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EDITOR'S LETTER

Dear Reader:

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THE APPLICATION OF VAT IN AGRICULTURE – BRIEF OVERVIEW OF PROPOSED CHANGES TO THE EXISTING TAX CODE

This article discusses the legal system for Value Added Tax (VAT) in force in Mozambique in accordance with Law No. 32/2007 of 31 December (CIVA), as it applies to agriculture and based on changes proposed in the VAT Code Amendment which was recently made available to the private sector for analysis and comment.

VAT is an indirect tax on the value of transmission of goods and services undertaken in the country for consideration by a taxable person acting as such, as well as on the import of goods. VAT is levied on the price of products or services whether purchased by intermediaries or by the final consumer; however, unlike the latter, intermediaries can recover the difference, by exercising a right of deduction or claiming back the VAT so that the value paid is only incident on the added value of production of the good or service.

Considering the key role that agriculture plays in the Mozambican economy, the government has opted to support the development of this vital sector by creating various fiscal incentives ranging from the reduction of the corporate tax (IRPC) rate in the sector to 10%, to reduction in the rate levied on fuel, and exemptions from VAT on domestic supplies of goods and services and imports of goods, among other benefits.

Note that the general rule for agriculture set out in CIVA is that the exemption from that tax on farming is a "simple exemption" which differs from "complete exemption", the latter allowing the deduction of input VAT. Because the exemption for agriculture is a simple exemption, VAT included in agricultural inputs cannot be recovered, and must be treated as a cost as we explain below.

To avoid the adverse effects of this type of exemption on the production chain and on the final product, to date the VAT Code provides two main mechanisms, namely: (i) a wide range of exemptions on the acquisition of certain production inputs and equipment and (ii) the option to waive the exemption regime.

The VAT Code, Article 9, Paragraph 7, establishes the following as being exempt from VAT: transmission of goods and services in farming, forestry, animal husbandry or fisheries, and within these sectors on supplementary processing carried out by producers on products produced by them using their own resources, as long as this transformation is carried out in ways generally used in agricultural, forestry, livestock and fisheries activities.

In the context of agriculture this requirement is primarily intended to benefit the end consumer by exempting the first operation in the economic cycle and subsequent operations when these are carried out by the producer on their own products, using those means regarded as standard in their sector of activity.[1] Thus, in subsequent operations, wholesalers, retailers and others should include the tax in the price of their products and, for example, a retailer who has acquired the product wholesale with VAT can recover the tax by deduction and channel this to the State differently from the producer. And if the deduction results in a negative balance the retailer in our example may request a refund of the difference.[2]

In order to avoid this negative impact, the law allows a waiver of this exemption so that those affected can pay and deduct input VAT.

It should be noted that the proposed amendment to the VAT Code would grant the right of deduction to taxable persons who benefit from this exemption. This is the major change in the draft law under discussion. Accordingly, operators benefiting from the exemption would be able to deduct input VAT on purchases without waiving the exemption, in order to reduce the negative impact of said exemption.[3]

Consequently the exemption will not only benefit producers when they are carrying out active operations, but also when they purchase goods and services in order to carry out their activities, and reduce the red tape required for the waiver (currently comprising a submission to the Tax Authority).

While appreciating the positive economic effects that such a measure would bring, one cannot ignore the fact that the measure could create pressure on the Tax Authority's reimbursement system or the existence of major risk associated with the measure, especially if its introduction is not accompanied by some possible mitigation measures such as the establishment of a set of minimum applicability requirements (i.e. the obligation to have formal accounting, for example) and the possible introduction of a special type of invoices to ensure better control.

Clauses a) and b) of paragraph 13 of the above-cited article, provide a temporary exemption, until December 31, 2015, on the transmission of sugar, and procurement of raw materials, intermediate products, parts, components and equipment by national sugar industry and on the transfer of goods and provision of services related to sugarcane production for this industry.

This exemption makes transmission of sugar and of raw materials and equipment used for the sugar industry less onerous but results in all VAT paid by intermediaries in the purchase of inputs for the production of goods or services into a cost to be incorporated into the final product.

The proposed amendment to the VAT Code suggests an extension of this exemption up to 31 December 2017. In this regard, we understand that although the duration of the initial exemption is ending, the state's planned objectives for this sector have not yet been achieved. We can go further and state that the extension appears timid, because the relatively short extension period may prevent possible positive effects from continuing with the exemption, particularly given the current state of the world economy, which in Mozambique translates into increasing inflationary pressures.[4]

Other provisions that define exemptions for the agricultural sector are: (i) VAT Code, Article 9, Paragraph 10, for the transmission of corn, corn flour, rice, bread, iodized salt, wheat and wheat flour, tomatoes, potatoes, onions[5] (ii) clause h) of Paragraph 12, for the transfer of goods and equipment, seeds, fertilizers, pesticides, herbicides, fungicides and the like, contained in the Customs Tariff Code; (iii) Paragraph 13, clause f), for the transfer of goods and services related to the agricultural production of sugarcane and for its use in industry; (iv) VAT Code, Article 12, for the import of products listed in a) and b) of paragraph 13 above.[6]

With the exception of Paragraph 10 referred to above, the aforementioned exemptions are simple exemptions. Accordingly, the taxable person does not charge the tax to their customers and at the same time is not entitled to deduct the tax paid on purchases from their suppliers.

Moreover, informal traders marketing agricultural products have an advantage over formal business because they are allowed to buy and sell without VAT. So any formal operator that trades with an informal operator must, when legally required, liquidate, retain and channel VAT to the state or risk incurring fines.

In addition, it follows from the Corporate Tax Code (IRPC Code) that the tax rate for costs which are not properly document is 35%. Thus, a formal business that includes in its accounts any charges that are not properly documented is penalized by being subject to the application of 35% tax on the value of sales made and not properly documented. This rate represents a serious constraint to the inclusion of products from the family sector into the formal market for agricultural products, and also represents a constraint for large companies which transact with informal operators (who sell at low prices) because they need to acquire high volumes.

In addition to the exemptions discussed above, we note that VAT paid on the purchase of diesel for road transport of merchandise is deductible at 50% or 100% depending on the case, which directly and positively impacts the agricultural sector. In short, the government's aim of supporting this major sector by creating tax and other incentives for agriculture and related sectors is most welcome. However, while the draft bill suggests improvements in the VAT system for agriculture, many aspects remain to be regulated and consolidated, for example, non-exemption from VAT in secondary transmissions, and mechanisms for transactions involving the informal sector, among other matters.

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[1] When purchasing exempt goods and services the end consumer still contributes some tax though this is less than it would be if the exemption did not exist.

[2] The reimbursement mechanism is slow and bureaucratic meaning that intermediaries rarely request reimbursements instead converting the unrecovered tax into a cost.

[3] The proposal is not referring to anything particularly innovative since the door to the right to deduct was never completely closed.

[4] Related to this and perhaps with greater justification it may be worthwhile also considering extending the IRPC reduced rate for agriculture (10%).

[5] Complete exemption – the right to deduct VAT is allowed.

[6] Related to the VAT exemption on the import of sugar it is worth mentioning that this measure aims at not discriminating between imports and local production. It is debateable to what extent retaining this exemption is favourable to the national economy.

INTER-COMPANY LOANS BETWEEN ASSOCIATED COMPANIES - A FISCAL PERSPECTIVE

To solve cash flow problems and in order to meet their commitments companies often turn to loans[1] which can take various forms in the business context.

Loan agreements are defined in Article 1142 of the current Civil Code (enforce CC) as a form of contract whereby one party lends money or a fungible item to another, the second party being required to repay the loan with something of the same kind and quality. Clause 1 of Article 1145 of CC establishes that the parties may agree to pay interest in return and this is presumed to be the case if no stipulation is made.

Rather than going to a bank, seeking a loan from another company that may or may not belong to the same corporate group can be economically feasible and advantageous especially considering flexibility in (i) providing the amount in question without the need for major bureaucracy, and (ii) establishing interest rates which are lower than those charged by commercial banks.

In this article we intend to touch on some of the issues that might come up when a loan is agreed between two companies belonging to the same group or which have another form of special relationship, as regulated generally by Article 96 of the General Tax Law (hereafter LGT) and more specifically by paragraph 5 of Article 49 of the IRPC Code (hereafter CIRPC) in respect of transfer pricing.

Where one company lends a certain amount to another at an agreed remuneration, i.e. with interest,[2] the CIRPC indicates that the interest is subject to retention at source at the rate of 20%, except where there is an agreement to avoid double taxation. As a rule these agreements provide lower retention rates than those in the CIRPC, and can range from 0% to 10% in the agreements which exist to date between Mozambique and other countries.

In instances where the tax authorities invoke the existence of a special relationship between the contracting companies (borrower and lender) under the aforementioned Article 96 of the LGT one needs to take into account the question of transfer pricing as set out in Article 49 of CIRPC. Here the legislator intended to ensure that the tax administration would make the necessary corrections for the purposes of determining taxable amounts if two companies with a special relationship agreed to pay interest on an inter-company loan at a rate differing from the prevailing market rate, or had not agreed anything as regards interest when interest would be payable in the market.

The tax considerations associated with the amount established by the parties as being payable as interest should also be taken into account as regards transfer pricing. Without prejudice to the basic principle of contractual freedom at private law, the interest value cannot be established by the parties at will, and special attention should be paid to what would be considered reasonable in relation to market rates for the currency in which the loan is agreed.

Transfer pricing means the amount charged by a company for the sale or transfer of goods, services or intangible property to a company related to it. It relates to prices that are not negotiated in a free and open market and which might deviate from those that would have been agreed between unrelated trading partners in comparable transactions in the same circumstances.

The law therefore seeks to manage the risk of companies manoeuvring between themselves in order to change the taxable profits of each.

It is also important to consider the issue of thin capitalization, in other words the level of corporate tax related to the interest that the borrower makes available to the lender as a result of their loan agreement, and which can be deducted from the tax owed. For tax purposes this deduction occurs within the limits of what is tax deductible, i.e. the debt cannot be more than twice the value of the corresponding share in the equity of the taxpayer when the actual circumstances referred to in paragraph 3 of Article 52 of the CIRPC are verified.

In this regard we note that that in relation to prospecting and exploration in the mining and oil industry the legal framework makes special relationships irrelevant for the purpose of thin capitalization as established by Laws No. 27/2014 and 28/2014, both of 23 September 2014, Articles 26 and 36 respectively.

The rules in CIRPC and Laws No. 27/2014 and 28/2014 are similar, though the latter two are more specific, in that they establish as the fiscally acceptable deduction limit a debt to capital ratio of 2:1 pursuant to paragraph 1 of Article 26. The distinction is the fact that for the latter two pieces of legislation the existence of a special relationship is irrelevant for tax purposes.

Finally, although the concepts of thin capitalization and transfer pricing are often found together we must stress that both have distinct origins and functions in tax law, though the existence of repayment with interest at rates differing from those in the market is common to both. The difference lies mainly in the fact that transfer pricing is concerned with pricing while thin capitalization is concerned with the loan transaction itself and not the interest rate.

Although inter-company loans are a practical tool for day-to-day business and provide clear advantages when compared to banking practice in terms of reduced bureaucracy and favourable interest rates, it is important to take the necessary precautions to avoid thin capitalization and transfer pricing.

Both concepts play a major role for tax purposes in inter-company loans between related companies, except in the situations covered by Laws No. 27/2014 and 28/2014 of 23 September, as mentioned above, where special relationships are irrelevant.

We can thus conclude that thin capitalization and transfer pricing are legal tools that allow the tax administration to correct the taxable amount by adjusting the price in the one case, or using debt/equity ratio limits in the other.

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[1] Lending is regulated by the Law on Credit Institutions and Financial Companies, Law No. 15/99 of 01 November, amended by Law No. 9/2004 of 21 July, and is an activity which is exclusively reserved to credit institutions and finance companies, in accordance with Article 7 of that law. Nevertheless exceptions are permitted in commercial activity, namely: (i) credit provided by suppliers to their customers and generally for short periods of time after the delivery of goods or services, and (ii) holdings in which loans are given to affiliated companies within the same group.

[2] Also as regards interest, pay attention to Civil Code Article 1146.

This article discusses advantages for the Mozambican business community, particularly for those who import goods or equipment pursuit to their activities as well as the challenges or obstacles they encounter.

To this end we will briefly analyse the legal arrangements for temporary imports, the limitations imposed by the law governing this matter and to conclude we will make a few observations that we deem relevant to this issue.

The customs regime for temporary imports is, in a way, an incentive for the business community in the sense that it creates an opportunity to import equipment for a certain period of time without the business owner having to bear the cost of customs duties, VAT and other related fees.

The following legal instruments regulate temporary imports: Decree No. 34/2009, of 06 July, 2009 which approves the General Rules for Customs Clearance of Goods; Ministerial Decree No. 16/2012, which approves the Regulation of Customs Clearance of Freight; and Ministerial Decree No. 116/2013 approving the Customs Transit Regulations.

We stress that the abovementioned laws specifically regulate temporary imports among other matters.

Paragraph 1 of article 28 of Decree No. 34/2009 defines temporary import as the entry of goods into the customs territory for a purpose other than consumption where said goods will temporarily remain within the country, being subject to subsequent re-export, and therefore benefitting from the suspension of payment of customs duties, taxes and fees, provided that they meet the conditions laid down in specific legislation.

Paragraph 3 of the same article indicates that temporary import is only available for goods which have (i) trademarks (ii) manufacturers' numbers or (iii) other means of identification. The main reason for this restriction is to ensure identification of goods that have been imported temporarily so that they can be re-exported to their country of origin at the end of the temporary import period. So there must be a reference number for the item which can easily be checked by Customs thus ensuring the effective re-export of temporarily imported goods.

Goods for which the temporary import procedure is available are listed in Table VI of Decree No. 34/2009 - Goods Eligible for the Temporary Import Regime. The period for which the goods can stay depends essentially on the nature of the equipment and ranges from 30 to 360 days.

Temporary import is subject to the presentation of a guarantee (Article 18, Ministerial Decree 116/2013), which may be provided as (i) cash; (ii) certified cheque; (iii) insurance policy; (iv) guarantee letter from a bank or other financial institution; and (v) disclaimer / acceptance of responsibility document. The guarantee should be equivalent to what the importer would have paid if making a full import. Values of guarantees are established on the basis of the charges payable (paragraph 7 of Article 28 of Decree No. 34/2009), as follows:

Fees payable in Meticais	% Guarantee
Less than 125,000.00	100%
125,000.00 or more but less than 250,000.00	75%
250,000.00 or more but less than 500,000.00	50%
500,000.00 or more but less than 1250,000.00	25%
1250,000.00 or more but less than 2500,000.00	10%
2500,000.00 or more but less than 25000,000.00	5%
Over 25000,000.00	5% or an amount determined by the Director-General of Customs on application by the importer

After temporarily importing the equipment the importer is obliged to re-export it within the deadline established and failure to meet the deadline gives rise to:

a) A court process for committing a tax infringement; and

b) Immediate cancellation of the temporary import regime with application of the customs value contained in the declaration submitted at the time of import plus rates and tariffs calculated at the exchange rate of the day.

Authorization of temporary imports depends on the type of goods being imported and there is a hierarchy for granting it as follows:

- Heads of Customs offices;
- Regional Directors;
- Director General of Customs; and
- Chairman of the Tax Authority.

As mentioned above, Decree No. 34/2009, of 06 July contains a table listing the equipment that can be imported temporarily and the respective deadlines. However, this list is limited. This limitation is being increasingly felt with the increase of foreign investment in the country which has culminated in a series of new and diverse projects. For example megaprojects have greatly increased the volume of temporary imports of equipment because of their need to carry out specialized studies including, but not limited to, impact evaluations and the construction phases of gas liquefaction projects.

We note that that the legislation is silent on these situations and in turn this omission creates difficulties for business, not only in importing equipment, but also in time spent obtaining the necessary authorizations. As a result, sometimes the applicant gives up on importing the equipment. Note that during the waiting period the business is already incurring costs abroad related to the rental of equipment, not to mention the company being hampered because it cannot carry out the activity for which it requires the equipment within the predetermined period because of delays in granting permission to temporarily import said equipment, because of customs bureaucracy.

Conclusion

We have noticed that the temporary imports legislation is not well known by the business community. We hope this article helps clarify what temporary import means and the procedures and constraints inherent in it in Mozambique.

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