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Tax Policy and Administration in Sub-Saharan Africa

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I. Introduction

In recent years, the Fiscal Affairs Department has produced a number of reports on taxation matters in sub-Saharan countries at the request of Fund member countries in that region. 1/ Most of these reports have been general reviews of tax systems, but some have been limited to analyzing particular aspects of the latter. This study is an attempt to identify some of the commonest taxation problems of the members concerned, with a view to seeking generalizations of the possible solutions offered which may be useful either to the area as a whole or to groups of countries. It should be noted, however, that the problems and experiences of individual sub-Saharan countries are by no means identical and, therefore, that what is valid for a country or group of countries may not be valid for other countries. A parallel study provides a general statistical framework for assessing the tax systems of the countries in the region. 2/

The appropriateness of different taxes and tax bases for sub-Saharan Africa can be judged with reference to traditional criteria, such as their fruitfulnes as revenue sources, their effects on resource allocation, their ability to improve equity of distribution, and their ease of administration. However, in evaluating the potentials of different tax bases, it is also important to note that tax systems and tax policy have limits. The ability of a system to raise revenue is limited by possible undesirable effects on resource allocation, equity, and distribution, all of which tend to grow stronger as the ratio of taxes to gross domestic product (GDP) rises; this is especially true for the developing countries of the sub-Saharan region, since the scarcity of their administrative resources makes it difficult for them to raise large amounts of revenue from relatively complex taxes, such as the income tax, that generally have the fewest undesirable side effects.

A combination of administrative constraints and the small size of many tax bases also imposes limits on the ability of the government to use the tax system positively to influence resource allocation and the distribution of income and property. And finally, the political process and the political and ideological bent of each government impose additional constraints that limit the degree to which and manner in which the tax system can be used both to raise revenue and to carry out policy.

1/ Since the inception of the department in 1964, 66 reports have been produced, 39 of which over the last eight years.

2/ See Taxation of Sub-Saharan Africa--Statistical Analysis, prepared by Vito Tanzi, DM/81/21.

The use made by a government of other instruments, such as monetary and exchange policies, also affects tax policy. Monetary and credit restraints may have strong effects on tax bases and may either reinforce or counteract tax policy. Exchange policy, particularly in sub-Saharan Africa where foreign trade is the most important tax base and where many of the economies are very open, can have a forceful effect on tax revenue. Similarly, tax policy, particularly tax incentives and such devices as rebates of tax at export, can act as a supplement to monetary, credit, and exchange policies.

Of the various criteria for evaluating taxation, the ability to raise revenue is the most fundamental. Rarely is a tax which yields little or no revenue justified on other grounds, and rarely is such a tax able to interact with the rest of the economy in such a way as to influence allocation or distribution significantly. In examining the revenue potential of tax bases and taxes in this paper, two aspects will be primarily considered: (1) the magnitude of the base relative to alternative bases and relative to the economy as a whole; and (2) the elasticity and buoyancy of the base and the tax. The latter includes the elasticity of the base itself in relation to GDP, the elasticity of the tax in relation to the base, and the buoyancy of the tax in relation to GDP.

In examining the potential of taxing a base with reference to resource allocation, a prime concern usually is that the tax either be neutral in its allocative effects or have effects which will be positive regarding development of the economy and optimum use of resources. And in examining the equity and distribution effects of a tax, two important concerns are that the vertical equity of the system not be lessened and that as few horizontal inequities as possible be created.

A final concern in evaluating the suitability of different components of a tax system is ease of administration. A tax base which cannot be reached adequately with available administrative resources is an inappropriate base, even though in theory a tax on it would have great advantages with respect to resource allocation and distribution of income and property.

This paper is organized as follows. Following a chapter in which the main conclusions of the study are summarized (Chapter II), Chapters III to VII deal, respectively, with the following five general issues:

1. Taxation of imports and its policy and administrative implications;
2. Taxation of consumption, with special reference to general sales taxes;
3. Taxation of the agricultural sector, including subsistence agriculture and primary export products;
4. Taxation of income and property in the modern sector;
5. Special tax incentives and their impacts on policy objectives.

All these five chapters mention the tax administration problems specifically related to each issue, and a final chapter on general aspects of tax administration (Chapter VIII) covers ground that is common to various forms of taxation.

Given the broad scope of the study, it was imperative to adopt a highly selective approach regarding the particular themes covered. It should also be noted that, although the paper draws heavily on the Fiscal Affairs Department taxation reports mentioned previously, care has been taken to preserve the confidential character of the reports. Hence, the specific recommendations made to individual countries in the reports are not set out in the paper.

II. Summary of Conclusions

In this chapter, an effort is made to summarize the main issues discussed in the following chapters. To allow focusing on the region's most important problems no attempt has been made to include all of the subjects covered in Chapters III through VIII; the reader is referred to those chapters for information about matters not included here.

In using the criteria mentioned above to evaluate the adequacy of the tax systems of the sub-Saharan countries, care should be taken not to disregard that there have been necessary tradeoffs during the period in which these tax systems have taken shape. These tradeoffs have been forced by a variety of circumstances, (e.g., historical, social economic, political) and cannot be ignored. Frequently, an analyst will find fault with a particular tax instrument on grounds, of, say, economic efficiency, but will overlook the fact that the government using it cannot afford to replace it because of immediate revenue needs. Such flawed analysis is particularly likely to result when a narrow sectoral approach is used.

1. Taxation of imports

Reliance on import tariffs for revenue has been, and still is, characteristic of many countries in the region. This reliance is a direct result of the countries' inability to find other tax bases and, therefore, is to a large extent justified.

But while one must recognize that taxation of imported goods is likely to remain an important revenue source for some time, this does not necessarily mean that revenue should be obtained exclusively from import duties. Ideally, import duties should be used only for protection, with a view to developing domestic production gradually. General sales taxes and excises, applying equally to imports and domestic production, should be used to raise revenue, and to improve equity, and possibly for regulatory or sumptuary purposes.

In using import tariffs as protective instruments, caution is needed to avoid overprotecting domestic industry. Excessive levels of protection result in low economic efficiency, and effective, as opposed to nominal, protection may not be easy to identify and measure. There is, therefore, a need for detailed studies, or at least careful consideration, of the proper scope and level of protection. Only after such work is done would it be possible to restructure a particular tariff.

Since, however, few countries in the region have done much to rationalize their tax systems in the manner discussed here, it is necessary to keep in mind the second-best alternative, in which import duties as such are important revenue producers. In this situation, the use of ad valorem rates instead of specific rates, the limitation of exemptions, and the improvement of valuation methods can help to ensure proper yield and elasticity and to minimize distortions.

2. Taxation of consumption

General sales taxes and excises are the two most important tax instruments that can be levied on consumption. They should apply equally to both imports and domestic production, so that unintended and undesirable protection of inefficient local industries is avoided. This approach should be taken, even if there is as yet no domestic production of some of the taxed goods.

General sales taxes are likely to become main tools for producing revenue as countries in the region continue to develop. To avoid administrative complications and distortions in resource allocation, a general sales tax should have the broadest possible coverage and little or no rate differentiation. Regarding the form of sales tax to be preferred, experiences in countries outside, as well as within, the region would seem to indicate either a multistage value-added tax or a single-stage manufacturer/importer sales tax. In any case, economic efficiency is best served by avoiding cascading, thus making the tax neutral with respect to the number of stages in production/importation and distribution; if this is achieved, there will be no discrimination against items produced with taxable inputs or items that require a long chain of production and distribution. Several mechanisms have been used to avoid cascading. By definition, a tax on value added avoids the problem, since it allows taxpayers to credit sales tax paid on inputs against tax due on their sales. Production taxes applied by francophone countries provide for a deduction from gross sales of the value of raw materials and intermediate goods that are incorporated in the product, while most countries levying manufacturer/importer sales taxes allow producers to buy inputs tax free, to apply for refunds, or, as is done for value-added tax, to compute a credit equal to the tax on inputs and apply it against the tax due on sales.

In view of equity and administrative considerations, sales taxes should not be levied on transactions relating to unprocessed agricultural goods. In most of the countries in the area, administrative difficulties involved would make it inappropriate to extend multistage sales taxes to small retailers or to include small artisans and producers in the coverage of a manufacturer/importer sales tax. It is clear that the amount of revenue collected as a result of such broadened coverage would not justify the effort involved in dealing with small businesses.

Finally, mention should be made of the treatment of capital goods. It has been generally argued that exemption of these goods from sales taxation is called for if cascading is to be avoided, since otherwise tax would be paid on a final product whose cost would already include part of the tax payable upon purchase of the capital good. On the other hand, the taxation of capital goods has been advocated to counteract the effects of too many exemptions granted to users of capital goods under incentive schemes and to encourage increased utilization of labor.

Excises can play, at earlier stages of economic development, a role quite similar to that of general sales taxes. This is particularly true in economies where the manufacturing sector is small and produces few items. In more developed economies, selective excises should supplement a general sales tax. The selectivity of excises makes them useful for emphasizing distributional goals by imposing additional levies on goods and services consumed by high-income sectors of the population. They can also be used for discouraging undesirable consumption--a feature of excise taxation which, in recent years, has become important from the standpoint of energy conservation. Excises should in general be imposed at ad valorem, rather than specific, rates; and if specific rates are preferred, for administrative or traditional reasons, they should be subject to frequent adjustment.

3. Taxation of the agricultural sector

The large share of GDP that is produced by agricultural activities in most sub-Saharan countries makes it imperative that special attention be paid to the tax instruments that can be used in the sector. Whichever the choice, however, the constraints--mainly administrative--inherent in these tax instruments are of such magnitude that it would not be realistic to expect much from taxes levied on the agricultural sector, especially in terms of enhancing productivity. The limited significance and potential of land taxes illustrates the point, although special land tenure systems have also contributed to this minor role of land taxation.

From the point of view of revenue, production of primary export products is the most important agricultural subsector. Export duties on these products have been extensively used by many countries in the region. Since the possibilities of shifting these duties forward is extremely limited, there is a serious risk of adversely affecting production if they are imposed without paying due regard to the profitability of the subsector; there may be negative effects on both government revenues and the balance of payments. On the other hand, taxes on exports could and should be used in situations where production of certain crops is clearly profitable and income taxes are not considered feasible. Implicit taxation of exports through the pricing policies of marketing boards have not worked too well in recent years owing to difficulties in forecasting and in meeting urgent revenue needs. If, however, the marketing board approach is used, considerations similar to those expressed for export duties are valid.

There are doubts about the desirability of taxing the subsector related to subsistence production, but even if there were none, it is generally recognized that the subsector is not easy to tax. Apart from a few crude substitutes for the income tax--such as poll taxes, graduated personal taxes, and taxes on livestock--which have been found objectionable on grounds of equity and ease of administration, taxation of the subsector has generally been undertaken through levies on goods consumed by the population engaged in subsistence production. These levies are, of course, not less regressive than the other tax instruments just mentioned but are, at least, easier to administer.

4. Taxation of income and property in the modern sector

The modern sector, comprised mainly of companies and individuals in urban areas, constitutes one of the most elastic components of the tax base. The present revenue yield from the sector may be relatively small in many sub-Saharan African countries, but the potential field is large. Because of the greater sophistication of taxpayers in this sector, it is here that the income and property taxes can best be applied.

Of property taxes, the annual levy on real property is the most important in sub-Saharan Africa, especially in countries following the British tradition. Countries following the tradition of continental Europe also rely on stamp and registration duties applied to transactions involving real estate, and some of these countries have no annual tax on property. In all cases, yield is low. Problems are raised by the variety of land tenure systems and the lack of accurate ownership records or modern real estate cadastre, complicated by inadequate administrative resources. A serious risk of horizontal inequity and misallocation of resources is raised by the tax in most countries.

All countries in the region tax income of both individuals and enterprises. Countries following the continental European tradition tend to favor a primarily schedular income tax, with only a small part of revenue derived from a tax on global income; others rely more on a tax on global income of individuals and are more likely to tax income of legal entities separately--with or without integration of the taxes on corporations and shareholders--from that of other enterprises. Problems arise in the individual income tax with respect to selecting the appropriate adjustment for the family unit and the appropriate level of initial exemption, deciding whether foreign-source income and capital gains should be taxed, and how withholding should be applied. Excessively high top rates may discourage savings and encourage evasion, while very low beginning rates are not worthwhile from the standpoint of revenue.

Despite its relatively low revenue yield, the individual income tax has an important role to play in regard to equity and income distribution, and efforts should be made to improve its structure and administration. For this purpose, introduction of a unitary income tax should be considered by those countries having a schedular tax system. A move in this direction has already been observed.

The tax on business income presents problems with respect to choice of rates, depreciation rules, incentives to new businesses and treatment of very small and very large businesses. Countries who are members of the Communauté Financière Africaine (CFA) have used a minimum business tax, creditable against the profits tax but nonrefundable, as a means of preventing underreporting of taxable profits; its application is not without shortcomings. Finally, placement of taxes on business income on a current basis has been recommended mainly for purposes of removing the discrimination against other incomes (e.g., wages and salaries subject to current withholding) and of reducing the erosion of tax payments arising from inflation.

Supplementing the income and property taxes, many countries of the region levy registration and stamp duties, poll taxes, and business license fees. The latter two may act as rudimentary substitutes for income taxes, but it is usually wise to phase them out when the skills of taxpayers and tax administrators have advanced sufficiently; problems of revenue distribution between central and local governments should also be carefully considered. Stamp and registration duties often are inappropriate to socioeconomic conditions in sub-Saharan Africa, and most of these should be phased out, merged with other taxes, or at least modernized to improve their revenue yield.

5. Special tax incentives

In sub-Saharan Africa, the principal reason for introducing special tax incentives has been to encourage expansion of the modern sector of the economy. It has been argued that the revenue temporarily sacrificed would be recovered later through the increases in domestic supply and in the tax base. The most important incentives have taken the form of total or partial exemption from tax and have been granted mostly in connection with income or profits taxes and customs duties.

Improvement of resource allocation through the use of incentives appears to be a legitimate goal. A considerable effort must be made though to avoid granting incentives in an ad hoc manner and without careful study if this goal is to be reached. In addition, the risk of introducing serious inequities between individual taxpayers and sectors can only be diminished by thorough planning.

To a large extent, the scope and level of tax incentives granted by any given country are likely to be determined by its desire not to be too far out of line with its neighbors. In any event, the following comments should be taken into account. First, it is advisable to limit the duration of special incentives, both to reduce constraints affecting revenue and to allow for possible changes in the circumstances that made the incentives desirable. Second, there may be a case for limiting the amount of benefit in relation to invested capital, particularly to prevent industries which quickly become highly profitable from enjoying excessive and unnecessary concessions. Third, incentives focusing only on capital investment are less efficient than general tax holidays on account of the latter's neutrality regarding production factors. Finally, the importance of governments obtaining full information regarding revenue foregone, exempt base, and other relevant particulars from the beneficiaries cannot be overemphasized; this is the only way to ensure availability of the data base needed to evaluate the efficiency of the incentives and to check on compliance with the conditions established for granting the exemptions.

6. General aspects of tax administration

Tax administration issues have generally not been given enough attention in sub-Saharan countries, and more emphasis on these issues is required if the tax policy goals are to be attained. Proper enforcement of existing taxes is likely to generate additional revenue and to make unnecessary, or at least reduce the proliferation of taxes. It should be noted, however, that these revenue results are likely to occur in the medium and long term. Only in exceptional cases (e.g., large accumulation of collectible arrears) will improved administration produce quick results.

Staffing problems are of paramount importance throughout the region. Recruitment and training procedures for tax officials, as well as salary scales, need to be reviewed in order to increase efficiency. Improved assessment and collection techniques should be developed, together with systems to detect noncomplying taxpayers and to apply adequate sanctions.

Further decentralization is also needed. Regional offices should be established as needed, in accordance with the availability of trained staff and revenue potential, while some activities which lend themselves more readily to centralized execution should remain at the head office level. Codification of tax laws has become indispensable in many countries in order for them to have up-to-date and manageable texts available to both taxpayers and tax officials.

An effort should be made to have representatives of the tax administration participate in the work of tax policy planning units in charge of long-range policy studies. Such participation should help to prevent the occurrence of problems when tax changes are implemented.

The structure of tax departments should be carefully studied with a view to avoiding duplication of certain services, thus saving the government money and the taxpayers inconvenience. Other objectives of this study should be to provide efficient coordination between assessment and collection activities and to ensure taxpayer convenience.

Finally, since taxation has been associated with foreign domination in most countries in the region, it is important that satisfactory communications with taxpayers be established to convince them that the tax system is being administered fairly, that enforcement is adequate to deter delinquency, and that the money collected is being spent wisely.

III. Taxation of Imports

1. Introduction

Most countries in the region still rely heavily on the taxation of imports for revenue; this reliance reflects the inadequacies of other tax bases and the countries' reluctance to make use of other taxes which may require more sophisticated administrative capabilities. 1/ The consequence has usually been that an excessive emphasis has been put on the revenue function of tariffs; this concentration on revenue raising runs counter to the view, generally accepted in economic theory, that tariffs' major role should be to grant adequate levels of protection to domestic production.

If a tariff were to play this role, the importance of economic efficiency considerations should be underscored. Economic development can be greatly hampered by protecting domestic industries to the point of rendering them noncompetitive. Ideally, the ultimate objective of each country should be to develop efficient resource-based industries which can make maximum use of its comparative advantages.

As might be expected, remnants of the recent colonial past of most countries are easily detectable. The structure of levies, the pattern of trade preferences, the affiliation with regional groups, and the characteristics of national legislations have all been influenced to a large extent by the colonial history of each country and, in some cases, have lagged behind the formulation of national and regional policies.

Other prevailing features of the taxation of imports in sub-Saharan countries are the proliferation of exemptions, the fairly extensive use of specific rates as opposed to ad valorem rates, and the reliance on price lists rather than on internationally accepted definitions of value for purposes of valuing imports.

1/ In 15 countries in the region import duties accounted for more than 40 per cent of total tax revenue, and in 24 countries the proportion exceeded 30 per cent. See, Tanzi, op. cit., p. 16.

2. Salient policy aspects

a. Tariff functions

The structure of customs tariffs in the sub-Saharan countries is such that, in general, they are reasonably adequate instruments for equity and revenue purposes, but these positive characteristics are achieved at the expense of their suitability for protecting and developing domestic production. Because tariffs were originally designed to collect revenue and to improve equity and because practically no country in the region has been able to do away with their revenue function, it has not been possible to transform the tariffs into successful tools of protective policies. At the root of the problem lies a basic dilemma: maximization of revenues cannot occur if a tariff constructed to afford protection to domestic industries succeeds in its main objective and import substitution takes place.

Moreover, even the equity objective may be inconsistent with revenue considerations; too high taxes on luxury products may result in less revenue being collected by encouraging local production, by acting as too powerful a deterrent to consumption, or by encouraging contraband. For example, imports of luxury products in Somalia are subject to combined tax rates ranging from 129 per cent to 736 per cent, the latter rate being applicable to spirits and liquors; taxation at these levels does not normally produce much revenue.

Some limited degree of fine tuning, allowing for a tariff with multiple functions, is possible. The difficulties inherent in the exercise, however, dictate a different solution. From the point of view of tax policy, tariffs are just part of the system of indirect taxation. It seems best, therefore, to try and rationalize the latter by assigning a particular goal to each particular tax instrument. This approach would facilitate considerably the study of the effects that tax changes may have and would make it easier to achieve multiple policy goals.

Under such a rationalized system, customs duties would be used mainly for protection. 1/ They could also be used, preferably on a temporary basis, for balance of payments purposes but not for equity or revenue purposes. A general sales tax could be the main instrument used to collect revenue, while considerations of equity, energy conservation, and the need to discourage consumption of socially undesirable goods and services would best be served by a system of excise duties. Both the general sales tax and the excise tax should be equally levied on imports and domestic production. A clear distinction between import duties and sales tax and excises is desirable, even when the bulk of the sales tax base consists of imports and when some of the luxury goods that are to be specially taxed are not produced locally, because the separation avoids giving unintended protection to actual or potential local production.

1/ The term "customs duties" is used in this paper as equivalent to import duties.

b. Nominal and effective protection

The confusion between the revenue and protective functions has also led to excessive levels of protection, resulting in damaging effects on resource allocation. Thus, when customs duties are brought to bear heavily on luxury goods, an incentive is created to produce them domestically, and it is likely that this kind of import substitution will not make any country better off. Instant recognition of the problem has been made more difficult by the realization that it is effective protection, a concept developed only in the last 15 years, that matters when the resource allocation effect of a particular tariff structure has to be determined. While nominal protection levels are easily identifiable and measurable, rates of effective protection of domestic production are determined by reference to the value added by local manufacturers and are difficult to quantify. 1/ Nevertheless, it is clear that, because many raw materials, intermediate goods, and capital goods are either tax exempt or taxed at much lower rates than final goods, effective protection of import substitutes--including luxuries--may have become excessive. This is particularly true for industries--such as batteries, cosmetics, and assembly plant industries in general--where the nominal tariff on the final product is high and the share of domestic value added tends to be low. The seriousness of the problem is underscored by the fact that the costs of this inefficient allocation are likely to rise with the level of industrialization. On the other hand, domestic production of essential food items may have actually been discouraged by negative effective protection resulting from low or zero nominal duties and high domestic value added. It is quite possible that, instead of encouraging production of items in which the countries have noticeable comparative advantages, external economies can be effected, and dependence on foreign exchange availability is lessened, the protective policies more commonly found have done just the opposite. 2/

Solutions to these shortcomings are not easy to identify. The first step should be to undertake a detailed study of the existing protection levels for various industries and sectors. It goes without saying that data availability is of the essence to make such a study possible, particularly regarding industrial costs and processes. Every effort should be made to finalize these studies as soon as possible after preparation starts since their relevance may be lessened by changes in rates, the structure of imports, and other factors. This should be followed by careful determination of which levels of protection would be compatible

1/ A relatively simple measure of the effective protection rate for a particular product would be given by a fraction, the numerator of which is the difference between the tariff rate on the product, and the average tariff rate on the inputs used in its production weighted by the latter's share in the product price on the world market; and the denominator of which is the value added per unit of output, measured in world market prices.

2/ Quantitative restrictions and exchange controls have also been widely used as protective devices.

with improved resource allocation in the economy, efficient foreign exchange utilization, and incentives to agriculture. Only then would it be possible to restructure the customs tariff with a view to achieving these objectives. The complexity of this task only highlights the vital importance, pointed out before, of not trying to use the tariff for too many purposes.

c. Exemptions

It has frequently been observed that the composition of imports changes as economic development progresses and that the share of items such as machinery and transport equipment in total imports grows over time. Since these items are generally subject to low rates of duty and sometimes are even zero-rated, their increased relative importance vis-à-vis other imports tends to make customs revenue inelastic. By way of illustration, 25 per cent of Sierra Leone imports in the fiscal year 1977/78 were zero-rated; the share of exempt imports in total imports was roughly the same in Mauritius in 1978. A much higher level of exemptions, about 65 per cent of total imports, was observed in Liberia in the period 1973-76. Cameroon, Gabon, and Senegal also exempt large shares of their imports.

Fast growth of exemptions has also eroded the bases of import taxes. In many countries, imports needed to carry out government contracts and developmental projects, imports of raw materials, direct government imports, imports of plant and machinery for local manufacturers, imports of agricultural inputs and machinery, and imports of certain quasi-government institutions are partially or totally exempt from duties or other levies on imports. For example, in Sierra Leone, the proportion of the value of imports exempt from the entry fee and the licensing fee went from 36 per cent in 1976/77 to 54 per cent of imports in 1979/80. Equally, exemptions in Somalia expanded from less than one half of the total value of imports in 1977 to more than three-fifths the following year. Perhaps the most dangerous institutional arrangement, which is found in some sub-Saharan countries, is the one conferring broad powers on ministries of finance to grant ad hoc exemptions. When there has been a departure from the principle that legislation on exemptions should be restrictive, considerable pressure has often been exerted on ministry staff to grant more exemptions and proliferation of exemptions has ensued. These pressures, however, may have had their origin in duties which are excessive and which, if applied, would preclude certain importers--particularly manufacturers--from operating under normal conditions. In these circumstances, investment laws and other incentive schemes, under which the authorities are empowered to grant exemptions, gradually become important policy instruments while the customs tariff loses its role and importance. To a large extent, this has been the case in Senegal and the countries which are members of the Central African Customs and Economic Union (UDEAC).

These widespread exemptions and the low level of taxation for certain imports need to be re-examined in the light of the countries' medium-term objectives. Thus, the exemption or low taxation of oil imports by some countries might have been justified before 1973 on grounds of the need to aid industrialization and transport activities, but now it runs counter to energy conservation efforts. In addition, it introduces distortions in the allocation of foreign exchange by making imported oil relatively cheaper than dutiable raw materials and intermediate inputs used by other industries. In some cases, it may even happen that preference is given to imported goods even when locally produced goods of equivalent quality are available, particularly if the exemption has resulted in removal of a protective duty. No less damaging is the zero-rating of essential food. Although always predicated on equity grounds as a means of helping the needy, this policy would encourage importation--and discourage domestic production--of staple foods such as rice, maize, and fish. Similarly, there is no good reason to exempt government imports or imports needed to carry out government contracts or goods imported by quasi-government institutions. This exemption tends to decrease artificially the costs of government services and consequently to establish implicit subsidies, since the prices charged for those services will not reflect true costs. It also encourages the use of imported materials and introduces the possibility of abuses and leakages. The argument that this policy does not have a net revenue effect is, therefore, neither entirely correct nor relevant.

Contrary to the case of protection, where quick action is usually ruled out until a number of complex studies are completed, governments can generally take immediate steps to remedy, at least partially, the erosion of the taxable base caused by exemptions. It is not uncommon for governments in urgent need of additional revenue to move quickly to levy minimum or additional customs duties on oil and on essential foods. Such a move would also help a country to achieve its medium-term energy conservation objectives, in the case of oil, and to encourage its agricultural production in the case of essential foods. Equally, removal of exemptions on government imports and imports needed to carry out government contracts need not be delayed. In general, all exemptions should be reviewed with a view to removing them unless their *raison d'être* is beyond doubt. In doing so, however, caution should be exercised not to violate international agreements, laws, and other legal instruments which may have granted exemptions over specified periods of time. In these cases, it may be necessary to wait until the exemptions have lapsed.

d. Regional groupings

Affiliation of many sub-Saharan countries with regional agreements, such as customs unions and other arrangements, has inevitably limited their freedom to use customs tariffs as policy instruments. Examples of these arrangements are: the Mano River Union Agreement involving Liberia and Sierra Leone; UDEAC, which includes Cameroon, the Central African Republic, the People's Republic of the Congo, and Gabon; and the Economic Community of West African States (ECOWAS), founded by Benin, The Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo, and Upper Volta. Normally, these customs unions have common external tariffs, and changes in the tariffs have to be effected through central committees on which all member states are represented. Agreement between them is not easily reached, and the failure of member states to agree on tariff changes has often led to inelasticity of customs revenue and has narrowed the base of import taxes.

Some of these regional arrangements contain provisions for the imposition of special taxes by individual member states, particularly where rate differentiation among them was deemed desirable. One example is the UDEAC's complementary tax. Since these taxes are the only instrument available to member countries for conducting a tariff policy of their own, these countries have allowed these taxes to proliferate, which has resulted in a distortion of the effects of the common tariff and a reduction in the uniformity of import taxation. Even when the regional agreements do not have these escape clauses, some member countries have introduced taxes on imports, disguised by a variety of names, to make up for the loss of revenue caused by adoption of the common tariff.

The advantages of regional integration are many and complex and cannot be evaluated solely from the viewpoint of taxation policies. Nevertheless, the existence of a customs union and a common external tariff should not be construed by the member states as an obligation to renounce the sound principles of tariff reform. On the contrary, it seems imperative that the member countries pursue these principles relentlessly, working through available regional channels. Thus, simplification of the common tariff objectives, minimization of exemptions which are not sufficiently justified, and harmonization of tariffs with indirect internal taxation appear to be reasonable targets for any regional grouping of countries as well as for a country in particular.

e. Import taxes and exchange rate

In some cases, the authorities of a country may choose to raise import duties to compensate for an overvalued exchange rate. Although the ultimate objective--to increase the cost of imports to a realistic level--is achieved without going through a politically less palatable currency devaluation, the action has a basic flaw; the tariff is not particularly well suited for this use. Even without taking into account the fact that choosing import taxes over devaluation does not help exports, the authorities should resist the temptations to solve the problem of raising import costs in this way. It is even possible that, to the extent that exporters' inputs are imported and that no refund or drawback system is available, import taxes will raise costs for exporters. The most important consideration should be that manipulating the tariff for this purpose substantially distorts its protective function and may have harmful allocative effects.

3. Administrative considerations

a. Proliferation of duties and taxes

It is not uncommon in the region to find that imports are subject to a variety of duties, fees, and other levies. A few examples can be provided. In Sierra Leone, there is (a) a customs tariff, (b) two import fees (the invoice entry fee and the import licensing fee), and (c) a foreign exchange user charge levied on import licenses. In Somalia, imports are subject to an import duty (customs duty plus fiscal duty), and to an administrative and fiscal duty. In addition, there are wharfage and storage fees, and an ad valorem stamp duty. In UDEAC countries a customs duty, an entry duty, a turnover tax on imports, and a complementary tax coexist.

This proliferation of import taxes is mainly due to ad hoc attempts at raising additional revenue by superimposing new charges over and above the original tariff, sometimes even using across-the-board flat rates. It is also the result of efforts to differentiate taxation of imports according to their origin in certain cases where there have been agreements with other countries to lower tariff barriers; the mutually agreed reductions would apply to some, but not all, of the various levies. A classic example is provided by the experience of the UDEAC. Before the 1975 Lomé Convention, the UDEAC, as associate member of the European Economic Community (EEC), exempted imports from the EEC and associated African countries from customs duties. For revenue purposes, the common external UDEAC tariff included another levy called the entry duty. Although the differentiation of imports according to their origin no longer occurs, the two levies have continued to exist side by side. In some cases, charges such as statistical taxes, which had been originally introduced to defray the costs of certain services, became a part of the tariff's rate structure and ceased to bear any relation to those costs. The rate structure of the tariff is, itself, often unnecessarily complicated, with negligible differences among many different rates. For example, there are 28 different ad valorem rates in Sudan, including 6 which range from 5 per cent to 15 per cent. The same problem was observed in 1977 in Togo, where 9 rates of the fiscal import duty ranged between zero and 30 per cent.

This complex structure of import taxation greatly complicates administration and may result in inconsistent rate patterns. First, the calculations required to assess the tax liability become unnecessarily numerous, increasing the possibility of errors. Second, the complex structure makes it difficult to put together in one publication or volume the various taxes and duties falling on imports. The result is that self-assessment by importers or customs brokers--a labor-saving device for the customs department which becomes indispensable as the volume of trade grows--is not feasible. Third, proliferation of duties and taxes is incompatible with the effort being made in most of the countries in the region to introduce a rationalized classification standard, such as the one provided by the Brussels Tariff Nomenclature. Moreover, proliferation leads to extreme difficulty in readily identifying total tax burdens on particular items if a policy decision needs to be made.

To remedy this situation, the first step should be to consolidate the customs duties and all additional levies with equivalent effect into one or two charges. 1/ It should then be possible to simplify the structure of the tariff by establishing a small number of even-modal rates and a maximum rate which would be in accordance with the rate distribution of the original tariff in the absence of new policy directives. In the long run, when--as discussed previously--the desired degree of protection to be given to each industry has been determined and other necessary changes have been introduced in the tax system, a comprehensive realignment of import duty rates should be undertaken in the framework of a comprehensive development strategy.

b. Use of specific rates

Generalized use of specific rates of duty instead of ad valorem ones, has also been an important factor--particularly in many nonfrancophone countries--behind the inelasticity of customs revenues. The case of Sierra Leone is illustrative. In the fiscal year 1977/78, as much as 15 per cent of its total imports entered the country at specific rates of customs duty. This preference for specific rates has usually been justified on grounds of administrative convenience; these rates are applied irrespective of values and are, therefore, easier to administer than ad valorem rates. Governments should be aware, however, that in times of rising prices, specific duties simply mean a steadily decreasing effective rate of taxation of imports, which will tend to undermine the objectives of the original tariff, including its protective function. This is the reason why many countries around the world have increasingly resorted to ad valorem duties in the last 50 or 60 years.

The solution to the problem involves two separate steps. First, the justification for each existing specific rate should be carefully reviewed. Then, there is not enough reason to maintain a specific rate,

1/ In some cases, a second duty is necessary to allow for agreements already negotiated with other countries or to give the country an advantageous point of departure in future negotiations of tariff reductions.

it should be converted to an ad valorem rate; if, on the other hand, conversion to ad valorem rates is undesirable, a mechanism should be introduced to increase specific rates as frequently as changes in import values make such action imperative to maintain the level of import taxation in real terms.

In any case, even a limited minimum price list for valuation purposes (discussed below) would be easier to update than specific duties and would be, therefore, preferable to them.

c. Reliance on administrative values

Lack of adequately trained personnel has been the main factor precluding many sub-Saharan countries from following sound valuation principles. One of the most important functions of any customs administration is to make sure that imports are correctly valued in accordance with widely accepted methods. For this reason, standards such as the Brussels Definition of Value and, more recently, the General Agreement on Tariffs and Trade (GATT) Definition of Value have been developed by international agencies. Unfortunately, application of these standards requires a high degree of technical knowledge and experience on the part of customs personnel. This requirement is likely to prove extremely difficult to fulfill.

To prevent underinvoicing, many countries have therefore resorted to establishing price lists, against which the value declared by importers or shown on the respective invoice would be checked. 1/ If the listed administrative price is greater than the value obtained from the importer, the former would be used for customs purposes. Such systems are simple enough but they have shortcomings. One shortcoming, not directly related to revenue, is the degree of trade unfairness that these systems make possible. If a country which uses a list of administrative values decides to confer a high level of protection to a certain item that is domestically produced, all it has to do is to inflate artificially the list price of similar imported products. Thus, there is no need to go through the highly visible process of raising the tariff level. The most serious shortcoming, particularly from the point of view of revenue, is that the list has to be updated at frequent intervals, especially at times of worldwide inflation. If this updating is not done, revenue erosion occurs, in much the same way as it occurs when specific rates of duty are not adjusted for price changes. The cases of Somalia and Chad deserve to be mentioned as examples. The list used in Somalia in March 1980 had not been updated since February 1977. Meanwhile, wholesale

1/ In countries with exchange controls, insofar as for many relatively low-duty items the foreign exchange premium may be higher than the import tax penalty, overinvoicing may be widespread. Since this deviation from actual prices would only be in the direction of enhancing customs revenue, it will not be discussed here.

or industrial prices in the countries from which Somali imports mainly originate went up by between 9 per cent (Federal Republic of Germany) and 39 per cent (Italy) over the period 1977-79. Equally, in Chad, standard values established in 1970 were still being used in late 1976.

In the long run, all customs administrations will have to rely on internationally accepted valuation standards if they are to avoid disputes and differences of opinion with trading partners. It will take time to familiarize the trading community with the new standards and to establish the administrative capability required to apply them; and, therefore, it would be wise to start as soon as possible. Recruitment and training of qualified personnel, introduction of needed legal changes, setting up of a valuation unit within the customs department, and compilation of information that is relevant for valuation purposes are all tasks which cannot be performed over a short period. In view of this, it is generally admitted that some countries will have to continue using minimum price lists in the near future. In any event, their use should be restricted to goods known to be underinvoiced, and every effort should be made to set realistic prices. To avoid the revenue-eroding effect mentioned above, however, it is imperative that the price lists be frequently updated. This could be done by compiling comprehensive and reliable data on prices that are obtainable from foreign trade journals, retail and wholesale catalogs, and other sources. In addition, customs officers should be aware of the value of their own daily work for purposes of updating the price list.

d. Customs procedures and personnel problems

In many of the sub-Saharan countries, attention has been paid to matters dealing with the organization of customs departments and with customs legislation in general. It is in the area of customs procedures and personnel matters where the most serious deficiencies and loopholes are still discovered. Only a comprehensive review of these aspects is likely to have a meaningful positive effect on the efficiency of the Customs operations.

Included in this review there should be the following: adequacy of warehousing provisions and charges for allowing surveillance of goods, and availability of a system of bonded warehousing; controls for duty-free concessions, temporary importation, and transit; prevention of leakages through provisional clearance underguarantee, and refunds and drawback schemes; quality of the work of examination of goods for clearance; quality of the systems for payment of duties; arrangements governing the activities of customs agents; methods used for lodgment, registration, and postaudit of import entries; flow of documents within the customs administration; and efficiency of the statistical reporting system. Once the review of these and other procedures has been concluded and shortcomings have been identified, new procedures should be designed and carefully implemented over the medium run.

Of paramount importance in avoiding failure is the setting up of training programs. These should be based on detailed instruction manuals that are prepared with a view to ensuring uniform application of the new procedures throughout each country. Other procedural changes will be necessary if and when the system of customs valuation is reformulated along the lines discussed above. Finally, much more attention has to be paid to improving the salaries of the staff and their working conditions. Failure to do so will only result in increased corruption--to which customs work is particularly vulnerable--or in an acceleration of the exodus of the best-qualified and best-trained personnel to the private sector. In the last analysis, the success or failure of carefully thought-out policies depends to a large extent on the suitability of the staff in charge of carrying them out.

IV. Taxation of Consumption

1. Introduction

Like countries in other regions of the world, sub-Saharan countries are using several tax instruments to collect revenue from domestic consumption. 1/ Two of them, however, tend to outweigh the others in terms of revenue importance: excises and general sales taxes. A distinction between these two categories of taxes is not always easy to make, but the scope of coverage and the number of rates are probably the features most widely used to differentiate one from the other. While excises usually consist of different rates imposed upon the production or sale of particular commodities (or services), a general sales tax is normally levied with one rate or a few rates applicable to sales of a wide range of goods (or services). It should be noted, however, that a widespread system of excises and a general sales tax with numerous rates and exemptions would be quite similar in coverage and rate structure.

Excise on goods are common throughout the region, while general sales taxes, which originally were found only in francophone countries, have also become common in former British colonies. Thus, between 1968 and 1973, the three East African countries (Kenya, Tanzania, and Uganda) and Zambia introduced general sales taxes. In many cases, both excises and general sales taxes are also levied on services. Like taxation of imports, taxation of domestic consumption may be unnecessarily complex. This has often been the result of regional agreements coupled with ad hoc measures to increase revenues that have been put into effect under pressure and without considering the tax system as a whole. The case of Cameroon exemplifies the problem. It has an internal tax, the UDEAC single tax,

1/ For most of the countries in the region taxes on goods and services ranged between 10 and 30 per cent; but the share exceeded 30 per cent in Ghana, Kenya, Malawi, Niger, Sudan, Tanzania, and Zambia. See, Tanzi, op cit., p. 16.

a national single tax, and an internal production tax. In addition, there are a few special excises. Rates and exemptions under these taxes are diverse, and the administration of the taxes is divided between the Customs and Tax Departments. These taxes produced, on average, one fourth of total tax revenues over the period 1974-78.

In addition to excises and general sales taxes, some countries operate fiscal monopolies from which profits are derived. These profits should be considered the equivalent of taxes. Equally, certain modalities of the stamp tax, such as the stamp tax on receipts from sales, are closer to turnover taxation than to any other type of tax. Other taxes which are sometimes included in this group of taxes on domestic consumption are business and professional licenses and motor vehicle taxes.

Taxation of domestic consumption also bears, as other taxes do, the influence of former colonial patterns. For example, francophone countries have been applying variant forms of the French production tax of 1936 that evolved into a value-added tax in Ivory Coast and Senegal. In addition, the situation in some of the UDEAC countries nowadays is highly reminiscent of the situation in France before the enactment of the 1936 tax, when single taxes were widely applied and a general turnover tax was in existence. It is not uncommon to find that the structure of taxes on domestic consumption is still basically the same as that introduced before independence. If anything, the situation has probably worsened since independence because revenue needs and other considerations have tended to erase the simplicity which was the most valuable characteristic of these taxes when they were introduced. Reform, however, must be undertaken with extreme care in view of the fairly large share of total tax revenue that is derived from taxes on domestic consumption.

The coverage of this chapter will be restricted to the main issues related to excises and general sales taxes. The latter have been singled out for more extensive discussion, in view of the likelihood that they will play a pivotal role in the revenue systems of most sub-Saharan countries. Some of the other domestic taxes on goods and services mentioned previously are covered elsewhere in this paper.

2. The case for taxes on domestic consumption

a. Roles of excises and general sales taxes

When domestic production of goods begins to expand following diversification of economic activity, it becomes apparent that the tariff can no longer be considered the sole important instrument used to collect the revenue needed to finance a government's activities. Not only does domestic production emerge as a new source of government revenue but also--as mentioned in the previous chapter--the composition of imports changes from one in which high-duty consumer goods prevails to one in which the share of capital goods and raw materials, which are generally subject to lower duties, becomes dominant. In these circumstances, increasing recourse to taxes on domestic consumption seems unavoidable.

Historically, excises have preceded general sales taxes. This has been so because there is no reason to use broad-based taxes when production is not diversified. Excises are more akin to customs duties and therefore can generally be administered without requiring extensive retraining of customs personnel; in particular, classification and valuation techniques used in customs work are normally applicable also to excise administration. In an economy where the manufacturing sector is small and is dominated by a few products--a case that is fairly common in the early stages of economic development--the easiness with which excises can be administered relative to general sales taxes makes the former preferable from the viewpoint of collecting revenue. An example of this is Sierra Leone, where excise taxes on goods have averaged about 15 per cent of total revenues in the past ten years, even though they are imposed only on domestic output. Five groups of products--tobacco, petroleum, beer and stout, soap, and confectionary--account for about 97 per cent of excises on goods.

At a later stage of development, however, the revenue function is best performed by general sales taxes. These taxes are especially suitable for situations where domestic value added by industries and by purely commercial enterprises has become sizable. As the number of taxable products increases, the degree of rate differentiation provided by an excise tax system is no longer feasible. Gradual expansion of the base, however, enhances the revenue producing capability of a general sales tax and tends to increase the elasticity of a revenue system. A general sales tax would be fairly easy to administer, would produce minimal distortion of the allocation of economic resources, and would react rapidly to economic growth and to changes in the economy. Its addition to a tax system does not mean that excises should be discarded. Selective excises would supplement a general sales tax by imposing additional taxes on goods and services, consumption of which the government wishes to discourage or penalize, or which it considers luxuries instead of necessities.

b. Coordination with import duties

As mentioned in the previous chapter, the main objective of an import tariff should be to protect domestic industry from foreign competition. A general sales tax should be mainly used to raise revenue through a general levy on domestic consumption of imported or domestically produced goods, as broad-based and within as few rates as possible. The excise tax system should constitute the only other major component of taxation of domestic transactions and could apply a higher tax to certain items--whether imported or domestically produced--for equity purposes or to discourage their consumption. The key characteristic of this arrangement is that neither the general sales tax nor the excise tax system would be used to discriminate against imports, while protection would be pursued only through the import tariff. It should be noted that, although excises, rather than general sales taxes, have been preferred for the purpose of treating imports and locally produced goods differentially, there have been cases in which general sales taxes were used as an instrument of protection. In Uganda, goods such as building materials and certain textile products are subject to higher sales tax rates if they are imported than if they are manufactured domestically. Malawi and Zambia uplift values when imposing sales tax on imports, arguing that domestic manufacturers perform more of a wholesale, and even a retail, function than is included in the import price. Such actions may also be construed as discrimination against imports.

Even if this is achieved, there still would be the need for a careful review--and a realignment, if required--of rates in order to ensure that the total burden on any particular product is compatible with the objectives of each one of the applicable tax instruments. Care should be taken to avoid excessive rates on certain products as a result of expanding the coverage of the sales tax and the excises to imports in cases where they only covered domestic production before.

c. Elasticity

As in the case of import taxation, the elasticity of domestic taxes on consumption, particularly excise taxes, can be severely limited by the use of specific rates when these are not frequently adjusted for inflation. Excises with specific rates are predominant in many countries. 1/ In Somalia, for example, all excises have specific rates, with the sole exception of the excise tax on soap and shampoo. One of the most visible cases is that of excises on petroleum products, which are fairly common and important in many sub-Saharan countries. While domestic prices of oil products have generally been adjusted upward following the price increases imposed by the oil producing countries, specific rates of excise duty on these products have not been changed or, more frequently, have been increased by a smaller percentage than the percentage increase in prices. Failure to take commensurate action on duties vis-à-vis prices has substantially eroded the effective rates of excise taxes.

Although the situation may be rectified through frequent adjustments, a more lasting solution would be the conversion of specific rates to ad valorem rates. This step, however, would make valuation necessary and would complicate administration. On the other hand, it would have the advantage of imparting complete automaticity to the adjustment, making it unnecessary for the government to take discretionary action each time that prices change. If the price is administered by the government, the need for an ad valorem rate is probably greater, since otherwise the government will be forced to decide on two discretionary changes (price and tax) instead of one (price) to keep the excise tax system responsive.

1/ See, Tanzi, op. cit., Appendix Table II.

The argument that specific rates should be used rather than ad valorem rates because the former are easier to administer is no longer valid in some sub-Saharan countries. There are cases in which a general sales tax with ad valorem rates has been introduced after excise taxes have been effective for many years, and some items are taxable under both taxes. There is, therefore, an explicit valuation procedure in existence which could also be used for purposes of the excise tax system. For example, this has been the situation in Sudan since a general sales tax on all domestically manufactured goods, the so-called development tax, was introduced in 1974.

d. Equity and conservation objectives

Assuming that general sales taxes are mainly entrusted with the function of raising revenue, it is for the excise taxes to play an important role in promoting equity in a situation in which consumption of the items to which they apply increases with income. In many countries, however, excises--and often sales taxes--have traditionally been levied on mass consumption goods, such as cigarettes, beer, and kerosene; and the most recent data on expenditure patterns show that consumption of these items tends to bear little relation to income. Whenever this occurs, these taxes will be regressive. An example can be found in Zambia. Several studies conducted there concluded that, from a burden distribution standpoint, the tax most seriously affecting the lowest income groups was the excise on beer, which accounted for almost 18 per cent of total tax revenue in 1976. Heavy taxation of beer has been, of course, a deliberate policy choice on the part of the Zambian authorities.

Regressivity could be attenuated by reducing the excise duties on mass consumption goods, but this would conflict with other objectives--such as revenue and elasticity--that may have been assigned to the excise tax system. These conflicts of objectives could be minimized if each tax instrument were, as was discussed before, to be chiefly used for a different purpose. Another aspect deserving attention is the possibility of introducing inequities through extensive use of nondifferentiated specific rates, which are a common feature of excise taxes. When different qualities of a given commodity are available, ad valorem rates produce automatic differentiation, since the amount of tax will always be proportional to the price. It is true that the same effect can be achieved by a set of different specific rates which would be applicable depending on the sale price of the commodity, but this appears to be unnecessarily complicated.

Excise taxes can also be designed to discourage consumption of certain goods and services. Perhaps the clearest case in point in recent years has been the increased use of excises on petroleum products by some countries to encourage conservation of energy and foreign exchange. It is important to bear in mind, however, that the objective of conserving energy may well be in conflict with the equity objective unless the rates of excise duties properly differentiate among petroleum products (for example, imposing a higher burden on gasoline than on kerosene).

3. General sales taxes

a. Choice of form of sales tax

The extent to which a sales tax can be applied to a large number of sales of goods and services is, of course, determined by the social objectives of the particular government and by the administrative constraints that may be encountered. It should be borne in mind, however, that neutrality is enhanced, and resource allocation is least distorted, by a broad-based sales tax with few exceptions. Moreover, a sales tax with these characteristics is also best suited to fulfill the revenue objective.

In choosing the form of general sales tax that should be preferred, the experience of other countries--insofar as this is transferable to a particular national or regional situation--may be one of the most valuable guides. This experience seems to indicate that a multistage value-added tax and a single stage manufacturer/importer sales tax are the two most adequate forms.

The value-added tax has been the choice of countries that have become members of regional economic groupings, such as the EEC or the Latin American Association for Integration and Development (formerly the Latin American Free Trade Association). Before deciding on value-added taxation, the EEC countries conducted extensive studies in order to ascertain which was the best way to harmonize turnover taxes within the Community. These studies concluded that value-added taxes were the best option for purposes of, inter alia, neutrality, uniformity of the tax burden, and incentives for increased productivity and industrialization. The EEC countries also concluded that the advantages of the tax were maximized when the retail stage was included in the taxable net. Administrative difficulties, however, have led many developing countries which have value-added taxes to limit their application up to the wholesale level or to restrict in some other manner the number of taxpayers. Such is the case in Ivory Coast, Madagascar, and Senegal, all of which make their value-added taxes reach up to the wholesale level. 1/ It should be noted, however, that previous experience with turnover taxes extending to the retail level has allowed some developing countries to introduce successfully value-added taxes with the same coverage. Although no regional economic grouping in Africa has yet decided that its member countries should adopt a value-added tax, this possibility has been considered in UDEAC countries. Up to now, the predominant role of the UDEAC single tax, and of national taxes based on the same principles, has been a factor in precluding early adoption of a value-added tax.

Another consideration which may be important is that the longer the chain of taxed production and distribution, the less necessary it is to resort to high tax rates, since the same amount of revenue would be

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1/ See also the discussion later in the paper on domestic taxation of small businesses.

collected through a broader base. This is an argument in favor of general sales taxes reaching beyond the manufacturing/importing stage because lower tax rates mean lesser rewards for tax evasion.

A manufacturer/importer sales tax should be considered in countries where a large proportion of retail sales are made by itinerant traders and small shop owners, and where there is not always a clear distinction between wholesale and retail transactions. This is so because imports are already subject to customs control and manufacturing enterprises subject to the tax are few, provided that small manufacturers are exempted.

It is not possible, however, to select one form of sales tax which would be superior to the others in all circumstances. The choice of form must be made in each case, paying careful attention to factors such as amount of revenue needed, trade structure in the country, extent of record keeping in the business community, administrative capability of the revenue department, standards of voluntary compliance among taxpayers, and previous experience that the country may have had with other taxes on domestic consumption.

b. Need to avoid cascading

The advantages of a broad-based sales tax covering as large a number of sales of goods and services as possible do not justify taxing goods and services more than once. Such cascading would imply that a consumer of items which are manufactured using taxed inputs or which go through a long chain of processing and distribution would be faced with a higher tax burden than he would face if the tax were neutral vis-à-vis the number of stages in production and distribution. Although this anomaly may be relatively unimportant in less developed economies, where domestically manufactured products do not normally use a high proportion of locally produced primary and intermediate goods, it is desirable to introduce some mechanism to minimize cascading, so as to prevent distortions in future economic growth. These distortions would arise from the generally accepted viewpoint that cascading encourages undue vertical integration along the chain of production and distribution. It should also be borne in mind that as the structure of an economy becomes more complex, the chains of production and distribution tend to get longer, making it more imperative to remove cascade effects.

One way of avoiding cascading would be provided by a value-added tax, which would allow each taxpayer to compute a credit for sales tax paid on inputs, whether imported or purchased locally, and apply the credit against tax due on his sales. With this system, the tax base would be the value of final sales by taxpayers plus the value of imports by nontaxpayers. Sales from one taxpayer to another or imports by taxpayers would thus not be taxed twice, even though tax on such transactions would actually be collected on account of the tax which will be generated by the final sale to the consumer.

Other mechanisms that avoid cascading are in use. Francophone countries applying sales taxes based on the 1936 French production tax (as modified in 1948) have attempted to avoid cascading by allowing taxpayers to deduct from gross sales the purchases of inputs that are physically incorporated into the manufactured product (known as the physical ingredient rule). It has been argued, however, that this mechanism discriminates against capital equipment, since only purchases of raw materials and intermediate goods are deductible from taxable sales. Another mechanism, which is fairly common under manufacturer/ importer sales taxes, is to allow manufacturers registered as taxpayers to acquire locally-produced goods or imported goods, which are used by them as inputs, tax free. This provision, by which tax is suspended until sale of the final product takes place, has resulted in abuses, such as tax-free acquisition of goods not intended for manufacturing but rather for consumption by the manufacturer. Prompted by these abuses, some countries have repealed the provision and have replaced it with a refund mechanism, which, in turn, has produced too many claims and too much unproductive work for the administration. 1/

The best solution, even for a manufacturer/importer sales tax, probably is a credit system similar to that in use for value-added taxation. With this system, at least a part of the tax is payable when the inputs are purchased and any subsequent action by the manufacturer to evade taxation will result in a loss of only part of the tax.

c. Rate structure

Restricting the number of rates to one or two is not only a matter of neutrality, it is also a prerequisite if a government wants to stress simplicity in the administration of a general sales tax. Most sub-Saharan African countries which have general sales taxes use a maximum of three rates. There are, however, exceptions. In 1978, Tanzania's manufacturer/ importer sales tax had 24 ad valorem rates plus 24 specific rates. Also, Uganda started a general sales tax of the same type in 1968 with five ad valorem rates and a few several specific rates; by the beginning of 1980, there were 19 ad valorem rates in addition to several specific rates. Multiple rates require that taxpayers break down their reported sales into as many components as there are rates, and this may prove difficult, particularly where the tax is levied beyond the manufacturing stage. In addition, administrative checks on compliance become less effective, because many of these checks are designed to ascertain the reliability of a taxpayer's total turnover but cannot be used to establish the correctness of the turnover breakdown established by the taxpayer. For this purpose, new procedures have to be contrived, but the effectiveness may be limited and their application would tend to use additional tax audit resources. When it is felt that a particular item should bear a higher rate of taxation, the best solution is not to establish a differential rate under the general sales tax but rather to use the excise tax system.

1/ One of the countries in the region, after repealing the suspension mechanism, experienced a more than three-fold increase in the number of refund claims.

Limitation of the number of exemptions can be justified for similar reasons and to avoid the erosion of the taxable base that exemptions bring about, thus detracting from the revenue role of general sales taxes. There are, however, two cases which merit special consideration. First, it is generally accepted that export sales should be exempt. This is necessary to ensure a country's competitiveness in the international markets, because most countries apply the destination principle to sales taxation and therefore do not subject their exports to tax. Second, exemptions are commonly granted on certain goods to reduce the amount of tax ultimately paid by low-income consumers; these goods usually include unprocessed foodstuffs and mass consumption items. These exemptions undeniably help to reduce the regressivity of the tax.

d. Some special problems

(1) Capital goods

A widely accepted view is that capital goods should be exempt from sales tax, mainly because any tax payable upon acquisition of a capital good will eventually be incorporated in the production cost of the final product, which will again be taxable at some point before reaching the consumer. Thus, cascading will occur. Making capital goods taxable has been sometimes defended on the grounds that it would be a way of counterbalancing the many exemptions and incentives schemes (for example, regarding income taxation) that are available to users of capital goods and that may make these foods preferable to local labor. It appears, however, that the logical solution to excessive exemptions or incentives would be to limit them, rather than to offset them by means of other taxes. Even when incentive provisions are not excessively generous, a case can be made for including capital goods in the sales tax base in order to encourage labor-intensive, rather than capital-intensive, production methods. The taxation of capital goods may be particularly advisable if the exchange rate is overvalued and interest rates are too low.

A special problem is posed by the treatment of capital goods under a value-added tax. The credit mechanism offers a way to avoid cascading but the timing of the credit has to be decided. If it is given at the time of the purchase, the credit may erase a major part of the nominal tax liability on sales; and this may cause a disruption in the steadiness of the revenue flow to the government, particularly if the purchases of capital goods are substantial because of special incentive schemes, dismantling of exchange controls, or similar reasons. A solution would be to spread out the credit for tax paid on the capital good, and the best way of doing so would be to apportion it over the useful life of the good, assuming that its output would be evenly distributed over the depreciation period. The tax would then be an income-type value-added tax as distinguished from the more usual consumption-type tax, under which immediate credit is allowed for capital outlays. The income-type tax is less favorable to investors and requires more complex reporting, but it ensures a steady revenue flow to the government.

(2) Agriculture

Sales of unprocessed agricultural goods are generally exempted from sales taxation. There are two main reasons for this. First, most unprocessed agricultural goods are food items which, as mentioned above, can be considered basic necessities of the low-income sector of the population. In exempting them, the government attempts to mitigate the regressivity of a general sales tax, even though it recognizes that equity should be pursued mainly with other tax instruments. Second, agricultural producers tend to be of small economic size; geographically scattered; and, in general, extremely difficult to reach with a general sales tax. If it is felt that they should contribute revenue, it is probably better to tax some of their inputs.

(3) Small businesses

Most general sales taxes contain provisions that exclude small businesses from coverage. The reason is, again, administrative. The effort that the tax administration must make to force small businesses to pay sales tax is disproportionate with respect to the tax revenue generated. This is particularly true in developing countries, where standards of compliance are low, and the keeping of accounts is not a general practice.

The first step in deciding whether to exclude small businesses from a sales tax should be to ascertain the capabilities of the taxpayers and of the tax administration to, respectively, comply with, and enforce compliance with, the tax law. This evaluation should lead to a determination of the approximate number of taxpayers who can be considered manageable and, from there, to selection of a limiting factor--generally, total turnover--which would be used to draw the borders of the universe of taxpayers. It would be helpful not to establish this limit in the law, but rather to empower the government to do it by regulation; this would provide adequate flexibility and would allow future expansions of the number of taxpayers by successively lowering the minimum annual turnover as the tax administration gains experience and confidence.

This approach may be followed no matter what form of sales tax a government may have chosen. If it has chosen a single-stage, manufacturer/importer sales tax, the government's goal should be to eliminate from the universe of taxpayers the small artisans and producers. On the other hand, there is no need to exempt small importers, because the tax is generally collected at customs and, in the rare cases in which this is not done, it can be safely assumed that even small importers have enough capability to comply with the tax law. If the form chosen is of the multistage variety, either cumulative as a turnover tax or noncumulative as a value-added tax, the reasons for limiting the universe of taxpayers are even more valid. This is so because these types of sales taxes would, unless a limitation were introduced, include all taxpayers in the stages of production/distribution covered by the tax. It is clear that sub-Saharan countries should avoid the burden of having to deal with massive numbers of small retailers.

It has been argued that exemption of small businesses gives them an edge over larger firms which are included in the tax net. The argument is correct, but this consideration is clearly outweighed by the administrative considerations. In addition, the distortive effects of exempting small businesses are somewhat offset because they do pay some tax (on part of their inputs at least). Furthermore, the tax advantage enjoyed by small businesses is probably outweighed by the economies of scale that are inherent in larger firms.

Alternatively, some governments--mainly in the francophone countries--have resorted to forfait systems, such as making turnover taxes of small businesses the equivalent of some of their other taxes--for example, the business license tax. A case in point is Cameroon. There, taxpayers whose turnover is between CFAF 5 million and CFAF 20 million pay the internal turnover tax on the basis of the forfait of the business enterprise tax. Smaller businesses pay the equivalent of their business license tax as internal turnover tax. These or similar methods of estimating assessments without determining the actual transactions of small businesses are generally ill-suited to detecting the need to change the original estimates and, therefore, do not function well under inflationary conditions such as those prevailing in many countries at present. In addition, they tend to confer too much power on the tax administration, increasing the chances for corruptive practices.

(4) Services

In many developing economies, services may provide a suitable base for taxation. Hotels and restaurants have been frequently taxed, but financial and business services--such as banking, insurance, accounting, and rental and leasing services--have not, probably because an easily quantifiable base has been difficult to define. Other services which are usually taxable, or have been considered as possibilities for taxation, include utilities, such as telephone or electric companies.

There are at least two valid reasons to tax services. First, the contribution of the sector to gross national product is sizable, and, consequently, it may have a fairly large revenue potential. Second, most of the services which are likely to become taxable are used by high-income sectors of the population, and, therefore, subjecting these services to taxation may improve equity.

The question remains, however, whether a government should tax services under a general sales tax or an excise tax system. Both solutions have been tried, but the latter seems preferable. The main reason is that services lend themselves better to selective taxation, both in terms of coverage and rates, than to be taxed under a general sales tax which, ideally, should be as broad-based as possible and with very few rates.

V. Taxation of the Agricultural Sector

1. Introduction

Agriculture is the most important economic sector in the majority of the countries in the region. 1/ It is characterized by the preponderance of traditional agricultural pursuits. According to the conventional development theories, the expansion of the nonagricultural sector is part of the development process and requires increases in the marketed supply of food, in the nonagricultural labor force, and in capital formation outside of agriculture. Agricultural taxation is one of the instruments available to governments to help bring about all or some of the these transformations. 2/

Agricultural taxation may also affect resource allocation within the sector by penalizing the underemployment or inefficient utilization of resources, mainly land. Heavy agricultural taxes, as the argument goes, may paradoxically increase agricultural productivity, because it can be mobilized through the combined stick-and-carrot approach of increasing taxation and making investments outside agriculture more attractive. In addition to the development considerations mentioned above, a strong case for horizontal equity is often put forward in support of agricultural taxation. Heavy direct taxes, usually on land, can make the rich landowners pay their fair share of taxes. Furthermore, such taxes may complement or replace land reform efforts by forcing many large landowners to sell some of their land, thus reducing land prices by increasing the supply on the market and permitting small peasants to acquire land.

In recent years, however, an alternative view has emerged, placing more emphasis on agricultural development as an essential component of economic development. Whether the flow of resources should be to or from agriculture depends, in this view, entirely upon the particular circumstances of the country in question--its social and institutional framework, its technological and market prospects and possibilities, the relative size and productivity of the agricultural and nonagricultural sectors, and so on.

1/ See Tanzi, op. cit., Table 2, p. 3.

2/ Various nontax policies may also be used to alter the internal terms of trade between agriculture and other sectors--for example, credit policies, subsidies and other expenditure policies, protective policies, and price controls.

No general prescription can or should be expected to fit all circumstances. In addition, the potential of taxation policies to solve the many and varied problems underlying low agricultural productivity appears to have been overestimated. Agricultural taxes should be analyzed together with the use that governments will make of the proceeds. For example, the latter could, on the one hand, finance expenditures to improve agricultural infrastructure or to reduce the price of essential goods, but could, on the other hand, finance urban wage increases, especially those of high-cost civil servants. Enhanced agricultural taxation may, by restraining agricultural output, force the importation of certain food items and actually reduce the availability of foreign exchange, posing an additional constraint on development.

Increased agricultural productivity achieved through massive use of fertilizers, improved seeds, and other inputs further complicates public finance issues in developing countries and requires a reorientation of both taxation and expenditure policies, since substantial new investment is likely to be needed in agriculture. The immediate effect of this increase in productivity will probably be to accentuate inequality within the sector, making changes in agricultural taxation policies unavoidable. Equity issues have tended to become as important as maintenance of productivity increases in designing the appropriate mix of tax instruments to tap the presumably increased taxable capacity of agriculture.

For purposes of discussion in this chapter, the agricultural sector is divided into three subsectors: (1) subsistence production; (2) production of primary export crops on a commercial scale; and (3) production for commercial sale on the domestic market, mainly of fresh vegetables and dairy products for sale in urban areas. Tax instruments used include income and personal taxes, livestock taxes, export duties, land and land-related taxes, import duties, marketing taxes, and sales taxes and excises. In addition, there may be nontax levies through surpluses of marketing boards, and implicit contributions through exchange rates. Although data are not available on the total revenue contribution of the agricultural sector in countries of the region, export duties constituted the major part of agricultural taxation; their contribution to total tax revenue reached 70 per cent in 1978 in Uganda, 36 per cent in 1980 in São Tomé and Principe, 26 per cent in 1977 in Ethiopia, and 26 per cent in 1978 in Ghana. On the other hand, the relative share of personal taxes declined in Niger from 34 per cent in 1968 to 3 per cent in 1977, and in Mali from 21 per cent in 1962 to 4 per cent in 1977. Land taxes contributed very little as a result of the predominance of tribal land tenure systems in many of the sub-Saharan countries.

2. Taxation of the subsistence sector

Development strategies have aimed at making fundamental structural changes in the economy through reducing the share of the population and of other resources devoted to the agricultural sector. Some development programs have used fiscal measures to accelerate this structural change.

In recent years, however, there has been a reaction against such policies, based on doubts about the validity and social desirability of such change and on the increasing realization of the inability of other sectors to absorb the population released from agriculture. Moreover, the largest numbers of chronically poor people are in the agricultural sector, and increased attention to agriculture has been considered mandatory to solve the problem of poverty. One of the major results of this attention has been a tendency to reduce tax rates on, or to exempt, goods purchased by the subsistence sector.

The possibility of using income taxation in the subsistence sector will be discussed first. Farming in this sector has traditionally been, and still is, more a way of life than a commercial venture. Only a small proportion of subsistence farmers have taxable incomes in excess of the standard family allowances and other deductions conventionally provided under an income tax. Moreover, in considering how subsistence farmers could be taxed, attention should be paid to the usual conditions for a successful income tax: (1) existence of a predominantly monetized economy; (2) a high level of literacy; (3) prevalence of reliable accounting records to determine income; (4) a large degree of voluntary compliance; (5) an appropriate political environment; and (6) an honest and efficient tax administration.

An attempt to overcome the difficulties of direct taxation of the subsistence sector in the region was the introduction of the personal taxes which replaced the traditional tribute payments. Examples of these taxes are: the poll tax and the hut tax in Liberia, which is levied on men and women between ages 18 and 61; the minimum tax in Mali, which is levied on men and women age 14 and above; the head tax in Madagascar, which is levied on men age 20 and above; the head tax in Chad, which is levied on men and women between ages 18 and 60; the minimum tax in Malawi, which is levied on men age 18 and above; and the personal tax in the Central African Republic, which is levied on men age 18 and above. Most personal taxes are levied on those listed on the tax rolls and do not require individual tax returns. As a rule, these taxes have been levied by central governments but collected by local authorities, with the proceeds going to both levels of government in many countries. In view of their contribution to revenue and of their role in inducing monetization of this sector, these taxes should probably be maintained in the short run; however, their gradual transformation into a modern income tax should be considered the ultimate goal because of the inherent inequities of the personal taxes, their regressive character, and their enforcement problems. 1/ In particular, enforcement measures involving

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1/ It should be noted that not only income taxes can be used to replace poll taxes. For example, the Tanzanian authorities, when they introduced a general sales tax in 1969, announced that sales tax revenues would be used, inter alia, to make up for the revenue lost as a result of having abolished the personal rating.

jail penalties or forced labor for taxpayers who do not comply have been observed in several countries. The poll tax, as such, has been neither understood nor generally accepted by the taxpaying community. Furthermore, uneven enforcement of this tax has contributed to substantial tax evasion and arrears.

A hybrid between a poll tax and a simple income tax has been used in some countries, following the pattern of the graduated personal tax first adopted in Uganda. This has been the best approximation so far to a modern income tax. For farmers, crop incomes per acre are estimated and multiplied by acreage under cultivation; for livestock owners, income per head of livestock is presumed and multiplied by the number of cows, etc., owned by an individual. Incomes from other activities is essentially presumed. The main difficulty has been that wide differences exist in the level and quality of assessments among the various districts. Complaints of favoritism and discrimination are frequent because the local assessment committees rely heavily on the parish chief's estimates. Lesotho, northern Nigeria, Swaziland, Tanzania, and Zambia apply similar techniques.

In countries where livestock raising is important, a type of property tax is levied on owners of livestock as a crude substitute for the income tax. Cameroon, Mali, Sudan, and Upper Volta levy this tax. It may cover cattle, sheep, goats, mules, camels, donkeys, and horses. This tax has often been criticized for the enforcement problems it creates (e.g., coping with smuggling of herds across borders where control is difficult) and for discouraging marketing of livestock.

With respect to land taxation, a few governments in sub-Saharan Africa have successfully assessed taxes on land values, but because of the customary nature of most agricultural land holdings, especially in tribal areas, such taxes have been effectively limited to urban areas or to land owned and leased by the government. In many countries, individual ownership of agricultural land is the exception rather than the rule. For instance, in Malawi, 85 per cent of the land is used or occupied under customary laws, against 2.5 per cent under individual ownership and 12.5 per cent under government ownership; in Zambia, the land tax was levied only on the European farming area, along the line-of-rail.

Another instrument which is used in taxing the subsistence sector is taxation of goods purchased by the people in this sector (e.g., salt, sugar, basic clothing, kerosene, tobacco, coffee, and tea). As was explained in Chapter IV, traditional excises and sales taxes which are levied on mass consumption goods for revenue purposes have regressive effects on tax burden distribution. A good example of this outcome is provided by Kenya. According to a household survey conducted there in 1974, expenditures on taxed items were, on the one hand, 77 per cent of household incomes in the lowest rural income group; these expenditures were, on the other hand, only 14 per cent of household incomes for the highest rural income group.

3. Taxation of primary exports

Many countries in sub-Saharan Africa are producers of primary export products, such as coffee, cocoa, tea, tobacco, sugar, groundnuts, cotton, livestock, and timber. Export taxes have traditionaly raised substantial revenue for the budget. Export taxes have three principal forms, and a country may apply a combination of all of them. The first form is an explicit export tax levied on an ad valorem or specific basis. Rates can be specific, proportional, or based on a sliding-scale in which the rate varies with the export price of the commodity. The second form involves the purchase and sale of export products by state marketing boards which have a statutory export monopoly; their operating surpluses constitute an implicit tax on agriculture. The third form involves the use of the exchange rate system; overvaluation of the domestic currency results in the implicit taxation of exports. In addition, profits generated in the export sector have also been subjected to income taxation.

a. Export duties

Export duties are a convenient means of taxing producers of export crops; they are administratively easy to levy and to collect. While they can be evaded through smuggling or underinvoicing, most other taxes involve far more serious enforcement problems. Export duties have sometimes played the role of a crude substitute for an income tax on small and medium farmers. In some countries, a de facto income tax exemption is granted to producers of dutiable export crops. If such is the case, a statutory exemption should be introduced to formalize the situation until the administrative machinery is established to implement an effective agricultural income tax. From the point of view of equity, export taxes do not, however, possess the virtues of an income tax levied on the entire income of an individual at progressive rates corresponding to his ability to pay.

Fund missions have evaluated the impact of export duties on agricultural crops in various countries of the region on production and export of such crops. In doing this, it has been difficult to make a firm judgment without carrying out a detailed analysis of the cost-price structure in the export sector and to assess the potential of alternative revenue sources (e.g., land taxes and progressive income taxes) which are not always feasible in many countries of the region.

The incidence of export duties is determined by factors like the nature and organization of production, the country's share in the world market for a particular crop, and the options open to market participants. If the taxing country supplies a large part of total world exports of a crop, such as Ghana does for cocoa, or if similar taxes are levied by several exporting countries, there is a greater possibility of shifting part of the tax burden to foreign consumers. But such shifting is limited even in such cases by the possibility that a price rise will, in time, stimulate production elsewhere or that other products may be substituted for the taxed one if its price rises (for example, substituting tea for coffee, synthetic rubber for natural rubber, and one vegetable oil for another). International commodity agreements may help, however, regulate production and the price of the commodity involved. But the main incidence of export duties in sub-Saharan Africa is generally assumed to be on domestic producers and distributors.

Export duties may result in lower producer prices, which, in turn, may have adverse effects on production. Experiences of several countries in the region have indicated a responsiveness of production to changes in producer prices. Governments should be cautious in setting these prices because of the risk of creating disincentives to agricultural production. They may, however, compensate for low producer prices by using more of the proceeds from export duties and net profits of marketing boards for the support of agriculture. As regards certain crops regulated by international arrangements, their production may need to be curtailed because the country is bound not to exceed the limit set by its export quota. It is generally agreed that most countries in the region cannot presently afford to abolish export duties because of their urgent need for tax revenue. Instead, they should review, and adjust from time to time, their existing export tax structure to maximize revenue while maintaining a reasonable relationship between production costs and export prices.

The majority of agricultural exports are taxed on an ad valorem basis, although specific rates are applied by some countries. For instance, specific rates are levied on livestock in the Congo, Mali, and Somalia; on peanuts and peanut oil in Cameroon and Mali; on tobacco in Benin and Malawi; on coffee in Burundi, Cameroon, the Central African Republic, the Congo, Ethiopia, and Malawi; on hides and skins in Burundi and Uganda; and on timber and logs in Ghana and Liberia. As in the case of imports taxed at specific rates, the Fund has generally recommended a shift to ad valorem rates in taxing exports in order to increase the elasticity of export duties or, alternatively, the review of specific rates as frequently as changes in export values make it imperative, to keep the level of export taxation buoyant. 1/

As regards ad valorem taxation of exports, the general principle is reliance on f.o.b. values based on internationally accepted standards. This taxation requirement, however, has posed extremely difficult problems in several countries because of a lack of trained personnel needed to cope with frequent underinvoicing problems. Many countries have, therefore, resorted to the establishment of minimum price lists or administrative values for their traditional exports as a substitute for the actual f.o.b. export price. Somalia and most of the francophone countries in the

1/ Other, more specialized, criteria have occasionally been used. For example, in case of forestry product exports, Fund missions have recommended rate differentiation in favor of processed goods with higher local value-added in order to encourage more employment in the country and better utilization of transportation capacity, while leaving the country less exposed to the price fluctuations of logs.

region use this technique. Revenue erosion had been observed in these countries because the administrative prices had not been updated at frequent intervals to reflect increasing world market prices of the goods involved.

b. Marketing boards

The main purposes of marketing boards, when they were organized during World War II and the immediate post-war period, were to improve facilities for the marketing of major export crops, stabilize prices received by producers, and improve and standardize quality. But marketing boards can also serve as fiscal instruments by raising revenue in lieu of export duties. Given this function of marketing boards, profits of these boards are regarded by producers as an effective tax equal to the value of all export proceeds in excess of the official product price. From the government's point of view, the large fluctuations of these profits have added an element of uncertainty to the flow of revenue that has made financial management more difficult. In addition, the operation of marketing boards often requires commodity price forecasting capabilities that governments in the area do not have. With respect to the use of profits of marketing boards, Fund missions generally have recommended that the central government should set the priorities for development purposes rather than granting these boards the power over such considerable investment resources, although the boards should be allowed a profit margin that is sufficient for their proper management.

c. Exchange rates

As regards implicit taxation through exchange rates, Fund missions generally have advised against such practices. In addition to the basic Fund policy against their use, there is the fact that they discourage official exports while encouraging smuggling and inhibiting the development of the country's export potential in various agricultural activities.

d. Income taxation

Income taxation may prove more feasible for farmers who produce for the commercial domestic market or for export markets than for farmers in the subsistence sector. Fund missions, in fact, have recommended gradual replacement of export duties on agricultural goods by improved enforcement of the income tax on producers with rising incomes. Compliance is, however, rather low in countries where agricultural incomes are subject to tax. In Cameroon, for example, the schedular tax on agricultural incomes represented less than 1 per cent of total individual income tax in 1977/78. The ability of income tax departments to assess the income of the farming population is limited. Farm households often have multiple sources of income under the African extended family systems. Taxation of farmers is relatively haphazard, and there are generally very few tax offices outside capitals to reach even the medium to large farms. If a farmer has never filed a tax return, the departments simply do not know that he exists. In cases where filing does take place, figures submitted on costs of production are normally accepted without an audit. Tax departments seldom use either norms of productivity or of costs of production of different crops which might be available through farm management surveys conducted by ministries of agriculture; nor do they generally use data on producer prices and purchases which might be provided by marketing boards.

Two major techniques are used in taxing agricultural incomes: (1) the actual income basis, and (2) the presumed income basis. The first technique involves determination of agricultural income in exactly the same way income figures are derived from industrial and commercial sources, through regular record keeping and accounting. The second technique, largely used in francophone countries under the so-called *forfait* regime, requires determination of farm income on the basis of the kind of crop, area planted, quantity harvested, and other factors. In essence, a national net income per hectare is established for the various agricultural products and regions; and from this base, each farm's net income is derived. Except for forestry activities, farmers are given the option of choosing the *forfait* regime. Although this scheme seems to be working satisfactorily in the country of its origin, France, the different conditions of land tenure, the virtual absence of property cadastres, and the lack of comparable administrative capabilities make it less practical in African countries. Graduated personal taxes, as noted above, are a practical but crude approximation of presumptive assessment of farm incomes.

In addition to enforcement difficulties, there is some statutory discrimination in favor of agricultural income taxation in various countries. Rates of schedular taxes on agricultural incomes in francophone countries are usually lower than those on other incomes, and other favorable deductions and allowances are also granted to farmers. In Cameroon, the schedular tax rate on agricultural incomes is 15 per cent, as against 22 per cent on industrial and commercial incomes. In the Central African Republic, agricultural companies are taxed at 25.5 per cent as compared with 30 per cent on other companies, while the corresponding rates are 26 per cent and 35 per cent, respectively, in the Congo. Additional deductions of 15 per cent in the Central African Republic and 20 per cent in the Congo are allowed for agricultural schedular income tax purposes. In Kenya, a generous depreciation allowance of 37.5 per cent is granted on agricultural machinery, and a full deduction is allowed for capital expenditures by farmers to combat soil erosion, clear land, and plant permanent and semipermanent crops. These allowances primarily benefit rich farmers owning large, mechanized farms and may, in fact, have encouraged overmechanization to the detriment of the employment of labor. Fund missions have generally recommended elimination of such differentials in order to reduce horizontal inequities between farm and nonfarm incomes; and they have also advised strengthening enforcement and developing a system of standard assessments on farmers who are hard to tax.

4. Produce taxes

In several countries, taxes are levied on marketed produce in lieu of land and income taxes. These taxes are aimed primarily at truck farmers serving urban centers. They are levied normally only when transactions take place in relatively controlled markets. Production for self consumption is, therefore, excluded from the tax. In most cases, these levies are collected by local authorities. In Tanzania, for example, a produce cess ranging from 0.5 per cent to 5 per cent was levied until 1971 on agricultural produce, hides, skins, livestock, and fish bought or sold within, or exported from, a district; now various market dues are levied for the use of shops or stalls in market places maintained by local authorities; in the cattle markets, a fee is charged on each head of cattle sold. Similar levies are applied in other countries. In Sudan the traditional tithe, Ushur, has evolved into a market tax on agricultural produce sold. Types of produce that are taxed and rates of the tax differ from province to province. The Gabana, which originated as a weighing charge in markets, is now levied as a surtax on the Ushur. The rates of both levies appear to be specific rather than ad valorem. These levies tend to penalize commercial marketing of agricultural goods, whereas the main objective of agricultural policy in many countries of the region should be to improve the supply of food to the nonagricultural sector. Furthermore, differential costs of production are neglected, which results in varying degrees of incidence on operators of different farm units. Producers of cash crops are heavily taxed, while others who consume most of their own produce are lightly taxed. If, on the other hand, many or all of the marketing taxes are shifted forward to consumers, then these levies become the equivalent of highly regressive consumption taxes.

VI. Taxation of Income and Property in the Modern Sector

1. Introduction

Taxation of income and property occupies a prominent position in most discussions of fiscal policy. Here, reference is made to these taxes as they are applied to the modern sector of the economies of sub-Saharan African countries.

a. Definition

The modern sector is defined here largely by reference to potential taxpayers. Included in the modern sector are public enterprises and the government itself; all corporations and other legal entities, including branches of foreign companies; any other nonincorporated businesses or individual proprietorships capable of filing tax returns; all individuals who can be subject to withholding (i.e., most of the employees of the three categories previously mentioned); and any other individuals who would be capable of filing returns, such as independent professionals and small traders. This chapter will not discuss the large enterprises engaged in extraction of oil and mineral resources, since these usually have special fiscal arrangements outside the regular tax system. The main focus will be on the tax base to be found in urban areas and within the domestic economy.

b. Special characteristics

One characteristic of the sector is that its elasticity to GDP is extremely high: as a country grows, a disproportionately high part of the growth will occur in urban areas and in the modern sector. This means that taxes levied on this sector, even when their present yield is still a relatively small part of total government revenue, deserve special attention because their potential yields are exceptionally high.

Import duties, sales taxes, and other levies can all be applied to the modern sector. However, the distinguishing characteristic of the sector is that, largely because of the greater sophistication of the taxpayers involved, it is more amenable to the use of complex tax instruments. In particular, the individual and corporate income taxes can be used. Income taxes, other than the most rudimentary ones, require filing of an annual return that includes at least a minimum of information, or else they require intermediation by a withholding agent capable of keeping reasonable accounts. Similarly, taxes on real and personal property can be applied to the modern sector. These do not necessarily require sophistication on the part of the taxpayers, although this would be desirable, but they do demand skills and resources on the part of the revenue administration which usually are too limited until the growth of the modern sector is well advanced. The most complex taxes on wealth and property, of course, require taxpayers to file annual returns and demand considerable expertise on the part of both taxpayers and the tax service.

Together with the application of income and property taxes comes a special vulnerability. These complex taxes lend themselves (or appear to lend themselves) to achievement of multiple objectives--for example, not just raising of revenue but also improvement of income distribution or better allocation of property. However, estimating the effects of these taxes is difficult, particularly when administrative inadequacies and taxpayer resistance create substantial discrepancies between the legal and the actual tax bases. Thus, a highly progressive income tax rate scale may worsen horizontal equity (because of differences in administrative ability to ascertain income of equal-income taxpayers) so much that gains in vertical equity are partially nullified. Throughout sub-Saharan Africa, government employees complain that their salaries are among the few incomes fully subject to withholding taxation and that work with the government is correspondingly penalized. Perhaps the extreme case is Somalia, where, in 1970, gross government salaries were lowered by an amount equivalent to a development levy applied to salaries in the private sector, making future withholding unnecessary. In addition, it should be remembered that, unlike private sector employees, government employees cannot usually shift their tax burden onto their employer.

A tax on urban property so structured that construction of new buildings greatly increases assessments while ownership of underutilized land gives rise to little tax may encourage speculation in urban land holdings while delaying actual development of such land. In Liberia, only a low specific-rate tax applies to the site value of land in municipalities, while buildings are subject to tax at a proportional rate; it is possible that this system has delayed development of urban land. Especially vulnerable, of course, to use in ways that thwart intended development are tax incentives. These will be discussed in the next chapter. Essentially, the great flexibility of income and property taxes makes them attractive as primary vehicles for experimentation in the tax system. In addition, non-African texts and technical advisors often are oriented toward income and property taxes to a greater degree than perhaps is justified in the present African context. This may result in a disproportionate concentration of intellectual, policy, and administrative effort on reform of these components of the tax systems of sub-Saharan Africa and undue optimism concerning the degree to which these taxes can be used to influence the economy of a developing country.

2. Use of tax instruments in sub-Saharan Africa

a. Regional characteristics

With respect to the taxes discussed here, there are two major groupings of countries: those following the continental and European traditions and those following the British tradition.

With respect to taxes on income, the countries with a continental tradition tend to have separate schedules for different income sources; and if there is a complementary rate scale applied to global income, it often is of lesser revenue importance than the other schedules. Countries with a British tradition tend to rely primarily on a unitary income tax with, at most, a credit for earned income. The continental tradition countries, particularly those following the French family quotient system, tend to give larger family allowances in the individual income tax. This system provides for dividing total family income into a number of parts that is determined by the size of the family, applying the progressive rate to each part, and then multiplying the results by the number of parts. The effect is to compensate for family status by lowering the progressivity of the rate scale. At similar levels of development, there seems to be a slightly greater reliance on income taxes for revenue in the British tradition countries than in others. 1/

1/ See Tanzi, op. cit. Table 8, p. 15.

Regional characteristics regarding taxes on property also tend to follow the continental/British division. Countries with a continental tradition are less likely to consider a general tax on real property as an important revenue instrument, and some have no general real property tax at all. Most British tradition countries have general taxes on both urban and rural land, although seldom is the yield very high. Cameroon, for instance, has no general annual tax on real estate; however, even in British tradition countries the general land tax may be missing from the system, as in Kenya. On the other hand, duties on registration of land and stamp and other taxes on the transfer of land are more commonly used and more important in continental background countries than in the rest of sub-Saharan Africa. Finally, although both groups of countries have death duties, in the continental tradition countries these tend to fall on the heirs, whereas in British tradition countries they tend to be levied on the estate.

b. Taxes on property

Almost all kinds of taxes on property exist in sub-Saharan Africa. Real property is subject to an annual tax in many countries. Seldom is a single tax universally applied to all property. Often only urban property is taxed, or different rates are applied to rural and urban land; urban site value may be taxed separately from buildings, and special levies may apply to unused urban land. Where land is assessed at market value, the assessment may be arrived at by capitalization of annual rental values or by direct calculation.

The annual taxes on real property in sub-Saharan Africa often suffer from fundamental defects. First, the substantive tax structure may encourage inequities, misallocate resources, or decrease revenue; exemptions for owner-occupied dwellings or recently constructed buildings may mean that wealthier individuals pay less tax (in Senegal, for instance, owner-occupied dwellings are exempt from tax, as are new buildings for the first five years after construction); failure to tax undeveloped urban land may lead to speculation (the example of Liberia has been noted; to combat this effect, other countries, such as Gabon, have introduced special taxes on underdeveloped urban land); and specific rates may lower elasticity. Second, property ownership records may be confused; no cadastre, or only an inadequate one, may exist; and failure to make the tax in rem may prevent action against the property itself. Third, lack of administrative resources may prevent efficient application of the law. A chief result of these problems is that revenue from annual taxes on real property is low and is inelastic in those sub-Saharan countries that have these taxes. Equally, assessed values are below the optimum level, and this underassessment has negative repercussions not only on property tax revenue but also on revenue from other taxes for which assessed property value forms part of the base.

Little is known about the revenue yield of other taxes on property in sub-Saharan Africa, but few are thought to be efficient revenue sources. Death duties are often enacted as part of a registration or stamp tax law, and the proceeds of these duties are seldom separately accounted for. Where they are separate, they yield little in relation to the administrative effort required, and their coverage is usually too haphazard for them to increase equity or influence resource allocation substantially. In general, the minimum exemption for death duties should be quite high, so that the tax administration may concentrate on a few large cases. Personal property taxes in sub-Saharan Africa are seldom applied in the modern sector, except for annual taxes on motor vehicles; use of annual taxes on livestock was discussed in Chapter V. Betterment levies are applied in a few countries. The Central African Republic, for instance, applies a betterment levy of 2 per cent of the value of improvements caused by public works. Since betterment levies require considerable administrative and economic expertise if they are to be applied satisfactorily, their use is unlikely to be expanded in the near future. Finally, no country in sub-Saharan Africa has a general net wealth tax as part of its system; again, given the difficulties such a tax presents, its absence seems justifiable.

c. Taxes on individual income

All countries in the area employ some form of direct taxation of individual income. Most of these taxes are on annual income, and are either schedular or global. They are uniquely appropriate to the modern sector, because all require filing of a return, either by the taxpayer or by a withholding agent.

A typical income tax system for an anglophone country applies a progressive rate schedule to annual income from all sources within the country, with a credit for earned income; for the typical country with a continental background, there are a series of as many as six or seven schedules, each with a proportional rate aplied to a particular kind of income, with a progressive rate scale applied to the sum of schedular income. The incomes most commonly subject to separate schedules are wages and salaries, real estate rentals, interest and dividends, and individual business profits. Variations are many, such as progressive rates applied to schedules, partial use of a schedular system in countries with a global system, and worldwide rather than territorial coverage of the tax. Revenue from the individual income tax is not a major portion of total central government revenue in any country. This observation should not be construed as advocating neglect of the individual income tax. Even if it is not a major revenue producer, its characteristics make it important for purposes of improving equity and income distribution.

The form of the income tax system may influence the revenue productivity and the distribution of the tax burden. A schedular tax system is sometimes advocated because it reduces the revenue costs of personal exemptions and differentiates the tax burden according to the source of income. Earned income is usually taxed more favorably than income from other sources, as the schedular tax on wages and salaries has a low rate and sometimes a minimum personal exemption. On the other hand, a unitary income tax is widely considered to be superior to a schedular tax system. The former can be adjusted to the particular circumstances of the individual taxpayer more precisely than is possible under the schedular tax. A unitary tax considers income, regardless of its origin, as the sole norm to determine ability to pay, and therefore, horizontal and vertical equities are enhanced. It also has the advantage of relative simplicity vis-à-vis the schedular tax, since the latter requires multiple tax returns and tends to present complications associated with the definition of incomes.

Problems with the tax on individual incomes in sub-Saharan Africa are many. Some are due to the inherent complexities of such a tax; others are derived from the region's colonial heritage, in that laws have been drafted using a European model which often makes erroneous implicit assumptions regarding the structure of society and the economy and the capabilities of taxpayers and tax administrators. Subsequent revisions which attempted to introduce the latest refinements from developed countries or which experimented with doubtful innovations untested elsewhere compounded the difficulties.

A common problem is that of defining the taxpaying unit and the treatment of the family. Should spouses file joint returns? Should allowances be made for dependents through a deduction from income, a credit against tax, or an income split? Should only the nuclear family qualify for allowances, or should others be included? Some countries have opted for separate treatment of each income-receiving individual, with no adjustment for family status or dependents. Such is the case, for instance, in Ghana and Guinea-Bissau. Others place an absolute limit on the number of dependents which may be taken into consideration. None adjust for dependents or extended family arrangements based on traditional, rather than European, law. Since the individual income tax applies only to the modern sector, this may present no practical difficulty. Policy recommendations on this point have tended to favor recognition of the nuclear family as the taxpaying unit, with joint returns optional and with tax credits allowed for dependents; deductions from income for dependents have been recommended on occasion, but the income split, or family quotient, has been criticized as undesirable because it reduces effective rates significantly and discriminates in favor of large families with incomes falling in higher brackets.

The problem of horizontal equity--equal treatment of taxpayers with equal incomes--is posed by virtually all schedular systems, since different rates are applied to income from different sources. It is also posed where withholding is used, since tax collection in practice is much more effective with respect to income subject to withholding. Where foreign source income is not covered by the income tax, another anomaly in treatment of equal-income individuals is created. To improve horizontal equity, countries of sub-Saharan Africa have tended to de-emphasize the importance of schedular taxes and to create or expand global income taxes. In this context, a trend to substitute a unitary income tax for schedular taxes is perceptible among francophone countries. There are difficulties however. For instance, the unitary taxes adopted in Chad and in the Congo have not achieved horizontal equity, as wages and salaries continue to benefit from special treatment and are exempted from other taxes levied on incomes from other souces. Withholding should be expanded in some cases and administrative efficiency in dealing with taxpayers whose incomes are not subject to withholding should be improved by various methods. Wage and salary withholding creates a de facto tax bias against employees, particularly government workers, but the solution lies in effective pursuit of other taxpayers rather than abandonment of withholding. This is important because, if wage and salary earners feel that they are being discriminated against, both productivity and availability of national technical manpower may be adversely affected. Finally countries which do not already do so should not extend their income tax to cover worldwide income; the administrative difficulties and costs and the chance of creating further horizontal inequity may outweigh the advantages. Conversely, making foreign-source incomes taxable might be helpful in imposing taxes on the basis of outward signs of wealth or enhancement of capital, as taxpayers would not be able to launder taxable funds by disguising them as foreign-source income.

Another problem with the individual income tax lies in selection of the level of initial exemption. Some countries have found that too low an initial exemption raises administrative costs excessively by requiring returns and minimum payments from many low-income taxpayers without generating a compensatory increase in revenue or equity. In general, great caution should be exercised in establishing tax-exempt minima, and it has occasionally been suggested that existing ones be raised, particularly when inflation has significantly reduced them in real terms and the number of taxpayers has increased accordingly.

The structure of the progressive rate scales for taxes on global income of individuals also deserves attention. Those countries with a low initial rate have found that by raising it they could increase the efficiency of the system by obtaining increased revenue from low-income taxpayers; also the lowering of top marginal rates if they exceed, say, 60 per cent should be considered by countries where it is felt that the disincentive effect is too great.

In many countries of sub-Saharan Africa, capital gains of individuals are not taxed unless they arise in the course of business operations. Potential or actual revenue from taxing capital gains is of relatively little importance to central government budgets. In general, taxation of such gains has not been deemed worth the necessary investment of administrative resources, given the competing claims.

d. Taxes on business and corporate income

All countries of sub-Saharan Africa tax business income. However, not all of them have separate taxes on the incomes of corporations or other legal entities.

Where a tax on global income of individuals exists, a separate proportional rate tax on income of legal entities is more likely to exist. Sometimes there is a schedular tax on business income which applies to both legal entities and sole proprietorships or informal partnerships. Most frequently, the schedular tax on business (or the tax on legal entities) bears either a single proportional rate or a progression of two or three rates. However, in some countries, such as Sudan, it bears a full progressive rate scale. In general, the heritage from previous metropolitan powers is likely to be evident; countries in the British tradition tend to have a separate tax on income of legal entities, whereas others are somewhat more likely to have a schedular tax applied to all business income. Some countries, particularly those in the French tradition, may have both a proportional tax on legal entity income and a schedular tax on business income of individuals.

Where there is a special tax on dividends paid by corporations, dividend income received by individuals may be exempt from global income tax. In other countries, credit against tax on global income is given for tax withheld on dividends. There is no consensus among the countries of sub-Saharan Africa regarding the integration of the taxes on corporations and shareholders, and it appears that the issue is not yet considered to be of major importance. It may also be that, in many countries, the largest corporations showing profits are owned either by foreign shareholders or the government. Nevertheless, Ghana, Malawi, Sierra Leone, and The Gambia have integration systems--and Kenya had one until it was repealed in 1965--reflecting the British tradition as expressed in a standard income tax ordinance which served as a model for the income tax acts of many former British colonies.

A special feature of the income tax systems of CFA countries is the minimum business tax. The tax is levied on corporations in all CFA countries and on profits of individuals in a few of them. Its rate is usually 1 per cent of the previous year's turnover, and the tax is credited against the profits tax, but no refund is given if the amount of minimum business tax paid exceeds the profits tax payable or if the taxpayer has experienced losses. The minimum tax approach is generally justified on administrative grounds as a safeguard against underreporting of taxable profits or as a means of counteracting techniques occasionally used by foreign corporations to underestimate actual profits. There are, however, arguments against a minimum tax. If a business is not profitable over a number of years--sometimes the case of new firms--the tax can become an additional burden that may strain further a taxpayer's financial viability. In addition, there is the danger for the tax administration of relying too much on the existence of a minimum tax instead of strengthening enforcement of the profits tax. If the taxpayers realize that this is happening, they will tend to underreport profits systematically and pay the minimum tax instead of the profits tax.

Where revenue from a corporate or business income tax is separately stated in government accounts, it is seldom of major budgetary importance. And where it is apparently significant, further investigation is likely to show that most of the revenue is derived from tax paid by one or two enterprises which exploit mineral or other basic resources. Mauritania is an example of this phenomenon, since an iron mining corporation provides most of the corporate tax revenue. Thus, business in the modern sector is not yet a major contributor to government resources in most countries. Part of the explanation is that a significant number of enterprises in the sector are so new that they still benefit from tax holidays, or they are so important to the economy or balance of payments that they have been able to negotiate favorable tax terms on an individual basis.

Problems in taxing business in the modern sector are many. One difficulty is posed by the many small businesses, often unincorporated or sole proprietorships, which are only marginally "modern." They may be barely capable of filing returns, and the tax administration may have little confidence in the fidelity of the data given in such returns. Such businesses are often subject to taxation under a special schedule or tax which, typically, applies a proportional rate, or a scale of specific rates, to the business on the basis of its gross sales. The gross sales may be based on estimates, sometimes of a complex type, as when the French forfait system is followed. Often this tax is a part of the income tax; in other countries it is a business license fee. The main difficulties are that such taxes are highly arbitrary, can cause inequities and distortions in resource allocation, and may require administrative effort that is excessive in relation to the revenue produced. Further, if they are applied too widely, such taxes may delay the shift of growing and modernizing enterprises to filing of full returns and payment of income tax on the basis of regular accounts. A partial solution to this problem can be found in a shift to a minimum tax on business using only a proportional rate creditable against regular income tax. As mentioned previously, however, this approach has shortcomings. The fact is that the problem of accurately taxing the small business in sub-Saharan Africa, and elsewhere in the world, remains essentially unsolved.

At the opposite extreme of the modern sector are the largest corporations, particularly the multinationals. The resources and ingenuity of such taxpayers often exceed those of a national tax administration. Devices such as transfer pricing, assignment of home office expenses, and changes in the debt/equity ratio of the subsidiary vis-à-vis the home office are hard to combat. Helpful administrative solutions have been found through training of national tax officers in the home countries of the major trading partners and through developing tax treaties which permit exchange of information between national tax administrations. Substantive law can assist by placing limits on interest rates or royalties payable to home corporations and by providing for administrative redetermination of prices which fail to reflect arm's length transactions.

A general problem with taxation of business is treatment of depreciation. To encourage industrial growth, rapid depreciation is desired; however, rapid depreciation encourages capital-intensive growth that is undesirable in labor surplus countries. Standardization of depreciation methods within each country has yet to be achieved, and systems vary throughout the sub-Saharan region. As inflation increases, the adaptation of depreciation and inventory accounting to inflationary conditions, almost nonexistent at present, will become more necessary. Policy recommendations in this field have so far been limited to proposals for standardization and simplification and caution against excessively rapid depreciation.

Another aspect which deserves mention here is the need for accelerating payment of the taxes on profits to put them on as current a basis as possible. The reasons for doing that are mainly three: (1) to remove, at least partly, the discrimination against wage and salary earners subject to current withholding; (2) to reduce the erosion of tax payments that takes place under inflationary conditions because of time lags; and (3) to make government revenue more responsive to changes in income and economic activity. The transition to a current payment system may present the serious problem of doubling tax payments, since the taxpayer will be confronted with the tax liabilities of the previous year and the current year. Two methods have usually been recommended to solve this problem. One method is to forgive part or all of one year's tax liability. The second method is to provide for a gradual shortening of the payments lag over a period of years, (e.g., three to five), until the transition is completed. The second method seems preferable on grounds of equity, since full forgiveness of one year's tax for businesses will undoubtedly have an adverse effect on the distribution of the tax burden.

e. Poll taxes, registration duties, stamp taxes, and business licenses

Direct taxation of property and income in the modern sector is complemented in many parts of sub-Saharan Africa by a series of other levies which are often archaic methods of attempting to reach property or income where illiteracy, evasion, or administrative inadequacy make other taxes impossible to apply satisfactorily. To some degree, these alternate levies fulfill useful purposes. However, in many countries, they are no longer necessary, yet these levies continue to divert administrative resources urgently needed elsewhere. In Somalia, for instance, much more administrative effort is devoted to the stamp tax than to the sales tax, despite the greater revenue importance of the latter. In the worst of cases these levies constitute vestiges of the region's colonial past that were not suited to Africa, where there is less dependence on the offices of notaries and on complex legal forms for even minor transactions than in Europe.

Of this group, the poll tax is still the most useful, in some countries providing as much as 10 per cent of revenue and acting as a surrogate income tax for the lowest income members of society. An example is Guinea-Bissau, which has a simple tax system and economy. However, the obvious inequities of the tax make its elimination advisable whenever administrative capabilities have advanced to the stage where a withholding system or other form of income tax can be used to reach most low-level income taxpayers in the modern sector.

Registration duties and stamp taxes fall on legal transactions, most of which signify transfer of property or payment of income. However, they also fall on a series of other legal operations, such as issuance of certificates and documents, which may have little economic significance. In the best of cases, such taxes may be viewed as alternate forms of taxation of capital gains, real property, or perhaps sales. Even then, they apply to single transactions and thus fail to consider the overall situation of the taxpayer. In the worst of cases, they are costly nuisances. Countries in sub-Saharan Africa should decrease the importance of such duties and taxes and, when feasible, should eliminate altogether nuisance levies and those charges with specific rates. Registration and stamp taxes which duplicate other levies should be integrated with the more important levies. For instance, stamp taxes on imports should be eliminated and customs duties--or other taxes on imports, such as general sales taxes--raised correspondingly, and registration duties on rental contracts should be reduced in favor of better enforcement of the income tax on rentals.

Business license fees are the most pervasive of the minor taxes and are found in virtually all countries of the region. Often they provide revenue for municipalities and cannot be eliminated without adjustments in central/local fiscal relations. Usually such license fees are based on gross sales, although many other indicators can be used to establish the tax. They may be viewed as surrogates for the income, sales, or property taxes. Depending somewhat on how they are viewed, it has been suggested that they be combined with, or credited against, other taxes. The revenue importance of such taxes is small and has been decreasing, and the administrative effort involved in collecting them should be devoted instead to improve enfrcement of other taxes.

3. Special problems

Taxation of the modern sector in a developing country involves special risks that are seldom present in as stark a form in developed countries. First is the trade-off between revenue elasticity and incentives to development. The most elastic tax bases often are the parts of the economy which the government wishes to see grow as rapidly as possible, giving them encouragement if necessary by exempting them from taxes. Thus, aqueducts and irrigation works, which greatly increase the value of farm land, may be exempt from property tax; or a profitable new industry may benefit from a long income tax holiday. Or the opposite may occur. High taxation of new buildings may slow development of a city, heavy taxes on the income of professionals may encourage a brain drain, or high taxes on industries may discourage modernization.

A second, and closely related, problem is the conflict between equity and certain goals related to resource allocation and development. If the modern sector is taxed lightly in order to encourage rapid development, then inequities in income and property taxation between the modern and traditional sectors or between individuals with equal property holdings or incomes may be increased. Yet heavier taxation of the modern sector may lead to a sub-optimal amount of resources being allocated to it.

Another difficulty posed by the modern sector is how the taxes chosen should be distributed between labor and capital. Extensive use of withholding on wages and salaries, together with substantial payroll taxes, for instance, might encourage more capital-intensive development. High taxes on property or on profits of capital-intensive industry might slow development. Perhaps the thorniest problems are posed by taxation of small enterprises and individuals with independent professions. The widely used practice of estimating income or property value on the basis of some indirect indicator often leads to a considerable divergence between practice and theory and may make it unclear whether elements of labor or capital constitute the tax base. Examples of this use of indicators are a tax levied on income estimated on the basis of square feet of floor space in a store, or a tax on property, the market value of which is estimated from a notional rental. The more distant the proxy indicator is from the element being estimated, the more the tax resembles a levy on the proxy itself; if the latter is the case, the tax may introduce unpredictable distortions in equity and resource allocation.

An additional general problem with taxation of the modern sector is the increasingly important one of adapting to an inflationary environment. Some of the solutionsthat have been offered--elimination of specific rates or updating of property values--help increase revenue, while others--such as indexing of nontaxable minima--decrease revenue. Equity and resource allocation effects of adaptations or of failures to adapt are often difficult to predict.

No clear solutions to the problems mentioned here have been found. Given the present state of the art, however, it appears it would be best for a system to be as neutral as possible with respect to resource allocation and to attempt to achieve the highest possible degree of horizontal equity, while maintaining reasonable vertical equity. A key to solving many of the problems (and even to identifying whether, and to what degree, the problems exist) is the development of a competent administration buttressed by accurate and well organized statistical data. Unless these fundamental improvements are made, any solution can only be a partial one.

VII. Special Tax Incentives

1. Introduction

Most countries in sub-Saharan Africa offer tax incentives. These may be in the form of reductions in taxes, which increase the rate of return to selected factors of production or to certain industries or other activities. Or they may be in the form of stabilization agreements --a feature of francophone countries--guaranteeing to a taxpayer that the tax system as applied to him will remain unchanged during a given period of time.

The incentive systems utilized in sub-Saharan Africa usually have as a principal objective expansion of the modern sector of the economy, that, it is hoped, will bring about an increase in domestic supply and, eventually, an expansion of the domestic tax base. The assumption is that a temporary sacrifice in revenue will provide an incentive for investment, will accelerate balanced growth of the economy and will eventually be repaid through increased tax revenue. Tax incentives do this by making the use of certain factors of production more attractive, for instance by lifting duties on import of capital equipment, or by granting certain kinds of activity a higher after-tax return, thus encouraging import substitution, promoting exports, expanding agriculture, or increasing employment in a disadvantaged province.

National policies regarding incentives cannot be determined without a careful evaluation of what other countries in the region are offering to the investor. Since most countries in sub-Saharan Africa do not possess clear comparative advantages vis-à-vis their neighbors, it could be argued that their tax incentives schemes are likely to play a role in investors' decisions to invest. But the countries have recognized that offering too much will probably cause retaliation from competing neighbors, while offering too little will fail to attract investors. Thus, these constraints have resulted in a certain degree of uniformity of the various national systems of tax incentives.

2. Types of incentives

Several types of incentives are used in sub-Saharan Africa. One type is the general incentive, for which the taxpayer need obtain no special approval. Representative of this category would be a general roll-over provision exempting sale of business assets from capital gains tax if the proceeds are reinvested in the business. Another example is accelerated depreciation of capital goods to promote industrialization.

These general incentives are not usually set forth as part of a special incentive program and are viewed more as additional facets of whatever tax law they are part of. Policy recommendations with respect to these provisions have usually been couched in terms of overall improvement of the specific tax, rather than of the general incentive program. Considerable attention has been devoted to such incentive provisions of particular taxes, but in this paper most comments on the subject are made in the segments of the report dealing with the given tax.

A second type of tax incentive, to be found in almost all sub-Saharan countries, is that granted under special incentive laws, which require that the taxpayer obtain approval from the government--or from an investment board operating under authority delegated by the government--in order to be eligible for the incentive. Only through such special incentive laws, for instance, are stabilization agreements made. Usually such agreements extend to all aspects of taxation and guarantee the beneficiary that no changes will be made in the rates or in the terms of application to him of not only the income tax but also the sales taxes, import and export duties, property taxes, and others. Some incentive laws provide that stabilization agreements may extend up to 25 years. The tax incentive provisions agreed by the UDEAC treaty, for instance, provide 25-year stabilization as the most generous of the four levels of incentive arrangements possible.

The incentive laws usually focus on three aspects of taxation: (1) exemption from income tax for profits of the investor for a period such as 5, 10, or 20 years from the date of the initial investment; (2) exemption from customs duties, or a special low duty rate on imported inputs for the new industry; and (3) exemption from sales tax or a special sales tax rate on output of the new industry. Exemptions from real property tax, registration duties, and stamp tax may also be given, but these are of lesser importance.

Member countries of the Fund seldom have requested advice with respect to these laws, since they constitute special exceptions to the general tax systems which form the usual focus of technical assistance. However, in a few cases special studies have been requested, and in others the Fund staff has felt that discussion of special incentive schemes was unavoidable, given the influence of the incentive laws on the general tax system.

3. International agreements

a. Bilateral

Many countries in sub-Saharan Africa have signed bilateral treaties with developed countries providing either for investment guarantees or for double taxation relief. Virtually none of these treaties, however, provide specific tax incentives. The investment guarantee treaties, which have most widely been negotiated with the Federal Republic of Germany, Switzerland, and the United States, are uniformly silent regarding fiscal provisions. The double taxation treaties do not provide incentives in the sense discussed so far; they merely remove disincentives from the path of investment. The most notable general concession contained in such treaties is the provision found in most treaties between France and countries which formerly were French colonies, which provides for a tax credit (avoir fiscal) for tax paid in one country at the corporate level to be available against income tax on the individual level, which in practice encourages investment in francophone Africa by French corporations.

b. Multilateral

The regional groupings of countries in sub-Saharan Africa have dealt with the issue of tax incentives in various multilateral treaties. Such treaties aim at standardization and coordination of incentives so as to avoid a costly competition in offering incentives, and when possible to promote integrated area-wide development. Most detailed of the multilateral treaties is that of the UDEAC, which sets forth a standard incentives law for all member countries, with multinational approval needed for the granting of some of the incentives. The ECOWAS treaty, in contrast, merely calls for coordination among member countries but does not set forth a model.

4. Problems

a. Revenue loss

The most obvious problem with tax incentives is that by granting them the government foregoes revenue which it would have otherwise received. The benefits accruing to the economy and to the government because of the actions induced by the incentive must be worth the sacrifice or else the incentive is inefficient. In other words, the incentive must have increased (or redirected) domestic supply sufficiently to justify its cost.

Unfortunately, there are several theoretical and practical problems with measurement of the efficiency of incentives. On the theoretical side, the question is whether the new addition to the potential tax base would have occurred if the incentive had not been granted. And if the new addition had not occured in the form encouraged by this incentive, would some equally productive alternate increase in the base have arisen? On the one hand, exemption from customs duty of goods which would not have been imported without the exemption is not a direct sacrifice of revenue; nor is exemption from income tax of the profits of a company which would not have expanded without the exemption. On the other hand, exemption from property tax and income tax on rentals for five years (a fairly common practice) for a newly-constructed building, which would have been built and rented even without the exemption, is a clear loss. Thus, even when the exact amount of tax foregone can be calculated, further information is needed before the amount of real fiscal sacrifice can be determined. Since such information is almost always conjectural, such calculations can seldom be made with certainty.

An alternative is simply to quantify the total tax foregone and compare this with other indicators, such as total government revenue and expenditure, to estimate whether the sacrifice appears too great. Here the practical difficulties have been considerable in sub-Saharan Africa. Most countries have, or can easily compile, statistics on the amount of customs duties foregone, since usually the value of exempt imports or exports is registered by the customs department. However, with respect to other taxes, data about the exempt base may be missing; industries operating under incentive laws, for instance, may file no income tax returns, no sales tax returns, and no property tax returns. Or, if they do file, the returns may be so brief as to be uninformative and, in any case, are unlikely to be audited for accuracy. Fund recommendations in this field have centered on making reporting less ad hoc, and on requiring development of fuller statistical information. 1/ This information is also needed to ensure compliance with the conditions set by the authorities to grant the exemptions.

Regarding possible ways of limiting revenue losses to the government, an effort should be made to minimize these losses when they would arise from granting excessive benefits to new industries which are able quickly to capture a stable market for their products and to become highly profitable. The best way to do this would probably be to limit the amount of benefits to a specified percentage of the value of the investment, say 150 per cent. Such a provision, while attractive enough to investors, would remove the government's obligation to continue compensating them after it has clearly become unnecessary.

b. Resource allocation

Well-used tax incentives should improve the allocation of resources and direct them according to priorities set by the government. Unfortunately, several factors often combine to produce incentives that may work against

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1/ For instance, Fund reports have recommended establishment of special administrative units to compile statistics on enterprises benefiting from tax incentives.

an optimum distribution of resources. A most important factor is the inadequacy of the planning process. Subject to extraneous pressures and often ill-trained, the planners make decisions about the granting of incentives as best they can, but the beneficiaries are not always the most appropriate; and unforeseen effects may even make the incentive-induced actions highly undesirable for the economy. Even the most orderly process of granting incentives is still somewhat of a gamble, since there is always a risk that the sacrifice of revenue may only create a further unexpected distortions in the economy.

Deepening the pitfalls inherent in the initial granting of incentives is the long duration of the benefits, which is seldom shorter than five years and often ten years or longer. Investors tend to use a high rate of interest in calculating the profitability of an investment and therefore, to attach little value to benefits accruing to them in the distant future. Governments, on the other hand, have a longer time horizon and are likely to apply a lower interest rate in discounting the value of future revenue sacrifices. In addition, most specific tax incentives are in the form of agreements or contracts with specific companies regarding specific actions which they must take in order to obtain the tax benefits. Only certain actions are rewarded. If, later on, the enterprise wishes to change or broaden its operations, it may find it cannot do so without losing the incentive or endangering the agreement. Similarly, if the government decides later on that the activity encouraged by the incentive is no longer as desirable, it cannot withdraw the incentive until the end of the agreed period. Thus, an incentive seen as desirable in year 1 may in year 10 or 20 still be encouraging the same resource allocation, even though by then it may be perceived by the company or the government as inappropriate or undesirable. Another shortcoming of having tax incentives of long duration is the element of rigidity that they introduce in government revenues. The enterprises benefiting from tax incentives usually are in sectors which have faster rates of growth than most other sectors, but governments are prevented from taxing them accordingly because their tax burdens are stabilized over long periods. 1/

Another allocative aspect that should be mentioned is that some countries in the region have predominantly used investment allowances and other incentives focusing specifically on capital investment, as opposed to tax holidays, which are neutral between capital and labor. Given the underutilization of labor that characterizes many economies in the region, it would appear preferable to de-emphasize incentives that promote only capital investment.

Finally, many incentives are so structured as to discourage a change of resource allocation even after the tax holiday period has ended. Production methods and kinds of inputs cannot be changed easily, and a business may find itself, say, heavily dependent on supplies of

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1/ For these reasons, Fund reports have suggested that the duration of incentives, particularly stabilization agreements, be limited to 10 years.

imported oil due to the kind of machinery it imported tax free well after the price of oil has risen above the prices of domestic alternatives and the privilege of tax-free imports has disappeared. Or incentives may be granted in the form of deferral of tax until realization of profits from the sale of, say, a building constructed in a renewal area. The need to pay massive taxes accumulated as a result of the incentive may delay sale of the building well past the optimum date. In sum, because tax incentives are ill-adapted to the rapidly changing economic conditions of many developing countries, they run a high risk of misallocating resources in the future rather than improving their distribution.

c. Equity

A basic premise of tax incentives is that they create horizontal inequities. The beneficiary of a tax holiday pays no income tax on his profits; the neighboring enterprise does. Without this inequity, there would be no inducement to take advantage of the incentive or to direct resources toward the field encouraged by the incentive. To a large degree, the creation of tax incentives supposes that the benefits that will accrue to the general economy will outweigh the attendant inequities.

Practical experience in sub-Saharan Africa has shown that problems of equity, nonetheless, can be serious. First, most incentive laws provide for absolute cessation of benefits at the end of the incentive period, rather than a tapering off. If other potential taxpayers in the same field still benefit from incentives, or if a large portion of the modern sector has been developed under the stimulus of incentives, any potential taxpayer reaching the end of his incentive period may find himself at a strong competitive disadvantage and may be placed in an inequitable position vis-à-vis the market. In such a situation, which may easily arise if tax incentives are widely used during the initial stage of modernization of the economy, the enterprise not benefiting from an incentive becomes the exception instead of the norm. The government, unable to withdraw incentives already granted, may be forced to extend the web of tax concessions further than it desires to and, consequently, to lose more revenue than is justifiable.

Second, the inequities between individual taxpayers that are caused by incentives are mirrored by the inequities between sectors. Attempts to direct investment toward industrialization may create a modern sector paying little tax while an established agricultural or mining sector pays heavy tax. Again, the risk is one of excessive spread of incentive grants as all sectors ask for similar treatment.

d. Administration

Many of the problems discussed above are complicated by defects in the administration of incentives. The failure to gather adequate statistics has already been mentioned. Two more problems are noted here: the dispersion of authority in administration of the incentive process, and the lack of follow-up once incentives have been granted. Typically, tax incentive laws are administered jointly by the planning and the finance ministries, with possible participation also of ministries of economics, commerce, and foreign affairs. A failure to establish or interpret clearly the purposes of the incentives may occur. Delays, inconveniences to taxpayers and investors, and conflicting actions or grants may result. Instead of a coherent set of actions, the incentive program may become a patchwork of laws and regulations confusing grants of privilege, losing revenue, misallocating resources, and creating inequities. Even where such perils have been avoided in the process of according incentives, there may be a failure to do an effective follow-up during the period the incentives are in force because no one of the several agencies involved is clearly in charge. Thus, it is not uncommon for governments to be unaware whether incentive beneficiaries have continued to comply with all requirements (i.e., minimum percentage of domestic value added, minimum levels of employment), have lived up to expectations, or have justified their revenue lost. Fund advice in this area has consistently been that one agency should be responsible for general supervision of the incentive process and that the supervision of beneficiaries should continue throughout the period in which the incentives are in effect.

VIII. General Aspects of Tax Administration

1. Introduction

Many countries in the region have placed increasing emphasis on the role of tax policy in their search for instruments best suited to their economic development. The various kinds of taxes, as well as the combinations and alternatives within each kind, have been carefully studied with the help of technical assistance provided by bilateral aid programs and international agencies. As a result, most governments have been able to introduce broad and fundamental reforms in their tax laws. Proper enforcement of the existing taxes, on the other hand, has received considerably less attention. Yet a more efficient tax administration would be instrumental, in many cases, in providing a considerable part of the needed additional revenue and could make unnecessary, or at least reduce, the proliferation of taxes. It should be noted that introduction of new levies may place such strain on an already weak administration that the quality of its enforcement activities would be further endangered. In addition, adoption of new taxes may distort the internal balance of the system as a whole, because the rationale of the structure could soon be lost in a complex maze of taxes.

It is clear, therefore, that tax administration should receive far greater attention than it has received up to now if countries' tax policy goals are to be attained. In most cases, however, adaptation of administrative machinery set up by a former colonial power to substantially different circumstances--in terms of economic and fiscal policies, legal framework, and availability of staff--is a formidable task. Even so, it has to be undertaken, because it would be futile to try to close large budgetary gaps by raising additional revenue without making coordinated efforts to strengthen the tax administration. Comprehensive changes in tax laws are bound to take time. This time should be spent improving the efficiency of the tax administration to prepare it for the substantive advances sought.

While the solutions to specific tax policy issues may well differ from country to country, and within the same country, as the development process evolves, many of the problems and goals of tax administrations are similar throughout the region. Generally, a tax administrator would define his goal as the efficient assessment, collection, and enforcement of taxes legally due, without unjustified cost to the government or the taxpayer in terms of money, time, and convenience. An international meeting of tax administrators would find common grounds concerning their problems and solutions much more quickly than would a meeting of fiscal policymakers. In this context, the recent launching of the Association of African Tax Administrators is a welcome development. The Association will provide a forum for exchanges of views and discussion of issues, such as joint training facilities, and other possible avenues of collaboration in enforcement activities.

Caution should be exercised, however, not to underestimate the time that reforms of tax administrations take to produce revenue results. It would be safe to assume that these reforms will have a significant impact on revenues only in the medium term and in the long term. Rapid results can reasonably be expected only in a few cases, for example when improvements in collection allow quick recovery of accumulated arrears (and even in this case, success will depend on the current collectability of such arrears)

2. Organizational issues

a. Participation in tax policy formulation

In many countries of the region, tax policy planning is not clearly assigned to a specific unit, either at the ministerial level or at the level of the various revenue agencies. Any tax law change is usually designed in an ad hoc manner and is based on expediency rather than on long-range studies. In some cases, the so-called research divisions attached to the minister or to the heads of revenue departments devote their time to solving day-to-day problems rather than to long-range studies. 1/ Moreover, tax statistics collected are usually not adequate to allow a sound evaluation of the present tax system, notwithstanding existing data processing capabilities in many countries.

1/ There are countries where the ministry of finance has no planning office and most important statistics are simply not available, or where directors of internal revenue and customs departments and the minister of finance have each separate research units which mainly deal with routine matters.

There is general agreement that a unit in charge of tax policy planning should be placed at the ministerial level and should be staffed by economists, tax officials, and lawyers. The heads of revenue departments, however, should take part in discussions regarding tax law changes and should be given the opportunity to suggest changes on their own initiative. Their advice as to the practical possibilities and limitations of new proposals is essential. Also, by taking part in the policymaking process, they will be able to gain an understanding of policy objectives that they need to discharge their responsibilities correctly. A continuous process of tax reform planning has sometimes been suggested as a means of providing an integrated framework of decision making in the related fields of tax policy, legislation, and administration.

b. Organizational structure

The number of tax agencies in individual countries of the region depends largely on their colonial heritage. In one group of countries --mainly those following the British tradition--customs duties, excises, and sales taxes tend to be administered by a separate agency, whereas income taxes are entrusted to another agency. Other revenues--for example, motor vehicle taxes, land taxes, trade licenses, stamp duties, registration fees, and mining taxes--are left to the attention of specialized departments which collect these charges as a subsidiary function. In another group--mainly the francophone countries--inland taxes, including excises and sales taxes, are usually administered by a single agency and customs duties by a separate agency, with or without collection responsibility. Earmarked taxes in both groups are usually administered by the departments to which such revenues are reserved.

Rationalization of the structure of revenue agencies should be based on an analysis of the interrelationship among the tasks which should be performed to administer the various taxes in order to permit pooling certain services at reasonable cost, to provide efficient coordination of assessment and collection activities, and to ensure convenience for taxpayers. Even the administration of earmarked taxes--if such schemes are to be maintained at all--should be assigned to a tax authority to achieve uniformity and efficiency. The designation of an undersecretary, reporting directly to the minister and supervising all revenue departments, would probably provide the best organizational arrangement to carry out this objective. Immediately below that level, a customs department and an internal revenue department would generally be appropriate. Excises and sales taxes need not be administered by the customs department, although the justification for doing so had been that, in developing countries, these levies are mostly collected on imports. However, as domestic production becomes more diversified, integration of the administration of income taxes with that of excises and sales taxes may prove useful. Such integration by no means implies that the customs department should not continue acting as a collection agent for excises and sales taxes on imports, a task which it can perform better than any other office in the government. This does not, however, preclude, an internal revenue department from being entrusted with the administration--in a much broader sense than collection--of these taxes, in recognition of the likely future broadening of their domestic base.

c. Separation of assessment and collection

The approach to separation of assessment and collection activities varies widely in the region. In some countries, assessment is carried out by various revenue departments, and collection by the Treasury. This pattern is primarily observed in the francophone countries. In some other countries, both assessment and collection are undertaken by the revenue department involved. The former case is justified by its proponents as the best method of ensuring honesty of tax officials, but it has been observed that this arrangement generally produces undesirable effects. Its main weakness seems to be lack of coordination between the two agencies involved, which generally resulted in massive tax arrears. It appears, therefore, that a revenue department should be entrusted with both assessment and collection responsibilities and that other methods should be used to encourage officials to be honest.

d. Delegation of authority and decentralization

The degree of success which revenue departments in the region have had in fighting excessive centralization is, in itself, a measure of their efficiency. In general, Fund missions have advised that regional offices be established in accordance with availability of staff and geographic distribution of high revenue potential. Activities such as planning, budgeting, research, statistics, internal audit, recruitment, training, legal and technical advice, appellate functions, and, in most cases, field audit should remain part of the head office organization. On the other hand, most of the day-to-day operations of the service--that is, assessment and collection work--should be assigned to field offices. Monthly reporting as well as inspection visits to review the performance of the field offices are recommended in order to set standards, to improve the quality of the work, and to reduce temptation to corruption.

e. Codes and manuals

Codification of tax laws has become indispensable in many countries to the establishment of an authoritative, up-to-date, and manageable statement of tax rules for both taxpayers and tax officials. The proliferation of taxes--which are imposed at different or supplementary rates and involve different tax bases, different times of payment, separate returns, and separate administrative and judicial procedures--has created a pressing need for a single code of tax laws and regulations that contains all the required information.

Fund missions have also recommended preparation of procedure manuals, which should contain detailed instructions and guidelines for the performance of the various routine functions. Setting standards in this manner should facilitate uniformity in the daily work of tax offices.

3. Resource problems

a. Staffing

The recruitment and retention of adequate staff constitute serious problems in the countries of the region. Low salaries, lack of training, understaffing for some categories of staff, and overstaffing for others have been major factors in creating this situation. Staff turnover is high, and vacancy rates sometimes reach alarming proportions. In Tanzania, for example, in 1978, the Income Tax Division had a vacancy rate of 37 per cent for the entire staff and 45 per cent for technical staff; the corresponding rates for the Revenue Division were 23 per cent and 29 per cent. As technical staff acquire expertise, they are able to find better-paying jobs in the private sector or in parastatal enterprises. Dismissal of incompetent or unsatisfactory employees is difficult, both because of procedural bottlenecks and because of perennial staff shortages.

Two approaches have been suggested to solve the salary issue: (1) making the revenue departments closed units, with their own schemes of service and salary scales, on the ground that the resulting increase in the efficiency of tax officials will produce increased tax revenue; and (2) upgrading the revenue positions where salary scales must be kept uniform because of strict provisions regarding the civil service. Merit increases to selected officials and frequent upgrading of positions in line with increased responsibilities are also suggested for the same purposes. Conversely, any attempt to deal with the salary problem by instituting a bonus or commission system, under which an official receives a percentage of the additional taxes he assesses or collects, should be discarded. These schemes tend to encourage highly arbitrary actions on the part of officials, which may foster public hostility. Moreover, officials who are not engaged in assessment and collection work cannot benefit from these plans.

Some countries in the region have training institutions under the ministry of finance--for example, tax schools, customs schools, financial management institutes, and accounting schools. Usually, they can also benefit from similar institutions in their former colonial mother countries. Apart from this formal training, however, few opportunities exist, for office or on-the-job training programs, both for newly-recruited staff and long-employed officials. Systematic training programs should be instituted to provide the tax officials with a better understanding of the operation of the tax department as a whole, of the relation of their specific jobs to the work of the department, and of the requirements of their jobs.

b. Equipment and facilities

Physical facilities in many sub-Saharan countries have been found inadequate and not conducive to efficient working conditions, staff morale, or taxpayers' respect for the tax service. Moreover, equipment is often not readily available, and shortages of calculators, vehicles, and stationery have created frequent delays in operations. Fund missions have suggested that tax offices be conveniently located and provide adequate space for the efficient conduct of operations. Revenue services in one area should be consolidated in one building or should at least be reasonably near one another, both to facilitate internal communications and for the convenience of taxpayers. Stripping files of outdated material has also been recommended, so that active files remain manageable and in good order, while old documents are moved to archives and, in due course, discarded.

4. Assessment, collection, and enforcement

Severe difficulties in identifying and locating individual taxpayers are apparent in the countries of the region. In some cases, there are considerable differences between the number of taxpayers registered by the tax departments and the number of persons with business licenses issued by other public agencies. 1/ To remedy this situation, general and specific surveys are suggested--for example, door-to-door canvassing and combing public and nonpublic registers; property rolls, records of new construction; membership lists of trade, merchants, and professional associations and clubs; and automobile registrations. Exchange of information between revenue departments and among other governments agencies in the country should, of course, be a routine procedure. Inexplicably, this is seldom done. Once master files are established, they should be kept current, on the basis of information obtained continuously from all available sources. Numbering taxpayers at a centralized level is suggested in order to avoid duplicate numbers in identifying the same taxpayer in different areas of the country or for different taxes. In countries where a social security system exists, it may prove practical to use the social security identification numbers for taxpayers identification also.

Although, ideally, taxes ought to be assessed on actual taxable bases--for example, incomes, sales, customs values, and property rentals or market values--presumptive assessments have been used in many countries in the region where unsatisfactory record-keeping practices in the business community and unavailability of skilled tax officials have forced a departure from ideal practices. Various standards are used to reach approximations of actual tax bases--for example, _forfait_ regimes for income taxes and administrative values for property and foreign trade taxes.

Auditing of tax returns is another area where the sub-Saharan countries need to take action. In view of their limited trained staff, integrated auditing is suggested for closely related taxes, such as the business income tax, business licenses, the general sales tax, and taxes on wages and salaries.

1/ In one particular country, in 1977, the number of taxpayers registered by the Ministry of Commerce differed considerably from the number registered by the Tax Department.

The existence of large amounts of tax arrears is a sure sign of ineffectiveness of the tax administration, and, unfortunately, such arrears are not uncommon in the region. 1/ Sanctions to deter delinquency are generally inadequate--a fact that tends to aggravate excessive statutory payment lags. These excessive lags originate in provisions which allow payment of last year's tax out of the current year's income. If the latter drops substantially below that of last year, delinquency may be unavoidable. Payment dates, therefore, have to be set as close as possible to dates of realization of income, or other tax bases. Taxes withheld on incomes and sales taxes should be remitted as frequently as possible. Penalty interest should always be applied from the date the tax was due, making it clear to the taxpayer that his "involuntary loan" from the government will not be free. In this context, it is advisable that the penalty interest rate be at least as high as the prevailing market rate. An adequate structure of sanctions--including civil monetary penalties and, in extreme cases, criminal penalties--is also needed to deter noncompliance and fraudulent conduct by taxpayers. It is imperative that tax departments be adequately authorized to collect delinquent accounts through imposition of liens on real property where there is a registry system and through distraint of property, garnishment of wages and salaries, and similar actions.

As an aid to collection, tax clearance certificates are required in many countries. They are demanded by the authorities on certain occasions, such as when a taxpayer is in the process of traveling abroad or of obtaining his annual business license. In most places, these certificates have proved helpful. The only common shortcoming seems to be that sometimes taxpayers in need of them are forced to experience inordinate delays and inconvenience to obtain them, due to the inability of the tax administration to perform the necessary checks within a reasonable time. This situation should be avoided at all costs, because it has the potential to generate considerable ill will on the part of the taxpayers.

Litigation systems in the countries of the region are not always organized for an effective and speedy disposal of tax cases. Usually, the administrative review process is not properly developed. In addition, defective drafting of tax laws is often conducive to frivolous objections by taxpayers, which are filed only to delay payment. In some countries, appeals and litigations are being handled by local--and national--autonomous bodies, composed of tax officials and representatives of taxpayer groups. This mixed membership has been justified on the grounds that it provides protection for taxpayers against an arbitrary administration. However, the system has been unwieldy, because it lends itself to local prejudices and domination by local cliques.

1/ In some countries, the problem has been compounded because senior government officials are among the most delinquent taxpayers. Also, noncompliance of public enterprises has been widely tolerated in several countries and has often been justified by the existence of unpaid government debts. In such cases, appropriate set-off procedures should be established.

The need for an efficient appellate system is fully recognized nowadays, not only to ensure fair treatment for taxpayers but also to avoid backlogs which can clog the tax administration. Depending on its legal and judicial systems, each country should design appeal procedures to satisfy the two basic principles of fairness and expediency.

5. Other administrative issues

The need for taxpayer education should be given priority. In countries where taxation has been associated with foreign domination, such education is even more crucial and should receive immediate attention. Taxpayers should be convinced that: (1) the tax system is being administered fairly, and the money collected is being spent wisely; and (2) enforcement is adequate to deter delinquency. The low level of literacy, the technical nature of various tax procedures, and the lack of trained staff constitute major difficulties in establishing the desired level of communication between taxpayers and the tax administration in sub-Saharan countries. Publication of booklets explaining tax procedures, tax withholding tables, and bookkeeping and return filing requirements is recommended. Moreover, notices in newspapers and on radio and television are also suggested. The provision of assistance to taxpayers in meeting their return filing requirements is also recommended.

Dishonesty and corruption have been hovering over tax departments in many countries of the region. Low pay scales are often cited as a major factor in attracting mainly the incompetent and in leading to part-time outside employment. But the lack of adequate internal auditing, close supervision, and disciplinary sanctions have also been important factors in the present state of affairs. To transfer staff within or outside tax departments to deter collusion and corruption has been found rather to be counterproductive, as it tends to cause serious disruptions in training needs and career development. The Taxation Department of one country, for instance, has been following the policy of transferring staff with the objective of preventing the growth of friendship between taxpayers and tax officials and thus deterring an atmosphere conducive to collusion. An internal audit unit is a much more effective deterrent to collusion, bribery, and corruption. Its activities should include frequent inspections and investigations supported, whenever needed, by severe sanctions.

Tax statistics provide basic data for the formulation of economic and fiscal policies and are an essential tool for managing the revenue departments. Yet the statistics collected in the countries of the region are generally inadequate, are in some instances unreliable and inconsistent, and are not fully utilized when they are available. Furthermore, they are not conceived--together with research, planning, programing, and budgeting activities--as an integral part of the process of supervising and improving the operations of the tax department. The collection of statistics is not reviewed frequently with a view to deciding if changes are needed. Furthermore, the collection process is usually rather slow. Fund missions have frequently suggested that attention be paid to this important task and that careful studies be conducted to determine how to set up specialized units to compile statistics, what their location should be in the organizational structure, and what type of information they should collate.