

MOZAMBIQUE DRAFT MINING TAX LAW

Comments

EXECUTIVE SUMMARY

The purpose of the consultant's study was to review the draft mining tax law of Mozambique and to comment on it from various points of view. The draft mining law was found some minor definitional ambiguities and a number of ambiguities in the body of the law. 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 tax analysis, especially as to maximum cumulative taxes, would require computer simulations.

The section on reintegration (meaning capitalization) and depreciation were found confusing and revealed an apparent preference against deducting operating expenses and the law reveals a questionable preference against allowing losses for abandoned exploration activities. 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 high tax rates; this needs to be cured or else producers will only select cheap and easy projects and will be induced to abandon them too early. It may, however, be that that is what you want.

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, some of which track the comments on the draft petroleum law, principally:

1. Convert the Mineral Resource Tax 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 minus transportation costs, not imaginary ones. This will keep the royalties out of the income of the producer, thus simplifying and making fairer the computation of the corporate income tax. 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 concept of an increased tax based on discounted was approved, but with a preference for using a cash flow analysis based on long-standing accounting practices used in the business world which are more realistic and faithful to the purpose behind the tax increase.

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 those 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 and the impossibility of knowing potential Concessionaires that are discouraged and therefore never materialize.
7. The local content requirement was understandable, but was considered a possible source of conflict.
8. 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
9. 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).
10. The consultant considered that a top total tax take was within norms, but only because the Rent Tax applied top rate by reducing the production-sharing quota for the year.
11. The consultant recommended that the Rent Tax be eliminated in favor of raising the corporate income tax by 10 percentage points. This would avoid complicated calculations and the administration of a separate tax regime.
12. 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. This recommendation is in part because the withholding taxes are likely high enough to encourage the use of branches to avoid withholding taxes.

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.