

# **Tax & Investment Climate in Africa Conference**

***Next steps – Regional perspective***

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# Old truths - reformulated

- ***“Taxes are what we pay for civilized society”.***
  - US Chief Justice Oliver Wendell Holmes, Jr.
- **“No taxation without representation”** – within SADC not a major issue, BUT . . .
- **“No taxation without service delivery by government”** –
  - regionally, this is increasingly becoming a matter of concern for tax policy design, as it may effect tax morale
- Can **net fiscal impact** (tax take & service benefits returned) objectively be measured & compared across jurisdictions?
- **Performance indicators** on tax & expenditure sides of budgets:
  - Tax-to-GDP ratios
  - Tax structure & revenue importance of individual instruments (equity principle)
  - Millennium Development Goals – level of implementation towards targets:
    - Health care
    - Access to water
    - Unemployment
    - Km of transport/energy infrastructure per capita?
    - Literacy rate, etc

# The need for simple, predictable & buoyant revenue systems

- **Tax morale declines & tax abuse/avoidance escalates where governments fail to—**
  - Implement comprehensive taxation systems
  - Implement /rely too heavily on regressive taxes (VAT, etc)
  - Failure to charge all income to tax
  - Inefficient, biased, corrupt or too aggressive tax administration
  - Existence or proliferation of tax incentives & harmful tax practices
  - Insufficient taxation of natural resource extraction
  - Tax revenues do not buy sufficient quality & quantity of public services (*benefit received principle of taxation*)
- **Tax policy is about trade-offs—the ultimate ‘*political battleground*’—**
  - Pressures of globalisation in respect of capital movements with growing risk of co’s relocating to low tax jurisdictions in absence of attractive tax concessions
  - Can tax competition lead to effective country development strategy?
  - Evidence is mixed: see Scandinavian model vs. tax incentive paradigm (SA example)
  - Realistic limits to these supply side measures: when does it erode integrity of CIT?

# Public policies enhancing investment returns

(ranked in order of priority)

1. Improve infrastructure (transportation, communication, energy & water)
2. Lowering duties & barriers on international trade (trade liberalisation & improved access to wider regional markets)
3. Firmly committed to macroeconomic stability: low inflation & deficit
4. Reduce BoP risk by maintaining market-based exchange rate
5. Investing in health and education services (increase skills base)
6. Eliminating excessive red-tape through deregulation, procedural simplification & civil service reform (*cut costs of doing business*)
7. Governance: effective laws & institutions to control corruption
8. Protect property rights, enforce contracts & control crime
9. Ensure unrestricted repatriation of profits & capital from FDI
10. Reduce financial crises by instituting strict prudential banking regulations
11. **Establish attractive tax laws with moderate effective tax rates**
12. **Providing special fiscal investment incentives (tax breaks, direct grants/subsidies, additional deductions for wages/wage subsidies)**

# What else determines economic growth & FDI?

- **Look at costs & tax treatment of all 4 production factors:**
  1. User cost of capital – we heard about METR, but ...
  2. Cost of labour
  3. Cost of land (& access to land and finite mineral resources)
  4. Cost of entrepreneurship
- **Total costs of doing business – tax costs for all levels of government plus cross-border transaction costs**
- **Average [effective] tax rate** – taxpayer's total actual tax liability expressed as percentage of pre-tax income base (taking into account tax deferrals)
  - This tool could indicate preferred locality of direct investment
  - Could more analytical work be done at this level?

# Recent review of tax compliance burden:

*Doing Business in 2006, World Bank/IFC*

<u>Economy</u>	<u>Payments (number)</u>	<u>Time (hours) spent on compliance</u>	<u>Total tax payable (% gross profit)</u>
<b>East Asia &amp; Pacific</b>	28.2	249.9 (31 days)	31.2
<b>Europe &amp; Central Asia</b>	46.9	431.5 (54 days)	50.2
<b>Latin America &amp; Caribbean</b>	48.2	529.3 (66 days)	52.8
<b>Middle East &amp; North Africa</b>	27.3	241.9 (30 days)	35.1
<b>OECD</b>	16.3	197.2 (25 days)	45.4
<b>South Asia</b>	25.8	331.7 (41 days)	35.3
<b>Sub-Saharan Africa</b>	41.4	394.0 (49 days)	58.1

# Recent review of tax attractiveness

*Doing Business in 2006, World Bank/IFC*

Country	Year	Paying Taxes		
		Payments (number)	Time (hours)	Total tax payable (% gross profit)
AVERAGE	2005	31.9	366.4	57.6
Angola	2005	30	656	32.5
Botswana	2005	24	140	52.9
Congo, Dem. Rep.	2005	34	312	134.7
Ghana	2005	35	304	45.3
Lesotho	2005	19	564	37.7
Madagascar	2005	29	400	58.9
Malawi	2005	33	782	56.5
Mauritius	2005	7	158	38.2
Mozambique	2005	35	230	50.9
Namibia	2005	23	50	43.9
Nigeria	2005	36	1,120	27.1
Rwanda	2005	42	168	53.9
Sierra Leone	2005	20	399	163.9
South Africa	2005	32	350	43.8
Sudan	2005	..	..	..
Tanzania	2005	48	248	51.3
Zambia	2005	36	132	38.6
Zimbabwe	2005	59	216	48.6

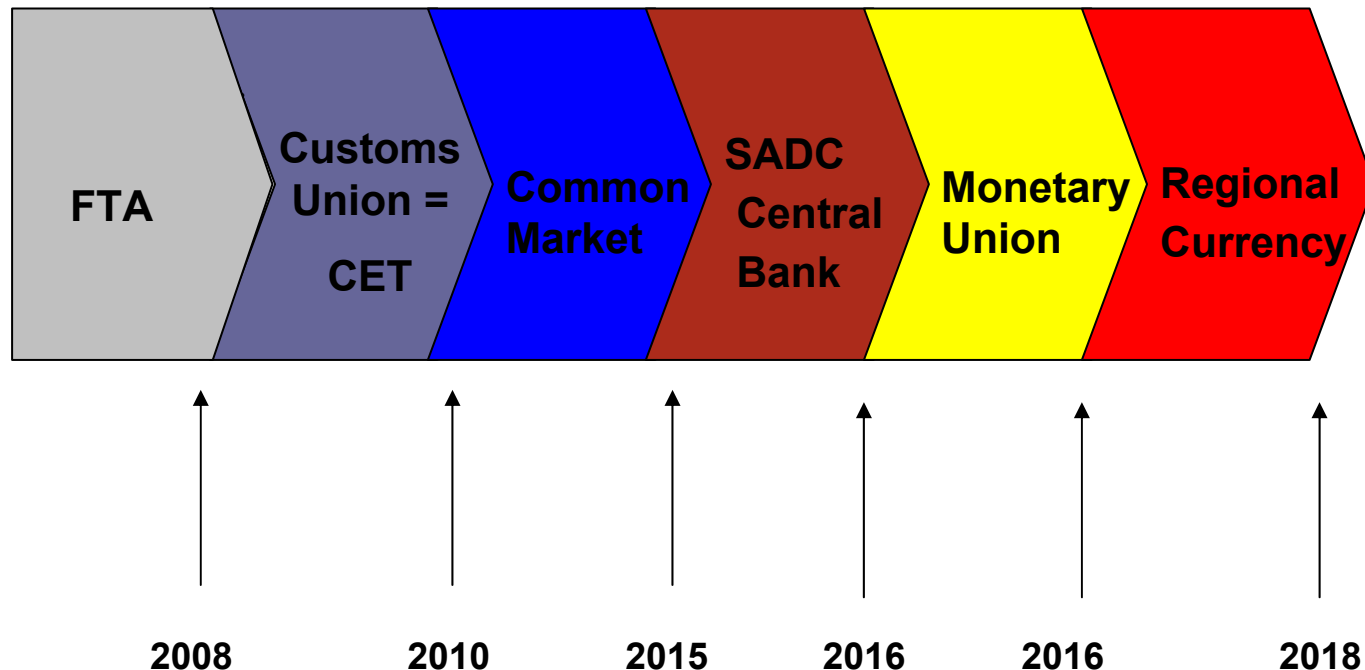
## SADC member states' 2006/07 record on trade certification compliance burdens

SADC member state & benchmark nations / groups	Number of documents for export	Time for export in days	Cost to export (US\$/container)	Number of documents for import	Time for import in days	Cost to import (US\$ / container)
East Asia & Pacific	6.9	23.9	\$848.8	9.3	25.9	\$1 037.1
Europe & Central Asia	7.4	29.2	\$1 450.2	10	37.1	\$1 589.3
Latin America & Caribbean	7.3	22.2	\$1 067.5	9.5	27.9	\$1 225.5
Middle East & North Africa	7.1	27.1	\$923.9	10.3	35.4	\$1 182.8
OECD	4.8	10.5	\$811	5.9	12.2	\$882.6
South Asia	8.1	34.4	\$1 236	12.5	41.4	\$1 494.9
Sub-Saharan Africa	8.2	40	\$1 561.1	12.2	51.5	\$1 946.9
Hong Kong	2	5	\$425	2	5	\$425
Singapore	5	6	\$382	6	3	\$333
Denmark	3	5	\$540	3	5	\$540

Source: Word Bank / International Finance Corporation, *Doing Business 2007: How to Reform – Comparing Regulation in 175 Economies*, 89 – 91.

# SADC – deeper economic integration

- Role of tax policy & administration:
- SADC econ. integration agenda seeks to eliminate intra-SADC trade / transaction cost in support of economic growth
  - SADC – 14 member states, SA trade tax dependency 1% of total tax revenues vs. +40% in others (CET negotiations & revenue-raising pressures)



# SADC: Annexes to Finance & Investment Protocol

<b>MOU</b>	<b>Sub-Committee</b>	<b>Key Objective</b>
<b>MACRO CONVERGENCE</b>	<b>Macroeconomic Sub-Committee</b>	<b>Macro stability and convergence</b>
<b>DFI's</b>	<b>DFI Sub-Committee</b>	<b>Co-operation between SADC DFI's</b>
<b>INVESTMENT</b>	<b>Investment Sub-Committee</b>	<b>Harmonize SADC investment regimes</b>
<b>TAXATION</b>	<b>Taxation Sub-Committee</b>	<b>Harmonize SADC tax regimes</b>
<b>INSURANCE ETC</b>	<b>CISNA</b>	<b>Regulators to co-operate &amp; harmonize</b>
<b>STOCK EXCHANGE</b>	<b>COSSE</b>	<b>Integrated SADC securities market</b>
<b>EXCHANGE CONTROLS</b>	<b>CCBG</b>	<b>Co-ordinate exchange control policies</b>
<b>ICT</b>	<b>CCBG</b>	<b>Co-ordinate ICT solutions for central banks</b>
<b>LEGAL FRAMEWORKS</b>	<b>CCBG</b>	<b>Harmonize central bank legal regimes</b>
<b>PAYMENT SYSTEMS</b>	<b>CCBG</b>	<b>Convergence of payment systems</b>
<b>BANK SUPERVISION</b>	<b>ESAF</b>	<b>Co-operation in banking supervision</b>

# Continental Mandate

## ***Abuja Treaty deadlines/stages:***

- Stage 1: Strengthening existing RECs & creating new ones where needed (5 years) → [1994-1999]
- Stage 2: Stabilisation of tariff & other barriers to regional trade, strengthening of sectoral integration, particularly in trade, agriculture, finance, transport & communication, industry and energy, as well as coordination & harmonisation of RECs' activities (8 years) → [1999-2007]
- Stage 3: Establishment of FTA and CU at the level of each REC (10 years) → [2007-2017]
- Stage 4: Coordination and harmonisation of tariff and non-tariff systems among RECs, with a view to establishing a Continental Customs Union (2 years) → [2017-2019]

# SADC Tax Subcommittee

- **Tax Subcommittee formed 1999** out of Macroeconomic Convergence Subcommittee
- **Original Terms of Reference:**
  - Establish a SADC Tax Database
  - Appropriate use of tax incentives (to attract FDI)
  - Work towards the elimination of barriers to intra-SADC trade
  - Reduce revenue losses from smuggling and tax fraud
  - Build institutional capacity on policy-making and revenue collection

# SADC Tax Subcommittee

- **Key additional aim** – to develop a non-legally binding MOU/Annex on taxation with the aim of “realising substantive progress towards tax co-ordination at the SADC level”
- **Consultative process** - introduced working groups on:
  - Tax Incentives
  - Capacity building
  - Tax Agreements: exchange of information (all taxes) & mutual assistance agreements
  - Indirect Taxes

# SADC Tax Annex

- Signed by SADC Committee of Ministers for Finance & Investment August 2002
- Now Annex 3 to F&I Protocol (ratification by member states began October 2006)
- Introduced binding language & commitments in terms of tax policy coordination & administration within SADC
- Concern is about selective discretionary incentives & harmful tax practices for highly mobile financial services
  - “State Parties shall endeavour to achieve common approach to the treatment and application of tax incentives and will, amongst other things, ensure that tax incentives are provided for only in tax legislation.”
- Underpins aim of formulating policies to:
  - Improve efficiency of collection
  - Safeguard the respective Member States’ tax bases
  - reduce obstacles to intra-SADC trade and investment

# SADC Tax Annex contd.

- Key document - Short – but **very ambitious**
- **Just 6 substantive articles** in these areas:
  - Development of a SADC tax database
  - Capacity building - development of the professionalism & expertise of tax officers
  - Cooperation to achieve a common approach to tax incentives
  - Develop a common approach to negotiation of tax treaties & mutual assistance agreements
  - Coordination & harmonisation of indirect taxes
  - Give consideration to introducing mechanisms for the settlement of tax disputes between MS

# Implementation of Art 4: Tax Incentives

most problematic & divisive

- This is where top level political guidance becomes imperative!
- EU example: tax coordination driven by ECJ on the back of legally binding EU competition policy, state aid rules & code of conduct regarding business income tax
- SADC has none of these enforcement instruments or institutions or framework policies ...
- Tax Subcommittee can continue to commission reports, adopt these but to what effect?
- 2 consultancy studies are now official SADC policy documents – but proliferation of tax incentives continues ...
  - i. SADC Study on the *'Effectiveness & Economic Impact of Tax Incentives in the SADC Region'* (2004 Bolnick Report)
  - ii. Ongoing consultancy on *'Guidelines and Tax Expenditure Budgeting Framework Design'* (2006 Ogle Report)

# Regional approaches:

*“prevent unsustainable race to the bottom” –*

SADC governments through utilisation of productive revenue systems need to create fiscal space for poverty alleviation, addressing basic human needs, infrastructure development & reduction of trade tax dependency (as required by Finance & Investment Protocol’s trade liberalisation & economic integration imperatives)



# Does tax coordination work within SADC?

- **There is policy slippage**, but it's early days ...
- Work by IFC and FIAS highly important to inform regional economic integration process (especially tax policy advice on mining industry, tourism & SME sector was well considered & balanced)
- **However, region and beyond needs own, Africa-based and determined research in areas of tax policy design and administration plus customs practices**
  - Avoid constant tax policy & admin paradigm changes dictated from outside (*'flavour of the month'* approach ...)
- **Africa has very unique conditions & needs:**
  - Limited capacity within Treasuries and RAs
  - Unique fiscal decentralisation issues (tax assignment & revenue sharing):
    - Colonial legacy of drawing country borders arbitrarily, resulting in high incidence of ethnic strife – fiscal devolution could mitigate pressures
  - Common mining tax policies within SADC to arrest race to the bottom
  - Common trade facilitation measures

# SADC – discussing strategies for closing tax gap

- Business & government benefit from simple, few & fair taxes:
  - Consolidate number of taxes (many jurisdictions raise 95% of all tax revenues from principally 6 tax instruments) —
    - How many tax instruments within SADC?
    - Tanzania, 50 local business taxes/fees
    - Georgia cut taxes from 21 to 9
  - Broaden tax base by economic use of tax expenditures, thereby affording moderate-to-low tax rates
  - Simplify filing requirements
  - Enhance effectiveness of revenue authorities by:
    - Creating semi-autonomous revenue authorities – only one of the options
    - Organizing tax administration on functional basis
    - Establishing large taxpayer units
    - Establishing small taxpayer assistance units?
    - Single tax environment for SMEs or introduction of presumptive taxes?
    - Introduction of tax amnesty only when tax policy reforms have been instituted, supported by evidenced effective revenue collections?

# Independent revenue authorities & governance issues

- Is this a transitional phase & is it the only model for Africa?
- How to govern these RAs? – Delineation of functions?
- How to benchmark performance of RAs across boundaries?
  - Efficiency indicator: budget/total revenue collections
  - Level of complaints by taxpayers per tax instruments
- Reporting structure & oversight over RAs
  - Revenue Board: do they exist? Are they sidelined if they exist? Do they report to Parliament or simply the Minister?
- Can RAs transfer revenue collection costs to taxpayers at will, thereby increasing compliance burden?
- Are **periodic performance surveys** sufficient protection? or
- Should all SADC states introduce taxpayers' bill of rights, monitored by independent tax ombudsman/adjudicator?
  - Role of ombudsman / adjudicator anchored in Constitution & should report annually to Parliament on service delivery by RA

# Strategic approach to taxpayer service delivery

- OECD's Forum on Tax Administration released 2005 survey on taxpayer service initiatives, as adopted by RAs:
  - Differentiating service delivery actions across various taxpayer segments (LTUs, MTUs & STUs)
  - Treating taxpayers as persons with rights, as clients or customers
  - More cost effective to leverage service actions via taxpayers' representatives (tax professionals, industry/business) – valued partners
  - Consult with taxpayers/their representatives prior to changes of law/rules
  - Make full use of IT (e-filing, tel-answering, direct deposit program, e-reg)
  - Monitor service delivery performance accord. to service performance std.
  - Measuring client satisfaction with level of service offered
  - Demonstrating accountability by publicizing performance levels accord. to set standards (independent adjudicator, reporting to Parliament?)
  - Ensure proper balancing of resources between service & enforcement
  - Systematically identify weaknesses in service delivery & develop organizational action plans

# Who is still missing in regional tax policy debate?

- Regional economic integration towards SADC CU & Common Market requires extraordinary political vision & commitment
- Tax Officials understand dangers & risk of SADC CU and high levels of tax expenditures but ministers of trade & industry and investment promotion agencies do not ...
- SADC will host in July 2007 a dedicated high-level workshop for Ministers of Finance on tax coordination program as envisaged by the Finance & Investment Protocol:
  - How to give up fiscal sovereignty for attaining a higher goal?
  - How to bind MS into their commitments? (especially on tax incentives)?
  - Enforcement mechanism such as the Tribunal (see ECJ influence)
  - Process hopefully informed by EU's current and past political leaders