**Institute of Advanced Legal Studies**
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# Tax reform in the context of new Revenue Authority administration for Liberia

MA 2011-2012
**Taxation (Law, Administration and Practice)** (Tax)

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Dissertation

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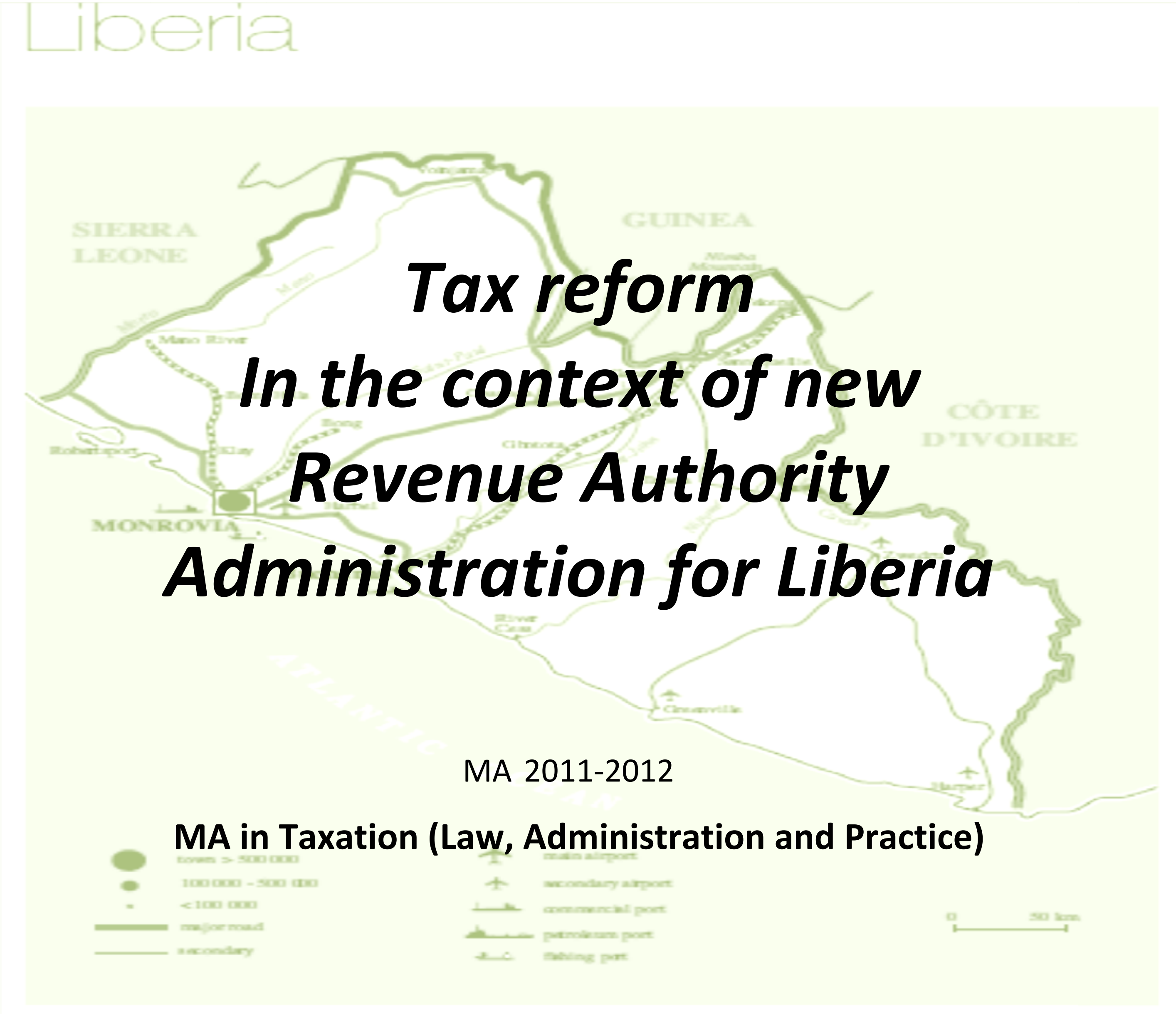


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# Table of Abbreviations

| | |
|---|---|
| BCE | Bureau of Customs & Excise |
| BIR | Bureau of Internal Revenue |
| CTA Act | Consolidated Tax Amendment Act |
| DOR | Department of Revenue |
| ECOWAS | Economic Community of West African States |
| FAD | Fiscal Affairs Department |
| GDP | Gross Domestic Product |
| GST | Goods & Services Tax |
| HR | Human Resource |
| IMF | International Monetary Fund |
| IT | Information Technology |
| LD$ | Liberian Dollar |
| LRA | Liberia Revenue Authority |
| LTO | Large Tax Office |
| MOF | Ministry of Finance |
| PAYE | Pay-As-You-Earn |
| PIT | Personal Income Tax |
| RA | Revenue Authority |
| RCL | Revenue Code of Liberia |
| TA | Technical Assistant |
| VAT | Value Added Tax |

# Introduction

Presently in Liberia, the BIR and BCE of the Department of Revenue (DOR) are completely dependent on MOF for almost all key components of their core business and supporting administration. This dependency of DOR on the MOF has always posed a major constraint on the smooth and effective operation of the DOR. This is because the DOR lacks the statutory power to independently handle administrative issues such as appeals, internal audit, IT, public relations, human resources, and other financial needs to effect the collection of revenue for the state.

In an effort to mitigate these constraints, the government intends to institute a major tax reform by establishing a semi-autonomous Revenue Authority for Liberia which shall have the power to independently handle its own administrative affairs without political interference from the executive, and to introduce a broad-based Value Added Tax (VAT) regime to replace the current narrow-base Goods & Services Tax (GST) regime in Liberia.

In this respect, this paper intends to analyse the experiences of tax reforms undertaken by RAs in some African countries in order to adequately inform the government decision in this regard.

Meanwhile, the analysis in this paper is divided into five sections;

Section one makes a brief historical review of revenue collection in Liberia between the years 1970 to 2005, it briefly discusses the justice system in which the laws governing tax administration operate in Liberia. It outlines how the civil crisis affected the tax system and also gives a short account of all taxes such as income tax, sales tax, inheritance tax, customs duties etc. and the various rates at which they were levied.

Section two focuses on the current structure of the revenue generating system of Liberia which comprises the revenue administration and the system of taxation. It summarizes how the current revenue administration is structured and managed. It then takes a brief look at the current structure of the entire system of taxation that encompasses taxes such as the Personal and Business Income Tax, Goods and Services Tax, Excise Taxes, Customs Duties, and Real Property Taxes.

Section three is all about the subject matter of tax reform, its definition and the principles for tax policy reform.

Section four then moves on to explain the movement for tax reform in some developing countries, making a comparative analysis of tax reforms with respect to the experiences of the introduction of Value Added Tax in South Africa, Gabon, Kenya and Nigeria. It also discusses key administrative features of Revenue Authorities in some African states with a specific emphasis on the governing structure of the Revenue Authorities of South Africa, Kenya and Mauritius.

Finally, section five concludes the analysis of the paper with a conclusion in which a tax reform proposal is developed to adequately inform the government decisions to establish a semi-autonomous Revenue Authority for Liberia that would have the power to independently handle its own administrative affairs without political interference from the executive, and to introduce a broad-based Value Added Tax (VAT) regime to replace the current narrow-base Goods & Services Tax (GST) regime in Liberia.

# Section-1

## 1.1 A brief historical review of revenue collection in Liberia

Before proceeding on this note, I will firstly give a short synopsis of the justice system of Liberia, for it is within this that the laws governing the collection of taxes in the country operate.

### 1.2 OVERVIEW OF THE LIBERIAN JUDICIAL SYSTEM

The legal system of Liberia is closely modeled on that of the United States. The January 6, 1986 constitution provides for the establishment of a Supreme Court consisting of a chief justice and four associate justices, to be appointed by the president from a panel recommended by a Judicial Service Commission. The consent of the Senate is required for these appointments and for the confirmation of lower court judges, to which a similar procedure applies. In theory, cases originate in magistrates' courts and may be taken on appeal to one of 10 circuit courts or to the highest court. Serious cases originate in the circuit courts. Traditional courts are presided over by tribal chiefs. A labor court was created in 1986.

For many years, the judicial system has suffered from corruption and domination by the executive. By mid-1990 the system had collapsed and justice administration was co-opted by the military commanders of various factions. In 1991, the Interim Government of National Unity (IGNU), revived the court system in the Monrovia area, and the National Patriotic Front of Liberia (NPFL) reopened courts in the areas under its control. After 1997, donors trained paralegals and human rights monitors to protect citizens up-country, and the US Department of Justice rebuilt magistrate courts, compiled 30 years of Supreme Court decisions, and published the Liberian Code so that judges and lawyers could have recourse to those decisions. Rebuilding the courts was expected to become a major thrust of the Johnson-Sirleaf government. The tax court was established by the regime of the incumbent President Ellen Johnson-Sirleaf to adjudicate cases arising between taxpayers and the Republic of Liberia.

## 1.3. TAXATION

Government's revenues, especially[1] the foreign exchange component, were largely derived from maritime programme receipts during the war years, averaging about US$1.3 million

[1]See the presentation made by the Liberian government during the 3rd United Nations conference on the least developed countries which was held in Brussels, 14-20 May 2001

per month. Other sources of revenue are derived from taxes on international trade, income and profits, domestic manufacturing production, property and non-tax revenues.

The foreign exchange component of domestic financial resources fell dramatically from about US$10 million[2] per month in the 1980s to the equivalent of about US$2.2 million per month in the mid 1990s.

The dismal state of the economy in general was reflected in the poor fiscal performance over time. This was due to a combination of factors such as: a) the narrowing down of the tax base due to the dramatic decline in production, and the disruption of other economic income; b) the erosion of the government's economic management capacity, particularly the capacity to mobilize resources and prudently manage public spending.

The government's ability to mobilize domestic resources has been greatly eroded. The reduction in economic activities in some sectors and the complete inactivity in others as a result of the civil crisis contributed to a significant reduction in the revenue generating capacity of government. For example, maritime revenue, that represented a mere 1.9 percent of GDP in 1987, constituted the single most important revenue item (5.6% of GDP) in 1997. Tax revenue, which was 17.0% of GDP in 1987 declined to a mere 3.9% in 1997. Total revenue intake declined from US$210.1 million[3] in 1987 to only US$28.3 million in 1998.

[2]See Worldmark Encyclopedia of Nations | 2007
[3] See footnote 2 on page 5

Before civil conflict began in Liberia, concession agreements negotiated between foreign interests and the Liberian government often provided tax exemption or modification for periods of 10 or more years after the start of operations.

A moderately progressive tax on net income earned from Liberian sources by individuals, partnerships, and corporations was the largest source of government revenue. Net income was taxed at rates ranging from 11% to a maximum of 65% on income over $99,000. Corporate tax rates ranged from 20–34% of taxable income with marginal rates of up to 50%.

An additional national reconstruction tax of up to 8% on income over $1,000 was imposed in 1981, and was still in effect in 1991. Also levied were a sales tax of 0.5–2%, inheritance and gift taxes, and social security payroll taxes. In 1999, for instance, imports were improbably over three times the reported exports, a sign that not all exports were being reported. Of the $60 million[4] in tax revenue collected in 1999, only 22.4% came from income taxes on corporations and individuals. Sales taxes accounted for another 16%. The main sources of tax revenue have been import duties (almost 30%) and fees paid to Liberia's "flags of convenience" maritime registry (more than 23%). In 2003, the violent chaos into which the society had descended while waiting on the international community to send aid made most questions about the tax regime irrelevant. In recent history, Liberia's wealth has been smuggled out, not taxed.

[4] See footnote 2 on page 10

## 1.4. CUSTOMS AND DUTIES

In the 1970s and 1980s[5] up to the outbreak of the civil crisis in Liberia, all imports were subject to tariff duties, ranging from 2.5–25%, which constituted a major source of government income. Import duties are specific (based on weight) for some commodities, ad valorem (based on cost, insurance, and freight value) for others. Specific duties apply to foodstuffs, beverages, petroleum products, and certain rubber and textile products. All exports and some imports require licenses. Customs duties were 25% on luxury items such as alcoholic beverages, apparel, cosmetics, electronics, jewelry, and tobacco.

In 2005, the post-war Liberian annual budget stood at US $98 million[6]. At the time, the single largest component of government income included donations from the international community into national recovery programmes. There was substantial lack of access to the various local revenue bases of government, as much of the country remained inaccessible due to insecurity, the lack of civil governance and poor infrastructures amongst others. Tax revenue accounted for 30% of total government income as there was a general reduction in private investment spending partly due to lack of trust in the Public Expenditure Management (high corruption), speculation as to high macroeconomic instabilities and insecurity amongst others. But the election of a new government and the introduction of the Governance and Economic Management Programme (GEMAP) as a strategic socioeconomic and sociopolitical tool for improving the government's Public Economics Management (PEM) with an objective of ensuring fiscal discipline and redistribution of

[5] See footnote 2 on page 11
[6] Liberia: Ministry of Finance Report; FY 04/05, page 4

wealth necessary for preventing perceived conflicts, improved the situation but with a number of corruption loopholes.

Within the 1st Quarter of FY2006/2007 (July, August and September), the tax revenue base had expanded as taxation accounted for 84%[7] of total revenue collected. Total revenue jumped by 7% above projected revenue and 53% above the previous year. By the 1st quarter of 2007/2008 again tax revenue stood at 84% of the total revenue income for government. It accounted for 21% higher than projected and 36% above the same quarter of the previous year. The Internal Revenue was the major contributor to revenue growth accounting for 47.2%, customs revenue 46.7%, and maritime revenue 6.1%. The key contributor to internal revenue was taxes on income and profits which also accounted for 24% of total revenue collected.

## Section - 2

### 2.1. The current structure of the Liberian Revenue generating system

The fiscal policy of Liberia follows the pattern of the unitary state model which is unlike that of the federal[8] state model. In Liberia, the taxing powers at the lower tier authorities are created by the central government and such can be abolished by the central government through the processes of ordinary legislation. Similarly, the taxing

[7] Liberia: Ministry of Finance Report; FY 07/08, pg 6

[8] In Federal States like USA, Germany & Nigeria etc. the taxing powers are laid down in the constitution. Such states have had a separate existence at one time but have then voluntarily come together to form a Federal State.

power at lower levels of government and the form they take are determined by the central government and may be changed by it.

In Liberia, like many other countries around the world, the revenue mobilization system encompasses two major components which are the *Revenue Administration* and the *System of Taxation*.

### 2.2.1. The Revenue Administration

The Revenue Administration[9] of Liberia is fully controlled and managed by the Ministry of Finance through its Department of Revenue which is headed by the Deputy Minister of Finance for Revenue. The Department of Revenue is principally structured into three core functional areas which are; the Shared Services, the Bureau of Customs & Excise (BCE) and the Bureau of Internal Revenue (BIR).

### 2.2.2. The Department of Revenue

It is responsible for coordinating the collective efforts of its three core functional areas to ensure the collection of the government of Liberia's revenue by ensuring full compliance with the Revenue laws. It focuses on providing professional delivery of efficient, effective and quality service to taxpayers and improving taxpayer's awareness and tax education. It ensures the improvement of tax compliance, thereby boosting the overall revenue intake. It has the mandate to ensure the smooth facilitation of

[9] See Section 56(a) & (b) of RCL Act 2000.

international and domestic trades to promote economic growth and development of the country.

### 2.2.3. Shared Services

This part of the department is mainly charged with responsibility for the general and administrative services of the Department of Revenue[10]. It is technically headed by the Assistant Minister of Finance for Revenue who reports directly to the deputy Minister of Finance for Revenue. It comprises several subsections including; Revenue General Services, Policy Unit, Common Services, Internal Affairs Division, Ruling and Interpretation Unit, Risk Management & Compliance Division and Corporate Service Division and Reform and Modernization Unit, Data Capture & Reconciliation and the Information Technology Section.

### 2.2.4. Bureau of Customs & Excise (BCE)

This Bureau is headed by a Commissioner and was established by an Act of the National Legislature on March 6, 1952 with the responsibility of collecting Customs duties on all commodities imported into and exported out of Liberia, it prevents the importation of contraband and helps in the facilitation of trade and development.

[10] See footnote 8 on pg 31

BCE has a vision to be recognized as a professional, efficient, and modern customs service which contributes to economic growth and the advancement of social welfare of Liberia and a mission to enhance revenue collection, facilitate legitimate trade, protect the economy and the environment by adhering to modern customs standards and procedures and be a repository of trade statistical data.

### 2.2.5. The Bureau of Internal Revenue (BIR)

The Bureau of Internal Revenue consists of Tax Operations and Tax Headquarters. It is headed by a Commissioner who is charged with the responsibility to coordinate the day to day affairs of all Divisions within the BIR to administer and collect all inland related revenues specified in the Revenue Code of Liberia, Act of 2000.

BIR's vision is to build an efficient, vibrant and effective Internal Revenue Service that is consistent with evolving regional and international revenue administration trends and standards that will seek to deliver quality and superior services to all taxpayers and stakeholders including the business community, private sector, ordinary citizens and the diplomatic community. Its mission is to maximize revenue collection using the principles of fairness, transparency, integrity and professionalism in delivering services to taxpayers.

The BIR is comprised of six (6) main operational Divisions including; Large Taxpayers Division (LTD) with a threshold from LD$30M upwards, Medium Taxpayers Division (MTD) with a threshold between LD$3M and LD$30M, Small Taxpayers Division (STD) with a threshold from LD$3M downwards, Rural Tax Division, Real Estate Tax Division and Sector Ministry Division and Design and Monitoring Unit[11].

## 2.3. An overview of the Structure of the current System of Taxation in Liberia

In Liberia, taxes in effect include: the Personal[12] and Business Income Tax (Corporation, Partnership and Sole appropriator/Individuals), Goods and Services Tax, Excise Taxes, Customs Duties, and Real Property Taxes.

The tax revenue as a percentage of GDP[13] has experienced a decline from 37.7% in 2010 to 29.4% in 2011 but recently took an upward trend in 2012 thereby putting the tax revenue to GDP ratio at 31.8%.

## 2.4. Personal Income Tax

Personal Income Tax (PIT) is defined as taxes paid by ALL gainfully employed individuals on their total gross income (aggregate of all economic benefits of whatever kind that the taxpayer derives such as salary[14] and wages on a Pay As You Earn (PAYE) basis, rental[15] income received from leasing property, Business income etc).

[11] This unit is dutifully charged to design revenue forms and monitor other technical operational issues.
[12] Section 4 of RCL Act 2000
[13] Macro-fiscal Analysis Unit (MFAU) Ministry of Finance & IMF 6th ECF Review, July 2011.
[14] PIT table in Section 201 of the RCL Act 2000
[15] Rental income tax is assessed at 10% of amount paid(RCL Section 905(d))

The PAYE is computed on a progressive basis with the annual effective rate ranging from 3% - 25% on gross annual income and payable by all natural persons who exercise employment or work in Liberia no matter the agency or entity or the kind of work being done, or citizens working with the Liberian Government in foreign service.

It is also paid by non-resident natural and legal persons on Liberian-source income. The amount of L$70,000.00 is deductible annually from every personal earning as personal allowance. Taxes on personal income and profit[16] account for 18 per cent of the total revenue forecast for the fiscal year 2011/2012.

## 2.5. Corporation income tax

The statutory rate for corporate income tax is 25% with a marginal rate of up to 40% on net taxable income. This is payable quarterly in advance, calculated at the rate of 2% or 4% of gross quarterly revenue, depending on income level. Advance[17] payments on higher incomes (greater than L$500,000 or US$6,667) are calculated at the rate of 4% for annual income amounts. The payments are creditable against annual tax liability at year end. Excess payments may be credited against other taxes and/or against future taxes or refunded if taxpayer prefers a refund and requests it.

Corporation profit taxes account for 10 per cent of the total national revenue forecast for the fiscal year 2011/2012[18].

[16] See Liberia: Ministry of Finance revenue forecast for FY2011/2012 at page 4
[17] Section 904 of RCL Act 2000
[18] See footnote 14 at page 6

### 2.6. Taxes on Mining Projects

Mining projects[19] like petroleum and other mineral exploration projects are taxed on their taxable income at the effective rate of 30%. The surtax[20] rate of 20% is charged on income from High-Yield Mining Projects. This depends on the positive net accumulated cash flow at the close of a tax period and the amount of this liability is deductible from gross income for the tax period in accordance with Section 705(b) of CTA Act of 2010.

### 2.7. Royalty

A petroleum[21] producer, including the National Oil Company of Liberia, engaged in the exploitation or extraction of petroleum deposits of Liberia is required to pay a royalty at the rate of 10% on gross production before the deduction of any cost.

The royalty[22] charged on the extraction of iron ore is 4.5%, gold and other base metals are also subject to 3% royalty and commercial diamonds at 5% as well.

### 2.8. Consumption Taxes

Consumption-based taxation involves the consumer being taxed on his or her spending on goods and services. There are a number of different forms of consumption tax. Some are levied on the producer of goods, others on retailers, other again on both. Most consumption taxes are designed so that they are built in to pricing structures and

[19] Section 702(a) of CTA Act 2010
[20] Section 730(d) of CTA Act 2010
[21] Section 753 of CTA Act 2010
[22] Section 704(a) of CTA Act 2010

so passed onto the ultimate consumer of the goods and/or services. In the case of Liberia, consumption taxes include Goods and Services Tax and Excise Tax.

### 2.9. Goods and Services Tax (GST)

This is one of the area where the major tax reform in Liberia is envisaged as the plan for migration from the current Goods and Services Tax (GST) regime to the world wide most popular regime of the Value Added Tax (VAT) still remains certain given the fact that the draft VAT legislation and Act to establish a Semi-autonomous Revenue Authority in Liberia have been submitted to the House of Parliament for subsequent enactment. Section 5 of this paper is entirely dedicated to the proposed tax reform specifically designed to affect the entire administrative structure of the current Revenue Administration and the GST component of the system of taxation in Liberia.

Nevertheless, at present, Goods[23] and Services[24] are taxed at the effective rate of 7% of gross charge. Every person who carries on a business involving the supply of taxable goods or services has an obligation to register at the end of any period of twelve months in which the person made taxable supplies or services, the total taxable amount of which equaled or exceeded LD$3,000,000(approximately US$40,000); or at the beginning of any period of twelve months where there are reasonable grounds to expect that the total amount of taxable supplies or services to be made by the person during that period will equal or exceed LD$3,000,000.

[23] Section 1000(b)(3), RCL Act 2000
[24] Section 1021(b)(1), RCL Act 2000

## 2.10. Excise Tax

The effective rate for this tax ranges from 5% - 35% mostly levied on luxury goods imported into or manufactured in Liberia.

Excise tax[25], at a rate of 35 percent is levied on all products of alcohol beverages and tobacco products intended for consumption in Liberia.

Excise tax, at the rate of not less than 5 nor more than 10 percent, as determined by regulation, is levied on any cosmetics or any cosmetic aids imported or produced in Liberia, including perfumes, toilet preparations, hair products, and nail care products. Soap, toothpaste, toilet tissue, and disinfectants are not cosmetics or cosmetic aids.

Consumption taxes accounted for 10 per cent[26] of the total national revenue forecast for the fiscal year 2011/2012.

## 2.11. Customs Duties

Customs duties accounted for 33 per cent[27] of the total national revenue forecast for the fiscal year 2011/2012.

At present, all imports are subject to tariff duties at the harmonized[28] rate of 5%. During the years between 1990 and 2010, the customs tariff actually ranged from 7.5% - 25% on all imports to Liberia. Import duties are specific (based on weight) for some commodities, ad valorem (based on cost, insurance, and freight value) for others. All exports and some

[25] Section 1120, RCL Act 2000
[26] See footnote 14 at page 7
[27] See footnote 14 at page 9
[28] Section 4 of CTA Act 2010

imports require licenses. Goods manufactured in Liberia for export purposes are zero rated and exports other than those manufactured in the country are standard rated in keeping with the customs tariff.

Goods may be landed, stored, sorted, repacked, re-forwarded, or transshipped within the area of the Free Port of Monrovia without payment of customs duties.

## 2.12. Real Property Taxes

The effective tax rate in this category ranges from 0.08% - 1.5% depending[29] on the location and value of the property.

### 2.12.1. Business or commercial use

For buildings and other improvements which are being used for business or commercial purposes, in whole or in part, a tax of one and one half percent of assessed value.

**2.12.2. Industrial use**: When such buildings and other improvements are being used for industrial purposes, in whole or in part, a tax of one and one half percent of assessed value. **Residential use**: When such buildings and other improvements are being used exclusively for residential purposes, a tax of one twelfth of one percent of assessed value.

**2.12.3. Farm use in urban areas**: When such buildings and other improvements have been constructed on parcels of land used as farmland located within the corporate limits of any city, town, municipal or commonwealth district or village and are being used exclusively for farm purposes, a tax of one third of one percent of assessed value.

[29] See Section 2000 of CTA Act 2010

### *2.13. Exemption*

The tax system of Liberia has a general rule that exempts[30] from taxation all property of the Government of the Republic of Liberia, government agencies, and charitable private organizations that are approved by and registered with the MOF, Republic of Liberia and are therefore referred to as "Exempt Persons" and such legal person are only exempt from tax to the extent provided by the RCL.

### *2.14. Special Tax Incentives*

The tax system offers special incentives for an investment[31] activity qualifying under both paragraphs (1) and (2) of Section 16 of CTA Act of 2010, for a period of five (5) years from the commencement of investment as stated in the Minister's certification. Any special tax incentives allowable under the above mentioned paragraphs with respect to a qualifying cost may be deducted in lieu of (and not in any way combined with) any incentive deduction otherwise allowable under Section 204(d) of the RCL Act 2000.

# Section - 3

## 3.1. Tax Reform

Dictionaries give essentially two meanings of 'reform'. One is to 'improve', 'make better', and 'remove imperfections'. The other is, literally, to 're-form', to 'restructure', and to 'change'. When politicians claim to be reforming taxation they use the term in both

[30] Section 9(a) of CTA 2010
[31] See Section 16(a)(3) of CTA 2010

senses – a restructuring which is also an improvement. But whether a particular change in the tax structure is an improvement or not is very much a matter of personal value judgment. History abounds in examples of tax changes made by one government in the name of tax reform which are then reversed by a succeeding government also claiming the mantle of tax reform. And whilst this is most frequent when a new government comes to office of a different ideological persuasion from its predecessor, it can also happen with successive governments of the same political persuasion, as in the case of Liberia where the current Unity Party-led government instituted a tax reform by reducing the effective tax rates affecting the statutory corporate tax rate from 35% to 25% in 2010 and also a significant reduction in the brackets of PAYE from 8 to 4 and a further reduction in the rate of Real Property Tax as well.

Doing away with the value judgment and using ‘reform’ in its second sense of restructuring[32] or change without necessarily implying that the change is for the better, clearly not any and every change can be dignified by the designation ‘reform’. To justify that title it needs to be a non-trivial change and to have as its objective something more than simply adding a little to government revenue or returning something to the taxpayers. Within that rubric, ‘tax reform’ could embrace the introduction of a substantial new tax, the abolition of a tax, major changes in tax rates, a change in the tax mix, significant changes in tax administration such as the introduction of a system of self-assessment, a change in the tax unit or the indexation of the tax system.

[32] See Cedric Sandford 2000 on why tax system differ (at page 156)

Most commentators use the term “tax reform” to include only major legislative changes that result in some “improvement” of a country’s tax system.

Tax reform[33] includes any legislative change in a country’s tax laws that are the product of serious planning. By serious planning is meant a considered attempt to adjust the tax system to accomplish some specific tax policy goals, in contrast to ad hoc changes for political purposes in which the implications for income distribution and economic stabilization are ignored. A narrower definition of “tax reform” would involve controversy, useless for the purposes, as to what kinds of adjustments were major and what constituted a “good” change.

Changes caused by judicial decisions or by improved administration are excluded. Judicially created reform does not involve tax reform planning, but is instead done on a case-by-case basis, without much coordination with other departments. It is implemented by judicial decree rather than by any legislative process. For statutory reform the key institutional requirements concern the formulation of a tax reform plan and then the implementation of that plan through the political process of the country.

Administrative reform is a key element in tax reform planning, for it is the ability of the tax administration to effectuate a range of alternative proposals that makes tax policy possible.

[33]See Article on institionalizing Tax reform process Vol.2,1975 by Mclntyre & Oldman, Harvard Law School of International Tax Program

### 3.2. Tax Policy Reform Principles[34]

***Efficiency/ Fiscal Neutrality***. Taxes should be raised, as much as possible, in a non-distorting fashion, leaving economic choices the same as they would have been without taxes. This involves, for example, minimizing tax exemptions and special regimes whereby governments try to favor specific economic sectors or economic activities. The plan to adopt a broad-based VAT with a minimum exemption to replace the current narrow-based GST in Liberia will be based on the principle of efficiency and fiscal neutrality.

***Simplicity and transparency***. Simple taxes are good taxes, for all can understand them and few can evade them. In this respect, a tax with simple rules, few and low rates, minimal exemptions, as well as clear, wide and measurable base provide more revenue and less opportunity for evasion. Furthermore, the tax system should be based on few such taxes in order to avoid the proliferation of small, inefficient taxes that represent heavy administrative costs and provide opportunities for corruption. The adoption of this principle in the tax system of Liberia is evidenced by the low rates of taxes such as corporation tax at 25%, a minimum number of brackets of PAYE with a top rate at 25% and a very simple rule for self-assessment.

***Equity***. Although countries may hold widely different views on equity, it is generally suggested that individuals with similar incomes should pay similar taxes (horizontal equity) and that individuals with higher income should pay more taxes (vertical equity).

[34] See IMF-Topical Trust Fund- Capacity Building Technical Assistance in Tax Policy Administration 2011 at page21

The administration of personal income tax or (P.A.Y.E.) in Liberia is based on the principle of equity whereby low income earners are taxed at a lower rate than those of the economically wealthy individuals who are taxed at a higher rate.

***High revenue generating capacity.*** The tax system should be able to supply the government with the resources it needs to meet its spending obligations on a sustainable basis. Furthermore, as tax revenues from different taxes might fluctuate, the tax system should rely on a mix of a few taxes to lower the risk of wide annual fluctuations in overall tax revenue. In a straight compliance with this principle, the tax system of Liberia is comprised of a mixture of varieties of taxes such as corporation tax, personal income tax, goods & services tax, property tax and a mixture of fees etc.

***Harmonization/ Coordination with other systems.*** Tax harmonization and coordination with economic partners or geographical neighbors will help prevent opportunities for various forms of tax avoidance and/ or evasion, and avoid incentives for tax competition that could lead to revenue loss. In adherence to this principle, Liberia has adopted the ECOWAS Common External Tariff system which is intended to facilitate trade amongst the ECOWAS countries. The introduction of VAT in Liberia will also be in direct compliance with this principle because Liberia still remains the only ECOWAS state that administers the narrow-based GST.

***Greater reliance on domestic taxes.*** Less reliance on distortionary trade taxes and greater reliance on domestic taxes such as VAT and excises which tax all goods and services irrespective of their origins, helps countries to obtain the benefits of free and open trade, as well as to prepare for WTO entry when that is feasible.

***Feasibility.*** The design of taxes should be aligned with the capacity of tax administration to actually implement and collect tax revenue.

***Integration.*** All main taxes should be consistent, in terms of thresholds, rates and registration in order to ensure fair treatment of all taxpayers, and minimize administrative costs.

# Section - 4

## 4.1. The Movement of tax reforms in developing countries

The discussion on the topic of tax reform tends to be very broad and complex as developing countries are focusing, in particular, on attracting investment and raising revenue to promote development, and developed countries are predominantly preoccupied by safeguarding their tax bases to preserve the welfare state and to meet the challenges of ageing.

For the purpose of this paper, I have tried to avoid such broadness and complexity of the subject matter and narrow my focus entirely on the tax reforms in developing countries, especially in some African countries that have been successful in their reform endeavors through the establishment of Semi-Autonomous Revenue Authorities. This is because of the fact that Liberia as a developing country needs to be properly informed before introducing any reform and as such should be based on the critical review of the experiences of those successful Revenue Authorities in Africa.

In Africa, tax reform can be looked at from two main perspectives; firstly, tax reforms involving the system of taxation where new tax kinds were introduced into the tax system thereby replacing the ones somewhat regarded as obsolete and the broadening of the tax base and as well as the shift in the effective tax rates.

The second aspect of the tax reform was directed towards the structural adjustment of the tax administrations and witnessed the proliferation of the establishment of autonomous and semi-autonomous revenue authorities, which is being heavily endorsed and even supported both financially and technically by the World Bank and the IMF with the aim of improving and increasing the level of effectiveness and efficiency in revenue collection by the States.

## 4.2. A comparative review of tax reform experience with respect to VAT in some African states

The tax reform undertaken in this area was championed by the introduction of Value Added Tax (VAT) in the tax systems of some selected African countries including South Africa, Gabon, Kenya, and Nigeria.

### 4.2.1. VAT experience in South Africa

The South African VAT resembles the New Zealand model. In 1991, it adopted a broad-based VAT levy at a standard rate of 14 percent on goods and services, including government and financial services; 19 basic foodstuffs that account for about 10 percent of the base are zero-rated, as are exports. The registration threshold in South Africa is approximately US$42,000[35] and the exempt commodities include items consumed disproportionately by the poor, including corn (mealie) meal, rice, milk, eggs, vegetables, and fruit, but the difference across income classes in the proportion of consumption on zero-rated goods is small. The gains in administrative simplicity from eliminating zero-rating would be considerable. In addition, if the added revenues were spent roughly in proportion to other public spending, the poor collectively would gain far more from the added public services than they would lose from added tax burdens. Nonetheless, groups representing low-income earners and others fiercely resist curtailing or eliminating zero-rating.

As part of its tax reform policy, South Africa (in cooperation with other African countries) is bidding to host the Square Kilometre Array (SKA), an international collaboration to build the world's largest radio telescope. SKA is eligible for income-tax exemption under existing public-benefit provisions. Under consideration is providing VAT[36] relief either in the form of a refund mechanism or the zero-rating of consideration received by the project and for imported goods and services if South Africa were to win the bid.

It also intends to eliminate the VAT zero-rating of interest earned on loans to non-residents to level the playing field in the sector of financial services. The South African

[35] See South African Tax System: A Nation in Microcosm Africa, Taxes, Tax Reform by Henry J. Aaron, Senior Fellow, Economic Studies Joel Slemrod, 1999.
[36] See SARS Tax Proposals Budget 2012

Government is also considering reviewing the VAT treatment of temporary imports to promote local processing, while protecting the fiscus.

#### 4.2.2. VAT experience in Gabon

Gabon[37] introduced VAT in 1995 with the basic characteristics of a modern VAT such as large, broad base coverage, a single rate at 18 percent, with few exemptions, a high threshold to disallow small business registration, and special procedures to monitor the VAT refunds to exporters. The government of Gabon made a strong political commitment to implement the VAT two years before it was introduced. Before the introduction of VAT, the authorities gradually implemented a strategy that included (i) a reliable Taxpayer Identification Number (TIN) system, (ii) a pilot large taxpayers unit to monitor registration, collection, audit, and enforcement and (iii) a basic computerized tax system to detect, control and enforce late filers. Bases on those policy and administration measures taken, Gabon experienced high taxpayer compliance because of the simplicity of the system. The registration threshold for VAT was put at US$150,000[38] with about 800 VAT taxpayers. Because of the computerized VAT system all receipts and notices were issued electronically, and 80% of returns were filed on time and 87% upon receipt of the first reminder. During the first year of implementation, VAT revenue was 45% greater than the revenue from the taxes it had replaced. In 1995, for the first six months of its implementation, VAT accounted for about 32% of the total non-oil revenue and 5.5% of the non-oil GDP.

[37] See http://unpan1.un.org/intradoc/groups/public/documents/IBFD/UNPAN019991.
[38] See Jean-Paul Bodin /IMF fiscal expert presentation on Small Taxpayer Administration Workshop sponsored by East AFRITAC July 7–11, 2008

### 4.2.3. VAT experience in Kenya

In 1989, the Kenyan government passed legislation to introduce a credit-invoice value-added tax, which became effective on January 1, 1990[39]. At that time the concept of tax policy simplicity had not firmly taken root in Kenya: the VAT was introduced with a standard rate of 17 percent, but with 14 other rates (the highest being 210 percent in 1989-90) that made the VAT appear more like a differentiated commodity tax regime. This multiplicity of rates was particularly difficult to rationalize in light of the fact that excise taxes on specific classes of goods were maintained during (and indeed after) the transition and implementation of the VAT.

The high and wide range of rates is thought to have led to widespread misclassification and other methods of tax evasion. In response to these concerns, the number of VAT rates was quickly reduced to four by 1993-94, when the top rate was set at 40 percent. Since then, the rates have been further lowered, and currently there is just a single standard rate of 16 percent, with some sales zero-rated and others exempt.

All businesses with annual turnover greater than KSh 3 million or approximately US$75,000[40] are supposed to register as VAT taxpayers and submit monthly returns. In addition, certain traders and members of certain professions are required to register independently of their turnover, but this requirement is not well enforced.

[39] See Tax Reform in Kenya: Policy and Administrative Issues by Nada O. Eissa and William Jack 2009 on page 14.
[40] See footnote 37

In Kenya, the responsibility for paying VAT on certain sales rests not only with the seller but also with the buyer, a system referred to as VAT withholding.[41] VAT withholding was first introduced in late 2003 and applied to government agencies that purchased goods and services subject to VAT. There was a concern that the government, through these agencies, was paying VAT-inclusive prices to suppliers, who were not necessarily remitting the revenue to the Kenya Revenue Authority. Subsequently other purchasers were brought into the withholding regime, and in 2004-05 there were about 2000 so-called VAT withholding agents – purchasers who were required to withhold VAT. In that year, about 40 percent of VAT revenue was collected from these agents.

### 4.2.4. VAT experience in Nigeria

An important landmark in tax reform in Nigeria was the adoption of the value-added tax (VAT) through the VAT Act No. 102 of 1993 but its implementation actually began in January 1994. Since its introduction, 15 of the 42 sections of the Act have been amended. Replacing sales tax, VAT[42] was originally imposed on 17 categories of goods and 24 service categories. Such items as basic foods, medical and pharmaceutical products, books, newspapers and magazines, house rent, commercial vehicles and spare parts and services rendered by community and people's banks, however, were VAT free.

[41] See footnote 36 on page 15
[42] United Nation University Research Paper No. 2006/03 on Tax Policy Reforms in Nigeria by Ayodele Odusola 2006

The revenue generated was to be shared 20:80 between the federal and state government: currently it is shared 15:50:35 among the federal/state/local levels. The state's allocation was to be earmarked as 30 per cent for the state of origin, 30 per cent for consumption/destination and 40 per cent for equality of the state.

Although VAT is a consumption tax, a 5 per cent rate is levied on suppliers (i.e., taxable individuals) who are expected to add this amount to invoices for collection from customers and for further remittance to the VAT authorities on a monthly basis. VAT is retained at 5 per cent regardless of the stage of production or distribution.

Even though enforced by federal legislation, VAT was excluded from federal jurisdiction by the 1999 Constitution. This was unusual because at the time of introduction, the federal government's tax administrative machinery was used to collect VAT on behalf of the state governments, as they had jurisdiction over the sales tax that was being replaced by VAT. It is a non-discriminatory tax with regard to locally manufactured or imported goods. The Act designated the FIRS as the responsible body for implementing VAT. In practice, however, the Nigerian Custom Service collects VAT on imports on behalf of FIRS.

### 4.3. A comparative review of tax reform with reference to the Structure of Tax Administration in Some African States

The advice of the IMF-FAD and Technical Assistant (TA) for revenue administration[43] reform has been consistent but evolving over the period. As elsewhere, the IMF has advocated a gradual opening of markets and freer trade in Anglophone Africa that has encouraged tariff reform and strengthened domestic tax instruments, particularly through the introduction of VAT. The need to mobilize additional revenue beyond anticipated trade tax losses has emphasized the criticality of an effective VAT regime and administration, often accompanied or followed by strengthened direct tax regimes and their administration.

Consistent advice has been given for a broad-based VAT with a single rate, minimal exemptions, and in the case of weak administration, a relatively high threshold. While integrated tax administration is a superior model in terms of reduced administrative and compliance costs and the creation of new organizations to administer VAT in Anglophone Africa, it was perhaps a risk averse and pragmatic recognition of the fragility and limitations of income tax administration at the time.

However, this position did not constitute long-term FAD endorsement[44] of a "tax type" administration model as is evident by LTO initiatives from the late 1990s to begin the integration effort. From around 2003, a vision became increasingly clear; namely, a fully integrated single domestic tax administration with a strong and effective headquarters

[43]See IMF-FAD working paper on Revenue Administration Reforms in Anglophone Africa Since the Early 1990s by David Kloeden 2011

[44] See footnote 42 at page 10

and field operations with taxpayer segment focus, beginning with an LTO fully within the administration, and, over time, development of appropriate policies and administrative arrangements for other taxpayer segments. Several countries are moving in this direction, others have it under consideration, a small group perseveres with the more traditional model, and a handful of latecomers to modernization have the opportunity to leapfrog the historical approach.

While Revenue Authorities (RAs) are now a reality of Anglophone Africa, their creation was not at the forefront of FAD advice for revenue administration reform. The RA concept developed considerable momentum across Anglophone Africa with the support of many academics and consultants, and underpinned a number of major revenue administration reform programs supported by British Government finance[45] and TA. Only in a few cases did FAD advocate the RA as a critical requirement for revenue administration modernization. In most other instances, governments were already committed to the RA agenda, so FAD advice focused on maximizing its potential benefits, particularly for VAT administration with a view to eventual integration. For the most recent RA launches, FAD has more strongly encouraged critical administrative reforms during the launch of the RA rather than a number of years later as has been observed in recent third generation reforms.

[45] See footnote 43 at page 11

## 4.4. Revenue Administration Reform Drivers and Characteristics[46]

***4.4.1. Revenue enhancement has been a prime motivator behind many revenue administration reforms***. When domestic finances are inadequate, intense pressure often drives revenue agencies to seek ways to increase collections to reduce the deficit. As a result, reforms are sometimes too simplistically judged on their ability to deliver results to the fiscal bottom line, often in an unrealistic timeframe rather than against more comprehensive measures of both revenue and nonrevenue performance indicators over longer horizons.

***4.4.2. Poverty reduction strategies have increased the urgency for more domestically sourced revenue.*** The September 1999 announcement of a poverty-focused approach by the IMF and the World Bank provided some impetus for revenue administration reforms. Through a structured process, countries like Liberia prepare poverty reduction strategy papers (PRSPs) outlining poverty reduction goals and plans for their attainment. Strategic policy intentions for revenue administration reforms have typically included expanding the tax base and improving the tax system to promote equity and provide resources for the poverty alleviation agenda. The PRSP process often provides a public affirmation that revenue reform is an important factor in achieving national goals.

[46] See footnote 43 at page 12

**4.4.3. *Expansion of the tax base to reduce the burden from just a few taxpayers is increasingly becoming a reform driver.*** Large taxpayers in some Anglophone African countries have been quite vocal in this regard, complaining they bear a disproportionate share of the tax burden—that the revenue agencies were not making enough effort to collect all the taxes possible from a wider net. They further argue that a wider net would not only share the burden more equitably, but would create the opportunity to reduce tax rates or provide tax incentives that would reduce the costs of doing business and encourage reinvestment of earnings.

## 4.5. Characteristics of reforms[47]

### *4.5.1. Self-assessment and voluntary compliance concepts began to underpin reforms for both tax and Customs administration.*

VAT was the trigger given that its feasibility depends on adopting self-assessment. However, outcomes have been mixed as some administrations have struggled to relinquish administrative assessment methods for income tax and have even imposed some for VAT. Acceptance of risk-based approaches has only recently begun to be grasped, with many old 100 percent control habits persevering such as trying to administratively assess every income tax return, trying to inspect every import consignment, or demanding details of every VAT invoice.

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[47] See footnote 43 at page 14

With a few exceptions like South Africa, effective risk assessment is still in its infancy, but there are indications that the approach has begun to influence compliance management strategies for both tax and Customs.

Most Anglophone African revenue agencies have been supported to some extent by information technology (IT) systems, often coming from a zero or very low base. While some administrators appreciated that routine and repetitive operations could be automated to liberate resources to better value-adding tasks such as audit and enforcement, others were probably just part of a wave that viewed automation as a sign of modernity. VAT generated volumes for returns, payments, and other transactions required IT systems to avoid backlogs. Similarly, increasing international trade volumes necessitated Customs automation. Moreover, the trade community, particularly large businesses were computerized. Outcomes so far have been disappointing with varied and piecemeal approaches to technology projects, with Customs automation possibly marginally more successful than tax administration.

#### *4.5.2. Donor influence and TA over the period was important.*

The British Government was very influential in the establishment of RAs using their development arm, the Overseas Development Administration (ODA) and its successor, the Department for International Development (DFID). These agencies hired and financed many U.K. experts, often from Her Majesty's Customs and Excise (now merged with Inland Revenue to become HMRC), Crown Agents and various commercial consulting firms to provide revenue administration reform TA, thus setting the context in which advice was provided. With British TA to Anglophone African revenue administration reform predominating, the IMF's role was strategically focused and complementary to the downstream TA and financing from other bilateral and multilateral donors. As such, FAD advice on issues such as establishing separate VAT departments and RA was more nuanced. Since 2003[48], the East and West AFRITACs are having an impact on TA delivery by supporting the implementation of reforms to complement FAD's more strategic role. The World Bank has had limited involvement, other than their mega role in Tanzania where they, with a group of other development partners, have funded a tax administration and reform project from 1999–2009 that involves capacity-building TA, infrastructure, systems, and logistic and equipment support to Tanzania RA. GTZ (Germany) has strongly supported tax reform in Tanzania and Ghana; the U.S. Treasury in Liberia (as well as USAID), Nigeria, and Uganda; Norway in Uganda and Zambia; and the African Development Bank (e.g., Liberia, Swaziland) and the European Union (The Gambia, Seychelles) are increasingly financing tax administration reforms.**4.6.**

## The Revenue Authority Model

The advent of the semiautonomous RA over the past two decades has been a distinguishing feature of revenue administration reform in Anglophone Africa, perhaps more so than in any other region. This accordingly has been extremely influential in the

[48] See footnote 43 at page 16

organizational and management approaches to Customs and tax administration respectively, which the following discussion investigates.

Leading the RA trend, Ghana[49] established separate semiautonomous revenue services for tax and Customs administration in the mid-1980s that were loosely brought under the auspices of an RA governing board (RAGB) in 1998, followed by Nigeria's creation of separate revenue services for Customs (NCS) and tax administration (Federal Inland Revenue Service (FIRS)) in the early 1990s. However, in 1991, Uganda established the first incarnation of the model that became widely emulated over the next two decades, initially in Eastern and Southern Africa (Kenya, Zambia, Rwanda, Tanzania, and South Africa) during the 1990s. By 2010, 16 of the 19 Anglophone countries had some form of RA with a 17th (Swaziland) formed in early 2011, leaving only Liberia and Namibia with more traditional ministry of finance (MOF) departments.

While previously unobserved elsewhere in Africa, the RA model was adopted in Lusophone Mozambique in 2006 and is being considered by Angola, and has just been extended to Burundi in January 2010.**4.7.**

## Revenue authority governance

The RA model broadly attempts to provide a degree of autonomy through a governance arrangement that is theoretically at a distance from the minister and the MOF unlike the more traditional government department[50]. Several factors may limit this objective. First,

[49] See footnote 43 at page 17
[50] See footnote 43 at page 18

the minister of finance usually retains influence and power in several key areas: (1) to make or recommend appointments to the board; (2) through one or more senior ministry officials with ex officio board membership; and (3) legislatively mandated ministerial powers to give broad direction to the board. Second, tax policy determination usually (and desirably) remains the preserve of the MOF, although importantly with inputs of an administrative nature from the RA. Third, like all spending institutions, an RA is dependent on adequate government funding from the MOF. Even the few RAs with statutory funding formulas instituted to protect their financial independence sometimes find these provisions overridden and subject to the more typical bidding for scarce budgetary resources. Notwithstanding the fuzziness of defining or measuring autonomy, the existence of a governing board is a typically cited characteristic of autonomy. RA governing boards in Anglophone Africa can be broadly categorized as advisory, operational, or empowered. Except for Seychelles, the other 15 RAs began with a governing board although South Africa subsequently dropped theirs for an advisory board, and from 2002, just has ad hoc advisory committees. Nigeria's FIRS has an operational board, headed by the executive chairman (who is also the FIRS chief executive) with membership approximately split between senior FIRS operational managers[51] and ex officio appointments of certain government officeholders. The 'empowered' board predominates, typically comprising a mix of ex officio and private sector appointees, with the latter usually the unilateral choice of the minister of finance (except by the prime minister in Rwanda and in consultation with the president in

[51] See footnote 43 at page 20

Zimbabwe). Appointment of the board chairman is the prerogative of the president in Kenya and Mauritius, and the prime minister in Rwanda. Except in Zambia, boards are generally legally prohibited from operational or case work.

However, in practice, the Zambian board acts in essentially the same way as other empowered boards deferring operational decisions and activities to the commissioner-general (CG) notwithstanding the powers conferred upon it by the ZRA Act.

One of the purported benefits of autonomy of more distant MOF oversight may be illusionary.

The RA model is no obstacle to a finance minister wishing to maintain close control and direction over this critical fiscal institution of government. Some commentators[52] have observed political interference or meddling either directly or via the board in several countries.

Sound corporate governance calls for a mechanism of assurance to the chief executive that institutional strategies are being followed and systems and procedures are functioning as intended. This is usually provided via an internal audit function (that sometimes includes internal staff affairs) reporting directly to the chief executive. Given the strategic oversight role that RA boards usually limit themselves to, most RA legislation mandates a role for the board to set the broad internal audit agenda and objectives and to have unfettered access to its reports and findings. Thus, most RA internal audit units have two reporting lines, directly to the chief executive and indirectly

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[52] See footnote 43 at page 21

to the board. Mauritius is an exception, as the RA internal audit function reports exclusively to the board, suggesting the need for a separate and possibly duplicative assurance function for the chief executive. Some boards have appointed subcommittees mandated to oversee internal and external audit activities. To avoid conflicts of interest and to protect taxpayer confidentiality, the board should not be privy to any taxpayer specific information in internal audit or other reports.

### 4.8. Collection responsibilities of RAs

RAs in several countries with significant natural[53] resource endowments (oil, diamonds, other minerals, lumber, cocoa, etc) collect resource rents through traditional corporate income tax regimes (perhaps tailored to these resources), through special regimes (e.g., petroleum profits tax in Nigeria), through royalties, and export levies (diamonds in Sierra Leone, cocoa in Ghana).

Given the fiscal importance of these revenues, some special RA administration units have been established (e.g., an oil and gas office in Nigeria and previously gold and diamond office in Sierra Leone), or at a minimum, the typically small number of affected taxpayers are subject to heightened audit and compliance attention, often by an LTO.

Establishing resource sector expertise within an LTO is a pragmatic response that FAD has encouraged in Ghana, Malawi, Uganda, and Zambia given the lack of capacity and resources to create separate resource tax administration units.

[53] See footnote 43 at page 21

The collection mandate of many Anglophone African RAs extends beyond national level tax and Customs administration, including a range of minor revenue handles. While local governments often assess and collect property related taxes, this is a central government function of the registrar-general's department of the Mauritius RA, and an emerging role in Tanzania. All East African RAs collect taxes and fees associated with motor vehicles, with Kenya having a dedicated department, while Tanzania, Rwanda, and Uganda have units within their tax departments. A few RAs are tasked to collect a multiplicity of government fees and charges, ranging from passport application fees to traffic fines.

But, is the collection of minor taxes and fees extraneous to the core business of an RA? A rationale often advanced for their placement in an RA is that assessing, collecting, and accounting for revenue collections is an activity that many other government agencies are poorly equipped to perform. Interdependencies and synergies are claimed to be available to the RA as well as economies of scale, allowing payment, receipting, and accounting systems to service these revenue streams at marginal additional cost. Vehicle ownership may be indicative of relative wealth or commercial activity that can be exploited. Problematic enforcement of small transport operators can be enhanced by linking the tax payment with annual vehicle registration.

These arguments are attractive, but costs can easily exceed the benefits in environments where effective revenue administration is hindered by insufficient capacity and resources, underfunding, and inadequately automated and cumbersome systems and procedures. Risks arise that the core business of securing the major central government revenue sources are relegated or neglected to handle a growing portfolio of responsibilities that are resource-intensive and may pose risks to the agency's reputation. The only interaction of many citizens in some countries with their revenue administration is to obtain a drivers license or pay a minor fee, influencing opinions on the efficiency, transparency, and client responsiveness of the agency, even though it can be argued that the activity is not core to its existence. However, if the risks are recognized and addressed, an efficient RA could have wider collection responsibilities for which its marginal collection costs are compensated.

## 4.9. Integrated Customs and Tax Administration Functions

Customs and tax administrations are indisputably core central government revenue administration functions, With the exceptions of Nigeria and Ghana (until 2010)[54] that have had separate tax and Customs services, the Anglophone African RA model brings all major central government revenue collection activities, particularly tax and Customs administration under one organizational umbrella. The revenue collection function of Customs in Africa remains critical despite the declining importance of duties given that a major share of VAT is collected at the time of entry. While the border protection and trade facilitation roles of Customs have increased everywhere, the need for close tax

[54] See footnote 43 at 23

and customs administration linkages are vital given the continuing fiscal importance of the latter.

Neither South Africa nor Zimbabwe[55] has a clear organizational delineation between tax and customs administration in their RA structures (particularly at the corporate level), that are functionally and regionally arranged. Conversely, there is a clearly discernible Customs department and one or more tax departments evident in all the other RA organizational structures.

Customs and tax administration reside together under a single RA in 16 countries. While customs and tax administration are much more closely coupled in South Africa and Zimbabwe except at the frontier, the degree of integration of core activities that are common across customs and tax administration in the other 13 RAs varies. Shared rather than separate functional units/programs within tax and customs departments, respectively, are found for debt collections, investigations and enforcement activities, and most commonly for legal services (sometimes including appeals), and taxpayer services and education. More strategically focused are units for research and planning (R&P), revenue forecasting, and tax policy at the corporate level.

A motivating rationale for integrating some customs and tax administration functions is to avoid duplication and increase efficiency and effectiveness, leading to a single and cohesive image of the RA. There are however some drawbacks, possibly the diminution

[55] See footnote 43 at page 22

of accountability for the broader tax administration and customs administration programs respectively.

### 4.10. Example of key features of RAs in South Africa, Kenya and Mauritius

The South African Revenue Service (SARS) was launched in 1997[56]. The core business functions for customs and tax administration are integrated. There are units for Legal, Operations and Services that perform core functional activities across customs and tax administration. The units for Finance, HR and Procurement provide support services function for both customs and tax administration within the SARS. There is also a specific unit for large business center with branches as well.

Interestingly, each of the units within the SARS is headed by a General Manager[57]. There are two tiers of General line Managers; the lower tier General Managers (for Communications & Corporate Relations, Operations Standards & Policies, Small Business, Operations Support, Legislative Policy, Enforcement etc) report directly to those General Managers in the upper tier. General Managers in the upper tier (Corporate Services, Customs, Large Business Centre, Enforcement and Risk Legal and Policy, Finance etc.) report directly to the Commissioner who is the head of SARS. The positions for the Internal Auditor and the Commissioner are all appointed.

The Kenya Revenue Authority (KRA) which was created in 1995[58] is comprised of five departments including Customs Service Department, Human Resource Department,-

[56] See footnote 43 on page 13
[57] See SARS Annual Report 2007 - 2008 Page 11

Domestic Taxes Department, Road Transport Department[59] and Support Services Department that are integrated in term of core business functions. There are units for Enforcement, legal, and Research & Planning that perform core functional activities across customs and tax administration.

The units for Finance, IT, Internal Affairs and Procurement provide support services function for both customs and tax administration of the KRA.

Each of the departments is headed by a Commissioner who reports directly to the Commissioner General of the KRA.

In Mauritius, the revenue authority was established in 2005[60]. The features of the Mauritius Revenue Authority (MRA) are very peculiar to those of the above mentioned RAs of South Africa and Kenya. It is headed by a Director General and the core business functions for customs and tax administration are fully integrated. It has departments for Customs, Large Taxpayers, Finance & Administration, Fiscal Investigations, Internal Audit, Human Resource, Information Systems, Internal Affairs, Operational Services, Taxpayer Education and Communication, and Medium & Small Taxpayer. Each of the departments is headed by a Director who reports to the Director General of the MRA.

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[58] See footnote 43 on page 13
[59] See http://www.kra.go.ke/index.php/kra-portal
[60] See http://website.informer.com/visit?domain=mra.gov.mu

## Section -5 Conclusion

After a thorough review and analysis of the current structure the Liberian tax system and the experiences of tax reforms undertaken in some African countries, I have therefore come to a conclusion by developing a tax reform proposal which I certainly believe would improve and enhance the collection of revenue for the people of Liberia.

Notwithstanding, before I proceed to present the tax reform proposal, it is therefore a matter of vital importance that I give brief explanation with regards to the potential policy impacts the tax reform would have on the economy of Liberia in general.

### 5.1.1. The impact of the Proposed Tax Reform on Liberia

The establishment of a robust and efficient Revenue Authority in Liberia that will have the statutory power to independently handle its own administrative affairs void of political interference from the executive will mean a lot for Liberia in terms of economic development. The new LRA will create the enabling environment for the successful introduction and implementation of an efficient and effective VAT system that will subsequently enhance the collection of more revenue to finance government development programs.

The adoption of VAT in Liberia will definitely guarantee the potential for the augmentation of revenue yields to promote and encourage fiscal sustainability for government, support improvements to social programmes, help increase public sector savings and maintain higher levels of public sector investments thereby generating additional growth in the economy. Additionally, VAT is capable of stimulating the productive sector of any country's economy by indirectly subsidizing exports. The exemption of exports from VAT base can serve as an indirect subsidy to exporters that allows them to produce more outputs for export. Subsidy for exporters tends to reduce unemployment pressure on national government because more labor will be required in the productive sectors. As more labor is involved in the productive sector, it will lead to more capital utilization in the productive sector of businesses to increase their profits earning and such earning will be reverted into the economy. The increase in the productive sector and subsequent export of those products will enable local laborers to grow efficiently and effectively in their field of activities by acquiring new skills and techniques on their jobs. The exemption of exports by the VAT system is a possible way of acquiring foreign reserves into the Liberian economy since more exported goods can be purchased in foreign currency. Finally, increase in production simply results in increase in the utilization of factors of production (labor, land, capital & entrepreneur) thereby allowing the owners of those factors of production to benefit. The increase in VAT revenue is associated with an increase in GDP per capital and a subsequent reduction in the share of agriculture production to GDP. The value added tax leaves more money in individuals' paychecks, thereby allowing more money to be efficiently distributed throughout the economy.

A broad-based VAT applying at a single standard rate, with high threshold and minimum exemptions is economically efficient which is in keeping with the principle of fiscal neutrality for it does not distort consumers' choices for goods and services and does encourage savings without distorting the allocation of capital. Economists generally agree that a well designed VAT system imposes a lower excess burden than most other taxes for any given amount of revenue. Reducing the excess burden of taxation on the economy is an important way that the tax system can encourage economic growth.

### ***5.1***.2. **Proposed Tax Reform for Liberia**

As mentioned earlier in section 2.9 of this paper, the proposed tax reform for Liberia is envisaged in two areas. Firstly the reform is intended to establish a semi-autonomous Revenue Authority for Liberia to replace the current governing structure of the Revenue Administration which is fully controlled and managed by the Ministry of Finance through its department of Revenue. The second aspect of the reform is aimed at introducing the world wide most popular, broad-base Value Added Tax (VAT) regime to replace the current narrow-base Goods & Services Tax (GST) regime in Liberia.

### ***5.1.3. A Proposed Liberia Revenue Authority (LRA)***

Presently, the BIR and the BCE rely on MOF for all key components of their core business and supporting administration e. g. appeals, internal audit, IT, public relations and HR. Implementation of a revenue authority usually means that the authority itself assumes responsibility for these areas. In addition, autonomy also means that the RA itself manages the entire range of HR, finance and administrative policies approved by the board. All these require some level of staff support. It should also be noted that properly implementing a revenue authority can take anywhere from 18 to 24 months[61]. It demands a great deal of executive engagement and commitment, all while support and forward movement continues in all other areas of reform.

#### *5.1.4. The political will to establish the LRA*

Upon her re-election in 2011, the President of the Republic of Liberia, Ellen Johnson Sirleaf announced in her inaugural speech that a revenue authority (RA) is to be established in Liberia. This proclamation by the President has created a greater urgency for the establishment and subsequent implementation of the LRA. The mandate was also reiterated by the current Finance Minister of Liberia, Amara Konneh during his briefing to the IMF in the USA, saying that the country is transitioning[62] to a Revenue Authority and merging the Ministries of Planning and Finance. He further mentioned about the transition to the ECOWAS Common External Tariff and moving from GST to VAT to help increase revenue.

[61]But according to Jenard Leo Wachira, a Kenyan audit consultant for LTD/BIR in Liberia, the RA reform in Rwanda took about 4-6mths which seems to be an exception to situation where RA reform has taken up to 1-2yrs.

[62] Liberia news: WWW.frontpageafricaonline.com 19 April 2012 edition

### *5.1.5. Key legal issues being highlighted for careful consideration*

Three main issues need to be resolved in relation to the structure of the new LRA due to their implications for the wider macro-fiscal program. These include: (1) transitional provisions related to the current staff of the department of revenue and the process of staffing the new LRA; (2) the basis of the financing support for the LRA operation; and (3) provisions in the current LRA draft legislation which provides for powers conferred on the Minister of Finance (MOF) under the current legal arrangements, to be transferred to the Commissioner General (CG) of the proposed LRA.

The above enumerated issues are to be carefully considered for proper resolution before any move towards the full establishment of the LRA.

### *5.1.6. Key policy decisions to be made before RA—or any-- legislation can be properly drafted.*

Once a government has made a decision to implement a revenue authority, the key policy decisions should be made before any legal drafting begins. These policy decisions generally fall into four broad categories: (1) degree of autonomy—legal form, funding, budget, HR and other management authorities; (2) governance framework—roles of the minister, the board and the Commissioner General (CG); (3) accountability—reporting to government and parliament and external and internal audit provisions; and (4) scope—what taxes and agencies will be included in the RA. In most countries, recommendations in each of these areas would be presented to cabinet and with cabinet's agreement, drafting instructions can be developed.

### *5.1.7. Draft legislation*

Comments were made during the IMF mission on recent drafts of legislation to create the Liberia Revenue Authority (LRA). Based on this review, it is clear that policy thinking had not been completed and decisions had not been taken as to the form and shape of a possible LRA. While it appears that RA laws from other jurisdictions were reviewed for guidance, it is insufficient to directly adopt practice in other countries on the assumption that they are suitable for Liberia. Many provisions strike to the heart of the relationship between the government (through the minister) and the RA and must be given careful consideration. Examples include:

The extent of autonomy that the LRA would normally have included HR as well as all other areas of management—budget, procurement, real property, IT etc. Autonomy is not defined in the draft law.

The role of the minister- the minister of finance usually has general direction or supervision over the RA and many countries like Kenya, Uganda, South Africa etc., give the minister the power of special direction in terms of fiscal policy formulation in consultation with technical staff of the RA.

The roles of the board and CG—with a clear delineation that the board has no operational role or involvement. To avoid conflicts of interest and to protect taxpayer confidentiality, the board should not be privy to any taxpayer specific information in internal audit or other reports.

The nature of LRA funding—a regular appropriation with a possible incentive?

These are but a few examples of the decisions that should be made before legal drafting should even begin.

### *5.1.8. Proposed structural reform to the current structure*

There have been numerous reforms and modernizations undertaken by the department of revenue involving the Bureau of Internal Revenue and the Bureau of Customs & Excise. There is no further alteration required at the moment in term of the various functions of these bureaus because those reforms and modernizations were intended to be prepared for the transition to LRA.

The proposed structural adjustment is therefore directed towards divisions and units within the Share Services area of the department of revenue.

They include: Corporate Services Division, Policy Unit, Internal Affairs Division, Revenue General Services, Common Services Division, Ruling and Interpretation Unit, Risk Management & Compliance Division, Reforms & Modernization Unit, Data Capture & Reconciliation, and the Information Technology Section.

In this regard, the Corporate Services Division and Policy Unit need to be replaced with two new Divisions. These include; Revenue Policy Planning & Forecast Division and Media Service Division. The reason for this is because the Corporate Services Division is characterized by two main functions namely; Media Service (for taxpayer's education) and Revenue forecasting, the latter can easily be aligned with the function of the Policy Unit which is responsible for developing national tax policies.

The nomenclature of Common Services Division will also need to be replaced with the Human Resource Division to better align the actual function with its title for it is the division charged with the duty to handle all personnel matters ranging from setting staff remuneration, welfare, to training, recruitment and staff development etc. The rest of the divisions within the Share Services area will therefore remain unchanged.

Notwithstanding, there are some other new Departments and divisions that need to be created. These include: Support Services Department, Internal Revenue Department, Customs & Excise Department, Litigation & Anti-avoidance Division, Taxpayer Advocate Unit, Budget & Finance Office, and the Internal Audit Division.

### *5.1.9. Support Services Department*

As a common practice in Kenya and other RAs, the Support Services Department shall comprise of all divisions, sections and units of the LRA that are not part of the proposed departments of Internal Revenue and Customs & Excise. It shall be headed by a Commissioner who will report to the Deputy Commissioner General.

The Internal Revenue Department and the Customs & Excise Department shall replace the Bureau of Internal Revenue (BIR) and the Bureau of Customs & Excise (BCE) respectively and each shall be headed by a Commissioner as it is practiced in Kenya. Note that this replacement does not entail making any alteration to the current structure and functions of the BIR and BCE as it is only intended to change the nomenclatures of these bureaus so that they can fit within the new structure. The new LRA is proposed to comprise of three (3) main departments as enumerated above with each headed by a commissioner who reports to the Deputy Commissioner General and who then reports to the Commissioner General of the LRA.

The proposed structure of LRA can be somewhat closely compared to that of Kenya but with some variations. The Kenyan Revenue Authority is comprised of Departments of Domestic tax, large taxpayers, Customs, Support services, HR, and Road Transport with each of them being headed by a Commissioner. However, directly copying from this structure with all its features to be used for LRA might not be well suitable for the Liberian economy at the moment given its size which is characterized by very large informal sector and indeed much smaller as compare to that of Kenya.

#### *5.1.10. Litigation & Anti-avoidance Division*

As international best practices demand, coupled with the fact of it being a common practice in countries like South Africa, Uganda and Kenya etc. the new LRA will certainly need to have a division which will be dutifully charged to prosecute all tax cases and to perform other legal services for the LRA. The division will also be responsible for developing strategies to combat tax evasion and avoidance, and to undertake double tax treaty negotiations as well. The reason for the creation of this division is because there is no such division within the current structure and all tax cases are being forwarded to the Ministry of Justice for prosecution which is not effective due to capacity problems.

#### *5.1.11. Taxpayer Advocate Unit*

The LRA will also need to create a Taxpayer Advocate Unit. This unit is to serve as an independent body to help taxpayers resolve problems and recommend changes that will prevent such problems. The unit will ensure the LRA's prompt adherence to all provisions in the taxpayer's bill of rights.

#### *5.1.12. Budget & Finance Office*

This office will be responsible for formulating the annual expenditure required to run the LRA and handle all the finances of LRA ranging from staff remuneration, to training, travel costs and all other financing requirement of the LRA.

#### *5.1.13. Internal Audit Division*

This division should be dutifully charged to conduct routine audit on operational procedures and the use of funds appropriated for LRA in order to ensure accountability, fiscal probity, and transparency at all level of the LRA. The head of this division shall report directly to the chief executive and indirectly the board as it is practiced in countries like Kenya, Uganda, and Nigeria etc.

## 5.2. Proposed Value Added Tax (VAT) regime for Liberia

In respect to the fact that VAT administration is completely a new phenomenon to the tax system of Liberia, it is therefore vitally important that I make a brief synopsis as it relates to the principle of VAT.

### 5.2.1. The principle of VAT

Unlike the current GST regime in Liberia in which tax is charged at only one stage of production with no cascading effect and in the event of fraud or evasion at one stage of production or distribution, the government ultimately stands no chance of recovering the tax due.

For VAT, the basic principle[63] is that tax should be charged at each stage of the production and distribution process but that the total tax due should be borne by the final consumer of the product. This is achieved as follows:

(a) Traders who are registered for VAT are required to charge VAT on their sales and must account for this *output tax* to the tax authority, but

(b) Such traders are allowed to recover from the tax authority the *input tax* which they pay to their own suppliers, so that

(c) In effect, registered traders suffer no VAT and the total VAT is borne by the consumer at the end of the distribution chain.

[63] See Alan Melville: Taxation Finance Act 2011 , 7th Edition at page455

### 5.2.2. VAT Implementation in Liberia

#### 5.2.2.1. Legislation

Under its ECOWAS obligations, Liberia is committed to reforming its indirect tax system with the introduction of VAT. The report of the January 2011 IMF-FAD tax policy mission provided a fairly general discussion about shifting from the current relatively narrow-based GST to a broad-based VAT. Issues addressed were mostly of a policy and design nature, but importantly, a relatively high registration threshold was proposed similar to the previous GST threshold (L$ 5million, approx US$66,667) given administration and compliance challenges of the Liberian environment. The mission also noted from experience that a 2 – 3 year lead-time was typically needed for a successful VAT launch.

### 5.2.3. Selected Issues of the Draft VAT Act

5.2.3.1. **The draft VAT legislation is an amalgam of legislation from several jurisdictions including some provisions that may be inappropriate for Liberia.** There is serious risks arising from drafting legislation based on laws from other jurisdictions before key policy considerations and choices are complete. It often entails an unnecessarily lengthy drafting process at the risk of legal draftsmen inappropriately making critical policy decisions. Also, even with considerable vigilance, inappropriate foreign references may remain undetected in the draft legislation (as is the case with references to the Ghanaian customs law in the current draft VAT act).

**5.2.3.2. VAT administration in Liberia should be fully integrated with income tax.**

Given ongoing commitment of the Liberian authorities to modern tax administration principles (integrated administration of direct and indirect taxes, functionally structured headquarters and units, and a segmented approach to taxpayer management), the provisions of Part X (articles 36 to 53) of the draft VAT Act are surprising. They are copied directly from superseded Ghanaian law that previously provided for a separate VAT service with its own governing board that was replaced in January 2010 by an integrated revenue authority. These provisions should be struck out in their entirety.

**5.2.3.3. VAT provides an opportunity to modernize and harmonize legislated administrative provisions.** Many countries have used their new VAT law to introduce improved provisions such as for record keeping, payment and filing requirements, and compliance and enforcement, such as penalty and interest provisions. While welcome, an unfortunate byproduct can be inconsistent treatment of identical or similar situations for other taxes. This can be avoided by concurrently amending administrative provisions for other regimes, particularly income tax to mimic the new VAT provisions. A superior approach is not to include specific administration provisions in the VAT law, it would therefore be wise to strip out existing provisions for income tax, and consolidate common administrative provisions in a single instrument, often called a Tax Administration Act, or Tax Procedure Code. Liberia's introduction of VAT provides an ideal opportunity to pursue this approach. In this case, most of Part IX (interest and tax recovery), Part XI (objections and appeals), Part XIII (offences and penalties)[64], and the record-keeping aspects of Part VIII could be covered by common provisions and hence not needed in the VAT Act.

**5.2.3.4. Commonly observed features of VAT regimes in the region or elsewhere in Africa should not be assumed to reflect best practice.**

Several examples are found in the draft VAT Act that should be reconsidered. Examples include: (1) limiting only the largest taxpayers to monthly filing/payment with all others having either bimonthly or quarterly obligations; (2) not mandating the use of government controlled and issued VAT invoices; (3) ensuring streamlined refund mechanisms are accommodated by not requiring submission of all supporting invoices for every refund claim unless explicitly requested; and (4) considering a VAT deferral arrangement for the importation of capital goods by compliant taxpayers (the draft Act suggests that these goods may be inappropriately exempt).

### 5.2.4. Recommendations

Draft legislation only when choices have been made and endorsed for key tax policy and administration issues – strip out any existing provisions in the draft Act that do not comply to avoid the impression of endorsement.

64 Illustrative of the risks of compiling legislation from extracts of foreign laws, Part XII is missing from the draft Liberia VAT Act.

Consider consolidating modernized and harmonized administrative provisions for all taxes to avoid divergence and the need for specific provisions in the VAT Act.

Maintain openness to best VAT practices rather than commonly observed features in other jurisdictions which might not be suitable for Liberia.

#### *5.2.5. Some Key policy decisions required to drive the process of implementation.*

In December 2011 an IMF-FAD tax policy mission provided extensive advice on important policy issues that must be decided in order to set the stage for development of a targeted and realistic implementation plan. These issues include decisions on the registration threshold, treatment of certain goods and services as it relates to being exempted or zero-rated, and the VAT rate.

A standard rate of 5% would better suit the Liberian society at the moment, in that it is under the rate of the current GST at 7%. At present the VAT rate in Nigeria is 5% which is in line with the ECOWAS harmonized VAT rate of 5%.

***5.2.5.1. The VAT should be implemented with a single standard rate and a limited selected group of exemptions.*** International experience has shown that countries that have introduced a VAT with a single standard rate, high threshold and minimum exemptions have maintained the integrity and simplicity of the VAT regime. It is ill-advised to have a rate structure that does not support a single standard rate. Any concerns about protecting certain segments of the society or economic sectors should be addressed through the use of targeted social programs, and choices of goods and services for exemptions and zero-rated status.

5.2.5.2. ***The design of an effective refund program will be important to the success of the VAT program.*** The credit mechanism and an efficient system of refunds is the core of a well functioning VAT system. Many variations exist for the treatment of the credit and refunds process across countries that have implemented a VAT varying from "giving no refunds" to a robust and efficient refunds process. In order to preserve the credibility of the VAT system, it is important that the process of refunds be accommodated with the appropriate checks and balances to mitigate risks for abuse.

### *5.2.6. A project management and governance structures to manage the VAT project*

A fully staffed VAT project team needs to be set up to drive the implementation program. An effective governance structure is very essential to drive decisions around the key policy issues to mobilize the implementation program. Once these decisions have been made and a policy document completed, this will set the stage to begin to roll out the components of an effective VAT implementation program.

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