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THE GAMBIA

TAX REFORM TOPICS: THE CAPITAL GAINS TAX AND ITS ADMINISTRATION

ADMINISTRATIVE DISCRETION IN THE INCOME TAX AND DEVELOPMENT ACTS

PENALTIES AND COMPLIANCE

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A. INTRODUCTION

Hybrid Feature of the Capital Gains Tax

1. What is called the capital gains tax in the Gambian income tax code is actually a hybrid tax combining a capital transfer tax and a capital gains tax. The tax charged is the maximum of the two taxes calculated separately - 15% of the capital gain or 5% of the transfer price for individuals, who pay most of the tax. A separate rate schedule applies to limited liability companies: 25% of the gain or 10% of the transfer price.

Yield of the Capital Gains and Other Direct Taxes

2. The yield of the capital gains tax was only D 1.0-1.9 million in the last two fiscal years, less than 2% of the total yield of direct taxes in The Gambia (Table 1.1). For FY 1994, the Central Revenue Department (CRD) estimates that the yield will be somewhat higher, but this estimate is not based on any formal revenue estimating methodology. The question has been raised of whether the tax should be eliminated on grounds the tax yield is hardly worth the public and private costs of collection.

TABLE 1.1 YIELD OF CAPITAL GAINS AND OTHER DIRECT TAXES, FISCAL YEARS 1992-1994 (D'000)

Tax	1991-92		1992-93		Est. 1993-94	
Capital Gains Tax	1,030	1.2%	1,870	1.6%	2,500	2.2%
Personal Income Tax	32,574	37.8%	33,293	29.0%	36,200	31.7%
Expat. Payroll Tax	1,868	2.2%	2,093	1.8%	2,200	1.9%
Company Income Tax	50,771	58.9%	77,442	67.5%	73,400	64.2%
Total Direct Taxes	86,243	100.0%	114,698	100.0%	114,300	100.0%

Source: Ministry of Finance and Economic Affairs

B. PRESENT EXPERIENCE

Survey of Capital Gains Tax Returns

3. A statistical profile of the tax was derived from a stratified sample of the 327 confidential capital gains tax returns filed from January 1993 through April 1994.[1] All 11 returns with tax greater than D 20,000 were tabulated and a 20% sample of the remaining returns was taken. The sample results, when expanded to the universe, provide the following profile: the median tax paid was only D 3,750 and the median claimed transfer price was just D 30,000 (Table 1.2). Seventy-six percent of the returns paid tax calculated on capital gains (and paid 79% of the total tax), and 24% paid tax calculated on the transfer price (and paid 21% of the total tax).

Compliance Record

4. In contrast to the poor taxpayer compliance in the income tax, taxpayer compliance in payment of the capital gains tax on real estate transfers appears

TABLE 1.2 CAPITAL GAINS TAX: DATA ON TRANSFER PRICE AND CAPITAL GAINS, 1993-1994* (D'000)

	Claimed Transfer Price	Assessed Transfer Price	Claimed Capital Gain	Assessed Capital Gain	Tax Paid
1st Quartile	20,000	25,000	7,000	12,000	2,250
Median	30,000	40,500	14,750	20,000	3,750
3rd Quartile	75,000	80,000	22,500	33,000	5,250

* Based on a sample of capital gains tax returns January 1993-April 1994 (para.3).

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1 This period has the advantage of covering the most recent experience with the tax. It may or may not be representative, since the capital gains tax varies with the economic conditions on the real estate market. One particular factor likely to affect both real estate prices and capital gains tax revenue in the near and medium future is the activity of the Asset Management Recovery Corp. (AMRC) which in early 1994 had a portfolio of 4,700 non-performing assets with a book value of D 330 million it acquired from the defunct Gambia Commercial and Development Bank. If the AMRC should dump these assets on the thin Gambian real estate market, depressed real estate prices could crowd out some non-AMRC sales, reduce the capital gains on those that did occur and thereby reduce government capital gains revenues. Even though AMRC sales are specifically exempted from the capital gains tax, the government will not lose revenue for this reason. It will be channeled to the AMRC, however, rather than to the CRD.

to be very high in terms of filing and paying tax.[2] The principal reason for the high compliance appears to be the requirement of a capital gains tax clearance from the CRD in order to register the lease assignment or conveyance of the deed in the case of the sale of a freehold.[3] To verify the expected high compliance, I surveyed the register of deeds kept in the Ministry of Justice to determine how many properties liable for the capital gains tax had been registered during the survey period. This survey of the deeds register counted 246 registrations of property subject to capital gains tax, which compares with an estimated 287 non-gift capital gains returns filed for the same period[4]. Why there were more tax returns than registrations is not clear, but at least it is evidence to support the conclusion of high compliance with the filing requirement of the capital gains tax.

Yield Affected by Undervaluation

5. While compliance in filing required capital gains tax returns is high, the yield of the tax appears to be low due to substantial undervaluation of the transfer prices in these returns. No data exist on the extent of the average undervaluation, but knowledgeable persons interviewed who had opinions on its extent guessed that reported sales values have typically been one-third to one-half of the true values. In the Gambian system, the Commissioner of Income Tax has the power to assess taxpayers if he does not believe that accurate data have been supplied. In the case of the capital gains tax, he used this power in 56% of the returns liable for tax.

6. Data were available on almost all returns to calculate both alternative tax bases - the transfer price and the capital gain - irrespective of which one was actually used to calculate the tax. Using this data, the average assessed transfer price was found to be 19% higher than the average transfer price claimed by the taxpayer, and the average assessed capital gain found to be 43% higher than that claimed by the taxpayer. Up to the present, the Commissioner's procedure for assessment has relied on his general personal knowledge of property values and his desire to collect revenue based on negotiation rather than through the application of statutory rates to verified statutory tax bases. If the conventional wisdom about the undervaluation of property values is correct, our survey shows that the Commissioner recovers only a minor proportion of the tax deficiency.

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2 Little data exist on number or size of transfers of other assets, but compliance in the payment of capital gains tax on these assets is undoubtedly low, since few non-real estate returns are filed.

3 Freeholds are largely restricted to Banjul. Elsewhere, individuals acquire land under long-term, assignable leases from the state. The term of these leases was recently extended from 25 to 99 years.

4 The number of non-taxable gifts to family members was estimated and removed from the total number of returns based on the proportion of gifts in the sample.

C. FEATURES OF THE GAMBIAN CAPITAL GAINS TAX[5]

Taxes on Capital Transfer

7. In the absence of inheritance and gift taxes in The Gambia's tax code, the transfer tax part of the hybrid capital gains tax, when it is applied, is the country's principal capital transfer tax. There is a second, smaller capital transfer tax that operates in parallel with it, a stamp duty equal to 2% of the transfer price. This duty is charged to register real estate deeds and is collected by the Accountant General's office rather than the Central Revenue Department. In general, capital transfer taxes suffer from lack of horizontal equity[6], since they penalize those properties which change hands frequently - what might be called a "turnover" problem. They can also act to inhibit capital transactions. Advanced tax codes opt universally for inheritance and related gift taxes rather than for general capital transfer taxes. They mitigate the "turnover" problem by doing so and achieve objectives of vertical equity.[7]

Tax on Capital Gains

8. Although the capital gains tax is specified in the income tax act, it in fact is a separate tax with its own rate schedule. The tax is also due at the time of realization of the capital gain, rather than at income tax time. Most advanced tax codes integrate the capital gains tax with the income tax, although a significant minority administer a separate tax like The Gambia's. In the integrated systems, capital gains, or some percentage of them, are considered to be ordinary income and taxable as such. This has the advantage of not discriminating among different types of income, but it loses the close connection between the timing of a capital transaction and its associated tax liability.

Treatment of Inflation and Short- v. Long-Term Gains

9. There is no mechanism in place in The Gambia's tax code to shield taxpayers from paying tax on inflationary capital gain, and no distinction is made between short-term and long-term gains. Advanced tax systems typically either index the gain or reduce it formulaically by a percentage before adding it to ordinary income, sometimes using the distinction between short- and long-term gain.

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5 None of the statements in this report on the legal aspects of the Gambian tax code should be considered definitive, since the author is not a legal specialist and they are based on a limited set of legal documents and interviews.

6 Horizontal equity is defined as requiring the imposition of similar taxes on those similarly placed.

7 Vertical equity is defined as requiring that those with greater ability to pay should pay more tax.

Scope of the Capital Gains Tax

10. The definition of assets subject to the capital gains tax includes all real estate and associated rights and any business plant, fixtures and equipment. Securities per se are not mentioned in the income tax act but are considered by the tax authorities to be covered. There are rollover provisions for the sale and subsequent purchase of a principal residence or agricultural land. Advanced tax codes vary considerably as to which assets they cover, with exemptions in most cases given for principal residences and life insurance proceeds and in some cases for foreign exchange, certain securities, and household assets (equipment, automobiles, jewellery and objets d'art).

Loss Carry Forward

11. Capital losses are deductible only against capital gains in the calendar year of their occurrence. Advanced tax codes usually allow capital losses to be carried forward for multi-year periods and frequently to be offset against ordinary income.

Residence of Taxpayer

12. In general, residents and non-residents are taxed alike on capital gains accruing in or derived from The Gambia. Conversely, both are usually exempt from tax on transactions involving assets located outside The Gambia until the proceeds are brought into or received in The Gambia.*

D. INCREASING THE YIELD OF THE CAPITAL GAINS TAX

Understatement of Capital Transfer Prices

13. Although the evidence for the widespread understatement of capital transfer prices is only anecdotal, it is sufficiently convincing to make it clear that the most important reform for the capital gains tax would be the reform of the valuation procedure. The sample results presented in para. 5-6 suggest that the attempts by the Commissioner to correct for undervaluation have not been sufficient to correct for more than a minor part of it. In order to make more objective assessments, what he will need is more objective information on property values.

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* In reality, no attempt to track the proceeds of transactions in assets outside The Gambia would be fruitful. Thus, in practice, such transactions can be considered fully exempt.

Supply of Property Valuation Professionals

14. In advanced economies, information on property values can be straightforwardly obtained from a range of professionals concerned with property valuation. The tax authorities in these economies usually have a staff of such people and often use the services of privately contracted valuers as well. Prior to making mortgage loans, banks routinely evaluate property themselves and often require buyers to provide valuation reports from independent professionals. The supply and qualifications of such professionals in the Gambia is somewhat limited, but it would appear that there is a sufficient number of them for the CRD to move to a more professional approach to valuation in which all tax returns are accompanied by a property valuation.

15. In The Gambia the experienced valuers are a mix of quantity surveyors trained mostly in the United Kingdom and graduates of business administration programs trained in various countries. A very few are trained directly in real property valuation, but in the main, valuation skills have been acquired through experience. However acquired, they appear to be in demand, with valuers able to demand compensation far above civil service salaries. The government has a small staff of valuers in the Lands Department, who mainly assist local government in property valuation for local property taxes.

Property Valuation and the Capital Gains Tax

16. Four alternative ways for the CRD to bring the services of valuation professionals to bear on property valuation would be to:

(1) request valuation services from the Department of Lands,

(2) add two or three qualified valuation professionals to the CRD staff,

(3) contract the service out to licensed, private professionals, and

(4) require taxpayers to present valuation reports prepared by professional valuers of their own choosing.

17. The problem with obtaining assistance from the Department of Lands is that its valuation staff needs strengthening. Just two experienced supervisors supervise a largely untrained staff, which additionally has a several months' backlog of work. In the context of this backlog, interdepartmental requests for assistance are unlikely to be given top priority. The likelihood is that either real estate transactions and revenue capture would be delayed or that valuations would not be done. Furthermore, there is a good possibility that the department's experienced valuers will be attracted away by the private sector in the future, further diminishing the department's capability.

18. The second alternative - CRD hiring of its own staff of valuers - faces even more damaging deficiencies. First, the threatened cutback of CRD staff would have to be reversed. Even with civil service clearance, the ability of the department to compete with the private sector employment for experienced valuers would be virtually nil.

19. The third alternative - contracting out the service to licensed private professionals - is the procedure recommended. It avoids the problems of the civil service and of the fourth alternative (which requires the taxpayer to contract directly with the valuer and presents the problem of collusion among the valuers and buyers and sellers. Numerous problems, of course, inhere in the recommended procedure, but they can be minimized.

20. An outline of the recommended alternative is as follows: A licensing board would be required to license private valuation professionals for tax valuation purposes. Such a board, with perhaps four members could be appointed by the Minister or the head of the civil service and should include equal numbers from the government and the private sector. On the government side, the members could be the Commissioner of Income Tax and the Auditor General. On the private side, the members could be prestigious members of the legal, accounting or valuation professions. Three votes would be required to license a valuation professional. The board would establish qualification, experience, and probity criteria appropriate for The Gambia.

21. The CRD would contract, say, two licensed valuers annually to be available for preparing valuation reports for taxpayers within set deadlines and at an agreed fee schedule. The selection would be competitive. Fees would be payable directly by the taxpayer. (This would be necessary to avoid the problem of delayed government payments.) The valuation report would include an opinion on the market value of the property and on each of the elements of the calculation of capital gain, including original and current sales prices, sales expenses, the value of improvements, and the amount of depreciation previously claimed in the income tax. As a way to reduce gross fraud, no de minimis threshold is recommended; instead, the successful valuation contractors would be required to provide valuation reports for small property sellers for a minimum fee. The Auditor General should be given the authority to audit the operations and methods of the valuation professionals working under contract to the CRD.

22. The underlying incentive for taxpayer compliance with the requirement to submit a valuation report would be the same as that for the present high compliance; tax clearance would continue to be a condition for legal transfer of title. The registration procedure should be modified so that particulars of all registered property sales, including both the sales price and the judged valuation, were available as public information. Registration records should be computerized as soon as possible to assist the public in inspecting this information.

23. The Commissioner, who should retain his power to make an independent assessment of value, would be required by regulation to provide the taxpayer with a written statement giving the detailed basis for his assessment, including a reference to the valuation report. A copy of this statement should be placed in the taxpayer's confidential tax file.

E. OTHER DESIRABLE REFORMS IN THE CAPITAL GAINS TAX

Unification of Rates

24. Several other reforms in the capital gains tax should be considered in the interest of fairness and efficiency. In the first place, the current capital gains tax discriminates against limited liability companies for no justifiable reason. This discrimination should be ended because it constitutes an unintended incentive to avoid the corporate form of business organization. At present the capital transfer tax rate for companies is double that for individuals and partnerships (10% compared to 5%). Company capital gains rates are also substantially higher - 25% compared to 15%. A unified schedule is suggested below. In this schedule, I recommend a capital gains tax rate of 20% rate on grounds that it is consistent with the highest marginal income tax rate for individuals of 35%.[9] As enforcement of the income tax continues to improve, a 15% capital gains rate may increasingly distort economic activity toward operations that earn capital gains rather than ordinary income.

Indexation of Capital Gains

25. This recommendation of a 20% tax rate on capital gains is predicated on the adjustment of these gains for inflation. A seller's proceeds from the sale of real estate do not include any real capital gain if the purchasing power of the proceeds has not increased over that of the cost. Thus, if we are to equitably compare the value of capital gains (and losses) to the value of income from profits or employment in a given year, we need to make an adjustment for inflation to convert the cost basis of the assets into current-year values before determining whether there is a real gain or loss. A practical method, using the Consumer Price Index (CPI), is available. While the available CPI is an index for low income consumers and an index for middle income consumers would be somewhat more appropriate, the low income CPI is nevertheless good enough for the purpose and would be a major improvement over the present failure to make any inflation adjustment at all. Rather than being written into law, the choice of the index and the method of use should be prescribed by regulation by the Minister of Finance and Economic Affairs.

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[9] It would also be consistent with the proposed 35% company income tax rate.

Unification With the Income Tax

26. Unification with the income tax would be a worthwhile long-range goal for the Gambian tax system (or any other with a separate capital gains tax), but compliance considerations argue against it even in the medium term for The Gambia. If the capital gains tax were unified with the income tax, its outstanding compliance record (in returns) would be exchanged for the still poor compliance record of the income tax. Cash flow and record keeping is also likely to be more favorable at the time of the registration of property sales than at income tax time. Thus, I recommend against unification of the capital gains and income taxes in this current round of tax reform.

Loss Carry Forward

27. There would be grounds in considerations of horizontal equity to recommend that capital losses be allowed to be netted against ordinary income and capital gains for a multi-year period after they were realized. On grounds of administrative ease and reduction of fraud, however, I recommend that capital loss carry-forward continue be limited to one year and only against capital gains during this phase of tax reform. The year, however, should be one year prior to any particular transaction rather than within a given calendar year. In the future, when the CRD is confident in its ability to deal with a multi-year tax frame, the carry forward period could be lengthened so that taxpayers in similar situations would pay similar amounts of tax.

Dehybridizing the Capital Gains Tax

28. The hybrid quality of the present capital gains tax is perhaps the most serious instance of horizontal inequity in the tax. Taxpayers with no capital gain or with capital losses can be charged the same tax as those with substantial gain.[10] No tax system is, of course, immune from horizontal inequity. In some cases, such as the separate Gambian capital gains tax, there are practical reasons to discriminate among different kinds of income and thus different kinds of taxpayer.

29. There does not seem to be any compelling reason for maintaining the capital gains tax in its hybrid form, however. Several reform alternatives suggest themselves:

(1) retain only the capital transfer tax,

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[10] Consider the following example: Two properties sell for D 60,000. The first suffers a capital loss of D 20,000, having been bought for D 80,000, and the second has a capital gain of D 20,000, having been bought for D 40,000. Despite the fact that one has a gain and the other a loss, they both pay D 3,000 in tax, the first taxpayer in line with the 5% capital transfer tax and the second in line with the capital gain tax of 15% on the gain.

(2) retain only the capital gains tax, and

(3) retain both and apply them both to all taxpayers.

Although transfer taxes can be inequitable or have an undesirable impact on economic activity, they have undeniable revenue attractiveness. For this reason I recommend the alternative of eliminating the hybrid quality of the tax by applying both to all taxpayers.

Unification With the Stamp Tax

30. The 5% capital transfer tax now part of the hybrid capital gains tax is not the only capital transfer tax in the Gambia. There is also a 2% stamp duty paid to the Accountant General's office as a registration tax. Those who pay the 5% to the CRD thus pay a total of 7%. Our working judgment not backed by any analysis is that this level is too high and could be having an undesirable impact on the liquidity of the property market as taxpayers seek to avoid it. Our recommendation is that the two taxes be unified and set at 5%. There would be some efficiency in tax administration if it were collected by the CRD, which would be collecting the capital gains tax, rather than the Accountant General's office, but in any case it should be unified and collected by just one office.

Narrowing the Scope of the Capital Gains Tax

31. The present scope of the capital gains tax - real estate transactions and business plant, fixtures and equipment, together with some coverage of securities - appears roughly appropriate, but it should be narrowed somewhat further. As a small country subject to capital flight, the government should avoid setting its tax policy in ways that discriminate against capital employed in The Gambia. The operative principle is that the distortionary impact of the tax should be on the value of the asset rather than on its location. For example, a tax on Gambian real estate will tend to lower land prices in Gambia as it works its way into real estate prices, whereas a tax on portfolio investment or other mobile assets in The Gambia will tend to make those mobile assets relocate outside the country. Another principle (also stated previously above in another context) is that the tax code should not discriminate against the corporate form of business organization by, in this case, charging companies capital gains taxes that cannot practically be collected from individuals.

32. These principles suggest that the scope of the tax should be limited to real estate transactions and sales of stock by major stockholders companies doing business in The Gambia. The latter need to be taxed because, if they were not, real estate transactions could escape the tax by simply being wrapped in a company cloak. A practical rule to keep this securities tax from disadvantaging portfolio investment in The Gambia generally would be to

exempt sales of stock by sellers owning less than 10% of a company. Although the 10% may seem low, the legitimate possibilities of tax avoidance will in practice result in a much higher effective threshold.

Treatment of Depreciation

33. Although in theory, and formally in the Gambian tax code, the cost basis for calculating capital gain should be the written down cost, in practice the relationship between depreciation and the inflation-corrected value of real estate improvements is unreliable. Taking account of depreciation also adds a significant administrative complication. Probably the best practical rule, when tax computerization allows it, will be to write down the cost basis by only the depreciation that has been charged against income tax. To provide the data for this, the income tax return form should be revised to allow the tracking of cumulative depreciation on individual pieces of real estate. In the meantime, the tax code should be adjusted to conform to practice and eliminate the requirement that the written down cost be used in calculating the cost basis. The code should state that treatment of depreciation would be subject to regulations issued by the Minister of Finance and Economic Affairs. The initial regulation, which should eliminate the use of depreciation in the calculation of capital gain, could be revised when data and CRD capability allow it.

Computerization of the Capital Gains Data Base

34. For this and other reasons (e.g., improvement in tax records and data security), data on capital gains taxation should be computerized and referenced with both sellers' and buyers' tax identification numbers. Among other things, this would allow the CRD to keep track of the cost basis of givers' and decedents' property. The present tax code provision, which should be retained, but which has been unevenly enforced, is that, while recipients or heirs are not liable for capital gains tax upon their acquisition of property, their cost basis depends on the cost of the property to the former owner.

F. REVENUE IMPLICATION OF RECOMMENDED REFORMS

Revenue Estimation Model

35. In order to develop the revenue implications of the various recommended reforms, I developed a revenue estimation model based on the sample of 1993-1994 tax returns referred to in para. 3 and on the Commissioner's revenue projection for 1993-1994 of D 2,500,000. I set our base estimate for 1994-1995, which assumes the continuation of the current tax structure, equal to that projection. The results of this model are presented in Table 1.3. Alternative revenue estimates, using a lower base estimate of D 2 million, are presented

in Appendix A, Table A.1. Index numbers, which will allow the use of any other base estimate and the calculation of percentages, are presented in Table A.2.

Revenue Estimates

36. In the absence of reform of property valuation, considered singly the various other recommended reforms designed to make the tax fairer and less distortive have various revenue impacts. Indexation alone would result in a drop in revenue from the tax of 14% (col. 2, line 1). If only the capital gains tax were charged, the drop in revenue would be 56% (col. 2, line 3). The unification of rates on the recommended rates, implemented as the sole reform of the still-hybrid tax, would result in a small increase of 3% in collections (col. 1, line 5), but indexing this tax would result in a decrease of 35% (col. 2, line 5). All recommended reforms together, but without any improvement in valuation, would result in a revenue loss of 18%, according the model (col. 2, line 8).

37. Without an improvement in the realism of property valuation, the other reforms most often result in revenue loss. Significant improvements in valuation, however, would result in large increases in revenue, even with the other recommended reforms (cols. 3 and 4). These estimates are based on the assumptions that improved valuation of property would result in assessments 2 to 3 times current taxpayer valuations. Using these assumptions to set a range, revenue would be expected to rise by 243-467% to D 6-12 million if all major reforms, including those designed to improve valuation, were implemented (col. 3-4, line 8). Picking and choosing among the reforms would also result in large increases in revenue. For instance, keeping the current structure and rates, but improving valuation would result in estimated revenue of D 4-9 million, according to the estimates (col. 3-4, line 1).

G. SUMMARY OF RECOMMENDATIONS

38. The following recommendations on the capital gains tax were developed in the text above:

(1) The Central Revenue Department (CRD) should contract the valuation of property for capital gains tax purposes out to licensed, private professionals.

(2) The Minister of Finance or the head of the civil service should appoint a board to license private valuation professionals for tax valuation purposes.

TABLE 1.3 REVENUE ESTIMATES FOR ALTERNATIVE CONFIGURATIONS OF THE CAPITAL GAINS TAX, 1994-1995* (D'000)

Tax Structure and Rates	Based On Commissioner's Actual Assessment - Not Indexed (1)	Based On Commissioner's Actual Assessment - Indexed (2)	Assessment at Taxpayer Claims Multiplied By 2 - Indexed (3)	Assessment at Taxpayer Claims Multiplied By 3 - Indexed (4)
CURRENT RATES FOR INDIVIDUALS & COMPANIES&				
1 Current Hybrid Tax@	2,500	2,200	4,400	8,600
2 All Charged Only Transfer Tax	1,900	1,900	2,800	4,300
3 All Charged Only Gains Tax	2,200	800	3,300	6,800
4 All Charged Both Taxes	4,100	2,700	6,100	11,100
GAIN 20%, TRANSFER 3%, ALL TAXPAYERS#				
5 Current Hybrid Tax	2,600	1,600	4,700	9,500
6 All Charged Only Transfer Tax	1,000	1,000	1,700	2,600
7 All Charged Only Gains Tax	2,500	1,100	4,400	9,100
8 All Charged Both Taxes	3,500	2,100	6,100	11,700

* Revenue model based on the sample of 1993-1994 tax returns described in para. 3.

& Current rates are: transfer tax 5% and 10% and gains tax 15% and 25% for individuals and companies, respectiv
The transfer tax is actually 7% when the 2% stamp duty is added in.

@ This and all other revenue estimates in this table are based on this 1994-1995
forecast for the currently configured tax. Estimates based on an alternative D 2,000,000 projection are presen
in Appendix I.

When the 2% stamp duty is added in, the total transfer tax is 5% (para. 28).

(3) The CRD should contract, say, two licensed valuers annually to prepare valuation reports for capital gains taxpayers within set deadlines and at an agreed fee schedule.

(4) The Auditor General should be given the authority to audit the operations and methods of the valuation professionals working under contract to the CRD.

(5) The registration procedure for deeds should be modified so that particulars of all registered property sales, including both the sales price and the judged valuation, is available as public information.

(6) The registration records of deeds should be computerized as soon as possible to assist the public in inspecting this information.

(7) Each taxpayer should be provided with a written statement giving the detailed basis of the Commissioner's assessment.

(8) Discrimination against limited liability companies in the capital-gains and capital transfer rates should be ended.

(9) I recommend a unified capital gains tax rate of 20% rate for both companies and individuals.

(10) Capital gains should be indexed using the Consumer Price Index. Rather than being written into law, the choice of the index and the method of use should be prescribed by regulation by the Minister of Finance and Economic Affairs.

(11) I recommend against unification of the capital gains and income taxes in this current round of tax reform.

(12) I recommend that capital loss carry-forward continue be limited to one year and only against capital gains during this phase of tax reform, but that the year be the year prior to the transaction rather than the calendar year.

(13) I recommend eliminating the hybrid feature of the present capital gains tax by applying both capital gains and capital transfer taxes to all sales of eligible property.

(14) My recommendation is that the capital transfer tax, which now has different rates for companies and individuals, and the 2% stamp duty collected by the Accountant General's office be unified and charged to all taxpayers at a 5% rate.

(15) The scope of the capital gains tax should be limited to real estate transactions and sales of stock by major stockholders of companies doing business in The Gambia, the latter defined as those owning more than 10% of a company.

(16) Depreciation should not be deducted from the cost basis when calculating capital gains for tax purposes. However, when the CRD data base allows it, the cost basis should be reduced by any depreciation that has been charged against income tax.

(17) Data on capital gains taxation should be computerized and referenced with both sellers' and buyers' tax identification numbers.

II. ADMINISTRATIVE DISCRETION IN THE INCOME TAX AND DEVELOPMENT ACTS

A. INTRODUCTION

39. The premise of this analysis is that discretion on the part of those who manage a country's income tax system should be reduced to a minimum in the interest of base broadening and taxpayer perceptions of fairness. Actions in those areas where discretion remains necessary should be transparent and accountable. This applies not only to positive actions but, even more importantly, to acts of omission.

40. The first section will examine the specific powers of discretion contained in The Gambia's income tax and development acts through which specific classes of potential taxpayers can be and have been exempted from payment of income tax. The second section will look at the role of discretion in the operation of the income tax system.

DISCRETION IN THE LAW & DISCRETION IN MANAGEMENT OF THE TAX SYSTEM

B. SPECIFIC POWERS OF INCOME TAX EXEMPTION AND REMISSION

General Presidential Authority To Exempt and Remit

41. The broadest power to exempt taxpayers from payment of income tax is the presidential authority of Section 9.4 of the income tax act:

> The President many exempt any person or class of persons from all or any of the provisions of this Act on any ground which to him may seem sufficient.

A related power is in Section 79.1:

> The President may remit, wholly or in part, the tax payable by any person if it will be just and equitable so to do.

42. Given the obvious sensitivity of presidential powers and my lack of standing to advise on The Gambia's political circumstances, I approach the tax policy questions involved in presidential powers with a set of options for increasing the transparency, accountability and access to expert opinion, rather than with an explicit recommendation. While presidential powers to exempt and remit have not been grossly abused to date, a pattern of granting exemptions to particular groups of taxpayers has emerged in recent years. Now exempt from income tax are at least the following (I could not obtain a fully definitive list):

(1) the non-practicing allowances of medical doctors;

(2) the special allowances of the vice president and the attorney general;

(3) the rent allowance of cabinet ministers; the constituency allowances of members of parliament;

(4) the allowances of judges, the solicitor general, the director of public prosecutions, law officers and state counsel; and

(5) the salaries of non-commissioned military personnel.

Presidential powers have also been used to exempt certain contractors under specific contracts with the government, but no data are available on the extent of the practice.

RECAST

43. The most far reaching option would be to repeal the presidential exemption powers, repeal all existing exemptions, and substitute budgetary compensation and a phase-out period for any continuing benefits.

44. Intermediate options could set more or less restrictive criteria for presidential exemptions and remissions, e.g., require the President to state the reasons for the actions, estimate their revenue consequences, formalize the procedure by requiring that the actions be recommended by the cabinet or a board with a specified membership, and/or specify that all exemptions would time-limited.

45. The least far reaching option that would still significantly increase transparency and accountability would require the President to make any exemptions and remissions only after receiving the advice of the Minister of Finance and Economic Affairs the opinion of the Commissioner of Income Tax and to publish official notices with comment periods prior to effectiveness.

46. In all options, the Commissioner should be required to annually publish a list and description of all currently active exemptions.

Remission Powers of the Commissioner of Income Tax

47. The Commissioner of Income Tax has certain powers to remit interest due on overdue tax liability (Section 73.3) and all or part of the tax liability on grounds of poverty (Section 79.2).

48. The grounds for the remission of interest due are clearly overbroad: "for any good cause shown". Any attempt to specify them further, however, would quickly encounter the lack of any convincing distinction between interest owed and tax owed. In use, moreover, this kind of discretionary

power can lead to the worst type of horizontal inequity. Thus, I recommend repeal of this section.

49. The power to remit tax on grounds of poverty is also overbroad. The Commissioner needs the ability to recognize when all or part of a tax liability is uncollectible due to the taxpayer's present and future inability to pay. In such cases, it is in the interest of the government to negotiate a settlement to recover what revenue is recoverable and avoid the poor public relations of overzealous enforcement. In the context of significant revision of the income tax law, this provision should be redrawn along these lines. Otherwise, this discretionary power should be circumscribed by regulation.

Exemption of Interest on Public Debt

50. Section 9.2 provides for presidential authority to exempt interest payable on "loans charged on the public revenue". At present, the Commissioner is assessing income tax on interest earned on 90-day treasury bills, an interpretation being contested by some affected taxpayers. Since the issues involved are relatively technical, involving as they do both monetary and fiscal policy, it would be wise to amend the law to confer authority on the Minister of Finance and Economic Affairs (rather than the President) to deal with the question. He should do it by regulation and be required to consult with the Governor of the Central Bank.

Income Tax Holidays as Investment Incentives

51. Exemption from income tax under the Development Act (Section 5.1) and the provision of other benefits are designed to stimulate investment in certain sectors and generate a range of economic development benefits. By temporarily removing income tax from the cost structure of new operations, the objective is to improve their profitability and ease their initial cash flow problems. With the widespread international adoption of such investment incentives schemes, individual countries have the further objective of staying competitive with similarly situated countries. In most such schemes, administration of the investment incentives program is highly discretionary.

52. Recommendations on how to reduce discretion in the investment incentives program generally should await the planned full analysis of the program. However, with respect to the income tax holiday, I would recommend capping it at three years from the start of production, with the last year being a partial holiday of 50%.

C. DISCRETIONARY POWERS RELATING TO THE MANAGEMENT OF THE TAX SYSTEM

Minister of Finance's Power to Issue Regulations

53. The law provides that the Minister of Finance and Economic Affairs may "make rules for the carrying out of provisions" of the income tax act (Section 5.1). This appears to be ample authority for developing, publishing and updating a set of tax regulations and tax guides for the public. A few tax rules have been issued as subsidiary legislation and one requiring tax identification numbers is currently under consideration, but the ministry should considerably expand its effort in this area.

54. In order to achieve maximum compliance, taxpayers need to know exactly what is expected of them. Achieving this kind of clarity requires a solid legislative framework, clear implementing regulations and effective public information materials. The tax authorities also need to make a continuous effort to refine, update and communicate. Considering the flexibility of desktop publishing techniques, the ministry is also now in a position to issue its own publications.

55. I recommend that the Minister establish a standing committee on tax regulations and publications within MFEA to draft and continuously update a set of tax regulations and annual tax guides for the public. Without being fully aware of organizational practices in the ministry, I envisage the committee under the chairmanship of the Permanent Secretary with the Commissioner as vice chair. The committee should meet frequently and take proposals for new and revised regulations from the Tax Reform Committee, the CRD, the Ministry of Justice and other sources. The Commissioner would be expected to provide detailed written comment (including estimated revenue impact) on all proposed regulations being actively considered by the committee.

56. Early priorities would be to clear up the small number of major areas of confusion as to tax-relevant accounting principles (in many cases opting for one of the competing principles), to state in detail taxpayer responsibilities and taxpayer rights in information requests, field audits and property seizures and to specify penalties for non-compliance. When legislative support for needed regulations is missing, weak or inconsistent, the committee would advise the Minister.

Discretion in the Management of the Income Tax

57. The income tax act gives the Commissioner of Income Tax wide discretionary powers to enforce the act. Sections 57 gives him the powers to require taxpayers to appear and

> to produce for examination any books, documents, accounts and returns which [he] may deem necessary.

Section 59 gives him the power to order taxpayers who

> fail ... to keep records, books or accounts ... which are adequate for the purposes of the tax, ... [to] keep records, books and accounts as directed.

According to Sections 63 and 64, the Commissioner may refuse to accept a taxpayer's return and

> to the best of his judgment, determine the amount of the chargeable income of the person and make an assessment accordingly. ...[and] within six years ...assess such person at such...additional amount as according to his judgment ought to have been charged.

58. Ironically, despite these large discretionary powers, the clear impression is that the recently retired former Commissioner used his discretionary power to avoid vigorous enforcement rather than to promote it. Non-filing and under-reporting of income appear to have been widespread. No attempts were made to make field audits. No income tax cases were filed in the courts during the last ten years to enforce the production of information or remedy the underpayment of tax. This pattern of enforcement reflects the weak perceived position of the Commissioner. Basically, taxpayers and the Commissioner negotiated agreed settlements based in many cases on fictional information brought in to a single meeting between the Commissioner and the taxpayer. The whole process was conditioned by taxpayer expectations of no further enforcement action. This pattern has continued, at least temporarily, under the new Commissioner.

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59. I have no full understanding of the causes of the weakness of tax effort under the former Commissioner, but observers have identified lack of human and other resources in the income tax department, an ineffective and unsympathetic judiciary, lack of sustained political will, the impact of a consensual culture, inadequate supervision and auditing by MFEA and government auditors, and, finally, lack of specific powers, such as the power to conduct field audits.[11] At the end of the process, Commissioner does not have sufficiently detailed information on taxpayer operations and does not have the human resources or the institutional power to get it.

60. Despite this history, the overall climate appears to have changed in several ways that are favorable to increased effort. First, the tax reform effort itself indicates increased political backing for systemic reform. Second, income tax enforcement efforts have received a boost from better enforcement

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[11] At present, the government has no settled position on the sufficiency of the Commissioner's power to require information from taxpayers. The present Commissioner believes that he does not now have the power to conduct field audits, that is, to have CRD staff enter taxpayer's business premises and request the production of tax-relevant documents to be examined there. The Solicitor General believes that the Commissioner does have enough authority to do this, or close to enough. All agree that increased legislative authority would be desirable. Drafting this should be a top priority of the tax reform effort.

of tax clearance procedures in customs. Third, the development of a computerized tax information system now allows the connection of previously separate data bases. Fourth, for the first time a significant number of tax enforcement cases (all customs at present) are being processed in the courts.

61. The time therefore appears ripe for movement on several tax-reform fronts. My recommendation is first that the new Commissioner, with the firm support of higher levels of the finance and justice ministries, should use his existing discretionary powers to undertake a vigorous enforcement effort in a selection of significant cases. Even a small but serious enforcement effort will quickly exhaust the resources of the CRD, however. Success will be an argument for increased resources. Failure will pinpoint the need for specific reforms. The Comissioner's seizure powers, which are not disputed but have been allowed to fall into disuse, could have a role in the effort. See Appendix B for further discussion of an enforcement effort using existing powers.

62. Second, I recommend a program of increasingly demanding taxpayer information requirements to be phased in over ten years. In light of the difficulty that the Commissioner will have in increasing the institutional capability of the CRD to increase enforcement effort and the process increased taxpayer information, responsibility for improving taxpayer information should as much as possible be placed on a developing private-sector tax-advice industry. When the phase-in period is over, all medium-sized and large businesses would be required to provide detailed financial statements as part of their tax returns; for all companies and businesses above a threshold, the statements would have to be audited. Below the threshold, an income statement would probably still be required from businesses with any significant tax liability, but assets could be listed rather than valued.

63. Because of the problems of illiteracy of business people, business inexperience with accounting procedures and the lack of development of the accounting profession, implementing such a phased program would require effective study and planning.[12] Yet the alternative, a persistently weak income tax program, is unacceptable. One action that can be taken in the immediate future, while planning is proceeding on the broader taxpayer reporting program, would be to enforce the existing requirement that all companies register annually and submit an annual report to Registrar of Companies. With the impending computerization of the company register, expected later this year, the company data base should be routinely available

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[12] If immigration policies are facilitative, The Gambia's small size would allow the rapid augmentation of the number of accounting and bookkeeping professionals through immigration from other African countries or from international skills exporters like the Philippines. These professionals in turn would be in a position to train lower-level tax advisers whose skills and fees would be appropriate for small businesses.

to the CRD. The form of the required annual report is inadequate and needs to be respecified by regulation to require tax-relevant, standard financial information.

64. Greater enforcement activity on the part of the CRD will immediately raise issues of transparency and accountability in the exercise of the Commissioner's wide discretionary powers. The arbitrariness of these powers should be constrained through regulation and the publication of taxpayer materials. An administrative tax appeals board should also be established to hear taxpayer appeals prior to entry into the court system. The income tax act now empowers the Commissioner to hear appeals of his own actions.

65. A number of provisions in the income tax act deal with the discretionary power of the Commissioner. I recommend that they be revised as follows:

> Section 10.1.e.ii. This part of Subsection (e) allows the Commissioner to determine allowable depreciation for certain plant, machinery and fixtures. This and all of Subsections (c), (d), (e) and (k) give unnecessary detail about allowable depreciation. These should be deleted and a statement substituted that depreciation will be allowed according to regulations issued by the Minister.
>
> Section 74. It should be clarified that the Commissioner and agents he may designate have police powers in connection with the seizure of movable property. The procedures under which he can seize immovable property and padlock business establishments should also be specified.
>
> Section 77. The Commissioner should be able to sue for the recovery of tax without reference to whether seizure of movable property is practicable.

66. A provision in the income tax act confers unnecessary discretionary power on the courts:

> Section 68.1.5. This subsection allows a Supreme Court judge to alter the Commissioner's assessment of tax "as to him may seem fit". This should be amended to indicate that the tax ordered by the judge should be at statutory rates and based on the judge's findings as to chargeable income or property value.

D. SUMMARY OF RECOMMENDATIONS

67. The following recommendations on the discretion in the tax acts were developed in the text above:

(1) No recommendation is presented on reform of the President's wide powers to exempt and remit tax. Options are presented from repeal to the requirement to receive advice and opinion from the Minister and the Commissioner. Publication of currently active exemptions is recommended.

(2) I recommend repeal of the Commissioner's powers to remit interest due on overdue tax liability and all or part of income tax on grounds of poverty.

(3) The law should be amended to confer authority on the Minister of Finance and Economic Affairs (rather than the President) to deal with the question of taxability of government debt by regulation but require him to consult with the Governor of the Central Bank.

(4) Recommendations on how to reduce discretion in the investment incentives program generally should await the planned full analysis of the program. However, with respect to income tax holidays, I recommend capping them at three years from the start of production, with the last year being a partial holiday of 50%.

(5) I recommend that the Minister establish a standing committee on tax regulations and publications within MFEA to draft and continuously update a set of tax regulations and annual tax guides for the public.

(6) My recommendation is that the new Commissioner, with the firm support of higher levels of the finance and justice ministries, should use his existing discretionary powers to undertake a vigorous enforcement effort in a selection of significant cases.

(7) I recommend a program of increasingly demanding taxpayer information requirements to be phased in over ten years, after which all medium-sized and large businesses would be required to provide detailed financial statements as part of their tax returns.

(8) Recommendation to enforce the existing requirement that all companies register and submit an annual report to the Registrar of Companies, the form of which needs to be respecified to be tax-relevant.

(9) An administrative tax appeals board should be established to hear taxpayer appeals prior to entry into the court system. The income tax act now empowers the Commissioner to hear appeals of his own actions.

(10) The provisions on depreciation in Section 10 of the income tax act should be replaced by a statement that depreciation will be allowed according to regulations issued by the Minister.

(11) The seizure and police powers of the Commissioner should be clarified.

(12) The Commissioner should be able to sue for the recovery of tax without reference to whether seizure of movable property is practicable.

(13) The courts' power in the income tax act to alter the Commissioner's assessment of tax should be amended to indicate that the tax ordered by the judge is to be at statutory rates and based on the judge's findings as to chargeable income or property value.

III. PENALTIES AND COMPLIANCE

A. INTRODUCTION

Guiding Principles

68. Few of the persons interviewed had any opinions as to the appropriateness of the tax penalties specified in the income tax act; obviously, this came from the fact that penalties (aside from interest) have rarely been applied. In revising the penalty structure, the guiding principles should be:

(1) as much as possible relate penalties to the potential gain from noncompliance,

(2) distinguish interest on money owed the government from penalties for noncompliance,

(3) express most penalties relative to the taxpayer's tax liability in order to keep them from being eroded by inflation and appropriate to both large and small taxpayers, and

(4) design them to be automatically applied by the tax assessor, rather than in a discretionary manner or contingent on court action.

69. The purpose of penalties is to influence the behavior of taxpayers so that compliance is largely voluntary. Penalties are only one element in producing this result; even more important are taxpayer perceptions that the tax code is fair and non-onerous and that the taxes are being used for legitimate public purposes. But even the fairest tax code and best expenditure policies cannot solve the free rider problem that arises when some taxpayers are seen by others as being able to evade taxes without consequence.

Legitimacy of the Gambian Income Tax System

70. In The Gambia, the legitimacy of the tax system is seriously undercut by taxpayer perceptions that enforcement is lax and evasion virtually universal. In the eyes of potential evaders, this justifies their own evasion. Evasion starts with the withholding of key information about turnover, income and property value. By far the most effective way to do this is simply not to respond to the Commissioner's notices to file a return or, one step back, to fail to inform him of one's chargeability when he fails to send a notice. There is some disagreement as to whether this failure to file a return or give notice of chargeability is widespread. In some analyses, it is very widespread, even among companies.

B. INTEREST ON MONEY OWED FOR TAXES, PENALTIES AND INTEREST

The Function of Interest

71. The income tax act provides for interest to be charged on tax not paid when due. This is necessary and reasonable to prevent taxpayers from taking interest-free loans from the government by delaying payments owed. The imposition of interest should leave the taxpayer in approximately the same position as if he had paid the tax, interest and penalties when due. Penalties, on the other hand, are designed to leave him in a worse position than if he had paid the tax on time, as an inducement to do so. Even if the taxpayer has reasonable cause for non-compliance, interest should still apply, but penalties may not.[13]

72. Thus, the references in the income tax act to interest as a "penalty" should be deleted.[14] It should also be clearly stated that interest applies to all amounts owed in connection with taxes, including penalties and interest. Interest should accrue on penalties from the time that the associated tax is due, not from when the penalties are imposed.

Specification of the Interest Rate

73. The CRD needs better guidance on what interest rate to charge. It has not changed the rate - now set at 25% - for some time. The interest rate stipulated in Section 73.1 of the income tax act, the "current bank rate", is not specific enough, being defined as the current rate of interest charged by banks on commercial advances. There are a multiplicity of such rates. An interest rate series published by the Central Bank and called the "Bank Rate"[15] is too low, being defined as 2% <u>less</u> than the Discount Rate, the interest rate on Treasury bills.[16] What is needed is a rate that is close to the opportunity cost of money to the taxpayer and also easily ascertainable on a regular basis by the CRD. I recommend that the CRD use the series published by the Central Bank and labeled the "Rediscount Rate". This is defined as the interest rate on Treasury bills <u>plus</u> 3% and was 18.5% at the end of April

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13 Note the recommendation above to repeal the Commissioner's power to remit the "penalty" (i.e, interest) specified in Section 73.1.

14 The references are in the margin and in Section 73.3.

15 The Bank Rate is the rate at which the Central Bank lends to commercial banks and public entities. It is not now active in this lending.

16 To forestall some confusion over a fine point, it is noted the Central Bank's so called Discount Rate is not the rate of discount at which Treasury bills are purchased, but is in fact the interest rate calculated from this.

1994.[17] Specification of the interest rate should be done by regulation, rather than in the income tax act.

C. PENALTIES TO ASSURE TIMELY COMPLIANCE

Inadequacy of Present Penalties

74. The non-filing penalties in the income tax law are seriously deficient. Not only are they out of date, but they depend too much for their enforcement on court action. The scheduled penalty for failure to furnish returns, statements or information or to keep records required is just D 500 plus D 25 per day, the liability for which is to commence following court conviction. Free riders would certainly not be worried about these penalties, especially since no income tax cases have been brought to court.

Failure to File

75. To rectify this situation, penalties to assure timely compliance should be stiffened considerably, placed on a basis where they relate to the tax being evaded and protected from being eroded by inflation. I recommend that, at a minimum, the penalty for failure to file a return or a notice of chargeability be 5% of the assessed tax per month, up to a total of 50% of assessed tax, from the date when the tax would reasonably have been due. (Table 3.1 summarizes my penalty recommendations.) Where insufficient information is available to make an assessment, the Commissioner could make a provisional assessment as the basis for a penalty sufficient to motivate compliance. If the case is brought to court, the court would have the authority, under this recommendation, to set a higher penalty in order to induce compliance.

Failure to Furnish Information

76. Under this recommendation, failure to furnish information requested by the Commissioner would make the taxpayer liable to the same 5% per month penalty. That is, subsequent to formally filing a return, the failure to provide sufficient additional information as defined by regulation and requested by the Commissioner would be faced with a continuation of the penalty up to its maximum.

Failure to Pay

77. Actually paying the assessed tax is something that needs to be induced for some taxpayers. In theory, charging interest on unpaid tax should leave the payer equally well off if pays or does not pay. A penalty is needed to

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[17] At the same time, the Discount Rate was 15.5%, and the Bank Rate was 13.5%.

make the taxpayer worse off when he does not pay the tax when due. The recommended penalty is to double the interest rate on the unpaid tax portion of the amount owed. It should automatically be applied, unless the taxpayer can show that the failure to pay is due to reasonable cause.

78. The maxima for the three non-compliance penalties are designed not be additive. Since the behaviors behind them are often simply aspects of the same basic non-compliant behavior, the maximum of 50% of assessed tax should apply to the sum of the three penalties. Application of penalties by the Commissioner should not be subject to negotiation, but should be automatically and thus predictably applied.

C. PENALTIES TO ASSURE FULL PAYMENT OF TAX

Inaccurate Return

79. Once the taxpayers' formal responsibilities to provide information and pay tax have been complied with, there is the problem of poor quality information leading to underpayment of tax. The taxpayer needs an incentive to make sure the information provided to the CRD is accurate and, of course, to not willfully mislead the tax assessor. The penalty should be appropriate to the amount of the underpayment and more severe for more serious offenses. My recommendation is that the penalty for inaccuracy be 10% of the resulting underpayment, even when the taxpayer shows reasonable cause for the understatement.

80. The penalty should be 50% of the underpayment, when the taxpayer shows no reasonable cause, and 150% of the underpayment, when the offence is either very large relative to the tax liability (gross understatement or undervaluation[18]) or the result of substantial fraud. Cases where the evidence of substantial fraud rises to the Gambian standard for criminal prosecution should be referred to the public prosecutor.

D. TAXPAYER APPEALS

81. In light of the considerable discretionary power of the Commissioner to assess taxes and the increased stringency of the penalties recommended in this report, taxpayers should have access to a prompt administrative law remedy prior to seeking relief in the courts. A Tax Appeals Board should therefore be appointed by the President to hear taxpayer appeals within a certain time limit.

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[18] Gross understatement or undervaluation would be defined as one-third of chargeable income or property valuation.

TABLE 3.1: RECOMMENDED INTEREST AND PENALTY SCHEDULE

A. Interest on Money Owed for Taxes, Penalties and Interest

1. Central Bank Rediscount Rate (equal to the interest rate on Treasury Bills plus 3 percent). To be revised quarterly.

B. Penalties to Assure Timely Compliance*

1. Penalty for Failure to File Required Return or Notice of Chargeability (FTF)

Minimum of 5% per month up to 50% of assessed tax* from the date the tax would reasonably have been due until the return or notice is filed. When there is no formal assessment, a provisional assessment may be used for the purpose of assessing the penalty. The penalty will be revised in line with the formal assessment when it is made.

or

In greater amount as ordered by a court of law to induce compliance.

2. Penalty for Failure To Furnish Information or Keep Records Requested (FFI)

Minimum of 5% per month up to 50% of assessed tax* from the date the information would reasonably have been due until its presentation or, in the case of records requested to be kept, satisfactory evidence of a good faith effort to keep them. When there is no formal assessment, a provisional assessment may be used for the purpose of assessing the penalty. The penalty will be revised in line with the formal assessment when it is made.

or

In greater amount as ordered by a court of law to induce compliance.

3. Penalty for Failure to Pay Tax When Due (FTP)

Equal in amount to interest accrued monthly at the rate specified above on the unpaid portion of the assessed tax, up to 50% of this unpaid portion.

* NOTE: The FTF, FFI and FTP penalties together may not exceed 50% of the assessed tax, except as ordered by a court.

C. Penalties to Assure Full Payment of Tax

1. Penalty for Underpayment Due to Inaccuracy or Civil Fraud

10% of the underpayment due to understatement of chargeable income or property valuation, but taxpayer having reasonable cause.

50% of the underpayment due to understatement of chargeable income or property valuation, taxpayer having no reasonable cause.

150% of the underpayment due to gross understatement, defined as one-third of assessed chargeable income or property valuation, or substantial fraud.

E. SUMMARY OF RECOMMENDATIONS

82. The following recommendations on penalties were developed in the text above:

(1) The references in the income tax act to interest as a "penalty" should be deleted.

(2) There should be a clear statement that interest applies to all amounts owed in connection with taxes, including penalties and interest.

(3) Interest should accrue on penalties from the time that the associated tax is due, not from when the penalties are imposed.

(4) I recommend that the CRD use the Central Bank's "Rediscount Rate" as the interest rate to apply to tax money owed the government, and that the interest rate should be specified by regulation, rather than in the income tax act, and revised quarterly.

(5) I recommend that, at a minimum, the penalty for failure to file a return or a notice of chargeability (FTF) be 5% of the assessed tax per month, up to a total of 50% of assessed tax.

(6) The failure to furnish requested information or keep records (FFI) as directed should result in the continuation of this penalty.

(7) I recommend that the penalty for failure to pay tax (FTP) be equal to the interest rate but applied only ~~to~~ on the tax and penalty portion of the amount owed.

(8) I recommend that the FTF, FFI and FTP penalties together not exceed 50% of the assessed tax, except as ordered by a court.

(9) My recommendation is that the penalty for underpayment of tax due to inaccuracy or civil fraud be 10% of the underpayment even when the taxpayer shows reasonable cause, 50% when he or she does not, and 150% when the offence is either very large.

(10) Cases where the evidence of substantial fraud rises to the Gambian standard for criminal prosecution should be referred to the public prosecutor.

(11) An administrative Tax Appeals Board should be appointed by the President to hear taxpayer appeals within a certain time limit.

APPENDIX A

TABLES

APPENDIX TABLE A.1 REVENUE ESTIMATES FOR ALTERNATIVE CONFIGURATIONS OF THE CAPITAL GAINS TAX, 1994-1995* (D'000)

[THIS TABLE USES A BASE CASE REVENUE ESTIMATE OF D 2,000,000; COMPARED TO TABLE 1.3 WHICH USES A BASE CASE ESTIMATE OF D 2,500,000]

Tax Structure and Rates	Based On Commissioner's Actual Assessment - Not Indexed (1)	Based On Commissioner's Actual Assessment - Indexed (2)	Assessment at Taxpayer Claims Multiplied By 2 - Indexed (3)	Assessment at Taxpayer Claims Multiplied By 3 - Indexed (4)
CURRENT RATES FOR INDIVIDUALS & COMPANIES&				
1 Current Hybrid Tax@	2,000	1,700	3,500	6,900
2 All Charged Only Transfer Tax	1,500	1,500	2,300	3,400
3 All Charged Only Gains Tax	1,700	700	2,600	5,500
4 All Charged Both Taxes	3,300	2,200	4,900	8,900
GAIN 20%, TRANSFER 3%, ALL TAXPAYERS#				
5 Current Hybrid Tax	2,100	1,300	3,800	7,600
6 All Charged Only Transfer Tax	800	800	1,400	2,000
7 All Charged Only Gains Tax	2,000	900	3,500	7,300
8 All Charged Both Taxes	2,800	1,600	4,900	9,300

* Revenue model based on the sample of 1993-1994 tax returns described in para. 3.

& Current rates are: transfer tax 5% and 10% and gains tax 15% and 25% for individuals and companies, respecti
The transfer tax is actually 7% when the 2% stamp duty is added in.

@ This and all other revenue estimates in this table are based on this 1994-1995 forecast for the currently configured tax. Estimates based on an alternative D 2,000,000 projection are pres in Appendix I.

\# When the 2% stamp duty is added in, the total transfer tax is 5% (para. 28).

APPENDIX TABLE A.2 REVENUE ESTIMATES FOR ALTERNATIVE CONFIGURATIONS OF THE CAPITAL GAINS TAX, 1994-1995* (D'000)

[THIS TABLE PRESENTS INDEX NUMBERS, BASE CASE = 100]

Tax Structure and Rates	Based On Commis-sioner's Actual Assess-ment - Not Indexed (1)	Based On Commis-sioner's Actual Assess-ment - Indexed (2)	Assess-ment at Tax-payer Claims Multi-plied By 2 - Indexed (3)	Assess-ment at Tax-payer Claims Multi-plied By 3 - Indexed (4)
CURRENT RATES FOR INDIVIDUALS & COMPANIES&				
1 Current Hybrid Tax@	100	86	177	345
2 All Charged Only Transfer Tax	77	77	114	171
3 All Charged Only Gains Tax	87	33	131	273
4 All Charged Both Taxes	164	110	245	444
GAIN 20%, TRANSFER 3%, ALL TAXPAYERS#				
5 Current Hybrid Tax	103	65	188	380
6 All Charged Only Transfer Tax	39	39	68	102
7 All Charged Only Gains Tax	101	44	175	364
8 All Charged Both Taxes	140	82	243	467

* Revenue model based on the sample of 1993-1994 tax returns described in para. 3.

& Current rates are: transfer tax 5% and 10% and gains tax 15% and 25% for individuals and companies, respectiv
The transfer tax is actually 7% when the 2% stamp duty is added in.

@ This and all other revenue estimates in this table are based on this 1994-1995 forecast for the currently configured tax. Estimates based on an alternative D 2,000,000 projection are preser in Appendix 1.

\# When the 2% stamp duty is added in, the total transfer tax is 5% (para. 28).

APPENDIX B

FURTHER DISCUSSION OF THE USE OF EXISTING DISCRETIONARY POWERS IN ENFORCEMENT

83. In targeted cases, the Commissioner should use his discretionary power to refuse to accept taxpayers' insufficiently documented returns or to negotiate their income tax liabilities on the basis of it. Instead, the Commissioner should request voluntary field audits. If this is refused, he should request the production of a full array of basic documents, such as all invoices, bank account records, import documents, etc., and proceed with court action if they are not produced. Although the present penalties for backing this section up are seriously insufficient (see Section III on penalties), the current penalty for the related offense of understating income - double the tax deficiency - should constitute a significant incentive to achieve voluntary cooperation in some cases, even though enforcement through the courts is likely to be slow. The necessity for income tax clearance for the release of goods from customs will of course be an even stronger incentive for some importers.

84. Whether judicial reform is a precondition of effective tax enforcement through the courts is beyond the scope of this report, but unless some cases are tried, there will be no experience on the point. Five customs tax cases have been pending in the courts since 1992.

85. Without delving further into tactics or entering the controversy of whether present powers constitute the power to conduct field audits, this discussion supports the belief that with requisite higher level support, the new Commissioner has sufficient discretionary powers for more vigorous enforcement.