

GATCA

The automatic exchange of information carries local prospects



By the end of 2016, Lebanon will most likely abide by the requirements of the Organisation for Economic Co-operation and Development (OECD) in regards to the fight against tax fraud. This will be done by signing the conventions relating to the automatic exchange of information and revising a law allowing the sharing of information related to bank accounts held by non-residents at the request of foreign tax authorities.

INFORMATION ON DEMAND

Passing a handful of laws in the fall of 2015 allowed the country to avoid an imminent listing on the black list of non-cooperative countries. However, the conditions provided by the new regulations to authorize the lifting of banking secrecy were considered by our partners as unacceptable. Obviously, the local authorities will have to systematically and fully cooperate with any request for information pertaining to a bank account held by a resident of a concerned country, without the need for excessive justification such as a proof of tax evasion. While we were still delaying the conformity of its legislations relating to the communication of information on demand, the issue was already outdated and the OECD had succeeded in imposing the automatic exchange of information on almost every country in the world (except the United States).

HOW IT WORKS

The mechanism of such exchange (sometimes named GATCA in reference to FATCA) is in principle simple: Each year, every country must communicate to the other countries a list of bank accounts opened in the name of residents of these countries. This list, which includes the accounts' balances, interests, dividends, and other information, allows third countries to become aware of taxpayers that are subject to taxes in their home countries and, specifically, those who are trying to evade such taxes by opening bank accounts in foreign jurisdictions, generally covered by banking secrecy. In signing the conventions on the automatic exchange of information, Lebanon would have lifted, in fact and by law, the banking secrecy on all accounts held by non-residents in Lebanese banks. These new provisions (applicable starting in 2018) are problematic for residents of foreign countries who hold accounts in Lebanon (including nationals living outside Lebanon), and as such are seen as a challenge to the local banking system.

Jean Riachi,
Chairman of
FFA Private Bank

A TWO-WAY STREET

On the other hand, through reciprocity, we will be informed of all accounts held abroad by Lebanese residents. It is widely believed that Lebanese wealth in securities and bank accounts held outside the country is in the tens of billions. The 'Swiss Leaks' scandal revealed that HSBC Switzerland alone holds more than four billion dollars' worth of assets belonging to Lebanese residents. Therefore, GATCA could be an opportunity for Lebanon. The objective of our Government should be to:

- Encourage residents in Lebanon to come clean and declare their worldwide income to the tax authorities
- Encourage citizens (especially businesspeople and retirees) living abroad (and possibly foreigners) to relocate to Lebanon in order to benefit from generally lower income tax rates
- Encourage Lebanese residents to repatriate funds held outside and invest them through local banks, including their foreign securities portfolios.

REGIONAL FINANCIAL PLATFORM

In order to achieve the three goals and benefit from massive capital inflows and a notable increase in the Treasury's revenues, the authorities must take four important measures:

Align the tax rate on foreign securities held through Lebanese banks with tax rates on Lebanese securities and bank deposits:

Article 51 of Law 497/2003 sets the tax at five percent on interest on bank deposits and income on local securities. On the other hand, income generated by foreign securities is set at ten percent according to article 72 of the Income Tax Law. However, article 3 of Law 234/2000 exempted financial intermediation accounts from such taxes. Notwithstanding the above, the Ministry of Finance has systematically rectified and penalized Lebanese banks which were not withholding taxes on their clients' interest and dividends generated by foreign securities held through financial intermediation accounts. Shouted down by the Association of Banks in Lebanon (ABL), the Ministry of Finance recognized the existence of article 3 of Law 234/2000, but argued that article 51 of Law 497/2003 (which was issued three years after law 234) implicitly included the financial intermediation accounts in the definition of 'fiduciary and asset management accounts', which according to article 51 are subject to a five percent taxation. Although

this interpretation is debatable, it implies that the income of foreign securities held in accounts in Lebanon is taxable at five percent. Therefore, instead of imposing a ten percent tax on foreign securities held in brokerage accounts with Lebanese banks, the Government should tax them at five percent. By doing so, income on foreign securities would be taxed at ten percent if said securities are held abroad and at five percent if they are held through Lebanese banks. By benefiting from a reduced rate, residents will be more likely to transfer their portfolios of foreign securities to banks in Lebanon (securities are held 'off-balance sheet', therefore immune from any bank or country failure). Billions could be repatriated, benefiting indirectly the economy by creating new jobs in the financial sector and directly given that a portion of this wealth will inevitably end up being invested in the country.

Declare a tax amnesty: Article 72 of the Income Tax Law was never applied except for persons wishing to benefit from double taxation treaties. It is very unlikely that anyone has ever voluntarily declared to the Lebanese tax authority the dividends and interest in bank accounts held abroad. If individuals subject to such tax are going to come clean and take the initiative to declare their income (and therefore inform the tax authority that they have been in possession of a bank account abroad for years), the risk is to have tax collectors go back several years and impose flat-rate adjustments and penalties. People do not want the 'Sword of Damocles' hanging over their heads and we should not underestimate peoples' skills when it comes to evading taxes, especially when the taxation is seen as unfair and arbitrary. It would be indeed unfair to claim arrears of taxes in application of a law that was never applied. It is then a matter of justice and efficiency. An amnesty law for the fiscal years preceding 2017 concerning article 72 should be declared and the Ministry of Finance should take advantage of this amnesty through a far-reaching media campaign, to inform the public about GATCA and its tax policies. A well mediatized amnesty and inducement and information campaigns on Lebanese taxation rules will motivate residents to initiate the regularization of their situation and non-residents to settle in Lebanon.

Clarify the tax base: In accordance with the income tax law, and for individuals, only interest and dividends deriving from securities are taxable, excluding capital gain. The jurisprudence has specified that the non-taxation of capital gains also applies to foreign securities. Some officials of the Ministry of Finance insist on taxing capital gains, particularly when demanding that banks withhold the tax. This demand is not only illegal, it is also absurd. How can taxes on capital gains be withheld? Contrary to an income, capital gains are not paid by the bank. This is an accounting concept that requires a calculation rather than a flow, and as such, expecting banks to withhold taxes on capital gains is not possible. In countries that tax capital gains, the latter is declared and



Article 51 of Law 497/2003 implicitly included financial intermediation accounts

paid by the taxpayer. The bank may provide calculation elements provided it has acquired such elements from another institution. How can the bank know the amount of a capital gain made on a sale transaction when the purchase was executed in another institution? In case the law changes and capital gains are taxed, it should not be executed on a case-by-case basis. Capital losses on a security should be deductible from capital gain and income on other financial assets. Moreover, if a certain year is globally negative, there should be a possibility to carry forward the net losses.

Exempt non-residents from taxes on foreign income deriving from portfolio management, fiduciary or financial intermediation accounts: Article 51 of law 479/2003 states that the five percent tax on bank deposits and Lebanese securities is withheld and this also applies if such deposits and securities are held by non-residents. This taxation makes sense as the income is derived from Lebanon. In one of the clauses pertaining to article 51 that relates to managed accounts and fiduciary accounts, non-residents are not mentioned. We can conclude that, considering the absence of such explicit mention and by virtue of the principle of tax territoriality, non-residents are not subject to taxation on such accounts. Beirut can become a regional financial platform for foreigners who use their accounts with Lebanese banks to manage their global wealth and benefit from expertise in wealth management. Global portfolios can be easily moved from one jurisdiction to another. It is therefore unthinkable to levy any tax on foreign assets held by non-residents, whatever the nature of the account. This principle should be clearly confirmed by our tax authorities.

We should not underestimate peoples' skills when it comes to evading taxes, especially when the taxation is seen as unfair and arbitrary
