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POLICY BRIEF



TAXATION AS A DOMESTIC RESOURCE MOBILISATION TOOL FOR FINANCING DEVELOPMENT IN SUB SAHARAN AFRICA

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Background

This brief looks at the tax systems for Lesotho, Mozambique and Zimbabwe amid the realisation of the growing role and impact of tax in the development agenda. The brief is based on the three studies commissioned by AFRODAD on "What has tax got to do with Development" in the Sub Saharan Africa countries of Lesotho (2012), Mozambique (2011) and Zimbabwe (2011).

Introduction

The global financial crisis exposed the vulnerability of developing countries for their reliance on foreign aid resources for their development agenda. The crisis resulted in the dwindling of resources for the countries advancing aid and subsequently affected the flow of development finance to the recipient country. In order to meet the socio-economic needs of the citizens, national governments resorted to domestic resources mobilisation. Mobilising domestic resources as a means for financing development has thus become an important development issue, especially through taxation. Domestic resources constitute a stable and long lasting source of funding for developing countries in the face of dwindling aid flows. Taxation ensures citizen participation to development as it acts as a source of the social contract between government and the citizens. Through such a contract, the responsibility of each player is defined making it a responsibility for every citizen to pay taxes and not an obligation whilst ensuring that the government is held accountable for the utilisation and allocation of public resources.

The Importance of Domestic Resource Mobilisation

In the past, the emphasis on financing development focused on scaling aid and external borrowing. For a long time mobilising domestic revenue has been neglected, despite being a better long-term option. The reasons for this overlook included the inherent pessimism about raising revenue, a prevalent 'small-state' ideology and a preference for foreign aid-led solutions.

There is a rising debate on taxation and development amongst civil society organisations, governments and regional and international development institutions. Such debates recommend a paradigm shift in the way governments consider taxation towards viewing it as the main source of government revenue. Aid and debt finance should be additional mechanisms to supplement national efforts.

Lesotho and Zimbabwe are ranked the highest in terms of the ratio of tax to GDP with 21.9% and 30% respectively. On the lower end, the tax to total domestic revenue for Mozambique stands at 15.4%. Zimbabwe's over reliance on tax revenue is due to withdrawal of funding by the Breton Woods Institutions and other donors. Even though Zimbabwe has high tax to domestic revenue ratio, not much is transformed into development outcomes as more than 70% of the revenue is channeled towards salaries for public servants. However, tax revenues are, on average, lower in developing countries than in rich countries; in sub-Saharan Africa, the average is 18 per cent of GDP compared to 38 per cent in western European countries. Hence the argument that if developing countries were able to collect sufficient tax revenues, they might be able to increase their independence, the provision of social protection, infrastructure and basic services such as education and health care which are crucial for development.

The revenue contribution of the specific tax types varies for the three countries under consideration. Tax on consumption (specifically VAT) is the main source of tax revenue in Mozambique and Zimbabwe whilst customs duty constitutes more than 50% of tax revenue for Lesotho. For Zimbabwe, in 2012, VAT recorded the highest contribution of 33% to total revenue. During the financial year 2009/10, VAT generated revenues equal to 5.4% of GDP in Mozambique. Value Added Taxes generally are regressive in nature and CSOs in these respective countries campaign against VAT or else some of the products should be exempt from VAT in order to make it progressive.

The three countries under study have been putting in place policies and strategies to raise internal resources through the expansion of the tax base to reduce dependency and meet the growing needs of their population in line with the medium to long term plans and the Medium Term Expenditure Frameworks (MTEF) and Public Finance Management (PFM) systems among others. The frameworks are aimed at improving planning and budgeting processes including procurement systems in the respective countries. The Medium Term Expenditure Framework for Lesotho and Mozambique and the Medium Term Plan in the case of Zimbabwe guide the budget for the forthcoming year whilst providing indicative fiscal priorities for the subsequent years.

The principal reason for imposing taxes is to raise revenue for the government in order to finance public goods and services. Tax revenue is raised by levying common taxes such as corporate tax, personal income tax, value added tax, customs and excise duty among others. Apart from being a major source of Government revenue, taxation acts as a means for altering the distribution of wealth, as a means of discouraging the consumption of goods and services with high social costs (e.g. taxes on cigarettes and alcohol etc) and the ability to influence aggregate demand in the economy.

In addition to its redistributive and allocative role, taxation acts as a means for increasing a government's responsiveness towards calls for transparency and accountability by its citizenry from whom it derives its mandate to govern. Taxation also serves as a basis for the establishment of a social contract between a legitimate government and its citizens whereby a government will be responsible for the collection of taxes for development finance and the provision of goods and services while the citizenry keep their end of the bargain by paying their taxes thereby asserting the legitimacy of the government.

Why Legal and Institutional Frameworks for Tax Administration?

The elements of accountability, transparency, equity, effectiveness and efficiency which are entailed in good tax governance cannot be realized without a credible governance framework. Good Governance

¹ Budget Speech to Parliament for the 2011/2012 Fiscal Year, Lesotho by Honourable Timothy T. Thahane Minister of Finance and Development Planning Maseru – Lesotho, 14th February 2011, <http://trc.org.ls/wp-content/uploads/2011/02/budget-speech-2011-2.pdf>

² National budget statement, Ministry of Finance, Zimbabwe http://www.parlzim.gov.zw/attachments/article/30/15_Nov_2012_39-50.pdf.pdf

³ Heritage foundation, 2012 Index of Economic Freedom downloaded from individual country information, www.heritage.org/index/ranking

⁴ Oxfam Research Report (2011), Progressive Taxation: Towards Fair Tax Policies, accessed on http://www.oxfam.org/sites/www.oxfam.org/files/rr-progressive-taxation-fiscal_systems-260911-en_0.pdf

⁵ Statement by the ZIMRA Board Chairman on Revenue Performance for the year ended 31 December 2012

The tax systems in Mozambique, Tanzania and Zambia: capacity and constraints, Commissioned by Norad, 2011, http://www.norad.no/en/_attachment/340669

is central to the collection and utilisation of resources. By having proper governance structures in tax administration, citizens will develop trust in the government thereby strengthening the social contract between the government and the taxpaying citizens. Over the years, Sub Saharan Africa countries including Lesotho, Mozambique and Zimbabwe embarked on massive tax reforms including the establishment of revenue authorities in order to increase efficiency in tax collection and administration. Such was an attempt by national governments with the aim of raising domestic resources in order to defend/maintain their sovereignty. These revenue authorities are established by acts of parliament and are responsible for assessment and collection of tax revenues on behalf of the government as well as giving policy advice to the Ministers of Finance. The most common acts in these countries are those governing Income Tax, Value Added Tax and the Customs and Excise duties. The Ministers of Finance in the respective countries are responsible for providing the oversight function over the activities of revenue authorities and developing the tax policies, (including drafting any amendments to laws or legislations on taxation for their respective countries). Whilst the parliamentarians hold the executive government politically accountable for their actions, the judiciary on the other hand holds them legally accountable and adjudicates in cases of disputes.

The Role of Private Sector in Tax Administration

The business sector also plays a key role in the taxation affairs of the government. Hence the need for governments, business and CSO's to foster collaborative efforts in order to meet the common aims of a fair, stable, and sustainable tax system of a country. To this effect, revenue authorities enter into agreements with business associations, for instance, the Lesotho Revenue Authority (LRA) signed agreements with several bodies such as Lesotho Institute of Accountants (LIA), Lesotho Chamber of Commerce and Industry, tax associations, banks, accounting and auditing bodies, educational institutions and others in an attempt to increase compliance and minimise tax evasion, a move which has been more successful than the "doing-it-alone" approach. In addition to this is yet another platform called the LRA-Business Forum which provides a platform for private sector and LRA to interact and make recommendations to the tax policy committee of the government of Lesotho. Among other government, Business engagements in Zimbabwe's tax administration, a Tax Steering Committee comprising of ZIMRA, government and the private sector was constituted soon after the Inclusive Government came into office in 2009, whose work included reviewing the Income Tax Act. Thus as governments in the region consider employing measures and strategies to balancing tax collection and business activity, the business sector remains critically important, especially the local business operators (small and medium enterprises) which do not usually gain from tax benefits awarded to megaprojects and newly established business operators. Regional countries too tend to lose revenue for financing development through tax incentives offered to Foreign Direct Investors (FDIs) among other fiscal benefits, which the IMF confirmed to be irrelevant in attracting investment into the country.

The Role of Civil Society Organisations

Civil Society organisations have increasingly become an agent for promoting good governance like transparency, effectiveness, openness, responsiveness and accountability. Generally, CSOs play a critical role in policy analysis and advocacy, regulation and monitoring of state performance and mobilising particular constituencies, particularly the vulnerable and marginalised sections of society. In relation to taxation, civil society organisations remain at the centre of the dialogue between the government and the taxpaying public including companies. Up until recent years, the role of CSOs in taxation decisions in Sub Saharan Africa has been insignificant with little or no participation in the budget process.

With increasing importance of taxation in the development agenda, CSOs have become very critical in

influencing pro-poor taxation systems by advocating for policy change whilst mobilising and capacitating the masses to seek accountability from the government in relation to the use of public funds to meet the development needs of the general citizenry. However, due to stronger political systems against weak civic society groups in Sub Saharan Africa, the impact of CSOs is still limited, but the few CSOs working on tax justice are working towards ensuring fair, equitable and pro-poor taxation systems.

Since Sub Saharan Africa countries have highest levels of inequalities in the world, CSOs are key in bridging the gap between the rich and the poor in the region. Furthermore, CSOs have a role to play in ensuring that the fiscal incentives extended to Multinational companies do not perpetuate the disparity between local investors and foreign investors. Moreover, with the increase in corruption, tax evasion and avoidance, CSOs have the potential to expose and shame the perpetrators of such illicit financial flows

The Role of the Extractive Industries in the Development Agenda

The extractive industry in Africa, if fully tapped into, can contribute more to sustainable development than they are currently doing. Countries need to develop the resources which are at their disposal, while meeting international environmental, social, and governance standards, and use the tax revenue from such industries transparently and effectively. However, the contribution of the natural resources to domestic revenue remains considerably low due to low corporate taxes, low royalty rates, fiscal incentives (including exemptions and tax holidays) and limited or no scope for beneficiation. The table below summarises the tax regimes in the mining sector for the three respective countries.

Lesotho	Mozambique	Zimbabwe
1. Royalties for mining operators with an agreement or lease are charged at a rate of 10% for precious minerals	1. Corporate income tax is set at 35%	1. 15% income tax on Mining
2. Royalty rates for other mineral products 3%	2. Exemption of the dividend withholding tax, normally levied at 18% for ten years	2. 10% withholding tax on remitted dividends (5% in on the stock exchange)
3. Royalty tax for mining operators without agreements or lease is 15%.	3. Royalty rates as follows · All mineral production 3%, · Excepting precious metals – 5%, · Gemstones – 6% · Diamonds – 10%	3. Royalty rates as follows: · Precious stones-10% · Precious metals-3% · Base metals-2% · Industrial metals-2% · Coal bed methane gas-2% · Coal 1%

Source: AFRODAD compiled from respective Revenue Authorities

⁷ Principles of Taxation, <http://homepages.ucl.ac.uk/K.Bain/tax1.pdf>

⁸ AFRICAN TAX ADMINISTRATION FORUM (ATAF), A research on Good tax Governance in Africa, February 2012

Tax Regimes for Lesotho, Mozambique and Zimbabwe

Transparency and accountability in the licensing, exploration, contracting, extraction, revenue generation and allocation of resources from the extractive sector lies at the heart of natural resource governance globally. However, in spite of a plethora of global governance initiatives like the Kimberly Process, Publish what you pay Campaign and the Extractive Industries Transparency Initiative, there is still a lot of secrecy around the negotiation and signing of mining contracts in Lesotho, Mozambique and Zimbabwe. Of these three countries, only Mozambique is a signatory to the EITI. However CSOs in Zimbabwe have been very active in pushing for the Publish What You Pay Campaign (PWYP) which gave birth to the Zimbabwe Mineral Revenue Transparency (ZMRT) initiative. CSOs, mining experts and Government internalised the EITI to instigate the ZMRT initiative which acts as a pilot project to the EITI. The objectives of these initiatives are very similar which entails transparency and accountability in the extractive industry. Although Mozambique subscribed to the EITI, there is still a lot of secrecy in the negotiation and signing of mining contracts. Such lack of transparency and accountability inhibit socio economic development in these countries in particular and Sub Saharan Africa in general.

National governments in these countries should ensure that the mining activities benefit the local citizens especially the communities highly endowed with mineral resources. There should be policies in place that encourage corporate social responsibility earmarked for local community development since there are no such policies in Lesotho, Mozambique and Zimbabwe. In the case of relocation, the government policies should ensure that the standards of living for the relocated families should be made better off. Common Challenges affecting Taxation in the region

Tax evasion and avoidance are common within the region due to lack of a taxpaying culture amongst individuals and companies. Residents cite lengthy and complicated procedures as the major reasons for not paying taxes. National governments are therefore losing tax revenue through tax evasion and avoidance which subsequently translate into less revenue for financing development. Between 1970 and 2008, Africa lost US\$854 billion in illicit financial outflows. During the same period Zimbabwe alone lost a total of \$22.6 billion.

The large informal sector in Africa is another challenge that impedes adequate revenue collection for development finance. Due to the large informal sector, revenue authorities tend to levy taxes based on the convenience rather than the ability to pay taxes. For instance, a watch man is obliged to pay income taxes because it is convenient to levy taxes through pay as you earn whilst informal business operators who should be paying more are reluctant to pay since there are no mechanism to bring them into the tax bracket.

Moreover, the capacities of revenue authorities to ensure compliance are weak institutionally resulting in none monitoring of transfer pricing and other forms of tax evasion and avoidance. Bribery and corruption among revenue officials are also common to the extent that most of the revenue authorities in the region admit that corruption is rampant amongst their officials.

Whilst Fiscal incentives play an important role in attracting investment in any country, nurturing domestic production and encouraging existing firms to expand their operations and revenue base for companies and government, national governments in Sub Saharan Africa, however, tend to lose revenue that could otherwise be used for financing development. In other words, although tax incentives are largely considered as a medium for attracting FDIs, experiences with tax incentives have shown that countries that have been most successful in attracting foreign investors have not offered any investment incentives. The IMF also confirmed that investment incentives imply forgone resources that could be used elsewhere in enhancing economic development. Instead, to attract foreign direct investments, countries should ensure that there is good quality infrastructure, low administrative costs of setting up and running

⁹ The World Bank, Accountability in Governance, <http://siteresources.worldbank.org/PUBLICSECTORANDGOVERNANCE/Resources/Accountabilitygovernance.pdf>
¹⁰ www.itdweb.org/RwandaConference/.../Lesotho_Presentation...

businesses, political stability and predictable macro-economic policies
Policy Recommendations

1. The government should increase the amount of money retained by revenue authorities for administrative purposes, for instance, hiring competent experts who can detect and plug illicit financial flows (tax evasion and avoidance), especially by multinational companies through transfer pricing.
2. Revenue authorities can also be capacitated to curb illicit financial flows through instituting legislative measures: For instance Governments can introduce similar legislation such as the US Foreign Account Tax Compliance Act (FATCA), requiring tax authorities to automatically exchange tax information relating to citizens and corporations through submission of an annual report to the responsible authorities detailing information regarding account balances, gross deposits and gross withdrawals. In addition to this, governments should also enact legislation requiring multinational corporations to report their financial information on a country-by-country basis detailing the names of all companies belonging to them and trading in each country, their financial performance in each country, their tax liability in each country, the cost and net book value of their fixed assets in each country, as well as their gross and net assets in each country. And to help curb tax evasion through transfer pricing, Governments should stress to the revenue authorities the importance of requiring 'related party transactions' (i.e. transactions taking place within the same corporation) to be declared on annual tax returns.
3. In order to do away with corruption amongst revenue officials, senior politicians and government officials, the government should guarantee the rule of law and ensure that there is impartiality in passing judgment. The other option is to make use of the existing relationships between revenue authorities and other arms of government, tax payers and CSOs in weeding out corruption, tax evasion and avoidance by naming and shaming the perpetrators of such illicit financial practices. This can be supported by laws and regulations that encourage and support whistle blowing. Furthermore Governments should also require the filing of public statutory accounts in all jurisdictions
4. CSOs are also key in coordinating and leading national and sub national campaigns on tax justice. Civil Society organisations should engage the general citizenry and educate them on the need to pay taxes and empower them through training on how to hold the government accountable for the use of state funds. Moreover as CSOs advocate and lobby for policy change, they should as well make use of their engagements with regional and international institutions to seek their support in their fight for tax justice and domestic resource mobilisation.
5. In order to bring the informal sector into the tax net, national governments should introduce presumptive taxes payable by different categories of business players in the informal sector. Since informal business operators do not have proper record keeping mechanisms, a fixed amount or percentage for respective categories should be arrived at in order for the government to realise revenue from this sector. In addition to this, governments should also seek to incentivise hitherto unregistered informal sector enterprises to join the formal, taxpaying economy, e.g. by introducing, distribution and marketing assistance, micro-credit schemes, or purely financial incentives in efforts to broaden the tax base and raise tax revenue for development.

¹¹ Dr. Aisha Ghaus-Pasha, Role of Civil Society Organisations in Governance, 2005: <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan019594.pdf>

¹² Ibid

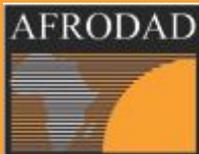
¹³ Tax evasion is the deliberate non payment of tax

¹⁴ Tax avoidance is when less tax is paid through analysis of tax and is therefore legal.

¹⁵ Global Financial Integrity, Illicit Financial Flows from Africa: Hidden Resource for Development, accessed on http://www.gfintegrity.org/storage/gfip/documents/reports/gfi_africareport_web.pdf

¹⁶ Ibid.

¹⁷ IMF, Kenya, Uganda, and United Republic of Tanzania: Selected issues 1 December 2006, p.11.



About AFRODAD

Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

Objectives include the following:

- 1 To enhance efficient and effective management and use of resources by Africa governments.
- 2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of people in the world.
- 3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being apolitical, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat is based in Harare, Zimbabwe.

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