TAX MOVEMENT SIERRA LEONE

FAIR TAX MONITOR STUDY FOR SIERRA LEONE

POLICY BRIEF

FAIR TAX MONITOR(FTM) -INTENSIFYING DOMESTIC REVENUE COLLECTION AND EXPENDITURE RATIONALIZATION.

June 2022

INTRODUCTION

Domestic Resource Mobilization (DRM) is of prime importance for any country to meet its development aspirations, inclusive of Sierra Leone. In its Mid-Term National Development Plan (MTNDP) 2019- 2023, Sierra Leone planned to spend approximately US8.15 billion to meet its development aspirations. The plan intends on restoring macroeconomic stability through fiscal consolidation, which involves intensifying domestic revenue collection and expenditure rationalization[1]. While the emphasis is placed on the need for domestic resources to play a key role in financing development, natural resource-rich[2] Sierra Leone is ranked 181/189 countries on the Human Development Index (HDI), with 64%[3] of people still living in poverty and unemployment standing at over 70%.[4] This naturally begs the question of where the much-needed domestic resources to finance development should come from and if will be raised in a fairway.

Fairness in revenue mobilization plus the efficient utilization of the revenue proceeds is a fundamental concern for all countries including Sierra Leone. It is however always difficult to measure fairness, especially when data is not readily available. International NGOs and think tanks like ActionAid, Oxfam Novib, and Tax Justice Network–Africa in collaboration with partners and Oxfam Country Offices succeeded in developing the Fair Tax Monitor (FTM) Methodology in December 2014. The FTM Methodology assesses, compares and evaluates fairness; and investigates the general characteristics of countries' tax systems based on a Common Research Framework (CRF)[5] developed by the FTM Methodology experts.

[1] Sierra Leone's Medium-Term National Development Plan 2019-2023, available at https://www.slurc.org/uploads/1/0/9/7/109761391/sierra_leone_national_development_plan.pdf/

[2] International Trade Administration, 2021, https://www.trade.gov/country-commercial-guides/sierra-leone-mining-and-mineral-resources#:~:text=Sierra%20Leone%20is%20well%20known,well%20as%20promising%20petroleum%20potential./

[3] Sierra Leone Multidimension Poverty Index, 2019 available at https://ophi.org.uk/wp-content/uploads/Sierra_Leone_MPI_2019_final.pdf/

[4] United Nations Development Programme, 2021, About Sierra Leone available at https://www.sl.undp.org/content/sierraleone/en/home/countryinfo.html/

[5] The CRF was developed throughout a pilot phase in 2015/2016 and was first applied to four pilot countries, namely: Bangladesh; Pakistan; Uganda; and Senegal. In 2017, the CRF was further revised and implemented in nine countries, including Senegal, Tunisia, Nigeria, Uganda, Occupied Palestinian Territories, Pakistan, Bangladesh, Viet Nam, and Cambodia.

The FTM Working Group identifies a fair tax system to include the following:(1) progressive and serves as a mechanism to redistribute income in a gender responsive way; (2) allows to raise sufficient revenue to perform government functions and provide high-quality essential public services; (3) refrains from and eliminates tax exemptions and incentives to the elite (individuals and corporate); and (4) tackles causes of illicit capital flight and tax evasion & avoidance by multinational companies and the wealthy

WHY WE DID IT?

Taxation is the main means by which a government finances its expenditure. Taxation is also the cornerstone of the social contract between state and citizens– quality gender-responsive public services provided by the state in exchange for taxes paid – and therefore, a vital path to building legitimacy and a sense of fairness.

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This is predicated on a tax system that is based on principles of transparency, accountability and participation. A regressive tax system though may be fair because it is applied to everyone but tend to place a greater burden on especially the poor compared to high-income earners.

However, the pronouncement by the current Government of Sierra Leone at the State Opening of the 5th Parliament of the Republic of Sierra Leone[6] that the nation's domestic revenue to GDP ratio would be increased from about 10 percent to 20 percent by 2023[7], gives hope to champion reforms that will increase the government revenue profile to finance needed public

[6] Presidential Speech at the State Opening of the 5th Parliament

[7] Save the deadly Corona virus that is currently terrorizing the world economy including Sierra Leone. In fact, recent pronouncement by the Minister of Finance reported revenue projection initially reported at Le6 trillion will be revised to Le2 trillion in 2020

services. Also, the Government's commitment in the form of increased budgetary allocations in the 2019 budget to education from 14 percent to 21 percent is a clear indication that there is a political will to champion revenue reforms to finance these expenditures.

It is against this background that ActionAid Sierra Leone (AASL) and Civil Society Organizations through the Tax Movement Sierra Leone (TM SL) working on Taxation decided to commission the first Fair Tax Monitor (FTM) evaluation in Sierra Leone.

The study utilized the common FTM framework to evaluate the Sierra Leone tax system for the past five (5) years (2015 to 2019). The criteria used in this framework focus on the first three (3) of the six (6) thematic areas namely: **distribution of the tax burden** and **progressivity**; **revenue sufficiency** and **tax leakages**; **tax competition** and **corporate incentives.**

HOW WE DID IT?

The goal of this study is to contribute to a better understanding of tax issues in Sierra Leone and to provide a firm basis for both civic education and advocacy campaigns to promote a fairer tax system.

In terms of scope, this FTM study for Sierra Leone focuses on the first three (3) of the six (6) thematic areas namely: distribution of the tax burden and progressivity; revenue sufficiency and tax leakages; tax competition and corporate incentives.

The specific and target-oriented objectives are stated below.

1. Provide a detailed review of Sierra Leone's tax system and expenditure on public services based on the FTM methodology.
2. Provide strong evidence-based support for country-level advocacy, campaigns and influencing work.
3. Create a framework to compare tax systems of selected countries over time and measure changes in tax policy in Sierra Leone.

4. Contribute to the global level advocacy on taxation by showcasing the relative fairness of selected tax systems and providing strong recommendations for national tax policy making on cross-border tax issues.

The main research method of the FTM for Sierra Leone is synthesis an interpretation through secondary information. The study utilizes the common FTM framework for measuring several indicators and methodology using rapid assessment techniques such as key informant interviews with some experts of key relevant institutions.

The FTM in its present version has six distinct thematic evaluation categories as stated below.

1. Distribution of the tax burden and progressivity

assessing the relevant content (quantitative methodology). For further evidence, the report also utilized qualitative research

2. Revenue sufficiency and tax leakages
3. Tax competition and corporate incentives
4. Effectiveness of the tax administration
5. Government spending
6. Transparency and accountability

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Exploratory methods are mainly applied in this study. Information is acquired via two channels: (1) by researching secondary data and archival resources, and (2) by using rapid assessment techniques such as key informant interviews.

Many group discussions between the research team and stakeholder groups/organizations were conducted. In the discussions, the subject, scope, and method of this study were presented. Feedback from the participants in the discussion was collected and served for research. With a careful selection, a limited number of tax practitioners in the National Revenue Authority (NRA), the Ministry of Finance (MoF) and other think tank organizations such as Non-State Actors (NSA), Budget Advocacy Network (BAN) were interviewed on their perceptions on the country's tax system, tax administration and on overall revenue structure. It should be noted that this report evaluates fairness under the FTM Research Framework. Therefore, the assessment results can be different when compared to other studies using different research methods.

WHAT WE FOUND

The summary result of the FTM Index shows that Sierra Leone's overall tax system is **moderately** progressive and sufficient, with somewhat **unfair** competition in the tax system.

SUMMARY OF FAIR TAX MONITOR INDEX

Scoring themes	1	2	3	4	5	6	7	8	9	10
Overall Progressivity										
Overall Sufficiency										
Overall Tax Competition										
Key	0-2		2-4		4-6		6-8		8-10	
	unfair								Fair	

THE SPECIFICS

On Distribution of the Tax Burden and Progressivity.

a. The research found that Indirect taxes (which are generally less progressive) contributed marginally higher 45.1 %, as compared to Direct taxes at 37.9% (which are generally more progressive) and non-tax revenue 17%, between the period 2015 -2019. The main direct taxes in Sierra Leone are Personal Income Tax (PIT) (28.8%) and Corporate Income Tax (CIT) 9%, PIT is collected from only 0.03% of the country's population from a projected 0.14%, and CIT is hampered by income tax incentives given to some mining and agricultural investments and potentially by inadequate rules for transfer pricing and thin capitalization.

b. Women face a higher tax burden considering that they earn way less and generally are less wealthy than male compatriots in the economy. Despite government policies being clear on gender equality, interestingly, the survey reported that for households that pay personal income tax, female-headed and female-dominant households pay a larger proportion of tax relative to household income.

c. Although a step has been taken to develop legislation relating to transfer pricing and thin capitalization, it is questionable if current rules such as the demand dividend rule and authority given to the commissioner general[8] to reverse transactions classified to lead to tax avoidance are adequate. There is no evidence whatsoever that the Commissioner-General has used such powers. Enactment by Parliament of this regulation will help address problems of transfer pricing.

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Revenue sufficiency and Tax Leakages.

a) In terms of sufficiency, Sierra Leone has seen a significant and steady increase in domestic revenues (direct taxes, indirect taxes, and non-tax revenues). Domestic revenues increased in nominal terms by 130.8 percent to Le5.39 trillion in 2019 from Le2.33 trillion in 2015. On average, the Government was able to collect about 95.6 percent of its budgeted revenues for the period under review (2015-2019). However, the tax system is **less sufficient** because the country is not free from chronically high debt and the tax to Gross Domestic Product ratio (10.4%) is less than the least developing country's average of 13%.

[8] Part XI of the Income Tax Act (ITA) 2000 (Anti-Avoidance), that gives powers to the Commissioner General to distribute, apportion or allocate assessable income, deductions or credits between the taxpayers using the arm's length transaction

b) In Sierra Leone, inflows and outflows estimated from import mis-invoicing and export mis-invoicing stood at US$132 and US$572 million respectively in 2015 (Global Financial Integrity, 2019). Despite concerns about tax

c) revenue leakage in the mining sector the government of Sierra Leone is yet to take action to safeguard its tax base. Comprehensive legal and administrative reform is urgently required if Sierra Leone is to combat tax avoidance and secure its fair share of resource rents.

d) To combat IFFs, corruption and to recover stolen assets, the country has enacted subsequent Anti-Corruption Acts (2000 and 2008),

e) the latest was its amendment in 2019. Also, enactment of the Anti-Money Laundering and Combating of Financing of Terrorism Act 2012. On June 18, 2019, the ACC presented a cheque of Le7.5 billion

(US$750,000) to H.E the President of the Republic of Sierra Leone, Dr. Julius Maada Bio as part of a whooping Le16 billion (US$1.6 million) of stolen cash recovered from corrupt officials.

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Competition and corporate incentives

a. Sierra Leone offers several tax incentives across different sectors, this is extended to several exemptions on selected tax handles such as Goods and Services Tax (GST), Withholding Tax (WHT) and import duties. In as much as the tax forgone from exemptions and incentives from import duty and GST is published, corporate tax incentives and their impact is not monitored on a yearly basis by the government. Data on the opportunity costs and benefits of the income tax incentives are unavailable. Incentives lead to massive losses to potential government revenue and hence should be informed by cost-benefit analysis. In cases where incentives are redundant, they should be scrapped.

b. The tax system is somewhat less competitive as per the Fair Tax Monitor assessment. Despite, there being clear and transparent rules for granting corporate tax incentives, uniformity of incentives is a problem for corporation tax. Waivers are granted to some companies articulated in mining agreements. Notwithstanding, the enactment of the Extractive Industry Revenue Act (EIRA) of 2018 tends to solve this problem

c. The tax rates for small and micro businesses range from 2% to 6%. This is among the highest in Africa, the report would benefit from a commentary on the impact on such for small and Micro businesses. Tax policy changes targeting formalisation could have been made for only purposes of generating revenue while impacting business survival.

Conclusions

How efficient and equitable national and sub-national taxes are administered and subsequently how the tax proceeds are expended is critical towards enhancing economic development. However, in practice, there is always a tradeoff between equity and efficiency in tax administration. The extent to which tax authorities reach a fine balance between equity and efficiency makes a big difference in tax administration. Policy practitioners and social activists often pay more attention to the tax burden on citizens and during spending, who deserves the greater share of the budget.

Sierra Leone, like many other African countries, has a robust legal and to a large extent institutional framework on taxation. However, the country is still yet to raise the tax-to-GDP ratio (11.1 percent in 2019) to the level of other low-income countries (13 percent). This is mainly attributed to a number of factors but not limited to losses in revenue due to the long lists of legal provisions on tax incentives and exemptions and the continued closure of the iron ore mines and its attendant negative impact on growth, revenues, foreign exchange and inflation. Despite the Government pronouncement to curtail duty waiver to MDAs articulated in subsequent budget speeches: all NGOs are required to pay import duty on their imports into an Escrow Account which can be reclaimed (FY 2017 budget speech); all contracts for the procurement of goods, services and works by MDAs and donor-funded projects must be at market price, inclusive of all applicable taxes (FY 2018 budget speech); and elimination of duty and tax waivers/exemptions for contracts awarded by MDAs for the supply of goods, services and works (FY 2019 budget speech), import duty waiver granted to Government MDAs still continue to account for a significant portion of duty waivers in 2019 estimated at Le347.43 billion (US$36.73 million) or 0.93 percent of GDP. Importantly also, is the unprecedented social policies stated to be implemented in 2020 especially. To name but a few, adding to the already proliferated lists of exemptions/rebates to include a reduction of import duty (from 20 percent to 5 percent) of all raw materials, semi-processed and finished products, properly labeled for use as input into the production of goods by manufacturing companies; exempt from GST all aviation-related charges,[9] and on free and promotional calls and free data use. Also, Sierra Leone depends largely on indirect taxes (e.g., excise duty, GST, and customs) averaging 45.1 percent for the period 2015 to 2019 and non-tax revenues (mining, road user and vehicle licenses, etc.), averaging 17 percent for the same period. Indirect taxation also affects women more because they spend a higher proportion of their income on consumer goods for their families.

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TAX MOVEMENT SIERRA LEONE

RECOMMENDATIONS

Government

a) Speed up the automation of tax collection processes and procedures through the implementation of Information Technology Systems including Integrated Tariff Analysis system (ITAS) and ASYCUDA World.

b) The Ministry of Finance and the National Revenue Authority should strongly think of putting together a framework to quantify the size of tax incentives and exemptions in Sierra Leone. The outcome would inform the Government of the quantum of lost revenues, which will guide the appropriate policy measure to curtain incentives and exemptions.

c) Government also needs to speed up the full-blow execution implementation and enforcement of regulation on transfer pricing and thin capitalization. There is high risk of revenue loss while clear legislation on these is yet to be enforced.

d) Government to pay attention to sincerely implementing its tax policies as articulated in the 2019 budget speech, especially the tax policy relating to eliminating duty and tax waivers/exemptions for contracts awarded by Ministries, Departments and Agencies (MDAs) for the supply of goods, services and works. Addressing this will increase the tax revenue/GDP ratio by 0.9 percent.

e) It is quite evident from studies that there is a knowledge gap on the types of taxes administered by NRA and rates paid by taxpayers including when and how taxes should be paid. There is a need to double efforts in simplifying the existing tax laws and policies, where applicable in local languages, including simplification of the budget speeches that dictate annually the revenue measures to be implemented to boost the revenue profile of the Government.

f) In other to strengthen tax compliance, the Government through NRA should further strengthen the existing aggressive nationwide taxpayer education and sensitization program and put a robust taxpayer assistance strategy for SMEs; strengthen the field audit of large taxpayers and conduct special audits on the mining and telecommunications sectors; pursuing the establishment of a tax court to prosecute tax defaulters; and to build systems for the effective taxation of professionals (lawyers, doctors, accountants and engineers.) One way to do this is to ensure renewal of practice licenses is pre-conditioned to obtaining a Tax Clearance certificate from NRA as implemented in other African countries like Uganda.

g) Given the non-functionality of the real estate market,[10] which is critical to determining rates, the implementation of the points-based system of property taxation should be improved upon to determine rates in a way that will mimic the true market value of properties.

h) Focus on implementing all other revenue reforms articulated in previous years' budget speeches that deem worthy to be implemented to increase the revenue profile of the Government.

i) Given that female-headed and female-dominant households pay a larger proportion of tax relative to household income, there is a need to provide specific tax exemptions on specific business activities dominated by women.

CSOs and NSAs

a) There is a need to build public awareness of their constitutional duty to pay taxes and influence government affairs (including demanding quality public services). Citizens need to understand that as taxpayers they can make their voices heard and actively take part in public policy decision-making processes about how taxes are collected and spent on public services and hold governments accountable.

b) There is a need for more advocacy work by CSOs and NSAs in ensuring tax administration by the government is transparent and accountable.

c) To make effective engagement on tax policies, there is a need to undertake more empirical studies (evidence-based) to determine how equitable and efficient the tax system is and the impact of taxes on various categories of people.

d) NSAs to engage the government to ensure its tax policies are gender-sensitive and could undertake gender audits of taxes and demand that government implements gender-sensitive tax policies.

ACTIONAID SIERRA LEONE (AASL)

ActionAid Sierra Leone is a member of the global Federation of ActionAid working to achieve social justice, gender equality and poverty eradication. Our work has been clearly identified with our commitment to putting women at the center of everything we do which gives us the space to build solidarity with social movements and other interest groups to achieve social justice and gender equality.

TAX MOVEMENT SIERRA LEONE (TMSL)

Tax movement Sierra Leone is a social movement meant to create an open space for all CSOs working around economic governance, public financial management, children's rights, Women's rights, young people's issues in society in relation to **progressive domestic tax mobilization that enhance gender-responsive public service delivery Tax Movement**