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CENTRO PARA DEMOCRACIA E DESENVOLVIMENTO

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

The gas companies

Contents

Introduction

In 2006, a major discovery of natural gas in the Rovuma Basin off the coast of Cabo Delgado in northern Mozambique saw energy giants and international investors flood into the region.[1] Currently French and Italian oil and gas giants TotalEnergies and Eni lead the two megaprojects planned to exploit the gas reserves, constituting (according to TotalEnergies) the largest investments in Africa to date. With these investments came promises of increased economic development and local job creation, which have so far not sufficiently materialised.[2] The projects have also directly contributed to the outbreak of civil war in the region. This caused TotalEnergies to declare force majeure in 2021 and put the project on hold.

To exploit the gas reserves both consortia have attracted billions in investment from public investment banks, export credit agencies, and commercial banks. A 2018 presentation to creditors by the Mozambican government shows that the government does not expect any interest withholding tax income for either the Area 1 or the Area 4 project.[3] This is remarkable given the massive amount of foreign debt financing for both projects, and the billions in associated interest payments. The reason for this is likely the use of the Mozambique–United Arab Emirates (UAE) tax treaty by both consortia in the financing structure to take advantage of this tax treaty's 0 per cent interest withholding tax rate.

Both consortia have set up mailbox companies in the UAE to channel the debt financing into Mozambique. This use of a UAE-based letterbox company is a clear case of treaty shopping, depriving Mozambique of much needed tax revenue. This briefing provides an estimate of how much interest withholding tax revenue Mozambique could lose out on due to this treaty shopping scheme. Furthermore, we show how the ownership structure used by both consortia also enables the avoidance of dividend withholding tax in Mozambique.

Chapter 1 gives a concise overview of human rights and environmental issues surrounding the gas projects. Chapters 2 and 3 begin with an overview of the corporate ownership structure of respectively the Area 1 TotalEnergies-led consortium and Eni's Coral South FLNG (floating liquefied natural gas) project, before detailing the treaty shopping scheme used in the financing of both projects and calculating an estimate of how much interest withholding tax is lost as a result of this scheme. The analysis in the chapter of Coral South FLNG builds on reports by the Mozambican Centro de Integridade Pública (CIP) and by Oxfam International.

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. 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, TotalEnergies and Eni had the opportunity to review the findings. As part of SOMO's internal quality assurance process, our reports are published or shared with external parties only after the investigated company has had the opportunity to respond to research findings. TotalEnergies did not respond to our request for comment. Eni responded, and its response has been included in section 3.4.

Additionally, 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.

The Paquitequete beach in Pemba is where most of the internally displaced people (IDP) arrive by boat from northern Mozambique and spend their first nights before being moved to an indoor sports stadium.

Photo by JOHN WESSELS/AFP via Getty Images

1. Human rights and environmental issues

Displacement

To build the infrastructure needed for Mozambique's Area 1 and Area 4 gas projects, the initial owner of the Area 1 project, Anadarko, forcibly relocated thousands of families from their homes in Cabo Delgado.[4] Anadarko began the community consultation and compensation scheme surrounding the relocation in 2017.[5] This process has been deemed extremely inadequate by NGOs united in the "Say No to Gas! in Mozambique" campaign, and has been found to violate numerous human rights.[6]

As part of the relocation, fishing communities have been moved inland[7] and can now access only one fishing area by shuttle bus.[8] Fishing communities argue that reliance on the shuttle bus is incompatible with the irregular nature of their fishing practices. Moreover, access to only one fishing area has resulted in an extreme concentration of activity, leading to overexploitation of marine life in the area.[9]

Communities are also unhappy that replacement land has been up to 10 times smaller than previous plots[10] and lacks access to affordable, non-polluting energy as well as sufficient vegetation and trees for shade and socialising.[11] Further, it has been reported that community members who opted for cash compensation had to do so publicly and as a result have been victims of military extortion and threats of violence.[12]

While this process was initiated by Anadarko and is now being continued by TotalEnergies,[13] the services built on the land are being used by all the liquid natural gas (LNG) projects in the area led by TotalEnergies, Eni and ExxonMobil.[14] Thus all shareholders should share equal responsibility for the impact on local communities.

Conflict

In October 2017, armed conflict broke out in Cabo Delgado province.[15] While the conflict is often portrayed as religiously motivated, started by insurgents labelled Islamic terrorists with links to ISIS and Al-Shabab,[16] the reality is far more complex.[17] Cabo Delgado has been a site of conflict for decades; however, since 2017 this conflict has been much more organised and larger in scale.[18]

TotalEnergies commissioned a mission to assess the humanitarian situation in Cabo Delgado in 2022, led by former French diplomat Jean-Cristophe Rufin. In May 2023 the mission published its report, which lists a number of contributing factors to the conflict in the region. In its press release, TotalEnergies uses these findings to diminish its responsibility for the situation, highlighting that the conflict "pre-dates the gas development projects and finds its roots in multiple factors not related to Mozambique LNG".[19] The report includes as numerous contributing factors behind the conflict: regional inequalities between southern and northern Mozambique, with Cabo Delgado being the poorest province in the country; ethnic rivalries within Cabo Delgado between the Muslim Mwanis and Makweans and the Christian Makondes; unresolved issues from the civil war; a lack of sufficient public services leading to mistrust of the government and increased crime and mafia presence; limited opportunities for an expanding population of young males; and influence from extreme groups in neighbouring countries (such as the Democratic Republic of the Congo, Somalia and Tanzania). All of this has been compounded by the increased inequality caused by the gas projects, creating an environment for violent conflict to erupt.[20]

The Mozambican government and the gas companies have reacted to the conflict with increased militarisation, involving the Mozambican and Rwandan military as well as international paramilitary groups from France, Russia, South Africa, and the US.[21] More than 4,000 people have lost their lives in the conflict, and a further 800,000 have been displaced.[22] There have been reports of civilians being killed for no reason, sexual assault, extortion, and torture.[23]

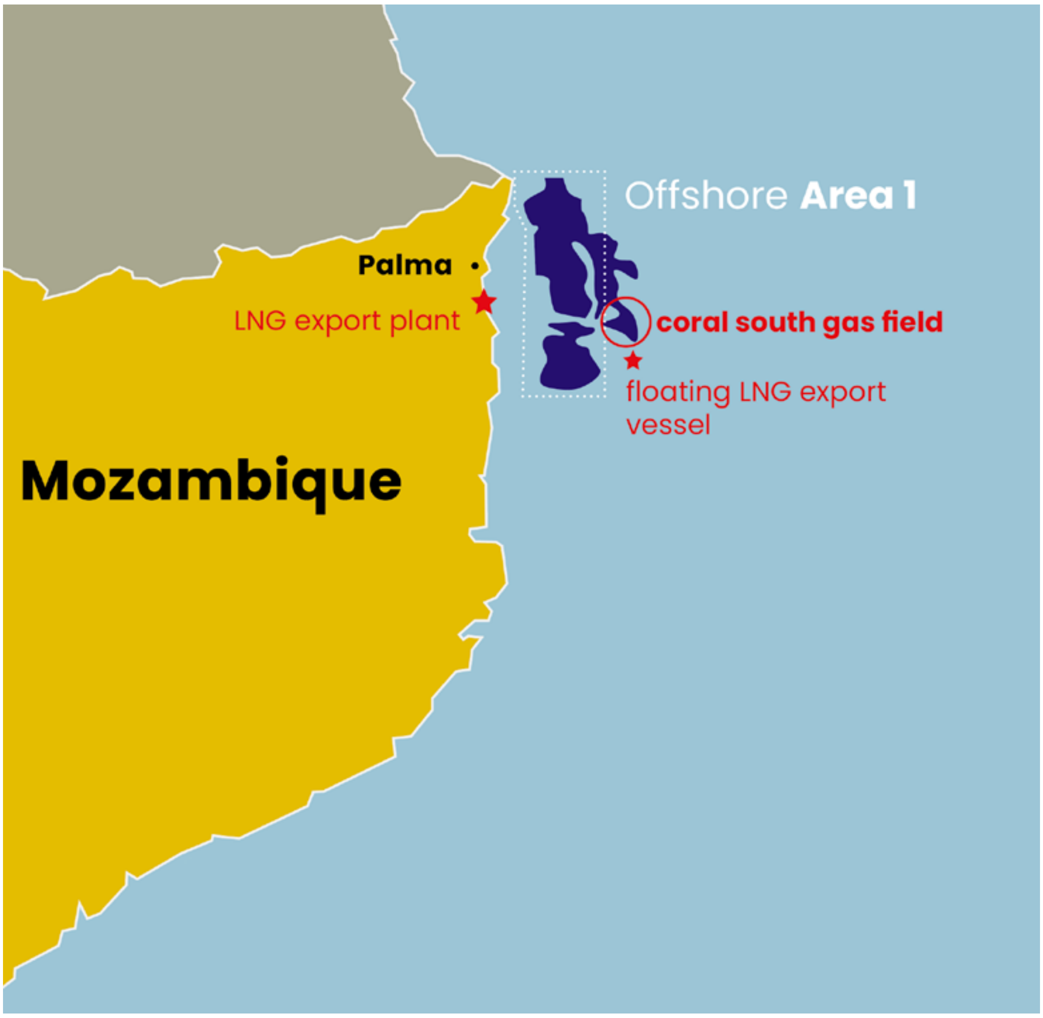
Friends of the Earth International states that the focus of the response to the insurgency has clearly been "prioritising protecting gas infrastructure, at the expense of local communities",[24] as "local communities still report living under constant fear of mistreatment by the military and by private security actors rather than feeling protected from the attacks".[25]

Environment and climate

Mozambique has been categorised as one of the most vulnerable countries in the world to face the impact of climate change.[26] Cabo Delgado in particular has already experienced major climatic events in recent years, including severe flooding, droughts, tropical storms, and deadly cyclones that have killed hundreds of people and displaced thousands.[27] These events have caused increased food insecurity[28] in a country where 40.4 per cent of the population are already classified as severely food insecure.[29]

Despite this, major fossil fuel projects are underway in the region. The new gas projects are expected to increase Mozambique's annual fossil fuel emissions by 49 times,[30] having been estimated to release approximately 44.9 million tonnes of greenhouse gases.[31] Alongside this, the construction of the projects has already led to the destruction of biodiversity and important habitats,[32] threatening endangered species that rely on such habitats for their survival.[33]

2.
Area 1: TotalEnergies consortium



Overview of Area 1

Both the Area 1 and the Area 4 gas projects are located in the Rovuma Basin of northern Mozambique. Area 1 consists of 20 offshore wells, a 40 kilometre pipeline, and a 17,000 acre onshore LNG facility.[34] The project comprises a total of US$ 20 billion in investments, $ 14.9 billion of which is financed by export credit agencies (ECAs), development banks, and commercial banks.[35] According to TotalEnergies, the project financing for Area 1 is the largest ever undertaken in Africa.[36] Of Area 1's future production, 86 per cent has already been sold to buyers in China, France, India, Indonesia, Japan, and the Netherlands.[37]

The project was originally majority owned (26.5 per cent) by US multinational Anadarko Petroleum Corporation, which began exploration in 2007, followed by a successful gas discovery in 2012. The environmental licence and project development plans were approved in 2018, and a final investment decision was made in 2019. In August 2019, Anadarko sold its 26.5 per cent share to TotalEnergies, making TotalEnergies the project's largest shareholder.[38] TotalEnergies is headquartered in France, the second largest producer of LNG globally and the largest in Africa.[39]

The project was expected to start producing gas in 2024.[40] However, in March 2021, after the violent attack described in the section above on a nearby town, Palma, killing dozens of civilians and displacing tens of thousands.[41] In response to the attack, TotalEnergies declared *force majeure* and suspended work on the project, withdrawing all site staff.[42] Work has been on hold since and is currently predicted to restart in 2023.[43]

Corporate structure Area 1

The rights to Area 1 gas field are controlled by a group of seven companies, with TotalEnergies serving as the project's operator through its Mozambican subsidiary, TotalEnergies EP Mozambique Area 1. The other shareholders are Mitsui Group of Japan, Mozambican state-owned ENH, Thai state-owned PTT Exploration and Production, and three Indian state-owned oil and gas companies: ONGC, Bharat Petroleum, and Oil India. Several of these companies have structured their ownership using offshore holding companies to control their share of the Area 1 project. Table 1 summarises these ownership structures.

Table 1. Overview of corporations with a participating interest in the Area 1 project and their holding companies[44]

Corporate group	Country of group headquarters	Area 1 holding company	Country of holding company	Ownership percentage
TotalEnergies	France	TotalEnergies EP Mozambique Area 1	Mozambique	26.5%
Mitsui Group	Japan	Mitsui E&P Mozambique Area 1 Ltd	UK	20%
Empresa Nacional de Hidrocarbonetos (ENH)	Mozambique	ENH Rovuma Area Um SA	Mozambique	15%
Oil and Natural Gas Corporation Ltd (ONGC)	India	ONGC Videsh Ltd	India	10%
Oil and Natural Gas Corporation Ltd / Oil India Ltd	India	Beas Rovuma Energy Mozambique Ltd	Mauritius	10%
Bharat Petroleum	India	BPRL Ventures Mozambique BV	The Netherlands	10%
PTT Exploration and Production	Thailand	PTT Exploration and Production Mozambique Area 1 Ltd	Cyprus	8.5%

Unincorporated joint venture and avoidance of dividend withholding tax

According to projections by the Mozambican Ministry of Economic Affairs and Finance, the government expects to collect a very limited amount of dividend withholding tax from the Area 1 project.[45] A reason for this could be the use of branches – also known as permanent establishments – by the consortium, rather than controlling the project through Mozambican subsidiaries.

The consortium has set up an unincorporated joint venture to manage the project, rather than incorporating a jointly owned Mozambican project subsidiary.[46] /Unincorporated joint ventures often use contracts to determine the terms for the management and division of profits, rather than organising this within a separate legal entity. Their use provides various benefits to participants, including economic advantages like a flexible arrangement for cooperation that can easily be dissolved if a project does not reach viability.

An effect of using an unincorporated joint venture for their investments is that most of the projects' investors do not have a legal presence in Mozambique. Only Mozambique's national oil and gas company ENH and TotalEnergies hold their share of the Area 1 concession through a Mozambican subsidiary. For the other joint venture participants, the profits they derive from the Area 1 project will instead be taxed at the level of their branch – also known as a permanent establishment – in Mozambique.[47]

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 Mozambique specifically, a foreign company is deemed to have such a branch if it has any fixed place of business, which would include a gas well like the one the Area 1 consortium intends to exploit.[48] This designation of branches allows tax authorities to ensure that profits generated within their country's borders remain subject to domestic corporate income taxes.

Once these profits are paid out as dividends, they generally become subject to dividend withholding tax. Withholding taxes are applied to cross-border payments by companies, such as the payment of dividends or interest. In Mozambique, the statutory withholding tax rate for dividends is set at 20 per cent.[49]

Once the Area 1 project becomes profitable, its participating investors will each share in the profits. TotalEnergies EP Mozambique Area 1, for example, is likely to pay out some of the profits it receives as dividends to its shareholders abroad.[50] When it does, these dividends will be taxed at the statutory dividend withholding tax rate of 20 per cent, as the dividends would be paid out to the company's parent company – TotalEnergies SE – based in France,[51] a country that does not have a double taxation agreement (DTA) with Mozambique.[52] It is likely that this will be the source of the limited amount of dividend withholding tax expected by the Mozambican government in the projections mentioned above.

For the five other foreign participants in Area 1, however, moving their Mozambican profits abroad will likely not incur dividend withholding taxes. As the other shareholders are present in Mozambique solely through branches of companies incorporated outside Mozambique, the profits generated in Mozambique will be accounted for in those companies' books, not at the level of their branches. Branches as such do not pay out dividends, but instead remit their profits to their head office, which is a transaction that does not incur dividend withholding taxes in Mozambique.[53] As such, when those head offices pay out their dividends, they may become subject to dividend withholding tax in their respective jurisdictions, but not in Mozambique.

Following projections by Mozambique's National Petroleum Institute, these dividends are likely to amount to billions of dollars.[54] Assuming that the five Area 1 participants with branches but not subsidiaries in Mozambique will indeed be exempt from withholding tax on their dividends, Mozambique is likely to lose out on hundreds of millions of dollars in tax revenue. Had these companies instead incorporated a joint venture in Mozambique, the dividends they would receive would then be subject either to Mozambique's statutory dividend withholding tax rate (20 per cent) or to a reduced rate enshrined in one of Mozambique's DTAs, depending on the home state of the participant.

Avoiding interest withholding tax

To finance the Area 1 project, its owners attracted approximately $ 14.9 billion in loans, a large portion of which was provided by public financial institutions. The foremost of these are the Export-Import Bank of the US ($ 4.7 billion in financing),[55] the Japan Bank for International Cooperation ($ 3 billion), UK Export Finance ($ 1.2 billion), the African Development Bank ($ 0.4 billion), and the Export-Import Bank of Thailand ($ 0.15 billion).[56]

The remainder of the project financing – approximately $ 5.45 billion – has reportedly been provided by 21 commercial banks with loans insured by publicly financed export credit insurance agencies.[57] These insurers are Japan's Nippon Export and Investment Insurance, UK Export Finance (providing and insuring loans simultaneously), Italy's SACE (Servizi Assicurativi del Commercio Estero), the Export Credit Insurance Corporation of South Africa, and Atradius Dutch State Business.[58]

Instead of providing these loans directly to the Area 1 operation in Mozambique, all but one of the financial institutions involved lent the money to a financing company, a special purpose entity (SPE) owned by the project's shareholders, called Mozambique LNG1 Financing Company, based in Abu Dhabi in the United Arab Emirates (UAE). In turn, this UAE-based subsidiary serves as a conduit, passing the loans on to the Area 1 operator in Mozambique.

One notable exception to this is the African Development Bank (ADB), which, as prescribed by its policies, chose to provide its $ 0.4 billion in financing directly to a Mozambican SPE set up by the project partners, instead of to the UAE-based SPE.[59] The other financiers mention only the UAE-based company as the beneficiary of their loans, leading us to believe that the rest of the project financing for Area 1 was provided via that entity.

The ADB estimates the Area 1 consortium will pay $ 4 billion in interest on its loans over the project's lifespan,[60] while the Mozambican government estimates the total interest costs for Area 1 will amount to $ 8.08 billion.[61] Because of the insertion of the UAE-based conduit for most of Area 1's financing, most interest paid by the Area 1 consortium will flow to the UAE first, instead of directly to the actual financiers. This means that, instead of Mozambique's statutory withholding tax rate on interest (20 per cent), the tax rate enshrined in Mozambique's DTA with the UAE (0 per cent) will apply to these interest flows.

This arrangement will allow the Area 1 owners to avoid paying Mozambican withholding tax on most of the interest they incur for its financing. The UAE financing vehicle Mozambique LNG1 Financing Company is located in the Abu Dhabi Global Market,[62] a special economic zone with a 0 per cent corporate income tax rate.[63] Because of this, the company will not pay any corporate income tax on the interest income it registers in the UAE.

How much interest withholding tax the Area 1 consortium will avoid because of this treaty shopping scheme requires the composition of a counterfactual scenario. For this, it is necessary to assess how the financing would have been set up if the project's shareholders had not used tax avoidance structures. In a world without fiscal considerations, it probably would have been structured very differently, with finance flowing directly from where it originates (the banks) to where it is needed (Area 1).

Currently, direct financing applies only to the $ 0.4 billion provided by the ADB and its subsequent interest payments. This $ 0.4 billion amounts to approximately 2.7 per cent of the total financing, interest on which is likely already subject to Mozambique's statutory withholding tax rate of 20 per cent. This is because the ADB is based in Côte d'Ivoire, a country that does not share a DTA with Mozambique.

Without the use of the conduit subsidiary in the UAE, interest paid by Area 1 to the remaining financiers would be paid to different jurisdictions. To assess which jurisdictions these would be, we can look at the institutions providing the financing. Should any of these financiers be located in a jurisdiction that does not have a DTA with Mozambique, interest paid from Mozambique to the financier would incur a 20 per cent withholding tax payment. If any financiers should instead be located in a jurisdiction that does have a DTA with Mozambique, the withholding tax rate on interest enshrined in the DTA would instead apply.

As described above, we can account for approximately $ 9.45 billion in financing provided to Area 1 by five public financial institutions. None of these five organisations are located in Mozambique's DTA partner countries.[64]

Their public finance is supplemented by $ 5.45 billion in loans from commercial banks, of which 16 have been identified. These 16 banks account for $ 5.43 billion – or nearly all – of the commercial bank loans.[65] Among these 16 commercial banks, only five are present in one of Mozambique's DTA treaty partners. These five banks are all based in South Africa, and together they have provided the Area 1 project with $ 1.15 billion in loans, approximately 7.7 per cent of the total loans provided for the project. The tax treaty between South Africa and Mozambique includes a 0 per cent withholding tax rate on interest payments to banks. This means that in the proposed counterfactual scenario, the Area 1 consortium partners still would not have to pay withholding taxes on the interest payments made to these South African banks.

As noted above, the 2.7 per cent of the finance provided by the ADB is still subject to Mozambican interest withholding tax, while the 7.7 per cent provided by the South African commercial banks would also be exempt in the proposed counterfactual scenario.
Continuing this counterfactual, the remainder of the interest payments – approximately 89.6 per cent of the total interest – would be taxed at Mozambique's statutory rate of 20 per cent. The estimated tax revenue losses for Mozambique are presented in Table 2.[66]

Table 2.
Estimated interest withholding tax (WHT) revenue losses by Mozambique for Area 1 project

	ADB interest estimate ($ million)	ADB interest estimate ($ million)
Total interest incurred on Area 1 financing	4,000.0	8,080.0
Current situation: what is owed to Mozambique		
• WHT owed on payments to ADB	21.6	43.6
Counterfactual: what is owed to Mozambique		
• WHT owed on payments to South African banks	–	–
• WHT owed on payments to ADB	21.6	43.6
• WHT owed on payments to the other financiers	716.8	$ 1,447.9

As the table above shows, Mozambique is estimated to lose between $ 717 million and $ 1.48 billion in interest withholding taxes due to tax avoidance by the participants in the Area 1 project. The two estimates vary strongly due to the difference in total interest cost estimates for the project made by the ADB and the Mozambican government.

3.
Coral South FLNG: Eni-consortium

Overview of Coral South FLNG

The gas fields discovered in Mozambique's Rovuma Basin were divided into two concessions, Area 1 and Area 4. The Area 4 concession, also known as Rovuma LNG, is the larger and more ambitious of the gas projects; the Italian oil and gas giant Eni acquired the rights to exploit it in 2006, and the project has faced significant delays.[67] ExxonMobil acquired a 25 per cent interest in the concession in 2017, becoming the largest participant together with Eni, which also has a 25 per cent interest. They have split leadership of the project, with Eni taking the lead on Coral South FLNG and upstream operations, and ExxonMobil leading the construction and operation of all future natural gas liquefaction.[68]

The Area 4 consortium has, however, not yet managed to arrange sufficient investment and financing to reach a final investment decision to begin exploitation of the entire gas reserve, besides the Coral South FLNG project. The financial sector watchdog BankTrack has reported that, by March 2023, only the US government's International Development Finance Corporation and the French bank Crédit Agricole have committed financial support to the project.[69] In response to questioning by BankTrack, BNP Paribas (France) and UniCredit (Italy) have ruled out supporting Area 4/Rovuma, while two banks have "privately assured us [BankTrack] that they will not finance Rovuma".[70]

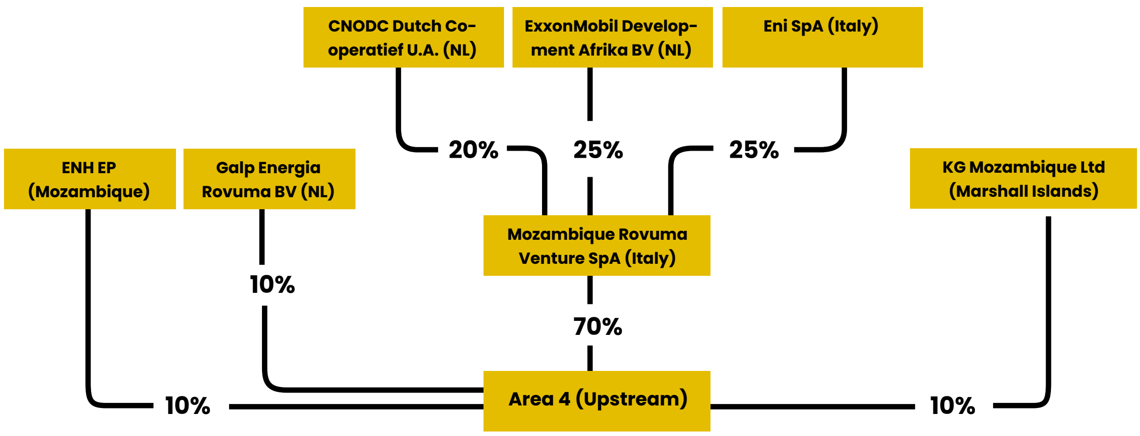
Because so far only the Coral South gas field, part of the larger Area 4 concession, has actually been financed and developed, the discussion in this section therefore focuses on the Coral South project. To exploit the Coral South gas field, Eni opted for a floating vessel system to exploit the Coral South gas field, so both the exploitation and processing takes place off shore. The Mozambican government approved Eni's development plan for the FLNG project in 2016.[71] The project has a total estimated cost of $ 7 to $ 10 billion and is expected to generate direct profits of around $ 40 billion, with about $ 19 to $ 20 billion to be collected by the Mozambique state.[72] The consortium has attracted nearly $ 5 billion in debt financing to fund the project.

The Coral South FLNG vessel was constructed in South Korea and arrived at the beginning of 2022 at the Rovuma Basin. Coral South started producing gas during the second half of 2022, and the first cargo was loaded in November 2022.[73] The Coral South field has an expected lifespan of 25 years.[74]

Corporate structure of Coral South

The Area 4 consortium created a special purpose entity (SPE) in Mozambique to own and manage the Coral South FLNG vessel. This SPE, Coral South FLNG SA, incorporated in Mozambique in 2007, is owned by the consortium partners.[75] These companies have similar stakes in the Mozambique SPE to their overall stakes in the Coral South project.[76] As can be observed in Figure 1, the SPE is owned by intermediary subsidiaries located in two conduit countries, the Netherlands and the Marshall Islands, as well as ENH, Mozambique's state oil and gas company.[77]

Figure 1.
Holding structure of Coral South FLNG SA



The use of an SPE in Mozambique suggests that dividend withholding tax will be paid in Mozambique, as the dividends paid out by this SPE to the consortium partners in the Netherlands and the Marshall Islands will be subject to Mozambique's statutory 20 per cent dividend withholding tax rate.

The benefits of an intermediary holding structure in the Netherlands

The fact that the intermediary subsidiaries of the foreign oil companies are located in well-known tax havens (the Netherlands and the Marshall Islands) is a clear red flag for tax avoidance. The Netherlands is ranked fourth on the Tax Justice Network Corporate Tax Haven Index, and the Marshall Islands is listed on the EU tax haven blacklist for having no corporate income tax and a lack of substance requirements for letterbox companies.[78]

Further, the fact that most of these intermediary subsidiaries are administered by a corporate service provider[79] and do not have employees[80] indicates that the subsidiaries do not have a material presence in the country where they are incorporated. This strongly suggests that this corporate structure has been chosen for tax avoidance reasons. However, due to a lack of transparency regulation in the Netherlands and the Marshall Islands, these companies provide very limited information in their annual reports and shroud their activities in secrecy. It is therefore difficult to assess whether or how the subsidiaries based in the Netherlands and the Marshall Islands enable the consortium members to avoid taxes (Table 3).

Table 3.
Disclosure of financial statements by Coral South project subsidiaries incorporated in the Netherlands and the Marshall Islands

Subsidiary	Galp Energia Rovuma BV	CNODC Mozambique BV	ExxonMobil Development Africa BV	Eni Mozambique LNG Holding BV	KG Mozambique Ltd
Availability of financial statements	Very limited information	Very limited information	Very limited information	Available	Not available

One obvious reason for the intermediation of subsidiaries in the tax havens of the Netherlands and the Marshall Islands is the preferential tax treatment of international passive income payments (such as dividends, interest, royalties, and service fees) through their tax treaty network and domestic tax laws. However, the Netherlands and the Marshall Islands do not have a tax treaty with Mozambique. Therefore, any outbound passive income payments made by the Mozambique-based SPE Coral FLNG SA will be taxed under Mozambique's domestic-law-based withholding tax.

The Netherlands does offer an extensive network of bilateral investment treaties, including with Mozambique.[85] The investment treaty between Mozambique and the Netherlands enables companies such as Eni to sue the Mozambican government through international arbitration for state action that negatively affects their business activities.

Financing structure and avoidance of interest withholding tax

To fund the Coral South FLNG project, the Eni-led consortium attracted a total of $ 4.7 billion in debt financing. Next to the 65 per cent project finance, 25 per cent is debt funded by interest-free shareholder loans[86] and the remaining 10 per cent by shareholder equity.[87] Export credit agencies (ECAs) and state-owned banks were crucial in securing the financing. Several of these ECAs directly financed the gas project, while others secured loans provided by third parties, mainly (commercial) banks.[88]

Rather than having these banks provide loans directly to a subsidiary in Mozambique, the consortium set up a special purpose entity in the UAE to collect all the financing and reroute it to Mozambique. As stated by Eni itself, this SPE, named Coral South FLNG DMCC 13, has the "sole purpose" of structuring the ECA-backed loans.[89] The principal reason for structuring the loans via the UAE is most probably the avoidance of withholding taxes on interest payments. Based on the tax treaty between the UAE and Mozambique, no withholding taxes can be levied on interest payments. Further, the UAE does not levy withholding taxes (its domestic tax law does not account for withholding taxes). Any interest payment sourced in Mozambique and directed via the UAE to a third country will therefore be exempt from any withholding taxes.

Take, for example, the Industrial and Commercial Bank of China (ICBC). This state-owned bank has supported the Coral South project with about $ 550 million.[90] There is no public information available on the interest rates on the loans. If we assume an annual interest rate of 10 per cent, this would result in an annual interest payment of $ 55 million. China does not have a tax treaty with Mozambique. Any interest payments outbound from Mozambique to China would therefore be liable for withholding tax on interest at 20 per cent under Mozambique's domestic tax law. Annual interest payments of $ 55 million sourced in Mozambique and paid direct to the ICBC would therefore incur an annual withholding tax of $ 11 million, to be collected annually by the Mozambique tax authorities.

However, this is not the case here. The ICBC loan is provided to the UAE letterbox company (Coral South FLNG DMCC 13), and the latter is therefore also the recipient of interest payments from Mozambique. The UAE letterbox company will then, in turn, pay the interest due to ICBC in China.

Mozambique and the UAE have a tax treaty that exempts the payment of withholding tax on interest transactions between the two countries. Further, the UAE does not have a withholding tax provision in its domestic law. Interest transactions from the UAE-based SPE to China are therefore not liable for withholding tax. Therefore, the interposition of this SPE in the UAE means that no withholding tax on interest has to be paid in Mozambique.

Figures 2 and 3 provide a visual explanation of this treaty shopping scheme.

Figure 2.
Financing structure without UAE conduit structure

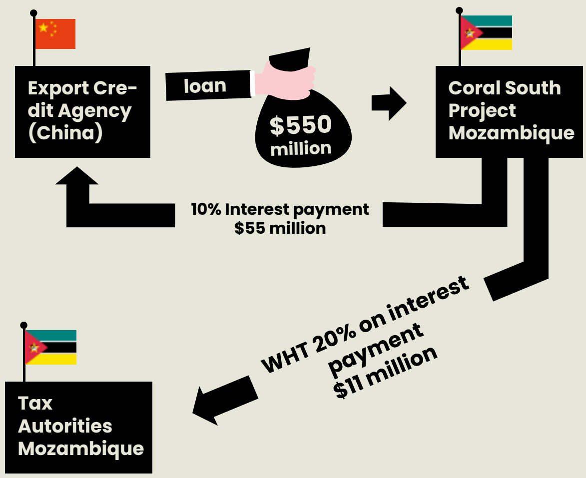
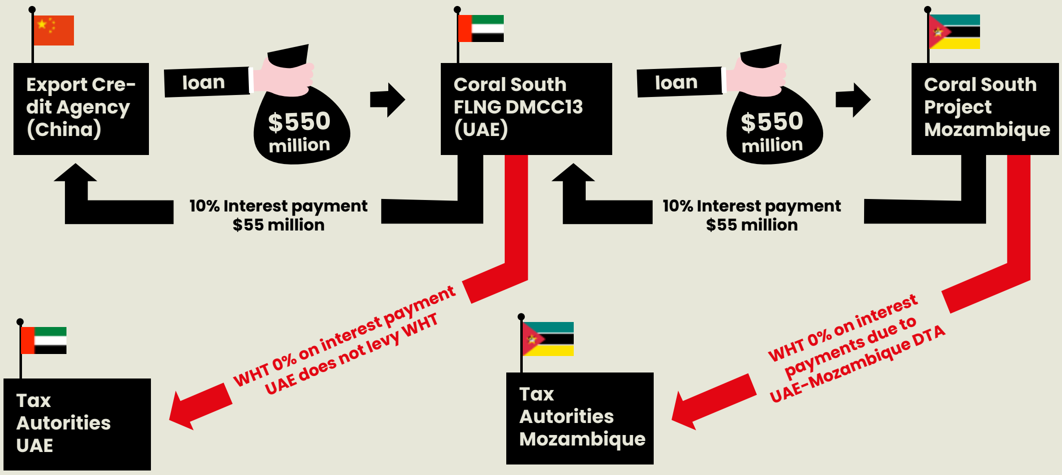


Figure 3.
Financing structure with UAE conduit structure



The total debt financing of the Coral South project, amounting to $ 4.7 billion, is provided by commercial banks and ECAs based in four countries:

- contribution by creditors from South Korea: $ 1.8 billion (38.3 per cent of total project finance);[91]
- contribution by creditors from China: $ 1.75 billion (37.2 per cent of total project finance);[92]
- contribution by creditors from Italy: $ 700 million (14.9 per cent of total project finance);[93]
- contribution by creditors from France: $ 450 million (9.6 per cent of total project finance).[94]

Without the UAE treaty shopping scheme, all interest payments would be subject to a 20 per cent withholding tax in Mozambique, with the exception of interest payments to Italy. Italy does have a tax treaty with Mozambique, which lowers the withholding tax on interest payments to 10 per cent. Structuring loans originating from Italy via the UAE therefore reduces the otherwise applicable withholding tax of 10 per cent to 0 per cent.[95]

No first-hand information is available regarding the amount of the interest payments due on the Coral South loans. However, a financial model for fiscal analysis made by Resources for Development Consulting for Oxfam International in 2019 does account for interest payments made to the project creditors. We have used information from this model on annual interest payments (during the period 2018–2031) to estimate Mozambique's loss in tax revenues.[96]

Table 4.
Estimated interest payments on Coral South project finance, 2018–2031, by country of origin

	Total interest payment on project finance ($ million)	Interest payment to creditors in South Korea ($ million)	Interest payment to creditors in China ($ million)	Interest payment to creditors in Italy ($ million	Interest payment to creditors in France ($ million)
2018	18.1	6.9	6.7	2.7	1.7
2019	74.4	28.5	27.7	11.1	7.1
2020	164.3	62.9	61.1	24.5	15.8
2021	272.3	104.3	101.3	40.6	26.1
2022	381.2	146.0	141.8	56.8	36.6
2023	432.1	165.5	160.7	64.4	41.5
2024	384.1	147.1	142.9	57.2	36.9
2025	336.1	128.7	125.0	50.1	32.3
2026	288.1	110.3	107.2	42.9	27.7
2027	240.1	92.0	89.3	35.8	23.0
2028	192.0	73.5	71.4	28.6	18.4
2029	144.0	55.2	53.6	21.5	13.8
2030	96.0	36.8	35.7	14.3	9.2
2031	48.0	18.4	17.9	7.2	4.6
Total	**3,070.8**	**1,176.1**	**1,142.3**	**457.5**	**294.8**

Table 5.
Estimated loss of withholding taxes on interest payments related to Coral South project finance, by country

	Total interest payments ($ million)	Treaty with Mozambique	WHT rate without UAE (%)	Total WHT tax ($ million)	WHT rate with UAE (%)	WHT tax avoided ($ million)
South Korea	1,176.1	No	20	235.2	0	235.2
China	1,142.3	No	20	228.5	0	228.5
Italy	457.5	Yes	10	45.8	0	45.8
France	294.8	No	20	59.0	0	59.0
Total	**3,070.8**	**–**	**–**	**568.4**	**–**	**568.4**

Tables 4 and 5 set out the expected interest payments to be collected by the various creditors (ECAs and banks) in the corresponding countries as well as the withholding tax that would be paid (both with and without the intermediation of the UAE-based SPE). Table 4 shows that the creditors in South Korea, China, Italy, and France are expected to receive, in return for the provided loans, a total amount of approximately $ 1,176 million, $ 1,142 million, $ 458 million, and $ 295 million in interest payments respectively.

Table 5 shows that, in the absence of the UAE-based SPE, a 20% withholding tax would need to be paid on interest payments to South Korea, China, and France, and (based on the Mozambique–Italy tax treaty) a 10% withholding tax on interest payments channelled to Italy.

Following this counterfactual, Mozambique would be expected to collect a total of $ 568.4 million in withholding taxes on interest payments for Coral South. However, through the intermediation of the UAE subsidiary, no withholding tax need be paid on interest transactions. We therefore estimate that Mozambique is expected to lose a total of $ 568.4 million in interest withholding taxes on the project.

Eni's review response

In response to SOMO's request for comments, Eni replied as follows:

"As a taxpayer, Eni operates in full compliance with the local and international legislative and fiscal framework. Eni's projects in the countries where it is present generate economic and social benefits at the local level in terms of taxes, employment, training and social projects. Furthermore, Eni's Tax Guidelines ensure a correct interpretation of tax regulations with the prohibition of undertaking fiscally aggressive operations. Mozambique, following the projects in which Eni participates, is becoming an important global player in the LNG sector."[97]

4.
Conclusion

This briefing illustrates how the shareholders for the two largest foreign investments ever made in Mozambique have managed to avoid paying their fair share of taxes. The findings presented here – as well as in the accompanying report *The Miners* – show widespread use of tax haven subsidiaries by extractive industry companies in Mozambique. By employing mailbox companies in the UAE as conduits for loans provided to the projects, both the TotalEnergies- and the Eni-led consortium have gained access to the benefits enshrined in the DTA between the UAE and Mozambique. The zero percent withholding tax rate on interest that this treaty prescribes severely limits Mozambique's taxing rights, and will allow the projects' shareholders to avoid approximately $1.3 to $2 billion in Mozambican taxes. The simple act of interposing a mailbox company in the UAE between the gas projects in northern Mozambique and the projects' financiers across the world affords the shareholders with access to DTA benefits they should have no right to, to the detriment of Mozambique's tax income. These treaty shopping schemes show how easy it is for multinational corporations to avoid taxes by using letterbox companies in tax havens like the UAE.

As far as tax treaties go, the treaty between the United Arab Emirates and Mozambique is exceptionally harmful, as it entirely removes Mozambique's ability to levy withholding taxes on interest or dividends. The fact that the United Arab Emirates is the second biggest source of foreign direct investment in Mozambique is likely due to the tax benefits provided by this treaty. The use of UAE-based letterbox companies by the TotalEnergies and Eni consortia shows how easy and financially rewarding it is for multinational corporations to apply a treaty shopping scheme to avoid paying taxes in Mozambique. To stop this type of tax treaty abuse, we call on the Government of Mozambique and the Government of the United Arab Emirates to renegotiate this treaty, in order to afford more taxing rights to Mozambique. Specific recommendations for how to do so are presented below.

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.[98] 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,[99] which notably lowered withholding tax rates significantly less than the UAE's treaty with Mozambique does.[100] 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 the TotalEnergies-led Area 1 project, 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

Juli 2023

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Design: Karen Paalman
Cover photo:

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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