

Study on the VAT Refund Situation in Public Works Contracts in Mozambique

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in Mozambique**

*- Draft for Discussion Purposes Only –
- Subject to Alterations-*

Maputo, 8 August 2006

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Preamble

Background

On 12 May 2005 the Government of Mozambique and the group of 18 direct budget support providers (G17) concluded successfully their annual Joint Review of the implementation of the aid programme.

Among the conclusions of the assessment of the performance road sector in 2004, it was mentioned that an area of major concern was the Government delays in payments to contractors, which might have a detrimental impact on them.

The debts of the Government for allowable claims, late payments and non-payment timely of due Value Added Tax (VAT) refunds in the roads contracts mirror a more widespread situation affecting all public works contracts currently being implemented in Mozambique.

Further analysis of the problem led to focus on the long delays in refunding the due VAT to contractors operating in public works in Mozambique, as the major source for concern. .

The Government of Mozambique and the G18 agreed on the urgent need to study the problem.

Furthermore, in the Development Partners Group (DPG) of the 6th October 2005 the European Commission received a mandate to launch a study on the issue.

Objectives

The technical assistance to be provided is requested to assist the Government of Mozambique, the DPG and the G18 in collecting relevant information, analyzing the situation of the VAT refunds in Mozambique and assessing the extent to which lack of/delays in its due reimbursement to public works contractors is a serious contingent liability of macro-economic dimensions and a deterrent to an efficient implementation of public works contracts in Mozambique. Other specific sectors may also be identified if major difficulties have been encountered.

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3. Anticipated Outcome

The Consultant will give a qualified opinion about the genesis of the VAT situation, analysing any relevant data, as well as progress and performance of the Government of Mozambique in dealing with the problem.

The Consultant will also give a formed legal opinion on the feasibility for the Government of Mozambique to incorporate in its legislation and in its international cooperation strategy the principle that all cooperation funds be subject to Mozambican taxation including VAT.

The Consultant will carry out a statistical and sampling survey among current public works contractors and comparing their claims with the relevant Government records with a view to assessing the global dimension of the VAT contingent liability.

1. THE VAT IN MOZAMBIQUE: GENERAL ASPECTS

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VAT was introduced in Mozambique with effect from June 1, 1999. The Mozambican VAT authority is designated as SCIVA – VAT Central Services (SCIVA _ *Serviços Centrais do IVA*).

1.1. Rates and Scope

Rates

The Mozambique (unique) VAT rate is 17%.

Scope

VAT is levied on the –

- supply of goods - understood as the transfer of the right to dispose of tangible property as owner, which includes, amongst others, commercial transactions, hire-purchase, sale in installments with reserve of ownership, commission, consignment, and application of goods forming part of a business for private use or for non-business purposes when on such goods tax has been deducted, use of goods on which tax has been deducted for a purpose or in a sector where right of deduction is excluded;
- supply of services - as a residual concept it includes all the operations carried out which are not a supply of goods, including the supply of services free of charge made by the company in view of the personal needs of the company or of its staff, or to purposes not related to the company, and the personal use of company's goods as well as its use for purposes not related to the company and in exempt sectors of activity when on such goods tax has been deducted;
- Importation of goods (understood as the entry of goods into the territory of the country).

The following persons will be liable for the payment of VAT:

- Any person carrying out an economic activity on an independent and regular basis;
- Any person carrying out an operation on an occasional basis;
- Non-residents carrying out operations;
- Importers (whether or not being entrepreneurs);
- Cases of self-assessment;
- Any person who unduly charges VAT on an invoice;

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- State, except if those activities are not carried out in a significant manner (includes telecommunications, water, gas and electricity distribution, transports, ports and airports, TV and radio, etc).

1.2 Exemptions and zero-ratings

Single exemptions (without credit)

In this case the taxpayer does not charge VAT to the purchaser. He is also not allowed to deduct input VAT. VAT in these cases becomes a full cost to the acquirer.

Complete exemptions (zero-rated supplies)

In this case the taxpayer, when carrying out operations, does not charge VAT to the purchaser but is allowed to deduct input VAT. Exports (such as transactions and international transport) benefit of a complete exemption.

Partial exemption

Taxpayers carrying out, simultaneously, *VATable* and exempt activities can recover VAT on inputs on an apportionment basis. These taxpayers are only allowed to deduct a part of the input VAT or obtain a partial reimbursement of credit VAT.

1.3. Refunds

As per the VAT legal diploma, whenever VAT credit exceeds MZM 50 million or during any consecutive 12 months period an entity is in a VAT credit situation, it would be possible to reply for a VAT refund.

The tax authorities must pay refunds within 30 days (otherwise interest will be payable).

The refund must be applied for in writing duly justified, attaching the following documentation and information –

- Last three VAT returns presented (this requirement may be overcome if the company exists or did not have the filing obligation, if the VAT credit claim exceeds MZM 50 million);
- Trial balance (in Meticals and in Portuguese);
- List of Suppliers (for the period the claim refers to).

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1.4. Other Relevant VAT rules for this Study

(a) Bad debts

A taxpayer may recover/deduct the VAT previously invoiced to the debtor only if the debt has been formally recognized by the Court as a bad debt within an insolvency or bankruptcy/liquidation process of the debtor.

Where the taxpayer is, in the case of insolvency or bankruptcy able to recover from such process part of his outstanding debts, he must account for the VAT corresponding to the recovered amounts.

State or public entity debts are not allowed for provisions.

(b) VAT on Public Works – Decree 27/2000

The time of supply rules determine when VAT becomes chargeable and the time from which the tax authorities may reclaim tax.

These two relevant moments may not occur simultaneously whenever an invoice or equivalent document is issued, although the term for invoicing is counted from the taxable event.

As an illustration some normal rules of taxable event are the following-

- Supply of goods - the moment that the goods are delivered to the customer;
- Supply of services - the moment that the service is concluded;
- Imports - when the goods are cleared at customs;

Special Regime in force for the Public Works

VAT on construction services is only payable at the time of receipt of the invoiced value. This is also applicable to subcontractors.

This Rule was introduced by Decree 27/2000, as a possible measure to address the financial impact caused in the public sector contracts, namely those involving Public Works.

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2. MAIN CONSTRAINTS IDENTIFIED

2.1. Identification of the Problem

It is understood that for a period of time, the State contracting entities in the Public Works sector did not proceed with timely payments of the VAT charged by the civil construction companies.

This has led to a situation of substantial amounts being due by the ANE to the contractors, namely for the economic period comprised in the period 1999 to 2004. The debt incurred by ANE in these contracts has not been yet settled and major construction companies are still awaiting for the full settlement of such debts, as these are not allowed for provision, nor recovery of the VAT, under the principle that State Debts are not bad debts (Corporate Tax Code – CIRPC).

From 2004 to date, the situation seems to have been mitigated by the use of the Road Fund, which is in the process of paying such VAT to the contractors since then. However, there is still a substantial amount pending of debts, as far as we could conclude.

Furthermore, it is a known fact in Mozambique, that the VAT Services responsible for the refunds are not, at all, complying with the legal deadlines established by law, nor proceeding with the accrual and payment for late refunds.

The main conclusions above are based in the following findings

- Under the normal VAT rules in force since 1999, these types of services are fully subject to VAT at the standard rate of 17%. Although these services are rendered to the State, there is no legal and express vat exemption established by law.
- Therefore the construction companies awarded with these contracts, Mozambican or even Non-residents entities, are legally obliged to charge the VAT at full rates, as per the general rules mentioned in the initial chapter of this study.
- The substantive part of these types of infrastructural works are usually financed by the principle Donors and other International Finance institutions, under the cooperation and budget support agreements entered by the Mozambican State.

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- Such financiers do not assume nor ensure the utilization of such funds for the payments of the VAT due as charged by the construction companies, and it is understood that the VAT should be borne by the Mozambican State entity or company that benefits from such Donations, Grants and/or loans.
- In fact, there are Express clauses excluding the utilization of such amount for the purposes of supporting local taxes, as for example stated in the World Bank and IMF standard terms of contracts, which allow for a lump sum amount excluding any local taxes.
- To complicate the situation further, the public entities that contract such construction services are faced with serious, very serious indeed, budgetary restrictions that preclude the prompt and in time full compliance with their commitments towards the contractors.
- Not only these obligations to support and pay out the VAT component to the construction companies are not met in due time but, furthermore, such public entities do not appear to assume the normal obligation of paying additional interest on outstanding amounts due.
- This leads to construction companies building up massive input VAT credit situations, as they usually have to face the normal mobilization expenses of contracts of big magnitude, combined with the input VAT accrued on their acquisition for other construction contracts, namely in the private sector.
- In fact, whenever the construction companies purchase their raw materials and construction items they are obliged to pay VAT to their local suppliers or the VAT charged on imported items. This means a constant cash flow pressure on such companies.
- Furthermore, as notably noticed by the construction companies, when they submit the VAT refund requests, these are usually very long and complex processes, translating into delays in the approval of refund (some construction companies claimed to be waiting for more than a year).

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- This creates further financial pressure on the construction companies, as they argue that substantial amounts are usually impacted by these conjoint of factors, leading to the constant need of having overdraft facilities at high interest rates.
- As a conclusion, from the construction companies perspective, these situations are the main cause for the constraints presently impacting the sector.

In Conclusion:

We understand that this is mainly a two fold problem requiring immediate attention -

1. In the first instance it is of paramount importance to resolve the past debts and the payments due to the construction companies for the period from 1999 to 2004, as well as to accelerate any other pending debts accrued from 2004 to date;

2. In the second instance it is important to define the future legal alterations to avoid these constraints, either by way of changing the modus operandi of the donations, grants and loans, or by way of alterations to the tax current legislation, or, finally, through a State budget solution.

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2.2. Methodology

In order to obtain a credible basis of analysis, to understand the legal, economic and financial motivation for the current VAT situation, we planned to –

- (a) Obtain the relevant data from the Public Institutions involved in the sector, namely Road Fund and ANE;
- (b) Obtain information from the VAT Refund Services;
- (c) Obtain information from the construction companies; and, finally,
- (d) Proceed with a cross checking of all information and financial data received from the entities above.

This approach should be sufficient to analyse the quality and certainty of the information provided by each party concerned and to provide us a reasonable basis of analysis and certification of the financial data, through the cross checking.

Furthermore, we have also considered the following assumptions in the treatment and subsequent analysis of the financial data –

- (a) The relevance of costs of opportunity, namely in respect to the indebtedness requirements for the construction companies;
- (b) An average rate of 27%, based on *Tabela IV.A.3 do Boletim Estatístico n° 50 do Banco de Moçambique (Março de 2006)*, in respect to the evolution of FPC (“Facilidade Permanente de Cedência”), added by an *spread* of 5%;
- (c) This was also based on the annual reports issued by the Central Bank of Mozambique, namely for the last 6 (six) economic years; and,
- (d) The levels of inflation in the same period.

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In terms of currency, it is important to highlight that the reference currency considered in this study is the Metical (or MTn), due to the following factual reasons -

- (a) All information provided by ANE and Road Fund is expressed in Metical
- (b) In order to proceed with a multi currency analysis, the consultant would have to analyse a substantial part of circa 200 contracts, with different currency designations
- (c) Moreover, some contracts have exchange rates fixed and pre-determined, others have variable exchange rates
- (d) Payments of contracts are usually made in different currencies and using different exchange rates
- (e) os pagamentos dos Contratos são efectuados, por vezes, de forma parcial, e com recurso a diferentes divisas referidas a diferentes taxas de câmbio
- (f) The analysis of other currencies that the Metical would bring additional difficulties in the treatment and analysis of the financial information obtained from such different entities.

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2.3. ANE – ADMINISTRAÇÃO NACIONAL DE ESTRADAS

We have been provided with several files, comprising the public Works contracts awarded by ANE under different financing agreements, namely European Union, World Bank, and others.

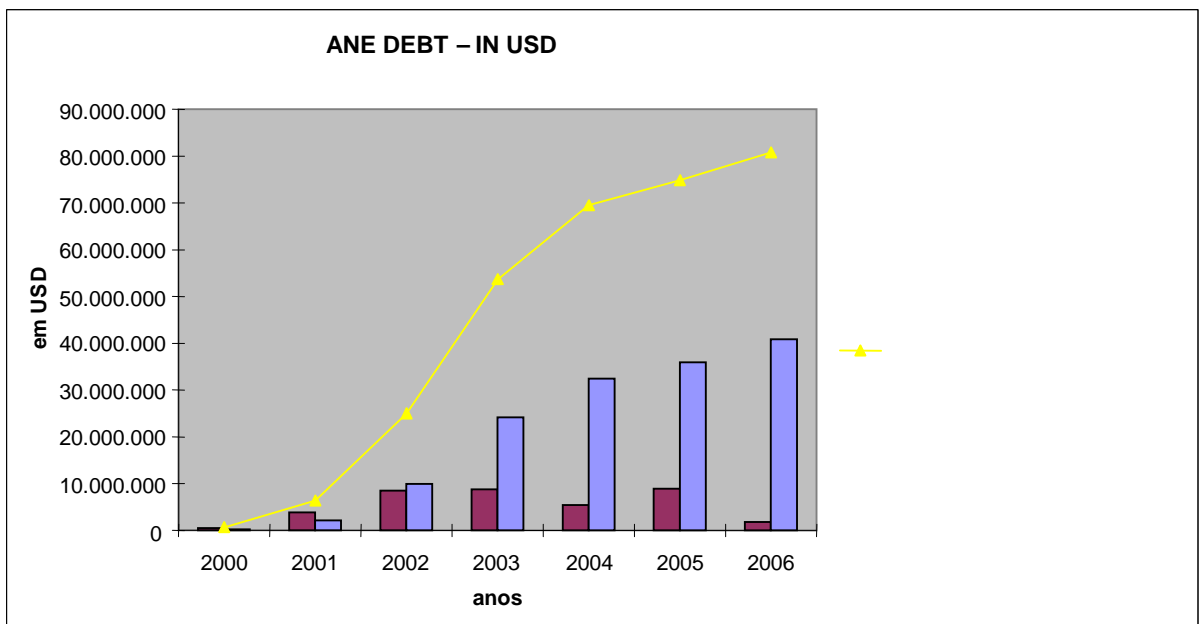
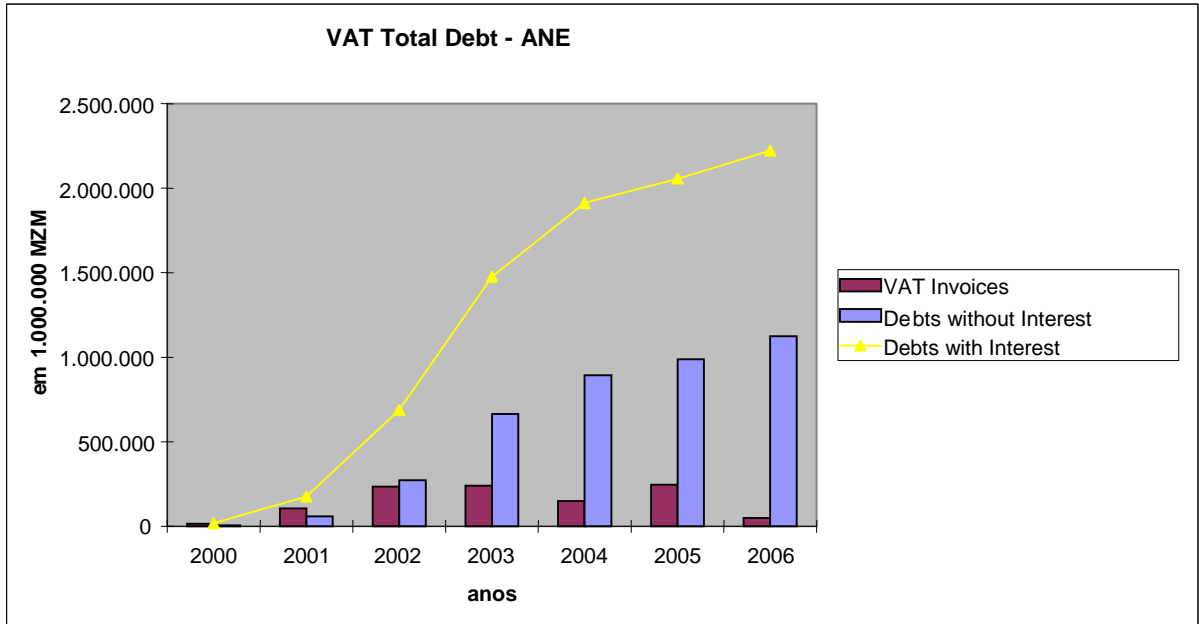
The main findings from these financial documentations reflects that –

- (a) There is clearly a critical incapacity to honour the financial commitments with the contractors, namely in respect to the VAT charged under these construction contracts;
- (b) This scenario leads to the conclusion that there will probably be a very serious difficulty for the public entities to honour its financial commitments with the main construction companies;
- (c) The scenario is even more critical if we consider the past debts incurred, namely with an emphasis in the financial period from 1999 to 2004;
- (d) In fact, we estimate that the current debts due amount to circa USD 40.000.000,00, without a consideration of interest and/or penalties eventually due to the contractors;
- (e) In terms of UE projects, we estimate that the current debts, without interest, stand at circa USD 5.000.000,00
- (f) Therefore, one of the main problems to be considered in any action plan has to do with the extreme urgency in addressing the debts accrued and build up in ANE accounts in the financial period from 1999 to 2004.

Below are the schedules and graphics based on which we have formulated the findings mentioned.

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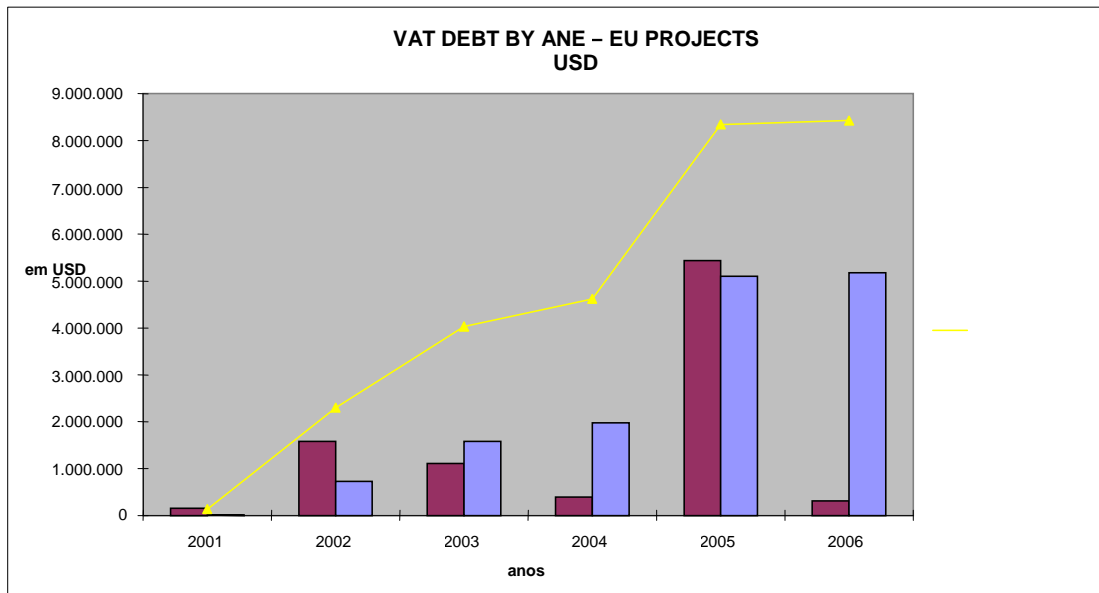
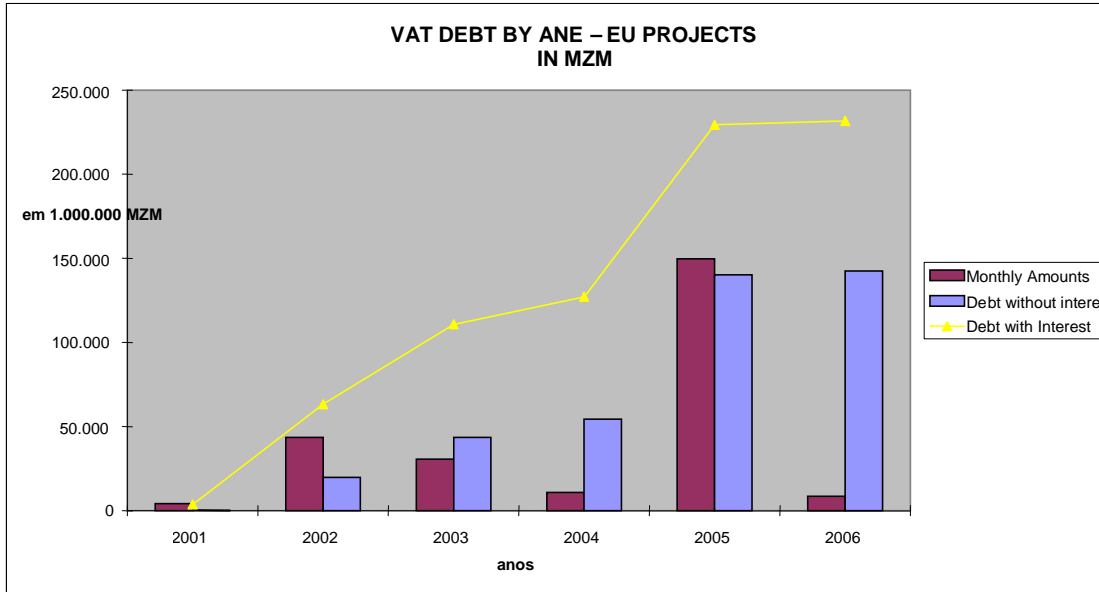
VAT Debt in Total for the Period 2000 to 2006



The conversion to USD, was done at a exchange rate of de 27.500,00/USD

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VAT Debt – EU Projects



The conversion to USD, was done at a exchange rate of de 27.500,00/USD

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**UE PROJECTS
VAT ACUMMULATED DEBT**

Int. Rate **27.00%** **19-Jun-06**

Nº	Valor do IVA dos Fornecimentos	Valor Pago	Data para Pagamento	Data do Pagamento	Dias em Mora	Juros Devidos Acumulados	Dívida Total em Processo	Dívida Total Acumulada	Dívida IVA s/ Juros	Dívida Acumulada s/ Juros	IVA	
1	1.388.149	1501.388.149.150	30-Sep-01	30-Jun-03	638	1.180.939	7381.180.939	7381.180.939	738	0	0	
2	1.736.149	3321.736.149.832	30-Out-01	30-Jun-03	608	1.407.543	1202.588.482	8581.407.543	1202.588.482	858	0	
3	961.810.857	961.810.857	31-Dez-01	30-Jun-03	546	700.250	2043.288.733	063 700.250	2043.288.733	063	0	
4	197.851.868	0	30-Sep-01			252.171	0543.540.904	116 450.022	213.738.755	484 197.851.868	197.851.868	
5	4.773.549	5084.773.549.508	31-Jan-02	30-Nov-04	1.034	5.179.869	5838.720.773	7015.179.869	5838.918.625	069	0	
6	7.541.123	689 0	31-Jan-02			8.925.384	7507.646.158	4516.466.508	4385.385.133	5087.541.123	6897.738.975	
7	801.884	405 0	28-Feb-02			932.470	7321.8.578.629	183.734.355	1327.119.488	645 801.884	405 8.540.859	
8	793.000	293 0	31-Mar-02			903.955	5619.482.584	339.696.955	4488.816.444	094 793.000	293 9.333.859	
9	2.550.334	0362.550.334.036	30-Abr-02	30-Jun-03	426	1.448.697	1080.931.281	444.448.697	1080.265.141	200	0	
10	3.908.070	332 0	30-Abr-02			4.368.151	9225.299.433	373.276.222	2598.541.363	4598.908.070	3323.241.930	
11	1.812.956	738 0	31-Mai-02			1.984.815	1027.284.248	474.797.771	8402.339.135	2991.812.956	7385.054.886	
12	1.694.988	435 0	30-Jun-02			1.818.049	2399.102.297	713.513.037	6735.852.172	9731.694.988	4356.749.875	
13	2.802.404	2592.802.404.259	31-Jul-02	31-Jan-05	915	2.603.976	0331.706.273	742.603.976	0348.456.149	004	0	
14	4.682.870	2184.682.870.218	31-Ago-02	30-Jun-03	303	1.892.019	7993.598.293	544.892.019	7990.348.168	803	0	
15	3.410.083	6443.410.083.644	30-Sep-02	31-Mai-05	974	3.154.848	0386.753.141	583.154.848	0363.503.016	841	0	
16	1.624.950	420 0	30-Sep-02			1.632.340	6088.385.482	183.257.291	0266.760.307	8671.624.950	4208.374.825	
17	2.595.714	3932.595.714.393	31-Out-02	30-Jun-03	242	837.612	5239.223.094	779.837.612	49257.597.920	459	0	
18	840.592	866 0	30-Nov-02			806.485	5230.029.580	302.647.078	3899.244.998	848 840.592	866619.215	
19	741.989	462 0	30-Nov-02			711.882	9850.741.463	288.453.872	4480.698.871	296 741.989	46219.957.408	
20	2.904.690	3602.904.690.360	31-Dez-02	30-Nov-05	1.065	2.628.580	4583.370.043	742.628.580	4563.327.451	754	0	
21	2.722.006	1532.722.006.153	28-Feb-03	30-Nov-05	1.006	2.326.799	2065.696.842	952.326.799	2065.654.250	960	0	
22	1.278.561	7901.278.561.790	31-Mar-03	30-Nov-05	975	1.059.249	2386.756.092	192.059.249	2386.713.500	200	0	
23	469.882	934 0	31-Mar-03			408.759	5327.164.851	724.878.642	4667.592.142	666 469.882	93420.427.290	
24	3.656.121	531 0	31-Mar-03			3.180.525	2290.345.376	956.836.646	7604.428.789	428.656.121	5315324.083	
25	715.721	265 0	30-Abr-03			606.735	5450.952.112	497.322.456	8105.751.246	235 715.721	2652624.999	
26	4.404.327	537 0	31-Mai-03			3.632.665	2194.584.777	718.036.992	7583.788.238	9914.404.327	5375329.103	
27	920.787	449 920.787.449	30-Jun-03	31-Mai-05	701	613.100	7755.197.878	492.613.100	7784.401.339	766	0	
28	613.385	389 0	30-Jun-03			492.304	7945.690.183	283.105.690	1885.507.029	949 613.385	38929.816.846	
29	699.739	570 699.739.570	31-Jul-03	31-Mai-05	670	445.313	3276.135.496	613.445.313	32785.952.343	277	0	
30	3.780.281	343 0	31-Jul-03			2.947.377	0059.082.873	616.727.658	8482.690.002	1283.780.281	3438433.97	
31	1.380.266	1141.380.266.114	31-Ago-03	31-Mai-05	639	837.757	4599.920.630	763.837.757	4893.517.759	270	0	
32	2.986.286	807 0	31-Ago-03			2.259.841	8662.180.472	624.246.128	6698.763.887	9372.986.286	8078076.583	
33	1.873.211	875 0	31-Ago-03			1.417.533	8463.598.006	463.290.745	7162.054.633	654.873.211	8758798.456	
34	2.195.247	405 0	30-Sep-03			1.612.514	4785.210.520	935.807.761	8765.862.395	522.195.247	4054080.651	
35	2.013.309	452 0	31-Out-03			1.432.704	1086.643.225	033.446.013	5509.308.409	082.013.309	452452.665	
36	898.794	617 0	31-Dez-03			599.400	4567.242.265	493.497.835	0130.806.244	156 898.794	617123.563	
37	1.019.081	880 0	31-Jan-04			655.842	0167.898.107	503.674.923	8902.481.168	048.019.081	880884.583	
38	735.082	487 0	28-Feb-04			457.845	6248.355.953	128.192.928	1113.674.096	156 735.082	487475.318	
39	874.304	898 0	28-Mar-04			525.804	5768.881.757	697.400.109	4685.074.205	625 874.304	898896.192	
40	786.349	253 0	30-Abr-04			453.712	7469.335.470	444.240.062	0006.314.267	625 786.349	253536.978	
41	2.656.844	403 0	30-Jun-04			1.413.077	2770.748.547	715.069.921	6120.384.189	292.656.844	4034089.635	
42	554.645	541 0	31-Jul-04			282.276	5917.030.824	306.836.922	3021.221.111	431 554.645	541450.190	
43	3.369.080	814 0	30-Nov-04			1.410.583	3702.441.407	676.779.664	1826.000.775	613.369.080	814813.559	
44	819.104	858 0	31-Dez-04			324.163	5532.765.571	228.143.268	4127.144.044	025 819.104	858854.378	
45	9.325.568	2889.325.568.288	30-Abr-05	31-Jul-05	92	786.287	4273.551.858	655.786.287	42727.930.331	452	0	
46	3.950.979	567 0	30-Abr-05			1.212.896	6044.764.755	255.163.876	1133.094.207	623.950.979	5675688.329	
47	9.744.363	7689.744.363.768	31-Mai-05	31-Jul-05	61	544.755	3775.309.510	630.544.755	37133.638.962	994	0	
48	5.964.505	7375.964.505.737	31-Mai-05	31-Jul-05	61	333.443	6827.642.954	312.333.443	8823.972.406	676	0	
49	1.320.327	293 0	31-Mai-05			375.045	2987.017.999	610.695.372	5935.667.779	2671.320.327	2932959.649	
50	113.681	046 0	31-Jul-05			27.161	9847.045.161	593.140.843	0285.808.622	296 113.681	046659.763	
51	11.401.205	2581.401.205.258	30-Sep-05	31-Dez-05	92	873.479	6047.918.641	197.873.479	6046.682.101	900	0	
52	11.401.205	2581.401.205.258	30-Sep-05	31-Dez-05	92	873.479	6047.792.120	800.873.479	60437.555.581	503	0	
53	452.163	228 452.163.228	31-Out-05	31-Dez-05	61	22.968	8507.815.089	650.22.968	45037.578.550	353	0	
54	4.069.377	7744.069.377.774	31-Out-05	31-Jan-06	92	305.416	2398.120.505	889.305.416	2387.883.965	592	0	
55	4.037.245	885 0	31-Out-05			689.871	3048.810.377	193.727.117	1882.611.083	780.037.245	885883.800	
56	2.805.101	308 0	31-Out-05			479.326	4879.289.703	682.284.427	7975.895.511	572.805.101	3083066.605	
57	3.356.257	6803.356.257.680	31-Dez-05	31-Jan-06	31	84.877	6379.374.581	319.84.877	63745.980.389	215	0	
58	2.963.988	5652.963.988.565	31-Dez-05	31-Dez-05	0	0	79.374.581	319	0	145.980.389	215	0
59	2.673.093	359 0	31-Dez-05			336.150	64479.710.731	963.009.244	0088.989.633	212.673.093	3593569.278	
60	729.040	850 0	31-Dez-05			91.679	38479.802.411	347.820.720	23849.810.353	451 729.040	85070.007	
61	3.569.641	9683.569.641.968	31-Dez-05	30-Abr-06	120	328.586	58180.130.997	928.328.586	58150.138.940	032	0	
62	1.458.081	3861.458.081.386	31-Dez-05	30-Abr-06	120	134.216	8180.265.214	744.134.216	1150.273.156	848	0	
63	19.685.045	299 0	31-Dez-05			2.475.461	8682.740.676	602.160.507	1602.433.664	009.685.045	299299.692	
64	2.321.297	179 0	31-Dez-05			291.911	7083.032.587	672.613.208	2495.046.872	252.321.297	179192.014	
65	2.334.816	529 0	31-Dez-05			293.611	7483.326.198	842.628.427	7037.675.299	962.334.816	5295294.349	
66	19.685.045	299 0	31-Dez-05			2.475.461	8685.801.660	702.160.507	1699.835.807	1209.685.045	299299.034	
67	2.321.297	179 0	31-Dez-05			291.911	7086.093.571	782.613.208	2892.449.015	362.321.297	1791796.355	
68	2.334.816	529 0	31-Dez-05			293.611	7486.387.182	954.628.427	7095.077.443	072.334.816	5295298.690	
69	6.224.613	429 0	31-Dez-05			782.766	4567.169.949	410.007.379	8842.084.822	957.224.613	4294294.817	
70	15.360.852	708 0	31-Dez-05			1.931.679	8389.101.629	2477.292.532	5829.377.355	495.360.852	708780.275	
71	2.135.979	610 0	28-Feb-06			175.384	4089.277.013	652.311.364	0281.688.719	5162.135.979	610612.411	
72	3.354.052	3803.354.052.380	31-Mar-06	31-Mar-06	0	0	89.277.013	652	0	231.688.719	516	0
73	3.113.362	8213.113.362.821	30-Abr-06	30-Abr-06	0	0	89.277.013	652	0	231.688.719	516	0

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2.4. ROAD FUND - FUNDO DE ESTRADAS

At the outset, and as we refer in more detail in the specific section of possible solutions, the Road Fund has been the State entity responsible for the payment of the local taxes to the construction companies.

This means that, in the major projects involving funds of international donors, bank institutions, etc that do not allow for such funds to be used for payment of local taxes, the Road Fund is the vehicle responsible for the payment of the tax liabilities, namely the VAT charged by the construction companies.

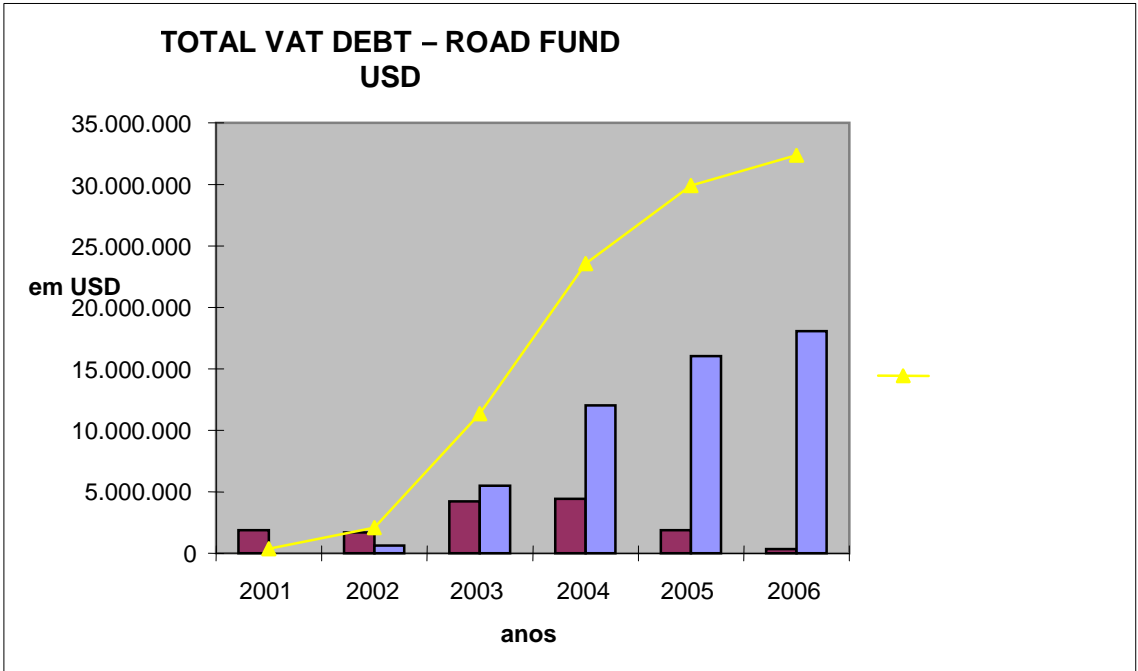
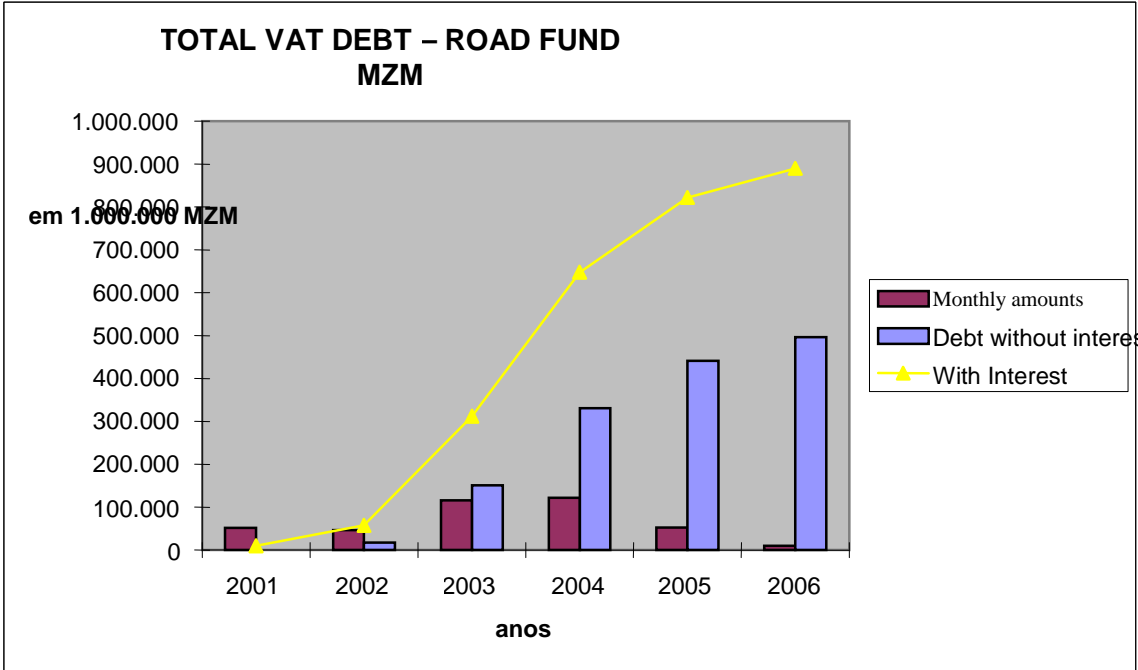
As one of the main stakeholders of this subject, we have also analysed the financial information provided by the Road Fund.

The following findings should be considered –

- (a) There is clearly a critical incapacity to honour the financial commitments with the contractors, namely in respect to the VAT charged under these construction contracts.
- (b) Although the situation is less critical when compared to ANE, as the Road Fund has been trying to pay in time and in accordance with the budget and financial limitations, the debt is also accruing and increasing to unsustainable levels.
- (c) This situation also leads to the building up of massive debts towards the construction companies, without a short term perspective of resolution.
- (d) In fact, we estimate that the current debts due amount to circa USD 20.000.000,00, without a consideration of interest and/or penalties eventually due to the contractors.

Below are the schedules and graphics based on which we have formulated the findings mentioned.

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2.4. VAT DEPARTMENT – REFUNDS SERVICES

We have also analysed the financial information provided to us by the VAT department, namely by the Refund Services.

Based on the information obtained, as well as on the discussions had during the first workshop on this subject, the situation may be defined as follows –

- (a) In general the VAT Department takes quite a substantial amount of time to process and pay the refunds.
- (b) Furthermore, as notably noticed by the construction companies, when they submit the VAT refund requests, these are usually very long and complex processes, translating into delays in the approval of refund (some construction companies claimed to be waiting for more than a year).
- (c) The legal rule of 30 days is not usually followed, and the refunds applications are dealt with for a long period of time.
- (d) The amounts that are approved are not those requested, as the VAT department usually disallows some input VAT in the analysis of the refunds applications.
- (e) The refunds services argue that the tax payers do not present the VAT refund claims in accordance with the laws and regulations in force.
- (f) For these reasons, the VAT Department requests additional information and also proceeds with additional diligences before approving any VAT Refund.
- (g) Although due by law, interest is not paid for late refund of VAT. The VAT Department argues that such payment has to be formally requested, and this is usually not followed by the taxpayers in general and by the construction companies in particular.

*We have prepared summary of the VAT Refunds, as provided to us by the VAT Department, Refunds Services. This is attached to the present report as **Annex 1**.*

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3. IMPACT OF THE VAT ON PUBLIC WORKS- MAIN CONCLUSIONS

3.1. Accumulation of Massive Debts in the Public Sectors Accounts

The public accounts have been subject to high pressure caused by the substantial amounts due to the obligation of the Mozambican State entities to support the tax liabilities arising from the major construction contracts.

The amounts of debts are very high and the payment is, to a certain extent, unsustainable for the State entities involved, considering that there are other social, economic and financial priorities under the Government approved Plan.

3.2. Accumulation of Credits by the Construction Companies

Although we have not been provided with the necessary and accurate financial information from the construction companies, it seems clear from the cross checking of the other information sources, that the construction companies are growing their credits over the State, be it by way of debts from ANE, Road Fund, or by way of pending VAT Refunds.

3.3. Increasing Liquidity problems - Cash/ Loan requirements

Although we have not been provided with the necessary and accurate financial information from the construction companies, we may conclude that the constant late payments of the VAT component to the construction companies increases their needs to obtain working capital with banks, in order to ensure their treasury requirements with suppliers.

This has a negative impact in terms of costs and therefore implies additional financial restraints to the construction companies.

3.4. Increasing Indebtness Costs

Although we have not been provided with the necessary and accurate financial information from the construction companies, we may conclude that constant late payments of the VAT component, added by the need of

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obtaining working capital with the banks, may have an economic impact in the indebtedness costs of such companies.

3.5. Possible inflationary reactions

Due to the combination of the factors mentioned in 3.1, 3.3 and 3.4 above there could be a tendency for construction companies to start inflating the contract costs due to the inherent and evident risks posed by such factors.

This ultimately impacts all the stakeholders involved in the construction sector, namely donors, State entities, companies, and, most important, the final user of the goods and services delivered and/or to be delivered.

3.6. Possible Inhibition of future projects

As we made reference before, the major part of these projects are financed by Donors, Financial institutions.

Such financiers do not assume nor ensure the utilization of such funds for the payments of the VAT due as charged by the construction companies, and it is understood that the VAT should be borne by the Mozambican State entity or company that benefits from such Donations, Grants and/or loans.

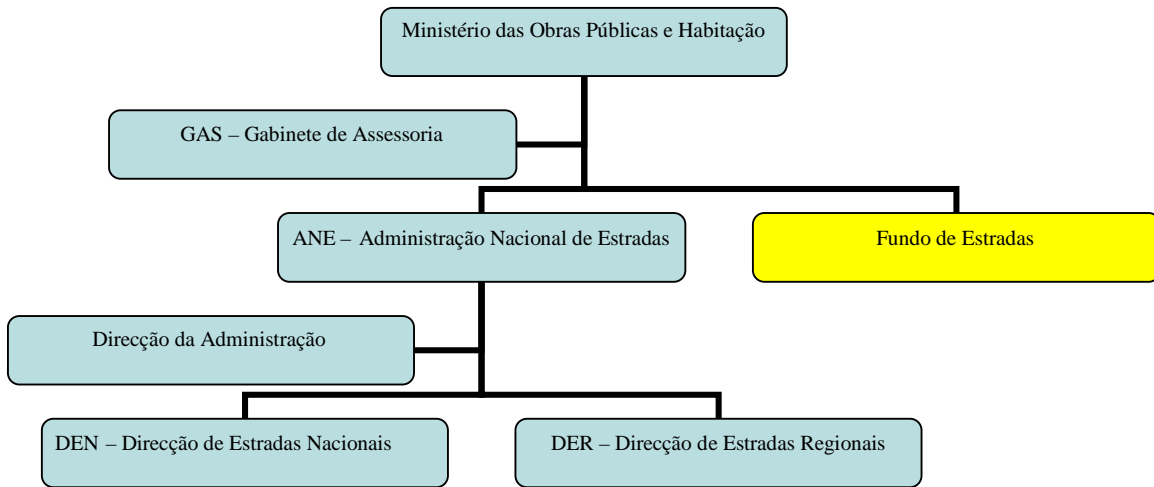
Due to the combination of the factors mentioned in preceding points, this could be a possible negative and inhibiting factor for future projects, as the situation is growing to unsustainable levels.

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4. POSSIBLE SOLUTIONS – PRESENTLY AND FOR THE FUTURE

4.1. The Road Fund Solution – A “False” solution

Since its creation, the Road Fund is in direct dependency from the Ministry of Housing and Public Works.



As from 2004, the Road Fund carries the following attributions –

- To allocate and coordinate the maintenance of the Roads; For this the Fund was granted with Donations, Budget support and the revenue from the Taxes levied on petrol;
- To assume the payment of the VAT component to the construction companies.

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However, although the financial capacity has allowed the Road Fund to proceed with payments to contractors, such financial capacity is not enduring and will not be a sustainable solution to meet and face the old debts accrued to 2004, nor the future financial pressure of the contractors.

In fact, as a pre-condition for the sustainability of this solution it is necessary to have a direct linkage between the income generated by the Road Fund and the mechanisms to pay the VAT to the contractors.

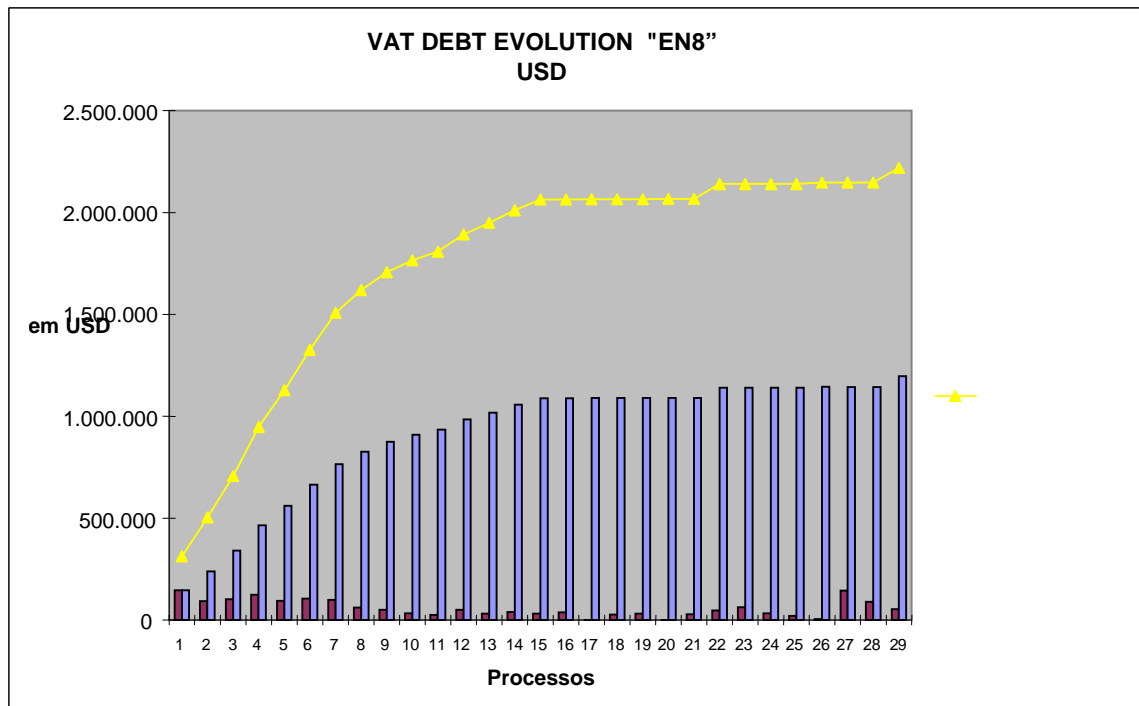
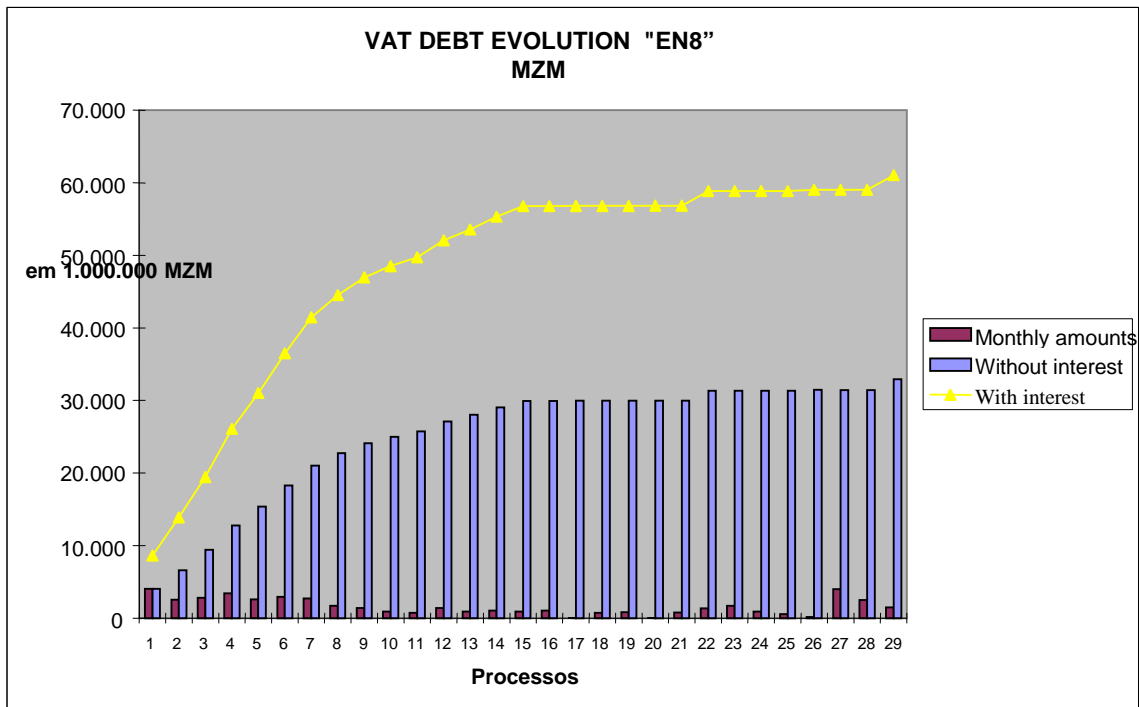
This means that the Road Fund will not have the financial capacity to carry on with this solution.

Furthermore, this solution delegates an attribution to the Road Fund totally different from its essence and purpose: to maintain the roads and infrastructures.

And the odd of this is that the present solution means, clearly, that the Road Fund is using tax collected as taxes levied on petrol to pay another tax, the VAT due to the contractors.

To confirm our analysis, we have analysed the project implementation of the EN 8 contract (Nampula-Nacala). On this case, for example, and although the apparent regularity of payments, the fact is that the Road Fund has not been able to pay in due time and the VAT amount owed to the contractors totals circa USD 1.000.000,00, without the computation of any interest or late payment penalties.

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OTHER POSSIBLE SOLUTIONS TO CONSIDER

4.2. Alteration of the Donors/Financiers Framework

One of the possible solutions that arose during our meetings, namely with the G-18 Group Economists, was the possibility of the Donors and Financiers agree to change the current *modus operandi*.

This would mean that the funds made available to State entities, such as ANE, would include a portion to support directly the VAT charged by the construction companies.

This is a debatable solution, as each Donor and/or Financier has its own rules and policies and amending such policies would imply an alteration to conventions previously signed. This was one of the major aspects debated during the workshop.

Moreover, this solution only tackles the problems for the future and do not address, nor consider, the past situation of high debts and interests due to the construction companies.

4.3. Strengthen of Budget allocations to ANE and Road Fund

This solution would imply a substantial diversion of State budget funds to –

- (a) Pay all the debts pending and accrued interests from 1999 to 2006, e.g. all payments in arrears due to the construction companies; and,
- (b) Support the payment of the VAT component for future projects.

Considering the current Government Policy and its priorities, we do not believe that such substantial diversion of State budget will be feasible.

The State has clearly adopted other major goals (poverty reduction; district development; health care and education, etc) and these requires that State budget funds are allocated to priority areas.

4.4. Solutions trough tax and legal measures

For the past debts, a possible solution would be to issued tax credit certificates in favour of the construction companies affected by the VAT delays.

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However, to gain adherence from the construction companies, such credit certificates should be able to offset any future tax liabilities of the companies, namely for corporate tax, VAT and import duties on importations, Tax levied on Petrol.

For the future, there is the possibility of exempting the transactions related with the public works in Mozambique, for VAT purposes.

A crucial aspect to be considered is the type of exemption –

- (a) A simple exemption would mean that the contractors would not deduct the input VAT, or it would deduct on a pro rata or apportionment basis, thus increasing the final price.
- (b) A complete exemption would mean that the tax payer would be allowed to deduct all input VAT and would not charge out VAT on its price. However, this solution would also mean that the construction companies would be on a permanent VAT credit situation. If the refunds are not processed and paid in due time, then the situation will be the same

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