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# Liberia

## Domestic Revenue Mobilization Policy Notes

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# Contents

# Domestic Revenue Mobilization in the Context of Fiscal and Development Challenges

1. **Following general elections in Liberia in 2017, a new government was formed with a mandate to achieve ambitious development objectives.** Following a nationwide consultative process, the new medium-term national development plan, Pro-Poor Agenda for Prosperity and Development (PAPD)-2019-2023 was developed focusing on:

    a. strengthening public institutions;

    b. accelerating infrastructure investments for productive capacity;

    c. improving productivity in the real sector through enhanced economic diversification;

    d. increasing investment in human capital (youth employment, health, and education); and

    e. improving competitiveness, while safeguarding macroeconomic and debt sustainability.

2. **Such a comprehensive approach and strong pro-poor orientation is understandable giving the living conditions of the majority of the population**. In the presence of inevitably declining aid flows from the elevated levels during 2014–16 period, the government will face a daunting task of pursuing a demanding development agenda to meet high expectations generated during the last electoral cycle, while safeguarding macroeconomic fiscal and monetary stability, securing investment resources for future growth, and ensuring debt sustainability in the medium-to-longer run.

3. **At the same time, Liberia is a challenging fiscal position**. It heavily depends on external grants as a source of revenue. Recent IMF Article IV mission to Liberia (February 25 – March 8, 2019) concluded that macroeconomic stability has proved elusive and fiscal stance has loosened significantly during the second half of 2018 calendar year despite improved revenue collection. At the same time GDP growth estimate for 2018 has been reduced from 3.2 to 1.2 percent, while the forecast for 2019 has been revised down even more dramatically from 4.7 to 0.4 percent. This will inevitably reduce the projected tax base and put additional pressure on revenue reforms to compensate for slower GDP expansion and sufficiently expand the resource envelope to enable a much-needed increase in social spending.

4. **Macro fiscal situation threatens successful implementation of PAPD**. Official numbers for the July 1 – December 31, 2018 period (Q1 and Q2 of FY 2018/19) released by the Ministry of Finance do not reveal the full extent of ensuing macroeconomic imbalances: growing fiscal deficit financed by accommodative monetary policy of the Central Bank, depreciation of the exchange rate by 26 percent and accelerated inflation which reached 28 percent at end-December. This level of inflation markedly erodes the living standards of the most vulnerable social groups and threatens the success of the pro-poor agenda of the Government.

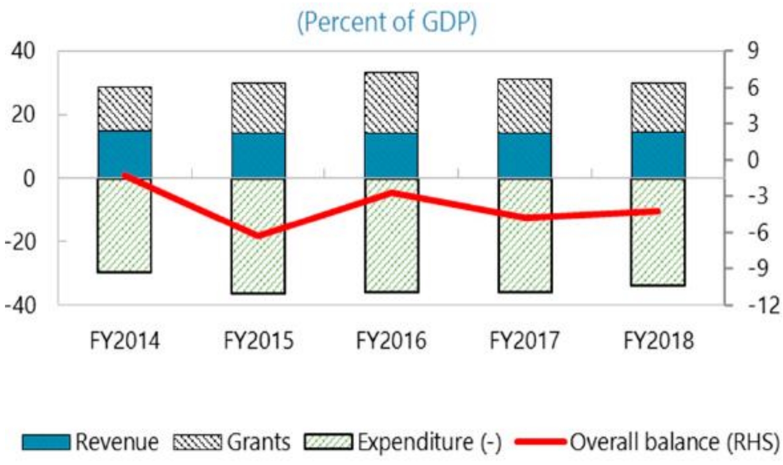
5. **The focus of fiscal policy should be twofold – raising revenues while sustaining deficit at financeable level**. In such a tight fiscal situation, the imperative is to secure equal or improved quality of public services by prioritizing and improving the composition of expenditure, enhancing efficiency, and expanding the resource envelope by stepping up the revenue mobilization efforts. Sustaining pro-poor development agenda, will likely require a political resolve to reduce the share of government resources devoted to high-paid public servants and discretionary expenditures, as well as improve the efficiency and transparency of government spending. Otherwise, the financing gap created by an announced decline in grants and other forms of external assistance may be difficult to close.

6. **The evolving fiscal pressures assign growing importance to revenue reforms in the context of Domestic Revenue Mobilization Strategy** which envisages a number of specific reforms, including more focused excise taxes, rationalization of tax exemptions, and improved tax administration.

7. **Liberia has been embarking on tax reforms since 2013**. Liberia's main domestic taxes include corporate income tax, personal income tax, goods and services tax, and excise tax. The Liberia Revenue Authority (LRA), in charge of administering revenues in Liberia. The LRA was established on July 1, 2013 replacing a revenue department of the MFDP. Recently, LRA implemented a wide range of measures to improve tax compliance and to reduce leakages, such as introducing a desk audit system for large taxpayers and educating taxpayers through workshops with support of development partners. A new compliance management framework was introduced in the first half of 2017 for further improvement of revenue mobilization.

8. **At the same time, the reliance on grant to finance expenditures has not decreased and revenue performance remains weak**. Despite relatively rich natural resource base, especially in iron ore, rubber, rubber-wood, gold, diamonds, and a range of other minerals, and a large share of sectors based on natural resources in GDP and exports, Liberia collects minimal public revenues from these activities (see Annex 1 for detailed revenue performance).

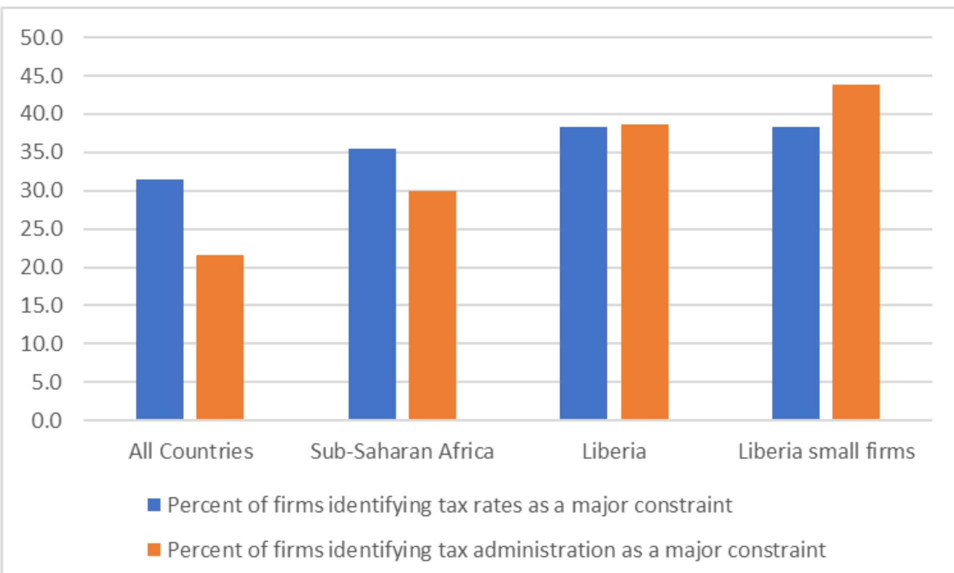
**Figure 1: Liberia: Limited Revenue Mobilization and Dependence on Grants**




*Source: IMF*

9. **While the administration processes to ensure compliance are under development, the tax administration seems to pose burden on taxpayers, which is perceived higher than in the region** and has a particularly negative impact on small companies.

**Figure 2. Tax Rates and Tax Administration Perception by Businesses, 2017**




*Source: World Bank Enterprise Surveys*

10. **These policy notes provide a closer look in several important areas of the DRM agenda** including natural resource taxation, introduction of VAT, tax exemptions, and streamlining of the tax legislation.

# Taxation of Natural Resources

11. **In the context of a need to increase revenues and create a fiscal envelope for a pro-poor development agenda, natural resource taxation deserves special attention** as it may offer a win-win vehicle to enhance revenues, improve country's even regional development, and boost its overall development capacity, without hurting domestic investment and doing-business conditions.

12. **Based on World Bank assessment, Liberia is one of 81 countries in the World in which natural resources play a dominant social, economic, and political role.** According to the latest, albeit almost four year old, Liberia 2014-15 EITI report, extractive industries (in agriculture, forestry, mining, and oil and gas) contribute to around 15 percent to GDP, 26 percent of government tax revenue, and 49 percent of overall employment. The mining sector accounts for 52.7 percent of extractive industries revenue, followed by oil and gas which contributes 21.1 percent although still at exploration stage. Agriculture sector is third with 14.9 percent and forestry last with 11.2 percent. Out of ten largest companies in terms of contributions to government revenue, the Mining sector has five companies (ranked 1st, 2nd, 4th, 8th and 9th) with combined share in revenues of 47.4 percent. Oil and gas sectors have three companies (ranked 3rd, 6th and 7th) with 18.4 percent combined share. Finally, agriculture has one company (ranked 5th) with 5.5 percent share, and forestry has one (ranked 10th) with 3.3 percent share.

13. **Most of natural resource revenues in Liberia come from licenses and payroll taxes**. In terms of tax instruments, the largest contribution (27.1 percent of total natural resource revenues) comes from licenses and various fees sectoral and administrative fees. The second largest are taxes on wages (social contributions and payroll taxes) with 26.8 percent share natural resource revenue. Ordinary taxes (including CIT, excise taxes, and various resource taxes) are third with 21.3 percent. Finally, royalties contribute only 11.6 percent of natural resource revenues.

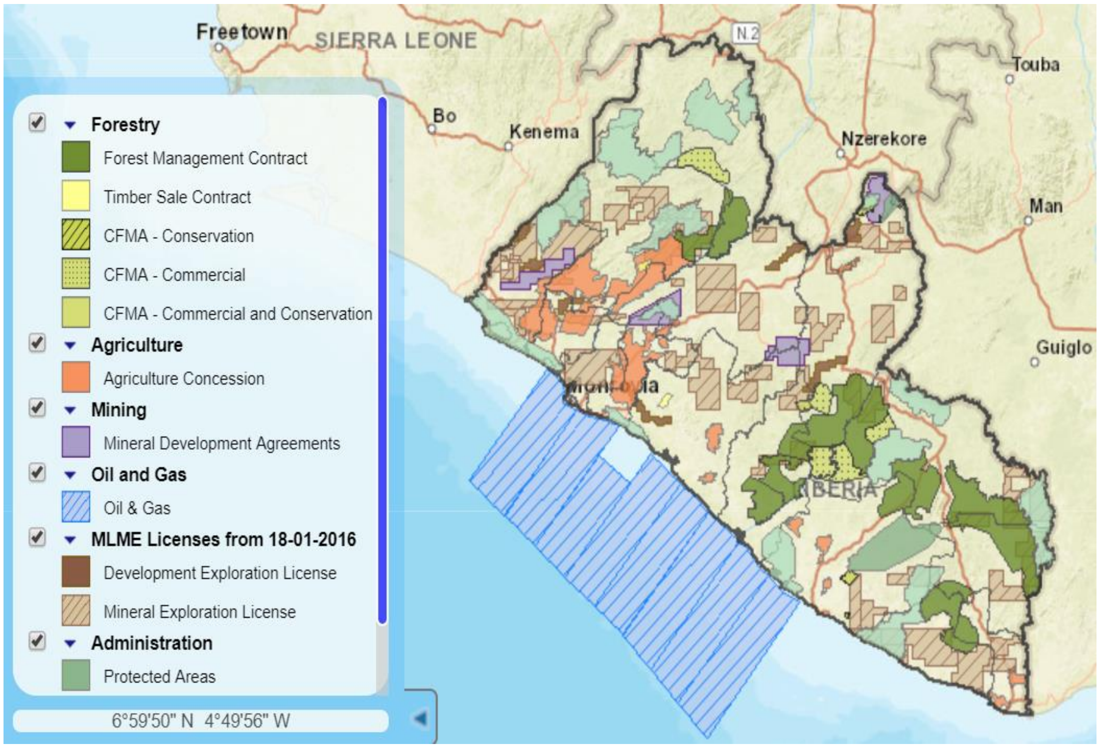
14. **Given the available information on natural resource endowments, unless there is a breakthrough in oil and gas explorations, it is very likely that the mining sector will continue to dominate the contributions to employment, production, GDP, exports, and government revenues**. Forestry is likely to show strong growth in the coming years as demand for rubber-wood continues to increase, but its share in government revenue will not change much due to low base.

## Natural Resources in Liberia

15. **Liberia has rich mineral deposits**. Mineral extraction – particularly of iron ore, gold and diamonds – has been one of the main sources of value added and exports. For the most part minerals are exported in a raw or semi-finished form. In addition to large iron ore

deposits, there are substantial diamond and gold deposits as well as potential deposits of manganese, bauxite, uranium, zinc and lead. Diamond deposits, primarily alluvial and artisanal diamond mining, are widespread in most parts of the country. The government complies with the Kimberly Process (KP) of Origin Certification, which enables Liberia to legally trade rough diamonds with other KP member countries.

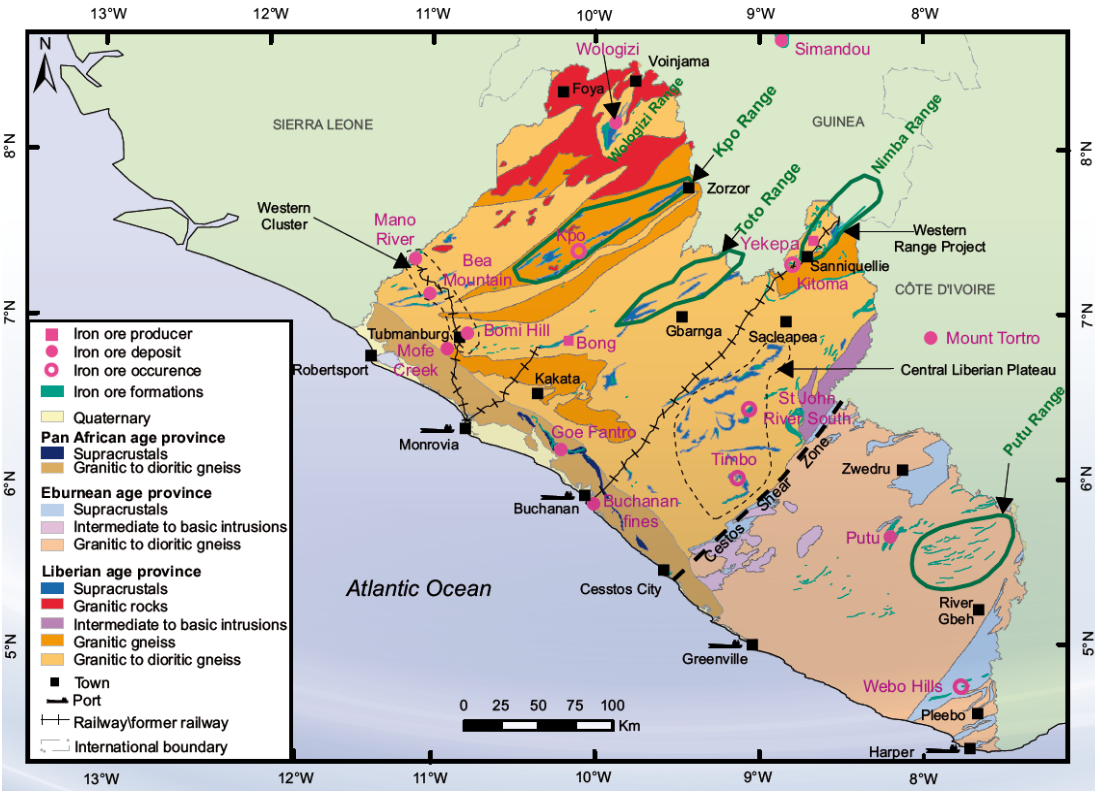
**Figure 3. Liberia: Natural resource endowment**




*Source: World Bank*

16. **The country has substantial iron ore reserves.** Mining largely ceased during the 1990's with the onset of the civil war. Liberia's iron ore reserves at grades of 30-70% are probably the largest in Africa and there is renewed interest in the exploitation of the iron ore deposits. As indicated in the map and table below, Liberia has more than three billion tons of iron ore with an average iron content of 38.9 percent. Presently Liberia ranks no 22 in iron ore production with 5.1 million tons or 0.2% of World production. Iron ore mining has a major role in the economy and accounted for nearly 30 percent of total export earnings in 2016.

**Figure 4. Liberia -- Iron Ore Deposits**




*Source: Ministry of Lands, Mines & Energy, Liberia. The Potential for Iron Ore in Liberia*

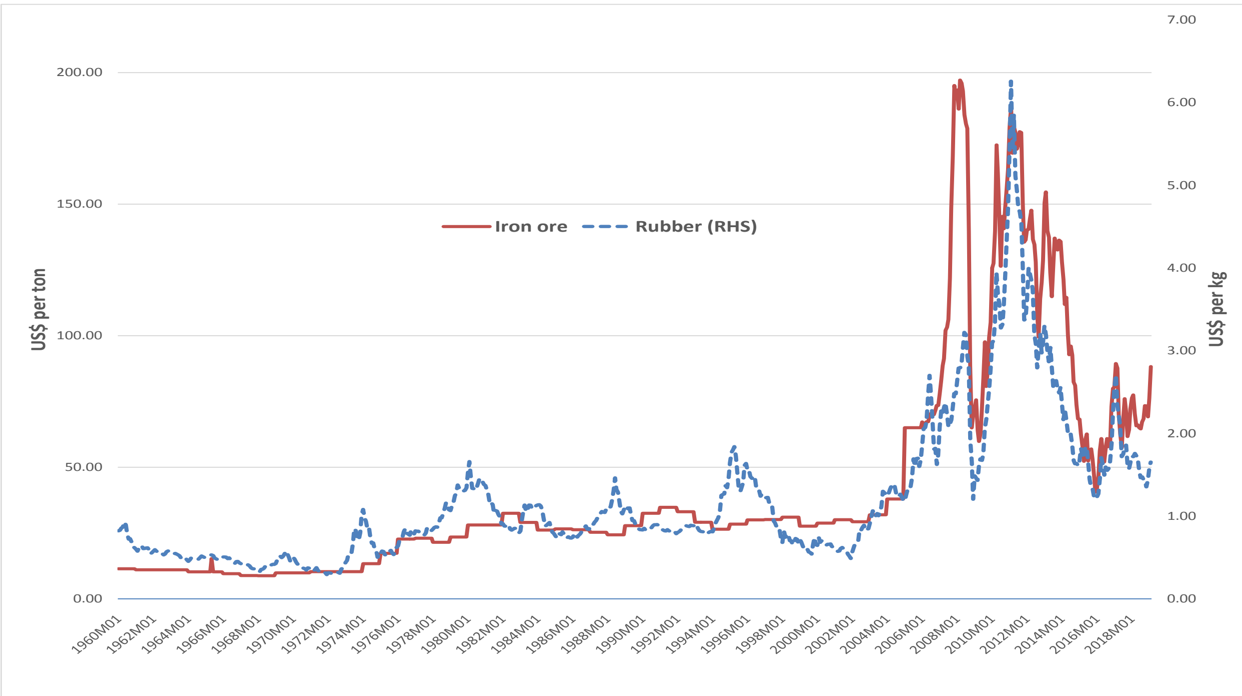
17. **Liberia has a long tradition of producing and exporting natural rubber.** First concession was signed with Firestone in 1926 for a 99-year lease of one million acres of land (at location to be picked by the company) at US 6 cents per acre. The lease has been extended in 2005 and amended in 2008 yielding Liberia significant economic benefits, despite recent labor disputes. In 2013 the Government suspended the exports of raw rubber and requested all companies to do at least some processing in Liberia to increase value added (and hence GDP) leading to higher wages and better conditions for local workers. Many rubber companies (Firestone, Bridgestone and Salala) responded by processing part of raw rubber and exporting latex and similar rubber products. This increased the value of combined rubber exports to US$200 million, almost half of merchandise exports.

18. **Recently, Liberia further expanded the rubber value-chain when it started cutting and selling rubber-wood from about 600,000 hectares under overgrown rubber-wood farms with trees between 30 and 60 years old.** Based on conservative FAO assessment of 100 cubic meters of rubber-wood per hectare (Non-forest tree plantations, FAO 2001), the volume of wood makes Liberia a possible competitor in the fast-growing rubber-wood products market with strong import demand from the US, EU countries, Australia and Japan. Asian countries (Malaysia, Thailand, and Philippines) currently dominate exports but increasing labor cost and other factors affecting their competitiveness may open opportunities for Liberia and other competitors that can supply

competitive products and ensure adequate supplies. Rising consciousness among consumers about the environment will likely result in increasing demand for rubber wood and provide Liberia with a clear opportunity to enter this market and create productive jobs that could help reduce poverty in the country.

19. **At the same time, dependence on natural resources comes at a price due to volatility in commodity markets.** After more than four decades (1960-2006) of moderate growth, prices of Iron Ore and Natural Rubber sharply increased in response to high demand driven by the unprecedented growth of the global economy (first and foremost China). The initial boost to economies driven by natural resources (2006-2009) was followed by a sharp reduction in prices following the global recession (2009-2010), another revival (2010-2014) and a final return to price levels recorded in 2005-2006.

**Figure 5. Iron Ore and Natural Rubber prices, 1960-2019**




*Source: World Bank, Commodity Prices database.*

20. **This price volatility seems to be over for iron ore as has been following a strong upward trend since early 2016, with projected positive growing trend until 2025 and beyond**. Rubber prices experienced another cycle in 2017 and are now poised for moderate steady growth until 2025 and 2030. Both price forecasts are based on the latest World Bank commodity price projections.

## Revenues from Natural Resources in Liberia

21. **The effective tax rates have changed significantly over the last five years** (see table below) due to world (export) prices and mix of applicable tax instruments with elements of progressivity and regressivity. For iron ore, effective tax rates are likely to recover from the lower levels recorded in 2018 and remain at above 6 percent level in the coming years. Effective tax rates in gold have been continuously falling since 2015 and are projected to remain low due to increased competition in the world markets. In rubber, the effective tax rates have been fluctuating around 10 percent in line with price movements in international markets. In the coming years effective tax rates are projected to gradually increase in line with growing global demand for natural materials. In forestry, the declining trend of effective tax rates observed over the last four years is expected to be reversed and start increasing due to new production and exports of rubber wood.

**Table 1. Liberia Effective Tax Rates of Selected Commodities, percent of the value of production**

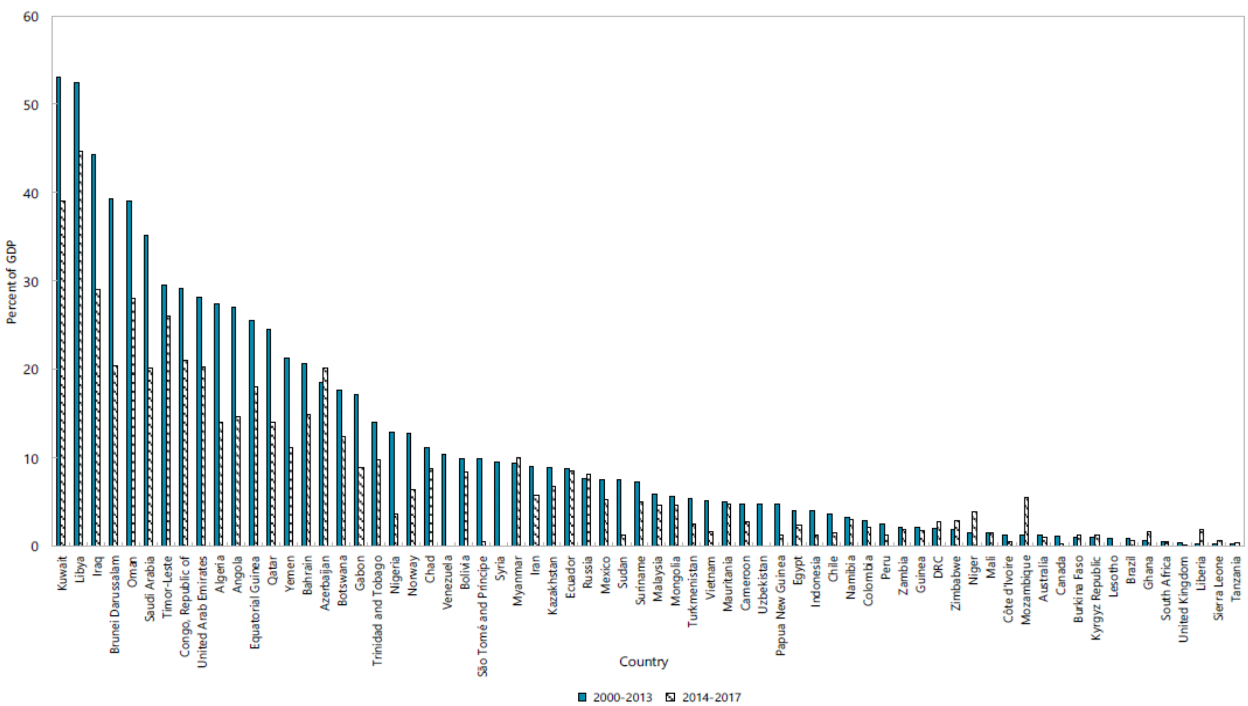
| | FY15 | FY16 | FY17 | FY18 | FY19 (preliminary) |
|---|---|---|---|---|---|
| Iron Ore | 6.6 | 6.0 | 6.1 | 4.8 | 6.7 |
| Gold | 23.4 | 12.1 | 9.5 | 7.2 | 5.5 |
| Rubber | 9.4 | 10.0 | 11.4 | 10.0 | 14.3 |
| Forestry | 20.9 | 22.1 | 16.8 | 8.2 | 15.6 |
| Other (selected commodities) | 8.6 | 9.1 | 9.2 | 6.6 | 7.6 |

*Source: IMF Staff Calculations*

22. **Despite relatively rich natural resource base, especially in iron ore, rubber, rubber-wood, gold, diamonds, and a range of other minerals, and a large share of sectors based on natural resources in industry value added, GDP and exports, Liberia collects minimal public revenues from these activities**. Allowing for errors caused by inadequate classification of tax revenues (since most public revenues from natural resource activities come from CIT which cannot be appropriately allocated to sectors and subsectors), it appears that Liberia still:

- Does not devote enough attention to enforcement of the applicable tax legislation;
- Grants tax exemptions in a discretionary and non-transparent way; and
- Does not apply fiscal transparency rules related to natural resources (see Box 1 below).

**Figure 6. Natural Resource Revenues (2000-2013 and 2014-2017), Percent of GDP**




*Source: FAD Resource Revenue Database*

23. **The over-reliance on payroll taxes and licenses and less focus on corporate income tax lead to inability to adjust taxation of corporations in natural resource sectors during the cycle**. The recent announcement that Firestone plans to lay down workers to cut the overhead costs is a proof of it. The corporate income tax is very low as compared to its regional and global peers (Box 1). The administration of CIT is weak. The online filing rates are very low except for large taxpayers. In 2018 the CIT declaration for online filing was updated with the support from USAID project, while the paper form remained old. Given that the taxpayer is free to choose how to file, having multiple formats undermines comprehensive oversight of tax administration.

**Box 1: Corporate Income Tax – the weakest link in the chain of tax instruments**

Corporate Income Tax (CIT) nominal rates in Liberia are similar to those prevailing in the rest of the African continent and are comparable to worldwide averages. Yet, corporate income tax revenues in Liberia are very low, yielding only 1.45% of GDP. This is less than half the average for the Sub-Saharan Africa countries included in the ATO study as well as the worldwide average reported in the USAID Collecting Taxes Database.

Liberia's CIT productivity of 0.06 is less than half that of its neighbors in Africa and around the world. The main sources of this leakage seem to be more policy than administratively related and may potentially be explained by multiple and non-transparent tax exemptions related to the natural resource sectors.

*Source: USAID (2017). Benchmarking the Tax System in Liberia.*

24. **Liberia authorities introduced transfer pricing into the tax legislation that should help mitigate some of the risks to tax base if implemented properly**. The Official Gazette of the Government of Liberia dated November 11, 2016 promulgated the Liberia Income Tax Transfer Pricing Regulations which introduced Arm Length Principle starting

2017/2018. The new rules include documentation obligations of taxpayers. Liberia also has signed the Amended OECD Convention on Mutual Administrative Assistance in Tax Matters, which provides a comprehensive multilateral framework for the exchange of information and assistance in tax collection. The first transfer pricing audits are underway. What is important that rhese developments require strengthened administration to be able to effectively increase revenue collections.

## Extractive Industry Transparency Initiative (EITI)

25. **Liberia has been a member of EITI since 2008 but failed to comply with standard requirements resulting in suspension of membership**. Liberia successfully passed the first validation and made meaningful overall progress towards meeting the new 2016 EITI Standard. It made satisfactory progress in twelve areas out of 24 evaluated, recorded meaningful progress in another nine areas, albeit with some remaining concerns. Liberia made inadequate progress in four required areas and no progress in one area. Since it did not make sufficient progress by the end of November 2018, Liberia membership status was put in suspension until the following requirements are met:

- Improved quality of Multi-Stakeholder Group (MSG) governance through more adequate representation and capacity to carry out MSG duties
- Up to date and accurate work plan that sets EITI implementation objectives aligned with national priorities for the extractive industries.
- Disclosure of relevant information related to the award or transfer of licenses pertaining to the companies covered in the EITI Report, including description of the process, technical and financial criteria used, information about the recipients of the licenses, and any non-trivial deviations from the applicable legal and regulatory framework.
- Publicly available register or cadaster system with timely and comprehensive information on license holders, license area and duration, dates of application and award, commodity produced etc.
- Explain in annual EITI Reports the prevailing rules and practices regarding the financial relationship between the government and state-owned enterprises (SOEs).
- MSG identifies which payments and revenues are material and must be disclosed.
- MSG and the Independent Administrator check whether there are any agreements involving the provision of goods, services and financing in exchange for oil, gas, mining exploration, production concessions or physical delivery of commodities.
- Disaggregated disclosure of tax payments.
- All payments and revenues are subject to credible, independent audit.
- MSG discloses a time-bound action plan addressing the deficiencies in data quality.
- Disclose the distribution of revenues from the extractive industries and indicate if they are recorded in the national budget.

- Disclose and reconcile social expenditures by companies mandated by law or the contract. For benefits provided in kind disclose the nature and the deemed value of the transaction.
- MSG discloses info on any quasi-fiscal expenditures.
- Disclose information on the contribution of the extractive industries to the economy.
- MSG publishes annual progress reports on the efforts to strengthen the impact of EITI implementation on natural resource governance.

26. **Main problems arising from non-observance of EITI transparency requirements indicate weak governance arrangements in the sector, lack of transparency, and lack of data disclosure rules with possible adverse impact on future investment, production, jobs and exports.** Most visible governance problems start with MSG arrangements resulting in inadequate representation and capacity to discharge MSG leading role. These weaknesses are further reflected in inconsistent observance of clear disclosure rules particularly regarding the role and involvement of the state in the extractive industries (i.e. relationship to SOEs, presence of barter arrangements, data quality, distribution of revenues from extractive industries, and presence of quasi-fiscal expenditures). These weaknesses may materially affect the decisions of large corporations regarding existing operations and, especially, future contracts in explorations and production. Oil and Gas, Iron Ore and the whole mining sector may be particularly vulnerable as they depend large on long-run investments by large corporations. It is, therefore, important that Liberia makes an effort to meet the 2016 Standard requirements as soon as possible.

# Conclusions and Recommendations

27. **The taxation and regulation of natural resources must be viewed in the context of other tax instruments in Liberia**, as well as the regional and global context as foreign investors and multinational companies make their investment and production decisions vis-à-vis prevailing conditions in the West Africa region and comparator countries elsewhere in the world.

28. **Furthermore, adequate attention must also be paid to other enabling factors** (such as availability and quality of related infrastructure, logistical services, skilled labor force, and the overall doing business conditions) as they define important dimensions of foreign investors. Overlapping jurisdictions must also be factored in as natural resources are frequently the subject of taxation and regulation by multiple authorities as traded goods follow complex shipping and storage patterns in present global trading and value chain conditions.

> **Box 2: Integrating Natural Resource Management into Fiscal Transparency Initiative**
> IMF has recently expanded its Fiscal Transparency Initiative to include Natural Resource Management Issues as the fourth pillar. It focuses on **Resource Revenue Management** and provides a transparent framework for:
>
> (a) Natural resource rights and ownership,
> (b) Resource revenue mobilization,
> (c) Collection and utilization of public revenues from natural resources, and
> (d) Reporting on and disclosure of all natural resource activities.
> Clearly, the four dimensions of the fourth pillar have strong horizontal linkages to the original three pillars of the Fiscal Transparency initiative, especially regarding the first (Fiscal Reporting) and the third pillar (Fiscal Risk Analysis and Management).
> The expanded framework will be particularly useful for resource-rich countries, such as Liberia, in addressing unique natural resource transparency issues across the revenue management chain, or in seeking an in-depth analysis of natural resource fiscal efficiency and transparency.
>
> *Source: IMF (2019). Policy Paper. Fiscal Transparency Initiative: Integration of Natural Resource Management Issues.*

29. **Finally, one should factor in principles of natural resource revenue management recently added as the fourth pillar of the comprehensive Fiscal Transparency Initiative** (Box 2) calling for clear statement regarding natural resource rights and ownership, resource revenue mobilization, collection and utilization of public revenues from natural resources, and reporting on and disclosure of all natural resource activities.

30. **In order to increase revenue mobilization from natural resource sectors of the economy, Liberia needs to create basis for the transparent, competitive and efficient system**. This includes both short term and longer term measures. Once the system is in place it will achieve key results – limit discretionary granting of tax exemptions and ensure universal enforcement of existing rules.

31. **Possible quick wins include the following:**

- Strengthen tax administration enforcement of existing laws pertaining to natural resource taxation;

- Strengthen audit capacity of the LRA, in particular for audit of the companies working in natural resource sectors;
- Strengthen capacity of the LRA to conduct transfer pricing audits and utilize global exchange of information arrangements;
- Create a data base of present tax incentives and tax expenditures granted through executive orders and decrees;
- Review all tax exemptions and tax expenditures in terms of economic and commercial rationale at the time granted and presently, and estimate foregone revenues to the budget;
- Eliminate or phase out economically unjustified tax incentives where possible;
- Enforce filing and payment of Corporate Income Tax and ensure a unified CIT declaration is in place regardless of the mode of filing.

32. **Longer term reform agenda:**

- Implement fully Liberian Extractive Industries Transparency Initiative by meeting the 15 requirements posed during the second stage of the validation process;
- Strengthen the natural resource management and taxation based on principles recently introduced in the global tax transparency initiative;
- Establish a data base of natural resource endowments building on various sources of information from satellite images and on-land explorations focusing on:
    - Iron ore
    - Rubber-wood areas suitable for economic exploitation
    - New rubber plantations
    - Other mining options.
- Make a forecast of possible new sources of natural tax revenue utilizing experience from other countries and OECD approach to supporting investments in natural resources exploration and exploitation;
- Review taxation regime of mining.

# Tax Concessions (Incentives) in Liberia

33. **Liberia tax base is narrow and eroded by multiple tax concessions (exemptions, reduced rates, incentives).** The GST revenue to GDP stood at 2.3 percent in 2017 with the standard rate of 7 percent, while corporate income tax stood at 0.17 percent while the rate is 25 to 30 percent depending on the sector. While some of the low efficiency is attributed to weak tax administration, it is likely that a considerable share is die to exemptions granted by the legislation and outside of the legislative oversight.

**Table 2. CIT Efficiency Rates of Select Countries**

| | Standard CIT Rate | CIT collection, % of GDP | CIT Efficiency |
|---|---|---|---|
| Botswana | 22 | 4.7 | 0.21 |
| Malawi | 30 | 2.8 | 0.093 |
| South Africa | 28 | 5.6 | 0.2 |
| Zimbabwe | 25.75 | 4.5 | 0.17 |
| **Liberia** | **25** | **1.7** | **0.068** |

Source: IMF database, LRA Annual Report 2017/2018, authors calculations

34. **While tax concessions are a universal feature of tax codes around the globe, extremely narrow tax base in Liberia as well as lack of scrutiny on granting incentives as well as fiscal implications calls for changes in the approach to tax concessions.** The ability to deliver economic or social support to groups or types of taxpayers by allowing exemptions, deductions and tax credits can be a powerful tool for policy makers. Unfortunately, tax exemptions generate real costs (see Box 2) to the budget in form of foregone revenues but operate without the need for a large infrastructure to deliver the targeted support and thus can be subject to less scrutiny than direct spending programs.
35. **This note will look into the issues of how tax concessions are defined in Liberian legislature and look closer at tax concession granted in the Revenue Code on Corporate Income Tax and Goods and Services Tax.** This note is a review of existing legislative provisions with recommendations on how to better define tax concessions in a transparent way and suggest recommendations where existing tax exemptions, deductions or preferential treatment deviates from good practice.

## Defining Tax Concessions

36. **There is no definition of "tax exemption" or "tax concession" term in the Revenue Code of Liberia** (further Code). However, there are several provisions in the Code that define exempt persons and exempt taxable supply. Absence of clear definition of tax concession is an obstacle to assess the volume of non-taxable income. At the same time tax authorities during the meeting with the World Bank mission in February expressed

clear understanding that any deviation from the regular taxation can be considered a tax concession.

37. **In case of Liberia, many tax exemptions are granted through concession agreements.** When a concession agreement is ratified by the Parliament, it is considered international agreement and its provisions are superseding the law. In fact, any agreement is a negotiation of the Government of Liberia and a concessioner about special tax conditions and rules. As a result, a concession agreement may contain, for example, reduced tax rates and the concessioner's obligations to invest in social projects. The main question remains whether there is a clear understanding of whether the agreed terms are on balance beneficial for the country. The answer to this question would provide justification for introduction of the tax concession.

38. **A tax concession represents a deviation from a benchmark or reference tax system.** However, there is a lack of consensus in determining what exactly the benchmark tax system should be. Thus, a variety of possible benchmarks have been developed. These benchmarks vary in their treatment of certain fundamental components such as the tax unit, tax base and tax period. Each benchmark is unlike the others in how it defines one or more of these components and, therefore, each benchmark produces a different set of tax concessions. Annex 4 provides possible approaches to defining the benchmarks for each component of the tax system to illustrate how the list of tax concessions changes with each benchmark.

**Box 3. Tax Expenditures**

**In order to be able to analyze efficiency of granted, the concept of tax expenditures is frequently used.** Tax expenditures are defined as revenue losses that arise due to concessions from the "regular" tax system, that is a benchmark which a country's authorities have defined as the reference tax system. Tax expenditures are typically concessions included in the tax system to achieve policy objectives, such as encouraging investment, training, innovation, relieving certain demographic groups from the burden of taxation, etc. Tax expenditures can take many forms such as special exclusions, exemptions, deductions, credits, deferrals, and preferential (lower) tax rates. Examples of tax expenditures include:

- Deductions and exclusions – reduced amount of income subject to tax
- Exemptions – reduced amount of income subject to tax for a class of taxpayers
- Credits – reduced tax liability
- Preferential rates – a reduced rate applied to a class of taxpayers or activities
- Deferrals – relief that takes the form of delaying payment of taxes (e.g. accelerated depreciation)

## Tax concessions for Income Tax in Liberia

39. **The Code does not clearly define exempt taxpayers or transactions**. Part Two of the Code describes provisions on taxation of income. There is no indication of exempted individuals or organizations specifically related to income taxation. The list of exempted persons is presented in Part One, Section 9 of the Code and does not contain a separation of individuals and legal entities. However, the provisions of Section 9 relate

mainly to legal entities or other institutions, rather than individuals. Only the last item (i.e., (g) Cross-Reference) refers in part to individuals, but the nature of the item is more likely to concern tax liabilities than tax exemptions.

40. **The list of exempted taxpayers in the Section 9 is not exhaustive and not clear.** Some terms must be defined before the list. For example, a public corporation is defined as tax exempted only if it is a public institution, but the term "corporation" itself is defined in section 10. There is no definition of a regulatory agency, and the wording of the exemptions for this type of institution looks rather general. Registered charities are listed as exempted, but at the same time, a number of cases are presented that determine when an organization should not be treated as a registered charitable organization. Central Bank is listed among legal entities exempt from income taxation but at the same time the Code promulgates that Central Bank should be a subject for other taxes except Excise, Goods and Services Tax and Customs duties. There is no clear understanding that the usual practice is that the Central Bank is not for profit organization, however frequently obtains profit from the difference in cost of printing money and value of money. This profit is transferred to the budget and thus it is not tax exemption and should be regulated by the Central Bank legislation. In addition, in Section 202 several tax concessions are presented as exclusions from taxable income for recipients such as payments for illness, injury and deceased; donative transfers or transfers by death; noncash benefits provided by an employer. Section 303 exempts property of a partnership, allowing deferral of tax on the property gain of a participating partner for five years.

41. **Another example of presentational issue is inclusion of several non-taxable components in gross income, such as non-taxable interest, rent, royalties, and dividends**. In particular, dividends from a resident corporation that are exempted from taxes if they are received from another resident corporation (Section 400) cannot be considered as factual tax exemptions, since they can be included and taxed as a part of gross income. But, on the other hand, in Section 905 there is a provision for withholding tax on payments to residents (item (b)), where non-taxable dividends, rent and royalties are taxed at a rate of 15%. In this case, the definition of "gross income" becomes irrelevant, since each element of gross income is subject to a different tax rate.

42. **It is usual practice in many countries to define tax concessions in section on relevant tax instruments**. For example, tax concessions on CIT should be defined in the section describing CIT. Introducing two separate sections for CIT and PIT would improve clarity of legislation and help define concessions less ambiguously.

43. **A number of tax incentives are presented in Section 16 as special investment incentives** for investments of one million US dollars for foreigners and 300,000 USD for businesses with 100 percent Liberian ownership. Investments that are provided for creation of hospitals and clinics must be at least 50,000 USD. Special investment incentives are mainly provided by removing the deduction limit from 30 percent to up to

100 percent, depending on the percentage of local materials used in the production process; percentage of investments directed to depressed zones; a number of jobs created to reduce unemployment. These special incentives are provided for five years. For investment exceeding 10 million USD duration of special incentives is 15 years.

## Tax concessions for GST in Liberia

44. **GST in Liberia leaves a significant share of consumption outside of the tax base.** The GST system in Liberia has limited tax base, since GST is imposed on taxable supplies and taxable imports of registered producers only. In fact, this means that most of the final consumption, which is usually the tax base for this type of tax is not part of the taxation of goods and services in the country.

45. **GST provisions attempt to exempt inputs to ensure final consumption is taxed**. here are a number of tax exempt items, which are inputs in nature and therefore not part of final consumption and not subject to sales tax. In particular, raw materials or other inputs that are used directly in production, forestry, projects for renewable resources, mining or petroleum projects are included in the list of exempt supplies. (Section 1001, (e), (6) (A) - (E), (f)).

46. **The list of actual exemptions of final consumption goods is limited.** After taking out exempt inputs, exemption applies to food, goods for the natural disaster relief and humanitarian emergencies, medical aid, textbooks and some others. (See Attachment 1. List of Tax Exemptions). Tax exemptions for imports are the same as for supplies, if imported goods are used in the same way as exempt supplies.

47. **Some GST exemptions are introduced in section 16 as special investment incentives similar to incentives for income tax.** Most of the special exemptions are provided for medical and educational equipment directly related to investment activities under condition that the equipment is installed within one year after purchase. Other equipment, machinery, specialized vehicles, spare parts and other specialized capital goods related to the activity and intended to be in service immediately after purchasing are also exempt from GST. The following fifteen incentive activities are listed in the Code: tourism; manufacturing; energy; health services; real estate; transport; technology; agriculture; poultry; horticulture; exploration on sea products; agriculture food-crop cultivation; rubber and oil cultivation, processing; manufacturing or assembly for export; waste management.

48. **In case of Liberia, GST mainly covers wholesale, which is considerably narrower than conventional consumption taxes, and leads to revenue losses.** The lack of detailed and reliable information does not allow to accurately assess the loss of income associated with such restrictions. However, based on GDP breakdown by sector in 2016, shares of services and manufacturing in GDP constituted 30 percent and 9 percent,

accordingly. The GDP estimate stood at USD 2.14 billions in 2016. This implies that the amount of GST collected at the rate of 10 percent would be 3 times higher than actual collections.

## Conclusions and Recommendations

49. **The definition and presentation of tax concessions in the Code should be streamlined and clarified**. First, a definition of tax concession should be introduced alongside with forms in which tax concessions are provided. The tax concession for each tax is best placed under the section of the Code on this tax. Tax exemptions on income tax would be clearer if income tax on individuals and legal entities is separated.

50. **Tax base of GST could be significantly expanded in the interim period before introduction of VAT:**

    a. The GST tax base should be expanded to include all final consumption items. Expanding the tax base will help to increase the share of GST in budget revenues. In addition, it would help transition from GST to VAT when time comes. Expansion of the GST coverage will also facilitate future transition to VAT.

    b. Tax exemptions for GST should only apply to final consumption items Inputs cannot be a part of exempt items since they are not a part of GST tax base and not taxable under properly established GST system.

51. **CIT concessions should be streamlined to ensure that concessions that are granted have clear rationale and policy objective**. There are many incentives provided to corporate entities in Liberia. Not all of them are included into the Code, but provided through concession agreements and other legislative acts.

52. **Finally, good governance and transparency are important for tax concessions to be effective**. Transparency is necessary to facilitate accountability and reduce opportunities for rent seeking and corruption:

    a. Tax concessions should be consolidated in the Revenue Code and thus be subject to legislative review.
    b. There should be a process established to assess fiscal implication of tax concessions and the report on tax expenditure should be made public.
    c. While a tax concession could be suggested by multiple government agencies, there is a need for ultimate authority to approve the incentive prior to legislative review. This authority is best placed under the Ministry of Finance and Development Planning.
    d. Monitoring of implementation of tax incentives should be undertaken by the LRA.

# Introduction of VAT: Revenue and Distributional Impact Considerations

53. **Liberia operates a GST with a narrow tax base**. The GST is imposed on imported products, sales made by manufactures of domestic products and eleven specified services excluding other sectors which constitute almost 47% of the GDP in Liberia. Revenue contributions from GST are projected to decline from 2.8 percent in 2016 to 2.4 percent in 2018[1] More than 70 percent of the collected GST is on imported goods with a domestic collections accounting for less than 30 percent. The Liberia Revenue Authority had 358 domestic registered GST taxpayers in 2015[2].

54. **Studies have demonstrated improved average revenues yields from VAT compared to the preceding GST collections including through improved compliance**. Table 3 compares average revenue increases in VAT collection yields for a period of three years after implementation with average three-year GST collections before transition.

**Table 3: Revenue Difference Between VAT and Predecessor Sales Tax in Selected African Countries, percent of GDP**

| Benin | Burkina Faso | Gabon | Guinea | Kenya | Togo | Uganda | Zambia |
|---|---|---|---|---|---|---|---|
| 2.0 | 0.9 | 3.0 | 1.0 | 0.8 | 0.2 | 1.0 | 0.9 |

Source: IMF, The Modern VAT.

55. **Liberia has an obligation to introduce VAT under the ECOWAS Common External Tarif (CET) agreement, although actual introduction has been long delayed**. VAT Steering Committee (SC) composed of multiple ministries and agencies is currently being set up. Discussions with government officials reveal that government's strategy is to transition to VAT with a 'change of nomenclature'. This implies moving to keeping the existing 10 percent GST rate[3] in the short term, expanding the VAT base to cover more products and services. A draft Government VAT White Paper needs updating to reflect new Government's Pro-Poor agenda and highlight likely fiscal impact of the transition. The draft Domestic Revenue Mobilization Strategy, LRA and MFDP authorities recognize a need to 'elaborate a framework to simulate revenue implications and monitor progress in migrating from GST to VAT while detailing a road map with timelines, the human capacity

[1] IMF Country Report No. 18/172, June 2018.
[2] TADAT Liberia Performance Assessment Report, July 2016.
[3] ECOWAS sub-region VAT rates range between 15% and 18%.

building and material resources requirements, in support of [4]” and update of the existing Government white paper.

## Impact of Transition to VAT

56. **Precise estimates of the impact of moving from the current GST to VAT is not possible due to lack of reliable sectoral data from national accounts and narrow scope of existing GST**. Unfortunately, latest available data on sector output and consumption dates back to 2011.In addition, tax base for the future VAT will likely be much broader than existing GST, which also makes it difficult to extrapolate impact of changing the tax instrument.

57. **This note attempts to look into both fiscal and poverty implication of VAT using household survey data**. This approach works better for the poverty impact, although does not take into account considerably lower compliance under current GST system (discussed in the policy note on tax concessions). In terms of fiscal impact, it assumes that both GST and VAT tax final consumption and applies exemptions and rates as per latest draft VAT paper and Liberia Revenue Code for GST. The rates and base are summarized in the Table 4 below.

**Table 4. Comparison of Rates of GST vs VAT**

| **Current structure of indirect taxes** | **Introduction of VAT** |
|---|---|
| Purchased alcohol taxed at 10% | 15% or 10% |
| Purchased food taxed at 7 % | 15% or 10% |
| Own produced food is exempt 0% | Own produced food is zero rated |
| Expenditures on cell phone vouchers, telecom taxed at 18% | 15% or 10% |
| Expenditures on travel and tickets taxed at 10% | 15% or 10% |
| Expenditures on education and health are exempt 0% | Expenditures on education, health, public transport, LEC electricity, piped water (water supply) are exempt |
| All other non-food is taxed at 7% | 15% or 10% |

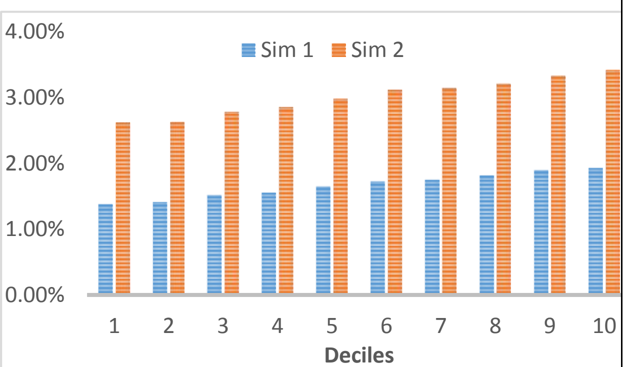
58. **A rough estimate based on the assumptions discussed shows an 80 percent increase in revenues with the VAT rate of 15 percent and 25 percent increase with the VAT rate of 10 percent.** While the estimate based on the GST rates assumes consumption structure based on household survey data and perfect compliance, it is useful to see the direction and magnitude of change. The increase estimated with this caveat is from around 90 million US dollars to almost 160 million US dollars under the 15 percent rate and to about 110 million US dollars under 10 percent.

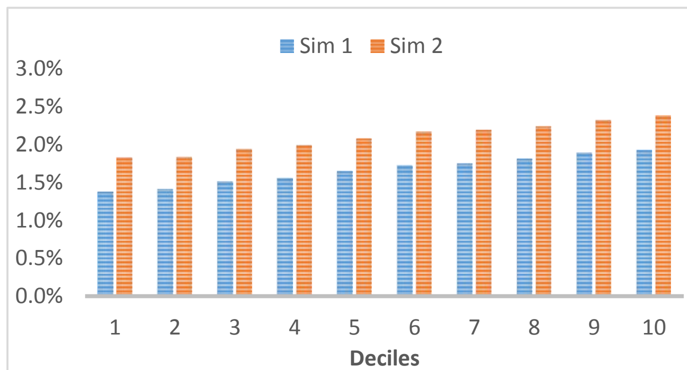
[4] Consolidated Liberia Domestic Revenue Mobilization Strategy, Draft *September 2018.*

59. **An impact new tax instrument or changes in tax instrument on poor is frequently an important consideration for policy design**. Taxing consumption is regressive by design as poorer households tend to spend higher proportion of their income on consumption and lower proportion (if any) of their income on investment. To mitigate this adverse effect, many countries provide a relief through zero rating of certain “social” goods such as food. This is the case for both GST and future VAT system in Liberia.

60. **VAT share in total consumption would be higher than existing GST as a result of broader coverage and rate, however it does not seem to introduce additional inequality**. We measure inequality as share of taxes in total consumption estimated for each decile of population.

**Figure 5. Share of Tax in Total Consumption**

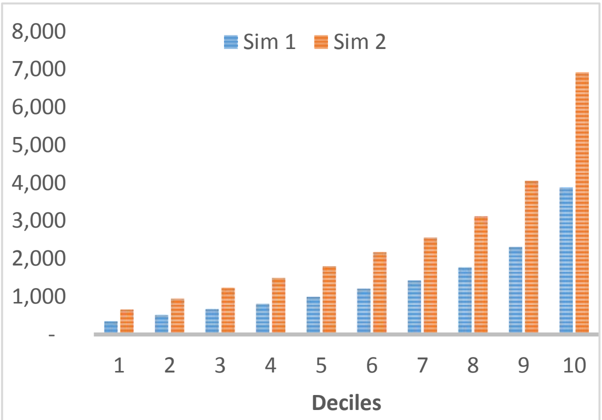
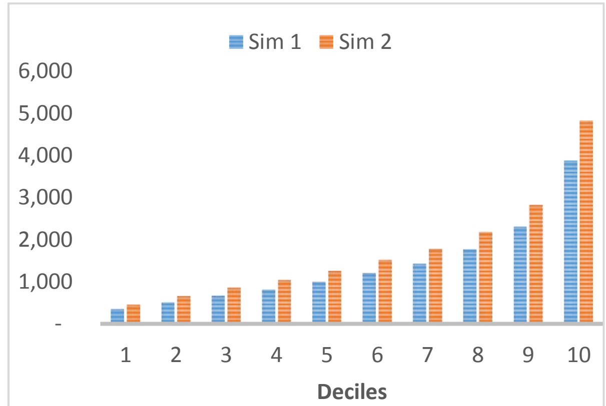
<table>
<tr><td>15% VAT rate</td><td>10% VAT rate</td></tr>
<tr><td>


</td><td>


</td></tr>
<tr><td colspan="2">Sim 1 is GST and Sim 2 is VAT</td></tr>
</table>

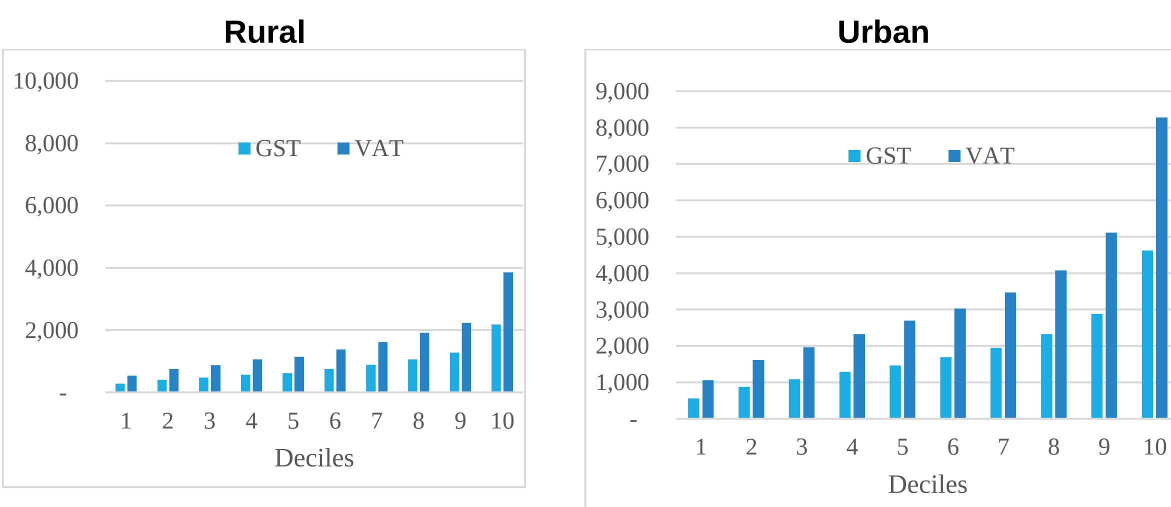
61. **Moreover, if we look at the actual amount an average household would contribute to VAT most of the increase comes from three richest deciles.** In terms of poverty impact it is not only distribution that is important, but actual amount of money households will have to pay. The figure below shows mean value of taxes per adult equivalent paid under GST and future VAT systems in Liberian dollars.

**Figure 6. Average Value of Taxes in Absolute Terms**

| 15% VAT rate | 10% VAT rate |
|---|---|
|   |   |
| Sim 1 is GST and Sim 2 is VAT | |

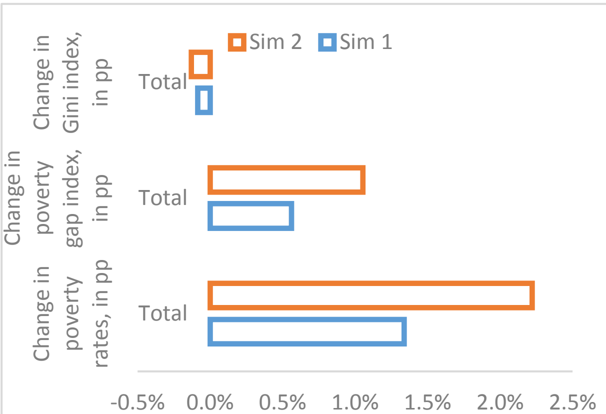
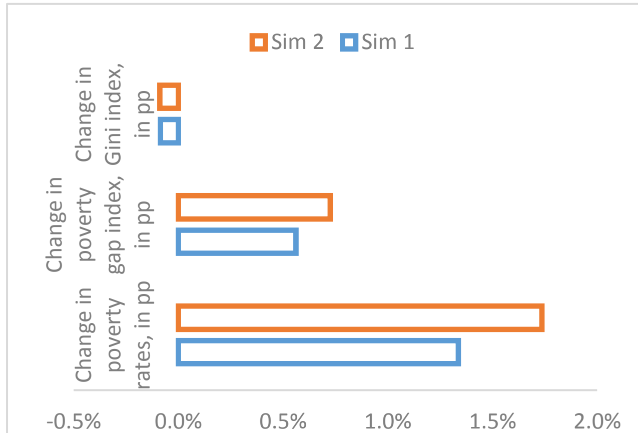
62. **The distribution patterns do not change once population is divided into rural and urban.**

**Figure 7. Average Value of Taxes in Absolute Terms, Urban-Rural Divide at 15% VAT**




63. **Finally, the estimates show that while there will be slight increase in poverty associated with introduction of VAT, the VAT design is more progressive and reduces inequality** by providing less arbitrary exemptions from tax base**.**

**Figure 8. Aggregate Welfare Impact of GST and VAT**

<table>
<tr><td>15% VAT rate</td><td>10% VAT rate</td></tr>
<tr><td>
</td><td>
</td></tr>
<tr><td colspan="2">Sim 1 is GST and Sim 2 is VAT</td></tr>
</table>

64. **While increase in poverty is a negative impact, it could be mitigated through targeted social assistance programs, which additional revenues from VAT can finance.** The half a percentage point increase in poverty gap index is not major. Given an expected increase of 80 percent in revenues from consumption taxes, these funds could be used to fund social assistance programs and ensure that poor are properly compensated while wealthier pay fair share in their taxes. In case of 10 percent VAT rate, the increase in poverty gap increase is only 0.1 percentage point.

## Considerations for Introduction of VAT

65. **Design of VAT has several important features that need attention – zero rating and exemptions and refund process** (see Box 4 for additional considerations)**.** The draft Law on VAT provided by the GAZT to the World Bank team is a comprehensive document, which however could further benefit from streamlining of these aspects.

66. **The refund process is not well defined in the draft.** The draft only mentions that the credit may be requested as refund when it is older than six months. This may put exporters in a disadvantageous situation, especially new exporters who just entered the market. The refund should be processed much faster for exporters.

67. **Good practice in VAT design is destination principle, which implies that all exports are zero rated.** This principle is not fully implemented in the draft VAT law. Schedule 1 of the draft provides a short list of exempt export supplies. This should be revised to ensure all exports are zero rated.

68. **There are number of exemptions introduced on domestic supply and imports, most justified, but some could be clarified or eliminated.** The table below summarizes review of suggested exemptions.

**Box 4. Best practices in VAT design**

What are the key challenges in designing a VAT? A survey of the IMF's advice and experience with VAT policy and administration in 37 countries showed that many issues in the design of the tax are not contentious. More striking, however, there were several areas in which IMF advice was consistent across countries but not fully accepted.

(a) Zero rating—under which sales are not taxed, but tax paid on inputs can nevertheless be reclaimed—is recommended only for exports, but, in practice, is used more widely.
(b) Provision of input credits for capital purchases is often less timely than advised.
(c) Exemptions—situations under which tax is not charged on output but also cannot be recovered on input—are more common than advised, undoing the VAT's good work in avoiding distortions of input decisions and compromising its transparency.
(d) Single rate is generally better than multiple rates.
(e) Countries tend to set registration thresholds at much lower turnover levels than advised.

The threshold issue is of great practical importance, given that the low initial threshold in several countries has been cited as one of the VAT's key weaknesses. It is considered a prime reason why Ghana's VAT failed when first introduced in 1995 (at a registration level of $20,000, compared with $75,000 on its successful reintroduction in 1999). It is also one of the reasons Uganda's VAT nearly failed when it was introduced in 1996 (at $20,000, later raised to $50,000). Clearly, if there were no administrative or compliance costs, the most efficient threshold would be zero. But, of course, this is not the case. A simple rule of thumb is to set the threshold at the point where the collection costs saved are balanced against the revenues lost. Given that, in most countries, the value-added base is concentrated among relatively few firms, a high threshold is, by far, the most efficient approach.

*Source: Ebrill et al, The Allure of the Value Added Tax, IMF, 2002*

**Table 4. Exemptions from VAT in Liberia**

| Tax Incentive | Comment |
| --- | --- |
| Exempt supply of financial services | Legitimate tax exemption |
| Exempt supply of medical services except cosmetic procedures | Legitimate tax exemption |
| Exempt supply of prescription drugs or medicines and services by a registered person in the ordinary course of operating a public medical facility, including a hospital, maternity center, nursing center, convalescent home, hospice, or clinic | Rationale is unclear |
| Exempt supply of educational services | Legitimate tax exemption |
| Exempt residential accommodation | Legitimate tax exemption |
| Exempt land use as a renewable resource project | Legitimate tax exemption |
| Exempt religious services | Legitimate tax exemption |
| Exempt supply of water and electricity below thresholds | Suggest reviewing the rationale of the measure and consider providing support outside of tax system (i.e., direct transfers) |
| Exempt supply of services by local transportation of passengers with a driver registered by the Minister of Transport | Rationale is unclear |
| Exempt supply of services by a trade union, to a member or to another Trade Union, where the supply is made solely in the ordinary course of its objectives as a Trade Union | Rationale is unclear. Establishing reasons why supply is made will also be difficult to monitor |
| Exempt supply of services provided directly by a facility to the following registered persons who need care:<br>i. Aged registered persons<br>ii. Indigent registered persons<br>iii. Infirmed Registered persons<br>iv. Handicapped registered persons | Legitimate tax exemption |
| Supply of hearing aids, crutches, manual and motorized wheelchairs, trusses and similar appliances and apparatus and identifiable spare parts for relief of permanent bodily disablement | Legitimate tax exemption |
| Exempt import of goods and services where the supply within Liberia would be exempt | Legitimate tax exemption, but unclear why repetition is needed |
| Exempt personal effects of a passenger as prescribed by the Customs Code of Liberia, carried in his/her baggage or on his/her person which he/she might reasonably be expected to carry with him/her for his/her regular and private use including the duty free and gift allowances as admitted by the Commissioner for Customs | Legitimate tax exemption |
| Household goods and personal effects as prescribed by the Customs Code of Liberia, arriving within 3 months of a passenger’s arrival and declared to have been in the use and possession of the passenger for at least one year | Legitimate tax exemption |
| Exempt used implements, instruments and tools of profession, trade or occupation in the possession of a passenger as provided for in the Customs Code of Liberia or any existing regulation in effect thereof. | Legitimate tax exemption |

69. **Finally, the draft VAT law provides details on appeals, enforcement and other aspects, which should not be unique for VAT, but handled through administration section of the Revenue Code.**

## Conclusions and Recommendations

70. **Moving from GST to VAT has a number of benefits – reducing informal economy, increasing revenues and complying with international obligations of Liberia.** The VAT proves to have positive impact on reducing informal economy through its tax credit system, which encourages businesses to deal with formal suppliers. It will also likely generate more revenues as it will be a tax with base broader than current GST with estimated increase as high as 80 percent at 15 percent VAT or 25 percent at 10 percent VAT.

71. **The poverty impact of moving to VAT is limited and could be mitigated through targeted social assistance programs.** The distributional analysis of VAT suggests that the tax in the current rate structure and consumption patterns is slightly progressive and will have small negative impact on poverty. This impact however could be mitigated with the fraction of additional resources generated.

72. **Finally, the draft VAT law needs more work to provide a streamlined framework for administration and ensure fair and efficient taxation**. There are certain exemptions that could be reviewed and clarified. The VAT refund process needs to be clearly defined. Also, the administration part should be handled as part of the broader Revenue Code overhaul discussed below.

73. **The transition to VAT needs to be well planned and prepared**. The Government needs to ensure that awareness of taxpayers as well as capacity of the LRA are sufficient to introduce VAT before implementation of the new revenue instrument. It may take several years, however work needs to start early on. At the same time, it would be helpful if GST tax base is broadened to cover most final consumption, which will increase revenues but also help prepare for the introduction of broad based VAT.

# Liberia Revenue Code: How to Ensure Clarity and Comprehensiveness

74. **Easy to understand tax law translates into lower compliance costs for both for taxpayers and for tax administrators**. Clarity of tax legislation has relatively higher importance than many other laws as it applies to nearly every individual and business in the country. Each tax law contains the same key elements (taxpayers, rates, tax base, procedure, and administration), and understanding is improved if all taxes are regulated following the same structure of these elements.

75. **Liberia Revenue Code sets out legal framework for all taxes and customs duties in the country**. In principle, codification of tax legislation has advantages over separate laws regulating specific taxes. The most important is elimination of inconsistencies, duplications, contradictions and gaps that may occur if tax procedures and rules are presented in several laws. Terms and administrative procedures common for all taxes could be presented better in a single place in the Code.

76. **At the same time, Liberia Revenue Code could improve in terms of comprehensiveness and clarity**. Lack of a unified structure to present each tax, cross-references existing almost on each page of the document, complicated presentation of definitions and administrative procedures that are scattered across the Code create "common misunderstanding of the Law" and lead to high compliance costs according to 2016 TADAT Assessment.

77. **The Code contains many provisions that are difficult to understand without additional information located in various parts of the Code.** Some definitions are provided after they have been used in the context. A number of cross-references are presented chaotically, which creates additional difficulties for the reader. Some examples of inconsistencies are presented in the Box 4. The list of examples is not exhaustive and may be supplemented by other examples selected from other sections of the Code.

**Box 4. Examples of Inconsistencies in the Liberia Revenue Code**

Example #1. Section 9 *Exempt Person*, item (g) contains information on taxation of non-resident natural and legal persons. Terms "person" and "legal person" are introduced in the next section (Section 10), and definitions of non- residents and residents are provided in Sections 800-802.Example #2. In Section 9, item (c) term "Regulatory Agencies" is defined that "is a subject to … duties … except as a withholding agent". At the same time there is no definition for withholding agent although this term is used in Section 53, and further in the Code. Example #3. Section 206, item (f) contains the following cross-reference "A person who … pays … tax in accordance with Section 806 or 905 is not permitted to deduct … amounts … if the person file the income tax return in accordance with Section 900 or Section 901 the amount … credible against income tax liability''

78. **There is no clear delineation between tax policy and**

**administrative provisions, which is a good practice.** Most of the administrative provisions are presented in Part I of the Code, but at the same time, some of the administrative provisions are provided in other parts of the Code.

79. **The personal and business income taxes could be presented in different chapters to facilitate clarity of obligations of individual taxpayers and businesses that generate income**. Currently, there is a chapter on personal and business income tax that contains a combination of provisions for individuals and legal entities with various treatments for different groups of taxpayers depending on their type of ownership. This complicates presentation of expenses and deductions intended for individuals and legal entities. As a result, the presentation of taxable income as a tax base for each category of taxpayers is cumbersome. An example of an issue arising from a joint chapter on all income taxes is a definition of "partnership" and "corporation". The Code defines corporation as "a joint stock company, an insurance company, a business trust and any similar organization". This part of the definition refers to legal entities. The definition continues to define stakeholders and stockholders as "any person having an ownership or equity interest in corporation" that may refer either to individuals or legal entities. Partnership is defined as "any joint enterprise or venture organized to engage in activities for profit" other than corporation, trust or estate. (All definitions are listed in Section 10 of the Code). Separate treatment of CIT and PIT would clarify what are eligible expenses to be deducted for the purposes of each tax.

80. **Some improvements to the income taxation regulation could be introduced in the short term without waiting for a full review of the Code.** In particular, definition of gross income of individuals could be streamlined. The components of gross income are listed in Section 2001 (b) of the Code as active income (wages) and passive income (interest, dividends, etc.). Passive income is collected from withholding agents and included in the gross income of individuals as non-taxable components. However, taxation of these components is presented in Section 905, which is separate from income taxation section. In addition, all other provisions relating to individuals right for deductions, social tax benefits etc. could be consolidated under a single PIT section. In fact, this would be the first step towards creation a separate chapter on the taxation of personal income.

81. **There is no best practice on how to draft revenue code, but Liberia could draw on other countries' experience and basic principles of comprehensiveness and clarity.** Liberia low tax to GDP ratio needs to increase revenue collection but improving tax legislation is "necessary condition" to solve this problem. One of the wide spread approaches is to organize Revenue Code around three key sections:

a. General Provisions (scope of the legislation, how it related to other legislation in Liberia, government agencies responsible for revenue collection, list of revenue instruments, list of definitions of terms common for the entire Code).

b. Administrative Provisions (rights and obligations of tax authorities; rights and obligations of taxpayers; administrative rules and procedures that are general for all taxes such as appeal, filing, etc.)

c. Sections on Specific Taxes with unified structure for each tax (taxpayer, object of taxation; tax base; tax rate; tax calculation rule; tax period; terms and procedures for tax payments; terms and procedures for tax return submission; tax benefits if any). Additional terms may be entered for a specific tax in the appropriate tax section.

# Key Recommendations on Raising Tax Revenues in Liberia

82. **The analyses in the previous section have shown a number of issues with raising tax revenues in Liberia**. Liberia heavily depends on external grants as a source of revenue and has not managed to raise enough domestic revenues so far. Governance of revenue mobilization is weak as evidenced by failure to comply with EITI requirement on natural resource revenue side, extremely narrow tax base for GST and other taxes. Finally, the clarity and comprehensiveness of tax legislation is far from optimal and the Revenue Code requires a complete overhaul to become a legal basis for taxation in eh country.

83. **To start addressing these issues, there is a need for comprehensive, but also realistic and well sequenced approach**. We will identify some of the short-term (within 12 months) and medium-term (1-5 years) that the Government of Liberia can put in place to help raise revenues.

84. **Short term measures** include:

    a. **Broaden the tax base for the GST** by expanding it to cover all final consumption.

    b. **Ensure unified declaration for Corporate Income Tax** building on the new template developed for online filing to be able to capture tax incentives used by companies.

    c. **Create a data base of present tax incentives** granted through executive orders and decrees (<u>outside of the Revenue Code</u>);

**Box 5. Revenues from Liberia Ship Register**

Liberia has the second largest open ship registry in the work after Panama, yet, it is lagging behind its peer countries providing similar service in revenue performance. Today, roughly 80 percent of the world fleet is operating under a flag of convenience from an open registry. Open registries generally provide vessel owners with more operating flexibility and lower operating costs than national-flag registries. Countries who provide open ship registries are benefiting financially through the registration fees and payments as well as other services. In FY16/17, Liberian budget received USD 9.8 million dollars in maritime revenues as compared to over USD 50 million-dollar transfer in Panama or around USD 11 million in Cyprus (including registration fee and tonnage tax), with 4 times less ships registered. Singapore having a quasi-flag of convenience generates a transfer of close to USD 150 million a year to the budget between the registration services and port services.

The weak revenue performance could be related to increasing competition among open registries, however it is also likely a result of administration arrangements in Liberia. In Liberia open registry is managed by an agent which is a commercial company that has a contract with the Government. Maritime Agency is in a regulatory body managing for the Open Registry. The revenue from open registry is shared 30 percent to the agent and 70 percent to the government from the profit. Then the government share is further split with 25 percent going to the Maritime Agency and 75 percent to the budget.

The revenue sharing arrangements provides for distorted incentives to participant in several ways. First, the revenue sharing arrangements based on net profit where the Government has limited control over costs, does not provide incentives for efficient operation for the agent. Second, Maritime agency being a regulatory body should be brought on budget and prepare budget request in way similar to other government regulators.

d. **Revise draft VAT law** to ensure that the core design principles of VAT are followed, i.e. destination principle, refund process, and list of exemptions needs to be improved.

85. **Medium term measures**:

a. **Move to VAT** as this move leads to limited poverty impact mitigated through the social assistance programs and improved distribution of tax burden as compared to the current GST system.

b. **Streamline and strengthen overview of tax incentives**. Tax concessions should be consolidated in the Revenue Code and thus be subject to legislative review. There should be a process established to assess fiscal implication of tax concessions and the report on tax expenditure should be made public. While a tax concession could be suggested by multiple government agencies, there is a need for ultimate authority to approve the incentive prior to legislative review. This authority is best placed under the Ministry of Finance and Development Planning. Monitoring of implementation of tax incentives should be undertaken by the LRA.

c. **Undertake comprehensive review and revision of the Revenue Code** to improve clarity but also strengthen governance arrangements for revenue management in Liberia.

d. **Implement fully Liberian Extractive Industries Transparency Initiative** by meeting the 15 requirements posed during the second stage of the validation process.

e. **Strengthen the natural resource management and taxation** based on principles recently introduced in the global tax transparency initiative.

f. **Strengthen capacity of LRA to conduct audit, especially of large taxpayers, and enforce compliance.**

g. Finally, **consider reviewing the revenue sharing arrangement for the Liberia open ship registry** as currently the revenue to the budget from the ship registry seems to be disproportionately low compared to the peer countries (See Box 4).

# Annexes

## Annex 1. Liberia Tax and Non-Tax Revenues, 2009-2018, USD million

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| ***11 Tax revenue*** | ***101.9*** | ***209.5*** | ***288.5*** | ***380.6*** | ***437.5*** | ***409.4*** | ***387.7*** | ***400.8*** | ***385.9*** | ***375.6*** |
| **111 Taxes on income and profits** | **39.3** | **70.0** | **110.6** | **146.1** | **203.3** | **168.7** | **147.9** | **162.8** | **145.5** | **137.0** |
| 1111 Taxes on residents | 19.0 | 38.2 | 59.1 | 53.8 | 171.3 | 149.1 | 130.0 | 142.6 | 138.5 | 132.3 |
| CIT/PIT section 200b (residents) | | | | | 42.4 | 44.0 | 29.6 | 34.3 | 32.6 | 41.7 |
| Withholding taxes (residents) | 19.0 | 38.2 | 59.1 | 53.8 | 126.5 | 102.9 | 98.9 | 106.4 | 104.1 | 89.4 |
| of which: on salaries and wages | 18.2 | 36.3 | 43.7 | 37.5 | 58.4 | 72.9 | 70.9 | 78.8 | 76.5 | 67.1 |
| on rent | | | | | 3.3 | 3.8 | 4.5 | 5.1 | 4.4 | 3.2 |
| on payments for serv. rendered | | | | | 17.1 | 14.8 | 18.1 | 16.9 | 15.9 | 12.6 |
| on interest, dividends, royalties, license fees, etc, | | | | | 3.5 | 8.1 | 1.8 | 1.4 | 4.1 | 4.4 |
| on payments of acquisition price | | | | | 42.5 | 0.8 | 1.3 | 1.1 | 0.4 | 0.3 |
| 1112 Taxes on non-residents | 17.5 | 27.0 | 50.2 | 92.0 | 31.2 | 18.4 | 17.0 | 20.0 | 7.0 | 4.7 |
| 1113 Additional taxes | 2.8 | 4.8 | 1.3 | 0.3 | 0.8 | 1.2 | 0.9 | 0.3 | 0.0 | 0.0 |
| **113 Property taxes** | **1.6** | **4.6** | **2.2** | **2.5** | **3.8** | **4.1** | **4.4** | **5.9** | **5.1** | **5.4** |
| **114 Taxes on goods and services** | **14.8** | **33.0** | **54.5** | **57.4** | **69.8** | **68.0** | **53.5** | **47.0** | **48.2** | **46.0** |
| 1141 General taxes on goods and services | 4.9 | 10.9 | 13.2 | 19.5 | 26.3 | 28.3 | 25.4 | 26.6 | 25.2 | 24.2 |
| 1142 Excise taxes (domestic) and taxes on fiscal monopolies | | | 10.0 | 11.5 | 15.0 | 5.9 | 4.6 | 5.1 | 5.4 | 5.4 |
| 1145 Taxes on use of goods or performed activities | 9.9 | 22.1 | 12.1 | 11.2 | 8.1 | 7.4 | 6.2 | 6.9 | 7.7 | 7.7 |
| 1146 Other taxes on goods and services (Maritime Revenue) | | | 18.4 | 15.1 | 20.3 | 26.4 | 17.3 | 8.3 | 9.8 | 8.7 |
| **115 Taxes on international trade** | **46.2** | **101.9** | **111.2** | **151.8** | **148.8** | **155.8** | **167.7** | **184.9** | **184.0** | **185.6** |
| 1151 Customs and other import duties | 45.6 | 99.4 | 109.3 | 148.0 | 148.3 | 155.4 | 167.3 | 184.4 | 183.6 | 185.2 |
| *1152 Fees and other levies on exports* | *0.5* | *2.5* | *1.9* | *3.7* | *0.5* | *0.5* | *0.5* | *0.6* | *0.3* | *0.4* |
| **116 Other taxes payable by businesses** | | | **10.0** | **22.9** | **11.8** | **12.7** | **14.3** | **0.1** | **3.2** | **1.7** |
| 11610 Social dev. contributions | | | 7.3 | 14.6 | 6.5 | 2.6 | | | | |
| 11612 Social dev. contributions (forestry and agriculture) | | | 2.6 | 8.2 | 0.4 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| 11613 Social dev. contributions (mineral mining) | | | | | 4.6 | 10.1 | 14.2 | 0.0 | 3.1 | 1.7 |
| **13 Non-Tax Revenues: Grants** | **23.5** | **13.4** | **43.2** | **26.9** | **36.8** | **28.4** | **79.0** | **68.2** | **5.7** | **16.2** |
| 131 Grants from foreign governments (capital and current) | | | 0.5 | 0.1 | 0.0 | 2.6 | 13.1 | 13.1 | 5.7 | 4.8 |
| 132 Grants from international organizations (current) | 23.5 | 13.0 | 42.7 | 26.8 | 36.8 | 25.8 | 66.0 | 55.1 | 0.0 | 11.3 |
| **14 Other non-tax revenue** | **16.4** | **64.9** | **52.3** | **59.9** | **85.3** | **73.9** | **49.4** | **100.7** | **74.4** | **46.7** |
| 141 Property income and administrative fees | 5.5 | 45.3 | 50.4 | 48.1 | 68.0 | 57.0 | 45.8 | 45.5 | 70.3 | 45.5 |
| 143 Fines, penalties and forfeits | 1.0 | 1.8 | 1.8 | 2.6 | 3.4 | 2.7 | 3.5 | 3.5 | 3.1 | 1.1 |
| 145 Sales of other goods and services and overdue taxes | 0.4 | 11.0 | 0.2 | 9.2 | | | | | | |
| 147 GSM licence fees and miscelaneous revenues | 9.5 | 6.8 | | | 14.0 | 14.2 | 0.2 | 51.7 | 1.0 | 0.1 |
| **15 Total borrowings** | | | | | | **10.3** | **122.2** | **0.0** | **56.3** | **25.4** |
| 150121 World Bank (External IDA) | | | | | | 10.3 | 28.7 | 0.0 | 39.1 | 25.4 |
| 150123 Other External Sources | | | | | | | 93.5 | 0.0 | 17.3 | 0.0 |
| **Grand Total** | **141.8** | **287.7** | **384.0** | **467.4** | **559.6** | **522.0** | **638.5** | **569.8** | **522.4** | **463.9** |

# Annex 2. Liberia Mining Fiscal Terms

| | ISSUE | REVENUE CODE | Evidence |
|---|---|---|---|
| 1. | **Term of Agreement** | Not specified | 25 years |
| 2. | **Corporate Income Tax Rate** | 30 % (**Section** 702) | 25-30% |
| 3. | **Resource Rent (high-yield surtax)** | Positive net accumulated cash flow is taxed at 20% and deductible from gross income for the tax period.<br>Applies when pre-tax rate of return/yield is 22.5%<br>(**Section** 730- **Section** 732 | Per LRC |
| 4. | **Royalties** | Royalty rate for iron ore is 4.5% (**Section** 704(1))<br>Payment due at the time of each shipment. | 3.25-4.25% |
| 5. | **Up-Front Payment** | No provision | $10-40 million in 1-6 installments |
| 6. | **Surface Rental** | Annual surface rent ($ per acre yearly):<br>$0.20 for mining exploration<br>– $5.00 for mining license contract area (1-10 years)<br>– $10.00 for mining license contract area (11-25 years).<br>Indexed by GDP Deflator<br>(**Section** 704). | Per LRC |
| 7. | **Loss carry-forward** | 7 years from start of commercial production (LRC 2009 **Section** 707)<br>5 years under 2000 LRC **Section** 203(e) | Per LRC |
| 8. | **Interest Carry forward** | Deduction in the tax year limited to interest received plus 50% of taxable income. 2000 LRC **Section** 203(d)<br>Incurred interest can be carried forward to the next tax period LRC 2011 **Section** 708 | From no carry forward to LRC |
| 9. | **Import Duties** | Import duties due per Customs Tariff Code. (**Section** 1701). Exemption until start of commercial production on: equipment, intermediate inputs, and raw materials (except gas). | Per LRC |
| 10. | **ECOWAS Trade Levy** | Not in LRC but other applicable laws. | Per applicable law. |
| 11. | **Customs User Fees** | Up to 1.5% of CIF value of imports even those exempt from import duty.<br>No fee on exports except for unprocessed (2.5%), semi-processed (1.25%), and goods in transshipment (2.5%) LRC (**Section** 18.2) | Per LRC rate or specific annual amount. |
| 12. | **Export Taxes** | No duties on exports or transshipment (LRC ‘09 **Section** 1701(a)(2)).<br>Custom user fees still apply (**Section** 1802 (a)(2)). | Per LRC – no export taxes or duties. |

| | | | |
|---|---|---|---|
| 13. | **Withholding Tax Rate on Payments -**<br>**Dividends**<br>**Interest Services** | Non-resident Resident<br>Dividends 5% 10%<br>Interest 5% 10%<br>Services 6% 6%<br>(LRC '09 **Sections** 806 and 905) | Per LRC with some variations |
| 14. | **GST** | Raw materials and capital goods used in Mining projects are exempt | Per LRC |
| 15. | **Real Property Tax** | Real property used in mining is exempt (LRC **Section** 2009). | Per LRC |
| 16. | **Inspection Fees** | Reasonable fees for pre-shipment inspection (LRC **Section** 1802).<br>Fees for scanning of cargo containers (up to US$7 per foot). | Per LRC |
| 17. | **Mineral Development Fund and Science Research Fund** | No provision | One-time $50,000 fee plus $100,000 annual fee. |
| 18. | **Community Development Fund** | No provision | Specific amounts ranging from $100,000 to $3.5 mil |
| 19. | **Regulatory Fees** | As provided throughout the LRC. | Per LRC |
| 20. | **Stabilization Clause** | None in 2000 LRC.<br>Proposed LRC **Section** 17 allows for fixed fiscal terms up to 15 years:<br>(1) Income tax rate;<br>(2) Royalty on mineral production<br>(3) Loss carry-forward<br>(4) Depreciation & cost recovery;<br>(5) Withholding of tax on payments;<br>(6) GST Exemptions<br>(7) "Import Duty" exemptions; and (8) "Real Property" tax Exemptions | 15-25 years |

# Annex 3. List of Tax Exemptions as Presented in the Revenue Code of Liberia

| Type of Tax | Tax exemption as introduced in the Code | Part, Chapter Section | Remark |
|---|---|---|---|
| The Personal and Business Income Tax | | Part II | |
| | The Government of the Republic of Liberia, government agencies, and charitable private organizations that are approved by and registered with the Ministry of Finance | Part I, Chapter 1, Section 9 (a) | Tax exempt |
| | Public Corporation | Part I, Chapter 1, Section 9 (b) | Tax exempt |
| | Regulatory Agencies | Part I, Chapter 1, Section 9 (c) | Subject for Custom Duties, or Income tax if making profit. Subject for taxation as a with-holding agent Otherwise tax exempt |
| | Central Bank | Part I, Chapter 1, Section 9 (d) | Tax Exempt |
| | Foreign Agencies | Part I, Chapter 1, Section 9 (e) | Tax Exempt under international agreements |
| | Registered Charities | Part I, Chapter 1, Section 9 (e) | Tax Exempt |
| | Sickness, Disability or Death benefits received as payments | Part II, Chapter 2, Section 202 (a) | Excluded from income of recipient |
| | Gifts and Transfer by Death | Part II, Chapter 2, Section 202 (b) | Excluded from income of recipient |
| | Noncash Benefits Provided by An Employer | Part II, Chapter 2, Section 202 (c) | Excludible from the Income at 100 percent o market value that in aggregate not exceed 100,000 LD per tax yea |
| | Credit for medical insurance prei or medical expenses | Part II, Chapter 2, Section 219 | Natural person entitled to the medical credit against income tax, 50 percent of approved medical expenses plus carry-forward expenses if expenses exceed the |

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| | | | limit (less than 120,000 LD |
| | Dividends from resident corporation | Part II, Chapter 4, Section 400 (b) | Dividends received by resident corporation from resident corporation are tax exempt |
| | Investment at $1 million for foreign own businesses and $300K for 100 percent Liberian ownership; $50K for hospitals and clinics | Part 1, Section 16, (a), (2), (C); (3), (A) | Up to 100 percent deduction of the qualifying costs with respect to the equipment and machinery (30%); construction of new hotels or tourist resort (30%); buildings and fixtures (10%), depending on level of local materials used and deprived zone |
| | Investments Exceeding $10 million | Part I, Section 16, (d) | For 15 sectors listed in subsection (a), (2), (A) additional incentives may be granted (not specified) |
| GST | | Part III | |
| | Supply of foodstuffs for human consumption, for general use of educational and philanthropic institutions | Section 1001 (e), (1) | Tax exempt |
| | Supply of goods for relief of distressed persons in case of natural disasters or other humanitarian emergencies | Section 1001 (e), (2) | Tax exempt |
| | Supply of a pharmaceutical or medicinal preparation | Section 1001 (e), (3) | Tax exempt |
| | Supply of medical aids or appliance specifically designed for persons with illness or disability | Section 1001 (e), (4) | Tax exempt |
| | Supply of textbooks or other instructional materials | Section 1001 (e), (5) | |
| | Supply of medical and educational equipment | Section 1001 (e), (8) | Tax exempt |

| | | | |
|---|---|---|---|
| | and supplies purchased for use directly or in connection with acti described in Part II, Chapter 6 and 7 | | |
| | Supply made to a renewable resource contractor subject to Part II, Chapter 6 and the business of agriculture | Section 1001 (e), (8), (F) | Tax exempt |
| | Supply made to a mining project producer, subject to Part II, Chapter 7, Subchapter A | Section 1001 (e), (8), (B) | Tax exempt |
| | Supply made to a petroleum project producer, subject to Part II, Chapter 7, Subchapter B | Section 1001 (e), (8), (C) | Tax exempt |
| | Investment at $1 million for foreign own businesses and $300K for 100 percent Liberian ownership; $50K for hospitals and clinics | Part 1, Section 16, (a), (2), (C); (3), (B), (i) | Medical and educational equipment placed within one year Tax exempt |
| | | Part 1, Section 16, (a), (2), (C); (3), (B), (ii) | Assets purchased for 15 activities, placed immediately after purchasing |

# Annex 4. Components of the Benchmark System

87. **Key components to consider to appropriately define the benchmark are the tax unit, the taxation period and the tax rate structure.**

88. **Tax unit defines a person (legal or natural) who will bearing the tax burden.** For Personal Income Tax it could be individual such as in Canada or many European countries or family in countries such as the United States. In the case of the corporate income tax system, the benchmark tax unit is the corporation. This definition of the corporate tax unit is most highly correlated to the treatment of the tax unit in the existing tax system. Even though there are occasional measures to recognize inter-corporate ties, in general, taxes and tax provisions are based on the single, legal, corporate entity. Under the VAT (or GST), the ideal tax unit is taken to be the final consumer of goods or services in the country reviewed, whether the consumer is an individual person, an unincorporated business or a corporation.

89. **Taxation period is another integral part of the benchmark tax system.** In many countries, the benchmark tax period for the personal income tax and for the VAT is the calendar year. For the corporate income tax structure, the taxation period is the fiscal period ending in the calendar year. This is more of a convention than a rule, established for ease of accounting.

90. **Tax rate structure needs to be defined as deviations from benchmark rate structure is considered tax concession.** In the case of progressive personal income tax systems, the progressive tax rate structure, including surtaxes where applicable is usually taken as part of the benchmark. For the corporate income tax, the benchmark rate is usually defined to be the same as the standard rate of corporate income tax. Any preferential rates, such as a lower tax rate for a specific industry such as manufacturing and lower rates applicable to smaller businesses, represent a departure from the benchmark and should be considered tax concessions. The VAT also has a flat benchmark tax rate. Any deviation from the general VAT rate is usually considered a tax concession.

91. **In addition to the basic components of the benchmark, there are other features of a tax system that are elements of a fair tax system.** Measures to include these features should be considered part of the benchmark and should not be considered tax concessions:

    a. Measures to Reduce or Eliminate Double Taxation of Income. For example, some tax systems have special provisions to recognize that some of the taxes on dividend income have already been paid at the corporate level and that this income should not be taxed again under the personal income tax. The element of the tax system that are in place to reduce double taxation of income and increase the neutrality of the overall tax structure should not be considered as tax concessions. Similar reasoning lies behind the foreign tax credit, which recognizes that income earned abroad has in some cases already borne tax and so provides a tax credit to avoid that this income be taxed again in the home country.

b. Loss Carry-Overs recognize the cyclical nature of business and acknowledge that losses suffered in one period may be offset by gains in another. Income in one year may not be an accurate indicator of ability to pay taxes due to substantial losses in a previous year. Consequently, carry-overs allow losses to be applied to past or future income for individuals, businesses and corporations to smooth income to a certain degree over the business cycle. As such, these carry-overs should be considered as being part of the benchmark and not a tax concession provided that such carry overs are equally applied across all taxpayers.

c. Deduction of Expenses to Earn Income. It is generally accepted that taxes should be assessed on income net of expenses incurred to earn income, rather than gross income.

92. **At the most fundamental level, each country has a choice of how general or detailed its benchmark system will be.** A country with a very general benchmark (i.e. very few exemptions or deductions) could consider many provisions of the actual law to be tax concessions. This is the case, for example, for Canada or the United Kingdom. In another country, a more elaborate benchmark might include some of those same kinds of provisions, which are considered tax expenditures in other countries (e.g. tax provisions for the spouse or dependent children). Liberia should put in place a team to review the various taxes and determine, for each type of tax, which elements should be considered part of the benchmark and which element should be considered tax expenditures.