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How Mozambique's tax treaties enable tax avoidance

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1
Key takeaways

- Mozambique's tax treaty network is depriving the government **of millions of dollars in tax revenue** each year, particularly its treaties with Mauritius and the United Arab Emirates.
- **Seventy per cent of all foreign investment in Mozambique comes from tax havens Mauritius and the United Arab Emirates.**
- We estimate that, as a result of its tax treaties with tax havens Mauritius and the United Arab Emirates, **in 2021 Mozambique lost USD 315 million in withholding taxes on interest payments and dividends.[1] This is 7.4% of the country's total tax revenue**, which could have been spent on hospitals, schools, and other public infrastructure.
- Mozambique is currently negotiating a tax treaty with **the Netherlands, a tax haven notorious for enabling treaty shopping** and aggressively negotiating low withholding tax rates. There is a great risk this treaty will further erode Mozambique's taxing rights and deprive the country of much-needed tax revenue.
- We call on the Government of Mozambique to terminate and/or renegotiate its tax treaties with Mauritius and the United Arab Emirates, as well as to review its other tax treaties. **Mozambique should be very cautious in signing a treaty with the Netherlands** and should ensure this treaty does not erode its taxing rights.
- **Mauritius and the United Arab Emirates should agree to renegotiate their treaties** with Mozambique and allow for provisions that better favour Mozambique. The Netherlands should not negotiate heavily reduced withholding tax rates with Mozambique and should use the UN Model tax treaty as the basis for negotiations.

2 Introduction

Over the past 10 years Mozambique has seen a huge influx of foreign investment. **The discovery of natural gas reserves has attracted billions of dollars in investment from multinational corporations** from countries including China, France, India, and the USA. These investments have the potential to generate considerable revenue for the Mozambican government through taxes, royalties, and production sharing agreements. However, many foreign investors in Mozambique **use letterbox companies** in tax havens such as Mauritius and the United Arab Emirates to take advantage of their tax treaties with Mozambique. These treaties were signed before Mozambique's foreign investment boom and contain **very unfavourable conditions for Mozambique**. The treaties greatly limit Mozambique's ability to tax the income generated by these foreign investments.

In this briefing paper we show how multinational companies abuse Mozambique's tax treaties to avoid taxes, and we give an estimate of how much tax revenue could be lost as a result. We call on the Government of Mozambique to revise its tax treaties and re-negotiate or terminate the most harmful treaties, particularly those with Mauritius and the United Arab Emirates. Mozambique is currently negotiating a tax treaty with the Netherlands, a tax haven notorious for enabling treaty shopping. The Government of Mozambique should be very cautious about signing a treaty with the Netherlands, and we call on both governments to ensure that a new treaty does not deprive Mozambique of much-needed tax revenue.

Section 3 of this paper gives an explanation of tax treaties and their main issues, and section 4 provides an overview of Mozambique's tax treaty network. Section 5 follows with an analysis of the sources of foreign investment in Mozambique and an estimation of the potential revenue losses from its tax treaties. After the paper's conclusion (section 6), we provide policy recommendations in section 7 to address the negative impacts of Mozambique's tax treaties.

Photo: Xinhua, 11 November 2022

The discovery of natural gas reserves has attracted billions of dollars in foreign investment.

3 What are tax treaties?

The international taxation system comprises **more than 3,000 bilateral tax treaties**, also known as double taxation agreements (DTAs).[2] Once signed, the majority of tax treaties supersede domestic tax law for the time they are in force.[3,4] **The original purpose of tax treaties was to prevent companies being taxed twice** for business activity which takes place across the two signatory states, **known as double taxation**.[5] In order to prevent this, tax treaties contain provisions which distribute taxing rights between the signatory nations. In other words, they define under what conditions each country can tax certain cross-border income (such as dividends and interest) and at what rate. Among other things, **tax treaties contain provisions on how cross-border payments such as dividends and interest are taxed**.

Most countries already have legislation to prevent double taxation, so the original purpose of tax treaties is mostly no longer relevant. In the case of Mozambique, the government already allows companies to use foreign tax credits to prevent double taxation. Moreover, Mozambique provides companies with significant tax incentives and exemptions.[6] This brings into question the necessity of tax treaties for Mozambique altogether.

In spite of the increased criticism of tax treaties, new treaties continue to be signed, often inspired by the idea that they will supposedly help attract foreign investment, which could outweigh the loss in tax revenue.[7] After years of research, there is still no conclusive evidence to back up this claim: “for every published study that finds a positive association between tax treaties and investment in lower income countries, there is another that does not”.[8] Recent research by the International Monetary Fund (IMF) has shown that tax treaties do not lead to additional investments and are rather used by

multinational corporations to avoid taxes on investments they were already committed to, regardless of these tax treaties.[9]

> **"For every published study that finds a positive association between tax treaties and investment in lower income countries, there is another that does not."**

The abuse of tax treaties by multinational corporations to avoid taxes has led to a number of African governments cancelling their tax treaty with Mauritius. In 2020 Senegal and Zambia terminated their treaty with Mauritius, both citing the reduced withholding tax rates as the reason.[10] Both countries are currently negotiating a new treaty. Rwanda has successfully renegotiated its treaty with Mauritius, after terminating it in 2012, because it was considered to facilitate treaty shopping and reduce Rwanda's taxing rights.[11] Lesotho has also successfully renegotiated higher withholding tax rates in its treaty with Mauritius.[12] The IMF has also urged capital-importing countries like Mozambique to consider adapting their domestic legislation rather than signing a tax treaty, arguing that "because withholding rates and the permanent establishment definition can be provided in domestic law, the reciprocal benefits of a treaty for a developing country may be of relatively little value".[13]

As we will see in the following section, rather than preventing double taxation, tax treaties today often result in countries like Mozambique signing away their taxing rights, while also enabling tax avoidance by multinational corporations.

The OECD and UN Model Tax Conventions

Most of the tax treaties currently in force are based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, which generally shifts taxing rights away from the country that receives the investment (the "source state") towards the country of origin of the investment (the "resident state").[14] This is because the OECD model was designed by and for wealthy OECD countries with relatively equal economic positions, which import and export a roughly equal value of goods and services to and from each other.[15]

Under this equal economic relationship, both signatory states are simultaneously a source (capital-importing) and a resident (capital-exporting) country. So the amount that they can tax will not be impacted much by the tax treaty, while protecting their taxing rights over the activities of their multinational enterprises abroad.[16]

However, the lack of an alternative model meant that the OECD model was also used by the wealthy OECD countries as the basis for treaties with lower-income countries of very different economic positions and involving uneven investment relationships. This enabled the wealthy OECD countries to invest in lower-income countries under very favourable conditions, and greatly reduced the ability of these lower-income countries to tax the income generated from these foreign investments.

Under these asymmetric relationships, the distribution of taxing rights in DTAs based on the OECD model results in sacrifices for only the capital-importing source countries, which are predominantly lower-income countries.[17] For instance, lowering withholding tax rates means that a state is less able to tax the income (for example, interest) generated by incoming foreign investment. For a lower-income country such as Mozambique that is mainly an importer rather than an exporter of foreign investment, signing a tax treaty therefore greatly limits its taxing rights.

In response to the highly disadvantageous nature of the OECD model for lower-income countries, these countries called on the United Nations in the 1960s and 1970s to develop a model treaty that better recognised their interests. The UN was to come up with guidelines that would "fully safeguard their respective revenue interests".[18] This led to the publication of a UN model in 1980, the United Nations Model Double Taxation Convention between Developed and Developing Countries, which increased source taxing rights. The UN Model Convention has seen various updates, most recently in 2021.

The UN model has been criticised for not going far enough, because it is still based on the OECD model, and because, despite increasing source taxation, it still contains some articles which are restrictive for source countries.[19] Moreover, despite the UN model being more favourable for lower-income countries, the OECD model still continues to form the basis of the majority of DTAs between lower- and higher-income countries.[20] For example, in the case of Mozambique, its DTAs largely follow the OECD model, depriving the country of significant taxing rights.[21]

4
Key issues in Mozambique's tax treaties

Mozambique has signed 10 tax treaties, two of which (with Botswana and Ethiopia) are not yet ratified. Table 1 lists the treaties and the contents of key articles, which we explain in depth below.[22] Mozambique is currently in tax treaty negotiations with at least the Netherlands and Turkey.[23] Following the table we explain the concept of treaty shopping and key issues in Mozambique's tax treaties.

Treaty article	Country	Mauritius	United Arab Emirates	Italy	South Africa	Portugal	Macao	India	Vietnam[25]	Botswana	Ethiopia
	Year ratified	**1999**	**2005**	**2005**	**2009**	**2010**	**2011**	**2012**	**2012**	**Not yet ratified**	**Not yet ratified**
5(3)(a)	Construction PE (months)	6	12	6	6	6	6	12	6	6	6
5(3)(b)	Service PE (months)	6	9	No	6	6	6	9	6	6	6
10	WHT on dividend	8% (15%)[27]	0%	15%	8% (15%)[28]	10%	10%	7.5%	10%	0% (12%)[29]	10%
11	WHT on interest	8%	0%	10%	8%	10%	10%	10%	10%	10%	10%
12	WHT on royalties	5%	5%	10%	5%	10%	10%	10%	10%	10%	10%
12a	WHT on technical service fees	No	No	No	No	No	No	No	10%	10%	15%
13(4)	Capital gains – immovable property	No	Yes	No	Yes	Yes	No	Yes	Yes	No	No
13(5)	Capital gains – movable property	No	No	No	No	Yes	No	Yes	No	No	Yes
29	General anti-abuse rule	No	No	No	No	No	No	PPT	No	No	PPT

Red indicates the treaty article is not in line with the UN model. In the case of WHT it means a reduction by more than half of Mozambique's statutory 20% WHT rate.

Table 1

Treaty shopping

In most cases, countries have only signed a limited number of tax treaties, which in theory should mean that tax treaty benefits only apply to a select group of investors: those based in these countries. Mozambique, for example, has signed tax treaties with 10 countries. Tax treaty negotiations are performed by teams from the two signatory countries, based on their national context. Foreign investors in Mozambique from non-signatory countries should therefore not be able to take advantage of the favourable conditions offered by tax treaties that were designed for a bilateral economic relationship between two specific countries.

However, in today's globalised economy, multinational corporations can easily set up letterbox companies in tax havens across the world. These letterbox companies enable multinationals to take advantage of the tax haven's treaty network. By structuring their investment in Mozambique using letterbox companies in a country with a favourable tax treaty with Mozambique, companies can take advantage of the tax benefits offered by that treaty. This is called treaty shopping.

Mozambique has signed tax treaties with two known tax havens, Mauritius and the United Arab Emirates. The UAE has been ranked as the 10th worst tax haven worldwide in the Tax Justice Network's Corporate Tax Haven Index, while Mauritius ranks 15th.[30] The UAE has signed 137 tax treaties with countries across the globe.[31] Mauritius has signed 45 tax treaties.[32] These countries, also referred to as investment hubs or offshore financial centres, enable multinational corporations to easily set up letterbox companies and offer a large network of favourable tax treaties and other tax benefits (such as an absence of withholding taxes or corporate income tax).[33]

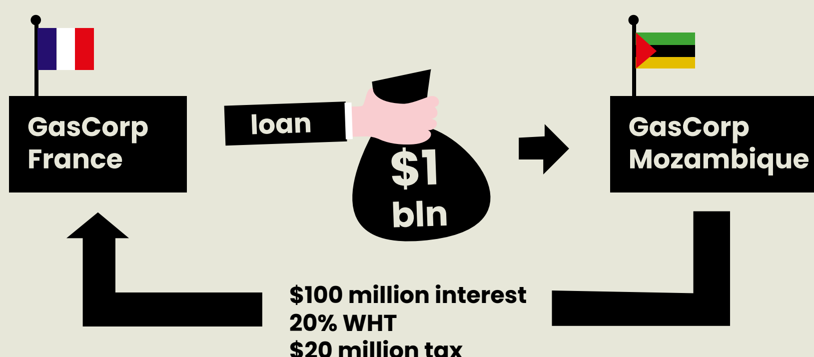
How the Mozambique–United Arab Emirates treaty can be abused

The following example illustrates how a company can use Mozambique's tax treaty network to avoid taxes. As explained above, Mozambican domestic tax law outlines a 20% withholding tax rate on outbound interest, dividends, and royalties. In 2003 Mozambique signed a tax treaty with the United Arab Emirates which reduces this withholding tax rate to 0% for companies registered in the UAE investing in Mozambique.

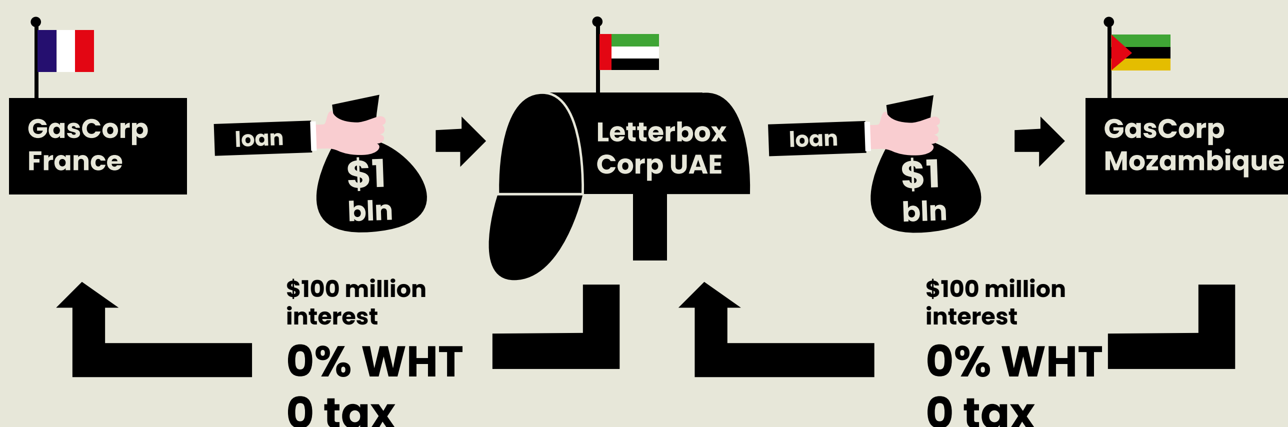
Imaginary company "GasCorp" is making a large investment in Mozambique's gas fields, and financing this investment through loans. GasCorp is registered in France, where its headquarters are. Mozambique and France have not signed a tax treaty, so Mozambique's 20% withholding tax rate would generally apply to any outbound interest payments made by GasCorp from Mozambique to France. In order to avoid paying these taxes GasCorp sets up a letterbox company in the UAE to take advantage of the 0% withholding tax rates agreed in the Mozambique–UAE tax treaty. GasCorp then uses this UAE subsidiary as an intermediate financing vehicle to route its loans into Mozambique. This enables GasCorp to take advantage of the 0% withholding tax rates in the Mozambique–UAE tax treaty and avoid paying withholding tax in Mozambique on the interest payments made for these loans.

Figure 1

Loan financing without treaty shopping



Loan financing with treaty shopping



Example of abuse of Mozambique–UAE tax treaty

Because the UAE does not levy any withholding taxes itself, any outbound dividends or interest payments made by GasCorp from the UAE to France or elsewhere are in turn also exempt from withholding tax. This shows that simply by setting up a letterbox company in the UAE, GasCorp can entirely avoid paying withholding taxes in Mozambique.

Both consortia operating the Golfinho gas concession in Mozambique, led by Total, and the country's Coral FLNG (floating liquefied natural gas) concession, led by ENI, appear to use this treaty shopping scheme. Both consortia have set up financing companies in the United Arab Emirates to provide loan financing to the projects in Mozambique.[34] According to calculations by OpenOil, by applying the 0% interest withholding tax rate agreed in the Mozambique–UAE tax treaty, Mozambique is estimated to lose up to $ 1.6 billion in withholding tax revenue over the lifetime of the two projects.[35]

Issue 1. Reduced withholding taxes

A key provision in tax treaties is the limitation on withholding tax rates for dividends, interest, and royalties. Withholding taxes provide a key source of government revenue for capital-importing countries such as Mozambique. They provide a final way for Mozambique to tax the income generated from foreign investment before this income leaves the country, but its tax treaties greatly reduce the country's ability to do so. This becomes clear when considering Mozambique's tax treaty with the United Arab Emirates.

Mozambique levies a 20% withholding tax on outbound interest, dividends, and royalties. The UAE does not levy any withholding taxes. The tax treaty between the two countries reduces the withholding tax rates on interest, dividends, and royalties to 0%. This tax treaty therefore greatly limits Mozambique's taxing rights, while changing nothing for the UAE in terms of withholding tax rates. As we will see in more detail in section 5, this inequality in taxing rights is compounded by the fact that the UAE is a major source of investment for Mozambique, while very few investments in the UAE come from Mozambique.[36] This illustrates the one-sided nature of Mozambique's tax treaties, with the benefits largely accruing with foreign companies and investors rather than Mozambican companies.

No withholding taxes on service fees

In addition to interest payments, dividends, and royalties, cross-border service fees are a form of taxable intra-group transaction that can be covered by a tax treaty. These fees can include for example payments for consultancy, financial, human resources, or IT services made by a Mozambique subsidiary to its parent company.

It can be difficult to determine permanent establishment status for these service-providing companies. Companies often do not need a physical presence in a country to provide technical services, due to the use of information and communications technology and the digitalisation of the economy.[37] This means that foreign companies can in fact provide services in Mozambique and have enough economic substance there to have what would ordinarily be a permanent establishment, but by not having a physical presence they can avoid permanent establishment status and not be subject to tax in Mozambique.

This is increasingly becoming a problem as the global economy becomes more digitalised. A solution can be found by introducing a withholding tax on technical service fees, which the UN model has included since 2017. Strengthening permanent establishment provisions for services is also an option but more challenging because of the difficulty in effectively applying them and determining permanent establishment status. Introducing a withholding tax ensures that companies cannot so easily use service fees to erode their tax base and shift profits. This withholding tax is similar to existing withholding taxes on, for example, interest and royalty payments, and is applied to all cross-border payments, regardless of whether the service company is deemed to have a permanent establishment. However, only one of Mozambique's tax treaties currently in force includes such a withholding tax: the treaty with Macau includes a 10% withholding tax on technical service fees.[38] The treaties with Botswana and Ethiopia also include such a withholding tax, but these treaties are not yet ratified.

Issue 2. Definition of permanent establishment (PE)

Reduced withholding tax rates are not the only treaty clause multinational companies can use to lower their taxes. Countries also risk losing out on the taxation of active income because of unfavourable definitions of "permanent establishment". These definitions can lead to a foreign company's income from business activities in Mozambique being taxed not in Mozambique but only in the treaty partner country. This works as follows: permanent establishment (PE) definitions set the conditions when a company is considered by the country's government to have a fixed place of business in the country. These conditions usually include the level of physical presence and the minimum amount of time the business must operate in a country in order for it to be taxed, along with the types of business activity that qualify (or not) as a permanent establishment.

If a foreign company is considered to have a permanent establishment in a country, it is liable for income tax in that country. However, tax treaties contain rules that define when a company from a treaty partner is considered to have a PE. These PE threshold rules in tax treaties are often much more generous than those of countries' domestic tax laws. In some cases, these rules result in companies structuring their business activities so that they fall below the PE threshold in tax treaties and avoid paying taxes in the source country altogether.

The definition of permanent establishment is particularly relevant when considering service-providing companies. It can be difficult to establish service-providing companies as having a PE in a country because they do not necessarily need to have a physical presence (unlike a mining or construction company). The OECD model treaty does not include any provisions to address this issue. The UN model does include a service PE length provision (article 5(3)(b)), which states that service provision, including consultancies, constitutes a permanent establishment if the service activities continue for more than six months in a year.

The tax treaty between the Mozambique and the United Arab Emirates allows for a company's construction site or consultancy services not to be considered a permanent establishment if their length does not exceed 12 months or 9 months respectively.[39] Companies can also take advantage of this clause by splitting their service contracts into multiple short contracts of 9 or 12 month periods to avoid PE status.[40] A recent example of the kind of problem service-providing companies can pose to tax authorities was reported by CIP (Mozambican NGO Public Integrity Center), showing how ENI in Mozambique contracted UAE-based consultancy firm Progeco NeXT to possibly avoid personal income tax in Mozambique by not having a permanent establishment.[41]

The treaty between the Mozambique and the UAE also allows a company's permanent establishment in Mozambique to deduct from its profits interest and royalty payments made to its head office.[42] This can enable companies to set up artificial intercompany arrangements to lower their tax bill, using inflated interest and royalty payments to reduce their income tax liability in Mozambique.

Issue 3. Capital gains tax and offshore indirect transfers

Another form of tax avoidance that tax treaties can facilitate is capital gains tax avoidance. Capital gains taxes are usually applied to the gains made from the sale of valuable assets from one company to another (the difference between the initial price paid for the asset and the sale price). These are taxable by the country in which the asset is located (the source country) if the country levies capital gains tax, which is the case for Mozambique.[43] However, capital gains clauses in tax treaties set restrictions by outlining conditions that such transfers must fulfil in order to be charged capital gains tax. These clauses can be abused by multinational corporations to avoid capital gains tax in Mozambique using so-called offshore indirect transfers (OITs).[44]

An offshore indirect transfer takes place when multinational corporations have a holding company which is listed as the legal owner of a valuable asset (such as a mining licence) and instead of selling the asset directly they sell their shares in the holding company that legally owns the asset. In this way, control over the valuable asset has been transferred from one multinational corporation to another, without the legal owner of the asset changing (the holding company). Thus, no capital gains are seen to have been realised, so capital gains taxes cannot be applied. Mozambique has domestic legislation that can enables capital gains taxation of such indirect transfers, but its tax treaties also need to include provisions that enable it to do so.[45]

Article 13(4) and article 13(5) of the OECD model and UN models allow for capital gains taxation of offshore indirect transfers. These provisions enable a country to tax capital gains on the sale of shares, if at least a certain percentage (50% in the OECD model treaty) of the value of those shares is derived from immovable property (article 13(4) of the OECD model treaty). This can, for example, enable a state to tax an offshore indirect transfer of a mining licence through the sale of a holding company, if the value of the mining licence makes up 50% or more of the holding company's assets. The same provision exists for movable property, which can include not only physical properties (such as ships) but also financial assets and intangibles such as intellectual property rights (article 13(5) of the UN models).[46]

Mozambique's tax treaty with Mauritius does not include a capital gains tax provision for immovable property, meaning that multinational companies can use holding companies in Mauritius to avoid capital gains tax using offshore indirect transfers. It does include a 13(5) provision, allowing Mozambique to tax capital gains on offshore indirect transfers of movable property. Mozambique's tax treaty with the United Arab Emirates includes both provisions.

Anti-abuse measures are not the catch-all solution

One way in which Mozambique could challenge treaty shopping is through anti-abuse measures. These measures can deny treaty benefits to a company in circumstances that

are deemed to be a case of abuse or treaty shopping. However, of the 10 tax treaties that Mozambique has signed, only two contain anti-abuse measures: the treaty with India (signed in 2010 and effective since 2012) and the treaty with Ethiopia (signed in 2017 and not yet in force). In both cases a so-called principal purpose test (PPT) is included. The PPT is used to determine whether the main purpose of an arrangement or transaction was to gain treaty benefits and to deny such benefits to those found to have entered into an activity with the principal purpose of gaining tax benefits.

The Multilateral Instrument

Recognising the problems with tax treaties regarding tax avoidance, the Multilateral Instrument was developed in 2016 as part of the OECD's Base Erosion and Profit Shifting (BEPS) project. The OECD BEPS project is a multilateral initiative led by the OECD and G20 to introduce measures to tackle tax avoidance. The Multilateral Instrument (MLI)[47] is a multilateral treaty which came into force in 2018 and enables countries to modify the application of their current and future tax treaties to include provisions from the BEPS project.[48]

When countries sign up to the MLI, they select which of their tax treaties it will cover, and which provisions (other than the minimum standard) they will and will not include. While representing a significant step forward, the range of modifications covered by the MLI is relatively limited in scope.[49] Countries can opt in on relevant articles on permanent establishment, capital gains tax for immovable property, and mandatory binding arbitration. The MLI also includes an anti-abuse measure, whereby countries can opt in to a principle purpose test (PPT), a limitations of benefits clause (LOB), or a simplified LOB (SLOB).

Signing up to the MLI can therefore be beneficial to Mozambique, depending on what provisions the country opts in to. However, a shortcoming of the MLI is that it only takes effect if both treaty partner countries have signed on to the MLI and ratified it, and then it only applies to the provisions that both have opted in to. If Mozambique signs on to the MLI, this will not immediately affect all of its treaties but only those with countries that have also signed on and ratified. Second, this will bring into play only the provisions both countries have opted in to, meaning that the MLI acts only as a lowest common denominator solution.

Mauritius and the United Arab Emirates, for example, have signed on and ratified the MLI, but opted out of the most impactful provisions.[50] Thus, for especially unfavourable tax treaties, renegotiation or termination is still the only way to significantly improve treaty provisions which are not covered by the MLI.

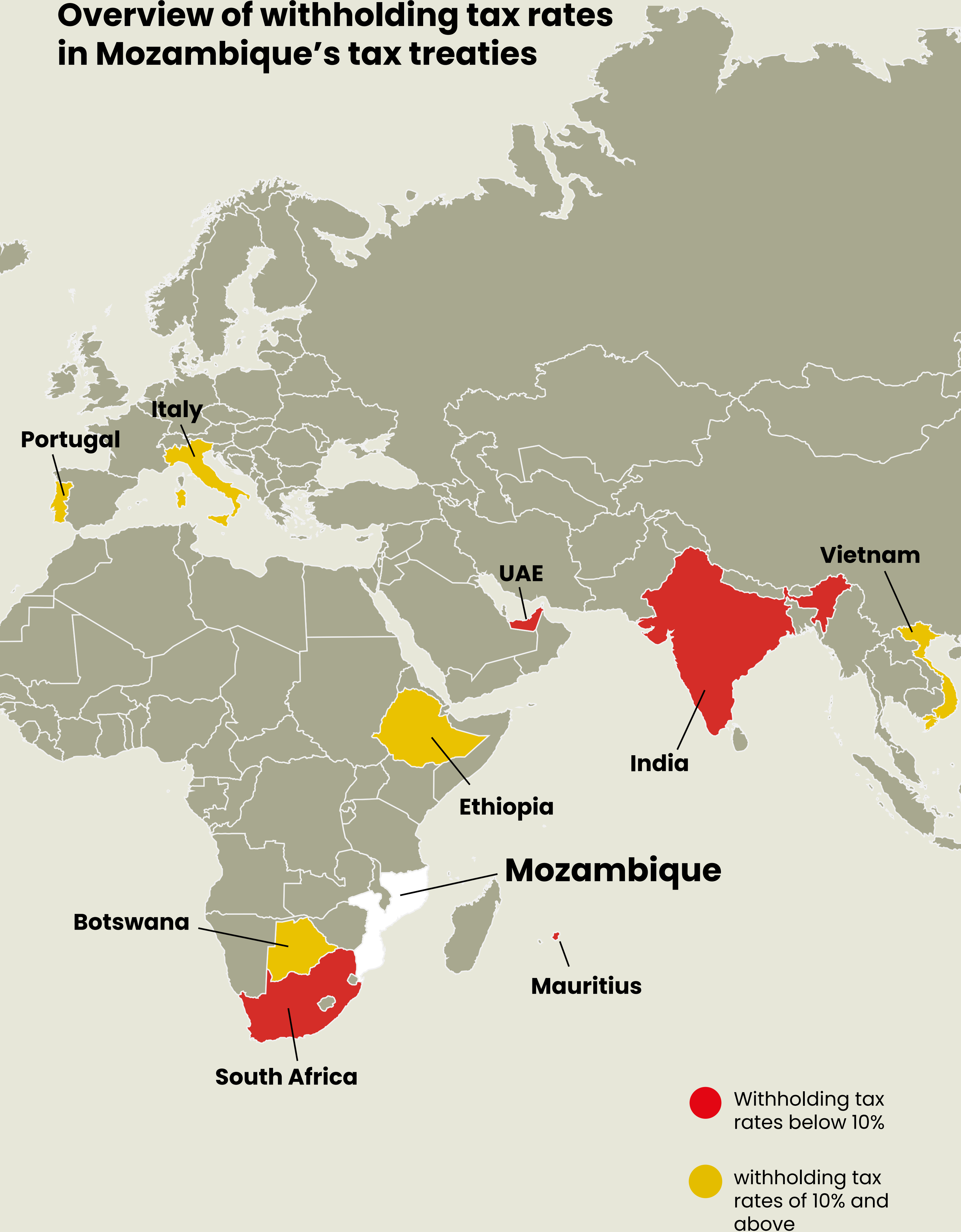
Different types of anti-abuse measure

The principal purpose test (PPT) is the minimum standard and default anti-abuse measure included in the OECD and G20's Base Erosion and Profit Shifting (BEPS) project.[51] Countries can also opt for a stronger anti-abuse measure, the so-called limitation on benefits clause (LOB), or a combination of the PPT and LOB. A full LOB clause seeks to prevent treaty abuse by outlining criteria that must be met in order to qualify for treaty benefits.

The PPT is easier to implement and less administratively intense than the full LOB. The full LOB consists of numerous objective tests to determine whether a taxpayer qualifies for treaty benefits, which can be overwhelming for tax authorities with limited capacity.[52] The application of the PPT on the other hand is highly subjective, as the state uses its own judgement to determine whether transactions will receive treaty benefits or not. This can result in inconsistencies and uncertainty.[53] For these reasons the third route of a combined PPT and simplified LOB (SLOB) is generally recommended for lower-income countries to ensure sufficient protection from treaty abuse, without overburdening the tax administration.[54] The SLOB includes a significantly reduced number of objective tests than the full LOB, while still aiming to cover all of the most important features.[55]

The overall problem with anti-abuse measures as a solution to treaty shopping, however, is that they place the burden of proof on the government impacted by the treaty abuse. This is problematic because, for a country like Mozambique, government resources are limited, and experience with applying anti-abuse measures may be lacking. Furthermore, a government may be hesitant to apply anti-abuse measures to a company because of fear this could make the country appear unwelcoming or uncooperative to foreign investors.

A man washes his car with a billboard in the background showing an offshore oil rig in Maputo.



Overview of withholding tax rates in Mozambique's tax treaties
Italy
Portugal
UAE
Vietnam
India
Ethiopia
Mozambique
Botswana
Mauritius
South Africa
Withholding tax rates below 10%
withholding tax rates of 10% and above

5. Mozambique's lost revenue due to tax treaties

In this section we explain how Mozambique's tax treaties are used by multinational companies to **avoid taxes**, focusing on **withholding tax rates and the treaties with Mauritius and the United Arab Emirates**.

Table 2 provides a summary of the withholding tax rates on interest, dividends, and royalties in Mozambique's tax treaties. As shown in the table, all of Mozambique's tax treaties include withholding tax rates significantly lower than the statutory rate (20%), reducing the amount it can tax foreign multinational corporations operating within its borders. The lowest rates are with the United Arab Emirates, South Africa and Mauritius. These low rates make it attractive for multinational corporations to structure their investment in Mozambique through these countries. As we will see below, most of Mozambique's foreign investment indeed comes from Mauritius and the UAE.

Overview of withholding tax rates in Mozambique's tax treaties

	Dividends	Interest	Royalties
Statutory rates Mozambique	***20%***	***20%***	***20%***
India	7.5%	10%	10%
Italy	15%	10%	10%
Macau	10%	10%	10%
Mauritius	8% (15%)[56]	8%	5%
South Africa	8% (15%)[57]	8%	5%
United Arab Emirates	0%	0%	5%
Vietnam	10%	10%	10%
Portugal	10%	10%	10%
Botswana	0% (12%)[58]	10%	10%
Ethiopia	10%	10%	10%

Red indicates a reduction by more than half of Mozambique's statutory 20% WHT rate

Table 2

Mozambique's foreign direct investment is nearly entirely debt financing, a major tax avoidance liability

Following the discovery of gas fields in 2010,[59] Mozambique saw a surge in foreign direct investment (FDI), as Figure 2 shows.[60] Current FDI stocks (total foreign investment) stand around $ 76 billion, a more than fifteenfold increase from $ 4.6 billion in 2010.[61]

Figure 2 shows that Mozambique's inward FDI is nearly entirely made up of debt financing. Equity investment increased almost fivefold between 2010 and 2019, from $ 2.4 billion to $ 9.6 billion, dropping sharply in 2020 due to major divestment from South Africa. Foreign debt investment, however, increased heavily from $ 2.2 billion in 2010 to $ 74 billion in 2021. The extremely high amount of foreign debt investment is worrying because of the use of debt and loans as a tool for base erosion and profit shifting by multinational corporations.

Incoming FDI stock, debt and equity
in US$ millions

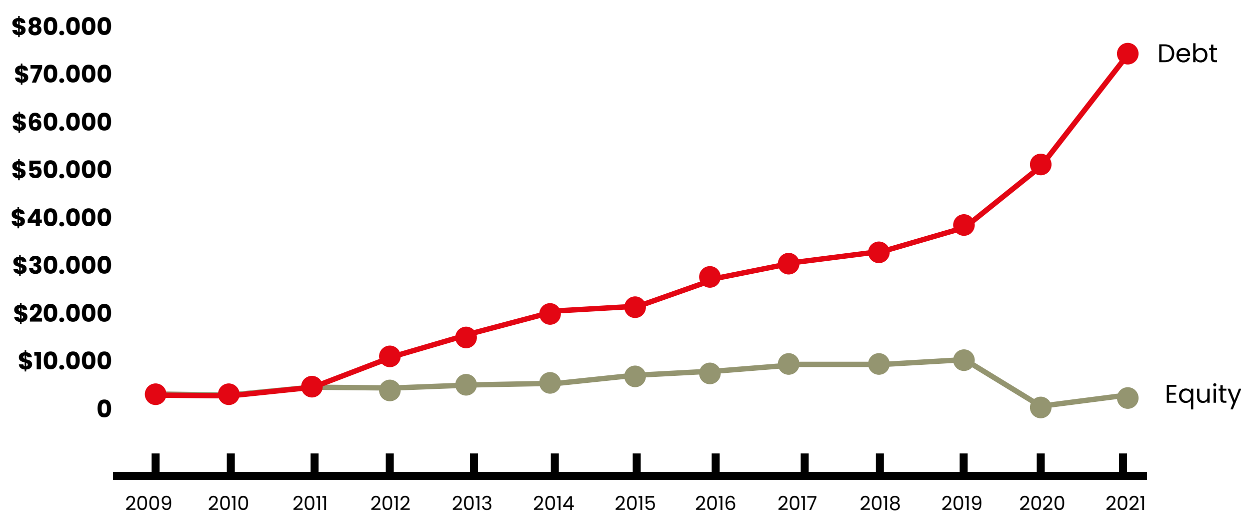


Figure 2

Multinational corporations can use the interest payments from loan financing both to shift profits offshore and as a tax-deductible item to erode their tax base in Mozambique.[62] To illustrate this using the earlier example in the previous chapter, fictional French multinational enterprise GasCorp finances its investment in Mozambique's gas fields not with equity but through loans provided through a tax haven (the United Arab Emirates). This can allow GasCorp to use high interest payments in Mozambique to reduce its taxable base and with that its Mozambican profits, avoiding both corporate income tax and dividend withholding tax. It can then use these interest payments to shift profits from Mozambique to the UAE.

Tax havens are Mozambique's biggest source of foreign direct investment

Figure 3 shows the development of incoming foreign direct investment (FDI) from Mozambique's main FDI partner countries between 2010 and 2021. Four of five biggest sources of FDI in Mozambique are countries with which it has a tax treaty: Mauritius, the United Arab Emirates, India, and Portugal (see Table 3).

Given the size of their economies and linkages with Mozambique, it is likely that there are a significant number of Portuguese and Indian companies investing in Mozambique. **This is not the case for tax havens Mauritius and the UAE, which suggests that the large amount of FDI from these two countries is likely a result of treaty shopping by multinational corporations, with the FDI from Mauritius and the UAE actually originating from third countries.**

Incoming FDI stock in million US$

2010-2021

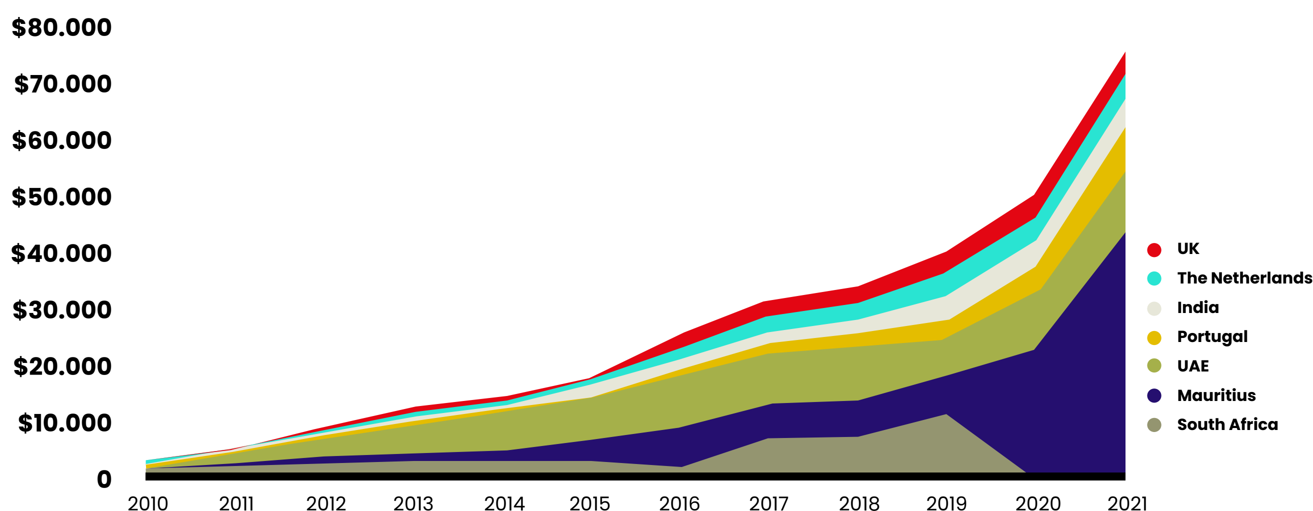


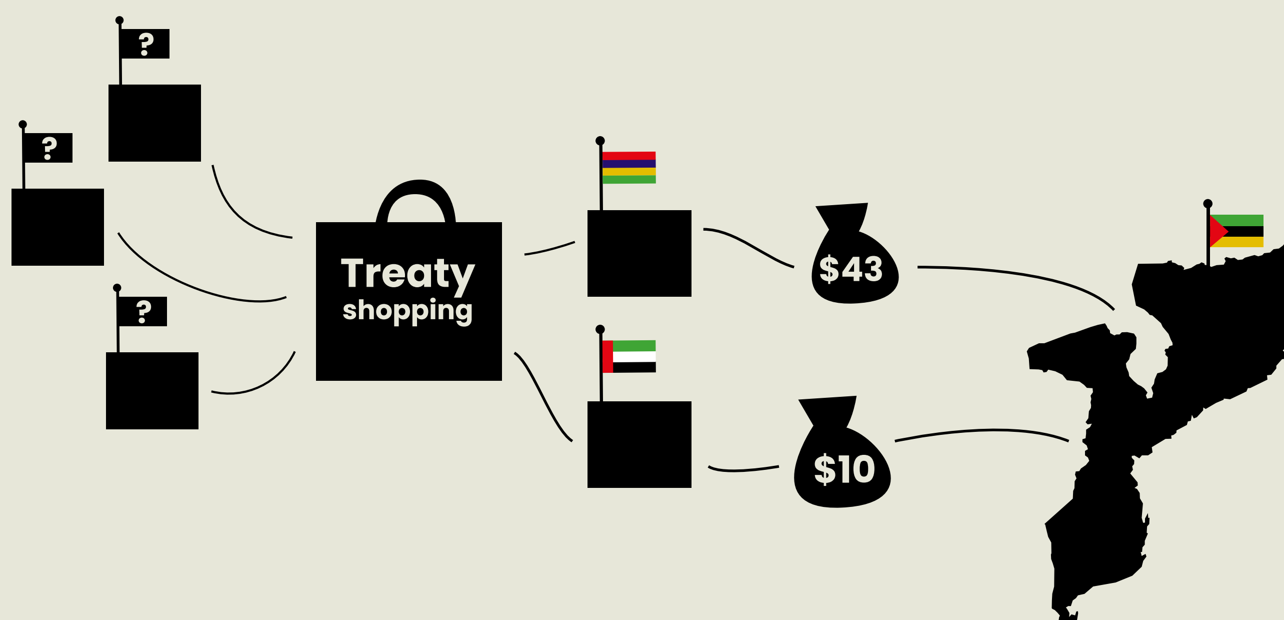
Figure 3

Given the size of FDI from Mauritius and the UAE into Mozambique, the amount of taxes lost by Mozambique due to its tax treaties with these countries will be significant. While it is difficult to make an exact calculation of how much tax revenue is lost from tax treaties, researchers have used various methods to give a rough estimate of these losses.

Below we apply a method used by IMF economists and others to calculate withholding tax losses from tax treaties.[64] This method assumes a conservative yield of 6% and 4% on debt and equity investments, respectively,[65] to provide an estimate of the amount of dividend and interest payments paid on a country's FDI.[66] It then calculates the difference in withholding taxes that would be paid on these flows between the statutory rate and the treaty rate.

This method gives a rough estimate of revenue losses and is used here to illustrate the approximate costs of Mozambique's treaties with Mauritius and the UAE. This estimates the forgone withholding tax only on dividend and interest payments, not on royalties or other types of passive income payment.

This method needs to assume that behaviour does not change as a result of the introduction of a tax treaty.[67] It does not factor in the possibility that an investor would have made a different investment without the treaty, since without this assumption it would not be possible to compare the scenario with a treaty and without a treaty by comparing the statutory with the treaty rates. Also, due to a lack of data we cannot establish for sure whether the FDI from Mauritius and the UAE is largely a result of treaty shopping and does in fact originate from third countries. However, given the popularity of both countries as offshore financial centres and their economies' relatively small size, this is likely the case for the majority of this FDI.



Inward FDI stock, Mozambique, top five countries, 2021

Country	Amount	Share of total FDI
Mauritius	$ 43 billion	56%
United Arab Emirates	$ 10 billion	14%
Portugal	$ 8.8 billion	11%
India	$ 4.5 billion	6%
The Netherlands	$ 4.5 billion	6%

Table 3

Estimated tax revenue losses from Mozambique's tax treaties

Figure 4 shows the total estimated lost withholding tax on dividend and interest from 2010 to 2021 for all Mozambique's tax treaties. Table 4 below shows the estimated lost withholding tax on dividends and interest for each treaty country in 2021.[68] These figures indicate the extent of Mozambique's tax revenue losses due to its tax treaties. The assumed yield percentages for debt and equity investment used in this calculation method are conservative, and higher real-world yields would imply higher actual losses.

Mozambique's high losses resulting from its treaties with Mauritius and the UAE are particularly problematic because they are likely to be the result of treaty shopping by foreign investors. In 2021 the Mozambican government is estimated by our calculation to have lost $ 315 million as a result of the reduced withholding tax rates on interest and dividend payments in the treaties with Mauritius and the UAE alone, 7.4% of its total tax revenue.

The figures for Mauritius are particularly high because of the extraordinary amount of debt FDI coming into Mozambique from the island state in 2021. Due to the lowered withholding tax rate on interest in the Mozambique–Mauritius treaty, Mozambique could be missing out on up to $ 179 million in withholding taxes on interest flows to Mauritius alone.

Treaty partner country	Lost dividend WHT revenue	Lost interest WHT revenue	Total lost interest and dividend WHT revenue 2021	Total lost WHT revenue as % of total Mozambique tax revenue[69]
Mauritius	$ 42 million	$ 179 million	$ 221 million	5.2%
United Arab Emirates	$ 26 million	$ 67 million	$ 94 million	2.2%
Portugal	$ 12 million	$ 27 million	$ 39 million	0.9%
South Africa	$ 0	$ 18 million	$ 18 million	0.4%
India	$ 0	$ 18 million	$ 18 million	0.4%
Total	$ 80 million	$ 309 million	$ 390 million	9.1%

Estimated tax revenue losses from Mozambique's tax treaties, 2021

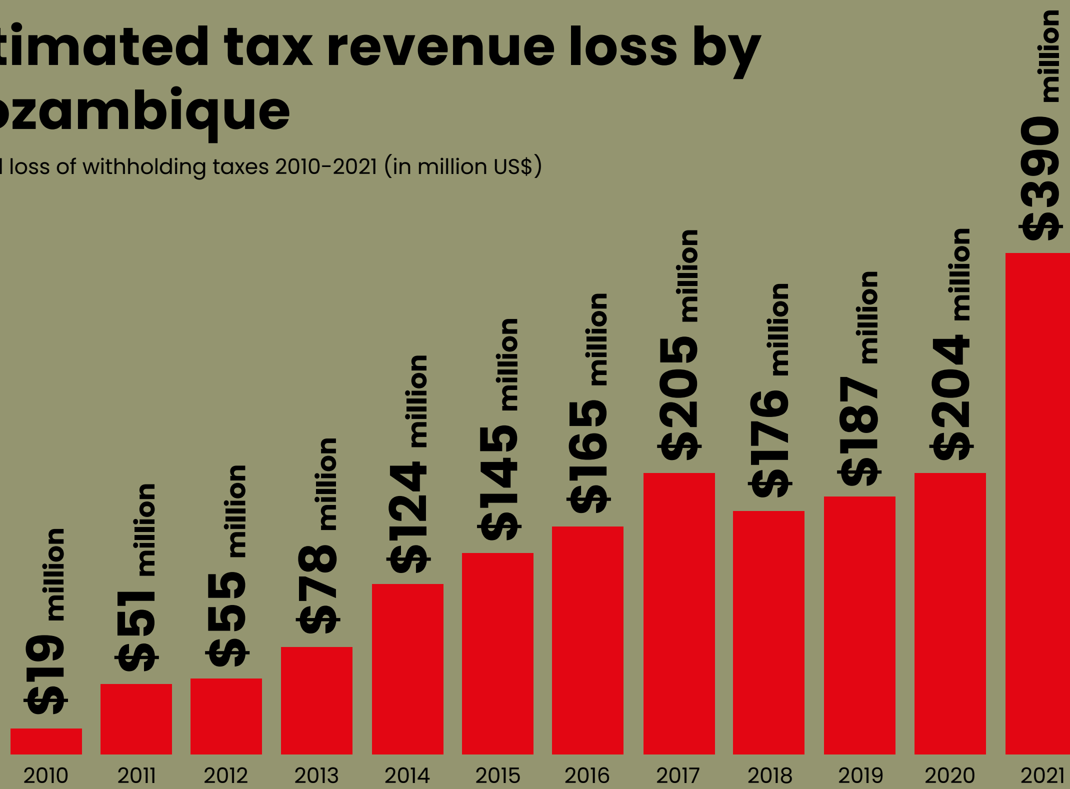
Table 4

These figures show the urgent need for Mozambique to renegotiate or terminate its treaties with Mauritius and the UAE, and illustrate what a liability signing a tax treaty with a tax haven is. By signing harmful tax treaties with conduit countries such as Mauritius and the UAE, due to the treaty shopping opportunities offered by these countries, Mozambique has effectively signed them with the world. Because Mozambique is mostly a destination for investment instead of a source of investment, these treaties unilaterally limit Mozambique's taxing rights, as they favour its capital-exporting partner countries and the companies willing to use them as conduits for their investments.

Figure 4

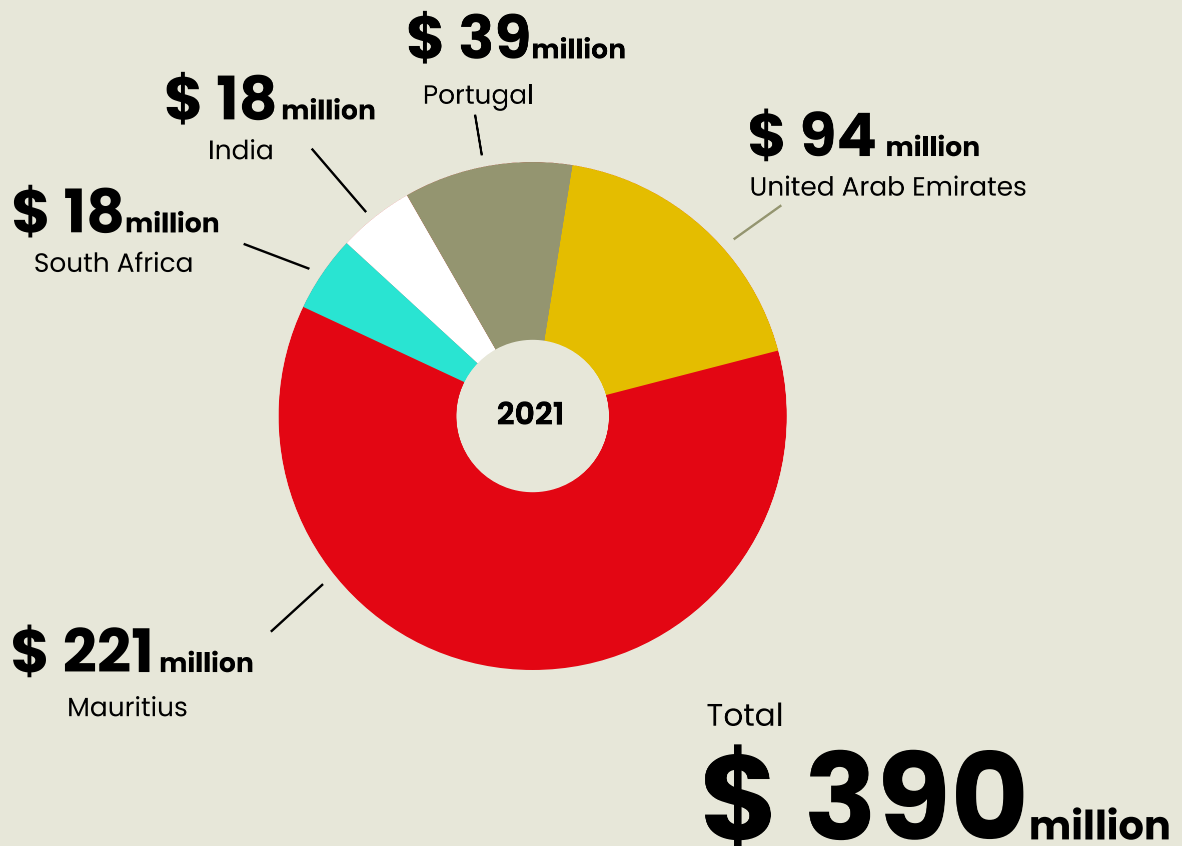
Estimated tax revenue loss by Mozambique

Annual loss of withholding taxes 2010-2021 (in million US$)



Estimated loss by tax treaty

Estimated loss of dividend and interest withholding taxes due to tax treaties in 2021 (in US$ million)



The impact of a tax treaty with the Netherlands

Mozambique is currently negotiating a tax treaty with the Netherlands. As this treaty is still under negotiation we cannot yet know its proposed contents. However, because the Netherlands is a notorious tax haven and conduit country similar to Mauritius and the UAE, there is a significant risk that a tax treaty with the Netherlands can also open up Mozambique to treaty shopping. Given the already high FDI coming from the Netherlands, signing a tax treaty means Mozambique could miss out on millions of dollars in withholding taxes on the income generated from these investments. The Netherlands has already concluded several tax treaties with African countries which include very low withholding tax rates.[70] The Government of Mozambique should therefore protect its fiscal interests and be extremely cautious in signing a tax treaty with the Netherlands.

To illustrate Mozambique's potential tax revenue losses from signing a treaty with a 10% withholding tax rate on interest and 5% on dividends,[71] and applying the same estimation method as used above, Mozambique could lose more than $ 20 million a year.[72] Should the tax treaty between Mozambique and the Netherlands contain even lower withholding tax rates and foreign investment increase, this amount could be substantially larger. There are already major foreign investors investing in Mozambique through holding companies in the Netherlands, including Galp, ENI, and ExxonMobil.[73]

Mozambique's withholding tax losses in a hypothetical tax treaty with the Netherlands for the year 2021

Based on treaty rates of 10% interest WHT and 5% dividend WHT and FDI stock figures from IMF CDIS database[75]

Treaty partner country	Lost dividend WHT revenue	Lost interest WHT revenue	Total lost interest and dividend WHT revenue 2021	Total lost WHT revenue as % of total Mozambique tax revenue[76]
The Netherlands	$ 4.5 million	$ 16 million	$ 20.5 million	0.6%

Table 5

6. Conclusion

This briefing demonstrates that Mozambique's tax treaty network is a major tax leak for the country. Mozambique has signed tax treaties with two of the world's most notorious offshore tax havens: Mauritius and the United Arab Emirates. Mozambique has witnessed a boom in foreign direct investment over the past 10 years, largely due to the discovery of gas reserves. Mauritius and the UAE enable foreign multinational corporations to take advantage of its favourable tax treaties when investing in Mozambique.

The two countries are now the largest foreign investors in Mozambique, with 70% of the country's total foreign investment coming from these two tax havens. We estimate that, as a result of its tax treaties with Mauritius and the UAE, in 2021 alone Mozambique lost $ 315 million in withholding taxes on interest payments and dividends. This is 7.4% of the country's total tax revenue, which could have been spent on hospitals, schools, and other public infrastructure. This year UNICEF has made a call for $ 113.1 million in emergency funding to "meet the essential humanitarian needs of more than 1.3 million people, including 1 million children" in Mozambique, particularly the Cabo Delgado province.[77]

We therefore call on the Government of Mozambique to immediately renegotiate its treaties with Mauritius and the UAE. Should renegotiation fail to increase Mozambique's taxing rights, we urge the government to unilaterally cancel the two respective treaties. We also call on the government to be very careful in signing new tax treaties, particularly with the Netherlands, another notorious tax haven. The Netherlands is already a major source of foreign investment for Mozambique, which means signing a tax treaty could greatly restrict Mozambique's ability to tax the income generated by these investments.

The Government of the Netherlands should not sign a tax treaty with Mozambique that further erodes the country's taxing rights. Reducing withholding taxes can deprive Mozambique of much-needed government revenue. UNICEF states that, without sufficient funding, it "will be unable to provide critical life-saving assistance to vulnerable children and communities in Mozambique. About 685,000 people will face inadequate access to safe water. In conflict-affected provinces, nearly 500,000 children will go without life-saving vitamin A supplementation, and 300,000 children, adolescents and caregivers will not benefit from mental health and psychosocial support."[78]

7. Policy recommendations

To the Government of Mozambique

1. Be very cautious in signing new tax treaties, especially with the Netherlands

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.

The Government of Mozambique should be especially wary of signing a tax treaty with the Netherlands, which is a tax haven with an existing network of aggressive tax treaties. 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.

2. 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. Termination has proved a successful route to renegotiation for some countries. These two treaties are a major tax leak for Mozambique and need to include better provisions to combat treaty shopping.

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 Mozambique's statutory withholding tax rate of 20%.

→ Capital gains and permanent establishment definitions which are (at a minimum) in line with the UN model:

→ No longer than a six-month activity threshold to require permanent establishment registration for both construction and services, making sure to also include supervisory activities.

→ Ensure Mozambique has the ability to tax capital gains on offshore indirect transfers by including the provisions on capital gains on immovable property from article 13(4) of the OECD and UN models and article 13(5) of the UN model on movable property.

→ 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.[79]

→ Design and implement a clear and transparent tax treaty negotiation and ratification process which allows for public and parliamentary input prior to signature.

→ Ensure domestic tax legislation sufficiently protects Mozambique's tax base and complements treaty provisions.

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.

To the Government of the Netherlands

1. Follow the UN model in the treaty negotiations with Mozambique, and do not include heavily reduced withholding tax rates

The UN model should be followed in all treaties with Mozambique, since this better protects Mozambique's taxing rights as a source country. The Netherlands should not seek to lower Mozambique's withholding tax rates, since this will deprive Mozambique of much-needed tax revenue.

2. Prevent treaty shopping

The Netherlands needs to do more to combat treaty shopping by improving substance requirements for companies and applying stringent anti-abuse measures. This will challenge multinational companies setting up letterbox companies in the Netherlands just to take advantage of a future tax treaty with Mozambique.

Endnotes

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65. These yields are generated by "interacting IMF balance of payment and IMF CDIS data in relation to investments in developing countries", which suggest an "average expected yield on foreign direct investment equity of 10 percent and (…) on debt of 4.4%": ibid, 144.
66. Leduc and Michielse (ibid.) state that yields of 10% for equity and 4.4% on debt are more likely. In the case of Mozambique, these yields are likely very conservative, since government bonds carry interest rates of more than 20%. AllAfrica.com, "Mozambique: Govt Domestic Borrowing Up $900 million this year – a 25% jump", 5 December 2022, https://allafrica.com/stories/202212050479.html.
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68. Italy, Macao and Vietnam are excluded here because of the negligible amount of FDI originating from these countries in 2021.
69. Due to lack of data for 2021, total tax revenue for 2020 is used here. Data from World Bank, "Tax revenue (current LCU) – Mozambique", accessed 16-01-2023, https://data.worldbank.org/indicator/GC.TAX.TOTL.CN?locations=MZ.
70. E.g. the tax treaty between the Netherlands and Kenya includes a 0% WHT on dividends and 10% on interest and royalties.
71. The tax treaties the Netherlands has signed with Kenya, Malawi, and Zambia include a 10% WHT on interest and 5% on dividends – except for the treaty with Kenya, which includes a 0% dividend WHT.
72. FDI data taken from IMF, "Coordinated Direct Investment Survey, Table 2, Direct Investment Positions (Inward and Outward, and Equity and Debt Instruments) by End-Year", accessed 16-01-2023, https://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&sId=1482331048410.
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Colophon

How Mozambique's tax treaties enable tax avoidance

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Authors: Jasper van Teeffelen, Dimas Sinoia, Sidonie East, Nelsa Langa

Design: Karen Paalman

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KNSM-laan 17
1019 LA Amsterdam
The Netherlands
Tel: + 31 (20) 6391291
Email: info@somo.nl
Website: www.somo.nl

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Nº 279 Rua de Dar-Es-Salaam, Maputo
Mozambique
Tel: +258 21 085 797
Email: info@cddmoz.org
Website: www.cddmoz.org

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