Taking stock of the tax reform process in Angola .... and why tax incentives should be avoided

Angola is currently implementing a tax reform. The main objective of the reform is to increase non-oil tax revenues by broadening the tax base, rationalize incentives, increase control with voluntary tax payments and fight tax evasion. There is also a desire to use the tax system as a mechanism to provide incentives to investments and diversification of the economy. This brief argues that tax incentives in the form of lower rates, tax holidays and exemptions are likely to have negligible effects on investments. Extensive tax incentives are likely to undermine the efficiency and effectiveness of the tax system by creating room for bribery and corruption, increasing loopholes for tax evasion and distorting competition. Sticking to clear, unambiguous tax rules with not too many exceptions would likely avoid many unnecessary current and future conflicts.

JUSTIFICATION AND DRIVERS OF THE TAX REFORM
The current tax system in Angola is seen as "obsolete, inefficient, excessively complex and at times based on laws that date back to colonial times...". It is therefore likely that the tax reform would have been initiated in any case, but the global economic crisis and the sharp drop in oil revenues in 2008/2009 is commonly referred to as the main driver behind the reform. The IMF did play also play a role when it entered with a stand-by agreement with the Angolan government. Short of a principal driver, the IMF did help key players in government sustain the momentum of tax reform.

Why didn’t the tax reform happen before? It is possible that it was not prioritized until 2008 since other issues took precedence, such as the initial reconstruction of the country’s infrastructure, re-establishment of a democratic process within a multi-party system, and writing the new Constitution. This sequencing of major reforms has rendered the advantage that the on-going tax reform is starting out under the broad orientation of the Constitution. The Constitution is not specific in its instructions on the design of the tax system. Still, some of its general principles suggest a progressive tax system, since it lays down a just distribution of the national income and wealth, as well as the duty to contribute according to economic capacity.

How would a progressive tax system affect the various residential zones in Angola?
Redistribution through progressive taxes and welfare transfers has been central to reducing inequality in developed countries. There are many challenges related to creating a progressive tax system in highly unequal societies that the Angolan government will have to be aware of. But the recent reform of the urban property tax system (Imposto Predial Urbano) and taxation of urban rental income are promising approaches to enhance revenues through progressive taxes. Let us assess the two main components of the reform: tax legislation and administrative changes.

**TAX LEGISLATIVE REFORMS**

Legal reform is seen as vital with a number of specific priorities both in relation to the general tax codes and to legislation for specific taxes. In the short-term the Government aims at correcting the most unjust and bureaucratic aspects of the existing legislation. Subsequently the priority is to create three tax codes: 1) a new General Tax Code (Código Geral Tributário) will replace a law from 1968; 2) a Code of Tax Procedure (Código de Processo Tributário) will replace regulation dating back to 1948; and, 3) a new Tax Collection Enforcement Code (Código das Execuções Fiscais) aims to replace a law from 1950.

Decree 50/11 emphasises that this legislation needs to be advanced even if it will have to be readjusted when the reform process is further implemented. This might also imply more wide-ranging reforms of the tax administration such as the integration of the domestic tax and customs departments into one institution.

A medium term priority is to create specialised tax courts (to address non-criminal issues) and create a Superior Council of Taxpayers (Conselho Superior de Contribuintes) to reduce the pressure on the courts. These measures partly aim to strengthen the rights of taxpayers in connection with tax disputes and represent important changes to the legislation. If taxpayers’ rights are unclear for both taxpayers and tax authorities, tax compliance and accountability are likely to be affected. This is indeed a grave challenge for Angolan reformers.

The legal reform also targets international taxation. Here the short term objective is to create a specialised team in the Ministry of Finance to negotiate double taxation treaties with countries with which Angola enjoys a large degree of economic integration. Rather ambitiously, the Government aims at full adoption of a single customs union within SADC.

The legal reforms also aim to address the numerous fees, licences and charges that affect the lives of ordinary citizens and companies adversely. The tax reform decree notes that such fees and charges add to the excessive bureaucracy and represent a major obstacle for the formalisation of micro and small enterprises. Experience shows that a complicated and non-transparent fee structure can be used to ‘justify’ bribery to ‘smoothen’ official procedures. Some observers even argue that extensive public sector regulations and complicated fee and licence systems are the result of a deliberate strategy by civil servants, including senior tax officials, to facilitate corruption. Rationalisation and simplification of these fee structures is therefore a most welcome development.

**Box 1: Tax reform milestones**

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<tr>
<th>November 2009</th>
<th>Cabinet of a number of general tax law drafts before the end of 2010 and a time-bound action plan for the tax reform programme.</th>
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<tbody>
<tr>
<td>July 2010</td>
<td>The action plan for the tax reform (Linhas Gerais do Executivo para a Reforma Tributária) materialised in a presidential decree (50/11 of March 15).</td>
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<tr>
<td>Late 2010</td>
<td>The reform is coordinated by the Tax Reform Technical Unit (Unidade Técnica Executiva para a Reforma Tributária – UTERT) in the Ministry of Finance.</td>
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**TAX ADMINISTRATIVE REFORMS**

Interestingly, administrative reform is coined “…the priority of priorities” in Decree 50/11. It is recognized that this is a challenging task that will not be resolved in the short-term. Existing human resources are reported as being “limited, demotivated and with insufficient levels of academic and professional training”. The two main government bodies responsible for tax collection – the National Tax Directorate (Direcção Nacional de Impostos - DNI) and the National Customs Services (Serviço Nacional de Alfândegas - SNA) – suffer from a rigid structure and salary-system, which contribute significantly to the poor state of the human resources. A reform of these two departments aiming to achieve better coordination in the short term, and – in the medium term – full integration under one management, should be prioritised. This
might be in the shape of a semi-autonomous revenue authority, which also has been established with some success in several other African countries.

The chronic inefficiencies of the existing revenue departments in Angola placed in the Ministry of Finance certainly make substantial administrative reforms required. The establishment of a semi-autonomous revenue authority is a relevant option.

In the short run, and independently of the possible establishment of an integrated revenue authority, the Government aims to strengthen the revenue administration by: (a) recruit and train new technical staff; (b) make training a permanent feature of a career in the tax administration and in customs; and (c) modernising customs in the major entry ports to the country. These are all important measures that may lay the foundation for more substantive tax administrative reforms. Clearly, improved tax administration cannot compensate for poor tax design and there is not much merit in marginally improving an inefficient tax system. That is why reforming the tax structure through legislative reforms should precede the reform of tax administration.

CONFLICTING OBJECTIVES
Angola needs to reduce its substantial non-oil fiscal deficit, in 2011 amounting to 23.2 per cent of GDP, so increasing revenue is evidently one of the main objectives of the reform.\(^3\) In the 2012 budget it is estimated that non-oil tax revenues will increase from 7.5 per cent to 10.2 per cent of GDP.\(^4\) By international standards this is a significant increase. A possibly conflicting objective is the desire to design the non-oil tax system in a way that provides incentives to investments in non-oil related sectors. This is likely to imply reduced tax revenues, at least in the short run. Balancing these two objectives is a major challenge for the Government.

One of the arguments to support the provision of tax incentives is that a favourable tax regime will attract more foreign direct investment and thus contribute to economic diversification and growth. Although it is not uncommon that countries use the tax system to try to attract investments, research shows that tax incentives in the form of lower rates, tax holidays and exemptions, only have negligible impacts on potential investment decisions.\(^5\) Other factors such as the market potential, infrastructure (roads, water, and electricity), red tape, political stability and long-term predictability are most important for investors. In Angola these other factors seem overwhelming. According to the World Bank’s Doing Business survey, Angola ranks 172 out of 183 countries, and has recently fallen on the ranking.

According to the Economist Intelligence Unit (2011), the tax system in Angola presents only a moderate risk to doing business. The corporate tax rate, at 35 per cent, is marginally higher than Angola’s peers, although broadly in line with international rates. Further, the tax regime does not discriminate against foreign firms. The main challenges for investors are related to red tape, including cumbersome procedures and regulations for business registration and tax payment – with corruption as a constant threat. Obtaining licenses and permits to carry out various economic activities remains a difficult and expensive procedure. In this situation, generous tax incentives to specific industries and sectors are likely to lead to large revenue losses and distorted competition. The Government needs to do a lot more than improving its tax system to attract and create an enabling environment for investors.

Tax holidays are open to abuse, undermining tax revenue by providing enterprises with a strong incentive to use transfer pricing and financial arrangements to shift taxable profits into ‘tax holiday enterprises’. Such devices can operate across national borders, and also between domestic firms. No matter how clever the legal provisions crafted to address this risk, experience suggests that companies will outwit governments in finding ways to avoid them. Even the most developed tax administrations have difficulties dealing with this kind of tax evasion. In addition, by offering tax holidays, the government is to some degree signalling its own untrustworthiness in tax matters. Many companies apparently find holidays attractive because they spare them the necessity of dealing with a corrupt or inefficient tax administration. Therefore, offering a holiday can itself signal a corrupt or inefficient tax administration. Such underlying problems should instead be addressed. Generally an “investor friendly” tax regime is not characterised by generous tax incentives,

FACT BOX
Revenue authorities share a few significant de jure features. They are:

1. Granted some autonomy from central executive power (partly to limit direct political interference in its day-to-day operations)
2. Meant to be quite independent of the financing and personnel rules of the public sector in general (managers can recruit and promote quality staff, by paying salaries above civil service pay scales, in some African countries almost at private sector levels)
3. Integrating all central government tax operations into one single purpose agency.
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CONCLUSIONS AND RECOMMENDATIONS

Comparative literature on tax and development has brought out some clear lessons. Firstly, there are many arguments in favour of developing the domestic tax system in natural resource-rich Angola. An effective tax system is central for a sustainable development because it can both mobilise the domestic tax base as a key mechanism to escape single resource dependency, and reinforce government legitimacy through promoting accountability of the government to taxpayers and companies. One hitherto weakness of the reform process is that it appears to be based on the needs of the urban economy. Few initiatives address the challenges of the integration of the non-urban sectors of the economy.

Secondly, the way domestic revenue is raised can significantly influence both economic growth and democratic consolidation. In particular, a substantial “governance dividend” can be gained from mobilising domestic financial resources from citizens and businesses through the tax system. A virtuous circle may be generated whereby the generation of tax revenues leads to improved service provision, which in turn increases citizens’ willingness to pay their taxes. Thus, taxation and state-building are linked. The state-building dimension of the Angolan tax system reform is not explicitly stated as an overarching objective. However, the implicit emphasis on diversifying the public revenue sources and the economy has state-building dimensions. How far this develops remains to be seen.

The Angolan tax reform seems to have strong political support. The collection of non-oil tax revenues has increased substantially. As of end November 2011 the value of non-oil tax revenues was 18.1 per cent higher than in 2010. Given that 2012 is an election year, the legislative part of the tax reform process is put on hold. It may recommence quickly after the elections, but will the momentum of the tax reform be regained with oil prices that already are reaching pre-2008 levels? The availability of oil revenues may reduce incentives for the national government to raise domestic taxes in general. Most governments are genuine in their desire to raise revenue, but the availability of large oil revenue flows reduces the urgency to reform the tax system.

Our study suggests that there is a political and technocratic impetus to push forward the reform at the central level. In contrast, implementation of a local government tax policy has not advanced due to lack of institutional backing and legal foundation. Local tax- and fee collection is therefore bound to remain quite random and disorganised.

If properly designed and implemented, a non-oil tax system may improve the efficiency and responsiveness of the public sector. However, it will be a challenge to convince the citizens of Angola about the value of paying taxes. This will require not only reforms, but a major cultural shift, adding up to a change in the very polity system. Reforming the local government revenue system is particularly important in this respect, since increased local fiscal autonomy, if properly designed and implemented, will contribute to the efficiency and responsiveness of the public sector.

Our research indicates that a major weakness of the reform process so far is lack of public consultations and real debate more generally about tax in a sound democratic polity. Decree 50/11 gives PERT a crystal clear mandate: “the process of implementing the reform process has to be accompanied by public debate”. Debate and popular accept is a crucial aspect of a tax reform. Even if few take delight in paying their taxes, far-sighted politicians have reminded their peers and citizens that all democratic polities – those who have inspired the current Constitution of Angola – have evolved in a constant negotiation over the “social fiscal contract” where taxation is a key component.