CENTRO DE INTEGRIDADE PÚBLICA

Anticorrupção - Transparência - Integridade

Fiscal Implications of Channeling Mozambique's Gas Projects Financing through Special Purpose Vehicles based in the United Arab Emirates

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Director: Edson Cortez

Peer Review: Edson Cortez, Borges Nhamirre, Gift Essinalo e Rui Mate

Propriety: CIP

Language Review: Samuel Monjane

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Maputo, May 2024

Abstract

This study critically examines the engagement of Empresa Nacional de Hidrocarbonetos (ENH), Mozambique's national oil and gas company, in financial arrangements involving Special Purpose Vehicles (SPVs), particularly considering the fiscal benefits for international gas consortia that utilize SPVs. The rerouting of loans for the Coral Sul project through an SPV located in the United Arab Emirates (UAE) is expected to result in withholding tax losses ranging from 100.7 million USD to 276.6 million USD. Moreover, our analysis indicates that guarantees issued by the gas consortium for ENH's involvement in the project financing of the Coral Sul project could reduce Mozambique's corporate income tax revenues by up to 68.9 million USD, due to the treatment of these financial guarantees as deductible expenses. The findings underscore the complex relationship between Mozambique's fiscal stability and the hydrocarbon sector's transnational financial activities, advocating for enhanced fiscal transparency and strategic policy interventions.

1. Introduction

In 2022, Empresa Nacional de Hidrocarbonetos (ENH), Mozambique's national oil and gas company, experienced a sudden and profound reduction in its reported debt. The Ministry of Economy and Finance (MEF, 2023a) documented a decrease in ENH's debt from 2.98 billion USD to just 18 million USD. This significant reduction in the debt stock was primarily attributed due to the isolation of a state guarantee for ENH for the Mozambique LNG project (Area 1) and the transfer of ENH assets and liabilities for the Coral Sul project (Area 4) to the balance sheet of a Special Purpose Vehicle (SPV) in Mozambique (IMF, 2023, 2024; ENH 2022; MEF, 2023a). According to the MEF (2023a; 2023b), the isolation of the project financing through SPVs has relieved the State from the obligation of providing guarantees for ENH, contributing to a reduction in contingent liabilities for state-owned enterprises from 22% to 4% as a percentage of GDP in 2022 compared to the previous year.[1] However, given the financiers' likely insistence on a guarantee for ENH's stake in the project financing, it appears that the state guarantee may still be in effect, albeit through the SPV. This study aims to shed light on the financial structuring through SPVs, which lack transparency, and analyzes their fiscal implications.

TotalEnergies, a French multinational, leads an oil and gas consortium and operates the Mozambique LNG project dedicated to natural gas exploration in Area 1 of the Rovuma basin, off the coast of Cabo Delgado. The final investment decision of this project was made in June 2019. ENH holds a 15% participatory interest in the Mozambique LNG project, with the investment being "carried" by its project partners (ENH, 2019; IMF, 2023).[2] Financing for the project development was secured from export credit agencies and commercial banks. The funding for the Mozambique LNG project is secured through an SPV, named Moz LNG1, incorporated in the United Arab Emirates (IMF, 2023; TotalEnergies, 2022; ONGC Videsh, 2022).[3] To support ENH's involvement in the Mozambique LNG project, the Government of Mozambique issued a guarantee amounting to 136.1 billion MZN in 2019, which was equivalent to more than 2.2 billion USD at the time (*República de Moçambique*, 2018; MEF, 2019; CIP, 2019).

In 2021, the concessionaires of the Mozambique LNG project, as per their respective stakes, provided guarantees in the amount of 14.9 billion USD for the financing agreements of the SPV based in the United Arab Emirates (PTTEP, 2021; 2022).[4] The Coral Sul project, located in Area 4 of the Rovuma basin, is operated by the Italian energy company Eni. The oil and gas consortium of the Coral Sul project comprises the Mozambique Rovuma Venture, with a 70% stake (including Eni, ExxonMobil, and CNPC), as well as KOGAS, Galp, and ENH, each holding a 10% stake (ENH, 2019). Project funding is also facilitated through an SPV, the Coral South FLNG DMCC established in the United Arab Emirates (IMF, 2023). The financing mix for ENH's 10% stake in the Coral Sul project comprises 70% debt finance and 30% equity finance, with the equity finance portion being supported on a proportional basis by the concessionaires through a "carry" arrangement (ENH, 2023).

To finance its participation in the Coral Sul project, ENH secured a loan of approximately 500 million USD for capital expenses and another loan of up to 640 million USD for servicing its debt share (Eni, 2017). In accordance with their participatory interests, the project's international consortium members have issued guarantees for ENH's share of the project financing through the SPV, Coral South FLNG DMCC (Galp, 2022; Eni 2022). This study reveals that the provision of these guarantees by the oil and gas consortium increases the consortium's recoverable costs and, consequently, decreases

1 *"In 2022, the State's exposure to guarantees decreased by 13% of GDP compared to 2021, explained by the restructuring of the financing lines for ENH's Special Purpose Vehicle (SPV) projects, for which the guarantee coverage is not attributable to the State as guarantor. The creation of SPVs for specific ENH projects eliminated the State's responsibility to provide a guarantee on debt previously held by ENH."* (Author's translation, MEF, 2023b, p. 22).

2 TotalEnergies operates Mozambique LNG with a 26.5% participating interest alongside Mitsui E&P Mozambique Area 1 Ltd. (20%), ENH Rovuma Área Um S.A. (15%), ONGC Videsh Ltd. (10%), Beas Rovuma Energy Mozambique Limited (BREML) (10%), BPRL Ventures Mozambique B.V. (10%), and PTTEP Mozambique Area 1 Limited (8.5%) (TotalEnergies, 2019; ONGC Videsh 2023).

3 The consortium's shares in Moz LNG1 Holding Company Ltd, established in the Abu Dhabi Global Market, are proportionately held by the members of the Mozambique LNG project. For instance, TotalEnergies possesses a 26.5% stake in Moz LNG1 Holding, while ONGC Videsh has a direct 10% share and an additional indirect 6% share through its susbsidiary BREML. Furthermore, Moz LNG1 Holding Company Ltd is the sole shareholder of Moz LNG1 Financing Company Ltd, which is also established in the United Arab Emirates (TotalEnergies, 2022; ONGC Videsh, 2022).

4 TotalEnergies issued 4.6 billion USD in guarantees to support the financing of the Mozambique LNG project (TotalEnergies, 2021; 2022). Given that TotalEnergies' proportional share of project funding amounts to approximately 3.9 billion USD (26.5% of the project financing of 14.9 billion USD), the excess amount could theoretically proportionally cover ENH's share of the financing. However, TotalEnergies has not specified that this coverage is intended for ENH, nor has ENH confirmed receiving such coverage.

Mozambique's corporate income tax revenues.[5] This study underscores the fiscal implications and illustrates the financial trade-offs involved in the issuance of contingent liabilities.

Based on its financial statements, ENH's liabilities amounted to 1,195 million USD (78 billion Meticais) by the end of 2022, covering both the carried amount for Area 4 and the Development Loan Agreement (DLA). A letter from ENH to CIP, dated 9 April 2024, indicates that the Ministry of Mineral Resources and Energy (MIREME) approved the restructuring of this debt through an SPV in Mozambique on 6 June 2019. Although the transfer of ENH's debt to the SPV has not yet been fully completed and depends on the ongoing project implementation, ENH anticipates that the finalization will occur soon.

The projections of the MEF (2018) highlighted that initial revenues of the Coral Sul project are earmarked for debt reimbursement related to equity carry financing during exploration and development phases. Notably, the MEF's study anticipates withholding taxes as significant revenue sources, alongside corporate income tax, the government's profit share from LNG production, royalties, and production bonuses.

During a shareholder meeting, Eni (2019) asserted that the SPV was created solely to secure third-party project financing, with the implication that no shareholder funds would be directed through the UAE-registered entity. The rerouting of Coral Sul project loans through the UAE enables the oil and gas consortium to benefit from the UAE's policy of no withholding tax on interest payments. Utilizing the double taxation treaty between Mozambique and the UAE signed in 2003, the hydrocarbon companies can bypass the withholding tax of 20% on interest that would otherwise apply within Mozambique (United Arab Emirates, 2024; Hearson, 2021). While the international oil and gas consortium has an incentive to leverage SPVs to optimize financial arrangements and minimize tax liabilities, the benefits for ENH, a state-owned company, remains unclear. This study quantifies the loss in withholding taxes due to the rerouting of the ENH Coral Sul loans to the SPV in the UAE.

Our study reinforces existing research on the fiscal resource curse, emphasizing the hydrocarbon sector's potential to undermine fiscal stability. Masi et al. (2024) highlight that oil and gas, as point-source resources, can have stronger detrimental effects than some hard-rock minerals, which, due to their labor-intensive extraction, can benefit a wider segment of the population. Mosca (2024) emphasizes the hydrocarbons sector's limited employment creation and value addition in Mozambique, amidst a context of favorable conditions for hydrocarbon companies and low economic diversification. Ross (2015) and Overy and Ribeiro (2024) point out that resource wealth often enriches corrupt elites instead of benefiting the wider population, exacerbated by weak governance structures. Frynas and Buur (2020) explore the concept of the 'presource curse', illustrating how the expectation of resource revenues can lead to adverse socio-economic and political effects prior to the commencement of extraction, especially in countries with high levels of national debt. This discussion sheds light on the behavioral dimensions of the resource curse and its early manifestations, such as the conflict in Cabo Delgado, underscoring the curse's far-reaching and anticipatory effects (also compare CIP, 2023b). Lastly, Masi et al. (2024) argue that strong political institutions with the power to limit executive authority can mitigate these negative effects, suggesting that robust governance is essential for harnessing natural resources without sacrificing fiscal health.

The remainder of this paper is organized as follows: Section 2 delineates the fiscal costs and trade-offs associated with assigning guarantees for ENH. Section 3 underscores the fiscal repercussions of rerouting ENH's Coral Sul project loans through an SPV in the United Arab Emirates. Finally, Section 4 summarizes the main findings and provides policy recommendations to enhance public sector transparency.

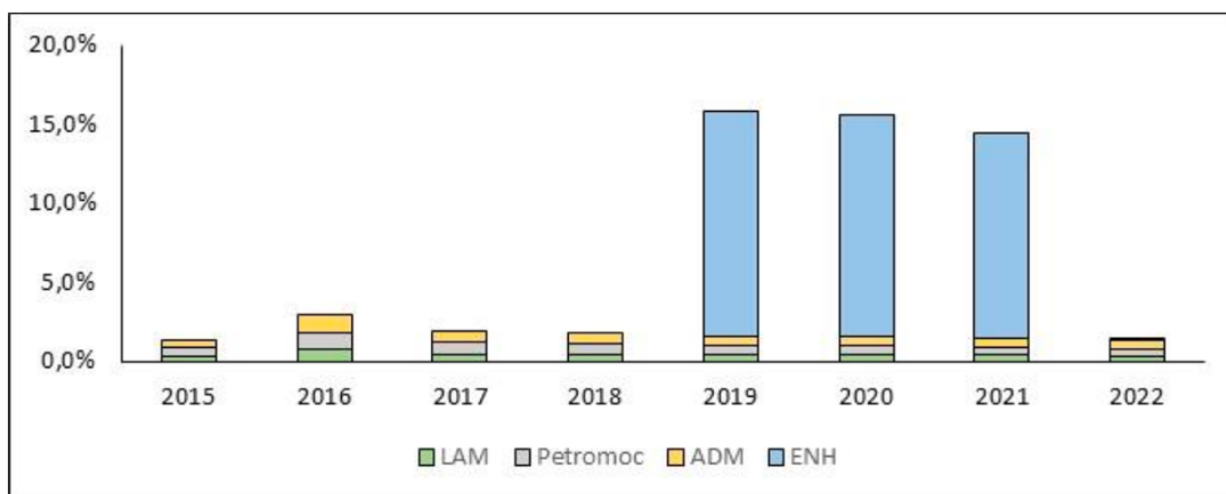
5 In each year, the cost recovery mechanism allows the oil concessionaires to recover 65% of net revenues at Area 1 and 75% at Area 4 (*República de Moçambique*, 2006; MEF, 2018).

2. Guarantees for ENH's project financing

2.1 Change in reported guarantees for ENH's participation in the Mozambique LNG project

The Ministry of Economy and Finance (2023a; 2023b) reported a 13-percentage point reduction in the state's exposure to guarantees as a proportion of GDP in 2022 compared to the previous year, as illustrated in Figure 1. The MEF attributes this reduction to the isolation of project financing for the Mozambique LNG project through an SPV, thereby influencing the state's obligation to provide guarantees for ENH's debts. Despite this financial restructuring and the intended ring-fencing of the project, concerns persist regarding the continuity of the state guarantee for ENH. An anonymous yet well-informed senior industry insider contends that the state guarantee for the project's financing remains in effect. Based on our assessment, unless the international oil and gas consortium formally takes over these guarantees, the state's guarantees for ENH are likely still in place.

Figure 1 Guarantees for state-owned enterprises (% of GDP)



Source: MEF (2023b)

The decision to isolate project financing through SPVs may be influenced by both fiscal and political considerations. The financial restructuring suggests a more favorable debt profile for the country, potentially facilitating access to loans and being more attractive to foreign direct investment by making Mozambique's debt levels appear lower, without actually altering the state's underlying contingent liabilities. This situation underscores the complex interplay between the government's fiscal strategies, political objectives, and the international perception of Mozambique's fiscal stability.

During an industry-government dialogue hosted by the International Energy Agency (IEA), Patrick Pouyanné, CEO of TotalEnergies, questioned strict IMF debt rules regarding the issuance of state guarantees for risky energy projects and argued that African governments frequently refrain from providing state guarantees due to instructions from the IMF (Hernandez, 2024). The CEO also mentioned cases where international financiers ask for relatively higher state loan guarantees than those provided by private companies, leading TotalEnergies to self-insure projects to avoid burdening governments with additional debt.

For the Mozambique LNG project in Area 1, the Mozambican government has issued guarantees for ENH's proportional financing. Meanwhile, for the Coral Sul project in Area 4, the international gas consortium provides guarantees for ENH's participation in the project financing. These private guarantees impact Mozambique's corporate income tax revenues by increasing the deductible expenses of the companies issuing them. The remainder of Section 2 aims to analyze the circumstances under which issuing state guarantees for ENH's project financing would be fiscally more beneficial, and when it would be preferable to have financing guarantees issued by the international oil and gas companies on behalf of

ENH.

2.2 Fiscal costs of guarantees by the international gas consortium for ENH's participation in the Coral Sul project

As part of the financing for the Coral Sul project, the oil and gas consortium has issued guarantees on behalf of the SPV, Coral South FLNG DMCC (Eni 2022). Proportional to their participatory interests, the consortium members, excluding ENH, have provided guarantees for ENH's 10% stake in the project financing. For instance, the annual report of the consortium member Galp (2022) reveals that it has guaranteed 1/9 (which corresponds to 10% of the remaining 90%) of the Debt Service Undertaking (DSU) for ENH's share in the Coral Sul FLNG project financing, equating to 48 million EUR as of 31 December 2022. Consequently, the estimated total guarantee provided by the international consortium for ENH's stake in the Coral Sul project financing is approximately 432 million EUR in 2022 (equivalent to roughly 468.9 million USD).[6]

The issuance of loan guarantees for ENH's 10% stake in the Coral Sul project by the international consortium carries important fiscal implications. By assuming these guarantees, the oil and gas consortium's recoverable costs increase, leading to a decline in corporate income tax revenues. This occurs as the consortium can recognize the assumed guarantees at their fair value as an expense, thereby lowering its taxable income and deferring corporate income tax payments. While this offers financial leverage for the gas consortium, it concurrently affects Mozambique's public revenues at a time of high fiscal need. This subsection explores the fiscal trade-offs and potential repercussions of issuing guarantees on behalf of ENH.

While the assumption of guarantees by the international hydrocarbon companies reduces the government's risks, it is accompanied by deferred and potentially lost tax revenues. The decline in corporate income tax revenues is dependent on the accounted value of the guarantee and the applicable corporate income tax rate. A financial guarantee serves as a risk mitigation tool by assuring payment in case of the debtor's default, thus generating a contingent liability for the guarantor. When a guarantor issues a guarantee without receiving a premium—as is the case with the oil and gas consortiums' coverage for ENH's participation in the Coral Sul project—the guarantee can be recognized as an expense at its fair value at the time of issuance. The valuation of the guarantee involves comparing the Net Present Value (NPV) of expected cash flows under both guaranteed and non-guaranteed scenarios, essentially assessing the difference in cash flows with and without a guarantee. This approach quantifies the economic advantage of decreased risk exposure for the beneficiary, which is pivotal in evaluating guarantees where no premium is exchanged, including intra-group and affiliated party guarantees (Goodman, 2016; PTTEP, 2022). The fair value of the guarantee thus reflects its financial benefit to ENH:

$$\textit{Fair value of guarantee} = NPV_{\textit{without guarantee}} - NPV_{\textit{with guarantee}}$$

To estimate the fair value of the guarantees issued on behalf of ENH, we consider the following scenario: The international consortium provides the guarantees for ENH without imposing any charges, and for simplicity, repayments are structured over 15 years post-development using equal annual annuities.[7] For the Coral Sul development phase, ENH's debt carries an interest rate of 8.7% per annum until fully paid (IMF, 2023; ENH, 2022). These terms are contrasted with an interest rate of 18.32%, which represents the average yield of Mozambique's treasury bonds in 2023 (BVM, 2024). This rate is used to reflect the potential public borrowing costs that the state-owned enterprise ENH could face in the absence of the consortium's guarantee, aligning with the government's rates for domestic borrowing in 2023.[8]

6 The conversion rate from EUR to USD used in this section was taken from the *Banco de Moçambique* (2024) on 9 April 2024.

7 For details on ENH debt repayments, refer to IMF (2023, 2024). According to the IMF, ENH's debt repayments for the exploration and development phases are deducted directly from LNG project revenues. For the Coral Sul project, 90% of ENH revenues after deducting operational costs are used to pay off its project debts, while for the Mozambique LNG project 80% of ENH revenues are used. For both projects, any debt remaining will be allocated to debt settlement after 15 years, or upon reaching a predetermined financial threshold.

8 The interest rate for Mozambique's treasury bonds ranged between 16% and 19% across nine series issued in 2023 (BVM, 2024).

Table 1 presents the estimated fair values of the financial guarantees among the international consortium members of the Coral Sul project, based on their participatory interests. It illustrates how the fair value attributable to the guarantee on behalf of ENH could be recognized as an expense by each consortium member.[9] Overall, the fair value of the guarantee, which is eligible for expense recording by the consortium, is estimated at 215.3 million USD (equivalent to approximately 198.4 million EUR).

Table 1 Estimated recoverable guarantee expenses

Company	Participatory interest	Fair value of guarantee for ENH (in million USD)
Eni	25%	59.8
ExxonMobil	25%	59.8
CNPC	20%	47.8
KOGAS	10%	23.9
GALP	10%	23.9
Total	**90%**	**215.3**

The recognition of the financial guarantee's fair value as an expense by the consortium diminishes Mozambique's corporate income tax ***(Imposto sobre o Rendimento das Pessoas Colectivas, IRPC)*** revenues. Mozambique applies a standard IRPC rate of 32% on net profits after allowable expense deductions. To encourage foreign direct investment, a preferential IRPC rate of 24% for the initial eight years of production has been negotiated by the oil and gas consortium (***República de Moçambique,*** 2006). Consequently, with the financial guarantee expense surpassing 215 million USD, Mozambique could see a considerable decline in corporate income tax revenue, estimated to range from about 51.7 million USD under the reduced IRPC rate to 68.9 million USD under the standard rate.[10] This highlights the profound fiscal implications of recoverable guarantee expenses by the oil and gas consortium.

9 The valuation reflects the fair value at the time of the transfer. At each subsequent reporting date, the financial guarantee would be measured as the higher of (1) the amount of the loss allowance (expected credit loss based on the probability of default by the borrower) and (2) the amount initially recognized as the fair value less the cumulative amount of income recognized (IFRS, 2021).

10 The application of the standard or reduced tax rate will depend on when Coral Sul project begins to generate profits, as the reduced IRPC rate is applicable only for the first eight years of production.

Box 1. Trade-off between default risks and tax revenues for the government.

In a simplified illustrative comparison, the Mozambican government's decision to refrain from providing state guarantees could be beneficial if the anticipated financial repercussions of a potential credit default by ENH exceed the expected loss in corporate income tax (IRPC) revenues due to the deductible guarantee expense:

Expected credit loss > Expected revenue loss

$$\text{Probability of default} \times \text{Loss given default} \times \text{Guaranteed amount} > \text{Fair value of guarantee} \times \text{IRPC rate}$$

$$\text{Probability of default} > \frac{(\text{Fair value of guarantee} \times \text{IRPC rate})}{(\text{Loss given default} \times \text{Guaranteed amount})}$$

Using the IRPC rate of 32% and assuming no loss recovery upon default, the simplified comparison suggests that refraining from state guarantees is favorable for the government if the probability of ENH defaulting exceeds 14.7%. At a reduced IRPC rate of 24%, it becomes beneficial to refrain from issuing state guarantees if the default probability exceeds 11%. Thus, the decision to refrain from providing guarantees largely depends on the government's assessment of significant credit default risk by ENH.

An increase in the valuation of the guarantee raises the fiscal costs associated with private guarantees due to the enhanced deductible costs for the consortium. When Mozambique's non-concessionary domestic borrowing rates significantly exceed those available to the international consortium, the fiscal costs associated with private guarantees for ENH increase and the provision of state guarantees becomes relatively more attractive, everything else equal.

Note: The illustrated comparison offers a simplified view of the government's trade-offs. It assumes risk neutrality, treats the probability and guarantee values as exogenous, and considers the tax loss to be permanent, while disregarding potential impacts on the government's reputation, as well as other inter-temporal and fiscal constraints.

The government's decision to refrain from providing state guarantees for ENH for the Coral Sul project could be implicitly based on an assessment of significant credit default risk by ENH, as illustrated in the simplified comparison provided in Box 1. High domestic borrowing costs in Mozambique escalate the fiscal costs associated with the provision of private guarantees. This is because increased interest rates affect the fair valuation of the guarantee, thereby influencing the deductible expense amount for the consortium.

The recognition of financial guarantee expenses by the consortium may not only defer corporate income tax revenue for Mozambique but can also lead to irreversible fiscal shortfalls. Permanent CIT revenue losses could arise from a range of scenarios: the project's unprofitability, an escalation in deductible expenses, or production stoppages due to force majeure related to conflict. The World Energy Outlook by the IEA (2023) projects that new LNG projects around the world are set to add 250 billion cubic meters per year of liquefaction capacity by 2030, which is equal to almost half of today's global LNG supply. Due to the expected global decline in LNG demand after 2030, there is the prospect of lower gas prices, influencing the long-term profitability of LNG projects. These market developments are particularly relevant for Mozambique, because most of its LNG revenues are expected later in the project cycles. These circumstances, resulting in either delayed or completely lost tax revenues, place considerable pressure on Mozambique's fiscal stability, already burdened by significant public debt and high interest payments.

The assumption of financial guarantees by international oil and gas companies, even after its potential expiration, provides the companies with notable financial benefits by having enabled deferred tax payments. Such deferrals not only grant the consortium financial leverage by postponing corporate income tax liabilities but can also indirectly impact government revenues through the *R-factor*. This ratio, which reflects cumulative revenues against cumulative costs, dictates the profit-sharing schedule between the government and the oil and gas consortium. After the consortium recovers its initial costs, profits are divided according to a pre-agreed profit-sharing factor. The tax deferrals resulting from the deductibility of guarantee expenses delays the achievement of higher *R-factors*, consequently postponing more favorable profit-sharing outcomes for the government.

2.3 Fiscal implications if the guarantee for ENH's participation in Mozambique

LNG was assumed by the international consortium

Unlike the Coral Sul project, where the international oil and gas consortium provides guarantees on behalf of ENH, the Mozambican government provided guarantees for ENH's project financing in the Mozambique LNG project. This subsection shows the potential fiscal implications if the international consortium were to assume this responsibility.

If the international consortium were to assume the guarantee for ENH's 15% stake in the Mozambique LNG project, valued at approximately 2.2 billion USD, there would be significant fiscal consequences. Such a transfer of guarantees would increase the consortium's deductible costs, leading to a substantial decrease in Mozambique's corporate income tax revenues. The total fair value of the guarantee, which would be eligible for expense recording by the consortium, is estimated at approximately 1,578.7 million USD.[11] Consequently, Mozambique could experience a considerable decline in corporate income tax revenue, estimated to range from about 378.9 million USD under the reduced IRPC rate to 505.2 million USD under the standard rate, if the international consortium were to assume the guarantees for ENH's financing for the Mozambique LNG project. Therefore, a potential assumption of guarantees for ENH by the international consortium would come with high fiscal costs and would hinge on the government's assessment of significant credit default risk by ENH. Given the high deductible expenses associated with the international consortium providing loan guarantees for ENH, these fiscal considerations are crucial in negotiating financing agreements for other gas projects, such as the Rovuma LNG project.[12]

3. Fiscal costs of rerouting ENH's Coral Sul loans through an SPV in the UAE

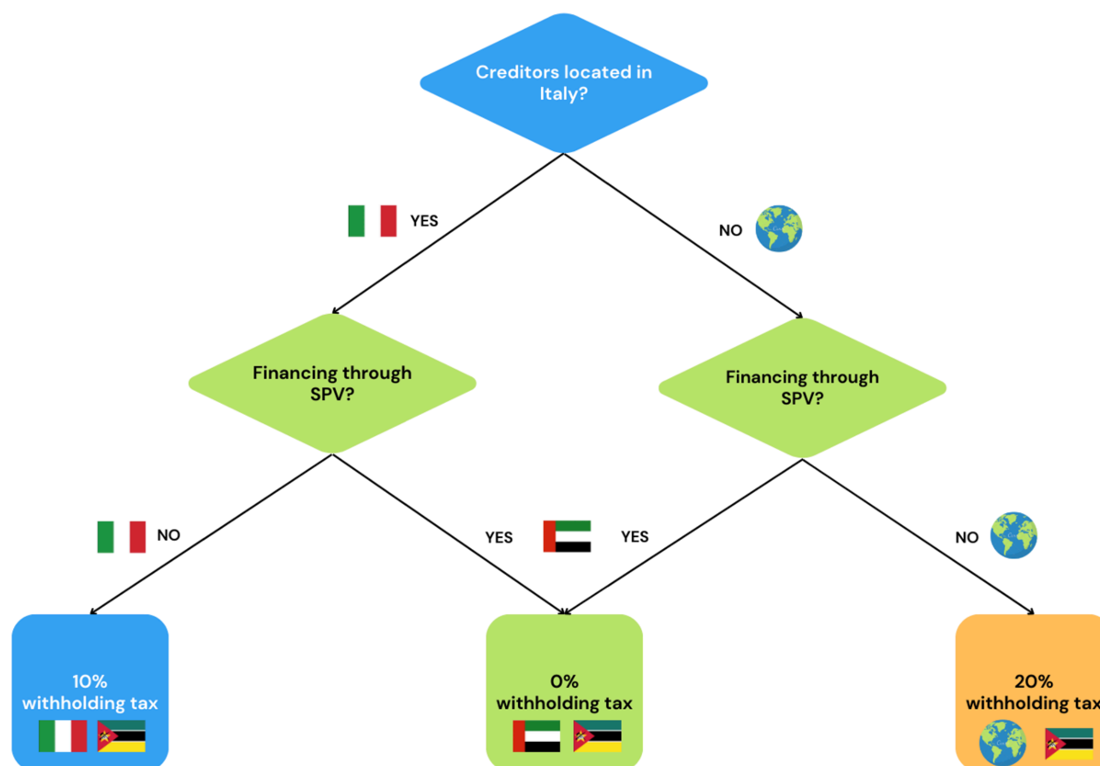
This section estimates the fiscal impact of rerouting ENH's loans related to the Coral Sul project through an SPV in the United Arab Emirates. This financing structure, motivated by the double taxation treaty between Mozambique and the UAE signed in 2003, enables the multinational oil and gas companies to bypass withholding tax on interest, causing a significant loss in tax revenues.

Van Teeffelen and Kiezebrink (2023) outline that the Coral Sul project has secured financing from export credit agencies and commercial banks located in South Korea (accounting for 38.3% of total project finance), China (37.2%), Italy (14.9%), and France (9.6%). Interest payments on direct financing from South Korea, China, and France is generally subject to a 20% withholding tax rate. In contrast, interest payments on direct financing from Italy is generally subject to a reduced withholding tax rate of 10% due to a double taxation agreement between Mozambique and Italy (Hearson, 2021). However, with project financing rerouted through an SPV in the United Arab Emirates, interest payments are subject to a 0% withholding tax rate (as illustrated in Figure 2).

11 To estimate the fair value of the guarantee associated with ENH's stake in the Mozambique LNG project, we assume debt repayments will commence in 2029, following the anticipated completion of the project's development phase (refer to CIP, 2023b). According to the project's financing structure, ENH's 15% stake in Area 1 resulted in a debt of 2,235 million USD. This debt carries an annual interest rate of 9% until one-year post-development, which then increases to 13% until full repayment, as reported by the IMF (2023). The remaining assumptions are consistent with those in the previous section.

12 External factors, such as regional stability, can also influence the issuance of private or public guarantees to secure and access project financing. A delay in the funding of the Mozambique LNG project by the Export-Import Bank of the United States (US EXIM), however, has been largely attributed to the conflict in the Cabo Delgado region rather than being associated with guarantees (Africa Intelligence, 2024).

Figure 2 Potential withholding tax rates for ENH loans



In a manner similar to ENH's project financing, the oil and gas consortium circumvents withholding tax on interest for ENH's 10% equity-financed stake in the Coral Sul project. The location of the affiliated creditor thus determines the applicable withholding tax rate. Eni Spa (registered in Italy), ExxonMobil Development Afrika BV (registered in the Netherlands), and CNODC Dutch Cooperatief UA (registered in the Netherlands) have established Mozambique Rovuma Venture SpA in Italy, which holds a 70% participatory interest in the Coral Sul project (ENI, 2022; Van Teeffelen and Kiezebrink, 2023). Direct interest payments from Italy would incur a withholding tax of 10% due to the double taxation agreement between Italy and Mozambique. Meanwhile, the other shareholders, Galp Energies Rovuma BV and KG Mozambique Ltd, registered in the Netherlands and the Marshall Islands respectively, would typically face a statutory withholding tax rate on interest of 20%.[13] Nonetheless, by routing financing through an SPV in the United Arab Emirates, the consortium ensures that affiliate financing for ENH, regardless of the source country, benefits from a 0% withholding tax rate.

Under the structure of 70% debt project financing and 30% affiliate equity financing (ENH, 2023), the average withholding tax rate on interest would be approximately 16.6% in the absence of an SPV.[14] In contrast, channeling payments through a UAE-based SPV reduces the rate to 0%. Utilizing this discrepancy and following Hubert's (2019) general framework as well as the following assumptions, we estimate the withholding tax loss on interest payments arising from the redirection of ENH's financing through the United Arab Emirates.[15] The interest rates applied to ENH's loans during the exploration phase were initially based on the London Inter-Bank Offered Rate (LIBOR) plus one percent (*República de Moçambique*, 2019). After the phase-out of LIBOR in 2022, these rates transitioned to the Secured Overnight Financing Rate (SOFR), in line with the global switch from LIBOR to SOFR (TotalEnergies, 2022). Data for LIBOR and SOFR rates are sourced from MarketWatch (2024) and the Federal Reserve Bank of New York (2024), respectively. For the Coral Sul development phase, ENH's debt carries an interest rate of 8.7% p.a. until fully paid (IMF, 2023). As ENH debt repayments are structured to be deducted directly from LNG revenues through the available cashflow, oil and gas prices influence potential revenues from withholding taxes. Our base price scenario is built on a Brent crude oil price of 70 USD per barrel (bbl), while

13 Van Teeffelen and Kiezebrink (2023) point out that the registration of consortium members in the Netherlands and Marshall Islands is likely due to the limited disclosure requirements in these countries.

14 For the debt project financing part, which is 70% of the total financing, the interest payments would attract a 10% withholding tax rate for the portion coming from Italian creditors, representing 14.9% of the project financing. For the affiliate equity financing, which accounts for the 30% of the total financing, the interest payments would incur a 10% withholding tax for the part financed through the Italy based Mozambique Rovuma Venture (applicable to 70/90 of ENH's equity financing due to Mozambique Rovuma Venture's 70% stake and ENH's 10% stake). The remaining portion of the financing would be subject to the standard 20% withholding tax rate:

15 The model by Hubert (2019) was prepared by Resources for Development Consulting for Oxfam by Don Hubert and Gordon Kirkwood.

$$t_{average} \approx Project\ fin\left[ITA_{Project\ fin} \times t_{ITA} + (1 - ITA_{Project\ fin}) \times t_{Standard}\right] + Affiliate\ fin\left[ITA_{Affiliate\ fin} \times t_{ITA} + (1 - ITA_{Affiliate\ fin}) \times t_{Standard}\right]$$

$$t_{average} \approx 70\%\ [14.9\% \times 10\% + (1 - 14.9\%) \times 20\%] + 30\% \left[\frac{70}{90} \times 10\% + \left(1 - \frac{70}{90}\right) \times 20\%\right]$$

$$t_{average} \approx 16.6\%.$$

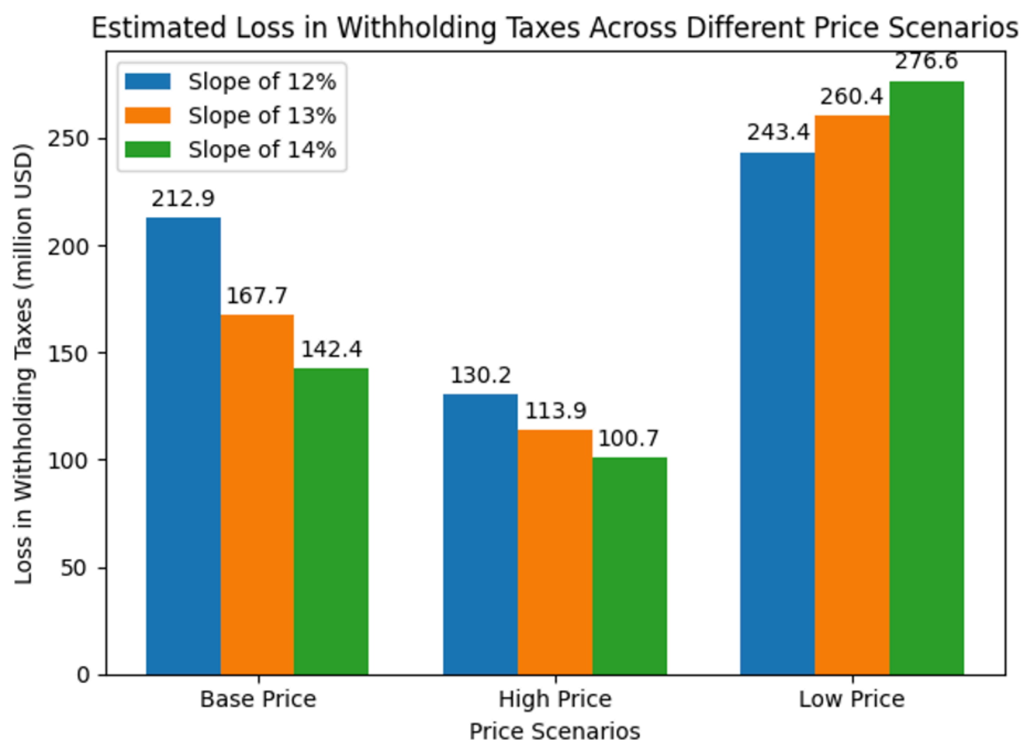
high- and low-cost scenarios are based on prices of 85 USD and 55 USD bbl, respectively. We then calculate LNG prices with oil-linked slopes ranging from 12% to 14%, which equate to LNG prices of 8.4 USD to 9.8 USD per million British thermal units (mmbtu) in the base price scenario.[16]

Our estimations in Table 2 show that at a baseline oil price of 70 USD per barrel, the government is anticipated to lose revenue from withholding taxes ranging between 142.4 million USD and 212.9 million USD, a direct consequence of routing Coral Sul loans through the SPV.

Table 2 Estimated loss in withholding taxes due to rerouting of ENH's Coral Sul loans through the UAE-based SPV (in million USD)

	Base Price 70 USD/bbl	High Price 85 USD/bbl	Low Price 55 USD/bbl
Oil-gas slope of 12%	212.9	130.2	243.4
Oil-gas slope of 13%	167.7	113.9	260.4
Oil-gas slope of 14%	142.4	100.7	276.6

Figure 2 Estimated loss in withholding taxes due to rerouting of ENH's Coral Sul loans through the SPV (in million USD)



In scenarios of lower oil and gas prices, the fiscal impact significantly worsens. Under such adverse conditions, the estimated loss in withholding tax attributable to the routing of loans through the SPV could escalate to about 260.4 million USD. This increase is largely due to ENH's prolonged loan repayment period, which stems from reduced cash flow caused by lower LNG revenues from depressed market prices. Specifically, in a low gas price environment, ENH is faced with significant delays in repaying its loans, incurring higher interest due to the extended repayment period.[17] On the other

16 The slope of oil-linked LNG contracts describes how much the gas price changes relative to a change in the oil price. See S&P Global (2023) for a discussion about typical slopes of LNG contracts.

17 In our simulations, ENH is not anticipated to be profitable over the lifetime of the Coral Sul project under low oil and gas price scenarios. As a

hand, under higher gas price scenarios, ENH's loan repayment capacity is less restricted, leading to faster repayment and, thus, lower interest accrual. Nonetheless, the withholding tax losses on interest payments due to ENH's maneuver remain considerable, estimated at around 113.9 million USD under high LNG price conditions.

In general, slower loan repayment capabilities by ENH lead to an accumulation of more interest over time, escalating the potential withholding tax liabilities.[18] Normally, these higher withholding tax revenues would mitigate some of the impacts of reduced corporate income tax revenues from the multinational oil and gas companies and the high interest expenses ENH incurs resulting from unfavorable market conditions. Therefore, the rerouting of loans through the SPV not only reduces government revenues but also amplifies fiscal risks. It increases of loans through the SPV increases the government's vulnerability to low gas price conditions, directly affecting its ability to generate revenue from withholding taxes and thereby exacerbating the financial strain during periods of adverse market situations and economic downturn.

result, ENH's cash flow would be insufficient to repay the full loan amount. Under low oil prices, the withholding tax loss on ENH's loans is higher with a lower oil-gas slope compared to higher slopes, due to ENH's inadequate cash flow for repaying the full development loan. For example, ENH's projected aggregate project cash flow stands at a negative 54.1 million USD with a contract slope of 12%, in contrast to a negative 5 million USD with a slope of 14%. This indicates that the total fiscal loss for the government, encompassing both ENH's project loss and the loss in withholding taxes due to the rerouting of ENH's Coral Sul loans, is higher under lower oil-gas slopes than under higher ones – as expected.

18 For instance, IMF (2023) points out that if ENH's debt service related to the Coral Sul project is solely carried from the Coral Sul production and if there are further delays in the resumption of the Mozambique LNG project, ENH is likely to face a negative cash flow balance.

3. Conclusion and recommendations

This study highlights the fiscal costs of the provision of guarantees for ENH's participation in LNG projects by international companies, particularly overlooked in previous considerations of ENH's financing. The analysis reveals a considerable erosion of Mozambique's corporate income tax revenues, estimated to be between 51.7 million USD and 68.9 million USD, due to the treatment of financial guarantees for ENH as deductible expenses by multinational oil companies involved in the Coral Sul project.

Furthermore, the strategic reallocation of Coral Sul project financing to a UAE-based SPV, incentivized by the double taxation treaty, further intensifies the depletion of Mozambique's projected tax revenues, with estimated withholding tax losses between 100.7 million USD and 276.6 million USD. The rationale for ENH, a state-owned entity, partaking in such financial structures remains unclear, amidst evident incentives for international consortia to utilize SPVs for fiscal advantages. This strategic circumvention of Mozambique's withholding tax via SPV structures suggests wider fiscal implications. This necessitates a call for improved transparency regarding financial maneuvers by both multinational firms and the ENH, alongside strategic policy measures aimed at preserving Mozambique's fiscal interests.

In response to the challenges related to Mozambique's hydrocarbons sector, the following policy recommendations are proposed to safeguard fiscal health, and ensure sustainable development:

- **Enhance Transparency and Oversight:** Oversight mechanisms should be strengthened to monitor transactions involving Special Purpose Vehicles (SPVs) in tax havens more closely, ensuring transparent reporting and auditing processes that safeguard the integrity of Mozambique's fiscal policies and guard against the erosion of its tax base.

- **Strengthen Political Institutions:** Robust political frameworks, including an independent Court of Audit, should be established to check executive power and prevent the misallocation of resource revenues. This will enhance regulatory capacity and promote accountability among all stakeholders.

- **Mitigate the Fiscal Resource Curse:** Fiscal resilience should be improved, and strategies aimed at diversifying the economy should be developed to lessen strong reliance on the hydrocarbons sector. Investment in sectors that offer widespread economic and social benefits and that create local jobs is crucial for sustainable development.

- **Regular Reporting on ENH's Debt and Production Data:** To foster transparency and enhance fiscal planning, the Ministry of Economy and Finance, along with ENH, should follow the International Monetary Fund's (2024) guidelines and publish quarterly updates on ENH's debts, repayments, interest accumulations, debt term modifications, balances of state guarantees, as well as production data and financial performance of LNG projects.

- **Address Potential Fiscal Loopholes:** Tax treaties that may facilitate tax avoidance should be evaluated and, where needed, renegotiated tax, ensuring that multinational entities contribute fairly to Mozambique's tax revenues. Closing loopholes in existing double taxation agreements and being cautious about entering into new ones are vital measures to prevent profit shifting and base evasion.

By adopting these recommendations, Mozambique can enhance its fiscal stability and ensure that its natural resource endowments contribute positively to sustainable development and the well-being of its citizens.

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