African Group submission of two Payment Regimes for consideration by the Council of the International Seabed Authority

Introduction

1. The Regulations[i] proposed by the International Seabed Authority[ii] for deep-sea mining in the Area included a payment regime with an ad-valorem royalty as the only significant tax[iii]. The royalty is levied on the value of minerals exported from the contract area. The value of minerals is based on the average grade and list price of relevant minerals (likely cobalt, copper, manganese and nickel) contained in nodules. The Regulations also outline that different royalty rates can be applied to different relevant minerals and that these royalty rates will vary between the first and second periods of commercial production. The Regulations do not, however, include the actual royalty rate for the first or second periods of commercial production.

2. The Implementing Agreement Section 8.1.B mandates that:

> ''The rates of payments under the system shall be within the range of those prevailing in respect of land-based mining of the same or similar minerals in order to avoid giving deep-seabed miners an artificial competitive advantage or imposing on them a competitive disadvantage'.

3. A proper interpretation of the phrase 'rates of payment' is the share of profits received by the government/authority in the jurisdiction where mining (land-based or deep-sea) is occurring. That is:

> The share of profits received by the ISA from deep-sea mining in the Area should be equal to the share of profits that a government of the jurisdiction where land-based mining is occurring receives from land-based mining.

4. This Submission therefore proceeds as follows: First, it summarizes land-based mining payment regimes. Second, it calculates for a model mine the share of profits received by the government of the jurisdiction where mining is occurring. Third, it examines the share of profits the ISA would likely receive under the payment regimes proposed in the MIT June 2019 report. And fourth, it outlines payment regimes that would conform to the Implementing Agreement and create a level playing field between land-based and deep-sea mining.

Summary of land-based mining payment regimes

5. Table 1 summarizes land-based mining payment regimes. The countries in the table 1 were selected because they are major producers of a metal (or metals) contained in nodules, or in the case of the Cook Islands, as they are a possible location for deep-sea mining. The table only summarizes the main fiscal instruments/taxes levied on land-based mining. For example, the table does not include a range of fees that land-based miners typically pay or VAT. Thus, table 1 and the analysis undertaken later in this Submission may materially understate the true rates of payment/burden of taxation faced by land-based miners.

6. All the land-based mining payment regimes included in table 1 include both royalties[iv] and/or a profit share[v]. None of these land-based mining tax regimes includes only a royalty. In addition, a

study undertaken by PwC in 2012[vi] summarises 22 land-based payment regimes none of which includes a royalty as the only tax.

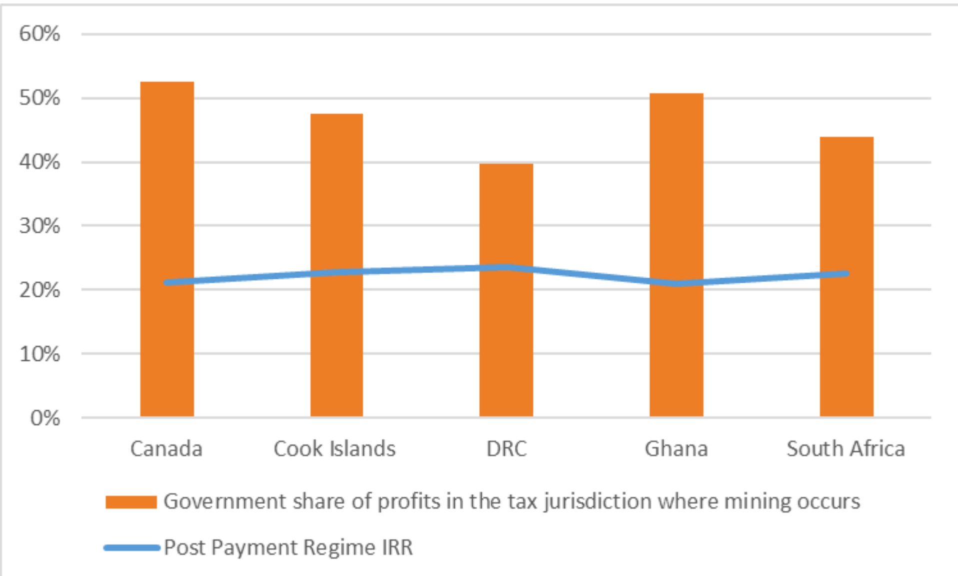
7. It follows that if land-based mining tax regimes have many fiscal instruments (royalties, profit shares and additional profit taxes) and the deep-sea mining payment regime only has a royalty, then the rate of that royalty must be much higher than the royalty rates commonly seen in land-based mining taxes regimes in order for the rates of payment under the ISA payment regime to be similar to rates of payment under the payment regime of the governments of the jurisdictions where land-based mining occurs.

Table 1: Summary of land-based mining payment regimes[vii]

Country	Ad-Valorem Royalty or Similar	Profits Share	Excess Profits Tax	Withholding Tax
Canada(British Columbia)[viii]	2%[ix] net current proceeds tax	27%[x] profits and 13% net revenue tax	N/A	25%
Cook Islands	3%	20% (resident) / 28% non-resident	25% at IRR 20%	15%
Democratic Republic of Congo	2%	30%	N/A	10%
Ghana	5%	35%	N/A	15%
South Africa	3.75%[xi]	28%	N/A	15%

8. Graph 1 shows the share of profits the government of the jurisdiction where mining occurs would receive from mining based on a model land-based mine (pre-tax Internal Rate of Return of 30%) and the tax regimes summarised in table 1[xii]. As can be seen from graph 1:
   - none of the payment regimes modelled show the government of the jurisdiction where land-based mining occurs receiving less than 40% of the profits from mining; and
   - on average governments of the jurisdictions where land-based mining occurs receive 47% of the profits from mining.

Graph 1[xiii]: Share of profits received by the government of the jurisdiction where mining occurs



9. In addition, the results in graph 1 may materially understate the government of the jurisdiction where mining occurs share of profits from land-based mining as:

   a.) they do not include VAT, area fees or other fees; and
   b.) the modelling assumes immediate expensing and unlimited carry forward of losses.

10. The results summarized in graph 1 are also supported by more comprehensive[xiv] analyses undertaken by Otto at al (2006)[xv] and the Commonwealth Secretariat (2009)[xvi]. Otto et al's (2006) results show that on average governments of the jurisdiction where mining occurs receive 47% of the profits from land-based mining. These results are represented in ISA Technical Study 13 page 52. The Commonwealth Secretariat (2009) concludes that, for a medium profitability model mine, the government of the jurisdiction where mining occurs receives 49% of the profits from the mine on average.

11. To summarize, there is overwhelming evidence that payment regimes for land-based mining result in the government of the jurisdiction where mining occurs receiving over 40% of the profits from mining. Any deep-sea mining payment regime that results in the ISA receiving a lower than 40% share of profits is thus not resulting in rates of payment 'within the range of those prevailing in respect of land-based mining', is giving deep-sea miners an artificial competitive advantage over land-based miners and is contrary to UNCLOS. A necessary (but not sufficient) condition for the African Group to support any payment regime is that it results in the ISA receiving at least 40% of the profits from mining under a wide range of scenarios.

Share of profits received by the ISA under the payment regimes proposed by the MIT June 2019 Report

12. Graph 2 models[xvii] the share of profits the ISA would receive from the model mine under three of the payment regimes proposed in the MIT June 2019 report. As can be seen, the payment regimes proposed by the MIT June 2019 report will result in the ISA receiving a much lower share of profits than governments of the jurisdictions where land-based mining occurs commonly receive.

Graph 2: Share of profits received by ISA (using a model mine pre-tax IRR 30%) under three payment regimes proposed by MIT

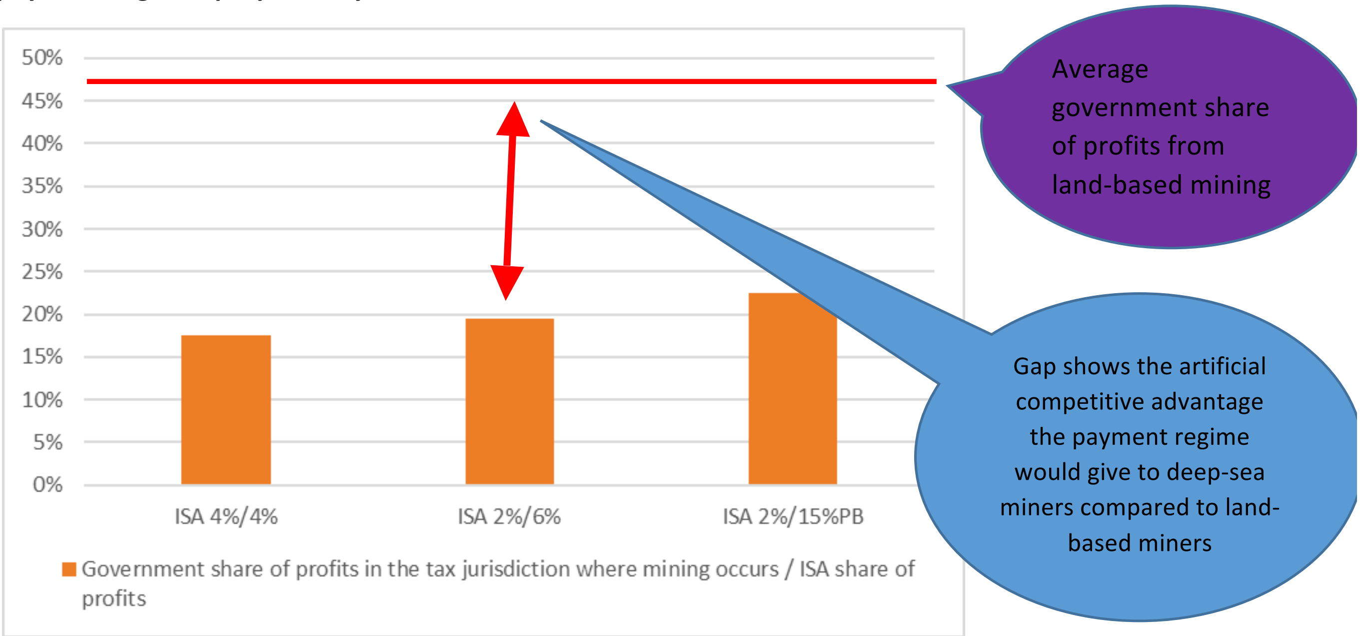


Table 2: MIT June 2019 Report Proposed Payment Regimes and ISA Shares

Proposed Payment Regime	ISA Share
Royalty at 4%/4%	15%
Royalty at 2%/6%	21%
Royalty at 2% and Profit Share at 15%	21%

13. The above conclusion is also supported by the analysis summarised in the MIT June 2019 report. This report presented the ISA's share of profits for various payment regimes based on a detailed model/forecast of the likely costs, revenues and profits of deep-sea mining for nodules in the Area. As can be seen in table 2 all the payment regimes included in the MIT June 2019 report will result in the ISA receiving a much lower share of profits than governments of the jurisdiction where land-based mining occurs receive from land-based mining.

Should sponsoring States' corporate income tax rates be included in the above analysis?

The view of the African Group is that it would be incorrect to include sponsoring States' corporate income tax rates when comparing rates of payment from land-based mining with deep-sea mining. There are four principal reasons for this and are the following:

14. **First**, land-based miners may have to pay taxes in the jurisdiction where mining occurs and in some cases where their parent company is headquartered/domiciled for tax purposes. The 47% land-based mining profit share figure quoted earlier (in graph 2 and paragraph 10) refers only to the profits paid by land-based miners to the government of the jurisdiction where the mine is physically located: **it does not** include any taxes paid by the parent company in the jurisdiction where it is headquartered. The correct comparison for this figure is thus the taxes paid by deep-sea miners to the ISA and not the total tax burden borne by a deep-sea mining company.

15. **Second**, under a territorial tax system profits from foreign jurisdictions are often excluded from taxable income in the domestic jurisdiction. This means it is possible (although this may vary according to the exact tenants of domestic tax law and the nature of taxes/royalties paid to the

ISA) that some or all of the profits made from deep-sea mining will be excluded from the definition of taxable income in the sponsoring State. Under a residential tax system profit taxes paid by a company in a foreign jurisdiction are often creditable (again this depends on the exact tenants of domestic law) against taxes paid in the domestic jurisdiction, potentially reducing or eliminating the company's tax burden in the domestic jurisdiction. Including sponsoring State corporate income tax effectively assumes that all profits from deep-sea mining in the Area are treated as taxable income in the sponsoring State and that there are no offsetting tax credits. The view of the African Group is that this assumption is likely incorrect and that it may well be the case either that profits in the area do not form part of taxable income in the sponsoring State (as they are regarded as foreign income under a territorial tax system), that there are tax credits in the sponsoring State for taxes or royalties paid to the ISA or that contractors have negotiated exemptions from corporate income tax in the sponsoring State. The African Group recognizes that this is a complex issue that can only be resolved by a detailed review of every tax law and sponsorship agreement in every sponsoring State.

16. **Third**, taxable income is normally (there are exceptions for certain types of economic activity) calculated at the level of the corporation and not individual economic activities. This means losses from one economic activity can be offset against profits from another economic activity when calculating taxable income. It cannot then simply be assumed that losses and profits from a deep-sea mine in the Area are equivalent on an annual basis to the losses and profits of the corporation being taxed. For example, if a corporation makes profits of $100 million from deep-sea mining in the Area and losses of $100 million from dredging then its taxable income for corporate income tax may well (and this is admittedly a simplification) be zero for corporate income tax purposes and it would pay no corporate income tax.

17. **Fourth**, contractors have signed agreements with sponsoring States. Many of these agreements are not publically available and thus it is impossible to know with certainty what tax exemptions and other provisions they contain. In the absence of the publication of these agreements, it is not possible to know with any degree of certainty the taxes a contractor is liable for in the sponsoring State. It is, however, worth noting that many sponsoring States are in a weak position to negotiate a large sponsoring tax with a contractor as they do not own the resources being mined and the contractor can be sponsored by Member State.

18. Although for the reason outlined above, it is incorrect to include sponsoring State corporate income tax in an economic model of a deep-sea mine, any additional fee paid by a deep-sea mining contractor to the sponsoring State specifically for the right to mine in the Area should arguably be included. Once all contractors have published all their agreements, contracts and tax agreements with all sponsoring States, the African Group is happy to include the average of such fees in its analysis.

What payment regime would result in the ISA receiving 47% of profits

Table 3 presents a payment regime with a reasonable royalty and a profit share that would result in the ISA receiving approximately a 47% share of the profits from deep-sea mining. This ISA share of profits in this table accounts for the royalty being levied on the value of nodules and not their sales price from the collector to the processor.

Table 3: Payment Regime 1: Royalty and Profit Share

Regime 1	Royalty Rate Levied on Value of Nodules[xviii]	Rate of Profit Share	ISA Share of Profits
Royalty and profit share	5%	32%	47%

Some ISA member countries have raised concerns that the ISA lacks the capacity to implement a profit share. A royalty is, however, an inflexible tax as it does not result in the ISA receiving a higher share of profits as prices increase and contractors make excess profits. A partial possible solution to this problem is a royalty rate that varies with nodule prices (and thus metal prices).

Table 4: Payment Regime 2: Royalty that varies with nodule value[xix]

	Royalty Rate Levied on Value of Nodules	ISA Share of Profits	Post-tax IRR
Nodule value $700	12%	Varies	<18%
Nodule value $701 to $800	14%	43%	18%
Nodule value $801 to $900	16%	46%	19%
Nodule value $901 to $1000	18%	50%	20%
Nodule value $1001 to $1100	20%	54%	20%
Nodule value $1101 to $1200	21%	55%	21%
Nodule value $1201 to $1300	22%	56%	22%
Nodule value $1301 to $1399	23%	58%	23%
Nodule value above $1400	25%	Varies	>23%

Conclusion

1. The African Group is committed to ensuring that deep-sea mining only occurs if it is demonstrably beneficial to mankind. It is of benefit to mankind if metals are mined cost effectively. If deep-sea mining is a lower cost way of producing minerals than land-based mining, then deep-sea miners should be able to pay the ISA at least as high as the share of profits that land-based miners pay the government of the jurisdiction where land-based mining occurs.

2. Governments of the jurisdiction where land-based mining occurs receive on average 47% of the profits from mining. And there are very few, if any, countries where the government of the jurisdiction where land-based mining occurs does not receive 40% or above of the profits from land-based mining. Any deep-sea mining payment regime that results in the ISA receiving less than 40% of the profits from deep-sea mining in the Area is thus giving deep-sea miners an artificial competitive advantage over land-based miners and would effectively be encouraging investment in risky, high-cost and inefficient mining. This would be contrary to Implementing

Agreement. It will, therefore, be difficult for the African Group to support any payment regime that does not result in the ISA receiving at least 40% of the profits from deep-sea mining.

3. The African Group has submitted two payment regimes for consideration by the ISA. These payment regimes warrant serious consideration.

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[i] This Submission uses the term 'Regulations' to refer to the 'Draft Regulations on Exploitation of Mineral Resources in the Area in July 2018 (Regulations).'

[ii] This Submission uses the acronym 'ISA' to refer to the International Seabed Authority.

[iii] This Submission uses the term 'tax' to refer to all profit taxes and royalties.

[iv] The British Columbia payment regime for land-based mining does not strictly speaking include a royalty, but it does include a tax on net proceeds which is similar in some regards to an ad-valorem royalty.

[v] This Submission uses the term 'profit share' to refer to all taxes levied on profits/taxable income.

[vi] Corporate income taxes, mining royalties and other mining taxes, a summary of rates and rules in selected countries, June 2012, PWC. Available at: https://www.pwc.com/gx/en/energy-utilities-mining/publications/pdf/pwc-gx-miining-taxes-and-royalties.pdf.

[vii] It should be noted that tax systems are inherently complex and that this table inevitably simplifies and summarises complex tax systems for ease of reading and understanding.

[viii] Sources are:

a.) Government of Canada (https://www.canada.ca/en/revenueagency/services/tax/businesses/topics/corporations/corporation-tax-rates.html)

b.) Canada Mining Taxation, PWC (2016) https://www.pwc.com/ca/en/mining/publications/pwc-canadian-mining-taxation-2016-11-en.pdf

[ix] This British Columbia fiscal regime for mining is not easy to summarise according to the standard criteria used in the above table. The Mineral Tax Act outlines a 2% tax on net current proceeds. Net current proceeds can broadly speaking be thought of as revenues minus operating expenses (but not allowing for exploration, development and capital expenditures). Mining companies are also liable for a 13% net revenue tax. Net revenue can broadly speaking be regarded as net current proceeds minus capital costs, exploration costs, pre-production development costs and an investment allowance from net current proceeds. The 2% net current proceeds tax is fully creditable against the 13% net revenue tax.

[x] This is the combined federal and provincial rate of tax.

[xi] Withholding tax rates are often reduced by tax treaty for certain countries.

[xii] For ease of computation the following was assumed when undertaking this modelling exercise: a.) only major taxes/fiscal instruments were modelled (e.g. not fees, area rents etc) b.) immediate expensing and c.) losses are carry forward without limit.

[xiii] Please note that Canada refers to British Columbia, Canada. Also please note that rates of withholding tax are sometimes reduced for the remittance of dividends to certain jurisdictions through tax treaties with that jurisdiction.

[xiv] By comprehensive here we principally mean that they cover more countries and also include less simplifying assumptions regarding depreciation and the carry forward of losses.

[xv] Otto, James, et al. Mining royalties: A global study of their impact on investors, government, and civil society. The World Bank, 2006.

[xvi] International Benchmarking of Mining Fiscal Regimes, Commonwealth Secretariat, 2009

[xvii] It should be noted that the results in the next graph account for the fact that the royalty proposed by MIT is levied on the value of nodules and that the sales value of a dry tonne of unprocessed nodules maybe approximately half this amount.

[xviii] The term value of nodules means that value of the metals contained in the nodule and not the price tonnes of dry nodules are sold for. If the royalty is levied on the sales price of dry nodules the royalty rate will have to be significantly increased.

[xix] The below table is calculated based on the African Group's replication of the ISA's model without the inclusion of sponsoring state corporate income tax.