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The treaty trap: tax avoidance in Mozambique's extractive industries

The miners

Contents

Introduction

While Mozambique's gas extraction boom is relatively recent, the country's mining industry has been thriving for several decades. This report will provide insight into the financial structuring of three mining projects in Mozambique, and how this allows the projects' owners to avoid Mozambican taxes.

Gemfields mines rubies in the northern Mozambican province of Cabo Delgado, which has been plagued by a violent insurgency in recent years. Kenmare Resources operates a titanium mine in neighbouring Nampula province. Third, there's the Nacala Logistics Corridor, an infrastructure network that services the Moatize coal mine in Tete province and was owned by Vale and Mitsui until 2022.

What all these companies have in common is that they employ similar corporate structures and use subsidiaries in tax havens to limit the taxes they would otherwise owe in Mozambique. They use these subsidiaries – often little more than mailboxes with a few financial or administrative staff at most – as conduits for financial flows that come in the form of interest, dividends, and royalties. By employing such tax avoidance structures, companies can shift their profits from high tax jurisdictions to low tax jurisdictions, thereby reducing their overall tax burden.

In the case of Mozambique, another aspect that characterises corporate tax avoidance is the illegitimate use of double taxation agreements (DTAs). DTAs are bilateral treaties negotiated between states, and their purported aim is to increase investment between the treaty partners, although the evidence in support of DTAs leading to increased investment is mixed at best. In part, DTAs do this by lowering the taxes on corporate financial flows – also known as withholding taxes – between the signatory countries. Companies that qualify for the benefits enshrined in a DTA will therefore often be subject to lower tax rates on the interest, dividends, or royalties they receive from partners abroad.

However, the fact that companies can freely incorporate subsidiaries in most jurisdictions means there is little to stop foreign multinational corporations from gaining access to the benefits enshrined in a country's DTAs. Take, for example, a hypothetical company from Germany looking to invest in Mozambique. It can do so directly and invest in a subsidiary in Mozambique through debt or equity, but because Mozambique and Germany do not share a DTA, all related interest or dividend flows going from Mozambique to Germany will be subject to Mozambique's statutory withholding tax rate. If, instead, the company sets up a Mauritian subsidiary, and uses that as a conduit for its debt or equity investments in Mozambique, the related interest and dividends will instead be taxed at the lowered tax rates provided for by the Mauritius–Mozambique DTA. This simple act of setting up a conduit company to illegitimately gain access to a country's treaty network is known as treaty shopping.

SOMO's previous report on corporate tax avoidance in Mozambique – *How Mozambique's tax treaties enable tax avoidance* – details how much the country loses annually to the illegitimate use of these treaties.[1] Specifically, we found the DTAs Mozambique shares with Mauritius and the United Arab Emirates (UAE) to have cost Mozambique approximately US$ 315 million in tax revenues in 2021 alone.

In this report – as well as in the accompanying publication *The Gas Companies* – we illustrate how this DTA abuse works in practice and how extractive industry companies investing in Mozambique use tax haven subsidiaries to avoid taxes.

Research methodology

The findings and estimates of tax avoidance in this briefing are based on information from publicly available sources. They are therefore limited by what the companies and governments involved make available. Data sources we have used for this report include:

- annual reports and annual accounts from the companies named in this report;
- corporate ownership data from national corporate registries and databases including Orbis and Company.info;
- reports by media, NGOs, and academia.

Our research draws primarily on publicly accessible information, including corporate press releases and annual reports and accounts. Although SOMO finds widespread abuse of tax treaties and tax avoidance by extractive industry companies in Mozambique, these findings are heavily limited by a general lack of data availability. Companies operating in Mozambique are not required to publish their annual accounts – neither directly nor via a publicly accessible corporate registry. And companies investing in Mozambique often do so via the corporate secrecy jurisdictions Mauritius and the UAE.[2] Consequently, we could access only very limited financial information for this research. Despite these constraints, SOMO has encountered widespread use of tax haven subsidiaries and tax avoidance by extractive industry companies in Mozambique, adding urgency to calls for the Mozambican government to regulate and limit these practices.

Prior to publication, we sent Gemfields, Kenmare, Vale, and Mitsui SOMO's findings and gave them the opportunity to comment. Their comments have been integrated into the report where appropriate, and factual errors in the reporting have been corrected based on their feedback.

In addition, the research presented here was reviewed by Prof. dr. J.L. van de Streek and J.C. van der Have (Msc), tax law academics employed by the University of Leiden. Their comments have been integrated into the report.

Chapter 1 discusses the case of tax avoidance by Gemfields on its profits from the Montepuez mine. This is followed in Chapter 2 by the case of Kenmare Resources and its use of a Mauritian subsidiary to avoid Mozambican taxes. Chapter 3 describes how Vale and Mitsui avoided tax while financing their Nacala Logistics Corridor. The report ends with a summary of our findings, conclusions and recommendations.

Workers separate rubies from gravel at the sorthouse at Gemfields Group Ltd.s ruby operation near Montepuez in Mozambique, on Wednesday, June 13, 2018

1. Gemfields' Montepuez ruby mine

In 2012, Gemfields acquired the rights to 75 per cent of a mining concession in Mozambique's northern Cabo Delgado province.[3] The same year, the Montepuez mine – named after the nearest major city – went into operation, and it has been producing ruby gemstones since.

Gemfields is based in the UK, with its headquarters in London, and the group's parent company is incorporated in the tax haven jurisdiction of Guernsey.[4] The company specialises in the mining and marketing of gemstones and operates mines in Mozambique and Zambia.[5] In Zambia, Gemfields acquired the Kagem emerald mine in 2008, and it has since expanded its Zambian portfolio to 11 mining licences.[6]

Gemfields' corporate structure

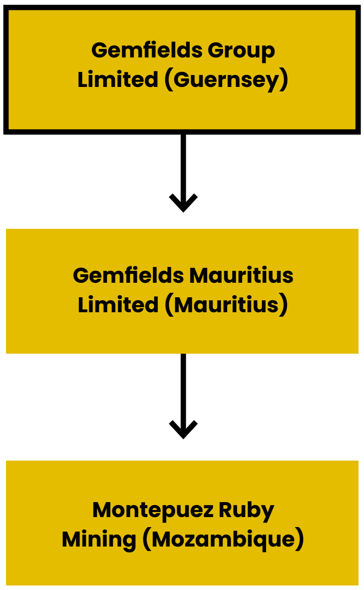
The Montepuez ruby mine is operated by Gemfields' Mozambican subsidiary, Montepuez Ruby Mining Limitada (MRM). The ownership of this company is split between minority shareholder Mwiriti Limitada, which has a 25 per cent share, and Gemfields. However, Gemfields' 75 per cent share is not owned from its operational headquarters in London, nor from its Guernsey-based parent company. Instead, MRM is owned by a Gemfields group subsidiary in Mauritius called Gemfields Mauritius Ltd.[7]

The Mauritius Corporate and Business Registration Department lists the registered address of this Mauritian subsidiary as located at the address of First Island Trust Company Ltd in the country's capital, Port Louis.[8] This indicates that the company is administered by a trust company, implying that it operates as a mailbox company, with limited genuine economic activity. The Organisation for Economic Co-operation and Development (OECD) defines a mailbox company as "a company which has complied only with the bare essentials for organization and registration in a particular country. The actual commercial activities are carried out in another country."[9] In this case, evidence suggests that Gemfields Mauritius Ltd is a mailbox company that holds Gemfields' shares in the group subsidiary MRM and does not participate meaningfully in Gemfields' real economic activity, which is mining.[10]

Gemfields has disputed this finding, stating instead that "Gemfields Mauritius Ltd has its own office which serves as a regional office providing investment management and financial, auction and management services... [which] is a physical location that can be visited, is staffed by a team and has directors which include Gemfields' most senior executives." The company lists an address for Gemfields Mauritius Ltd that is separate from First Island Trust, and specifies that it employs four personnel, all of whom it says are involved in the management of Gemfields' finance.

However, according to the Mauritius registry, four of the directors of the company are UK or India based,[11] while the remaining two work for First Island Trust Company.[12] The fact that the team of four employed in Mauritius are all involved in financial operations also points to the company's function as a mailbox company, as they show that this subsidiary does not play a central operational role in the asset it controls, the Montepuez mine in Mozambique. Financial services are relatively easy to relocate to a tax haven jurisdiction, and are often the main function performed by mailbox companies. This also appears to be reflected in the list of offices presented in Gemfields' annual accounts, where a "regional office" in Mauritius is conspicuously absent.[13]

Figure 1.
Gemfields' Montepuez ownership structure



Avoiding tax on Montepuez's dividends

Mauritius is a known tax haven that facilitates tax avoidance by multinational corporations.[14] The country offers an effective 3 per cent corporate income tax rate to companies that undertake various activities, including investment holding.[15] The Mauritius authorities formerly referred to this beneficial tax regime, which is tailored to attract foreign multinationals, as their Global Business Company regime.[16] Gemfields Mauritius Ltd reportedly operates as a Global Business Company and has likely benefited from this tax regime.[17]

Mauritius provides resident companies with the benefits of its many double taxation agreements, many of which offer low to zero per cent withholding tax rates applicable to cross-border financial flows leaving and entering the country.[18] The DTA between Mozambique and Mauritius is an example of one that severely limits the taxing rights of Mozambique, providing tax rates as low as 5–8 per cent for cross-border interest, royalty, or dividend payments.

Considering Gemfields' UK origins, the lack of a mining industry in Mauritius, and the absence of any Gemfields operations in Mauritius, it appears likely that Gemfields Mauritius Ltd's only purpose is to hold the group's investments in Mozambique. The tax benefits Mauritius offers resident companies are therefore likely to be the primary reason Gemfields set up this holding structure, which appears to have little to do with the company's real business – mining gemstones – and to serve mostly to avoid Mozambican taxes.[19]

Here is how it works. If Gemfields had made its investment directly into MRM from its parent company in Guernsey, profits generated by Montepuez would then be paid directly to the UK Crown Dependency island as dividends. Because there is no applicable DTA between Guernsey and Mozambique, any such dividends would be subject to the statutory Mozambican withholding tax rate, which is 20 per cent.[20]

Instead, Gemfields set up a subsidiary in Mauritius, which holds Gemfields' entire share of MRM. This way, dividends paid from Mozambique to Guernsey first pass through Mauritius, allowing the company to benefit from the Mozambique–Mauritius DTA. As described above, this DTA limits Mozambique's taxing rights on dividends to 8 per cent of the total amount, thereby saving Gemfields the 12 per cent in tax it would have paid additionally had the dividend been paid directly to Guernsey. Hence, through the simple act of setting up a Mauritian mailbox company and using it as a conduit for the ownership of its Mozambican mine, Gemfields saves on its tax obligation, to the detriment of Mozambique's coffers.

Table 1 provides an estimate of how much Mozambique loses as a result of Gemfields' offshore tax avoidance structure.

Although the Montepuez ruby mine has been in production since 2012, figures on dividends paid out by Gemfields' Mozambican subsidiary were available for only the most recent six-year period. During this period, Montepuez generated $ 108.9 million in dividend payments, of which $ 81.7 million were attributed to Gemfields Group. Based on the benefits enshrined in the Mozambique–Mauritius DTA, the Mozambican revenue authorities very likely charged Gemfields 8 per cent of these dividends in withholding tax, or approximately $ 6.5 million.

Had Gemfields instead invested in Montepuez directly from the UK or Guernsey – a more straightforward structuring that would not have resulted in withholding tax avoidance – the company would have been subject to Mozambique's 20 per cent withholding tax rate, leading to a total $ 16.3 million tax obligation. The difference between these two figures shows that the simple act of rerouting its Montepuez ownership via Mauritius has allowed Gemfields to avoid approximately $ 9.8 million in Mozambican tax.

Table 1.
Estimated withholding tax (WHT) revenue losses for Mozambique from Gemfields' Montepuez investment, 2017–2022

	2022	2021	2020	2019	2018	2017	Total
Gemfields' share of 1 Montepuez dividends ($ million)	15.38	15.00	18.75	0.00	17.55	15.00	81.68
Moz.–Mau. DTA dividend WHT rate (%)	8	8	8	8	8	8	–
Current situation: dividend WHT owed ($ million)	1.23	1.20	1.50	0.00	1.40	1.20	6.53
Moz. statutory dividend WHT rate (applicable to financial flows to Guernsey) (%)	20	20	20	20	20	20	–
Counterfactual situation: statutory dividend WHT owed ($ million)	3.08	3.00	3.75	0.00	3.51	3.00	16.34
Dividend WHT avoided: counterfactual WHT minus current situation WHT ($ million)	1.85	1.80	2.25	0.00	2.11	1.80	9.80

Involvement with the Mozambican military

As described above, Gemfields shares its ownership of the Montepuez mine with minority shareholder Mwiriti Limitada. Corporate information databases provide little to no information on Mwiriti or its owners, apart from the fact that it is registered in the city of Pemba in Cabo Delgado,[21] and we were unable to retrieve annual accounts for the company. However, media reports identify Mozambican army general and former senior member of the governing Frelimo party Raimundo Pachinuapa as the company's owner.[22]

In our correspondence with Gemfields, the company confirmed that Mr Pachinuapa owns 60 per cent of Mwiriti Limitada, giving him a 15 per cent stake in the Gemfields Montepuez ruby mine. Mr Pachinuapa is reportedly a veteran of Mozambique's independence struggle, served as governor of Cabo Delgado province until 1986 and as Mozambique's inspector general until 2005, and today sits on Frelimo's political commission, which guides its party policy.[23]

Reportedly, Mwiriti managed to take control of the Montepuez concession area after rubies were discovered there in 2009, though it is unclear what the company paid the Mozambican government to do so. In 2012, Gemfields paid Mwiriti $ 2.5 million for its 75 per cent share in the concession.[24]

The involvement of Mr Pachinuapa, a former army general and high-placed Mozambican official, in the Montepuez mining operation poses serious corruption and human rights risks for Gemfields and for other Mozambican stakeholders. Information on how Mr Pachinuapa managed to secure ownership of the Montepuez concession is not publicly available, but his position of power in Mozambique poses questions about potential conflicts of interest. [25]

Human rights abuses

In 2016, Mozambique enacted new mining legislation, changing the status of artisanal miners without mining concessions from "unlicensed" to "illegal" and giving companies and authorities more power to punish offenders.[26] The following year, in 2017, Gemfields was granted exclusive rights to mine a 340 km area in the Cabo Delgado province of northern Mozambique.[27] Following the granting of Gemfields' concession came what a recent report commissioned by energy company Total calls a "violent crackdown" on artisanal miners in the area.[28] The report's authors claim that this crackdown was an important contributary factor to the violent conflict that has since erupted in Cabo Delgado, as it reportedly displaced a large number of people, who then sought justice through the violent insurgency.[29]

In 2017, video footage surfaced of this crackdown, showing Gemfields' security personnel as well as Mozambican army forces torturing artisanal miners near the Montepuez concession area.[30] The methods of torture included forcing victims to hold strenuous positions, humiliation, and beatings.

Further accusations against Gemfields surfaced in 2018 when Gemfields was sued in a UK court by law firm Leigh Day, representing 100 Mozambican plaintiffs made up of local community members and artisanal miners. The claims included mistreatment, stealing of land, sexual abuse, and unlawful detention and murder at the hands of Gemfields' security forces and Mozambican military personnel.[31] Nine months later, Gemfields settled the plaintiffs' claims, agreeing to pay them £ 5.8 million while accepting no liability for the alleged human rights abuses.[32]

Media reporting on these issues has been relatively limited considering the nature and scope of these alleged abuses.[33] One reason for this could be that Gemfields has been extremely active in monitoring and counteracting critical media. Numerous outlets have had to publish apologies or remove articles due to complaints from Gemfields, indicating a serious undermining of press freedom and freedom of speech on issues involving the company.[34]

Gemfields' response

As part of SOMO's review process, Gemfields was given the opportunity to respond to the research findings presented above. Where appropriate, Gemfields' comments have been integrated into the text.

In its response, Gemfields does not dispute taking advantage of the Mozambique–Mauritius DTA to lower the tax it pays in Mozambique. Nor does it dispute our figures estimating the amount of withholding tax avoided through this structure. With regard to using the DTA, Gemfields states: "Utilising the double taxation treaty … is tax efficient, makes commercial sense and is an entirely legal and legitimate practice that is well understood and accepted by the Mozambique Revenue Authority"

Gemfields does dispute SOMO's finding that the company has used its subsidiary in Mauritius to avoid Mozambican taxes. Instead, the company states, the main incentive for using this structure is the bilateral investment treaty (BIT) between Mozambique and Mauritius. Gemfields argues that the treaty serves to "protect investments made in Mozambique by foreign companies, and to pay compensation if, for example, the investment is lost due to instability or insurgency". The protection Gemfields refers to here is the investor-state dispute settlement (ISDS) mechanism included in the BIT between Mauritius and Mozambique.[35]

ISDS is a mechanism provided by BITs that allows companies to sue states before international arbitration tribunals over state actions affecting their operations or damaging their profitability.[36] Companies have in the past evoked ISDS in reaction to states implementing policies in the public interest, such as environmental regulations or employee protections.[37] Gemfields' admission that investment protection was one of the driving factors behind its use of a Mauritian subsidiary gives further credence to the view that Gemfields Mauritius Ltd operates as a mailbox company. The fact that gaining access to the legal benefits afforded to Mauritian resident companies was why Gemfields Mauritius Ltd was created indicates that Gemfields' actual economic activity – mining gemstones – was not central to its incorporation.

Using mailbox companies in this way to gain access to a jurisdiction's treaty benefits is a practice known as treaty shopping. To engage in treaty shopping, companies create a legal presence in a jurisdiction where they are not resident in order to illegitimately become subject to treaties intended for domestic companies.

It is not possible for SOMO to assess exactly what drove Gemfields' use of its Mauritian subsidiary. However, if Gemfields was indeed motivated in large part by gaining access to investment protection, the company could have taken a simpler course of action. Although the jurisdiction of its parent company, Guernsey, does not share a BIT with Mozambique, the UK – where Gemfields' headquarters are located – does.[38] Had Gemfields made its investment from the UK instead, the company would have received similar investment protection to what it has now, although it would have missed out on the opportunities for tax avoidance that Mauritius offers.

2. Kenmare's Moma titanium mine

Kenmare Resources first established a presence in Mozambique in 1987, when it acquired an interest in the Congolone heavy mineral deposit on Mozambique's northeast coast.[39] In 2004, Kenmare started construction of its Moma mine, a titanium mine near the eponymous town of Moma. Titanium production at the Moma mine commenced in 2007, and the mine has since become Kenmare Resources' primary mining asset.

Kenmare itself was incorporated in Ireland, where its parent company and headquarters are still located. A history of the company's former mining operations is not publicly available, but since 2007 Kenmare's only mining activities appear to have been at Moma.

Kenmare in tax havens

Considering that Kenmare mines exclusively in Mozambique, you would expect the company to operate a fairly small and simple corporate group. However, Kenmare's corporate group consists of seven companies,[40] five of which are located in the tax havens of Mauritius and Jersey.[41] Meanwhile, none of the group's subsidiaries are present in Mozambique, its primary country of operation.

Kenmare's three subsidiaries in Jersey have the Zedra Trust Company (Jersey) listed as their administrator, indicating that they are mailbox companies without real economic substance.[42] The group's two Mauritius-based subsidiaries – Kenmare Moma Mining (Mauritius) Ltd (KMML) and Kenmare Moma Processing (Mauritius) Ltd (KMPL) – are located at the same address as corporate service provider DTOS,[43] indicating that these companies likewise operate as mailbox companies with limited personnel or economic substance.

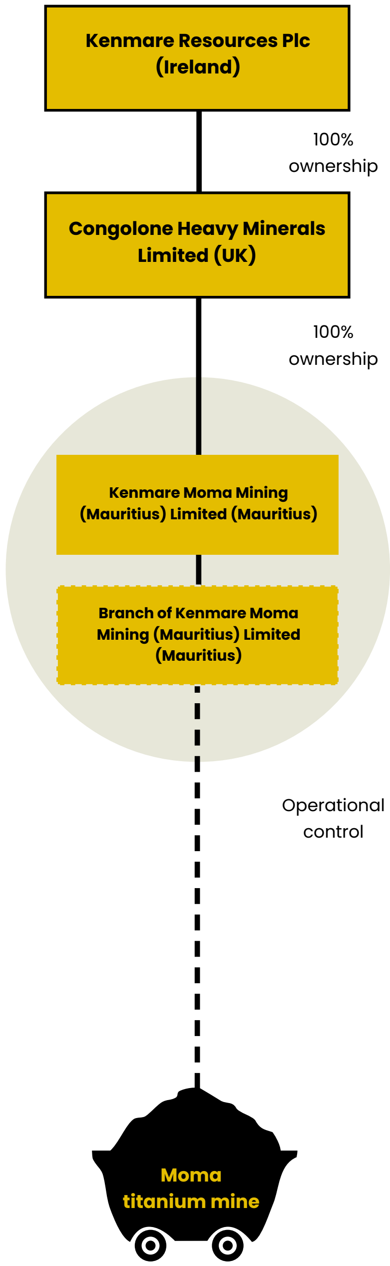
While the Mozambican Moma mine is Kenmare's primary asset, the group does not run the mine through a local subsidiary. Instead, a Mozambican branch of Kenmare's Mauritian subsidiary KMML operates the Moma mine. Similarly, a Mozambican branch of the other of the group's Mauritian subsidiaries, KMPL, runs the minerals processing operation for Moma (Figure 2).

Generally, companies use branches in foreign jurisdictions to house structural economic activities without being required to set up a new subsidiary in that jurisdiction. If such activities endure over a substantial period of time (often more than several months), tax authorities will aim to tax the profits on those activities within their respective jurisdiction, which is when the need to designate a branch arises.

In the case of Kenmare, however, the Mozambican branches are not involved in a limited set of activities for their Mauritian head offices, but instead operate the Kenmare corporate group's primary mining asset. The ownership structure employed for the Moma mine is remarkable, and combined with the widespread use of tax havens by Kenmare Resources, provides a clear indication of tax avoidance by the company.

In Mauritius, Kenmare's subsidiaries KMML and KMPL have operated as so-called "authorised companies",[44] a category applied to management or holding companies that are considered not to be economically active or tax resident in Mauritius. As a result of not being considered tax resident in Mauritius, KMML and KMPL are not subject to any Mauritian taxes. Any profits these companies generate in Mauritius through services provided to their permanent establishments in Mozambique are therefore likely to be exempt of all corporate income taxes.

Figure 2.
Kenmare's ownership structure for the Moma mine



Tax incentives for Kenmare

A 2013 report by the Mozambican Centro de Integridade Pública (CIP) and Eurodad shows that Kenmare received generous tax incentives to operate in Mozambique from the Mozambican government.[45] KMML was given a 50 per cent reduction in corporate income tax between 2008 and 2018, a reduced royalty rate, exemption from import and export taxes and from VAT, and an exemption from dividend withholding tax that lasted until 2018. Its sister company KMPL was designated as active in an Industrial Free Zone and received even more extensive fiscal incentives as a consequence. The company is still today fully exempt from Mozambican VAT, import and export taxes, corporate income taxes, and dividend withholding taxes.

Responding to this research, Kenmare told SOMO that it has an agreement with the Mozambican government that the applicable tax regime at the start of the Moma investment (in 2001) will prevail for the project's duration. Such an agreement is generally known as fiscal stabilisation, and it provides an assurance for investors that they will not unexpectedly face significantly higher tax rates than they have planned for. Fiscal stabilisation agreements allow investors to more effectively assess the expected profitability of a project. Simultaneously, these agreements can also lock in any damaging tax incentives or loopholes for tax avoidance, by ensuring that any efforts at regulation by the host state do not affect the respective project.

The OECD comments on fiscal stabilisation that it can be used as a rent-seeking tool, rather than a method for creating financial assurance.[46] Two important factors in this are duration – the OECD advises to limit its period – and the scope of what fiscal stabilisation covers. In the case of Kenmare, the period of fiscal stabilisation appears to be the total duration of the Moma project, while its scope covers the entire tax regime affecting the project.

As discussed previously, the tax incentives provided to KMML were extensive: a lowered rate or exemption from corporate income tax, VAT, and withholding taxes for 10 years. And KMPL received arguably the most far-reaching of tax incentives due to its Industrial Free Zone status: total exemption from all significant Mozambican corporate taxes.

In its 2018 publication on tax incentives in mining, the OECD advises governments to abolish such damaging tax incentives.[47] Further, it writes that fiscal regimes that provide different tax incentives for related companies (in the way that KMPL receives more far-reaching incentives than KMML) create opportunities for profit shifting between these related companies, and advises governments to avoid such incentives. It should be noted here that Kenmare provided SOMO with access to its annual accounts for KMML and KMPL, and SOMO found no immediate indications of profit shifting between these companies. As such it seems unlikely that Kenmare is aggressively pursuing such methods for tax avoidance, though this type of analysis is complex and difficult to execute solely on the basis of annual accounts while lacking extensive knowledge of the titanium mining industry. Kenmare writes that, as a result of its fiscal stabilisation, some of the fiscal terms of its investment – including the corporate income tax rate – are less favourable than terms available to companies that have invested in Mozambique since. Without illustrations of these more favourable terms it is difficult to gauge the truthfulness of this statement. However, considering the extensive tax incentives Kenmare was granted, it is clear that more favourable tax terms would have only further limited Mozambique's taxing rights, thereby exacerbating the tax injustice associated with the Moma project.

Avoidance of dividend withholding taxes

Due to its array of tax incentives, Kenmare Resources has been subject to few of Mozambique's taxes since the inception of the Moma mine. In 2018, however, KMML's exemption from dividend withholding tax ran out. Dividend withholding taxes are generally levied on cross-border payments of dividends, meaning that dividend payments from the Moma mine to its corporate owners after 2018 could have become subject to such taxes.

However, the unusual holding structure employed by Kenmare, whereby the Moma mine is run by a Mozambican branch of one of its Mauritian subsidiaries, allows the group to avoid paying dividend withholding taxes in perpetuity. Because a branch operates not as a separate legal entity but instead represents a foreign company, when a branch generates profits that are then paid out as dividends, tax authorities may note these payments as coming from the head office instead.[48] In this case, the head office would be the Mauritian-based Kenmare subsidiary KMML, whose dividend payments are not subject to Mozambican withholding tax. In its response to this research, Kenmare has confirmed that KMML is not subject to Mozambique's dividend withholding taxes.

In 2021, KMML paid out its first dividend of $ 20 million to its shareholder Congolone Heavy Minerals Ltd, one of Kenmare's Jersey-based subsidiaries.[49] In 2023, this was followed by a second dividend payment of $ 30 million.[50] Considering that operating the Moma mine is KMML's only real economic activity, it is obvious that the underlying profits that make up this dividend were generated in Mozambique.

Had Kenmare operated its Moma mine out of a Mozambican subsidiary – as is common practice – the group would have been subject to Mozambique's statutory withholding tax on dividends, which is levied at 20 per cent.[51] In that situation, Mozambique's tax authorities would have recognised dividend payments crossing the country's borders on the way to Jersey, which would have incurred a $ 4 million tax obligation for Kenmare in 2021 and a further $ 6 million obligation in 2023. Had these payments been made instead to Kenmare's parent company in Ireland – the expected final destination for such dividends – they would similarly have been subject to a 20 per cent withholding tax in Mozambique, as Ireland and Mozambique do not share a DTA. Because the company set up its current structure using branches in Mozambique, however, Kenmare manages to circumvent these dividend withholding taxes, causing Mozambique to lose approximately $ 10 million in tax revenues in 2021 and 2023.

Kenmare's response

As part of SOMO's review process, Kenmare was given the opportunity to respond to the research findings presented above. Kenmare were forthcoming and transparent in their response to the research, providing SOMO with insight into their operations and access to annual accounts that they were in no way required to. Where appropriate, Kenmare's comments have been integrated into the text.

In its response, Kenmare argues that, because the Mozambican government was aware of and agreed to Kenmare's intended use of Mauritian subsidiaries for its investment, there is nothing remarkable or illegitimate about the investment structure the company has employed for its Moma mine. Although it is worth investigating why the Mozambican government would have agreed to the terms for the Moma investment, cases like this – where low- and lower-middle-income countries sign agreements with foreign extractive companies that fail to safeguard the host country's taxing rights – are a common occurrence. This could be attributed to many different factors, including unequal technical and negotiating capacity between the state and the company. However, assessing what happened between the Mozambican government and Kenmare in 2001 lies outside the scope of this research.

Further, Kenmare states that its finance needs required the use of subsidiaries in an African state with a "streamlined, efficient, flexible and developed corporate law regime based on common law, that would lend itself to complicated secured project financing". The idea that the only African state suiting this description coincidentally happened to be tax haven Mauritius, where Kenmare's KMML and KMPL subsidiaries reside while being considered non-resident for tax purposes, strains credulity.

Kenmare also states that the use of its subsidiaries in Mauritius does not result in avoidance of tax in Mozambique. Seemingly, the reasoning here is that no Mozambican taxes are avoided, because the Mauritian subsidiaries are not tax residents in Mozambique, and they cannot avoid tax they are not subject to in the first place. This statement appears to miss the central point of SOMO's research findings, which is that Kenmare's Mauritian subsidiaries enable the avoidance of Mozambican taxes exactly because they are located in Mauritius, instead of in Mozambique where their mining operations are located, thereby allowing them to avoid paying Mozambican withholding taxes.

The Nacala Logistics Corridor

The Nacala Logistics Corridor (NLC) is a 912 km railway used to transport coal from mines in the Tete province of western Mozambique to Nacala port on Mozambique's eastern coast, passing through part of Malawi (Figure 3).[52]

This infrastructure project was created by Brazilian mining company Vale, which entered a partnership with Japanese energy company Mitsui & Co.[53] The NLC reportedly received $ 2.7 billion of outside investment, part of which was provided by development banks, such as the Japan Bank for International Cooperation ($ 1.03 billion) and the African Development Bank ($ 300 million).[54]

Figure 3.
The Nacala Logistics Corridor[55]

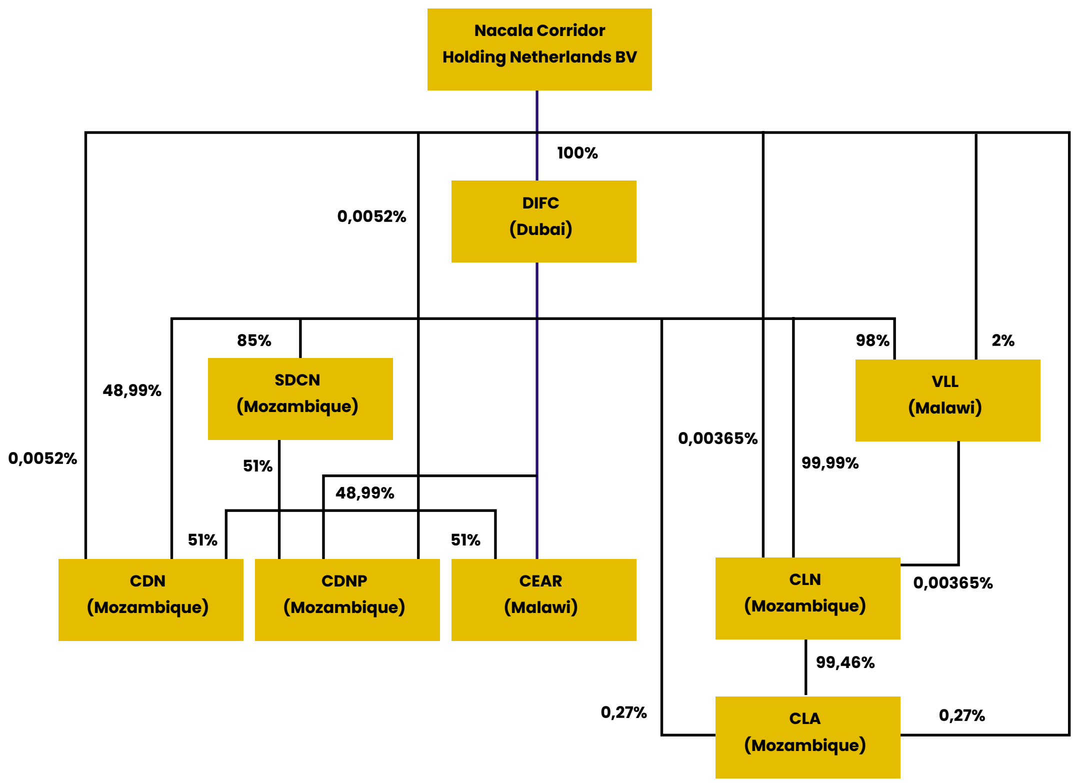
From March 2017, the NLC was jointly owned by Vale (50 per cent) and Mitsui (50 per cent).[56] In June 2021, Vale bought Mitsui's share.[57] And in April 2022, Vale sold the entire NLC, including its Moatize coal mine,[58] to Vulcan Minerals, a subsidiary of the Jindal Group, headquartered in India.[59]

In the years preceding the sale, however, Vale and Mitsui employed financing structures for the NLC that have likely allowed it to avoid Mozambican taxes. The following sections explain the workings of the NLC's tax avoidance structure.

Ownership and financing structure

Under Vale and Mitsui's ownership, the NLC's ownership was structured through a Dutch company, Nacala Corridor Holding Netherlands BV.[60] This Dutch company served primarily to hold the ownership of the NLC and a separate infrastructural investment in Malawi. These investments were structured using seven subsidiary companies, five in Mozambique and two in Malawi. It controlled these subsidiaries indirectly, however, via an intermediary holding company called Nacala Corridor (DIFC) Ltd, set up in Dubai in the United Arab Emirates (UAE) (Figure 4).

Figure 4.
Ownership structure for the NLC until 2022[61]



Avoidance of interest withholding tax

Between 2016 and 2020, Vale and Mitsui financed their Nacala operations in Mozambique and Malawi through loans from abroad. The annual reports for Nacala Corridor Holding Netherlands BV reveal that the subsidiaries outlined in figure 4 received loans from other Vale and Mitsui subsidiaries worth hundreds of millions of US dollars. These loans originate from four different companies located in the tax havens of Switzerland and the UAE.[62] These lenders are Vale International SA (Switzerland),[63] Vale Emirates Ltd (UAE), Mitsui & Co. Nacala Infrastructure Finance Ltd (UAE), and Mitsui & Co. Mozambique Coal Finance Ltd (UAE).[64] The three UAE-based lenders were all based in the Dubai International Financial Centre (DIFC),[65] a special economic zone that offers 40 year tax holidays to resident companies.[66] Swiss lender Vale International SA operates a branch in the DIFC zone, although no indication was found that its branch was directly involved in financing the Nacala project.[67]

Using publicly accessible information, it is not possible to say definitively why Vale and Mitsui structured their project finance this way. However, there are clear tax benefits to doing so. This is because the UAE has a tax treaty with Mozambique that reduces the withholding tax rate on interest payments to zero per cent. Withholding taxes are generally charged on international payments of dividends, interest, management fees, and royalties. In the case of interest, Mozambique's statutory withholding tax rate is 20 per cent, meaning any interest paid by a Mozambican company to a foreign counterpart is charged at 20 per cent. However, DTAs often lower such taxes, and the treaty between Mozambique and the UAE reduces it to 0 per cent.

As a result, any interest paid by the Mozambican subsidiaries operating the NLC to the affiliated company lenders in the UAE will not have been subject to Mozambican withholding taxes. If tax had not been a consideration in structuring the financing for the NLC, you would instead expect these loans to originate from the home states of the project's ultimate shareholders, Vale and Mitsui. Had these loans instead been provided from Brazil by Vale and from Japan by Mitsui, the interest on these loans would have been subject to Mozambique's 20 per cent statutory interest withholding tax rate. Unfortunately, the annual accounts for Nacala Corridor Holding Netherlands BV do not provide the specifics of these financing arrangements, leaving it unclear which portion of each loan from the UAE has gone to each of its eight subsidiaries. A variety of loans provided by Vale's and Mitsui's financing companies in the UAE to Nacala Corridor Holding Netherlands BV's subsidiaries in Malawi and Mozambique are specified in the annual accounts. Many of these loans are referred to as "project finance loans", indicating that they have been used to fund the NLC. It is therefore at least clear that Nacala Corridor Holding Netherlands BV's operational subsidiaries located in Malawi and Mozambique received loans worth hundreds of millions of dollars between 2016 and 2020.

How these loans were split between Mozambique and Malawi, however, is not disclosed. This is essential information for analysing Mozambique's potential tax revenue losses, because the extent of these losses depends on the amount of interest paid by the Mozambican subsidiaries operating the Nacala project to their UAE-based lenders.

It is possible, however, to estimate the division of the loans provided to Nacala Corridor Holding Netherlands' subsidiaries in Malawi and Mozambique by using their relative revenues as a proxy for the loans. As both a company's total revenue and its financing needs reflect its size, the relative size of the revenues generated by Nacala Corridor Holding Netherlands' Malawian and Mozambican subsidiaries is likely to correlate with the amount of finance they received from their lenders in the UAE. Without access to more detailed financial information, this is the best possible method for estimating the interest paid from Mozambique to the UAE, and hence Mozambique's tax revenue losses, even though the estimate is likely to be imprecise.

Nacala Corridor Holding Netherlands' annual accounts reveal that, between 2016 and 2020, the percentage of its subsidiaries' revenues generated in Mozambique varied between 70 and 80 per cent,[68] while the remainder was generated in Malawi. Table 2 provides an overview of the total interest owed by companies in Malawi and Mozambique involved in the NLC and an estimate of which portion of that interest can be attributed specifically to the Mozambican entities.

Table 2. Interest owed by Mozambican NLC companies to their UAE-based lenders[69] (in $ million)

	2020	2019	2018	2017	2016
Total interest owed to UAE lenders	82	88	113	193	172
▶ **Owed to Vale Emirates Ltd (UAE)**	65	68	95	191	172
▶ **Owed to Mitsui & Co. Nacala Infrastructure Finance Ltd (UAE)**	6	6	4	2	–
▶ **Owed to Mitsui & Co. Mozambique Coal Finance Ltd (UAE)**	11	14	14	–	–
% of revenue generated in Mozambique (%)	74.39	76.73	72.86	70.33	80.18
Estimated interest owed by Mozambican subsidiaries	61	68	82	136	138

Using the estimated interest owed by Nacala Corridor Holding Netherlands' Mozambican subsidiaries to affiliated companies in the UAE, it is possible to estimate the tax revenue losses Mozambique has suffered as a result of the tax avoidance structures employed. As mentioned previously, the structuring of loans that finance the NLC via the UAE allowed the project's corporate owners – Vale and Mitsui – to avoid paying Mozambican withholding taxes on interest.

To determine how much tax revenue Mozambique lost as a result, it is necessary to determine a counterfactual by answering the question: how would these loans have been structured if tax avoidance was of no concern? Considering that Vale is based in Brazil and Mitsui in Japan, excluding tax avoidance as a factor makes it likely that the loans would instead have been provided directly from those jurisdictions. Because neither Brazil nor Japan has a DTA with Mozambique, any interest payments made to service the loans would then have been subject to Mozambique's statutory interest withholding tax rate of 20 per cent.[70]

Applying this 20 per cent to the interest payments owed over the 2016–2020 period provides an estimate of the total interest withholding tax Mozambique lost due to the use of UAE-based mailbox subsidiaries as lending conduits by Vale and Mitsui (Table 3).

Table 3.
Estimated NLC withholding tax (WHT) losses by Mozambique[71] (in $ million)

	2020	2019	2018	2017	2016	Total
Estimated interest owed by NLC subsidiaries in Mozambique to Vale in UAE	48.23	52.26	68.91	134.36	137.66	**441.4**
Mozambican interest WHT rate (%)	20	20	20	20	20	**20**
Total interest WHT avoided by Vale	9.65	10.45	13.78	26.87	27.53	**88.28**
Estimated interest owed by NLC subsidiaries in Mozambique to Mitsui in UAE	12.7	15.4	13.4	1.6	0.0	**43.1**
Mozambican interest WHT rate (%)	20	20	20	20	20	**20**
Total interest WHT avoided by Mitsui	2.55	3.08	2.68	0.31	0.0	**8.62**
Total interest WHT lost by Mozambique	12.2	13.53	16.46	27.18	27.53	**96.9**

Our calculations estimate that Vale and Mitsui together have avoided **approximately $ 96.9 million** in interest withholding taxes through their NLC financing structure over the 2016–2020 period. This was done by rerouting loans via intermediary companies based in the UAE to take advantage of the tax treaty between the UAE and Mozambique, which reduces the applicable Mozambican interest withholding tax rate from 20 per cent to zero. In the UAE, profits made by the financing companies off the interest flows from Mozambique will have been exempted from corporate income tax, due to those companies' residence in the DIFC special economic zone.

As explained above, the NLC is no longer owned by Vale and Mitsui. In June 2021, Vale sold the project to the Indian multinational Jindal Group's Vulcan Minerals subsidiary. Included in this sale was the Dutch holding company Nacala Corridor Holding Netherlands BV and all of its subsidiaries. At the time of writing, it is unclear whether Vulcan has continued to use the financing structure for the NLC that allowed Vale and Mitsui to avoid Mozambican taxes.

Vale and Mitsui's response

As part of SOMO's review process, we invited both Vale and Mitsui to respond to the research findings presented above. Both companies have declined to address the specific allegations presented, and instead give a general response stressing their compliance with tax legislation.

Mitsui specifically refers to its policy on tax transparency,[72] wherein the company proclaims that it will not use arrangements that have tax avoidance as their sole purpose, or arrangements that erode the tax base in a state where it is involved in economic activities, by shifting profits to a different state where it could avoid taxes. Our findings above present an arrangement employed by Mitsui that did exactly that, shifting profits generated by economic activity in Mozambique to financing companies in the UAE and thus allowing Mitsui to avoid paying its fair share of Mozambican taxes.

4. Conclusion

The research presented in this report illustrates how extractive industry companies operating in Mozambique avoid the country's withholding taxes. In another recent report, *How Mozambique's tax treaties enable tax avoidance*,[73] SOMO has demonstrated how much tax revenue Mozambique loses to DTA abuse on an annual basis, with tax losses estimated of upwards of $ 315 million in 2021. The findings on Gemfields' Montepuez mine, Kenmare's Moma mine, and the Nacala Logistics Corridor presented here show how this tax avoidance works in practice, with these three operations accounting for an estimated $ 116.7 million in lost Mozambican tax revenues in recent years.

This research was based on the limited financial information available for companies operating in Mozambique. Because Mozambique does not require companies operating in its jurisdiction to publish annual accounts, and because companies avoiding taxes typically make use of secrecy jurisdictions (Mauritius and the UAE in this case), it is difficult to identify financial flows to and from Mozambican subsidiaries. Therefore, it is likely that SOMO has missed elements of tax avoidance in its analysis.

Nevertheless, the findings presented here – as well as in the accompanying report *The Gas Companies* – show widespread use of tax haven subsidiaries by extractive industry companies in Mozambique. The DTAs Mozambique shares with Mauritius and the UAE severely limit Mozambique's taxing rights and create incentives for international investors to employ mailbox subsidiaries in these tax havens to illegitimately gain access to the benefits their DTAs with Mozambique provide.

We identified such DTA abuse in Gemfields' operation (Chapter 1), where the company's use of the lowered rate for dividend withholding tax enshrined in the Mozambique–Mauritius DTA allowed it to avoid an estimated $ 9.8 million in Mozambican taxes. Similarly, in their financing of the Nacala project (Chapter 3), shareholders Vale and Mitsui used financing companies in the UAE to take advantage of that country's DTA with Mozambique, causing Mozambique to suffer an estimated $ 96.9 million in tax losses. In both cases, the tax haven subsidiaries employed secure access to legal benefits that generate tax benefits while appearing to have little relation to the projects' economic substance – the mines in Mozambique.

With regard to Kenmare's Moma titanium mine (Chapter 2), SOMO finds that the company enjoys the benefits of damaging tax incentives while employing a branch structure to operate its mine. This has allowed the company to avoid paying approximately $ 10 million in Mozambican taxes. The fact that Kenmare uses a branch of a Mauritian subsidiary to operate its primary mining asset appears to make little sense with regard to the company's real economic activities, but instead seems to serve to create a legal presence in Mauritius that presents tax benefits for Kenmare.

Considering the widespread use of tax avoidance structures by extractive industry companies in Mozambique, SOMO calls on the Mozambican government to act to limit these practices. Specific recommendations for how to do so are presented below.

Photo by Matthew Hill/Bloomberg via Getty Images

Montepuez is home to the worlds biggest known ruby deposit.

5. Recommendations

To the Government of Mozambique:

1. Terminate and/or renegotiate harmful tax treaties

The Government of Mozambique should terminate and/or renegotiate its most harmful tax treaties, in particular those with Mauritius and the United Arab Emirates. In recent years, various other African states have chosen to either terminate or renegotiate their tax treaties with Mauritius, motivated by the tax avoidance risks those treaties created. These include Lesotho, Rwanda, Senegal and Zambia.[74] With regard to the UAE, there has not been such a series of terminations and renegotiations, although in 2021 Germany did opt to terminate its treaty with the UAE,[75] which notably lowered withholding tax rates significantly less than the UAE's treaty with Mozambique does.[76] Termination or a renegotiation improving the terms of these treaties would decrease the tax revenue losses Mozambique suffers as a result of their existence and illegitimate use.

If and when (re)negotiating tax treaties, we advise Mozambique to ensure the following provisions are included at a minimum:

- Withholding tax rates for all passive income payments (interest, dividends, and royalties), and for technical service fees, that are in line with or close to Mozambique's statutory withholding tax rate of 20%.
- Strong anti-abuse provisions should be included in all current and future tax treaties. One way to do this is to ratify and implement the Multilateral Instrument. If Mozambique ratifies the MLI, the default principal purpose test will come into effect as a minimum standard. It is strongly recommended for Mozambique to go beyond a PPT and implement a simplified limitations of benefits clause (SLOB) in its tax treaties alongside it. Once Mozambique has implemented these anti-abuse measures, it is important to also designate sufficient capacity and resources to ensure they are implemented and monitored well.
  - Mozambique should also consider implementing additional complementary anti-avoidance legislation in the form of either specific anti-avoidance rules (SAARs) or general anti-avoidance rules (GAARs). Legislators will then be able to uses these in conjunction with strong domestic tax laws and well-provisioned tax treaties to combat various forms of tax avoidance.
- Ensure domestic tax legislation sufficiently protects Mozambique's tax base and complements treaty provisions.

2. Be cautious and critical in signing new tax treaties

Mozambique should approach tax treaty negotiations with extreme caution and with clear awareness of the potential taxation losses they could bring. Prior to engaging in any treaty (re)negotiations, consider whether a double taxation agreement is the right tool, or whether the desired outcomes might better be achieved with other domestic legislation. We strongly advise against negotiating any tax treaties without a clear tax treaty policy and process in place in Mozambique and we advise against negotiating any treaties with known conduit countries or tax havens. Mozambique would be served by a transparent tax treaty negotiation and ratification process which allows for public and parliamentary input prior to signature.

In particular, the Government of Mozambique should be wary of signing a tax treaty with the Netherlands, with which it is currently negotiating a treaty. The Netherlands is a tax haven with an existing network of tax treaties, many of which aggressively lower withholding taxes and facilitate corporate tax avoidance. Similar to the Mauritius and United Arab Emirates treaties, signing a treaty with the Netherlands presents a major treaty shopping risk. Given the high amount of foreign direct investment already coming into Mozambique from the Netherlands, lowering withholding taxes on outbound payments to the Netherlands would present a major tax leak for Mozambique.

3. Close the loophole of branches being used to avoid dividend withholding tax

As was illustrated in the case of Kenmare's Moma mine, companies in Mozambique can operate through a branch (or permanent establishment) of a foreign company, allowing them to avoid paying dividend withholding tax on profits generated in Mozambique. Mozambique could close this loophole by changing its laws to ensure that branch profit remittances to foreign head offices are taxed at a rate similar to the country's statutory dividend withholding tax of 20%.

To the governments of Mauritius and the United Arab Emirates:

1. Accept Mozambique's proposal to renegotiate the tax treaty and follow the UN model as the basis for a renewed treaty

The UN model should be used as the basis for negotiations in the treaty with Mozambique, since this better protects Mozambique's taxing rights as a source country. The minimum provisions recommended above should be included in a new treaty.

2. Prevent treaty shopping

The governments of Mauritius and the United Arab Emirates need to combat treaty shopping by improving substance requirements for companies and applying stringent anti-abuse measures. Neither country should enable multinational companies to set up letterbox companies to take advantage of their low-tax regime and tax treaties only to avoid taxes in Mozambique.

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Colophon

The treaty trap: tax avoidance in Mozambique's extractive industries

The gas companies

Julyi 2023

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This paper, published by SOMO and CDD, is part of the Going Public project, funded by the Finnish Ministry for Development Aid (FINNIDA). The Going Public project empowers civil society organisations to influence and hold political decision-makers in sub-Sahara Africa accountable, with the aim of increasing domestic revenue mobilisation from extractive industries and ensuring that these revenues contribute to improving access to essential public services. The project focuses on Mozambique, which has attracted significant foreign investment from multinational corporations in extractive industries such as gas and mining. Due to unfair international tax rules, a lack of inclusive public spending, and insufficient transparency, these investments have not made a significant contribution to increasing tax revenue and reducing inequality in Mozambique. Going Public is implemented by the Centre for Democracy and Development (CDD), the Centre for Research on Multinational Corporations (SOMO), Oxfam Mozambique, Tax Justice Network Africa, and Oxfam Novib.

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