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REPORT ON THE
TAX STRUCTURE AND TAX
ADMINISTRATION IN SOMALIA

Prepared for:

Agency for International Development
USAID/Mogadishu
(Contract No. AFR-0348-C-5037-00)

Prepared by:
International Science and Technology Institute, Inc.
1129 20th Street, N.W., Suite 800
Washington, D.C. 20036

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Task No. 22

Prepared by:

Fuat M. Andic, Ph.D.
Consultant

International Science and Technology Institute, Inc.
1129 20th Street, N.W., Suite 800
Washington, D.C. 20036

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PREFACE

This report analyzes the present tax system of Somalia with respect to its structure, rates, revenues and administration. It was prepared for the United States Agency for International Development by International Science and Technology Institute, Inc. (ISTI). This represents the final report prepared by Dr. Fuat Andic after five weeks of stay in Somalia. A preliminary version was presented to AID/Mogadishu prior to his departure from the country.

The report is organized as follows: Chapter One presents the major findings and recommendations in a summary form. Chapter Two analyzes the tax structure of Somalia from the point of view of the basic principles of taxation. It briefly describes the system and subsequently looks into the system's correspondence to objectives of revenue, equity, efficiency and growth. Chapters Three, Four and Five review with some detail taxes on foreign trade, goods and services, and income respectively. In each chapter a series of recommendations is offered not only with the purpose of increasing government revenues but also for enhancing equity, efficiency and economy growth. While considering growth, the private sector's special needs and problems are also discussed. Chapter Six deals exclusively with tax administration. A separate treatment of the administrative issues is warranted, since in more cases than not, they appear to be the major problem in each and every tax.

Before this preface is concluded, Dr. Andic wishes to express first and foremost his gratitude and sincerest thanks to Dr. Meredith Scovill USAID Economist, Mogadishu. He benefited greatly from her knowledge of Somalia in general and its tax system in particular. It must be stated emphatically that without her unfailing support and help this report could not have been prepared within the prescribed time limit and would have contained many more errors and misjudgments than it may contain now. Messrs D. Pfeiffer, R. Rhoda and C. Gordon (all USAID/Mogadishu) have read the preliminary version of the report and made most useful comments for which Dr. Andic is very grateful. Thanks are also due to Messrs. Ali Musse (Assistant Economist USAID/Mogadishu), G. Lovorn (Long-term revenue adviser SOMTAD/AID), Cleveland Thomas, (Private Sector Advisor for AID, from ISTI), Hussein Siad, advisor to the Ministry of Finance, Umberto Del Anno (IMF/Mogadishu), and A. M. Hassan (SOMTAD) for their assistance. The staff of the Ministry of Finance and

Revenue, particularly Mr. Abdi Khalif, Director General, and the heads of the departments of statistics, personnel, customs, direct and indirect taxes were very helpful in providing the necessary data as well as discussing with him, with an outstanding frankness, the issues and problems of taxation in Somalia.

Needless to say none of the persons mentioned above can be held responsible for the errors, omissions and misjudgments.

CHAPTER ONE

SUMMARY AND RECOMMENDATIONS

1. Scope of the Report:

The main concern of this report is tax structure and its administration in Somalia under the present legal and administrative framework. Somalia collects very little in tax revenues, both in absolute terms and in relationship to the country's needs. Tax revenues are not buoyant. In other words increases in tax revenues do not keep up with the overall expansion of the economy. Given the ever increasing expenditures in shilling terms the government is in dire need of revenues. Given the narrow tax base, a condition which is dictated by the economic and administrative conditions, it is not surprising to observe that several different taxes are imposed on the same bases and on a cascading fashion. Cascading results in having tax on tax, e.g., the same base is taxed several times. A tax system of this nature gives rise to inequities and inefficiencies.

This report, prepared after five weeks of research in Somalia, does not pretend to be an exhaustive study. It only strives to call attention to some major issues. Without forgetting the revenue needs of the government, some obvious deficiencies with respect to equity and efficiency are noted. It is worth mentioning at this stage that efficiency, i.e., rational allocation of resources, and the development of the private sector must be viewed as important and perhaps more important than equity at this juncture, especially if the guiding principle of the government is the welfare of its citizens.

With the exception of a few minor changes, this report does not propose new taxes or any increase of present tax rates. In fact, further increases in the numbers of taxes or rates of existing ones are likely to be counterproductive. With the exception of a few new taxes--which might be implemented in the near future--the emphasis is on tax administration. It is our firm belief that collections from the existing taxes can easily be enhanced if they are administered much more efficiently.

The next section presents an overview of the tax system, followed by major findings and recommendations. In the subsequent chapters the major taxes are studied and the recommendations are offered with their corresponding rationale. The last chapter looks into tax administration as a separate and very important topic and also puts forward some concrete suggestions for improving the administrative aspects of the Ministry.

2. General Overview of the Economy of Somalia

Somalia is one of the poorest countries in the world with a per capita income of about $260 per year. The economy is basically agricultural and there is a large subsistence/nomadic sector. Gross domestic product is estimated to be about $1.5 billion. Both the GDP and per capita income figures are only indicative of ranges of magnitude rather than firm figures. Because of the preponderance of the nomadic sector the figures are more likely to be "guesstimates."

The agricultural sector plays a dominant role. According to the latest estimates (1985/86) about 58% of the value added was generated in the agricultural sector as opposed to 9% in the industrial sector. Somalia also has very limited export capabilities. Despite the dominance of agriculture, agro-based exports are less than 10% of GDP. The export structure is basically one of mono-culture (livestocks) with a single market (The Gulf States).

Somalia's efforts toward economic development are constrained by limited natural resources and a harsh and variable climate. Only about 14% of the land is arable and drought occurs frequently. Nevertheless, 80% of the population earns its livelihood in the agricultural sector.

For over ten years Somalia practiced "scientific socialism." The experience left the country with government-owned factories and service industries characterized by poor management and low productivity. Prices of agricultural products were kept low resulting in insufficient incentives for farmers. Skilled managers and technicians left the country for higher wages offered in the Gulf States. In addition, a series of events during the seventies--a severe drought in 1974-75, the outbreak of regional hostilities in 1977-78, the ensuing inflow of refugees, and the severance in 1978 of relations with the Soviet Union which up to then had been the major source of financial and technical assistance--contributed to economic stagnation and added to domestic and external financial deficits.

In 1981 Somalia had some success in restraining demand and promoting production. Agricultural prices were largely decontrolled, some government-operated enterprises were shut down, and policies were instituted to encourage private participation in the economy. Currency devaluations and monetary controls led to improvements in the internal and external financial accounts. But the economy still suffers from inefficient public enterprises, excessive controls on the private sector, and weak management of government institutions in general. Balance of payments difficulties have been compounded by an overvalued exchange rate and a ban imposed by Saudi Arabia in 1983 on cattle imports from Somalia deprived the currency from hard currency earnings.

To promote economic development Somalia needs to push forward with its efforts to liberalize the economy and increase the role of the private sector. Recent decontrolling of producer prices has led to increased agricultural production, but further policy reforms are needed if the country is to break the vicious circle of underdevelopment of which it is a hostage. These required policy reforms affect practically all the facets of the socio-economic life of the country.

Within the realm of public finance, it should be noted that the economy generates hardly any savings. The resource balance, i.e. the difference between resources required and resources available, is negative and stands at the rate of 18-19% of GDP. Investments, therefore, are <u>solely</u> financed by foreign funds and transfers. Under the circumstances one major source of savings could conceivably lie in the public sector. But the budget itself has been in deficit for quite some time. Total government revenues are insufficient to cover current expenditures. The reform of the public finances, i.e. of both revenues and expenditures, and their rationalization thus acquires paramount importance. The public expenditures remain beyond the scope of this report. Its weight is on tax revenue, its possible reform, and suggestions conducive to such a reform.

3. Major Findings

3.1 Tax Burden:

Tax burden is not high in Somalia. Tax revenue as a percent of GDP averaged about 6.2% during the last three years. In fact the burden has been declining. During the late seventies tax burden was well over 13%. In 1983, it declined to 12.4%, and in 1986 to 6.9%. This is the last year for which we have some reliable macroeconomic figures.

It must be noted, however, that the overall macro measure of tax burden can be rather misleading. A more micro approach, i.e., relating each tax to its proper base, yields different results. Import taxes for instance are a heavy burden on some imports; several taxes such as excises and sales tax are imposed on a limited number of transactions, often with high total rates. This heavy concentration of taxes on certain commodities does not imply that tax revenues cannot be increased above their present level. Undoubtedly the government has the faculty of imposing new taxes or raising the rates of the existing tax. As it will become evident from the rest of this report, however, these alternatives are not as preferable as either improving tax administration, thereby raising revenue with respect to the already established base, or controlling expenditures. The latter alternative, of course, is beyond the scope of this report.

3.2 Tax Structure:

The structure is weighted heavily toward indirect taxes, i.e., custom duties, excises, sales tax, etc., with import duties being by far the major source of revenue. The weight of indirect taxes within the overall tax structure eventually should be reduced. Given the need for revenue, such restructuring at present is not feasible. There will also be administrative problems given the lack of taxpayer identification and private and public sector recordkeeping. The overall structure of taxes violates two of the basic principles of taxation, namely equity and efficiency. Certain measures are suggested in this report to redress the situation.

3.3 Tax Administration:

The administration is weak. It suffers from a lack of trained personnel but not from inadequate staff size. It also suffers from the lack of documentation, equipment, and other amenities that are necessary for a better administration. It is the firm belief of this report that better administration can quickly lead to increased tax collection. Enforcement is almost nonexistent for a number of reasons. Better administration does lead to a better tax collection when it is coupled with taxpayers' education.

3.4 Tax System and Development:

Regardless of intent, the structure of the tax system is not conducive to private sector development. Although tax laws contain a number of incentives for agricultural and industrial development, their effectiveness is questionable at this point. Moreover, it appears that there is no harmonization between fiscal policy and other policy measures conducive to private sector development.

4. Major Recommendations:

The totality of recommendations are listed here in a summary form. These recommendations are derived from the subsequent chapters where specific issues are analyzed and the reasons for each recommendation are clearly indicated. One cannot overemphasize enough that to implement all the recommendations at once would result in more harm than good. A priority list will have to be drawn out and short term measures will have to be separated from the long term ones. Improvements in administration via training of lower level employees, reforms in customs duties, updating the valuation list, identification of taxpayers, and the unification of excise and sales duties--as well as levying them at a single stage--may very well be considered as short term goals.

4.1 Recommendations Related to Foreign Trade Taxes:

- Eliminate, as much as possible, the numbers of items exempt from tax.
- Reduce arrears.
- Eliminate remaining specific duties, i.e., taxes related to the quantity of items, not value.
- Simplify the list of goods subject to import taxes.
- Harmonize the rates and eliminate inconsistencies.
- Update the valuation list and keep it updated; seek additional information on a regular basis from abroad for updating.
- Consider the possibility of contracting a consulting firm for improving duty collection.
- Review export taxes; consider the possibility of elimination or a reduction of rates.
- Design a system whereby a favorable exchange rate may be recognized for the exporters in order to eliminate hidden export taxes.
- Eliminate stamp duty on exports.

4.2 Recommendations Related to Taxes on Goods and Service:

- Fortify enforcement, audit and tax collection.
- Combine excises and sales tax.
- Eliminate the cascading effect by imposing tax at a single stage, preferably at the import/production stage.
- Review the desirability of increasing the hotel service tax to 10%.
- Review the feasibility of imposing an "airport departure" tax, in the near future.
- As administration improves, consider the feasibility of extending "service tax" on other services.

4.3 Recommendation Related to Income Tax:

- Take immediate measures for identifying taxpayers since this measure is a prerequisite for the subsequent improvements.
- Enforce all requirements for obtaining accurate data from employers in order to identify and determine employee salaries, tax liabilities and their taxes deducted at source.

- As administration improves, consider unification and revision of tax schedules applied on various income sources.
- As administration also improves substantially, revise the definition of taxpaying unit.
- Enforce the law much more vigorously and increase penalties for tax evasion and tax arrears.
- Design a campaign to educate taxpayers.
- Require businesses to maintain better bookkeeping and enforce the regulations.

4.4 <u>Recommendations to Foster the Private Sector</u>:

- Revise all tax incentives, systematize them; eliminate arbitrariness.
- Make tax incentives consistent with the rest of the policy measures.
- Consider immediately the feasibility of eliminating export duties.
- Consider the possibility of unification of excise and sales tax, and its imposition at a single stage of activity.
- Improve administration of customs thereby making customs clearance efficient and speedy.
- Reduce smuggling as much as possible.

(N.B. Most of the above are mentioned among other recommendations as well).

4.5 <u>Recommendations Related to Administration</u>:

- Prepare job descriptions for each post in the Ministry.
- Prepare up-to-date information on personnel and have a personnel file for each employee.
- In due course computerize personnel information file.
- Fortify the "Statistics and Planning Office" to enable the unit to have current information on budget statistics, financial legislations, monthly tax collections, etc. This office should be in a position to prepare annual reports, estimate collections on a monthly basis and monitor the progress of tax collections.
- Take necessary steps for installing a suitable computer for data storage and analysis.
- Undertake a program of training within the Ministry (ongoing basis); determine the needs and the scope for such training. Start the training process from lower to higher echelons; make full use of local expertise as well as available foreign expertise in the Ministry.
- Start a program for taxpayer education.

- Take a leading position in the country for the improvement and standardization of public and private bookkeeping, thereby hastening the day when taxpayers are expected to maintain accurate records for tax purposes.
- Draw a timetable and an action plan for administrative improvement; determine the budget for such improvements indicating the necessary financial and technical assistance.

5. Priorities and Timing:

- Recognize the fact that all changes suggested in this report--even if they are accepted as necessary--cannot be implemented at once.
- Make short term and medium term improvement plans.
- In making such plans delineate priorities clearly, moving always from simple to more complicated changes and reforms, advancing forward in a block building fashion.
- Realize that changes, improvements and reforms require, more efficient work effort. Keep in mind that a better remuneration of employees is necessary since better output is expected of them.
- Prevent piracy of trained employees first within the public sector. Consider eventually the ways and means of preventing such piracies from public to private sector. It would be a serious drain of resources if after training, employees move from Ministry of Finance to elsewhere.
- Finally after developing a plan for reforms seek additional financial and technical assistance.

CHAPTER TWO

OVERVIEW OF THE TAX SYSTEM

1. Introduction

Certain general and methodological considerations are in order before entering into the discussion of Somalia's tax system. The first and perhaps the most important is methodological in nature and refers to the recognition that any fiscal variable, whether referring to taxes or expenditures, can have a meaningful policy connotation only if considered within the general structural framework of a given economy, so that its implications as well as those of its alternatives can be gauged within the proper perspective, and the most feasible policy decision can be taken. Taxation and expenditure programs of each country will have to be defined as that level and pattern of taxing and spending that corresponds to its own proper and independent variables.

It is of importance to also keep in mind that economic development depends, among other conditions and variables, on a carefully thoughtout tax and expenditure structure. Tax structure considerations become particularly important where public expenditures have a tendency to rise faster than output and governments are usually reticent to control expenditures. As will become evident from the subsequent discussion, while in many LDCs taxes are not buoyant, and Somalia is no exception, government expenditures show exactly the opposite tendency.

Thus, an analysis of a tax system can only be meaningful if such analysis relates the tax system to the overall budget and places it within a general socio-economic frame of reference. The present report cannot pretend to be such an exhaustive one. The monumental task, though necessary, will have to await its opportune moment. Within a much limited and narrow scope this chapter aims at identifying the main characteristics of Somalia's tax system and evaluating it in general terms by means of widely accepted criteria. These criteria are derived from the overall economic goals of the country, such as revenue yield, responsiveness of the tax system to macroeconomic changes, equity, economic efficiency, and economic growth. In the subsequent chapters these criteria will be applhed in frdater detail to each tax b`tegory so that policy recommendations can be ddrived. Given Somalia's particular circulstanber, tax administration will bd analxzdd in great detail in the last chapter of this report.

2. <u>General Characteristics</u>:

The most striking characteristic of the Somali tax system is its excessive reliance on revenue from taxes on foreign trade, especially from import taxes. As can be seen from Table II.1 about 50% of the total central government revenue (i.e., tax and non-tax revenue) consists of taxes on imports and exports. Considering that the export taxes are really insignificant, the weight is on the import duties. In addition to revenue classified under import taxes, a proportion of revenue comes from other taxes applied to imports such as stamp duties, excises, sales tax, etc.

A corollary to this is the relative unimportance of the direct taxes.[1] In fact, even if we include the income generated by public enterprises, direct taxes on income account for at most only 10% of the total revenue. To some extent low reliance on direct taxes is understandable, even inevitable, since the tax base is extremely narrow and a sizeable section of the population is basically outside the cash economy.[2] Structural and administrative deficiencies, characteristics which are inherent in the tax system, are at least partially responsible.

A very important characteristic of the system is that taxes are layered, schedular and cascading. In part, perhaps due to administrative necessity, different taxes apply to the same base. For example, some imports are taxed by custom duties, administrative and statistical tax, excises, sales tax and stamp duties. The income tax is schedular rather than global. Incomes from different sources are subject to different rates without any rationale behind such differences. Moreover, there exists a great deal of inefficiency in identifying taxpayers. A deficiency of this nature compounds the negative aspects of a schedular tax. Sales tax is a cascading tax since it is imposed on a good at each stage of the economic process.

Another characteristic of the system is the erratic enforcement of many taxes. Suffice it to note that tax liability arrears are considerably higher than what is usually permissible in LDCs that are at about the same economic level as Somalia.[3]

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1 Taxes on wages, salaries, profits, property and property income from public enterprises and public enterprise profits.

2 According to 1984 census of population, 25.4% of the population is urban, 28.6% rural and 46.0% nomadic.

3 Tax arrears constitute a major problem in all LDCs. However, the case of Somalia appears to be exceptional. It is difficult to quantify the arrears, but two

Table II.1

Central Government Revenue

(Million Shillings) 1978 - 1986

Item	1978	1979	1980	1981	1982	1983	1984	1985	1986(1)
Total Revenue	1,419.6	1,526.0	1,421.4	2,250.6	2,587.6	4,074.5	3,773.7	5,220.0	9,287.7
Tax Revenue	1,228.2	1,377.1	1,242.1	2,067.3	2,477.9	3,463.5	2,979.9	4,582.4	8,379.6
Tax on Net Income	74.4	90.8	94.6	145.8	133.3	269.2	302.7	311.4	1,014.8
Tax on Earned Income(2)	68.0	83.0	86.2	113.2	90.5	94.7	123.5	141.5	251.1
Other Income Taxes(3)	6.4	7.8	8.4	32.6	42.8	174.4	179.2	169.9	763.7
Property Registration Tax	45.0	60.5	67.2	142.2	84.5	166.5	136.1	166.5	304.9
Enterprise Turnover Tax(4)	74.0	62.3	49.5	65.4	202.8	92.5	1.1	5.0	0.0
Taxes on Goods & Services	227.1	71.0	139.0	312.5	472.0	304.7	458.7	1,129.2	1,832.4
Sugar and Spirits	98.5	19.6	51.0	196.7	323.2	106.5	177.6	326.5	530.8
Fiscal Monopolies	118.6	18.1	55.0	55.8	83.7	118.3	93.1	245.4	423.1
Motor Vehicle Tax	2.8	4.8	6.1	6.8	7.4	10.4	7.2	9.1	9.7
Sales Tax	0.0	0.0	0.0	0.0	0.0	0.0	71.9	181.7	412.4
Other	7.2	28.5	26.9	53.2	57.7	69.5	108.9	366.5	456.6
Taxes on Internal Trade	704.4	944.0	765.2	1,206.4	1,398.5	2,332.1	1,863.4	2,640.2	4,738.5
Customs duty	702.8	774.6	565.9	922.4	1,039.1	1,662.0	1,333.0	1,719.1	3,280.7
Adn/stat tax	114.3	153.3	180.9	233.7	236.2	536.3	483.1	831.7	1,374.9
Export Duties	17.3	16.1	18.4	50.3	123.2	123.8	37.3	89.4	82.9
Stamp Taxes	103.3	148.5	126.6	195.0	186.6	308.5	227.9	330.1	488.7
Non Tax Revenue	191.4	148.9	179.3	183.3	109.7	611.0	793.8	637.6	908.1

1. Figures for 1986 and 1987 are provided by the Ministry. Figures for 1978 to 1985 are from World Bank Report No. 6542-SO. 1978-85 figures are essentially, but not completely, comparable with subsequent years. In 1986, the Ministry of Revenue made extra-ordinary efforts to collect arrears. Arrears collected appear in their respective tax categories and it was impossible to separate them form current tax collections. Penalties and interest collected are excluded.

2. Includes extraordinary tax while it was imposed.

3. The substantial increase in this category beginning with 1987 is due to the construction activities financed by the Italian Fund. Corresponding taxes were directly reimbursed by the Italian Government to the Somali Treasury.

4. Rates are determined by the Minister of Finance on some public enterprises that report profit. As of 1986, this revenue is included under "other income taxes."

5. 1987 figures are included for comparative purposes only since little macroeconomic data are available for 1987 at this stage. Subsequent analysis will be done only for the period of 1978-1986.

Table II.2
GROWTH OF CENTRAL
GOVERNMENT REVENUE (1978=100)

	1979	1980	1981	1982	1983	1984	1985	1986
Total Revenue	107.5	100.1	158.5	182.3	287.0	263.1	388.8	654.2
Tax Revenue	112.1	101.1	163.3	201.6	282.0	220.6	373.1	682.3
Tax on Revenue	122.0	127.2	196.0	179.2	361.8	414.7	418.5	1,364.0
Taxes on Goods & Services	313.0	61.2	137.6	207.8	134.2	202.0	497.2	806.9
Taxes on International Trade	134.0	108.6	171.3	198.5	329.7	263.1	374.8	672.7
Stamp Duties	143.8	122.6	188.8	163.2	298.6	220.6	319.6	473.1
Non-Tax Revenue	77.8	93.7	95.8	57.3	319.2	414.7	333.1	474.5

Source: See Table II.1

TABLE II.3
SHARE OF TAXES IN TOTAL REVENUE
1978-1986

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Tax Revenue	86.5	90.0	87.4	91.9	95.8	85.0	79.0	87.8	90.2
Taxes on Income	5.2	6.0	6.7	6.5	5.2	6.6	8.0	6.0	10.2
Taxes on Goods & Services	16.0	5.2	9.8	13.9	18.2	7.5	12.2	21.6	19.7
Taxes on International Trade	49.6	62.9	53.8	53.6	54.0	57.0	49.1	50.6	51.0
Stamp Duties	7.3	28.2	8.9	8.7	7.2	7.6	6.0	6.3	4.9
Non-Tax Revenue	13.5	9.8	13.0	8.1	4.2	15.0	21.0	12.2	9.8

Source: See Table II.I

Within these preliminary observations we can now turn our attention to the tax system prescribed by law.

3. Central Government Tax System -- A Summary:

3.1 Taxes on Net Income and Profits:

In this general category the following taxes are imposed:

3.1.1 Taxes on Companies, Corporations and Enterprises:

This tax comes from Law No. 3 of February 19, 1966, which has been amended in various dates.

The Nature of the Tax: It is applied on net income from Somali sources accruing to or received by domestic companies and enterprises. Foreign companies are taxed on income derived only from Somali sources. The law provides the following exemptions:

(a) State and local administrations;
(b) International organizations;
(c) Charitable, educational and cultural organizations; and holders of special concessionary agreements.

The law also allows the following deducations:

(a) 40% of undistributed profits or 25% of taxable income whichever is lower if the amount is set aside for investment; and,
(b) Ordinary and necessary expenses, interest paid, depreciation, net losses, contributions to gratuity funds.

The Tax Rate: 35% of net taxable income.

3.1.2 Taxes on Individuals:

Taxes on individuals comprise taxes on income from employment and other taxes on net income. As can be seen, the rate and other regulations vary depending on the source of income.

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indicators may suffice to illustrate the point. One indicator is the budget entry of "arrears" which fluctuates widely, from year to year, and leads even a casual observer to believe that large arrears do exist but the enforcement is lacking. The second indicator is the inherent and extraordinary inefficiency in administration.

3.1.2.1 Taxes on Income from Employment:

This tax is applicable to monthly income from employment in Somalia, including wages and salaries, bonuses, fees, severance pays and payment in kind. Only income earned in Somalia is taxable. The employer is responsible for withholding the tax and paying the government monthly.

The law recognizes the following exemptions:

(a) Diplomatic personnel of foreign governments;
(b) The President of the Republic;
(c) Members of the Armed Forces below the rank of non-com officers;
(d) Social Security allowances provided that the average amount per year of service is not greater than SoSh. 200;

The Law also recognizes the following deductions:

Social security and pension fund contributions;
Stamp tax.

The following rates apply to monthly taxable income:

Monthly taxable income (Sh)	rate (%)
Less than 201	0
201 - 800	6.3
801 - 1500	12.6
More than 1500	18.9

It is worth noting that no deductions, allowances or credits are recognized for family status, dependents, etc. Each member of a family pays his (her) tax separately.

3.1.2.2 Other Taxes on Income:

In this category there are a variety of taxes: (1) a tax on net income from sources other than real estate and employment; (2) income from real estate and (3) local administration tax and trade licenses, now retained by the Central Government. Legal base of these taxes is also Law No. 3 as subsequently amended.

The law provides certain deductions such as necessary expenses incurred, depreciation, etc.

Income other than from employment and real estate is subject to a progressive schedule and the rates are as follows:

Annual income (Sh)	rate
Less than 2,401	0
2,401 - 3,600	9
3,601 - 4,800	11
4,801 - 6,000	13
6,001 - 7,200	15
7,201 - 8,400	17
8,401 - 9,600	19
9,601 - 10,800	22
10,801 - 18,000	25
18,001 - 30,000	28
More than 30,000	30

Income from real estate rentals, on the other hand, is subject to a flat rate of 21%.

The tax on trade licenses varies depending upon location and categories. The fixed amount fluctuates between SoSh 50 and SoSh 300 in Mogadishu and SoSh 25 and SoSh 300 in other local administrative areas depending upon the license category.

3.2 Taxes on Property

3.2.1 Inheritance Taxes:

The legal base is Law No. 5 of December 28, 1971 as amended subsequently, and various decrees. The tax base is transfers by reason of gift or inheritance. It is payable by the estate or by donor on the basis of the actual value transferred or net value of the share of the estate located in Somalia. An estate whose value does not exceed SoSh 300 is exempt.

Rates are progressive, varying between 4 and 12%.

3.2.2 Property Transfer Tax:

Registration taxes are levied on the transfer of liquid assets and real estate. Contracts and mortgage transfers are also taxable.

There are no specific exemptions or deductions. The rates vary according to the type of property transferred. The schedule is as follows:

Property Transferred	Rates (%)
Real and Immovable	11
Movable	4
Tenders and Contracts	1
Mortgages	2

3.3 Taxes on Goods and Services

3.3.1 Selective Excises:

The legal base for this tax is Law No. 10 of June 10, 1963 as subsequently amemded. The tax base includes both locally manufactured and imported goods, and is calculated on the price charged to the wholesaler or by the custom valuation. There are about 30 items subject to excises. Export goods and alcohol used for medical purposes are exempt.

Rates vary from 5-100% and they are ad-valorem by nature (Table IV.3).

3.3.2 Sales Tax:

The legal base is Law No. 2 of January 7, 1984. The tax base varies. It is levied on the value of goods imported (inclusive of customs duties). The tax is also levied at the manufacturing level and at the wholesale level, as well as on hotel services.

The following items are exempt: Food (except canned), medicine, fuel, electricity, water, domestic agricultural products, livestock and exports.

The rate is 5% at each stage of activity.

3.3.3 Motor Vehicle Taxes:

The legal base of the tax is legislative Decree No. 4, December 28, 1965, as subsequently amended by various laws.

The tax is levied on all motor vehicles as a one time ad-valorem tax at the registration level. Whenever the title of the vehicle is transferred the base is the transfer value.

Diplomatic vehicles, official state vehicles, vehicles used by hospitals, fire departments are exempt.

The tax rate is 2% of c.i.f. value when first registered. Transfer tax is specific according to use and the size of the vehicle.

3.4 Taxes on International Trade:

3.4.1 Import Duties:

There are basically two types of import duties: customs duties and administrative and statistical tax.

3.4.2 Custom Duties:

The legal base is Law No. 7 of June 10, 1963 as subsequently amended by laws and decrees.

The tax base is the c.i.f. value of all imports. Tariff classification is according to CCCN. Either invoice or letters of credit may be taken as declared value. Custom valuation[4] lists are used for imports without invoices. Certain adjustments are made to the value of imports if an import item is classified as non-essential (20% above the declared value) or if classified as imports under the external accounts (50%). In other words, certain items are subject to value modification, irrespective of the declared value.

Exemptions are varied. Imports of diplomatic and international agencies are free of duties. Imports of machinery and equipment by newly established agricultural, industrial and oil prospecting enterprises are also imported duty free. The power of granting exemption is vested in the Minister of Finance.

The rates were a mixture of ad-valorem and specific, though specific rates have now been eliminated. While food, machinery and equipment are subject to low rates, luxuries are subject to high rates (see Table III.1).

3.4.3 Administrative and Statistical Tax:

The legal base is Legislative Decree No. 9 of December 19, 1966 as amended. The tax base is the value of imports as determined for the purpose of custom duties.

The same exemptions are applied to this tax as are applied to custom duties. The rate is 20% of the assessed value, a few food items are subject to 10% tax.

3.4.4 Export Duties:

Legislative Decree No. 7 of June 10, 1963 as amended constitutes the legal base. The tax base is the F.O.B. value of exports of certain commodities, except livestock whose value is predetermined by the government. All goods not specifically listed are exempt from export duties.

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4 Valuation List is explained in detail in Chapter Three.

The rates are varied and mostly ad-valorem.

Export Item	Tax Rate (%)
Livestock	25
Gum Arabic	12
Animal Fat and Butter	15
Gray Amber	30
Charcoal	65
Animal Skin	Varied

3.4.5 Harbor Fee:

Legal base is Law No. 3 January 10, 1978. The tax is levied on all goods loaded or unloaded at national ports. The same exemptions applicable to custom tariffs are also applicable to the harbor fee. The rate is 3.0% of the value of goods.

3.5 Other Taxes

3.5.1 Stamp Tax:

Legislative Decree No. 6, December 7, 1966 as amended constitutes the legal base. The tax is levied by affixing stamps on documents related to invoices, bills of lading, credit instruments, etc. (2% ad-valorem); it is also levied (specific) on most fiduciary documents, ship manifests, etc. Rates vary from SoSh 6 to SoSh 10 per sheeted legal documents and SoSh 200 for ship manifests.

4. Revenue Adequacy and Expenditure Growth

The main concern of Somali tax policy appears to be the collection of sufficient revenue to support the growth of government expenditures. Nevertheless, revenue collections remain low. Other objectives such as efficiency, equity, and stimulating economic growth (especially private sector economic growth) seem to be subservient to tax collections.

Even a cursory look at the changes that took place in the tax legislation during the last decade or so indicates that all efforts have been directed almost solely toward raising revenue. The economic effect is not encouraging. Not only has the tax structure led to inequities and distortions of economic efficiency, it also has resulted in decreased revenue with respect to GDP. A quick look at the aggregate fiscal indicators (see Table III.4) shows that in 1978 total revenue as percent of government expenditure was 59.9% while in 1985 it stood at the level of 46.3%. Total revenue as percent of GDP decreased from

22.5% to 7.0%. Considering the fact that an appreciable portion of the economic activity occurs outside of the cash economy, and therefore outside of the tax net, a better measure would be to relate total government revenue to non-farm GDP. In 1978, total revenue as percent of non-farm GDP was 37.1% while in 1986 it was 19.1%.

Although there is no precise or widely accepted norm for determining taxable capacity or the tax burden, it seems Somalia is having difficulties in raising additional revenue given the existing base.[5] It must be understood right at the outset that limits to the raising of revenue depend upon a number of economic and non-economic factors such as the resource base, the degree of monetization of the economy, the degree of openness as well as the administrative apparatus and institutional and cultural elements.

Several policy measures can be considered to increase the revenue to meet the ever increasing expenditures. One could raise the rates of existing taxes or impose additional taxes on the same and already taxed base. Both measures would raise the tax burden on the same source. Alternatively, one can take measures to raise revenue by (a) imposing new taxes on bases that

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5 If the tax burden (defined as tax revenue as percent of GDP) of Somalia is compared with the tax burden of other countries which are approximately of the same development level, the point becomes more apparent. As the index indicates, the Somali tax burden is considerably less than most of the other countries where per capita income varies around $250 per annum.

Tax Burden Index

	Somalia = 100.0
Bangladesh	122.0
Burundi	119.5
Ethiopia	47.5
Haiti	136.8
Lesotho	66.5
Nepal	116.6
Rwanda	115.2
Zambia	192.6

Based on 1986 or nearest year figures.
Source: IMF International Finance Statistics January 1988 and IMF Government Finance Statistics Yearbook 1987.

are presently not taxed; (b) by improving the administration and assuring that legally imposed taxes are actually collected; or (c) by controlling the expenditures. Since the scope of this report does not cover government expenditures, their control and their rationalization, the alternative (c) is not examined here. Specific measures with respect to alternatives (a) and (b) are put forward throughout this report.

Table II.4 - Aggregate Fiscal Indicators

Indicator	1978	1985	1986
Total Revenue as % of Total Gov't Exp.	59.9	46.3	75.8
Total Revenue as % of GDP	22.5	7.0	9.5
Tax Revenue as % of Non-Farm GDP	37.1	19.1	24.8

Source: National Account Aggregates 1977-86, Ministry of Planning, and data supplied by the Ministry of Finance.

5. Responsiveness of the Tax System

Taxation can play a variety of roles in an economy. Over the short run it can stabilize the economy counteracting a recession or an inflation. Over the long run taxation may mobilize increasing amounts of resources to sustain public expenditures which might have high development content in terms of infrastructure expenditures or in the form of productive investment. It can be conducive to resource mobilization and private investment as well. These functions of the tax system are contingent upon its responsiveness to fluctuations in prices and economic activity.

The automatic responsiveness of a tax is measured by the elasticity of its yield with respect to the effective base, whereas the overall responsiveness is given by the buoyancy of its yield to its base. The elasticity indicates the percentage change in tax revenue with respect to the percentage change in the effective base under a stationary tax structure, e.g., no change in tax rates, regulations, etc. The buoyancy represents the percentage change in tax revenue including the effect of tax policy changes as a proportion of a given percentage change in the base. Following this definition, the buoyancy estimates are presented for the major categories of tax in Table II.5. It is calculated by simply averaging the ratios of annual percentage changes in revenue and the changes in the proxy base for each category during the 1982-1986 period. Given the scarcity of data as well as the time constraint, no attempt was made to calculate elasticities. Several of the buoyancy estimates are related to non-farm GDP rather than to total GDP, because of the assumption made that the agricultural/non-cash sector pays no tax.[6] Moreover, the national account estimates of farm sector output are far less reliable than those with respect to non-farm GDP, the reliability of which is also questionable.

As it can be seen from Table II.5, the buoyancy with respect to GDP (irrespective whether adjusted to a non-agricultural income or not), is substantially below unity. Irrespective of whether long-term (1978-1986) or short-term (1983-1986) periods are taken, revenues are growing at a slower rate than GDP. Only taxes on income other than wages and salaries and taxes on goods and services indicate some buoyancy, but their relative weights are rather insignificant within the total tax collection. Import taxes are now beginning to show some buoyancy, and only during the last three years. During this period the shilling value used for import purposes increased greatly and therefore the customs tax base expanded.

Therefore, the overall responsiveness of the tax system is still far from being satisfactory. There are several inferences that can be drawn from these buoyancy coefficients. First of all, despite the changes in rates and the imposition of additional taxes (such as sales tax), the overall system is still not sufficiently responsive to economic changes. Secondly, tax enforcement and tax compliance are far from being satisfactory as can be seen from the declining buoyancy coefficient of taxes on income other than wages and salaries. Thirdly, the Somali tax system cannot be used effectively as tools of stabilization and resource mobilization. Clearly, therefore, any attempt to improve significantly these two properties of the tax system would require an extraordinary expansion of the Central Government's effective tax jurisdiction to the entire economy.

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6 This assumption was made not because the agricultural sector pays no tax, or should pay no taxes, but simply because the non-farm sector, being far more monetized, provides tax bases that can be more easily exploited.

Table II.5 - Buoyancy Estimates of Major Taxes

Tax Category	Effective Base	Buoyancy Coefficient 1978-1986	Buoyancy Coefficient 1983-1986
Adjusted tax revenue	GDP	0.65	0.71
Adjusted tax revenue	Non-farm GDP	0.56	0.45
Tax on employment income	Non-farm GDP	0.37	0.37
Other income taxes[7]	Non-farm GDP	2.28	1.04
Taxes on goods and services	Non-farm GDP	0.96	0.78
Import duties[8]	Imports c.i.f.	0.93	1.25
Export taxes	Exports fob	6.06	0.33

Source: Buoyancy calculations are based on data obtained from: National Accounts Aggregate, 1977-1986, Ministry of Planning, Mogadishu. Somalia World Bank Report No. 6552-SO and data provided by the Ministry of Finance.

6. Equity, Efficiency and Growth

6.1 Equity:

Equity simply means equal treatment of equals. In other words, those taxpayers who are at the same economic level or capacity should pay the same amount of taxes. Conversely, those who are at a higher (lower) economic level should pay progressively more (less) tax.

In order to pass any judgement with some certainty as to whether the tax system in Somalia is equitable or not, a tax incidence study must be conducted. Such a study, however, requires data related to household incomes and expenditures, size of families, numbers of income earners, etc. No such data are available at present in Somalia. The only way to discern some idea of equity is to look at the statuary tax system.

A cursory look at the tax rates reveals the following: taxes on income do not treat equally the taxpayers who are in equal circumstances. For example, if income is derived from employment and the yearly income is, say, SoSh 9600 (SoSh 800X12)

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7 Including income from public enterprises.

8 Including administrative and statistical duties but excluding harbor changes.

the tax rate is 6.3%. On the other hand, if a person (assuming the same family composition) derives the same amount of income from activities other than employment, the tax rate is 19%. If again the same income is derived from real estate rental, the rate is 21%. This is a clear violation of equity. Even within the same source of income, the treatment is unequal. Let us assume two families, one composed of husband and wife but no dependents and one wage earner, and the other composed of husband and wife, three dependents and again one wage earner. In both cases the wage earner pays the same amount of employment tax on the same wage level, yet both families are totally unequal.

One last example, perhaps, highlights the matter even more clearly. Again let us take two families composed only of a husband and wife. In one family, only the husband derives income from employment and his taxable earning is SoSh 1500 per month. His tax liability, according to tax schedule is therefore SoSh 126 per month. The other family has two wage earners, i.e., both husband and wife work, and each earns SoSh 750 per month, in this case the total family income is still SoSh 1,500 per month, but the total tax paid is only SoSh 95.50 per month (SoSh 47.25 x 2). Clearly, same family income is treated very differently, which violates the very basic concept of horizontal equity, in other words equal treatment of equals.

A certain amount of equity in the form of vertical equity (different treatment of families in unequal income levels) appears to exist in the tax system via the import duties. Although it is impossible to quantify such a contention even in the most rudimentary form, one can assume that since non-necessity items are subject to high import duties and since such items can only be consumed by higher income groups, some vertical equity might exist in the system. However, since a fairly large non-cash economy also exists in Somalia, one can say that <u>the system in all probability is not conducive to equity</u>.

Another important aspect of the equity consideration is the relationship between inflation and progressive tax rates. The present inflationary conditions of the country make a progressive tax on employment income and other personal income less equitable in the vertical sense because cost-of-living wage increases tend to raise the tax burden on households as they are placed in successively higher taxable income brackets, even though the real income may remain the same.

It should be kept in mind that during recent years the cost of living in Somalia increased rather dramatically. Measured by the consumer price index, between 1980 and 1986 prices increased 760%.[9] This increase, even with a lag, must have been reflected in some salary increases, thus pushing the nominal earnings up to higher brackets.

6.2 Efficiency

Growth and development depend on the utilization of scarce resources in activities that have the highest marginal return. In simple terms, resources both from the public as well as from the private sectors must be directed towards those activities where the return (in a social sense) is the highest. The tax system, much like public expenditures, can enhance as well as hinder the efficient allocation of resources. In general terms, taxes as well as government expenditures influence decisions such as allocating time or income between work and leisure, between consumption and savings, between purchases of domestically produced and imported goods, etc.

Taxation performs the allocative function by altering commodity prices and factor incomes. Factor income, due to a reasonably large labor force employed by the government, and the commodity prices, due to direct and indirect price control, remain under the jurisdiction of the government. Neither time nor available statistics would permit this report to enter into the intricacies of a cost/benefit analysis of fiscal and regulatory policies. However, certain observations still can be made with respect to efficiency.

In the foreign trade area, relatively high tariffs on many consumer items, coupled with foreign exchange restrictions contribute to an artificial over-valuation of the Somali shilling.[10] This in turn can easily hamper exports and can make the imported investment goods artificially cheaper with respect to labor. Cheaper capital goods encourage capital intensive production methods in a country like Somalia where unemployment and disguised unemployment are rampant.

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9 Somalia: Recent Economic Development, 1987 the World Bank op.cit, p. 113.

10 Many consumer items enter into the country illegally and the payments to exporters are made with foreign exchange obtained in the black market--a transaction that creates wide disparities between fixed and legal rates of exchange and the rate that fluctuates according to demand.

Again, within the foreign trade area another distortion that in all likelihood may hamper efficiency is the wide application of duty exemptions. Such exemptions undoubtedly encourage the importation of goods that do not necessarily have much development content.

Another distortion is also introduced into the system via import bans. Items which are banned can and are smuggled into the country. As a net result, the process deprives the treasury of its rightful revenue and thus the budget deficit turns out to be larger than it might have been otherwise. Additionally, since smuggled goods are financed by the black market foreign exchange, an artificial shortage is created which in turn may hamper the importation of essential goods (e.g., spare parts) and therefore has negative effects on economic efficiency. So far as the direct taxes are concerned, the system, as it is, in all probability gives rise to further inefficiencies. In an inflationary economy like the Somalia economy, wages and salaries always lag, especially in the public sector. There must exist an exodus from the public to the private sector where the salaries are much more on a par with the level of inflation. Granted the private sector is very limited and the employment opportunities are not excessive. Even so, however, especially well trained persons who can obtain higher paying jobs in the private sector may leave the public sector. A constant shortage of qualified personnel in the public sector is obviously not conducive to efficiency.

The above remarks cannot be quantified at this stage, but observations and conversations with the responsible and knowledgeable persons lead this report to sustain that the Somalia tax system at present cannot be said to be very conducive to efficiency.

7. Tax System and the Private Sector

Given the overall development level one can easily surmise that the private sector in Somalia is still in its infancy. Being basically an agricultural society, the private sector other than agriculture was, for a long time limited to trading activities. Industrial activities, i.e., manufacturing, processing, etc., are somewhat recent. Yet, Somalia, like all developing countries, also aspires to expand its industrial sector as well as to rationalize its agricultural sector. Although for quite sometime in the recent past the impetus for industrial development was expected to come from the public sector via public enterprises, the development policy stand should be to fortify the private sector.

To stimulate and to support the private sector requires a host of policy measures which are in fact interrelated. For example, fiscal and monetary measures such as taxes and government expenditures on the one hand and foreign exchange regulations and interest rates on the other cannot really be looked upon as two sets of policies that are independent from each other.

The present study, however, cannot at this stage enter into the discussion of all the policy measures which are conducive to private sector development in Somalia. The discussion here is limited only to those measures pertaining to tax policy, while fully realizing that tax policy does interact with the rest of the policies.

The Government at present has two major tax policy instruments conducive to private sector development. One set of policy refers to custom duties and the other involves income tax exemptions or tax holidays.

Incentives to a given sector through custom tariffs can take two forms. One is to protect local industry from the competition of imported goods by levying high import duties as well as other charges so that the c.i.f. value of imports plus taxes renders the price of the good the same or usually higher than the price of the same good produced locally. The other side of the coin is to exempt those imports from import taxes which are used as inputs in local manufacturing activities (or tax them minimally).

Somalia makes use of both methods. Several inputs are exempt (or very lightly taxed) if they are used in the agricultural sector, or in manufacturing or in petroleum explorations. This exemption applies to all capital equipment imported either to establish new enterprises or to expand an already existing enterprise which intends to renew its facilities or to raise production.

Bona fide raw materials, defined as materials in their natural state, and used as inputs by the local manufacturers are also exempt from import and administrative and statistical duties (or subject to reduced rates). For example, certain raw materials and spare parts are subject to only 50% of customs and administrative and statistical duties. (Law No. 8, January 1984)

In addition to the above mentioned general rules, the Minister of Finance has the discretionary power to grant exemption from import duties to a particular enterprise if the enterprise is deemed to be in need of such exemptions in order to survive; or to an enterprise which has prospects of creating employment.

From the available information, it is very difficult to discern which imports are heavily taxed for the purpose of protecting local industries and which ones for the sole purpose of generating government revenue. In fact, the primary objective in Somalia has long been to generate government revenue, and nominal rates are rather high.[9] Undoubtedly several import items are prevented from being an effective competitor of the same locally produced items, but it is also conceivable that such protection is only a by-product of revenue objectives of the government.

Certain tax holidays are also in effect. The income tax law (Art. 17) states that the Minister of Finance, upon the recommendation of Minister of Industry and Commerce, may, as an exceptional measure, exempt new industrial or agricultural enterprises from income tax. The exemption period, however, cannot exceed 10 years. Already established businesses may also benefit from such exemption if such businesses radically enlarge or renovate production capacity and/or production processes. An enterprise applying for the exemption must prove that the production or renovation implies severe and extraordinary risk. The burden of proof is on the applicant. In any case, income exempted from tax cannot exceed 10% of the invested capital.

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9 Incentives to a chosen sector cannot be quantified through nominal tariff rates. The impact of government incentives for industrial (or agricultural) development must make a distinction between nominal and effective rates, and the protection of native industrial sectors and subsectors should be protected by the custom taxes based upon effective rates. Indeed, if and when the government of Somalia takes the necessary steps to rationalize and harmonize its incentives program with the overall system and with the well articulated development criteria, it will be essential for the government to undertake a study on effective protection on an item by item basis. In fact, for a study of this nature, the theoretical groundwork and the methodology have been prepared. (See Quantitative Analysis of Incentives and Disincentives for Expansion of Industrial Output and Employment in Somalia. Report prepared by HIID for USAID, July 1985.) But a word of caution is necessary here. Given the state of art in the Ministry of Finance, as well as severe data limitations, a study of effective protection rates aimed at determining such rates on an item by item basis should not be considered as the first priority.

As can be gathered from this brief description, the private sector is provided with certain protection and stimulus through the customs duties and the income tax.

The effectiveness and efficiency implications of such measures at this stage are rather difficult to quantify, or even document. It was not possible, for example, to obtain a complete list of the exempt enterprises. As long as effective protection rates are unknown, no definite judgement can be passed with respect to the protection of native industrial or agricultural activities.

Despite the good intentions of the government to stimulate industrial and agricultural activities, certain anomalies do stand out. Granting income tax exemption can be subject to wide interpretations and variations. Since considerable discretionary power is vested upon the Ministers of Finance and Industry and Commerce, such discretionary powers, in any country, not just Somalia, are always subject to pressures, political interferences, or even favoritism. It is much more advisable to put all incentives under one umbrella and designate with detail and as much precision as possible those industrial and agricultural activities which are beneficiaries of tax holidays. Such precision undoubtedly would require setting up priorities concerning which activities (and geographical areas) are considered most worthy of necessary stimulation within the overall economic development of the country. In addition, this process would fulfill the efficient resource allocation requirement within the objectives of factor utilization and employment. To a great extent, a well detailed list would eliminate the possibility of discriminating, voluntarily or involuntarily, against certain segments of the private enterprises.[10]

Government may also wish to consider incorporating into the umbrella of incentives a "drawback" mechanism. A drawback mechanism gives producers the right to be reimbursed for all indirect taxes levied upon their products to the extent that such

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10 In 1987, the Government of Somalia adopted a new foreign investment code which improved upon the previous law. Obligatory state participation in any new foreign investment is now eliminated and rules regarding the remittance of profit and repatriation of capital have been relaxed. Nevertheless, the new law is not quite free of ambiguities, the most important of which is the exchange rate to be used in case of capital repatriation.

products are exported. Such an incentive would encourage export oriented industries and would also improve the competitiveness of Somali exports in the world market. (At present, only excise taxes are refundable, see excess tax law Art. 14.)[11]

It is interesting to note that while certain incentives are offered to import substitution industries (mostly, but not exclusively) the private export sector is in fact subject to a set of disincentives. As was explained briefly above and detailed in the subsequent chapter, major export commodities of Somalia are subject to export tax.

Somalia exports are much too insignificant in the world market to be price leaders. Both the volume of exports and the types of goods exported force Somalia to be a price taker. Therefore, such taxes cannot be shifted forward and are borne by the exporters.

Another disincentive for the private sector is smuggling. Smuggling is nothing else but <u>de facto</u> exemption of some imports from import duties and other taxes. To the extent that smuggling is prevalent, the public revenue is forgone. From the manufacturing sector's point of view, smuggling constitutes a major obstacle to profitable production, since it leaves local industries vulnerable to unfair competition.

Poor tax administration, especially customs, constitutes another disincentive. Clearing goods from the customs is a slow and costly process. This cost is a hidden cost, and it is borne by the importers and producers alike, unless it is passed on to the consumer. To expedite the matters requires, in more cases than not, certain payments which are neither visible, nor are they legally deductible.[12] In so far as the government abstains from effectively curtailing smuggling or improving customs administration, the private sector is faced with serious disincentives.

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11 According to the officials interviewed, Article 14 is inoperative mainly due to administrative constraints. Although a "drawback" system is desirable, its implementation, once again, will have to be postponed until the administration is able to cope with it.

12 It is of course impossible to quantify the magnitude of such charges. Some local producers/importers however, estimate them to be as high as 20% of the declared value of imports.

It must be noted here that tax incentives and/or disincentives cannot be considered in isolation. Their impact is felt within the overall development policies. One can only point out, within the context of this report, that as long as Somalia's private sector faces difficulties such as lack of credit, foreign exchange restrictions, poor financial services, price controls or state monopolies and the like, fiscal incentives lose their effectiveness, even if they were the best designed ones in the world.

The private industrial sector in Somalia is in its infancy. The expansion of this sector requires positive action, if the government deems it desirable. The sector is aware of its own problems and already in a very systematic fashion has indicated some solutions.[13] Many of the solutions require immediate actions by the government and fairly quick results are in fact reachable within a reasonable short period, such as eliminating export taxes, instituting a "drawback" system, unifying excises and sales taxes, etc. Unless, however, such measures are taken in the near future, the expansion of the private sector will be effectively postponed to the twenty-first century, and with it the possibility of enlarging the tax base and increasing the government revenues.

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13 See: Proposed Recommendations for Solutions to Some Industrial Problems. Industrial Performance Symposium, October 10-14, 1987, Mogadishu.

CHAPTER THREE

FOREIGN TRADE TAXES

1. Overall Trends

Taxation of foreign trade, particularly merchandise imports, constitutes the most important source of the Central Government revenues. Moreover, it appears that the importance of foreign trade taxes is rising. In 1975, 39.2% of the total revenue came from taxes on international trade. In 1978, the ratio moved up to the level of 49.6%, in 1985 to 50.6%, and in 1986 was at the level of 51.0%. Part of the increase reflects the substantial increase through time in rates. (An important revision was made in 1978 and other minor ones thereafter.) An additional reason is the shift of the import mix, from low duty to high duty items. It is also worth mentioning that the entry of high duty items was encouraged by the franco valuta system, a practice which now is discontinued.

Average total tax burden on imports has increased from 48.0% in 1978 to 57.6% in 1986.[14] It must be noted, however, that this average rate masks the wide variance in the rates, especially due to the fact that a number of import items are duty free.

Export taxes are far less important and are imposed only on a few items; in 1978, they constituted only 2.4% of the taxes on international trade and 1.1% of total revenue. In 1986, these percentages were 3.3% and 1.8%, respectively. These percentages do not include harbor fees which are additional charges both on imports and exports.

14 Import taxes are the most important item within foreign trade taxation. Their yield has fluctuated widely during the period of 1980-1985. The average tax rate on total imports was 50.8%, but the value of standard deviation amounted to 16.8%. Moreover, while export taxes have been growing very slowly, import tax revenues have been growing much faster.

Table III.1

Relative Importance of Taxes on International Trade

Taxes	1978	1979	1980	1981	1982	1983	1984	1985	1986
Customs Duty	81.3	82.1	74.0	76.5	74.3	71.9	71.9	65.1	69.2
Adm/Stat Tax	16.2	16.2	23.6	19.4	16.9	23.1	26.1	31.5	29.0
Export Taxes	2.5	1.7	2.4	4.1	8.8	5.3	2.0	3.4	1.8
Total Tax on Int'l Trade	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: see Table II.1.

Table III.2

Growth of Taxes on International Trade

(1978 = 100)

Taxes	1979	1980	1981	1982	1983	1984	1985	1986
Customs Duty	130.0	98.8	161.0	181.4	290.2	232.7	300.1	572.7
Adm/Stat Tax	134.1	158.3	204.5	206.6	469.2	426.7	727.6	1203.0
Export Taxes	93.1	106.4	290.8	712.1	715.6	215.6	516.8	479.8
Total Tax on Int'l Trade	134.0	108.6	171.3	198.5	329.7	263.1	374.8	672.7

Source: see Table II.1.

2. Import Taxation

2.1 Rate Structure:

In general merchandise imports are subject to an import duty plus an administrative and statistical duty plus harbor charges.

The base of import duties and the rates are classified according to the Brussels tariff nomenclature (CCCN). The statistical/administrative duty as well as harbor charges are levied at flat rates. The administrative and statistical duty is 20% (except for a few select items such as medicine, flour, vegetable oil, etc., for which the rate is 10%), and harbor fees are 3% of c.i.f. value of imports. Import tax rates are listed in Table III.3 in a summary fashion.

Import tax rates adhere fairly well to three policy criteria: Government revenue, income distribution, and domestic economic growth.

Revenue aims are pursued both via various ad-valorem rates as well as other flat charges mentioned above. Equity is obtained on the assumption that as one's income rises, so does the consumption of goods subject to sharply higher rates. The differentiation of tariff rates by the degree of processing of imported goods aims to protect domestic industries from foreign competition.

One would assume that protection would be a temporary measure to protect infant industries only as long as such measures are necessary, and then the protection would be reduced as industries mature. Given the level of industrial development in the country, the discussion of how long such measures should continue to be enforced is rather premature.

It is worthwhile, however, to dwell upon the equity and efficiency aspects of the import duties. In a country like omalia, many items which are designated as luxury items, i.e., toilet preparations or spirits and liquors, which carry rates of 287% and 400%, respectively, are indeed consumed by higher income groups, even though middle income groups, for a variety of reasons, may consume such items by necessity (toilet goods for example) or simply because of the demonstration effect. Thus, high custom duties may easily fall upon such income groups unintentionally and hamper the equity considerations. Equity considerations of the system are also in conflict with revenue considerations. Some of the high import duties are in fact so high that imports become prohibitive and therefore generate no revenue for the fisc at all.

Equity considerations are in conflict with the objectives of development and efficiency. While from the point of view of equity, high customs duties on luxuries may be desirable since such duties would tax high income groups, but from the efficiency point of view they may not be desirable at all; this is because high tariffs can easily encourage the production of a number of luxury items in the country. The result of course is that scarce resources, especially investment, may tend to be shifted towards the production of luxury items rather than more urgent and socially more productive goods.

It is important therefore that, the rates be revised, and lowered if need be to more realistic levels. They also must be harmonized eventually so that domestically produced and imported goods would have price levels that do not violate revenue and equity principles.

Certain additional observations are in order. The tariff structure is extremely cumbersome and also plagued with inconsistencies. Eventually the rate structure will have to be simplified and inconsistencies eliminated. Several examples clearly illustrate these inconsistencies. Wheat carries a duty of 10%, wheat flour only 2% and wheat products (such as spaghetti) carry only 22.5% duties. This is not the only inconsistency. Tractor tires carry a 35% duty, but so do the passenger cars. It is hard to imagine that the most essential capital equipment in an agricultural country is treated in the same manner as private cars. Admittedly these are *ad hoc* observations, but it stands to reason that if the items and sub-items are checked one by one, many such inconsistencies would surface rather quickly.

2.2 Exemption

There has been considerable proliferation of exemptions in addition to agreements with international organizations charitable and religious organizations, etc. The Ministry of Finance has the faculty to grant exemption on a case by case basis. Certain exemptions granted by law have a perfect *raison d'etre* such as exempting agricultural machinery or certain food items. However, discretionary exemptions must be kept to a bare minimum, and certain other items which now enter duty free must be subjected to a revision. In a country like Somalia where fish is abundant, for example, there could be absolutely no reason for exempting it from import duties.

2.3 Valuation

The customs valuation of imports is rather weak in Somalia. If imported goods arrive at customs with a *bona-fide* invoice, the declared value is usually accepted. If over or under invoicing is suspected or a good arrives at ports without proper documentation, the declared price is checked against an unpublished minimum price list prepared by the valuation committee. Both under and overinvoicing are common practices in developing countries and Somalia is no exception. Overinvoicing usually occurs when importer wishes to transfer abroad (for personal purposes) foreign exchange which is subject to control. Underinvoicing occurs when importer wishes to avoid paying, at least, part of the duty.

Table III.3

Customs Tariff[15]

Section		Rates[16]
I.	Live Animals	25 - 123
II.	Vegetable Products	9.5 - 123
III.	Animal and Vegetable Fat and Oils	2 - 30
IV.	Prepared Foodstuffs, Alcohol and Tobacco	25 - 700
V.	Mineral Products	Exempt (except a few)
VI.	Products of the Chemicals	Exempt or 5 - 287
VII.	Artificial and Plastic Materials	Exempt or 10 - 50
VIII.	Raw Hides and Skin	25 - 70
IX.	Wood and Articles of Weed	10 - 50
X.	Paper-making Material	10 - 50
XI.	Textile and Textile Articles	15 - 171
XII.	Foot-wear, Headgear, Umbrellas, etc.	30 - 171
XIII.	Articles of Stone, or Plaster	10 - 60
XIV.	Pearls, Precious and Semi-Precious Stones	Exempt or 10 - 88
XV.	Base Metals	Exempt or 10 - 70
XVI.	Machinery and Mechanical Appliances	10 - 123
XVII.	Vehicles, Aircraft, and Parts	Exempt or 10 - 153
XVIII.	Optical, Photographics, Cinematographic	77 - 127
XIX.	Arms and Ammunition	171
XX.	Miscellaneous Manufactured Articles	10 - 123
XXI.	Works of Arts	171

Source: Customs tariff of the Somalia Republic Jan. 1969, changes in rates in 1978 and the subsequent changes were obtained from the Office of the Director General of Customs, Ministry of Finance.

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15 Rates are classified in 21 sections which altogether comprise 99 chapters.

16 Import duties are divided into two groups: Fiscal duties and customs duties, originally only fiscal duties were applied to import from EEC and both duties to all other imports. Due to fiscal crises, the preferential treatment of EEC-originated import has been eliminated. The rate structure given above is the sum total of the two duties.

In order to avoid such practices and also to value uninvoiced goods, the customs administration makes use of the valuation list. If the stated value of an imported good is lower than the price listed in the valuation list, the higher price is taken as the true value of the good. In short the valuation list has a paramount importance. To examine it in detail was not possible, but I was allowed to have a cursory look at it. It was dated January 1st, 1987.

Despite the fact that it was revised about a year ago, many items are still quite out of line with world prices. The list price for sugar, for example, is only about one tenth of the world sugar price; several passenger cars also appear to be undervalued. Although these observations are, admittedly, made on an <u>ad-hoc</u> basis, it stands to reason that they are not isolated cases.

The valuation committee uses only presented invoices, and a good judgement for revision purposes. They have no access to any other information source. For example, the customs office at the Mogadishu port - the biggest in the country - does not even have a telex for verifying prices with exporters or with the diplomatic representatives of Somalia abroad.

However, in view of the fact that world prices show a tendency to rise rapidly and in view of the fact that the Ministry lacks sufficient personnel to apply the Brussels definition adequately, the valuation list acquires a great deal of importance. Unless the list is up to date, there would be a great deal of revenue erosion.

<u>It is imperative therefore that the valuation list is revised and revised regularly</u>. Revision more than once a year is extremely desirable. Somali government through its diplomatic representation in the exporting countries should be able to obtain the necessary information. Moreover in a number of countries several enterprises collect and disseminate such information for a modest fee (Dunn and Bradstreet being one of them in the USA). Services of such firms may very well prove to be useful to the Ministry. Lack of adequate lists not only encourages dishonesty on the part of importers but hinders development programs, such as the cash auction and commodity import programs, where proper invoicing in the rule.

3. <u>Export Taxation</u>

Export taxes are of little importance especially from the point of view of their contribution to the central budget. It should be kept in mind that Somali exports have been declining in value terms. While in 1980 total exports amounted to $134 million, in 1985 their value was reduced to US $92.5 million. The major decline being in the live animal category. The primary cause of the reduction has been the Saudi Arabian ban on importation of livestock from Somalia. Since 1985, Somalia has sought new markets but has not yet completely returned to the pre-ban level. A case may be made for export taxes purely from the point of view that the livestock sector of the economy is virtually outside of the net of all other taxes. Nevertheless, taxing exports discourage exports at a time when marginal gains to exports can make a difference regarding profitability of exporting.

3.1 Rate Structure:

Rates are Ad-valorem[17]. From the point of view of the competitiveness of the goods exported they are rather high. In practically all the goods exported Somalia is a price taker rather than a price setter. Goods such as skins and hides, domestic animals, animal fats and the like are already very competitive in the world market. From the pure economic standpoint it is difficult to sustain the existence of such taxes. Moreover exports are also subject to stamp duties.

In reality exporters are taxed, and taxed very heavily in yet another indirect way. As long as there is a difference between the shilling's official rate of exchange and the parallel market and as long as exporters are forced to change their foreign earnings at the official rate, the difference between the official and in parallel market exchange rate becomes a tax that falls on exporters. This implicit tax in turn places Somali exporters in a disadvantageous position vis-a-vis their competitors. Two alternatives present themselves: Either the rates are substantially lowered or eliminated or alternatively a mechanism must be created so that exporters are able to change their earnings at the free market rate. In any case stamp duties must be eliminated for they serve no useful economic purpose other than providing a meager revenue for the fisc.

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Gum Arabic	12%
Animal Fat	15%
Gray Amber	30%
Hides and Skins	Different ad-valorem
Charcoal	65%
Livestock	25% of value as listed (as of Nov. 1981) for duty purposes. These are: Goats and sheep SoSh 250 per head, cattle SoSh 1,400, and camels SoSh 2,500.

3.2 Evaluation:

It stands to reason that an exporter, under the present circumstances, would have every incentive to under-invoice. In order to counter attack this practice, customs administration relies on the valuation list. From the tax revenue point of view relying on valuation list is certainly acceptable. But this list is very much like the import valuation list, i.e., outdated. Therefore in many instances the custom value is lower than the corresponding "invoiced" value.

Several alternatives present themselves: One alternative is to abolish the valuation list, the other is to bring it up to date. The third alternative though appearing to be drastic, is total elimination of the tax. If one were to conduct a study of the cost of collecting this tax as opposed to the revenue generated, one would probably discover that the benefit/cost ratio is not very high. Therefore elimination cannot be considered a drastic suggestion. Needless to say, harbor charges should be collected as before.

CHAPTER FOUR

TAXES ON GOODS AND SERVICES

1. Overall Trends

Taxes on goods and services are the second most important tax group within the tax revenue structure of Somalia. The group includes taxes on sugar and spirits, fiscal monopolies' earnings, motor vehicle taxes, sales tax and others. Sales taxes have been imposed and collected since 1984. Taxes on sugar and spirits, some of the earnings of fiscal monopolies and other taxes can conceptually be combined as excise taxes. The relative importance of these taxes increased somewhat between 1978 and 1986. While in 1978 these taxes constituted 16% of total revenue, in 1986 the ratio was 19.70%.

The yield composition and the relative importance of individual taxes have also changed through time. This change can be attributed to several factors. One obvious factor is the change in rates. Another factor is tax enforcement. The third factor is purely statistical, namely the change in classifications. In fact the "other" category is included in a variety of minor taxes at one time or another. It is therefore recommended that the above figures should be viewed as indicative of general tendencies only.

In the subsequent sections of this chapter, two major components of taxes on goods and services, namely excises and sales taxes will be analyzed. Earnings of fiscal monopolies (other than excises imposed upon their products) and stamp taxes will not be the subject of this report.

Table IV.1

Relative Importance of Taxes on Goods and Services

Taxes	1978	1979	1980	1981	1982	1983	1984	1985	1986
Sugar & Spirits	43.4	27.6	36.7	62.9	69.6	35.0	38.7	28.9	29.9
Fiscal Monopolies	52.2	25.5	39.6	17.9	16.7	38.8	20.3	21.7	22.4
Motor Vehicle	1.2	6.8	4.4	2.2	1.6	3.4	1.6	0.8	0.6
Sales	-	-	-	-	-	-	15.7	16.1	22.9
Other	3.2	40.1	19.3	17.0	12.1	22.8	23.7	32.5	24.8
Taxes on Goods and Services	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: See Table II.1

Table IV.2

Growth of Taxes on Goods and Services

(1978 = 100)[18]

Taxes	1979	1980	1981	1982	1983	1984	1985	1986
Sugar & Spirits	19.9	51.8	199.7	328.1	108.1	180.0	331.5	538.9
Fiscal Monopolies	15.3	46.4	47.0	70.6	99.7	78.5	206.9	356.7
Motor Vehicle	171.4	217.9	242.9	264.3	371.4	257.1	325.0	346.4
Sales	-	-	-	-	-	100.0	252.7	573.6
Other	395.8	373.6	738.9	801.4	965.3	1512.5	5090.3	6341.7
Taxes on Goods and Services	31.3	61.2	137.6	207.8	134.2	202.0	497.2	806.9

Source: See Table II.1

2. Excise Taxes

2.1. Tax Base and Tax Rate

Excises are imposed upon 30 different commodities, and the rates vary; the highest being 100% (on cigarettes and pure alcohol) and 5% (on edible goods, spare parts, etc.). The excise tax schedule is given in Table IV.3.

Excises are imposed on locally manufactured goods as well as on imported goods. Excises date back to 1978. Originally conceived as specific taxes, they were later converted into ad-valorem taxes. This must be considered as a step in the right direction. Their imposition on imports may be viewed as increasing the burden of customs duties even further. However, to the extent that local production requires protection, exempting imports from excises can put the local production in a disadvantageous position.

An argument can also be made that the excises should be combined with customs and incorporated into the customs' rate schedule. This would be a wrong view simply because the incorporation, although providing the same protection to local industries, would not allow the government the flexibility of adjusting the rates whenever it sees fit. It would also mask the

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[18] For sales taxes 1984 = 100.

distinction between excises, which the government is attempting to enforce equally on domestic and imported items, and import duties, which serve the additional functions of protection, conservation of foreign exchange, etc.

Table IV.3

Excise Tax Rates

Goods		Rate (%)
1.	Caramels, sweets, gum	15
2.	Syrup, james, marmalades	15
3.	Chocolates, candied fruits, halva	15
4.	Liqueurs and other sweetened beverages	12
5.	Fruits in syrup and fruit juices	10
6.	Cakes, pastries, biscuits and others	5
7.	Other products containing sugar	10
8.	Cigarettes	100
9.	Matches	80
10.	Shampoo, soap, hair oil	20
11.	Sugar	60
12.	Mineral Water	10
13.	Alcoholic beverages	80
14.	Pure alcohol	100
15.	Tomatoes khal	10
16.	Construction material	15
17.	Leather and leather products	15
18.	Perfumes	20
19.	Foam, etc.	15
20.	Home Utensils	10
21.	Clothes	5
22.	Meat	5
23.	Fish	5
24.	Edible oil	5
25.	Pasta	5
26.	Milk and milk products	5
27.	Carton, plastic, etc.	5
28.	Furniture	5
29.	Spare parts	5
30.	Manufactured goods (not classified elsewhere)	5

Source: Ministry of Finance, Excise Tax Department. The tax base for imported goods is the c.i.f. value, and for locally produced goods is ex-factory.

2.2 Problems

Several problems present themselves. One problem lies in the tax burden. Heavily excise taxed items are also the ones which are subject to high customs duties. This might very well be desirable from the revenue standpoint, but from the standpoint of a tax burden on consumers it is hard to justify. The second problem, which is more of an administrative one, is the absence of a manufacturing census in Somalia. Therefore, it stands to reason that certain establishments can easily avoid the tax. Admittedly part of the tax collection is less problematic. The customs department is responsible for collecting excises on imported goods and the indirect taxation department is responsible for collecting excises on domestic goods. While collection of excises on imported goods is considerably easier since the Ministry exercises control at the ports of entry, at the domestic level an efficient tax collection presupposes reliable statistical information and data on local establishments that are apparently lacking.[19]

There are a number of additional problems as well. Excise tax schedules include, as a final entry, manufactured goods not classified elsewhere. This broad classification gives rise, at best, to confusion, and could easily lead to a heavy burden on small scale or cottage industries. Yet the law is so general and so unspecified that its application is rather chaotic. Another problem refers to the record keeping of such taxes. From the budget data one can only discern the amount collected on alcohol and sugar (sugar and spirits) and on tobacco and matches (state monopolies). The rest of the excises are lumped together as "other." There is no quick and ready way for the Ministry to evaluate tax collection with respect to their corresponding bases. This is one of the many problems here with respect to record keeping ability, and the need to train at lower levels, and to stress better record keeping procedures. Excises also give rise to the undesirable cascading effect.[20]

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19 Ministry of Industry maintains a partial list of public and private enterprises. According to that list there are 33 private and 39 public enterprises which should be subject to excise and sales taxes. The insistence of the Ministry of Finance that such a list does not exist is rather indicative of poor communications among ministries.

20 Several problem areas of excises have been detected, and the Ministry has already received a report to that effect including the possible solutions. (See Excise Taxation in Somalia by M. M. Sethi (UN/DTCT) 1987.) Most of the diagnosis and solutions set forth in that report are worth serious consideration. There are some

For a variety of reasons it may be advisable to consider combining excises with the sales tax. Suggestions pertaining to excises will be made at the end of this chapter. (Section 4 below.)

3. Sales Tax

3.1. Base and Rate:

The tax base is the value of goods which are either imported or locally produced. If the good is imported, the tax base is the c.i.f. value of the good plus all customs charges plus excises. If locally produced, the tax is charged on the value at the manufacturer's level. The rate is 5%. The same rate is also applied (5%) once again at the wholesale level. It is therefore a cascading tax. Most goods with the exception of uncanned food, medicine and domestic agricultural products and exports, are subject to sales tax. Hotels are also subject to sales tax which is also 5%.

The tax is relatively important. Although it dates back only to 1984, in 1986 its share within the taxes on goods and services was 16.1%.

4. Problems and Recommendations

Excise and sales tax, especially with the cascading nature of the sales tax, undoubtedly represent a heavy burden on the consumer. The government is in dire need of revenue both for its ordinary and extraordinary expenditures. However, since practically the same segment of the population and the same goods are taxes over and over again, some relief may be considered in due course.

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points however in which the present report differs from the Sethi report. The Sethi report suggests that excises at the import level be fused with import duties. This would be a grave error since the raison-d'etre of these levies is very different. The Sethi report also suggests that one solution to eliminating the cascading effect is to eventually consider the implementation of the VAT system. Under the present conditions, to contemplate such a system, let alone implement it, is beyond the capabilities of the Ministry and may cause more harm than good. An easier and quicker solution lies in instituting a "drawback" system (also suggested by Sethi as an alternative). As it is mentioned elsewhere in this report, the solution may very well be a single stage general sales tax (excise plus sales) with a proper drawback system.

Both sales and excise taxes, for an efficient tax collection, and for equitable assessment, do require a fairly good record keeping at the private sector level. Admittedly the problem is much less serious at the customs level, but at the domestic and especially at the wholesale level tax collection is bound to be much less than optimal. In addition to administrative improvements, which are discussed in the last chapter, one major suggestion is put forth at this juncture: namely <u>combining excises and sales taxes in a single tax at one level only, in the form of a general sales tax</u>.

A general sales tax (replacing the present excise and sales) can be imposed on the manufacturing (import) level, say at 10% on all goods once and for all. Certain exceptions can be made in order the prevent the revenue loss. For example, sugar, alcohol, tobacco, matches and the like can be subjected to a higher sales tax. A higher rate on certain items can be justified from the point of view of reaching those sectors of the economy that mostly remain outside of the cash economy.

Administratively a general sales tax can also be justified from the efficiency viewpoint. A combined department would have more staff to monitor and enforce the tax collection. Also there would be fewer enterprises to be checked and controlled since wholesalers would not be legal taxpayers. In other words, payment and collection of taxes would remain much more within the capabilities of the administration since the universe of the taxpayer would now be limited to a much smaller number of taxpayers. Moreover, manufacturers are more capable of keeping reasonably accurate records than wholesalers and therefore much better compliance could be achieved.

Economic distortions are best minimized by a single sales tax with a broad base so that only a very few segments of the economy or products are exempt. The <u>products of state enterprises, for example, should not be exempted from this general tax</u>.

A general tax collected only at a single point of the production chain eliminates the <u>cascading</u> effect, thus reducing the tax burden of the consumer without necessarily reducing the government revenues. Since the tax now is at various stages, the "mark-up" from, say manufacturer to wholesaler and again from wholesaler to retailer is based on cost plus tax. Shifting the tax base from wholesalers to manufacturers/importers can bring about a reduction in the overall price level. Since the proposed tax would have the manufactured (import) values as its base it would no longer be necessary to wait for tax payment by the wholesalers.

A 5% hotel service tax should not be eliminated but maintained. It can easily be raised at 10%, to be at par with the general sales tax. Eventually and to the extent that the Ministry of Finance would have capabilities, the extension of, say a 10% tax to other services can be considered.

One immediate candidate for a service tax could be an airport tax. Collected at the port of exit (at the rate of US $10 per passenger), this airport tax would yield a reasonable revenue. At the exit the nationals would pay the tax in local currency and foreigners in foreign exchange. Very similar to a users charge, a service charge of this nature could then be used to meet airport and port expenditures and thereby reduce such claims on the general budget in addition to yielding some revenue in the form of foreign exchange.[21]

If the unification of sales tax and excises resulted in revenue loss (though this may not necessarily be so) an airport exit tax could at some extent offset this loss.[22]

A service tax (at 5% level) may also be imposed on services other than hotels. Obvious candidates are restaurants, entertainment facilities (movie houses), garages and repair shops, travel agencies, etc.

This suggestion, of course, proposes that the Ministry staff is well prepared to monitor the compliance with these new service taxes. No new attempt should be made in terms of expanding the scope of service tax unless the compliance is assured.

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21 Despite a vigorous search it was impossible to obtain accurate figures on passenger departures. However, based on the number of flights, type of aircraft and the load factor it was estimated that approximately 50,000 persons use the Mogadishu airport facilities.

22 An exit tax, say, US $10 would yield $500,000 or with the present exchange rate SoSh 50 million. Foreigners may be required to pay this tax in foreign currencies. Due to lack of data it is impossible to determine the breakdown of passenger numbers between national and foreign, but obviously a certain portion of this tax could be collected in hard currencies.

It should also be kept in mind that the unification of excise and sales taxes (at 10% on one stage rather than the present 5% at every stage) may not require additional taxes to compensate for the revenue loss. There may, in fact, be no revenue loss at all. In fact by unifying and moving the taxpaying responsibility to the manufacturing/importing level, the revenue yield should automatically increase since it stands to reason that, at present, at the wholesale level there must be more tax evasion and avoidance than there could possibly exist at the manufacturing/import level.

CHAPTER FIVE

INCOME TAXATION

1. General Trends

Taxes on income include taxes on wages and salaries, taxes on profits and interest, tax on rental income and taxes on companies, all of which are subject to different rates. Income taxes are relatively unimportant within the overall revenue structure. Available statistics differentiate only earned income (wages and salaries) and unearned income (profits, rent, interest, and company earnings); therefore the analysis here is necessarily rather crude.

In 1978, income taxes constituted only 5.2% of total revenue. In 1986 the share amounted to 10.9%. The relative importance of taxes on unearned income within the total income tax has increased considerably. In other words, these taxes grew much faster than the taxes on wages and salaries.

Table V.1

Relative Importance of Taxes on Income

Taxes	1978	1979	1980	1981	1982	1983	1984	1985	1986
Taxes on Earned Income	91.4	91.4	91.1	77.6	67.9	35.2	40.8	45.5	24.7
Taxes on Unearned Income	8.6	8.6	8.9	22.4	32.1	64.8	58.2	54.5	75.3
Taxes on Income	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: See Table II.1

Table V.2

Growth of Taxes on Income

1978 = 100

Taxes	1979	1980	1981	1982	1983	1984	1985	1986
Taxes on Earned Income	122.1	126.8	166.5	133.1	139.3	181.6	208.4	369.1
Taxes on Unearned Income	121.9	131.3	509.4	666.8	2726.6	2800	2651.6	11932.8
Taxes on Income	122.0	127.2	196.0	179.2	361.8	406.9	418.5	1364.0

Source: See Table II.1

As can be seen from Tables V.1 and V.2, taxes on unearned income have become much more important than taxes on earned income and the rate of growth has also been much faster. However, especially in 1986, the numbers are not strictly comparable, for in the budget only public sector employees as well the employees of state enterprises are listed. One may suspect inaccurate classification or reporting. In addition, tax collections on earned and unearned income are not strictly comparable. The tax on wages and salaries is collected at source while other taxes are subject to declaration. Considering the arrears, tax disputes, etc., and considering that irrespective of the tax year tax collections on unearned income are tabulated on a current basis, yearly collections may include tax liabilities of the previous years. Therefore, to the extent that collection efforts vary, so does the tax yield. Nonetheless the trend in the above tables is rather indicative.

2. Individual Income Tax

2.1 Wages and Salaries:

The base is monthly earnings and the rates are as follows:

Monthly Income (SoSh)	Yearly Income (SoSh)	Rates (%)
Less than 200	Less than 2400	0
201 - 800	2401 - 9600	6.3
801 - 1500	9601 - 18000	12.6
1501 and over	18001 and over	18.9

The tax liability falls on each individual wage earner irrespective of family size and composition. Incomes of two or more wage earners in one family are not pooled. Hence the taxpaying unit is not the family but the individual. Moreover if a family has various sources of income, they also are not pooled but taxed separately.

2.2 <u>Other Incomes (other than rental income)</u>

These incomes are taxed on the basis of net income, allowing the deductions for the expenses necessary to produce such incomes. The taxpaying unit is the individual, and no allowance is made for family size or dependents. However, where husband and wife are holders of separate trade licenses and the respective activities are undertaken on the same premises, their incomes are required to be consolidated, and the tax will be charged in the name of the spouse officially undertaking the activity. The rate brackets are very different from those applied to wages and salaries and they are as follows:

Annual Income (Sh)	Rate (%)
Up to 2,400	0
2401 - 3600	9
3601 - 4800	11
4801 - 6000	13
6001 - 7200	15
7201 - 8400	17
8401 - 9600	19
9601 - 10,800	22
10,801 - 18,000	25
18,001 - 30,000	28
30,001 and over	30

The law allows certain expenses to be deducted provided that such expenses are necessary in the production of taxable income.

In order to promote economic development the Minister of Finance has the faculty to grant an exemption of up to 10 years to those new enterprises whose industrial and agricultural activities are considered to be conducive to the development of the country. Taxpayers are required to submit tax returns on 31 March of each year.

2.3. <u>Rental Income</u>:

Rental income is subject to a flat 21% rate. There is no clear indication in the law as to what type of expenditures are deductible from the rental income. In practice, however, 20% of the rental income is assumed to constitute legitimate expenses and is deducted.

3. Taxes on Companies and Corporations

Taxes are applied on the net income from Somali sources accruing to or received by domestic companies and enterprises. Foreign companies are taxed on income from sources within Somalia unless other provisions are contained in tax treaties.

Ordinary and necessary expenses are deducted, as are the contributions to gratuity funds. The law also provides an exemption from tax of up to 40% of undistributed profits (or 25% of chargeable income, whichever is lower).

The tax rate is proportional (35%). Until January, 1983, 5% of the collections were transferred to local governments; the practice is now discontinued.

Before we enter into the discussion of problems and recommendations, two notes of caution are necessary. From the government statistics it is impossible to discern the amount of tax paid by corporations. In addition, taxation of public enterprises always clouds the statistics since taxes payable by these enterprises include a turnover tax (excise), a share of net profit, and a share of depreciation allowance.

4. Problems and Recommendations

Taxes on individuals are plagued by a number of problems.

Complying with the basic principles of modern taxation all incomes should be pooled and should be subjected to the same rate. The family unit should be considered as a taxpaying unit; otherwise, as explained in Chapter Two, serious inequities become part of the system.[23] This is not the case in Somalia. In addition, in view of the inflationary conditions, the tax brackets and rates are very out of date. (Rates are basically left over from 1966.) The system also has additional, perhaps minor inconsistencies.

The report suggests changes related to the tax base, taxpaying unit, and tax rate. Before the recommendations are considered, however, the Ministry must be in the position to monitor and enforce any new system. This would entail better record keeping, taxpayer identification (by taxpayer member), and statistical knowledge. No attempt should be made, other than perhaps adjusting the rates before such capabilities are at hand.

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23 It must be pointed out in all fairness, however, that whether the individual or the family is a better taxpaying unit, especially in a country where record keeping is difficult and tax administration poor, is still an unresolved issue in the literature.

In addition, a certain amount of taxpayer education is also necessary. Without such education and dissemination of information the new system would be condemned to failure right at the outset.

In order to provide horizontal equity, all taxpayers at the same income level must be treated equally, irrespective of the source of income.

Again, in order to comply with horizontal and vertical equity, the tax should differentiate family sizes; allowances for dependents must be introduced if they can be adequately administered.

A new tax rate must be put into effect taking into consideration the changes in the prices since the original rates were set. For convenience, the number of tax brackets should be kept to a minimum.

Examples are given below for demonstration purposes.

According to some estimates, per capita income of Somalia is about U.S.$260 p.a. However, population estimates vary, and there also might be some margin of error in the national account statistics due to the fact that a fairly large proportion of the population is virtually out of the cash economy. Be that as it may, one can start with the assumption that per capita GDP stands approximately at SoSh 25,000 at the official rate of exchange. Based on that figure, a new marginal tax schedule may very well be similar to one of the three examples given below:

Income Ranges	Schedule I Rate (%)	Schedule II Rate (%)	Schedule III Rate (%)
Less than 7,500	0	0	0
7,500 - 10,000	10	15	10
10,000 - 15,000	15	15	15
15,000 - 20,000	20	15	15
20,000 - 30,000	25	30	15
30,000 - 50,000	30	30	25
50,000 - 75,000	35	30	25
75,000 - 100,000	40	45	45
100,000 and over	50	45	45

A mechanism could be added to adjust the schedule periodically based on changes in per capita income and price levels. It is accepted right at the outset that the determination of tax rates is subject to a host of considerations and the most weighty one is the political consideration. The above schedules are no more than examples and are offered as a basis of possible discussion. Nevertheless, the simpler the rate schedule, the easier the administration and the better the compliance.

It is important to keep in mind that if tax rates for individuals are revised, the corporate rates may also be revised, although the present rate does not appear to be out of step with rates prevailing in many countries.

The revenue implications of these changes cannot be calculated at this stage due to a lack of data. It stands to reason that changes might very well prove to yield higher revenues. The present schedule as applied to wages and salaries stops being progressive after SoSh 18,000; schedules for other income (except rental) cease being progressive at SoSh 30,000. The schedule given in Example I continues to be about the same at SoSh 30,000 level and only slightly higher at SoSh 18,000 for other income and wage income respectively. The major difference is that lower incomes are taxed at a lower rate and higher incomes at a more progressive rate.

Moreover, applying the same rate to wage and non-wage earnings (including rental income) eliminates the inefficiencies with respect to allocation of resources which the present system's differentiated schedules generate.

There are other problematic areas within the realm of individual taxation. The most important among them is tax evasion. It is absolutely impossible to quantify, even to determine the ranges of this practice. Although it is common knowledge that tax evasion is rampant, such allegations at this stage cannot go beyond hearsay. National income statistics for example do not provide data with respect to the payments to factors of production. Therefore even the most crude estimate cannot be put forward. The contention is that only wage earners pay income tax.[24] This may stem from two factors. One is that there is willful tax evasion by taxpayers (as happens in practically all developing countries). The other factor is the absence of proper bookkeeping, lack of necessary documents, etc. Some reduction in tax evasion (elimination can never be attained) may be achieved. The government may consider exerting pressure

24 Since the employer in the private sector is responsible for deducting taxes from employees monthly and paying the treasury quarterly, and since they do not properly report such tax withholding to the authorities (by not submitting the names of their employees for example) the treasury believes that evasion is rampant. However, since there is no record of taxpayers, control is impossible.

on traders to provide better accounting of their transactions. Also companies should submit complete accounts of their transactions, balance sheets, etc., as required by law. A severe penalty rate of interest (a minimum of double the rate of inflation) on delinquent taxes, and less severe (the same as the rate of inflation) but equally firm interest charges on arrears must be put into effect. It should be remembered, however, that penalties alone are not desirable, nor are they sufficient to reduce tax delinquency. A well designed taxpayer education program is just as necessary as firmness and punishment.

As far as taxes on wages and salaries are concerned, immediate action should be taken to identify the taxpayers. Otherwise there would be no possible way to control under-reporting of tax collection by employers.

Finally, and most important of all, the government should undertake intensive training programs for the staff of the Ministry especially in the area of auditing.

CHAPTER SIX

TAX ADMINISTRATION

1. Introduction

The preceding chapters discussed the characteristics of the tax system and also suggested some of the general directions of necessary changes. A crucial element for any analysis of a tax system and/or its reform is the understanding of the administrative possibilities and constraints. Administrative constraints and bottlenecks affect the entire range of taxes, their structure, rate, collection, etc. Irrespective of the merits of the system and its design, if the administration fails so does the system. Even a well designed system fails to fulfill its objectives if the administration is not capable of carrying out its functions. The system eventually becomes inefficient and inflexible. The reforms and changes introduced into the system become no more than good intentions without any concrete improvements simply because poor administration also makes the system unadaptable to any substantive changes in the law.

In Somalia, administrative constraints imposed on the tax system are extreme. There are constraints which are internal; in other words, the Ministry suffers from the lack of trained personnel, physical facilities, equipment and material. There are also a number of external constraints such as the lack of knowledge among taxpayers, absence or inadequacy of financial records, poor record keeping habits, etc., and most important of all the persistence of negative tax paying habits formed by historical circumstances.

This chapter will discuss the problems surrounding the tax administration and will put forward some concrete suggestions.

2. The Existing Administrative Structure

The basic structure of the present revenue administration is shown in Chart 1. This structure dates back only as far as December, 1987. In mid-1985 the Government of Somalia made the decision to divide the then Ministry of Finance into two Ministries. The Ministry of Finance as such continued to perform its functions related to expenditures an the new ministry, "the Ministry of Treasury" assumed the responsibilities of revenue administration. The two ministries functioned quite independently from each other until they were merged again into one single Ministry of Finance in December, 1987. The present system is not quite firm. As yet certain changes are being made; titles are being altered, etc.

Notwithstanding the changes in the immediate future, the main structure is not likely to be substantially different than the one described here. The highest ranking civil servant is the Director General of the Revenue Department who reports to the Vice-Minister of Revenue. There are seven offices (or sub-departments or units) the heads of which carry the title of director. These sections are Customs, Direct Taxation, Indirect Taxation, Financial Control, Audit and Control, Labor (personnel), and Research and Planning. Each office has several sections.

For administrative purposes there are several field offices in the districts which administer the collection of direct and indirect taxes, responding to the offices of the directors of direct and indirect tax respectively.

Customs administration is entrusted with the administration of excise and sales taxes at the import level, in addition to custom taxes proper.

3. Staffing

The Revenue division of the Ministry employs approximately 1,200 which constitute about 70% of the total staff of the Ministry. There are 237 "A" level staff, 607 "B" level staff, 158 "C" level staff, 88 "D" level staff, and about 90 in "X and F" level staff. According to civil service classification A level is the highest and "D" the lowest in terms of pay and responsibility. X and F are separate categories which mostly comprise certain skilled persons who do not have a formal education.

There are 3 Somali PhDs (one with a degree from a school in France and two with degrees from Eastern Europe) and 30 MBAs. Some 190 persons hold either a B.A. or an associate degree, and the rest have a secondary education or lower.

4. Remuneration

Civil servants are rather poorly paid in Somalia and the difference between the pay of the government employees and those of private sector or several international agencies for approximately similar jobs is great. Although the Ministry of Finance has a much better remuneration system (with the exception of Central Bank and perhaps Ministry of Foreign Affairs) the gap between the Ministry salaries and the private/international sector is still appreciable. Some examples may illustrate the point. At the grade "A," for example, the basic salary is SoSh 600 p.m. Grade "A" requires a university degree and carries a "degree allowance" of SoSh 700. In addition, a grade "A" employee receives SoSh 2,000 by the virtue of being an employee of the Ministry of Finance. There is also SoSh 500 allowance for milk. Total remuneration therefore, comes to 3,800 shillings or $38 a month at the present exchange rate.

The Grade "D" basic salary on the other hand is a mere SoSh 600. Overtime pay is authorized to such employees which can bring their earnings to maximum SoSh 1,500 or US $15. Absolute earnings can be misleading. They must be viewed with respect to the general price level in the country as well as with respect to a host of other socio-economic conditions. Be that as it may, however, based on controlled prices, a grade "D" person with full overtime pay will have to work about 12 hours in order to be able to buy one kilo of rice or one kilo of sugar, two and a half days for one kilo of beef, or almost a full month for a pair of trousers. At price levels existing immediately prior to the introduction of controls, the same individual would have needed to work two to three days for one kilo of sugar and five days for one kilo of beef.

In short there is hardly any pecuniary incentive to work for the Government irrespective of the grade level. Morale is low and corruption is high. It cannot be otherwise.

5. Basic Infrastructure

The Ministry lacks practically everything, and the list is quite long. Filing and record keeping are practically nonexistent. All operations must be performed by hand since there is not one single EDP system. And yet the use of electronic equipment can revolutionize a tax organization and achieve enormous savings by the virtual elimination of routine clerical and arithmetical work. In efficient tax systems, the issuance of tax returns, issuance of reminders, computation of tax liability, and any other routine functions are performed by computers. The supply of statistics for general information, annual reports, and budget projections flows as an inexpensive by-product from these operations. Of course the use of computers presupposes a certain flow of information; at this point in time such information and data base are also lacking.

The Ministry has no library, no reference books, manuals, or routine publications of international agencies.

Power shortages are also a serious impediment. Battery operated computers and calculators would certainly be a partial solution to the problem; nevertheless frequent shortages definitely affect the functioning of staff.

Retention of staff in various departments is rather difficult since the primary aspiration of every employee is to be transferred either to customs or to tax collection units where, regretfully, one can find (not necessarily legally) means of supplementing his or her income. In short the Ministry is ill-equipped and ill staffed to provide an effective administration.

6. Statistics, Planning, Personnel and Training

As it was mentioned briefly above, the Ministry has a conspicuous lack of current and comprehensive statistics and a data bank, both of which are indispensable not only for day-to-day management but also for long range planning and policy design. Information is scattered around, usually in the drawers of the employees' desks. Within the new configuration of the Ministry there is in fact an office called "Statistics and Planning." However, it is hopelessly understaffed, and only two of the employees are economists. It has no library, no reference books, not even an elementary statistics textbook. The office does not have a proper filing system of information or archives, let alone a simple computer facility.

There is no general identification system of taxpayers: a system which can be used in all tax transactions and through which the Ministry can obtain a comprehensive picture of the taxpayer's activities. There is no data at the moment that can be used to cross-check income tax and property tax data. In a country like Somalia where a great number of taxpayers have the same names, the first priority should be to give identification numbers to taxpayers. Using the numbers for administrative and analytical purposes, however, pre-supposes the availability of even rudimentary EDP systems--systems which are not available at present.

Personnel administration and training are centralized within the "labor" department of the Ministry. The observations made with respect the research and planning department are equally valid for this department as well. There is hardly any personnel management and personnel training. The director of this unit for example is a young and energetic economist but he has absolutely no tools to work with. He also faces the problem of excessive staff mobility because it is difficult to retain employees in departments where employees are not in direct contact with taxpayers.

7. Taxpayers and Tax Education

Many taxpayers are still not quite familiar with the requirements of tax compliance. Tax education of citizens simply does not exist. Many taxpayers file their tax returns late, inadvertently or intentionally; the returns may be inaccurate, and yet penalties and sanctions are rather light or for a number of reasons not applied. Moreover, bookkeeping in the country is neither universal nor standard. Therefore, tax inspectors or auditors are faced with a great deal of difficulty in determining the right amount of taxable income.

8. Recommendations

Problems pertaining to administration are numerous and grievous. This report only scratches the surface. Most of the recommendations made here for improving the administration have basic resource constraints such as skilled personnel, financial resources, etc. And yet, with few exceptions, none of the recommendations put forth in the previous chapters can be effectively implemented unless the administration is improved first.

The very first step for administrative improvement should be taken in the personnel department. The technical quality of the department must be upgraded as soon as possible. Three areas of immediate need present themselves. First is the preparation of job descriptions for employees. Unless jobs and activities are clearly spelled out, there will be no way to measure the efficiency and the activity of employees and it will be extremely difficult to design training programs. The personnel department needs technical assistance for the preparation of job descriptions. This assistance should also include on-the-job training for the staff.

The second need is the preparation of a data bank for personnel files. Again information concerning personnel is scattered and the available information about personnel more often than not is quickly out of date. The Ministry will need short term technical assistance to develope a methodology for establishing a data bank of personnel information and provide on-the-job training for the staff of the department. Concomitantly or shortly thereafter, an EDP system installation is also necessary. A microcomputer at this stage easily fulfills this need. Any microcomputer should be a battery operated one and its installation should be accompanied by some technical assistance to train its operators.

The Statistics and Planning Unit, as it is, cannot discharge its functions properly since it also suffers from the lack of personnel as well as from the lack of basic amenities. The Unit first and foremost must start to create a statistical archive/data base and this data base should also be computerized. A microcomputer is a necessary tool for this department. Technical assistance is required for data collection and storage and its computerization as well as for training the operators. This Unit also needs a basic library in statistics, planning and budgeting, and tax policy. Such books and documents are easily obtainable from the United Nations and its specialized agencies as well as from the donor countries. Although the need for administrative strengthening appears to be most urgent in personnel administration and statistics and research, it is even more advisable that a training program be developed for the whole Ministry in a programmatic fashion, especially taking advantage of the presence of several high quality foreign advisors in the Ministry. The Ministry already has one long-term revenue advisor (USAID/SOMTAD) and three high caliber experts (UNDP) who have a great deal of expertise in the areas of tax policy, customs and direct taxes. Other short-term experts should join them on an as needed basis. What is urgently needed, however, is a program designed for such activities. A brief memorandum to that effect has already been submitted by the long term revenue advisor to the Ministry. The suggestions made in the memorandum seem to be quite pertinent. (See memorandum of Gene Lovorn addressed to Director General, Dec. 23, 1987.) It is suggested here that his recommendations be implemented without delay. Although the implementation of it will be decided at the ministerial level, the execution of the program may very well be the joint responsibility of the directors of Labor and Research and Planning.

Since the training needs are so well articulated in the above mentioned memo, no further elaboration is really needed here. They will only be listed below in a tabular form.

Table VI.1

Training Needs

Levels	Training Areas
Top Level	Management Techniques --Organization and structure --Delegation of authority --Personnel management --Budget management
Middle Level	Basic Management Techniques --Basic accounting --Basic auditing --Inventory evaluation --Basic cost accounting --Basic statistics --Work flow procedures --Techniques of revenue collection --Computer training
Lower Level	Office Equipment and Procedure --Typing --Filing --Computer training --Electric calculator training

It should be pointed out that field office personnel should also participate in the training programs.

Training cannot be viewed as a one-shot activity. It should be on-going or at least periodic. In addition to training, every effort should be made so that some written material in the form of manuals, instruction books, etc., begins to be available for further training courses and for reference. The Research and Statistics Unit should be the depository of such material.

The Ministry should also undertake a forceful program for the taxpayers' education to create a habit of tax compliance. Undoubtedly this program cannot yield quick results. Such efforts would take considerable time and perseverance before yielding concrete results. However, the sooner a program starts, the sooner the desired results can be achieved.

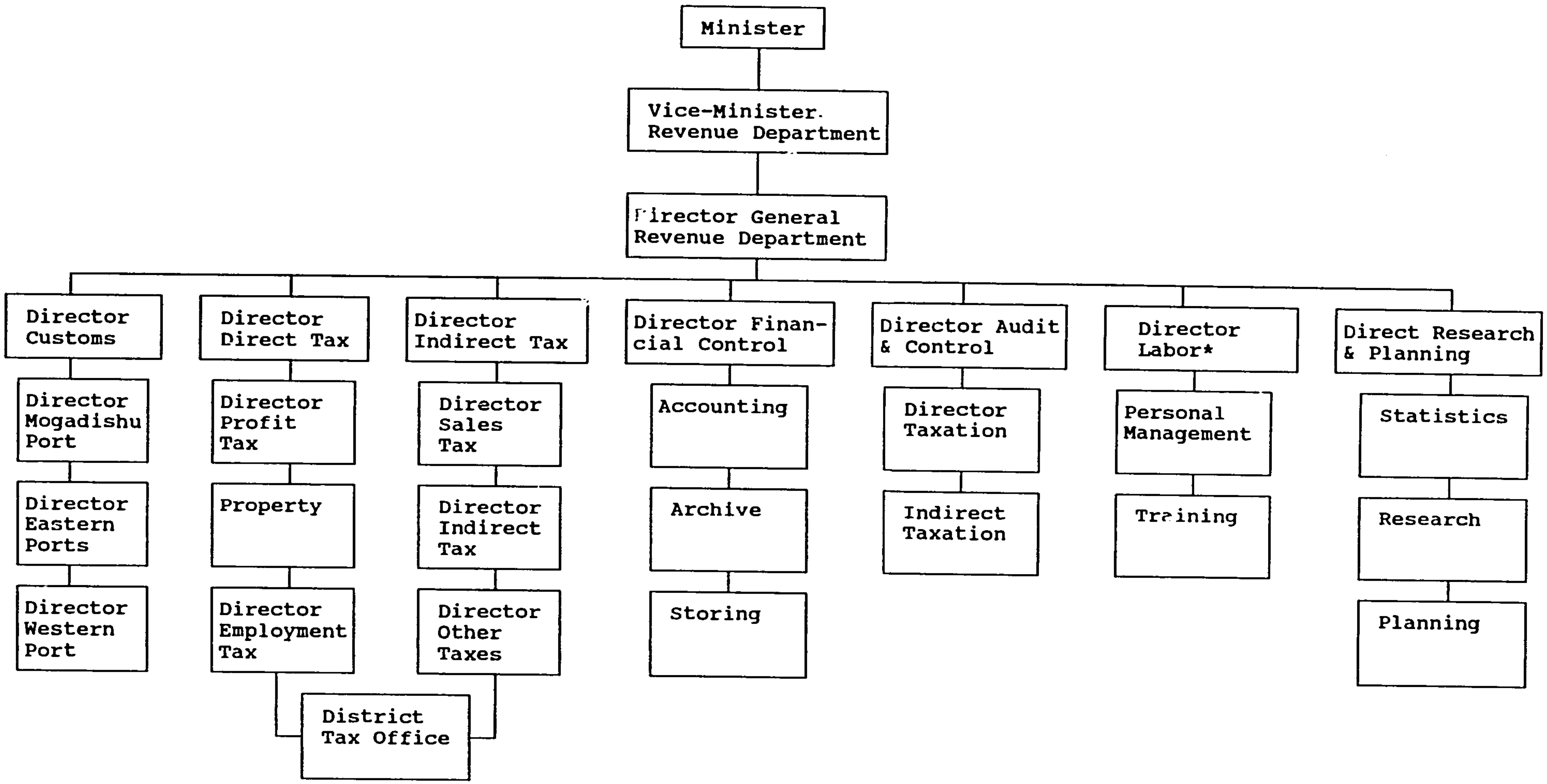
Taxpayers must be educated about their obligations and duties as well as their rights. Concomitantly, severe penalties must be imposed in the case of non-compliance. In order to apply the penalties justly, standard audit and inspection norms must also be developed.

Finally, the Ministry should take the lead and, in collaboration with the professional organizations, should <u>standardize bookkeeping practices in the country</u>.

It cannot be overemphasized that <u>in any country</u>, without exception, <u>the tax system is always as good as its administration</u>.

CHART VI.1

Organization of the Ministry of Finance
(Revenue Division)



* To become a section attached to the director of personnel and administration of the Ministry.

CONCLUDING REMARKS

Conclusions of this report are bound to be short but not necessarily sweet. As can be gathered from the totality of the observations made in the preceding chapters and suggestions put forward, the Somali tax system needs a major restructuring. However, it would be a grave mistake to make such an attempt at once with the existing administrative structure. The golden rule at this point is to accept the reality and separate what is actually possible from what is ideally desirable. <u>Restructuring the tax system and improving its administration will have to be carried out step-by-step within a well thought-out program and within guidelines which would specify the priorities and the actions to be taken, and the time frame</u>.

Many restructuring efforts and administrative improvements will have prerequisites in terms of other reform efforts. For example, personnel will have to be trained in record keeping and filing before a data bank is established; computer installation and proficiency in use of a computer are prerequisites for using taxpayer identification numbers; government revenues must be increased before the pay scale of employees is revised, and so on.

<u>First and foremost the Ministry must commit itself to changes and reforms and</u> then it must <u>draw up an action plan</u> and make every effort to follow the plan. This plan must specify the nature of the action; time within which the action is to be completed, and resources required (technical and financial). It must be drawn up by a committee presided by no less than the Director General of Revenue.

This report cannot pretend to outline an action plan even for demonstrative purposes. It can, however, try to make some suggestions. Within the area of administrative improvements, several actions can be taken immediately. Training of personnel should start from the low level. At the same time, work can start in preparing job descriptions and work flow within the Ministry. As soon as possible, two support departments, namely personnel and statistics and research, must be fortified. Thereafter, training for the installation of EDP systems should begin. When a small but well trained cadre of EDP personnel is at hand, then and only then can electronic data processing be made available to all departments.

Revision of taxes will have to wait until the staff is trained. No new taxes should be imposed--perhaps with the exception of airport departure fees--without first enlarging the tax base. Otherwise very serious equity and efficiency violations would ensue.

One major exception to reforming taxes immediately is customs. One reason, of course, is expediency and government revenue. Considering its weight in total tax revenue the impact of improving the collection of customs duties would make an appreciable impact on total revenue. The first step for such an improvement would be in the areas of administration and procedures in customs duty collection. There are several consulting procedures of customs duty collection. There are several consulting firms who, for example, accept as a fee a certain percentage of increased revenues. Employment of such a firm can easily increase tax collection almost immediately, and at the same time provide training for customs employees. In addition, this would enable the customs to have access to modern methods and procedures of tax collection. They could ensure provision of up-to-date valuation lists, which will improve revenue, equity and efficiency. Two other areas where initial reform can begin and which will make future improvements in administration easier are simplification (and rationalization) of the rate structure and a decrease in the number of separate items listed.

As it is stated above these are but mere examples to indicate the magnitude of action and the order within which reforms should be pursued. The sole purpose of these examples is to emphasize the need for a plan of reforms.

It is quite clear that the Ministry will need considerable assistance from the multilateral and bilateral donor agencies. Such assistance can be useful only if the overall restructuring is implemented within a clear, specific and realistic plan of action.

BIBLIOGRAPHICAL NOTE

There is very little published on the public finances of Somalia. Most of the existing few materials are by international organizations. The most complete study is by Vito Tanzi, et al., Tax Survey of Somalia, IMF, August 1980. Although undertaken eight years ago, many issues the study raises and solutions it suggests are still valid. The present report benefited greatly from it. Two additional studies, also by IMF, Somalia - Recent Economic Developments, SM/86/234 (September 10, 1986) and Somalia - Economic and Financial Policy Framework, EBS/87/123 (June 5, 1987) contain chapters pertinent to public finance problems. A recent World Bank report, Somalia: Recent Economic Developments and Medium-Term Prospects, No. 6542-SO (February 10, 1987) is also a very useful document. The Ministry of Finance of Somalia has recently published a Compendium of Tax Laws, a volume in which all tax laws are given in English, Italian and Somali.