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Building a Fair, Transparent and Inclusive  
Tax System in Sierra Leone

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# **SIERRA LEONE REPORT**

## Tax Justice Country Report Series

This report is part of an initiative to create a comprehensive, and globally representative series of country reports that touch on diverse tax justice issues. The production of this report is the collective effort of all of the organisations involved.

The Tax Justice Network promotes transparency in international finance and opposes secrecy. TJN was initiated at in 2002, and is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. Tax Justice Network Africa was launched in 2007 with the aim of bringing tax issues to the foreground of the broader development agenda. We work to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens.

The Budget Advocacy Network (BAN) is a network of CSOs who believe in rights-based approaches to development, promoting pro-poor, inclusive, gender-sensitive and equitable generation and use of national resources through research, analysis, social mobilization and advocacy. BAN has conducted an analysis of policies and financial statements of the 2008-09 Budgets, completed a study on District Budget Oversight Committees, developed the ability to track the flow of resources in the health sector, and cultivated strategic relationship with oversight bodies.

The National Advocacy Coalition on Extractives (NACE) is a coalition of leading national and international non-governmental organisations. NACE envisions a Sierra Leone society where there is a maximum return and benefits from natural resources endowments (mining, forestry, marine). NACE advocates for the implementation of the extractive industry transparency initiative (EITI), empowering CSOs and building a critical mass of local activists to engage on government and mining companies policies and practices. As a national platform for policy dialogue on extractive issues, NACE has established a solid reputation on engaging with mining contracts reviews, influencing mining legislations and policies and publishes evidence-based research report to inform mining policies reviews for change.

The report itself draws on months of research conducted in June- July 2010 by Wilson Prichard and Samuel Jibao. The report was written by Wilson with enormous contributions from Samuel Jibao, Amadu Sidi Bah and Kadi Julia Jumu. We owe a debt of gratitude to all those who contributed their time and knowledge to this report. Finally special thanks are due to former Coordinator of BAN, Mr. Patrick Zombo, NACE coordinator, Cecilia Christiana Mattia for their valuable contributions and ideas that enriched the contents of the report. Our thanks also go to the Mr. Tijani Hamza, Ibis Country programme director and to Mr. Mark Curtis whose work on the mining sector provided significant data for the report. We would like to acknowledge the support provided by the Integrated Public Financial Management Reform Project Unit, the National Revenue Authority, the Ministry of Finance and the host of civil society organisations that participated actively during the validation exercise of the report. We also acknowledge with thanks that this report is produced with funding support from Christian Aid UK, Ibis, UK Department for International Development (DFID) and Tax Justice Network- Africa and Trust Africa.

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# Introduction

Building an effective tax system is among the most pressing challenges facing any state, as taxation provides the resources necessary to finance government activities and has equally important implications for economic growth, inequality and governance

Despite this reality, tax debates have tended to remain the preserve of a narrow, technocratic elite, while broader, popular engagement has remained very limited. This report provides an overview of the political economy of the tax system in Sierra Leone in order to support more extensive and informed public debate and advocacy around tax issues. It draws on a combination of official data, published sources and, most importantly, a wide array of interviews conducted with policy makers and other stakeholders in June–July 2010 (see Appendix 1).

Debate about tax issues has tended to focus overwhelmingly on generating additional revenue in a way that is also supportive of economic growth. This is a hugely important goal, but it is equally important to focus on building tax systems that are fair, transparent and inclusive. These goals are important in order to encourage broader development gains, and because they are essential to enhancing tax compliance and the legitimacy of the tax system.

Sierra Leone faces particularly acute challenges in pursuing this goal. Not only were the economy and tax

administration devastated by the civil war during the 1990s, but even *prior* to the civil war the tax system in Sierra Leone was among the weakest in the world. Against this background, significant progress has been made over the past decade, as the government has implemented substantial policy and administrative reforms. However, levels of tax collection remain low relative to other countries in the region, and below levels achieved by similar post-conflict countries (Table 1). While only very limited research exists on the specifics of these different cases, it is important to note that all four countries in Table 1 have pursued similar trajectories of policy and administrative reform. As such, weaker than expected performance in Sierra Leone appears to be explained by the politicisation, and limited effectiveness, of implementation, particularly since 2004–2005. This message is reinforced by the disconcerting fact that the past five years have witnessed stagnation and even decline in revenue collection as a share of gross domestic product (GDP), reflecting the persistence of corruption, politicisation and poor tax enforcement among elites. There is thus an urgent need for public pressure for reform.

**Table 1 : Tax as a percentage of GDP in Sierra Leone and other low-income, post-conflict countries**

Region	2004	2005
Sierra Leone	11.2%	9.88%
Liberia	12.9%	13.2%
Mozambique	11.3%	10.8%
Ethiopia	11.6%	10.8%

**Source:** Data from assorted International Monetary Fund (IMF) Statistical Appendices.

The remainder of this report is structured as follows. Chapter 2 provides an overview of why taxation matters for development outcomes. Chapter 3 explores the history of taxation in the country in order to set the social, political and economic context for current reform efforts. Chapters 4 to 6 then turn to analysing the political economy of the contemporary tax system, focusing, in turn, on central government taxation, local government taxation and minerals taxation. Finally, Chapter 7 presents a series of recommendations for civil society advocacy and engagement. While the report presents detailed technical information about the tax system, it is focused on capturing the broad political economy of taxation, as political factors hold the key to building a fair, transparent and inclusive tax system moving forward.







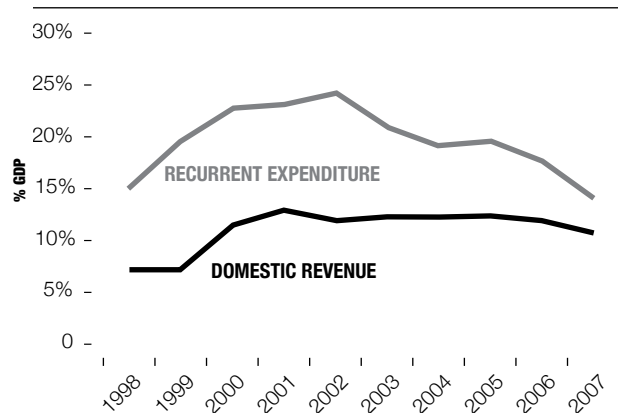


# Taxation and development

The importance of taxation begins with the fact that it provides the revenue necessary to finance government activities

Without increased revenue the government will remain heavily reliant on foreign aid and unable to finance important public goods and services. At a minimum, the tax systems should aim to meet the recurrent expenditure costs of the government, and while progress has been made towards this goal, it has not yet been achieved (Table 2).

**Table 2: Domestic revenue and recurrent expenditure 1998-2007**



**Source:** Data to 2007 from IMF Government Finance Statistics and World Development Indicators. For the years 2003–2006 there are significant discrepancies between IMF and GSL data, owing to diverging GDP estimates. The tables in this report rely on GDP estimates provided by the IMF, as the GSL GDP figures produce a seemingly implausible break in the data in 2003–2004.

Improving the effectiveness of taxation also holds the potential to contribute to development through a variety of equally important, but often overlooked, channels (Cobham 2006):

- **Economic growth:** Successful private sector

development requires that tax policy and administration be fair and predictable. Where administration is arbitrary, and demands are excessive, investment will be discouraged. When those with political connections receive unfair advantages, productivity will suffer and smaller businesses will be unable to compete.

- **Redistribution:** An effective tax system can contribute to reducing inequality by funding public services, but only if elites are required to pay their fair share.
- **Re-pricing:** The government is able to discourage undesirable activities by taxing them heavily, for example by effectively taxing environmentally damaging mining, fishing or forestry practices.
- **Strengthening state capacity:** In order to regulate the national economy, the government needs reliable information about economic activities within its borders. Effective tax systems are the most effective means to acquire such data and thus to improve economic policy-making and curb illegal activities, including corruption (Bräutigam 2008; Prichard and Leonard 2010).
- **Increasing responsiveness and accountability:** Taxation has the potential to contribute to broad improvements in governance, by encouraging taxpayers to engage directly with government to demand public services and accountability in return for tax compliance. In simple terms, those who pay taxes are more likely to take an active interest in how government revenues are spent. However, such outcomes are not guaranteed, and taxation is

more likely to contribute to broader governance gains when the tax system is easy to understand, transparent, equitably enforced and offers opportunities for public engagement (Levi 1988; Moore 1998, 2008; Prichard 2009).

Of course, while tax systems can have all of these positive effects, this has often not been the case in practice. Tax collection is frequently arbitrary and coercive, corruption is common, and elites receive widespread formal and informal privileges and exemptions. Most fundamentally, citizens have little confidence that the taxes that they pay are consistently translated into public services from government. Under such conditions it is little wonder that most citizens prefer to evade taxation and view tax collection as exploitation rather than a contribution to national development.

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## The challenge for civil society organisations is not to push for more taxation, but rather to push for better taxation

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Therefore, the challenge for civil society organisations is not to push for more taxation, but rather to push for better taxation. Such efforts hold the potential to contribute to all of the development benefits noted above, while also allowing for increased levels of tax collection by curbing corruption and elite privileges. Thus, civil society should be interested in pushing for a tax system that meets three basic criteria:

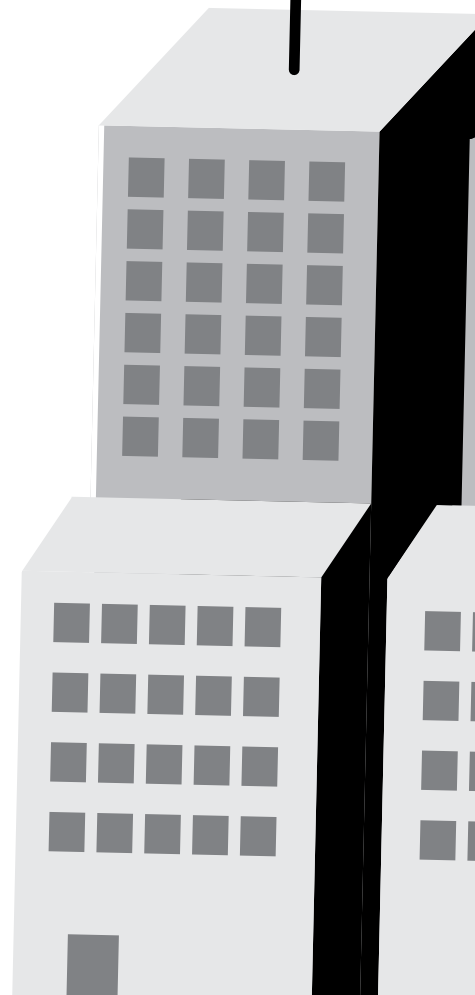
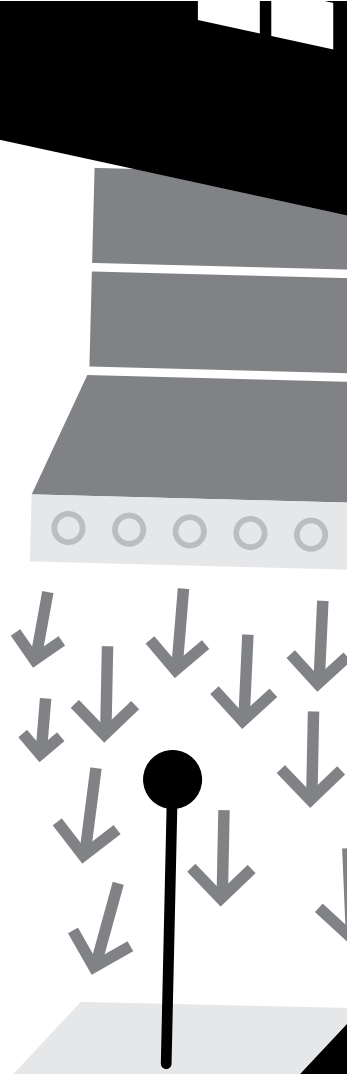
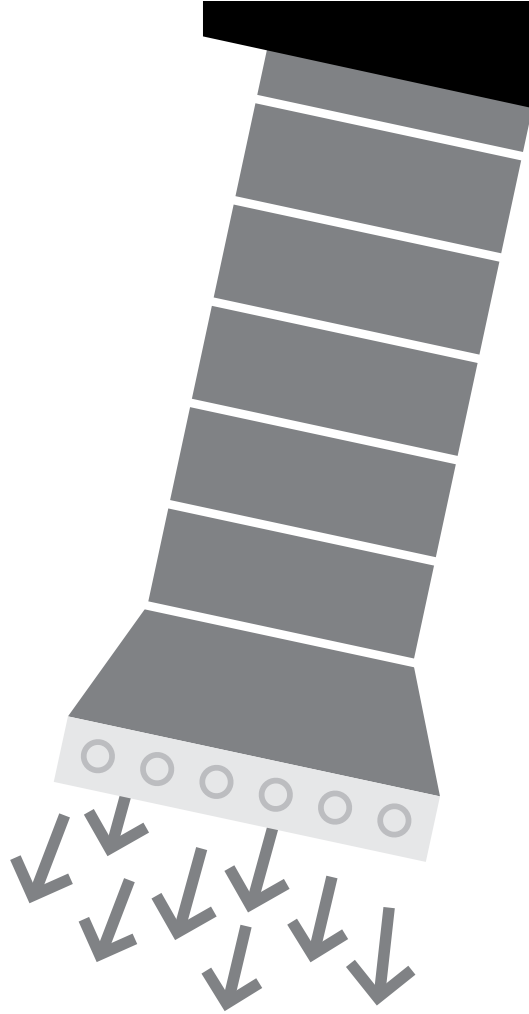
- **Fairness:** Taxpayers with similar characteristics should all be subject to the same tax burden ('horizontal equity'), while those with higher incomes should bear a heavier tax burden as a share of income than those with less ability to pay ('vertical equity'). In developing countries the primary barrier to equity lies not in tax policy, but in the fact that many elites do not pay their fair share of taxes owing to a combination of bureaucratic corruption and political favours. Curbing such leakages would yield large revenue gains, improve private sector

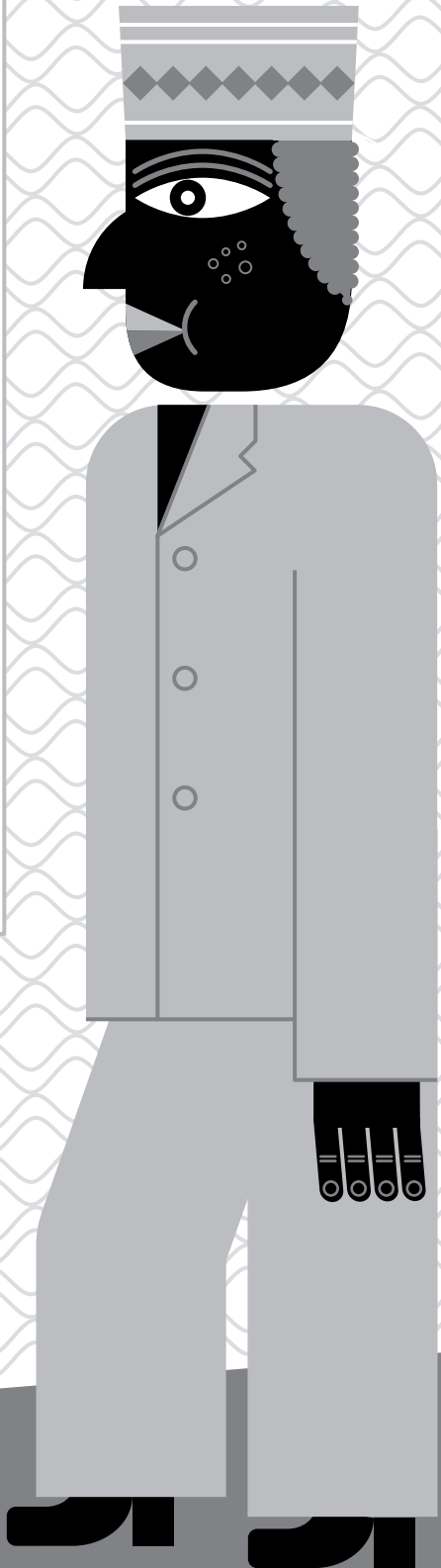
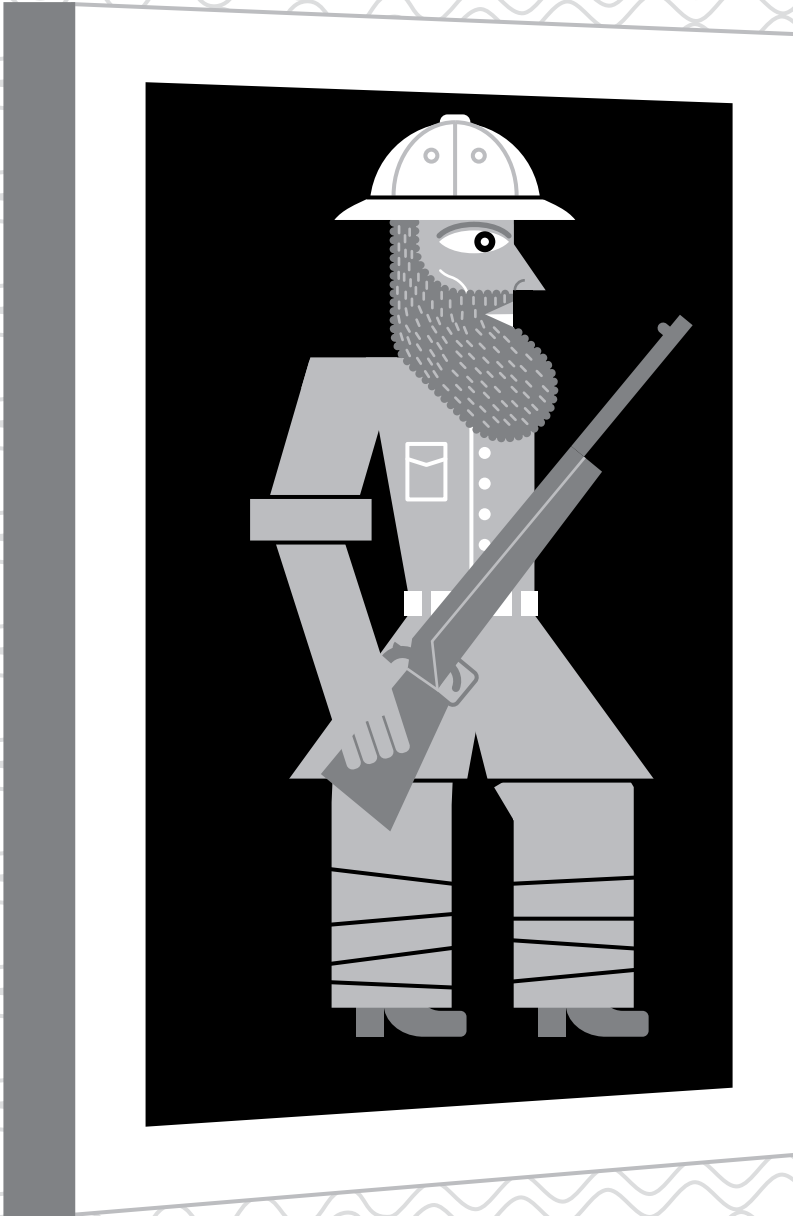
performance, reduce inequality and contribute to an overall improvement in the perceived legitimacy of government.

- **Transparency:** Taxpayers should have a clear understanding of (a) the legal basis for their tax liabilities, (b) the amounts of revenue collected and from whom, and (c) how tax revenue is used. This is frequently not the case in Sierra Leone, and in most developing countries, as taxpayers have little understanding of the basis for the taxes that they are forced to pay, while governments are rarely transparent about those who receive special tax treatment, the details of revenue collection, or the specifics of how that revenue is used. Transparency does not only mean announcing tax laws and total revenue collection – it means actively providing for tax education and supplying detailed information to taxpayers about what revenue is collected, from whom, and linking collection as directly as possible to public spending programmes.
- **Inclusiveness:** Finally, there should be scope for taxpayers to engage actively with the government around both revenue and expenditure issues. This may involve creating space for citizens and civil society groups to participate directly in tax assessment processes<sup>1</sup> or creating open forums for citizens to engage with local governments, tax authorities and national MPs around revenue and budgeting decisions. Where space for such engagement is created, taxation can become a catalyst for active public engagement among citizens and for long-term improvements in governance.

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<sup>1</sup> In various countries in sub-Saharan Africa this is already the case. In some cases associations of taxpayers have been directly responsible for collecting taxes from their members and remitting them to government, while in others citizens have been represented on committees charged with estimating tax liabilities for small and medium businesses (Prichard 2010).





# Historical context: Taxation and governance since independence

Sierra Leone achieved independence from British rule on 27 April 1961, and inherited a particularly challenging colonial legacy

Throughout the period prior to independence Sierra Leone had been divided into two separate entities: a formal colony in Freetown and a protectorate covering the remaining territory. The economic and political life of the colony was consequently focused on Freetown, while the protectorate was characterised by a particularly acute example of ‘indirect rule’, with power vested in the so-called native authorities with the primary aim of maintaining political order (Mamdani 1996; Young 1994). While these native authorities derived from the pre-existing system of chieftaincy, British intervention in chieftaincy affairs was frequent and contributed to the system becoming increasingly coercive and arbitrary. The increasingly coercive character of local governance was reflected early on in the Hut Tax War of 1898, and this pattern continued throughout the colonial period and into the independence era (Fanthorpe and Sesay 2009).

Independence witnessed the election of the Sierra Leone People’s Party (SLPP) under the leadership of Sir Milton Margai, while subsequent elections were held in 1967 and brought the All People’s Congress (APC) to power, led by Siaka Stevens. The new government was immediately overthrown by a military coup, but the coup was quickly reversed, thus returning Stevens to power in 1968. The APC again won elections in 1973, but the

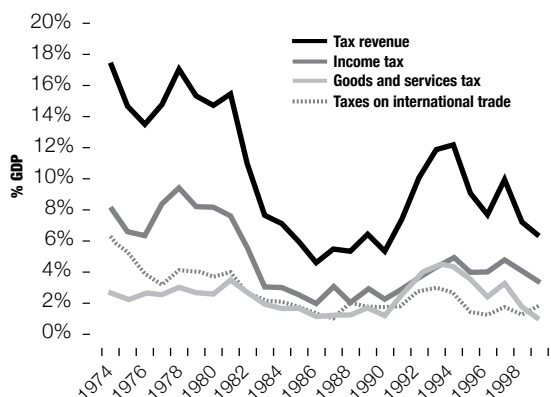
elections were undermined by an opposition boycott amidst accusations of widespread fraud and intimidation. A further APC electoral victory in 1977 was again characterised by widespread fraud and abuse, and was followed by the establishment of a one-party state in 1978.

As with many countries in the region, politics during this period became increasingly autocratic, unaccountable and centralised, with investment in infrastructure and social services progressively declining. This was best illustrated by the fate of local government, which was based on a network of district councils, which oversaw governance at the chieftaincy level. In practice, local government at all levels became increasingly politicised and ineffective, and in 1972 the system of local government was abolished entirely, further marginalising the provinces. During the first two decades after independence, the role of patronage politics became ever more pronounced, as political power came to rely on the ability of those in power to dispense privileges to their most powerful supporters. As a result, the government and its allies increasingly appropriated state resources for personal and political gain. The gradual process of political and economic decline grew into a full-blown crisis beginning in the early 1980s, as the basic functions of the state began to be eroded. While the economic crisis and the erosion of public ser-

VICES had multiple roots, including the impact of external economic shocks in the 1970s and the economic contraction associated with structural adjustment programmes, there is little disagreement about the fact that the crisis was first and foremost the result of rent seeking and abuse by political leaders (Kpundeh 1994; Reno 1995).

The extent of the decline during the 1980s is starkly reflected in the state of government revenue (Table 3). Until 1981 tax revenue hovered consistently around 15% of GDP, which was entirely comparable to levels elsewhere in the region. However, the years that followed witnessed a dramatic decline in revenue to 10% of GDP in 1982, 7.5% in 1983 and less than 5% by 1986. Such low levels of revenue were not nearly sufficient to operate a modern state, and by the late 1980s the government found itself unable even to meet the salaries of civil servants and the military. While the economic crisis played an important role in precipitating this fall in revenue, such a dramatic decline can only be fully explained by the increasing politicisation of tax collection, as exemptions were granted to political allies, corruption expanded and the state lost its ability to monitor and regulate activities within its borders. While the onset of acute crisis corresponded with the handover of power from Siaka Stevens to Joseph Momoh in 1985, it is clear that the sharp decline in state revenue, and the corresponding inability of the government to achieve political stability and regulate activities within the country, predated this change (Reno 2000).

**Table 3: Sierra Leone tax revenue 1974–1999**



**Source:** Data from IMF Government Finance Statistics and World Development Indicators. Goods and services tax includes domestic sales tax, the petroleum excise tax and other excise taxes. Taxes on international trade includes both import duties and import sales tax.

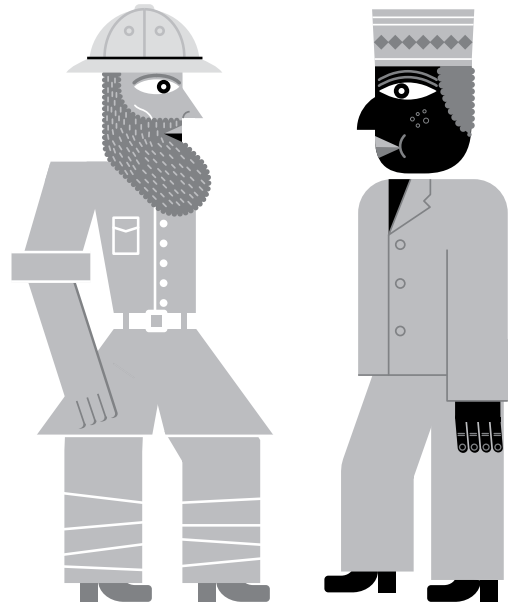
After a decade of economic and political decline, the country was beset by civil war in 1991, as conflict in Liberia spilled over the border and supported the formation of the Revolutionary United Front (RUF). While the conflict in Liberia was a catalyst for the onset of war, the conflict equally reflected the profound weakness of the Sierra Leonean state. By 1991 the government was unable to pay salaries, had almost totally withdrawn from development programmes in the provinces and had, to a significant degree, simply lost control of the regions of the country where conflict first emerged (Reno 1995). Confronted by the rebel threat, the government succeeded in increasing revenue generation to some degree, but gains tended to be fleeting, and the financial weakness of the state continued to figure prominently in its inability to re-establish order. Peace was formally restored in 1999 with a peace settlement backed by significant external intervention, while actual violence was gradually brought under control prior to successful elections held in 2002.

In the aftermath of the war, Sierra Leone faces significant development challenges, and these constrain the potential for high levels of tax revenue generation. Since independence in 1961, Sierra Leone has remained among the lowest-income countries in the world, with GDP in 2007 estimated at Le 4,968.9 billion (US\$1,664.8 million), or only US\$241 per capita, while it ranks third from the bottom in the Human Development Index. Infrastructure in the country is correspondingly limited, owing to consistent neglect since independence and significant damage inflicted by the civil war. In recent years economic growth has been solid, though unspectacular, at an estimated 2.6% per annum, though roughly 70% of the population remains below the official poverty line of US\$1 per day. The country is an essentially agricultural economy, with the agricultural sector accounting for 46% of GDP in 2006, while the extractives sector accounts for an additional 15% of GDP.<sup>2</sup> Sierra Leone remains overwhelmingly a cash economy, which poses serious challenges to tax administration.

While this is a vastly simplified picture of developments over four decades, it provides three important messages relevant to this report:

<sup>2</sup> Data from IMF Statistical Appendix 2009.

- **First, taxation provides a valuable lens through which to understand broader political developments.** When tax revenue declines significantly, and without a clear economic explanation, this is likely to reflect broader political developments, and particularly the spread of politically motivated exemptions and corruption.
- **Second, the politicisation of the tax system can have dramatic consequences for governance,** as private privileges distributed through the tax system historically undermined the ability of the state to sustain public services and to monitor and regulate activities within its borders.
- **Third, there has been a long and damaging history of ineffective and politicised taxation in Sierra Leone.** This suggests that the issue warrants greater attention as a significant risk factor as the country continues to recover from the civil war. It also highlights the fact that the use of the tax system to disperse patronage to political allies in the form of corruption, privileges and exemptions has a long history. Therefore, significant political commitment will be necessary if fundamental reform is to be achieved.







# Central government taxation since 1999

At independence Sierra Leone largely inherited the tax system put in place by the British, and that tax system remained relatively unchanged between independence and the end of the civil war

Even amidst collapsing revenue collection and rising corruption during the 1980s and 1990s, tax reform remained relatively limited aside from changes in rates and thresholds. The tax system remains based on three major tax types: income taxes, sales taxes and trade taxes, with taxes on international trade providing the preponderance of revenue throughout Sierra Leone's history. A more detailed description of these different tax types is provided in Appendix 2.

The period since the end of the civil war has witnessed an accelerated pace of policy and administrative reform, as successive governments have sought to rehabilitate revenue collection. This has included the creation of a new structure for revenue administration, the National Revenue Authority (NRA), as well as the introduction of new legislation across the major tax types. Given the weakness of pre-war tax performance, these reforms represent a significant achievement, but major challenges remain. What follows presents an analytical history of the most important tax developments over the past decade, followed by a more general analysis of the political economy of taxation. The discussion highlights a number of specific areas for reform, while highlighting the

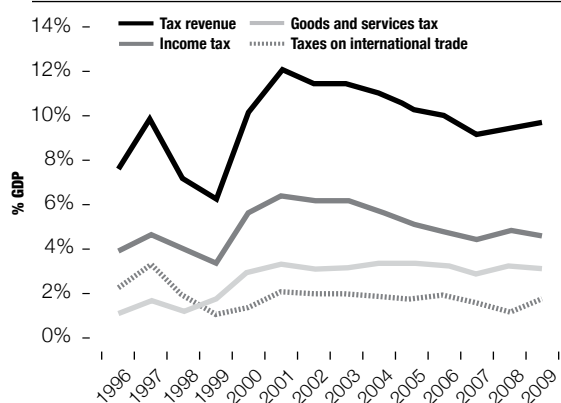
more general message that while capacity constraints pose an obvious challenge, the key to reform lies in the need for greater political commitment to curbing corruption and elite privileges in tax administration.

## Tax revenue and tax reform since 1999

At the time of the peace settlement in 1999, tax revenue collection in Sierra Leone was woefully inadequate, at only 6% of GDP. This reflected not only the weakness of tax policy and administration, but also the decimation of the economy during the final years of the civil war, during which rebel forces briefly occupied the capital. During the years immediately following the war, impressive progress was made in rebuilding revenue collection, but since 2003 revenue performance has been disappointing despite substantial policy and administrative reforms (Table 4). The latter pattern points towards a government that is committed to reform in principle, but which has been unwilling to take the difficult political steps necessary to restrain corruption and politically

motivated privileges. In order to understand these developments more clearly, what follows divides the recent history of tax reform into four distinct periods.

**Table 4: Tax collection 1999–2009**



**Source:** Data 1996–2007 from IMF Statistical Appendices for Sierra Leone. Data for 2008–2009 from Government of Sierra Leone authorities.

## Rapid revenue growth and the creation of the NRA 1999–2003

After experiencing significant gains during a period of relative stability in 1996 and early 1997, government revenue fell sharply in 1998–99 as rebel forces increased their attacks and eventually seized parts of Freetown in early 1999. Peace was officially re-established in 1999, and while there was some continued violence throughout 2000–01, the initial peace settlement set the stage for a sharp recovery in government revenue.

From a low of slightly above 6% of GDP in 1999, tax revenue had almost doubled to 12% of GDP by 2001 and remained at nearly that level in 2002–03. Buoyed by renewed economic growth and a surge in foreign aid (which increased from 11.5% of GDP in 1999 to 44% in 2001), tax revenue increased in all areas and reached a level not seen since the 1970s. While economic gains figured prominently in the growth of revenue, improved administrative performance appears to have played an equally important role. This is most apparent in the case of taxes on international trade, which increased sig-

nificantly more rapidly than did the share of imports in GDP.<sup>3</sup> Given that customs administration had long been viewed as suffering from endemic corruption, this improved collection performance points towards substantial political commitment to tax collection in the aftermath of the war.

Alongside these significant revenue gains, the period following the war witnessed two important developments aimed at providing a firmer base for revenue administration moving forward. First was the enactment of the Income Tax Act 2000, which replaced the previous Income Tax Act, which was put in place under the military government in 1994. The second was the creation of the National Revenue Authority in 2002, which brought the Customs and Excise and Income Tax Departments under a single administration and sought to address problems including a fragmented revenue collection authority, inadequate pay, poor training, high operating costs, and low morale. Aside from administrative reorganisation, the creation of the NRA involved major staffing changes, as roughly half of the staff was replaced in favour of more qualified, and frequently younger, recruits. As with improvements in revenue collection, the creation of the NRA points to significant political commitment to improving taxation. Whereas donors have frequently driven the creation of semi-autonomous revenue agencies in the region, the creation of the NRA appears to have been largely championed internally, building on a plan developed during the brief period of democratic rule in 1996–97.

## The key to reform lies in the need for greater political commitment to curbing corruption and elite privileges in tax administration.

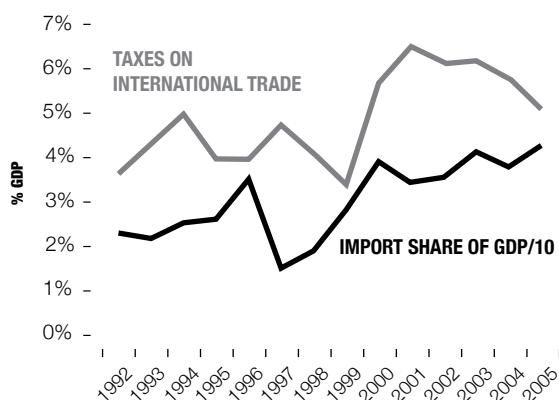
<sup>3</sup> From 1999–2001 taxes on international trade increased from 3.39% of GDP to 6.54% of GDP (a 93% increase), whereas imports as a share of GDP only increased from 28.3% of GDP in 1999 to 39.4% of GDP in 2000 (a 39% increase) before declining slightly in 2001.

## Stagnating revenue and gradual reform

After experiencing impressive revenue growth until 2003, the NRA saw tax revenue collection as a share of GDP decline from 11.53% of GDP in 2004 to only 9.16% of GDP by 2007. This overall decline was driven by a dramatic fall in customs collections, from 6.20% to 4.54% of GDP, while the collection of both goods and services and income taxes fell only very slightly.

Slowing economic growth does not appear to be a sufficient explanation for falling customs revenue. From 2003 to 2007 the share of imports in GDP continued to rise, but the share of revenue from import taxes nonetheless began to fall (Table 5). Given this pattern, falling revenue must have resulted from either a change in the composition of imports, changes in tariff rates or increased leakages and corruption. While more research with respect to import composition is possible, there is no documented evidence to support a shift sufficiently large to explain the sharp fall in revenue. On the policy front, the government moved to adopt the Economic Community Of West African States (ECOWAS) Common External Tariff (CET) in 2005, and the NRA predicted that this was likely to yield revenue losses up to 0.44% of GDP.<sup>4</sup> While the change in tariff rates thus probably played a role in falling revenue, it is clearly insufficient to explain the extent of the fall. The remaining possibility is growing corruption at the ports.

**Table 5: Imports vs. taxes on international trade 92–05**



**Source:** Imports data from World Development Indicators, taxes on international trade from IMF Government Finance Statistics and Statistical Appendices.

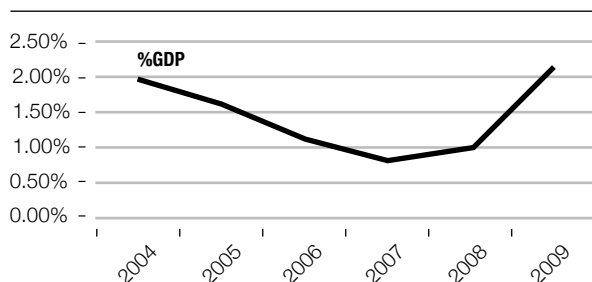
The conclusion that corruption began to expand at the ports during this period is corroborated by interviews with well-placed officials, while it also helps to explain the stagnation of income tax revenue during the period. Sierra Leonean tax law provides for the collection of a 3% withholding tax on imports, which is counted towards future income tax payments. Prior to 2003 this tax was collected directly by the Income Tax Department (ITD) and was an essential source of information for identifying and taxing domestic taxpayers. Yet after 2003 the collection of this tax was transferred to the customs authority, and the ITD reports that difficulties in getting detailed collection information from customs has made it more difficult to enforce domestic income taxes.

The stagnation of income tax collection also appears to reflect two additional factors. First, the rate of corporate tax was reduced from 35% to 30% in 2004. This reduction is striking in that it occurred despite some concerns among tax officials about the revenue impact, while it seems to have attracted very little public scrutiny at all. Second, the NRA began to report difficulties in collecting taxes due from major parastatal companies,<sup>5</sup> and the persistence of this problem is supported by interviews with officials outside the NRA. The difficulty of collecting taxes from parastatals is not only important as an explanation for falling revenue, but is also indicative of declining political support for effective revenue collection.

While there were thus significant negative trends during the period, it is equally important to acknowledge several positive developments. On the policy front, this period saw planning begin towards several of the reforms that were implemented in subsequent periods, and this process attracted financial support from the UK's Department for International Development (DFID) in particular. More tellingly, responsibility for managing various revenue collection activities that had previously been handled by other agencies was transferred to the NRA in 2004, with impressive results. The transfer of responsibility for collecting non-tax revenues resulted in revenue growth from 0.45% of GDP in 2003 to 0.85% in 2004. Meanwhile, responsibility for the oversight of duty-free exemptions was transferred to the NRA from the Ministry of Finance. The result was a step decline in revenue lost to 'discretionary' exemptions (those not approved by Parliament), and total duty-

free exemptions declined from 1.99% of GDP in 2004 to only 0.81% of GDP in 2007 (Table 6), while the increase in duty-free exemptions after 2007 followed a decision to shift administration back to the Ministry of Finance. Aside from pointing to the impressive performance of at least parts of the NRA, the fall in duty-free exemptions further highlights the poor performance of customs administration, which should have experienced significant revenue increases as a result.

**Table 6: Extent of duty-free exemptions 2004–2009**



Source: National Revenue Authority.

Overall, the period from 2004 to 2007 presents a picture of a government still committed in principle to pursuing tax reform, but which was unwilling to take aggressive action to address declining performance at customs in particular. In the eyes of at least some observers this reflected a broader trend in government, as it achieved impressive gains in the initial aftermath of the war, but saw concerns about corruption grow in intensity over time, as reflected in a dramatic cutback in foreign aid prior to elections in 2007.

### The 2007 elections and tax modernisation

Elections held in 2007 saw the victory of the opposition APC. Like its predecessor, the new government has shown important support for reform measures at the NRA, but has simultaneously seemed unable or unwilling to decisively counter the politicisation of revenue collection, with significant consequences for revenue performance. Overall, revenue collection in the aftermath of the elections has experienced a modest recovery, growing from 9.2% of GDP in 2007 to 9.7% in 2009, but has still remained significantly below levels earlier in the decade.

On paper, the pace of policy and administrative reform since the elections has been impressive. This reform

has centred on the NRA's Tax Modernisation Plan, which began to be developed prior to the elections, and was officially launched in 2008 with the support of a GBP16.4 million grant from DFID. The programme has set an ambitious reform agenda, which generally mirrors reforms undertaken elsewhere in the region with donor support. The first, and most straightforward, step taken during the programme has been the introduction of Taxpayer Identification Numbers (TINs). Being able to share information about individual taxpayers across departments, and with outside agencies, is the most basic requirement for effectively tracking tax liabilities, and the introduction of TINs is an important step towards that goal.

More ambitious has been the introduction of the goods and services tax (GST). Following a pattern common in other countries, the introduction of a value-added tax had long been a priority for foreign donors, who considered it an efficient means to raise additional government revenue. Planning for the introduction of the GST dates at least to the earliest stages of DFID support for the NRA in 2004-05, and was the centrepiece of the Tax Modernisation Programme initiated in 2008. Legislation was passed in 2009 which dictated that the new GST would replace an array of existing taxes: import sales tax, domestic sales tax, entertainment tax, restaurant tax, local communications tax, foreign communications tax and professional fees. The introduction of the tax was initially scheduled for later that year, but was then postponed until 1 January 2010 amidst protests led by importers who claimed to be insufficiently prepared to implement the tax. When the tax was finally implemented in 2010 it was met by continued protests from importers, who briefly closed their shops, but this resistance was short-lived given decisive government commitment to the new tax.

The GST had been designed to leave prices largely unchanged, as the rate of 15% was equivalent to the existing rates of import and domestic sales tax, which comprised the overwhelming bulk of expected revenues. Any significant price increases were expected to reflect improved enforcement brought about by the added transparency associated with the GST regime. In practice, the introduction of the GST nonetheless resulted in a significant increase in prices, which apparently resulted from a combination of (a) misunderstand-

ing leading vendors to add 15% on top of existing prices and (b) opportunistic behaviour among vendors who used confusion about the GST as cover for increasing prices and profit margins. These price increases led to significant public unhappiness but never erupted into broader public opposition or jeopardised the implementation of the tax. The weakness of opposition speaks both to the clear commitment that government had made to the tax, and to the weakness of civil society organisation and engagement with tax issues. It is likewise believed by many observers that the lack of opposition reflected continuing goodwill for the government, which had won overwhelming support in Freetown during the 2007 elections.

Since implementation, the operation of the GST has proceeded reasonably smoothly, with revenue collection in the first half of 2010 significantly exceeding revenue targets, and 70% of registered firms submitting tax returns during the second quarter of the year. That said, lingering concerns remain. First, the tax has given rise to latent public unhappiness, as the GST is blamed for high prices. Second, understanding of the tax among many taxpayers remains limited, despite some public education efforts by the NRA prior to implementing the tax. Third, and perhaps most broadly, there remain significant concerns among civil society actors that the emphasis placed on the GST has been misplaced. Although measuring tax incidence precisely is extremely difficult, it is widely accepted that the GST is likely to be either regressive or neutral in its incidence, thus placing a relatively high burden on lower-income individuals. While most observers feel that the GST can nonetheless be a valuable source of government revenue (with potential for redistribution through progressive government spending), there is a major concern that in Sierra Leone the success of the GST has been achieved partly at the expense of the Income Tax Department. The introduction of the GST has seen several senior staff and auditors shift to the GST Department, and there are concerns within the administration that this focus on the GST is leading to a reduced focus on the collection of much more progressive, and redistributive, personal income and corporate taxes. While the appropriate balance between expanding revenue through the GST and focusing attention on more progressive income taxes is a complex question, there is evidence that the focus on the GST may have been excessive, perhaps in part as a

result of strong donor support for the GST.

Following the implementation of the GST, the government has maintained an ambitious agenda for policy and administrative reform. On 1 April 2010 the government officially launched the ASYCUDA system, which is a widely used IT system for automating core customs operations. Unfortunately, unlike the relatively smooth implementation of the GST, the implementation of ASYCUDA has faced significant challenges, described in greater detail below. Moving forward, the NRA also has ambitious plans to (a) introduce an IT system for income tax administration, (b) improve data sharing across the different revenue agencies and, within a year, (c) merge the Income Tax and GST Departments into an integrated Domestic Tax Department. This agenda has the potential to achieve major gains, as experience elsewhere on the continent suggests that the simple ability to compare data across tax agencies is among the simplest, but most effective, means to identify tax evasion. On the other hand, such data sharing and transparency can be seen as a threat by both taxpayers and tax administrators. Therefore, pushing through effective data sharing will require significant political commitment.

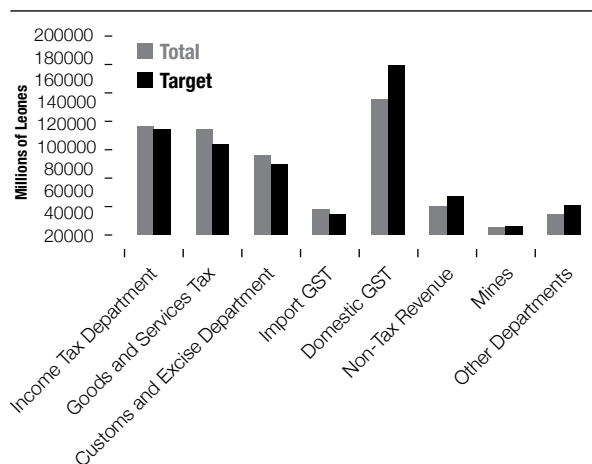
While critics may justifiably argue that this reform agenda appears to reflect international priorities, the reforms hold significant potential and do appear to enjoy significant support at the highest levels of the NRA. Moreover, the fact that significant reforms have been achieved over the past two years points towards a measure of political commitment to taxation, and the implementation of the GST and of ASYCUDA is not likely have succeeded without the resolute commitment of the government leadership. That said, the pace of policy and administrative reform has far outpaced growth in revenue. The major question now facing government is whether it has sought only cosmetic reform to satisfy donors, or whether, having put in place more robust systems, it is also committed to challenging the strong vested interests that have continuously undermined revenue collection.

### **Politicisation, corruption and declining revenue**

Unfortunately, despite the rapid pace of policy and administrative reform since 2007, there are reasons to be sceptical of the government's commitment to support-

ing a more fundamental transformation of tax collection in the country. While tax revenue grew at a modest but steady rate in 2008 and 2009, customs revenue has fallen dramatically below targeted levels in the first half of 2010 amidst broader evidence of the creeping politicisation of the revenue authority (Table 7).

**Table 7: Actual vs. targeted revenue collection in first half of 2010**



**Source:** Government of Sierra Leone authorities.

**Note:** The classification of taxes employed by local authorities has changed with the implementation of the GST, and thus differs from those used in earlier tables.

In order to understand the difficulties being experienced in 2010 it is necessary to consider developments within the NRA since the 2007 elections. Soon after the arrival in office of the new government, there were major changes at the highest levels of the NRA. The new government immediately chose to replace Commissioner General John Karimu, who was viewed as a competent NRA director but also had long-standing political ties to the SLPP. This resulted in a highly politicised search for a replacement, reflecting the prominence and strategic importance of the position, with the government eventually opting to appoint Allieu Sesay from outside the NRA as the new Commissioner General. This prompted the resignation of both the Deputy Commissioner General and the Director of Internal Audit, both of whom expressed unhappiness with the new appointment, while the Director of Finance was also due for retirement. As in the case of the Commissioner General, the Deputy Commissioner General and Director of Finance positions were filled by individuals

drawn from the diaspora and outside the NRA,<sup>6</sup> thus completing a dramatic transformation within the senior ranks of the administration.

These changes were accompanied by significant staffing changes within the core departments of the NRA. While staffing figures are difficult to access and notoriously inaccurate, unofficial figures provided by the NRA indicate slightly fewer than 400 staff prior to the elections, while that number had increased to as many as 600 by 2010. Meanwhile, senior members of the NRA report a widespread perception that a significant part of this new hiring has been politically motivated, and they argue that this has contributed to falling morale and to the resignation or gradual withdrawal of many experienced staff. While it is far beyond the scope of this report to judge the merits of these hiring processes, or of those who have been hired, it is clear that the high level of staff turnover at all levels has contributed to internal dissatisfaction and the emergence of factional divisions inside the NRA.

The creeping politicisation of the agency has become particularly apparent in controversy surrounding the suspension of the Commissioner General. Towards the end of 2009 external auditors employed by DFID raised concerns that several procurement efforts under the Tax Modernisation Programme had not followed proper procedures. This resulted in the Commissioner General being suspended while the Anti-Corruption Commission launched an investigation. There were hopes that the case, which reportedly involved less than GBP100,000 of contracts, would be resolved quickly, but as of the time of writing there remained no resolution, while the case remained shrouded in uncertainty. The Commissioner General has denied the allegations made against him. It is widely believed that the lack of resolution reflects political infighting as different factions inside and outside the NRA seek to influence the process.

The absence of the political commitment necessary to resolve the impasse is troubling because it is apparent that the resultant uncertainty is undermining NRA performance. There is a feeling among many NRA staff

<sup>6</sup> Since 2007 Sierra Leoneans from the diaspora have been recruited into a variety of senior posts at the NRA and elsewhere in government. While this report is not in a position to comment on the basic merits of these appointments, it appears that there has frequently been some tension between existing staff and new staff from the diaspora.



themselves that uncertainty has led staff members to adopt a cautious, wait-and-see attitude, as staff members are positioning themselves to take advantage of looming changes. More importantly, at a time at which the NRA is seeking to implement an ambitious reform agenda the Acting Commissioner General does not enjoy sufficient security of tenure, and thus authority, to push aggressively for necessary efforts to tackle internal and external resistance.

Within the Income Tax and GST Departments these concerns about staff morale and creeping politicisation are readily apparent in interviews, but have not resulted in any major revenue losses. During the first half of 2010 both revenue categories exceeded revenue targets, while plans for the creation of a Domestic Tax Department continue to progress. By contrast, there are clear signs of deeper problems in customs administration. The first half of 2010 was devoted to the implementation of the ASYCUDA automation system, which is the most commonly used system in low-income countries around the world. Preparation for the implementation of ASYCUDA began in 2008, active piloting of the system began at the beginning of the year in 2009, and the system was put fully into operation in 2010.

The implementation of ASYCUDA was expected to yield relatively immediate gains by improving record-keeping and transparency and thus reducing the scope for ‘negotiation’ and corruption at the port. However, in practice, revenue has fallen sharply, achieving only 80% of the half-yearly target. Although this may in part reflect increased smuggling from neighbouring Guinea, in light of political uncertainty there since 2009, such a sharp fall in revenue can only be fully explained by aggressive resistance to ASYCUDA implementation among customs officials at all levels. While this resistance has officially been based on concerns about inadequate capacity to implement the IT system, this claim appears disingenuous in light of the success of the system in many other low-income settings. Instead, it is difficult to avoid the conclusion that resistance reflects the fact that the greater transparency implied by the ASYCUDA system will (a) undermine opportunities for corruption and (b) pose a risk to taxpayers currently involved in tax evasion. As one senior official graphically put it, ‘people are seeing their power erode into a machine’.

Given these recent events, the government faces a stern test of its resolve over the next year. On the one hand, it has so far shown a genuine commitment to reform in pushing through the implementation of both ASYCUDA and the GST. On the other hand, it appears to have been beholden to competing political interests in failing to decisively resolve the question of the Commissioner General, and in not decisively tackling aggressive resistance to the implementation of ASYCUDA. Many observers optimistically believe that the government, having now pushed through improved systems, is poised to aggressively tackle remaining resistance. The next 12 months will provide a clear indication of whether the government is, indeed, willing to take those politically difficult steps, or whether its commitment to improving tax administration is largely cosmetic.

## Political patronage and the political economy of taxation

Developments over the past decade point to a government in internal conflict. On the one hand, there appear to be important elements within government that are committed to genuine tax reform. Despite their limitations, recent reforms represent important successes in a country where the historical record of tax collection is extremely poor. There is, moreover, clear evidence of serious commitment to reform among many within the NRA. On the other hand, despite significant policy and administrative reform, actual revenue performance has stagnated and even declined.

The persistence of poor revenue performance reflects continued corruption and politicisation in tax administration and the absence of sufficient political commitment to demand change. This is consistent with the powerful role of patronage politics in Sierra Leone since independence, as political power has rested to an important degree on success in distributing individual benefits to political, economic and bureaucratic elites. The historical weakness of the tax system reflects these patterns, as supporters are permitted to enrich themselves through administrative corruption, while political allies are similarly permitted, informally, to escape their

fair share of taxation. The use of the tax system as a tool for delivering political patronage has a long history, and is difficult to change. Powerful vested interests have incentives to block or undermine reform, while those who seek reform risk losing political support among those who benefit from existing arrangements. Nowhere is this political impasse more apparent than in the struggle for reform at the Customs and Excise Department and in the unresolved case of the Commissioner General, which appears to reflect behind-the-scenes political struggles.

From a development perspective, what is most troubling about the weakness of the tax system is that it appears to frequently be the powerful and politically connected who benefit most from the continuing weakness and politicisation of tax collection. These benefits undermine the rule of law and the ability of government to provide public services, contribute to the growth of inequality and ensure that the powerful and politically well-connected are able to dominate business at the expense of small firms and outsiders. While such elite privileges are inherently hidden from view, four issues point towards this broader reality, and collectively point towards the importance of broad-based public engagement if reform is to be successful.

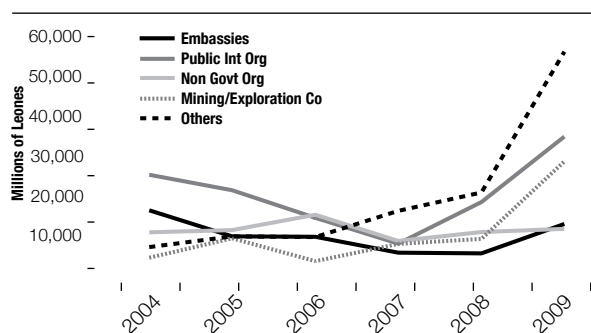
### **Tax exemptions**

The first issue of interest is the experience of duty-free exemptions. As was noted earlier, the administration of duty-free exemptions was shifted to the NRA in 2004 in order to curtail the abuse of ‘discretionary’ exemptions granted by ministries and agencies without the approval of Parliament. This change resulted in a dramatic fall in duty-free exemptions as the enforcement of the rule of law governing exemptions was strengthened. However, despite this success, the administration of duty-free exemptions has since been returned to the Ministry of Finance, and the level of exemptions has skyrocketed from 0.81% of GDP in 2007 to 2.11% of GDP in 2009 (greater than 20% of total tax revenue). While this growth is partly explained by increased exemptions for foreign agencies, and it is impossible to verify which of the remaining exemptions fall into the ‘discretionary’ category, such an increase almost certainly reflects meaningful abuse. In particular, the fact that exemptions classified as ‘other’ have grown exponentially since 2007 should be cause for concern (Table 8).

As important as the scale of these duty-free exemptions is the fact that they refer only to exemptions from customs duties. Many private firms operating in Sierra Leone also benefit from other types of tax exemptions and concessions, frequently negotiated on a somewhat ad hoc basis. While the NRA has detailed data about duty-free exemptions, it does not have similarly detailed data about other types of tax exemption, while there are regular complaints that those firms that have benefited from tax holidays do not submit tax returns at all, thus further undermining monitoring by the NRA. While the granting of such exemptions should minimally be overseen by Parliament, MPs are extremely forthright about the fact that they lack even the basic capacity and resources necessary to monitor tax issues. While parliamentarians periodically raise concerns about tax exemptions, in practice public data remains non-existent, thus raising the likelihood of extensive exemptions driven by political, rather than economic, considerations. If progress is to be made, three principles must be paramount: (i) the reduction of discretionary power in the granting of tax incentives and exemptions, (ii) absolute transparency about who is receiving tax benefits, and (iii) a clear mandate for the NRA to monitor and verify all incentive and exemption claims. Without reduced discretionary power and increased transparency, unwarranted and abusive tax benefits are likely to remain commonplace as a result of both political considerations and simple administrative corruption.

Civil society organisations and other foreign agencies have occasionally sought to apply pressure for the curtailment of such exemptions, but their ability to do so is compromised to some extent by the fact that they continue to be the recipients of a large share of tax exemptions. These exemptions are defended based on the fact that these organisations are charitable in their objectives, and the consequent belief that international funds committed to them should be used entirely for those charitable purposes. However, in a context in which the employees of aid-funded agencies are comparatively well-paid, the continued existence of exemptions for their organisations may serve to undermine the perceived legitimacy of calls by those agencies for the curtailment of other types of exemption.



**Table 8: Duty-free exemption by official category 2004–2009**

Source: National Revenue Authority.

### Taxation of professionals

The experience of the NRA in attempting to tax professionals, including lawyers, doctors and consultants, is equally telling. Taxing professionals poses a particularly acute challenge to governments around the world, as it is extremely difficult to monitor their incomes and professionals are thus able to vastly understate their incomes (Bird and Zolt 2005). As a result, professionals are only likely to pay significant taxes if there is a clear commitment from the highest levels of government that tax evasion will be aggressively pursued. Unfortunately, the evidence suggests that such commitment has been largely or entirely lacking in Sierra Leone.

Historically the NRA has found itself almost entirely unable to meaningfully tax professionals, and as a result a ‘professional fees’ tax was introduced, which amounted to a 10% withholding tax on payments to professionals. This was designed not only to secure some revenue but also, more importantly, to acquire verifiable information about the incomes of professionals, which could then be used in income tax assessment. However, in practice, this tax met major opposition from lawyers in particular, and was never effectively implemented, with revenue in 2009 (the only year in which the tax was enforced at all) reaching only Le 37 million (about US\$9,000), thus implying total reported income of US\$90,000 for all professionals in the country. The professional tax has now been subsumed by the GST, with GST payments to professionals intended to furnish the tax administration with income information. However, in practice, it seems likely that in the short term professionals will only be taxed effectively when the government also demon-

strates a willingness to aggressively pursue individuals whose assets are clearly inconsistent with their extremely low tax declarations.

### Weak income taxation and external audits

The weakness of income taxation presents further evidence of the relative inability of the tax system to effectively capture elite incomes. Since 2002 income tax collection has stagnated at slightly above 3% of GDP, which, like tax collection in general, is somewhat low by regional standards. In policy discussions much is made of the narrowness of the tax base, with only slightly more than 300 large firms, which are assessed by the Large Taxpayers’ Office, reportedly accounting for over 80% of collection. While this focuses attention on tax evasion by small firms, it can also be a strategy for distracting attention from the fact that while some large firms pay significant taxes, many pay far less than they should. Indeed, data from the NRA indicates that taxes on sole-proprietor businesses and the self-employed amounted to 29% of total corporate tax collection, which is an extremely high proportion by regional standards, and further emphasises the weakness of collection among many large firms.

At the level of large firms, the basic problem facing income tax collection is that the tax administration has limited audit capacity, while large companies are able to employ sophisticated accounting practices in order to obscure tax liabilities. Interviews with NRA officials make clear that while they may be very confident that firms are under-declaring profits and salaries, they lack the capacity to *prove* that this is the case. While this problem has technical roots, it is clear that it is also political, as the ability of the tax administration to pursue suspected tax evasion depends on them having the political support necessary to compel cooperation by offending firms. It is apparent that in many cases such support is not forthcoming, further undermining the ability of officials to undertake effective audits. While aggregate data is only indicative, it is notable that withholding taxes account for almost 40% of total corporate tax collection, suggesting a striking inability to monitor the independent economic activities of large firms.<sup>7</sup>

One provision of the corporate tax system in Sierra

<sup>7</sup> Withholding taxes are withheld by government ministries, departments and agencies, as well as certain non-governmental entities, at a rate of 5% of value of contracts.

Leone is that tax returns are to be verified and certified by professional accounting companies. In the absence of significant audit capacity within the NRA, the goal has been to rely on the professionalism of external auditors to ensure tax compliance. However, in a context where there are real concerns that the declared salary payments and incomes of many large firms are under-stated, there is a suspicion that these accounting firms, many of them with international ties, certify highly questionable accounts which could make them complicit in the tax evasion.

### **Local and central government taxation**

Finally, as in most low-income countries, large firms and wealthy individuals are primarily affected by central government taxes (income tax, the GST, customs duties), while lower-income taxpayers are most affected by local government taxes (local tax, market dues, business licences, etc). As such, it is at least somewhat telling that since 2007 the government has made a strong commitment to strengthening local tax collection (discussed in Chapter 5), while a similar commitment has not been apparent at the central government level. The overall impact is to shift a greater share of the tax burden to the middle and lower classes, while the stagnation of central government revenue suggests that formal and informal exemptions for elites appear to have been largely unaffected. Of course, the government now has the opportunity to capitalise on recent policy and administrative reforms in order to curb leakages at the central government level, but recent trends are not encouraging.

### **The importance of public engagement**

Historically popular engagement with tax issues has been largely limited to resisting taxation by governments that are perceived to be unaccountable and unresponsive. The analysis here suggests that there are powerful reasons for citizens and civil society to engage more actively with tax issues, generating political pressure for tax systems that are fair, transparent and inclusive.

Despite progress since the end of the civil war, the tax system continues to suffer from low tax compliance. Tax evasion is frequently associated with non-compliance by small taxpayers, reflecting the inherent difficulty of taxing small producers, limited administrative capacity and a weak culture of tax compliance. Yet the most important problem facing the tax system is not evasion by small taxpayers, but uneven enforce-

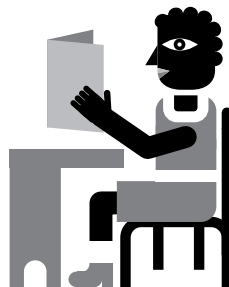
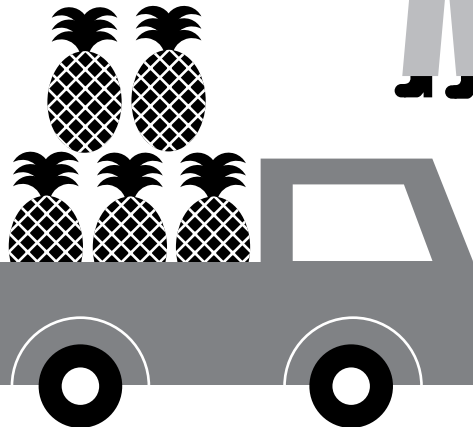
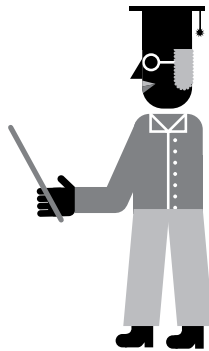
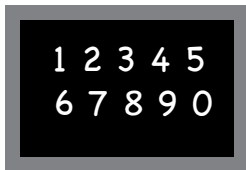
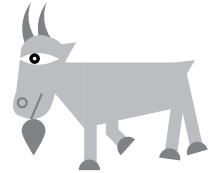
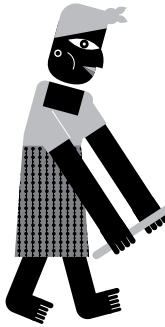
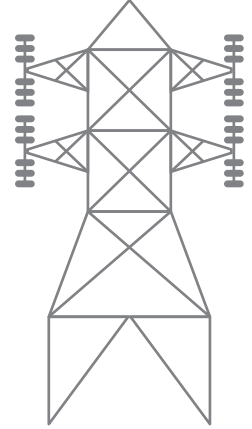
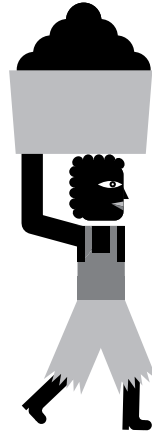
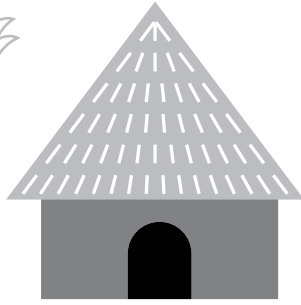
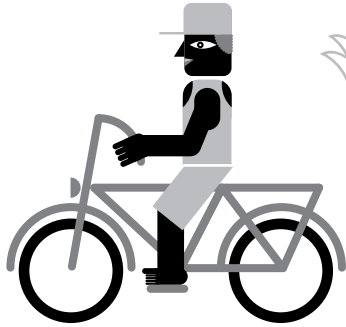
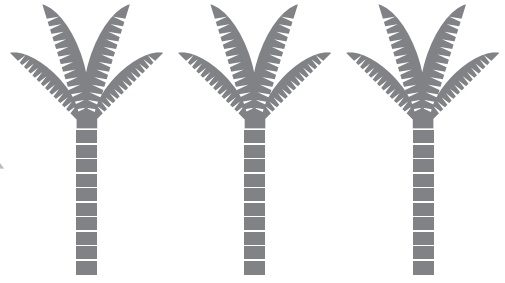
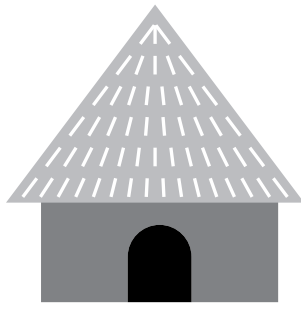
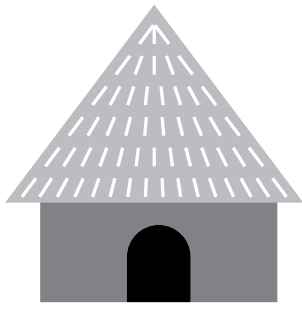
ment among medium and large taxpayers, as some large taxpayers bear a very heavy tax burden, while others do not pay even close to their fair share. In these cases the greatest barrier to more equitable enforcement is political, and the result is that benefits continue to flow to an already comparatively prosperous elite. This undermines the rule of law and the ability of government to provide public services and private sector competition and growth. Equally, the corruption and politicisation of tax administration can become a vicious cycle, as those with the power to push for reform are the very people who benefit from the continuing ineffectiveness of enforcement. Given that those who benefit from the current system represent strong vested interests working to undermine reform, progress demands genuine and broad-based public demands for progress in curbing corruption, exemptions and unpunished evasion. This issue is taken up in the Recommendations in Chapter 7 of this report.

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**The most important problem facing the tax system is not evasion by small taxpayers, but uneven enforcement among medium and large taxpayers, as some large taxpayers bear a very heavy tax burden, while others do not pay even close to their fair share**

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# Local government taxation

While the government has been working to rehabilitate central government tax collection since the end of the civil war, even more dramatic reforms have been undertaken at the local government level

On the surface, local government taxation appears comparatively unimportant, as total local government revenue collection (including fees and licences classified as non-tax revenue) amounted to only 0.14% of GDP in 2008, or less than 1.5% of total government revenue. Even amidst reports of sharp increases in revenue collection in 2009-10 (local government revenue data has yet to be verified, consolidated and publicly released), it is unlikely that local government collection has amounted to more than 3% of total government revenue. This largely reflects the fact that the taxation of large firms and formal sector employees is reserved for the central government, while the local government tax base is comparatively small.

However, the importance of local government taxation to long-term development is likely to be much greater than these modest revenue levels suggest, for three reasons:

- First, local government taxes have a much wider reach than central government taxes, as every adult and every small business in the country is liable for local government taxes. This implies that local government tax enforcement has particularly **direct implications for the welfare of low-income individuals**. Perhaps more importantly, it has the potential to be a **rallying point for more active political engagement by the majority of citizens** and for the construction of a more meaningful ‘social contract’ between citizens and government.
- Second, the rehabilitation of local government has been a major priority for successive governments since the end of the civil war, but **decentralisation cannot succeed in the absence of a local tax system that generates revenue in a way that enjoys a degree of popular legitimacy** (Jackson 2005; Robinson 2008).
- Third, despite the relatively low share of tax revenue collected by local governments, many citizens look to local governments for essential local-level service provision. While some observers feel that citizen expectations can be excessive, given the limited revenue base, the fact remains that **citizens frequently assess government performance, and the strength of connections between revenue and expenditure, largely on the basis of local government activities**.

The discussion of local taxation here proceeds in several parts. The first presents a brief history of decentralisation and local government in Sierra Leone, as that history is essential to understanding recent reforms and challenges. The second lays out the key components of the Local Government Act 2004, which provides the legal context

for local government taxation. The third looks in detail at district council and chiefdom-level taxation since 2004, while the fourth looks at city council taxation, with a focus on important recent developments.

## The history and politics of decentralisation

As was noted earlier, for much of the colonial period Sierra Leone existed as two separate entities: a British colony in Freetown and a British protectorate elsewhere. The protectorate was ruled ‘indirectly’ through chiefs who were ostensibly traditional authorities, but were in practice overseen, and sometimes deposed and replaced, by the British. This process of outside intervention contributed to increasingly coercive practices in the chiefdoms, as well as setting a precedent for central government interference in local-level politics (Reno 1995; Mamdani 1996).

By the time of independence, the colony and protectorate had been merged, and a two-tier system of government put in place. Below the central government, based in Freetown, local government was organised into elected local councils, which, in turn, oversaw the activities of chiefdom councils, which were not recognised as a formal level of government but retained effective power at the local level. For rural councils the primary source of local government revenue was the local tax, which was a tax on all adult males, while city councils were also able to rely on a variety of other taxes on commerce and property. Despite the official jurisdiction of the local councils, the chiefs remained responsible for collecting the local tax and were expected to provide a share of the tax (a ‘precept’) to the local councils.

In practice this system of local government was highly ineffective, and the quality of governance rapidly deteriorated, with local government abolished entirely in 1972. In broad strokes, the failure of local government in the period following independence reflected several important factors, among which three are particularly relevant to this study:

- First, **there were immediate tensions between the local councils and the chiefdoms, as both vied for control of local governance.**
- Second, **local government was simply too weak to play an effective developmental role**, as it lacked substantial revenue as well as necessary capacity.
- Third, and perhaps most importantly, **both the chiefdom councils and local councils became entangled with central government politics, as powerful politicians sought to intervene in local government affairs in order to gain national power.** This tended to undermine the legitimacy, responsiveness and accountability of local government, thus leading to growing tensions between local authorities and citizens (Fanthorpe and Sesay 2009).

With the abolition of formal structures of local government in 1972, formal power became ever more centralised, while de facto local power returned to the increasingly politicised chiefdoms. The centralisation of power meant that the already poorly served rural population was even further deprived of basic economic opportunities, public services and political participation. Meanwhile, local power exercised at the chiefdom level became increasingly politicised and unaccountable, resulting in growing conflict between chieftaincy institutions and local populations, particularly among youths. As a result, the collapse of local government,

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**With the abolition of formal structures of local government in 1972, formal power became ever more centralised, while de facto local power returned to the increasingly politicised chiefdoms**

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increasing centralisation and the politicisation of chieftaincy are widely cited as important causes of the civil war that began in 1991 (Jackson 2005; Fanthorpe 2006; Sawyer 2008).

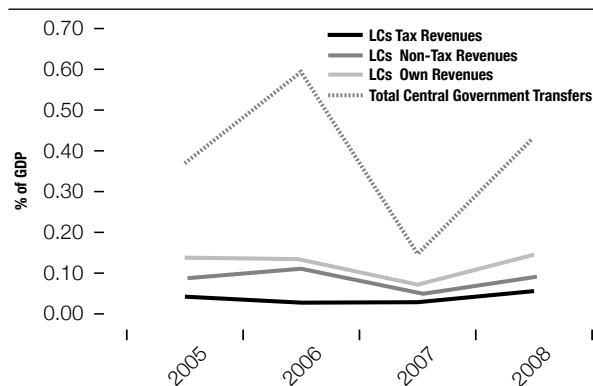
## Fiscal decentralisation since 2004

Given that over-centralisation had been widely cited as a cause of the civil war, launching an ambitious decentralisation process was an immediate priority for government and donors alike after successful elections in 2002. With the high-profile support of donors including the World Bank, the International Monetary Fund (IMF), the European Union (EU), the Department for International Development (DFID) and the African Development bank (ADB), the government enacted the Local Government Act (LGA) in April 2004, which laid out the legal framework for local government and fiscal decentralisation (Robinson 2008).

To a significant degree the LGA recreated the system of local government that had existed prior to 1972. The new Act organised local government around 19 elected local councils, comprising five city councils, Bonthe municipality and 13 district councils. Below the local councils lie 149 chiefdoms, governed by chiefdom councils, which are not recognised as a formal level of local government but exercise significant local power in practice. In the realm of fiscal management, councils control a wide array of small taxes, licences and fees, though large taxpayers are reserved for the central government. The overall revenue base is correspondingly limited and the Act calls for transfers from the central government in order to meet the remaining costs of service provision. These central transfers comprise the bulk of local government revenue, particularly in district councils, though transfers have been highly unstable owing to political conflict and a lack of legislative clarity. This is exemplified by a sharp fall in transfers in 2007, which appears to have been driven by overspending at the central government level in advance of national elections (Table 9). At the national level, the Ministry of Local Government is generally charged with overseeing local government operations, though the oversight of

local government fiscal operations is largely managed by the Local Government Finance Department of the Ministry of Finance (Fanthorpe 2004).

**Table 9: Local government revenue and central government transfers 2005–2008**



### ernment transfers 2005–2008

Source: Government of Sierra Leone authorities.

While there was widespread agreement prior to 2004 about the need for decentralisation, the specific details of these efforts have been the subject of significant debate, which cannot be summarised in the limited space available here. From the perspective of this study it is useful simply to highlight two broad issues:

- First, there are obviously major challenges involved in building local governing capacity after three decades of formally centralised rule.
- Second, **the new system has involved the insertion of a new level of government between the central government and the chiefdoms, and this has inevitably resulted in both confusion and political conflict.** Decentralisation has put local councils in conflict with chiefdoms eager to defend their existing authority. Equally, the major political parties have continued to meddle in local government affairs, seeking in particular to win the support of chiefs in order to mobilise electoral support. These internal conflicts have, predictably, emerged as a barrier to more effective progress (Fanthorpe and Sesay 2009).

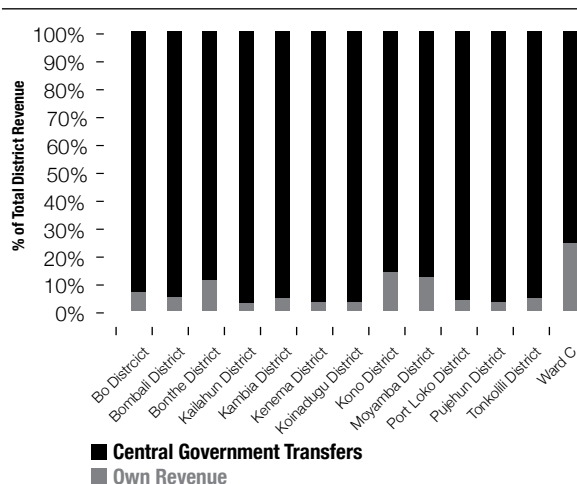


## District council and chiefdom taxation

District councils have access to several types of tax and non-tax revenue: local tax, property tax, market dues, business registration, licences, fees and charges. Some district councils also benefit from significant revenue from mining activities: mining companies are required to pay surface rent for those lands being used for mining purposes, while 0.75% of the export value of minerals is earmarked for community development funds. The collection of taxes is carried out in partnership with the chiefdom councils within each district, with chiefdoms retaining the right to collect the local tax and market dues within their jurisdictions and then remitting a share of those taxes to the district councils. Of the revenues thus collected, the chiefdoms are expected to remit 40% of local tax receipts and 20% of market dues to the district councils, though this system is at present subject to extremely weak oversight (Fanthorpe 2004; World Bank 2008).

**While the law thus provides a relatively clear framework for local tax collection, in practice experience since 2004 has been disappointing,** with central government grants amounting to 85% of total local council revenue in 2006, 86% in 2007 and 93% in 2008 (Table 10). The heavy reliance of district councils on central government grants is not entirely unexpected, as low incomes within the districts impose severe limits on the revenue that can reasonably be collected. Yet, revenue collection remains strikingly low even after taking this caveat into consideration. In 2008 total revenue collected by district councils amounted to Le 1,616 million, of which roughly one-third was from mining rent, leaving non-mining revenue collection of Le 1,081 million, or only Le 2,850 per household. Of this non-mining revenue, about 30% (Le 330.5 million) came from local tax, 18% from assorted fees and charges, 15% from business registration and licences, 7% from market dues and 30% from unidentified other sources. The fact that such a large share of revenue is categorised as coming from ‘unidentified sources’ is indicative of the weakness of existing monitoring and administration.

**Table 10: Own revenue collection as a share of total revenue, by district, 2008**



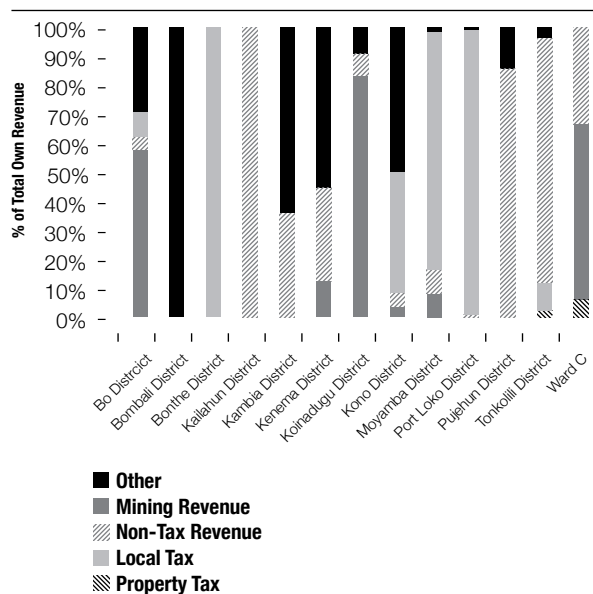
Source: Local Government Finance Department.

As striking as these low levels of revenue collection are, there are dramatic differences between districts in terms of both revenue performance and the composition of revenue. Table 11 presents data on the composition of own revenue collection for each of the 13 district councils, and the variation is dramatic. Four districts (Bonthe, Kono, Moyamba and Port Loko) collected a large share of revenue from mining. However, Bonthe and Port Loko were also the two weakest collectors of other taxes, as mining revenue had apparently removed incentives for local tax collection. Perhaps most surprisingly, the local tax played a dominant role in the revenue of three districts (Bo, Koinadugu and Ward C) but was low or non-existent in the other districts despite the fact that it is expected to be the primary source of revenue for district councils.<sup>8</sup> Finally, the importance of the ‘other’ category in many of the districts would seem to speak to the overall informality of tax collection and the weakness of bookkeeping practices. This informality and weakness is also apparent in the two further trends: major fluctuations from year to year in both the aggregate composition of revenue and total levels of collection.

<sup>8</sup> This may possibly reflect a decision, mentioned in Fanthorpe and Sesay (2009), to retain local tax receipts in order to pay the overdue salaries of chiefdom officials, though this would do nothing to change the more general conclusion that tax collection is both highly variable and poorly regulated.



**Table 11: Different components of own revenue collection, by district, 2008**



Source: Local Government Finance Department.

### Local tax and the political economy of district council revenue

Given that the local tax is the most important source of district council revenue, it is a useful entry point for further analysis. According to the law, a local tax of Le 5,000 is to be paid by every male and female adult in the chiefdoms, of which 40% should be sent to the district councils.<sup>9</sup> Record-keeping is rudimentary, and relies heavily on a system of receipt books: every taxpayer is to be given an official receipt for their tax payments, while the Ministry of Local Government monitors the total number of receipt books acquired by each chiefdom council. In addition to these receipts, the Treasury Clerks in each chiefdom maintain generally handwritten registers of taxpayers, though the accuracy of these lists is open to question and records are frequently lost (Fanthorpe 2004).

Given the consequent absence of detailed and readily available records, it is impossible to precisely estimate the effectiveness of local tax collection. However, it is possible to arrive at a very rough estimate of collection performance by comparing

<sup>9</sup> At the time of finalising this report there is some ongoing discussion about reducing the precept to the district councils to 20% of local tax collection, though no change has been made.

the actual level of local tax revenue reported by the district councils with the level of collection predicted by the population level. Based on the 2004 census, the total adult population of the districts is roughly 2 million, while the district councils should receive Le 2,000 from each taxpayer (40% of Le 5,000).<sup>10</sup> This provides an estimated potential revenue of Le 4,000 million, which is more than *ten times* the Le 330.5 million that was actually captured by district council accounts in 2008.

This strikingly poor collection performance is particularly surprising given that virtually all of those interviewed for this study emphasised relatively high levels of collection at the chiefdom level. The chiefs and sub-chiefs responsible for collecting local tax generally know all of the members of their chiefdom areas, while some of those interviewed suggested that many local people carefully retain local tax receipts as evidence of compliance and their contribution to the community. How then to explain the enormous revenue shortfall, and the apparent contradiction between individual experiences of the local tax and official figures?

Unfortunately, there is very little data or prior research to draw on, and conclusions are thus necessarily speculative, while much more research is needed.<sup>11</sup> That said, four issues would seem to contribute to an explanation.

#### Tax resistance and limited technical capacity

The simplest explanation is simply that there is much more resistance to the local tax at the chiefdom level than is assumed by those officials interviewed for this study. There is a sizeable literature documenting a degree of popular unhappiness with many chiefs in the country, and it would be unsurprising if this resulted in efforts at tax evasion. This possibility is reinforced by evidence of the very limited tax collection capacity of chiefdom officials.

<sup>10</sup> In 2004 the total population of the 13 districts was 3,753,034, which extrapolates to approximately 4,000,000 by 2008. Meanwhile the share of the population over 19 years old was about 47%, meaning that, using a cut-off age of 18 years, roughly 50% of the population are adults.

<sup>11</sup> The Local Government Finance Department has made important strides, having completed a 2008 study of chiefdom finance with the support of the World Bank, while also producing detailed reports on local financial performance every two years. The only other research of which I am aware is a 2004 DFID-commissioned study of a handful of chiefdoms by Richard Fanthorpe (2004).

Within most chiefdoms the Treasury Clerk oversees tax collection, while it is carried out by either section/village chiefs or the chiefdom police. All of the Treasury Clerks within a given district are meant to be supervised and supported by Central Chiefdom Finance Clerks (CCFCs), who are responsible to the Ministry of Local Government. In practice, it appears that the Treasury Clerks often lack the capacity to oversee tax collection effectively at the chiefdom level, while they receive limited support from the CCFCs or the Ministry of Local Government. In a 2004 study Fanthorpe highlights the example of the Treasury Clerk in Biriwa chiefdom, who lacked even the resources needed to travel to the different villages within the chiefdom in order to supervise collections. Given such limited collection capacity, it is certainly plausible that there is, in fact, significant tax evasion at the chiefdom level, but much more evidence is clearly needed.

#### **Lack of transparency and effective record-keeping**

An alternative possibility is that tax collection is, in fact, quite effective at the chiefdom level, but that much of the revenue does not end up in official government accounts. In the most detailed study of chiefdom finances to date (World Bank 2008: 19), the authors wrote that, ‘There are very poor bookkeeping practices across the chiefdoms. Detailed examination of the books of Treasury Clerks in all the chiefdoms visited showed that up to date accounts were not being maintained. There were also discrepancies between bank statements for chiefdoms that produced copies, and book keeping records that were not rectified; there is also no regular timeframe for requesting for bank statements. Poor cash management was an outstanding feature with the signatories to the accounts having no idea of the bank charges and amounts held with the banks.’ They continued by noting that, ‘There were no traces of yearly budgets prepared by the chiefdoms’, despite a clear legal expectation that such budgets should be prepared in cooperation with the district councils.

The clearest evidence of the weakness of record-keeping and transparency is the simple fact that the Local Government Finance Department still does not have regular data on revenue collection and public expenditure at the chiefdom level. Interviews with officials leave little doubt that the lack of transparent record-keeping both reflects and facilitates the diversion of much of the revenue collected at the chiefdom level into informal

channels. This is echoed by the 2008 report, which found that many paramount chiefs complained of largely unpunished corruption by Treasury Clerks, while chiefdom staff complained that salaries were rarely paid despite the collection of adequate revenue from taxpayers. Fanthorpe and Sesay (2009) similarly suggest that much of the tax collected is diverted into informal funds for hosting visiting dignitaries. Whatever the specifics, there is thus a strong sense that while taxes are collected, the lack of transparency allows revenue to be used for non-official purposes or simply stolen.

#### **Conflict between section and paramount chiefs**

Because revenue collection at the chiefdom level is mediated through section and village chiefs, as opposed to relying on strict bureaucratic procedures, there appears to be significant scope for conflict between different levels of chiefdom authority. Thus, there are reports of section chiefs unwilling to collect or remit tax revenue to paramount chiefs with whom they are in conflict. At the same time, a share of local tax revenue is meant to be returned from the chiefdom treasury to section chiefs, but there are complaints that these rebates are often not provided. In the absence of more robust accounting and transparency, it is difficult to assess the validity of these complaints, let alone address them. What seems certain is that such conflicts further undermine the predictability of chiefdom finances, and thus the likelihood of accountability to taxpayers.

#### **Ongoing conflict between chiefdoms and district councils**

Finally, the most compelling explanation for apparently poor revenue performance lies in a deep conflict between the district councils and chiefdoms. This conflict not only explains the low level of revenue at the district council level, but also presents a significant barrier to reform.

This conflict stems from the simple fact that district councils and chiefdoms are competing over a limited revenue envelope and over broader governing power at the local level. Chiefdom officials have powerful incentives to disguise revenue collected at the local level in order to avoid remitting 40% of that revenue to the district councils. This not only reduces district council revenue, but also acts as a major barrier to reforming the institutions for revenue collection, as chiefdoms and tax collectors have incentives to ensure that record-keeping

and transparency remain limited.

It is very likely that levels of local tax collection at the chiefdom level are far higher than those reported in official statistics, and complaints to that effect are common among district councils. While this to some extent reflects the simple pursuit of narrow self-interest by the chiefdoms, existing evidence suggests that it also results from the fact that revenue given to the district councils is rarely returned to the chiefdoms in the form of public services. Just as taxpayers are likely to resist taxation when they receive little in return, so too are chiefdoms likely to resist remitting tax revenue to unresponsive district councils.

While this dynamic is most acute in the case of local tax revenue, it is likely to affect the ability of district councils to collect other taxes as well. A compelling example is detailed in an anecdote from Moyamba district, recounted in the 2008 annual report published by the Local Government Finance Department:

‘To effectively and efficiently administer the collection of business licenses in all of its chiefdoms, the council in early 2008 decided to contract the Treasury Clerks to collect licenses in all chiefdoms for a fee. Collection of this source was seriously hampered by the contractors themselves as the council realized that they owe more allegiance to their chiefdoms instead of the council to the extent that chiefdom receipts were issued for licenses instead of the local council receipt...[upon realizing that this was the case] the council quickly reacted and decided to collect all the receipts issued by the chiefdoms from the business owners and or occupiers. The council is however awaiting the chiefdoms to refund all license monies collected by the chiefdom’ (Local Government Finance Department 2008: 56)

This example not only points to the difficulties in raising revenue, but also highlights the fact that competing loyalties further complicate the context for revenue collection.

Just as tax collection officials may seek to favour one level of government over another, central government officials may favour either the district councils or the chiefdoms in pursuit of personal benefits or political influence. During the course of this research, officials repeatedly complained that the Ministry of Local Government sends

receipt books for the local tax directly to the chiefdoms, bypassing the district councils and thus preventing them from ascertaining how much revenue is being collected. This is explained by the fact that the major political parties have an interest in currying favour with chiefs (even at the cost of undermining decentralisation reform), as chiefs can mobilise electoral support for national political parties. Even if such problems are not universally the case, these examples speak clearly to the extent to which rivalry between different levels of government has given rise to behaviours that reduce the quality of revenue collection, as well as the transparency surrounding that process (Fanthorpe and Sesay 2009).

### **Representation, accountability and district council taxation**

Simply increasing revenue collection will not carry development benefits unless it is linked to improvements in the performance of local government in providing valued public services. Thus, reforms that increase revenue extraction but do not improve the ability of citizens to hold their governments accountable are more likely to be cause for concern than celebration. While impossible to verify, there is anecdotal evidence that the police are increasingly being deployed to enforce tax compliance in the districts. While this may generate increased revenue, these measures are just as likely to lead to exploitation as to developmental gains unless accompanied by broader reforms. The challenge for civil society is not to push for greater collection as such, but to push for reforms that increase the transparency of local revenue collection and budgeting. Such measures, if successful, are likely to significantly increase the funds available for development projects without greatly expanding the burden on citizens.

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**The challenge for civil society is not to push for greater collection as such, but to push for reforms that increase the transparency of local revenue collection and budgeting**

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It is clear to all stakeholders that the existing system of taxation lacks even basic elements of transparency. There is no reliable data available related to numbers of taxpayers, amounts of revenue collected or how that revenue is used. Taxpayers have very little understanding of how tax revenue is used, aside from a relatively universal sentiment that little of, if any, revenue is returned to communities in the form of public services. In this context there is palpable unhappiness among citizens, but little basis upon which they can demand improved performance from local government. Therefore, efforts to provide credible and publicly accessible data on revenue collection, alongside basic annual budgets, offers a natural entry point for encouraging public engagement at both the chiefdom and district council levels.

While the absence of such transparency is often attributed to a lack of technical capacity, the discussion so far has made clear that this is an insufficient explanation. The system of providing receipts for tax payments, coupled with at least moderately accurate census data, provides a reasonable basis for approximating expected local revenue collection. That this is not currently the case is a largely political issue, reflecting the fact that limited transparency (a) favours chiefdoms in their efforts to combat the revenue demands of district councils, (b) facilitates corruption among chiefdom and district council officials and (c) is sometimes encouraged by external officials with their own interests. Greater transparency around revenue collection would likewise facilitate efforts to link revenue collection to specific and visible development projects. This holds the potential not only to allow citizens to monitor the use of tax revenues, but also to gradually strengthen the legitimacy of local government, which has been a central motivation for decentralisation.

In addition to these general issues, Sierra Leonean law provides a more direct link between chiefdom taxation and chiefdom elections. While there are growing calls for chiefdom elections to be made fully democratic (for example Fanthorpe and Sesay 2009), under the current system chiefs are elected by chiefdom councils, which are, in turn, meant to be composed of one representative for every 20 taxpayers. Under this system, accurate, and publicly available, records about tax collection directly shape the electoral prospects of competing candidates. Consequently, the manipulation of taxpayer

information offers a potential means to shape outcomes. While it is unclear to what extent such intentional manipulation of tax information has been a regular feature of chieftaincy elections, Fanthorpe (2004) provides evidence of significant divergence between numbers of taxpayers and numbers of chiefdom councillors in several chiefdoms, and attributes this in part to political manipulation. Interviews meanwhile provide significant anecdotal evidence that in at least some chieftaincies the sale of entire tax receipt books to wealthy community members has been used as a strategy for inflating the electoral representation of certain groups. Equally, Fanthorpe and Sesay (2009) argue that because of the lack of transparency around tax collection, rather than groups of taxpayers selecting their own council representatives, sitting chiefs have been able to control the selection of chiefdom councillors to represent taxpayers. All of these issues make clear that greater transparency around tax collection at the local level would provide an immediate means to improve the legitimacy, credibility and inclusiveness of chieftaincy elections.

## City council taxation: Developments and issues

When the Local Government Act was passed in 2004, the city councils found themselves in a position similar to the district councils. They had little existing governing capacity and faced the risk that external political interests would politicise their activities. On the other hand, the economic base available to the city councils is much larger than that which exists in the district councils, offering correspondingly greater potential for tax collection. Consistent with those initial conditions, revenue collection in the city councils has remained far below what is possible, but has nonetheless been roughly ten times higher on a per household basis than in the district councils. More importantly, whereas the conflict between district and chiefdom councils has undermined the potential for reform in rural areas, at least some of the city councils have achieved tremendous gains in revenue collection since 2008 as they have increased both revenue collection and, in some cases, transparency. The remainder of this section proceeds in three parts: the

first introduces the most important city council taxes, the second explores the dramatic revenue gains over the past three years, and the third contrasts two alternative approaches to improving revenue performance.

### Major city council tax types

Whereas weak economic conditions force district councils to rely heavily on the local tax as well as various small taxes, charges and fees, the city councils are able to rely heavily on property taxes and taxes on small businesses for their revenue. Therefore, it is useful to describe these two categories of taxes in slightly greater detail.

### Licences, market dues and informal sector taxation

Much has been written about the importance of the informal sector to the economies of low-income countries. Though it is impossible to know the size of the informal economy with any certainty, Schneider and Klinglmaier (2004) have estimated the size of the ‘shadow economy’, which captures a diverse array of activities that lie beyond the regulation of the state, at 43.9% of GDP.

The discussion here is focused specifically on the activities of small firms that fall below the threshold for standard income taxes or the GST, which is currently set at an annual turnover of Le 200 million (US\$50,000). These firms pose a particular challenge for tax administrators, as they generally do not keep detailed accounts upon which to base tax liabilities, while they also frequently change locations. The standard approach to addressing this problem is to adopt some form of presumptive tax regime, which levies a tax based on the *estimated* turnover of small firms, which is, in turn, based on observable characteristics of the firm (that is, size, class of business).

At present in Sierra Leone *both* the central government (standard assessment) and the local councils (business registration, licences and market dues) levy some form of presumptive tax on small businesses. Both standard assessment by the NRA and business licences levied at the council level are based on collecting a fixed tax based on the type of business being operated, though little detailed information is available about the administration of business licences at the council level. In addition to these taxes, the city councils (and to a lesser

extent district councils) levy market dues, which are fees paid regularly by those operating in organised markets.

Recent years have seen growing attention to the technical question of how best to design presumptive tax regimes for small businesses in order to maximise revenue collection (Alm, Martinez-Vazquez and Wallace 2004). While these technical questions are important, there is a growing recognition that improving the effectiveness of small businesses taxation regimes is likely to require building a more cooperative relationship with taxpayers by providing positive incentives for formalisation (taxpaying). This argues for three general measures, the details of which are likely to be context specific:

- **Improving cooperation between central and local government tax officials:** At present small businesses are subject to multiple, overlapping, taxes levied by the central and local governments, while there is little or no cooperation between the two levels of administration. This has led to complaints about ‘double taxation’ and has fed public unhappiness with the regime, as well as perceptions that it is arbitrary and exploitative.
- **Increasing the fairness, transparency and credibility of tax assessments:** The basic challenge involved in taxing small and medium enterprises is revealed in a 2006 survey that asked whether small firms were satisfied with their tax assessments. The survey found that 58% of firms are unhappy, 32% have no understanding of how assessment is carried out and only 10% are satisfied (Ministry of Finance 2006: xii). Assessments inevitably involve a degree of subjectivity, and will thus be subject to disagreements, but the situation can clearly be improved by applying clear rules in a transparent manner. While appropriate solutions will be context specific, experience elsewhere in sub-Saharan Africa has often centred either on (a) including citizen and business association representatives on assessment committees or (b) working directly with business associations to assess and collect taxes.
- **Working with small businesses to provide information and positive incentives for formalisation:** Finally, a growing body of recent research (much of it conducted by donor agencies, and



thus unpublished) finds that a large share of small businesses would willingly comply with business registration, licensing and tax rules if (a) they had a clearer understanding of how to do so, (b) the costs of doing so were reduced and (c) there were tangible, even if modest, benefits in return (simple protection from harassment by tax collectors and police has frequently been important elsewhere). In the survey noted above, 52% indicated that they would like to formalise, largely owing to a desire to access possible benefits for doing so (xii). A later question asking what factors would encourage formalisation found that 35% favoured simplification of registration procedures, 26% favoured reduction in taxes, 18% favoured provision of microcredit opportunities, and 18% pushed for greater access to information about opportunities and taxes in the formal sector (xii). In a separate survey carried out by the World Bank and DFID, 76% of informal businesses reported little or no understanding of tax and business registration regulations (Everest-Phillips 2008). This survey evidence suggests the value of more robust dialogue between civil society, led by associations representing small businesses, and city councils.

### Property taxation

Property taxes have long been hailed throughout the developing world as an ideal solution to the problem of local government finance. Property taxes are a highly progressive tax on wealth and do not distort economic incentives, while they are, in principle, difficult to evade due to the immobility of property. In practice, the collection of property taxes has historically been disappointing, though recent years have seen dramatic improvements in performance in some localities.

In Sierra Leone, as in most countries, property taxation is based on annual payment of a percentage of the annual assessed value of a property. The LGA dictates that the specific tax rate is chosen by the city council and should be uniform for all properties within a given property class, though councils are free to divide properties into multiple classes (for example residential or commercial). In practice, the collection of property taxes can be thought of as comprising three stages: identification, valuation and collection.

First, city councils must identify and create a database of all taxable properties, which should be assigned numbered street addresses wherever possible.

Second, the city councils must employ a staff of valuation officers who are trained in assessing the value of individual properties. This process of valuation tends to be highly contentious, as it inevitably involves significant discretion on the part of valuation officers as a result of the general absence of verifiable data on rental prices or sale prices of similar properties. It is the responsibility of city councils to ensure that valuation is viewed as fair and impartial by minimally taking two steps:

- **First, define clear criteria upon which valuation is based and make these criteria widely understood by the public.** Standard criteria include: (a) dimensions of the property, (b) type of building materials, (c) access to public facilities (roads, hospital, water, electricity), (d) comfort and (e) the class of building.
- **Second, ensure that valuation is transparent and that taxpayers have opportunities to appeal valuations perceived to be unfair.** The LGA dictates that valuation should involve three stages: (i) the preparation of a draft valuation list by the valuation officers, (ii) review of the list by the assessment committee and (iii) final approval by the council. This process is likely to be most successful when it is transparent, and when specific processes for appeal are put in place.

While these general guidelines for effective property valuation are relatively straightforward, evidence suggests that they are only partially observed in practice. In many cases, valuation criteria are only loosely adhered to, there is limited transparency in the process and there are poorly defined channels for appeal.

Finally, once valuations have been approved, the taxes need to be collected. While this is a relatively straightforward process in principle, in practice many within the tax administration view this as the greatest barrier to effective revenue mobilisation. This to some extent reflects poor record-keeping, but appears primarily to reflect the simple unwillingness of taxpayers to pay, and the inability, or unwillingness, of city councils to

enforce compliance. The inability of city councils to enforce tax collection is particularly striking in light of the fact that the tax rates remain very low. Officials in Bo, for example, estimate that property taxes on residential properties generally range from Le 30,000 to Le 300,000, which appears very modest compared to the likely incomes of property owners.

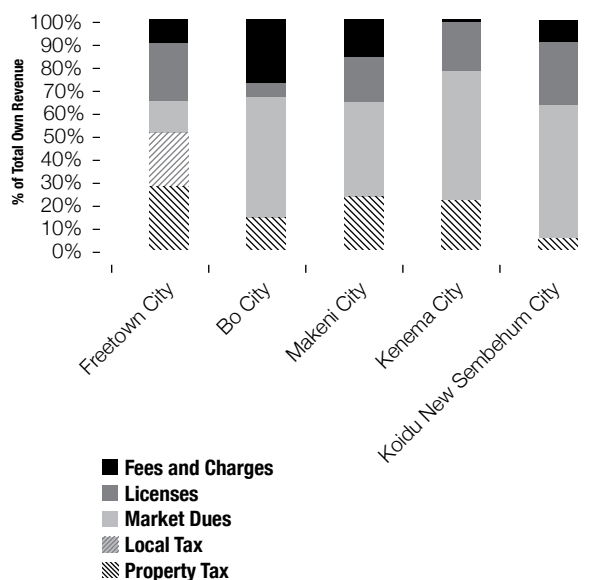
While there is tremendous potential for property tax collection to provide a major source of revenue for city councils, actual performance has historically been disappointing, with total collection in 2007 of about Le 890 million. This is consistent with experience elsewhere in sub-Saharan Africa, where property taxes have rarely emerged as an effective basis for financing local government. This has often been explained as a problem of technical capacity, given the challenges associated with developing property lists, establishing credible valuations and keeping valuations up to date. This argument is not without merit, as there is certainly a need for more and better trained valuation officers at many, if not all, of the city councils. However, the reality is that the primary obstacle to more effective property tax collection is political, rooted in the fact that it is the wealthy who would bear the greatest tax burden (Kelly 2000; Bird and Slack 2006). The use of simple valuation techniques to tax at least large and easily identifiable properties is undeniably within the capacity of any city council, but has not been consistently and effectively carried out. Arguably, the best evidence of the political nature of property tax collection is the fact that, with political support, collection has expanded dramatically in recent years, as discussed below.

### Revenue performance and recent reform

In 2008 total revenue collected by the five city councils (excluding Bonthe municipality, which received the vast majority of its revenue from mining) amounted to Le 6,664 million, of which Le 2,038 was collected by the four city councils excluding Freetown. Collection by the city councils amounted to Le 32,683 per household, which is more than ten times the level achieved by the district councils. Consistent with greater access to own revenue sources, the city councils were much less reliant on central government transfers, which averaged 52% of total revenue. As illustrated in Table 12, revenue for the five city councils came from five primary sources: market dues (25.21%), property tax (23.48%),

licences (22.77%), local tax (16.49%) and fees and charges (11.06%). When Freetown is excluded, the importance of market dues jumps to 50.3%, while local tax was not collected outside Freetown in 2008, though that has since changed in some city councils.

**Table 12: Composition of revenue, by city council, 2008**



Source: Local Government Finance Department.

What is more noteworthy is that 2008 marked the beginning of what appears to have been a dramatic increase in city council revenue collection. In 2008 revenue from property tax collection nearly doubled relative to the previous year, while Freetown increased collection of the local tax from near zero in previous years to over Le 1,000 million. This is three times the total collected by all of the district councils combined, and suggests a relatively high compliance rate of around 50%.<sup>12</sup>

While increases were thus apparent in 2008, interviews indicate much more dramatic increases in 2009 and in the first half of 2010, although complete data for those years is not available. By most accounts this surge in revenue collection has resulted primarily from dramatic improvements in property tax collection, along with the

<sup>12</sup> The population of Freetown in 2004 was 772,873. If we assume that slightly more than half of the population are adults (as the population in Freetown has fewer young children than other regions) then that would yield roughly 400,000 taxpayers and expected revenue of Le 2,000 million, or slightly less than double the amount that was actually collected.

first concerted efforts to collect the local tax in urban areas. While the massive increase in local tax collection in Freetown in 2008 is indicative of that trend, gains in the collection of property tax revenue are epitomised by the experience in Bo. Revenue from property tax collection was Le 84.95 million in 2008, while interviews with local officials indicate that that total had risen to approximately Le 250 million in 2009, while they anticipated revenues of more than Le 600 million in 2010. This represents a tremendous increase, even if the 2010 estimates prove to be overly optimistic.

The challenge for both researchers and civil society is to understand the causes of dramatic improvements in revenue collection across the city councils, and three factors seem to have played a role:

- **The emergence of strong political commitment at the highest levels of national government since 2007:** To some extent this reflects a natural shift from the urgent needs of post-conflict reconstruction to focusing on longer-term development priorities. It also appears to have been shaped to some extent by the reluctance of the previous government to press for greater local government tax collection prior to the 2007 elections. Interviews with local officials indicate that they feel that since 2007 they have been operating with the support of the national government, and this has clearly emboldened them in risking public unhappiness while expanding tax collection.
- **Improvements in administrative capacity within the city councils:** When the LGA was passed in 2004, administrative capacity at the city and district councils was very limited, and therefore gradual improvements in capacity are to be expected. At least equally important has been significant donor support to efforts to strengthen property tax collection in particular. This began with a VSO project in Makeni in 2008, but has accelerated since then with United Nations Development Programme (UNDP) and World Bank support for reform in Kenema and Bo in 2009 and in the other city councils beginning in 2010. This support has focused on developing cadastral surveys (identifying properties for taxation), training valuation officers and introducing a new IT system for managing city

council revenue. While the unavailability of official revenue data for 2009-10 makes it impossible to definitively evaluate the success of these programmes, all available interview evidence suggests that property tax revenue has consistently increased by 100% or more in targeted city councils. As noted above, the most striking example comes from Bo, where property tax revenue reportedly increased by 300% in 2009, and where provision is being made from a further doubling of revenue in 2010. This evidence, once confirmed by hard data, presents a strong case for such programmes, and the need to both ensure sustainability and extend benefits to the district councils.

- **Improved governance at the city council level:** While donor support for improved revenue performance has been provided to many of the city councils, performance has improved most dramatically in Bo. When asked to explain this success, observers universally point to the capability and commitment of the mayor, thus offering a valuable reminder that overcoming resistance to property taxation in particular is a political challenge, requiring committed leadership. Where that leadership exists, rapid progress is possible.

### **Alternative revenue strategies: Coercive and contractual taxation**

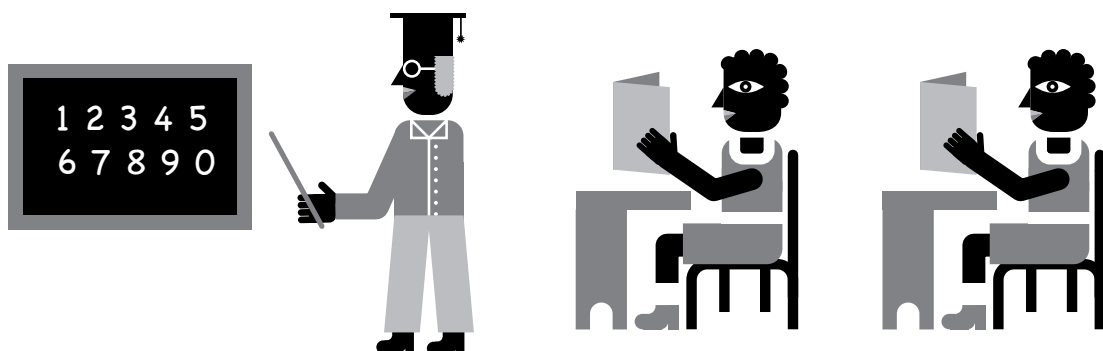
While the city councils thus appear to be achieving widespread revenue gains, they have differed markedly in the strategies that they have adopted in order to achieve those gains. These differing approaches lie along a spectrum ranging from coercive taxation at one extreme to contractual taxation at the other (Moore 2008: 37). While any effective tax collection strategy involves the threat of legal repercussions for non-compliance, *coercive taxation is characterised by the absence of clearly understood rules, arbitrary behaviour by tax collectors, the absence of taxpayer rights and a lack of basic transparency.* By contrast, *contractual taxation maintains a reliance on legal sanctions, but aims to encourage compliance by persuading citizens (a) that taxes are fairly enforced and (b) that they are receiving significant public benefits in return for their tax payments.*

These different approaches are captured in the experi-



ences of the Freetown and Bo city councils, both of which have achieved dramatic revenue gains since 2007. In Freetown, the most dramatic revenue gains have come through the relatively coercive enforcement of the broad-based, but regressive, local tax. In this vein, the presence of regular police roadblocks on the main road in front of the city council headquarters has become symbolic. The council has likewise gained a reputation for aggressively enforcing market dues and licences for informal sector businesses, shuttering the stalls of those who fail to pay. The city council argues that these measures have been necessary to begin to build a culture of tax compliance, and the large increases in revenue that have been achieved are, indeed, impressive. What is disappointing is that the city council has relied heavily on coercion, while not appearing to have taken simultaneous steps to actively encourage voluntary compliance. Most strikingly, recent calls from the media, civil society and business associations for the city council to widely publicise total revenue collection and the specific projects being funded using that revenue have remained unanswered. Moving forward, the challenge for the council lies in adding a stronger element of contractualism to tax collection efforts that have so far relied heavily on coercion.

This relatively coercive strategy stands in sharp contrast to the contractual approach pursued in Bo, where the city council has focused on strengthening property tax administration and encouraging voluntary compliance. Remarkable improvements in property tax collection have already been noted, and while this has reflected improvements in administrative capacity, and thus in coercive enforcement, it has also reflected success in building public support for improved tax collection. This effort to encourage comparatively contractual forms of taxation has focused on two elements: first, ensuring that tax enforcement follows clear and transparent rules and offers forums for taxpayers to raise objections where enforcement is considered unfair; and second, extensive efforts to inform citizens about the revenues raised and how specifically that revenue is being used by the council. Most notably, the city council holds a one-hour radio programme every Wednesday during which revenue and expenditure information for the week is publicised and citizens are invited to call in to raise questions and concerns. This transparency stands in contrast to the lack of public information about similar issues in Freetown, and has been essential to sustaining the public support necessary to achieve such large revenue gains.





# Minerals taxation

Alongside the taxes discussed so far, Sierra Leone has the potential to secure significant revenue from the large, and growing, minerals sector

Unfortunately, actual revenue collection from the minerals sector has been hugely disappointing, owing to a combination of overly generous, and ad hoc, mining agreements and limited administrative capacity. The inadequacy of revenue collection from the minerals sector has recently been the subject of two high-quality civil society reports, coordinated by the National Advocacy Coalition on Extractives (NACE), though much more attention remains both warranted and necessary if greater revenue is to be collected in the future (NACE 2009, 2010). Given these existing reports, this study seeks only to summarise key issues and relate them to broader debates about taxation.

## Overview of the minerals sector

The formal mining sector in Sierra Leone was decimated by the civil war, but has begun to recover rapidly since the end of the conflict. In 2007 mining production comprised 14.7% of GDP and 87% of exports by value and the extent of mining activity is expected to continue to expand rapidly over the next decade.<sup>13</sup> Diamonds are the primary export commodity, comprising 68.8% of official minerals exports in 2007,

while the actual trade in diamonds is estimated to be as much as double official figures, owing to a large informal trade (NACE 2009). Alongside diamonds, Sierra Leone also exports significant quantities of rutile and bauxite, while major investments in iron ore and gold are being initiated.

The diamond mining sector is divided into three sub-sectors: (i) large-scale industrial, (ii) mechanised small-scale and (iii) artisanal mining. The latter two sectors continue to dominate production, with small-scale and artisanal production providing 81% of official exports in 2006, and probably employing between 200,000 and 400,000 people (NACE 2009; Le Billon and Levin 2009). That said, the role of industrial mining is expected to continue to expand, as the government, with the support of donors, has sought to increasingly formalise the sector (Le Billon and Levin 2009). Koidu Holdings is the largest company engaged in industrial mining of kimberlite diamonds, having resumed operations in 2004. The primary firm engaged in rutile mining is Sierra Rutile, while Sierra Minerals is the primary miner of bauxite. Finally, African Minerals Limited and London Mining are actively involved in developing significant iron ore concessions, while Cluff Gold plc is hoping to dramatically expand gold production in the country over the next three years.

## Revenue performance

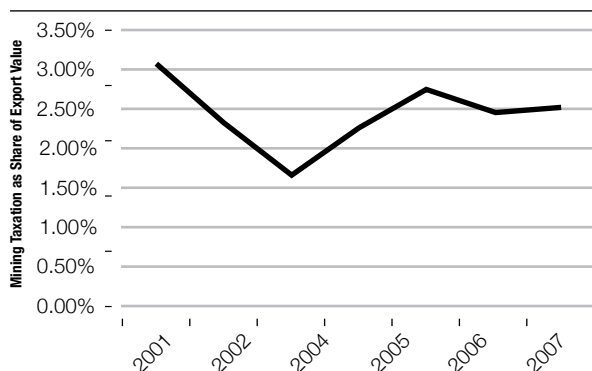
Mining has the potential to contribute to local economic development through multiple channels, including

<sup>13</sup> Calculation based on dividing the value of mineral exports by GDP and total exports, respectively, with data drawn from IMF documents. The recent NACE (2009) report suggests that minerals exports could reach as high as US\$1.2 billion by 2020, up from US\$244.9 million in 2007.

employment generation, infrastructure development and local community development projects. However, it is well accepted that the capital-intensive character of industrial mining means that developmental benefits are likely to be heavily reliant on the generation of significant government revenue for reinvestment in broad-based development programmes (World Bank 1992).

In practice, revenue generation from the mining sector in Sierra Leone has been consistently very disappointing. Because revenue is collected by multiple, poorly coordinated, departments and agencies, and the record-keeping system remains largely manual, the quality and reliability of available data is poor. Nonetheless, the overarching message is that revenue generation is far below regional norms. The Adam Smith Institute estimated total revenue from mining in 2006 at US\$10.45 million, which is equivalent to only 5.8% of the total value of minerals exports. More recently, the first report of the Extractive Industries Transparency Initiative (EITI) provided what are likely to be the most accurate figures available, estimating total mining revenue at US\$7.2 million in 2006 and US\$10.18 million in 2007, amounting to only 3.56% and 4.16% of the value of mineral exports respectively. Finally, while data from the National Revenue Authority probably underestimates revenue collection, owing to the omission of some revenue sources, it does provide an indication of the stability of these low-revenue yields over time (Table 13).

**Table 13: Mining tax revenue as a share of export value, based on NRA data**



**Source:** Revenue data from National Revenue Authority. Value of mineral exports from IMF Statistical Appendices.

What these figures make clear is that, even putting aside

the large informal trade in diamonds, revenue performance has been hugely disappointing. The government is collecting only at best 5% of the total value of mineral exports in tax revenue. The inadequacy of this level of revenue collection is made clear by a recent report that estimates that tax revenue as a share of export value lies between 10% and 15% in many comparable countries in East and West Africa. That report goes on to argue that the government should set a minimum of 10% as its own target (NACE 2009). This target is relatively conservative, but would imply major revenue gains for the government, with the likelihood of corresponding governance gains.

Equally distressing as low levels of revenue collection by the central government is the apparent disarray associated with the collection of mineral rents by local governments. In principle, local governments should receive three forms of revenue from mining firms: mining surface rent from small-scale miners; mining surface rent from large-scale miners; and contributions to the Community Development Fund, equal to 0.75% of the export value of minerals. These flows to local communities are hugely important in order to compensate communities for the immediate costs of mining activities, including the seizure of agricultural land and environmental degradation. However, while some local councils have received meaningful revenue from mining activities (see Chapter 5 on local government revenue), these revenue flows remain inadequate, are extremely poorly documented and are almost universally believed to result in significant corruption and lost revenue (NACE 2009).

## Explaining weak revenue generation

Given extensive attention elsewhere to the details of revenue collection in the minerals sector, it suffices here to highlight the most important factors contributing to weak revenue collection. As with taxation more broadly, weak revenue collection in the minerals sector can be attributed to two factors: (a) weak administrative capacity and alleged tax evasion by some mining firms, and (b) tax exemptions and patronage politics.

## Challenges in administration and enforcement

At a basic level, improving revenue generation from the minerals sector requires addressing the significant challenges faced by the NRA and other agencies in enforcing tax regulations. There are strong grounds to suspect that some minerals firms have employed questionable accounting practices in order to reduce their reported profits, and thus their tax burden. In broad terms, this mirrors the experience of corporate tax collection more generally, as the technical capacity of the accountants working for large firms frequently exceeds the audit capacity of the tax administration. While the use of dubious accounting practices is inherently difficult to prove, two points are particularly suggestive of such abuse.

Most telling is that, despite the rapid growth of mineral exports, as of 2008 **none of the major mining firms were reporting profits. It is suspected that in some cases, this was for tax purposes.** While it is possible, it seems implausible that none of the major firms were profitable. As an aid official quoted in an earlier report explained, ‘The companies wouldn’t be here unless they were making profits. But the government’s capacity to regulate them is very limited’ (quoted in NACE 2009: 7). The second point is that **many of the major mining firms in the country are registered overseas in known tax havens** (NACE 2009). These tax havens offer both low or zero tax rates and extensive secrecy provisions, which hinder efforts to scrutinise company financial operations. These tax havens give multinational firms incentives to manipulate their accounts in order to shift profits into these tax havens, and thus reduce their tax liabilities. The secrecy surrounding company operations makes it impossible to chart these efforts in detail.

Drawing on experience from other countries as well as on the insights of officials in Sierra Leone, it is possible to highlight several methods by which firms may artificially reduce their taxable profits. First, firms may manipulate the export price of minerals, reporting lower export prices within Sierra Leone in order to shift profits to low-tax jurisdictions. Second, firms may overvalue capital imports in order to claim large capital allowances and reduce tax liabilities. Third, firms may overstate local operating costs, which are difficult for government officials to verify.

While these possibilities are speculative, anecdotal evidence in Sierra Leone and elsewhere suggests that they warrant significant attention, as they not only reduce revenue but also violate state laws. Unfortunately, the combination of weak government enforcement capacity and the secrecy offered by offshore tax havens make counteracting this behaviour difficult.

The weakness of the audit capacity of government is strikingly reflected in claims by NRA staff that detailed audits of the financial accounts of the mining firms have never been undertaken, despite provisions in all of the mining agreements. Alongside being indicative of limited administrative capacity, this pattern most probably also reflects obstruction by mining companies and a lack of political commitment. This last issue is a reminder that ‘enforcement capacity’ can be both a technical and a political issue. In either case, in-depth audits of the accounts of the major mining firms should be an important goal moving forward.

## Tax exemptions and patronage politics

While largely technical issues have thus played an important role in undermining revenue collection in the minerals sector, the most important barrier to progress is political. Upon coming to office, the All People’s Congress government set up a task force to explore the weaknesses of revenue collection and broader regulation in the mining sector. The task force consisted of: two conveners from the Office of the President; the Minister of Mineral Resources (often represented by the Deputy Minister); the Minister of Finance and his representative, especially the NRA; the Attorney General and his representative; and representatives of civil society, the mineworkers union, chiefs and parliamentarians. The task force concluded that weak revenue performance was primarily the result of the highly problematic mining agreements. Existing mining agreements were all company-specific and, in the view of the task force:

- provided extensive and excessive tax holidays, tax relief and customs duty exemptions;
- provided extensive deductions for capital allowances and exploration expenses;
- provided for unlimited loss carry forward, allowing each company to carry forward indefinitely, and

deduct from taxable income in subsequent years, losses incurred in any one year.

Arguably, the most notorious such agreement was the Sierra Rutile ‘amendment agreement’ of February 2004, which reduced the applicable royalty rate from 3.5% to 0.5% until 2014; the turnover tax from 3.5% to 0.5% until 2014; and the import duty on fuel from 12% to 1% (NACE 2009: 16). This and other agreements deprived the government of significant revenue, and serve to explain the disappointing contribution to the national revenue portfolio.

There is thus little debate that weak revenue performance is primarily attributable to agreements that made excessive concessions to mining firms. While this may be attributable to some extent to the limited technical capacity of government negotiators during and immediately after the civil war, it is widely feared that it may also reflect corruption in the negotiation of highly discretionary mining agreements. Given that even small changes in legal provisions can imply millions of dollars in profits for the companies involved, the incentives for exchanging personal benefits for tax concessions are considerable.

While the problem is simple to identify, it is much more difficult to change. Corruption is a longstanding issue in Sierra Leone and was a central strategy by which political officials dispensed benefits to their supporters prior to, and during, the civil war (Reno 1995, 1999, 2000).

## The Mines and Minerals Act 2009

Recognising that inadequate mining agreements have been the primary cause of strikingly low levels of revenue collection, there has been growing pressure on successive governments to revise the legislative framework in order to reduce the scope for discretion in the negotiation of contracts. Until recently the primary legislation governing the minerals sector was the Mines and Minerals Act 1996, which was accompanied by various additional policy instruments and guidelines. Established at the height of the civil war, the 1996 Act was subject to

significant criticism owing to the vagueness of many provisions and the consequent scope for official discretion and varying interpretations of the law. The weakness of the Act was starkly revealed by the fact that, in practice, all of the country’s major mining operations have been regulated by bilateral agreements signed between the government and individual mining firms.

Complaints that this reliance on bilateral agreements could open the door to widespread corruption led the incoming APC government in 2007 to announce both that it would be reviewing all existing mining contracts and that it would introduce new legislation to govern the minerals sector. The latter goal was achieved with the passage of the Mines and Minerals Act 2009, which has been introduced in hope of increasing revenue by ensuring a more regular, and less discretionary, legal framework for mining operations. The passage of the new Act has also seen the government begin to fulfil its pledge to review existing mining agreements, and a review of the existing agreement with Koidu Holdings was completed in June 2010.

The passage of the new Act has been heralded by some as a significant break with the past, and an opportunity to usher in a much more effective regulatory and tax regime for the mining sector. While there have been unavoidable disagreements with respect to the content of the law, there is nonetheless broad agreement that, on paper, the new Act represents an important step forward. However, the primary challenge lies in fully and transparently implementing the provisions of the new Act, and the results so far, while a step in the right direction, have nonetheless been disappointing.

Two mining agreements have been signed since the legislative change, while one existing agreement has also been reviewed. In all three cases, the new agreements have been more transparent and have provided for greater levels of taxation than earlier agreements, but all three have also failed to strictly adhere to the terms of the new Act. The details of these agreements are reviewed in detail elsewhere, while only the key trends are summarised here. The first agreement was signed with London Mining on 31 December 2009, only one day after Parliament had approved the new Mines and Minerals Act, but nonetheless contained various tax and other concessions not provided for by the new legisla-

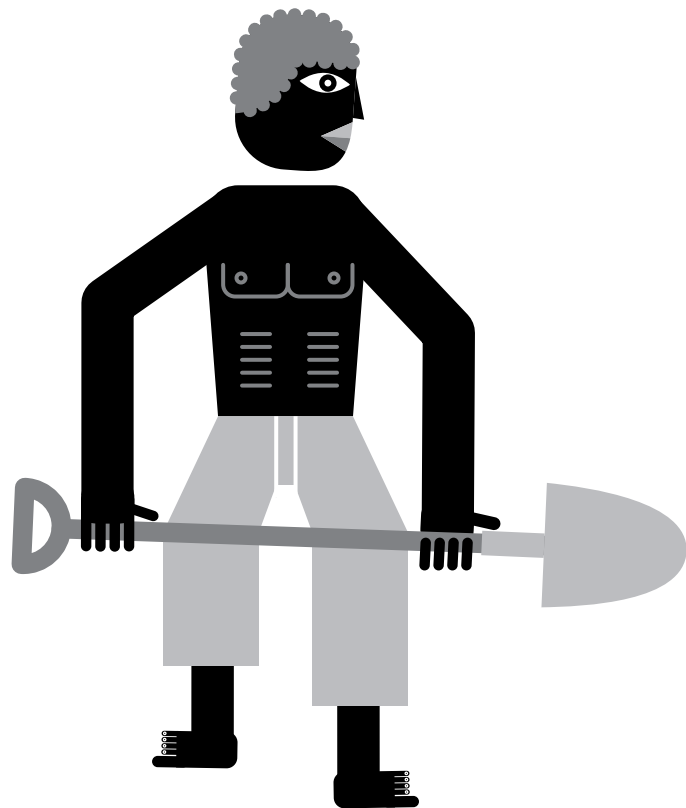
tion. While the agreement was undoubtedly superior to earlier agreements, civil society groups argued that the failure to adhere strictly to the new Act would fatally undermine efforts to eliminate discretion in the negotiation of mining agreements. This concern was reflected in the second agreement, signed on 6 August 2010 with African Minerals. While the agreement was, again, superior in many respects to earlier mining agreements, it followed the London Mining agreement in failing to strictly adhere to the law passed by Parliament, and contained various additional concessions to the mining firm. Finally, the review of the existing agreement with Koidu Holdings has followed a similar pattern, as the revised agreement is expected to yield significantly greater revenue than the original agreement, but nonetheless makes additional concessions to the mining firm that are inconsistent with the law.

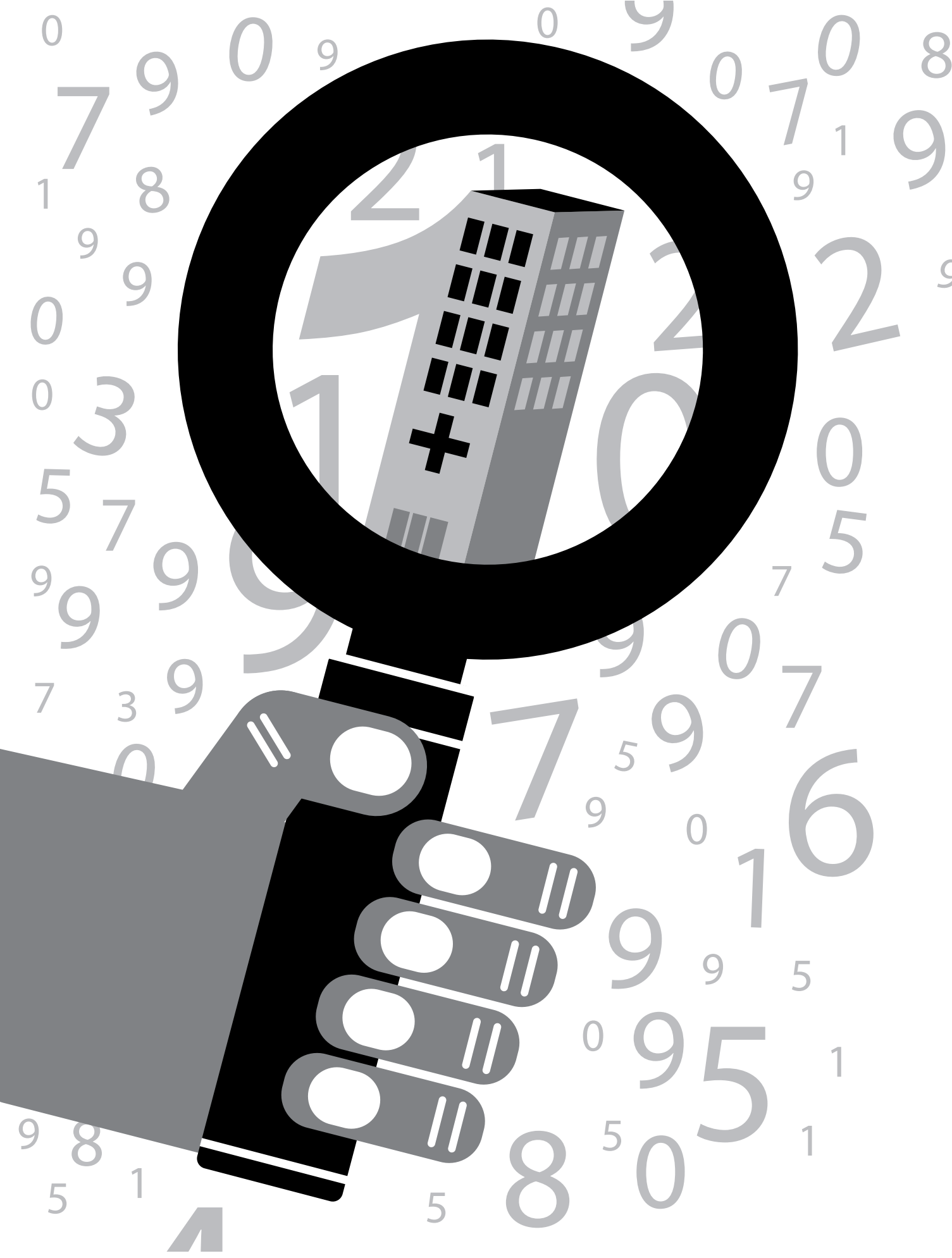
In assessing these developments it is important to acknowledge the progress that has been made, as the new legislation is superior to that which it replaced, and the new mining agreements are superior to those that came earlier. That said, the government has transparently failed in its commitment to eliminate discretion in the negotiation of minerals contracts, and this poses significant risks moving forward. In simplest terms, although the new agreements represent an important step forward, the continued presence of discretionary concessions implies the risk that mining revenues will continue to be far below what they should be. In the absence of clearly defined, and inviolable, rules governing mining contracts, each negotiation holds the possibility of significant concessions without political commitment and vigilance from civil society. As with other areas of taxation, what is thus most needed is **vastly expanded transparency and strict adherence to existing laws**. Given the history of corruption in these areas, committed political leadership, supported by activism among citizens and civil society, is necessary if those vested interests that expect to benefit from mineral contracts are to be tackled. In the shorter term, the continued presence of discretion in the negotiation of mining agreements implies that aggressive oversight by civil society actors will be essential to further progress in strengthening the revenue yield from mining activities.

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**As with other areas of taxation, what is thus most needed is vastly expanded transparency and strict adherence to existing laws**

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# Recommendations

This report has provided a detailed look at the content, evolution and performance of the tax system in Sierra Leone over the past decade

This level of detail has been necessary as a means to substantiate broader generalisations, highlight opportunities for reform and provide a resource to members of civil society seeking to engage with tax issues. The challenge in this final chapter is to shift from this relative complexity to a set of practical recommendations for engagement by civil society. In broad terms, civil society organisations have two major opportunities: **first, to push for reforms designed to make taxation more fair, transparent and inclusive; and second, to use tax concerns and revenue-raising processes as an entry point for encouraging public engagement, mobilisation and demands for improved governance.**

## Policy and administrative issues

The most straightforward approach to advocacy around tax issues is to push for greater fairness, transparency and inclusiveness in tax policy and administration. As in most low-income countries, the overwhelming challenge facing the tax system in Sierra Leone is not the inadequacy of tax policy, but problems of tax administration. This reflects the well-known mantra that in developing countries ‘tax administration *is* tax policy’, and this is particularly true in post-conflict settings such as Sierra Leone. While tax policy questions surely matter, both the level of revenue collected and

the impact of taxation on different groups are shaped primarily by how tax is enforced in practice.

Owing to the influence of international norms and pressure from international institutions, tax policies differ remarkably little across sub-Saharan Africa, but performance is hugely variable, reflecting the importance of administration. The reality is that the potential impact of a change in the GST or corporate tax rates matters much less than whether or not these taxes are fully enforced, particularly among elites. Currently low levels of tax collection in Sierra Leone primarily reflect two things. First, while some large firms and elites carry a heavy tax burden, many elites pay far less than their fair share of tax because of corruption and politically motivated privileges. This pattern undermines revenue collection, the rule of law and the redistributive potential of taxation. Second, popular support for taxation is very limited, and voluntary tax compliance correspondingly low, owing to perceived unfairness in the enforcement of taxation and a lack of transparency about how tax revenue is used.

Given this picture, the greatest opportunity for civil society advocacy lies in focusing on two simple messages:

- **Tax enforcement should be fair, such that every taxpayer is treated equitably according to the law.**
- **The tax system should be transparent and inclusive, such that citizens have easy and regular access to detailed information about revenue collection and**

how that revenue is spent. Importantly, this information must be presented in a way that is meaningful and understandable to the majority of citizens.<sup>14</sup>

These messages are not only potentially transformative, but have two very practical advantages:

- They are sufficiently **simple and emotive** to engage a popular constituency with advocacy efforts.
- **They are concrete and lend themselves to simple, concrete, real-world examples** that can transform tax issues from technical issues for experts into issues of genuinely popular concern.

In seeking to achieve these advocacy goals, three core principles should be borne in mind:

- First, tax reform is an overwhelmingly political challenge. Strong vested interests have an interest in blocking reform, and committed political leadership is needed to overcome this resistance. Therefore **the role of civil society must be to generate broad-based political pressure for reform by actively engaging a broad public constituency.**
- Second, while this report has been critical of the overall performance of the tax system **there have been important achievements over the past decade, and there are many highly committed individuals inside and outside the NRA working to achieve further reform.** Civil society should view these reformers as allies.
- Third, there is already widespread popular frustration with the tax system, reflecting concerns about corruption, unfair enforcement and the failure to translate tax revenue into public services. **The challenge for civil society is to translate this latent public frustration into active public engagement aimed at curbing unfair tax evasion and translating tax revenue into public benefits.**

<sup>14</sup> To illustrate, we can consider the two most common ways of reporting tax revenue: as a share of GDP and in nominal terms. When tax revenue is reported in nominal terms it is misleading, as it almost invariably rises from year to year (due to inflation and population growth) but tells us little about the *effectiveness* of collection efforts. Reporting tax collection as a share of GDP provides a much more accurate picture of the effectiveness of collection, but most citizens do not understand the concept, and there is a consequent need for careful efforts to communicate relevant ideas clearly.

## Fairness in tax enforcement

The continued weak revenue performance of the tax system largely reflects the continued ability of bureaucratic, economic and political elites to gain narrow privileges. This is reflected in:

- the failure to enforce appropriate taxes among elites, due to a combination of formal exemptions and intervention by political and bureaucratic elites;
- extremely disappointing revenue collection from the mining sector as a result of widespread concessions to mining firms and weak enforcement;
- the failure to fully tackle networks of corruption within tax administration, and particularly at customs. These networks are widely believed to be a source of patronage resources for political elites, in a context in which such patronage has been a central strategy for attaining political power.

The failure to sustain the rule of law in the enforcement of taxation undermines government revenue and thus the availability of vital public services. It also profoundly distorts competition in the private sector, as those who are subject to tax laws cannot compete with those who are able to use bureaucratic and political influence to avoid taxation. The need for greater fairness in enforcement is thus universal, and is relevant to all of the major tax types. That said, this report has raised several areas that could be focal points for short-term advocacy:

- **Strengthening institutions for tax administration:** While tax administration is a highly political process, the construction of institutions that are independent and easily monitored is an important strategy for curbing corruption and abuse. This should include putting in place clear processes and regulations for dealing with taxpayer grievances, for addressing complaints about corruption in tax administration and for prosecuting tax evaders and defaulters. These processes and regulations must be accompanied by dedicated enforcement capacity, for example in the form of appellate commissioners and specialised revenue courts for addressing both evasion and taxpayer grievances.

- Improving transparency and enforcement at customs:** Customs administration is universally viewed as a site of significant corruption, and recent developments have seen performance decline still further. This not only undermines customs revenue, but also the ability of the NRA to enforce other domestic taxes. Overt resistance to the implementation of the ASYCUDA IT system, coupled with further declining revenue, poses a clear challenge to the political leadership, which needs to take aggressive action against existing corruption. Public proclamations are no longer sufficient, and aggressive action against corruption at senior levels, coupled with observable revenue gains, must be the standard against which performance is measured.
  - Reducing discretionary exemptions in the minerals sector:** Nowhere is the poor revenue performance of the government more in evidence than in the mining sector, where total revenue collection is less than half of what could reasonably be achieved in the short term. Poor revenue collection is attributable to a significant degree to major tax concessions that have been granted to mining firms through bilateral agreements which are inconsistent with existing legislation and have been plagued by allegations of corruption. Despite new legislation, reductions in the extent of the concessions granted to mining firms are only likely to be achieved through active oversight and advocacy by civil society actors. The NACE has played an important role to date, but additional effort holds the potential to achieve major revenue gains.
  - Curbing ‘discretionary’ tax exemptions:** The past two years have witnessed an enormous surge in duty-free exemptions following the shift of monitoring powers away from the NRA. Curbing such exemptions, and ensuring that all existing exemptions are approved by Parliament and open to public scrutiny, is both feasible and necessary. Importantly, this transparency should move beyond the realm of ‘duty free’ exemptions alone to capture tax exemptions granted across all tax types. The key to more effective management of tax incentives and exemptions is likely to lie in reduced discretionary powers in the granting of tax benefits, total transparency about the recipients of such benefits and an unambiguous mandate for the NRA to implement and monitor all incentives and exemptions.
  - Strengthening income tax enforcement:** The heavy reliance of income tax collection on withholding taxes is indicative of significant untapped potential. While barriers to improved collection include limited audit capacity, there is a strong suspicion that it also reflects the fact that tax administrators are unable to aggressively pursue evasion by many elites due to a lack of political backing for such efforts. Public support for improved enforcement could thus empower NRA efforts.
  - Taxing professionals:** While a comparatively minor issue in total revenue terms, the continued non-payment of sufficient taxes by most professionals is a highly visible symbol of the privileges enjoyed by elites, but is only likely to change in the face of public pressure.
  - Avoiding an excessive reliance on the GST:** While the GST has proven valuable as a means to expand tax revenue in many developing countries, it is also a comparatively regressive tax and thus care must be taken not to expand the GST at the expense of other, more progressive, tax types. Specifically, the redirection of essential resources away from the Income Tax Department in order to strengthen the GST Department is a cause for some concern and warrants further attention and review.
  - Continuing to strengthen property tax enforcement:** Property taxes are potentially the most progressive tax available to governments, as well as the most viable basis for strengthening local government. Recent gains (particularly in Bo city) make clear that enormous revenue gains are possible in the presence of genuine political will.
- Transparency and inclusiveness**  
The counterpart to pushing for fair enforcement of taxation is pushing for transparency and inclusiveness in the tax system. **This implies that citizens should have detailed information about how taxes are assessed, how much tax revenue is collected and how that revenue is used.** This is universally relevant, but appears to be particularly important at the local govern-

ment level, where citizens already complain that tax assessment is arbitrary and that information about how much revenue is collected and how it is spent is unavailable. Such measures are important because they will enable citizens to monitor the fairness of tax collection efforts and because such transparency can be the basis for encouraging voluntary tax compliance and more broadly building the legitimacy of government. This report has highlighted several areas that are likely to be particularly important:

- **Pushing for the passage and enactment of a Freedom of Information Act:** The Freedom of Information Bill can provide the legislative basis for demands for greater transparency related to a wide array of tax and revenue issues. While passage of the Act must be accompanied by dedicated effort to improve data collection and sharing in individual areas (noted below), the Act would provide a valuable starting point for pressing for such improvements.
- **Continuing to strengthen transparency in the mining sector:** Alongside the need to curb exemptions for mining firms, there is a need for dramatically improved transparency as to the revenue that is collected, and how it is used. There are good reasons to believe that, even after accounting for existing concessions, the revenue collected from mining firms is far lower than it should be, while transparency as to these amounts remains very limited. Centralised and up-to-date data available to the public on mining revenue should minimally be available at the national level. The need for greater transparency is still more apparent at the local level, where direct payments from mining firms to chiefdoms and councils are very poorly documented, while transfers of mining-related revenues from the central government to communities are equally difficult to trace, thus making local-level accountability very unlikely. While the Extractive Industries Transparency Initiative (EITI) has been a focal point for civil society activities, implementation by the government has been too slow, and additional advocacy remains essential to long-term development prospects. More generally, the efforts of the EITI campaign may offer a model for advocating for transparency in revenue collection more generally.
- **Transparency surrounding tax exemptions:** At the central government level, the most glaring example of the absence of effective transparency relates to tax exemptions and concessions. While good aggregate data is available about duty-free exemptions, many such exemptions have been ad hoc and of questionable legality, as reflected in the sharp increase in duty-free exemptions beginning in 2008. More troubling is the total absence of effective data tracking exemptions from income and sales taxes, which appear to be widespread but frequently discretionary. This not only makes it impossible to assess the costs and benefits of such exemptions, but opens the door to corruption and the granting of exemptions to those who are politically well-connected. The government should be pushed to follow the lead of countries that have publicly published full lists of those receiving tax benefits, and of the tax revenue foregone.
- **Publicising revenue collection and expenditure information:** This is important at all levels of government, but it is particularly notable that media and civil society representatives have recently made demands that local councils publicise revenue collection and expenditure data. Such measures should be universally adopted, following the example of weekly radio programmes held by the Bo city council. These efforts should not merely capture aggregate revenue and expenditure figures, but should be able to link particular taxes, and increases in collection, to improvements in particular public services. At both the national and local levels, one possibility is to explicitly earmark certain tax collection (such as a share of total VAT collection or of the collection of market dues) for specific spending priorities, subject to enhanced transparency and oversight conditions.
- **Implementing a transparent system of tax assessment for small firms:** Any system of presumptive tax assessment for small firms involves a degree of subjectivity, and thus the legitimacy of such a system must be based on transparency and clearly defined rules. While strategies will vary, they should include: (a) making assessment rules more accessible to small businesses, (b) involving community members directly in the assessment process, and (c)

regularly publicising information about collections from particular business groups.

- **Improving basic data management and transparency at the chiefdom level:** There is a near total absence of credible revenue and expenditure data at the chiefdom level. This perpetuates conflict with district councils, undermines the credibility of chiefdom governance and threatens the success of decentralisation efforts. This lack of transparency reflects both local interests and a lack of commitment by national officials more interested in seeking political favour with chiefs than insisting on reform. Local pressure for transparency thus has the potential to yield major benefits.
- **Expanding transparency in property tax assessment:** Recent reforms have sought to achieve precisely these types of transparency goals in property tax assessment, and should be further strengthened.

## Taxation, public engagement and good governance

The discussion so far has focused on opportunities for civil society to press for a tax system that is fair, transparent and inclusive. This final section is committed to thinking more broadly about the potential for tax debates to be an entry for broader improvements in governance. In more concrete terms, it is about the potential for concerns about taxation to lead citizens to demand improved public services and a greater say in government decision-making.

As noted above, there is a growing body of evidence that citizen concerns about taxation can be a catalyst for leading them to make broader demands for responsive and accountable government. In simplest terms, when citizens pay taxes they also acquire a greater stake in ensuring that those payments are used to provide public services and promote development. This has strong historical roots in Sierra Leone, where popular anger against unjust taxation has frequently acted as a catalyst for broader public protest, dating

back to the Hut Tax War of 1898.

However, while taxation *can* be a catalyst for citizen engagement and demands for reciprocity, this need not be the case. Taxation has frequently generated deep public unhappiness without that public unhappiness being transformed into genuine improvements in governance. Concerns about taxation are more likely to be transformed into constructive public engagement and improved governance when the following are true:

- When the public is well informed about the tax system, including how much revenue is collected and the laws governing how it should be used.
- When the media and organised members of civil society can help to organise widespread public concerns into organised and specific demands on government.

In practice these conditions have rarely been met in Sierra Leone, where the civil war has contributed to public reluctance to challenge the government, and where civil society activism has often taken the form of high-level policy advocacy, while failing to reach a broad-based public constituency. At the same time, existing evidence is universal in finding that low-income citizens in particular have a very limited understanding of the content of tax laws, the levels of tax revenue collected by government or how that revenue is used. As a result, in developing advocacy campaigns around specific aspects of tax policy and administration, civil society actors also have an opportunity to use tax concerns as an entry point for broader public engagement.

Much as public advocacy has often been organised around the concept of human rights, there is now an opportunity to organise around **taxpayer rights, and the simple message that, ‘As a taxpayer you have the right to demand public services and accountability from government’**. This rests on posing a simple question: ‘Taxpayers in this community have contributed X amount to the government – what have you received in return?’ While relatively abstract, growing evidence from around sub-Saharan Africa suggests that this can be a powerful and tangible framework for spurring broader public engagement at the grassroots level.

## Appendix 1: Methodology

This report is based on a combination of secondary literature and primary sources, including official data, published sources and, most importantly, a wide array of interviews conducted with policy makers and other stakeholders in June–July 2010.

As with most countries in the region, there is relatively little published information dealing explicitly with issues of tax collection and revenue generation more generally. Therefore, while secondary sources have been valuable in providing the broad political economy context, detailed information about the tax system has been drawn overwhelmingly from primary sources. The process of compiling this evidence has comprised three broad components:

1. **Data:** The foundation for much of the research lies in extensive efforts to gather and analyse tax collection data. Given the highly politicised and somewhat secretive nature of tax collection efforts, it is frequently data that can most clearly point towards underlying political and administrative dynamics. At the national level, data over the past decade was available through the NRA, while historical data was drawn from historical IMF reports. Historical data on local tax collection was not available, but more recent data was provided by the Ministry of Finance, while data from 2009 and 2010 was secured directly from local tax authorities.
2. **Published documents:** While there is comparatively little published material on taxation publicly available, various annual and project reports produced by the NRA and the Ministry of Finance proved to be useful resources in capturing the major concerns of those authorities. Unfortunately, limited institutional memory has meant that such documentation was generally only available after 2005.
3. **Interviews:** The most important source of information has been interviews with government officials

and civil society leaders. These interviews have been essential for effectively piecing together the historical record of reform, given the absence of published materials, and, more importantly, in order to understand the political and administrative issues that have surrounded tax collection over the past decade. While the interviews were conducted anonymously, interviews were drawn from, among others: the NRA (Income Tax Department, GST Department, Customs and Excise Department, the Tax Modernisation Programme), the Ministry of Finance and Economic Development (Tax Policy Unit, Local Government Finance Department), city council tax offices (Freetown, Makeni, Bo), the Parliamentary Finance Committee, the Office of the President and various civil society organisations engaged with tax issues. While most of these interviews were conducted in Freetown owing to the constraints of time, research trips to Bo and Makeni were also conducted.

## Appendix 2: The national tax system

The central government tax system in Sierra Leone is administered by the National Revenue Authority (NRA), which was created in 2002. The NRA is governed by a board of directors and is, in principle, granted financial independence through its ability to retain 3% of all collections to cover operating costs, as is the case for a growing number of administrations in the region. The NRA has three primary departments, reflecting the three major tax types: Income Tax Department, Goods and Services Tax (GST) Department, and Customs and Excise Department.

### Income Tax Department

Income taxes include both personal income taxes and corporate taxes and are governed by the Income Tax Act 2009, with tax rates as shown in Table A1. Personal income tax is imposed on every person who has chargeable income for the year of assessment, which is a 12-month period commencing on 1 January. The tax is payable on the taxpayer's aggregate income from all sources, excluding dividend income which is subject to withholding tax at source and is a final tax. The tax rate is progressive, with those with higher income subject to a higher tax rate (Table A1). The vast majority of personal income taxes are paid on a monthly basis directly by employers as Pay As You Earn (PAYE) tax, while the self-employed are expected to submit tax returns declaring taxable income. In addition to these standard income taxes, rental income is taxed at a rate of 10%.

The corporate tax rate is set at 30% of chargeable income, after appropriate deductions. The rate has been reduced in recent years, from 45% to 35% in 2000 and from 35% to 30% in 2005. In order to strengthen enforcement of company taxes, the government employs several withholding taxes. Withholding agents are required to withhold and remit to government 5% of the value of all contracts with suppliers/contractors as a pre-payment against corporate tax liabilities. Similarly, 3% of the value of all imports is to be withheld by the Customs and Excise Department as a pre-payment against tax liabilities. Finally, small firms with turnover below are subject to a simplified presumptive tax regime, known as standard assessment,

which levies a flat-rate tax on the basis of the type of business being operated.

### GST Department

For most of the period since the end of the civil war, the bulk of sales taxes has been collected by the Customs and Excise Department, with the remainder being collected by the Income Tax Department. By far the most important such taxes were the import sales tax, levied at 15% on all imported goods, and the domestic sales tax, levied at 15% on domestically produced goods. These taxes were accompanied by a series of smaller taxes focused on particular services and generally levied at a rate of 10% or 15%: entertainment tax; restaurant tax; sales tax on local and external communications; hotel and accommodation tax; and professional services tax. On 1 January 2010 these various taxes were replaced by a single goods and services tax, which levies a tax of 15% on the value added on all economic transactions. The introduction of the new tax was accompanied by the creation of the GST Department to oversee enforcement of the new tax, though in practice the bulk of revenue continues to be collected on imports.

### Customs and Excise Department

The Customs and Excise Department administers international trade taxes, and before 1 January 2010 also administered some domestic indirect taxes such as the domestic sales tax. It also administers domestic excise taxes, and retains responsibility for collecting the import GST as well as the 3% withholding tax on income on behalf of the GST and Income Tax Departments, respectively. Customs administration is governed by the Customs Tariff Act 1978, the Excise Act 1982 and the Sales Tax Act 1995, though a new Customs Act is yet to come into force. Import duties are levied consistent with the ECOWAS Common External Tariff (CET): 0% for computers and accessories; 5% for raw materials, 10% and 15% for intermediate goods; and 20% for finished goods. Very few items are currently outside the scope of CET ban, with the most noteworthy being imported beer and soft drinks, which are subject to a 30% import duty.



**Table A1: 2010 tax rates****1. Personal income tax (per annum)**

Chargeable income	Tax rate
Not over Le 1,800,000	Nil
Next Le 3,600,000	15%
Next Le 3,600,000	20%
Excess over Le 9, 000,000	30%

**2. Pay As You Earn (PAYE) (monthly):**

Chargeable income	Tax rate
Income bracket	Nil
Not over Le 150,000	15%
Next Le 300,000	20%
Next Le 300,000	30%
Excess over Le 750,000	30%

<b>3. Corporate tax</b>	30%
<b>4. Rent tax</b>	10% rental value
<b>6. Withholding income tax</b>	3% import value

**7. Withholding contract tax:**

Resident contractors	5% of contract value
Non-resident contractors	10% of contract value

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What are the principles of a fair and inclusive tax system? Why is tax administration inseparable from tax policy? Why are minerals so hard to tax? As the nation celebrates its 50 years of independence this year, these and other questions discussed in this report are likely to be ever more important in the future in guaranteeing basic rights, universal health care, and good governance.

Mining revenues have not recovered to the levels where they were before the civil war, due to overly generous tax exemptions to formal mining companies and hard to tax small-scale mining operations. Mining represented 14.7% of the Gross Domestic Product (GDP) and 87% of total exports in 2007, but mining taxation as a share of total export value was estimated between 2.5% to 4.16%. Comparable countries in West Africa collect taxes between 10-15% of the total export value, meaning that there would be scope for quadrupling mining revenues.

Tax exemptions are not limited to the mining sector. Prior to 2007 when the discretionary concessions were given by the National Revenue Authority (NRA) their share of GDP actually fell from 2% of GDP in 2004 to 0.8% of GDP in 2007. Since then as the authority to grant exemptions was granted to the Ministry of Finance they have skyrocketed to 2.1% of GDP in 2009, an increase of 160% in 2 years. The resulting shortfall in tax income could have funded many areas of essential needs met via public services.

Meanwhile ordinary Sierra Leoneans are being increasingly taxed, with the new Goods and Services Tax (GST) being implemented in 2010 at a rate of 15% replacing an array of previous taxes. While the GST was designed to leave prices unchanged, in practice prices have actually risen. This is due to the tax being easier to enforce and some vendors having taken advantage of the lack of awareness concerning the tax. These taxes are regressive, as lower and middle-income persons pay more in these taxes than wealthier citizens.

Citizens often assess the performance of their government on the basis of local government activities, even though local taxation represents less than 1.5% of total government revenues. Increased transparency of local taxation would build confidence, as up to 30% of the receipts are not attributed to any specific type of tax in the statistics. Also there is little accountability to the 0.75% of total mineral exports being earmarked to community development funds.

Transparency in all of the mentioned areas would allow for better governance, as interest groups could articulate more clearly their demands, based on a knowledge of how much is being lost in uncollected taxes, undue exemptions or outright corruption. These losses could then be linked to specific budget demands related to the provision of basic rights, protection of marginalised and vulnerable persons, and expansion and improvement of public services and infrastructure.