Intersessional Workshop Hosted by Australia & South Africa
23 May 2023

INTER-SESSIONAL DISCUSSION ON ISA PAYMENT REGIME: EQUALIZATION MEASURE

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

CONTENTS

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.

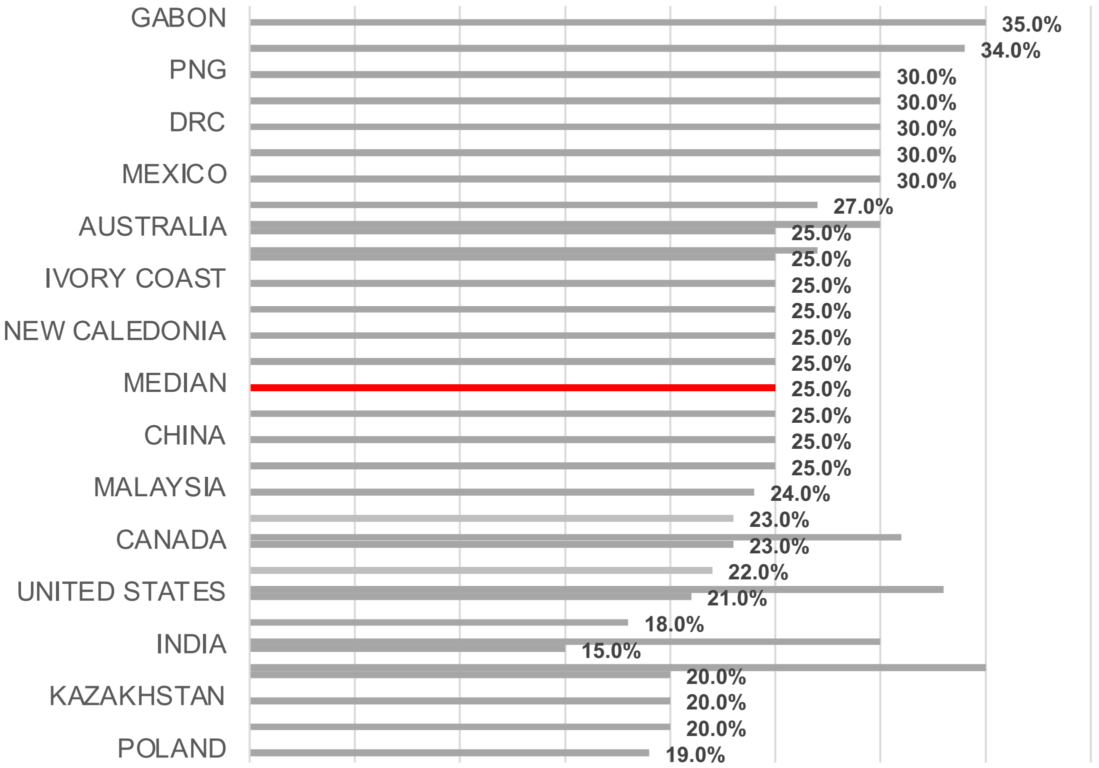
An "Equalization Measure" is needed to make sure this does not happen.

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

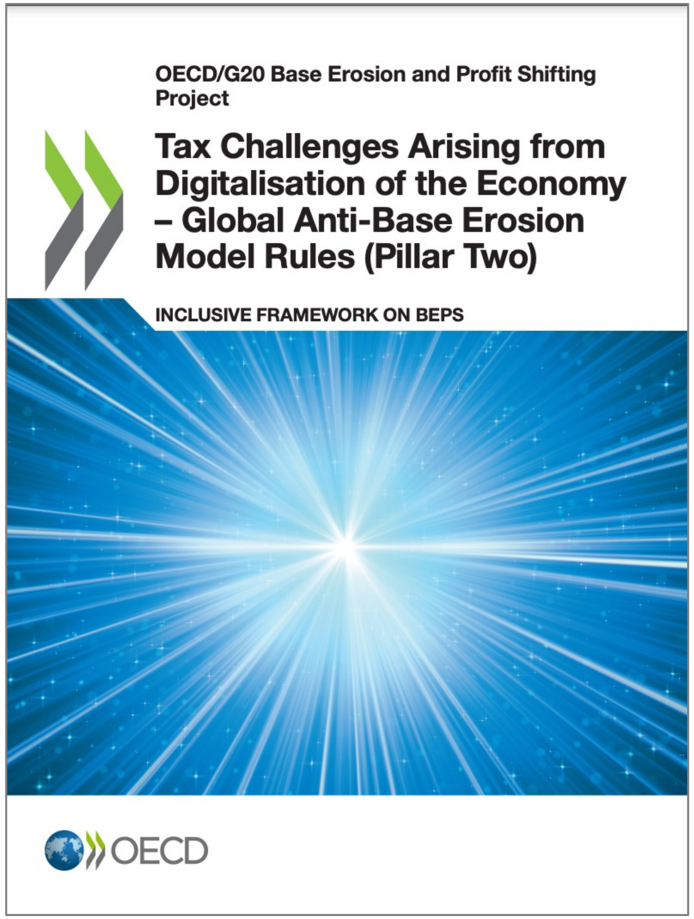
The MIT Project Lifetime Model uses the assumption that in addition to the mineral royalties and levies to the ISA, ISA Contractors pay a 25% tax of their profit from their mining business in the Area. Although the model calls this tax Corporate Income Tax (CIT) for simplicity, we propose to treat this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

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

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

Effective tax rate per jurisdiction and per financial year

=

Adjusted covered taxes of the constituent entities in the jurisdiction

———

Net qualifying income of the constituent entities in the jurisdiction

STEP 2: Calculate top-up tax percentage

15%
Minimum ETR

-

e.g.,
10%
ETR per jurisdiction

=

e.g.,
5%
Top-up tax per jurisdiction

HOW TO ADAPT 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 undertake activities that are covered by the ISA Exploitation Contract
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 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 - Consolidated 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?

Step 1:
Determine ‘Mining Perimeter’

- The relevant group companies in the ‘Mining Perimeter’ need to be identified in order to establish the ETR for deep-sea mining business in the Area
- The ISA Contractor will submit detailed disclosures on 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)

Step 2:
Calculate ETR

- Every year (after the first 5 years of Commercial Production), within 15 months of FY end as per GloBE Rules, the ISA Contractor will submit an audited ETR calculation for the Mining Perimeter using adjusted OECD GloBE Rules
- For ISA Contractors, this will be based on information which is audited by tax authorities and the statutory auditor of the Group
- Because of the widely adopted OECD GloBE rules framework, ISA can be supported by external service providers to conduct specific audits

Step 3:
Calculate ISA top-up profit share (if any)

- If ETR on business inside the Mining Perimeter is 25% or above, no further action is required from the ISA Contractor
- If ETR on business inside the Mining Perimeter is less than 25%, the ISA Contractor will submit an audited top-up profit share calculation that would equalize the ETR inside the Mining Perimeter to 25%
- If top-up profit share is due to the ISA, ISA Contractor will be liable to pay this amount to the ISA as per GloBE Rules

Step 4:
Non-payment of top-up profit share

- In case no payment has been received by the ISA within a pre-defined timeframe, ISA will have the right to impose reasonable penalties
- In case no payment has been received afterwards, ISA will have the right to pause Contractor’s mining activities under the ISA Exploitation Contract unless a definitive payment schedule has been agreed between the ISA and the Contractor.

WORKED EXAMPLE (1/3)

Step 1: **Determine ‘Mining Perimeter’**

Step 2: Calculate ETR

Step 3: Calculate ISA top-up profit share (if any)

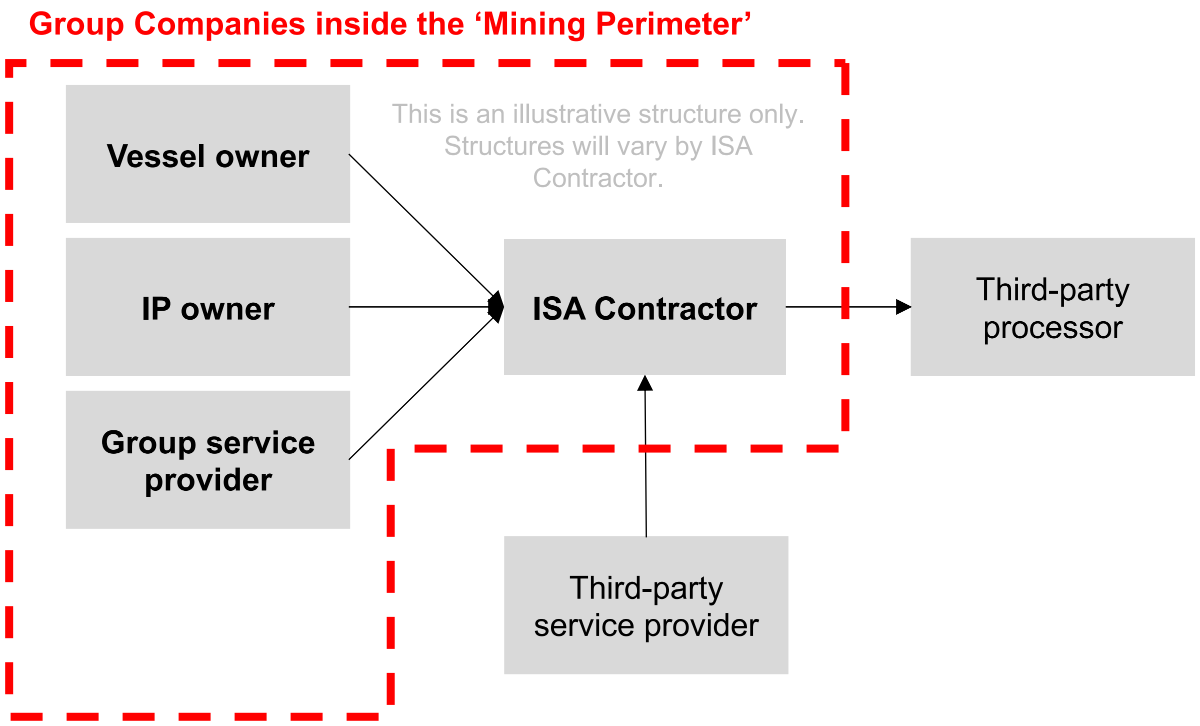
Step 4: Non-payment of top-up profit share

‘Mining Perimeter’ should include the ISA Contractor and all constituent Group Companies for GloBE Rules purposes that undertake activities covered by the ISA Exploitation Contract.

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.

‘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.

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



WORKED EXAMPLE (2/3)

Step 1:
Determine 'Mining Perimeter'

Step 2:
Calculate ETR

Step 3:
Calculate ISA top-up profit share (if any)

Step 4:
Non-payment of top-up profit share

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

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

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

WORKED EXAMPLE (3/3)

Step 1:
Determine ‘Mining Perimeter’

Step 2:
Calculate ETR

Step 3:
Calculate ISA top-up profit share (if any)

Step 4:
Non-payment of top-up profit share

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 - Starts from the financial results, which will also be audited by a company's statutory auditor - 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 - 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 avoidance, specifically cost overstatement (costs need to be audited and as well as link with the financial statements) - Potential for double taxation	- 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.

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 that undertake activities covered by the ISA Exploitation Contract 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 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.	