IGF contribution to the Inter-sessional Discussion on ISA Payment Regime: Equalization Measure

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Understanding the Interaction Between the Four Payment Options and Sponsoring State Taxes

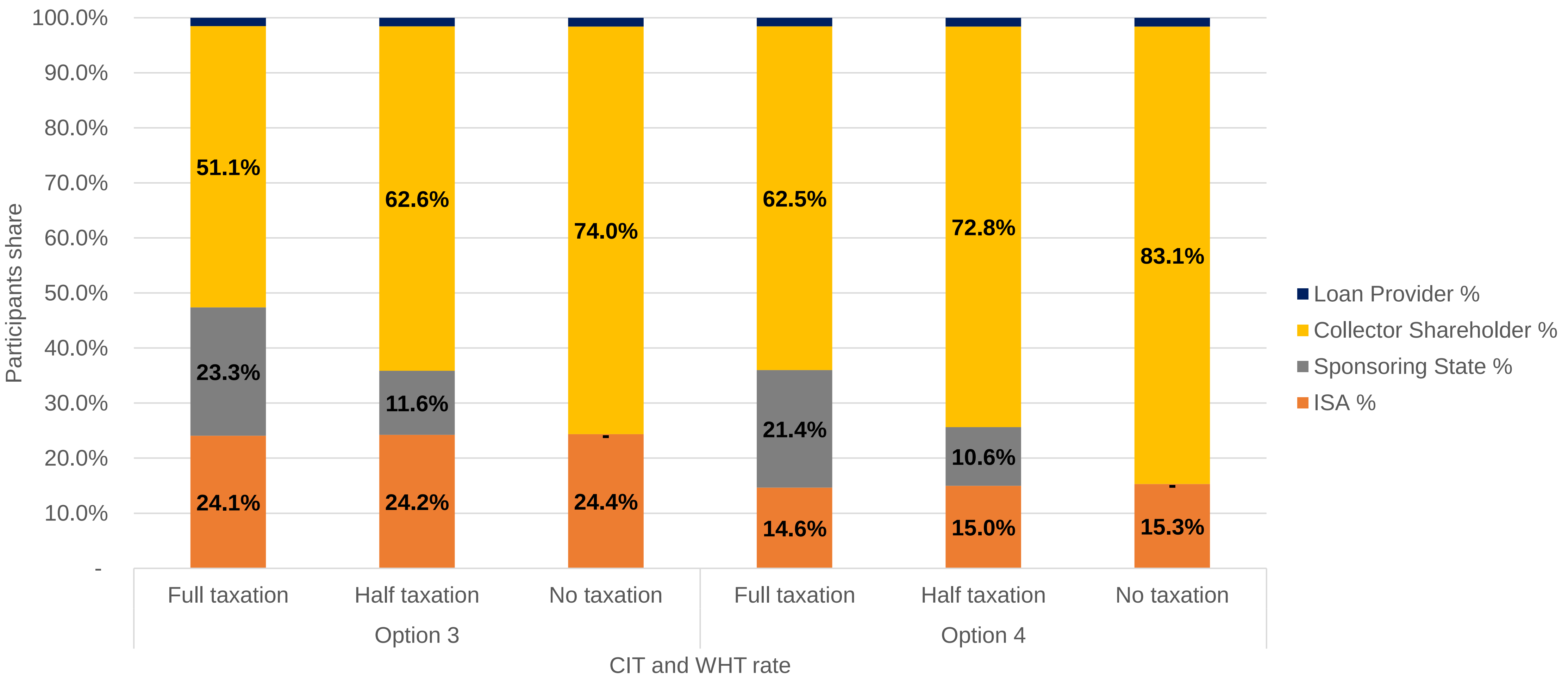
Understanding the impact of Sponsoring State taxes

We model three scenarios for Options 3 and 4:

- Full taxation: 25% CIT and 10% WHT on services, interests, and dividends
- Half taxation: 12.5% CIT and 5% WHT on services, interests, and dividends
- No taxation: 0% CIT and 0% WHT on services, interests, and dividends

Low or zero taxation in sponsoring states has a big impact on the AETR

Participants share under Options 3 and 4



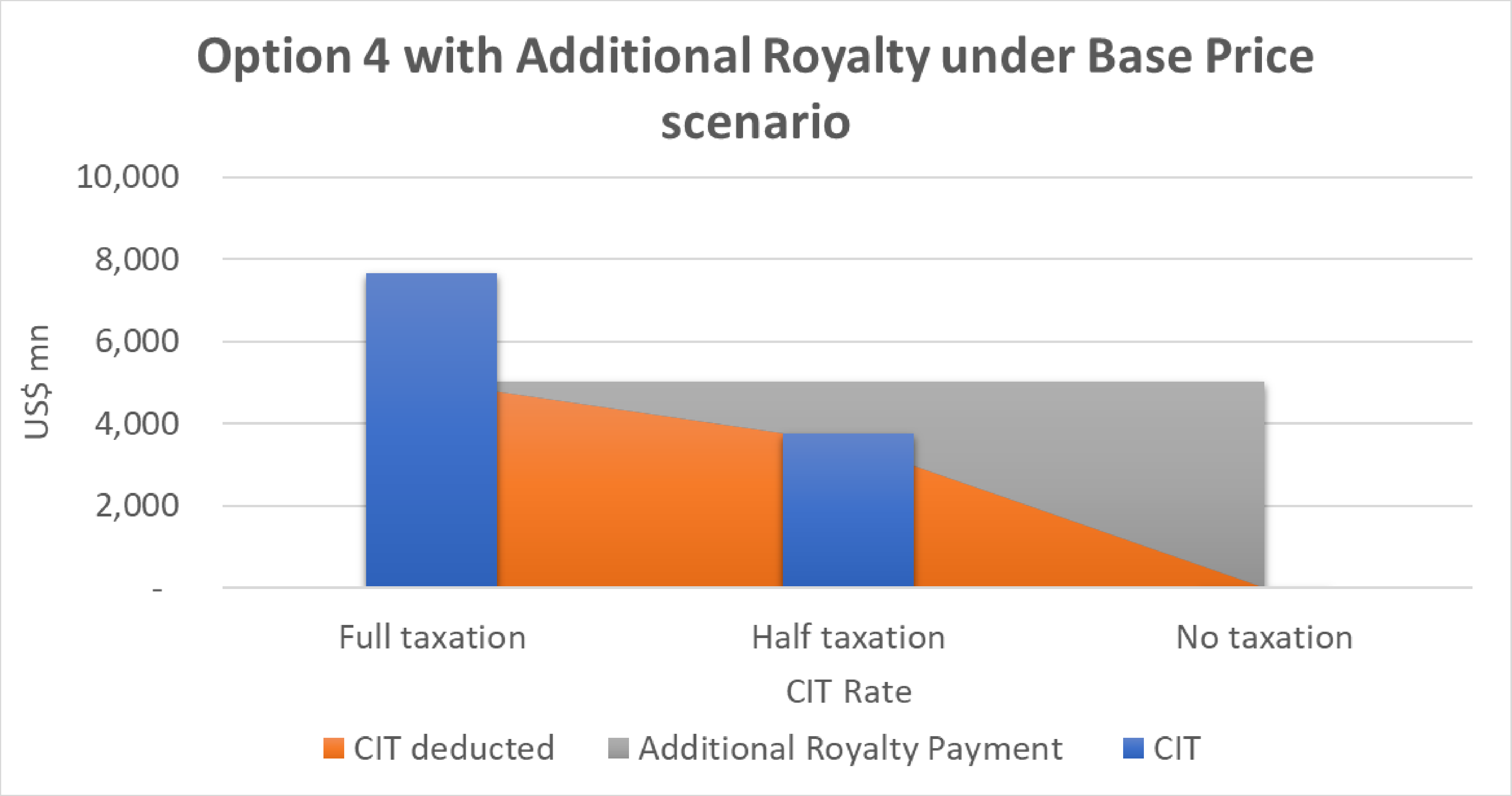
An equalisation measure is necessary to ensure all contractors have a similar AETR

Two options proposed so far – others may follow

- **Additional Royalty (**African Group)
  - 6% of gross revenue
  - Kicks-in five years after commercial production starts
  - Contractors can deduct CIT paid to their sponsoring state in the previous year

- **Profit share**
  - Additional profit share based on contractors' cumulative pre-tax cashflow
    - Immediate expensing of CAPEX i.e., no depreciation
    - No deductions for interest expense – accounts for cost of capital using uplift on negative cashflows
  - Contractors can deduct CIT paid to their sponsoring state in previous years

Additional Royalty – how it works



Additional Royalty – pro’s and con’s

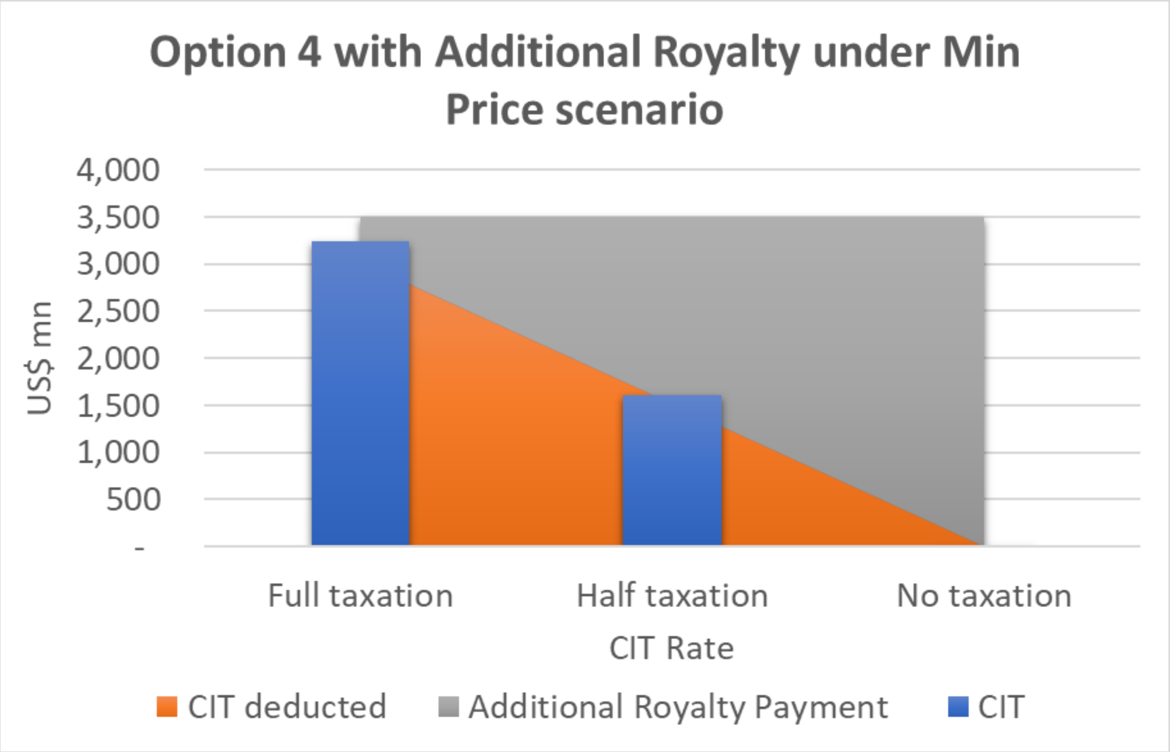
Advantages:

- Simple to administer – although may become more complex if more taxes are included.
- Based on information the ISA should already have: price, quality, and quantity of nodules

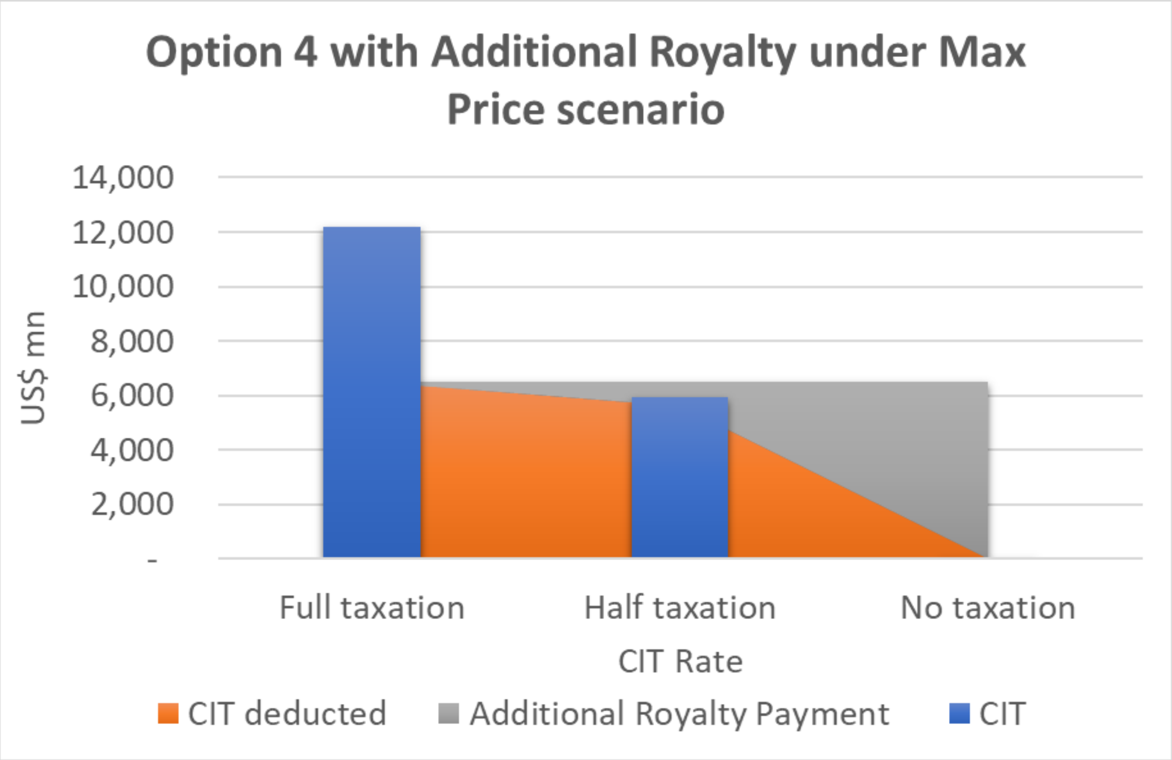
Challenges:

- Some contractors may have a comparable AETR over the life of the project, but pay no tax in the early years of production due to cost recovery, and capital allowances in sponsoring states. Consequently, there may be no tax to offset the additional royalty, leading to a lower IRR.
- A royalty is a regressive fiscal instrument – next slide.
- May be financially unsustainable for contractors, generating calls for renegotiation of the regime.

Additional Royalty – sensitivity analysis

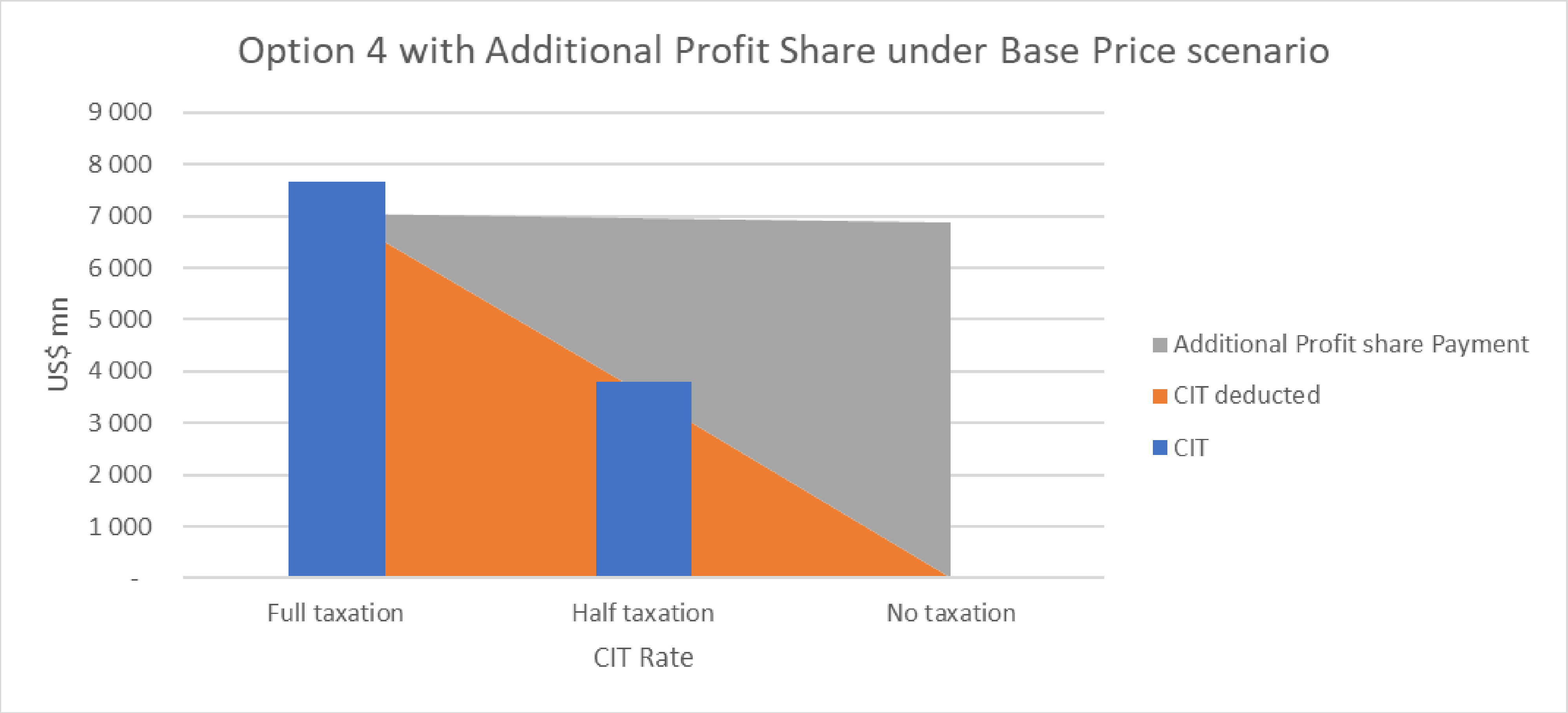


- Low profits = lower tax = less CIT to credit against royalty
- Contractor pays an additional royalty to the ISA over and beyond their CIT payments to the sponsoring state, even if they are paying a full 25% CIT rate.



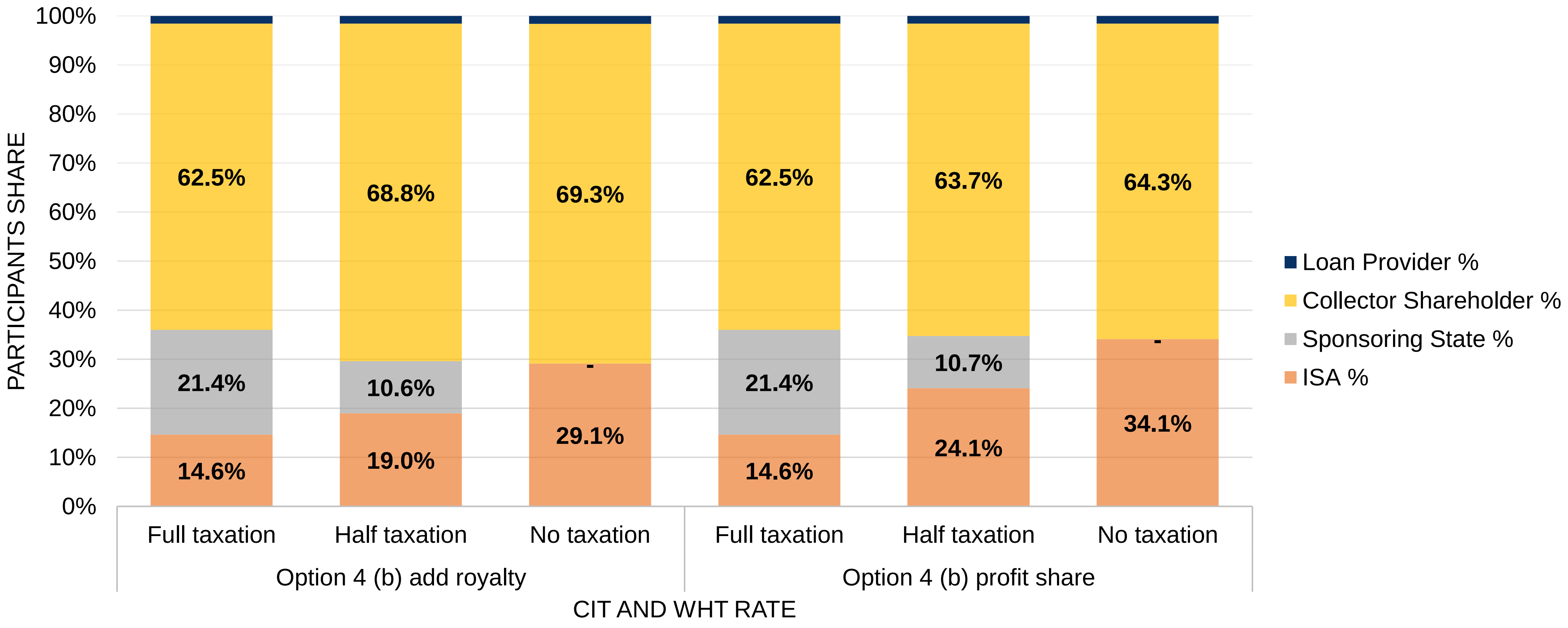
- Higher profits = higher tax = enough CIT to credit against royalty, even if its CIT rate is much lower than 25%.
- Not fulfilling role as equalization measure.

Additional profit share – how it works



Profit share slightly better than royalty at equalising

Participants share under Options 4b additional royalty and additional profit share



Additional Profit Share – pro’s and con’s

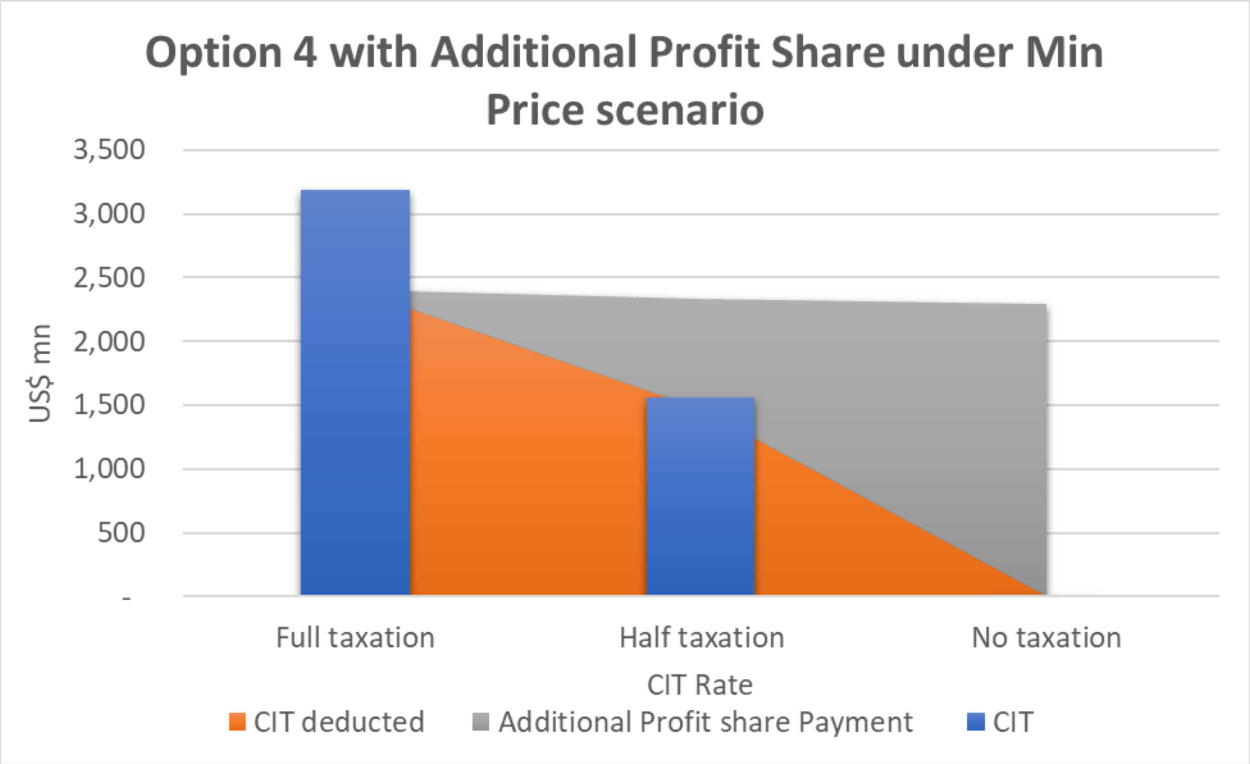
Advantages:

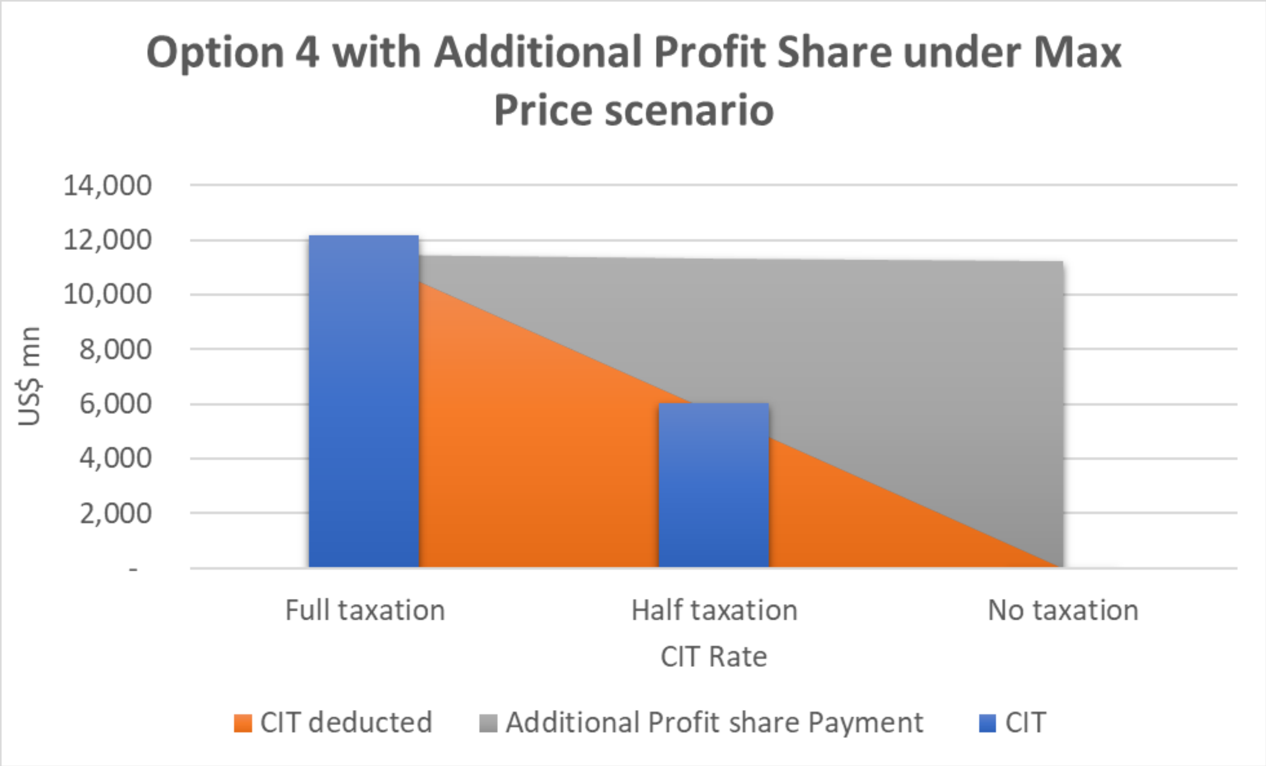
- More efficient – next slide
- Takes effect at the right time
- Likely to be included in the calculation of ETR for the global minimum tax

Challenges:

- Harder to administer – need to verify costs as well as revenues
- More vulnerable to tax avoidance – specifically cost overstatement
- ISA would need to audit costs
- Potential double taxation

Additional profit share – sensitivity analysis





- No additional payment as long as the rate of tax in sponsoring states is at 25%, regardless of market conditions.
- CIT in the sponsoring state would normally be paid before a profit share based on cash flows, which will allow contractors to carry forward any CIT payment to credit against the additional profit share.

Additional profit share – administrative challenges

Hard to administer / easy to avoid

- Cashflow basis eliminates depreciation charges and interest expense
- Related party loans biggest source of profit shifting in the sector

Audit capacity

- Technical assistance / capacity building
- Tax Inspectors Without Borders program – direct audit assistance
- Also necessary for tax on transfers

Double taxation

- Many countries provide unilateral double tax relief
- Double tax relief could be included in the ISA Mining Code

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