

## **JUSTIFICATION FOR THE INTRODUCTION OF GST IN SIERRA LEONE**

### **1.0 INTRODUCTION**

The introduction of Goods and Services Tax (GST) is key to the programme for the modernisation of the revenue administration which has as its focus, enhancing domestic revenue mobilisation to support priority spending.

### **2.0 RATIONALE FOR THE INTRODUCTION OF GST**

Nearly 40% of the National Budget continues to be donor sourced. In order to reduce over-dependence on donor funding, especially in respect of recurrent expenditure, we need to transform and modernise domestic revenue collection. The increasing pressure on Government to mobilise revenue for financing the economic and social infrastructure necessary for supporting private investment and creating the social stability required for orderly development necessitates modernisation of the tax system to ensure revenue stability and buoyancy.

#### **2.1 GST as a Replacement Tax**

It bears emphasizing that GST is not going to be introduced as an additional impost, but as a replacement for a number of existing indirect taxes currently administered by the NRA – Domestic and Import Sales Taxes, Restaurant and Food Tax, Messages Tax, Professional Services Sales Tax, Hotel Accommodation Tax and Entertainment Tax. It is these taxes that will be consolidated and administered as GST.

#### **2.2 A More Efficient way of Collecting Consumption Taxes**

Fundamental to the introduction of GST is the shift away from the collection mechanism by which tax on inputs is either deferred (in the case of Sales Tax) or paid and factored into the cost of production on which a tax is levied. The GST mechanism ensures that input tax is secured by enjoining the taxpayer to first pay the input tax and retain the invoice; it then goes on to relieve the input tax by requiring the taxpayer to automatically recover the input tax fully from the GST levied on sales. Invoice is issued for the taxable sale and a copy of it retained.

In comparison with the current Sales Tax regime, the GST mechanism is much more efficient for a number of reasons. GST has a much more effective audit trail since tax paid by taxpayers to their suppliers show up in the records of both the buyer and the supplier. This facilitates policing of the tax.

Unlike the present Sales Tax which is imposed at a single point, GST is levied at multiple points spread through the entire production-distribution chain. Evasion at any point is therefore limited to the tax revenue from the value added created at that given point and not the entire tax on the product.

The method of GST collection contributes to compliance through the inbuilt conflict of interest over invoice values. In a transaction between registered taxpayers, it is in the buyer's interest to have the invoice overstating the value of the transaction. On the other hand it is to the seller's advantage to have the value understated so as to reduce the amount of GST remittable to NRA. These conflicting interests tend to deter manipulation of values in taxable transactions.

In the absence of any mechanism under the present Sales Tax system for remission of taxes on input purchases from wholesalers and retailers and on indirect inputs, and under the other domestic indirect taxes (e.g. Messages Tax, Restaurant Tax) for recovery of any input tax, these elements of input tax creep into the base of Sales Tax, giving rise to cascading (i.e. tax on tax). By freeing inputs automatically from taxes, the mechanism for GST collection removes cascading or pyramiding of taxes.

### **2.3 Broadening the Tax Base for Revenue Stability**

It is envisaged that the introduction of a Goods and Services Tax will generate additional tax revenues through the widening of the tax base. It is expected to be revenue neutral in the first year and in time produce an increase of 1.9% of GDP. Indeed, the initiative to replace the current Sales Tax and five other Domestic Indirect Taxes with the GST is a critical element in the drive to broaden the base of the domestic indirect tax system by moving it from its restricted coverage at the import and manufacturing levels and stretching it to cover the growing wholesale and retail sub-sectors and also more supplies in the service sector. This is necessary for ensuring that growth in all sectors of the economy would be reflected in tax revenue.

With the introduction of GST, the horizontal base broadening involving wider coverage of goods and services and the extension of the vertical reach of the domestic indirect tax system to capture the wholesale and retail sectors removes differential tax treatment of sectors under the current Sales Tax regime. Considered solely on the criterion of domestic indirect tax treatment, the wholesale and retail sectors are currently among the most tax-favored sectors and therefore most attractive to investments as supplies in those sectors are exempt from tax.

### **2.4 GST as a component of the Tax Reform Programme**

The Introduction of GST is a key element in Government's programme to achieve the economic transformation required for full recovery and the attainment of sustained growth. Measures already instituted as part of the tax reform programme includes restructuring of tax institutions which involved the establishment of the NRA, reduction of tax brackets, flattening of rates and consolidation of tax laws.

These reform measures have made a positive impact on revenue, improved savings and contributed to the modest growth achieved over the past half decade. In spite of the perceptible improvement in the overall tax system, the domestic indirect tax sector remained largely unresponsive to the reform measures. The Sales and Service taxes have continued to be collected on mechanisms which, apart from being lax and open to abuse, do not grant full tax relief to inputs and therefore result in cascading of tax (i.e. tax on tax). The planned introduction of GST is necessary for full realisation of the benefits accruable to the economy from the tax reform initiative which is an essential policy support for the long-term growth objectives of Government, not only because the tax system is the source of revenue for financing public expenditure, but also because it affects the structure of incentives that defines the direction and pattern of investment in the economy.

## **2.5 Improved Competitiveness of domestic firms**

Although long-term revenue mobilisation is an important objective in the drive to introduce GST, efficiency of production and realignment of incentive structure for promotion of balanced growth are equally important items on the GST agenda.

The input credit mechanism of GST achieves complete relief of consumption tax on intermediate inputs and enhances efficiency of production for GST registered businesses. The input tax deferment facility currently operative under Sales Tax is confined to manufacturers, to the exclusion of service providers who also charge tax on their sales. Additionally, the suspension of input tax for Sales Tax registered manufacturers applies to direct inputs, leaving the tax on indirect inputs (e.g. office stationery, etc.) feed into the cost of production on which the Sales Tax is currently levied. This results in tax on tax (i.e. cascading or pyramiding of tax) which is eliminated under GST/VAT.

The role of GST as a policy thrust for the promotion of accelerated growth, economic stability and enhanced productivity is as important as, and inextricably linked to, the long-term benefit of increased revenue flow. In the light of the important economic benefits of cost efficiency of domestic firms, revenue collection efficiency, the removal of investment bias and enhanced competitiveness of local firms that flow from the introduction of GST, it is imperative that the necessary legislative processes be expedited to put Sierra Leone on a firm course to joining the ranks of the over 120 countries currently operating GST/VAT.