# 4 Sierra Leone

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## I. Introduction

### A) Geography, Population, Culture and Religions of Sierra Leone

Sierra Leone is a small country in the west of Africa, and has a total land area of about 27,699 square miles (71,740 $km^2$). The country is bordered by Liberia on southeast and Guinea on the northwest. Sierra Leone became a British Crown Colony in 1787 and regained its independence on the 27th April 1961. The country's official language is English and Freetown is the capital. There are twenty-three (23) recorded Africa languages spoken in Sierra Leone and the country has four (4) provinces including Western Area and twelve (12) districts. The temperature of Sierra Leone averages between 24ºC and 33ºC, and the country has two seasons, dry and rainy. The dry season starts October to April and the rainy season is between May and September.

The estimated population of Sierra Leone is 5.08 million people with annual average growth rate of 2.6 percent. Sierra Leone's population comprises of 20 percent indigenous African ethnic groups who make up 90 percent of the population. These include Mende, Temne, Limba, Creole, and other ethnic groups. Mendes, Temne and Limba are the major ethnic groups in the country. The Creoles are descendants of freed slaves from Great Britain and the West Indies who were resettled in Freetown in the late 18th Century.

Approximately, 37 percent of Sierra Leone's population lives in the capital, Freetown and 63 percent in rural areas. Now, because of the 10-year civil war, a large percentage of people have migrated to the capital city. As reconstruction activities continued in the provinces a good number have began returning to their respective homes.

Reliable data on the exact number of those who practice major religion are not available. However, most sources estimate that the population is 60 percent Muslim, 30 percent Christian and 10 percent practitioners of traditional indigenous religions. Report shows that, many syncretistic practices exist, with up to 20 percent of the population practicing a mixture of Islam and traditional indigenous religions or Christianity and traditional indigenous religions. Meanwhile, the Sierra Leone constitution provides for freedom of religion, and the Government generally respects this right in practice. There is no state religion.

Per capita income is estimated at $230 in 2000 and Sierra Leone is classified as least developed by the United Nations Development Index Survey. Over two-thirds of the population live in absolute poverty.

### B) History, Political Structure and Administrative Division

European contacts with Sierra Leone were among the first in West Africa, and Sierra Leone was one of the first West African British Colonies. Foreign settlement did not occur until 1787, when the British prepared a refuge within the British Empire for freed slaves. In 1787, the site of Freetown (capital of Sierra Leone) received 400 freedmen from Great Britain. Diseases and hostility from the indigenous people nearly eliminated the first group of returnees. Thousands of slaves were returned to Africa. Most choose to remain in Sierra Leone. These returned Africans, or Creoles as they came to be called were from all areas of Africa. Cut off from their homes and traditions by the experience of slavery, they assimilated British styles of life and built flourishing houses on the West Africa Coast. In the early 19th century, Freetown served as the residence of the British Governor who also ruled the Gold Coast (now Ghana) and the Gambia settlements. The colonial history of Sierra Leone was not placid. The indigenous people mounted several unsuccessful revolts against British rule and Creole domination. Most of the 20th century history of the colony was peaceful and independence was achieved without violence.

Local ministerial responsibility was introduced in 1953, when the Chief Minister was appointed. The Chief Minister became Prime Minister after successful completion of constitutional talks in London in 1960. Independence came in April 1961, and Sierra Leone opted for a parliamentary system within the British Commonwealth. Sierra Leone's political system has been dominated by one party, since independence, with supreme power vested in the Presidency. A new constitution in 1991, introduced a multi-party system, which calls for a more decentralized form of government with elected constituency members of Parliament. The legal system is based on British Civil Law system, with a common law influence. There are three arms of power, namely the Executive, the Legislature, and the Judiciary. The executive power is held by the President, who is elected for a 5-year term, with re-election possible but limited to a second 5-year term. The President is both the chief of state and head of government. Cabinet Ministers are appointed by the President with the approval of the House of Representative (Parliament). Legislative power rests with a unicameral House of Representatives, which consists of 80 seats: 68 elected by universal adult suffrage, and a Paramount Chief from each of the 12 Districts. (c) The Judicial arm comprises a Supreme Court which Judges are appointed by the President.

**C) The Sierra Leone Police and Republic of Sierra Leone Army Forces**

The Sierra Leone Police (SLP) is responsible for the internal security of Sierra Leone, while the RSLAF defends Sierra Leone's borders against external aggressors. The police are unarmed (with the exception of the operational support division) and rely on the building relations with local communities for intelligence gathering. The three core functions of Sierra Leone police are: 1) public security, 2) crime prevention, and 3) joint patrols with United Nations Mission in Sierra Leone (UNAMSIL) presently operating in Sierra Leone to maintain sustainable peace and order following the country's ten-year civil conflict.

**D) Education**

The British established the first African University (Fourah Bay College- University of Sierra Leone) in Sierra Leone in 1827, rapidly became a magnet for English-speaking Africans on the West Coast, and Grammar School for boys, Annie Walsh Memory School for girls were the first secondary schools established in 1845 and 1847 respectively by the British. The formal educational system is organized at four stages - Pre-primary, Primary, Secondary, and Tertiary stages. English is the official language at all stages of instruction. Sierra Leone served as the educational centre of British West Africa.

**E) Principal Resources**

The main cash crops are rice, cassava, citrus fruits, coffee, cocoa, sorghum, groundnuts, oil palms, piassava, and sweet potatoes. The main industrial sectors include diamond production, gold mining, iron ore, bauxite, rutile, cigarettes, and footwear. The country is also rich in fisheries and good potential for raising yield of agricultural products. Agriculture employs most of the population in low productivity and labour-intensive farming. Coffee, cocoa, piassava, and fish are the major agricultural exports. The mining sector accounts for about 10 percent of Gross Domestic Product (GDP) and is the most important source of foreign exchange earnings. Services account for about 40 percent of GDP.

**F) Infrastructure**

Domestic flights operate between the main centres i.e. Freetown, Makeni, Bo and Kenema. There is an international airport at Freetown-Lungi. Main roads are difficult to travel, especially during the rainy season. There was railway during the Colonial period but as the country gained independent this facility was stopped due to mismanagement.

**G) Sierra Leone Postal Services Limited (SALPOST)**

The company is charged with the responsibility of operating postal services efficiently, commercially and profitably. There are no plans to undertake any major restructuring exercise. However, enterprise reforms are required to continuously adapt the organizational and operational structures to the commercial functioning of the postal services. The scope of postal monopoly has been clearly defined. Following the liberalization of the economy generally and the transport and communications sector in particular, private courier companies operate in the domestic and international services. The absence of the legal scope and limits on competition vis-à-vis postal monopoly makes it difficult to monitor the activities of the private operators.

The Board of Directors of SALPOST is empowered to determine the scope of postal services in the country. The Board of Directors is responsible for fixing postal rates. Certain rates, especially on inland postage rates, are set lower than the cost price on the reason that basic postal services are part of essential social services, which must be affordable to the majority of the population. However, no corresponding compensatory measures for the company do exist.

SALPOST is required to operate commercially and profitably. The revenues generated are for self-financing. Losses are made good through subsidies from the Government who is a sole owner of the company. The company may also borrow from banks or other financial institutions. The company has a postal savings bank open to the general public, particularly the low-income earners. SALPOST recorded a profit during the 1994 financial year. Postal services have had a profitable trend over the past years. The company defines its own human resources policy including rationalization of labour to meet its operational and commercial requirements. The salary scales and remuneration levels are comparable with those in similar sectors though they tend to be somewhat low. The financial stability of the company remains the dominant factor in determining the levels of salaries and other remuneration systems.

**H) Currency**

The currency used in Sierra Leone is the Leone (SLL). A hundred cents is equivalent to a Leone. However, the Leone is not highly internationally convertible. The exchange between the Leone and other foreign currency is freely determined by the demand and supply of foreign currency.

# II. An Overview of Macroeconomic Activity and Fiscal Position

## 2.1 INTRODUCTION

The year 2002 marked a major milestone on the road to peace and political reconciliation in post-conflict Sierra Leone. The disarmament and demobilization of ex-combatants were ended at the beginning of the year, allowing for the process of their reintegration to begin, and facilitating the extension of government authority across the country. At the same time, elections were held in May, leading to the formation of a new government and the inauguration of a new parliament. These developments were followed by the return of internally displaced persons and refugees to their homes.

The increasing optimism and confidence generated by the above developments gave a boost to economic activity and improved the environment in which the government's poverty reduction and growth policies are being implemented.

Economic activity continued to rebound in 2002, reinforced by the recovery of activity in the agricultural sector, following the resettlement of the displaced population, and the expansion of reconstruction activity in the public and private sectors. Real gross domestic product (GDP) is estimated to have increased by 6.3 percent, while the annual average rate of inflation further declined to about -3 percent from 5 percent in 2001. The value of diamonds exported through official channels rose by 59 percent to US$42 million as a result of Diamond Export Certification Program (DECP).

Government revenue at Le238 billion (14.5 percent of GDP) slightly exceeded the program target. There was, however, a significant shortfall in program and project grants owing to the delay in the disbursement of budgetary aid in the case of program grants, and to the slower-than programmed implementation of projects in the case of project grants. Total expenditure and net lending amounted to 34 percent of GDP, well below the programmed level (40.7 percent of GDP), on account of slower-than-planned execution of capital and heavily- indebted Poor Countries (HIPC)-financed projects resulting from the introduction of community-based disbursement procedures and capacity constraints in implementing ministries. Overall current expenditure was significantly above the budget ceiling, due to higher-than-projected interest charges, and significant overruns on the wages as a result of higher-than-budgeted spending on the teachers' payroll, health workers pay, and statutory gratuities and allowances of parliamentarians. The overall deficit (excluding grants), at 20 percent of GDP, was substantially lower than programmed (26.3 percent).

Apart from the overall shortfall in external budgetary assistance during 2002 as noted above, the disbursement of budgetary aid that was received was concentrated during the fourth quarter of the fiscal year, rather than spread out evenly as envisaged under the program. Consequently, government's recourse to domestic financing was much higher-than programmed during the second and third quarters.

Following a steep depreciation in 2001, the Leone appreciated slightly against the US dollar during 2002. At the same time, the real effective exchange rate depreciated significantly. The spread between the official and parallel market exchange rates also remained steady in the range of 5-8 percent.

## 2.2 Macroeconomic Activity

In line with the government's interim poverty reduction strategy, the focus of government policies during the initial phase of the government poverty reduction strategy (2001-02) was on addressing the country's immediate post-war problems, including consolidating peace and security, ensuring the needs of the displaced population and war victims, improving service delivery, and maintaining macroeconomic stability. During the next three years, while these activities will be continued, the strategy will be shifting to focus on poverty reduction and long-term development issues. A full description of the new strategy and related policy objectives are to be spelt out in the full PRSP, which is to be issued by the end of 2003. In the meantime, the government established a National Recovery Committee intended to facilitate the restoration of civil authority throughout the country and to restore structures that will ensure a smooth transition from recovery to development. The 2003 program targets a real GDP growth rate of about 6.5 percent, supported mainly by the assumed buoyant recovery of the agricultural sector, the substantial increase in reconstruction and investment activities, and the continued rebound in service sectors. The program targets an average annual increase in consumer prices (CPI) of about 7 percent, and the maintenance of gross external reserves of the Bank of Sierra Leone (BSL) at about 2.2 months of import cover as shown in table 1.

**Table 1: Sierra Leone Selected Economic and Financial Indictors, 2000 – 2004**

| | 2000 | 2001 | 2002 | 2003 Prog | 2004 Proj. |
|---|---|---|---|---|---|
| **Income and expenditure** | | | | | |
| Real GDP | 3.8 | 5.4 | 6.3 | 6.5 | 6.8 |
| GDP Deflator | 6.1 | 6.1 | 3.9 | 6.4 | 4.8 |
| Nominal GDP | 10.2 | 11.8 | 10.5 | 13.4 | 11.9 |
| Consumer prices (end period) | -2.7 | 3.4 | -1.0 | 7.2 | 3.5 |
| Consumer prices (annual average) | -0.9 | 2.2 | -3.1 | 7.4 | 3.5 |
| Money and Credit | | | | | |
| Broad Money | | | | | |
| (including foreign currency deposits) | 9.7 | 33.7 | 28.0 | 14.0 | 14.1 |
| (excluding foreign currency deposits) | 7.7 | 30.8 | 29.5 | 14.0 | 13.6 |
| Velocity(level; excl. foreign currency deposits) | 7.1 | 6.1 | 5.2 | 5.2 | 5.1 |
| Velocity(level; incl. foreign currency deposits) | 6.1 | 5.1 | 4.4 | 4.4 | 4.3 |
| Domestic credit 1/ | -11.8 | 22.5 | 5.7 | 8.0 | 14.7 |
| Government 1/ | -13.6 | 19.4 | -1.9 | 7.3 | 8.1 |
| Private sector 1/ | 1.5 | 3.2 | 7.5 | 3.0 | 3.1 |
| (annual percentage change) | 12.1 | 24.6 | 62.3 | 19.8 | 19.2 |
| Reserve money | 9.2 | 29.4 | 24.9 | 11.3 | 11.5 |
| Interest rate 2/ | 20.0 | 14.7 | 15.0 | 14.0 | 13.0 |
| External sector | | | | | |
| Exports (U.S. dollars) | 22.3 | 2.8 | 34.8 | 8.7 | 34.5 |
| Imports (U.S. dollars) 3/ | 100.3 | 19.5 | 39.1 | 34.3 | 4.8 |
| Terms of trade (- deterioration) | -3.3 | 1.5 | 0.0 | -2.2 | 3.2 |
| Real effective exchange rate (- depreciation; end of period) | 32.1 | -15.8 | -10 | … | … |
| | | | (In percent of GDP) | | |
| Gross domestic expenditure | 116.1 | 117.2 | 122.6 | 130.8 | 124.6 |
| Gross domestic consumption | 108.1 | 111.2 | 112.6 | 111 | 105.1 |
| Government | 14.3 | 17.2 | 19.6 | 19.0 | 19.1 |
| Private | 93.8 | 94.0 | 93.0 | 92.0 | 86.0 |
| Gross domestic investment | 8.0 | 6.1 | 10.0 | 19.8 | 19.5 |
| Government | 5.2 | 4.8 | 5.2 | 12.6 | 13.9 |
| Private | 2.8 | 1.3 | 4.7 | 7.2 | 5.6 |
| Gross national saving | -1.8 | -2.8 | -0.1 | 4.6 | 5.8 |
| Gross domestic saving | -8.1 | -11.2 | -12.6 | -11.0 | -5.1 |
| Government | -2.9 | -3.2 | -5.1 | -4.4 | -3.8 |
| Private | -5.2 | -8.0 | -7.5 | -6.6 | -1.3 |
| Current account balance, including official transfers | -9.8 | -8.9 | -10.1 | -15.2 | -13.7 |
| Current account balance, excluding official transfers | -18.1 | -19.2 | -25.6 | -33.6 | -27.8 |
| Goods and nonfactor services (net) | -16.1 | -17.2 | -22.6 | -30.8 | -24.6 |
| Unrequited private transfers and factor services (net) | -2 | -2.0 | -3.0 | -2.8 | -3.2 |
| Overall balance of payments | 0.4 | 3.1 | 2.9 | 1.2 | 0.5 |
| Government revenue | 11.4 | 14.0 | 14.5 | 14.6 | 15.3 |
| Total expenditure and net lending | 28.7 | 29.8 | 34.2 | 39.9 | 39.5 |
| *Of which* : current expenditure | 22.7 | 24.9 | 28.9 | 27.2 | 25.3 |
| Overall fiscal balance | | | | | |
| (commitment basis, excluding grants) | -17.3 | -15.8 | -19.7 | -25.3 | -24.2 |
| (commitment basis, including grants) | -9.3 | -10.7 | -9.9 | -9.4 | -9.3 |
| Domestic primary fiscal balance 4/ | -5.5 | -5.4 | -7.4 | -6.6 | -6.7 |
| Domestic financing | 0.1 | 3.5 | 1.1 | 2.8 | 2.9 |
| External debt 5/ | 190.8 | 155.1 | 156.2 | 146.0 | 108.7 |
| | | | (In millions of U.S dollars, unless otherwise indicated) | | |
| **Memorandum items:** | | | | | |
| External current account balance, excluding official transfers | -115.0 | -143.8 | -200.3 | -294.1 | -268.9 |
| Gross international reserves | 49.6 | 51.9 | 84.6 | 87.0 | 100.0 |
| (in months of imports) 6/ | 1.7 | 0.0 | 2.2 | 2.2 | 2.4 |
| GDP (billions of Leones) | 1,330.3 | 1,487.7 | 1,643.3 | 1,863.0 | 2,085.0 |
| GDP | 634 | 749.0 | 783.6 | … | … |

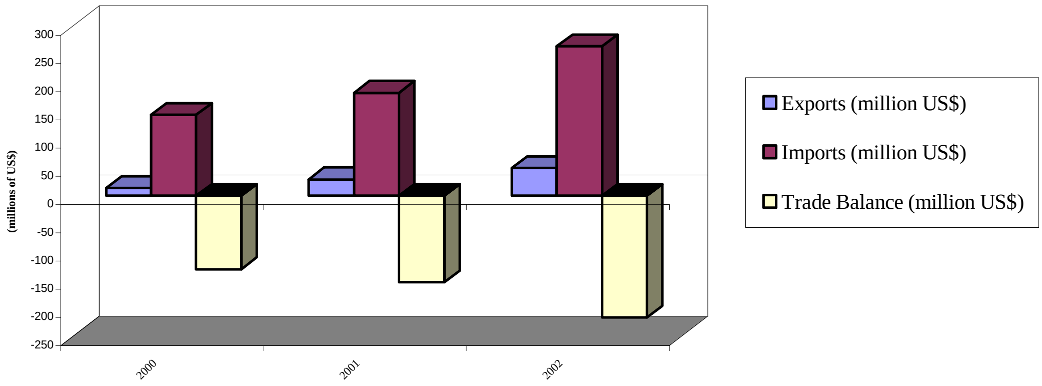
Sources: Sierra Leonean authorities; and staff estimates and projections.

### 2.2.1 International Environment

**A) Trade Balance and Current Account Balance**

The export sector continues to be depressed, apart from the substantial increase in diamonds exported through official channels. Agricultural exports picked up significantly, albeit from a very low level. Imports rose by 39 percent in US dollar value terms in line with the intensification of reconstruction activities.

**Figure1. Imports, Exports, and Trade Balance, 2000 - 2002**




Consequently, the external current account deficit (excluding official transfers) widened to 25.6 percent of GDP in 2002 (10 percent, including official transfers) from 19 percent in 2001 (see table 2). There was a significant increase (59 percent) in officially exported diamonds, thank to the diamond export certification scheme. In addition, a substantial tonnage of cocoa and coffee exports was registered.

The major imports are rice, which is the staple food, petroleum products, spare parts, and building materials. These developments contributed to the 35 percent increase in the U.S. dollar value of exports in 2002. The overall balance of payments recorded a small deficit of about US$3 million, compared with a small surplus registered in 2001 (See Figure 1 above).

**Table 2 Sierra Leone – External Trade and Payments, 2000 – 2002**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Merchandise Exports (million US$) | 13.4 | 28.9 | 48.7 |
| Merchandise Imports (million US$) | 143.3 | 182.2 | 264.3 |
| Trade Balance (in million US$) | -129.9 | -153.3 | -215.5 |
| Current Account Balance (US$M)(excl. official transfers) | -114.7 | -152.4 | -236.0 |

Source: Bank of Sierra Leone, Statistics Sierra Leone, and Ministry of Finance

**B) External Sector Policies**

The external current account deficit is projected to rise to about 34 percent of GDP in 2003, and to remain high over the medium-term. This high deficit reflects the large import requirements for the rehabilitation of rutile plants, and for reconstruction that is financed by a highly concessional program and project aid. The government is looking at various policy options for promoting export growth. For agricultural exports, a review is under way to find ways to revitalize cocoa and coffee production and export, including improving crop financing facilities, and increasing extension services. The draft report on the mining sector study is now being reviewed by stakeholders with a view to developing sector policies that would increase mining exploration and exploitation, while ensuring better living standards for mining communities and safeguarding the environment.

**C) The Foreign Exchange Market**

In 2002, a total amount of US$36.9 million was put on offer at the weekly foreign exchange auction held at the Bank of Sierra Leone. The total value of acceptable bids amounted to US$61.0

million. Hence, excess demand was about US$26.2 million. As a consequence, the clearing exchange rate and the auction weighted average exchange rate depreciated by 3.8 percent and 4.5 percent, respectively in 2002 from their 2001 levels (see table 3).

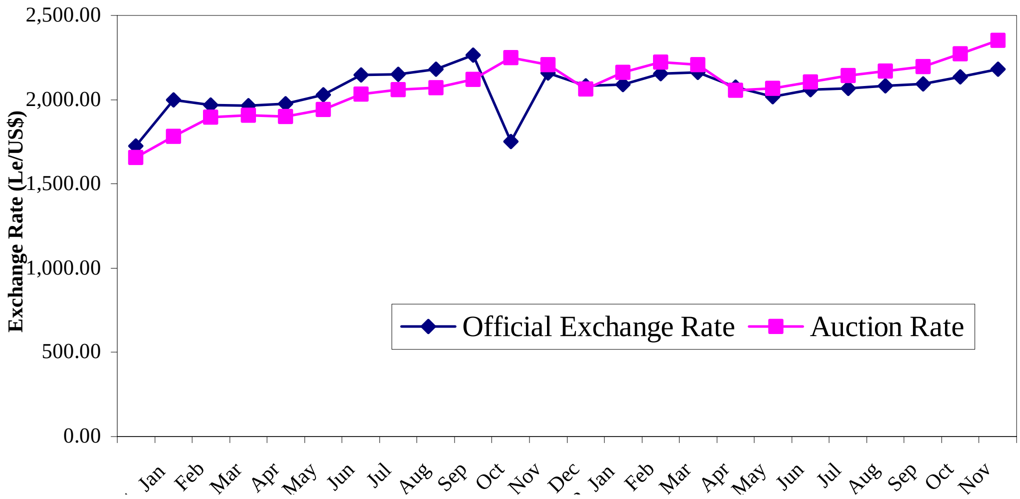
**Table 3. Sierra Leone – Exchange Rates and Gross External Reserves, 2000 – 2002**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Official Exchange Rate (period average, mid rate) | 2,097.9 | 1,985.3 | 2,098.4 |
| Official Exchange Rate (end period, mid rate) | 1,746.5 | 2,161.3 | 2,191.7 |
| Parallel Exchange Rate (period average, mid rate) | 2,312.6 | 2,169.3 | 2,265.5 |
| Parallel Exchange Rate (end period, mid rate) | 2,029.5 | 2,507.6 | 2,361.5 |
| Gross International Reserves (in million US$) | 49.6 | 51.9 | 84.1 |
| Gross International Reserves (in months of imports) 1/ | 2.1 | 1.8 | 2.2 |

Source: Bank of Sierra Leone
Note: 1/ In months of subsequent imports of goods and services.

During the year, the trend in the official exchange rate closely followed the auction rate. (See Figure 2 below). Despite increased demand for foreign exchange, the official exchange rate of the Leone to the US$ was relatively stable for the first three quarters of 2002. In the last quarter, the exchange rate depreciated by about 4.7 percent from its January 2002 level. This is mainly due to delays in donor disbursements, which together with the requirements to meet reserve levels depleted the funds available at the auction. The parallel market premium, which also remained relatively stable during most of the year, narrowed to 8.1 percent in December 2002 from 12.9 percent in January 2002.

**Figure 2. Trends in Exchange Rate (Le/US$), January 2001 - December 2002**




## D) External Debt

Sierra Leone's public and publicly guaranteed total external debt stock stood at about US$1.43 billion as at the end of December 2001. Multilateral and bilateral creditors accounted for 55 percent and 26 percent respectively while the residual balance of about 19 percent was owed to commercial creditors.

**Table 4. Sierra Leone – Public Debt and Debt Service, 2000 – 2002**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| Total External Debt (million US$) | 1,195.8 | 1,398.6 | 1,475.3 |
| Stock of Domestic Public Debt (Le m) | 232,663 | 288,478 | 347,481.0 |
| External Debt Service (million US$) | 37.0 | 87.81 | 41.82 |
| o/w Interest | 12.8 | 7.48 | 25.55 |

Source: Bank of Sierra Leone, and Ministry of Finance

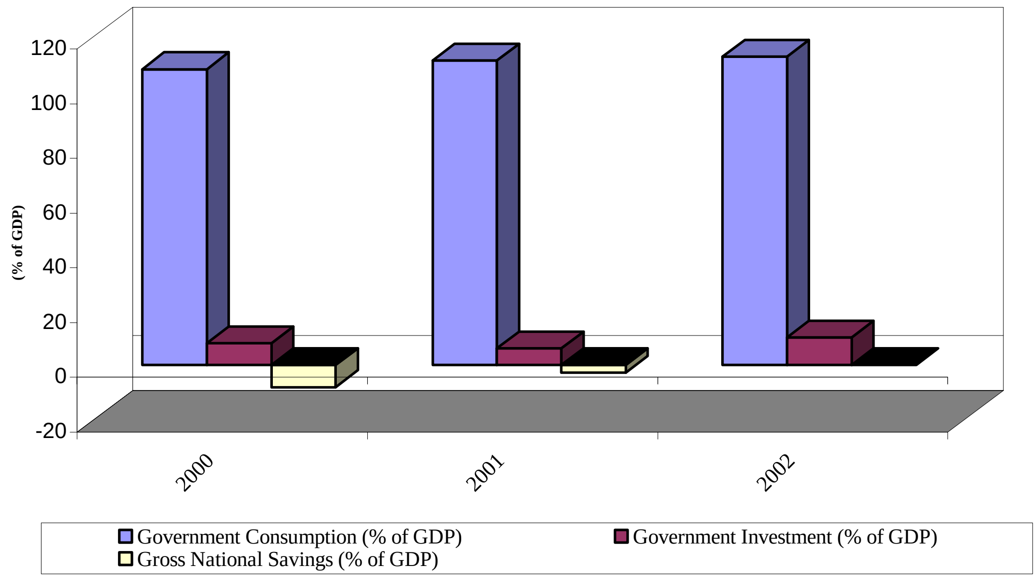
### 2.2.2 Domestic Environment

**A) Economic Growth and Inflation**

During the last three years, overall macroeconomic performance has significant improved. Real GDP growth has accelerated, albeit partly as a rebound from a period of protracted decline. The pattern of Government consumption, Investment and Gross National Savings is shown in Figure 3.

Inflation has remained negative for the period from January to December 2002, reflecting increased availability of imported consumer items, restraint in monetary expansion, and further reduction in import tariffs, large donor inflows and the relative stability of the exchange rate. The weekly foreign exchange auctions at the Bank of Sierra Leone also helped in reducing volatility in the exchange rate during the year (see table 5).

**Figure 3. Government Consumption, Government Investment and Gross National Savings, 2000 - 2002**




Source: Statistics Sierra Leone

**Table 5. Sierra Leone – Inflation Rates, 2000 – 2002**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| INFLATION (%) | | | |
| End Period (Yr-on-Yr) | -2.8 | 3.4 | -3.1 |
| 12 Month Average 1/ | -0.9 | 2.2 | -2.5 |
| 3 months on Annual Basis 2/ | 7.7 | -10.2 | -3.1 |

Source: Statistics Sierra Leone, and Ministry of Finance.

Notes: 1/ Calculated as the change in the average index for the latest 12 months over the preceding 12 months.
2/ The change in the average index for the latest 3 months over the preceding 3 months, annualized.

**B) Money Supply**

Broad money increased by 28 percent, reflecting increasing demand for money as a result of declining inflation, increased economic activity, and the opening up of areas previously controlled by rebels. Credit to the private sector rose by 62 percent, as the private sector continued to rebuild. Nevertheless, credit to the private sector remained a relatively small (14 percent) proportion of total commercial bank assets, which continued to be largely invested in government securities. The proportion of non-performing assets when compared to total bank assets continued to decline in 2002 to 24 percent from 29 percent in 2001. Real interest rates and interest spreads stayed at very high levels, with the former ranging between 22-25 percent, and the latter between 14–24 percent is shown in table 6.

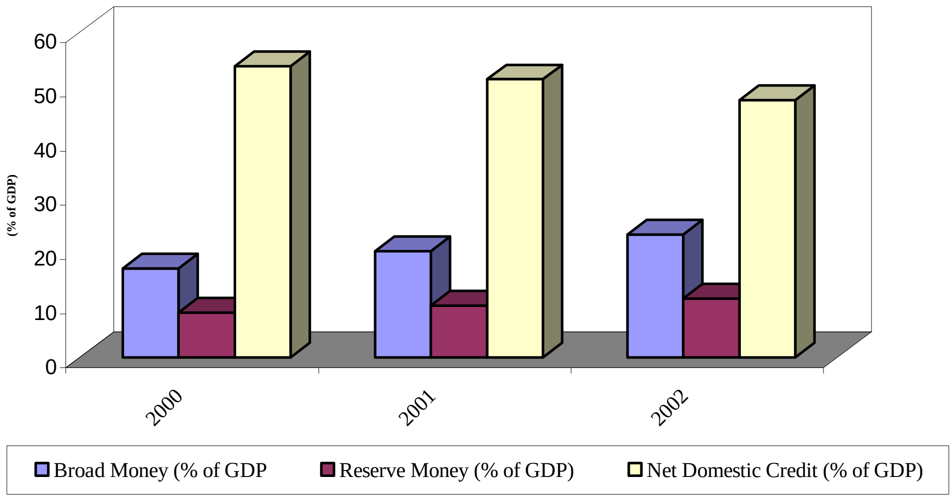
**Table 6. Sierra Leone – Money, Credit and Interest Rates, 2000 – 2002**

| | 2000 | 2001 | 2002 |
|---|---|---|---|
| MONEY & CREDIT | | | |
| Broad Money (million Le) | 217,605 | 290,864 | 372,311 |
| Reserve Money (million Le) | 109,843 | 142,103 | 177,441 |
| Net Domestic Credit (million Le) | 713,469 | 762,458 | 779,097 |
| o/w Credit to Government | 684,819 | 727,016 | 721,414 |
| Money Multiplier | 2.0 | 2.0 | 2.1 |
| INTEREST RATES (%) | | | |
| Commercial bank's prime rate (End period) | 35.0 | 34.7 | 32.0 |
| 3-month Deposit Rate (Period Average) | 8.8 | 7.7 | 8.2 |
| 12-month Deposit Rate (Period Average) | 11.5 | 10.1 | 11.1 |
| Treasury Bills (Effective yield)(Period Average) | 20.6 | 13.8 | 15.1 |
| Treasury Bearer Bonds (Effective yield)(Period Average) | 25.0 | 17.9 | 18.9 |

Source: Bank of Sierra Leone

Figure 4 depicts growth in Broad money, Reserve money and Net Domestic credit for the period 2000 -2002. The challenge for monetary policy in 2003 will be to sustain the low inflation rate attained during the last two years, in the context of rising public expenditures and the prospective draw down of accumulated government Heavily-Indebted Poor Countries (HIPC) deposits at the Bank of Sierra Leone (BSL). The BSL will aim to limit the growth of broad money at 14 percent through the control on the growth of its net domestic assets. The BSL also plans to maintain the level of its gross external reserves at about 2.2 months of import cover. Credit to the private sector is projected to rise by 20 percent in support of the continued growth in economic activity.

**Figure 4. Broad Money, Reserve Money and Net Domestic Credit, 2000 - 2002**




## C) Investment

The Government of Sierra Leone recognizes private investment to be the leading stimulus for economic growth. Accordingly, the legal framework regulating the activities and procedures are being revised, so that the granting of benefits, incentives and guarantees become largely automatic and transparent. Initial interest has been rekindled with the establishment of the Sierra Leone Export Development and Investment Corporation (SLEDIC) by Decree 23 of 1993, the Income Tax Amendment Act 1994, the Development of Tourism Act 1990, Mines and Mineral Decree 1998 and the Fisheries (Management and Development) Decree 1994. All of which are geared towards the provision of a favourable legal environment, with investment incentive packages for the growth of foreign direct investment.

The Government of Sierra Leone has outlined the nation's broad economic development strategies in the Presidential Speeches at the State Openings of Parliament, the Economic and Financial Policy Framework (1996/97) and other documents which place emphasis on the increased role of the private sector in the economy.

The major economic reforms implemented by Government include:

- Abolition of export and import licences;

- Rationalization and substantial reduction of import tariffs;
- Removal of restrictions on remittance of profits, dividends and expatriate earnings;
- Authorisation of residents and non-residents to open foreign currency accounts with the local banks;
- Provision for exporters to retain 100% of their export earnings in foreign currency rather than convert some part of it into Leones at the central bank as required by Laws of Sierra Leone.

These changes have enabled an active foreign exchange inter-bank market and foreign exchange bureaus to emerge as well as other financial services such as hedging and derivatives.

The present ongoing divestiture programme of the Government under the Public Enterprises Reform and Divestiture Commission (PERDIC) also underscores Sierra Leone's commitment to private sector initiatives and participation in the economic activity of the country. It aims at wider participation and raising revenue. Guidelines issued relate to transparency to win public confidence and provision for all investors to participate.

Accession to the General Agreement on Tariff and Trade/World Trade Organisation (GATT/WTO) membership means that trade policies would be more in line with its economic objectives and that practices would be harmonised with other countries of the world.

Sierra Leone is a member of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank, which provides non-commercial risks coverage for foreign investors in developing countries. The country has also entered into bilateral Investment Promotion and Protection Agreements with a number of countries to give further protection to their nationals wishing to invest in Sierra Lone, and it is anticipated that similar agreement will be negotiated in the future with other countries.

Sierra Leone now operates an open door economic policy for foreign investors and foreign capital is welcome. Guidelines provided by the Bank of Sierra Leone are geared towards the enhancement and promotion of foreign investment in all sectors of the economy.

The principles of transparency and non-discrimination would address problems of any existing trade policies deleterious to export-led growth and attraction of foreign investment. Published tariff schedules are simplified and not subject to administrative change or discretionary exceptions. The old practices of levying import duties on administered list prices has been replaced by the international norm of using invoice prices as the basis for valuation. The need to streamline broader formalities to reduce unnecessary cost of compliance and delay are being looked into.

## 2.3 FISCAL POSITION AND POLICIES

Fiscal policy will aim to maintain macroeconomic stability while enhancing revenue growth and increasing the effectiveness of public expenditures and systems to assure poverty reduction and accountability. Government domestic revenue is projected at 14.6 percent of GDP, while total expenditure is budgeted to rise to about 40 percent of GDP. The overall budget deficit (excluding grants), is programmed to widen to about 26 percent of GDP from 20 percent in 2002. Attaining these objectives would require the timely implementation of reforms to improve tax administration, strengthen the capacity of government ministries, departments and agencies, and improve delivery service. As the international community reduces its intervention in the securing of peace in Sierra Leone, the government will increasingly have to assume its responsibility in this area. The resulting pressure on the already stretched budgetary resources will require a more rigorous prioritization of government expenditures. Following significant reductions in import taxation during 2001-02, no major tax changes were included in the budget for 2003.

Expenditure policies for 2003 aim to tighten expenditure control, particularly on the wage bill, strengthen capacity for implementing poverty reduction expenditures, improve service delivery, and reinforce expenditure systems. In this direction, the government adopted measures in 2002 aimed at controlling the payroll of teachers. These measures led to a more realistic budgeting for teachers pay in the budget for 2003. For the 2003 budget year, the total number of teachers on the payroll was fixed at 25,000 or 11 percent higher than the estimated number of teachers in 2002. The government is convinced that the current budget ceiling on the number of teachers is adequate to avoid overruns on the 2003 teachers' payroll.

The Overall Fiscal Deficit, on a commitment basis and including grants, for 2003 is projected at 14.1 percent of GDP. On a cash basis and including grants, the deficit is projected at 8.4 percent of

GDP in 2003. For 2004 and 2005, the overall deficit on a commitment basis and including grants is projected at 11.5 and 11 percent respectively. It is projected that the fiscal deficit will be fully financed largely by net disbursements (See Table 7 below).

**Table 7. Sierra Leone Central Government Financial Operations, 2000-2003**

| | 2000 Act | 2001 Act | 2002 Est. | 2003 Prog. |
|---|---|---|---|---|
| | (In million Leones, unless otherwise indicated) | | | |
| **Total Revenue and Grants** | 258,282 | 302,692 | 400,027 | 566,938 |
| **Domestic revenue** | 152,175 | 207,669 | 238,691 | 271,678 |
| Income Tax Department | 39,742 | 54,395 | 62,881 | 73,785 |
| Customs and Excise Department | 95,424 | 138,181 | 160,589 | 176,439 |
| Mines Department | 1,518 | 1,196 | 2,034 | 4,402 |
| Other Departments | 10,850 | 7,712 | 6,262 | 9,540 |
| Road User Charges | 4,641 | 6,185 | 6,925 | 7,512 |
| **Grants** | 106,107 | 95,023 | 161,336 | 295,261 |
| Program | 89,445 | 57,268 | 118,199 | 165,395 |
| Projects | 16,662 | 37,756 | 43,137 | 129,866 |
| **Total Expenditure and Net Lending** | 382,344 | 472,263 | 562,252 | 742,870 |
| **Recurrent Expenditure** | 301,831 | 397,186 | 474,811 | 507,571 |
| Wages and Salaries | 89,495 | 111,856 | 142,769 | 154,100 |
| o/w Social security payments | 0 | 0 | 15,300 | 10,652 |
| Goods and Services | 56,879 | 136,734 | 154,606 | 191,179 |
| o/w Security-related expenditures | 53,101 | 54,620 | 51,446 | 64,303 |
| Defence | 28,636 | 37,868 | 33,371 | 42,600 |
| Democratization and DDR 1/ | 13,730 | 28,566 | 33,736 | 39,120 |
| Grants to Educational Institutions | 11,475 | 13,141 | 14,041 | 17,168 |
| Transfers to Road Fund | 4,930 | 6,180 | 6,925 | 7,512 |
| Socially Oriented Outlays (Soc. safety net) | 2,036 | 1,365 | 0 | 0 |
| Elections | 0 | 495 | 17,937 | 750 |
| Interest Payments | 83,915 | 72,796 | 104,797 | 97,742 |
| Domestic | 50,459 | 44,263 | 51,020 | 43,931 |
| Foreign | 33,456 | 28,533 | 53,777 | 53,881 |
| **Capital expenditure and net lending** | 80,512 | 75,077 | 87,441 | 235,299 |
| Development expenditure | 68,864 | 71,144 | 85,768 | 234,799 |
| Foreign | 62,464 | 56,542 | 65,227 | 212,299 |
| Loans | 53,082 | 43,823 | 53,827 | 120,553 |
| Grants | 9,382 | 12,719 | 11,400 | 91,746 |
| Domestic | 6,400 | 14,602 | 20,541 | 22,500 |
| Lending minus repayments | 11,648 | 484 | 1,223 | 0 |
| **Overall balance (commitment basis)** | | | | |
| Excluding grants | -230,169 | -264,594 | -323,561 | -471,193 |
| Including grants | -124,062 | -169,571 | -162,225 | -175,932 |
| **Total financing** | 124,062 | 169,571 | 162,225 | 175,932 |
| Foreign | 81,610 | 624,766 | 143,734 | 160,809 |
| Borrowing | 123,584 | 95,370 | 141,605 | 167,695 |
| Project | 53,082 | 43,823 | 53,827 | 120,553 |
| Program | 70,502 | 51,547 | 87,778 | 47,141 |
| Amortisation | -41,974 | -38,515 | -48,284 | -110,125 |
| Debt Relief | 0 | 567,911 | 50,413 | 103,239 |
| Domestic | 968 | 51,791 | 18,600 | 51,920 |
| Bank | -26,321 | 42,844 | -5,603 | 27,188 |
| Non bank | 27,289 | 8,947 | 9,981 | 3,500 |
| Privatisation receipts | 22 | 2,060 | 472 | 1,500 |
| Change in arrears | 43,310 | -533,199 | -3,586 | -38,433 |
| Domestic | -7,201 | -17,061 | -17,620 | -8,000 |
| Foreign | 50,511 | -516,138 | 14,034 | -30,433 |
| Uncounted | -1,847 | 24,152 | 3,004 | … |
| Financing gap 2/ | 0 | 0 | 0 | 136 |
| **Memorandum items:** | | | | |
| Nominal GDP (in billions of Leones) | 1,330,303 | 1,487,724 | 1,643,332 | 1,862,967 |
| | (In percent of GDP, unless otherwise indicated) | | | |
| Domestic revenue | 11.4 | 14 | 14.5 | 14.6 |
| Total expenditure and net lending | 28.7 | 29.8 | 34.2 | 39.9 |
| Recurrent expenditure | 22.7 | 24.9 | 28.9 | 27.2 |
| Overall fiscal balance (commitment basis) | | | | |
| Including grants | -9.3 | -9.4 | -9.9 | -9.4 |
| Excluding grants | -17.3 | -15.8 | -19.7 | -25.3 |
| Domestic primary balance 3/ | -5.5 | -5.4 | -7.4 | -6.6 |
| Domestic bank financing | -2.0 | 2.9 | -0.3 | 1.5 |
| Total wages and salaries | 6.0 | 7.5 | 8.7 | 8.3 |

Source: Statistics Sierra Leone, and Ministry of Finance

1/ Disarmament, Demobilisation and Reintegration

2/ for the 2001 program, the financing gap comprises US$199.1 million of arrears
3/ Domestic revenue minus total expenditure and net lending, excluding interest payments and externally financed capital expenditure and the DDR program

The focus in 2003 will be on advancing the restructuring of tax administration through the on-going operationalization of the National Revenue Authority (NRA). The NRA development work program will focus on the design and implementation of the organizational structure, personnel management, the remuneration and salary structure, financial management and procurement policies and procedures. In the administration of customs taxes, preparations will be continued for the eventual introduction of the Automated System for Customs Data (ASYCUDA), including the review of existing customs legislation, the improvement of information technology operations and the training of management staff, and a review of customs valuation procedures. In the income tax area, efforts will be focused on improving collection procedures and collecting tax arrears. The World Bank is expected to provide financial and technical assistance to support the development of the NRA financial and operational systems of foreign loans and grants thereby reducing financing from the domestic banking system both ensuring stable prices and freeing-up credit for private sector development.

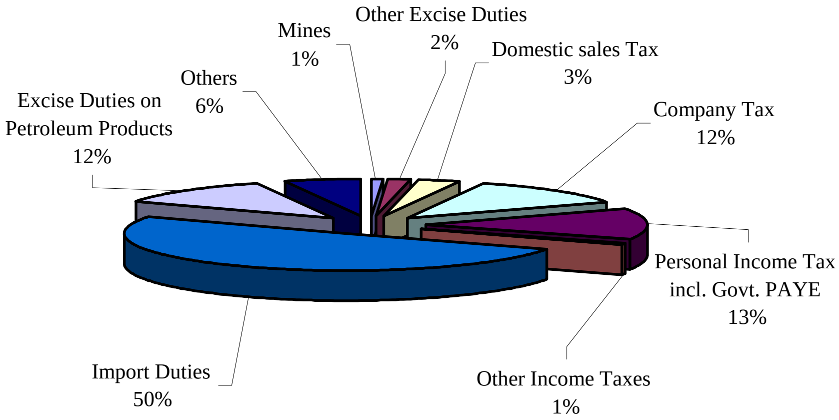
### 2.3.1 Domestic Revenue

As shown in Figure 5, of total domestic revenue collected in 2002, import duties accounted for about 50 percent. The slight decrease, despite higher import volumes, is due to the reduction in import duty rates and the removal of excise tax for most imported commodities.

Similarly, the contribution of domestic excise duties declined to 2 percent from 3 percent in 2001. In contrast, excise duties on petroleum products increased slightly to 12 percent from 11 percent in 2001. The contribution of domestic sales tax remained unchanged at 3 percent.

The contribution of company taxes to total domestic revenue rose to 12 percent in 2002 from 10 percent in 2001. However, the share of personal income tax dropped significantly to 13 percent from 18 percent in 2001. Lower marginal rates of income tax and a rise in the threshold of taxable income accounted for this drop. The contribution from other taxes rose to 1 percent in 2002 from zero percent in 2001.

**Figure 5. Where Taxes Come From (Percent of Total Domestic Revenue), 2002**




### 2.3.2 Government Expenditure and Public Borrowing

In 2002, the share of education and health expenditures in total non-salary, non-interest recurrent expenditure rose slightly to 12 and 11 percent from 11 and 9 percent, respectively in 2001. Similarly, the share of economic services and general public services rose to 32 and 13 percent from 22 and 12 percent, respectively. Spending on public order and safety and defence affairs and services decreased to 10 percent and 12 percent, respectively, from 14 percent.

The functional classification of expenditure (as a percent of GDP) is shown in Figure 6. Emergency defence expenditures declined to 2.0 percent from 2.5 percent of GDP in 2001. The share of subsidies and transfers rose to 1.4 percent from 1.2 percent of GDP in 2001. Interest payments rose to 6.4 percent from 4.9 percent of GDP in 2001 on account of the substantial payments of interest on ways and means during the first three quarters due to the late receipt of external aid disbursements. Government expenditure by composition and sector are shown in Tables 8 and 9.

**Figure 6. Where Taxes and Donor Funds are Spent (Percent of Total Rcurrent Non-Salary Expenditure), 2002**

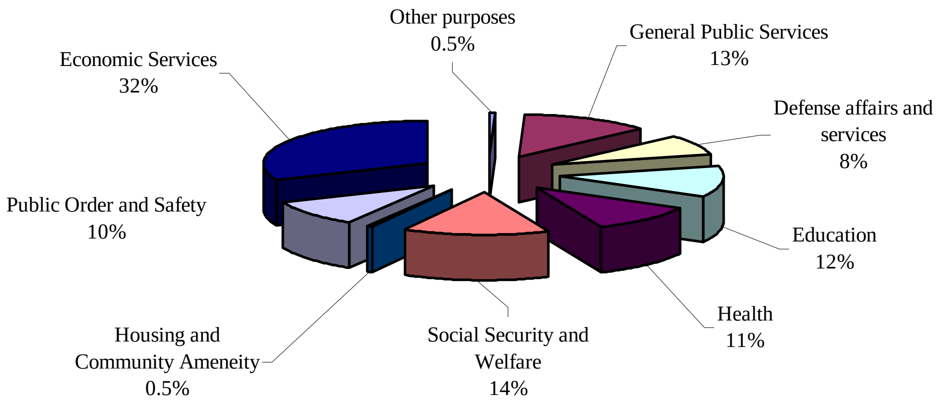



**Table 8. Economic Classification of Recurrent Expenditure, 2000 - 2002**

| | 2000 Act | 2001 Act | 2002 Act |
|---|---|---|---|
| | | (In millions of Leones) | |
| Wages and salaries | 93,985 | 111,856 | 142,769 |
| *Of which* Rice supplement | 0 | 0 | 0 |
| Purchases of goods and services | 142,850 | 136,734 | 156,270 |
| *Of which* Emergency defence | 45,083 | 37,868 | 33,371 |
| Subsidies and transfers | 18,362 | 18,016 | 22,615 |
| Education | 11,524 | 13,141 | 14,041 |
| Liberian relief operations 1/ | 0 | 0 | 0 |
| Local government | 6,838 | 4,875 | 0 |
| Pensions | 0 | 0 | 8,574 |
| Interest | 84,986 | 72,796 | 104,797 |
| Domestic | 51,530 | 44,263 | 51,020 |
| Foreign | 33,456 | 28,533 | 53,777 |
| | 2000 Act | 2001 Act | 2002 Act |
| | | (In percent of GDP) | |
| Wages and salaries | 7.1 | 7.5 | 8.7 |
| *Of which* Rice supplement | 0.0 | 0.0 | 0.0 |
| Purchases of goods and services | 10.7 | 9.2 | 9.5 |
| *Of which* Emergency defence | 3.4 | 2.5 | 2.0 |
| Subsidies and transfers | 1.4 | 1.2 | 1.4 |
| Interest | 6.4 | 4.9 | 6.4 |
| *Of which* Domestic | 3.9 | 3.0 | 3.1 |
| | | (In percent of total recurrent expenditure) | |
| Wages and salaries | 31.1 | 28.2 | 28.9 |
| Purchases of goods and services | 28.9 | 34.4 | 31.6 |
| Subsidies and transfers | 3.7 | 4.5 | 4.6 |
| Interest | 17.2 | 18.3 | 21.2 |
| *Of which* Domestic | 10.4 | 11.1 | 10.3 |

Source: Ministry of Finance.

1/ Sierra Leonean government's contribution to ECOMOG (Economic Community of West African States (ECOWAS) Monitoring Group).

**Table 9. Functional Classification of Recurrent Expenditure, 1999 - 2002**

| | 1999 Act | 2000 Act | 2001 Act | 2002 Act |
|---|---|---|---|---|
| | (In percent of Nominal GDP) | | | |
| General Public Services | 1.62 | 1.82 | 2.22 | 3.29 |
| Public Order and Safety | 1.08 | 1.27 | 2.56 | 2.61 |
| Defence | 0.28 | 2.36 | 2.55 | 2.03 |
| Education | 2.46 | 3.51 | 2.10 | 3.06 |
| Health | 1.22 | 0.88 | 1.69 | 2.72 |
| Social Security and Welfare | 0.05 | 1.98 | 3.00 | 3.73 |
| Housing and Community Amenity | 0.11 | 0.08 | 0.11 | 0.12 |
| Economic Services | 3.13 | 1.31 | 4.11 | 8.08 |
| Other purposes | 3.54 | 3.41 | 0.16 | 0.12 |
| | (In percent of total recurrent expenditure) | | | |
| General Public Services | 8.28 | 8.01 | 8.31 | 11.39 |
| Public Order and Safety | | 5.60 | 9.59 | 9.04 |
| Defence | 1.41 | 10.41 | 9.53 | 7.03 |
| Education | 12.60 | 15.47 | 7.88 | 10.61 |
| Health | 6.22 | 3.88 | 6.35 | 9.41 |
| Social Security and Welfare | 0.27 | 8.71 | 11.24 | 12.89 |
| Housing and community Amenity | 0.55 | 0.36 | 0.41 | 0.41 |
| Economic services | 16.00 | 5.77 | 15.38 | 27.97 |
| Other purposes | 18.14 | 15.03 | 0.60 | 0.41 |

Source: Ministry of Finance

### 2.3.3 Deficit Financing

Foreign inflows, mainly project and programme loans and grants, largely financed the fiscal deficit. At Le143.7 billion, it accounted for about 75.4 percent of the total financing requirement in 2002. Domestic financing, excluding HIPC funds held at the Bank of Sierra Leone, is estimated at Le46.8 billion. Bank financing is estimated at Le22.6 billion, of which central bank financing amounted to Le3.7 billion. Nonbank financing was about Le10.0 billion. The National Social Security and Insurance Trust (NASSIT) accounted for about 58.7 percent of non-bank financing.

# III. Tax Structure, Institutions and Reality

## 3.1 INTRODUCTION

The tax structure has undergone tremendous changes since independence. In April 1961, when the country gained independence, the government enacted an investment code to attract foreign capital and encourage import-substituting industrialization. The Government relied heavily on various types of taxes and tariff exemptions to promote socio-economic development. The tax structure includes various types of taxes levied during a specific period of time. The present Sierra Leone tax structure consists of direct taxes and indirect taxes. The responsibilities of collection and administration of direct taxes and indirect taxes and vested on Income Tax Department and Customs and Excise Department respectively. Local taxes are administered and collected by local government.

There have been numerous attempts also to reform the tax system in Sierra Leone since 1980. However, these reforms have not been part of a concerted effort to reform the entire tax system but part of efforts to raise more revenue through budget pronouncements affecting the tax rates or tax brackets. The reforms were also aimed at to increase efficiency and to improve good working conditions for the tax administration, and to reduce inequalities, distortion, and corruption among administration.

## 3.2 ENFORCEMENT OF TAX LAWS

The Ministry of Finance, through its independence departments (the Budget Bureau, the Economic Policy & Research Unit and the Revenue Department) is in charge of formulating, enforcing and amending tax laws and submitting these to Parliament for ratification. The responsibility of tax administration lies squarely with the newly established National Revenue Authority (NRA). Prior to the establishment of the NRA, this responsibility was shared between the Income Tax Department and the Customs and Excise Department.

The National Revenue Authority has a Commissioner- General appointed by the President with the approval of the House of Representatives. The NRA has seven-member Board, representing the interests of all major stakeholders in the national economy. There is a Deputy Commissioner-General and a Commissioner each for the Customs and Excise Department, and Income Tax Department. Each Commissioner has specific responsibilities and they independently manage their department and report to the Commissioner- General (See organagram on page 29).

## 3.3 THE TAX SYSTEM

Apart from the changes mentioned above, most of the tax system was inherited from British Colonial period. It is based on a self-assessment system and comprises domestic taxes and international taxes (direct taxes and indirect taxes). These taxes are administered by two departments of the Ministry of Finance- the Income Tax Department for all domestic taxes (direct taxes) and the Customs and Excise Department for all international taxes (indirect taxes).

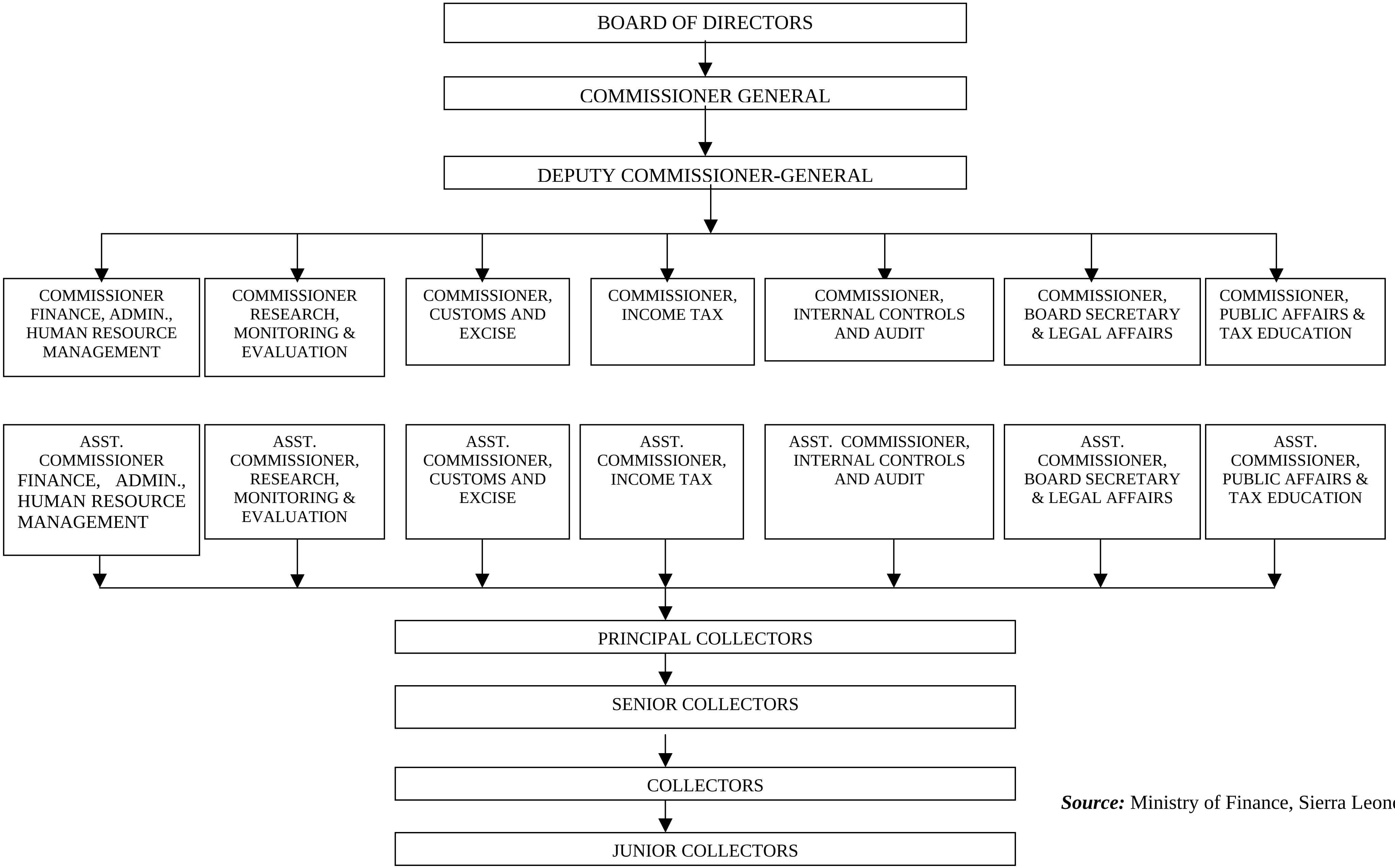
The duties of the Income Tax Department include, tax assessment and collection, implementation of tax laws, and research. All taxes are collected at national level and currently there are four-district tax offices in Sierra Leone and a head office in the capital-Freetown. All taxpayers get their services from the respective tax district bureaus, located in the district headquarter towns. The Income Tax Department carries out its functions within the framework of the tax law known as the Income Tax Act.

The Customs and Excise Department is legislated by the Customs Law of Sierra Leone. It carries out its functions through offices located at major ports, airports, industries, and mining areas in the country as well as at international border ports and posts. The main office of Customs and Excise Department in Sierra Leone is located at the main port in Freetown known as Queen Elizabeth II Quay. The tax year runs from 1$^{st}$ April through 31$^{st}$ March the following year.

### 3.4 TAXATION OF INCOME

Generally, in Sierra Leone, residents are assessable to tax on their worldwide income. Non-residents are subject to tax on income accrued in or derived from Sierra Leone. Tax at the appropriate corporate or individual rate is withheld on dividends, interest, royalty payments and certain other payments made to both residents and non-residents. The taxable income of insurance companies, arising from the insurance business, is calculated according to special rules. Income from the non-life insurance business is computed separately from that of the life insurance business. No estate tax is levied in Sierra Leone.

**Figure 7. The Organogram of the National Revenue Authority, Sierra Leone**




***Source:*** Ministry of Finance, Sierra Leone

### 3.4.1 Company Income Taxation

Income tax is levied on companies under the Income Tax Act 1996, which came into force on 1st April 2000 known as Income Tax Act 2000. Tax is imposed on the worldwide income of residents and the domestic-source income of non-residents. Company tax represents an important source of total tax revenue in Sierra Leone.

**A) Taxable Entities**

A company is considered a resident company if it is incorporated or formed under the laws of Sierra Leone (Cap 273), has its effective management and control in Sierra Leone, or under takes the majority of its operations in Sierra Leone. The branch in Sierra Leone of a non-resident company is treated as a separated resident Sierra Leone company. A partnership is not assessed as a company, but rather each partner is liable for their individual capacity on their share of the partnership income.

**B) Concept of Income Taxable**

Income includes all gains or profits wherever derived (worldwide) or, in the case of a non-resident company all gains or profits sourced in Sierra Leone. Dividends, interest, rent and royalties are subject to a withholding tax, which is a final tax, of such income in the case of non-residents. Income is broadly construed to include-: (1) employment income, (2) business income (defined to include gains on the disposal of non-depreciable business assets or on the satisfaction of business debts, balancing charges, gifts received in a business relationship context, payments for restrictive covenants, interest from trade receivables or from a banking or money lending business, rent from the business of holding or letting of property, and amounts received in respect of trading stock under a policy of insurance or contract for indemnity) (3) Property income (including dividends, interest, discounts, natural resource payments, rent, royalties and annuity payments, as well as gifts received in connection with the provision, use or exploitation of property), and (4) any other income or gain.

**C) Tax Rates**

Resident companies are subject to a standard tax rate of 35 percent of their net profit. Generally, the income of a non-resident company is taxed in the same manner as that of a resident, but only to the extent such income is derived from a Sierra Leonean source. Where a non-resident carries on business in Sierra Leone through a branch, the profits of the branch are taxed, in addition, the branch's repatriated in is taxed as a dividend distribution. The tax rate applicable to mining activities is 37.5 percent.

**D) Exemptions Income**

The Income Tax Act allows the following exemptions income:

i. Income of a religious or charitable organizational, amateur sporting association, trade union, educational institution or a cooperative society, provided none of its income or assets confers or may confer a private benefit on any person and its exempt status has been approved by the Commissioner of Income Tax. However, income derived from carrying on business unrelated to the function constituting the basis for the organization's exemption is taxable. Property income derived by such organizations is also taxable, as a general rule, but rental income derived by a religious or charitable organization or educational institution is exempt from tax if the property in respect of which the income is paid is used exclusively for the activities of the organization or institution,

ii. Income from agricultural activities involving tree crop farming such as coffee, cocoa, and oil-palm for a period of 10 years. There is a proviso that the company involved is incorporated in Sierra Leone and that full records of all transactions pertaining to the activity are kept. If these conditions are satisfied, 50 percent of any dividend paid during the 10-year period will be exempt from withholding tax,

iii. 5 percent of business income derived from export sales. The percentage calculation is based on the proportion that export sales bear to total sales,
iv. Gains on the disposal of property other than business assets or investment assets,
v. Investment income of an approved retirement fund, and
vi. Dividends received by a resident company from another resident company (with the exception of dividends received by a financial institution from ownership of redeemable shares in the paying company).

Exempt bodies under company taxation include the following:

i. the Bank of Sierra Leone
ii. income from the City Council, and
iii. Any person or organization exempted by the Government of Sierra Leone.

**E) Computation of Taxable Income**

Corporation tax is established on the basis of profits made during the preceding fiscal year. Chargeable income is computed as assessable income less any allowable deductions. The minimum taxable income of a company, which keeps proper accounts, is 10 percent of the turnover of business, irrespective of actual profits or losses. In the case of a person holding a mining lease, the minimum taxable income is 3.5 percent of turnover where the total taxable business income is less than 7 percent of turnover. Turnover is determined as the total gross receipts, in cash or cash-value, of any trade, business, profession, or vocation during the period of assessment. Where, however, the taxpayer’s books have been audited by a recognized firm of Accountants and the Commissioner after having conducted an audit, is satisfied that, complete and proper records have been kept, and there has been no false, artificial or fictitious transaction aimed at reducing the chargeable income of such business, then the above provisions relating to minimum taxable income will not apply.

**F) Deductible Expenses**

Any expenditure, which is incurred in the production of assessable income, is deductible for the purpose of calculating chargeable income. Certain deductions are specifically provided for, but each is subject to prescribed conditions in accordance with provisions of Income Tax Act of Sierra Leone. These include:

i. Expenses incurred on insuring and managing real property and expenditure incurred to repair, renew, alter or improve such property. Such expenditure must, however, be attributable to a period of occupation by a tenant and will be subject to certain limitations as to amount,
ii. Expenses on meals, refreshments or entertainment where the value thereof is included in the assessable income of the employee for whom such meals etc. are provided or the taxpayer’s business includes the provision of such meals, etc. and the persons to whom the benefits are provided have paid consideration at arm’s length thereof or the expense is in respect of hospitality to export customers,
iii. 80 percent of interest expenses incurred by a non-bank taxpayer
iv. Bad and Doubtful Debts-Here deduction is allowed only when the debts are written off in the taxpayer’s accounts,
v. Research and development expenditure including expenditure on prospecting or exploration, incurred or incidental to the production of assessable income. No deduction may be made, however, in respect of expenses incurred in ascertaining the existence, location, extent or quality of a natural deposit or for the acquisition of depreciable assets or lands,

vi. Retirement fund- the employer's contributions to a complying retirement fund up to limit of 30 percent of each employee's employment income.
vii. Business start up costs,
viii. Trading stock sold during the year of assessment,
ix. An allowable loss (i.e. the excess of the taxpayer's allowable deductions over the taxpayer's assessable income) to the extent that the loss has not been deducted in a previous year of assessment.

**G) Losses**

Losses incurred by the taxpayer in a business during any preceding year of assessment may be deducted from total income. Unabsorbed losses may be carried forward indefinitely. However, the tax payable each year may not be less than 50 percent of the tax due if such loss had not been carried forward.

**H) Depreciation Allowances**

A deduction is allowed for the depreciation of a taxpayer's depreciable assets. Depreciable assets are classified into groups, with a prescribed rate of depreciation for the pool of assets in each group. The adjusted cost base of an asset is added to the pool when the asset is placed in service. Separate capital allowances are provided in respect of expenditure incurred by persons engaged in the exploitation of mineral rights, prospecting and exploration licences, mining licences or mining leases granted under the Mines and Minerals Decree 1994.

The deductible amount for depreciation for each year is determined by applying the prescribed rate for the pool in each group to the balance of the pool at the end of the year of assessment. The balance of the pool at the end of the year of assessment is arrived at by adding the adjusted cost base of assets added to the pool in the current year of assessment to the balance of the pool at the end of the preceding year of assessment (less any deductions) and subtracting (but not below zero) the consideration received from the disposal of assets in the pool during the year of assessment. Any asset, which ceases to be a depreciable asset is deemed to have been disposed of by the taxpayer for its market value.

**I) Depreciation Rates**

The following are the depreciation rates prescribed for the listed groups of assets in accordance with provisions of Sierra Leone Income Tax Act:

| | |
|---|---|
| (a) Plant, machinery and equipment, including automobiles and trucks | 40% |
| (b) All other tangible depreciable assets except buildings, and intangible depreciable assets | 10% |
| (c) Buildings used to house industrial, manufacturing or agricultural activities | 15% |
| (d) Buildings used to house commercial activities other than those described in Group (c) above | 10% |
| (e) Buildings other than those described in groups (c) and (d) above | 5% |

If at the end of the year of assessment the consideration received from the disposal of assets in a pool in that year exceeds the written down value of the assets in the pool, the excess is included in the taxpayer's assessable income and taxed. However, if the written down value of the pool at the end of the year of assessment is less than SLL 100,000, the entire value is allowed as a deduction.

**J) Investment Allowance**

An investment allowance of 5 percent of expenditures incurred by the taxpayer in purchasing plants, machinery and equipment, including automobiles and trucks for business purposes, is deductible in the year of purchase. Businesses in the tourist industry will also be eligible for the investment allowance in respect of buildings used for commercial purposes.

**K) Non-deductible Expenses**

Generally, any expenditure not incurred in the production of chargeable income is not deductible. Deductions specifically disallowed by the Income Tax Act include:

i. Personal expenses
ii. Expenses incurred by a company on behalf of a director (other than a whole-time service director) or his dependants, on transportation to or from any place outside or inside Sierra Leone
iii. Income tax paid or incurred to Sierra Leone or to a foreign country
iv. An amount included in the cost base of an asset
v. Payments to a pension, superannuation, provident or similar fund not approved by the Commissioner, or payments made to such a fund in excess of the prescribed limit
vi. Payments in respect of redundancy, loss of office, termination of office or retirement or a similar sum in excess of SLL 4 million, except where such payment has been taxed as employment income
vii. Any gratuity to a past, present or future employee or dependant, except it has already taxed as employment income, and
viii. Fines or other penalties paid to the Government for any breach of law.

Apart from these, the Act also disallows expenses which may fall within those specifically allowed in deductible expenses above, but do not satisfy the conditions prescribed for their deductibility.

### 3.4.2 Individual Income Tax

Individuals are taxed under the same statute as companies, the Income Tax Act. A progressive scale of rates applies to the income of individuals and partnership. Individual traders may also avail themselves of the allowances and other deductions described under taxation of business income (company).

**A) Taxable Persons**

Resident individuals are liable to income tax in Sierra Leone on worldwide income. A "resident individual" is anyone who:

1. Has a normal place of abode in Sierra Leone and is present in Sierra Leone at any time during the year of assessment,
2. Is present in Sierra Leone on more than 182 days in a year of assessment, or
3. Is a Sierra Leone government official posted overseas during the year of assessment?

Cross-border workers performing dependent services in Sierra Leone, persons in transit, persons in Sierra Leone for medical treatment or full-time study and diplomats and dependants will not be regarded as being present in Sierra Leone.

The Income Tax Act also distinguishes between a resident individual and a "temporarily resident" individual, the latter being an individual who:

1. Is not a citizen of or domiciled in Sierra Leone,
2. Does not intend during the year of assessment to reside in Sierra Leone for a total period of more than 4 years, and
3. As of the end of the year of assessment has not been resident in Sierra Leone for more 4 years.

A temporarily resident individual is taxed on all his Sierra Leone-source income and on foreign- source income remitted to Sierra Leone.

Non-residents are subject to tax on all payments from which withholding tax is deducted (i.e. dividends, interests, royalties, rents etc) and all other assessable income from a source in Sierra Leone. Married persons are assessed to tax separately. Partners are required to make a join return in respect of their partnership income but they are liable for tax only in their separate individual capacities.

**B) Concept of Income**

The rules relating to the definition of business and property income are the same for companies and individuals stated earlier.

***Benefits in kind:*** Employment income is broadly defined to include a list of several types of benefits in kind (B.I.K) or otherwise given to an individual employee or his associates by an employer or its associates including, apart from salary, wages, leave pay, overtime payments, commissions and bonuses.

The following amounts will be added to annual chargeable income in respect of the following benefits:

1. Motor vehicle:
   **(C +R) x P**
   Where C= 20% of the cost to the employer of purchasing the vehicle or the full cost of leasing the vehicle
   R = the running costs of the vehicle in the year ultimately borne by the employer, and
   P = the proportion the employee's non-business use of the vehicle bears its use in the year.
2. Accommodation: The market rent value of the accommodation or housing less any payment made by the employee for the benefit.
3. Domestic assistants: The total employment income paid to the domestic assistant in respect of services rendered to the employee, less any payment made by the employee for the benefit.
4. Meals, refreshment or entertainment: The cost to the employer of providing the meal, refreshment or entertainment, less any consideration paid by the employee for it.
5. Utilities: The amount of the reimbursement or discharge by the employer of the employee's utilities expenditure.

For benefits at (1), (2), (3), and (5) above the taxable value will be the lower of the values described there and the values in the table 10 below:

**Table 10. Taxable value of certain benefits- in kind**

| Year | Housing Benefit (SLL) | Vehicle Benefit (SLL) | Utilities Benefit (SLL) | Benefit per servant (SLL) |
|---|---|---|---|---|
| 2000/01 | 2,000,000 | 1,000,000 | 500,000 | 250,000 |
| 2001/02 | 4,000,000 | 2,000,000 | 1,000,000 | 350,000 |
| 2002/03 | 6,000,000 | 3,000,000 | 1,500,000 | 450,000 |
| 2003/04 | 8,000,000 | 4,000,000 | 2,000,000 | 600,000 |

Source: Ministry of Finance/Income Tax Department.

**C) Exemptions Applicable to Individuals**

The exemptions mentioned under Taxation of business income also apply to individuals, where appropriate. Exemptions applicable to individuals also include:

i. the income of the Head of State of Sierra Leone,
ii. overseas allowances paid Sierra Leone diplomatic, consular, overseas or foreign service officials serving in posts outside Sierra Leone,
iii. ex-gratia capital sums received on death or as compensation for injury,
iv. wound and disability pensions given to members of the Sierra Leone Armed Forces,
v. lottery winnings
vi. certain widow's and orphan's pensions
vii. the value of property acquired by gift, bequest, devise or inheritance (but excluding such property falling under the definition of employment, business or property income),
viii. the official employment income of a diplomatic or consular employee who is not a citizen of Sierra Leone and who was not engaged in business in Sierra Leone,

ix. the official employment income of a public servant of a foreign country who is not a citizen of Sierra Leone where such income is subject to tax in that foreign country,

x. the official employment income of an employee of a public international organization, the income of which is exempt from tax, on condition that such employee is not a citizen of Sierra Leone

xi. foreign income derived by a person or a member of the immediate family of such a person whose official employment income is exempt as at h, i, or j above,

xii. scholarships paid to full-time students,

xiii. maintenance and child support payments,

xiv. the proceeds of life insurance policies,

xv. Foreign-source employment income derived by a resident individual if such income is chargeable to tax in the foreign country concerned, and the income of an individual trust or partnership derived from any agricultural activity involving tree crop farming such as cocoa, coffee and oil-palm for a period of 10 years from the commencement of the agricultural activities.

**D) Deductible Expenses**

The rules relating to the deductibility of expenses described under Taxation of business income apply, where appropriate, also to taxation of individuals. An individual's contributions to a complying retirement fund up to 30 percent of his employment and business income in the year concerned, less any contributions paid for his benefit by his employer, are also deductible.

Where an individual or his employer has incurred an expense, including any contribution to a fund other than a complying retirement fund, to acquire a pension or annuity, the expense or contribution will be deductible from the pension or annuity receipts in accordance with rules laid down in the Ninth Schedule of the Sierra Leone Income Tax Act. Under these rules, the non-taxable element of each such receipt will be 95 percent in the first year of receipt reducing by 5 percent in each successive year until a maximum of 50 percent of the receipt is taxed as income each year.

**E) Depreciation Allowances**

The rules relating to depreciation allowances mentioned under business income apply, where appropriate also to individuals.

**F) Losses**

The rules relating to losses described in business income apply also to individuals.

**G) Non-deductible Expenses**

The rules relating or applying to the non-deductibility of expenses described under Taxation of business income apply, where appropriate, the same to individuals.

**H) Computation of Taxable Income of Individuals**

Taxable or chargeable income is computed as assessable income less allowable deductions. The minimum chargeable income which on individual will be deemed to derive from a business-irrespective of profit or loss suffered, will be computed the same as that for any other business mentioned under the computation of taxable income of corporations (business income).

**I) Rates applicable to Taxation of Individuals Resident**

**1. Resident**

Following the reading of the Sierra Leone Government Budget in December, 2001 and pursuance of a desire to reduce the tax burden for individuals and to encourage individual effort and enterprise, Government decided to raise the minimum threshold for income tax from SLL800, 000 to SLL1, 000,000 per annum with effect from 1st April, 2002. The new tax rates are as follows:

| CHARGEABLE INCOME. | RATE OF TAX |
|---|---|
| Not over Le 1,000,000 per annum | 0% |
| Next Le 2,000,000 per annum | 20% |
| Next Le 2,000,000 per annum | 25% |
| Next Le 2,500,000 per annum | 30% |
| Excess over Le 7,500,000 per annum | 35% |

The threshold on non-taxable allowance per annum remains as SLL 800,000.

- **Property Income of Minors**

Property income derived by a minor is computed separately and taxed at the following rates:

| CHARGEABLE INCOME. | RATE OFTAX. |
|---|---|
| Up to Le 360,000 | 0% |
| Excess over Le 360,000 | 40% |

- **Standard Assessment or Minimum Tax**

A standard assessment will be issued and a minimum tax will be payable by various types of tradesmen (e.g. butchers, hairdressers, tailors, goldsmiths, motor mechanics, taxi operators, cattle dealers, booksellers, electricians, fishermen) in accordance with Income Tax Act 2000 in the First Schedule Part V.

In respect of diamond miners and dealers the standard assessment is follows:

| | |
|---|---|
| - Diamond exporters | 2% of export value |
| - Exporter's agents | SLL960, 000 per annum |
| - Non-citizen dealer | SLL360, 000 per annum |
| - Citizen dealer | SLL240, 000 per annum |
| - Alluvial diamond miner | SLL36, 000 per annum |

- **Income from Trusts**

A resident of Sierra Leone who distributes income of a trust to a non-resident beneficiary or applies trust income to the benefit of such beneficiary must withhold tax at the rate of 25 percent of the total amount, which is a final tax.

**2. Non-resident**

Generally, the income of a non-resident individual is taxed in the same manner as that of a resident. Employment income is subject to a withholding tax of 25 percent at source. Income other than that subject to withholding tax at source (dividends, interest, royalties, rents etc.) is taxed at 25 percent.

**J) Other Taxes Payable by Business**

**1. Payroll Tax**

A payroll tax is levied each year on employers in respect of every employee who is not a citizen of Sierra Leone. The tax is due each 1st January. A penalty of 10 percent is assessed on tax paid after 31st. January. Employee here means: (a) any individual who is not a citizen of Sierra Leone and who is engaged to work or render services in Sierra Leone for which he paid a salary whether he is engaged as a servant or as an independent contractor but does not include a domestic servant engaged in household duties, and (b) in the case of a partnership, a

Partner who is not a citizen of Sierra Leone and who owns less than 20 percent of the partnership. The tax payable under this levy is not deductible in ascertaining taxable income.

**2. Payroll Tax Rate**

The rate of tax is as follows:

(a) In the case of an employee who is a national of the Economic Community of West Africa States (ECOWAS), the tax levied is SLL 20,000; and

(b) In the case of any other employee the greater of SLL250,000 or 0.5 percent of the turnover of the employer for the previous year of assessment for the purpose of the Income Tax Act of Sierra Leone.

## 3.5 TAXES ON GOODS, SERVICES AND TRANSACTIONS

**A) Sales tax**

A sales tax was introduced by the Sales Tax Decree 1995. Sales tax is levied on:

i. All goods subject to customs duty;
ii. All goods subject to excise duty; and
iii. All goods listed in the First Schedule to the Decree.

These goods include foods and beverages, wines and spirits, hydrocarbons, tobacco, cement, medicaments, paints, perfume and toiletries, soaps, candles, matches, plastics, paper and paper articles, ammunition and weapons, furniture, motor vehicle bodies; structures and parts of structures for building, bridges, etc.

**B) Exemptions in Sales Tax**

The Second Schedule to the Decree listed a number of goods, which are exempt from sales tax. These include rice and baby foods, tar, printed books, brochures, coins, steam boilers and steam engines, gas generators, hydraulic and other engines and motors, steam road rollers, pumps, air conditioners, furnaces and refrigerators, agricultural machinery, books-binding and printing machinery, manufacturing machinery, electrical apparatus, railway rolling stock, aero planes, ships, invalid carriages, microscopes and optical equipment, and orthopaedic appliances, medical, dental and veterinary instruments and appliances

**C) Computation of Sales Tax**

The base for the computation of the sales tax will be as follows: (a) in the case of goods subject to customs duty, the sum of the cost, insurance, freight value and any duties payable on those goods, (b) in the case of goods subject to excise duty, the sum of the normal price of the goods and any excise duty payable on those goods (the term normal price means the open market value of the goods in question), and (c) in the case of goods not subject to customs duty or excise duty, the normal price of those goods.

**D) Sales Tax Rate**

A tax will be levied at the rate of 20 percent on all goods subject to sales tax.

**E) Sales Tax Payment**

Sales tax will become due and payable at the same time as customs or excise duty becomes due and payable on those same goods. Where goods are subject to neither customs nor excise duty, the provisions of the Excise Act 1982 regarding time of payment will apply.

**F) Excise Duties**

Excise duty is now only payable in respect of certain consumer items, whether imported or produced locally. The duty is levied at varying rates on imported goods and domestically produced goods

**G) Customs Duties**

Customs duties are levied on imported goods under a single customs tariff with no preferential or differential rates. Duties are both ad valorem and specific. The value of an import for ad valorem duty is the c.i.f. (sum of cost, insurance and freight) value. Specific duties apply to goods such as foodstuffs, petroleum products and beverages. The rates of customs duties range from 5 percent for essential items to 40 percent for luxury goods.

The following importers are exempt from the tax:(a) government departments, for official purposes, (b) local authorities, (c) the Bank of Sierra Leone and certain West African institutions, (d) certain accredited international organizations, e.g. the UN, diplomatic representatives of foreign countries restrictions with respect to their use, (e) the armed forces, (f) goods imported by specific educational public health care institutions, (g) machinery and plant for use in agriculture or in the prospecting for or preparing of any natural product of West Africa, (h) scientific instruments imported for educational or research purposes or the professional use of doctors or dentists and not destined for sale or exchange and baggage and effects of travellers.

**H) Entertainments Tax**

An entertainment tax is levied on all payments for admission to sporting events, films, theatres, concerts, casinos, and nightclubs. The rate of tax is 10 percent on the price of admission. Entertainment provided by a non-profit organization and for charitable or educational purposes is exempt from entertainment tax.

In order to overcome the problem of non-compliance in paying this tax, each international football match, international concert or other international event will attract an advance tax payment.

The owner of a place, any tenant or person in effective control of the place where the entertainment is held must produce a valid Entertainments Tax Clearance Certificate issued by the Commissioner of Income Tax. In the case of a failure to pay, the Commissioner of Income Tax, will make an estimation of the amount of tax due.

**I) Hotel Tax**

A tax of 10 percent is payable on the amount of all hotel bills.

**J) External Telecommunications Tax**

A tax, known as the external telecommunications tax, will be levied at the rate of 10 percent on all communications from Sierra Leone to a place outside the country by means of telephone, telegraph, telex or fax. This tax is known as message tax.

The tax will be collected by The Sierra Leone External Telecommunications Company Limited (SIERRATEL) and paid over to the Commissioner of Income Tax, within 3 days of collection.

**K) Stamp Duty**

Stamp duties are levied on a wide range of instruments and documents under the Stamp Duty Ordinance (Cap. 274). The instruments upon which stamp duty is levied include agreements, bills of exchange and promissory notes, bills of lading, bonds, leases, and powers or letters of attorney. The person who makes, signs, issues or executes the instrument or document is liable to pay the duty.

The rates of duty vary, from between 1 percent and 12.5 percent, according to the nature of the instrument, the matter to which it relates, and its value.

**L) Mining Royalty**

The Mines and Minerals Decree, 1994 provides that the holder of a mineral right must pay to the government a royalty in respect of any mineral obtained by him in the course of the exercise of that right. “Mineral right” is defined as “a prospecting licence, and exploration licence, a mining lease or an artisanal mining licence”.

**M) Mining Tax Rate**

The royalty is calculated ad valorem on the ex-mine price of the minerals in question at the following rates:

- 5 % for precious stones,
- 4 % for precious metals, and
- 3 % for all other minerals except building and industrial minerals.

The royalty will constitute an operating cost of the mineral right holder and as such will be allowed as a deductible expense in ascertaining his net chargeable income for income tax purposes. An annual payment is also levied on the holder of a mineral right in accordance with provisions of Mines and Minerals Decree, 1994.

**N) Agricultural Development Fund Levy**

It is also provided in the Mines and Minerals Decree, 1994 that a holder of a mining lease may, where appropriate, is required to make an annual payment to an agricultural development fund to be utilized in developing agriculture in the areas in which the mining lease is situated.

**O) Agricultural Development Tax Rate**

The rate of this payment will be 0.1 percent of the ex-mine price of minerals produced. It will be payable from the date of the first sale of such minerals.

## 3.6 ADMINISTRATIVE PROCEDURES

**A) Withholding Tax**

The person required to withhold tax ("withholding Agent") should provide the payee (i.e. the person receiving or entitled to the payment from which tax is withheld) with a tax-withholding certificate, which sets out the payment made and the tax withheld from it. If the payee is an employee of the agent, the certificate should be delivered within 28 days of the end of the year of assessment, or if the employee has ceased employment, within 7 days of the date on which the employment ceased.

When submitting a tax return, the payee must attach the tax withholding certificates relating to the year of assessment. Tax withheld must be paid to the Commissioner of Income Tax, within 15 days of the month in which it was or should have been withheld. If the tax withheld is not a final tax, any excess will be refunded to the taxpayer.

A withholding agent who fails to withhold tax is personally liable for tax which has not been withheld, but the withholding agent is entitled to recover the amount from the payee.

**B) Annual Income Tax Returns**

All taxpayers' subjects to the individual's income tax are required by the Sierra Leone Income Tax Act to file returns within statutory time limit. Unless The Commissioner of Income Tax specifically requires, a resident individual need not file a tax return if his chargeable income for the year is less than SLL1,000,000 (one million Leones). These returns must be accompanied by a detailed statement of all income received during the fiscal year. The returns should also specify family status, all costs normally deductible and any other document requested by the Commissioner of Income Tax.

**C) Requirement for Filing Income Tax Returns**

Unless the Commission specifically required, a resident individual need not file a tax return if his chargeable income for the year is below the threshold, and his total chargeable income (apart from income subject to final withholding tax) consists exclusively of either (1) employment income derived from a single employer from which tax has been withheld or (2) a pension from which tax has been withheld.

Every other taxpayer is required to file a tax return with 90 days after the end of the year of assessment. The Commissioner of Income Tax, may require a taxpayer to submit a tax return at any time covering a period of less than 12 months if that person is about to cease activity in Sierra Leone or if the Commissioner considers it appropriate to do so. Each return must state the total chargeable income for the year of assessment and any tax paid or withheld in that year in respect of the income. The return must be signed by the taxpayer and contain a statement as to its completeness and accuracy.

Persons making payments subject to withholding tax are also required to submit an information return within 28 days from the end of the year of assessment in which the amounts were paid. An extension of time for submitting a tax or information return may be granted on application to the Commissioner of Income Tax, without affecting the due date for payment of the tax withheld.

**D) Current Payment System**

The tax on the estimated taxable business income is payable in four equal instalments over the year of assessment. For a taxpayer who uses the normal year of assessment, the instalments are due on or before 15$^{th}$ June, 15$^{th}$ September, 15$^{th}$ December and 15$^{th}$ March, based on the accounting period.

**F) Audit Procedures**

Unless otherwise authorized by the Commissioner of Income Tax, a taxpayer shall maintain in the English language and in Sierra Leone such records as may be necessary for the accurate determination of the tax payable by the taxpayer. The Commissioner may disallow a claim for a deduction if the taxpayer is unable, without reasonable excuse, to produce a receipt or other record of the transaction or to produce evidence relating to the circumstances giving rise to the claim. The record or evidence referred to shall be retained by the taxpayer for the greater of six years or as long as it remains material to an audit commenced within that period.

**1. Selection of cases for Audit**

i. From the company's section after accounts or returns have been examined on routine basis,
ii. As a result of information from newspapers or radio relating to business activities (third party information).
iii. Examination of the nature of the business activities engaged in by the concern.
iv. Instruction from The Commissioner of Income Tax to audit, and
v. In a situation of huge or continuous loss declared by a concern.

**2. Desk Audit**

After a case has been selected for audit, desk examination or a desk audit is carried out in which queries are raised from the accounts or returns submitted. Questions are asked about certain items declared in the accounts or returns, which answer in writing before the Audit report. This is done to get a better understanding of the whole issue and at the same time reduce the time of the audit.

The Commissioner of Income Tax then writes a letter to the Taxpayer informing him of the audit exercise and the date of commencement of the field audit. In cases where the taxpayer has a tax consultant, a copy of this letter is sent to the tax consultant. If the scheduled date is not convenient, the taxpayer is given an option to decide a convenient time agreed with the Audit team.

**3. Field Audit Exercise**

After the date has been agreed upon, the audit team will then start the audit exercise by submitting a list of documents or information required after which the audit will commence.

The result of the audit exercise will determine whether there will an additional assessment or not will be undertaken. If anomalies were discovered, then a supplementary assessment will commence. On the other hand, if the audit exercise revealed no anomalies, the accounts will be agreed upon and a tax certificate issued.

### 3.7 ANTI-AVOIDANCE MEASURES

To counter transfer pricing strategies, the Commissioner of Income Tax is empowered to distribute, apportion or allocate assessable income, deductions or credits between transacting taxpayers who are associates in order to reflect the taxable income they would have realized in an arm’s length transaction. In cases involving the transfer or licence of intangible property between associates, the Commissioner may also adjust the income arising from the transfer or licence to ensure that it is equivalent to the income attributable to the intangible property. Any of such adjustments may be based on a recharacterization by the Commission of the source of income or the nature of any payment or loss.

# IV. Sierra Leone Specific Fiscal Issues

## 4.1 FISCAL POSITION

Efforts to strengthen expenditure control and improve expenditure management have been seriously affected by the recent proliferation of departmental accounts set up in an attempt to expedite the implementation of capital and Heavily Indebted Poor Countries (HIPC) related outlays. Such accounts have tended to loosen statutory expenditure controls and accountability for expenditures effected through them. Consequently, government has closed all departmental accounts except those required by donor-funded projects and programs, and will review the use of funds previously affected through these accounts.

As part of an enhanced expenditure control procedure during the recent conflict, and reflecting the government's concern for potential abuses and corruption, it has been standard practice to send all approved expenditure to State House for vetting before final payment to beneficiaries. While set up with good intentions, the application of this extra-legal requirement has led to increasing delays in effecting payments, and distorted expenditure recording. Current delays for approval of payments have ranged from 30-60 days. To avoid a build-up of domestic payments arrears, and in compliance with the statutory requirements for expenditure management and control, this practice has been abolished. However, to address the government's concerns with regard to accountability and transparency, the government intends to strengthen the Audit Service Commission to enable it to undertake timely audits of government's expenditures accounts, including the hiring of private audit firms as necessary.

During 2002, the government made serious efforts to stay current on payments for utility bills. Despite these efforts, arrears reemerged. In a recent survey of utilities' billing practices, it was discovered that the government was being improperly billed for the consumption of autonomous agencies, former government officials, and private individuals. In addition, due to shortages of staff with appropriate skills, the audit and reconciliation of new bills with past payments was not done in a timely manner, if at all. These irregular billing practices are a frequent cause of complaint not only in the public sector, but also in the private sector. In view of these continuing problems, the government had decided to:

a) establish a central monitoring unit in the Ministry of Finance, which will undertake monthly reconciliation work in conjunction with line ministries; this unit will also undertake an audit of utilities' overall billing practices with a view to establishing a current list of government establishments that qualify to be included in government utility bills;
b) carry out a financial audit of the National Power Authority (NPA) operations in 2002 by end-September 2003;
c) install pre-paid meters in all government buildings;
d) establish clear budgetary limits on the cost of free utilities to authorized individuals.

The government has been concerned about capacity limitations at line ministries, which have delayed the implementation of development projects and HIPC-financed outlays. To address this problem, government has decided to contract out the execution of some of the work of ministries to the National Commission for Social Action (NACSA) and private companies. NACSA is an autonomous government agency established originally to manage the resettlement of displaced population and related rehabilitation and reintegration activities. Government has also used the services of NGOs, private consultants, and technical assistance from donors to alleviate capacity constraints. For the medium to long-term, government expects that the various projects and programs underway will substantially improve capacity. These include the Rehabilitation of Basic Education Project to improve capacity for managing the education sector; capacity-building projects in health, agriculture and other sectors; and public sector reforms, including the civil service reform and reestablishment of local governments.

During 2001 to 2002, the Government reviewed with staff from the World Bank, the EU and the Fund as well as with bilateral donors the state of our expenditure systems. Government has started implementing some of the recommendations made during these reviews. With technical assistance from the Fund, a draft Organic Budget Law, The Government Budgeting and Accountability Law, was produced in late 2002. It is being reviewed in consultation with other stakeholders. The implementation of the medium-term expenditure framework is well underway. Similarly the expenditure tracking surveys are regularly being done to provide feedback on the extent to which pro-poor outlays reach the intended beneficiaries.

Furthermore, to provide for a comprehensive tracking of pro-poor expenditures, government is working on coding for development expenditure, so that the unified budget will now be able to generate this information for all government expenditures. The Government intends to review procurement procedures with support from the World Bank, DFID and UNDP, including the decentralization of the procurement agency, the introduction of bulk purchasing—wherever feasible (e.g. fuel)—and the streamlining of tendering procedures.

Previous support from the EU was instrumental in rebuilding our financial and accounting systems at the Ministry of Finance. As a result, the efficiency and transparency of public finance management improved significantly. Building on this work, the EU has agreed to provide further assistance in this area to strengthen and extend the Ministry's financial management systems, while creating local capacity to manage the systems on a regular basis. This support will help us address the weaknesses identified during the reviews referred to above.

# V. Where We Stand and Where Do We Go?

## 5.1 INTRODUCTION

The Government recognises that in the post conflict period, poverty reduction will be closely linked to higher economic growth and job creation. In this context, the government's medium-term macroeconomic programme will promote economic growth while maintaining macroeconomic stability to improve the living conditions of all Sierra Leoneans and, consequently, eliminate the wide disparities between rural and urban incomes.

The rebound of the economy is expected to continue as peace consolidates and the macroeconomic situation remains stable. Real GDP growth is projected at about 6.5 percent in 2003. This growth will be supported mainly by the anticipated recovery of the agricultural sector, the substantial increase in reconstruction and investment activities, and the continued rebound in the services sector. Growth is expected to rise to 6.8 percent in 2004.

Annual average increase in consumer prices is projected at about 7.4 percent in 2003. Domestic prices are projected to slow down in 2004 averaging about 5 percent. In this regard, the Bank of Sierra Leone will aim to limit the growth of broad money at 14 percent through controlling growth in net domestic assets.

The Government will continue to maintain strict fiscal discipline while enhancing measures for fiscal accountability and improvements in service delivery. In this regard, measures aimed at enhancing revenue generation will be given utmost priority. Hence, domestic revenue is projected to rise to 14.6 percent of GDP in 2003 from 14.5 percent in 2002. To accelerate the provision of basic services throughout the country and strengthen the operations of the security sector, total expenditure and net lending will rise substantially to 39.9 percent of GDP. As result, the overall budget deficit will rise to 26.6 percent of GDP in 2003. However, the basic primary balance will decrease to 6.6 percent of GDP in 2003 from 7.4 percent of GDP in 2002.

With the expected recovery of the agricultural and mineral export sectors, gross external reserves of the Bank of Sierra Leone are projected to increase to 2.4 months of import cover in 2003. However, the external current account deficit will widen to about 34 percent of GDP in 2003 due to projected higher imports to support reconstruction activities, including rehabilitation of roads and bridges.

In recent months, supply difficulties for petroleum products, mainly from Abidjan, have been aggravated by the continuing escalation of prices for crude oil in the international market following the start of the Iraq war. These developments, coupled with the recent depreciation of the exchange rate will likely lead to further increases in the prices of local petroleum products. This, in turn, will precipitate further increases in domestic consumer prices given the strong positive correlation between prices of petroleum products and consumer goods. Such adverse developments are likely to impact negatively on inflation with grave consequences for macroeconomic stability and economic recovery. This may increase the pressure on demands for wage adjustments. Thus, the projected medium-term outlook will largely depend on the fall out of the war in Iraq and its effects on the global economy, which is likely to affect the domestic economy's near-term growth prospects and continuing recovery.

## 5.2 EXTERNAL DEBT

In the medium-term and beyond, Government's key objective is to completely eliminate the external debt overhang and its associated debt service burden, which crowds-out private investment as well as public expenditures in the social sector, by reaching the Completion Point under the enhanced HIPC Initiative. Government expects all creditors to deliver their share of total relief and has committed itself to utilise all debt relief as additional resources to finance critical poverty reduction activities. However, Government is experiencing serious difficulties in persuading commercial creditors to contribute to HIPC debt relief. A number of these commercial creditors have taken or threatened to take legal action against the Government for non-payment. The Government has committed itself to targeting new grants and loans to be contracted on concessional terms only to improve basic social services and the revival of economic activities.

## 5.3 EMPLOYMENT

Despite the overall improvements in macroeconomic performance, the social situation has remained very difficult. Unemployment remains very high, particularly among the youth and ex-combatants. Although the bulk of displaced population has been resettled, life in the rural

Communities devastated by the war continue to face the need to reestablish permanent shelter and food security, and restart productive economic activity. Substantial efforts have been made by the international community and the Government to address these problems. Nevertheless, difficult social challenges loom in the period ahead.

## 5.4 GOVERNANCE

The Government has undertaken to improve governance by enhancing transparency and accountability in its operations and to fight against massive corruption for the passed thirty years. Government has focused its actions on public expenditure management, transparency in mining sector operations particularly diamond, gold and rutile, and the privatisation of all public corporations. To reinforce these measures, government have established two commissions, the Anti-Corruption Commission and National Commission for Privatisation (NCP)

In addition, measures have also been taken to correct the deficiencies of legal system and making it completely independent. Endowed with significant minerals and forest resources, the country has potential to be one of the richest countries in Sub-Sahara Africa considering its population.

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