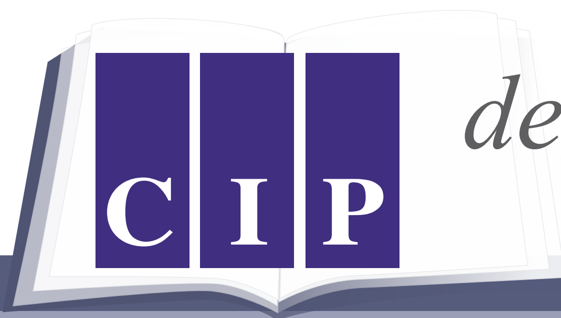

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Taxing "Capital Gains" in Mozambique's Extractive Sector

The largest tax payments in Mozambique's history have been assessed amidst extra-ordinary uncertainty. Prior to 2012, transactions worth tens of millions of dollars were not taxed. This changed after the sale of Riversdale to Rio Tinto. But application since that time has also been inconsistent. Revenues from capital gains taxes exceed $1 billion, but these are "one-off" payments that companies will claim back when production begins. The revenues seem large now, but are small in comparison the possible benefits from renegotiating core terms (such as royalties) in the very generous Rovuma contracts.

Inconsistent Application of the Capital Gains Tax

The defining moment for capital gains taxation in Mozambique's extractive sector was the 2011 sale of Riversdale coal concessions in Tete. The seller was a small exploration company called Riversdale, the buyer was the global mining Rio giant Tinto, and the sale price was approximately 4 billion dollars. Prior to that sale, there had been no significant discussion of capital gains taxation on extractive sector companies and no evidence of a capital gains tax being imposed on an international company.

The lack of early attention to the question of capital gains is surprising, given that the transfer of stakes from companies focused on exploration to companies focused on production are common (see discussion below on "junior" mining companies). It is also surprising because there had been many transactions prior to the Riversdale sale, several valued in the tens of millions of dollars (See Table 1).

The relevance of a capital gains tax in Mozambique was also largely ignored in analyses of the fiscal terms governing extractive sector companies. The IMF's 80-page review of Mozambique's fiscal regime for mining and petroleum, prepared in 2007, devotes only a footnote to the question of capital gains: "The CIT code is written so that gains and losses on capital transactions are treated as part of income for tax purposes."[1] Guidance on the legal framework governing the mining sector, written in 2010 by the leading law-firm in Mozambique, Sal and Caldeira, makes no mention of a capital gains tax for companies (though they do reference the obligation for individuals).[2]

Even after the public discussion surrounding the Riversdale sale, it is clear that investors did not expect a capital gains tax to be imposed on future transactions. When the Government of Mozambique announced that there would be a capital gains tax imposed on the Cove Energy sale, the companies stock price fell by more than 8%.[3]

Table 1: Extractive Sector Transactions & Capital Gains

Riversdale Coal Concessions

Period of Ownerships	Proportion of Gain Taxed	Effective Tax Rate
Less than 12 months	75%	24%
Between 12-24 months	60%	19.2%
Between 24-60 months	40%	12..8%
More than 60 months	30%	9.6%

Rovuma Area 1 – Anadarko Transactions

Seller	Buyer	Date	Stake (%)	Value	Tax
Anadarko	Artumas	2007	8.5%	?	?
Anadarko	Mitsui	2007	20%	?	?
Anadarko	Videocom	2008	10%	$75m	?
Anadarko	BPRL	2008	10%	$75m	?
Anadarko	OVL	2013	10%	$2.64b	$520m

Rovuma Area 1 – Secondary Transactions

Seller	Buyer	Date	Stake (%)	Value	Tax
Artumas	Cove Energy	2007	8.5%	?	?
Cove Energy	PTT	2007	8.5%	$1.56b	$175.8m
Videocom	OVL	2013	10%	$2.15	$227m

Rovuma Área 4 - ENI East Africa

Seller	Buyer	Date	Stake (%)	Value	Tax
ENI East Africa	GALP	2006	10%	?	?
ENI East Africa	KOGAS	2006	10%	?	?
ENI East Africa	CNCP	2013	20%	$4.1bn	$400m

Rovuma - Petronas and Statoil Transactions

Seller	Buyer	Date	Stake (%)	Value	Tax
Petronas	Total	2012	10%	?	?
Statoil	Tullow	2013	25%	?	?
Statoil	INPEX	2013	25%	?	?

Taxation of Capital Gains

Although full details are not public, it appears that the value of the Riversdale sale generated an intense debate within the Government of Mozambique on the need to tax foreign companies on their capital gains from the sale of extractive sector rights. This has provided the basis for the very large tax payments on transfers of stakes in the Rovuma Basin concessions.

The application of a capital gains tax for non-resident companies is based on the following

combination of provisions drawn from both the Corporate Income Tax Code (IRPC) and the Personal Income Tax Code (IRPS).

IRPC – Corporate Income Tax Code

1. Realized capital gains are determined to be income – IRPC 20 (h)
2. The "capital gain" is defined as the difference in net realizable value – IRPC 37.2
3. IRPC is applicable to non-resident companies IRPC 5.2 and 5.3 (a) and (b).
4. Income for non-resident companies is determined by rules in the personal income tax code (IRPS) – IRPC 45.

IRPS – Personal Income Tax Code

5. Capital gains earned by business and professional activities as defined under the IRPC are considered to be "Second Category" income – IRPS 8.3 (c)
6. Amount payable for acquisition and disposal of shares is defined in IRPS 45, while allowable deduction are set out in IRPS 47 and 50.
7. The percentage of the capital gain on which tax is paid declines based on the length of ownership (see Table 2) in IRPS 40.

Given these somewhat convoluted steps in the tax law, it is perhaps not surprising that a capital gains tax on foreign mining and petroleum companies did not figure prominently in overviews of the extractive sector fiscal regimes.

Table 2: Portion of Capital Gains Subject to Tax (IRPS)

Period of Ownerships	Proportion of Gain Taxed	Effective Tax Rate
Less than 12 months	75%	24%
Between 12-24 months	60%	19.2%
Between 24-60 months	40%	12..8%
More than 60 months	30%	9.6%

Textbox 1: Government Communications Failures

The inconsistent application of the capital gains tax on extractive sector transactions reveals a series of failures of communication.

Failure within Government: The Tax Authority admits in internal documents that it learns of transactions in the extractive sector not from other government ministries but from the news media and the Internet, usually after the transaction has been completed.

Failure with Companies: The imposition of a capital gains tax, and the changing of the rate, has profound implications for companies. Yet indications suggest that communications with companies on what amounts to renegotiation of their terms (see below) was poorly managed and has damaged Mozambique's reputation.

Failure with the Public: ENI's capital gains tax assessment in 2013 was (then) the largest tax payment in Mozambique history. Mozambican's first heard about the payment from an ENI press release. The Tax Authority provided details on capital gains transactions only after CIP raised questions about assessments being "negotiated." There is no proactive communication on either the assessment of capital gains taxes or how the money is incorporated into the budget and spent.

The basic logic of a capital gains tax is clear: the "gain" amounts to the selling price less the purchase price (if any) less other adjustments such as depreciation. As original owners of the licenses and concessions, companies such as ENI and Anadarko received their rights to explore and develop directly from the government. In these cases there is no purchase price to factor into calculating the "gain." For others, such as Cove Energy or Videocom, the purchase price is deducted from the sale price to determine the "gain."

The capital gains tax is always assessed at 32%, but it is assessed on a different "basis" depending on the length of ownership as set out

in Article 40 of the Personal Income Tax Code (IRPS). The proportion of the "gain" on which the 32% tax is assessed, declines as the length of ownership increases. It is this formula from the IRPS that explains why the tax as a percentage of overall sale price varies widely between different transactions.

Table 3 shows data provided by the Tax Authority on the first three capital gains tax assessments from the Rovuma Basin.

ENI East Africa is the simplest calculation. As ENI secured the concession directly from the government through the 2005 EPCC Licensing Round, the sale value and the capital gain value are identical. Since ENI held the asset for more than 60 months, the percentage of the gain that is taxable is 30%. When the tax rate of 32% is applied to the 30% value of the capital gain, the tax assessed is $400 million. What is unusual about the ENI tax assessment is the government's acceptance of a promise to build a 75 mega-watt power station many years in the future in lieu of $130 million in taxes that would have been paid in 2013.

The capital gains assessment on Cove Energy and Videocom follow a similar logic, except that these two companies purchased their original stake in the Rovuma 1 concession and therefore the capital gain is the sale price less the purchase price.

Revisions to the Capital Gains Tax – A Straight 32%

Over the course of 2012 new income tax laws for corporations (IRPC) and individuals (IRPS) were being developed. Late in the process, a change was introduced to the way in which capital gains on foreign mining and petroleum companies were assessed. Specifically, the new provisions would impose a flat 32% tax rate on capital gains irrespective of the length of time that the asset had been held. Surprisingly, the revisions to the tax laws retained the link between the IRPC and the IRPS, and merely added a new category that would make extractive sector companies liable for taxation on the full amount of the capital gain.

Revisions to the IRPC and IRPS were approved by Parliament in mid-December 2012 and forwarded to the President for signature. In January, the President refused to sign citing constitutional concerns on retroactive effects. Specifically, he argued that the Constitution prohibited both the retroactive applicability of the law (it was intended to apply from 1 January 2013) and an increase in taxes during the financial year.[4] The President sought the opinion of the Constitutional Council. The Council generated an extensive analysis, but ultimately refused to issue a ruling on whether the law was constitutional or not.[5] In the meantime, behind the scenes negotiations resolved the issue with the Parliament proposing that the new IRPC and IRPS laws come into effect only on 1 January 2014.

According to these new laws, all transactions of rights to mineral licenses and petroleum concessions made after 1 January 2014 should be assessed a 32% tax on the full amount of the capital gain. However, the relevance of the IRPC and IRPS for the extractive sector could be short-lived. New fiscal laws for mining

Table 3: Tax Authority Explanation of Rovuma Basin Capital Gains Tax Assessments

Seller	Sale Value	Capital Gain	Taxable Portion	Tax Base	Tax Rate	Tax Assessed
Cove Energy	1,564,161,025	1,373,439,345	40%	549,375,738	32%	175,800,236
Videocom	2,149,403,700	1,750,679,585	40%	700,271,834	32%	224,086,986
ENI East Africa	4,166,666,666	4,166,666,666	30%	1,250,000,000	32%	400,000,000

and petroleum currently awaiting approval from the Council of Ministers will break the link between extractive sector companies and Mozambique's general tax provisions. The capital gains provisions in the fiscal laws, while much clearer, will have the same effect: 32% tax on the full value of the capital gain.

Textbox 2: Cove Energy Capital Gains Tax

In 2009, Cove Energy purchased an 8.5% stake in Rovuma Area 1 from Artumas (a Mozambican subsidiary of a Canadian company). In 2012, Cove Energy sold the entire 8.5% stake to the Thai energy company PTT for $1.56 billion. This appears to be the first extractive sector transaction on which a capital gains tax was assessed with a tax payment of $175.8 million.

The Capital Gains Tax

The phrase "capital gains" refers to the increase in the value of an asset between the time when it was purchased, and when it was sold. In the extractive sector, the "asset" in question is either a mineral license or a petroleum concession, in addition to whatever capital infrastructure has already been developed. The sale of licenses and concessions is particularly important during the exploration and development phases, when rights to the resource can be valued in the billions of dollars even though the first revenues from production may be many years in the future.

What is Transferred and Why?

In some cases, the extractive sector company sells its entire stake in a project and departs the country. Particularly in the mining sector, it is common for smaller companies to conduct high-risk exploration. These "junior" companies have neither the capacity nor the intention of developing the resources if exploration efforts are successful. Their objective is to build the value of the asset and to sell. The sale of Riversdale's coal licenses to Rio Tinto is an example. In other cases, smaller companies hold a percentage stake in a consortium and decide to sell following a substantial rise in value. This has happened in Rovuma Area 1 with Cove Energy's sale of an 8.5% stake and with Videocon's sale of a 10% stake. The original company need not be small for the asset to be sold prior to the start of production. Anadarko is a top-40 international oil company, but they have no experience in developing liquid natural gas (LNG). Within industry circles, many believe that Anadarko will have sold its entire stake in the Rovuma Basin prior to the first export of gas.

A second common type of transfer is the sale of a percentage stake - often known as a "farm down." Here the leading company (the "operator") sells off part of its stake. As with other minority stakeholders, this can simply be a matter of taking some profit out of a successful exploration operation in order to improve broader company finances. The recent sale by ENI of a 20% stake in Rovuma 4 and Anadarko's sale of a 10% stake in Rovuma 1 both fall into this category. A special category of "farm down" is where the contractor offers a percentage stake in the project in exchange for exploration financing provided by the incoming company. This was the case with the recent transfers of ownership rights for Petronas and Statoil in the Rovuma Basin. In such a case, there is no sale price, though the value can be determined by the scale of costs of the exploration activities undertaken as part of the transaction.

To Tax or Not to Tax?

While, the sale of all or part of a mineral license or petroleum concession is a routine feature of the extractive sector, there is no standard practice for whether or not these transfers should be taxed. There are countries where

no tax is assessed on capital gains. From an economic perspective, this makes sense as the successful development of the project often depends on the introduction of new commercial partners with sufficient financial and technical capacity. It is not in the government's interest to discourage the transfer of properties to buyers who are better placed to develop them efficiently.

The counter argument is at least as much political as economic.[6] It is often argued that it is politically unfeasible in developing countries not to tax billion dollar sales of the right to exploit national resources. One of the very few ways that a government can extract revenue from extractive sector projects that will not generate a profit for years or even decades is to impose a tax on capital gains.[7] The early injection of substantial revenue from capital gains taxes is obviously very welcome. In some cases it is seen as a major victory over powerful international companies and a redress to generous tax concessions offered in the original contracts.

The significance of capital gains tax payments is often not well understood. In most countries, the capital gains tax is deductible against future assessments of taxable income. This means that a capital gains tax is not an additional source of government revenue. It does enable the government to bring forward some future revenue. But it also generates additional deductions against company taxable income. Securing early revenue in advance of production delays the onset of profit based taxes (IRPC) and pushes back the date when government revenues will become significant. The resulting offset in medium-term government revenues is considered, if it is even considered at all, a small price to pay for substantial early revenue.

The Risks of Large "One-Off" Payments

Successful imposing a capital gains tax however carries risks as well as benefits. The track record of resource rich developing countries effectively managing large one-off cash payments is not good. The government has little influence on the timing or scale of the sale of rights to extractive sector resources. Capital gains tax payments then cannot normally be anticipated or integrated into regular budged planning processes. The risks of ill-considered spending with this windfall revenue must therefore be considered high.

Large one-off payments — often in the form of signature bonuses — have also been responsible for some of the most staggering acts of corruption known in the extractive sector. Countries with vast proven oil reserves often demand a large lump-sum payment when the company acquires exploration rights. Like the main fiscal terms governing extractive sector operations, the size of these payments has traditionally been confidential.

It is not uncommon for at least some of the proceeds of signature bonuses to be diverted away from the national treasury. In Angola, it was reported that only half of the $870 million signature bonus paid by BP-Amoco, Elf and Exxon in the late 1990s for Blocks 31-33 ever appeared in government ledgers.[8] Much of the money appears to have been diverted, through the Presidency, to weapons purchases.[9] In 2001, when BP publicly disclosed a signature bonus payment to the of $111 million dollar, the Angolan government reprimanded the company for disclosing information of a "strictly confidential character" and that they reserve the right to take "appropriate action" including "contract termination."[10] The parallels between signature bonuses and capital gains tax payments suggest that both present significant opportunities for the misappropriation of state funds.

Administrative Challenges of Assessing the Tax

The theoretical pros and cons of applying a capital gains tax are sometimes secondary to the practical challenges facing a developing country

seeking to impose the tax on multinational companies. Companies pursue several tactics to avoid paying. Sometimes they argue that because the transaction occurred in a foreign financial center, the tax laws of the host-country do not apply. In other cases, they argue that what is being sold is not the rights to a license or concession but rather a subsidiary company. ENI explored this option when they claimed that they were selling part of a subsidiary company, ENI-East Africa. Mozambican tax authorities immediately rejected the ploy, as the rights to gas in the Rovuma Basin was ENI-East Africa's only asset.[11]

In jurisdictions where a capital gains tax is imposed, it is commonly imposed on the seller. The logic is clear, as the increase in value of the asset, when sold, represents a form of income. Where the company continues to operate in the country following the sale, enforcing payment is unproblematic. Recent sales by ENI and Anadarko fall into this category. But what happens when the company sells its entire stake and no longer has a financial presence in the country? This was the case with Riversdale after their sale to Rio Tinto in 2010. Mozambique sought to impose a tax assessment on Riversdale but had no leverage on the Australian. Had the Government of Mozambique been aware of the sale in advance, it might have been possible to intervene before the sale was completed. But it is not uncommon for tax authorities only to learn of the sale of the rights to natural resources through the media after the sale is already complete. In some jurisdictions, as in Uganda[12] (See Textbox 3), where the seller is beyond reach, attempts are made to impose the tax on the buyer. Mozambique has sought to do the same, though less aggressively, with Rio Tinto.

Textbox 3: Capital Gains Tax Controversy in Uganda

In 2010 Tullow Oil Uganda's Lake Albert fields from Heritage Oil for $1.45bn. The Government of Uganda sought to impose a capital gains tax on the sale, and issued a tax assessment to Heritage Oil for $434 million (30% of the transaction value) based on the most recent revisions to the country's income tax law.

Heritage disputed the tax assessment on two separate grounds. First, Heritage argued that they were not liable because the transaction took place outside of Uganda and was therefore not covered by Ugandan law. Second, Heritage argued that recent changes to the income tax law were inapplicable because "stabilization" clauses in the production sharing agreement precluded the imposition of new taxes. The Ugandan Revenue Authority rejected both claims.

As Heritage had sold their only asset in Uganda, the government had limited leverage. Ultimately, Heritage paid $121 million to the Revenue Authority as a deposit pending the resolution of the case through arbitration. In 2011, a Uganda court dismissed the claim by Heritage that it was subject to the capital gains tax. Heritage responded by invoking their contractual right to dispute resolution at the International Court of Arbitration in London. The arbitration court has indicated that it cannot make a determination on the underlying tax law in Uganda. It has issued a series of rulings on matters of jurisdiction and interpretation. Each of those rulings has gone against Heritage, and media reports now suggest that the tribunal final ruling requires Heritage to pay the full tax assessment.

The dispute also affected the new owner, Tullow, when the Ugandan government refused to allow the company to develop the fields or sell stakes in the concession to China's CNOOC and France's Total until they paid the outstanding $313 million as "security" on Tullow's behalf. Tullow promptly sued Heritage to reclaim the $313 million that Tullow claimed was an outstanding tax liability that according to the sales purchases agreement was the responsibility of Heritage. Heritage on the other hand argued that Tullow made a political payment, not a tax payment, in order to expedite its operations in Uganda. The lawsuit between Heritage and Tullow over the $313 million was also heard in London as English law governed the "sales purchase agreement". In June 2013 the court found in favor of Tullow, requiring Heritage to pay back the money.

Renegotiation Lite?

Given the size of the potential tax payments, and the distant revenues from actual production, it is not uncommon for governments to revise the terms for the application of capital gains taxes once large-value sales begin. Companies often claim that this amounts to "renegotiation" of the terms under which they decided to invest.

Many extractive sector contracts, including those signed to date in Mozambique, include what are known as "stabilization clauses." These provisions provide a guarantee to the company that the terms on which they decide to invest will remain in place for the duration of the contract, normally including around 25 years of production. In some cases these provisions "freeze" the terms in place when the contract was signed. In other cases, an "economic equilibrium" clause is used to stabilize the economic return of the investor rather than to stabilize the fiscal terms. Under this later formulation, tax laws can be changed, but if they have an adverse effect on the investor, the State commits to make other changes to ensure that the economic position of the company is maintained.

Mozambique contracts contain "economic equilibrium" clauses. The language from the most recent model Exploration and Production Concession Contract is indicative of the provisions in other extractive sector contracts. Article 11 Paragraph 9 states that if other taxes are introduced that have:

> "an adverse effect of a material nature on the economic value derived from the Petroleum Operations by the Concessionaire, the Parties will, as soon as possible thereafter, meet to agree on changes to this EPC which will ensure that the Concessionaire obtains from the Petroleum Operations, following such changes, the same economic benefits as it would have obtained if the change in the law had not been effected."

An argument can be made that the convoluted legal steps needed to impose a capital gains tax on extractive sector companies based on the 2007 IRPC and IRPS laws amounts to renegotiation. But this is a matter of debate. What is not a matter of debate is that the imposition of a 32% capital gains tax included in the 2013 revisions to the IRPC and IRPS does amount to renegotiation: it self-evidently has "an adverse effect of a material nature on the economic value derived from the Petroleum Operations by the Concessionaire."

Contrary to the claims of companies and international donors, the renegotiation of extractive sector contracts does not normally generate a crisis of confidence in foreign investors. In fact,

Comparing Capital Gains Tax v Increase in Royalty Rate

Compare, for example, the imposition of a capital gains tax versus changes in the royalty rate that governs the Rovuma Basin contracts. The tax on a 10% stake in Rovuma is worth about $400 million in tax; an increase in royalty rates from 2%-6% would generate an additional $400 million every year.

Capital Gains Taxation: The sale of a 10% stake in one of the two Rovuma Basin concessions currently yields approximately $400 million in capital gains tax for the government. This is a one-time payment, and will be reclaimed as an income tax deduction in future years.

Changing Royalty Rate: Perhaps the most generous feature of the Rovuma contracts is the 2% royalty rate on deep-water gas (applicable to all the gas found in the Rovuma Basin). Royalty payments are the only guaranteed source of government income and 2% is among the very lowest rates applied anywhere in the world. The rate in Mozambique was increased to 6% with the 2007 tax laws, but this change does not apply to the Anadarko and ENI contracts signed in 2006. According to the economic analysis in the Gas Master Plan, increasing the tax rate to 6% on a two-train (10 million ton per annum) project would generate an additional $400 million in government revenue each year from the start of production.

where the economic of a project fundamentally change, as was the case with massive oil price spikes between 2003 and 2008, renegotiation is commonplace.[13] In fact, in most cases the process is not even adversarial, as all parties understand that a fundamentally unfair deal is unsustainable and must be changed.

Company opposition to "contract renegotiation" therefore is not a legitimate barrier to making changes mid-stream to the terms governing the taxation of capital gains. The question is whether a "capital gains" tax is the right issue on which to renegotiate.

By making changes to the capital gains tax, the Government of Mozambique is generating some early income from the Rovuma Basin many years before gas production begins. These early injections of cash are a welcome addition to a budget under stress and seem appropriate given the vast sums of money being exchanged between companies for the rights to Mozambique's resources. But the actual size of these one-off payments is small in comparison to other changes that could be made to the contracts.

Furthermore, the way in which the imposition of the capital gains tax has been managed has damaged the perception that investors have of Mozambique far more than an orderly renegotiation of other key terms would have.

Case Studies: Inconsistent Application of a Capital Gains Tax

Mining: Riversdale / Rio Tinto

In 2006, the Australian company, **Riversdale Mining Limited** (an Australian Stock Exchange listed-company) secured rights to a series of coal licenses including the Benga and Zambeze projects from two private Mozambican companies. There is no public information on the value of the sale, the names of the Mozambican companies, or whether any capital gains tax was assessed.

During the time when Riversdale held the rights to these coal concessions, there were significant changes in the ownership of the rights in Mozambique and of the company itself. In 2007, **Tata Steel** acquired 35% of the rights to the Riversdale's Mozambique coal assets at a price of more than $88 million. Riversdale also had modest coal assets in South Africa. Two companies owned major stakes in Riversdale itself, in the lead up to the sale to Rio Tinto. Tata Steel held a 25% stake and the Brazilian steel maker **Companhia Siderurgica Nacional** held just under 20%. There is no public information that a capital gains tax was assessed on any of these transactions.

Rio Tinto Begins to Acquire Riversdale

Riversdale had neither the intention nor the capacity to develop the coal concessions it held in Tete. The company strategy was to build the value of the asset and sell to a major mining company. In December 2010, the global mining giant **Rio Tinto** made its first public offer to buy Riversdale. Already at this early stage Rio Tinto informed the Mozambican Prime Minister and the Minister of Mines of their interest in acquiring coal rights within Mozambique.

In October 2011, nearly a year after the initial offer was made, Rio Tinto Jersey Holdings 2010 Ltd, a wholly owned subsidiary of Rio Tinto plc of registered in the United Kingdom, began to acquire some of the 244 million shares that made up Riversdale Mining Limited. By June of 2011 Rio Tinto held 99.76 of the company and Riversdale was removed from the Australian

Table 4:Transactions for Benga / Zambeze Coal

Seller	Buyer	Date	Stake (%)	Value	Tax
Mozambicain companies	Riversadale	2006	100%	?	?
Riversdale	Tata Steel	2007	35%	$88 million	?
Riversdale (shareholder)	Rio Tinto	2011	100%	$4.1 billion	None

Stock Exchange. The total value of the shares purchased by Rio Tinto (it is important to note that they did not pay any money to Riversdale itself) was $4.1 billion. According to Rio Tinto, the actual value of the Mozambican assets was $3.6 billion.

During this process, Rio Tinto was in regular contact with authorities from the Government of Mozambique. In fact, in October 2011, Rio Tinto informed the Ministry of Finance, the Director General de Impostos and MIREM that it owned 41% of Riversdale.

Although the Mozambican authorities had been informed of the impending transaction throughout the process, the Tax Authority seems to have been unaware until after the transaction was completed. Internal documents from the Tax Authority reveal that they became aware of the transaction not through communications with the Ministry of Finance or MIREM but through reports in the news media.

It appears that the extraordinary sum of money involved in the transaction prompted the Government to explore legal options for the taxation of capital gains on transfers of rights in the extractive sector.

As has been shown above, the legal basis for the imposition and calculation of a capital gains tax on non-resident companies is somewhat convoluted. One thing is absolutely clear: the tax is a liability for the seller. The problem in this case, however, was that the seller no longer had any assets or presence in Mozambique. The Tax Authority sought to contact Riversdale to assess the tax, but they have no leverage over the foreign company.

Unable to tax Riversdale, the Tax Authority sought to impose the tax on the buyer: Rio Tinto. The dispute has now been running for more than two years. Rio Tinto has argued repeatedly that whatever tax liability exists relates to Riversdale and not to Rio Tinto. Yet it appears that the Tax Authority, having failed to monitor the protracted transaction and assess the tax against the seller of the asset, will not concede that the opportunity has passed.

The President of the Tax Authority in a recent interview is quoted as saying that "The Riversdale-Rio Tinto operation is a tax dispute, and we expect to have results. Taxation is a legal imperative. So the operation remains on the table and we shall follow it to the end". Media reports suggest that the Tax Authority is seeking roughly $200 million in capital gains taxes.

Mining: Talbot Group

Ken Talbot, head of the Talbot Group, had been an investor in Riversdale, selling his stake in that project for $190 million in November 2009. The Mozambican coal exploration company Minas de Revuboè was established in 2010. The ownership split was Talbot Group (58.9%), Japan's Nippon Steel (33%) and South Korea's Posco (8%).

Following Talbot's in 2011 in an aircraft accident in Congo Brazzaville, the Group decided to divest itself of all assets. Media reports suggested that the large mining company Anglo American would purchase the Talbot Group's stake for $500 million and that the sale would generate a capital gains tax of around $70 million (32% of 40% of the sale value). Eight months after the tentative agreement, however, Anglo American withdrew their offer. All indications suggest that the Talbot Group still holds 58.9% of the project and that no capital gains taxes were paid.

Table 5: Anadarko Transfers of Rovuma Stakes

Seller	Buyer	Date	Stake (%)	Value	Tax
Anadarko	Artumas	2007	8.5%	?	?
Anadarko	Mitsui	2007	20%	?	?
Anadarko	Videocom	2008	10%	$75m	?
Anadarko	BPRL	2008	10%	$75m	?
Anadarko	OVL	2013	10%	$2.64b	$520m

Petroleum: Rovuma Area 1 – Anadarko Concession

Minority stakes in the Anadarko-led Rovuma Basin Area 1 have changed hands multiple times. When the concession was awarded, **Anadarko** held 85% of the stake with rights to the remaining 15% held by the national oil company ENH.

Anadarko Sales

In 2007, Anadarko sold an 8.5% stake in Rovuma Area 1 to **Artumas** (a Mozambican subsidiary of a Canadian company) and a 20% stake to **Mitsui** (a Mozambican subsidiary of a British-registered company). There do not appear to be any public details on the value of this transactions or whether any capital gains tax was assessed.

In 2008, Anadarko sold stakes of 10% to the Indian company **Videocom** (a Maurisius-based subsidary of the Videocom Group) and to the Indian company **BPRL Ventures** Mozambique (a Mozambican subsidiary of Bharat Petroleum Corporation). Media reports indicate that the terms for the two stakes were identical. The sale value for Videocom was reportedly $75 million. There is no report of capital gains tax being assessed on these transactions.

In 2013, Anadarko sold an additional 10% of its remaining stake in Rovuma Area 1 to **ONGC**, the overseas arm of the Indian governments Oil & Natural Gas Corp. The value of the transaction was $2.64 billion. The capital gains tax assessment was $520 million (32% of the taxable capital gain of $1.625b).

Secondary Sales

In 2009, Artumus sold the entire 8.5% to **Cove Energy**, a UK-registered company. The sale was not based on a cash transaction. Instead, Cove agreed to pay Artumas a royalty of 6.4% on any "profit petroleum" earned in relation to the 8.5% stake. There is no indication of a capital gains assessment on the transaction.

In 2012, Cove Energy sold its entire 8.5% stake to the Thai energy company **PTT** (formerly Petroleum Authority of Thailand) for $1.56 billion. This appears to be the first extractive sector transaction on which a capital gains tax was assessed, with a tax payment of $175.8 million.

In early 2014, Videocom completed a sale of its full 10% stake to **OVL** (the overseas arm of state-run explorer Oil & Natural Gas Corp), and **OIL** (Oil India Limited) for $2.15 billion. The capital gains tax assessment was $227m.

Table 6: Secondary Sales – Rovuma Area 1

Seller	Buyer	Date	Stake (%)	Value	Tax
Artumas	Cove Energy	2007	8.5%	?	?
Cove Energy	PTT	2007	8.5%	$1.56b	$175.8m
Videocom	OVL	2013	10%	$2.15	$227m

Petroleum: Rovuma Area 4 – ENI East Africa

ENI East Africa secured the rights to Rovuma Area 4 in the 2006 Licensing Round. ENH holds the rights to 10%. From the outset, ENI brought in two partners: **GALP Energia** with 10% and **KOGAS** (Korean Gas Company) with 10%. There is no public information on the sale price for the 10% stake purchased by GALP or KOGAS and no indication that any capital gains tax was assessed.

In 2013, ENI sold a 20% stake in the project to the **Chinese National Petroleum Corporation (CNPC)** for $4.16 billion. ENI first sought to avoid the tax altogether by claiming that it was selling portion of ENI East Africa, a subsidiary registered in Italy. Given that Rovuma Basin concession was ENI East Africa's only asset, the Government of Mozambique rejected this approach. On 13 August, following a meeting with President Guebuza, the CEO of ENI Paolo Scaroni, announced that ENI had agreed to pay $400 million in capital gains tax. He also indicated that ENI had committed to construct a 75 mega-watt gas fired power station in Cabo Delgado, worth an estimated $130 million, to become operational when the LNG facilities completed, probably in 2020.

Media reports suggest that ENI East Africa is looking to sell an additional 15% stake in the project. Apparently ExxonMobil, Total, Shell and Chevron are all interested, but the front-runner is the **Chinese National Offshore Oil Company (CNOOC)**.

Media reports also suggest both GALP and KOGAS may be looking to sell as they reportedly will have difficult raising the financing required for their share in the LNG construction.

Petroleum: Rovuma Basin - Statoil and Petronas

In 2012, Statoil (the Norwegian state oil company) and Petronas (the Malaysian oil company), both "farmed down" their stakes in the Rovuma Basin. This means that they gave away a percentage stake in their concession in exchange for the incoming company paying exploration costs. There is no public information on the value of the transactions or whether a capital gains tax was assessed.

Statoil held the rights to Rovuma Area 2 and 5 based on bilateral agreement with the Government of Mozambique concluded prior to the 2006 Licensing Round (the original holder of the concession was NorskHydro). Statoil initially held the rights to the entire concession alongside ENH with the rights to 10%. In 2013, Statoil transferred a 50% stake in the project - 25% to the **Tullow Mozambique** (subsidiary of a UK-based company) and 25% to the **INPEX Mozambique** (a subsidiary of a Japanese company).

Two wells were drilled in mid-2013, but both were unsuccessful (the first contained non-commercial quantities of gas, the second was dry) and Statoil has officially departed

Table 7: Rovuma Area 4 Transactions

Seller	Buyer	Date	Stake (%)	Value	Tax
ENI East Africa	GALP	2006	10%	?	?
ENI East Africa	KOGAS	2006	10%	?	?
ENI East Africa	CNCP	2013	20%	$4.1bn	$400m*
ENI East Africa	CNOOC	2014	15%	?	?

** The assessment was $400 million. ENI commitment to build a 75 mega-watt power station was deemed to be worth $130 million. It appears that the actual tax payment in 2013 was $270 million.*

Table 8: Statoil and Petronas Rovuma Concessions

Seller	Buyer	Date	Stake (%)	Value	Tax
Petronas	Total	2012	10%	?	?
Statoil	Tullow	2013	25%	?	?
Statoil	INPEX	2013	25%	?	?

Mozambique. There is no public information on the assessment of a capital gains tax on the 2013 transfer of 50% of Statoil's stake.

Petronas secured the rights to Rovuma Area 3 and 6 through the 2006 Licensing Round, though the EPCC was only signed in 2008. ENH holds the rights to 10%. In late 2012, Petronas announced that it had transferred the rights to 40% of its stake in the Rovuma Basin to the French company **Total**. Once again, details of the transaction are not public, but it is assumed that Total would be responsible for the costs of exploration. There is little public information on Petronas exploration results, but reports suggest that these have not been successful and significant portions of Areas 3 and 6 have been "relinquished." There is no public information on the assessment of a capital gains tax on the 2012 transfer of 40% of Petronas' stake.

(Endnotes)

1 Philip Daniel *et. al.* Mozambique: The Petroleum Sector – Fiscal and Economic Terms, IMF, 2007, p. 27.

2 Introduction to the Legal Framework for Mining in Mozambique, (2nd Edition), Sal & Caldeira, July 2010, p. 37.

3 See for example, http://www.telegraph.co.uk/finance/newsbysector/energy/oilandgas/9119876/Cove-Energy-shares-fall-on-Mozambique-capital-gains-tax-threat.html)

4 The President based his arguments on articles 57 and number 4 of article 127 of the Constitution of the Republic, which deal with the principle of non-retrospective applicability of law, except when it benefits the citizens and other legal entities, as well as prohibition of the broadening of the contributory base and increase of income taxes in the same financial year.

5 See Acórdão no 01/CC/2013, 06 de Março de 2013.

6 According to the IMF, "Public sentiment requires that the government realize a share of these gains, otherwise there will be pressure to put in place more aggressive taxes which may lead to regime instability and a greater deterrent to investment than taxing gains in the first place." Alistair Watson, Mo- zambique: Reforming the Fiscal Regimes for Mining and Petroleum, IMG Fiscal Affairs Department, June 2012, p. 36.

7 The other main source of pre-production government revenue is signature bonuses.

8 See Phillip Van Niekerk and Laura Peterson, Greasing the Skids of Corruption, International Consortium of Investigative Journalists, 2002.

9 See "A Crude Awakening," Global Witness, 1999, p. 12.

10 See reports in the *Financial Times*, 2 September 2003 and 11 September 2003.

11 See, "ENI Tax Avoidance Ploy Confirmed, AllAfrica, 21 March 2013.

12 See Selling Oil Assets in Uganda and Ghana – A Taxing Problem, Revenue Watch Institute, 2010; Tullow Oil wins court case over Uganda tax dispute, Reuters, 14 June 2013; and John Skoulding, Capital Gains Tax: The New Resource Nationalism?" OilCouncil, 2012.

13 See, *George Kahale, III* "The Uproar Surrounding Petroleum Contract Renegotiations," Energy Forum, August 2010, p. 4.

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