforts on the detection of such cases and on the adoption of a zero tolerance policy in examining the recovery requests.

2 - The VAT tax yielded substantial revenues to the treasury, and it was necessary to increase the number of assessors to inspect at the premises of the taxable entities records, invoices and other documents and to follow the trail of the goods up to their source allowing them to ensure the correct collection of the tax (For instance, in cases of recovery at the Customs.) Good control and inspection methods lead to a better cooperation of taxpayers.

3 - The Administration has the obligation to improve its audit and control methods, because there will always be continuous attempts to illegally circumvent its efforts, to exploit the tremendous pressure it is under and consequently, possibly its shortcomings at times!

4 - The tax administration concentrates its efforts on the improvement of the regulatory procedures for a more effective control of the taxpayers' activities, in a way that makes the information and documented data (book-keeping) reflect the reality of the activities of the taxpayers; because any imbalance between the books and the actual activity is considered to be an evasion.

BIBLIOGRAPHY

Van Brederode (2008), Third Party Risks and Liabilities in Case of VAT Fraud in The EU, *International Tax Journal - Chicago*. - Vol. 34 (2008), No. 1 ; pp.31-38.

Gebauer A., Chang Woon Nam, Parsche R. (2007), Can Reform Models of Value Added Taxation Stop the VAT Evasion and Revenue Shortfalls in the EU, *Journal of Economics Policy Reform*, Vol.10 (2007), No. 1, pp.1-13.

Tavares J., Iglesias M., (2010), Dimensions of Causal Attributions of Tax

Evasion in Portugal, *Revista de Psicologia del Trabajo y de las Organizaciones*.

Fagbemi T., Uadiale O., Noah A., The Ethics of Tax Evasion : Perceptual Evidence from Nigeria. (2010). *European Journal of Social Sciences, Vol. 17 (2010), No. 3; pp.1-13.*

McGee R., Benk S., Yildirm H., Kayikci M., The Ethics of Tax Evasion: A Study of Turkish Tax Practioner Opinion (2011). *European Journal of Social Sciences. Vol.18 (2011), No. 3; pp. 1-14.*

Rihan W., Value Added Tax (2001). Series of Lectures made in the central inspection bursary.

Republic of Lebanon, Ministry of Finance, Value Added Tax Law, VAT Lebanon –law 2.3 and its modifications (2005).