

Mineral Policy for Mozambique

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Current Fiscal Regime for Mining

Item	Description
Tax Incentives	<ul style="list-style-type: none"> • Customs duties and VAT Exemptions for equipment: exempt for temporary import of necessary equipment • Personal income tax: exemptions for non-residents and expatriate personnel. • Corporate income tax: 32% on income derived from petroleum operations. If development was undertaken before the end of 2010, the CIT rate was reduced one quarter for the first eight years of commercial production. • Income tax by withholding: standard rate 20% upon payment to non-residents with a few exceptions. • Depreciation for income tax: exploration costs expensed in the year when commercial production starts. Development and production capital costs 25% each year from the year commercial production begins. • Carry forward of losses and deferral of depreciation: up to six years from when the loss incurred.
Royalty	<p>Mineral royalty is a production-based tax imposed on the value of the mineral extracted (price times quantity) from the land. Royalty payment is based on the gross value of minerals mined on a monthly basis. For mineral products sold, the value is based on the sales value declared by the extractive entity. If no sales are made, valuation is based on the market price of the product. In practice, most companies have negotiated with the government to pay royalties after sales have been made.</p> <p>Fixed rates: diamonds 15%; precious stones and metals 10%; semi-precious stones 6%; basic minerals 5%; coal and other mineral products 3%.</p> <p>Base = Gross Value.</p>
Other Taxes on Mining	<p>Activity and surface fees apply from the moment the mining product is extracted.</p> <p>Tax/license on concessions: reconnaissance license, prospecting and exploration license, mining concession, mining certificate.</p>

Some Profits Tax Provisions

Item	Description
Business Entities	Public company (SA), private limited company (Lda), joint venture, and branch of a foreign company.
Basis	Residents taxed on worldwide income; non-residents taxed only on Mozambique-sourced income.
Capital Gains	Included in ordinary income and taxed at standard rate. An inflation allowance is available on a case-by-case basis.
Losses	Carried forward 5 years; no carry back.
Rate	Standard company or branch tax rate is 32%. Penalty rate of 35% on unsubstantiated payments. An Alternative Minimum Tax applies to very small companies (turnover less than USD 71,500).
Tax Incentives	The Code of Fiscal Benefits details rules for tax credits and the reduction or exemption of income tax. Companies that invest in Rapid Development Zones and Industrial Free Zones, in agriculture, mining, oil, tourism, and industrial and services projects also may benefit from incentives that vary by location, the number of employees, and whether the products are exported.
Transfer Pricing	The arm's length principle applies to deals between related parties. For payments to companies in low tax jurisdictions, the authorities will need to be satisfied that the payment was genuine and reasonable.
Thin Capitalization	2:1 debt-to-equity (the deduction of intercompany interest may be limited where the indebtedness to a nonresident related party is more than twice the equity).
Consolidated Reporting	Consolidated returns are not required; each company in a group must file a separate return for tax purposes.

VAT and Trade Taxes

Item	Description
Value Added Tax	
Taxable Transactions	Supply of goods and services in Mozambique and imports.
Rates	17% standard rate. 0% for exports of goods and services. Exempt: banking; certain health, education, and philanthropic services.
Registration	Form 1 is used to obtain a Unique Tax Number and Form 6 is a declaration of initiation of activities.
Filing and Payment	Monthly VAT must be filed by the last day of the following month.
Other Taxes	
Excise Taxes	Levied on alcoholic beverages, tobacco products, and fuel. Only account for 7-8% of total tax revenues (2006-2010).
Trade Taxes	No export duties. Import duties account for less than 2% of GDP.

Perspective Taken in Evaluation

Function	Financial Payments to Government	Financial and Opportunity Costs
Ownership Function	Financial returns to ownership: <ul style="list-style-type: none"> • Bonus • Auction Bids • Royalties • Excess Profit Schemes 	<ul style="list-style-type: none"> • Reduction in wealth via accumulated extraction • Limited/Reduced diversification
General Tax Function	<ul style="list-style-type: none"> • Personal Income Tax • Profits Tax • VAT • Tariffs • Property Tax 	<ul style="list-style-type: none"> • Distortions in private sector decision making • Administrative and compliance costs
Passive Investment Function	<ul style="list-style-type: none"> • Dividends • Capital Gains • Interest (if passive investment is via loans) 	<ul style="list-style-type: none"> • Less diversification (both domestic and international) given investment budgets • Foregone current government expenditures (such as debt reduction or education)
Operating Company	<ul style="list-style-type: none"> • Returns to management (in addition to dividends and capital gains) 	<ul style="list-style-type: none"> • Further losses in diversification • Reduced efficiency in public sector enterprises

Emphasis on P and Q

- P and Q determine revenue.
- Needed for all charges except land rents.
- Valuation is important.

Basis of Valuation: P

- Net Back: $P_{\text{fob}} = P_{\text{Market}} - \text{Processing Cost} - \text{Transportation Cost} - \text{Other Costs}$

Where: P_{fob} = computed f.o.b. price
 P_{Market} = observed market price for final output

Economic assumptions necessary for this measure to be accurate are significant:

- a. Constant returns to scale (Marginal Cost = Average Cost)
- b. Arm's length pricing for all costs
- c. Hedged vs. Unhedged
- d. Contract price vs. Spot price
- e. Accounting rules for accruals are equivalent to economic accrual rules.

- Really: $P_{\text{fob}} = (1 - k) P_{\text{market}}$

Where: k = proportion of other costs in total value added

Basis of Valuation: Q

$$Q_{\text{Sold}} = \alpha Q_{\text{fob}}$$

Where: Q_{fob} = observed quantity transferred
 Q_{market} = amount of final output produced from one unit of input
 α = proportion of valuable content in one unit of input

Total Value

$$TR = (1-k) \alpha P_{\text{Market}} Q_{\text{fob}}$$

$$\text{Royalty} = \beta (1-k) \alpha P_{\text{Market}} Q_{\text{fob}}$$

Recommendation:

1. Follow Zambia's example and use Spot Price for downstream products (LME).
2. Define Q_{fob} as far upstream as possible.
3. Pick 'k' via surveys or use Spot Price with a lower royalty rate.
4. Mozambique owns the ore, not the output.

Variable Royalties have Been Proposed

$$\text{Ratio} = \frac{\text{Total Revenue} - \text{Total Cost}}{\text{Total Revenue}} = \frac{PQ - TC}{PQ}$$

Rate	Value of Ratio
3%	If Ratio < 0.3
3% + .0175*(Ratio-.3)	If 0.3 < Ratio < 0.7
10%	If Ratio > 0.7

Alternative Proposal

- Simple price participation.
- Royalty is β if Price $< P^*$. Royalty rate is $\beta^* > \beta$ on the increment if $P > P^*$.

Other Tax Issues

- Ring Fencing
- Capital Gains
- Thin Capitalization
- Option to Defer Depreciation
- Currency Adjustments
- Recapture of Incentives