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DOUBLE TAXATION AGREEMENTS

Mozambique lost around US$390 million in 2021 due to tax treaties

● "Mozambique's of tax treaties network is depriving the Government of millions of dollars in tax revenue every year. The original purpose of double taxation agreements was to prevent companies from being taxed twice for commercial activities that take place between two signatory states, but they are currently used by foreign investors to avoid taxation in countries where foreign direct investment takes place", This was one of the main points raised by the research on Double Taxation Agreements in Mozambique presented by CDD and SOMO, on March 9, 2023, in the city of Maputo.

The research entitled "How Mozambique's tax treaties enable tax avoidance?" was developed by the Center for Democracy and Development (CDD) and the Centre for Research on Multinational Corporations (SOMO) within the framework of the *Going Public* project, which brings together Mozambican and international organizations to collaborate on advocacy, research and capacity-building activities at local, national regional, and global levels to increase the mobilization of domestic revenues from the extractive industries and ensure that these revenues contribute to improving access to essential public services.

The "Going Public" project is funded by the Finnish Ministry for Development Assistance (FINNIDA) and is led by SOMO and implemented in cooperation with CDD, OXFAM Mozambique, Tax Justice Network Africa (TJNA) and OXFAM Novib.

“Double taxation agreements, which in the past were necessary to regulate bilateral commercial and financial relations between the signatory States, today undermine the possibilities of collecting tax revenues for Mozambique”

Prof. Adriano Nuvunga – Executive Director of the CDD

As he explained, double taxation agreements are not a new topic and the discussion is not exactly new, but it occurs at a time when Mozambique should already be taking advanced steps in terms of monetizing its natural resources. In the mining sector, progress has been significant, but deep problems persist in terms of Mozambique's possibilities to increase its levels of revenue collection. But the biggest challenges are in the hydrocarbon sector, which includes the third largest natural gas reserves in Africa, whose exploration is suspended due to the violent extremism that plagues the province of Cabo Delgado.

The double taxation agreements, which in the past were necessary to regulate bilateral trade and financial relations between the two signatory States, today, due to the new economic dynamics and the nature of Mozambique's natural resources (minerals and hydrocarbons), these agreements harm the possibilities for collecting tax revenues for Mozambique. The reason is simple: with globalization, companies, despite having a flag of origin and registration, move and position themselves in those countries with which Mozambique has signed tax treaties.

Prof. Adriano Nuvunga explained that the debate around the results of this research is aimed at influencing reforms to promote systems that support domestic revenue mobilization. “It should be remembered that in the past Mozambique was at the top of the countries with the highest volume of foreign aid collection, but this support has decreased to historic levels compared to previous years, hence the need for greater fulfillment of the State's obligation to mobilize domestic resources”.

International tax avoidance schemes contribute to global economic inequality and hinder development in countries such as Mozambique

Joseph Wilde-Ramsing – Director of Advocacy at SOMO

The country has attracted significant foreign investment from multinational companies in the extractive industry, but due to unfair international tax rules, lack of inclusive public spending and insufficient transparency, these investments have not made significant contributions to reducing inequalities in Mozambique.

Among the unfair international tax rules, double taxation agreements are highlighted as they are signed under conditions that disadvantage low-income countries such as Mozambique, depriving the Government of tax revenues necessary to provide public goods and services such as education, health and infrastructure.

Through international schemes, large companies around the world, particularly in the extractive sector, avoid paying their share of taxes through agreements that would have been signed for the benefit of investors in the two signatory countries only.

Tax avoidance by large companies shifts the tax burden onto workers, consumers, small businesses and civil society, which contributes to global economic inequality and undermines economic and social development in countries like Mozambique. "Therefore, the main message that this research intends to convey is that Mozambique can benefit more from the foreign investment when are observed tax rules that make the world fairer, more inclusive and egalitarian", concluded Joseph Wilde-Ramsing, Director of Advocacy at SOMO.

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Treaty shopping allows tax benefits from a bilateral agreement to be shared with the world, costing millions of dollars to the Mozambican government coffers

Nelsa Langa – CDD research assistant

Presenting the main points of discussion in the research, Nelsa Langa, a research assistant at the CDD, began by promoting a reflection on the expectations surrounding the huge flow of foreign investment in Mozambique.

The discovery of natural gas reserves in the Rovuma basin attracted billions of dollars in investments from multinational companies from countries such as China, France, Italy and the United States of America. These investments have the potential to generate considerable revenue for the Mozambican government through taxes, *royalties,* and production-sharing agreements. However, as explained by Nelsa Langa, 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 the foreign investment *boom in Mozambique and contain very unfavorable conditions for the country, greatly limiting Mozambique's ability to tax the income generated by these foreign investments.*

The CDD research assistant explained that tax treaties are bilateral agreements whose original purpose was to prevent companies from being taxed twice for commercial activities that take place between the two signatory states. To avoid this, tax treaties contain provisions that distribute tax rights among the signatory states, defining under what conditions each country can tax certain cross-border income (such as dividends and interest) and at what rate.

However, currently, most countries already have provisions in their tax legislation to avoid double taxation. In the case of Mozambique, the Government already allows companies to use foreign tax credits to avoid double taxation, calling into question the relevance of these treaties today. But new agreements continue to be signed, often inspired by the idea that they would supposedly help attract foreign investment, which could offset the loss of tax revenue. However, after years of research, there is still no conclusive evidence to support this claim: for every published study that finds a positive association between tax treaties and investment in low-income countries, there is

another that does not.

The second point raised has to do with the models used in the negotiation of double taxation agreements. Currently, most tax treaties in force are based on the model developed by the Organization for Economic Cooperation and Development (OECD), which generally shifts taxing rights away from the country that receives the investment towards the country of origin of the investment. As he explained, 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.

At the same time, there is the model of the Double Taxation Convention between Developed and Developing Countries, developed by the United Nations (UN), which increased source taxing rights for low-income countries. However, despite the UN model being more favorable to low-income countries, the OECD model continues to form the basis of most double-taxation agreements between low- and high-income countries.

For example, in the case of Mozambique, its double taxation agreements largely follow the OECD model, depriving the government of significant tax rights through setting very low and/or non-existent tax rates for taxing income such as dividends, interest, *royalties* and capital gains, unfavorable definitions of permanent establishment for tax purposes, among other conditions.

Of the 10 tax treaties that Mozambique has signed, two from known tax havens stand out: Mauritius and the United Arab Emirates. As explained by Nelsa Langa, Mozambique's tax treaty with Mauritius reduces withholding rates for interest and dividends from 20% to 8% and from 20% to 5% for royalties, while the treaty with the United Arab Emirates reduces them completely to 0%.

What makes this worse is the fact that these countries, also called investment centers or *offshore financial centers*, allow multinational corporations to easily create *letterbox companies,* taking advantage of the tax treaties signed with countries like Mozambique, when, in theory, the signing of tax treaties should mean that the benefits of tax treaties only apply to a select group of investors: those based in these signatory countries.

However, in practice, through a mechanism known as *treaty shopping,* other investors from non-signatory countries take advantage of the tax benefits offered by these treaties. "This means that, by maintaining these tax treaties, Mozambique will have signed double taxation agreements with the world", she concluded.

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Mozambique must renegotiate and/or unilaterally terminate its tax treaties with the UAE and Mauritius

Jasper van Teeffelen – Researcher at SOMO

Continuing with the presentation of the main points of discussion in the research, Jasper van Teeffelen, a researcher at SOMO, made it known that tax havens are the largest sources of foreign direct investment (FDI) in Mozambique.

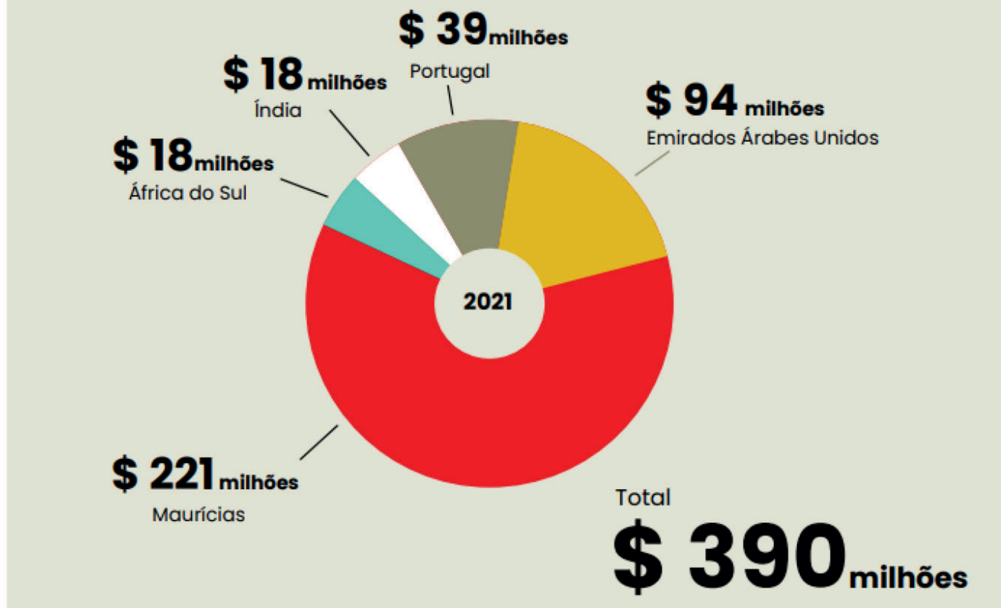
Four of the five largest sources of FDI in Mozambique are countries with which there is a tax treaty: Mauritius, United Arab Emirates, India and Portugal. Given the size of its economies and links with Mozambique, it is understood that there are a significant number of Portuguese and Indian companies investing in Mozambique. However, as explained by the SOMO researcher, this is not the case for Mauritius and the United Arab Emirates, which suggests that the large amount of investment that comes from these two countries is probably the result of treaty shopping by multinational corporations, being, therefore, Mauritius and UAE investment originating from third countries.

"The tax treaties that Mozambique signed with Mauritius in 1997 and the United Arab Emirates in 2003 are today barriers for Mozambique to tax the income and profits that are being generated by these investments. Incidentally, the benefits that these treaties bring to foreign investors represent a cost for Mozambique," he reiterated.

Using a methodology also used by the International Monetary Fund (IMF), the research presents an estimate of the value of dividend and interest payments paid on foreign direct investment from Mozambique and calculates the difference in withholding taxes that would be paid on these flows using the rate established in the national tax legislation and the tax treaty rate.

It is estimated that, in 2021, the Mozambican government lost around US$390 million as a result of reduced withholding rates on interest and dividend payments. Of this amount, 315 million dollars is the result of treaties with Mauritius and the United Arab Emirates, 7.4% of total tax revenue.

"The numbers for Mauritius are particularly high due to the extraordinary amount of foreign direct investment that entered Mozambique in 2021", ex-



plained the researcher.

At the end of his presentation, Jasper van Teeffelen advanced some research recommendations. The first consists precisely in renegotiating and/or unilaterally terminating tax treaties, particularly with Mauritius and the United Arab Emirates, to include clauses that are more favorable to the country. Countries such as Lesotho, Senegal and Zambia have successfully renegotiated their tax treaties with Mauritius.

Additionally, Mozambique needs to be cautious when signing new treaties with countries like the Kingdom of the Netherlands. Mozambique is currently negotiating a tax treaty with the Kingdom of the Netherlands, which is a tax haven with a aggressive tax treaties network and is the fifth largest source of foreign direct investment in Mozambique. It is estimated that a tax treaty with this country could cost up to around US$20 million for Mozambique.

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Revenues lost from double taxation agreements would be useful to finance social sectors such as education and health

Egas Daniel, Mozambican Association of Economists (AMECON)

In the opinion of the economist Egas Daniel, a member of the Mozambican Association of Economists (AMECON), double taxation agreements are, in fact, a part of the set of tax benefits that make up revenue losses that would be useful to meet Government expenses and finance social sectors such as education and health, which are in a very critical condition.

Commenting on the results of the research, Egas Daniel reiterated the importance of attracting foreign investment to finance the deficit of around 70% of the trade balance in Mozambique (for every 1 dollar you export, you import 3 dollars). "However, as the study showed, there is no clear scientific evidence that shows that it is these agreements that attract foreign direct investment. One of the ways to see this is from the origin of this investment. 70% come from the United Arab Emirates and Mauritius, but when we try to see what the origin of the companies that invest in Mozambique is, we will see that the original status of the holding company does not come from these countries, they only use these countries to reach Mozambique. Thus, it is just a way of avoiding taxes."

Furthermore, double taxation agreements do not convert the "70% of foreign direct investment" into revenues that are needed to finance rising expenditures. "And we cannot forget that the sector that needs greater dynamics to diversify the economy of Mozambique is the agriculture sector (which receives only 3% of FDI) and not the extractive industry sector which, by concentrating a large part of foreign investment, exposes the country to high risks", he concluded.

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