GOVERNAÇÃO ECONÓMICA

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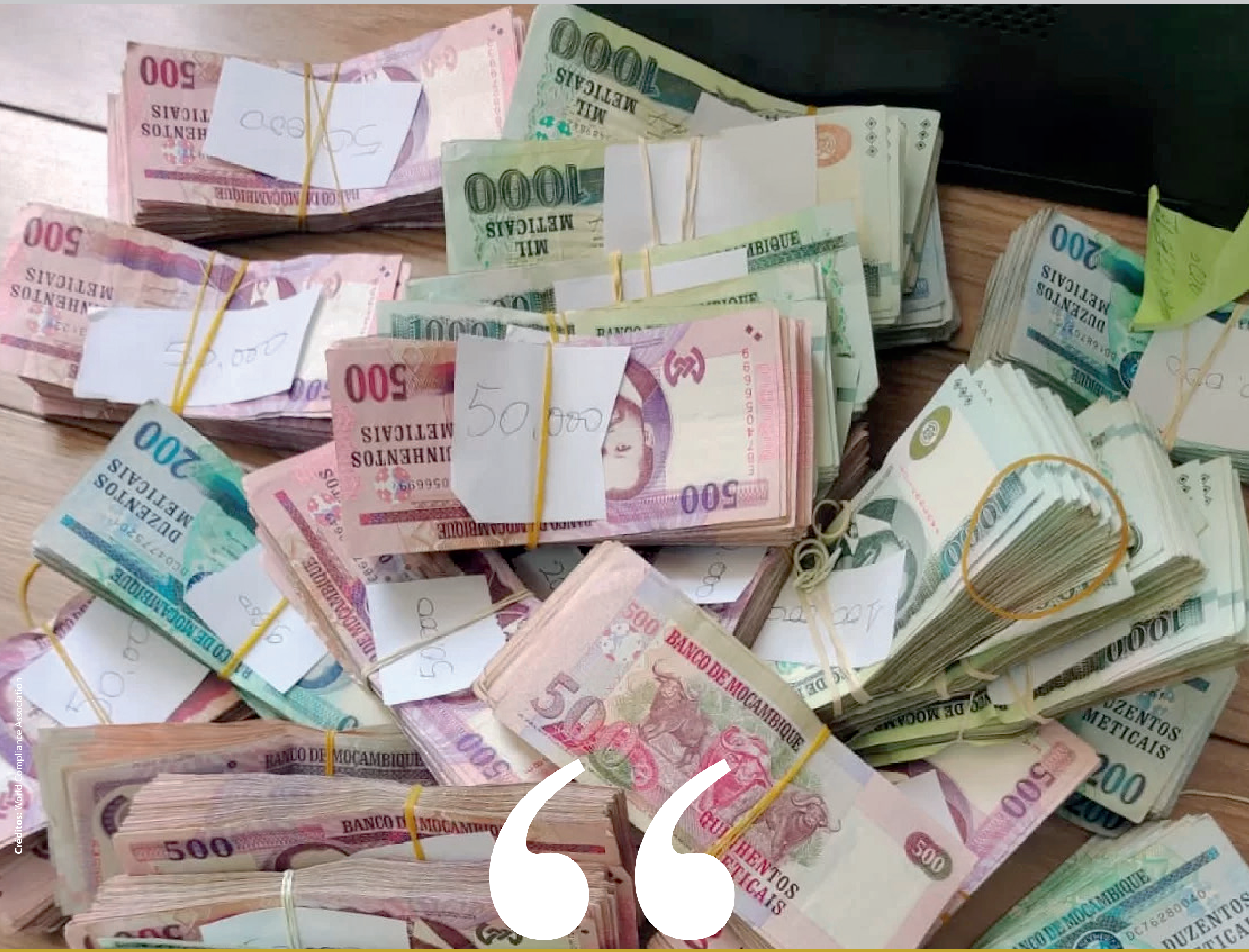
Monday, July 31, 2023 I Year V, NO. 25 I **Director:** Prof. Adriano Nuvunga I **English**

FAIR TAX MONITOR (FTM)

Urgent reforms required for greater and fairer domestic resource mobilization in Mozambique

● Greater efforts are urgently needed to increase the fairness of the national tax system to ensure that the richest individuals and large companies contribute their fair share of taxes. This implies improvements in the legal and institutional framework to stop "leakages", mainly in the extractive sector. This is one of the main messages of the Fair Tax Monitor recently launched in Maputo.



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The focus of this study is on the extractive industry, which is the great opportunity that our people have to lift themselves out of poverty”. Mozambique has very important natural resources. These resources are not being properly taxed. The State is not taxing the large multinationals.

Entitled "Fair and Efficient Taxation: A Way to Break the Curse of Natural Resources in Mozambique?", the report is the ninth in the series produced on the African continent[1], but the first published in Portuguese and focusing on the extractive sector. The study was carried out by the Center for Democracy and Human Rights (CDD), with technical support from *OXAFAM NOVIB* and *Tax Justice Network Africa* – partners responsible for developing the research methodology.

Identifying key challenges in the national tax system and providing strong evidence for advocacy is the main focus of the report. In the document of more than 160 pages, the authors propose recommendations on how the Mozambican tax system can be improved, not only to fill the financing gaps for its development but also to do so in an equitable way that guarantees that the tax burden is being shared fairly.

Speaking at the opening of the report launch event, the Executive Director of CDD, Prof. Adriano Nuvunga began by highlighting the importance of the study as an advocacy tool for greater and progressive domestic revenue mobilization. "No State in the world manages to fulfill its central functions, namely, to promote development, placing the poor at the center of the budget, if it cannot collect revenue", he highlighted.

Despite the advances, the Mozambican tax system still falls short of what is desired from a perspective of justice. As he explained, the existing perception is that the Mozambican State has assumed unfair taxation: "It is still not getting revenue where it should". An important part of the country's wealth, especially in the extractive sector, is still not being properly taxed.

PROF. ADRIANO NUVUNGA, EXECUTIVE DIRECTOR OF CDD

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Greater efforts are urgently needed to increase the fairness of the national tax system to ensure that the richest individuals and large corporations contribute their fair share of taxes. The degree of urgency is still important in the case of the extractive sector, since the effects of the resource curse, even before the exploitation of the significant reserves of the Rovuma Basin, are already overshadowing the country's economy.

Essentially, it is understood that the Government faces the important challenge of reorienting the process of resource mobilization and public spending to reduce inequalities and poverty in the country, which, contrary to what is wrongly assumed, does not imply "pursuing" the rich or creating economic distortions.

"Fair taxation does not mean punishing the rich. It does not mean undermining the success of large companies. It means creating a level playing field where everyone has the opportunity to succeed and contribute to society", explained Ilse Balstra, representative of OXFAM NOVIB.

[1] Mozambique joins eight other African countries with FTM reports, namely Tunisia, Morocco, Uganda, Kenya, Nigeria, Senegal, Zambia and Cameroon.

ILSE BALSTRA, REPRESENTATIVE OF OXFAM NOVIB

Mozambique is blessed with significant amounts of natural resources. And these have the potential to generate revenue and stimulate economic development. However, Balstra explained, without the appropriate structures, for example, foreign companies can exploit existing gaps and not pay taxes. There needs to be a fairer sharing of existing wealth, only then will we have a more prosperous, stable and harmonious society.

The most worrying aspects of the tax system are tax competition, corporate tax incentives, and the lack of pro-poor public spending

GABRIEL MANGUELE, CDD RESEARCHER

According to the main results of the report, there is still room for promoting greater equity in the national tax system. This conclusion is supported by the scores that the country obtained in the six components analyzed by the study[2], namely the progressivity of the tax system (6.20 points); revenue sufficiency (5.31); tax competition and tax incentives (4.19); effectiveness of tax administration (6.23); pro-poor public spending (3.96); and responsible public finances (8.04).

Contrasting the relatively better scores in terms of accountability of public finances and the effectiveness of tax administration, the low scores concerning the progressivity of the tax system and the absence of public spending directed at the neediest Mozambicans highlight the lack of an adequate focus of Mozambique's tax system for reducing inequality and poverty.

Overall, all areas assessed by the survey show room for improvement to make them more progressive. However, relatively more worrisome challenges remain in two main components: tax competition and corporate tax breaks and the lack of pro-poor public spending.

Implementing a reform of the tax incentive system could generate important additional revenues and help improve public revenues so that the government can finance the provision of public services. The lack of publication of data for a cost-benefit assessment and continuous review of the wasteful tax incentives granted to companies in the extractive sector, together with the companies' aggressive tax planning strategies, contribute to the regressiveness of the country's tax system. This situation

[2] Scores vary on a scale of 0 to 10, with 10 being the best rating.

ends up favoring new investors and large companies and overloading ordinary citizens and small companies.

On the expenditure side, the social sectors, namely education, health and social protection, are not sufficiently prioritized due to the growing public debt and the country faces asymmetries in budget allocations between the three regions of the country. In addition to strengthening the budgetary rules applicable to public debt, it is equally important to reinforce sensitivity to gender issues, since the process of collecting and executing resources at the State level does not yet reflect the national policy on gender equity.

Mozambique needs to convert its natural resource wealth into improvements in the standard of living of Mozambicans

As a departure from other reports prepared to date using the FTM methodology, the Mozambique report features an additional chapter focusing on the extractive sector. Fundamentally, the additional chapter provides an analysis of the main challenges for better taxation of the country's natural resource wealth.

The main results of the research show that, although the country has registered a positive evolution in the legal and institutional framework, as well as in the transparency and governance of the sector in recent years, the State and Mozambicans still cannot take their fair share of the dividend from the exploitation of natural resources in the country. In addition to the fact that a significant part of contracts in the hydrocarbon sector were signed a long time ago and with provisions that jeopardize the collection of revenues, the country loses huge flows of resources with "leakages" due to illicit financial flows and aggressive tax planning schemes by multinationals.

Indeed, it is estimated that in 2021 Mozambique's double taxation agreements, with only two tax havens – Mauritius and the United Arab Emirates, cost Mozambicans around US$315 million in withholding taxes on interest payments and dividends, equivalent to 7.4% of the country's total tax revenue. That is, Mozambique could mobilize significant revenues through the resignation or renegotiation of these two (and other) double taxation agreements.

Still within the legal framework, the report points to the lack of a normative instrument for the registration of beneficial owners of the extractive industries as a promoter of revenue "leakages" in the sector. Mozambique continues to face legal and institutional obstacles to making this information up-to-date and accessible. This lack of transparency of beneficial ownership in the extractive industry makes companies in the sector susceptible to being exploited to facilitate corruption, money laundering and illicit financial flows.

The challenges are not limited to aspects of legislation, the institutional framework also needs to be strengthened. In addition to strengthening tax administration in material and human resources, the challenges of illicit financial flows and the increasingly complex aggressive tax planning by companies in the extractive sector require greater collaboration between the country and other jurisdictions on tax matters.

Fundamentally, it is recommended that Mozambique becomes a member of the Global Forum on Information Exchange, the Convention on Mutual Administrative Assistance in Tax Matters, the Inclusive Framework (IF), and the Multilateral Convention to implement measures related to double taxation agreements to prevent schemes Base Erosion and Profit Shifting (BEPS), combating tax evasion and improving domestic resource mobilization through establishing a solid legal framework, technical expertise and infrastructure.

However, reforms for greater mobilization of revenues from the extractive sector remain only part of the path that the country must follow to benefit from the dividend from the exploitation of its natural resources. The study also focuses on the challenges for the country to convert its enormous wealth of natural resources into social and economic development for millions of Mozambicans.

The creation of the sovereign fund and the new revenue-sharing regime, favoring the allocation of 10% of *royalties* to producing regions[3], is highlighted by the study as a step in the right direction in terms of maximizing the benefits of the extractive industry in the country. However, there is still the challenge of promoting connections between the national business community and the extractive industry so that the latter contributes to structural transformation, diversification of the economy and improvement in the standard of living.

In short, the report proposes five main recommendations for the country to avoid the resource curse and create an environment in which the extractive industry benefits all Mozambicans:

1. **Fully apply the Gas Master Plan and prioritize the promotion of local content and added value in the extractive industry chain.** This also implies the approval of the shelved proposal for the Local Content Law and the encouragement of companies to bet on local suppliers and services, promoting the development of local labor and encouraging the establishment of downstream *industries*. Additionally, the Extractive Industry High Authority, established by Parliament in 2014 to oversee petroleum operations, should be operationalized to strengthen links between the extractive industry and the rest of the Mozambican economy.

2. **Demand greater transparency from the extractive sector, including on the beneficial owner.** Mozambique must increase the transparency of the extractive sector. This includes full and comprehensive beneficial ownership transparency, disclosure of revenues and payments made by companies, as well as the establishment of an independent mechanism to monitor and report the industry's impact on the environment, communities and human rights.

3. **Evaluate and reduce tax incentives in Mozambique's extractive industry.** Mozambique does not publish the total amount of revenue lost from tax incentives granted to the extractive sector, which prevents a proper analysis and assessment of the impact of these incentives on the economy and their fiscal sustainability. The Government is recommended to increase the overall transparency of the extractive sector through the publication of reports focused on the fiscal incentives granted to the sector, as well as a cost-benefit analysis of this public expenditure.

4. **Ensure adequate revenue sharing with affected communities.** The Executive must ensure that the benefits of the extractive industry are distributed equitably among the population, especially in areas where the industry operates. Mozambique currently has an allocation of 10% of *royalties* from natural resources for the development of provinces, districts and local communities where extraction takes place. It is essential that the Government effectively enforce this allocation, as previous reports noted that resources were not reaching communities. As part of the new decree being drafted to govern a new revenue-sharing system in Mozambique, the Government is recommended to establish clear mechanisms for the allocation of funds and promote strong citizen involvement (especially for marginalized groups of women and youth) to influence decision-making about how the 10% is used to ensure it delivers improvements that reflect community needs.

[3] Royalties on production, namely the Petroleum Production Tax (IPP) and the Mining Production Tax (IPM).

5. **Mozambique's outdated tax treaty network generates huge revenue losses and treaties with tax haven jurisdictions must be immediately terminated and/or renegotiated.** It is recommended that Mozambique terminate and/or renegotiate its tax treaties with Mauritius and the United Arab Emirates, as well as review other tax treaties. Mozambique must consider the risk of "creating" yet another source of tax evasion and tax evasion in its current negotiations with the Kingdom of the Netherlands. The Government must urgently address current inefficiencies in the revenue collection process, reassess all existing tax treaties and crack down on tax evasion and tax evasion mechanisms used by companies in the extractive industry and other sectors**.**

These recommendations were the center of the debate promoted by the panel at the launch event of the report, which not only endorsed them but also highlighted the urgency for the country to move forward with their implementation. This panel included comments from five main *stakeholders:* (i) Titus Quive, representative of the Ministry of Economy and Finance (MEF); Vasco Manhiça, Vice-President of the Confederation of Economic Associations of Mozambique; Henrique Alencar, representative of OXFAM NOVIB; Ishamael Zulu, representative of the *Tax Justice Network* (TJNA); Stiven Ferrão, representative of the Civil Society Platform for the Extractive Industry (PIE); and Egas Daniel, representative of the Mozambican Association of Economists (AMECON).

From left to right: Henrique Alencar (OXFAM); Ishamael Zulu (TJNA); Egas Daniel (AMECON); Stiven Ferrão (PIE); Vasco Manhiça (CTA); Titus Quive (MEF)

Follow the survey launch event through the link : (https://web.facebook.com/CDDMoz/videos/267826619171147/)

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EDITORIAL INFORMATION:

Property: CDD – Centro para Democracia e Direitos Humanos
Director: Prof. Adriano Nuvunga
Editor: Emídio Beúla
Author: Gabriel Manguele
Layout: CDD

Address:
Rua Dar-Es-Salaam Nº 279, Bairro da Sommerschield, Cidade de Maputo.
Telefone: +258 21 085 797

CDD_moz
E-mail: info@cddmoz.org
Website: http://www.cddmoz.org

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