SIERRA LEONE TAX REFORM

ENGAGEMENT NOTE

MACRO FISCAL CONTEXT AND REVENUE PERFORMANCE

1. **The new government elected in April 2018 inherited a declining economy** with slower economic growth in both iron-ore and non-iron-ore sectors, growing twin deficits (domestic fiscal and external current account), accelerating inflation fueled by depreciating exchange rate and the buildup of government arrears, and weaker performance of SOE's. Given the delays and the size of slippages, the 2017 ECF program was faced with a growing risk of going off-track. In the circumstances, the new government opted to cancel the ongoing IMF program and demonstrate its strong commitment to realistic improvements in macroeconomic performance defined under a new ECF concluded in November 2018.
2. **The new IMF arrangement retained many of the features of the old program aligned with the evolving circumstances.** Expected GDP growth rates were reduced throughout the five year period (2018-2022), accompanied by sustainable fiscal policy, debt and public finance management, low inflation and higher foreign reserve coverage; a safe and sound financial system; improved central bank governance; inclusive growth, expanded social safety net, and improved business environment. More specifically, the medium term growth is expected to reach 5.1 percent (compared to 7 percent in the previous program). Average inflation is projected to decline to single digits (9.6 percent) by the end of the program despite pressures from higher retail fuel prices (following elimination of subsidies) and probable continued exchange rate depreciation.
3. **The brunt of the underlying Fiscal Adjustment Framework is anchored in an ambitious revenue mobilization effort** expected to support continued strong capital (infrastructure) and social spending needs and yet allow the deficit reduction needed to stabilize and reduce public debt even in the event of unforeseen external and domestic shocks. Fiscal Adjustment Framework provides a sustainable mapping of government policy objectives into the foundation for macroeconomic stability and economic growth. Country's large (domestic and external) public debt burden is the main constraint in this process. The recent fiscal slippages and weaker output growth have added to this challenge. Sierra Leone is now classified as being at "high risk" of debt distress.
4. **Policy actions taken in recent months were aimed to raise revenue and control spending commitments (and thus support deficit reduction).** These include elimination of subsidies on retail fuel, expenditure controls through the Treasury Single Account (TSA), improved collection of dividends from profitable SOEs, and review and streamlining of duty and tax waivers. The Finance Ministry has introduced measures to

control domestic capital expenditures and spending on wages, goods and services (by identifying excessive charges and double payments).

5. **Going forward the success of these measures, and of sustaining the improved revenue performance of the last several months, will depend on the government and the National Revenue Authority maintaining strong efforts— both technical and political— to bring about a fundamental shift in the tax paying and collecting culture**. The improved revenue performance of the past several months would need to be sustained. Key elements of the Revenue Mobilization Strategy are already in place and yielding results in the near term, helping alleviate the budget's short-run cash shortage and arresting the growth of arrears. The revenue performance has also benefited from the government's increased efforts to improve tax collection across the board, and the determination to maintain this will be essential for the sustainability of revenue mobilization. Altogether, the key measures taken and currently underway are expected mobilize additional revenues sufficient to meet or exceed the budget financing needs under the ECF program In particular, fuel excise reform could generate ¾-1¼ percent of GDP annually, depending on how the recent fuel price increase affects the volume of imports (automatic indexation of imported prices is assumed). The annual surplus revenue collected by MDAs (ministries, departments, and agencies) above their budgeted expenses is projected to be about ½ percent of GDP, in line with the experience of the last several months since the consolidation of their accounts at the TSA. A number of other measures under the Revenue Mobilization Strategy that have been taken or are in the pipeline (suspension of import duty and GST waivers, comprehensive review of tax concessions, identified steps for improving tax administration) will contribute to higher revenue, but their precise yield is difficult to quantify at this stage.

6. **Tax revenue performance has been increasing lately but remains low**. A rising revenue-to-GDP ratio remains a key target, both to finance essential spending and to allow for an assumed gradual decline in official budget support.

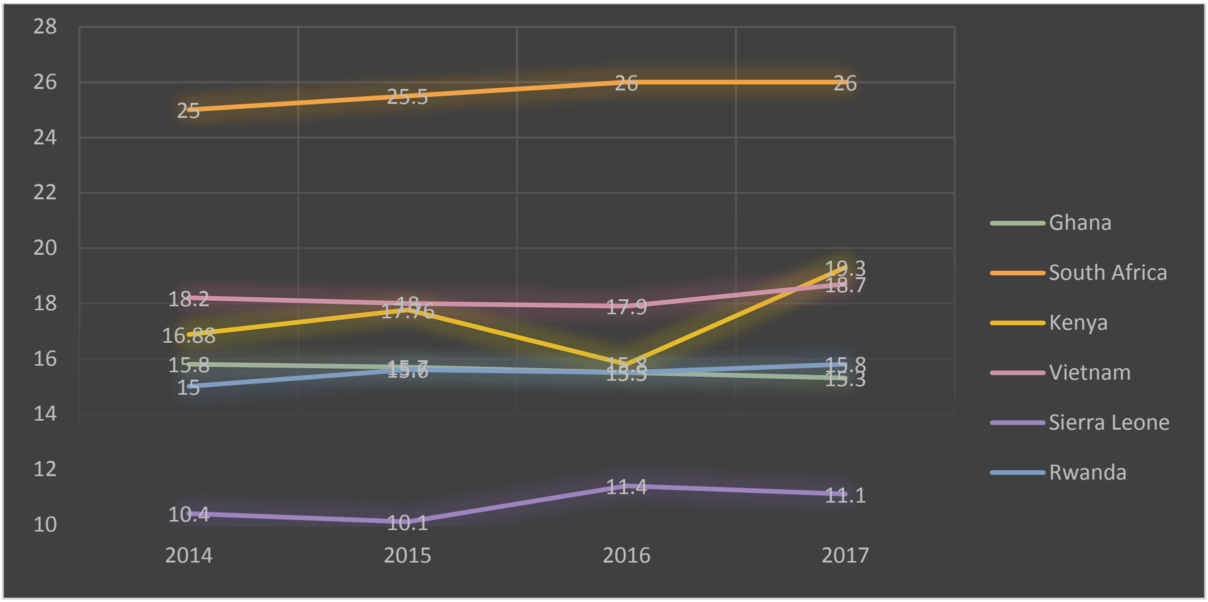
Table 1. Revenue performance in Sierra Leone, 2014-2018, % of non-iron ore GDP

	2014	2015	2016	2017	2018f
Revenue	10.8	10.8	12.1	12.2	13.8
Taxes	10.1	10.1	11.4	11.1	11.9
PIT	3.0	3.0	3.9	3.5	4.0
CIT	1.3	1.1	1.4	0.8	1.0
GST	2.2	2.8	2.8	2.6	2.8
Excises	1.1	1.0	0.8	1.5	1.1
Import duties	1.4	1.5	1.6	1.8	1.9
Mining royalties and license	0.9	0.4	0.7	0.5	0.7
Other taxes	0.2	0.2	0.3	0.3	0.4
Non-tax	0.7	0.8	0.7	1.1	1.8

Source: IMF

7. **The tax-to-GDP ratio has been considerably below comparators from the region and globally** (Figure 1).

Figure 1. Tax-to-GDP Ratio in selected countries

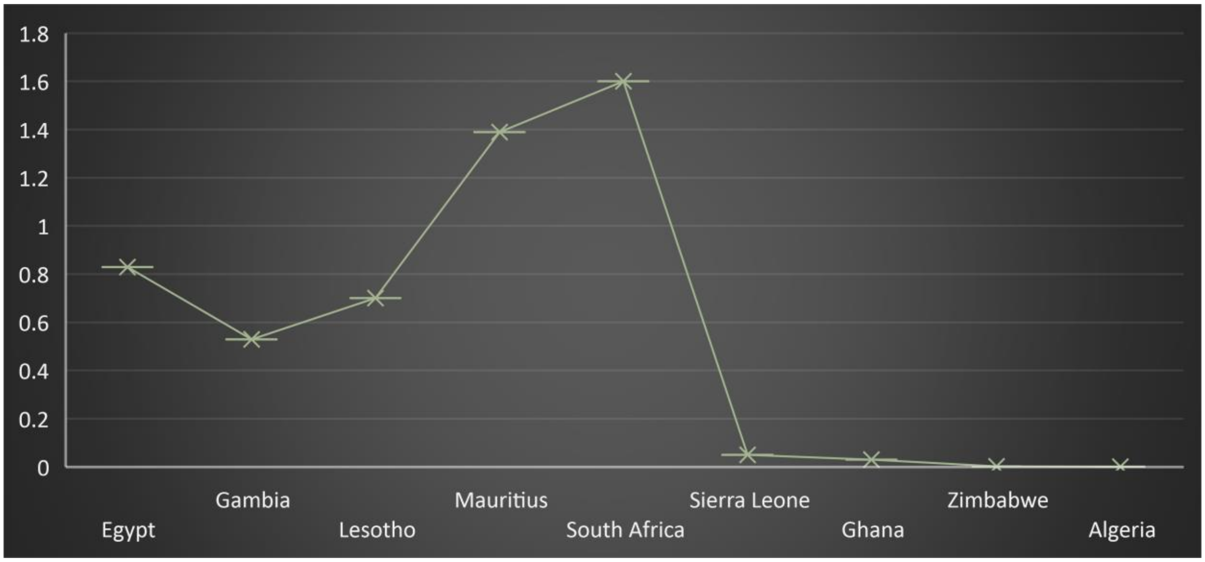


Source: IMF, World Bank

8. **Property taxation could be an important of source of local revenues from the current low level as a share to GDP.** The Figure 2 below compares select African countries suggesting there is potential for significant increases of property tax revenues. Property taxes are considered a good source of local government revenues since their tax bases are immobile within a given local jurisdiction. Because the tax base cannot be shifted by simple re-registration or relocation of the taxable object, taxing local properties does not entail significant economic distortions. The property tax is equitable since it is allocated and borne according to wealth criteria.

9. **The property tax by nature falls on an object but requires identifying a subject or person who is liable to pay the tax, so the dedicated effort to ensure taxpayer registration is also required** as discussed in the following section.

Figure 2. Property tax performance in select African countries, % of GDP



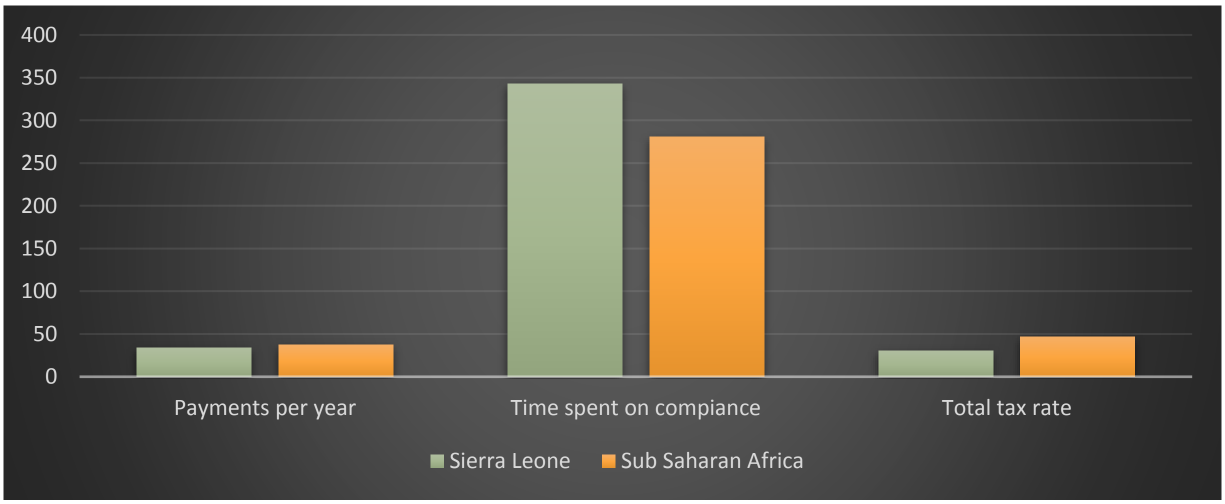
10. **Sierra Leone's longer-term growth prospects are promising, but experience has shown that the economy is fragile and will remain vulnerable to both domestic and external shocks:**
    a. Large public debt burden and exogenous downside risks will continue.
    b. Weaker balance of payments inflows could challenge Central Bank reserve targets in an underdeveloped domestic foreign exchange market with limited exchange rate flexibility.
    c. Mining sector remains volatile and is subject to uncertain global developments:
        i. Upside potential: from possible future mining prospects,
        ii. Downside risk: Drop in export demand has negative spillovers on the economy and budget revenue.
11. **In the longer run, if the share of revenues in GDP is not increased sufficiently, financing and debt sustainability constraints could necessitate a reduction in capital and social spending**. Lack of progress on structural reforms—particularly in PFM and the accountability and transparency of public institutions—would reduce the effectiveness of fiscal policy and undermine public trust needed to raise domestic revenues.

TAX ADMINISTRATION PERFORMANCE

12. **The Sierra Leone National Revenue Authority (NRA), a semi-autonomous body, is the Government Agency responsible for the administration of taxes and customs duties**. The NRA, which was established by an Act of Parliament, No 57 of 2002, is supervised by a Board of Directors and the chief executive is the Commissioner-General. The Board as well as the CG are appointed by the President with the approval of Parliament. NRA has 500 staff with 134 deployed in the Domestic Tax Department, which comprises one large taxpayers office (LTO), one medium taxpayers office (MTO) and three small taxpayers offices (STO) in the capital of Freetown as well as four provincial offices.

13. **One of the main reasons for low tax collection is poor tax administration.** A 2016 Tax Administration Diagnostic Assessment Tool (TADAT) assessment revealed major weaknesses in taxpayer registration; lack of risk-based compliance management across registration, filing, payment and audit; and lack of dispute resolution.
14. **All that not only undermines revenue performance, but also imposes undue burden on taxpayers.** Sierra Leone ranked 88th out of 189 countries on Paying Taxes indicator in the Doing Business 2019. A large number of payments (34) and complex and lengthy compliance procedures are main reasons for the weak performance.

Figure 3. Paying Taxes Indicator Dimensions, Sierra Leone vs Sub-Saharan Africa



Source: Doing Business 2019

15. **Small firms are bearing disproportionately high burden of compliance.** Firms operating (both domestically and foreign owned) in Sierra Leone see tax administration and tax rates as more of a problem than firms globally or in Sub Saharan Africa, and the problems are disproportionally affecting small firms.
16. **Sierra Leone stands out from other countries globally with its high level of informality** reiterating the issue with taxpayer registration pointed out in TADAT Assessment (although the level of informality is somewhat lower than Sub Saharan Africa average). It is notable that large companies face almost the same level of informal competition as their small peers, which is unusual and points to high level of informality even in the sector of the economy where large companies operate.

Figure 4. Perception of Tax Rates and Administration as Constraint in Sierra Leone vs Region and the World

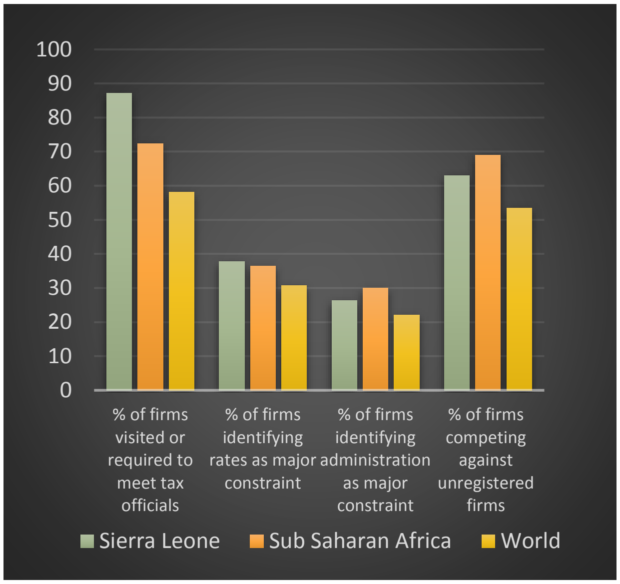
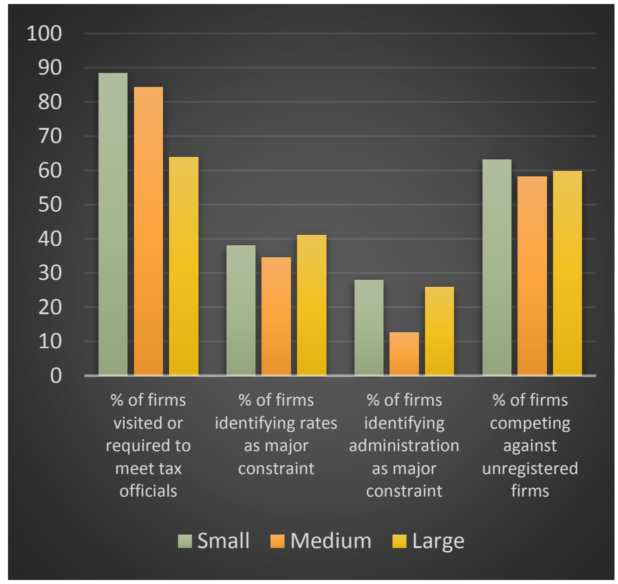


Figure 5. Perception of Tax Rates and Administration as Constraint in Sierra Leone by Size of Company



Source: Enterprise Survey 2017

17. **Close to 90 percent of firms are visited by tax authorities in Sierra Leone posing a risk of corruption and disrupting business operations of taxpayers**. Sierra Leone taxpayers see tax authorities much more frequently than average for Sub Saharan Africa and almost twice more frequently than global average. Moreover, the highest share is observed among small taxpayers, while only around 60 percent of large businesses are visited by tax authorities. This is reverse of global trend, when large taxpayers are more scrutinized, while small taxpayers are only subject to infrequent interactions to ensure compliance. It suggests no risk profiling applied to interactions with taxpayers.

18. **At the same time, non-filers and late filers are posing a problem to administration.** According to the data from TADAT assessment, only 63 percent of CIT declarations, 39 percent of PIT declarations and 59 percent of GST declarations are filed on time. Electronic filing is not utilized. Tax arrears data is not available.

19. **Moving forward there is a need to improve taxpayer registration and strengthen compliance management and enforcement activities.** Unless the fundamental basic systems such as registration, enforcement are addressed, it will be difficult to move forward with any further reforms.

DEVELOPMENT PARTNER SUPPORT TO DOMESTIC RESOURCE MOBILIZATION

20. **Several development partners provide support to the government of Sierra Leone to improve domestic revenue mobilization.** The World Bank, through the Public Finance Management Improvement and Consolidation project (PFMICP), supports deployment of critical ICT infrastructure to the NRA and related changes to customs and tax regulations

needed to ensure effective implementation of automated systems. The DFID provides two long-term advisors to support senior management and taxpayer services for a period up to March 2020. The Africa Development Bank (AfDB), plans to support introduction of electronic fiscal registers, carrying out of taxpayer appreciation days and MSME tax compliance preparedness. IMF supported Government of Sierra Leone in building capacity to manage the extractive sector, audit of specialized sectors, and customs risk-based systems. Future technical assistance from the IMF is being finalized. Through a budget support operation, the European Union Delegation embedded two revenue (i.e. development and adoption of revenue management strategy plus monitoring the implementation) related triggers in the EC Support program. See details in Annex 1 for details.

21. **The domestic revenue mobilization should be looked at the context of broader engagement of the World Bank.** The World Bank portfolio includes several projects with linkages to tax reform agenda. The PMFICP already mentioned above directly supports NRA. In addition, Smallholder Commercialization and Agribusiness Development Project supports commercialization of the small farmers which will in turn help formalize small agricultural businesses. Ensuring that tax compliance does not become too much of a burden for them is important. Extractive Industries Technical Assistance Project Phase 2 support improved governance in the mining sector. There are synergies between governance of the sector and improved natural resource taxation that should be considered.

REFORM PRIORITIES MOVING FORWARD AND MENU OF OPTIONS FOR ENGAGEMENT

22. **Recognizing the challenges, the Government adopted a Domestic Revenue Mobilization Strategy with a range of tax policy and revenue administration measures**. Implementation of the Revenue Mobilization Strategy with support of development partners, is the bedrock of the revenue improvement agenda. So far, government reformed the fuel subsidy by floating the retail fuel price at the same fixed ad-valorem excise level as the current commercial fuel formula, suspended majority of import duty and GST waivers, consolidated all revenue inflows of quasi-independent public institutions into the Treasury Single Account (TSA) and retain net excess revenues in the budget.
23. **The analysis above point to several key reform areas**:
    a. Continuous and longer term focus on revenue increase on the policy side, but in way which is equitable and growth oriented. This will require a comprehensive review of the tax system to ensure its alignment with government objectives.
    b. Improvement in revenue forecasting to ensure credibility of the fiscal framework and sustainability of public finance. The 2018 PEFA assessment pointed at high (from 20 to 32 percent) variance in revenue composition. Albeit overall revenue outturn being off target by up to 7 percent in the last three years, it likely

required urgent revenues measures, undermining sustainable fiscal management.

c. Property taxation could become an important source of local revenues after the design and administration of tax is improved.
d. Tax registry is incomplete and not reliable, which is a first order priority for improvements in tax administration.
e. There is a need for refocus compliance and enforcement efforts on high revenue potential taxpayers. Current situation when around 90 percent of small taxpayers have to see tax officials is counterproductive.
f. Finally, capacity development efforts for NRA staff are essential to equip NRA with skills to ensure compliance and enforce collection from taxpayers including large multinationals.

OPTIONS FOR WORLD BANK SUPPORT:

24. **Based on the existing and planned development partners' support to the Government and challenges that Sierra Leone is facing, the Bank can help through the following menu of options**:
    a. Analytical work on the improving tax system through comprehensive review of legislation to ensure pro-growth tax policy and sustainable resource envelope to finance service delivery at the central and local level
    b. Technical assistance support to development IT Strategy in DRM in Sierra Leone to integrate different IT investment into a sustainable medium term development plan
    c. Support to international taxation including capacity building in transfer pricing
    d. Technical assistance to improve quality and reliability of revenue forecasting.

ANNEX 1. DONORS' MATRIX

Donor	Program	Program Objective	Program Description	Implementing Agency	Main Counterparts	Time Period	Budget
DFID	Strengthening Public Financial Management, Anti-Corruption and Accountability Institutions in Sierra Leone	To improve Sierra Leone's ability to raise, allocate and account for the use of public funds; so that they can be invested in services e.g. education, health and growth.	DFID provides Pound Sterling 3.5 million to help Government improve Public Expenditure Management, Transparency & Anti-Corruption and revenue mobilization. In respect to Revenue, the project aims to strengthen the capacity of senior leadership within the National Revenue Authority (NRA) and Ministry of Finance to improve revenue generation to finance basic services and investments. The Project will provide two long term Advisors and short-term TA. One Long Term Advisor to NRA senior Management has been deployed. A second-long Term Advisor will focus on taxpayer services.	DFID	National Revenue Authority (NRA)	18 months	Flexible funding to allow program delivery on the 2 Long Term TA and Short-Term TA.
Delegation of the European Union	Budget Support to Sierra Leone		Regarding revenue, the European Union Budget Support disburses based on two triggers: • Sierra Leone Develops and adopts s a Revenue Mobilization Strategy (Now in place) • Report Evaluating implementation against action plan in Revenue Mobilization Strategy is availed.	EU Delegation	Ministry of Finance	2014-2020	Budget Support
African Development Bank (AfDB)	Not Yet Operational	TBD	Program is planned To Support Sierra Leone National Revenue Authority and involve the Revenue & Tax Policy Department in: • Introduction of Electronic Cash Registers (ECRs) • Tax Preparedness schemes which may include training of MSMEs, compliance improvements and MSME taxpayer education	NRA	NRA Revenue & Tax Policy Unit in Ministry of Finance	TBD	USD 1.4 Million

Donor	Program	Program Objective	Program Description	Implementing Agency	Main Counterparts	Time Period	Budget
			Implement a Taxpayer Appreciation Day				
IMF FAD & IMF AFRITAC West	TBD	TBD	IMF has provided TA to Sierra Leone in the following areas: • Effective Revenue Administration for the Extractive Sector • Tax Policy under Module 1 and 2 of the Managing Natural Resource Wealth (MNRW) project • Revenue Enhancement: Follow-up to TADAT • Assistance on specialized audits and • transfer pricing • Enhancing Risk Based and Offsite Supervision • Improving NRA Organization Structure A Request from government authorities has been submitted to IMF for consideration in several areas, including transfer pricing regulations	IMF FAD IMF ARITAC West	NRA Revenue & Tax Policy Unit in Ministry of Finance	TBD	TBD
World Bank	PFMICP	strengthen revenue policy, Legislation and taxpayer service through robust, off-the-shelf tax and customs tax administration system	The program is designed Sierra Leone • Update Tax and Customs Legislation • Implement upgrades of customs system from ASYCUDA ++ to ASYCUDA World • Deliver an Integrated Tax Administration System (ITAS) • Deliver Support ICT Infrastructure (Servers, Computers and Licenses) • A payment gateway full linked to IFMS and • Long Term ICT & Reforms Advisory Support	NRA	NRA	2014 - 2020	USD 9.56 million
US Treasury	Technical assistance	-	The program has not started. Expected focus on human resource management	NRA	NRA	2019-	TBD