

# Reforming the personal income tax system in Angola: An alternative proposal

Reforming the personal income tax legislation in Angola has been under preparation since 2011. There are many challenges related to creating an effective and fair tax system in a highly unequal society that the Angolan Government will have to take into consideration. This Insight examines the proposal for personal income tax reform in light of the current government's campaign slogan of growing more and distribute better, which are two areas that can be directly influenced through the tax system. The purpose of this Insight is to contribute to the public debate about the tax reform in Angola.

## Taxation and redistribution

Odd-Helge Fjeldstad

Senior Researcher, CMI &  
Research Director, ICTD

Søren Kirk Jensen

Independent Policy Analysis  
& Research Associate, CMI

Francisco Miguel  
Paulo

Researcher, CEIC-UCAN

**CMI** CHR.  
MICHELSEN  
INSTITUTE

The Angolan Constitution emphasises the importance of a fair distribution of the national income and wealth, as well as the duty for citizens to contribute according to their economic capacity. Although the Constitution is not specific on the design of the tax system, fairness is a guiding principle. The guidelines for the tax reform (Presidential Decree 50/11) is very clear of the need for a progressive tax system. Redistribution through progressive taxes and welfare transfers has been central to reducing inequality in developed countries. The income tax reform in Angola, however, has experienced significant delays in its approval. In particular, there seems to be strong reservations within the Government to reduce the number of tax bands.

### THE PROPOSED PERSONAL INCOME TAX REFORM

The Personal Income Tax in Angola is known as *Imposto sobre os Rendimentos do Trabalho (IRT)*, which can loosely be translated into *Tax*

*on Employment Income*. In this Insight we shall refer to the tax by its Angolan abbreviation IRT. Receipts from the IRT are low and come almost entirely from wage withholding from the staff of larger enterprises and public sector employees. More than 90 percent of the IRT revenues comes from employed individuals. IRT contributed with around US\$ 1.4bn to the state coffers in 2013 (up from US\$ 1.2bn in 2012) which represents about 15 percent of all non-oil revenues.<sup>1</sup> This makes it the third or fourth most important non-oil tax (together with the industrial or corporate tax, sales tax and customs duties).

The income tax reform is currently suffering substantial delays.<sup>2</sup> When the law finally is passed, the authorities have to pass the accompanying regulations within 180 days. The managers of the Tax Reform Project (PERT) have not encouraged public debate of the proposal and it was not straightforward for the authors of this Insight to get access to the draft legislation.

The proposed new law aims specifically at broadening the tax base and improve the fairness of the sharing of the tax burden. The broadening of the tax base seems, however, to be contradicted by a number of specific exemptions that narrow the tax base and increase the complexity of its administration. The introductory part of the draft law does state that a number of exemptions have been eliminated, but at least 14 detailed exemptions are still included. Several of these exemptions are not uncommon, for example, tax exemptions for the payment of social security contributions and certain social benefits. But some stand out as unwarranted because they undermine the tax base and complicates the administration of the law.

One example is the deductibility of payments to agricultural and domestic workers hired by individuals or families. Although the intention might be to promote employment of unskilled labour, the question is how this will work in practice. Are families supposed to document this kind of payments in their annual self-assessment? Another questionable exemption is the common type of holiday pay known popularly as the 'thirteenth salary', usually made at the end of the year or before planned holidays. Although practised in a number of countries, the logic of making this payment tax-free is not clear and taxing it would seem to be more coherent and in line with the objective of broadening the tax base.

In addition, certain groups are identified as being exempted from paying any income tax. In broad terms these groups are:

- Diplomats and employees of international organisations in line with international conventions.
- Employees of non-governmental organisations registered with the government.
- War veterans and families of people who lost their life in the civil war.
- Victims of war (with more than a 50% disability).
- People of more than 60 years of age.
- Military and paramilitary (in bodies for internal order and defence) personnel.

It is difficult to see the logic of benefitting non-government over government employees tax wise. What is for instance the fairness of exempting a doctor working for an NGO and not a doctor working in a public hospital? For the last four groups it seems more relevant to increase the personal allowance across the board as a simpler and more efficient way to ensure fairness and social justice than to specifically target military personnel, war

veterans or the elderly. Is it fair that the police officers do not have to pay tax while nurses and teachers have to? Why should a poor 55-year-old pay full income tax and not a wealthy 61-year-old? The elderly can be more efficiently targeted through transfers such as state pension payments than through tax allowances.

### THREE GROUPS OF PERSONAL INCOME TAXPAYERS

The draft IRT law identifies three groups of taxpayers, A, B and C, of which the two first are employees and self-employed. A and B are groups identified by most tax systems in the world, as they require slightly different approaches for assessing and collecting taxes. The C group in the draft law is a novelty as it has been 'imported' from the corporate income tax, which is also being reformed.<sup>3</sup> It is not at all clear in the draft law that this group differs from group B in that it is supposed to cover taxpayers who own a small business or is a small-scale entrepreneur carrying out "industrial and commercial activities". The B group is targeted at a specific list of professions, which unfortunately has not been submitted with the draft law but is understood to include amongst others: accountants, dentists, lawyers, physicians, etc. The C group is linked to a list of presumptive minimum profits, which is also relevant for determining the rate at which this group is taxed. This list has so far not been submitted to the Members of the Economic and Finance Committee for review. Thus, there is substantial room for improving the quality of the draft legislation and the material that has been submitted to the National Assembly.

The proposed law establishes that employers and contractors play central roles in calculating and paying taxes through withholding of the share of salaries that are to be paid in taxes (i.e. a Pay-As-You-Earn regime). For self-employed an element of withholding is to be applied in cases where the individual does not account for income and expenditures. In these cases, the taxable income is defined as 70 percent of the gross payment (with the remaining 30 percent defined as expenses and hence deductible) to which a flat 15 percent income tax applies (this is equivalent to a 10.5 percent tax on the gross payment).

Tax payments have to be made on a monthly basis. In February each year, the entities responsible for calculation and payment of taxes of the individual concerned must submit an annual tax return. It might be worth considering to establish regulations for when self-employed are required to have accounts. This could for example be when they achieve a certain level of annual turnover. However, it is essential that such regulations are simple and transparent to minimise taxpayers' compliance costs. The draft law does not establish a system of reimbursement of tax payments in excess, but establishes that the heads of tax collection units may

authorize compensation through deductions in future withheld payments by the entity responsible for this.

The use of fixed amounts for fines is outlined in chapter 12 of the draft law. Applying fixed amounts in general makes them regressive. This means that lower income groups will be more heavily affected than high-income groups. Moreover, fixed amounts are bound to be hollowed out by inflation over time and will need regular adjustments. To address these challenges, it should be considered to base the fines on percentages of the taxes due.

### THE UNREFORMED INCOME TAX SCHEDULE

The draft IRT law proposes to continue to base the income tax on an outdated schedule of income bands and tax rates. The schedule has 14 different income bands with different tax rates and fixed amounts payable. The way this works is that each income band has a fixed amount that corresponds to the amount of income at which the income band starts. In addition, there is a tax rate that is charged to the income above the amount to which the fixed amount is charged within that income band.

For example, if a person earns AKz 60,000 this would fall in the 50,001 – 70,000 income band.<sup>4</sup> This band has a fixed amount corresponding to the first 50,000 earned of AKz 1,750. On top of the fixed amount, the person would have to pay a tax rate of 10 percent of the 10,000 earned above the 50,000. This would lead to the total amount due of 1,750 + 1,000 = 2,750.

In the table below, we have listed the bands, fixed amounts and tax rates applied to income within the band as well as how much the fixed amount represents in percentage of the income to which it is charged. The income bands in the schedule are monthly levels (not annual).

The fixed amount is in reality the most important part of the tax as it applies to the majority of the income level. The tax rate is marginal in the sense that it only applies to the income above the threshold defined by the income band (AKz 5,000 for incomes between 25,000 and 50,000; AKz 20,000 for incomes between 50,001 and 110,000; and AKz 30,000 for incomes between 110,001 and 230,000). The numbers in the last column of the table are the fixed amounts presented as percentages of the amount to which they correspond. These are included as they give a better picture of the actual tax burden. As can be seen, this tax is substantially lower than the tax rate and this means the real tax rate paid on income is quite low. To continue with the example from above with the person earning AKz 60,000, the tax paid amounts to only 2,750 / 60,000 x 100 = 4.6 percent. A person earning exactly the maximum on the scale, AKz 230,000 would pay 11.2 percent of this income in tax.

### EXAMPLES OF REAL TAX LEVEL

A person who earns US\$750 per month is first taxed \$37.50 as a fixed rate on the \$700 and then 11 percent of \$50, which is \$5.50. This amounts to a total tax payment of \$43 or 5.7 percent of the total income.

A person who earns US\$1,500 per month is first taxed \$122.50 as a fixed rate on the \$1,400 and then 14 percent of \$100, which is \$14. This amounts to a total tax payment of \$136.50 or 9.1 percent of the total income.

Finally, a person who earns US\$3,000 per month is first taxed \$257.50 as a fixed rate on the \$2,300 and then 17 percent of \$700, which is \$119. This amounts to a total tax payment of \$376.50 or 13 percent of the total income.

Tax Band, Monthly income (AKz)	Fixed amount	Tax rate	On income above	Fixed amount in % of band base
Up to 25,000	Exempt			
25,001 – 30,000	0	5%	25,000	0.0%
30,001 – 35,000	250	6%	30,000	0.8%
35,001 – 40,000	550	7%	35,000	1.6%
40,001 – 45,000	900	8%	40,000	2.3%
45,001 – 50,000	1,300	9%	45,000	2.9%
50,001 – 70,000	1,750	10%	50,000	3.5%
70,001 – 90,000	3,750	11%	70,000	5.4%
90,001 – 110,000	5,950	12%	90,000	6.6%
110,001 – 140,000	8,350	13%	110,000	7.6%
140,001 – 170,000	12,250	14%	140,000	8.8%
170,001 – 200,000	16,450	15%	170,000	9.7%
200,001 – 230,000	20,950	16%	200,000	10.5%
Above 230,000	25,750	17%	230,000	11.2%

Table 1: Tax schedule presented as appendix in the draft IRT law

The tax rate starts at five percent and increases with one percent for each step in the income band ladder. This seems to be a straightforward linear increase in the tax burden, but it is not as the ‘width’ of the income bands increase (the gap between the minimum and maximum value increases). This implies that the tax on the last kwanza earned actually decreases, as illustrated in Figure 1 where the tax rates and income levels are plotted. It shows that the increase in the tax burden is much steeper for incomes in the low end of the scale, then lowers significantly for incomes in the middle of the scale (above AKz 50,000) and ultimately slightly lower for the incomes at the higher end of the scale (above 110,000). Had the increases in the widths of the income bands been even (with unchanged tax rates) the increase in the tax burden would have been linear.

When the percentages of the fixed amount tax is plotted into a coordinate system it shows a trend similar to the one for the tax rate with steeper increases in the low-income

end, which then flattens with rising incomes. Although the taxes are progressive, with higher percentages paid by higher incomes, they are less and less progressive the higher the income as the tax will get closer and closer to 17 percent. For very high incomes, the income tax system will therefore resemble a flat tax of 17 percent.

The main problems with this schedule are the number and narrowness of the income bands and the low levels of income used which essentially undermine the progressiveness of the tax.

In the following, we refer to the income bands in US\$ instead of Angolan Kwanza (applying the exchange rate of AKz 100 to US\$ 1) to better illustrate the limitations of the proposed schedule. The schedule starts at an income of \$250 per month, which is also the personal allowance of tax-exempt income. This corresponds to an annual personal allowance of \$3,000.

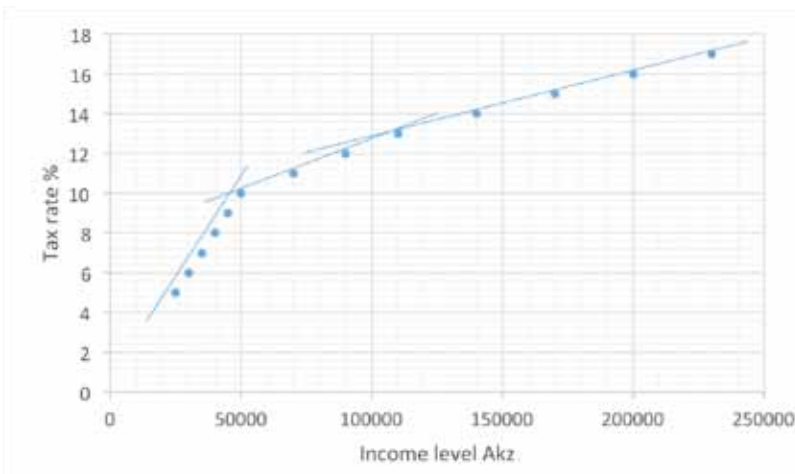


Figure 1: Decreasing progressiveness on ‘top’ tax rate

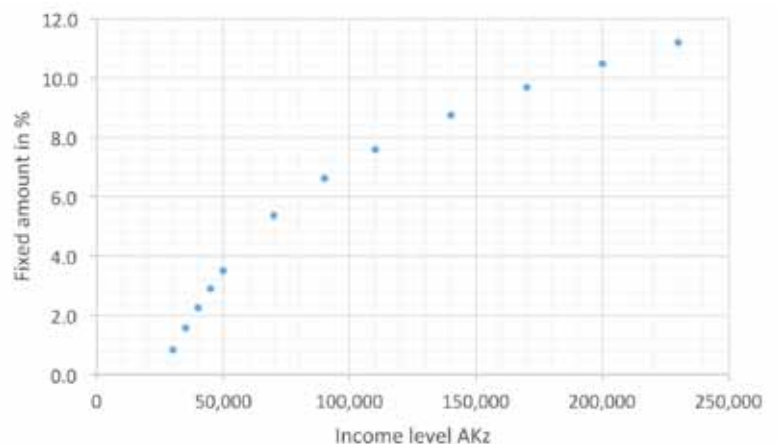


Figure 2: Diminishing progressiveness on ‘fixed amount’ tax



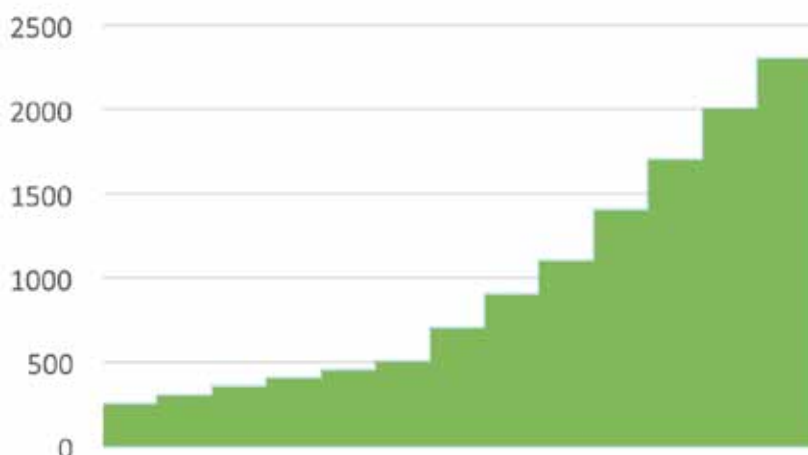


Figure 3: Narrowness of income bands

*The number and narrowness of income tax bands are problematic.*

The income bands then change for each \$50 of added monthly income in the first five bands up to a monthly income of \$500. The width of the bands then increases to \$200 for three bands up to a monthly income of \$1,100. After that, the band width increases to \$300 for the last 4 bands up to a monthly income of \$2,300 which represents the maximum income on the scale. As illustrated in Figure 3 the bands are very narrow especially for the first five bands. For incomes up to \$500 dollar per month, five bands are taxed at less than 3% (but differently for each band) plus a single digit tax rate on anything between \$1 and \$50. This makes no sense from neither an efficiency nor a fairness perspective. It only increases the administrative burden of collecting the tax. Even when the income bands widen they are still very narrow and with limited increase in the actual tax rate. International experience shows that a large number of income bands, exemptions and deductions undermine progressivity of income taxes. As noted by Tanzi and Zee: “...any reasonable equity objective would require no more than a few nominal rate brackets in the personal income tax structure.”

Another problem is that the income levels used are out of touch with the current salary levels in Angola, which therefore renders most of the income bands irrelevant. More data is necessary to shed light on this, but it seems that many formally employed earn more than US\$2,300 per month. This implies that many reach the top bracket too soon to use it for income redistribution purposes in any significant way. In addition, the personal allowance is relatively low at US\$3,000 per year. The government could benefit a large number of low and middle-income households (teachers, nurses, drivers) by increasing this allowance significantly and use this to simplify the system.

It clearly makes the creation of a fair tax regime more complex that income levels vary considerably between the majority of poor people with no formal income, people who are employed in the public sector and people who are employed in the oil charged private sector. More data on income levels would be necessary to inform the details, but it is beyond doubt that the tax system could be made more progressive by reducing the number of income bands substantially and raise the thresholds. In the following a proposal for an alternative and simplified income tax system is outlined.

### **POLICY RECOMMENDATION: AN ALTERNATIVE PERSONAL INCOME TAX SYSTEM**

#### **1. Double the personal allowance**

By increasing the monthly personal allowance to \$6,000 per year (12 x 50,000/100) Angola would get closer to the personal allowance levels of countries with a similar level of national income. It would benefit low to middle-income families and allow the government to

Tax Band, Monthly income (AKz)	Tax rate
50,000	Exempt
50,001 – 150,000	5%
150,001 – 250,000	10%
250,001 – 350,000	15%
350,001 – 450,000	20%
Above 450,000	25%

Table 2: Proposed tax schedule

eliminate some of the exemptions targeted at people by other criteria than income. Individuals earning less than this amount should not be required to declare their income and, thus, not submit an income tax return. Combined these measures would make the administration of the tax system much easier.

## 2. Half the number of income bands

The number of tax bands should be reduced to about 6. Further, the fixed rate should be eliminated, the bands expanded and the rates for the higher incomes should be increased.

These measures would bring the tax schedule up-to-date and ensure a higher degree of progressivity of the tax system. This proposal, which is provided only as an example, is illustrated in Figure 2. Here, a person earning between the personal allowance of AKz 50,000 and AKz 150,000 would be subject to the same tax rate of 5 percent. The next band would be from AKz 150,000 to 250,000 per month and so on up to AKz 450,000. This is equivalent to approximately US\$ 4,500 per month, which is not an uncommon salary level in Angola. This proposal suggests a tax of 25% for incomes above AKz 450,000 per month, which might be considered a significant jump from around 15.5 percent under the current regime, but still below the average of Sub-Saharan Africa of 37 percent (2004 figures) and necessary if the government is serious about promoting social justice.

## CONCLUDING REMARKS

This Insight has analysed the draft personal income tax law, which at the time of writing is being discussed in the National Assembly's Committee of Economy and Finance. Our hope is that the analysis will contribute to the debate in both Parliament and among the public about a tax that has significant importance and potential to generate revenue, but which also has a direct impact on many peoples' lives.

There is room for improvement of the draft law, which in its current version falls short of a profound and visionary reform of the income tax. It should be added that key supporting documentation has not been submitted as part of the draft law.

Surprisingly, the draft law does not include a revision of the current system of income bands and tax rates that determine the level of income tax to be paid by employees. This represents a missed opportunity to reform an outdated, inefficient, administratively costly and non-transparent model.

The Insight has outlined a framework for an alternative personal income tax system. The alternative proposal is imagined and would have to be adjusted to actual data on salary levels in Angola. But our recommendation is clear: Increase the basic personal allowance, reduce the number of income bands, widen the income bands and increase the tax rates for the higher income levels. This would facilitate the elimination of the numerous tax exemptions based on indicators other than income in the current draft and make the administration of the reformed tax much more straightforward.

Following this path would bring the Angolan personal income tax into the 21st century as a modern, progressive, simple and transparent system. It would benefit many low- and middle-income families to use the tax system to redistribute the national wealth more equally.

## ENDNOTES

<sup>1</sup> The estimates are based on data from PERT (2013): Apresentação e síntese do progresso e ponto de situação do PERT – 1º trimestre de 2013, unpublished and Min Fin (2013): Relatório de Fundamentação do Orçamento Geral do Estado 2014, <http://www.minfin.gv.ao/docs/dspOrcaCorren.htm>

<sup>2</sup> The draft law reviewed was expected to be approved in 2013 as the title reads: *Proposta de lei N.º \_\_\_/2013 de \_\_\_ de \_\_\_ (law proposal No. \_\_\_/2013 of \_\_\_ of \_\_\_)*, unpublished draft of the law.

<sup>3</sup> A forthcoming publication from CEIC-CMI will analyse this draft legislation in detail as it is closely connected with the IRT.

<sup>4</sup> 100 Angolan Kwanza (AKz) is equivalent to 1 US\$.

<sup>5</sup> Tanzi, V. & Zee, H. (2001): Tax Policy for Developing Countries. *Economic Issues* No. 27, March 2001, <http://www.imf.org/external/pubs/ft/issues/issues27/>



Centro de Estudos e Investigação Científica  
Universidade Católica de Angola

**CMI** CHR.  
MICHELSEN  
INSTITUTE

**CMI (Chr. Michelsen Institute)**

Bergen - Norway

Phone: +47 47 93 80 00

E-mail: [cmi@cmi.no](mailto:cmi@cmi.no)

[www.cmi.no](http://www.cmi.no)

**CEIC (Centro de Estudos e  
Investigação Científica)**

Universidade Católica de Angola

Phone: +244 922 280 541

E-mail: [ceic.ucan@gmail.com](mailto:ceic.ucan@gmail.com)

[www.ceic-ucan.org](http://www.ceic-ucan.org)

More information is available at the  
CEIC-CMI cooperation program website:

[www.cmi.no/Angola](http://www.cmi.no/Angola)

CMI is an independent development research institute in Bergen, Norway. CMI generates and communicates research-based knowledge relevant for fighting poverty, advancing human rights, and promoting sustainable social development. CMI's research focuses on local and global challenges and opportunities facing low and middle income countries and their citizens. Our geographic orientation is towards Africa, Asia, the Middle East and Latin America.

Editor: Ingvild Hestad Copy editor: KSA\_design