Bullion

Volume 37
Number 2 *Vol. 37 No. 2 - Vol. 38, April 2013 - March 2014*

Article 3

3-2014

Tax harmonization in the West African Monetary Zone: issues and challenges

Emmanuel Ating Onwioduokit
University of Uyo, Akwa Ibom

Follow this and additional works at: https://dc.cbn.gov.ng/bullion

Part of the Accounting Commons, Economics Commons, and the Taxation Commons

Recommended Citation

Onwioduokit, E. A. (2014). Tax harmonization in the West African Monetary Zone: issues and challenges. CBN Bullion, 37(2) - 38(1), 30-42.

This Article is brought to you for free and open access by CBN Institutional Repository. It has been accepted for inclusion in Bullion by an authorized editor of CBN Institutional Repository. For more information, please contact dc@cbn.gov.ng.

TAX HARMONIZATION IN THE WEST AFRICAN MONETARY ZONE: ISSUES AND CHALLENGES

EMMANUEL A. ONWIODUOKIT, PH.D[8]
Department of Economics
University of Uyo
Akwa Ibom State, Nigeria

Abstract

Monetary Union such as the one pursued by the West African Monetary Zone member countries requires the harmonization of not just the monetary policies across the countries of the Zone, but also the coordination of fiscal policies. There are several economic reasons for harmonising taxes among member states in a monetary union. The differences in direct taxes lead to: - inefficient allocàtion of capital due to tax consideration. This paper explored the theoretical underpinnings for tax harmonization in a monetary union and critically perused the existing tax system in the WAMZ countries and found considerable differences in the applicable tax rates across the countries in the Zone. The paper found that tax and proposes that tax harmonisation should be the goal for all aspects of Member States' tax systems and concluded that a high degree of harmonisation is necessary in the field of indirect taxes; as such taxes may create an immediate obstacle to the free movement of goods and the free supply of services within the Internal Market.

JEL Classification: H20, H23, H30, O19, P16

Keywords: Tax harmonization, Monetary Union, WAMZ

INTRODUCTION

A tax system comprises constitutional and legal elements on the various types of taxes, the tax bases, the tax rates and the administrative machinery. Monetary Union requires the harmonization of not just the monetary policies across the countries of the Zone, but also the coordination of fiscal policies. The nexus between monetary and fiscal policies is clearly identified in the literature (see Robson, 1998). Fiscal policies have implications for monetary management, especially in a monetary union. To this end, it is essential for the Finance Ministers to be thoroughly equipped with up-to-date information on the tax systems and laws that exist in the member countries. This is expected to provide the needed guide to policy harmonization.

Harmonisation of tax policy in the West African Monetary Zone has until recent not been given due consideration. Nevertheless, for effective operation of a monetary union certain level of tax harmonisation is inevitable. Member states have to close up to find a solution otherwise the 'real' benefit of the union will remain a mirage. In response to the internal and external challenges, tax policy is expected to support the continued success and development of the internal market and strike the right balance between cutting taxes, investing in public services and sustaining fiscal consolidation. These objectives cannot of course be sought in isolation. They must be consistent with the development of the zone and directly serve the interests of citizens and business wishing to take advantage of the benefits brought about by the union.

There are several economic reasons for harmonising taxes among member states in a monetary union. The differences in direct taxes lead to: - inefficient allocation of capital due to tax consideration. In an ideal monetary union there should be no tax considerations in the course of making decisions about the allocation of investment capital. Tax advantages can supplant other advantages in a certain location like lower production costs, and thus investment capital will be misallocated at the

[8]Emmanuel Onwioduokit is Associate Professor of Economics, University of Uyo, Nigeria. Views expressed are personal to the author.

expense of economic efficiency. Distortion of competition between undertakings from different member states due to different tax burdens. Competition should be as undisturbed as possible in a monetary union. Different tax burdens in different member states, however, severely interfere with equal conditions for all undertakings, including cross border double taxation due to different tax systems. Different systems of integration of corporate and personal income taxes among the member states may lead to double taxation where the shareholder is subject to full income taxation in his country of residence. Tax policy must therefore focus on the removal of tax obstacles which hinder these. Their removal will reduce costs, generate real efficiency gains and make a substantial contribution towards improving the competitiveness of Zone business.

With the expected advent of a monetary union in the WAMZ, differences in national tax systems would become increasingly evident and likely to have a growing influence on economic decisions by individuals and enterprises. Thus, the need for some level of harmonisation of the tax policy in the zone in the build up to the union becomes crucial. On the external front, the increasing globalisation of economies is also an important consideration. There is now greater competition for investment. Improvements in communication and transport, and above all the rise of the Internet, are creating new opportunities but also posing complex challenges for taxation systems. It is becoming easier to evade tax by moving mobile capital to low tax jurisdictions or tax havens.

A key question is what degree of harmonisation is appropriate? Although there is no need for an across the board harmonisation, as such approach would be an over-simplification of the issues, a high degree of harmonisation is certainly necessary in the field of indirect taxes, as such taxes can create an immediate obstacle to the free movement of goods and the free supply of services within the internal market. On the other hand, direct tax systems require only limited harmonisation. There is, for example, no compelling need to harmonise personal income taxes unless they entail discrimination or double taxation. Such taxes can generally be left to the Member States even when the Zone achieves a higher level of integration than at present. But there is an intermediate zone of direct taxation of mobile tax bases, in particular the taxation of companies and the taxation of capital, where the situation is less clear-cut and which may have direct effects on the internal market. In this area, the idea of increased co-ordination among member states becomes critical. There is convergence in the literature (Robson, 1998) that co-operation against harmful tax competition is desirable.

Economic policy harmonisation is a key tool in creating a single market in furtherance of a single economic space. It involves harmonisation of the rules for product standards, competition and legal frameworks across the Zone. This is to enable companies' trade as freely as possible within the Single Market. There are various forms or degrees of harmonisation depending on the extent to which harmonisation has been attained. Thus, there is 'full' harmonisation which requires national governments to implement identical standards in product design and taxation. On the other hand, 'partial' harmonisation implies a level of common ground achieved through minimum legal requirements or through incomplete implementation of the harmonisation programme.

Taxation is central to national sovereignty, as governments cannot implement any meaningful policy without revenue, which is largely derived from tax. It is an instrument of economic regulation which can be used to influence consumption, encourage saving or shape the way in which companies are organised. Tax policy is essential to all member states in a monetary union, and a country's actions can have an impact not only at home but also in other countries in the Union. In the monetary union where single market is the goal, member states need to work together and not strike out in different directions on tax policy.

In order to establish the internal market, the system of consumption taxes should be as neutral as possible. Where tax rebates on exports of goods from one member state to another were higher than the amounts actually paid they acted as export subsidies. In the envisaged WAMZ Zone, once the internal market becomes a reality and consumers are finally able to purchase goods in any member state and freely transport same to home country without hindrances at the borders, differences in tax rates on various goods would tend to divert business; and the resultant skewing of production and distribution can have wider social repercussions as well.

There are three main reasons for harmonising taxation among member states of an economic grouping. Differences in taxes could lead to inefficient allocation of capital, distortion of competition and double taxation across borders (Onwioduokit, 2002). In an ideal common market there should be no tax considerations in the process of making decisions about the allocation of investment capital. Tax advantages can supplant other advantages in a certain location like lower production costs, and thus investment capital will be misallocated at the

expense of economic efficiency. Distortion of competition may occur through undertakings from different member states due to different tax burdens. Competition should be as unobstructed as possible in a common market. Different tax burdens in different member states, however, severely interfere with equal conditions for all undertakings. Cross border double taxation may also occur due to different tax systems. Different systems of integration of corporate and personal income taxes among the member states may lead to double taxation where the shareholder is subject to full income taxation in his country of residence. The preparation towards a monetary union would require the pursuit of a single economic space, especially a custom union. Tax harmonisation is a critical element of a single market agenda.

In the light of the above the WAMZ's Authorities recently identified a compelling need to study the tax policy harmonisation in the WAMZ as the date to the monetary union draws close. The main objective of this paper is to review the existing tax system/laws in the WAMZ member states in order to identify the required adjustments that will move the countries asymptotically towards convergence. The paper also seeks to bring to the fore the issues as well as the challenges that tax policy harmonisation in the Zone entails. The rest of the paper is arranged thus, Part II dwells on theoretical issues, Part III contains a brief comparative analysis of the tax systems in the WAMZ countries and Part IV dwells on options and challenges, while Part V contains the summary, recommendation and conclusions.

2.0 THEORETICAL ISSUES

2.1 Rationale for Fiscal Policy Harmonization

The impetus for fiscal policy harmonization comes from the link between fiscal deficit, exchange rate and the external sector. The latter two in particular are the channels through which a country is linked with the rest of the world. Establishing such link is essential for successful regional integration. Since major macroeconomic balances in general and the fiscal posture in particular has a direct bearing on the external sector, its harmonization is imperative for effective regional integration efforts. As noted by Goldstein (1994), national policy actions can have quantitatively significant spill over effects, or externalities which need to be factored into decision-making process to reach global optimum. This can best be achieved by the use of macro policy harmonization. Put differently, the justification for fiscal policy harmonization is premised on the fact that some developmental objectives can best be handled by centralized (or coordinated) organs than individual countries. This is because they might have externalities or there could be the possibilities of exploiting scaled economies. As the experience in EU shows, fiscal policy harmonization at the level of Regional Economic Corporations (Monetary union) could focus on correcting distortions or exploiting externalities that cannot be corrected or exploited by national fiscal policies. Externalities such as tax competitions as well as issues where REC level of social returns exceed that at the national level are cases in point. The latter two factors were the main impetus behind fiscal policy harmonization in EU (Masson, 2000).

Another motivation for fiscal policy harmonization could be gleaned from its link with monetary policy. Masson and Pattillo (2001) after reviewing the experience of monetary union in West Africa noted that, instead of trying to meet a very short deadline for monetary union, the countries of the region need to focus on convergence on low inflation, sustainable fiscal policies and structural policies necessary for strong growth. They noted that, if the role of France in the monetary union of West Africa is not taken on board, the need for fiscal policy harmonization will be much more critical. For instance, pursuing open trade policy requires harmonization of exchange rate. The latter is linked, among other things, to inflation differential. One of the instruments to harmonize inflation differential is fiscal policy harmonization.

Another rationale for fiscal policy harmonization comes from the 'optimum currency area' literature that is usually discussed in the context of a monetary union, which is one of the major objectives of regional integration schemes. In this context fiscal policy harmonization is imperative because it is one of the important preconditions (apart from wage flexibility and labour mobility) for optimum currency area formulation (De Grauwe 1994).

The EU experience underscores the coordination of fiscal policy through the multilateral surveillance as adumbrated in the Maastricht Treaty, expressed in the Stability and Growth Pact. However, Canginao and Mottu (1998) argued that such EMU policy framework is closer to that of a federal than a pure monetary union, given that there is no central fiscal authority; it relies on coordination of fiscal policies. The important question is whether there is anything that monetary union can draw from the theory and experience of fiscal federalism.

The standard fiscal federalism theory concludes that two of the three basic functions of fiscal policy (i.e. Redistribution and stabilization) should be conducted at the central level. The third function (allocation) can be assigned to different levels of government. In practice, however, in existing federations all three are largely carried out by

the central governments (Canginao and Mottu 1998, Oates 1999). The question is what is the basis for allocating functions between central and local authorities in fiscal federalism context? And can we use that across countries in regional integration context. The EU experience shows that the answer to this is in the affirmative. This is handled by the so called `subsidiarity' principle[9] of the Maastricht Treaty. Thus, taking the three basic functions of fiscal policy, allocative efficiency in EU is largely pursed at the EU level (through establishment of single market, removal of fiscal frontiers, recognition and harmonization of standards, norms and procedures, harmonization of indirect taxes, etc.) while redistribution and stabilization functions are largely left to individual countries (Canginao and Mottu, 1998). Regional Economic Union can design their macro policy coordination efforts in general and fiscal policy harmonization in particular by drawing from this European experience, which basically adopted one of the principles of fiscal federalism.

Another element of the principle of fiscal federalism and subsidiarity is the question of tax harmonization. With increasing integration, and in particular with common currency or harmonized exchange rate regimes, tax competition is likely to increase. Canginao and Mottu (1998) advanced two reasons that could account for the increase to include: tax inclusive prices would become more transparent and; with the loss of monetary and exchange rate instruments, the role of tax policy in attracting business and enhancing competitiveness would become prominent. The latter in particular was the trend in many of African countries following trade liberalization policies. This tendency could entail severe fiscal imbalance. Moreover, divergence in tax system in the context of a regional integration scheme could have differentiated growth implication across member states (Frenkel and Razin, 1996). In his contribution to the subject (Oates 1999) argued that, there should be an attempt to refrain from harmful tax practices so as to avoid a `rush to the bottom' of the tax system which would prevent government from sustaining desirable tax policies and financing necessary expenditures.

Government budgets are responsible for the functions of resource allocation, income redistribution and economic stabilisation. As a consequence, much of the debate on the need of fiscal integration orbits around the question of whether these functions should be provided by national or by supranational authorities. In the past, most crucial decisions in the shaping of integration, especially in Europe were taken by political, rather than by economic motives. Although there are no reasons to believe that the decision making process will be substantially changed in the near future, it is important to ascertain if the rationale for or against fiscal integration can be established in terms of economic efficiency. In Robson (1998), theoretical assessments of the appropriate level of responsibility over fiscal instruments essentially consist of analysing the three budgetary functions in the light of three criteria: the existence of significant cross-border spill overs of economies of scale and of political homogeneity.

In the EU, and in most other market economies, the allocation function of domestic budgets is mainly directed to the supply of public goods such as defence, health and education, which are usually responsible for the majority of public expenses. Defence activities generate important externalities and economies of scale could be exploited by a provision at the EU level. On the contrary, in relation to health and education, not only are the spill overs less important, but there also appears to be a lack of homogeneity in preferences across member states, thus suggesting that responsibility over these issues should remain national.

The distribution function contributes to the spatial harmonisation of incomes and to the elimination of economic disparities. It is particularly important in regions prevented from using some macroeconomic instruments, as is the case of members of a monetary union. In fact, the absence of redistribution mechanisms may expose monetary unions to social, political and economic tensions that may become intolerable over an extended period of time. Theoretical underpinnings suggest that this function should be performed at the higher tiers of government, which in the case of the WAMZ, would be at the supra national level. However, in the absence of a common budget, the transfers necessary to assure an efficient distribution functions would have to be provided by the richer countries. Such a situation, if prolonged, is also unsustainable as it is not easily defensible upon those countries' public opinion and is therefore prone to political exploitation. As a result, the distribution function should be implemented mainly in the context of the regional policy.

The existence of considerable externalities deriving from

[9]The principle states that `in areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member states and can, therefore, by reason of the scale or effect to the proposed action, be better achieve by the Community' (Article 3b of the Treaty of EU quoted by Canginao and Mottu 1998).

domestic fiscal policy actions is one of the most cited arguments for the centralisation of fiscal policies in a context of integration. Another justification relates to the benefits of sharing the risks of random symmetric shocks (Good hart and Smith, 1993). Indeed, if such disturbances occur, member states may lack the incentive to take the appropriate measures, as part of their effort will be reflected in their partners' economies, thus reducing the effectiveness of national fiscal procedures. In such circumstances a more acceptable response would result from a centralised fiscal policy.

This analysis produces arguments that are mostly in favour of a centralisation of fiscal policies in a context of economic integration. Moreover, such conclusion is reinforced in the particular case of monetary integration given that, in such context, the instruments available to provide economic adjustment and stabilisation following specific disturbances are rare while the externalities of domestic policy measures increased. It has been argued for instance that in the EU even in cases of evident of externalities, scale economies and political homogeneity, fiscal policy centralisation could only be considered as a solution only if the alternative hypotheses of policy co-ordination or policy harmonisation that were not envisaged (in the subsidiarity principle in the Maastricht Treaty) fail. This was the case despite the fact that economic theory suggests that policy co-ordination or harmonisation are valid strategies only when the monitoring by involved parties is possible, otherwise non-compliance could be the rational option, thus making the decision to centralise the most appropriate one.

Contrary to the above proposition by the mainstream theory, Alesina, Angeloni and Etro (2001) model an integrated group of countries and concluded that there appears to be a bias towards centralisation in small size unions, and vice-versa. The authors uncover a trade-off between the advantages of co-ordinating economic policies and the costs of lost autonomy, and deduced that such trade off defines the nature and the dimension of unions. They averred that an already large union such as the EU, with potential for further enlargement in the near future, would tend to be less (rather than more) centralised, thus reducing to a minimum the number of policies whose responsibility are to be transferred to a supranational level.

If a decision to form a monetary union in a cluster of economically integrated, but heterogeneous, economies is not accompanied by a centralisation of fiscal policies, the need for an independent use of domestic fiscal instruments is enhanced. However, a high degree of fiscal autonomy in a scenario of monetary integration poses a number of problems. It is therefore important to assess latitude of governments in the management of fiscal policies in response to domestic needs and how the different interests may be harmonised in order to achieve the desirable results.

Until the 1970s, it was believed that fiscal and monetary policies could be used to attain short and medium term objectives, such as the promotion of economic growth and the management of aggregate demand. While fiscal policy was considered to be the main responsible for the control of demand, monetary policy was directed to the promotion of growth and employment and, if necessary, also to the support of fiscal policy, for instance via the monetary financing of deficits. It was assumed that this could be done without significant costs in terms of inflation and monetary stability.

The reality suggested however that, this paradigm was probably not correct and new theories have since emerged. The new approaches takes into account the processes of private expectations' formation, and the objectives of political agents indicated that instead of short-term discretionary strategies, directed to the macroeconomic fine tuning, the focus should be on the establishment of rules. These should be capable of providing long-term stability, via a consistent operation of monetary and fiscal policies, thus supplying an anchor for private expectations. Since the common monetary policy in a monetary union is devoted to the maintenance of price stability, domestic authorities have fewer incentives to take into account the inflationary impacts of national policies, and also the consequences that such policies may have in terms of global financial stability and external equilibrium. However, Hoeller, Giorno and Maisonneuve (2002), have argued that economic problems that may occur in the monetary union, the latter will have little or no effect on the whole union area and thus will not provoke a reaction on the part of the monetary authority.

Von Hagen and Mundschenk (2002) developed a macroeconomic model that demonstrated that the need to co-ordinate monetary and fiscal policies in a monetary union exists only in the short run. In the long run, these policies are independent and conflicts arise solely in short run. Such conflicts may also occur among independent fiscal authorities, particularly and whenever fiscal impulses are not costly, even if they pursue common economic objectives. It is also suggested that, in the assumption of central bank's inflexibility in relation to the objective of maintaining price stability, co-ordination between fiscal policies is necessary to avoid excessive deficits. On the other

hand, if the monetary authority decides to be less rigid at first, the final model equilibrium involves higher interest rates and larger deficits than in the case of central bank's inflexibility.

The authors claimed that if the monetary union is firmly devoted to the objective of price stability, the best common outcome would be obtained if member states co-ordinate domestic fiscal policies. However, instead of co-ordination, the option might be to restrict domestic fiscal autonomy by means of the constraints imposed upon public deficits and debts. The penalties that restrictions might inflict on the non-compliant members strengthen the need to make obligation of making fiscal impulses costly.

Uhlig (2002) identified political incentives not to impose such penalties for the fear of disrupting 'friendly political relationships'. The author therefore defended that the decision to penalise one country should not result from a discretionary decision, but instead be a consequence of a well-established automatic rules.

The integration of financial markets requires both the absence of obstacles to the free flow of capital across borders and the perfect substitutability of assets issued in different political jurisdictions. A number of empirical analyses reveal the existence of high levels of integration among core financial markets, even before the establishment of a monetary union, but also exposes many deficiencies in terms of capital mobility and assets' substitutability (Lemen, 1998).

An assessment of financial integration between Portugal and Spain developed by Vieira (2000) showed that each of the two peripheral countries shares stronger links with Germany than with each other, in spite of the more intense economic relationships between the two. This study involves empirical tests performed with data on short-term assets only. It is nevertheless important to mention that, when the interest of the analysis is on the assessment of financial markets as mechanisms of economic adjustment and stabilisation, the focus should also be on long-term capital. In effect, if short term financial flows are capable of providing immediate relief following a shock, it is long term capital that permits the structural. However, as the empirical literature suggests, signs of financial integration are always stronger in analyses performed with short-term data. Evidence of integration at the longer maturities was not found when it was not previously obtained for the short end of the maturity spectrum.

Empiricism suggests that financial markets can be relied upon to the end of stabilisation and adjustment precisely in areas where such a mechanism is in theory less necessary (Vieira 2000). Given that a higher level of economic integration exists among core countries, these are in principle less prone to the occurrence of asymmetric disturbances. Peripheral regions, on the other hand, may be more in need of using financial markets as alternative mechanisms of adjustment, but they will probably find it more difficult to obtain the funds to recover their economies following a shock. In such conditions, and in spite of the strong limitations imposed upon them, fiscal instruments will probably also have to be used to help recovery. It is therefore essential that fiscal policies are sustainable for this is a condition to effectively use fiscal instruments to this end.

2.2 Approaches to Tax Harmonisation

The theory identifies three basic approaches to tax harmonisation in common markets: The real harmonisation or equalisation approach, the differentials or co-ordination approach and the competitive approach. Under the Equalisation Approach, tax policy is passed from national to community level. The member states agree to a single taxation system and to single rates or a range of tax rates. The main advantage of this approach is the abolition of all market distortion and maximum efficiency in capital allocation. However, the handing over of the tax policy to the community is hardly reconcilable with the sovereignty of the member states since tax legislation is traditionally seen as a national matter.

The Differentials or Co-ordination Approach is based on the thesis that the tax system of each country functions as an instrument of policy for attaining major economic objectives. Therefore, different tax systems in the member states should be kept with the maximum welfare of the union as the sum of the members' welfare. Inter-community effects of the different tax systems like cross-border double taxation should be eliminated by co-ordination among the member states. The advantage is that the tax policy is left to the member states rather than being imposed by the community. Additionally, the approach recognizes the different economic and social circumstances in each member state which justify different tax systems. The differentials approach explicitly accepts tax differences among the member states and subsequently is contradictory to the economic analysis of the impact of direct taxation differences among member states. This is because it is based on the doubtful thesis that the welfare of the community is the sum of the member states' welfares. Under this presumption, social and economic circumstances in the respective member states have to be considered not only for taxation, but rather for all aspects of the common market. This, however, is contradictory to the whole idea of

the genuine internal market. Moreover, the necessary co-ordination among member states in order to eliminate the cross-border effects of different tax systems may be much more difficult than harmonising all the tax systems.

The competitive approach assumes that imposed tax harmonisation is not necessary since under a single market competition among member states intended to attract investment capital that will lead in the long term to an approximation of direct taxation. This has the great advantage of not interfering with national sovereignty but rather leaving tax policy to the member states. There are, however, a number of counter arguments against this approach. It takes a very long time for taxes to be approximated. Tax policy of the member states is not only determined by the attraction of investment capital. Social policy as well as the revenues consideration plays a significant role in tax levy. Furthermore, the competition approach presupposes absolute mobility of capital and zero transfer costs. This is, however, only (practically) true for mere money investment like buying shares or giving credit. All other assets face more or less immobility and subsequently a certain amount of transfer costs. On the other hand and in the absence of a minimum level for tax rates, tax competition would likely drive direct taxes to a very low level and due to the high mobility of money, capital income taxes may probably even be driven to zero. Corporate tax rates might reach such a low level that the incentive to shield income from personal taxation through incorporation would be unacceptably large.

3.0 OVERVIEW OF TAX SYSTEM IN THE WAMZ

This segment contains a brief overview of the various tax systems in the WAMZ member countries.

3.1 Taxes on Income and Profits

The WAMZ countries have more or less the same structure of taxation. The countries have introduced several Acts amending the previous income tax system in the last one decade, with a view to improving the tax system. These reforms notwithstanding, the current tax policies have several weaknesses. Although the definition of income is comprehensive, multiple rates apply, depending on the source of income. The top marginal rate under individual income tax is lower than the standard business income rate. The tax system gives the government significant power to grant exemptions, resulting in some proliferations of exemptions. Although most countries' tax incentives are targeted at promoting preferred sectors, their effectiveness in achieving the stated objectives has not been meaningfully achieved. However, there are currently marginal differences especially in companies and corporation tax among the Member States. Firstly, a number of different tax systems are in force. They can be divided into three major systems: under the classical system, retained earnings and distributed profits are taxed at the same tax rate and the latter are subject to full personal income tax at the shareholder level. This discriminates against distributed profits, because they are taxed twice. Nevertheless, The Gambia and Guinea operate this system, while Nigeria and Ghana run a full or partial imputation system where all or a part of the corporate tax is credited to the shareholder when he is taxed for personal income. Sierra Leone operates a split rate system, where distributed profits are taxed at a lower level than retained earnings.

While in The Gambia, loses are deductible but in Nigeria, loses may be carried forward against future profits for as long as four years. In Sierra Leone however, the loss could be carried forward indefinitely while in Ghana taxes excludes dividends from other companies which are taxed at a fixed rate of 10.0 per cent. But in other WAMZ countries such distinction are not made. The tax rate on companies and corporations is 35.0 per cent of net profit or 2.0 per cent of turnover in The Gambia. In Ghana for instance, and in addition to the basic rate of 32.5 per cent, segregated rates range between 30.0 per cent for companies listed on the Ghana Stock Exchange and 8.0 per cent for non-traditional exports companies. In Guinea, a flat rate of 35.0 per cent is applicable, lower rates are however obtainable on special arrangement. The basic rate in Nigeria is 30.0 per cent. However a concessionary rate of 20.0 per cent is applicable in the manufacturing sector. The basic rate of company income tax in Sierra Leone is 35.0 per cent.

3.2 Taxes on Individuals

Prior to reforms, the main problem with the personal income tax (on wages and salary and self-employment) in the WAMZ countries was the low level of compliance, resulting from weaknesses in the tax assessment and collection machinery. Personal income tax reforms deal with the tax threshold and tax bands, which are in most cases eroded by inflation. The issue of equity for low income tax payers was particularly emphasized.

In all the WAMZ countries, efforts were made to provide serious relief to workers who suffer too heavy a burden from PAYE (pay-as-you-earn). The income tax rates vary from country to country. For example, in The Gambia, the highest rate of income tax is 35.0 per cent, while the tax on the average income level was still 21.0 per cent. The progressive rate of the individual income tax varies between 10.0 per cent and 35.0 per cent according to the tax bracket. There is only one standard deductible of D7, 500

(US$267.86). The minimum taxable income is D7, 501 (US$267.89) and the highest rate apply to the income of D47, 500 (US$1696.43) However, official salaries and emoluments of the president are not taxed. For Ghana, this tax is payable, subject to the deductible and exemptions. Deductibles include married person's allowance of C300, 000 (US$33.33), dependence and contribution to social security are deductible. The non-taxable threshold of C1, 200,000.00 (US$133.33) is applied. Although the rate is progressive, income tax rate extends from 5.0 per cent to 30.0 per cent thus putting the tax on average income level of 16.0 per cent. In Guinea, the tax is levied on total net income of individuals residing or having their primary occupation in the country. Income amounting to less than GF100, 000.00 (US$27.26) is not taxed. Progressive scale of income brackets is - 10.0 per cent to 35.0 per cent for income between GF100, 000 (US$27.26) and GF20.00 million (US$5452.56); a uniform rate of 40.0 per cent applies to incomes in excess of GF20.00 million (US$5452.56). However the tax on the average income level was still 26.3 per cent.

Nigeria's personal income tax is charged on the income earned by any person resident in Nigeria. For resident individuals, taxable income includes both domestically and foreign sourced income. Non-residents are liable to tax on income sourced in Nigeria. Only the personal allowance is available to non-residents. Individual income is taxable at rates graduated from 5.0 per cent up to 25.0 per cent. The taxable threshold income in Nigeria is N30, 000.00 (US$227.27). The top tax bracket starts at annual incomes of N160, 000.00 (US$1212.12). Tax allowances are provided for all individual taxpayers. There is provision for deductions and allowances for unmarried child, dependent relatives, disable persons and alimony. The average tax on income is 15.0 per cent. In Sierra Leone, the tax is imposed on net income defined as difference between gross income and deductions as permitted by law. Benefits in kind are included in income for the purpose of calculating personal income tax. The minimum taxable income level is Le 2,000,000 (US$693.83) while the highest taxable income bracket is Le 7,500,000 (US$2601.85). The tax rate ranging from 20.0 per cent and 35.0 per cent is progressively applied. The average tax rate on personal income is 27.5 per cent. There are no special personal and family allowances or relief, neither are there any allowances for insurance premiums.

3.3 Taxes on Goods and Services

All WAMZ countries, except The Gambia and Sierra Leone have progressively converted their Sales Tax into standardized or generalized VAT, because, it is believed that converting to VAT will make indirect taxation more effective, more buoyant, more equitable and less distortionary. The introduction of VAT has been a centrepiece of successful tax reform programmes throughout the WAMZ countries because it generates a large and stable flow of revenue with minimal of economic distortions. However, VAT is also more complicated to administer than the sales tax in the sense that, it is a broad-based sales tax applying to each stage of production, processing and distribution. In other words, it is a "multi-stage general sales tax", which is collected in small doses as a product moves towards its final market.

In Ghana, VAT is levied on value-added, using the invoice method. VAT is levied on domestic sales and imports, with deductions for VAT paid on inputs to production. VAT paid on inputs to exports is reimbursed. Threshold of ¢200 (US$0.02) million per year is applied. Excess credits carried forward for 3 months after which at the taxpayers' option, can be refunded. Exemptions and Deductions: Zero rated: Export of taxable goods and services. Other exemptions include: Food stuffs produced in Ghana and sold in their raw state (e.g., rice, millet, cassava, yam, guinea corn, plantain, vegetables, fruits, nuts, coffee, cocoa, shea butter, maize, sorghum, and meat). The traditional forms of smoking, drying, frying and cooling does not affect the expression "raw state"; Agricultural and fishing inputs specific in the law; Industrial and mining equipment; newspapers and books (not paper used in producing these items exempt); petroleum, diesel and kerosene; medical, dental, and hospital services, other than veterinary services; essential drugs approved by the Ministry of Health; educational and training services approved by the Ministry of Education; domestic use of electricity; supply of water (excluding bottled water; transportation services; rental property; construction services. The applicable rate is 15.0 per cent, including the National Health Insurance Scheme tax of 2.5 per cent.

Value added tax (VAT) in Guinea is levied on producers, importers, exporters, and providers of services liable to tax. It is based on gross revenue. Exempted from VAT are sales of revenue stamps, newspapers, rice, flour, wheat, bread, edible oils, pharmaceutical products, fertilizers and phytosanitary products, books and school books. Traders with annual turnover of less than GF 150 million (US$40,894.22), and less than GF 60 million (US$16357.69) in annual sales, are exempted except by choice. The applicable rate are: exports and international transport (0.0 per cent) and 18.0 percent for taxable operations. VAT replaces the sales tax in Nigeria and covers all items not on the exclusion list which became effective on January 1, 1994. Exempted items

include the following goods: medical and pharmaceutical products; basic food items – beans, yam tubers, cassava, maize, millet, rice, milk, meat, fish, and infant food; books and educational materials, including exercise books, laboratory equipment, school fees, PTA levies, etc.; baby products, including feeding bottles, carriages, clothes, napkins, baby cream and powder, soap, toys, and baby dresses; and agricultural equipment and products, fertilizer, and veterinary medicine.

The following services are exempted: medical services; services by community banks, peoples' banks, mortgage institutions; and plays or performances conducted by educational institutions as part of learning. Educational goods and services incidental to education for an educational institution are also exempted. The tax carries a flat rate of 5.0 percent; however, exports are zero rated.

As noted earlier, in The Gambia and Sierra Leone, where VAT is not yet operational, sales tax is in place. Sales tax in The Gambia is imposed on the sale price of all goods manufactured or imported and on services such as hotel accommodations, telecommunications, insurance, air services, restaurants and bars, cinematographs, night clubs and casinos, and gambling houses. Exemptions and Deductions include; (a) Educational, technical, cultural, and religious institutions; (b) food and drinks not imported or industrially processed; (c) feeds for animals; (d) semi-finished products to produce (b) and (c); (e) medicines; (f) production equipment, excluding office equipment, motor vehicles, and electric generators; (g) butane gas and gas cookers; (h) school textbooks; (i) imported day-old chicks; and (j) packaging and freight for exports. The applicable rates are: imports (10.0 percent); domestic manufacturing and services (15.0 per cent); telecommunication services (18 percent). In Sierra Leone, however, sales tax is levied on the ex-factory price of domestic manufactures and C.I.F. price of imports plus duties (excise and import).Building materials and fabricated structures which are not excisable are included in the sales tax base. An embryonic value-added tax to provide rebates of payments of sales tax on inputs was introduced effective July 1993. Exemptions apply on goods manufactured in Sierra Leone that are shipped as stores for consumption outside of Sierra Leone and goods exported by the manufacturer. The rate of 17.50 percent is applied.

3.4 Taxes on International Trade and Transactions

In The Gambia, taxes are levied on value of imported goods to be declared on customs entries. Normally for goods imported under a contract of sale negotiated in fully open market conditions, the value is represented by the price made under that contract, adjusted as necessary to a. c.i.f. basis. Items are identified by the Harmonized Commodity Description and Coding System identifies items. If there is no invoice, the value is the price that the goods would fetch on sale in the open market in The Gambia, including freight, insurance, commission, and all other costs up to the port or place of importation. A levy of sales tax on the total earnings of lawyers was introduced effective August 1998. General exemptions include goods in transit; goods for use as aircraft's or ship's stores; advertising material having no commercial value such as: mosquito-proof gauze and netting; personal effects; certain goods imported by, or on behalf of, the government, privileged persons (within prescribed limits), and institutions, and certain goods (building materials, plant and machinery) purchased by the holders of development certificates during their tax holiday period.

For all goods, there is one unified tariff rate irrespective of country of origin, ranging from 0 percent to 18 percent. Generally, luxury goods are charged an excise tax in addition to the maximum duty rate. These commodities include liquor, cigarettes, and vehicles. Excise taxes (revenue tax) are charged at D50 (US$1.79)/kg net for cigarettes, D25 (US$0.89)/litre for beer, D50 (US$1.79)/litre for wine or spirits, D5 (US$0.18)/litre for mineral water, soft drinks and canned fruit, and 5 percent of the c.i.f. value for vehicles. As at the end-2003, these taxes were not levied on domestic goods. An environmental tax is charged on non-manufactured tobacco at D13.02 (US$0.47) /kg and at D1, 000 (US$35.71) for used motor vehicles. Duties on fuel are calculated according to a formula agreed with the oil companies based on specific duty rates. The National Water and Electricity Company pays 18.0 percent of the normal duty rate on importation of petroleum products. Customs processing fees are charged at 1.55 percent of c.i.f. and ECOWAS duty at 0.50 percent of c.i.f.

In Ghana, Duties are levied on most imported goods, generally as ad valorem taxes on the c.i.f. value, but for some goods the rates are specific. Exemptions are granted for special purposes. Most imports of World Bank projects, the Volta Aluminium Company Ltd. (VALCO), Volta River Authority, diplomats, and certain welfare organizations are also exempted. Other duty free items are: agricultural machinery and tractors; bank notes and coins; crude oil; educational material; newsprint; postage stamps; and veterinary drugs. Additional exempted items are: items imported for purpose of exhibition at trade fairs; advertising materials; aircraft parts; passengers' baggage and

effects not for resale; jute bags imported by COCOBOD; agrochemicals; and foodstuff of West African origin. Ghana maintains a column tariff based on the Harmonized System. There are four ad valorem rates: 0.0 percent, 5.0 percent, 10.0 percent, and 25.0 percent. Cocoa export tax is levied on the f.o.b. price received by the Cocoa Marketing Board for all cocoa exported from Ghana. The cocoa export tax is a 100.0 percent duty on all proceeds received from cocoa exports after paying producers' costs and COCOBOD's marketing and other costs.

International tax in Guinea is basically based on c.i.f. value of goods. Imports of butane gas and agricultural tools and materials are exempted. 25.0 percent reduction for students' personal effects. FRIGUIA's imported fuel, oil and other imported raw materials are exempted. CBG's imports are subject to a flat rate of 5.6 percent (in lieu of the DFE and DDE). Medicines are exempt if imported by approved wholesalers; or taxed at reduced rates. The applicable rate is 7.0 percent, except for office machines, refrigerators, freezers; computers, exercise books and school materials, and new motor vehicles are taxed at 2.0 percent. 6.0 percent for companies qualifying for exemption clauses under the Investment Code. Fiscal import duties are also levied on c.i.f. value of goods at the rate of 8.0 percent. However 6.0 percent applies for goods taxed at a DDE of 2.0 percent. Consumption surcharge is levied on luxury items or some goods that are also locally produced. The rate varies between 5.0 per cent and 50.0 per cent as follows: beer and alcoholic beverages (50.0 percent); flour and wines (25.0 percent); soft drinks, games and leather products (20.0 percent); video recorders, electrophones, mineral water (10.0 percent). Used vehicles over 5 years of age (10.0 percent); paints and plastic tubes (5.0 percent); vegetable oils (8.0 percent).

In Nigeria however, international tax is imposed on merchandise imports. Exemptions only include the following: aircraft equipment used by foreign airlines; films of educational, scientific, or cultural character imported by the United Nations or its agencies or an approved educational or scientific organization; fuel, lubricants, etc., used exclusively for operation of military equipment or aircraft; government imports by internationally recognized nonprofit organizations or by the Head of State, consular offices, or under diplomatic privilege, or for other technical assistance purposes; and life-saving appliances. A new tariff structure which includes a narrower and lower range of customs duty rates became effective in March 1995. The dispersion in import duty rates was reduced from 0-300 percent to 5-100 percent, with most rates clustering between 10.0 percent and 40.0 percent, compared with the previous structure of 25.0-75.0 percent. Raw materials (5.0-25.0 per cent); Components (5.0-50.0 per cent); Clothing (55.0 per cent); Luxury consumer goods ,except automobiles (30.0-50.0 per cent); Paper products (10.0-45.0 per cent); Vehicles (5.0-50.0 per cent); Soya meal, soya cake, and groundnut cake (35.0 per cent); Refined petroleum products (10.0 per cent); Wheat (60.0 per cent). With effect from January 1, 1987, an advanced payment of 25.0 percent of the assessed duty is required. With effect from January 1, 1999, the 25.0 percent export duty rebate was abolished.

Import surcharges are a tax on merchandise imports. Exemptions include the following: aircraft equipment used by foreign airlines; films of educational, scientific, or cultural character imported by the United Nations or its agencies or an approved educational or scientific organization; fuel, lubricants, etc., used exclusively for operation of military equipment or aircraft; government imports by internationally recognized nonprofit organizations or by the Head of State, consular offices, or under diplomatic privilege, or for other technical assistance purposes; and life-saving appliances. Three import duty surcharges apply: 5.0 percent port development surcharge; 1.0 percent Raw materials and Development Council surcharge; and 0.02 percent freight rate stabilization surcharge earmarked for the Nigerian Shippers' Council.

Specific and ad valorem customs duties are imposed on all goods imported into Sierra Leone for home consumption as specified in the tariff. Rates are ad valorem except specific duties imposed on tobacco, beer, and spirits. General exemptions are listed in the second schedule of the External Tariff Order. Goods originating in member states of the Mano River Union (MRU) and approved by the MRU Secretariat are exempt from payment of customs duties. Drawback of customs duties is allowed on goods exported up to 95.0 percent of the customs duty paid. Also exempt are direct government and other public sector imports, and those of certain international organizations, diplomatic representatives, and certain West African institutions. Ad valorem rates predominate and fall into the following categories: 5.0 percent on most food items, raw materials, agricultural machinery and spare parts; 5.0 percent on petroleum products; 15.0 percent on rice and baby food; 5.0 percent on most consumer durable items and electrical appliances; 40.0 percent on luxury consumer goods including large cars, cameras, leather apparel, carpets, garments, films and jewellery. As at 12/08/2003, new duty rates included: Cars less than 5 years old, 5 .0 per cent; Cars more than 5 years old but not more than 10

years old, 10.0 per cent; and Cars more than 10 years old 30.0 per cent.

An ad valorem tax is imposed on all goods imported into Sierra Leone for home consumption that are specified in the External Tariff as being liable. An ad valorem rate is imposed on the C.I.F. value plus any customs duty paid. Any imported good is exempt from the excise duty which is not listed in the schedule to the Excise Act. No excise duty is charged on tobacco and petroleum products; however, the duty rate of 30.0 per cent applies.

4.0 DIFFERENCES AND CHALLENGES TO TAX HARMONISATION IN THE WAMZ

4.1 Differences

A critical perusal of the existing tax system in the WAMZ countries clearly reveals that there are somewhat considerable differences especially in the applicable tax rates across the countries in the Zone. In The Gambia, the companies and corporations tax rate is fixed at 35.0 per cent of net profit or 2.0 per cent of turnover. In Ghana the applicable rate is 32.5 per cent, however reduced rates exist for investment in the preferred sectors of the economy. The tax rate on this sub head is 35.0 per cent in Guinea. In Nigeria the rate is 30.0 per cent, but a concessionary rate of 20.0 per cent is applicable to investment in the manufacturing sector. The basic rate in Sierra Leone is 35.0 per cent. Thus the The Gambia, Guinea and Sierra Leone maintained the highest rate of 35.0 per cent, followed by Ghana at 32.5 per cent. Nigeria has the lowest rate of 30.0 per cent.

There is also a serious disconnect in the tax rates on personal incomes across the countries. The minimum taxable incomes and the rate highest taxable income differ from country to country. For instance the non-taxable incomes for the WAMZ countries are: US$267.86 (The Gambia); US$133.33 (Ghana); US$27.26 (Guinea); US$277.27 (Nigeria); and US$346.9 (Sierra Leone). A more revealing difference could be gleaned from the differential in the applicable minimum and maximum tax rates. While an income of US$5452.56 attracts a tax rate of 35.0 per cent in The Gambia, the respective rates for the same income in other WAMZ countries are as follows; Ghana (30.0 per cent); Guinea (35.0per cent); Nigeria (25.0 per cent); and Sierra Leone (35.0 per cent), This further indicates that companies' income tax for example in both Nigeria and Ghana have the lowest individual income tax rates in the Zone, while the other three countries' rates seems to have converged upward.

The same tax pattern is maintained in taxes on goods and services. In the three countries (Ghana, Guinea and Nigeria) where value added tax operates: Ghana (17.5 per cent), Guinea (18.0 per cent) and Nigeria (5.0 per cent). Adopting the sales tax rates as a proxy for the equivalent rates for The Gambia and Sierra Leone would be: The Gambia (about 14.3); and Sierra Leone (17.5 per cent).

With respect to taxes on international trade, the rates also differ. The range is as follows: The Gambia (0.0-18.0 per cent); Ghana (0.0, - 20.0 per cent); Guinea (2.0 -50.0 per cent); Nigeria (2.5 -150.0 per cent) and Sierra Leone (5.0-40.0 per cent).

4.2 Challenges

4.2.1 Companies and Corporations Taxes

Apart from the differences in tax system and rate among the Member States, there are other obstacles to harmonisation of companies and corporations tax in the WAMZ. Currently, there are country specific taxes and for example, in Nigeria and Ghana, education tax exist which does not exist in other countries. Under the harmonisation of taxes and those are to be abolished or otherwise there will remain an undesired distortion of competition and inefficient capital allocation. The problem becomes even worse in Nigeria because, there are other taxes charged at sub-national government levels, and is thus one of the main sources of revenue for local communities. Moreover, the revenues of local communities in Nigeria are protected by unchangeable stipulations of the constitution.

Another problem will be the choice of one single tax system. While the classical system seems to produce the fewest difficulties, the implementation of a credit system would raise the problem of cross-border crediting, which would lead to considerable fiscal problems. For all these reasons, harmonisation of companies and corporations taxation poses a very big challenge to the Zone.

4.2.2 Taxes on interest income

There are two principal ways of solving the problems arising from different interest income taxation among the member states. One is a comprehensive control system like in Nigeria, where the bank informs the fiscal authorities about interest payments made to the customer. Thus, the revenue is taxed together with personal income tax in the country of residence. However, most other countries do not operate this system. Another solution is a single withholding tax levied at the source of interest payment. This, however, has some shortcomings as well. A withholding tax, like every source of based tax would drive capital out of the WAMZ. This was shown graphically when Germany tried to introduce a withholding tax on interest payments, but had to withdraw the measure after a short time as it resulted into a large capital flight

to other countries. Moreover, a cross-border credit system would be necessary that withholding tax would have to be credited at personal income tax level. This would lead states with international banking centres to bear the burden of tax levy without really having revenues. It is thus not desirable to attempt any harmonisation of this tax.

There is only one tax that is desirable to be harmonised in a monetary union that has single economic space objective, and that is the external tariff. It is gratifying to note that the WAMZ countries are already committed to Common External Tariff under the ECOWAS programme.

5.0 Conclusions

Owing to its multiple tasks, tax policy is always a disputed issue which usually generates a lot of discussion. It is closely linked to the development of the environment in which the economic activities take place. On face value, one might say the obvious answer is to harmonise the tax systems of the Member States, however, tax harmonisation should be the goal for all aspects of Member States' tax systems. A high degree of harmonisation is certainly necessary in the field of indirect taxes; as such taxes may create an immediate obstacle to the free movement of goods and the free supply of services within the Internal Market.

On the other hand, direct tax systems require only limited harmonisation. There is, for example, no need to harmonise personal income taxes unless they entail discrimination, double taxation or unintended non-taxation. Such taxes can generally be left to Member States even when the Zone achieves a higher level of integration. But there is an intermediate zone of direct taxation of mobile tax bases and in particular, the taxation of companies and the taxation of financial capital, where the situation is less clear-cut and which may have direct effects on the Internal Market. In this area, the literature is conclusively more favourable to the idea of increased co-ordination. However, it also stressed certain aspects of taxes such as company income tax rates that may not need to be harmonised.

Tax competition may encourage Member States to streamline their public expenditure as well as oblige governments to offer the best possible services at the lowest possible price. But, tax competition can become harmful if it undermines Member States' capacity to finance essential public services. It is possible for enterprises and individuals to arrange their affairs so as to benefit from low-tax jurisdictions for taxation purposes and high tax jurisdictions for the purposes of receiving public services. This so-called "free-riding" leads to a situation where in the end; all countries are left worse off. The way to get around this problem is by promoting a co-ordination of Member State tax policies – by encouraging and facilitating co-operation.

Selected References

Alesina, A., I. Angeloni and F. Etro. 2001. 'The political economy of international unions', *NBER Working Paper* 8645.

Cangiano, M. and E. Mottu. 1998. `Will Fiscal Policy be Effective Under EMU' *IMF Working Paper, Working Paper /98/176*, IMF, Washington, D.C.

De Gauwe, P. 1994. The Economics of Monetary Integration. Oxford: *Oxford University Press.*

Frenkel J.A. and A. Razin .1996. Fiscal Policies and Growth in the World Economy. Cambridge, MA: The MIT Press.

Goldstein, M. 1994. `Improving Economic Policy Coordination: Evaluating some new and some not-so-new Proposals' in P.B. Kenen, Francesco Papadia, Fabrizio Saccomanni (eds.). *The International Monetary System*. Cambridge, MA: Cambridge University. Press.

Goodhart, C. and S. Smith .1993. 'Stabilisation' *European Economy*, (5); June

Hagen, J. and S. Mundschenk. 2002. Fiscal and monetary policy coordination in EMU, *Oesterreichische Nationalbank Working Paper 70.*

Hoeller, P., C. Giorno, and C. Maisonneuve .2002. 'Overheating in small euro area economies: should fiscal policy react?' *OECD Economics Department Working Paper 323.*

Masson, P. and C. Pattilo .2001. `Monetary Union in West Africa: An Agency of Restraint for Fiscal Policies? *IMF Working Paper, WP/01/34*, IMF, Washington, D.C.

Masson, P. 2001. `Fiscal Policy and Growth in the Context of European Integration' *IMF Working Paper, Working Paper /00/133, IMF*, Washington, D.C.

Oates, E. 1999. `An Essay on Fiscal Federalism', *Journal of Economic Literature*, XXXVII (September)

Robson, P. 1998. *The economics of international integration*, Routledge, 4th Ed.

Uhlig, H. 2002 'one money, but many fiscal policies in Europe: what are the consequences? *CEPR Discussion Paper Series, 3296.*

Tanzi, V. and Howell H. Zee (1998) `Consequence of the Economic and Monetary Union for the Coordination of Tax Systems in the European Union: Lessons from the US Experience', *IMF Working Paper, WP/98/115*, IMF, Washington, D.C.

Vieira, I. 2000. 'How financially integrated are Portugal and Spain? Evidence from CIP and UIP, *Portuguese Review of Financial Markets, 3 (2), 33-47.*