actionaid

# INVESTMENT INCENTIVES IN GHANA

## THE COST TO SOCIO-ECONOMIC DEVELOPMENT

An ActionAid Ghana Research Report

**Preliminary Findings**

February 2014

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# EXECUTIVE SUMMARY

Ghana's trade policy and development agenda have over the years been dictated by the desire to attract Foreign Direct Investment and to increase export earnings. Tax incentives have, therefore, been a major strategic tool to achieve these goals. The result is that, trade taxes have declined, and currently Ghana has one of the overall lowest tax rates in the West Africa sub-region. While this may have boosted Ghana's competitiveness, it has tended to, at the same time, undermine the harmonisation of trade and investment regimes across the sub-region through initiatives such as the ECOWAS Common External Tariffs (CET). Ghana's trade and investment strategy has invariably contributed to the "race to the bottom" phenomenon that has bedevilled the sub-region in the last three decades.

While some gains have been realised–in the form of marginal increase in investment and exports–these may return negative values when set against the numerous tax incentives granted these investors. Ghana's Free Zones in particular has shown significant improvement in financial performance since 2007, but the fact that the country's trade balance is still in the negative suggests that the Free zones concept has so far failed to turn the trade balance in Ghana's favour.

In respect of Ghana's location tax incentive regime, the study finds that contrary to popular assertions, tax incentives on their own do not attract FDIs but other factors such as skills pool, availability of social and infrastructural facilities such as good schools, health facilities, road network, electricity etc. may also count as significant considerations in investment decisions.

In estimating the value of revenue lost through losses. The study estimates that Ghana may be losing close to US$1.2 billion annually as a result of tax incentives. This is usually about half the entire annual Government of Ghana budget for education. While the study recognises some usefulness of tax incentives, it emphasises the need to gauge how much is given as tax incentives against tax incentives, largely as a result of inadequate official data sources, the study relied on alternative data sources such as national budget statements to arrive at the overall tax the expected benefits.

The study particularly identifies as a major problem, the arbitrariness or the discretion in tax incentive administration in Ghana, such as the use of permits at the ministerial level without recourse to procedural steps set out in the statutes. In almost all cases, parliamentary approval is required in the granting of tax incentives but evidence from by this study shows that parliamentary approval is sometimes by-passed, resulting in excessive and unregulated granting of tax incentives. The study cites as an example, the case of SINOPEC, the Chinese firm undertaking the construction of Ghana's Western Corridor Gas Infrastructure Project, who has been granted exemption from import duties, VAT, and corporate income tax by the Ghana Gas Company without prior parliamentary approval. In response to public pressure,

the Minister of Finance and Economic Planning is only now putting together the necessary documentation for parliamentary ratification.

Instances of tax losses at the corporate level are highlighted in the report and identified as coming from loopholes in Ghana's tax laws and incentive regime. Various provisions in the tax laws are identified as open to varied interpretations and application. The study estimates that Ghana lost about US$90 million dollars between 2011 and 2012 in the mining sector alone as a result of stability agreement. In the Oil and Gas sector, the estimate is about US$70 million in two years, resulting from an ambiguous tax law, which could not be fully applied as a result of varied interpretation of the law.

The report recognises government's efforts, especially in recent times, to streamline the tax incentive system, and believes this offers the best opportunity for civil society in Ghana to follow up on these interventions and related promises made by government.

## ABBREVIATIONS/ACRONYMS

| | |
|---|---|
| ATSG | AFRICAN TRADE SERVICES GROUP |
| AU | AFRICAN UNION |
| CEPS | CUSTOMS EXCISE AND PREVENTIVE SERVICE |
| C.I.F | COST of INSURANCE AND FREIGHT |
| ECOWAS | ECONOMIC COMMUNITY OF WEST AFRICAN STATES |
| FDI | FOREIGN DIRECT INVESTMENT |
| F.O.B | FREE ON BOARD |
| GDP | GROSS DOMESTIC PRODUCT |
| GIPC | GHANA INVESTMENT PROMOTION CENTRE |
| IFF | ILLICIT FINANCIAL FLOW |
| L.I | LEGISLATIVE INSTRUMENT |
| MNEs | MULTINATIONAL ENTERPRISES |
| NGO | NON GOVERNMENTAL ORGANISATIONS |
| OECD | ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT |
| PITL | PETROLEUM INCOME TAX LAW |
| PNDC | PROVISIONAL NATIONAL DEFENCE COUNCIL |
| UN | UNITED NATIONS |
| UNTAD | UNITED NATION TRADE AND DEVELOPMENT |
| VAT | VALUE ADDED TAX |
| VRA | VOLTA RIVER AUTHORITY |
| WTO | WORLD TRADE ORGANISATION |

# *1.0 INTRODUCTION*

The role of taxation in development financing cannot be over-emphasised. However, the capacity of many developing countries to raise the needed tax revenue to finance their development can too easily be constrained by over-generous tax incentive regimes whose benefits have not been critically evaluated.

Tax incentives also known as tax expenditure because of their cost to governments, refers to the revenue a government foregoes through statutory or administrative provisions. It allows (1) deductions, exclusions, or exemptions from the taxpayers' taxable expenditure, income, or investment, (2) deferral of tax liability, or (3) preferential tax rates.
In 1985, Stanley Surrey and Paul R. McDaniel defined the concept of tax expenditure and posited that: an income tax is composed of two distinct elements. The first element consists of structural provisions necessary to implement a normal income tax, such as the definition of net income, the specification of accounting rules and the determination of the entities subject to tax. It also involves the determination of the rate schedule and exemption levels, as well as the application of the tax to international transactions.

The second element consists of the special preferences found in every income tax. These provisions, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favour a particular industry, activity, or class or persons. They take many forms, such as permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates. Whatever their form, these departures from the normative tax structure represent government spending for favoured activities or groups, effected through the tax system rather than through direct grants, loans, or other forms of government assistance. (Surrey 1985:p. 3)

Tax incentives, became a prominent feature of developing countries' strategies for attracting Foreign Direct Investments (FDIs) in the period of the IMF/World Bank-inspired structural adjustments of the 1980s into the 1990s, and have been maintained to date without assessing their real impacts, negative or positive. Thus far, tax incentives have managed to avoid intense public scrutiny.

The granting of huge tax breaks to attract large corporations, and the vast outflow of funds from developing countries to tax havens, continue to undermine the revenue mobilisation potential of developing countries. The trend is consistent with the neo-liberal tendencies which place greater premium on capital at the expense of labour. This has led to the shifting of the tax burden from capital to labour, even though in most instances they have proven both regressive and counter-productive from an employment creation perspective. As a result public finances have dwindled, leading to a retreat of public services and public investments in many African countries at the time of independence which were higher than in the current period.

It is indeed a paradox that, while developing countries are faced with the daunting task of mobilizing adequate domestic resources for national development, great amounts of potential revenues are given away yearly through the granting of huge tax breaks and outright exemptions to attract FDIs.

It is often argued that the key challenge for OECD countries as well as developing countries is to establish a strong policy and institutional framework that will help developing countries to attract increased trade and investment, and to ensure that these inflows benefit their societies and promote sustainable forms of development. In tax terms, this means:

a) Providing a fiscal environment that is favourable to Foreign Direct Investment and international trade in developing countries, yet not discriminating against domestic investors and undermining revenue generation for essential services;
b) At the international level, cooperation between developed and developing countries to ensure that developing countries get a fair allocation of tax base in relation to the Foreign Direct Investment they attract, preferring source and top residence taxation where profits are made;
c) Helping developing countries to develop efficient, progressive, accountable and fair tax policies and tax collection mechanisms that allow their governments to effectively fund sustainable policy measures in the economic, social and environmental fields;
d) Involving civil society at the international level and in particular in investors' home countries by encouraging taxpayers and in particular MNEs to behave in a responsible way when managing their taxes.

The above policy paradigm imposes a responsibility on citizens and citizens' groups to work to expose all forms of tax injustices in their countries, and to pursue the necessary redress actions through policy reforms to safeguard the tax revenue potential of their countries.

It is in this vein that recent trends where governments calculate the cost of tax incentives and present them as part of the national budget statements are encouraged. They provide insight into the cost of their incentive regimes and allow the public to measure them against the benefits in order to justify their maintenance or abolition.

The 2013 Budget and Economic Policy Statement of the Government of Ghana, for instance, estimates Ghana's tax expenditure at about 3.28 per cent of GDP. Set against the actual tax revenue/GDP ratio of 17.1 per cent, Ghana's tax expenditure can be described as pretty high. The Government recognises this and has since 2012 been contemplating the introduction of new control measures to reduce the overall impact of tax exemptions.

The 2013 budget cites a recent OECD study which shows that direct tax accounted for most of Ghana's tax exemptions, followed by VAT and customs exemptions. Prior to this study most of the control measures that were put in place affected mainly customs exemptions. It becomes clear that more ambitious and sweeping measures are needed to ensure the

exemption regime is not only cut back but also rationalised and applied in a more stringent manner.

Ghana's Finance Minister again disclosed to Parliament in its 2013 budget that the Ministry and the Ghana Revenue Authority was going to undertake a comprehensive review of the tax Incentive for agro-processing businesses; tax incentive for location of businesses; and withholding the tax rate on management and technical fees. Similarly VAT on imported services would be reviewed because it suspected abuses. It also announced the establishment of a special monitoring team to examine the administration and use of tax incentives granted to NGO's, charitable organizations and all other institutions under the various incentive regimes. The team was also to conduct periodic cost benefit analysis of the various tax incentives currently in place.[1]

The 2014 Budget Statement has further acknowledged that revenue loss from exemptions granted in duties and taxes continue to undermine the overall tax revenue performance. It revealed that tax expenditures constitute a significant proportion of total tax revenue, estimating it at 13.1 percent of total revenue and 2.1 percent of GDP. The budget, however, failed to report in detail what progress the Government had made in reviewing the current incentive regime and what new measures had been introduced to curb abuses.

This report recognises ongoing efforts by the Tax Policy Unit of Ghana's Ministry of Finance to provide better insight into the cost of tax incentives to the state. It also recognises the unique opportunity afforded by current tax reform processes for citizens to engage the government on tax matters. It aims at presenting empirical data to support advocacy for a paradigm shift in Ghana's strategy to attract FDIs. It advances the case for a strategy that de-emphasises tax incentives and rather emphasises other factors such as macro-economic stability, infrastructural development, and skilled workforce.

The specific objectives of the study are to:

1. Review investment incentives offered by the Ghana government to investors;
2. Identify and quantify revenue losses to government resulting from the granting of these incentives;
3. Identify areas of corporate abuse using at least two companies as case studies
4. Make recommendations on opportunities for engaging the Ghana government on incentive policies which are not beneficial to the poor and excluded, and on what policy changes are required.

The findings and recommendations of the study are intended for use in engaging the African Union High Level Panel on Illicit Financial Flow (AU IFF) with the ultimate aim of encouraging the Ghanaian government and other African states to adopt new policies and practices on incentives.

[1] The 2013 Budget and Economic Policy Statement of the Government of Ghana http://www.mofep.gov.gh/

## *2.0 FRAMEWORK FOR TAX EXEMPTIONS IN GHANA*

A Tax incentive can be described as a deliberate exemption or concession from a tax liability enacted into law as to encourage or boost investment in an economy. Tax Incentives in Ghana are underlined by legal instruments which define the extent of application[2]. But sometimes specific agreements tend to undermine these legal provisions. The principal law which gives expression to tax incentives in Ghana is the Internal Revenue Act 2000 (Act 592)[3]. This law, promulgated in 2001, takes its root from the Income Tax Decree of 1975 (S.M.C.D.5).

The replacement of the earlier Tax Decree saw a significant fiscal policy shift towards investment attraction. It also underlines the increased emphasis on lower taxes partly as a reflection of a more general shift in priorities in development thinking and practice globally. The Act together with other sector specific laws and agreements embody the entirety of tax incentives in Ghana. Below are some laws and agreements in the statutes of Ghana that offer incentives for specific sector policy initiative:

Internal Revenue Act 2000 (ACT 592) as amended;

Internal Revenue Regulation 2001(LI 1675);

Value Added Tax Act 1998 (ACT 546) as amended;

Value Added Regulations 1998 (LI 1648);

Customs, Excise and Preventive Service (Management) Law 2003 Act (PNDCL 330) as amended;

The Ghana Investment Promotion Centre Act 1994 (478), Additional incentives for the tourism industry were created through Ghana Investment Promotion Centre (Promotion of Tourism) Instrument, 2005 L.I. 1817. The GIPC Act of 1994 has been replaced by the new GIPC law, Act 856 of 2013

Ghana Free Zones ACT 1995(504) as amended;

Minerals and Mining Act 2006(ACT 703)

Minerals (Royalties) Regulations 1987 (LI 1349)

Petroleum Income Tax Law 1987 (PNDCL 188)

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[2] Ghana Revenue Authority 2009 ACT(791)

[3] Internal Revenue Act 2000 (ACT 592) as amended

## *3.0 GHANA'S TAX INCENTIVE ARCHITECTURE*

The specific tax incentive provisions in the above listed tax laws and agreements can be further categorised under their type or intended targets or effect. The following are the broad categories of tax incentives in Ghana:

*Corporate Income Tax Rates Incentive*: At various stages in Ghana's economic development, corporate tax cuts have been offered as a deliberate strategy to stay ahead of other African countries in the competition for Foreign Direct Investment. Many business and organizations benefitted from these cuts during the country's economic recovery programme from the 1980s through the structural adjustment programme of the 1990s into the new millennium.

This competition was founded on the conviction that FDI is the way to achieve rapid economic growth. Corporate income tax in the mining sector for instance was cut from as high as 45% in 1986 to 25% in 2011. At the same time initial capital allowances were increased (from 25% in 1986 to 80% in 2011), as well as a long mining list of exemptions and other expatriate employee tax incentives all in line with the attempt to attract investment thereby watering down tax rates[4]. Several other tax incentives in the agriculture manufacturing sectors have all conspired to create a tax competitive environment by reducing the effective tax rate.

The most significant corporate tax adjustment has been the reduction of the corporation tax rate of 32.5% in 2004 to 25% in 2006. In 2011, however, the corporate income tax rate for mining was revised upwards in response to civil society advocacy, to 35%. Other concessionary low rates such as the 8% for the export of certain determined quantities of manufactured goods and agricultural products were broaden in scope to cover rural banking; non-traditional exports particularly processed agricultural products. Typical traditional exports that don't fall in this category are cocoa and coffee beans, timber logs, unprocessed gold nuggets, electricity among others. Also the hospitality industry currently enjoys a reduced tax of 20% from a previous 22% and 25% in that order.

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[4] Akabzaa, M.T. and Ayamdoo, C. (2009). Towards a Fair and Equitable Taxation for Sustainable Development in Africa: A Study on Trends & Nature of Taxation in Ghana's Extractive Sector. Department of Geology, University of Ghana, Accra.

## 3.1 Tax Holidays

Tax holidays defer the payment of corporate taxes. Here companies are given time limits typically between 5 to 15 years from the start of their operations in Ghana where they are exempt from paying taxes. This gives special dispensation to companies to recover their investment costs before coming into tax-paying position. The policy, apart from presumably helping the country stay in competition for FDIs, is aimed at incubating new companies into maturity. The extent of the holiday is dependent on what policy-makers conceive as reasonable period to fully nurture the company into maturity.

Tax holidays in Ghana may also appear to be open ended as being witnessed in the cocoa sector. Typically time bound tax holidays in Ghana range between 5-15years except the cocoa sector where cocoa farmers have been tax exempt from income tax with no time limit to date. The cocoa sector in the 1960s until the late 1990s has been the highest foreign exchange earner for Ghana (once the leading producer in the world) and employs in excess of 3.5 million Ghanaians annually. Currently, the sector only ranks only behind the gold sector.

Other agricultural-based incomes (foreign and local) enjoy tax exemptions as follows:

- tree crop farmers (mango, sheanuts, cashew, coffee, oil palm, rubber and coconut) enjoy 10 years tax exemption from the date of first harvest;
- Cash crop farmers (groundnuts, cassava, yam, rice, pineapples, maize, etc.) enjoy 5 years tax exemption from the date of commencement of farming.
- Commercial Processors of cocoa by-products enjoy 5 years income tax exemption from the date of start of operation;
- Cattle ranchers have 10 years from date of start of business
- Poultry and other livestock including fish farmers also have 5 years from the start of business
- Agro-processing companies enjoy 5 years income tax exemption from the day of start of business.
- Producers of canned, packaged or processed meat, fish and crop products enjoy 3 years exemptions from the date of commencement of business.
- Companies registered under Ghana Export Processing Zones (Free Zones) also enjoy tax holidays for 10 years from the start of operation
- The income of a company whose principal activity is the processing of waste including recycling of plastic and polythene material for agricultural or commercial purposes is exempt from tax for a period of seven years of assessment commencing from and including the year in which the base period of the company ends, that is the period in which commercial production commences.

## 3.2 Location Incentives

Location incentives are an in-country investment dispersion tool. Historically, investments in the Ghanaian economy seem to have been over concentrated in three main cities, Tema, Accra and Kumasi. The policy rationale of business location incentives is therefore to encourage manufacturing and agro-processing companies to locate beyond these three cities. This is in line with the quest for regional balance in economic growth and development, which among other things aims at reducing rural unemployment to stem the urban-rural drift.

These kinds of incentives are provided for in the Ghana Investment Promotion Centre Act 478 (now replaced by Act 865 of 2013) and expressed in the form of tax rebate for investment in the following regions:

- With the exception of Accra(capital) and Tema(Industry City), all other regional capitals enjoy a tax rebate of 25%;
- All other places in Ghana other than the ten (10) Regional Capitals and Tema enjoy a tax rebate of 50%;
- Also, for agro-processing the emphasis is on value addition in the cocoa sub-sector where any processing with sub-standard cocoa beans, cocoa husks and other cocoa wastes as the predominant raw material qualifies for location incentive in the following ways:
    - Regional Capitals other than Accra and Tema has a tax incentive rebate of 90% of the applicable corporate rate (25%);
    - Any investment of the kind in Accra or Tema has a tax incentive rebate of 80% of the applicable corporate rate;
    - Other locations outside the regional capitals and the entire Northern, Upper West and East Regions have a 100% incentive rebate on the applicable tax rate.

Substantial as they may appear, these measures have not had any marked effect on the quantum and direction of investments within the country, suggesting that tax incentives are not the sole determinants of investment flow. Many investors prefer Accra (the capital) and Tema (the port city) for reasons such as availability of required skills set, proximity to port facilities, relatively better access to electricity, water and banking services.

## 3.3 Capital Allowance

Capital allowance is provided for in the Internal Revenue Act, 2000(Act 592) and the Minerals and Mining Act 2006 (Act 703). This incentive allows businesses with capital expenditure to depreciate the value of any prescribed physical capital other than cash invested over the years of operation or use for tax purposes. The rates of allowable depreciation are categories in six (6) classes of assets for application. These are:

*Table 1: A Table of Capital Allowance Classification*

| Class of Asset | Applicable rate (%) | Description |
|---|---|---|
| 1 | 40 | Computers and data handling equipment. |
| 2 | 30 | Automobiles, construction and earth-moving equipment, heavy general purpose |
| 3 | 80 | Assets referred to in subparagraph (3) in respect of long term crop planting costs. |
| 4 | 20 | Mineral and petroleum exploration and production rights assets |
| 5 | 10 | Buildings, structures and works of a permanent nature |
| 6 | Projected life-span | Railroad cars, locomotives, and equipment; vessels |

## 3.4 Carry Forward Losses

On the basis that companies may make losses and therefore they must be induced to take the risk of investment, carrying losses forward has become a major type of tax incentive offered in Ghana[5]. The provision states in section 22 of the Act (592) that, "for the purposes of ascertaining the income of a person for a basic period from agro processing, tourism, information and communication technology[sic] farming, manufacturing or mining business there shall be deducted, for a period of five years, a loss of the previous five basic periods incurred by that person in carrying on that business; and (b) where that person has incurred more than one such loss, the losses shall be deducted in the order in which they were incurred". The incentive, however, has some notable variations. For instance, with the exception of the insurance sub-sector enjoying a limitless period of this incentive, other businesses have a fixed period, usually 5 years to carry forward losses. These categories of businesses are therefore required to set-off their losses against their income in any accounting year for a maximum period of 5years. For businesses in the Tourism sector, they

[5] Internal Revenue Act 2000 (ACT 592) as amended(Act 700,2006)

only qualify for this exemption if they are registered with the Ghana Tourist Board. Likewise for the ICT sub-sector, only software developers enjoy this incentive.

## 3.5 Export Processing Zones (Free Zones)

The Free Zone regime was created by the Free Zone Act, 1995 (Act 504). Under the Act the imports of a free zone company are exempt from the payment of all indirect taxes and duties. In addition free zone companies enjoy a tax holiday of 10 ten years from the payment of income tax on profits. After the expiration of the stated holiday period, a free zone company pays corporate tax on profits at the reduced rate of 8%, while shareholders are exempt from the payment of withholding taxes on dividends arising out of free zone investments.

Companies operating under the Free Zones dispensation enjoy relief from double taxation for foreign investors and employees where Ghana has a double taxation agreement with the country of the investors or employees. Currently double taxation agreement has been ratified with France and The Netherlands. The relief is enjoyed exclusively by foreign investors and their expatriate workers.

Notable features of Ghana's Free Zones dispensation are that:

1. Companies are only required to produce 70% of the output for export, while the rest of their business can be carried out within the domestic market upon the payment of relevant taxes;

2. The fact that Free zone companies carry out part of their activities on the domestic market creates opportunities for the abuse of the dispensation, especially where monitoring and regulation are known to be weak. There is a high risk of goods produced in the Free Zones enclave being smuggled to the domestic market.

While a specially created Free Zone territory exists near the Tema port, companies can also apply for Free Zone status in any location across the country. This provision in the Free Zones Act makes monitoring more challenging. The Free Zone Act (Act 504) and its implementing regulations particularly provide relief from various bureaucratic bottlenecks and other statutory requirements such as expedited investment approval not exceeding 28 working days; an unimpeded issuance of expatriate work and residence permits; accelerated on-site customs inspection etc.
They are also given assurances of lower wage levels for employees though not below the recommended minimum wage prevailing in Ghana at any given time[6]. The Free Zones regulations (LI 1618) of the Act also make it possible for free zone developers and operators

[6] Freezones Act 1995, Act(504)

to lease land on long-term basis from the Free Zones Board, or propose properties they already own for the creation, development and operation of free zones.

**Table 2: Total C.I.F (Cedi) value of imports for all free zones by year**

| Year | F.O.B Cedi | C.I.F Cedi | Amount Assessed | Amount Exempted |
|---|---|---|---|---|
| 2002 | 58,719.34 | 68,181.91 | 0.00 | 12,269.13 |
| 2003 | 99,192,833.68 | 109,829,211.09 | 0.00 | 27,811,400.39 |
| 2004 | 139,355,167.76 | 160,304,639.82 | 3,642.57 | 38,046,885.84 |
| 2005 | 561,989,927.13 | 679,536,631.85 | 13,512.92 | 221,957,862.86 |
| 2006 | 192,149,487.69 | 230,915,653.27 | 28,706.80 | 59,237,167.07 |
| 2007 | 158,811,933.18 | 182,391,313.94 | 7,292.44 | 44,980,928.76 |
| TOTAL | 1,151,558,068.78 | 1,363,045,631.88 | 53,154.73 | 392,046,514.05 |

**Table 3: Total fob Value of Exports for all Free Zones by Year**

| Year | F.O.B Cedi | C.I.F Cedi | Amount Assessed | Amount Exempted |
|---|---|---|---|---|
| 2003 | 390,204.11 | 390,204.11 | 0.00 | 0.0 |
| 2004 | 54,351,975.03 | 54,351,975.03 | 14,993.09 | 120,528.58 |
| 2005 | 56,382,368.47 | 56,382,368.47 | 0.0 | 56,658.00 |
| 2006 | 84,835,690.70 | 84,835,690.70 | 0.0 | 60,177.59 |
| 2007 | 307,262,705.20 | 307,262,705.20 | 0.0 | 20,274.94 |
| TOTAL | 503,222,943.51 | 503,222,943.51 | 14,993.09 | 257,637.11 |

Source: ATSG Draft Report on Development of the CEPS Free Zones Unit (2008): In Ayine (2009)

**Table4: US$ Value of CIF Imports and Exports (2008-2013)**

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| Total CIF Value of Imports( US$) | 727,116,133.39 | 348,212788.35 | 316,685,908.53 | 385,681,724.79 | 980,466,249.02 | 220,212,834.58 |
| Total CIF Value of Exports (US$) | 131,028,3069.11 | 135,607,4171.96 | 170,810,9241.51 | 198,064,8156.14 | 14,442,598,720.41 | 11,182,378,328.47 |
| Net CIF Value of Export($ US | 583,166,935.72 | 1,007,861,383.61 | 1,391,423,332.98 | 1,594,966,431.21 | 13,462,132,470 | 10,962,165,490 |

Source: Ghana Free Zones Board Research Division (2014)

Tables 2 &3 above show the C.I.F and F.O.B value of imports and exports from the Free Zones area in Ghana between 2002-2007 quoted in Ghana Cedis, while table 4 shows the C.I.F value of imports and exports between 2008 and 2013 valued in US Dollars.

The C.I.F is the Cost of Insurance and Freight which when added to the base cost of an import or export basically increases the overall taxable base. F.O.B, on the other hand, is the Free on Board cost of an import or export, which implies there is no applicable tax included in the original base cost of import or export.

The table shows an improved trend from 2008 to 2013(table 4) compared to the pre-2008 data shown in tables 2&3. For instance according to Ayine (2009), the F.O.B value of imports for all the other years exceeded the export value except for 2007 where the F.O.B value of exports exceeded the C.I.F value of imports with GH¢ 307,262,705.20 as against GH¢182,391,313.94. The shortfall in the total imports as against total exports from 2002 to 2006 therefore amounted to GH¢859,822,688.37. At the same time, a total of US$ 29 billion ($29,001,716,043.52) net export CIF value generated between 2008 and 2013 seem to dwarf the initial losses stated above. While there are many other concerns about the Free Zones operations in Ghana, this data set shows a positive outlook in monetary terms, which cannot be overlooked.

It is however revealing that, at the same time that a positive out-turn is being reported from the Free Zones, Ghana is still recording trade deficit. In the second quarter of 2013 the

country recorded a trade deficit of 335.80 USD Million. According to Bank of Ghana data, the country's Balance of Trade averaged -650.10 USD Million from 2003 until 2013, reaching an all time high of 584.22 USD Million in the first quarter of 2010 and a record low of -638.10 USD Million in the third quarter of 2012.

These facts may in part support the widespread suspicion that substantial quantities of goods produced in the Free Zones jurisdiction find their way to the local markets, defeating in the process, the objective (export drive) of their establishment. The Ghana Free Zones Act provides that at least 70% of annual production of goods and services of Free Zone Enterprises must be exported, and up to 30% of annual production of goods and services authorized for sale in the local market.

## 4.0 TRADE-RELATED TAX EXEMPTIONS

Ghana's trade policy is aimed at enhancing international competitiveness and securing greater market access for Ghana's products and services[7]. This policy is hinged on the objective of making imports less attractive (an import substitution rationale) and promoting exports to increase foreign exchange earnings and to achieve trade balance as an end goal in this respect. Taxes on the export of goods and services therefore have seen appreciable decline as a result of exemptions and rebates, while those on imports have seen substantial surge over the years.

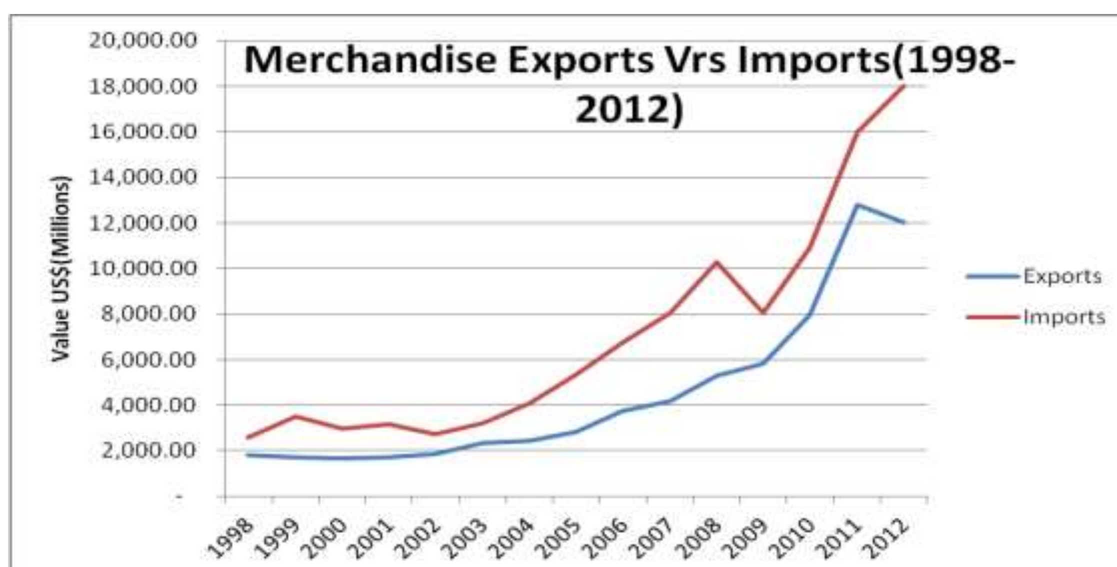
The country's trade incentive regime as discussed above hinges on opening-up the economy and promoting an export-led economic development[8]. While the country's strategy may have achieved some desired outcomes with considerable increases in aggregate exports from about US$2.0 billion in 2000 to about US$12billion annually in 2011, this is however, more than matched by imports, negating the overall trade balance. This fact raises serious questions about the effectiveness of tax policy as a tool for regulating consumption and therefore controlling or stemming import volumes. Figure 1 below shows total merchandise exports versus imports between 1998 and 2012. Considerable gap still remains even upon a range of incentive since 2000 to overturn the balance.

At the same time the share of trade taxes as a percentage of total revenues declined over the same period as shown in figure 2 below. This idea is hinged on a fundamental Ghana Government's policy over the years to make imports less attractive (an import substitution objective) and to promote exports as to increase foreign exchange earnings and to achieve trade balance as an end goal in this respect. Unfortunately, tax policy was the conveniently available tool to achieve this goal, as it was closely linked to the trade liberalisation agenda; it became more and more justifiable.

[7] World Trade Organisation (http://www.wto.org/english/tratop_e/tpr_e/tp159_e.htm)

[8] Fjeldstad (2013: p.4) Taxation and development: A review of donor support to strengthen tax systems in developing countries UNU World Institute for Development Economics Research (UNU-WIDER) Katajanokanlaituri 6 B, 00160 Helsinki, Finland :" Governments in developing countries have been urged to desist from using taxation to try to mobilize savings or to transfer resources from agriculture to non-agriculture; to rely less on revenue from easily-taxable imports and exports; and to place less emphasis on using high marginal tax rates in the effort to reduce income and wealth inequality"

## Figure 1: Ghana's Trade Balance Policy (1998-2012)




Source: World Bank Database

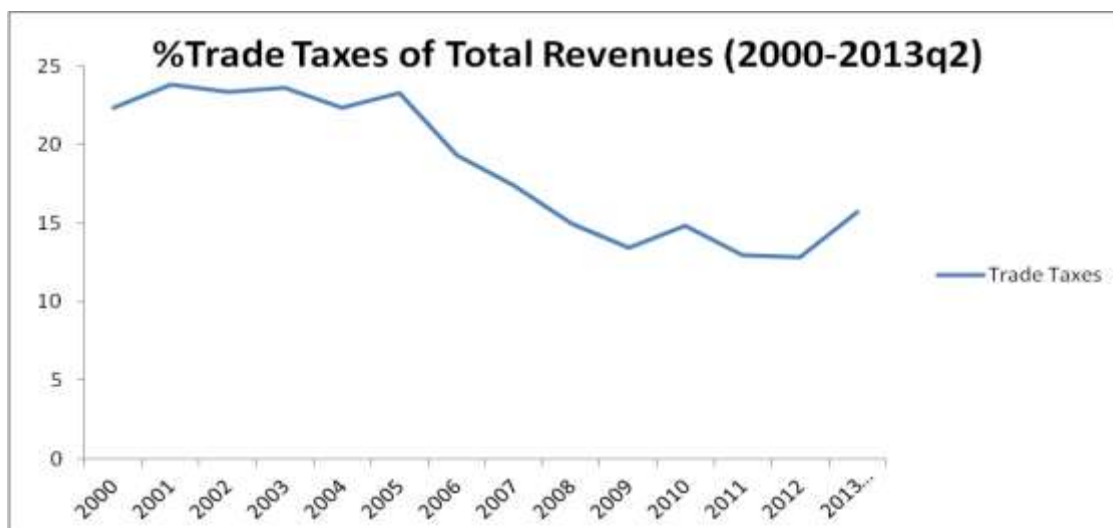
The impact of this strategy is seen in figure 2 below where trade related taxes consistently declined from a plateau between 2001 and 2005 to 2012 before inching-up marginally between 2012 and 2013. Table 1 and figure 2 below shows the extent to which share of taxes from trade declined over the last decade. The share of trade taxes a percentage of total revenues was around 22% and 23% between the year 2000 and 2005 but since declined to about 12.83% in 2012.

### Table 5: International Trade Taxes as a % of Total Revenues (2000-13)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 q2 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Trade Rev. | 22.35 | 23.79 | 23.34 | 23.62 | 22.33 | 23.29 | 19.31 | 17.41 | 14.97 | 13.44 | 14.82 | 12.98 | 12.83 | 15.69 |
| Import Duties | 81.88 | 80.74 | 81.51 | 74.92 | 75.28 | 76.96 | 84.57 | 94.19 | 94.4 | 97.8 | 91.74 | 99.67 | 94.81 | 75.99 |
| Export Duties | 18.12 | 19.26 | 18.49 | 25.08 | 24.72 | 23.04 | 15.42 | 5.81 | 5.56 | 2.2 | 8.26 | 0.33 | 5.19 | 24.01 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Ayine (2009); National Budget (2007-2013)

**Figure 2: Percentage Trade Taxes of Total Revenues (2000-2013)**




Source: Ghana National Budget (2008-2013Q2; Ayine, M. D. (2009)

The conglomerate of tax incentives outlined above also shows the extent of Government policy towards investment and the use of tax incentives as the tool to achieve these objectives. The whole policy perspective has its roots in a dominant global thinking where countries are encouraged to open up and enhance their investment environment, fuelling the "race to the bottom phenomenon"[9]. The selling point is to attract Foreign Direct Investment as a catalyst for job creation and improvement in the fiscal space for governments. The reality however is that, the view is associated with neo-liberalism and structural adjustment, and is largely unsupported by empirical evidence - no country has indeed developed economically through low taxes, the situation that the "race to the bottom" has brought many a poor country reliant exclusively on FDI flows for its development.

Since the early 2000s the Ghana government trade policy resulted in the rationalization of tariff lines mostly to satisfy WTO rules and to promote foreign direct investment to drive export[10]. In the Ghana Government's own statement, since 2001 merchandise export and import have increased by 17% and 14.9% respectively in 2008[11]. However, the associated share of trade taxes fell in the period in excess of US$234.8 million

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[9] Fjeldstad (2013: p.3) Taxation and development: A review of donor support to strengthen tax systems in

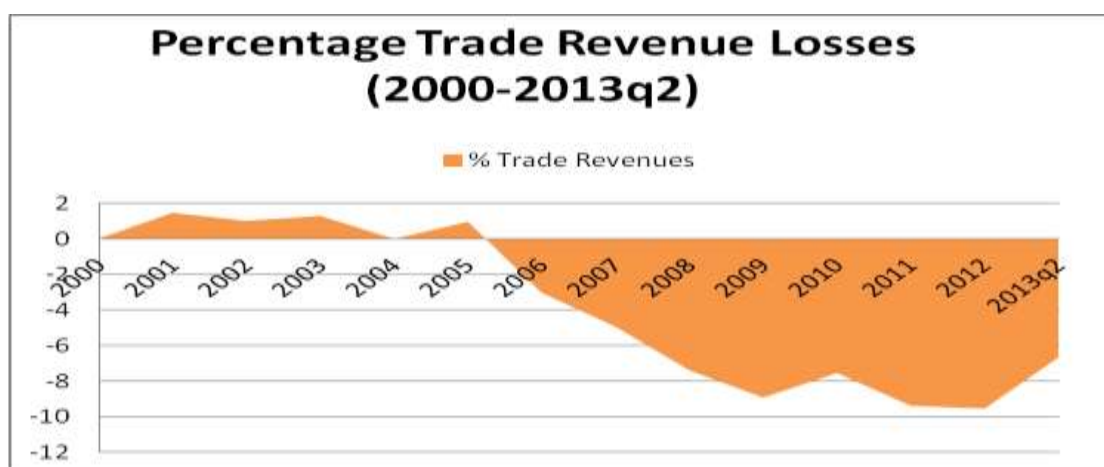
developing countries UNU World Institute for Development Economics Research (UNU-WIDER) Katajanokanlaituri 6 B, 00160 Helsinki, Finland

[10] Ghana trade policy review(2008),WT/TPR/S194/Rev.1, World Trade Organisation

[11] Ghana trade policy review(2008),WT/TPR/S194/Rev.1, World Trade Organisation

(Figure 3 below)[12] . This is also evidenced by the fact that since 2007, the applied average most-favoured-nation or MFN rate has fallen to 12.7%, down from 14.7% in 2000[13]. Around this period the estimated tax losses mainly as a result of the incentive policies calculated on the basis of the variance between the year 2000 trade tax percentage figure of 22.35% as a percentage of total revenues from 2008-2013 is shown in figure 3 below.

## Figure 3: Percentage Trade Revenue Losses over a Period




These graphs show a substantial area of taxes forgone as a result of lower trade tax ratios as a percentage of total revenues since 2000. Likewise the table below shows the variances over the years as trade taxes declined through these incentive policies. Also, on the basis of the year 2000 figure, overall trade taxes are estimated to have declined at a cumulative amount of 49.73% between 2008-2013 resulting in a loss of about Ghc 422.6 million (US$234,812,463) of revenues at current prices.

**Table 6: ANNUAL TRADE TAX EXEMPTIONS**

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013q2 |
|---|---|---|---|---|---|---|
| Amount(Ghc million) | 475.6 | 318.4 | 386.4 | 634.5 | 778.9 | 370.4 |

Source: National Budget and Economic Policy Statement (2008-2013)

[12] National Budget

[13] Ghana trade policy review(2008),WT/TPR/S194/Rev.1, World Trade Organisation

### Table 7:Trade Revenue Drop (2000-2013q2) as Percentage of Total Revenue

| Year | Percentage Revenue | Reference % Revenue | %Revenue Variance | Total Realisable Revenue | %Revenue Forgone |
|---|---|---|---|---|---|
| 2008 | 14.97 | 22.35 | -7.38 | 354,417,586.4 | 26,156,017 |
| 2009 | 13.44 | 22.35 | -8.91 | 499,310,322.2 | 44,488,549 |
| 2010 | 14.82 | 22.35 | -7.53 | 579,796,786.8 | 43,658,698 |
| 2011 | 12.98 | 22.35 | -9.37 | 1,195,195,098 | 111,989,780 |
| 2012 | 12.83 | 22.35 | -9.52 | 1,583,499,315 | 150,749,134 |
| 2013 | 15.69 | 22.35 | -6.66 | 684,988,843.7 | 45,620,256 |
| Total %Variance | | | -49.37 | | (422,662,434) |

Source: The Budget Statement and Economic Policy of Ghana (2000-2013 )

## 4.1 Other Tax Exemptions

In addition to the many tax incentives provided to businesses, there are also other tariff-based incentives that cover a wide range of imports. These cover specific goods which are not liable to import duty. For example goods and services imports of the president of Ghana, the blind, deaf and dumb, churches and religious bodies. They also include trade fairs and exhibitions, advertising matter, passengers' personal baggage and effects, educational, cultural and scientific materials of a broad range of types and those imported by the United Nations or its Agencies, fishing floats and gear as approved by the Commissioner[14] all qualify as exempt. Also there are exemptions targeting specific goods for specific uses such as: Volta Aluminium Company Ltd (VALCO); Volta River Authority (VRA); The British Council, infants' foods; machinery, apparatus and spare parts for agricultural purposes; chemicals for agricultural purpose as certified by the Ministry of Agriculture.

[14] Source: These exemptions are provided in the Customs, Excise and Preventive Service 1 (Management) (Duties, Rates and Other Taxes) Act, 1994 (Act 476) Parts A and B of the Third Schedule.

This group of incentives, particularly those for the presidency, are a subject of debate because it is believed to be opened up for serious abuses by person's acting on behalf of the presidency etc. Even though the law provides for prior Parliamentary approval, the practice over the years has been reduced to administratively securing permits from the sector ministry to benefit from the exemptions. The discretionary nature of the facility, which does not limit sector agency sponsorship or approval leads to systemic abuses resulting in huge losses of revenue to the state[15]. This is confirmed by the Minister of Finance in the 2014 budget and economic policy statement (section 111: p 41) promising to reduce all existing exemptions resulting from the clearance of goods on permit to the minimum.

The discretionary feature is given even more prominence in the current GIPC Act 2013(865). The Act in section 26(1), whiles deferring to the Internal Revenue Act, 2000 (Act 592), the VAT Act 1998(Act 546) and supported by Chapters 82,84, 85 and 98 of the Customs Harmonised Commodity and Tariff Code scheduled to the Customs, Excise and Preventive Service (Management ) Act, 1993(P.N,D.C.L 330), and any other law, further states in subsection (2) that "An enterprise whose plant, machinery, equipment or parts of the plant machinery or equipment are not zero-rated under the Customs Harmonised Commodity and Tariff Code scheduled to the Customs, Excise and Preventive Service(Management) Act, (1993) may submit an application for exemption of import duties, sales tax or excise duties on the plant, machinery, equipment or those parts to the Centre.

Also, the Act states in sub-section (4) that, for the purposes of promoting identified strategic or major investments, the Board of GIPC may, in consultation with the appropriate state agencies determined by the Board and with the approval of the President, negotiate specific incentive packages in addition to the incentives provided under section 23 for the period specified by the Board[16]. These provisions have done little to stem the discretionary features of the tax incentive system.

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[15] Value Added Tax 1998Act(546): Schedule 1&3

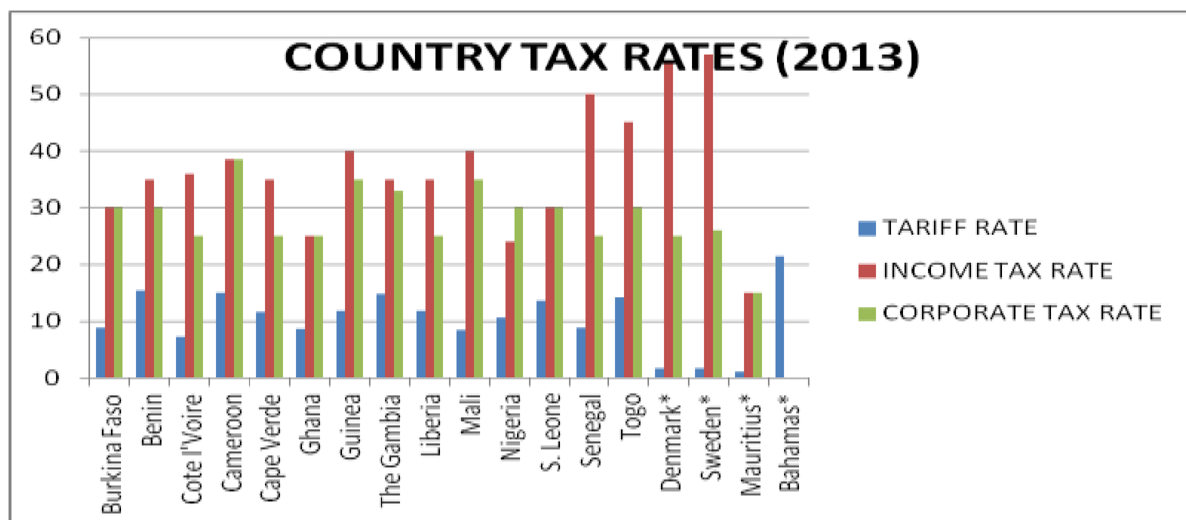
[16] GIPC Act 2013, Act (865)

## *5.0 TAX COMPETITION IN THE SUB-REGION (ECOWAS)*

The result of individual country economic and trade policies inevitably leads to tax competition amongst countries with similar development challenges, especially when the same prescriptive policies are hailed as the holy grail of economic emancipation. In the ECOWAS region, tax competition is particularly rife in the natural resource and agriculture sectors where there exist huge opportunities for investment. For example, in the mining area, Ghana, Guinea, Burkina Faso and Mali compete for FDI and in the agriculture sector, Ghana, and Cote d'Ivoire compete in cocoa export and value addition etc.

The overall tax application in the ECOWAS sub-region is shown in figure 4 and table 8 below. Also in asterisks (*) are Denmark and Sweden as high tax countries and Mauritius and Bahamas as low tax countries. These are to give perspective to tax competition in the ECOWAS region. From the figure below, it is obvious that Ghana has the lowest overall tax rate of 8.6%; 25%; 25% for tariff, income and corporate taxes respectively. In the tariff category, it is only Cote d'Ivoire and Mali that have lower tariff rates of 7.3% and 8.4% respectively and Ghana's 8.6%. The overall tax burden shown in table 7 indicates that Burkina Faso (7.8), Cameroon (10.3), Sierra Leone (11.6) and Ghana (12.1) in that order are the most competitive in terms of tax burden within country. "Tax burden" developed by Heritage Foundation is a measure of the average weighting of all applicable statutory taxes in a country in relation to the country's GDP per capita.

**Figure 4: RELATIVE TAX RATES IN SPECIFIC COUNTRIES**




Source: Heritage Foundation (http://www.heritage.org/index/explore?view=by-variables :(2013 Index Economic Data)

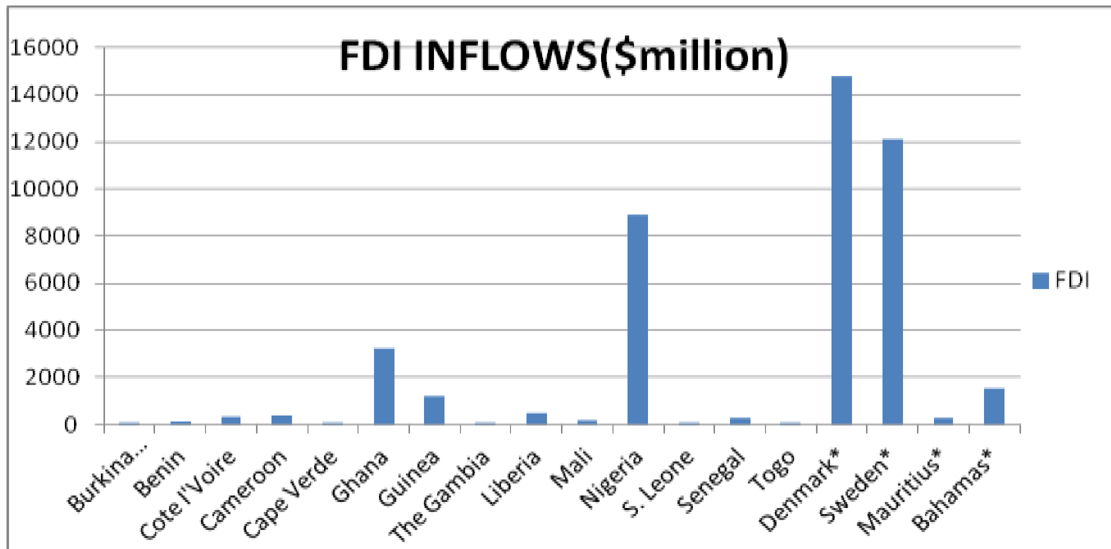
## Table 8: Tax Indicators for the Selected Countries

| Country | Tariff Rate | Income Tax Rate | Corporate Tax Rate | Tax Burden (Index) | FDI (million) |
|---|---|---|---|---|---|
| Burkina Faso | 8.8 | 30 | 30 | 7.8 | 7.4 |
| Benin | 15.4 | 35 | 30 | 16.2 | 118.5 |
| Cote I'Voire | 7.3 | 36 | 25 | 17 | 344.2 |
| Cameroon | 15 | 38.5 | 38.5 | 10.3 | 360 |
| Cape Verde | 11.6 | 35 | 25 | 19.1 | 93.1 |
| Ghana | 8.6 | 25 | 25 | 12.1 | 3222.3 |
| Guinea | 11.9 | 40 | 35 | 14.7 | 1210.8 |
| The Gambia | 14.8 | 35 | 33 | 13.2 | 36 |
| Liberia | 11.8 | 35 | 25 | 22.2 | 508 |
| Mali | 8.4 | 40 | 35 | 14.6 | 177.8 |
| Nigeria | 10.6 | 24 | 30 | 16.3 | 8915 |
| S. Leone | 13.6 | 30 | 30 | 11.6 | 48.7 |
| Senegal | 8.9 | 50 | 25 | 18.8 | 286.1 |
| Togo | 14.2 | 45 | 30 | 15.1 | 53.8 |

Source: Heritage Foundation

In terms of foreign direct investment (FDI) for 2012, Nigeria leads with US$ 8915 followed by Ghana with US$3222.3 million dollars. Guinea also received significant inflows of US$1210.8 million in 2012. The high figures for these three countries, Nigeria, Ghana and Guinea can be explained by their significant natural resource base and perhaps a coincidence of high investment in this sector during this period. Particularly for Ghana, this can be attributed to a significant investment in Ghana's new found oil industry between 2010 and 2012.

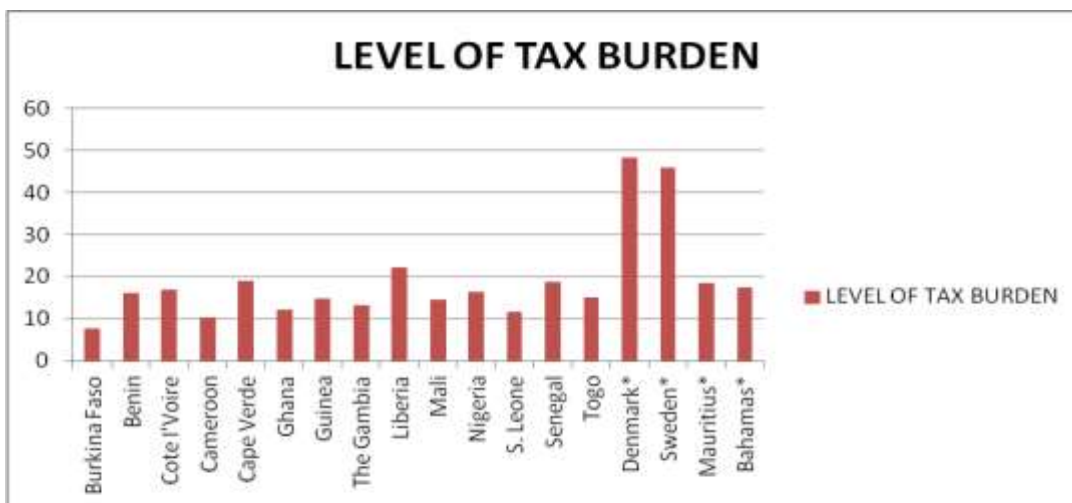
## Figure 5: REGIONAL FDI INFLOWS (2013)




*Countries outside West Africa with peculiar tax policies

Source: Heritage Foundation

## Figure 6: COMPARISON OF THE TAX BURDEN IN WEST AFRICA




Source: Heritage Foundation

## *6.0 AN ANALYSIS OF THE TAX EXEMPTION SYSTEM IN GHANA*

This chapter looks at the entire fiscal landscape of Ghana from both the policy angle and impacts. Tax related data from a variety of sources including the National Budget, Heritage Foundation, World Bank and Ministry of Finance was used. In order to quantify which category of taxes constitutes a majority of exemptions in the tax incentives basket, the overall percentage value of two categories of taxes as a percentage of total revenue and less grants, was determined. These categories are

1. profit, income and capital gain tax, VAT and
2. Trade taxes.

These two categories of taxes constitute the major source of tax revenues for Ghana, with a total value of Ghc 7.5billion (60.5% of tax revenues) in 2012. By categorising all the above listed incentives into two broad categories, we have the direct tax and the trade tax incentives. Significantly in the trade related tax exemption category are the discretionary exemptions targeting particular end-users and specific goods and services[17]. The biggest beneficiary of this kind of exemption is the President's office, which has been noted as open to abuses. This result is hugely consistent with the overall decline of trade related taxes[18] between 2000 to 2013 as shown in Figure 2 and 3 above.

## 6.1 Overall Tax Losses

The 2013 Budget and Economic Policy Statement of the Government of Ghana estimates that Ghana's tax expenditure is about 3.28 per cent of GDP[19]. Also in the 2014 budget, this figure has been re-adjusted to 2.1% of GDP. It is, therefore, estimated that in 2012, Ghana lost about Ghc 2.4 billion (US$1.2billion) as a result of tax incentives, equivalent to the total health sector budget for the year. This estimate shows that in the year 2012 alone, Direct tax and VAT exemptions amounted to US$ 876 million. This is about 67% of all exemptions with trade related exemptions making up 33% of all tax exemptions in 2012(see Table 1 below).

Taking the GDP base between 2012-2014, and an annual tax expenditure of between 3.28-2.1% of GDP means Ghana is losing close to about Ghc 2.4 billion (US$1.2billion) annually as a result of tax incentives. However, an analysis of the percentage component of total revenues given as incentives in the different categories shows that in 2012, 41% of trade tax revenues are lost through exemptions compared to 28% of direct tax and VAT revenues

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[17] Customs, Excise and Preventive Service (Management) (Duties, Rates and Other Taxes) Act, 1994 (Act 476).

[18] Supporting the Development of More Effective Tax Systems: A report to the G-20 Development Working Group by UN, World Bank, IMF,OECD (2011), p.18.

[19] 2013 National Budget Statement, section 207

which are also lost through exemptions. This shows that the incentive policy is much more skewed towards trade related taxes compared to the direct tax component. It could also be that the easy administration of the tax exemption and claiming process makes it more accessible and therefore the higher percentage.

### Table 9: ANNUALISED TAX EXEMPTIONS IN GHANA (2012)

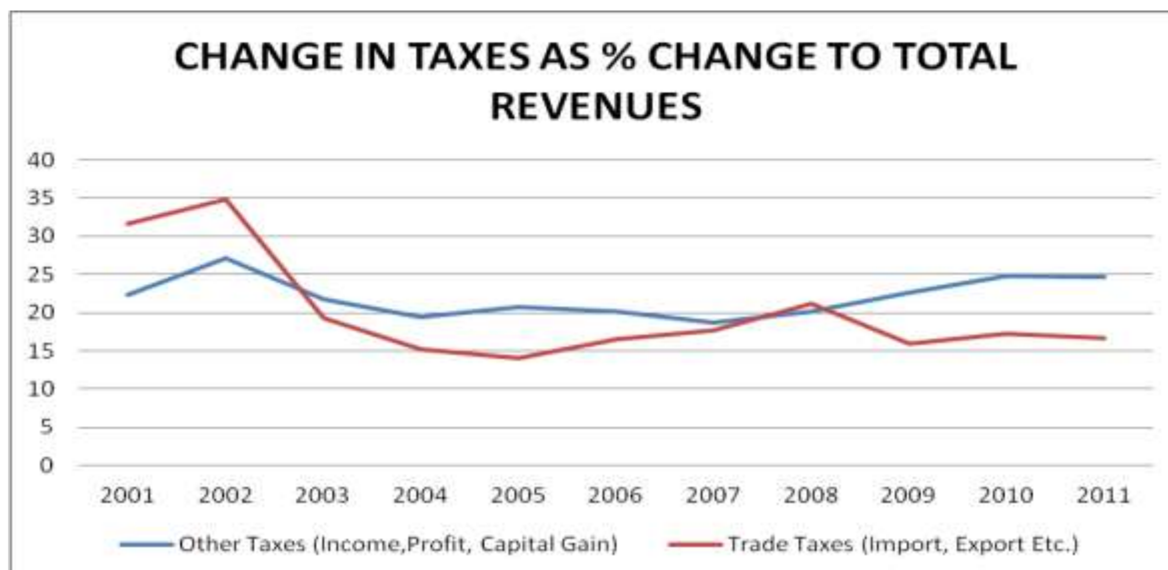
| ITEM | Percentage Exemptions (%) | Amount US$(Millions) |
|---|---|---|
| Total Exemptions | 100 | 1,309 |
| Total Direct Tax and VAT Exemptions | 67 | 876 |
| Total Int'nal Trade Tax Exemptions | 33 | 432 |
| % of Total Direct Income Tax and VAT Exemptions to Revenue | 28 | 876 |
| % of Total Trade Tax Exemption to Revenue | 41 | 432 |

Source: 2013 Ghana National Budget Statement

It can be shown in figure 7 below that the impact of the different categories of incentives changed over time, perhaps as a result of policy changes or emphasis. The analysis shows that before 2001, trade related taxes outperformed direct taxes as a percentage of total revenues. The convergence of these revenues occurred in 2003 with an equal share of about 22.5% apiece and also in 2008. However, while direct tax revenues have remained relatively steady over the period 2003 to 2008, trade tax revenues on the other hand have gone through wide swings from a high of 35% in 2002 to a low of 14% in 2005.

Also since 2003, direct tax revenues continue to outperform trade tax revenues as shown below. This is yet another indication of the impact and emphasis of the fiscal regime on trade liberalisation with trade taxes, which before 2000 were the biggest source of national tax revenues, are now well behind direct taxes. According to Ayine (2009), taxes on international trade as a proportion of total revenue averaged 38.8 per cent for the period 1980-93 and 32.1 per cent between 1996 and 1998.

**Figure 7: The Trend in Changes in the Contribution of Taxes to Total Revenue (2001-2011)**




**Source: World Bank database (**[http://data.worldbank.org/](http://data.worldbank.org/))

## *7.0 THE IMPACT OF TAX EXEMPTIONS*

Tax exemptions are typically offered to influence investment and consumption decisions of businesses and people. For developing countries such as Ghana, tax exemptions have been applied mainly for the purposes of influencing business investment decisions as well as attracting foreign direct investment[20]. The economic impact of exemptions has however been a mixed bag[21]. It is becoming clearer that business decisions in terms of direction and quantum of investment is swayed more in favour of factors other than tax exemptions[22].

Currently, estimates of the true policy impact of exemptions have largely been based on anecdotal evidences[23]. Until empirical study proves this beyond the data on FDI amounts, these assertions will remain value judgements. It is, however, possible to estimate the opportunities forgone on the basis of monetary value. In Ghana and particularly for the Free Zones areas, government likes to state economic impacts on the basis of the number of jobs gained in the area as well as the amount of FDI brought into the country.

Going by this approach, it can be argued that definitely some positive impacts such as job creation, increased FDIs etc arise from the exemption regimes. However, if the measure is to address trade imbalances, then the strategy could be deemed to have failed because Ghana still records trade deficits. This view is buttressed by the fact that from 1998 to 2012, Ghana's trade balance continued to show deficit (See figure 1) above. On the other hand, the low wages and the frequent abuses by companies under the Free Zones dispensation also discredit the benefits of the initiative.

Moreover, the impact of exemptions within the context of the amount of FDI received into the country cannot be a straight forward measure since many other factors come into play. For example, according to Heritage Foundation Data, Ghana outperformed many of her West African counterparts in the total amount of FDI won in 2012[24] .The amount correlates

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[20] Ghana investment Promotion Centre Annual report (2012)

[21] Supporting the Development of More Effective Tax Systems: A report to the G-20 Development Working Group by UN, World Bank, IMF,OECD (2011), p.19.

[22] van Parys, S. and S. James (2009). 'Why Tax Incentives may be an Ineffective Tool to

Encouraging Investment? - The Role of Investment Climate' (December)

[23] Fjeldstad (2013: p1) Taxation and development**:** A review of donor support to strengthen tax systems in developing countries UNU World Institute for Development Economics Research (UNU-WIDER)

Katajanokanlaituri 6 B, 00160 Helsinki, Finland

[24] GIPC Report (2012)

positively to the relatively lower tax burden (table 7) of Ghana compared to her neighbours. This, however, is not so when compared to Nigeria, which has a relatively higher tax burden yet had considerable FDI compared to Ghana. Nigeria's relatively huge size and highly exploited oil resources may explain this anomaly. Also, the 2012 UNCTAD FDI Attraction and Potential index, which rated Ghana at 16th as against Nigeria's 23rd, position in the sub-region[25].emphasises this anomaly.

Ghana's case is exceptional because between 2010 and 2012, significant Oil and Gas sector activities received so much investment[26] due mainly to a resource boom.

The premise for the location of tax incentives is very contestable. For instance, according to the GIPC, figures for 2012, 79.8% of total FDI received, worth about 80% of total value, were located in the Greater Accra Region alone[27]. The regional distribution of such inflows has not confirmed a positive impact of incentives on investment decisions. For instance, investment in other regions other than Accra has location incentives that sometimes outstrip the Greater Accra region by more than 80% tax rate. The table below shows the concentration of investment in Accra as oppose to other regions with comparatively higher tax incentive packages.

**Table 10: FDI Distribution in Ghana (2012q4-2013q2)**

| | 2013q2 | | 2013q1 | | 2012q4 | |
|---|---|---|---|---|---|---|
| Region | Number of registered projects | Estimated value of registered projects ($million) | Number of registered projects | Estimated value of registered projects ($million) | Number of registered projects | Estimated value of registered projects ($million) |
| Ashanti | 8 | 2.51 | 5 | 4.33 | 4 | 1.32 |
| Brong Ahafo | 2 | 2.54 | 2 | 7.6 | 1 | 0.8 |
| Central | 2 | 1.47 | 2 | 1.8 | 1 | 0.23 |
| Eastern | 1 | 0.41 | - | | 1 | 2.54 |

[25] GIPC Second Quarterly Report (2013)

[26] GIPC Report 2012

[27] GIPC Quarterly Report (2012q1-q4)

| | | | | | | |
|---|---|---|---|---|---|---|
| Greater Accra | 78 | 256.92 | 76 | 263.92 | 75 | 568.85 |
| Northern | 1 | 0.05 | - | | 1 | 0.34 |
| Upper West | 1 | 0.01 | 1 | 0.15 | - | - |
| Volta | 3 | 10.71 | 2 | 1.03 | - | - |
| Western | 9 | 9.35 | 6 | 15.85 | 11 | 82.96 |
| Total | 105 | 283.96 | 94 | 294.68 | 94 | 657.04 |

Source: GIPC Quarterly Reports (2012q4-2013q2)

This goes to attest to the fact that other factors such as the infrastructural network or availability of skilled workforce and the political environment play a significant role in investment decisions[28]. Also, considering the amount forgone in given exemptions, it can be hard to justify such give-aways just on the grounds of investment made. For example, Taking the GDP base between 2012-2014, an annual tax expenditure of between 3.28-2.1% of GDP means Ghana is losing close to about Ghc 2.4 billion (US$1.2billion) annually as a result of tax incentives. This amount is equivalent to about twice the entire Government of Ghana health budget for 2013 and about half the entire education budget. Certainly, there is the need to invest in sensitive sectors of the Ghanaian economy.

## 7.1 Foreign Direct Investment

Attraction of Foreign Direct Investment (FDI) has been a main feature of Ghana's Economic Recovery Program, which started in 1983 under the auspices of the World Bank and the IMF. Encouraging foreign investment in Ghana is therefore an integral part of Ghana's economic policy. This policy has also become a basis for Ghana's foreign policy. Ghana embarked on a privatization program which has resulted in the sale of about two-thirds of approximately 300 state-owned enterprises. Foreign firms comprise most of the bidders for these businesses. Few local investors participate in this process except in partnership with foreign firms because of an inability to raise sufficient capital.

The growth and determinants of FDIs are subjects that require more research but available studies all support the fact that both global and local/national factors influence the flows of

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[28] van Parys, S. and S. James (2009). 'Why Tax Incentives may be an Ineffective Tool to

Encouraging Investment? - The Role of Investment Climate' (December)

FDIs. Indeed, according to Cheng et.al, (2004), UNCTAD's report of 2002, has it that the "total stock of FDI in the world increased from US$763.4 billion in 1985 to US$4015.3 billion in 1998, and the total FDI stock as a percentage of the world's total GDP increased from 6.7% in 1985 to 14% in 1998. In developing countries, the percentage increased from 9.1% in 1985 to 20% in 1998". The global determinants of FDIs are commonly stated as the spate of globalisation and growth of capital markets facilitating cross border flows. But chiefly among the local factors, Obwona (2005) and Albuquerque et al., (2004) who wrote on determinants of FDIs in Uganda and International trade respectively, all agreed that growth in local productivity, financial depth, low Government burden, macroeconomic stability and political stability are important domestic drivers of FDIs.

Also, considering the Ghana data, it is obvious that most companies prefer to locate their businesses in either Accra or Tema for reasons which include the availability of social amenities such as good schools and hospitals, roads and access to public services. This observation dampens the impact of the tax incentives a major attraction for Foreign Direct Investment in Ghana and elsewhere.

Table 11 below shows the amount of FDIs accrued between 2010-2013q3. In 2010, the total amount received was US$1.1 billion as compared to US$6.8 billion in 2011. This figure declined to US$4.9billion in 2012. It is difficult to attribute this amount wholly to tax incentives because many other factors as stated above also influence investment decisions. However the sudden jump in FDIs between 2010 &2011 corresponds favourably to the resource boom as in the gold sector and a significant increase in oil and gas activities in Ghana during this period.

### Table 11: TOTAL FOREIGN DIRECT INVESTMENT (FDI) WON IN GHANA 2011-2013 (US$/ Millions)

| QUARTERS | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| | | | | |
| **1 Q** | 161.3 | 351.7 | 979.7 | 285.2 |
| **2 Q** | 599.3 | 552.2 | 1540 | 562.0 |
| **3Q** | 216.7 | 3220 | 1860 | 2680.6 |
| **4Q** | 131 | 2690 | 524.7 | |
| **Total** | **1108.3** | **6813.9** | **4904.9** | **3242.7** |

**Source: Ghana Investment Promotion Centre Quarterly Reports (2011q1-2013q3)**

# *8.0 CORPORATE CASES OF TAX LOSSES IN GHANA*

## 8.1 The Petroleum Sector

Over the past two years Ghana has lost about US$70[29] million in the Oil and Gas sector alone as a result of the country's inability to apply the Capital Gain Tax provision in the Internal Revenue Act, 2000(Act 592). Whether it is intended or not, the Ghana Petroleum Model Agreement has which constitutes a template for the granting of petroleum concession in Ghana has a provision which can be interpreted as an incentive provision. The provision in question exempts companies from paying the tax in question. The Ghana National Petroleum Corporation (GNPC) of Ghana "Model Petroleum Agreement of Ghana (17/8/2000) sets the legal framework and provisions for petroleum contracts in Ghana. All petroleum sector agreements are therefore based on this 'model' and therefore termed model agreements. These agreements, with significant tax provisions, seem to supersede other statutory tax provisions by some interpretations.

"The Model Agreement states in Article 12 subsection 12.1 that "No tax, duty, fee or other impost shall be imposed by the State or any political subdivision on the Contractor, its Subcontractors or its affiliates in respect of activities related to Petroleum Operations and to the sale and export of Petroleum other than as provided in this Article." It further states in subsection 12.2 (ii) that "Income Tax in accordance with the Petroleum Income Tax Law of 1987 (PNDCL188) levied at the rate of thirty-five percent (35%) as stipulated in the Petroleum Income Tax Law 1987, PNDC Law 188. Where a new income tax rate comes into force as a result of the promulgation of the new Petroleum Income Tax Law currently before Cabinet, the Contractor shall have the option of either applying the new income tax rate to this Agreement or remaining under the Petroleum Income Tax Law, 1987, PNDC Law 188[30];

A statement released by Ghana's Civil Society Platform on Oil and Gas in July 2013 and carried by the Public Agenda newspaper, blamed the Government of Ghana for allowing an obvious loophole in the statutes to go unplugged for two years after the Government's attention had been drawn to it. The statement said "the lack of action on a planned amendment or harmonisation of the Petroleum Income Tax Law (PITL) with the general income tax provisions is costing Ghana millions of dollars in potential tax revenue, even as the government explores innovative ways of raising badly needed financial resources to finance its 2013 budget." The statement recalled that, in July 2011 the EO Group concluded a deal with Tullow Oil for the transfer of the former's 3.5 percentage stake in Kosmos

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[29] Public Agenda Newspaper Friday 6th August 2011 Edition

[30] Ghana Model Petroleum Aggreements (2006), Ministry of Energy Ghana

Energy to the latter. It says, the question as to whether or not to assent to the deal became a source of controversy, with the then Attorney General and Minister for Justice Mr Martin Amidu disagreeing sharply with the then Energy Minister, Dr Joe Oteng Adjei on the matter.

While the A-G wanted the Government to withhold assent because of a supposed prima facie case established against the EO Group and on the basis of which criminal proceedings were being initiated for acquiring its 3.5 per cent stake fraudulently, the Minister for Energy thought the Government could go ahead and ratify the deal, in the view of the Minister for Energy, will not indemnify EO Group from prosecution.

In the end, the deal was ratified by Government allegedly without consulting with the A-G who, according to Article 88 (1) of the 1992 Constitution of Ghana, is "the principal legal adviser to the Government."

The ratification of the sale transaction sparked a new controversy as to whether or not Ghana can, legally speaking, tax the transaction, worth some US$305 million. In spite of assurances by the Ministries of Energy, and Finance and Economic Planning that Ghana will apply a 10 percent Capital Gained Tax on the transaction, amounting to US$30.5 million, the country has been unable to do that and therefore appears to have lost that potential tax revenue.

This was followed by the sale of Sabre Oil's sale of a 4.05 percent share in Tullow Oil to South Africa's national oil company, PetroSA. Unconfirmed reports say the deal was worth something in excess of US$365 million, meaning Ghana must have lost at least US$36.5 million. Combined with the revenue lost in the EO Group-Tullow transaction Ghana is losing approximately US$67 million for the lack of action on the PITL amendment bill,"

Government, according to the Civil Society Platform on Oil and Gas has largely ignored expert opinion on the subject, to the effect that even though the General Income Tax law (Act 592) imposes and mandates the payment of 10 percent Capital Gain Tax on the trading of capital assets, the existing Petroleum Income Tax Law does not, complicating any attempts to tax the transaction. This opinion, the Platform says, has been against the backdrop that, specific laws (like the Petroleum Income Tax Law) takes precedence over general laws, like Act 592, which currently is deemed inconsistent with the Petroleum Income Tax Law.

While this may seem far-fetched from the matter of tax expenditure and its economic impacts it is important to recognise that the dispute between the E.O. Group and the Government of Ghana has been about the former's claim to exemption from Capital Gained Tax on account of inconsistency between the provisions of the General Income Tax Law and the Petroleum Income Tax Law (the sector-specific law). The point here is that the rather broad spread of the incentives regime makes it difficult to keep track and to ensure coherence among the various legislations providing these incentives. The situation makes it easy for companies to exploit the gaps and inconsistencies in the laws to their advantage.

It is important to note however that this issue has finally received attention by the Government and captured in the 2014 Budget statement and stated in section 118 of the speech that "provisions relating to the capital gains tax in the Internal Revenue Act, 2000 (Act 592) should now be applied to petroleum operations[31]."

## 8.2 Revenue Losses in the Mining Sector

The mining sector has been the prime focus of tax reforms in Ghana. It has also been a major beneficiary of tax incentives since the early 1980s. Akabzaa and Ayamdoo (2009). Revenue losses in the Mining sector in Ghana has been a subject of a long standing debate on the generous fiscal regime resulting in sweeping fiscal reviews in the last two years. The review of incentives started in 2011 with the royalty rate changed from a sliding scale rate of 3-6% to a flat rate of 5%. Yet, the government increased the corporate tax rate from 25% to 35% in 2012 along side other initiatives such as a re-negotiation of stability agreement in the contracts of some mining companies mainly AngloGold Ashanti and Newmont. These two have a combined total size of about a third of all gold mining in Ghana.

It is believed that Ghana may be losing substantial revenues due to the inability of Government to apply the new fiscal rates as a result of stability agreements negotiated with these companies. Stability agreement or clause is usually a provision in the contracts of mining companies which freezes the tax laws of the host country in respect of their applicability to the companies concern for periods between 10 and 15 years. This is to allow the companies recoup their investments in good time. The clause will usually provide that any changes in the fiscal regime operative at the time of entering into the mining lease agreement will not apply to the company over the stated period, if the change will negatively impact on the economic fortunes of the company. In so far as stability agreements do not allow governments to collect taxes they will otherwise have collected if those provisions were not in place they can be categorised as revenues lost to the state. We have therefore estimated revenue losses as a result of the non-application of government reviewed tax policies for the mining sector to be about US$45 million a year since 2011.

Table 11 below shows the price per ounce of gold versus the operational cost of producing an ounce of gold. AngloGold Ashanti quoted total operational cost for 2011 and 2012 respectively with the percentage cost of producing an ounce of gold based on these market prices and operational cost being 60% and 64% respectively.

On the basis of these cost and price profiles, we calculated the tax forgone as a result of the non-payment of the new royalty rates and tax rate by AngloGold Ashanti and Newmont Mining Companies for 2011 and 2012. Table 12 below shows that in 2012 with the applicable rate of 5% royalty rate and 35% tax rate, the tax revenue forgone for every US$1

[31] National Budget Speech (2014: section 118)

revenue generated is 4% ( about 0.041 cents). On the other hand, in table 12 below, the revenue forgone in 2011 for every US$1 revenue generated is 1% (0.012 cents).

The estimation assumes a worst case cost scenario of 60% and 64% operational cost for any Gold Mineral won[32], as the Global average for 2011 was US$643 about (40%) cost per ounce of gold. [33] It should be noted too that the cost of producing an ounce of gold has been a major determinant of revenues, and for that matter the payment of taxes. It is also an area prone to transfer mis-pricing and illicit flows. While South Africa is noted as the most expensive place to produce an ounce of Gold due the extensive underground mining, Africa generally is said to be leading in cost of production of an ounce of Gold. Ironically, the Obuasi mine in Ghana has been cited as having the highest reported cash cost at $1519 per an ounce of gold produced.[34] This is a concern because variable cost can lead to abuses and transfer mispricing.

This implies that since the review of the mining sector corporate tax rate and royalty rates in Ghana the variance of 4% and 1% out of every revenue generated was lost in 2012 and 2011 respectively.

From the analysis below, if juxtaposed on revenues generated by AngloGold Ashanti and Newmont Gold Mining Ltd. (shown in table 13 below), the two combined biggest gold mining companies in Ghana with stability clauses shows that Ghana lost a total of $91.1 million between 2011 and 2012. This also implies Ghana loses about US$45 million per year due to the non-payment of the new rates as a result of stability clauses.

## Table 12: Price/Ounce of Gold Vrs Cost/Ounce of Gold in 2011-2012

| | Gold Price/Ounce (oz) | | Production (Cost/Ounce) AngloGold Ashanti | | Average % cost/oz | |
|---|---|---|---|---|---|---|
| **Year** | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 |
| | | | | | | |
| | 1571.52 | 1668.98 | 950 | 1078 | | |
| **Average % cost/oz** | | | | | 60 | 64 |

Source: AngloGold Ashanti Quarterly Financial Report (2012)

[32] Azumah Resources Wa Gold Exploration Feasibility Studies (2012)

[33] Chamber of Mines annual report (2011)

[34] http://www.mining.com/infographic-gold-production-costs-around-the-globe-88717/(accessed:12/12/2013)

## Table 13: REVENUE VARIANCE DUE TO TAX AND ROYALTY REVIEW (2012)

| | Revenue (Royalty @3-6% assuming minimum paid; income tax @25%) | | Revenue (Royalty @5%; Income tax@25%) | | Revenue Variance (Ghc) |
|---|---|---|---|---|---|
| | | Revenue | | Revenue | |
| **Unit Revenue Won (US$)** | 1.00 | | 1.00 | | |
| **Royalty (%)** | (0.03) | 0.03 | (0.05) | 0.05 | 0.02 |
| **Cost (Assumed) (%)** | (0.60) | | (0.60) | | |
| **Profit Before Tax** | 0.37 | | 0.35 | | |
| **Income Tax** | (0.0925) | 0.093 | (0.123) | 0.123 | 0.03 |
| **Shareholders Income** | 0.278 | | 0.228 | | |
| **Company Share (90%)** | 0.249 | | 0.204 | | |
| **Gov't Share(10%)** | (0.0278) | 0.0278 | (0.023) | 0.023 | (0.005) |
| **Dividend @ 8%** | (0.019) | 0.019 | (0.0164) | 0.0164 | (0.0036) |
| **Realisable Revenue/Unit Revenue Generated** | | 0.170 | | 0.211 | 0.041 |
| **% Revenue Loss/Unit Revenue Generated** | | | | | 4% |

## Table 14: REVENUE VARIANCE DUE TO TAX AND ROYALTY REVIEW (2011)

| | Revenue (Royalty @3-6% assuming minimum paid; income tax @25%) (Ghc) | | Revenue (Royalty @5%; Income tax@35%) (Ghc) | | Revenue Variance (Ghc) |
|---|---|---|---|---|---|
| | | Revenue | | Revenue | |
| **Unit Revenue Won (US$)** | 1.00 | | 1.00 | | |
| **Royalty (%)** | (0.03) | 0.03 | (0.05) | 0.05 | 0.02 |
| **Cost (Assumed) (%)** | (0.64) | | (0.64) | | |
| **Profit Before Tax** | 0.33 | | 0.31 | | |
| **Income Tax** | (0.0823) | 0.083 | (0.078) | 0.078 | 0.03 |
| **Shareholders Income** | 0.248 | | 0.233 | | |
| **Company Share (90%)** | 0.222 | | 0.209 | | |
| **Gov't Share(10%)** | (0.0248) | 0.0248 | (0.023) | 0.023 | (0.0015) |
| **Dividend @ 8%** | (0.0178) | 0.0178 | (0.0167) | 0.0167 | (0.0011) |
| **Realisable Revenue/Unit Revenue Generated** | | 0.155 | | 0.167 | 0.0124 |
| **% Revenue Loss/Unit Revenue Generated** | | | | | 1% |

**Table 15: Tax Revenue Lost Due To Stability Clauses (2011-2012)**

| TOTAL REVENUE WON US$ (Million) 2011-2012 | | | | |
|---|---|---|---|---|
| | AngloGold | | Newmont | Yearly Rev. Loss (US$) |
| | Aduapriem | Obuasi | | |
| **2011** | 306 | 493 | 919 | **21.3** |
| **2012** | **304** | **468** | **931** | **69.8** |
| **Total Revenue Lost (US$)** | | | | **91.12** |

Source: Ghana Chamber of mines Performance of the Industry Report (2012: p.11)

## 9.0 FINDINGS

The key finding of the study are as follows:

1. It is evident that Ghana lost substantial tax revenues as a result of trade tariff rationalisation and the general tax incentive policy since the early 2000s to date, amounting to about $1.2 billion dollars a year based on current prices and estimates.

2. Trade and investment policy was seen as a major policy tool employed by the Government of Ghana to overcome broad geo-economic imbalances between Ghana and her trading partners. This was also hinged on tax incentives and the mantra of attracting Foreign Direct Investment into Ghana, which invariably opened up the policy space for tax abuses and most times unbridled financial outflows abroad.

3. A policy failure is evident from the measure of Ghana's merchandise import and export volumes since 2001. The data shows that even though the policy intends to attract Foreign Direct Investment while improving export processing to help overturn long standing trade imbalances, these have not been achieved since the policy started. While gains in increased levels of Foreign Direct Investment can be reported, it seems to be negated by the incentive 'give away' to no overall gain in reaching the policy objective.

4. Contrary to a commonly held view that the Ghana Free Zones operations may not be yielding expected benefits, current data set shows that the financial performance of the Ghana Free Zones operations has seen tremendous improvement between 2008 and 2013. The Free Zones generated a net CIF value of more than US$29 billion in the period. At the same time Ghana's trade balance remained negative (-335.80 USD Million) during the second quarter of 2013, suggesting a failure of the Free Zones to overturn or at least even out Ghana's trade imbalance.

5. The legal and administrative tax framework in Ghana is fragmented and not properly coordinated for monitoring and evaluation purposes. This has invariably resulted in an unevaluated tax incentive system which has the potential of facilitating illicit transactions and financial outflows abroad.

6. Corporate abuses of the tax system especially in the extractive sector of Ghana are predominantly as a result of morbid contractual agreements, incoherent and the varied interpretation of the applicable tax laws.

7. Ghana has one of the lowest overall tax rates in the West African sub-region as a result of a drive towards trade and investment competitiveness. While this has

resulted in a marginal increase in the flow of FDI into the economy, it has not succeeded in over-turning the country's increasing trade imbalance.

8. Corporate abuses of the tax system especially in the extractive sector of Ghana are predominantly as a result of morbid contractual agreements such as rigid stability agreements and the varied interpretation of the uncoordinated applicable tax laws.

9. Considering the Heritage Foundation fiscal data of West African countries, Ghana has one of the lowest overall tax rates in the West African sub-region. This is as a result of a drive towards trade and investment competitiveness. In the extractive sector in particular the attraction of FDI is very much linked to low attractive fiscal regimes which tend to manifest as the 'race to the bottom' phenomenon in the Sub-region.

10. Attracting foreign direct investment can be said to be a result of several factors other than just tax incentives. Good infrastructure, social services such as schools and health and environmental concerns also play a role in attracting Foreign Direct Investment. This is evidenced from Ghana's juicy location tax incentive regime, which has struggled to attract investment up country of less developed regions apart from Accra and Tema.

11. Discretionary tax incentives contribute significantly to the tax incentive system which may be leading to the overall increased levels of most inappropriate tax incentives.

12. The study revealed that there is no consistent policy benchmarking and evaluation. Especially where the ultimate trade policy objective of Government has been to overturn trade balance deficits, this has never been achieved, but the tax incentive policies continue to dominate government decisions.

## 12.0 RECOMMENDATIONS

Government in the most current policy statement (2014 Budget and Economic Policy Statement) has conceded to the numerous abuses of the tax incentive system which have provided significant opportunities for CSOs to call attention to defects in the government's tax policy. CSOs must therefore seize this opportunity to constantly embolden Government and provide the needed evidence-based research to enable government to implement the various recommendations for progressive taxation.

Government must endeavour to benchmark and review economic policies, especially tax incentive policies as a sole means to achieve trade balance deficit problems. This policy has not worked since the late 1990s to date.

Generally, the number of exemptions noted in this study shows the extent to which the incentive regime is widespread. This creates monitoring and tracking problems for the already over-stretched revenue agencies. Government must consider reviewing these incentives regularly to ascertain their effectiveness and extent of application. Certainly incentives to the tune of 3.28% of GDP -- about twice the health budget -- must be too huge, which calls for a re-look at the whole incentives regime.

More generally, periodically evaluating the size and effectiveness of tax expenditures is necessary. It is good to estimate tax expenditures, because the revenues lost to such programs could be used for other purposes if evaluated to be much more worth-while—such as direct spending on poverty reduction intervention programmes.

The discretionary application of incentives is also widespread, with the Ministry of Education, Health, Trade, Agriculture, and the Presidency to grant or approve tax incentives. A case in point is the Ghana Gas Company, a state-owned limited liability company which has granted tax exemptions to SINOPEC the Chinese company undertaking the construction of Ghana's Western Corridor Gas Infrastructure Project. The action has been challenged by the Civil Society Platform on Oil and Gas and some members of Parliament insist that constitutionally, only Parliament can grant exemptions. Indeed due process and the law must be followed to avoid arbitrary application and abuse of the policy. This in our view may have led to the huge amount of tax expenditures quoted in national budget.

While the obvious policy change from dependence of trade taxes to emphasis on other taxes such as VAT, may be gaining deeper roots, the many exemptions and zero-rated VAT exemptions also undermine tax revenues. Additionally, it shifts the tax burden to the poor. For developing countries like Ghana, which have huge informal sectors, with less direct tax revenues, increasing the component of VAT in the revenue pot as a consumption tax may help to reach a wider section of tax payers but at the same time Government must be wary of its regressive effect and impact on the poor.

The numerous exemptions, especially those covering expatriates and diplomatic agencies can undermine the taxpaying culture of developing countries. Developing countries need to cultivate a tax paying behaviour which may be undermined by the numerous exemptions enjoyed by those they may perceive as well placed to pay some taxes yet are exempted.

The channels through which governments hold themselves accountable to citizens, where citizens can also communicate their demands for better government accountability currently only exist in theory. Government misapplication of tax revenues usually goes unpunished. To strengthen the rights of citizens to demand Government accountability with consequences, there is the need for a tax tribunal and other legal avenues where citizens would feel empowered to confront government on the misapplication of tax revenues. For example, earmarked tax revenue must be applied as intended and not diverted.

The cost profiles in the extractive sector must be examined closely as transfer mis-pricing opportunities could be some of the underlying reasons why African mines are quoted as the most expensive to operate in the world.

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