Focus on...

Focus on Cape Verde: Introduction of VAT

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1. INDIRECT TAXATION PRIOR TO VAT

The recent introduction of VAT in Cape Verde has been the most significant change in the country's system of indirect taxation in the last 40 years. Prior to VAT, Cape Verde's indirect taxes date back to the 1960s, when a major reform of the Portuguese colonial tax system was undertaken. The motive for that reform lay in the creation of a free trade area encompassing metropolitan Portugal and all Portuguese colonial provinces: legislation enacted in 1961 set the year 1972 as the deadline for the removal of all tariff barriers between these territories, leading to the ultimate creation of the *Portuguese Economic Area.*

The gradual reduction of tariff duties during the sixties presented a major problem for the fiscal policy of the Portuguese authorities. In fact, tariff duties had long been one of the major sources of revenue for the colonial provinces and if tariff duties on trade between the Portuguese territories were to be reduced, internal indirect taxes had to be thoroughly reformed to make up for the loss of revenue – this was the compelling reason for the creation of Cape Verde's *imposto de consumo* (consumption tax) in 1962.[2] Contrary to what one might expect, the consumption tax remained largely unchanged throughout the years of independence and during the socialist-oriented regime that followed. Central planning and economic stagnation led to the marginalization of taxation as a source of revenue and a policy tool, factors which may explain why most Portuguese-speaking African countries made no serious attempt to reform taxes until the 1990s.

Cape Verde's consumption tax reflected the country's particular economics and geography. As a small archipelago with a mostly barren landscape, Cape Verde has always had a limited agricultural and industrial output, which means that consumption has been dependent on imports. Its isolated location in the Atlantic Ocean, far from Portugal, which is its main supplying market, and over 400 kilometres away from the African coast made the flow of goods into the territory fairly easy to control. Taxing imports was thus an obvious choice for indirect taxation in the archipelago and it is only natural that the consumption tax created in 1962 retained many of the characteristics of tariff duties.[3]

The consumption tax was a single-stage narrow-based tax levied on goods. The tax applied only to the manufacturing and import stages and was wholly administered by the customs office, no specific service being created for its collection. The tax was due on a limited number of goods identified by their classification under the import tariff – manufactured goods for the greatest part – while services were not subject to tax at all.[4]

The early-stage narrow-based tax meant that importers and manufacturers paid the tax at the time goods were released for consumption, whilst, further along the chain of distribution, wholesalers and retailers were not subject to the tax, but merely passed on to their customers the tax already imposed on purchased merchandise. Service providers were entirely outside the system: they levied no consumption tax on services and, indeed, no tax was levied on services up to the introduction of VAT.[5] As a

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2. This was openly acknowledged by Art. 15 of Decree-Law No. 44,016 of 8 November 1961, which set the legal frame for the creation of the Portuguese Economic Area (*Espaço Económico Português*). There is ample Portuguese literature on the colonial tax reforms undertaken in the 1960s: Pedro Soares Martínez, "Apontamentos para o Estudo de uma Reforma da Tributação Directa na Província de Moçambique", *Ciência e Técnica Fiscal*, No. 63 (Lisbon: 1964), pp. 7-67; António Braz Teixeira, "Esquema dos Sistemas Fiscais Ultramarinos", *Ciência e Técnica Fiscal*, No. 77 (Lisbon: 1965), pp. 139-169; "O Sistema Fiscal de Angola", *Ciência e Técnica Fiscal*, No. 78 (Lisbon: 1965), pp. 211-276; "O Sistema Fiscal de Moçambique", *Ciência e Técnica Fiscal*, No. 80/81 (Lisbon: 1965), pp. 299-317. As for recent reforms in Cape Verde, José Carlos Gomes Santos, "Sistema Fiscal de Cabo Verde: Realidade e Tendências", *Ciência e Técnica Fiscal*, No. 350 (Lisbon: 1988), pp. 133-198; Anildo Martins, "Finanças Municipais: Algumas Notas", *Direito e Cidadania*, No. 2 (Cidade da Praia: 1998), pp. 163-190; Francisco Campaniço, "A Reforma Fiscal em Cabo Verde", in Sérgio Vasques, ed., *As Reformas Fiscais Africanas* (Lisbon: 1998), pp. 35-51; and José Carlos Gomes Santos/Carla Rodrigues, "Incidência Económica do Sistema Fiscal de Cabo Verde", *Ciência e Técnica Fiscal*, No. 414 (Lisbon: 2005).

3. In fact, only about one tenth of the country's land area is suitable for agriculture while scarce and irregular rainfall render production extremely difficult and insufficient, imports accounting for over 80% of the foodstuffs consumed in the country. As a whole, imports account for about 40% of GDP. Source: *Cape Verde: Poverty Reduction Strategy Paper*, Country Report No. 05/135 (22 April 2005), available at www.imf.org.

4. The difficulties of taxing services under pre-retail sales taxes are described by Ronald McMorran, "A Comparison Between the Sales Tax and a VAT", in *IMF Tax Policy Handbook* (Washington: 1995), p. 85.

5. Some specific taxation of services existed prior to the introduction of VAT. In fact, a tourist tax (*imposto de turismo*) has existed since colonial times and was last reformed by Law 40/IV/92 of 6 April 1992. This was one of the taxes abolished when VAT was introduced.

result, much of the business and professional community had never been confronted with the procedures of an internal indirect tax. The consumption tax was also fairly easy to collect because the tax liability was concentrated on a relatively small number of economic operators and the tax was due at the time of importation and manufacturing. As a result, the administration was never forced to deal with large numbers of taxpayers, nor was it confronted with the operational problems that usually come with an internal multi-stage indirect tax.[6]

These factors were of importance for both the administration and taxpayers when VAT was introduced.

2. INTRODUCTION OF VAT

The introduction of VAT in 2003-2004 was not the first step of Cape Verde's fundamental tax reform. In fact, the last decade has been a period of continuous changes: new taxes had replaced old colonial taxes, new procedural rules had been introduced, the first double taxation agreements were signed and had come into force, and tax incentives had been introduced to attract foreign investment. As is the case with many other African countries which have been under a single-party socialist government, the advent of representative democracy and market economy raised the need for an immediate and fundamental tax reform – the society had to be restructured to one which is supported by private enterprises while, at the same time, private enterprise must be encouraged. The government that emerged from the first elections in 1991 considered tax reforms as one of its main economic priorities and adopted a three-step programme under which taxation of income was reformed first, followed by the reform of taxation of property and, as tailpiece, reform of indirect taxes.

Already in 1992-1993, the General Tax Code and Tax Procedure Code were approved, setting the general rules in matters such as tax assessment and collection, administrative and judicial appeals, criminal penalties, etc. Reform of income taxation was then undertaken in 1995-1996 and, as a result, a new single income tax (*imposto único sobre os rendimentos*) applicable to both individuals and corporations came into force, replacing two different taxes as well as a complementary tax. In 1998, a single wealth tax (*imposto único sobre o patrimônio*) was introduced on the holding of immovable property, use of registered vehicles, transfer of immovable property and other registered assets, capital gains arising from the sale of immovable property as well as on specific corporate operations, such as increase of capital. In 2003-2004, VAT (*imposto sobre o valor acrescentado*) was introduced and accompanied by a new special consumption tax (*imposto sobre consumos especiais*) replacing separate excise duties on alcohol, tobacco and mineral oils, and a major reform of import duties.[7]

Tax reforms in Cape Verde

Year	Reform
1992-1993	General Tax Code, Tax Procedure Code
1995-1996	single income tax
1998-1999	single wealth tax
2004	VAT, excise taxation, tariff duties
2006	reforms of income tax, stamp duty and tax procedures?

The reform of the tax system has been extremely demanding for both the administration and taxpayers, who have constantly been confronted with new rules and procedures in the past ten years. And yet, further changes of the tax system are on their way, in particular in the fields of income tax, immovable property tax, stamp duty and tax procedures. With technical assistance of the International Monetary Fund, research on further amendments is already undertaken and new legislation may be enacted next year.

It is a fact that the single income and wealth taxes have caused many practical difficulties and that the rules on administrative procedures lack clarity. In addition, the government recently emphasized that the distributive effects of personal income taxation should be strengthened and that, in order to reduce their dependence on transfers from the central administration, the involvement of municipalities in property taxation should be extended. In the meantime, a commission for the reform of stamp duty was set up in April 2005. A new wave of tax reforms may be on its way.[8]

Cape Verde adopted VAT for the same reasons as many other developing nations: VAT was regarded as an effective source of revenue, a form of taxation that is neutral in respect of both domestic and international trade and equipped with built-in incentives to ensure compliance

6. That was not the case with Mozambique, where a turnover tax (*imposto de circulação*) was levied since 1987 at all stages of the production and distribution process alongside the consumption tax (*imposto de consumo*) due on imports and manufacturing since 1961. The turnover tax was to become one of the most distorting elements of Mozambique's system of indirect taxation, not only because of tax cascading but also because of widespread fraud. The flaws of the turnover tax, which became all too apparent during the 1990s, when the country transformed into a market economy and enjoyed a strong growth, were one of the main reasons for the introduction of VAT in 1999. See Ibraimo Ibraimo, "A Tributação Fiscal em Moçambique: Sistema, Instituições, Necessidades de Mudança", in Sérgio Vasques, ed., *As Reformas Fiscais Africanas* (Lisbon: 1998), pp. 111-119.

7. Cape Verde's VAT Regulation was approved by means of Law No. 21/VI/2003, of 14 July 2003. Excise duties on alcoholic beverages and tobacco had previously been reformed in 1993-1994, while those on mineral oils had been reformed in 1992-1993. An *ecological tax* on all imported goods using non-recyclable packaging materials was created in 1995. The tax is 1% of the c.i.f. value of imports and its revenue was earmarked for basic sanitation undertaken by local councils. The ecological tax was initially abolished when VAT was introduced, but reinstated shortly afterwards.

8. Under the *Poverty Reduction Strategy Paper* released in April 2005, legislation on local finances must be presented to Parliament this year. The government commission for the study of the reform of stamp duty was set up by Resolution No. 8/2005 of 4 April 2005.

under the invoice method.[9] The IMF has certainly played a decisive role in the introduction of VAT, firstly, by recommending its adoption as a part of the adjustment programme for 1998-2000, in support of which the IMF approved a "stand-by arrangement" and, secondly, as a part of the Poverty Reduction and Growth Facility Arrangements for the years 2002-2004.[10] Whatever the effects of the IMF's advice, at the beginning of the 1990s, the administration had become familiar with the VAT system and had accepted it as a modern and efficient alternative for its outdated consumption tax.

Indeed, since the introduction of the consumption tax in the 1960s, the number of exemptions had multiplied beyond reason and control. Exemptions were introduced for, inter alia, the importation of musical instruments and accessories; sports apparel; materials for cultural associations; machinery for building sites; pharmaceutical products; agricultural tools and fishing equipment; all sorts of materials for undertakings in the tourist sector; vehicles for public transport or rental; equipment for the police and armed forces; vehicles for use of judges and members of parliament; medical equipment and fire-fighting gear; printing machines; photo gear for newspapers; etc. While the original Consumption Tax Law of 1961 only consisted of 13 articles, the successively added exemption schemes had turned it into a vast and complex set of legal provisions as well as a myriad of different assessment rules. Having to deal with consumption tax had thus become a challenge for both the administration and business operators, not to mention ordinary citizens.

As the number of exemptions grew rampantly, the tax base narrowed and revenue derived from consumption tax decreased rapidly. If Cape Verde's public finances were to become less dependent on international aid and tax revenues were to grow, the multitude of exemptions had to be reduced and common procedural rules had to be set out.[11] Actually, the economy as a whole had outgrown the consumption tax, as manufacturing and commerce developed during the 1990s and the services industry, which had become the most important sector of the national economy and, yet, remained largely outside the scope of indirect taxes, grew to about 75% of the GDP. In summary, introduction of VAT was seen as the most obvious means of broadening the tax base and adapting the country's tax system to its developing economy.

Still, introduction of VAT was not a straightforward process. Even though official documents provided for the introduction of VAT in 1991, its actual introduction was repeatedly delayed on the ground of practical difficulties experienced by both the administration and business community. Having established, with the assistance of the IMF's Fiscal Affairs Department, a commission for the introduction of VAT and the reform of indirect taxation in November 1999, introduction of VAT was initially planned for early 2001. Subsequently, introduction was postponed to early 2002, the end of 2002, early 2003 and, at last, VAT came into force in January 2004. The postponement did not come as a surprise. Given the structure of the system of indirect taxation, introduction of VAT had to be accompanied by a reform of import tariffs and excise duties.[12] Such a comprehensive reform required careful budgetary planning and the setting up of a specific VAT division of the tax administration, which, until then, was not familiar with the process of managing a general consumption tax. It also required preparation and information of the business community that would soon be confronted with a radically new tax system that was also applicable to many operators that had managed to stay outside the scope of indirect taxation until then. While the repeated delays in the introduction of VAT reflected the seriousness of the implementation difficulties, they also allowed more time for the administration to inform business operators.[13]

From a technical point of view, the Cape Verdean VAT broadly follows the European template and, more in particular, that of Portugal, which can easily be explained by the country's economic and cultural ties. On the one hand, the legal culture and practice of Cape Verde, at least most of its legislation, is deeply rooted in Portuguese law. On the other hand, despite its membership of the *Economic Community of West African States,* Cape Verde's commercial links with Europe have always been much stronger than those with the neighbouring African nations. Presently, Portugal is the destination of 70% of Cape Verde's exports and the source of about 50% of its imports, while European companies provide most of the foreign direct investments. Therefore, it was only natural that the new VAT was modelled on the European template and that its technique closely resembles that of the Portuguese VAT Law.[14]

9. On the general merits of VAT, see Liam Ebrill/Michael Keen/Jean-Paul Bodin/Victoria Summers, *The Modern VAT* (Washington, 2001); Peggy Musgrave, "International Aspects of Value Added Taxes: Lessons for Developing Countries", *International VAT Monitor* 3 (2001), pp. 105-119; and Alan Tait, *Value Added Tax: International Practice and Problems* (Washington: 1988).

10. See *Cape Verde – Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding*, 11 March 2002; and *Cape Verde – Interim Poverty Reduction Strategy Paper*, 31 January 2002, both available at www.imf.org.

11. Average tax revenue was 11.1% of GDP for the period of 1988-1992, 16.6% for 1996-1999, and 19.8% for 2000-2002. Such figures are above those of most other countries with an equivalent level of economic development but the growth of tax revenues relative to GDP seems to have stagnated in the last few years.

12. On the subject of excise taxation, see Sata Kähkönen/Patrick Meagher, "Tax Policy in Sub-Saharan Africa: Re-Examining the Role of Excise Taxation", in 4 *Journal of African Finance and Economic Development* 1 (2001), pp. 31-64; Nehemia Osoro/Philip Mpango/Hamisi Mwinyimvua, "An Analysis of Excise Taxation in Tanzania", *African Economic Policy Discussion Paper* No. 72; Andrew Okello, "An Analysis of Excise Taxation in Kenya", *African Economic Policy Discussion Paper* No. 73; and Seth Terkper, "The Role of Excise Taxes in Revenue Generation in Ghana", *African Economic Policy Discussion Paper* No. 74, all three released in June 2001 in the context of the Equity and Growth through Economic Research (EAGER) Program of the United States Agency for International Development, available at www.us.aid.gov.

13. The VAT Services Department (*Direcção de Serviços do IVA*) was set up by Decree-Law No. 62/2003 of 30 December 2003.

14. Portuguese-speaking African countries continue to share a common legal tradition with Portugal and much of their recent tax reforms follow the technique

3. BROADENING THE TAX BASE

The need to broaden the tax base was one of the main reasons for the introduction of VAT. As a general consumption tax applicable to most goods and services, VAT certainly represented a step forward from a tax system under which, as a rule, services were not subject to indirect taxation and only a limited and continuously decreasing number of goods were subject to such taxes.

Drawing the service industry into the system of indirect taxation would, of itself, have been a strong argument in favour of the introduction of VAT. Anyway, introduction of VAT was accompanied by a thorough review and reduction of the existing exemptions. However, the broadening of the tax base should not be overestimated. A per capita GDP of about USD 1,500 does not allow imposition of a truly general consumption tax and, for social reasons, just like in most other developing countries, a significant range of goods and services have been left exempt from the tax.

The exemptions include:
- hospital and medical care;
- non-commercial public radio and television broadcasting;
- human organs, blood and milk;
- transport of sick or injured persons in ambulances or other specially designed vehicles;
- services and goods closely linked to welfare and social security work by public institutions and non-profit organizations;
- cultural and recreational activities provided by non-profit organizations;
- education and vocational training or retraining, including services and goods closely related thereto;
- tuition given privately by teachers and covering school or university education;
- admission to museums, art galleries or public parks;
- services relating to conferences;
- transfer of copyrights and works of art supplied by the original owners;
- services rendered by non-profit organizations to their members;
- fund-raising activities undertaken by non-profit organizations;
- postage stamps;
- garbage collection;
- funeral services;
- banking and financial services;
- insurance and reinsurance;
- leasing or letting of immovable property, excluding the provision of accommodation in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or camping sites, the letting of premises and sites for parking vehicles and advertisement and the letting of permanently installed equipment and machinery;
- transfers of immovable property subject to the single wealth tax;
- lotteries, sweepstakes and other forms of gambling subject to gambling tax;
- goods used for certain exempt activities in respect of which input VAT is non-deductible;
- agricultural products supplied by the farmers who produced them, and fish supplied by fishermen;
- services provided by farmers and farming cooperatives;
- services provided by artists to show business entrepreneurs.[15]

Exemptions on importation include:
- final importation of goods whose supply qualifies for exemption;
- reimportation of goods by the person who exported them, in the state in which they were exported, where they qualify for exemption from customs duties;
- services, in connection with the importation of goods where the value of such services is included in the taxable amount;
- importation of gold by the central bank;
- importation into ports by sea fishing undertakings of their catches, unprocessed or after undergoing preservation for marketing but before being supplied;
- importation of goods under diplomatic and consular arrangements, which qualify for exemption from customs duties; and
- importation of goods for the fuelling and provisioning of sea-going vessels and aircraft.

The most important exemptions for exports and connected transactions include:
- supply, modification, repair, maintenance, chartering and hiring of aircraft used by airlines operating both on domestic and international routes, and the supply, hiring, repair and maintenance of equipment incorporated or used therein;
- the supply of goods for the fuelling and provisioning of aircraft; and
- services for the direct need of those aircraft or their cargo.

International passenger transport as well as passenger transport between the Cape Verdean islands are exempt from VAT.

The list of exemptions is still impressive but they are now broadly in line with those under the Sixth Directive.[16]

of Portuguese law. The first Portuguese-speaking African country to introduce VAT was Mozambique, in 1999, and the Mozambican experience with VAT has provided a legal template and many practical lessons for the introduction of VAT in Cape Verde. Therefore, many similarities are to be found between Mozambique's VAT Code of 1999 and Cape Verde's VAT Regulations of 2003, as well as between these two texts and the Portuguese VAT Code enacted in 1986.

15. The Cape Verdean law only allows taxpayers a right of option for taxation in the case of agricultural, farming and fishing goods sold by the original producers.

16. It should be noted that public bodies are not considered as taxable persons when providing goods and services to the population free of charge. The free distribution of water during droughts or free distribution of clothing by public bodies is entirely outside the scope of VAT.

Even taking into account that some other goods and services are zero rated, it cannot be denied that the tax base is about as broad as it could be considering Cape Verde's present state of development. In fact, disregarding the zero rating of basic foodstuffs, the exemptions are not too different from those applicable in many European countries at the time when they acceded to the European Union.[17] For Cape Verde, the real challenge will be to keep the VAT base as broad as it initially was and not give in to pressure groups and occasional political interests calling for new exemptions. It is of vital importance to prevent recurrence of the process that so gravely eroded the consumption tax. In this respect, there is no ground for optimism because the Budget Law for 2005 has already introduced new exemptions for the supply of sand, the importation of machinery used by the sand extraction industry and goods and services to be used in the framework of international cooperation projects.

4. RATE STRUCTURE

At the time of introduction of VAT, a single rate of 15% applied. That single rate is broadly in line with the pattern of Sub-Saharan Africa, where the standard VAT rates tend to be relatively high and application of multiple rates is limited.[18]

According to studies commissioned by the Cape Verdean administration, application of a VAT rate of 15%, in combination with an across-the-board reduction of tariff duties, has led to a reduction of the tax burden on most goods. Still, the elimination of some tax exemptions and the higher perceptibility of VAT compared to the former consumption tax have led to a general fear of price increases, in response of which the administration undertook a public information campaign. There was no widespread protest against the introduction of VAT, even though some business sectors were critical of the elimination of exemptions applicable to them and of setting the tax rate at the level of 15%.

On the face of it, and disregarding the zero rate applicable to basic foodstuffs and other necessities, the Cape Verdean VAT is a single-rated tax. Just like under the abolished consumption tax, the zero-rated goods are identified in a separate schedule by reference of their classification under the import tariff and include meat, fish, milk, butter, cheese, eggs, vegetables, fruit, wheat, corn, rice, bread, animal and vegetable oil, books, newspapers and other publications, pharmaceutical products, and agricultural seeds and tools.

However, the effectives VAT rates are more diverse. In order to preserve price stability, under Decree-Law No. 63/2003 of 30 December 2003, the taxable amount in respect of goods and services which are subject to price controls is fixed at a percentage of their actual price. Those percentages are:

- 15% for passenger transport by road;
- 20% for water and butane gas;
- 30% for petrol, fuel oil, energy and wheat flour;
- 60% for telecommunication services;
- 100% for diesel; and
- 320% for gasoline.[19]

Therefore, in practice, the effective VAT rates range from 2.25% to 48%. Such a system of multiple VAT rates may be justifiable for social and policy reasons but it also makes the VAT system more complex. It will be more difficult for the tax administration to manage, and more costly for taxpayers to comply with, multiple rates.

In addition, the Budget Law for 2005 recently introduced a new reduced rate of 6% for tourist services and restaurant transactions.[20] The 6% rate has been introduced in response to the demands of the growing tourist industry in Cape Verde and it is probably inspired by the intermediate rate of 12% applicable to those services in Portugal since 1996. Introduction of the reduced rate of 6% only one year after VAT came into effect is disturbing because it shows that the tax authorities are still highly susceptible to lobbying which, in the past, has led to loss of revenue and erosion of the consumption tax and tariff duties. Since many inputs of the tourist and restaurant industry are taxable at rates higher than 6%, the new rate may lead to continuous claims for refunds of excess input tax, which may be an incentive for tax fraud and voluntary registration in this sector.

17. At the time of introduction of VAT in Portugal and its accession to the European Community in 1986, the Portuguese VAT Law provided for about the same exemptions, while Portugal's per capita GDP was much higher than that in Cape Verde. Besides, under the original Portuguese VAT Law most basic foodstuffs (cereals, meat, fish, eggs, milk), daily newspapers as well as goods and tools used on agriculture were zero rated; a reduced rate of 8% applied to a broad list of food and farming items, including ham, yogurt or fruit juice, education materials, soap and energy. An increased rate of 30% applied to luxury goods, such as whisky, jewellery and aircraft.

18. In March/April 2005, the only Sub-Saharan African VATs featuring reduced positive rates were those of Congo-Brazzaville, Equatorial Guinea, Gabon, Ghana and Kenya. Multiple positive rates are more common in more-developed countries. The highest standard VAT rates in present Sub-Saharan Africa are those of Madagascar and Tanzania, at 20%, the lowest those of Nigeria, a major oil-producing country, at 5%, and Botswana, at 10%. On the subject of VAT rates, see Sijbren Cnossen, "VAT in South Africa: What Kind of Rate Structure?", *International VAT Monitor* 1 (2004), pp. 19-24; and Marlene Botes, "Regressivity of VAT – The First Decade's Experience in South Africa", *International VAT Monitor* 5 (2001), pp. 237-244.

19. The percentages applicable to diesel, gasoline and butane gas have been changed in 2005 in response to price fluctuation on the international market. The current percentages are set by Decree-Law No. 3/2004 of 17 January 2005. Just like in Mozambique, the tax administration is authorized to adjust the taxable amount to the open market value of the goods and services supplied under specific circumstances. As regards Mozambique's VAT, see John Due, "Two New African Value Added Taxes – Tanzania and Mozambique", *International VAT Monitor* 3 (1999), pp. 117-123.

20. As regards the difficulties of preventing lobbying and special interests resulting in tax reforms, see Odd-Helge Fjeldstad and Lise Rakner, "Taxation and Tax Reforms in Developing Countries: Illustrations from Sub-Saharan Africa", (Bergen: Chr. Michelsen Institute , 2003), available at www.cmi.no.

Effective VAT rates in Cape Verde

Goods and services	Rate (%)
basic foodstuffs, etc.	0
passenger transport	2.25
water, butane gas	3
energy, petrol, fuel oil, wheat flour	4.5
tourist services, restaurant transactions	6
telecommunications services	9
standard rate	15
gasoline	48

5. REGISTRATION AND SIMPLIFICATION REGIMES[21]

While the significance of the introduction of VAT for the Cape Verdean administration and business community should not be underestimated, it should be borne in mind that the country's tax system operates on a modest scale. With a resident population of about 400,000, there are no more than about 17,500 registered taxpayers and about 5,000 businesses are subject to VAT, which means that the larger part of the population actually earns a living outside the tax system, not to mention VAT.

Given the fact that most businesses are small-scale operations, special attention was given to registration and simplification regimes.

The registration regime means that businesses whose annual income does not exceed CVE 180,000 (approximately EUR 1,800) are relieved from the obligations imposed on taxable persons under the VAT Law. Below the registration threshold, businesses are neither obliged to remit VAT on their outputs, nor entitled to a refund of the tax on their inputs.[22] However, they may opt for taxation under the normal or simplified VAT regimes at any time. If they take up that option, they must remain under the chosen regime for the following five years. Where they exceed the registration threshold, small businesses must immediately apply for registration, either under the normal or simplified regime.

The simplified regime may be applied by businesses whose annual income does not exceed CVE 5 million (EUR 50,000). Under that regime, on the one hand, businesses are not entitled to deduct input tax and, on the other hand, they only pay 5% VAT on their transactions, excluding supplies of used capital assets. That flat rate tax cannot be deducted by their customers. Under the simplified regime, the administrative obligations are much lighter than those under the normal regime. Businesses eligible for simplified taxation may opt for the normal regime at any time without being subject to any minimum period of permanence.

Number of businesses in Cape Verde

Districts	Registered businesses		Non-registered businesses
	Normal regime	Simplified regime	
Boa Vista	45	16	169
Brava	11	11	174
Maio	12	24	98
Mosteiros	1	184	11
Paul	1	1	159
Porto Novo	21	23	374
Praia	1,131	766	280
Ribeira Grande	37	18	457
Sal	303	613	129
Santa Catarina	41	101	1,198
Santa Cruz	10	14	138
São Filipe	19	481	13
São Nicolau	23	23	322
São Vicente	501	510	277
Tarrafal	13	87	545
Total	2,169	2,872	4,344

Source: Cape Verde's Tax Administration, March 2005.

A closer examination of the above table shows that the number of taxable persons under the normal regime is quite small, just over 2,000. Most of these taxpayers are concentrated in the districts of:

- Praia, the nation's capital and fastest growing city;
- Sal, the north-eastern island where most of the country's tourist industry and its only international airport are located; and
- São Vicente, the second most-populated island where the important port of Mindelo is located.

Some of the smaller, less-populated islands, such as Maio, Brava or Boavista have a negligible number of taxpayers under the normal regime, while Praia alone accounts for more of these taxpayers than the rest of the country as a whole.

While 2,169 businesses are subject to the normal VAT regime of VAT, 2,872 taxable persons are subject to simplified taxation. In most tax districts, taxpayers subject to the simplified regime outnumber those subject to the normal regime, the district of Praia being the only significant exception. The distribution of taxpayers under the simplified regime across the territory of the country is more uni-

21. Other special schemes have been introduced, most of which are now part of the inevitable apparel of VATs modelled on the European template. Second-hand goods, works of art and antiques are subject to a margin scheme by Law No. 32/VI/2003 of 15 September 2003; travel agents are subject to a special scheme set by Law No. 38/VI/2003 of 3 February 2003; public works commissioned by the government are subject to a special scheme regulated by Decree-Law No. 16/2004 of 20 May 2004.

22. It is a distinctive feature of the Cape Verdean VAT that the registration threshold is not set by reference to turnover, but to taxable income. The explanation for this lies in the attempt to harmonize the small businesses regimes of VAT and the single income tax. The income threshold is not the only condition for the application of the VAT exemption regime. Business operators may not be engaged in imports or exports, a condition which is of great importance in a country such as Cape Verde.

form than those subject to the normal regime, which means that many of the larger businesses are clustering around the capital, while small undertakings are more evenly spread over the country. The district of Praia accounts for 52.1% of normal regime taxpayers but for only 26.6% of taxpayers under the simplified regime.

The number of taxable persons below the registration threshold is quite significant in most tax districts and in the country as a whole. Santa Catarina and Tarrafal, both located on the island of Santiago, where the capital of Praia is located, stand out as having more than 1,700 businesses under the registration threshold, a disproportionately high number when compared to other important districts, such as Praia, Sal or São Vicente. As the registration process is still underway, and some switching between the three regimes may be expected, especially after the introduction of the 6% reduced rate, the local deviations will probably tend to smooth out and these numbers should not be regarded as definite.

6. FINAL REMARKS

Barely one year after the introduction of VAT, it is still too early to make an assessment of its success in Cape Verde.

The importance of VAT is certainly not open to dispute. Indirect taxes are the most important source of revenue and, amongst them, VAT has become the most important tax taking up the place that formerly belonged to the consumption tax. By providing about 32% of all tax revenue, VAT clearly is and will remain the backbone of the Cape Verdean tax system.

The need for introduction of VAT cannot be disputed either. The worn-out consumption tax had become too narrow and complex. Its increasing number of exemptions had added significantly to the workload for the administration and the compliance costs for the business community.

Along with the reform of import duties and excise taxation, the introduction of VAT enabled the Cape Verdean authorities to do away with many of the tax concessions that had been granted in the last 40 years and provided the country with a broader and leaner tax, in line with the current trends of its European and African economic partners. Foreign investors will now be able to operate in a tax environment they are generally familiar with and this is an advantage that grows day by day, as an ever increasing number of countries adopt VAT.

In the context of globalization, the widespread adoption of VAT across Sub-Saharan Africa, largely owing to the efforts of the IMF, arguably is a better solution than a puzzle of different indirect taxes, each subject to local traditions and features. While VAT provides a lingua franca that helps the integration of Sub-Saharan Africa in the world economy, it is true that social and administrative conditions prevailing in these countries demand some deviations from the European VAT template, even in better-off nations such as Cape Verde.[23]

In fact, the Cape Verdean VAT is much more of a tax on imports than on internal transactions and it is as much of a sales tax as it is a tax on value added. The largest share of the VAT revenue will certainly continue to be generated by the taxation of imports and, for the largest part of business undertakings, the introduction of VAT really has amounted to the introduction of a 5% sales tax. In both respects, VAT is a tax the Cape Verdean society is meant to slowly grow into.

All of this is perhaps inevitable. However, the most serious concerns are the possible amendments to the VAT system. The 40-year long experience with the consumption tax has shown how seriously indirect taxes can be distorted by political decisions and private interests. Resisting such pressures will certainly be one of the hardest tasks for the Cape Verdean authorities in the years to come.

23. Otherwise, Scott Riswold, "VAT in Sub-Saharan Africa – A Critique of IMF VAT Policy", *International VAT Monitor* 2 (2004), pp. 97-110.