
TAX REFORM AND BUSINESS ENVIRONMENT IN MOZAMBIQUE

INTRODUCTION

In reply to the TOR we proceeded with the review of the document on the Tax Reform and Business Environment in Mozambique, with special emphasis on the Concerns of the Private Sector.

In accordance with the TOR, the objective of the work consists essentially in adding, eliminating or adjusting the issues contained in the documents on *“Tax Reform and Business environment in Mozambique”* and *“Proposal for a Fiscal Policy”* in the light of the Mozambican legal and economic reality.

The document with title *“Tax Reform and Business Environment in Mozambique”* consists in a study prepared by Bruce Bolnick. The study lists the main taxes that comprise the Mozambican tax system, more precisely the ones levied on the activities of individuals, providing a macro economic analysis of the real impact of the same from a quantification and qualification point of view, on the basis of criteria that are normally considered with respect to the efficiency and justice of the tax systems in developing countries.

By means of a comparative analysis with the similar variants of the tax systems of sub-Saharan countries, it concludes by evaluating the tax competitiveness of Mozambique in this geographic area, systematizing, at last, the crucial aspects of the system that are considered as impediments to the economic growth or that compromise the economic development in the opinion of the private sector and the respective recommendations.

It must be highlighted that the document in reference is dated December 2004, which in our opinion is updated, given that the assumptions on which the same was based did not suffer any significant changes.

In the sequence of the document by Bruce Bolnick, the IEA Unit of CTA prepared the *Proposal for a Tax Policy* directed to; (i) promotion of the economic growth in Mozambique, (ii) promotion of competitiveness and productivity; (iii) render the system competitive in the region and attract foreign investment (iv) simplification of procedures; (v) a proposal that is compensating and neutral, therefore not affecting the current levels of the tax revenue (approx 15% of the GIP).

According to the authors, it represents a *discussion paper* that absorbs a number of recommendations contained in the document by Bruce Bolnick, it makes proposals for the reduction of rates, introduction or elimination of some taxes or tax incentive systems currently in force.

To answer to the objectives of our work, which scope is clearly defined in the terms of reference and in our proposal for services and, in order to avoid the reproduction of the documents under analysis, given that we intend the study to be simple, objective and clearly understandable by the whole entrepreneurial community, we opted to highlight the main conclusions and respective recommendations with our comments as follows.

In Chapter 1 we list the main conclusions of the document under analysis; Chapter 2 reproduces the recommendations in topics in accordance with each of the conclusions; In Chapter 3 we make our considerations ob the issues that we regard important with respect to the proposal for a new tax policy.

A REVIEW OF PRIVATE SECTOR CONCERNS

CHAPTER I

Main Conclusions

1. The New Tax Laws are too complex for local conditions;
2. The Tax Rates are too high;
3. The Tax base is too narrow;
4. Tax administration is inefficient arbitrary and prone to corruption;
5. The Tax System unduly impairs business cash flow and raises financing costs;
6. Various tax provisions tilt the playing against many domestic procedures;
and
7. Public information on the Tax System inadequate and public-private dialogue has been insufficient.

CHAPTER II

1. WITH RESPECT TO THE COMPLEXITY OF THE SYSTEM

Recommendations

- 1.1. Raise the Registration threshold for the normal VAT regime, the Simplified VAT regime, and the normal company tax, in order to eliminate the tax obligation for very small enterprises; adjust the threshold annually to compensate for inflation.
- 1.2. Accelerate implementation of the Indirect Tax Regime under IRPC by conducting necessary studies to determine the appropriate indicators.

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- 1.3. Establish a joint public/private task force to identify provisions of the IRPC and IRPS Code that can be simplified without a significant loss of revenue.
 - 1.4. Introduce a simple verified tax for very small and micro enterprises, in lieu of the simplified VAT and IRPS; exempt entities with an estimated income below the normal threshold for income tax liability.
 - 1.5. Revoke the Stamp Tax (while applying minimal fees as necessary to cover the cost of essential administrative services).

2. TAX RATES

Recommendations

The perception that we have from the analysis of the document with respect to the Tax Rates Mozambique would be in a better position to foster private sector development if government would offer more attractive standard tax rates – starting with some relief from the double tax on dividends and fewer special tax breaks. The following rate reductions would be desirable as a medium term objective, contingent on the need for prudent fiscal management.

- 2.1. Reduce the standard VAT rate from 17% to 14 %
- 2.2. Reduce the maximum import duty to 20 percent, and then to 15 percent, to reduce combined rate of VAT plus duty to 35 percent (which is still high in terms incentives for tax compliance)
- 2.3. Reduce the IRPC rate and the maximum IRPS rate from 32 percent to 25 percent as fiscal conditions allow.
- 2.4. As a priority, reduce the double taxation of dividend income by adopting provisions to integrate the Company Tax and Individual Tax on Dividends, at least partially.

3. TAX BASE

Recommendations

- 3.1. Avoid the false expectation that large amounts of revenue can be raised by taxing micro and small enterprises.
- 3.2. Target higher income tax evaders, possibly through a presumptive tax based on objective outward signs of lifestyle.
- 3.3. Mobilize special teams to inspect and audit target groups that are specially prone to evasion, and (in customs) to perform random checks on import clearances.
- 3.4. Pursue ongoing programs to strengthen and modernize tax administration, intensify staff training and fight corruption in the tax service.
- 3.5. Build capacity for careful economic and fiscal analysis of instruments for stimulating investment, to eliminate incentives that are not cost effective.
- 3.6. Enhance fiscal transparency by adopting tax expenditure budgeting, with regular public reports on the fiscal cost of tax incentives.
- 3.7. Maximize domestic retention of resources rents from the exploitation of mineral resources on renewable natural resources.
- 3.8. Consider the adoption of a corporate alternative minimum tax.
- 3.9. Enhance tax compliance by pursuing ongoing programs to reform public expenditure management and improve public service delivery.

4. TAX ADMINISTRATION

Recommendations

- 4.1. Enhance the transparency on VAT refund administration by publishing monthly reports on claims and approvals; provide information to the public about procedures and requirements.

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- 4.2. Adopt Risk Based Selective audits for inspecting VAT refund claims, including “gold card” treatment of regular exporters with a track record of accurate claims.
 - 4.3. Conduct a system audit of VAT refund procedures to ensure that valid claims can be paid without the separate step of approval from the Treasury.
 - 4.4. Reduce the volume of refund claims by increasing the threshold for claiming immediate payments, and eliminating “complete exemptions” (zero rating) for manufactured products that are not exported.
 - 4.5. Activate the public-private task force on VAT refunds.
 - 4.6. Amend the new regime on tax infractions to reduce the range of discretion and establish more transparent rules for determining the magnitude of tax penalties.
 - 4.7. End the sharing of tax penalties with officers involved in the decisions.
 - 4.8. Adopt a tough anticorruption program including Heavy Sanctions for errant tax officials, undertake and publish periodic corruption surveys.
 - 4.9. Implement the Planned Revenue Authority to ensure that it is adequately funded and professionally managed, without political interference

5. CASH FLOW COSTS

Recommendations

- 5.1. Take urgent steps to expedite VAT refunds.
- 5.2. Re asses provisions of the VAT Code Involving refunds for large capital outlays.
- 5.3. Enforce statutory provisions for the government to pay interest on overdue refund payments, and consider raising the stipulated interest payment rate to reflect the actual cost of funds to the business community.

6. THE TITLED PLAYING FIELD

Recommendations

- 6.1. Limit the scope of Special Tax incentives, and use the revenue so gained to reduce general tax rates.
- 6.2. Continue phased tariff reductions to achieve lower and more uniform tariffs, to reduce distortions that foster inefficiency and impair backward linkages.
- 6.3. Replace the special customs regime for manufacturing with a low uniform tariff on business inputs. (class K, M and I)
- 6.4. Review the deductibility of training expenses in the Tax Code to provide stronger incentives for upgrading labor stalls.
- 6.5. Enhance a capacity for Tax Policy analysis, to ensure that incentive programs are cost effective with a minimum of distorting side effects – especially those that discourage job creation.

7. PUBLIC INFORMATION AND DIALOGUE

Recommendations

- 7.1. Allocate staff and financial resources to producing and distributing public information on the tax system.
- 7.2. Develop a multimedia public information campaign including radio and television spots on tax issues and posting of all major tax documents to a well publicized website.
- 7.3. Train tax officers, including tax inspectors, to integrate education functions into every contact with the public.
- 7.4. Assist other institutions and organizations to establish affordable education programs for the public on taxation.

As previously referred, this study has the merit of agglutinating in a systematic form the most cadent problems of the Mozambican tax system in comparison to the countries of the region, what is good, as it calls the attention for the fragilities that tend to compromise the growth and economic development of Mozambique.

The recent character of the document under analysis validates all assumptions on which the same is based, namely:

General legislative and presidential elections took place last December and at such the legislature only became effective in February.

If we look at the nature of the recommendations we can conclude that all are directed to actions that are of the responsibility of the State, with the private sector being the promoter of the referred reforms.

Thus, the first semester of the year was reserved for the installation of new structures of power and therefore there was no development in the tax chapter that would suggest amendments to the document.

Anyway, we consider that it is important to make some considerations, particularly to the Proposal for a Tax Policy.

ANALYSIS AND SUGGESTIONS

PROPOSALS PRESENTED:

1. Reduce the IRPC rate from 32% to 25%

We agree with this if considering that the effective tax rate is significantly low due to the existence of wide tax incentives and benefits (see our report on “Evaluation and Reform of the Tax Benefits in the Republic of Mozambique”, E&Y). This would also incentive the local companies that normally do not have the dimension to benefit from the existent incentives with the same intensity as mega projects and which can be create stable employment. The lost of tax revenue resulting shall tend to be small due to the reasons referred above.

2. Reduce the maximum marginal IRPS rate from 32% to 25%

In our opinion, the affirmation that different maximum margins in IRPS and IRPC would create distortion is duly justified, namely in an “environment” as Mozambique. However, this is a concern to be kept. The proposal for reduction of the rate may be a positive sign for the beneficiaries of higher income but the same must, in our opinion, be accompanied by a wider and better taxation of such income. Thus, it would be recommendable that some reflection is done on the current deductions and charges for individuals, given that the deductions only comprise the personal and familiar situation of the taxpayers.

We call your attention for the fact that, in accordance with the estimation of the impact on the tax revenue that accompanies the document under analysis, the “loss” of income can now be considered significant. Why not a reduction that is

phased in time, on the basis of the budget availability (reduction from 32% to 30% in a first phase, then another reduction and so on).

3. Elimination of the economic double taxation of distributed profits

It seems to us that this is a pertinent and wanted measure, due to the penalization that the income tax systems, in general, operate on distributed profits (dividends), and the distortions generated on the remaining types of capital income (interest, capital gains) and forms of entrepreneurial funding (shareholders loans and bondholders, bank credits, etc.), which incentive tax planning and evasion.

However, special attention must be paid to the technical form by means of which the reduction or elimination of the said “double taxation” is to be achieved. In our days, the majority of the countries privilege the adoption of mechanisms that are directed to tax only 40% or 50% of the profits received by shareholders provided that these were effectively taxed in IRPC. Over and above that, it is a system much simpler than the “tax credit” or “double rate”.

4. Reduce the normal VAT rate from 17% to 14%

Our conclusions presented at the time of the Study of the TAX Reform - EY, December 2003 requested by CTA, justify this positioning, so we think that the arguments contained in the same should be recovered. We do not suffrage the argument (theoretic and practical) on the “absolute” regressiveness of VAT, according to the income earned by families. Namely, within the context of a country like Mozambique, where a significant part of the population lives below the minimum subsistence levels with strong resource to self-consumption [*we think...*]. The affirmation that “*a lower VAT has the effect of increasing the real income of the poor more than the income of the rich*” seems inadequate to us.

The result of the economic incidence of VAT by family income levels depend a lot of the structure of its rates and goods and of the dimension of the consumption base comprised by the tax. It can even happen that an increase of the normal VAT rate reduces the regressiveness of the tax by the greater concentration of the consumption in classes that earn medium and high income in the goods taxed.

From a different point of view, the issue of the reduction of the VAT rate proposed in the document may, however, be advisable: for example it may (?) constitute a lower stimulant for the informal sector if accompanied by more efficient measures for fighting smuggling and fraud in the trading and in the external acquisitions by travelers and Mozambican citizens.

In general, ” *the adequacy of VAT in less developed countries, brings some skepticism to its desirability specially when, in practice, the “theoretic model” applies “narrow bases” and the administration of the same is extremely inefficient is always discussible.*

With respect to the increase of competitiveness by means of reduction of the VAT, this is doubtful ... VAT on *inputs* is deductible and exports shall, in principle, be “clean” from all VAT of the economic circuit, on the basis of the application of the taxation in accordance with the “destination principle”. There can be some gain such as lower “financial immobilization” that will result for companies if the VAT on *inputs* is today significantly higher in Mozambique than in the neighbouring countries. This does not represent more than what a better efficiency in the administrative management of the tax and more celerity in VAT reimbursements can compensate.

We call attention to the fact that, if the figures contained in the document are correct, the impact on the revenue is very significant, affecting a tax that is “structural” for the tax revenue of the State. Thinking carefully and given that when talking about tax the losses of revenue are “certain” and the increase of revenue “uncertain” (why not proposing a phased reduction as previous referred?).

5. Elimination of VAT on transactions in the agricultural sector

We do not know what are the constraints and difficulties in this regard. However, it does not seem correct to us to consider the exemption of some agricultural products and small scale explorations. For example, we can look at the treatment given to the issue by the 6th Directive of the European Union. However, in our opinion, this does not seem to be advisable for transactions undertaken by medium or large explorations and taxpayers, especially when these have the obligation to keep organized accounts.

6. Increase the limit of turnover for integration in the normal VAT regime

7. Increase the limit of turnover for integration in the simplified VAT regime

8. Increase the limit for taxation by the “normal profit”

We think that it is an issue to be analyzed on the basis of the real situation and experience up to now. “*There is no interest*” to have in the different categories taxpayers who, by their dimension or other specialties, are not prepared to respond to the demands/requirements of the regimes (declarative, accounting, etc.), or when the tax administration itself does not have capacity to exercise the minimum effective control and follow up (due to the great number of taxpayers compared to the human resources of the tax administration at this stage).

We also consider that such review must be undertaken regularly, although the aim of the same should be that each time more taxpayers are integrated in the normal or “general” regimes and not the contrary.

9. Eliminate Stamp Tax

Eliminating taxes because they are considered to be “old” and “outdated” is a “temptation” to which not may resist (whether specialists or politicians!). However, it is not always the “*best policy*”. There is an old tell by the classic authors that says “*the best tax is the old tax*” [*it is evident that this must be assumed carefully and according to the cases under analysis*].

This tax should represent about 1% of the tax revenue. However, in Mozambique it represents an alternative to taxation of many financial operations (contracts, documents, capital and interest, etc.), and a mean to record certain important signs of economic capacity and wealth which, by other means would not be easily taxed or would place complex problems to the tax administration and systems which are not technically prepared.

The cost of assessment of this tax was recently “almost transferred” to the taxpayer as a consequence of the approval of Decree nº6/2004 dated 1st of April, which, notwithstanding having certain incoherence, simplifies the tax.

Any way, the existence of whatever element that is considered to be “strange” or less common within the context of the surrounding regional taxation (Sub-Saharan Africa), namely in the perspective of its “understanding” by foreign investors is “inconvenient”, so if this is the case its abolition is to be proposed.

10. Eliminate the incidence of Property Transfer Tax (SISA) on leasing

It is worth to recall that, with respect to “immovable property leasing” the law in force, namely Decree nº 46/ 2004 dated 27th of October, considers that there will only be transfer of the building once the lessee exercises the right of acquisition and the tax is calculated on the residual value of the respective contract.

11. Introduce an unique and simple tax on small and micro enterprises

We think that some proposals done under the assignment we did for the “Reform of Taxation of Income in Mozambique” (E&Y, Maputo) and, more recently, the study on “Informal Economy and Simplified Taxation Regimes” may help the fulfilment of this objective, in a form adjusted to Mozambican reality.

12. Increase of Consumption Tax on national and imported products

It would be convenient to articulate correctly this tax with the customs duties and VAT, as well as quantify the effective current global rates and the ones after the increase in order to avoid distortions and unwanted effects. The concentration of the tax on goods of low elasticity as recommended, although being able to minimize the effect of the “surplus charge” of the tax, does not prevent the occurrence of a strong smuggling impulse, parallel economy and corruption, which increase in the same proportion as the increase of the global tax rate.

13. Creation of a minimum IRPC for companies

See comment in 11 above.

14. Elimination of incentives to the import of raw materials and intermediate products

15. Elimination of incentives to the import of capital goods

The proposed elimination of incentives to imports is “technically correct” and advisable in some “forums”. In the case of Mozambique, that is highly

dependent on intermediate and capital goods *inputs*, such exemptions even represent a predominant slice of the existent “tax expense” (see study referred in 1.). We are however, a little bit sceptical with respect to the pure and simple abolishment in the case of capital goods, for which no production alternative exists in the short and medium terms.

Over and above this, the negative effects of its existence/ maintenance – as stated in the document under analysis – may be minimized if included in a selective and efficient incentives system for productive investment, according to criteria as effective employment created, satisfaction of internal supply needs, national component of the value of exports, etc. (in this regard, see the study referred and comments to proposal 1).

However, it is important to evaluate in what extend the current situation of multiple exemptions may be discouraging a strategy of “substitution of imports” and increase of the added value of the Mozambican exports, as well as see the possibility of replacing the high customs duties existent which cohabit with extensive exemptions on goods with lower rates and few exemptions (very selective) for short periods. This policy may result in benefits in terms of simplification and less administration and compliance costs for levels that are more or less identical of the customs revenue (also see proposal 17 below).

16. Creation of tax on natural resources (“royalties” on mining)

In our opinion it may be penalizing given that the Mining Law n° 14/2002 dated 26th of June foresees an additional tax system specific to mining activities and simultaneously with the general taxes, the tax on production (value of the mining product commercialized or used for any commercial or industrial purpose) and the tax on surface (due by the holders of prospecting and research licenses, mining concession or mining certificate) are levied.

This proposal does not seem incorrect if “coherent” with similar taxations in the area due to regional tax competitiveness.

17. Unique customs duties and of low value for the import of commercial “inputs”

See comments to proposals 14-15 above.

18. Subjection of public organisms (State) to interest rates of the market in the case of payment delays

This is a “non-fiscal” issue with which we agree due to transparency and efficiency reasons as well as for budget rigor.

IN CONCLUSION

- The study on the tax reform and business environment is current (up to date);
- It contains issues that are pertinent and that worry the entrepreneurial community;
- Identify tax constraints that represent an impediment for the economic growth and development;
- The recommendations contained in the same are pertinent;
- The study can be adopted with the necessary safeguards, to serve as a guideline for the discussions of the private sector with the Government.