June 2023

Revised ISA Contractor Submission Following OEWG Inter-Sessional Working Group Meetings on the Financial Terms of Contracts

INTRODUCTION

1. In Feb 2023, following a welcomed opportunity to engage with the African Group (AG) positions on the Financial Terms of Contracts during informal intersessional discussions convened at AG's initiative on 19-20 Jan 2023 in New York, a group of ISA Contractors made a formal submission responding to the African Group (AG) submissions dated 2019-2022. We now have the pleasure of making a revised submission.
2. Positions expressed and amendments suggested in this revised submission are informed by:
   i. Discussions during the 7th Open-Ended Working Group (OEWG) meeting on 15-16 March 2023 in Kingston, Jamaica (Part I of the 28th session of the ISA);
   ii. Discussions during the Intersessional Workshop Hosted by Natural Resources Canada on 26-27 April 2023 on Zoom;
   iii. Hybrid intersessional discussions co-hosted by Australia and South Africa on 2-4 May 2023 in New York and attended by representatives of Canada, UK, Jamaica, Ghana, representatives from IGF and MIT, and four ISA contractors (GSR, NORI, TOML, UKSR);
   iv. Follow-up discussions co-hosted by Australia and South Africa on 23 May 2023 on Zoom.
   v. Presentations shared at the above meetings by the AG, IGF and Canada.

3. We believe that revised positions expressed in this submission offer a pragmatic accommodation of valid concerns raised in the AG submissions and constructive discussions that they catalyzed over the last five months. If adopted, these positions would result in a payment regime that strikes a pragmatic balance in the implementation of the guiding objectives set forth in UNCLOS (Annex III, Article 13(1)) and the principles established by the 1994 Implementation Agreement (annex, Section 8(1)).
4. In summary, we assume the following positions on four topics:
   i. ISA Payment Regime
      a) We support the adoption of the OEWG's "Option 4" payment regime (two-stage progressive ad-valorem royalty) whereby a royalty would be levied on a basis consisting of metal prices for nickel, copper and cobalt and medium-grade manganese ore for the first 5 years of Commercial Production in the Area, with the option to simplify the basis to the price of the nodule ore (and adjust royalty rates accordingly) thereafter.
      b) We support the use of the MIT Project Lifetime Model to determine the provisional rates of the ISA royalty, targeting a total tax burden of 42.5%. The total tax burden includes mineral royalties, levies, net taxes, and charges expected to be paid by ISA Contractors to the ISA, to their Sponsoring States and other governments.
      c) We strongly believe that a two-stage approach is needed, with reduced rates during the first 5 years of Commercial Production for every exploitation contract to attract investments and technology to the exploration and exploitation of the Area.

ii. **Equalization Mechanism for taxes paid within the Mining Perimeter**

a) We support the AG's intent in proposing an equalization mechanism to prevent ISA Contractors from avoiding or minimizing their tax obligations through Sponsorship Agreements and other arrangements with Sponsoring States.

b) We cannot support the mechanism proposed by the AG ("additional royalty") because the mechanism (revenue-based) is fundamentally divorced from the objective (profit-based) and, depending on market conditions, is potentially regressive in nature and risks to undermine the entire investment proposition in DSM.

c) We can support the mechanism proposed by the IGF ("additional profit share on Contractor's pre-tax cash flow"), subject to agreement on the rate of uplift, 25% profit share and inclusion of all payments to Sponsoring States in the eligible offset taxes. We believe that this mechanism is better aligned with the objective of the equalization measure but is vulnerable to tax base erosion depending on how the ISA Contractor or parent company chooses to structure their collector business in the Area.

d) Our preference remains to achieve equalization through a top-up profit share mechanism using globally accepted OECD Model GloBE Rules (also known as 'Pillar Two') with adjustments for ISA-specific requirements. We believe that basing an equalization mechanism on a global system adopted by over 140 countries may significantly reduce the administrative burden on the ISA and concerns around tax base erosion, cross-country accounting comparisons and auditability while delivering on the objective of the equalization measure.

iii. **Rate and System Review mechanism of the ISA Payment Regime**

a) We support a position that rates of payments should be reviewed against the provisions of UNCLOS and the 1994 Agreement before the end of the first 5 years of Commercial Production and propose continued regular rate reviews every five years thereafter.

b) In alignment with the 1994 Implementation Agreement, Annex Section 8, 1(e) we support the view that system reviews can also occur as part of the regular review mechanism but should be subject to material changes in fundamental assumptions underlying the design of the ISA payment regime and/or market conditions.

iv. **Profit-share on direct and indirect transfer of exploitation rights**

a) We support the principle of a financial imposition on profits or capital gains realized through the direct transfer of exploitation rights granted by the ISA subject to *de minimis* threshold of 20%, *pro rata* taxation of the capital gains on the exploitation rights, tax rate within the range of capital gains tax (CGT) rates for jurisdictions of land-mining of same or similar minerals (our analysis shows the median of 20.5%) and subject to ensuring group reorganizations and project finance transactions are not captured by these provisions and the risk of double taxation is eliminated.

b) We observe that discussions have highlighted the complexities of administering a financial imposition on profits or capital gains realized through the indirect transfer of exploitation rights, and that it may not be practical or proportionate to introduce such an imposition during the initial few years of the ISA's administration of the exploitation regime.

c) We do not support the concept of a financial imposition on profits or capital gains realised through the direct or indirect transfer of exploration rights granted by the ISA.

5. This submission is structured into 4 parts:
   i. ISA Payment Regime
   ii. Equalization Mechanism for taxes paid within the Mining Perimeter
   iii. Review mechanism of the ISA Payment Regime
   iv. Profit-share on direct and indirect transfer of exploitation rights

ISA PAYMENT REGIME

6. **Two-staged variable ad-valorem royalty**: We support the adoption of the OEWG's "Option 4" payment regime (Two-staged progressive ad-valorem royalty) because it will provide the ISA a stable source of income from the start of Commercial Production in the Area independently of whether ISA Contractors generate profit and will be relatively easy to administer.

7. **Basis for the two-staged variable ad-valorem royalty**: In light of the current uncertainties around the valuation of nodules and difficulties establishing a nodule ore price before the start of Commercial Production, we support a royalty levied on a basis consisting of metal prices for Nickel, Copper and Cobalt and medium-grade Manganese ore price for Manganese contained in nodules for the first five years of Commercial Production, followed by moving to a royalty based on nodule ore price thereafter.

   Manganese is fundamentally different from Copper, Nickel and Cobalt markets where high-purity metal product formats account for most of the market. By contrast, Manganese is largely used in the steel industry as an alloying agent and 94% of all Manganese units are never refined to high-purity EMM. We propose to calculate Manganese royalty using medium-grade Manganese ore prices. Manganese ore is closely comparable to nodules and its market price is easily discoverable on several publicly traded commodity exchanges.

8. **Rates for the two-staged variable ad-valorem royalty:** We support the use of the MIT Project Lifetime Model to determine the rates of the royalties, targeting a total tax burden of 42.5%.

   The total tax burden includes mineral royalties, net taxes, levies and charges paid by ISA Contractors to the ISA, to their Sponsoring States and other governments.

   The AG has proposed a total tax burden of 46% based on the analysis of 10 jurisdictions of land-based mining of the same or similar minerals. The ISA Contractors proposed an average total tax burden of 39.2% based on the IMF data set covering 14 jurisdictions of land-based mining of the same or similar minerals. Given that the UNCLOS refers to "*within the range of those prevailing in respect of land-based mining of the same or similar minerals*", intersessional discussions converged on establishing a range of 39-46%, with the average of 42.5%.

9. **Two-staged approach:** We strongly believe that a two-staged approach is needed with reduced royalty rates during the first five years of commercial operations to "*attract investments and technology to the exploration and exploitation of the Area*" (Article 13(1)(b), Annex III of UNCLOS).

   The lower first-stage rate ensures a revenue flow to the ISA whilst the ISA Contractor can recoup part of the investment in developing a new industry.

EQUALIZATION MECHANISM FOR TAXES PAID WITHIN THE MINING PERIMETER

10. **25% tax on profits of collector business in the Area**: Given the pre-commercial phase of the industry, stakeholders can only rely on the MIT Project Lifetime Model to determine the rate of the ad valorem royalty. The current approach is to set ad valorem royalty rates at a level that results in a total tax burden on ISA Contractors that is within the range prevailing for the land-based miners of same or similar minerals. The MIT Model currently assumes that—in addition to the royalties, levies and other charges to the ISA—ISA Contractors pay a 25% tax on the profits of their nodule collector business. Our analysis of headline corporate income tax (CIT) rates of all land-based mining jurisdictions of same or similar minerals available in the PWC Global Tax Summaries data shows that the median headline CIT is 25%, consistent with the MIT Model assumption. We acknowledge that in practice <u>effective</u> tax rate (ETR) paid by land-based miners can be much lower than <u>headline</u> CIT (~20-80% lower). On the other hand, land-based miners can be subject to other taxes in addition to the CIT. Given the level of uncertainty around many of the MIT Model assumptions, we believe that, on balance, assuming that ISA Contractors should pay 25% on profits from their collector business in the Area is fair.

11. **Equalization measure objective:** Setting ISA royalty rates using the MIT Model relies on the assumption that ISA Contractors pay a 25% tax on profits from their collector business in the Area. As AG has pointed out in several of its submissions, if certain ISA Contractors avoid or minimise their tax burden, they would gain an unfair advantage compared to other ISA Contractors and land-based miners of same or similar minerals. AG proposed to design an equalization measure to guard against potential avoidance and minimization of taxes by the ISA Contractors and to ensure that ISA Contractors pay their fair share to the ISA and Sponsoring States. We support AG's intent to create an equalization mechanism in cases where an ISA Contractor's ETR on collector business in the Area is less than the 25% assumed in the MIT Project Lifetime Model.

12. **Equalization mechanism #1 / Additional Royalty (proposed by AG)**: Over the course of multiple submissions and intersessional presentations, AG proposed and developed a mechanism where each ISA Contractor would incur an additional ISA royalty gross liability against which ISA Contractors would be able to offset payments (e.g., mineral royalties, taxes and fees) made to Sponsoring States. The rate of this additional royalty would be set using MIT Project Lifetime Model to be equivalent to 25% tax on profits from the collector business. While we acknowledge that this mechanism would be easy for the ISA to administer because it relies on the same basis as the ISA primary royalty, we strongly oppose this proposal because the mechanism (revenue-based) is disconnected from the objective (profit-based) and can result in serious distortions. We agree with the scenarios articulated by IGF in their intersessional submission dated 23 May 2023:

    i. *"Under a scenario of low mineral prices and/or very high costs, profits would be lower, which would result in lower CIT payments, leaving contractors with less CIT to credit against the additional royalty. As a result, the contractors would end up paying an additional royalty to the ISA over and beyond their CIT payments to the sponsoring state, even if they are paying a full 25% CIT rate. If this happens in unfavourable market conditions, it could put a strain on investors' cash flows. This risks undermining the entire investment proposition in DSM, and may generate calls for renegotiation by the time the additional royalty is supposed to apply."*

    ii. *"Under a scenario of high mineral prices and/or low costs, profits would be higher, which would result in higher CIT payments, leaving the contractor with enough CIT to credit against the additional royalty, even if its CIT rate is much lower than 25%. As a result, the additional royalty would not be fulfilling its role as an equalization measure."*

13. **Equalization mechanism #2 / Additional Profit Share (proposed by IGF):** To address the above issues, IGF proposed a different equalization mechanism—an additional profit share in the form of a cash-flow tax, which belongs to the broader category of resource rent taxes. The details of this mechanism have been described by the IGF in various intersessional presentations. We believe that this mechanism is better aligned with the objective behind the equalization measure and, in principle, we can support it—subject to agreement on (1) acceptable rate of uplift, (2) 25% profit share and (3) the inclusion of all payments to Sponsoring States (e.g., revenue or production based charges should be included). Focusing on net cash flows does simplify the complexity of dealing with accounting standards that can vary significantly across countries (e.g., no need to deal with cross-country differences in depreciation, etc)—albeit the ISA will still have to have access to expertise to audit cash flow statements and tax certificates. The main weakness of this mechanism is that it is focused on the ISA Contractor's nodule collection activities in the Area, leaving scope for corporate structures where parts of collector business are outsourced to other group entities located in lower tax jurisdictions, resulting in a lower tax on the total collector business as currently envisioned in the MIT Model.

14. **Equalization mechanisms / Top-up Profit Share Using GloBE Rules (proposed by a group of commercial contractors):** To address the above issue, we proposed a top-up profit share mechanism based on OECD GloBE Rules (also known as Pillar Two). A detailed presentation on this mechanism with a worked example can be found in the Appendix at the end of this submission.

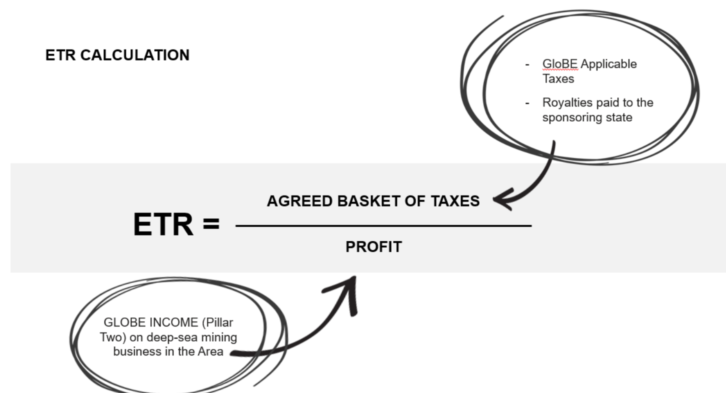
    We propose to perform an annual review of whether ISA Contractor and any group entities participating in collector business meet the 25% ETR requirement, and in cases where ETR is below 25%, for the ISA to impose a top-up profit share that equalizes the ISA Contractor's total collector business to 25%. ISA Contractors' collector businesses can be structured in different ways, with constituent companies spread across different jurisdictions, each with its own accounting rules and standards. This makes arriving at an ETR calculation that would be comparable across ISA Contractors challenging. Fortunately, most of the heavy-lifting in addressing this challenge has already been accomplished by the OECD Model GloBE Rules that have similar goals to the ISA's (i.e., prevent tax avoidance and tax base erosion by multi-national companies) albeit GLoBE Rules mandate a different quantum (i.e., min 15% ETR globally). These rules have been adopted and are now being implemented by over 140 countries and we expect most of the ISA Contractors to be subject to these rules from 2024 onwards. The ETR for ISA Contractor collector business and a top-up to 25% profit share due to the ISA can be calculated applying concepts from the GloBE Rules with the following adjustments:

Building block	**OECD GloBE Rules**	**Adjustments for ISA**
Scope	- Multi-national enterprise groups with revenue above EUR 750M (based on consolidated financial statements). - Certain entities are excluded from Pillar 2.	- No revenue threshold - Scope to be limited to the 'Mining Perimeter', i.e., the ISA Contractor and other constituent entities that are part of the Group for GloBE Rules purposes and have substantial transactions with the ISA Contractor's collector business in the Area
GloBE Income	- **Starting point**: Financial accounting net income/loss per entity used in the preparation of consolidated financial statements of the ultimate parent entity before intercompany eliminations and under an acceptable financial accounting standard. - **Adjustments**: Starting point amount is adjusted to eliminate common book-to-tax differences	- Arrive at GloBE Income using GloBE Rules for the 'Mining Perimeter'

	where that adjustment is justified on policy grounds, including Excluded dividends, Policy disallowed expenses (e.g. illegal payments) and at arm's length provisions to counter profit shifting.	
Covered taxes	- **Starting point:** Current tax expense accrued for Financial Accounting Net Income or Loss. - **Adjustments**: Starting point will be adjusted (through additions and reductions) to reflect certain timing differences.	- Add royalties and any production-based levies paid to the Sponsoring State under GloBE's definition of "Covered taxes"
ETR and top-up profit share calculation	- Effective tax rate (ETR) = Adjusted covered taxes / Adjusted GloBE income - Minimum ETR goal: 15% - Top-up % = 15% - ETR actual	- Effective tax rate (ETR) = Adjusted covered taxes (incl. royalties to sponsoring states) / Adjusted GloBE income for Mining Perimeter - Minimum ETR goal: 25% - Top-up % = 25% - ETR actual - Blending can occur within the Mining Perimeter instead of on a jurisdictional basis
Payment mechanism	- Complex set of rules to decide which jurisdictions gets the top-up	- ISA receives the top-up

Scope: The relevant group companies in the 'Mining Perimeter' would need to be identified to establish the ETR for 'collector business' in the Area. Such approach may in our view remove concerns around potential intra-group profit shifting and provide for a payment system which is neutral towards the organisation of the mining activities. The so-called 'Mining Perimeter' can be defined as the constituent entities that are part of the group for GloBE Rules purposes and have substantial transactions with the ISA Contractor's collector business in the Area. The ISA Contractor will submit to the ISA a detailed disclosure of the corporate structure used to conduct activities in the Area (including the entity that will hold the ISA Exploitation Contract, its subsidiaries, sister companies and third-party companies involved).

Applicable taxes definition: As some Sponsoring States may apply a royalty-based system instead of imposing additional levies through their corporate income tax system, we believe it is fair to add royalties (and similar levies) paid to such Sponsoring States to the GloBE definition of applicable taxes so that they are reflected in the ETR calculation.



Minimum GLOBE ETR: Whereas the ETR goal under GloBE Rules is set at 15%, we propose to increase this rate for ISA purposes to 25% in order to align with the MIT Project Lifetime Model. Furthermore, instead of 'jurisdictional blending' we suggest to blend the GLoBE income and taxes within the Mining Perimeter.

ISA as the recipient of top-up tax: If the ETR within the Mining Perimeter falls below 25%, the ISA is owed a top-up profit share to bring the ISA Contractor's collector business to 25% (A possible GloBE Top-up Tax to get to min 15% ETR goal that is due to a national tax authority should be excluded to avoid double taxation.)

15. **Surgical implementation of GloBE Rules**: We do not propose to implement a full GloBE Rules package, but we do suggest that the top-up profit share works by reference to some of the GloBE Rules building blocks (mainly: GloBE income, Covered Taxes, ETR and top-up calculation). We believe that this approach significantly reduces the complexity for the ISA as the rules around these building blocks are very well developed and currently being implemented globally.

    In addition, it is our expectation that many ISA Contractors will be subject to the GloBE Rules framework. The correct application of these rules (and specifically the calculation of GloBE income and Covered Taxes, ETR and top-up) will already be actively audited by their tax authorities in the context of GloBE Rules. The dataset will already be available for GloBE Rules purposes but can also serve ISA needs to assess a possible top-up profit share as an equalization mechanism.

    It is expected that the OECD will actively monitor the implementation of GloBE Rules and continue to issue guidance, materials, rules, and to close possible loopholes as they are discovered. As the proposed top-up profit share works by reference to certain GloBE building blocks, changes may apply automatically. This would significantly reduce maintenance efforts for the ISA.

16. **ISA Royalty vs. equalization measure**: We would like to stress that the 'corner stone' of the ISA Payment regime under option 4 remains the two-stage variable ad-valorem royalty, ensuring a stable revenue for the ISA. The top-up profit share based on GloBE Rules is only used to ensure that at least 25% tax is paid on the profits of the collector business as assumed in the MIT Project Lifetime Model to determine the rate of the royalty and, if not, to turn the difference between actuals and min targeted ETR into an additional revenue stream for the ISA.

    The mechanism would significantly reduce ISA Contractors' incentive to look for jurisdictions with a lower corporate income tax rate as these jurisdictions would simply trigger a top-up profit share for the ISA.

REVIEW MECHANISM OF THE ISA PAYMENT REGIME

17. **Dealing with high level of uncertainty**: It's important that all stakeholders acknowledge the challenge of designing a fair ISA payment regime and setting rates of payments in the absence of real-world data from commercial operations in the Area and high level of uncertainty around the inputs into the MIT Lifetime Project Model used to set the royalty rates. We believe a pragmatic way to deal with this high level of uncertainty would be as follows:

    i. **Put in place a provisional payment regime and rates for the first five years of Commercial Production in the Area**.

    ii. **Impose continuous disclosure obligations.** ISA should require annual submission of certain information (corporate structure used to conduct collector business, audited accounts for collector business). Standards-compliant prefeasibility and feasibility studies already required by the ISA before the start of Commercial Production, combined with at least four years of audited accounts and disclosure of corporate structures will give the Authority a greater insight into real-world project economics in the Area.

    iii. **Rate review before the end of the first five years**. Equipped with the above-mentioned real-world data for ISA Contractors and a new independent and current analysis of prevailing ranges of the total effective tax burden for land-based miners of same or similar

minerals, the LTC or the Authority's Economic Planning Commission (EPC) should have the mandate to review the fairness of the rates for the second stage of Commercial Production in the light of the updated understanding of ISA Contractor economics and total tax burden on land-based miners of same or similar minerals.

Based on this review, LTC or EPC should be empowered to propose to the Council changes in the rates to ensure that the ISA payment regime delivers on the objectives outlined in UNCLOS and 1994 Implementation Agreement.

iv. **Potential system review**. In alignment with the 1994 Implementation Agreement, Annex Section 8, 1(e) we support the view that system reviews can also occur as part of the regular review mechanism but should be subject to material changes in fundamental assumptions underlying the original design of the ISA payment regime and/or market conditions.

18. **Criteria used in regular reviews to assess payment rates and system**. We believe that 5-year rate reviews by LTC or EPC following the initial five years would ensure the principle of fairness to both ISA and ISA Contractors and enable the ISA to ensure that its rates of payments continue to be within the range of those prevailing in respect of land-based mining of the same or similar minerals—thereby delivering on the provisions of Article 8(1)(b) ("*fair both to the contractor and Authority*") and 8(1)(c) ("*avoid giving deep seabed miners an artificial competitive advantage or imposing on them a competitive disadvantage*").

    We believe that – in order to achieve the above goal – lowering the rate must also be an option during the rate review process (i.e., rates may be adjusted in both directions, depending on the outcome of the review).

PROFIT-SHARE ON DIRECT AND INDIRECT TRANSFER OF EXPLOITATION RIGHTS

19. **The case for ISA profit share on capital gains from transfers of exploitation rights:** We support the principle that the ISA should benefit from growth in value of exploitation rights in the Area, growth that will likely be enhanced by the commercial viability and environmental robustness of the regulatory regime to be adopted by the ISA. Mineral exploitation rights represent the "immovable property" which falls within the Area and could therefore be subject to profit share by the ISA. We therefore support AG's position, also shared by IGF—in line with emerging best practice - that the Authority should share in the financial upside accruing to the ISA Contractor from the sale of exploitation rights.

20. **Profit-share mechanism for direct transfer of exploitation rights**: Following in-depth intersessional discussions, we can support a profit share mechanism that is based on (1) *de minimis* threshold of 20%, (2) *pro rata* taxation of the capital gains on the exploitation rights (any auxiliary value created by ISA Contractors that is sold as part of the transfer should not be subject to profit share by the Authority) and (3) a tax rate within the range of Capital Gains Tax (CGT) for jurisdictions of land-mining of same or similar minerals (our analysis shows 20.5%, see below). We would support such a mechanism subject to three risks being explicitly addressed in the regulatory text:

    i. **Project finance:** As junior miners often use a sale of a stake in the project to raise funding to finance their project development or expansion, we must avoid creating a system which taxes these transactions, which are not intended to generate profit for the ISA Contractor but rather finance its operations. For avoidance of doubt, we would like to see these transactions explicitly excluded from the profit-share mechanism.

    ii. **Intra-group restructuring:** From time to time, groups of companies go through various forms of restructuring and reorganization for a variety of business reasons. No new

capital flows into the group and no capital gains are made. However, the reorganization can take the form of changes in the ownership of the ISA Contractor. For avoidance of doubt, we would like to see these transactions explicitly excluded from the profit-share mechanism.

iii. **Double taxation:** We believe the withholding tax format advocated by the AG and supported by the IGF would put the ISA Contractor at high risk of being double-taxed for the same capital gains, once by the Authority and again by the Sponsoring State (in case of direct transfers) or another jurisdiction (in case of indirect transfers). One of the contractors sought tax advice on this matter from an audit firm who confirmed this risk of double taxation for jurisdictions hosting that contractor's and related corporate structure companies. We view the ISA putting in place double-taxation treaties with Sponsoring States and other potentially relevant jurisdictions as extremely unlikely, leaving the ISA Contractor no recourse against double taxation. To remedy this, we would like to see regulatory text where (1) Member States commit to offering unilateral tax relief for ISA Contractors for the profit share paid to the ISA on the capital gains from the direct transfer of exploitation rights and (2) the Authority commits to indemnifying the Contractor against double taxation in cases where a non-Member State does not offer unilateral tax relief.

21. **Profit-share basis and rate for direct transfer of exploitation rights:**
    i. **Basis:** We suggest that the relevant basis for the purpose of the profit share should be the value of the exploitation rights, net of development expenses to the point of sale. Other business elements that contributed to this valuation (for example IP and knowhow, patent estate, physical production assets and on-land facilities, good will, other activities) should be excluded from the value relevant for the purpose of determining the base for the ISA profit share.

    ii. **Rate:** The AG proposed rate of 25% needs further validation through an independent study of CIT and capital gains tax (CGT) rates prevailing in respect of land-based mining of the same or similar minerals. While in some jurisdictions, corporate capital gains are subject to CIT rates, in others the rates are lower or not subject to any taxation (see PWC capital gains tax rates summaries). Our analysis of land-based mining jurisdictions accounting for 96% of manganese, 90% of cobalt, >80% of copper and 80% of nickel production globally (USGS 2023 commodity summaries) shows that the median headline CIT is 25% and CGT is 20.5%. We also note that headline rates can diverge significantly from effective tax rates paid by land-based miners which can be 20-80% lower due to both, financial incentives granted by local governments and land-based miners structuring their operations to minimize their local tax burden. Based on our analysis, we believe that 20.5% profit share rate would be fair.

22. **Profit-share mechanism for <u>indirect transfer</u> of exploitation rights:** We observe that intersessional discussions have highlighted the complexities of administering a profit share on profits or capital gains realized through the indirect transfer of exploitation rights, and that it may not be practical or proportionate to introduce such an imposition during the initial few years of the ISA's administration of the exploitation regime. We anticipate significant complexity and burden for the Authority and Contractors in administering a mechanism to impose a profit-share on indirect transfers of ownership. In case indirect transfers would be subject to ISA profit share, careful attention should be given to the fact that these capital gains (on shares) can be realized in every jurisdiction (i.e., not only in the sponsoring states and possibly outside the 'Mining Perimeter') and that taxation regimes may significantly deviate. For example, some countries may grant a capital gain exemption on shares (usually subject to specific conditions), whilst others may deem these gains taxable (be it at a lower or higher tax rate). We consider this to be unpredictable and would like to stress that double or unfair taxation can never be the goal of any taxation system. Hence, in case indirect transfers would be targeted, we propose to work on a mechanism which may provide for relief in case of double taxation.

23. **Transfer of <u>exploration rights</u>:** At this time, we do not support the concept of a profit share on profits or capital gains realised through the direct or indirect transfer of exploration rights granted

by the ISA. On a practical level, it would be helpful if the Authority could finalize and adopt exploitation regulations, before re-opening exploration regulations. We do not believe that much revenue can be obtained by the Authority from direct and indirect transfers of exploration rights at this time because in the absence of final exploitation regulations, deepsea ~~miners~~ explorers are trading at an order of magnitude lower valuations compared to land-based development projects for same and similar minerals at similar stage of development. For many deepsea explorers, valuations are currently below the total development capital spent on the projects.

June 2023

INTER-SESSIONAL DISCUSSION ON ISA PAYMENT REGIME: EQUALIZATION MEASURE

TOP-UP PROFIT SHARE BASED ON GLOBE RULES – UPDATED CONTRACTOR PROPOSAL

CONTENTS

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- How to adapt GloBe Rules for ISA purposes?
- How would the ‘top-up profit share’ equalization mechanism work?
- How does the top-up profit share compare to other proposed equalization mechanisms?
- Translating top-up profit share mechanism into regulatory text

A NOTE ON TERMINOLOGY

Focus of this presentation

Effective Tax Rate' or 'ETR' has been used to mean different things in various contexts.
For avoidance of doubt, we would like to propose to distinguish between 'Total ETR' and 'ETR on profit.'

TOTAL Effective Tax Rate

This is a total tax burden paid by miners on their mining business. This metric is important because we use it to derive ISA royalty rates: our goal is to pick a rate that would result in the total tax burden on ISA Contractors that is within the range of total tax burden with regard to land-based miners of same or similar minerals.

The range for total ETR currently under consideration is 39-46%.

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ISA Royalty and other levies on revenue

This is a component of the total tax burden that deals with royalties on mineral rights and other charges like the ISA environmental levy.

The rates are derived by assuming an ETR on profit from the mining business in the Area and making sure that chosen rates would impose a total ETR that is within the range of those prevailing with regard to land-based miners of same or similar minerals.

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Effective Tax Rate on profit / income

This component of the total tax burden includes taxes on profit (often described as 'income') like Corporate Income Tax (CIT). Income tax structures and definitions vary by jurisdiction and can include other taxes than just CIT. This is the component covered by the OECD GloBE Rules and is the focus for the purpose of the equalization measure proposed in this presentation.

The ETR on profit currently assumed in the MIT Project Lifetime Model is 25%.

EQUALIZATION MEASURE SUPPORTS ISA ROYALTY.

Focus of this presentation

	ISA Royalty	Equalization measure
Objective	- Ensure fair compensation to the ISA for granting rights to develop deepsea minerals deemed Common Heritage of Humankind - Without (dis-)advantaging ISA Contractors compared to land-based miners of same or similar minerals - While attracting investment and technology to the exploration and exploitation of the Area	- Prevent ISA Contractors from avoiding or minimizing their Effective Tax rate (ETR) on profit from their mining business in the Area through Sponsorship Agreements and other arrangements with Sponsoring States and other governments - Ensure that the ETR on profit from the ISA Contractor's mining business in the Area is at least 25% (an assumption used in the MIT Project Lifetime Model to determine the rate of the 2-stage progressive ad-valorem royalty)
Mechanism	Option 4: **2-stage variable ad valorem royalty**	Contractors' proposal: **Top-up profit share**
Methodology to derive specific rate / top-up amount	1. **Comparative range**: What is the total tax burden (incl. mineral royalties and taxes) on land-based miners of same or similar minerals over the life of a mine? Establish a range using a best-practice methodology (e.g., IMF's FARI). Currently proposed total ETR range is 39-46%. 2. **Royalty rate that fits the range**: Which ad valorem royalty rate would result in a total tax burden on ISA Contractors falling within the above range, assuming that in addition to ISA royalties, ISA Contractors pay an Effective Tax Rate (ETR) of 25% on profit from their mining business in the Area to their Sponsoring States and other governments?	1. **ETR on profit calculation**: Excluding ISA royalties and levies, what is the ETR that each ISA Contractor pays on their profit from the mining activities in the Area? Require each ISA Contractor to submit an audited ETR calculation annually using adjusted OECD GloBe Rules. 2. **Top-up profit share calculation**: If ETR on profit is less than 25%, how much top up profit share should each ISA Contractor pay to the ISA to equalize to 25%? Require each ISA Contractor to submit an audited ISA top-up profit share calculation using adjusted OECD GloBe Rules.

WHY DO WE NEED AN EQUALIZATION MEASURE?

Equalization measure

- Prevent ISA Contractors from avoiding or minimizing their Effective Tax rate (ETR) on profit from their mining business in the Area through Sponsorship Agreements and other arrangements with Sponsoring States and other governments
- Ensure that the ETR on profit from the ISA Contractor's mining business in the Area is at least 25% (an assumption used in the MIT Project Lifetime Model to determine the rate of the 2-stage progressive ad-valorem royalty)

Contractors' proposal:
Top-up profit share

1. **ETR on profit calculation**: Excluding ISA royalties and levies, what is the ETR that each ISA Contractor pays on their profit from the mining activities in the Area? Require each ISA Contractor to submit an audited ETR calculation annually using adjusted OECD GloBe Rules.
2. **Top-up profit share calculation**: If ETR on profit is less than 25%, how much top up profit share should each ISA Contractor pay to the ISA to equalize to 25%? Require each ISA Contractor to submit an audited ISA top-up profit share calculation using adjusted OECD GloBe Rules.

Given the pre-commercial phase of the industry, the MIT Project Lifetime Model is used to determine the rates of the 2-stage variable ad valorem royalty while aiming for a total tax burden that falls within the range prevailing with regard to land-based miners of same or similar minerals.

The MIT Project Lifetime Model assumes that—in addition to mineral royalties and other levies to the ISA — ISA Contractors will pay an ETR of 25% on profit from their mining business in the Area to their Sponsoring States and other governments.

If certain ISA Contractors avoid or minimize payments of taxes on profit from their mining business in the Area, their total tax burden can fall below the range of those prevailing with regard to land-based miners of same or similar minerals and other ISA Contractors who pay their fair share, putting tax-minimizing ISA Contractors at an unfair advantage.

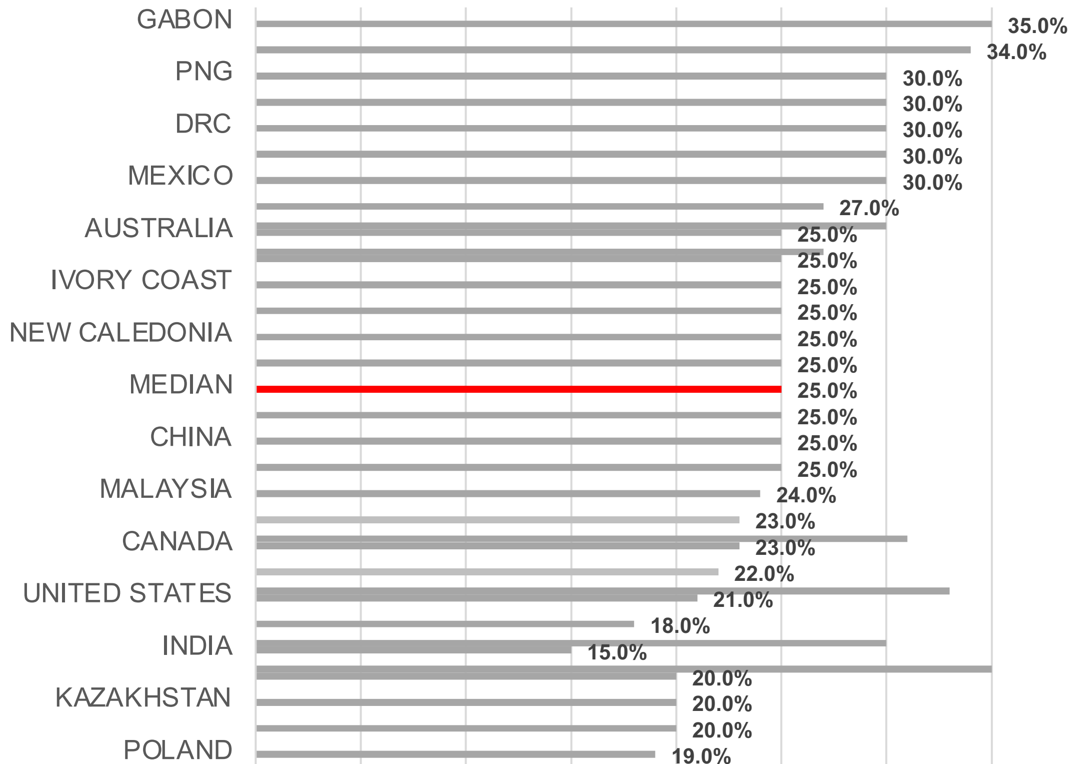
An "Equalization Measure" is needed to make sure this does not happen.

WHY MINIMUM 25%?

Land-based miners are subject to 25% CIT

Headline CIT Tax Rate in Selected Mining Jurisdictions

accounting for 96% of Mn, 90% of Co, >80% of Cu and 80% Ni mining (2022 USGS)



Source: PWC global tax summaries, visited on April 30, 2023

Note on ETR on profit vs CIT

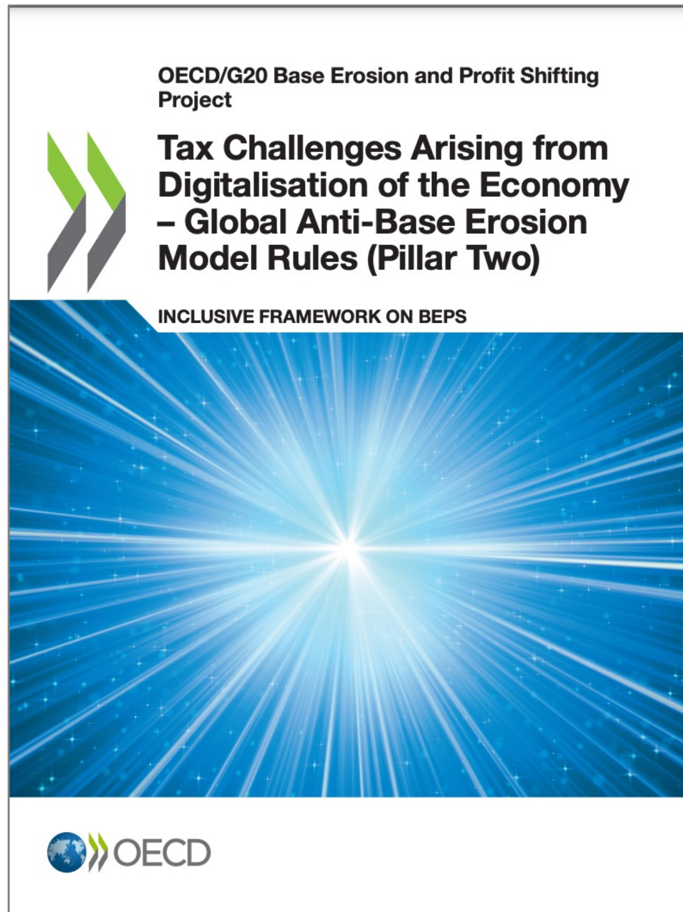
The MIT Project Lifetime Model uses the assumption that in addition to the mineral royalties and levies to the ISA, ISA Contractors pay a 25% tax of their profit from their mining business in the Area. Although the model calls this tax Corporate Income Tax (CIT) for simplicity, we propose to treat this assumption as a proxy for the ETR on profit that should be paid by ISA Contractors.

To validate the 25% ETR on profit assumption, we have analyzed Headline CIT rates of all 15 land-based mining jurisdictions of same and similar minerals contained in the PWC Global Tax Summaries. Our analysis shows that land-based miners are subject to a headline median CIT of 25%. Headline CIT is not a perfect proxy for ETR on profit paid by land-based miners because in practice (1) many land-based miners pay less than headline CIT but (2) they may also be subject to other taxes in addition to CIT.

Profit (income) based taxation regimes are complex and vary significantly by country and even by company. However, we believe that—on balance—a headline CIT of 25% provides a satisfactory level of validation for setting the Equalization Measure at min 25%.

WHY USE "OECD ANTI GLOBAL BASE EROSION" or "GloBE" Rules?

Also known as "Pillar Two Model Rules"



Background

- **Over 140 jurisdictions** agreed to enact an OECD Inclusive Framework to update key elements of the international tax system and implement a **15% global minimum tax rate**.
- GloBE Rules provide a co-ordinated system of taxation that **imposes a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis is below the 15% minimum rate.**
- Model GloBE Rules, Commentary, Administrative Guidance, Safe Harbours and Penalty Relief, Examples, Background material have all been developed. Consenting governments have to **convert these rules into national law by end of 2023**.

How do GloBE Rules help the ISA?

ISA Contractors' collector business can be structured in different ways, with constituent companies spread across different jurisdictions, each with its own accounting rules and standards. This makes arriving at an ETR on profit calculation that would be comparable across ISA Contractors challenging.

Fortunately, most of the heavy-lifting in addressing this challenge has already been accomplished by the OECD Model GloBE Rules that have similar goals to the ISA's (i.e., prevent tax avoidance and tax base erosion by multi-national companies) albeit with a different target quantum (i.e., min 15% ETR globally).

Because GloBE Rules are being implemented in over 140 jurisdictions, there is already an established community of accountants and auditors who will be able to implement and audit, diminishing the audit burden on the ISA. Also national tax authorities are gaining in depth knowledge about the rules.

If any loopholes are discovered during the implementation, the OECD project will continue evolving rules, guidance and background materials to close these loopholes, lessening the need for the ISA to do so.

Source: https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm; https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf
https://www.pwc.com/gx/en/services/tax/pillar-two-readiness/country-tracker.html#:~:text=Under%20an%20OECD%20Inclusive%20Framework,the%20digitalization%20of%20the%20economy

GLOBE RULES ENABLE A SIMPLE ETR CALCULATION THAT CAN BE COMPARED ACROSS JURISDICTIONS.

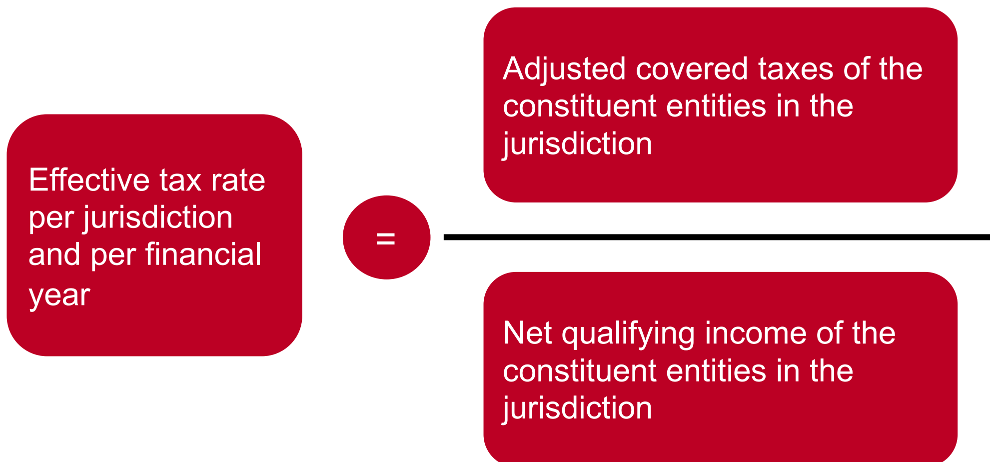
GloBE Rules define Applicable Taxes and all allowed adjustments

$$ETR = \frac{\text{COVERED TAXES}}{\text{INCOME}}$$

GloBE Rules define GLOBE INCOME and all allowed adjustments

GLOBE RULES: ONCE YOU HAVE ETR, CALCULATING TOP-UP TAX IS SIMPLE.

STEP 1: Calculate ETR

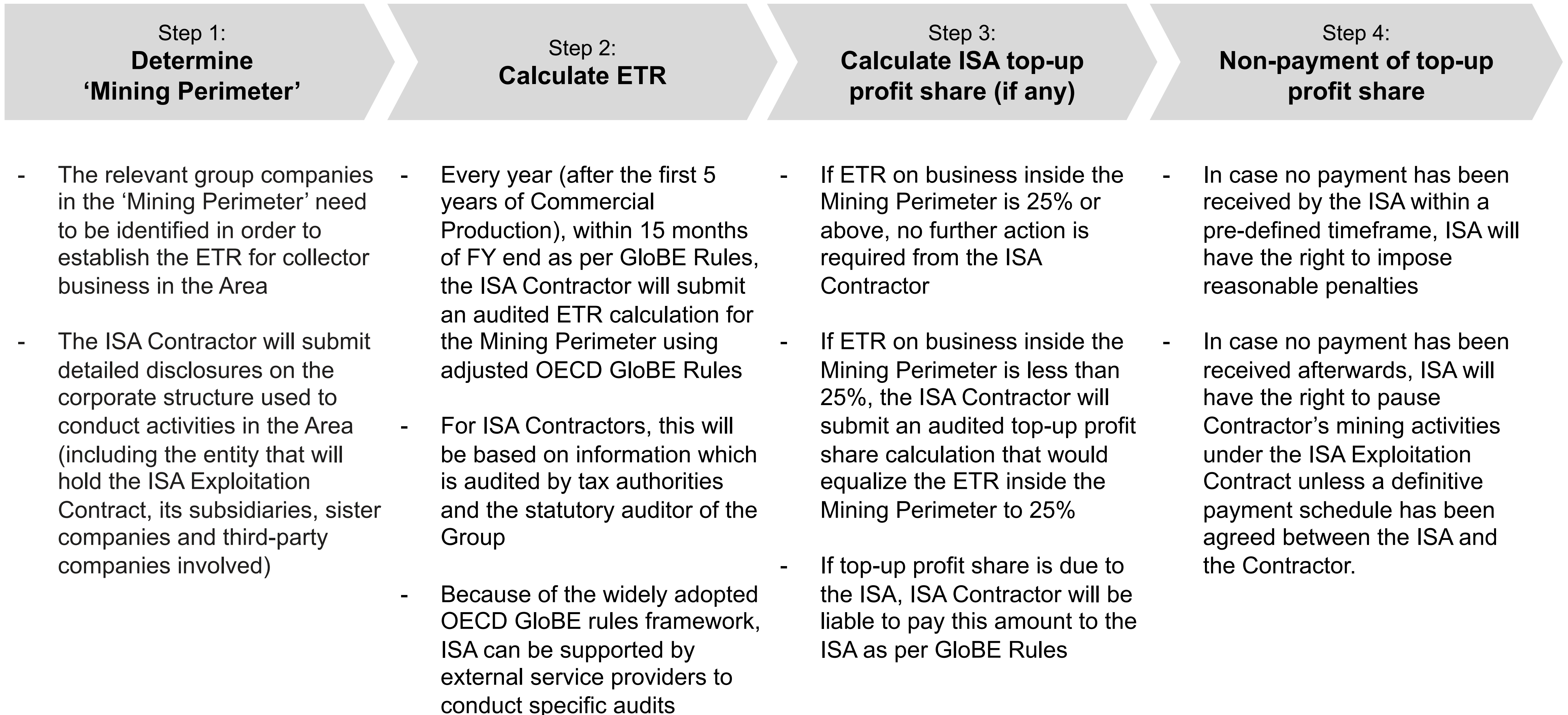


STEP 2: Calculate top-up tax percentage

HOW TO ADJUST GLOBE RULES FOR ISA PURPOSES?

	OECD GloBE Rules	Adjustments for ISA
Scope	- Multi-national enterprise groups with revenue above EUR 750M (based on consolidated financial statements). - Certain entities are excluded from Pillar 2.	- No revenue threshold - Scope to be limited to the 'Mining Perimeter' = the ISA Contractor and other constituent entities that are part of the Group for GloBE Rules purposes and have substantial transactions with the ISA Contractor's collector business in the Area
GloBE income	- **Starting point**: Financial accounting net income/loss per entity used in the preparation of consolidated financial statements of the ultimate parent entity before intercompany eliminations and under an <u>acceptable financial accounting standard</u>. - **Adjustments:** Starting point amount is adjusted to eliminate common book-to-tax differences where that adjustment is justified on policy grounds, including Excluded dividends, Policy disallowed expenses (e.g. illegal payments) and at arm's length provisions to counter profit shifting.	- Arrive at GloBE income using GloBE Rules for the 'Mining Perimeter'
Covered taxes	- **Starting point:** Current tax expense accrued for Financial Accounting Net Income or Loss. - **Adjustments**: Starting point will be adjusted (through additions and reductions) to reflect certain timing differences.	- Add royalties paid to the Sponsoring State under GloBE's definition of "Covered taxes"
ETR and top-up calculation	- ETR = Adjusted covered taxes / Adjusted GloBE income - Minimum ETR: 15% - Top-up % = 15% - ETR - Calculated per jurisdiction	- Effective tax rate (ETR) = (Adjusted covered taxes + Sponsoring State royalties) / Adjusted GloBE income for Mining Perimeter - Minimum ETR: 25% - Top-up % = 25% - ETR - Blended for Mining Perimeter (not per jurisdiction)
Payment mechanism	- Complex set of rules to decide which jurisdictions gets the top up	- ISA receives the top-up profit share

HOW WOULD THE 'TOP-UP PROFIT SHARE' MECHANISM WORK?

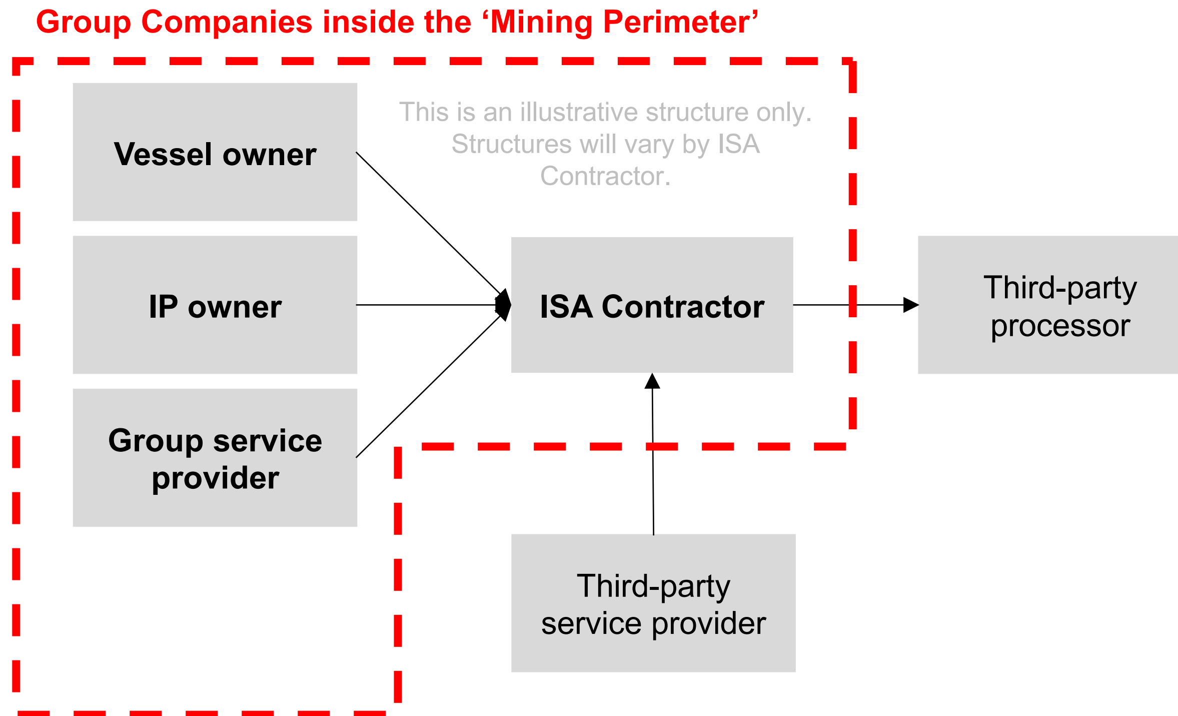


WORKED EXAMPLE (1/3)

'Mining Perimeter' should include the ISA Contractor and all constituent Group Companies for GloBE Rules purposes that have substantial transactions with the ISA Contractor's collector business in the Area

This approach removes potential concerns around intra-group profit shifting. It also creates a payment system that is neutral with regard to how the ISA Contractors structure their mining business in the Area.

In case a constituent entity within the Mining Perimeter has mixed activities, a segmented bookkeeping may be required.



WORKED EXAMPLE (2/3)

Calculate the ETR within the Mining Perimeter, applying the rules around GloBE Income and Covered Taxes.

Add royalties (and similar levies) paid to Sponsoring States to the GloBE definition of applicable taxes.

Royalties paid to the ISA will not be included in the calculation.

Mining Perimeter

$$\frac{19{,}500 \text{ total Covered Taxes}}{150{,}000 \text{ total GloBE Income}} = \mathbf{13\%} \text{ GloBE ETR}$$

Entity	GloBE income	Covered taxes
ISA Contractor	85,000	12,750
Vessel owner	40,000	4,000
IP owner	10,000	500
Group service provider	15,000	2,250

WORKED EXAMPLE (3/3)

Given that ETR inside the Mining Perimeter in our example is 13% only (less than 25% min ETR goal), the ISA Contractor will have to pay a 12% profit share on their GloBE Income = 18,000 to the ISA.

Note: In cases where the Group inside the Mining Perimeter is also subject to and has paid a top up to the OECD minimum 15% ETR, ISA would only be entitled to 25—15%=10% profit share (10% x 150,000 GloBE Income= 15,000). This adjustment would avoid double taxation of the ISA Contractor's GloBE income.

25% - **13%** = **12%**

Min ETR

ETR inside Mining Perimeter

Top-up profit share for ISA

12% x 150,000 total GloBE Income =

18,000

HOW DOES 'TOP-UP PROFIT SHARE' COMPARE TO OTHER PROPOSED EQUALIZATION MECHANISMS?

	ADDITIONAL ROYALTY	ADDITIONAL PROFIT SHARE ON NET CASH FLOWS	TOP-UP PROFIT SHARE ON GloBE INCOME
Proponent	African Group	IFG	Commercial Contractors
Description	Additional 8% ISA royalty gross liability against which ISA Contractors can offset taxes paid to Sponsoring States	Additional 25% profit share gross liability on pre-tax net cashflows from the mining business in the Area against which ISA Contractors can offset cash taxes paid on their mining business in the Area to Sponsoring States and other governments	Top-up (to 25%) profit share on mining business in the Area paid by ISA Contractors whose annual ETR is <25%
Pro's	- Simple to administer because it is based on the same mechanism as the primary ISA Royalty	- Mechanism (net cash-flow based) close to the modelling of CIT in the MIT Model (net cash-flows adjusted for linear depreciation)	- Mechanism (profit-based) closely aligned with the goal (profit-based) - Simple to administer and maintain as it relies on existing rules developed by the OECD - ISA in-depth audits can be outsourced to external service providers as the rules will be implemented in over 140 countries
Con's	- Mechanism (revenue-based) divorced from the goal (profit-based), can lead to fundamental distortions because additional royalty rate is set based on 25% CIT in the MIT model that has lower than +/- 50% accuracy level for costs - Assumes that all aspects of the collector business as modelled in the MIT Model would by conducted by the Contractor and taxed by the Sponsoring State, penalizing all other ways to organize collector business - Can push ISA Contractors outside the range of total tax burden of land-based miners of same or similar minerals	- Requires development of custom rules and guidance on how to calculate net cash flows, covered taxes, etc - More complex to administer - Vulnerable to tax base erosion (e.g., outsourcing parts of collector business to group companies in lower-tax jurisdictions) and tax avoidance (e.g., loading ISA Contractor with overstated costs from group entities)	- Requires some adjustment of GloBE Rules to fit ISA purposes - May result in minor deviations between mechanism (profit-based) and MIT model assumptions (based on net cash flows adjusted for linear depreciation)

KEY TAKEWAYS

- ✓ **Corner stone of the ISA Payment regime remains the 2-stage progressive ad-valorem royalty,** ensuring a stable revenue for the ISA.

  The equalization mechanism is only used to verify that ISA Contractors pay at least 25% ETR on profit from the mining activities in the Area, and if that is not the case, ISA Contractors pay a top-up profit share to the ISA to equalize their ETR to 25%.

  The mechanism would significantly reduce ISA Contractors' incentive to look for jurisdictions with a lower corporate income tax rate as lower tax jurisdictions would trigger an ISA top-up profit share.

- ✓ We do not propose to implement a full OECD GloBE Rules ('Pillar Two') package, but we do propose that the ISA **top-up profit share works by reference to some of the GloBE Rules building blocks** (mainly: GloBE Income and Covered Taxes)**.** We believe that this approach **significantly reduces the complexity for the ISA** as the rules around these building blocks are well developed and currently being implemented globally.

- ✓ In addition, it is our expectation that a lot of ISA Contractors will be subject to GloBE Rules ('Pillar Two'). The correct application of these rules (and specifically the calculation of GloBE Income and Covered Taxes) will **already be actively audited by their tax authorities** in the context of Pillar 2. The dataset needs to be available for Pillar 2 purposes anyway, but can also serve ISA needs to assess a possible top-up profit share.

- ✓ Lastly, it is expected that the **OECD will actively monitor the implementation of GloBE Rules** and continues to issue guidance, materials, rules (potentially also to close possible loopholes (if any)… As the proposed ISA top-up profit share mechanism works by reference to certain GloBE Rules building blocks, changes may apply automatically. It is clear that this would significantly reduce maintenance efforts for the ISA.

PRELIMINARY DRAFT

TRANSLATING TOP-UP PROFIT SHARE MECHANISM INTO REGULATORY TEXT (1/2)

Source	Reg	Amended text marked in tracked changes	Explanation and commentary
BNFTC	Draft Regulation 64	**Contractor shall pay royalty** 1. A Contractor, from the date of commencement of Commercial Production, shall pay a royalty in respect of the mineral-bearing ore sold or removed without sale from the Contract Area as determined in appendix IV to these regulations. 2. The date of commencement of Commercial Production, will be the date notified according to Regulation 27(2). 3. In addition to the royalty referred to in Regulation 64(1), a Contractor may be required to pay a top-up profit share on their profit from the mining activities in the Area as determined in Appendix IV to these regulations.	
BNFTC	Appendix IV	**3. Determining a top-up profit share** The top-up profit share on Contractor's mining activities in the Area may be payable to the Authority on an annual basis starting in the financial year following five years after the first day of Commercial Production. The top-up profit share shall be calculated in accordance with the Standard and taking into account the Guidelines.	

PRELIMINARY DRAFT

TRANSLATING TOP-UP PROFIT SHARE MECHANISM INTO REGULATORY TEXT (2/2)

Source	Reg	Amended text marked in tracked changes	Explanation and commentary
	Standard	**6. Calculation and payment of the Top-Up Profit Share** 1. **OECD GLoBE Rules** shall be used for the purpose of defining Group companies inside the Mining Perimeter and calculating Income, Covered Taxes, ETR and Top-up Profit Share subject to modifications outlined below. 2. **'Mining Perimeter':** Contractor and other constituent entities that are part of the Group for GloBE Rules purposes and have substantial transactions with the ISA Contractor's mining business in the Area will be deemed to be inside the 'Mining Perimeter.' No revenue thresholds or exemptions will apply. A Contractor shall submit to the Authority twelve months before the start of Commercial Production and every year thereafter, a detailed disclosure of the corporate structure used to conduct mining activities in the Area ('Group companies inside the Mining Perimeter'). 3. **Income:** Income for GloBE Rules purposes will be defined as consolidated income generated by Contractor group companies inside the Mining Perimeter. 4. **Covered taxes**: Covered taxes for GloBE Rules purposes will include any mineral royalties or other revenue-based levies paid by the Contractor group companies inside the Mining Perimeter to the Sponsoring State and other governments. 5. **ETR calculation**: Effective Tax Rate (ETR) calculation will be executed as per GloBE Rules but blended for the Mining Perimeter (adding up all Income and all covered taxes for group companies inside the Mining Perimeter). A Contractor shall submit to the Authority within 15 months of the end of the 6th financial year of Commercial Production and every year thereafter an ETR calculation for Mining Perimeter companies audited by an independent auditor qualified in the application of GloBE Rules. If ETR calculation shows ETR for the Mining Perimeter of 25% or more, no further action is required by the Contractor. 6. **Top-up profit share calculation**: If ETR for the Mining Perimeter is below 25%, Contractor will submit an independently audited top-up profit share calculation to equalize Mining Perimeter ETR to 25%. 7. **Payment of top-up profit share**: If a top-up profit share is due to the Authority, the profit share shall be payable to the Authority within [90] days.	