African Group Speaking Notes on the Payment Regime

Introduction

I would like to thank the Chair for this opportunity to present the views of the African Group.

We would also like to highlight that the African Group has made a recent submission to the working group. This submission provides text for changes to the Draft Regulations to ensure that the payment regime conforms to UNCLOS, the implementing agreement and international best practice in extractive industry taxation. The suggested amendments would also contribute to the payment regime passing more of the nine tests outlined in earlier African Group submissions, and against which we will continue to evaluate all proposed payment regimes.

In the interests of brevity, I do not intend to read all that submission. I will, rather, focus this intervention around five key issues, namely:

a.) the taxation of the transfer of rights;
b.) an additional royalty in lieu of sponsoring State corporate income tax;
c.) fiscal stability;
d.) the valuation of manganese; and
e.) the royalty rates included in Appendix IV.

Issue 1: The taxation of the direct and indirect transfer of rights

The current Draft Regulations would allow contractors to sell licenses, potentially for billions of dollars in profits, while the ISA and mankind would receive nothing. In our view this is unacceptable, first because mankind should be compensated when contractors benefit from DSM and second because land-based mining regimes commonly tax the transfer of rights either through capital gains tax or other taxes.

The African Group's August 2022 submission therefore provides, in draft regulation 23bis, text for a tax on the direct transfer of rights. This tax is paid at a rate of 25% of the profits the transferor makes when it sells the license to the transferee.

There is also a need for a tax on the indirect transfer of rights, as otherwise contractors will avoid the direct transfer tax by transferring licenses indirectly. An indirect transfer occurs when there is a change in the ownership of the contractor that holds the exploitation license.

Thus, the African Group submission provides in a new draft regulation 23 ter the text for a tax on the indirect transfer of rights. This tax would apply at a rate of 25% on any gain made from the transfer of a 20% or greater interest in any entity which derives 50% or more of its value from the exploitation license. These two hurdles are required to simplify administration of the tax and avoid the taxation of small sales of shares for investment purposes.

The indirect transfer tax is established as a withholding tax. The transferee is responsible for paying the tax in the first instance and withholding it from payment to the transferor. The transferor can in turn claim a tax refund if it can demonstrate that the amount withheld exceeded its tax liability. There are two significant advantages in setting up the indirect transfer tax as a withholding tax. First, the ISA can take effective enforcement action against the transferee, as it will hold the license going forward, and this provides it with a strong motivation to pay the withholding tax. Second, the transferor has a strong motivation to share information on the transfer with the ISA as otherwise it cannot claim any tax refund due.

Overall, the establishment of these taxes on transfers would ensure humankind benefits when contractors profit from selling licenses, increase ISA revenues and contribute to a level playing field with land-based mining.

Issue 2: An Additional Royalty in Lieu of Sponsoring State Corporate Income Tax

The royalty rates suggested by MIT assumed that contractors pay corporate income tax rates of 25%. The reality is, however, quite different with two thirds of published sponsorship agreements showing that contractors are completely exempt from sponsoring state corporate income tax. This contributes to the overall rates of payment faced by DSM being much lower than land-based miners and unfairly subsidises deep seabed miners.

One way to solve this problem is to have an additional royalty against which corporate income tax is creditable. The African Group's August 2020 submission provides draft text for this additional royalty in Regulation 64 bis. The key design features of this additional royalty are that:

Firstly, it is additional and separate from the existing royalty. This is essential as if there is a single royalty rate against which sponsoring state corporate income tax payments are creditable then any contractors that paid particularly high rates of corporate income tax could end up paying nothing to the ISA and humankind.

Secondly, the royalty is set at a rate of 6% from the 5th year of commercial production. This rate and start date are proposed as they would lead to a contractor that did pay a 25% sponsoring state corporate income tax having no additional tax burden from the additional royalty, according to the MIT model.

Third, it is only actual and verified sponsoring states cash payments of corporate income tax that are creditable against the royalty, which minimises the scope for tax avoidance.

The African Group would highlight that this proposal for an additional royalty is beneficial to reputable contractors, sponsoring states, land-based mining states and humankind.

It is beneficial to reputable contractors who will pay corporate income tax as it creates a level playing field between them and those disreputable contractors who have negotiated exemptions from sponsoring state tax.

It is beneficial to land-based mining states as it goes some way to creating similar rates of payment between land-based and deep-sea mining.

It is beneficial to sponsoring states as it creates a strong motivation for contractors to pay corporate income tax and demotivates tax avoidance and attempts to negotiate exemptions. As such, the additional royalty could indirectly lead to billions of dollars extra revenue for sponsoring states.

It is beneficial to humankind as the additional royalty is likely to increase the ISA's revenues from contractors who have avoided sponsoring state tax.

Overall, the African Group considers that the additional royalty has many advantages and recommends its adoption as specified in the text we have submitted.

Issue 3: The Valuation of Manganese

The African Group believes that it is important to understand that the Exploitation Regulations are not dictating how, or to what grade, manganese will be processed. Moreover, trying to understand the grade to which manganese will be processed is likely to be a fruitless and unconstructive task that will only serve to delay the Draft Exploitation Regulations for the following three reasons.

First, it is unlikely that all nodules will be processed to the same grade. The manganese in some nodules from some mines might be processed to the Electrolytic Manganese Metal Grade, while other nodules from other mines might be processed to a lower grade.

Second, different contractors will sell nodules to different processors, and not all processors will necessarily process manganese to the same grade, use the same process or have the same costs.

Third, it is likely that contractors will sell nodules to processors outside of the ISA's jurisdiction. Once that sale has taken place, contractors are not legally responsible, and may not even know, the grade to which the manganese in the nodules is processed. Moreover, the ISA has no jurisdiction over, and cannot compel, processors to share information.

The important point for the Exploitation Regulations is that the base the royalty is levied on is simple to understand and minimises scope for tax avoidance. A base for the royalty calculated based on the metal content of nodules and the price of copper, cobalt, nickel and electrolytic manganese metal achieves these objectives.

In addition, any movement away from using electrolytic manganese prices would lower the base for the royalty, lower revenues for humankind and further subsidise deep-sea mining relative to land-based mining. All the African Group's previous modelling also assumed that electrolytic manganese metal prices were used to calculate the base for the royalty. Thus, if there is any movement to a different royalty base that lowers ISA revenues then the royalty rates will have to be revised upwards from the 12% to 25% for a price varying royalty that the African Group currently considers acceptable.

Overall, the African Group would recommend that the base for the royalty is calculated using electrolytic manganese metal prices, and our recent submissions suggest amended text to Appendix IV.1 to make the Draft Regulations consistent with this recommendation.

Issue 4: Fiscal Stability

Draft Regulations 81 and 82 effectively provide contractors with fiscal stability for the 30 year term of an exploitation contract. This, as recognised by the Inter-Governmental Forum on Mining, Minerals and Sustainable Development, does not concord with international best practice. Specifically, a recent IGF report on deep-seabed mining in the Area states:

'Periodic review of financial terms of extractive industry contracts is increasingly seen as best practice. Stabilisation of the financial terms for the tenure or a contract (up to thirty years in this case) is not.'

The Draft Regulations should be amended to limit the fiscal stability afforded to contractors. The simplest way to do this would be to allow changes in the structure of the payment regime and changes in the rates of fiscal instruments to be applied to existing contracts after five years of commercial production have been completed.

Issue 5: Royalty Rates

It is important to understand that there is currently no consensus on the royalty rates. Despite this lack of consensus, the Chairman's Briefing Note of July 2020 inexplicably includes royalty rates of 2% and 5% to 9%. The African Group was extremely surprised that, despite the complete lack of consensus, these rates were included in the draft text. We, therefore, feel it is important to state once again, that our minimum acceptable royalty rates are:

for option 1, a single rate royalty 14.4%;

for option 2, the time varying royalty 6.4% and then 19.3 %;

for option 3, a hybrid regime, a 5% royalty, 30% profit share and 30% additional profit share; and

for option 4, a price varying royalty 12% to 25%.

Previous African Group submissions provided detailed economic models showing how these rates maximised revenues to mankind.

In conclusion, the African Group considers that its suggested amendments to the draft regulations, and in particular the amendments establishing a tax on the transfer of rights and an additional royalty, would make the payment regime more concordant with UNCLOS, the Implementing Agreement and international best practice, and would, thus, be in the interests of humankind.