CENTRO DE INTEGRIDADE PÚBLICA
Anticorrupção - Transparência - Integridade

EXTRACTIVE INDUSTRY

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After Enjoying Generous Tax Benefits Vale decides to Disinvest in Mozambique

- It is urgently needed to analyze the cost-benefit of tax benefits granted to large projects in the extractive sector

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1.Context

Vale S.A. signed a Head of Agreement[1] with Mitsui & Co on 20 January. In this agreement, two aspects raise concerns: a) the value of the announced transaction of USD1 for each Mitsui asset; b) the fact that the mining company intends to disinvest in the coal business in Mozambique exactly in the period of the end of the generous tax benefits granted to it by the Government of Mozambique.

According to the press release, the agreement aims at Mitsui's withdrawal (this year) from the Moatize mines and the Nacala Logistics Corridor (CLN), as a first step towards Vale's disinvestment in the coal business in Mozambique.

The agreement provides for Vale to buy, for USD 1 (one US dollar), the stake in each of Mitsui's mine and logistics assets. After the closing of the transaction, Vale will consolidate the CLN entities and therefore all its assets and liabilities, including the Nacala Corridor Project Finance, which has approximately USD 2.5 billion remaining. The consolidation of the Project Finance will involve approximately USD 300 million per year in operating expenses at the Moatize mine, associated with the CLN tariff, which currently impacts the Coal Business' EBITDA[2], with reclassification as financial expenses, debt amortization, investment in the maintenance of operations and others, with an equivalent increase in the Coal Business' EBITDA. The future refinancing of the Project Finance and simplification of the structure will lead to an estimated annual saving of approximately USD 25 million.

With the agreement for the acquisition of Mitsui's shares and, consequently, the simplification of governance and asset management, Vale will begin the process of disinvesting its stake in the coal business, which will be guided by the preservation of the operational continuity of Moatize and CLN, with the search for a third party interested in these assets. According to Reuters, Vale has contracted investment banks (Barclays Plc and Standard Chartered) to sell the Moatize coal project and CLN, most likely to China and India, currently the two largest coal importers worldwide[3].

The signing of this agreement, according to Vale's statement[4] marks the initial stage for the disinvestment of the coal business, "and it is in line with the strategy of discipline in the allocation of capital and the simplification of the company's portfolio, and reinforces, in addition to Vale's ambition to become a leader in low carbon mining, its commitment to the Paris Agreement".

1 Head of Agreement (HoA) – is a non-binding contract. The idea is that the parties sign the HoA in the pre-contractual phase of negotiations, with the intention that the parties continue the negotiations with the participation of lawyers and ultimately conclude a binding contract.
2 EBITDA – profits before interest, taxes, depreciation and amortization. It is a measure of the company's productivity.
3 https://www.reuters.com/article/us-vale-sa-coal-divestiture/brazils-vale-hires-banks-to-sell-coal-assets-in-mozambique-sources-idUSKBN29R0MT
4 http://www.vale.com/mozambique/pt/aboutvale/news/paginas/vale-assina-acordo-para-adquirir-participacao-da-mitsui-em-moatize-e-cln.aspx

In case of doubts, suggestions and questions related to this note, please contact: **inocência.mapisse@cipmoz.org**

2.Analysis

2.1. Purchase Value of Mitsui Shares

Vale Mozambique operates in Moatize, Tete Province, an open-air mine in an area of 23,780 hectares. The contract for coal mining was signed in 2007 between the Government of Mozambique and the company Rio Doce Mozambique (RDMZ) under Law No. 14/2002 of 26 June (Mining Law). The contract provides for a period of 25 years, renewable for the same period.

Moatize mine produces coal (metallurgical and thermal) since July 2011 and represents one of the Vale group's largest investments in Mozambique[5], exporting to the Indian, American, European and East Asian markets.[6]

Currently, Vale has an 81% participation in the exploration project in Moatize and Mitsui has a 15% participation. The remaining percentage belongs to the Mozambican Company of Mining Exploration, S.A (EMEM) representing the Mozambican State.

According to the press release, Vale will buy the stake in each of Mitsui's mine and logistics assets at USD 1 (one US dollar). The communiqué does not advance the concrete value of the purchase, thus opening space for speculation. Since this is a HoA, an agreement that may be non-binding, in the interest of transparency, CIP suggests that the concrete value of the transaction be announced for the purpose of probable collection of capital gains tax.

2.2 Tax benefits granted to Vale due to the drop in coal prices

In 2014, Vale requested the Mozambican Government to review the tax burden on its entire cost base. The most obvious argument was that the costs in Mozambique compared to the international price of coal at the time did not allow Vale to operate under acceptable conditions of productivity.

Specifically, Vale requested the reduction of taxes charged on inputs such as explosives and diesel oil; renegotiation of tariffs with the state-owned CFM, royalties and income taxes.[7]

In addition to granting the above benefits, evidence shows that Vale benefits from other benefits, notably the payment of production tax below the rate stipulated by law and a reduction in the Corporate Income Tax rate, as demonstrated below. (See Box 1)

5 http://www.vale.com (accessed in January 2021)
6 http://www.vale.com/mozambique (accessed in January 2021)
7 According to Vale's Coal Director in an interview with Notícias Newspaper (25 of May 2014)- http://www.jornalnoticias.co.mz/index.php/primeiro-plano/16405-precos-e-custos-sufocam-vale-perdro-guntemburg-em-entrevista-ao-noticias.html

Box 1: Tax and customs benefits granted to Vale Mozambique

Under the right granted to Vale Moçambique to carry out mining activities at the Moatize coal mine in Tete Province, the Government of Mozambique has granted the following fiscal and customs benefits from the effective date of the contract:

1. exemption from customs duties, VAT, excise tax on imports of construction materials, machinery and equipment, work vehicles, accessories, parts and spare parts used for the implementation and start of operation of the project for a period of 10 years counted;
2. Exemption for a period of 25 years, of customs duties on the import of goods classified in class "K" of the customs tariff;
3. Authorization for temporary importation of equipment, work vehicles, utensils, tools and machinery by providing a guarantee as established by customs legislation;
4. Deduction of confirmed fiscal losses from taxable profits until the first 15 years counted from the date of the beginning of production;
5. Reduction in 25% of the IRPC rate for a period of 5 years counted from the first fiscal year that the company has taxable profit;
6. For 10 years from the beginning of the implementation of the project, consider as costs for the purposes of determining the IRPC tax base, the amount corresponding to 150% of the amounts spent on the construction and rehabilitation of roads, railways, telecommunications, water supply, electricity, schools, hospitals and other works when considered to be of public domain and utility;
7. Exemption from withholding income from the IRPC, for income relating to large services, i.e. those worth more than one million US dollars or not available on the Mozambican market and the specialty or quality required in the project subject to the IRPC for a maximum period of 5 years from the effective date of the contract;
8. Exemption from withholding tax of interest on investment loans contracted during the same period;
9. Reduction of 50%, during the first 3 years of the project from the effective date of the contract, of the SISA rate on the acquisition of real estate exclusively for the implementation and exploitation of the project activity;
10. A 25% reduction in the IRPC rate due on the distribution of dividends to shareholders of the project implementing company from the annual profits generated by the project for 5 years from the first year of the referred distribution;
11. Exemption from the payment of VAT on the provision of services for the shipment of project products destined for export (including, but not limited to, the extraction, cleaning and improvement of coal and electricity) for a period of 30 years from the signing of the contract; the provision of services for extraction;
12. When calculating the production tax set at 3%, deduction in the value of the mining product sold, of transport and insurance expenses incurred before the sale, and borne by the implementing company. Any and all by-products resulting from the mining production that are marketable shall be excluded from the production tax basis;
13. The benefits set forth in numbers 1, 2 and 3 shall be extended to contractors, subcontractors and operators of the implementing company for the first 5 years from the effective date, provided that the imports are intended exclusively for the enterprise. They will also apply to the three phases of the Thermal Power Plant implementation, as provided for in the respective project.

2.3 Production Tax Reduction

The production tax rate established for coal exploitation is 3%, in accordance with the provisions of paragraph 4 of Article 28 of Law No 14/2002 of 26 June¸ and is levied on the value of the mining product sold.

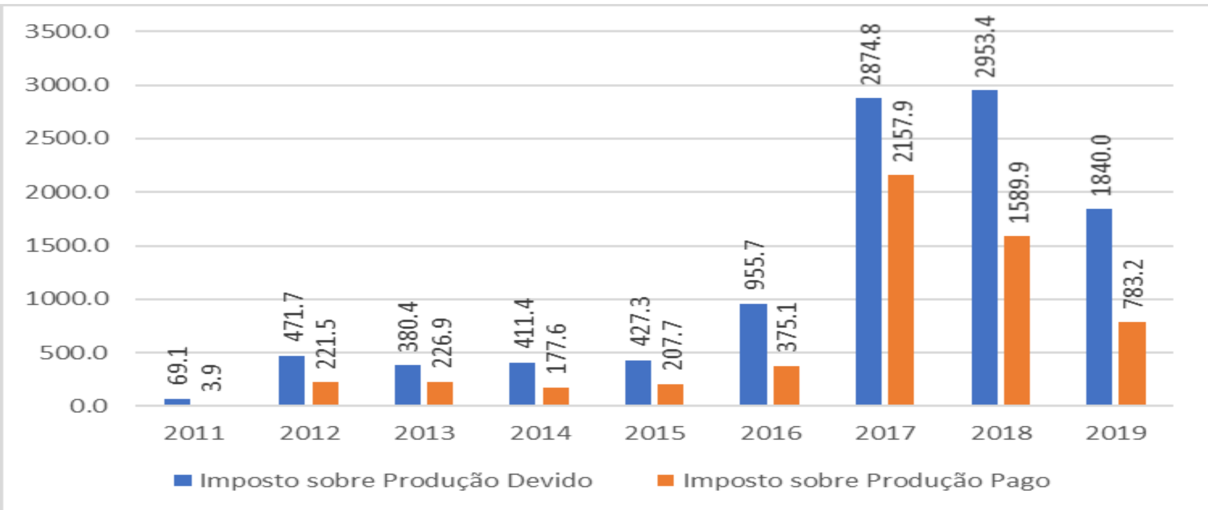
The mining contract signed in 2007 with the Mozambican Government provides for the company to pay the tax on mining production at the rate provided for by law (3%) and is charged on sales revenues from extracted coal, net of insurance and transportation costs incurred before sales. It happens that the exclusion of insurance and transportation costs from the sale greatly reduces the value of the revenue that the State could collect from the production tax. (see chart 1)

Data extracted from Vale show that insurance and transportation costs before sale have an average weight of 54% in relation to the amount that should have been paid if this benefit was not granted.

According to the data published in the Extractive Industry Transparency Initiative (EITI) Mozambique[8] Report, Vale Mozambique paid in Tax on Production 5.7 billion meticais between 2011 and 2019. However, as shown in Chart 4, these figures are far below what should have been paid without the tax benefits in this category. In 2011, for example, the amount of production tax paid by Vale was 3.9 million meticais and could have amounted to 69 million. In 2019 Vale paid only 42.6% (783.2 million meticais) of what it could have paid (1.8 billion meticais).

Therefore, in the period ranging from 2011 to 2019 the country lost about 4.6 billion meticais of tax on production, due to the tax benefits related to the deduction of insurance and transportation costs in the taxable base of the calculation of this tax.

Chart 1: Production tax paid by Vale Mozambique



Source: Vale Mozambique Accounts Report and EITI Reports (2011 to 2019)

8 https://eiti.org/mozambique

The tax benefit in the production tax category is one of the benefits granted to Vale mining company. In the case of the Moatize mines[9], for example, it was only established that the production tax rate would be 3% and falls on the gross production volume.

It should be noted that multinationals use companies from the same group to provide services. This being the case, there is enough room for abusive transfer prices and inflation of the insurance value, thus reducing the taxable income. Added to this is the exemption granted to Vale's contracted and subcontracted companies and operators that further reduce the revenue for the State.

2.4 Corporate Income Tax (IRPC) Reduction

The agreement[10] signed between Vale Mozambique and the Government foresees in terms of IRPC:

a. Reduction of 25% of the IRPC rate for a maximum period of 5 years counted from the first fiscal year in which the concessionaire obtains taxable profit;
b. Reduction of 25% of the IRPC rate due on the distribution of dividends to shareholders for 5 years, starting from the first year that the corresponding distribution is made;
c. For a period of 10 years, counting from the beginning of the implementation of the project, consider as costs for determining the taxable income, the amount corresponding to 150% of the amounts spent on expenses authorized by joint order of the MIREME and the Finance Department. This benefit ends exactly in 2021.

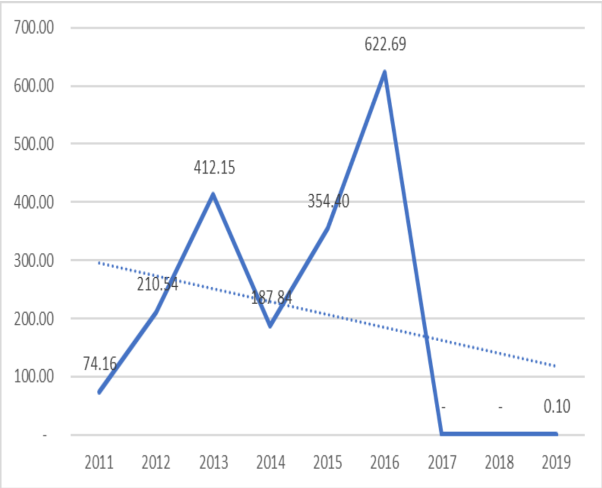
Logically, after the tax benefits phase, the project is expected to increase the tax contribution to the State. However, in the year in which the largest tax benefits cease to exist¸ Vale decides to enter the process of closing its activities in Mozambique.

The granting of tax benefits and their costs and benefits for Mozambique is an issue to be carefully analyzed. Associated with this fact is the regulation of the procedures of purchase and sale of assets (farm-in and farm-out) in the mining (and hydrocarbon) sector projects to allow the efficient taxation of capital gains. Otherwise this will be a way for companies to maximize costs in order to reduce the amount of taxes to be paid and eternalize the granting of tax benefits.

In terms of payment of IRPC, in general, Vale Mozambique showed a downward trend in the period ranging from 2011 to 2019, with no payment of this tax to the State in 2016 and 2017. With cost inflation at 150% in these years, it was expected that taxable income would be reduced and with an increasing trend even in a context of evolution of production volume. See graphs 7 and 8.

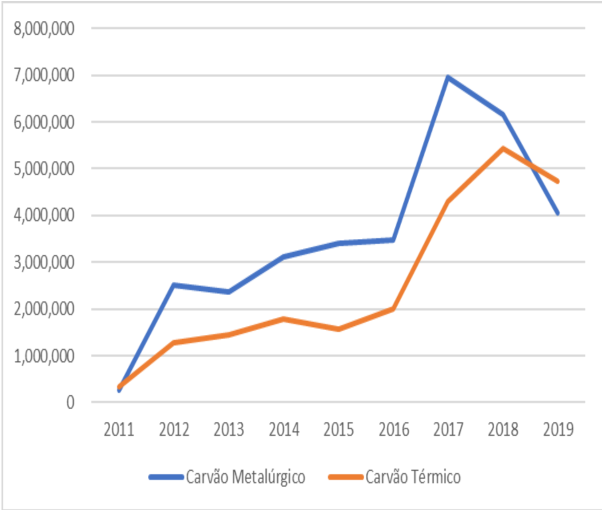
9 https://www.mireme.gov.mz/index.php?option=com_phocadownload&view=category&download=31:minas-moatize-lda&id=11:contratos-mineiros&Itemid=150
10 Mining Contract for Moatize Mine Concession between Government of Mozambique and Rio Doce Mozambique Limitada

Chart 2: IRPC paid – Vale



Source: EITI, Reports (2011 to 2019)

Chart 3: Evolution of Vale Mozambique coal production



Source: Vale, 2021

3. Conclusion and Recommendations

Conclusion

The announcement of Vale's intentions to stop investing in Mozambique raises issues that must be carefully analyzed to avoid multinational companies setting up in Mozambique, maximizing their gains at the expense of nationals and still benefiting from tax exemptions and close their activities without contributing to the economy with the existing potential. It is curious to say the least that the closure of Vale's activities in Mozambique takes place at a stage when the benefits granted by the Government of Mozambique are expiring.

During the production years (2011 to 2019) of Vale in Mozambique, the country lost about MT 4.6 billion in production tax benefits. In addition to this figure, there are amounts related to tax benefits on income tax and other categories that could not be calculated due to lack of data in publicly available documents.

Recommendations

Taking into account the above findings, CIP recommends the following to the Government (MIREME) and INAMI:

- In-depth cost-benefit analysis of tax benefits granted to companies in the mining sector;
- Supervision and control of costs incurred;
- Acceleration of the installation of the High Authority of the Extractive Industry (AAIE) to strengthen the control of its activities;
- Regulation of the farm-in and farm-out of the mining and hydrocarbon sector;
- Mention of the concrete price of the sale of Mitsui's assets to Vale.

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