

Once Again, Financing the Deficit with Depositors' Money

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At a time when banks are working to preserve and build up as much liquidity as possible in order to repay depositors, the State appears to be looking for additional sources of revenue for the Treasury, even at the expense of that liquidity, through tax measures that raise serious legal and accounting concerns and could impose additional burdens on banks, drawing on funds that should instead be available for the repayment of deposits.

For many years, the State relied on the Central Bank of Lebanon to finance its treasury deficit, ultimately using funds belonging to banks and depositors. Now that this form of financing has come to an end, and amid growing public resentment to higher taxes and fees, the State appears to be searching for new sources of revenue, even if that means tapping into the remaining dollars banks are trying to secure for depositors.

There is a striking contradiction here. The State defaulted on its Eurobond obligations in March 2020, inflicting substantial losses on banks. Yet today, it is considering taxing the accounting treatment of those very losses, to the point where a transaction that results in an actual loss in US-dollar terms could nevertheless be deemed to generate a taxable profit.

Is it reasonable for the State to stop servicing its debt, leave banks to absorb the losses, and then seek to tax those same losses, considering them profits that never actually existed?

The Risks Raised by the Large Taxpayers Department's Request

One of the most concerning aspects of the recent letter issued by the Large Taxpayers Department of the Directorate of Revenues and addressed to banks is the request to review their tax treatment and amend their tax returns for the years 2020 through 2024. This could result in additional tax liabilities not because banks earned profits, but because they incurred losses and because exchange-rate differences arose as a result of the collapse of the Lebanese pound.

The proposed tax treatment could therefore impose three successive burdens on banks, all stemming from the State's own default.

First, the State stopped servicing its Eurobonds, causing banks to incur substantial losses on those bonds, even though the State remains indebted for their value.

Second, banks established provisions for expected credit losses, approved by the Banking Control Commission and in compliance with accounting and regulatory standards. Yet some of these provisions were either rejected or restricted for tax-deductibility purposes.

Third, banks face today the risk of taxation on purely nominal profits created by the collapse of the Lebanese pound. The tax authorities could calculate the difference between the original purchase cost of the bonds at an exchange rate of LBP 1,500 to the dollar and their current market value translated at LBP 89,500 to the dollar, even though the bank may have suffered an actual loss exceeding 75% of the bond's value in US-dollar terms.

In other words, the State would not only have failed to repay its debt; it could also use the losses caused by that default as the basis for imposing additional taxes on its creditors.

Such taxation would not merely reduce the liquidity currently available, but it could also undermine banks' ability to generate new liquidity for depositors.

A Dollar Loss Turned into a Taxable Profit in Lebanese Pounds

Suppose a bank purchased a bond for USD 100 when the exchange rate was LBP 1,500 to the dollar, amounting to a cost of LBP 150,000. Following the State's default, the bank is forced to sell the bond for just USD 25, at a time when the exchange rate has reached LBP 89,500 to the dollar.

In economic terms, the bank has lost USD 75, representing 75% of its investment.

Yet under the tax approach being considered by the Directorate of Revenues, the sale proceeds would be translated into Lebanese pounds at the current exchange rate, while the acquisition cost would remain recorded at the historical exchange rate.

The USD 25 sale proceeds would therefore be recorded as LBP 2,237,500, against a historical acquisition cost of LBP 150,000. The result would be a nominal taxable gain of LBP 2,087,500.

In other words, a bank that has lost 75% of its investment in dollar terms could therefore find itself being asked to pay tax on a supposed profit in Lebanese pounds!

Is this really a tax on an actual profit, or merely a tax on an accounting difference created by the collapse of the currency, with no corresponding economic gain?

Consequently, using a historical exchange rate for the original cost of the bonds while applying a current exchange rate to their market value raises a serious issue that requires a comprehensive legal and accounting solution. It cannot simply be addressed by treating nominal exchange-rate differences as taxable profits.

Exchange-rate rules should not become a mechanism for taxing an actual economic loss merely because that loss appears as a nominal accounting gain in Lebanese pounds.

Banks are not asking to be exempted from their tax obligations, nor are they challenging the State's right to collect taxes that are legally due.

But there is a fundamental distinction between taxing a real profit and creating a taxable profit resulting from exchange rate fluctuations, especially when the underlying transaction has, in reality, incurred a loss in US dollars.

Therefore, it is necessary to reconsider these tax demands in light of the applicable laws and accounting standards, as well as their impact on bank liquidity. It is unreasonable to ask banks to prepare to contribute to the repayment of deposits while simultaneously adopting tax measures that could drain, in advance, part of the resources needed to make such repayments possible.

In Conclusion

The most dangerous aspect of this approach is not merely that banks could be taxed on profits that were never actually earned. It is that the Treasury could ultimately become a beneficiary of losses caused by the State's own default. If the State stopped repaying its debts, the losses suffered by its creditors should not then become a new source of revenue for the Treasury.

Searching for the last available dollar in the banking sector to finance the treasury deficit, while simultaneously asking banks to accumulate liquidity for depositors, risks repeating the very same mistake that contributed to the crisis, only through a different mechanism.

Unless this contradiction is addressed with sound judgment, efforts to pass legislation aimed at restoring deposits will be undermined from the outset by tax measures that may withdraw a substantial share of the very funds on which deposit repayment is expected to rely.

Note: This editorial is part of a series written by the Secretary General of the Association of Banks in Lebanon as part of his introductory articles to a number of periodicals published by ABL. It reflects his personal opinion and analysis of the developments and does not bind ABL.