WHAT HAS TAX GOT TO DO WITH DEVELOPMENT

A critical look at Mozambique's Tax System

AFRODAD

African Forum and Network on Debt and Development

About AFRODAD

Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

Objectives include the following:

1 To enhance efficient and effective management and use of resources by African governments,
2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of people in the world,
3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being apolitical, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of Seven programme and five support staff.

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ISBN: 978-0-77974-4560-4
EAN: 97807797445604

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Acronyms

CC	(Comite de Coodenacao) Coordinating Committee
CIP	(Centro de Integridade Publica) Centre for Public Integrity
CPI	(Centro de Promocao de Investimento) Center for Investment Promotion
DA	(Direitos Aduaneiros) Duty Tax
EITI	Extractive Industries Transparency Initiative
EIU	Economist Inteligent Unit
FT	Fuel Tax
GDP	Gross Domestic Product
GMD	(Grupo Mocambicano da Divida) Mozambican Debt Group
HIPC	Highly Indebted Poor Countries
ICE	(Imposto sobre Consumo de Especifico) Excise Tax
IESE	(Instituto de Estudos Sociais e Economicos) Institute for Economic and Social Studies
IRPC	(Imposto sobre Rendimento de Pessoas Colectivas) Corporate Tax
IRPS	(Imposto sebre Rendimento de Pessoas Singulares) Individual Tax
ISPC	(Imposto Simplificado de Pessoas Colectivas) Simplified Tax for Small Contributors
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MOZAL	Mozambique Alluminium
MT	Metical
MTEF	Medium Term Expenditure Framework
NGOs	Non Governmental Organisations
PARPA	(Plano de Accao sobre a Reducao da Pobreza Absoluta) Plan of Action for the Reduction of Absolute Poverty
REO	(Relatório de Execução Orçamental) Report on Expenditure Execution
VAT	Value Added Tax
UN	United Nations

Preface

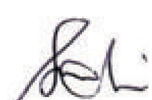
Mobilising domestic resources as a means to financing development has become an important development issue. In the past the emphasis on financing development focused on scaling aid and external borrowing. For a long time mobilising domestic revenue has been neglected, despite being a better long-term option. The reasons for this included the inherent pessimism about raising revenue, a prevalent 'small-state' ideology and a preference for foreign aid-led solutions.

Taxation is a major tenet of any domestic resource mobilisation tools at the disposal of developing countries. Taxation also plays an important role in shaping the distribution of benefits from higher income citizens to those most in need in a country. Another less discussed importance of taxation is its centrality to good governance, as it allows the government more policy space and capacity to be responsive and accountable to national objectives that are not tainted by the conditionalities of foreign aid. Taxation is at the heart of administration of government and provides the foundation for the provision of public goods and the implementation of effective regulation and acts as a vehicle for transporting public demands for responsiveness and accountability from their elected leaders. A "correctly" applied and "fair" tax system for African countries also offers the advantage of stability in comparison with traditional development financing mechanisms like aid and loans.

The link between development and taxation has come up in various fora as development practitioners and activists discussed methods of mobilisation of domestic resources for financing development in the South especially the need to finance the Millennium Development Goals (MDGs). Tax revenues are, on average, lower in developing countries than in rich countries; the average revenue in African countries was approximately 15% of GDP in 2008. Hence the argument that if developing countries were able to collect sufficient tax revenues, they might be able to increase their independence, the provision of social protection, infrastructure and basic services such as education and health care which are crucial for development.

Despite the importance of taxation in African development, public participation in debates about taxation has been particularly limited despite major issues of public interest related to tax system equity, tax avoidance and evasion and the broader drive for improved governance. It is with this background that AFRODAD believes that taxation acts as a stimulus to economic independence. This research forms part of AFRODAD's efforts to ensure tax justice and expand public participation in debates about taxation in order to improve development outcomes.

The report takes a closer look at the relationship between taxation and development in Mozambique by examining the various complexities surrounding taxation as a development finance mechanism in Mozambique including the current tax framework, the amount and extent of tax evasion and more specifically tax incentives and governance in various sectors of the Mozambican economy. The report proffers actionable policy and institutional recommendations to the government of Mozambique and civil society for the betterment of the tax system in Mozambique. AFRODAD hopes that the Mozambican government and other civil society organisations will take seriously matters arising in this report.



Collins Magalasi
Executive Director
AFRODAD

Acknowledgements

AFRODAD wishes to acknowledge their gratitude to Dr. Marta Cumbi for investing considerable time and effort in the research process and writing of this report. The report was enriched by the special contributions made by various institutions and individuals. The research work on this matter would not have been possible without their input and assistance.

We would also like to thank the reviewer Dr. Attiya Waris, a Law Lecturer at the University of Nairobi. This report benefited greatly from the tireless work of the AFRODAD Secretariat; Dr. Fanwell Kenala Bokosi the Policy Advisor who gave advice and incisive comments, Fiona Chipunza the Programme Officer for coordinating and facilitating the research and to Jonathan Zinyandu and Chipo Mbawu for proof reading the report. AFRODAD will forever be indebted to them for their valuable contributions. We also thank other colleagues not mentioned but whose input into the final product remains vital.

1 Executive Summary

Mozambique is an aid dependent country with 44% of its budget for 2010 funded by external resources. This poses constraints in the government's capacity to respond to the needs of its population and meet the Millennium Development Goals (MDGs). One of the avenues that the government is exploring to raise domestic resources is the expansion of the tax base through the promotion of private sector development.

The Mozambican tax system has undergone major reforms to conform to international and regional standards in order to attract foreign investment. In this regard, the country has been a preferred destination for Foreign Direct Investment (FDI) whose production has been contributing to economic growth and exports. Although the overall tax system is in line with international standards, some of the tax rates are slightly above the regional standards leading to complaints from small businesses who struggle to remain competitive while aspiring to expand their businesses.

The main existing taxes for the mobilisation of domestic resources are Value Added Tax (VAT), Corporate Tax (IRPC), Individual Tax (IRPS), Excise Taxes (ICE), Import Duties (DA), Simplified Income Tax for Small Contributors (ISPC) and Fuel Tax (FT) to name a few. The major contributors to fiscal resources are VAT, IRPS, IRPC and DA.

Fiscal benefits are granted to companies as a means of attracting foreign investment, promote the mobility of capital across sectors and promote specific industries and zones that are deemed important to the country's development. The provision of fiscal benefits, however, is not viewed as the only means to attract investment because some companies would invest with or without incentives. Companies are mainly attracted by the prevalence of political and macroeconomic stability, existence of infrastructures and low transaction costs.

The country still faces constraints regarding tax evasion because people claim lack of clarity about the destiny of their contributions whereas companies take advantage of government's limited capacity to monitor compliance as well as the existence of corrupt schemes to evade taxation.

The national private sector calls on the government to accelerate the implementation of the reforms underway that will enable them to increase production and productivity that will lead to economic growth and a further increase in tax resources.

There is a general understanding on the need to pay taxes but the government has to improve its communication with the public to build trust so that people will know what to expect from the money they pay.

The extractive industry has a potential to contribute to taxation and poverty reduction but it is still in an initial stage and is also a major beneficiary of fiscal benefits that reduce the extent to which it contributes to domestic resources. The country has decided to adhere to the Extractive Industries Transparency Initiative (EITI) a step that will increase public understanding about its contribution to economic development and government use of tax collected. Civil Society Organisations (CSOs) have been engaged in undertaking research, disseminating information and contributing to the present debate on taxation. The establishment of partnerships with government and the private sector for tax justice can bring tangible benefits to the country.

2 Introduction

The present world economic and financial crisis has, more than ever, exposed the vulnerability of developing countries for their reliance on foreign aid resources for their development agenda.

Despite world leaders' promises to engage in development partnerships for the achievements of the Millennium Development Goals (MDGs) by 2015, part of the commitments made are not being met. In 2008 Word Bank (WB) estimates showed that 1.4 billion people across the globe lived below the poverty line. With the onset of the world financial crisis one can expect that more people may have fallen back to the poverty trap. There is a pressing need from both developed and developing countries to see their internal problems solved which poses challenges on the allocation of the scarce resources. There is also a matter of political will from world leaders to go from promises to action.

The recent UN summit on MDGs held in September 2010 showed that progress has been made in meeting targets in many areas but stronger measures have to be taken if the MDGs have to become a reality to millions of people whose lives depend on world leaders' actions.

Domestic resources can constitute a stable and long lasting source of funding to development agendas. The private sector and citizens can contribute to this effort through taxation but most governments have been neglecting this venue of resource mobilisation and concentrating their attention to foreign aid.

Foreign aid is necessary to complement national efforts to foster development and reduce poverty. Indeed over the years OECD aid resources to developing countries have been increasing either in the form of donations or credit. The Highly Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI) have raised revenues that enabled poor countries to respond to the pressing needs of their populations.

Present discussions on aid effectiveness have caught the attention of governments, donors and civil society organisations. Through commitments made in the Paris Declaration and Accra Agenda for Action, governments and donors are trying to improve the way aid is disbursed and used to improve its impact on the lives of the beneficiaries. This, however, has to be additional to what developing countries are doing to raise domestic resources.

Within the globalisation framework that considers the private sector as the engine for development and the possibility of investment mobility across the globe, many developing countries have been opening their markets to Foreign Direct Investment (FDI) and promoting the development of national entrepreneurs. This means that there is an opportunity for the increment of domestic resources through taxation.

Taxation is a process through which governments mobilise the necessary revenues required to finance public goods and services while facilitating private sector development, promoting efficient investment and creating jobs.

Given that taxes have a pervasive influence on economic decisions of individuals and businesses and on social equity, the tax systems should achieve the appropriate level of revenue as efficiently and fairly as possible. Thus, tax systems should be effective in raising revenues, efficient in their effects on economic decisions of households and businesses and equitable in their impact on different groups in society[1].

In the last years NGOs and other development practitioners have been bringing taxation to the discussion table, viewing it as a means to foster development and poverty reduction. They also point to the fact that tax holidays, capital flight, tax avoidance, corruption and lack of stimulus to comply with tax regulations by citizens and companies are some of the challenges that developing countries have to deal with to ensure that taxation contributes to development efforts.

The objective of this research is to analyse the key features of the existing tax framework in Mozambique – its weaknesses and strengths and its impact on governance and revenue as well as to examine

1 Nathans Associates, (2004); A Review of Private Sector Concerns in Mozambique

the country tax system in terms of the allocation of the tax burden on different income groups and to identify ways of strengthening and/or adapting existing systems to address the needs of the poor.

3 Country Profile

Mozambique is a Southern African country with 22million inhabitants, 80% of whom live in rural areas. Mozambique is rich in natural resources such as petroleum, timber, sea products, sugar, cotton and has ample extensions of fertile land for cultivation. Indeed, the majority of the population lives on subsistence farming and animal husbandry.

Given its economic potential and the prevalence of peace and macroeconomic stability, Mozambique has been a preferred destination of Foreign Direct Investment (FDI) that has been contributing to the economic growth. Over the last few years, the country has registered impressive economic growth rates of 8.4%, 8.7%, 7.4% and 6.8% for 2005, 2006, 2007 and 2008 respectively. Per capita GDP was US$841 in 2008[2].

This growth, however, is based on megaprojects whose social impact is not felt by the majority of the population. The economy is also based on the production and export of primary goods, with little or no processing component. Therefore, Mozambique sells raw materials and imports consumer goods at high prices. There has been a chronic trade deficit over two decades with little sign for improvement.

External debt amounted to US$3.432 billion in 2008 with debt service of US$43 million. For 2010 external debt was estimated at US$4.624 billion with a debt service of US$109 million (EIU, 2010). This is a substantial increase in such a short period of time which poses concern to CSOs regarding debt sustainability. There is information that the government is putting in place a debt strategy to avoid a future debt crisis. Depending on its content, this strategy can be a useful tool that will help the government to have control of the different sector debt requests.

Exports reached US$2.6 billion in 2008 of which 55% were aluminum ingots from the MOZAL project. This shows the country's economic indicators do depend on a few foreign companies whose foreign currency can be expatriated in accordance with the provisions made in the investment law.

2 Economist Intelligent Unit, Country Report, Mozambique, 2010

Social indicators are still very low compared to the average southern African country. The rate of people living below the poverty line was 54.7% in 2002. According to recent figures released in August 2010 the number of people living below the poverty line has not changed over the period 2003/2009[3].

The rate of literacy is 54%. Women account for 69.4% of illiterate people compared with 36.1% of men. The rate of infection by HIV and AIDS is above 16% and women constitute 58% of the infected people. This is a big challenge to the government to meet its commitments to the people and to comply with international commitments such as MDGs.

Mozambique is an aid dependent country with 44% of its budget for 2010 funded by external resources. This poses constraints in government's ability to respond to citizens' felt needs because donors have to agree on what the government puts money in. In the first semester of this year the country almost stopped because development partners froze the disbursement of resources due to some divergent positions between them and the government.

The government has been putting in place policies and strategies to raise internal resources through the expansion of the tax base to reduce dependency and meet the growing needs of its population in line with several development instruments such as the Government Five Year Plan, Poverty Reduction Strategy Programme (PARPA), Medium Term Expenditure Framework (MTEF) and Annual Economic and Social Plan.

Within the Poverty Reduction Strategy Programme (PARPA II) framework for the period 2005/09, the government set specific objectives to improve the business environment for the increase of domestic resources by strengthening the existing tax system through the implementation of the following activities:

- Simplification and refinement of the tax system and broadening of the tax base,
- Consolidation of reforms made in direct and indirect taxes,

3 Report on Millennium Development Goals, Republic of Mozambique, 2010

- Evaluation of the effectiveness of tax and investment incentives,
- Modernisation and improvement of tax administration,
- Establishment of Industrial Free Zones,
- Strengthening of legal and fiscal framework for the mining sector.

The establishment of the Mozambican Tax Authority in 2006 was instrumental in facilitating the implementation of the set objectives and coordinating the overall process of tax collection and administration as well as sensitising the taxpayers regarding their fiscal obligations.

While the government is preparing the third PRSP (PARP) to deal with the prevailing challenges on poverty reduction, the Medium Term Expenditure Framework 2010 – 2012 foresees an increase of 11% on total resources budgeted for the three years.

For this increase to be realised and have a positive impact on the lives of people, the government has to work together with the private sector and civil society organisations to inculcate a culture of fiscal responsibility and ensure that the resulting resources are used to meet the needs of the citizens. People need jobs to generate income and demand goods and services that in turn will increase the economic activity. Tax can only be collected if people and companies have incomes and purchasing power to create demand for goods and services. A balance should be made between present income increase and business development efforts and only a fair tax system will lead to the fulfillment of peoples' needs while promoting development.

The government needs to further re-evaluate its current tax system not only in terms of policy improvement given that it is mostly in line with international standards for developing countries but also in tax administration looking at present fiscal incentives, tax evasion and corruption practices that have been having a negative impact on the economy.

4 The Tax System in Mozambique

The tax system in Mozambique has undergone major reforms since 1998 to mobilise foreign direct investment for the promotion of economic growth, increase total revenues and reduce poverty. The government views the present tax system as progressive, with the poor bearing the small portion and the rich paying higher amounts compared to their income. Import duties and excise taxes on goods consumed by the poor, though, have regressive effects. Nonetheless, the present tax system is seen to conform to international standards of other developing country tax systems.

According to Nathan Associates Inc[4], there is little scope for revenue gains through further tax policy measures, but greater potential for increasing revenue by broadening the effective tax base, allocating resources more efficiently and facilitating taxpayer compliance through further measures to modernise tax administration. These include functional integration of tax and customs operations; automation of procedures and systems; risk management; human resource management and development of a service culture among tax officials[5].

The private sector agrees that some improvements have been made over the years to improve the business environment in the country. However, it claims that the level of taxation is high and the small and medium enterprises are bearing a higher portion of the tax burden while big companies enjoy tax benefits.

There are several kinds of tax and tariffs levied on income, goods and services within the country. The main sources of domestic revenues are the Valued Added Tax, Corporate Tax and Individual Tax. Other taxes and custom duties are charged on goods and services and they also contribute to the domestic revenues. Detailed information of the tax features in Mozambique is presented below.

4 Nathan Associates, (2009), PARPA II Review, Abstract – The Tax System in Mozambique, http://www.open.ac.uk/technology/mozambique/pics/d119380.pdf

5 Nathan Associates,(2009) PARPA II Review, Volume I – The Tax System in Mozambique, http://www.speed-program.com/library/resources/documents/parpa_ii_review__tax_system_in_mozambique--volume_i.pdf

4.1 Existing Taxes and Custom Duties

The Value Added Tax is a 17% tax on consumption levied on transfers of goods, services and imports for business with an annual turnover greater than US$95,000. Businesses with a turnover below US$28,000 qualify for VAT exemption but they cannot claim credit for VAT paid on imports. Exports and certain basic goods and services are also exempt from the payment of VAT.

IRPC is a corporate income tax set at 32% with a special rate of 10% applied to agriculture and animal husbandry activities until 2010. Companies are also required to withhold a 20% tax on revenues from services provided to them within the Mozambican territory which are then remitted to the government tax authority on a monthly basis.

IRPS is a progressive personal income tax ranging from 10, 15, 20 and 32%, assessed on total household income after allowing for marital status and family dependents deductions. These taxes are withheld by companies and are also remitted to tax authorities on a monthly basis. Incomes below 36 times the minimum wage in force at the end of previous year do not pay tax.

Simplified Tax for Small Taxpayers is a new income tax aimed at attracting small and new businesses into formalisation. It is levied on businesses with an annual turnover of up to 75,000 MT, equivalent to US$2,345, at 3% tax rate.

Import Duties range from 0 to 20% depending on the categories of the goods, being 20% for consumer goods, 7.5% processed raw materials, 5% for capital goods and fuel, 2.5% for raw materials and 0% for basic goods. All the percentages are attached to specific goods according to the customs classification list.

Excise Tax is a selective tax on consumption levied on specific goods such as tobacco, beverages and alcohol, jewelry, vehicles and other luxury goods and ranges from 5 to 75%.

Fuel Tax is charged as a percentage on the price per liter of fuel and it is adjusted quarterly to compensate for exchange rates and price variations.

There are other small taxes such as stamp tax, municipal tax, vehicle tax, property tax transfer, tax on gambling, inheritance and gift tax, national reconstruction tax, royalties on mineral and petroleum extraction and surface tax on concessions that also contribute to the domestic resources.

4.2 Tax Revenues during the First 10 Years of Tax System Reform

The Mozambican government has been making efforts to put in place strategies to increase the level of domestic revenues to reduce dependency and defend/maintain its sovereignty. The restructuring of the tax system from 1999, the establishment of tax targets within the PARPA I and II, the definition of the MTEF and the creation of the Tax Authority in 2006 with the mandate to implement the objectives set in different governing documents regarding tax collection and administration, brought a new impetus to government capacity to raise domestic resources. Table 1 below shows the evolution of domestic revenues from the beginning of the restructuring process.

Table 1: Revenue by Type of Tax as % of GDP

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total Revenues	10.8	11.5	11.2	11.4	13.1	12.4	13.8	15.2	16.2	16.0
Fiscal Revenues	10.0	10.5	10.0	10.5	12.3	10.8	11.1	12.3	13.4	13.5
Income Taxes	1.5	1.6	1.8	2.1	2.9	2.7	2.9	3.5	4.5	4.9
Individual Tax	0.8	1.0	1.1	1.4	2.0	1.9	1.9	2.1	2.3	2.5
Corporate Tax	0.7	0.6	0.6	0.7	0.8	0.8	1.0	1.4	2.1	2.4
Gambling Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on Goods and Services	6.6	7.3	6.9	7.2	7.9	7.2	7.4	8.0	8.3	8.0
Value Added Tax (VAT)	3.9	4.4	4.2	4.4	4.9	4.5	4.5	5.2	5.4	5.4
VAT on Internal Operations	1.0	1.8	1.9	2.0	2.1	1.9	1.8	2.1	3.2	2.4
VAT in Imports	1.4	2.6	2.4	2.6	2.7	2.6	2.7	3.2	2.2	3.0
Taxes on Specific Consumption - National Products	0.6	0.6	0.6	0.6	0.7	0.6	0.6	0.6	0.6	0.7
ICE - Beer and Beverages	0.0	0.5	0.4	0.5	0.5	0.4	0.5	0.5	0.5	0.5
ICE - Tabacco	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1
ICE - Other Produts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on Specific Consumption - Imported Goods	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Duties and Surtax on Sugar	1.7	1.9	1.8	1.9	2.0	1.7	1.9	1.8	1.8	1.5
Other tax Revenues	1.9	1.6	1.3	1.2	2.2	0.9	0.8	0.7	0.7	0.6
Other Revenues	0.7	1.0	1.2	0.9	0.9	1.8	2.9	3.0	2.7	2.5
Fuel Tax	1.3	1.2	1.0	0.9	1.2	1.3	1.2	1.0	1.1	1.0

Source: Nathan Associates Inc, 2010

As shown in Table 1 above, fiscal revenues have been growing overtime, with the exception of 2004. In 2008 total revenues amounted to 16% of GDP of which 13.5% represented tax revenues. Of the tax revenues the major contributions came from Value Added Tax, Personal Income Tax and Corporate Income Tax with 5.4%, 2.5% and 2.4% of GDP, respectively.

This trend is welcomed by the government whose objectives on tax collection are being met. For the national private sector the evaluation is slightly different. The private sector welcomes government efforts to improve the business environment in Mozambique which will lead to the increase of economic activity and hence national resources. But it also recognises the need to balance tax collection with the expansion of the business activity. Given that most of the national business sector is still incipient and needs time to grow and also having in mind the present status of the Mozambican economy with underdeveloped infrastructure and high transaction costs, the national private sector claims that the tax rates are high which poses constraints in their efforts to expand their activities. They also call for further improvement and simplification of procedures to comply with tax requirements, reduction in corruption among tax officials which fuels tax evasion, elimination of double taxation on dividends and reduction of delays in VAT refunds which contributes to the lack of liquidity within companies.

The private sector also claims that small and medium enterprises as well as long time established companies are penalised because they cannot benefit from tax benefits provided to megaprojects and newly established companies. Megaprojects, they say, do not create positive externalities within the country as they have free access to imports, are capital intensive and do not contribute to domestic income in the first years of their existence due to tax benefits.

"The present tax system is negative and prejudicial to the development of economic activities of individual taxpayers. As traders of imported goods we cannot cope with tax rates and customs imposed on our goods and still be able to compete in the market. When we buy goods in South Africa we are required to pay import duties and on top of that we have to charge VAT to consumers so the price of goods gets very high. As a result, some people, in collaboration with tax officials, evade official payments and instead pay bribes as a matter of survival. See, at the moment who complains about taxation it is us, but if we set the price according to the total cost of the goods it would be the people complaining to the government. This could fuel social unrest like the ones we witnessed in 2008 and 2010.

Another concern for us also is taxation on savings, whatever little money we deposit as savings is taxed at an annual rate of 10%.

As per the simplified tax for small contributors, it is a good move but it is not bearing the expected results. The threshold of an annual turnover of US$2345 is very high, small traders do not manage (to make) that kind of money.

More than pushing for tax collection the government should (rather) promote economic efficiency. This means investment in key sectors such as agriculture, infrastructures, etc, and only afterwards taxes could be targeted. The government has to promote and instill the culture of production.

I do not mind paying taxes and I think everyone should do so but there are no incentives for that. For example, it would be good if good taxpayers had an ID or card that showed that they are in line with tax obligations. This card should allow the holders to benefit from special treatment in the access to basic services such as education, health or even, as traders, be able to participate in government tenders for the provision of goods.

Women are the most negatively affected by the tax system because of their level of education and lack of information, they are easily vulnerable to unfair treatment, corruption and punishment in case of lack of compliance.

The Tax Authority has brought a new dynamism within the tax system but it has to improve its efficiency, combat corruption and inform people about the importance of paying tax and what they get in return."
Representative of the Association of Informal Traders (Mukheristas) in which the majority of members are women.

5 Funding for the State Budget

The Mozambican State budget for 2010 amounts 117,977 million MT (equivalent to US$3,687 million) of which 44% is funded by external resources and 56% by domestic resources. Fiscal resources account for 40% of the total budget. The Medium Term Expenditure Framework estimates that in 2011 and 2012 external resources will constitute 48.3% and 48.5% respectively whereas domestic resources will be 51.7% and 51.5% of the total budget, respectively. The percentages for internal and external resources remain almost unchanged for 2011 and 2012 with a small positive variation in absolute terms. This could mean that the government planning authorities are being cautious about the impact of the world financial crisis and regional integration on businesses as well as the perspectives of the inflow of external resources.

According to the government Report on Budget Execution (REO), 55% of the total expenditure for 2009 was funded by internal resources whereas in 2008 this figure was 57%. Internal resources include also domestic debt. Fiscal resources accounted for 36% in 2009 and 35% in 2008.

The above figures show that there is an effort to raise internal revenues to finance development efforts but due to increasing pressing needs of the population, external resources are also on the rise.

According to government officials internal resources should cover recurrent expenditure whereas external resources should fund investment expenditure. However, the present volume of recurrent expenditure is not yet fully covered by internal resources. Current expenditure for 2008 and 2009 amounted 58.2% and 55.4% of total expenditure, respectively.

From the information above it is clear that the government is still heavily dependent on external funding even to cover part of its total budget. Although the decision of supporting recurrent expenditure with internal resources was met in the last few years, this was partly due to the recourse to internal debt which has been growing at significant levels in the past years.

The country is facing constraints in making sovereign decisions due to the high level of external dependency. In the first quarter of this year donors froze their resources due to some divergent views with the government. The situation was later cleared but it was enough to show the existing power imbalance between the government and donors.

The government has to find innovative ways of raising tax revenues, by increasing the tax base, combating tax evasion and eliminating and/or reducing fiscal benefits.

6 Fiscal Benefits and Tax Evasion

6.1 Fiscal Benefits

Fiscal benefits are fiscal measures taken by governments to reduce the amount of tax payments with the view to give a competitive advantage to activities with a recognised public, social and cultural interest as well as to promote the economic development of a given country.

Tax incentives might shift production from sectors with high rates of return to those with lower ones. Footloose export industries are more responsive to tax incentives because they can easily move from one country to another.

In countries where governments give incentives there is pressure from other companies to get incentives leading to the shrinkage of tax revenues.

Fiscal benefits are normally skewed to large companies and this creates serious equity problems among companies within the country with the disadvantage going to national companies because they are small and medium and have to comply with most tax requirements.

According to Mozambican legislation, fiscal benefits are fiscal and custom duties incentives namely: deductions made in collectable income, deductions to collections, accelerated depreciations and re-integrations, fiscal credit, exemptions and reductions of tax rates and contributions, deferments on the payment of taxes and other measures of exceptional character.

Under the Investment Act of 1993, investments approved by the Centre for Investment Promotion (CPI) qualify for specified fiscal benefits. Eligibility requires a minimum investment of US$50 000 for foreign companies and $5 000 for domestic companies, as well as detailed business plans and evidence of financial and management capability.
As part of the tax system reform the fiscal benefits also did undergo major alterations with the approval of a Tax Benefit Code in 2002 which was further improved in the 2009 Code, aimed to rationalise the fiscal benefits for investments and make them more effective as an instrument of the political economy.

Thus, the present fiscal benefit system is presented as follows:

Table 2: General Fiscal Benefits 2002 and 2009, Main Features

Benefit	2002	2009
Benefits on the import of goods	Exemption from payment of import duties on equipment included in class "K" of the customs Tariff Schedule.	Exemption from payment of import duties on equipment and accessories included in class "K" of the customs Tariff Schedule.
Fiscal benefits in respect of income	Investment carried out under the investment law shall benefit for the period of five (5) years from an investment tax credit equal to 5% of the total investment realised. In Maputo Province the percentage of the ITC shall be of 5%; in other provinces the ITC shall range from 10% to 15%.	Same. In Maputo province the percentage of the ITC shall be of 5%; in other provinces the ITC is 10%.
Accelerated depreciation	Permitted for new immovable assets. Accelerated depreciation at twice the normal rate set by law for the purpose of determination of taxable income subject to Corporate Income Tax (IRPC) and Personal Income Tax.	Same. Accelerated depreciation at 50% above the normal rate set by law for the purpose of determination of taxable income subject to Corporate Income Tax (IRPC) and Personal Income Tax. The same conditions also apply to rehabilitated immovable assets and equipment and machinery for industrial and/or agro industrial activities.
Modernisation and introduction of new technology	The amount invested in specialised equipment shall during the first five years from the date of commencement of activity, benefit from a deduction from taxable income for the purpose of the IRPC up to a maximum amount of 15% of taxable income.	The amount invested in specialised equipment shall during the first five years counting from the date of commencement of activity, benefit from a deduction from taxable income for the purpose of the IRPC up to a maximum amount of 10% of taxable income.
Professional training	Investment expenditure for professional training of Mozambican locals shall up to a maximum amount of 5% of taxable income be deductible from taxable income for the purpose of calculating corporate income tax. When the professional training is for the use of technologically advanced equipment, the allowable income tax deduction for the purpose of the calculation of the Corporate Income Tax shall be a maximum amount equal to 10% of taxable income.	Same. Same.

Table 2 cont: General Fiscal Benefits 2002 and 2009, Main Features

Benefit	2002	2009
Tax Deductible Expenditure – During a period of 10 years counting from the date of production, enterprises certain expenditures may be treated as deductible expenditure for the purpose of calculation of Corporate Income Tax (IRPC)	In the case of undertakings carried out in the city of Maputo, 120% of the value of expenditure in the construction and rehabilitation of roads, railways, airports, mail delivery, telecommunications, water supply, electric energy, schools, hospitals and other works that are considered to be of public utility by the competent authority and documented by the Tax Administration. In the case of other provinces, an amount equal to 150% of the expenditure.	In the case of undertakings carried out in the city of Maputo, 110% of the value of expenditure in the construction and rehabilitation of roads, railways, airports, mail delivery, telecommunications, water supply, electric energy, schools, hospitals and other works that are considered to be of public utility by the competent authority and documented by the Tax Administration. In the case of other provinces, an amount equal to 120% percent of the expenditure.
Exemptions from Stamp Tax	The acts for the incorporation of companies including the alteration of the share capital and article of association are exempt from stamp duty during the first five (5) years.	N/A
Exemptions in the rate of the real property transfer tax	Undertakings shall benefit from a 50% percent reduction in the rate of the real property transfer tax (SISA) with regard to the acquisition of immovable property used in industry, agro industry, and hotel as long as the property is acquired within the first three (3) years.	N/A

Source: PARPA II Review – Tax System in Mozambique, Volume II – Appendices
Note: Under Article 13 of the 2009 Code, "general" fiscal benefits apply to investments that are not covered by any of the specific benefits provided in the Code, and may not be cumulated with specific fiscal benefits unless otherwise specified in the latter provision.

Table 2 above on Generic Fiscal benefits shows that there was a slight reduction on the level of benefits provided in the different categories, with the exception on the benefits given to import duties that extended the benefits also to spare parts. On other categories the benefits reduced by about 5 to 30% whereas in few items the benefits remained unchanged. There is no evidence on how these targets were defined. Apart from the general benefits listed above the government also provides specific benefits under the Investment Law to investments made in the agriculture sector, tourism, Zones for Rapid Development covering the Zambezi Valley, Niassa Province, Nacala District and Ibo and Mozambique Island.

As shown in the map below, the Zones for Rapid Development are located along Zambezia, Tete, Niassa, Nampula and Cabo Delgado provinces. They have a big potential in natural resources such as de Cahora Bassa Dam in Tete Province, Niassa Lago and a world historic monument in Mozambique Island.

Thus, the aforementioned benefits aim to shift investment across sectors and regions which could bring benefits to marginalised regions and sectors due to their geographical location, low rate of return, and/or importance on economic development.

The mining and petroleum sectors have also been granted fiscal benefits under their respective sector laws. For the mining sector, fiscal benefits have been granted on import duties of equipment, devices, spare parts and exports of mineral resources as well as a 25% reduction on IRPC for investment above US$500 000. Imports are also exempt from the payment of VAT and ICE to the mineral companies and their contracted and sub-contracted partners.


MOZAMBIQUE
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TANZANIA
MALAWI
ZAMBIA
ZIMBABWE
SOUTH AFRICA
SWAZILAND
NIASSA
CABO DELGADO
NAMPULA
ZAMBEZIA
TETE
MANICA
SOFALA
INHAMBANE
GAZA
MAPUTO
Lichinga
Pemba
Nacala
Nampula
Tete
Quelimane
Chimoio
Beira
Inhambane
Xai-Xai
MAPUTO
INDIAN OCEAN
Mozambique Channel

In the petroleum sector, exemptions are made in the payment of import duties on goods and equipment to be utilised in the extraction activity and on export duties, and payment of VAT and ICE on imported and exported goods. Further exemptions of 25% are made on the payment of IRPC.

Two issues must be taken into consideration when analysing the extent to which the private sector can contribute to national income: First, the Mozambican economy is based on foreign domestic investment and research made by IESE (Instituto de Estudos Socias e Económicos) shows that 85% of private investment is funded by foreign resources. This means that the fiscal incentives provided in their diversified forms (export of profits, tax and duty exemptions) reduce the extent to which additional resources generated by investment contribute to economic development and poverty reduction. In other words, the incentives are not provided to national companies whose growth would contribute to intensive employment generation and use of national production inputs with positive multiplier effect in the economy but rather they are given to foreign companies who have the prerogative to import raw materials with exemptions and export their profits when they wish to. This also shows the country's further dependency on foreign resources which undermines its sovereignty[6].

Second, although tax incentives might have been critical in the negotiation of some few big projects, there are other aspects that are taken into account by investors before making their investment decisions. Factors such as political stability, macroeconomic stability, economic infrastructures are also decisive to investors and individuals.

Evidence from a research undertaken by Jose Macamo (2000) to determine administrative barriers to investment in 30 random investors showed that 76% respondents would have undertaken the same investment without tax and customs incentives[7].

Belnick (2009) study confirmed Macamo's findings and found out that fiscal and customs incentives are critical factors for the largest investment[8]. However, investments that depended on the availability of incentives were very capital intensive and created fewer jobs than those that would have been undertaken with or without tax breaks.

The country can reduce its dependence on foreign resources through taxation of big projects and big foreign investments. Incentive to invest should not necessarily be fiscal.

> "Four years ago I was working in Manica Province where there were a lot of Zimbabwe farmers and it was thought they would solve a lot of our problems. The government gave them 10 years of fiscal incentives. When I interviewed them they said: Mozambique is a wonderful country with extraordinary people but you do not have a slight idea of the meaning of business. *We left Zimbabwe and came to Mozambique to ask for land. You gave us land and fiscal incentives to attract us. We would rather pay taxes and with that money create facilities of support services to agriculture production. We want seeds, be able to make analysis of the soil, ask for credit but now we have to go all the way to South Africa. We want to install here the scientific conditions, the logistic base, etc, for the functioning of the production.* The point they wanted to make is that in Zimbabwe they were commercial farmers with great viability partly because they had public agricultural services of high quality, cheap and largely accessible. In Mozambique we don't have this. They said the representatives of the brands from whom they bought some machinery do not know the spares parts, farmers have to make the maintenance of their equipment and this implies that the machinery deteriorates rapidly and there is a waste of working time for its repair".
> *Carlos Castel Branco in Savanna Newspaper, October 2010*

6 Carlos-Castel Branco, (2010), Economia Extractiva e Desafios da Industrialização em Moçambique, Instituto DeEstudos Socias e Economicos, http://www.iese.ac.mz/lib/publication/cad_iese/CadernosIESE_01_CNCB.pdf

7 Nathan Associates,(2009) PARPA II Review, Volume I – The Tax System in Mozambique, http://www.speed-program.com/library/resources/documents/parpa_ii_review__tax_system_in_mozambique--volume_i.pdf

8 Ibid

This is clearly an example that investors do not invest in countries solely due to fiscal benefits. They want to have all or most of the production chain services provided and a sound political and economic stability. By providing and facilitating access to these services companies would be able to expand their production, generate more wealth and contribute more to the economy through taxation.

Some people argue that Mozambique has not been undertaking deep evaluation on the impact of the tax benefits to government income to see to what extent the benefits provided bring a net positive gain to the economy. Therefore there is a strong need that there should be a thorough cost-benefit analysis to determine the extent of tax benefits required to attract investment while promoting efficiency and equity.

Although the disaggregation of data on tax exemptions by industry is still under construction, available data gives us an idea of major tax exemptions between 2006 and 2008 as follows:

According to Table 3 above, tax exemptions amounted to over three billion MT in 2006 and more than doubled in 2007. It is important to note that between 2006 and 2007 the volume of IRPC exemptions were six times more than the previous year and constituted 57.8% of total exemptions for that year. In 2007 IRPC led the volume of exemptions with 57.8% of the total.

Tax receipts grew over time, reaching over 30 billion MT in 2008. As also shown in the table above, VAT, import duties, IRPC and IRPS and excise tax constitute the main sources of tax income. It is interesting to realise that although Mozambique has a considerable number of mega projects, IRPS surpasses IRPC. This could mean two things: either the majority of income tax is supported by individuals or small businesses and informal sector pay their IRPC as individuals.

There was an increase on exemptions as a percentage of receipts from 15.1% in 2007 to 26% in 2007 meaning that the percentage increase in exemptions is bigger than the increase in tax revenues, therefore losing money through tax benefits. There was no available information to calculate the tax gap to know the extent to which the government is losing money that could be used to meet the needs of the populations.

Table 3: Approved Tax exemptions in MT*

	Import Duty	VAT	Excise	IRPC	IRPS	Sum
Tax Exemptions						
2006	822.8	1534.3	271.8	517.4	0.2	3146.5
2007	923	1857.1	112.8	3967.2	0.9	6861
2008	710	1296.6	188.1	na	na	na
Tax Receipts						
2006	3260.6	9385	1818.6	2535.5	3784.4	20784.1
2007	3803.8	11314	2076.2	4364.9	4859.1	26418
2008	3597.4	12969.6	2634.3	5425.9	5957.2	30584.4
Exemptions as % Receipts						
2006	25.2%	16.3%	14.9%	20.4%	0.0%	15.1%
2007	24.3%	16.4%	5.4%	90.9%	0.0%	26.0%
2008	19.7%	10.0%	7.1%	na	na	na
Exemptions by type Tax %						
2006	26.1%	48.8%	8.6%	16.4%	0.0%	100.0%
2007	13.5%	27.1%	1.6%	57.8%	0.0%	100.0%
2008	na	na	na	na	na	na

Source: PARPA II – Tax System in Mozambique – Appendices (2010)
*In January 2010, 1USD=32.00 Mt

6.2 Is it possible to Renegotiate signed contracts?

Interviewed people said it is worth starting a dialogue with big companies who benefited from tax incentives in their contracts to reverse the present situation. According to them, although the 2009 Tax Code introduces some reductions in the benefits, the majority of known non-renewable natural resources have been allocated to companies whose contracts have big tax benefits. Therefore the new law will only cover few new contracts whereas the others continue to enjoy tax benefits.

Negotiations should be through mutual consensus. The government has created a good record as coherent and keeping up to its promises and it will not want to break this. For their part, companies want to work in a peaceful country. Therefore, the idea of starting a dialogue around renegotiation of fiscal benefits could also be of interest to companies who would want to contribute to national political stability.

Experiences from other countries on this matter have encouraged public figures to speak out about the need to improve the country's negotiation skills to deal with present and future tax issues. For the Governor of the Central Bank of Mozambique, the government should discuss the issue of tax benefits and obligations without taboos. In investment both government and the private sector should have gains otherwise it creates social tensions, added the Governor.

This is an important step towards the establishment of an important dialogue around mega projects and tax benefits and it encourages CSOs and other development actors to advocate for the review of the fiscal benefits.

6.3 Tax Evasion

6.3.1 Why are people and companies reluctant to pay Tax?

Tax evasion is a widespread practice within individuals and companies due to lack of tax culture. People interviewed stated that there is no incentive to pay tax because there is no information on what the government does with the resources collected from both individuals and companies. Some people also pointed to the fact that procedures to comply with taxation are lengthy and complicated, therefore, people tend to ignore the whole exercise. According to the Mozambican Debt Group study on the Challenges of The Tax System in Mozambique, until 2005 only 29% of potential individual contributors paid their taxes[9].

The perceived high tax rates and the practice of bribes that reduce the actual amount of money that taxpayers should disburse are also among factors pointed out as motivating tax evasion. A case in hand is the move from formal to informal sectors as a means of avoiding taxation. There are also cases where companies remain in the formal sector but create a chain of informal traders who sell their products in the streets and pay no tax on this business. The system also has shortfalls that are used to avoid the payment of tax.

There is also tax avoidance in the payment of VAT. Sometimes companies give the chance to customers to choose between paying the tax or not, depending if one needs the respective receipt. This is a strategy to lower the prices and have a competitive advantage in relation to those who charge VAT.

The scenario presented above called for government action to reverse the present trend on tax evasion. The creation of the Tax Authority in 2006 has been contributing to public education on taxation, expansion of tax collection entities to the provinces and improvement of tax officials' capacity and working conditions.

According to some people, there is a work in progress to implement further measures to rationalise the fiscal system in Mozambique. This includes the improvement of tax administration, training of the tax officials, improvement of oversight work, reduction of transaction costs to pay tax through further simplification of tax procedures, improvement in the auditing of big companies, use of e-taxation in collaboration with the banking sector, increase government's transparency in the use of collected resources and improve accountability. E-SISTAFE could be used to provide information on tax collected and its application on a regular basis, perhaps quarterly to keep the citizens updated on their contributions.

9 Carlos-Castel Branco, (2010), Economia Extractiva e Desafios da Industrialização em Moçambique, Instituto DeEstudos Socias e Economicos, http://www.iese.ac.mz/lib/publication/cad_iese/CadernosIESE_01_CNCB.pdf

7 Extractive Industry

In recent years the extractive industry in Mozambique has been growing in terms of resources invested and its potential in contributing to development and poverty reduction. According to Carlos Castelo Branco, private investment in mineral industry amounted 43% of total investment between 2000 and 2008 and investment in industry and energy (including MOZAL) was 20% in the same period.

The contribution of these projects to development should be judged by the extent to which they contribute not only to total investment, production, employment and trade but above all to the rate of retention and absorption of wealth by the economy.

Aware of this challenge, in 2007 the government reformed the tax code for mineral and petroleum industry, eliminating part of tax benefits provided under the previous law.

The present tax code is well conceived and can bring tangible benefits to the country. However, the challenge is that contracts signed prior to the law are not upheld by it. The only way to bring those companies to comply with the new law is to sensitise them to renegotiate the contracts, respecting the views of each party. There is a belief that if the companies are well approached they may accept the deal because their profits are not marginal.

There is also a concern about government's weak capacity to oversee the implementation of the contracts. It is not certain that the government can monitor production in terms of quantities and what is actually being extracted underground, even in terms of declared taxable income.

Concerns were also raised about the lack of information on contracts signed and their content. Although there are contract clauses protecting the confidentiality of information, some basic data could be provided to enable interested people to monitor the contribution of these industries to development overtime.

In 2009 the government decided to adhere to the EITI (Extractive Industries Transparency Initiative), a world programme launched in 2002 that appeals for the promotion of transparency in payments made by extractive companies to the government and in the income received and accounted for by those governments as a result of the exploration of finite extractive resources. Therefore Mozambique is a candidate to EITI and should complete the whole validation process by mid 2011[10].

A general concern is that the State Budget does not reflect such an initiative by providing detailed information regarding income projections as a sign of getting ready for the exercise. On the budget execution report though, a sign has been given by providing information of income received in 2008 from megaprojects namely energy, petroleum, natural resources and other megaprojects amounting 5.48% of total income[11]. This constitutes a very small portion of income, meaning that the country will have to wait a long time to have significant benefits from the exploration of mega projects and extractive industries due mainly to two factors: 1) production is still in its initial stages and 2) magnitude of benefits granted to these projects.

At the organisational level what has happened so far was the creation of the Coordinating Committee (CC) that aims to implement the EITI guiding principles and establish an institutional framework for organising, developing, monitoring and implementing the initiative in the country. The CC is comprised by the government, represented by five ministries, three people from the civil society and four people representing the private sector. The Ministry of Mineral Resources is the presiding entity. Apart from the CC there will be a National Secretariat, an executive body with the mandate to realise administrative, logistic, coordination and the implementation of the action plan.

> "everyone is eager to see this initiative kick off and produce the desired outcome which will contribute to the improvement of tax culture among companies and accountability by the government."
> *member of the Coordinating Committee*

10 CIP, (2010); Impacto de Iniciativa de Transparência das Indústrias Extractivas na Receita do Estado em Moçambique

11 Ibid

8 Taxation, Development and Good Governance Agenda

There is a shared belief that taxes are essential to raise domestic revenues, promote development and contribute to poverty reduction.

Tax rates have to be efficient in allocating investment across sectors, promoting private sector development and equity as well as promoting citizenship.

The Mozambican tax system has been improving in the last few years and it can contribute to the allocation of investment across sectors and regions because there is a differentiation between taxes paid in industry and agriculture, tourism and Special Economic Zones. Projects with marginal rates of return in industry can move to agriculture to benefit from the reduced corporate tax and other benefits provided under the fiscal benefit regime.

Taxes can promote private sector development when they enable investors to reinvest and expand their activities within the country. This means that when setting the tax rates the government should look not only to the present gain in tax collection but also to the future, hence enabling the private sector to grow today and pay more taxes tomorrow. There is a mixed feeling on this issue from different people, but the bottom line is that private sector urges the government to create an enabling environment for their development for them to increase production and productivity.

They recognise progress made so far in reforming the tax system but in their request to the President of the country within the Private Sector/Government XII Annual Meeting held on November 23, 2010, the private sector asks for accelerated implementation of reforms that will reduce production and transaction costs, improve access to infrastructure and services such as access to land, roads, water, energy, credit, labour, telecommunications and internet.

This will enable them to increase production and productivity and be in a better position to comply with their tax obligations.

Individuals also recognise the need to pay tax because this is part of citizens' duties. Theoretically, by paying taxes people will be able to demand accountability and transparency in the use of resources. This could trigger a sense of responsibility in other areas of citizenship such as voting for those who they think will take better care of their resources, take care of goods and services provided not only from tax money but overall country resources, advocate for a permanent dialogue between the government and citizens at all levels.

Decentralisation can be used as a means to promote citizenship and accountability. Modern governments have supported decentralisation on three grounds:

1) It improves economic efficiency by approaching government and citizens to build mutual trust, making it easy to identify problems, make better allocation of resources and promote their well being. In this context, citizens are more willing to pay taxes and contribute to the development of their community,
2) It facilitates resource mobilisation because the local governments can easily raise resources under their jurisdiction due to the facility to monitor economic activity, and
3) It promotes democracy because local governments are close to the people and promote pluralism while catering for their needs[12].

In Mozambique local governments with fiscal duties comprise of 33 municipalities created in 1997 with the responsibility to invest in infrastructure, health, education, water and sanitation. To this end they mobilise resources from taxation, donations and allocations from the central government. Some 38% of the Mozambican population lives in municipal areas in which 60% of GDP and 85% of national income are produced[13]. However, urban poverty is increasing amid rising concerns about the contrast between the rich and poor living in the same geographical area.

The municipalities still face challenges to raise enough resources to solve their increasing problems given the exodus of people from the rural to urban areas. Lack of capacity to deal with several aspects

12 Financas Autarquicas e Integracao Regional de Mocambique na SADC, Eneas Comiche

13 Financas Autarquicas e Integracao Regional de Mocambique na SADC, Eneas Comiche

of tax collection such as lack of updated information on taxable properties, goods and services, cost of tax collection, are cited as being the major constraints. In 2008 only 39% of municipality expenditure was funded by own resources with fiscal income amounting to 11%. The allocation from the central government amounts to less than 2% of the state income.

Contrary to the theory of bridging the gap between government and people at local level, there is no permanent mechanism of dialogue with citizens or a system of accountability. Even in the markets where vendors pay tax everyday there is no dialogue, except for isolated consultations and politicians engagement with the citizens in electoral years. Citizens are also not persistent in demanding accountability either from local or from central government.

Given the present status of aid dependency in the country, the government is accountable to donors in either bilateral or collective forums like the Joint Review. Although there are initiatives of forums that could be used to account to citizens such as provincial and national Development Observatories, so far these have been important forums of a consultative nature only.

There is also dependency on foreign resources for private sector development. Having in mind that the private sector has its own vested interests regarding the destiny of their business, the government has to build capacity and create mechanisms to make them comply with environment, production and tax requirements.

The government has been putting in place legislation, policies and strategies to regulate its relationships with donors and the private sector. The experience with donors is that the government is in a weak position when it comes to making critical decisions. Donors are dominant in decision making forums especially because they came together as G19 (Group of 19 donors) that support the State Budget.

Therefore, the government has to improve its negotiation capacity as well as the oversight and enforcement of the laws and regulations. As said before, a lot of work has been done in the area of legislation but its application is the present challenge. Our hope is that government weakness in dealing with donors does not extend to its engagement with the private sector according to their country of origin that can coincide with that of donors.

9 Civil Society Involvement in Tax Agenda

Civil society organisations have been involved in a variety of activities that contribute to a better understanding of the tax system and its challenges, public education and participation in the creation of EITI structure in Mozambique.

The Mozambican Debt Group (GMD) was instrumental in educating the public about external debt and its impact on the poor as well advocating for its cancellation. Presently, the Mozambican Debt Group is undertaking research and putting in place simple information about the tax system in Mozambique, its challenges and recommendations with the view to reduce external dependency.

Another initiative was a year ago when the GMD supported a pilot project in Nampula Province on Garbage Tax Collection. The community was facing sanitation problems without any response from the municipal authorities. Knowing that they paid tax for garbage collection they wanted to know where their money went to. They started doing budget tracking on who paid taxation and how the money was used. The main conclusions were: 1) There was a significant part of people who did not pay tax because the system used to collect it was the inclusion of tax in the electricity bill and not everyone had access to electricity; 2) Big companies paid less tax compared to the amount of garbage they generated; 3) The documentation was scarce and; 4) It was hard to link the source of funding (tax funds) to their allocation (expenses paid). Nonetheless this is an example of how citizens can demand accountability and transparency within the taxation framework and beyond.

TEIA – Mozambican Network of National NGOs was involved in a project aimed at educating citizens regarding the need to pay tax in collaboration with the Tax Authority.

Finally, CIP – Centre for Public Integrity is undertaking research on issues related to tax in Mozambique. The last work was on the Impact of EITI on State Income in Mozambique. Overall the work concludes that there will be benefits to the government and citizens because they will know about what companies pay and what government does with the resources collected. For companies this initiative will help mitigate the risk to the investment, especially political and reputation risks. Paying tax and disclosing information about it helps to improve the company's reputation and contribute to political stability because the government mobilises additional resources to respond to people's needs. Civil society organisations get access to information on tax collected and its allocation that can be disseminated and used to show best case practices to sensitise other companies to follow suit or to advocate for compliance in case of lack of commitment. They can also use the information to advocate for the allocation of resources in areas of extreme importance to communities and the public at large.

10 Conclusions and Recommendations

10.1 Conclusions

Developing countries need to raise additional resources to respond to the growing needs of their populations. Aid resources that come in the form of either donations or credits have been critical in supporting developing countries governments' efforts to foster development and reduce poverty but are limited due to growing needs of donor countries need to respond to their own internal challenges, especially after the global economic crisis.

Taxation can be used as a long term and reliable source of funding to developing countries but so far it has not been given due attention by governments because they concentrate most of their attention and time on aid.

In the past years an increasing number of voices from civil society, international financial institutions, donor countries and even from selected governments have been viewing taxation as an alternative to resource mobilisation. In fact, in a perfect world, domestic resources should be the primary source of development funding complemented by aid resources.

Most developing countries have abundant resources and their sustainable exploration and taxation could contribute to economic growth and poverty reduction. As a principle, taxation should promote growth, equity and poverty reduction. This means that governments should be able to balance between raising resources today and enabling companies to further grow and provide more resources tomorrow while creating jobs and reducing inequalities.

Mozambique is an aid dependent country with 44% of the budget for 2010 funded by external resources. Thus, the country has to take advantage of its vast natural resources to raise domestic revenues and reduce poverty.

The Mozambican tax system has undergone major reforms to accommodate global and internal changes. Taking advantage of political and macroeconomic stability established and under consolidation over time, the country has opened its doors to foreign direct investment while promoting the establishment and strengthening of national entrepreneurship. Indeed, Mozambique has been a preferred destination to foreign investment that has contributed to economic growth and exports. This situation however, has been subject to debate as the level of dependency to foreign investment was over 80% which poses challenges in the retention of wealth by the country.

There are several taxes and import duties applied to good and services. The main contributors to the domestic resources are VAT, IRPS, IRPC and import duties. Although the system is considered to be in line with international standards some concerns remain regarding its efficient implementation and also its ability to combat tax evasion and promote equity among businesses and individuals.

Tax evasion is frequent within Mozambique either by individuals or corporations. Lack of information on what the government does with collected resources is often used as an excuse for not paying taxes, especially by individuals. For companies apart from taking advantage of existing gaps in tax system implementation and evasion from paying their fiscal obligations, they create a chain of street vendors and sell goods without charging VAT to become more competitive compared with those who charge taxes.

The government of Mozambique approved a Code of Fiscal Benefits with the view to attract investment to the country and across sectors. Although this argument is supported by some people others say that political and macroeconomic stability as well as the existence of infrastructures are more relevant to attract investment than fiscal benefits. Available data shows that the country is losing money due to fiscal incentives and a cost-benefit analysis is recommended before attributing benefits to companies.

National private sector, especially the cross border traders, claims that the different taxes imposed on them are very difficult to meet. Import duties and VAT make their products very expensive to the public. For some of them to remain in business they avoid paying tax by collaborating with tax officials who charge bribes when they claim that the official amount due is too high. Women are the most affected by this phenomenon due to their lack of capacity to stand for their rights.

The tax system is not discriminatory in its conception but the impact of its implementation makes the national private sector less competitive and with serious difficulties in expanding their activities whereas foreign investment, due to its volume is eligible to tax benefits and exemptions leading to high profits with facilities to repatriation.

Overall the national private sector calls for the opportunity to increase production and productivity as a result of government action by reducing transaction and production costs, facilitating access to land, energy, communications and combating corruption.

Despite the constraints mentioned above, the level of domestic resources has been growing and individual taxpayers have been the major contributors by both VAT and IRPS payments. This means that they are in a good position to demand accountability from government using the present consultative forums such as Development Observatories.

The Mozambican decision to adhere to the EITI is welcome because it will allow citizens to know how much income the government expect from the companies, how much is actually paid in terms of taxes and other obligations and how does the government allocate the resulting resources.

There is work underway to strengthen government capacity to oversee the administration of the tax system by further reinforcing the human and financial capacities of the Tax Authority for it to fulfil its role more effectively.

10.2 Recommendations

10.2.1 To the Government

1) Put in place a database of all potential taxpayers and their respective contributions to calculate the present tax gap.
2) Facilitate compliance with tax obligations through the use of e-taxation as well as post office and shop facilities.
3) Create a hotline service to denounce cases of corruption and bribes on tax collection.
4) Renegotiate present fiscal benefits.
5) Engage with civil society organisations to disseminate information, make use of their research materials and advocacy platforms for the promotion of fiscal citizenship.
6) Disclose information on tax and related issues as well as create mechanisms of accountability to the taxpayers.
7) Undertake a cost/benefit analysis on tax benefits.

10.2.2 To the Private Sector

1) Comply with fiscal and social responsibilities.
2) Continue engaging with the government to implement recommendations on the enabling business environment.
3) Provide critical information to the public and collaborate with the government in the fight against corruption and briberies.

10.2.3 Media

1) Liaison with civil society organisations and research institutions to access information of tax debate.
2) Disseminate information on critical issues.
3) Strengthen capacity on tax issues and influence public opinion about the need to pay taxes while sensitising the government to be more accountable to the citizens.

10.2.4 Civil Society Organisations

1) Based on its experience on External Debt campaign, GMD in coordination with TEIA should start and lead a national campaign on tax justice.
2) Liaise with research institutions such as CIP and IESE to access information on tax issues.
3) Contribute to the sensitisation work about the exercise of citizenship and demand for government accountability.

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