

**Operational, Regulatory and Policy Changes Required to Eliminate  
Revenue Leakages in Free Zones and Bonded Warehousing  
Regimes**

**October 2001**



**Operational, Regulatory and Policy Changes  
Required to Eliminate Revenue Leakages in Free Zones and  
Bonded Warehousing Regimes**

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**In fulfilment of the following milestones**

- 10.1 A Document Specifying Operational, Regulatory and Policy Changes  
to Existing Bonded Warehouse and Free Zone Regimes to Reduce or  
Eliminate Revenue Leakages From These Sources**

**October 2001**

**Sigma One Corporation**

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## PREFACE

The study was carried out from September 10 to October 3, 2001 in Accra. The consultant met the following people:

Dr. Fenton B. Sands	Director, Office of Trade, Agriculture and Private Sector, USAID, Ghana
Dr. Anthony Akoto Osei	Special Assistant to the Minister of Finance
Paul Atubofour	Deputy Commissioner of Customs, Operations, CEPS
Kofi Danquah	Assistant Commissioner of Customs, CEPS, James Town
Hopeson K. Nyaxo	Chief Internal Auditor, CEPS
E. S. Akwerth	Ag. Assistant Commissioner, CEPS, James Town
Evans Klutse	Chief Collector, CEPS
Robert Kwami	Principal Collector, CEPS
K.N. Atuahene	Executive Director, Ghana Free Zones Board
Nana Yaa Jantuah	Public Relations Officer and Documentalist, Free Zones Board
Harry Owusu	Executive Secretary, Revenue Agencies Governance Board
Janet Opoku Acheampong	Commissioner for Internal Revenue
Dr. Augustine Fritz Gokel	Senior Lecturer, Department of Economics, University of Ghana
Andrew Lawson	Executive Director, Association of Ghana Industries
Nigel R. Gregory	General Manager, Ghana Community Network (GCNet)
Philippe Isler	Operations Manager, GCNet.

The consultant wishes to thank them for sparing time to meet and discuss with him. Special thanks go to Paul Atubofour, who was the contact person in CEPS, and K. N. Atuahene in Free Zones Board. Mr. Nyaxo and Mrs. Acheampong also deserve special mention. Without their reports and their frankness, the conclusions of this study would have been different.

Free Zones and Customs Warehousing are Customs concepts. The study has deliberately explained these concepts at length not only to provide an adequate theoretical context in which the practical issues will be discussed, but also to enrich the knowledge of the reader regarding these concepts.

## EXECUTIVE SUMMARY

The aim of the assignment was to identify the operational, regulatory and policy changes to the existing Bonded Warehouse and Free Zones regimes that would eliminate or reduce revenue leakages from these regimes. There had been several studies on these regimes by Sigma One Corporation and the IMF Fiscal Affairs Department, which mainly focussed on the policy issues, with recommendations to enable the Government of Ghana to enhance revenue. As it was not known whether the recommendations had been implemented, it was considered advisable for the present assignment to establish the current state of affairs and to focus on the regulatory and operational controls of these regimes. The Terms of Reference as reproduced in **Appendix 1** hereto were therefore revised as shown in **Appendix 2** hereto.

The concepts of Free Zones and Bonded Warehouses are well defined and recognized internationally. The Kyoto Convention of the World Customs Organization (WCO), formally the Customs Cooperation Council (CCC), defines these terms and lays down harmonized standards and best practices on such questions as licensing, goods that may be admitted into the facilities, permitted activities and the nature and extent of Customs controls. The present report starts with a brief presentation of the international concepts and best practices which are then used as a yardstick for the Ghana models of these facilities.

Ghana, like many other countries has introduced Free Zones as a means of attracting investment. A comparison of the Free Zone regime in Ghana with the Kyoto Convention provisions and guidelines reveals that the Ghana regime is in keeping with international practices. However, some of the provisions of the Free Zones Legislation need improvement in order to facilitate their interpretation by both administrators and investors. The Customs Warehousing regime in Ghana is similar to those of other countries; so too are the statutory provisions concerning Customs controls.

Although the Ghana models of the two regimes are based on internationally established concepts, they may not achieve the benefits expected because of the weakness in their monitoring and control. In this regard, previous studies had expressed serious reservations about the benefits of the ten years' tax holiday, and the tax rebate thereafter, for Free Zones enterprises. The studies point out that tax incentives need not attract investment and that what matter are political and economic stability, an appropriate infrastructure and skilled labour. Furthermore, the direct tax incentive discriminated against firms outside the Free Zones and encouraged firms to apply for Free Zone status while knowing that they would not be able to comply with the requirement to export 70 per cent of their production. In view of the weaknesses in the monitoring of Free Zones firms, it was possible that a large amount of imports were being diverted into home use without payment of corporation tax.

Regarding this possibility, officials of the Free Zones and CEPS pointed out that, the license fees, and the requirement to export 70 per cent of the production would make it very difficult for a firm to become a free zone enterprise with the intention of

producing only for the domestic market. Furthermore, the monitoring of Free Zones by both the Customs and the FZB had improved.

There was no data from the Free Zones Board on the basis of which the current situation regarding the monitoring of the Free Zones could be assessed since the compilation of the 2000 Annual Report had not been completed, and there were no other records. However, a report of the Internal Revenue Service (IRS) revealed that monitoring by the Free Zones Board was still very weak. Some companies visited had no tax files, and half of the companies with files had not submitted accounts. Furthermore, the accounts submitted did not show separately sales for the domestic market and sales for export in accordance with the 30/70 rule. The report also indicated that the IRS was not monitoring Free Zones enterprises; IRS district offices did not have a list of licensed companies in their districts, and did not even have the Free Zones legislation.

Another report on an audit of 16 companies operating as Single Factory Zones, which was carried out by CEPS Internal Audit, also revealed unsatisfactory Customs controls. The audit had exposed a short collection of Cedis 815,517,784 and undervaluation of goods imported into the Free Zones. In certain cases the value of goods entered for home use from the Free Zones was lower than the value of the goods when they were imported into the Free Zones despite the value added. The auditors also pointed out that the Free Zones Board was only issuing licenses and facilitating the establishment of Free Zones enterprises without monitoring the enterprises, as the law required them.

In the light of the foregoing, there was no doubt that revenue leakages were taking place through:

- Non-payment of corporation tax by Free Zones enterprises that are not exporting or are entering more than 30 per cent of their production into home use;
- Diversion of goods entered for Free Zones into the domestic market without payment of indirect taxes and direct taxes by the enterprise;
- Under-declaration of goods entered for home use as part of the 30 per cent allowed;
- Under-valuation of imports into the Free Zones and of goods out of the Free Zones to the domestic market.

As regards the Customs warehousing regime, it was noted with satisfaction that the warehousing procedures had improved thanks partly to the introduction of the ASYCUDA and better means of transmitting documents between Tema and Jamestown. However, the control of Bonded warehouses remained weak as revealed by the CEPS Internal Audit report. According to the report, importers, clearing agents and warehouse operators abused the system by:

- Diversion of goods meant for warehousing;

- Under-valuation of ex-warehoused goods;
- Short delivery of goods into, and pilferage of goods within, the warehouses resulting in stock shortages;
- Wrong tariff classification; and
- Application of wrong duty rates.

The report also points out that in a certain case it was clear that CEPS staff had connived with the importer to divert goods into home use. Like in the case of Free Zones, accounts and registers were not kept up to date. An audit of 42 warehouses revealed short collections assessed at Cedis 2,860,063,877. Although the use of the ASYCUDA system had facilitated control of balances of consignments in bonded warehouses, there was no network linking up the collections. A new computer system, which was likely to go live in February or March 2002, would improve the situation.

Paragraph 5.6.4 of the present main report contains a number of recommendations to improve monitoring by the Free Zones Board, controls by the Revenue Services, and collaboration between the Free Zones Board and the Revenue Services. Recommendations concerning the warehousing regime are contained in paragraph 6.5.1.

The measures listed below should start immediately in order to recover short collected revenue and prevent further revenue leakages. The activities should be conducted in a 3 to 6 months' campaign to be monitored by the Ministry of Finance and Ministry of Trade and Industry. At the end of the campaign an evaluation report should be submitted to the Ministers concerned.

- Increase the staff of CEPS Internal Audit so that they can complete auditing the Free Zones enterprises and bonded warehouses. At the same time IRS to resume the checking of the records and returns of the remaining Free Zones enterprises. The results of the audits to be shared with the Free Zones Board, and firms that do not have the required records or accounts or that have operated outside the law to be penalised and even to have their licenses revoked.
- CEPS and IRS management to mount a campaign to recover the short collections revealed by the audits and corporation tax from firms that have not complied with the 30/70 rule, together with penalties.
- Free Zones Board to verify that the actual activities of each Free Zones enterprise are those authorised by its license and, jointly with CEPS, inspect all Free Zones premises to ensure that they conform to the statutory requirements.

- Free Zones Board, CEPS and IRS to prepare a joint Free Zones Monitoring and Revenue Controls Manual. The manual to show the role of each authority and guidelines on how they will carry out their activities. Free Zones Board to adapt the manual for use by Free Zones enterprises.
- Establish an effective organization structure for implementing the WTO Agreement on Customs Valuation (ACV) at national level, and require Destination Inspection companies to provide training on the ACV. The training to include ACV valuation database maintenance, profiling and targeting, and post clearance auditing.
- Require that from January 2002 only security bonds issued by banks shall be accepted for Bonded Warehouses. Also from January 2002 raise the licence fee for Bonded Warehouses to USD 1,000. Should the law allow, change the validity of bonded warehouse licenses to be one year from January to enable CEPS to monitor validity of licenses.

## **MAIN REPORT**

### **1. INTRODUCTION**

#### **1. INTRODUCTION**

- 1.1 The aim of the assignment was to identify the operational, regulatory and policy changes to the existing Bonded Warehouse and Free Zones regimes that would eliminate or reduce revenue leakages from these regimes. There had been previous studies on these regimes by Sigma One Corporation and the IMF Fiscal Affairs Department (FAD) with recommendations to enable the Government of Ghana to enhance revenue. It was considered advisable for the present assignment to establish whether the recommendations had been implemented and the current state of affairs. The Terms of Reference as reproduced in **Appendix 1** hereto were therefore revised as shown in **Appendix 2** hereto.
- 1.2 The concepts of Free Zones and Bonded Warehouses are well defined and recognized internationally. The Kyoto Convention of the World Customs Organization (WCO), formally the Customs Cooperation Council (CCC), defines these terms and lays down harmonized standards and best practices on such questions as licensing, goods that may be admitted into the facilities, permitted activities and the nature and extent of Customs controls. The present report starts with a brief presentation of the international concepts and best practices and uses these as a yardstick for the Ghana models.

### **2. THE CONCEPTUAL FRAMEWORK**

#### **2. FREE ZONES**

##### **2.1 Purpose and Scope**

- 2.1.1 The Kyoto Convention defines a Free Zone (FZ) as the territory of a country where any goods introduced are generally regarded, as far as import duties and taxes are concerned, as being outside the Customs territory. The Kyoto Convention recognizes that the concessions may include waiver of both import duties and internal taxes. Equipment to be used solely inside the FZ for transport, storage and processing of goods may also be admitted free. Equipment to be used solely inside the FZ for transport, storage and processing of goods may also be admitted free; so too goods consumed by people working inside the FZ (office stores, fuel, food and beverages).
- 2.1.2 The Guidelines to the Kyoto explain the purposes and scope of Free Zones: The establishment of Free Zones is part of an economic policy that encourages the flow of investment into a Customs territory for manufacturing and other commercial

activities. The main purpose of FZs is to promote external trade and international commerce by granting relief from duties on goods imported to the territory. Additional benefits are the creation of employment in the FZs and the development of associated trade activities.

- 2.1.3 Goods manufactured in a FZ are usually intended for export. Since exports are generally exempt from duties and taxes, this facilitates and encourages the development of external trade. Domestic goods meant for export can also be admitted to free zones and become entitled to exemption from or repayment of internal duties and taxes. In some countries when processed goods are removed from FZs for home use, they may sometimes benefit from lower rates of import duties and taxes.
- 2.1.4 Customs controls exercised over goods placed in FZs are more flexible than that applicable to goods stored, for example, in Customs Bonded Warehouses. For goods in a FZ, Customs normally apply general surveillance measures only.
- 2.1.5 In many countries, distinction is made between “Commercial” and “Industrial” FZs. In commercial FZs, no processing or manufacturing operations of the goods are allowed. The operations that are allowed are restricted to only those required to preserve the goods or improve their packaging or marketable quality and which do not change the character of the goods. In industrial FZs, processing or manufacturing operations are allowed. In some countries, Customs facilities comparable to those features of FZs are granted throughout the territory in the context of other Customs procedures as Customs warehousing, drawback, and inward processing.

## **2.2 Responsibility for Regulating**

- 2.2.1 The Kyoto Convention requires Contracting Parties to specify in national legislation the requirements relating to the establishment of FZs, the kinds of goods admissible to such zones and the nature of the operations to which goods may be subjected in them.
- 2.2.2 Free Zones may be regulated by Customs, by other authorities or by both. However, the Customs formalities and controls are administered by the Customs. Requirements as regards the suitability, construction and layout of FZs are laid down by the Customs with a view to ensuring adequate Customs control. For this purpose Customs may, in particular:
- Require that the premises used for FZs be enclosed and constructed in a manner that ensures proper safety and accounting of goods;

- Impose restrictions on means of access and establish hours of business;
- Keep the premises and means of access to the free zone under permanent or intermittent supervision; and
- Require persons introducing goods into FZs to keep proper accounts of the goods (by using either special registers or the relevant declarations or by use of computers) so that the circulation of the goods can be controlled.

In some countries, Customs administrations share some of these responsibilities with other government agencies.

## **2.3 Customs Controls**

- 2.3.1 As mentioned above, Customs control in a free zone is more flexible than that exercised under the Customs warehousing procedure, and is principally concerned with the relevant documentation. The Customs has the right to carry out checks of the goods at any time they are stored to ensure that they are being accounted for satisfactorily, subjected to only authorized operations and that no unauthorized goods are introduced or removed. The extent of these checks should be based on a risk management system.
- 2.3.2 The Kyoto Convention recommends that no goods declaration should be required in respect of goods introduced into a FZ directly from abroad if the necessary information is already available in the documents accompanying the goods. The document may be commercial invoice, waybill, bill of lading, despatch note or simplified document on a special form identifying the goods entered into the free zone. Usually, no time is imposed on the duration of the stay of goods in a free zone.
- 2.3.3 In some administrations, the transfer of goods from one free zone to another is dealt with under a simplified procedure, with accounting from one free zone to another, without the need for separate Goods declarations. The facility of removing goods piecemeal for other procedures is also allowed. This enables the person concerned to remove only the quantity of goods that are required for immediate use.
- 2.3.4 The Kyoto Convention recommends that the Customs should not require security for the admission of goods to a FZ. However, the waiver of security is dependent on the existence of certain circumstances that are conducive to compliance on the part of the person getting the waiver. The convention does not

recommend a blanket waiver. Generally waiver is granted to persons who:

- are established in the Customs territory;
- are regular users of the Customs procedure concerned;
- maintain a financial position that can meet their commitments;
- have not committed any serious infringement of Customs or fiscal laws; and
- undertake to pay any claims in response to the first written request from Customs.

2.3.5 A waiver is not granted for goods which present risks because of high import duties and taxes involved. The guidelines point out that, in some instances providing security can actually offer greater facilitation as, for example, where the Customs applies audit-based controls. The requirement for security obviates the need for physical controls to ensure compliance.

2.3.6 As mentioned earlier, goods in any type of FZ are allowed to undergo operations necessary for their preservation and usual forms of handling to improve their packaging or marketable quality or to prepare them for shipment, such as breaking bulk, grouping of packages, sorting and grading, and repacking. For goods in an industrial FZ, the right to carry out processing or manufacturing operations may be made subject to the condition that the operations are regarded as advantageous to the national economy.

2.3.7 The only declaration required for goods on removal from a FZ is the declaration normally required for the Customs procedure to which those goods are assigned. For example if the goods are removed for export, it is an export declaration that will be required. As regards the transfer of goods from one FZ to another, some countries use a simplified procedure, with accounting from one FZ to another, without a need for separate goods declarations.

### **3. BONDED WAREHOUSING**

#### **3.1 Scope and Purpose**

- 3.1.1 The Kyoto Convention defines Customs Warehousing as the Customs procedure under which imported goods are stored under Customs Control in a designated place (a Customs Warehouse) without payment of import duties and taxes. In order to secure the import duty and taxes on the goods deposited in a Customs Warehouse, a security bond is usually required; hence the name Bonded Warehouse.
- 3.1.2 The need for this procedure arises from the fact that in international trade it is sometimes not known at the time of importation how the imported goods will finally be disposed of. This means that importers are obliged, or may choose, to store the imported goods for some time before they are finally disposed of. When the goods are intended for clearance for home use, the Customs Warehouse procedure enables the importer to delay the payment of the import duties and taxes until the goods are actually taken into home use. The importer may also choose to place the goods in a warehouse until they can meet the conditions relating to restrictions and prohibitions.
- 3.1.3 The procedure affords the person warehousing the goods sufficient time to look for the market for the goods in or outside the country or to find the funds to pay for the import duties and taxes if he plans to enter the goods for home use. The owner of the goods may also enter the goods in the market in piecemeal as and when they are needed or as and when there is a buyer. Where it is intended to re-export the goods, it is also in the importer's interest to place them under a Customs procedure which obviates the need to pay the import duties and taxes.
- 3.1.4 The justification for the concessions afforded by the Warehousing procedure is that goods deposited in a Customs Warehouse have been imported but are not yet in the domestic market. Import duties and taxes are paid only if goods are used or consumed in the domestic market.
- 3.1.5 The principal distinction between a Customs warehouse and a FZ is that the former is a Customs facility (and not a scheme) provided for the benefit of importers, and it is generally for storing goods on which duty and taxes are not yet paid; as such it is under the strict control of the Customs. Many countries have this facility the scope of which may extend beyond imported goods. For example, some administrations allow goods that are liable to, or have borne, internal taxes to be stored in Customs warehouses in order that they may qualify for exemption from or repayment of such internal duties. Goods that have previously

been dealt with under another Customs procedure may also be deposited in a Customs warehousing with a view to subsequent exportation or other authorized disposal.

3.1.6 It is also common practice to allow processing or manufacturing to take place in a Bonded warehouse (manufacturing in bond). The guidelines to the Kyoto Convention note that administrations allowing this are granting greater facilities than those generally allowed under the Customs warehousing procedure.

### **3.2 Types of Customs Warehouses**

3.2.1 There are two types of Customs warehouses, namely Public and Private Customs Warehouses. Public warehouses may be managed either by Customs or by other authorities or by natural or legal persons, and are open to any person who wishes to store goods therein.

3.2.2 Private Customs warehouses are allowed to meet the requirements of trade and industry, and allow specified persons to store goods in these warehouses for their own specific uses. Generally, private Customs warehouses are located within or near the premises of the manufacturing units.

### **3.3 Establishment and Management**

3.3.1 In general, a security bond is required. However, many Customs administrations waive the requirement for security where the physical characteristic of the warehouse or the Customs control measures applied make it practically impossible to remove or to substitute goods without the authorization of Customs. Generally Customs exercise the following controls:

- Require that Customs warehouses be double-locked (secured by the lock of the warehouse keeper and by the Customs lock);
- Keep the premises under permanent or intermittent supervision;
- Keep, or require to be kept, accounts of goods warehoused (by using either special registers or the relevant declarations, or a computerized database).
- Take stock of the goods in the warehouse from time to time;
- Submit returns to the Customs regularly.

- Use risk management techniques to concentrate on those B|W which pose risks to the revenue.

### **3.4 Admission of Goods and duration of stay**

3.4.1 Storage in public Customs warehouses is generally for all kinds of imported goods liable to import duties and taxes or to economic prohibitions and restrictions. Goods which constitute a hazard, or which are likely to affect other goods or require special installations are accepted for warehousing only in warehouse specially designed to receive them.

3.4.2 Private Customs warehouses are in a different category, and only those goods for which specific approval has been given can be stored in them. Customs permit the storage of goods taking into account the special requirements of the trade. Any restrictions regarding the goods would relate to the area of activities of the warehouse operator. Thus, persons manufacturing electronic products or components would be allowed to store only goods associated with this activity.

3.4.3 Generally, the duration of non-perishable goods in a warehouse is one year. In the case of restricted goods, warehousing provides sufficient time for the importer to arrange for licenses or permits and documents that may be required for clearance of the goods.

### **3.5 Authorized operations and removal of goods**

3.5.1 Allowing handling and other operations in Customs warehouses is a useful facilitation to traders and owners of goods. In general, operations that are allowed by Customs are those which do not affect the essential character of the goods such as fumigating, drying and ventilating, packing from bulk, sorting, grading and repacking to make the goods more marketable. The main purpose of allowing the operations is to preserve the goods while in storage so that they can be finally disposed of.

3.5.2 Where it is desired to grant greater facilities, blending, processing or manufacturing can be allowed.

3.5.3 When goods are not removed from a Customs warehouse within the storage period allowed, Customs must take action to ensure such removal. For example, Customs might collect the duties and taxes due from the security rather than take physical custody of the goods. Customs may also sell the goods and handover the proceeds of sale, after deducting import duties and taxes, to the owner of the goods.

### 3. THE GHANA MODELS

#### 4. FREE ZONES LAW AND PRACTICE

Ghana, like many other countries have introduced Free Zones as a means of attracting investment. First a comparison is made between the Free Zones legislation of Ghana with the Kyoto Convention provisions and guidelines to ascertain the extent to which the Ghana regime is in keeping with international practices. Then a number of issues regarding the implementation of the law by the Free Zones Board and the Revenue Services is examined.

##### 4.1 Establishment of Free Zones

- 4.1.1 Section 7 of the Act gives the President the power, on the recommendation of the Free Zones Board, to declare, by notice published in the Commercial and Industrial Bulletin, any area of land or building as a Free Zone and any airport, river port, seaport, or lake as a Free Port. The term Free Zone is defined by Section 43 of the Act as an area or building declared as a Free Zone and includes a single factory zone, Free Port, free airport, free river or lake port.
- 4.1.2 The definition of Free Zone does not indicate the functions or duty and tax status a Free Zone. Furthermore, the Act does not define a Free Port although a Free Zone includes a Free Port. However, it is clear from Section 7 that Free Ports are the Free Zones located at seaports, airports, lake-ports and river-ports.
- 4.1.3 It is clear from Part II and Part III of the Act that the aim of the legislators was to encourage not only Free Zone activities but also Free Zone infrastructures. This may explain why the definition of a Free Zone does not refer to the tax status of the facility. Section 8 of the Act gives the right to develop or manage a free Zone only to a body corporate registered under the Companies Code 1963, or to a Partnership registered under the Private Partnership Act 1962.
- 4.1.4 The rights and responsibilities of a Free zone developer are provided for in Sections 9 and 10 of the Act. Among the responsibilities are to provide fencing and enclosures to separate the zone from the national Customs territory, and to provide and contribute to the cost of facilities for Customs services as determined by CEPS.
- 4.1.5 It is Part III of the Act which provides for the right of to carry on business activities in a Free Zone. Only a body corporate or a Private Partnership licensed under the Act may carry on business activities in a Free Zone. Such an enterprise is referred to as a Free Zone Enterprise.

## **4.2 Licensing of Free Zones Enterprises**

- 4.2.1 Section 13 provides for the rights and responsibilities of a Free Zone Enterprise. Sub-section 1 as read with sub-section 2 limits the types of goods which can be produced in a Free Zone only to those goods that are not environmentally hazardous. Subject to this, a Free Zone Enterprise may carry on any kind of economic activity.
- 4.2.2 It is the licensing requirements that demarcate the kind of activities that can be carried on in a Free Zone. According to Section 15(1), the application for a license, to be submitted to the Board, must specify the trade, business or industry for which the license is applied. There are three types of licenses, reflecting the three kinds of activities that can be carried on in a Free Zone, namely, manufacturing, commerce and service. The license, if granted, also specifies the activities to be carried on.
- 4.2.3 The amount of the fees required for each license reflects that manufacturing is the most encouraged. While a commercial license costs USD 4000, and a service license USD 3000, a manufacturing license costs only USD 2000.

## **4.3 Import and Export in Relation to Free Zones**

- 4.3.1 Section 21 of the Act stipulates that the laws in force relating to the importation and exportation of goods ... shall not apply to importation of goods from outside Ghana into a Free Zone or exportation of out of a Free Zone to another country, except for consumer goods for commercial purposes. The laws can be made applicable only by regulations made under the Act. The suspension of the laws would be justified by the fact that a free zone is deemed to be outside the Customs territory. However, it is difficult to justify the exception since consumer goods for commercial purposes can also be brought into a FZ. In any case, the section is superfluous in view of the provisions of Section 22, which is discussed below.
- 4.3.2 Section 22<sup>1</sup> exempts imports of Free Zone developers and enterprises from direct and indirect taxes and duties. The waiver of import duties and taxes on the imports of Free zones enterprises is in accordance with international practice. It is significant that this provision is in Part V of the Act concerning import and export, and not in Part VI concerning Incentives. Again, this is a reflection of the international practice that Free Zones are considered as being within the Customs territory. It is not clear what direct taxes could apply to goods. It is to be noted

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<sup>1</sup> The version of the Act which is distributed by the Free Zone Board refers to Section 22 (1), but no other subsection is shown.

that waiver of income tax on profits is contained not in this part but in Part VI concerning incentives.

- 4.3.3 Section 23 provides for the power of the Minister of Trade and Industry to authorize up to 30 per cent of the annual production of goods and services of a Free Zone enterprise to be entered for home use, and such goods will be considered as imports and liable to any import duties and taxes payable on them. Damaged goods, rejects and samples may also be sold to the domestic market but they will constitute part of the 30 per cent.
- 4.3.4 There is no provision in the Act or in the regulations stipulating that goods or services produced in Free zone have to be exported. That 70 per cent of goods and services have to be exported can only be inferred from section 30. This is a serious drafting omission of the Free Zone legislation. The heading of Section 11 is Export Free Zone Enterprises, but the section simply provides for the right of any person to apply for a licence to establish an enterprise in a Free Zone.
- 4.3.7 Just as sales to the domestic market are considered as imports, sales from the domestic market to the Free zone are considered as exports. Furthermore, export incentives given to exporters to the outside world are to apply also to exporters to the Free Zones. These provisions, contained in Section 24, underline the international concept that a Free Zone is to be treated as being a outside the Customs territory.

#### **4.4 Free Zones Incentives**

- 4.4.1 As mentioned above, the direct tax incentives are contained in Part VI of the Act, whose title is "Incentives". Sections 28 to 33 contain provisions that are typically found in legislation providing for the promotion and protection of investment. The sections provide for the following:
- Exemption from income tax on profits for the first ten years from the date of commencement of operation;
  - Income tax after the ten years not to exceed 8 per cent;
  - Exemption from withholding taxes on dividends arising out of Free Zone investments;
  - Right of foreign and local investors to take and hold 100 per cent of the shares in any Free Zone Enterprise;

- Equal status to domestic and foreign investors “within the export free zones<sup>2</sup>”;
- Unconditional transfer through any authorized dealer bank in convertible currency dividends or net profits, payments in respect of loan servicing, fees and charges in respect of any technology transfer, the remittance of proceeds in the event of sale or liquidation;
- Guarantee against nationalization, expropriation or forced cession of interest;
- Guarantee against acquisition by the state except in compliance with certain conditions;
- Permission to operate a foreign currency account with banks in Ghana; and
- An impartial and friendly mechanism for dispute settlement.

4.4.2 The standard practice is to waive the import duties and taxes on goods admitted in a Free Zone because the Free Zone is considered as being outside the Customs territory. Some countries also waive internal taxes but this is not an essential feature of the Free Zone facility. In the case of Ghana, the waiver of internal taxes is an investment incentive combined with the Free Zone facility.

## **4.5 Customs Responsibilities and Controls**

4.5.1 The law requires Free Zone enterprises to erect 2.5m high fences or enclosures around Free Zones in order to ensure security and to facilitate Customs control. They also require the enterprise or factory building to be located at least 3m inside the enclosures. On application, a waiver of this requirement may be waived by the Board where it is not possible to comply with it because the building pre-dates the legislation.

4.5.2 The Customs has a significant share of the responsibility for controls Free Zones. Section 25 gives an authorized officer of any of the Revenue Services power to enter into a Free Zone and inspect buildings and any means of transport which is inside the Free Zone. To prevent or obstruct an authorised officer is an offence punishable by a fine not exceeding USD 1000, or its equivalence in Cedis, or imprisonment for a tern not six months or both.

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<sup>2</sup> The term is not defined, but it probably refers to the Free Zones with Manufacturing Licenses.

- 4.5.3 The Customs has also been given by Section 26 (1) the responsibility of controlling “zero-rated” goods<sup>3</sup> within a Free Zone, or in transit, or being moved into or out of a Free Zone. Sub-section 2 gives the Minister of Trade and Industry, after consulting with the Minister responsible for the Customs, powers to make regulations adapting, for the purposes of the Act, any Customs Regulations and any other regulations for controlling the movement of persons, vehicles, etc. in the Free Zones, for handling goods, for keeping and preserving records and accounts, and relating to the provision of security bonds.
- 4.5.4 Section 27 gives the Commissioner of Customs power to require the licensee of a Free Zone Enterprise to pay the duty and taxes on goods that are found missing. In addition to these provisions of the Act Regulations 23 to 31 provide in detail for the powers of the Customs in relation to the Free Zones and for Free Zone Customs formalities

#### **4.6 Conclusions Regarding the Legal Provisions**

- 4.6.1 The long title of the Free Zone Act is “An Act to enable the establishment of free zones in Ghana for the promotion of economic development; to provide for the regulation of activities in free zones and for related purposes”. The provisions of the Act and the regulations are adequate for the purposes of the Act, but there is need also to define more terms like Commercial, and Industrial, and to use the more widely used term “Export Processing Zones” for enterprises with industrial Free Zone licences.
- 4.6.2 It should also be noted that although the term “Free Zone” has been defined to include other terms like “single-factory free zones”, the defined term is often again used with the term it embraces as if they are separate terms.
- 4.6.3 Section 21 of the Act could be drafted more simply to achieve the same objective of treating a Free Zone as being outside the Customs territory. If all goods in a Free Zone are deemed to be outside the Customs territory then the reference to “other than consumer goods for commercial purpose” cannot be justified. The meaning of “zero rated goods” goods is not clear. It probably means goods on which duty has not been paid by reason of the fact that they are in a Free Zone or in transit.
- 4.6.4 Taxes applied to goods are indirect taxes. It is not clear what direct taxes mentioned in Section 22 could apply to goods. It should also be noted that Section 22 has no subsections.

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<sup>3</sup> This possibly means the goods on which duty and taxes have not been paid.

- 4.6.5 Section 23 provides for the power of the Minister of Trade and Industry to authorize up to 30 per cent of the annual production of goods and services of a Free Zone enterprise to be entered for home use, but there is no provision in the Act or in the regulations requiring goods or services produced in Free Zone to be exported. That 70 per cent of goods and services have to be exported can only be inferred. This is a serious omission even if in practice it does not present any problem.

## **5. FREE ZONES ISSUES AND RECOMMENDATIONS**

Certain issues raised in previous studies will now be reviewed and the recommendations of the studies evaluated in the light of the international standards and the Ghanaian legal provisions. The progress in the implementation of the recommendations will also be evaluated, and where necessary new recommendations will be made.

### **5.1 The Nature of the Free Zones**

- 5.1.1 One of the major concerns of previous studies is that many Free zones enterprises were engaged in trading activities with the result that their importations do not meet “the intent of production for export in the sense intended for Free Trade Zones”<sup>4</sup>. It is also pointed out that the distinction between Free Trade Zones, especially the Single Factory zones, and Bonded Warehouses is blurred, with the result that efforts by the Customs to improve controls of bonded warehouse may not be effective since Bonded Warehouse keepers can convert their facilities into Export Trade Zones.
- 5.1.2 Before considering this issue there is need to point out that the Ghana legislation in question is not the Free Trade Zone Act as mentioned by the studies but the Free Zones Act. As already mentioned above, the legislation establishes three kinds of Free Zones, namely, Industrial, Service and Commercial. The Industrial Free Zones are what are called Export Processing Zones (EPZ). An enterprise will take the license for the business activity it wishes to carry on, and there is no restriction on the number of Commercial Free Zones allowed.
- 5.1.3 It is correct that there may be no difference between the activities of a Single Factory Free Zone and a Bonded Warehouse where manufacturing is allowed. However, the critical difference is in the requirement that for all Free Zones 70 per cent of the annual production has to be exported. Customs and Free Zones Board officials pointed out that if an enterprise that is manufacturing in bond can achieve this it is legitimate for it to take a Commercial Free Zone license. They also pointed out

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<sup>4</sup> Text in inverted commas is quoted from one of the studies.

that, while Free Zone licenses cost between \$ 2000 and \$ 4000, a Bonded Warehouse License currently costs only Cedis 20,000, equivalent to only about \$ 3. The 70 per cent export requirement and the costly licenses for Free Zones would deter Bonded Warehouse owners from converting into Free Zone enterprises in order to get the internal tax exemptions. Customs officials were not aware of any Bonded Warehousing firm that converted into a Free Zone only for this reason.

## 5.2 Provision of Tax Incentives

5.2.1 The provision of tax incentives is another issue to which the previous studies gave much attention. The IMF mission of October 2000 suggested that the incentives could cause control problems. The mission made the following observations:

*“The perverse incentives created by the discrimination between enterprises in and out of FTZ can have serious revenue effects. Enterprises outside may evade taxes, including import duties, in order to stay competitive. In Ghana, the bonded warehouse facilities provide room for such tax evasion. Some enterprise may find it easier to qualify for FTZ status as, for example, re-exporting enterprises, even though their real intentions are to sell on the domestic market. With relatively weak customs monitoring system, such as the one in Ghana, and freestanding FTZs, which makes monitoring FTZ activities more difficult, there is real danger that revenue leakages could be substantial.*”

5.2.2 The studies also pointed out that tax incentives need not attract investment and that the basic factors for attracting investment are a stable political and macro-economic environment, neutral government policies, adequate physical and social infrastructure and availability of skilled manpower. The studies therefore recommended that Ghana harmonize efforts with neighbouring countries, including ECOWAS, to remove or alleviate general tax incentives. This recommendation has not been implemented.

5.2.3 As mentioned earlier, the standard practice is to waive the import duties and taxes on goods admitted in a Free Zone because the Free Zone is considered as being outside the Customs territory. However, some countries provide additional concession including waiver of internal taxes. For example, in Mauritius<sup>5</sup> Export Enterprises (EPZs) enjoy waiver of corporate tax, tax on dividends, capital gains tax, as well as customs duties and sales tax on raw material. Ghana is therefore not alone in granting

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<sup>5</sup> Source: 1998 Official ADC Trade, Industry and Investment Review.

these incentives. However, the important point to note is that these incentives give rise to additional risks to revenue, and they can be a source of revenue leakage in a country like Ghana where controls are weak.

5.2.4 A special study would be required to establish the extent to which the tax incentives are instrumental in attracting investment. It should also be noted that removal of the incentives would be seen as instability in the business laws, and this would discourage future investment. The best option left to the government would be to address any weaknesses in the monitoring and controlling of the regime.

### **5.3 Free Zones Monitoring by the Board**

5.3.1 The Free Zones Board, Internal Revenue Services and CEPS share the responsibility for monitoring and controlling the Free Zones regime. Given the objectives of setting up Free Zones, the monitoring role of the Board should include the following in addition to any other statutory roles:

- To ensure that Free Zones licenses are given to companies that are trustworthy and whose investment and business activities will contribute significantly to the economy of the country. To be guided by the quality of the investor rather than the number of investors.
- To implement the licensing conditions rigorously and ensure that licenses are given only to companies that qualify and which are committed to complying with the conditions of the licenses.
- To monitor regularly the compliance and performance of Free Zones enterprise through written records, accounts, reports, returns, etc, and by physical checks based on risk analysis.
- To impose heavy penalties on errant enterprises, including revocation of licenses.
- To collaborate closely with the Revenue Services and especially CEPS and IRS always reporting to them defaulting enterprises which should be denied tax incentives and from which taxes are to be recovered.
- To produce and distribute regularly to all stakeholders quarterly as well as annual reports on the activities and performance of the Free zones regime.

- 5.3.2 Previous studies consistently pointed out that monitoring of the Free Zones regime by the Board were weak. Officials of the Free Zones Board have denied this. They point out that they license only qualified companies. Using returns submitted by the enterprises and data from the Customs, the Board monitors the compliance of enterprises with the conditions of their respective licenses. The Board also monitors their business performance. The data from this activity is used to prepare the Annual Report of the Board, which is presented to the government.
- 5.3.3 It was further pointed out that the Minister of Trade and Industry himself had a keen interest in the success of the Free Zones and therefore required the Board to investigate any allegations of malpractices. Furthermore, there had been a change in the top management of the Free Zones Board, which had resulted in visible improvement in the day-to-day management and monitoring of the Free Zones regime. The Board had organised teams of officials who studied the returns of Free Zone Enterprises and visit their premises. Any allegations of malpractice were investigated to the satisfaction of management. A firm not complying with the conditions is addressed in writing to give an explanation, and if that explanation is not satisfactory, the license may be revoked.
- 5.3.4 An investigation of two companies was given as an example. In the case of the first company, there had been rumours and allegations that the company was flooding the local market with its products instead of exporting. Investigations revealed that the company's sales to the domestic market did not reach the 30 per cent limit, but the domestic market was flooded because of its small size.
- 5.3.5 The investigations on the other company revealed that the company was selling to the domestic market only but it had hopes of getting foreign markets. The company was allowed to continue assembling computers and to sell to the domestic market until it finds foreign markets. It was explained that this was a special indulgence given to this company because of the need to encourage computer assembly and to facilitate availability of computers to Ghanaians.
- 5.3.6 There was no independent data from the Free Zones Board on the basis of which the current situation regarding the monitoring and control of the Free Zones regime could be assessed since the compilation of the 2000 annual report of the Board had not been completed, and the Free Zones Board had no other records. However, the Commissioner of Internal Revenue provided a report on an inspection of selected Free Zones enterprises in the Greater Accra region, which gave an insight into the current state of affairs.

- 5.3.7 According to the report, which was completed in July 2001, there were 81 licensed Free Zones Companies but only 55 were operational. Of the 55, 39 were located in the region. Only 24 companies out of the 39 had tax files, and out of these only twelve had submitted accounts. The accounts submitted did not disclose local and export sales.
- 5.3.8 The report also reveals that IRS had not been played their role to monitor compliance by Free Zones enterprises with the conditions for getting waiver of corporation tax. IRS District offices did not have a list of the licensed enterprises, and the District heads did not have copies of the Free Zones legislation to guide them in examining the accounts of the enterprises. In the absence of records of Free Zones enterprises the IRS offices would not know from what date to count the ten years of waiver of corporation tax and would not demand tax from companies that were not exporting 70 per cent of their production. The IRS has to keep not only copies of the law but also up to date information on entitled Free Zones enterprises.
- 5.3.9 Another report was provided by the Chief Internal Auditor of CEPS. CEPS Internal Audit had audited 16 companies operating as Single Factory Zones enterprises. The report noted that the Free Zones Board was only issuing licenses and facilitating the establishment of Free Zones enterprises but was not monitoring the enterprises as they were required by the law.

#### **5.4 Customs Control of Free Zones**

- 5.4.1 As already mentioned, the Free Zones legislation gives the Customs all the necessary powers for controlling the Free Zones Regimes. The Customs role starts with approving of premises for Free Zones enterprises. The legislation requires the premises to be fenced in order to facilitate Customs control. It is therefore the responsibility of the Customs to ensure that premises are fenced and secure before they are licensed. CEPS have the necessary experience gained from approving premises for Bonded Warehouses. However, Customs officials confirmed that CEPS was not involved in assessing the security of the premises of Free Zone enterprises.
- 5.4.1 The next role of the Customs is to ensure that goods declared for a Free Zone are properly described, classified in accordance with the tariff and properly valued, and that the Free Zone enterprise exists. The Customs is also responsible for extracting data and maintaining statistics on imports of Free Zones enterprises and their exports overseas and to the domestic market. It is the responsibility of the Customs to ensure that firms are not diverting goods into the domestic market and to provide

the Free Zones Board and other stakeholders with data on movement of goods into and out of the Free Zones enterprises.

- 5.4.2 The Customs has to ensure that goods destined to the Free Zones or moving between Free Zones or between Free Zones and the port reach their destination under Customs control. A customs officer has to be available in a Free Zone when goods are brought in or moved out.
- 5.4.3 Customs officials with whom the role of the Customs was discussed admitted that initially there was uncertainty regarding the role of the Customs regarding the role of the Customs. However, the situation had changed, and CEPS was exercising adequate controls over the Free Zones regime. CEPS had posted Customs officers at the exits/entry points who were responsible for processing the movement of goods into and out of the Free Zones.
- 5.4.4 Goods to be moved into or removed from a Free Zone have to be entered on the SAD, which shows, among other things, the license number of the Free Zone enterprise. In the case of entry for home use, an application for the purpose has to be made on Form 9, which is designed for the purpose. Although there is no security bond required to secure the duty and taxes on goods in the Free Zone, a security bond is required for the movement of the goods from the port to the Free Zone for which they have been entered. Once the goods are delivered, copies of the documents accompanying the goods are certified and returned to the port office of dispatch as proof of delivery.
- 5.4.5 The officer posted at the Free Zone keeps the required registers and submit returns of movements of goods into and out of the Free Zone. The returns include goods entered for home use under the 30/70 per cent rule. The Customs keeps records for each Free Zone or enterprise, and the statistics prepared from the SAD data elements are therefore for the effective monitoring of the Free Zones regime.
- 5.4.6 One setback that was pointed out by Customs officials was that Free Zone enterprises do not have to submit a statement of composition. This is an account of the raw materials brought in and the quantities that have been incorporated into the compensating product going out. Such a statement would facilitate control since for each kind of compensating product it is possible to establish the quantity of raw materials required per unit. The statement would be an additional means of ensuring that all raw materials imported into a Free Zone or by a Free Zones enterprise have been accounted for.

- 5.4.7 It was admitted by Customs officials that CEPS had not developed detailed Departmental Instruction for implementing the Free Zones regime; only Commissioner's orders had been prepared. Furthermore, discussions with officials of the Board had revealed that at times no Customs officials were available when required at particular Free Zones. The explanation of the Customs was that the volume of activities of some of the enterprises was too small to warrant allocation of an officer full time. However, with proper co-ordination an officer was always made available.
- 5.4.8 The report of the Internal Auditor, mentioned earlier, indicated that an audit of only 16 Free Zones enterprises had detected a total short collection of Cedis 815,517,784, and 300% penalties amounting to Cedis 2,049,085,487 imposed during the 2000 audit period. The amounts could double if all the 89 companies had been audited. The report also noted that there was under valuation of goods imported into the Free Zones, but under valuation seemed to be a general problem because of the wrong application of the WTO Agreement on Customs Valuation (ACV). In certain cases the value of goods entered for home use from the Free Zones was lower than the value of the goods when they were imported into the Free Zones despite the value added.
- 5.4.9 The report further noted that the CEPS offices in charge of Free Zones in Tema and Accra were not well organised, no proper books of accounts were kept, work schedules were not defined, no adequate records to monitor return of payment of duties, returns were not properly checked for accuracy, recovery of short collections were not followed up, and that CEPS resident officers in Free Zones enterprises did not appear to fully understand the Free Zones Regulations.

## **5.5 Conclusions and Recommendations**

- 5.5.1 There is determination on the part of the Free Zones Board and the Ministry of Trade to make the Free Zones programme a success. Top priority should be given to addressing the weaknesses noted here, especially those relating to licensing and monitoring.
- 5.5.2 The Revenue Services should realize that each has an independent mandate to monitor and control the Free Zones enterprises. A Free Zones enterprise enjoys the incentives only when it is complying with the law. It is up to the Revenue Services, therefore, to verify compliance with the Free Zones Act. A firm that is not complying with the Free Zones legislation brings itself fully within the jurisdiction of the revenue laws.

5.5.3 In the light of the reports of IRS and CEPS Internal Audit, revenue leakage may be taking place through:

- Non-payment of corporation tax by Free Zones enterprises that are not exporting or are entering more than 30 per cent of their production into home use;
- Diversion of goods entered for Free Zones into the domestic market without payment of indirect taxes and direct taxes by the enterprise;
- Under declaration of goods entered for home use as part of the 30 per cent allowed.
- Undervaluation of imports into the Free Zones and of goods out of the Free Zones to the domestic market.

5.5.4 The following recommendations concerning the Free Zones regime are made in the light of the foregoing paragraphs:

1. There is room to improve the definitions should the Act be revised. There is need also to define more terms like Commercial, Industrial, and use the more widely term “Export Processing Zones” for enterprises with industrial Free Zone licences. Although the term “Free Zone” has been defined to include other terms like “single-factory free zones”, the defined term is often again used with the term it embraces as if they were separate terms.
2. Section 21 of the Act could be drafted more simply to achieve the same objective of treating a Free Zone as being outside the Customs territory. If all goods in a Free Zone are deemed to be outside the Customs territory then the reference to “other than consumer goods for commercial purpose” cannot easily be understood. The meaning of “zero rated goods” is not clear. It probably means goods on which duty has not been paid by reason of the fact that they are in a Free Zone or in transit.
3. It is not clear how direct taxes mentioned in Section 22 could apply to goods. The taxes waived should be mentioned specifically. It should also be noted that Section 22 has no subsections.
4. Section 23 provides for the power of the Minister of Trade and Industry to authorize up to 30 per cent of the annual production of goods and services of a Free Zone enterprise to be entered for home use, but there is no provision in the Act or in the regulations requiring goods or services produced in Free Zones to be exported. That

70 per cent of goods and services have to be exported can only be inferred. This is a serious omission even if in practice it does not present any problem.

5. In order to involve all the authorities with a stake in the Free Zones regime, it is recommended that a joint Task Force or Committee be formed to assist the Free Board to scrutinize applications for licenses, analyse records, develop profiles of Free Zone enterprises for purposes risk management, prepare periodic reports etc. The Task force would comprise officials of at least the Board, the Ministry of Trade and Industry, Ministry of Finance, and the three Revenue Services.
6. CEPS should approve premises of Free Zones enterprises before they start production. CEPS have the necessary experience gained from approving premises for Bonded Warehouses.
7. The Free Zones and the Revenue Services independently exercise their respective obligations to monitor the operations and performance of Free Zone enterprises.
8. CEPS should prepare comprehensive up to date instructions. This task should be carried out in collaboration with the Free Zones Board.
9. CEPS should ensure that there are proper, accurate and timely statistics of imports into and removals from the Free Zones.
10. CEPS should ensure that valuation of goods imported into the Free Zones is done according to the law and that export values, even for goods being entered for home use, reflect the value added in the Free Zones.
11. Free Zones enterprises should be required to submit composition statements to CEPS. This would facilitate control since for each kind of compensating product it is possible to establish the quantity of raw materials required per unit. It would be an additional means of ensuring that all raw materials imported into a Free Zone or by a Free Zone enterprise have been accounted for.
12. Direct tax incentives should not be granted unless a firm complies fully with the conditions of the license.
13. The authorities study the possibility of changing the law to limit the quantity of goods that can be entered for home use to a given percentage of achieved exports, subject to

a maximum of 30 per cent of annual production. To retain the annual ratio of 30/70 per cent at any time, the ratio of goods to be entered for home use to achieved exports would be just below 43 per cent. This would ensure that only a company certain of finding a foreign market would apply for a Free Zone license.

14. IRS should continue auditing the performance of the Free Zone enterprises, recover taxes and impose penalties where a firm has failed to comply with the conditions of the license.
15. The capacity of the Free Zones Board and the Customs should be enhanced by appropriate training in modern control techniques, like risk management and post-clearance auditing, and by providing them with computers.

## **6. CUSTOMS WAREHOUSING LAW AND PRACTICE**

### **6.1 Scope and Benefits**

- 6.1.1 Customs Warehousing in Ghana is in conformity with the international concepts discussed earlier. In Ghana too there is a clear distinction between a Free Zone and a Bonded Warehouse, the latter being for storing under Customs control goods on which duty and taxes have not been paid until the owner decides on the ultimate Customs procedure to apply to them. Manufacturing can be allowed by the Customs as an extra facility under certain circumstances.
- 6.1.2 Bonded warehouses can be classified by ownership, i.e. whether public (government, the Customs) or private. According to this classification most bonded warehouses in Ghana are privately owned. A more common and useful classification is whether the warehouse is for private use or for commercial use in the sense that it is for leasing space to various users. The latter are also referred to as general bonded warehouses. General bonded warehouses are for storage only, and the owner of the goods pays rent to the owner of the warehouse or warehouse keeper.
- 6.1.3 Private warehouses are allowed for special purposes, e.g. for storing petroleum products (hydrocarbons), for manufacturing, for storing certain goods like motor vehicles, etc. The whole oil refinery is licensed as a bonded warehouse, and so too are certain manufacturing installations.
- 6.1.4 Informal papers prepared by CEPS officials explain very well the advantages and disadvantages of the Customs warehousing

regime in Ghana. The advantages of Customs warehousing in Ghana are:

- The system meets the axiom that a tax should as far as possible be levied at a time and in a manner most convenient to its payment and should be brought as near as possible to the point of consumption to meet the convenience of the taxpayer.
- There is monetary advantage to the trader because his capital is not locked up in duty payment until he wants the goods for the home market or for export.
- Both interests and insurance payments in respect of duty are reduced where borrowing would have been resorted to.
- Small traders can hold large stocks of goods under the system.
- Large purchases can be made at favourable prices for storage until there are favourable selling markets.
- Export trade is fostered by reason of reserve stocks and the freedom to trade on a duty-free basis.
- Because of remission of duty on natural losses occurring in certain goods during storage, there is no loss of money to the trader.
- The system permits the trader to prepare his goods in the warehouse for the market and duty on genuine losses are remitted.
- Goods for exhibition, subject to security, may be temporarily taken out of the warehouse.
- Goods may be exposed for sale and samples may be drawn.
- The owner can pay duty as and when he receives orders and only proportionate to the order.
- The trader has the option of the home and foreign market while payment of duty remains deferred.
- Under the public/general system, the importer has the double security of the goods - the warehouse keeper and the Customs being interested parties in the goods - the former for the rent and later for the duty.

6.1.5 The following disadvantages are noted:

- The cost of revenue supervision is an extra expenditure to the State.
- Deferment of duty on goods, which finally enter the home market is a cost to revenue.
- The writing off of duty on losses occurring in warehouses is a loss to revenue.
- Close revenue control involves restriction of the warehouse keeper and extra expenditure as to: - structure of the building; working hours; storage and stacking; marking; stock taking; entry into bond; provision of accommodation for the officer, etc.
- The taxpayer, under the private warehouse system ultimately bears the cost of any revenue supervision on enterprises which benefit the private sectors of the economy - an unjustifiable charge on the public.

## **6.2 Licensing Procedures and Conditions**

6.2.1 The procedure for licensing a Bonded Warehouse starts with an application to the Commissioner of Customs through the Assistant Commissioner in charge of the station. The application has to be accompanied with a plan of the proposed premises, which has also to show the surroundings. The premises are inspected by the Customs to determine their suitability for the purpose and their capacity and the estimated duty liability on goods stored therein at any one time. This is important for determining the amount of the security bond that will be required.

6.2.2 If the premises are approved, the applicant is advised to execute a security bond which is adequate to cover the duty liability of goods that will be stored in the warehouse, and a removal bond for covering duty liability of goods while in transit to the warehouse. The bond can be given by a bank or a financial institution, like an insurance company. Following this, a license is issued. Currently a license fee is Cedis 20,000, equivalent to about US \$ 3. It is valid for one year from the date it is issued and is renewable annually.

6.2.3 The conditions for obtaining a bonded warehouse license are therefore:

- Approved premises
- An adequate security bond

- Payment of the license fee

6.2.4 Certain goods may not be stored in a general bonded warehouse. These include acids and other hazardous chemicals and products, and perishable goods. For permission to manufacture in bond additional conditions are imposed by CEPS. These include a requirement of two bonded warehouses, one for the raw materials and another for the finished products, and the applicant has to submit a composition statement showing the product to be manufactured and the materials to be used in the manufacture of the product.

6.2.4 There are now 274 bonded warehouses located in Accra - 202, Tema - 51, Kumasi - 4, Takoradi – 14 Tamale – 2, and Bolga –1. Appendix 4 is a list of Bonded warehouse in the Accra region showing their use. The general bonded warehouses are, in fact, storage facilities for letting at a rent. The renting of bonded warehouse facilities is therefore a business activity.

### **6.3 Warehousing Procedure**

6.3.1 Until October 1999 Warehousing entries for storage in bonded warehouses in James Town were lodged and processed in Tema. The goods were examined and moved under a removal bond and escorted to James Town. At the warehouse, the goods were checked against the particulars on the bill of entry and the Certificate of Warehousing, and when found to be correct were received into the warehouse. The goods were then recorded in the warehousing register. Details of ex-warehoused goods were entered in the register, and when the total consignment was ex-warehoused the entry in the register for that consignment was closed.

6.3.2 The old system was not satisfactory for several reasons. Goods could be diverted without the knowledge of the office of destination in James Town. Communication between the port and James Town relied on a facsimile machine which often broke down. Registers were not kept up to date with the result that the correct stocks in bonded warehouses could not be known without carrying out stock-taking.

6.3.3 From October 1999 a new system was introduced. Under the new system, the warehousing entries for goods to be warehoused in James Town are lodged in James Town. Here the amount of the security bond available for the warehouse and for removal in bond are checked and further processing is allowed only if the amounts are adequate.

- 6.3.4 Another change is the introduction of the ASYCUDA computer system in James Town. Following certification of the amounts of security bond available the entry is sent for data capture still in James Town. A check is also made to ensure that the appropriate Customs Procedure Code has been indicated. From data capture the entry is forwarded to the port for examination and release of the goods for warehousing.
- 6.3.5 The computer system is also used for the ex-warehousing process. It deducts from stock the quantity of goods being ex-warehoused and indicates the balance of the warehoused consignment remaining in the bonded warehouse together with the outstanding duty and taxes.
- 6.3.6 Customs officials admitted that the old system did not work well and that the management of controls was weak. They noted that the new system has worked smoothly and has not only harmonised the port and James Town procedures but also enabled more effective Customs control and monitoring.

#### **6.4 Customs Control and Monitoring**

- 6.4.1 To monitor and control effectively the Customs Warehousing regime it is necessary for the Customs to do the following:
- Ensure that there is an adequate security bond, which can be enforced in case goods are not accounted for to the satisfaction of the Customs;
  - Ensure that the description, tariff classification and value of goods being entered for warehousing are correct;
  - Ensure that goods declared for warehousing are actually delivered to the declared bonded warehouse;
  - Ensure that correct and up to date stock records are maintained;
  - Ensure that the same data entered on the warehousing entry (SAD) is used on ex-warehousing entry;

- Reconcile the totals for ex-warehousing entries for an individual consignment with the total quantities of the warehousing entry;
- Audit warehousing and ex-warehousing entries regularly and raise audit queries;
- Carry out regular stock taking of bonded warehouses; and
- Award severe penalties for offending parties.

6.4.2. Discussions with CEPS officials and CEPS Chief Internal Auditor indicated that control and monitoring of the Customs Warehousing regime had improved since the studies carried out in 1999 by Sigma One Corporation. However, the control of Bonded Warehouses still remained weak despite the improvement that has been made in the warehousing procedures. According to the Internal Audit Report for 2000, importers, clearing agents and warehouse operators abused the system by the following methods:

- Diversion of goods meant for warehousing;
- Undervaluing ex-warehousing values;
- Short delivery of goods into, and pilferage of goods within, the warehouses resulting in stock shortages;
- Wrong tariff classification; and
- Application of wrong duty rates.

6.4.2 The report gives examples of firms which had abused the system and the method they used. The report also points out that in a certain case it was clear that CEPS staff had connived with the importer to divert goods into home use. Like in the case of Free Zones, accounts and registers were not found up to date.

6.4.3 Out of 42 warehouses audited, 20 were awarded clean certificates. More than 50 per cent of the companies were involved in short collections assessed at Cedis 2,860,063,877. Penalties amounting to Cedis 8,263, 341,836 (300 per cent of

the short collections) were imposed. There are about 200 active bonded warehouse in Ghana, and if all of them were audited the amount of short collections could be tripled.

- 6.4.4 The Internal Auditor reported that in 1999 and 2000 only about 100 bonded warehouses had been audited and that given the small number of auditors it would not be possible to audit all the bonded warehouses in one year. It had not been possible to take stock of goods in all the Bonded Warehouses as recommended in previous studies. He also expressed disappointment that there was no aggressive follow-up of the Internal Audit reports.
- 6.4.5 As regards severity of penalties, the Internal Auditor pointed out that the policy was to impose the maximum penalty of 300 per cent. However, he found this counterproductive since those fined were not able to pay. He would recommend a fine of 100 per cent since this was affordable, and would not therefore result in endless disputes. In this connection the auditor's report indicates, for example, that out of the Cedis 11, 123,405,713 duties and penalties recoverable in respect of Bonded Warehouse short collections, only Cedis 260,667,039 had been recovered by April 2001, when the Auditor's report was submitted.
- 6.4.6 The use of the ASYCUDA system had facilitated control of balances of consignments in bonded warehouses. However, manual registers were still being used instead of computerised stock databases, and there was no network linking up the Customs stations or Customs offices with Bonded Warehouses. Customs officials pointed, however, that the computerisation problems will end when the new Customs computer systems goes live during the first quarter of 2002.
- 6.4.7 The building of the new computer system, called Ghana Community Network (GCNet), is at an advanced stage. The system, which is based on that of Mauritius and Singapore, is made up of two components, the Ghana Customs Management System (GCMS) and Tradenet. The latter is the communication component to which all interested parties will be linked. With the new system it will be possible to monitor Bonded Warehouses even at macro-level, e.g. to establish the revenue potential of goods in all bonded warehouses.

- 6.4.8 Several of recommendations to improve the Warehousing regime that had been made by the previous study by Sigma One Corporation had not been implemented. The study had recommended raising the license fee for bonded so that only serious firms would apply for licenses. This would reduce the number of bonded warehouses to a manageable number, and would earn the government significant revenue. CEPS senior officials with whom the recommendation was discussed found it acceptable, and thought that it had not been implemented simply because there had not been time and opportunity to study the recommendations of the studies.
- 6.4.9 The study had also recommended reduction in the number of bonded warehouses to a level consistent with effective Customs controls. As mentioned above, an increase of the license fees would result in the fewer Bonded Warehouses. Customs officials also pointed out that more use of computers would also improve controls as proved by the introduction of the ASYCUDA. This should be accompanied with improving the capacity of the Customs to carry out the necessary tasks, frequent training, and severe penalties for those abusing the system. These measures would be more appropriate than indiscriminate reduction, which would not be consistent with the need to provide service as expected by trade.
- 6.4.10 The previous study had also recommended that the security bond system be improved to guarantee executability, including restricting security to bank bonds. Again senior CEPS officials found this recommendation acceptable and pointed out that it could be implemented without changing the existing legal provisions.
- 6.4.11 Another recommendation, to restrict the conditions for re-warehousing by making duties and taxes automatically payable on selected goods stored in bonded warehouses, including those difficult to control, was not found acceptable. However, it was agreed that for goods in a general bonded warehouse, the maximum period for warehousing could be limited to one year without the possibility of re-warehousing. This restriction would not apply to goods in private bonded warehouses since these are mainly raw materials or inputs. Furthermore, private bonded warehouses are easier to monitor.

## 6.5 Customs Warehousing Recommendations

The following recommendations concerning the Customs warehousing regime are made in the light of the foregoing paragraphs. They include the recommendations discussed above since they have not been implemented.

1. CEPS top management should commit itself to implementing the recommendations of various studies to the extent possible and make periodic reports to the Revenue Agencies Board and to the Minister of Finance.
2. For the remaining months before the budget for the next fiscal year, CEPS should carry out a campaign to recover outstanding short collections submitting monthly recovery reports to the Revenue Agencies Board and to the Minister of Finance.
3. CEPS should develop a strategic plan to improve Customs controls, especially of Bonded warehouses and Free Zones, through adequate staffing, proper organization, training, and provision of computers.
4. The destination Inspection Companies should be required to provide training on the WTO ACV, and proper implementation structures at the CEPS headquarters and in the Long Rooms should be established. The training should include profiling and targeting and post clearance auditing.
5. Rotate staff resident in Bonded warehouses.
6. With the advice of the Attorney General, amend the Customs management law to provide for the possibility of criminal prosecution of fraudulent cases.
7. Pending the implementation of the new computer system, provide an adequate number of PCs for bonded warehouse and Free Zones database.
8. Research and Monitoring Branch at CEPS Headquarters prepare periodic (quarterly) reports to be submitted to the Minister of Finance. The reports would include the total value of goods in general bonded warehouses and their duty and tax potential.
9. Raise the annual licensing fee for general bonded warehouses to at least USD 1000. The period of validity of bonded warehouse licenses should one year from the 1<sup>st</sup> of January.

10. Improve the security bond system to guarantee executability, including restricting security to bank bonds.
11. Limit the maximum period for warehousing of goods in general bonded warehouse to one year without the possibility of re-warehousing.

## 7. CONCLUDING REMARKS

- 7.1 The weaknesses in these functional areas might also be a reflection of weaknesses in the ability to manage. The report of the Chief Internal Audit of CEPS clearly point to management weaknesses. For example, Internal Audit recommendations are not followed up, and the Legal Service does not give adequate support. There have been many changes in management positions in CEPS this year, and it might be an opportune moment for the new management to organize general refresher courses in supervisory and management skills for heads of divisions and various units. National management institutions could conduct the courses.
- 7.2. Another remark worth considering is that, the Free Zones and Customs Warehousing regimes are only two of the many areas where the Revenue Services are required to exercise effective control. If there are weaknesses in these areas there might be weaknesses in other areas too. CEPS management would benefit from implementing the recommendations of the “Review of Customs administration and Procedures in Ghana” carried out by Sigma One Corporations in October 1999, which have not been outdated by new developments.
- 7.3 The following three paragraphs<sup>6</sup> from that review might still reflect the current state of affairs:

The poor practices and absence of up to date regulations or instructions impede some officers and allow other to take a lax position with respect to their duties. In Ghana, the Inspectorate Organization, which was once tasked with monitoring operational performance and developing systems and procedures, is virtually defunct, leaving an operational policy vacuum. CEPS relies on a process of “crisis management” through ad hoc decisions when problems occur, often only to rescind the decision when it disrupts other procedures or adversely affects importers and exporters.

A significant challenge facing CEPS is the development of modern law, regulations and procedures that meet the test as “international best

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<sup>6</sup> See page 4 of the report, prepared by Vincent Castonguay

practices". CEPS does not have an organization dedicated to that activity, nor is it clearly articulated in the Gateway Project or other planning documents relating to CEPS organization. Therefore, the poor condition of operational procedures and lack of legal authorities will persevere, and CEPS will continue to make operational decisions on an ad hoc basis. With the best of intentions, the Gateway Project objectives will be jeopardized without CEPS organization tasked to research, develop and implement modern practices and concepts.

CEPS needs an internal organization charged with the responsibility to analyse operational problems. Consult with the private sector, Gateway and Government officials on CEPS programs and to design, recommend and implement systems and procedures based on modern practices. CEPS would also benefit from grater interface with the World Customs Organization (WCO) for information on international "best practices" and current training materials. ... "

## ORIGINAL TERMS OF REFERENCE FOR TECHNICAL ASSISTANCE

### 1. NAME OF ACTIVITY

Identifying Operational, Regulatory and Policy Changes Required to Eliminate Revenue Leakages in Free Zones and Bonded Warehousing regimes.

### 2. PURPOSE OF ACTIVITY

To enhance government tax revenue collection and taxpayer compliance by proposing (a) operation (b) regulatory and (c) policy changes on the operation of the Free Zone and Bonded Warehouse regimes that will eliminate present revenue losses.

### 3. SCOPE OF WORK

3.1 The ... expert will work with a team from the Ministry of Finance, the Gateway Project, the Ministry of Trade and Industry, CEPS, the VAT Office and the IRS to identify operational, regulatory and policy CHANGES regarding the Free Zone and Bonded Warehouse regimes to eliminate or significantly reduce leakages in Income Tax, Customs Duties, VAT and Excise Taxes arising from the current practices and legal framework for these regimes. The team will be under the leadership of a GOG official designated by the Minister of Finance.

3.2 The expert will assist the team to:

- a. Identify and quantify the sources of the revenue leakages
- b. Propose practical changes to the existing operations of these regimes to eliminate or substantially reduce such leakages within the current fiscal year.

### 4. REVIEW OF FREE ZONE ADMINISTRATION AND PROCEDURES

As regards the Free Zones, the team will review relevant administrative procedures and recommend methods of tightening their administration without unduly impeding the flow of goods into and out of the zones. In particular, the team will:

#### 4.1 Examine methods to reduce tax-free leakage from the zones to the domestic economy.

- 4.1.1 The team will evaluate methods currently employed to track the flow of goods into the zones, to bond the goods during production and storage and to monitor the export of finished goods.

4.1.2 Particular attention should be given to evaluating where scarce manpower can be used to move effectively to more effectively monitor and control the flow of goods so that leakage to the domestic market is minimized without sacrificing the benefits accruing from the zones.

#### 4.2 Examine Compliance with Stated Objectives and Conditions

It is necessary to examine whether firms continue to qualify for Free Zone status, and if not, the remedies undertaken. The team should review the performance monitoring process, how decisions are made and who is responsible for performance evaluations. Recommendations should be made to enhance compliance in a fair and reasonable, but effective manner.

#### 4.3 Review Free Zone Legislation

4.3.1 The team will review the Free Zone legislation, including amendments. Based on this review and the administrative evaluation, recommendations should be developed to modify the legislation, where necessary, to enhance compliance.

4.3.2 In addition, one stated objective of the Free Zone programme is to increase exports. It appears, however, that existing exporters may have been able to advantage of the Free Zone programme without incrementally increasing exports. The legislative and administrative basis for eligibility should be examined and recommendations made to limit the scope of the programme, where appropriate, to some measure of incremental exports.

### **5. REVIEW OF BONDED WAREHOUSE PROCEDURES**

Bonded Warehouses have been identified as potential sources of revenue leakage. The team will investigate ways to limit potential abuse of the Bonded Warehouse system and to rationalize procedures. In particular, they will:

#### 5.1 Examine Methods to Reduce the Demand for Bonded Warehouse Services

An examination of the types of goods entering Bonded Warehouses and the average length of storage will help indicate the type of traders involved in Bonded Warehouse activities. In addition, recommendations should be developed to implement procedures to reduce the need for Bonded Warehouses to a minimum. (In general importers should use Bonded Warehouses in only usual circumstances. That is, goods should clear Customs and enter the domestic market as fast as possible. In addition traders should not use Bonded Warehouses as an inexpensive storage system, reducing working capital requirements.)

## 5.2 Examine all Bonded Warehouse Requirements and Procedures

It is necessary to examine the licensing procedures for Bonded Warehouses and to review all normal monitoring procedures. Based on this review the team will recommend methods to improve licensing procedures so that compliance is enhanced. In particular:

5.2.1 Examination of the type of bonding is required with the aim of increasing the qualifications for obtaining a license for a private Bonded Warehouse.

5.2.2 An examination of inventory methods is necessary to ascertain whether controls are adequate.

5.2.3 An examination of CEPS control activities in this sector is necessary, and recommendations should be made on how to increase CEPS capabilities to control leakage from the Bonded Warehouse system.

5.2.4 Explore any relationship between the Bonded Warehouse system and activities in Free Zones.

## 6. **OUTCOME**

Removing unintended revenue leakages from the Free Zone and Bonded Warehouse Regimes will help reduce the deficit and enable these regimes to contribute to improved economy-wide international competitiveness and ultimately to the goal of private sector growth in Ghana. [Estimate the revenue yield of these measures].

## 7. **OUTPUT**

**(Contributing to CLIN #10: Milestone 10.1)**

A document specifying Operational, Regulatory and Policy Changes to the existing Bonded Warehouse and Free Zone Regimes to reduce or eliminate revenue leakages from these sources.

## REVISED TERMS OF REFERENCE

### 1. PRINCIPAL OBJECTIVE

To enhance government tax revenue collection and taxpayer compliance by proposing (a) operational (b) regulatory and (c) policy changes in the Free Zone and Bonded Warehouse regimes that will eliminate present revenue losses.

### 2. BROAD TASKS TO BE CARRIED OUT

- The team will focus especially on the issues which have not been addressed or which have not been given adequate attention by the IMF missions. These will be mainly the issues relating to Customs controls, administrative procedures, and the capacity of the Customs administration.
- The team will establish whether there is loss of revenue resulting from poor controls or weaknesses of the Customs systems, as opposed to revenue forgone due to granting exemptions under the FZ and BW regimes, quantify such losses if any, and recommend measures to avoid future losses.
- The team will establish the views of the authorities on the recommendations that have been made so far and the status of their implementation.
- The team will prepare a time-bound action plan for implementing the measures it will recommend and the recommendations of the IMF missions that are acceptable to the authorities.

### 3. DETAILED TASKS

#### Free Zone Regime

1. Review relevant administrative procedures and recommend methods of tightening their administration without unduly impeding the flow of goods into and out of the zones.
2. Evaluate methods currently employed to track the flow of goods into the zones, to bond the goods during production and storage and to monitor the export of finished goods.
3. Evaluate where scarce manpower can be used to more effectively monitor and control the flow of goods.

4. Examine whether firms continue to qualify for Free Zone status, and if not, the remedies undertaken.
5. Review the performance monitoring process, how decisions are made and who is responsible for performance evaluations.
6. Review the Free Zone legislation, including amendments and if necessary recommend amendments to enhance compliance.
7. Examine the legislative and administrative basis for eligibility to FZ regime and recommend a limit to the scope of the programme, where appropriate, to some measure of incremental exports.

### **Bonded Warehouse Regime**

1. Examine Methods to Reduce the Demand for Bonded Warehouse Services.
2. Examine the types of goods entering Bonded Warehouses, the average length of storage, and indicate the type of traders involved in Bonded Warehouse activities.
3. Recommend procedures to reduce the need for Bonded Warehouses to a minimum.
4. Examine the licensing procedures for Bonded Warehouses.
5. Review all normal monitoring procedures and recommend methods to improve licensing procedures so that compliance is enhanced.
6. Recommend additional qualifications for private Bonded Warehouse licensing.
7. Examine inventory methods to ascertain whether controls are adequate.
8. Recommend how to increase CEPS' capabilities to control leakage from the Bonded Warehouse system.
9. Explore any relationship between the Bonded Warehouse system and activities in Free Zones.