MOZAMBIQUE DRAFT OIL AND GAS TAX LAW
Comments

EXECUTIVE SUMMARY

The purpose of the consultant's study was to review the draft oil and gas tax law of Mozambique and to comment on in from a various points of view. It noted, but did not calculate the effect of, other taxes such as the surface tax and labor taxes because the study was conducted under a tight schedule. It also observed that a sophisticated conclusion, especially as to maximum cumulative taxes, would require sophisticated computer simulations.

The study found a need to correct numerous drafting flaws, particularly with respect to definitions, some of which were inconsistent or were capitalized terms in the body of the law but were not defined. These defects are easy to eliminate, as are many of the various inevitable ambiguities. The consultant considers that extensive interpretative regulations should be issued soon after enactment in order to assure transparency.

The law was found to be too complicated and to be in need of streamlining. The largest flaw is that high cost production could lead to tax rates in excess of 100% of revenues; this needs to be cured or else producers will only select cheap projects and will be induced to abandon them too early.

The law was also found difficult to administer, largely because of the need for difficult valuations of production instead of using actual sale prices.

There are many recommendations, principally:

1. Convert the IPP into a pure royalty that treats the government as an owner of the share of production that the royalty percentage represents, and base the royalty on actual sales, not imaginary ones. This will keep the royalties out of the income of the producer, thus simplifying and making fairer the computation of the income tax and the production-sharing. The royalty rate was considered within international norms and noted it is a good feature so as to assure revenue even if the producer loses money from production.
2. The income tax was generally accepted and the rate was approved as being within international norms.
3. The production-sharing part of the tax was generally approved, but with many observations, especially an overall. recommendation that the trigger for production-sharing be more in line with the way business people generate cash flow analysis for making business decisions, including specifically that all costs be considered, including those directly incurred prior to commercial production and taxes paid.

4. Thin capitalization, which results in denial of interest expense deductions, should be based on equity value, not book values. Doing this will bring the thin capitalization rules into line with the purpose of thin-capitalization rules, namely to disallow deductions for interest expenses with respect to debt that the marketplace would not provide.
5. Intercompany pricing rules should be clarified as to the government's authority. Under the present law the tax authorities can make any adjustments they want to, which can lead to capricious results. The recommendation is that in the event of a dispute over a government adjustment the adjustment will stand if it is not arbitrary and capricious.
6. Bonus payments were generally approved, subject to the comment that the government should consider the risk of not attracting smaller innovative producers.
7. Revenues should go to a separate formal government fund and be established and regulated in accordance with the Extractive Industries Transparency Initiative. The information concerning financial flows in and out of the fund should be readily accessible to the public and the press and part of the country's budget.
8. In order to facilitate information sharing with other governments and to facilitate intercompany pricing issues multi-laterally, the government should seriously consider entering into further bilateral tax treaties. It was also suggested that it consider entering into an existing multi-lateral tax treaty (The Convention on Mutual Administrative Assistance in Tax Matters).
9. The consultant considered that a top total tax take of about 80%, achieved via the production-sharing formula was within norms, and recommended that in the event the rate was exceeded, it be reduced to the top rate by reducing the production-sharing quota for the year.
10. The consultant recommended enactment of a branch profits tax to make the withholding tax system symmetrical as between subsidiaries of foreign corporations and branches of foreign corporations operating in Mozambique.

The consultant considered the timing of revenues to be generally appropriate, noting that the tax system encourages investments in rich fields, thereby encouraging early development of infrastructure for later less dramatic projects and provides the government with significant bonus payments.