Key Findings from IGF Draft Report on Payment Regimes for Deep Sea Mining

Date: 15th March 2023

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IGF 2021
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Building Tomorrow Together: Mining for a responsible and inclusive future

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- CAPACITY BUILDING
- TECHNICAL ASSISTANCE
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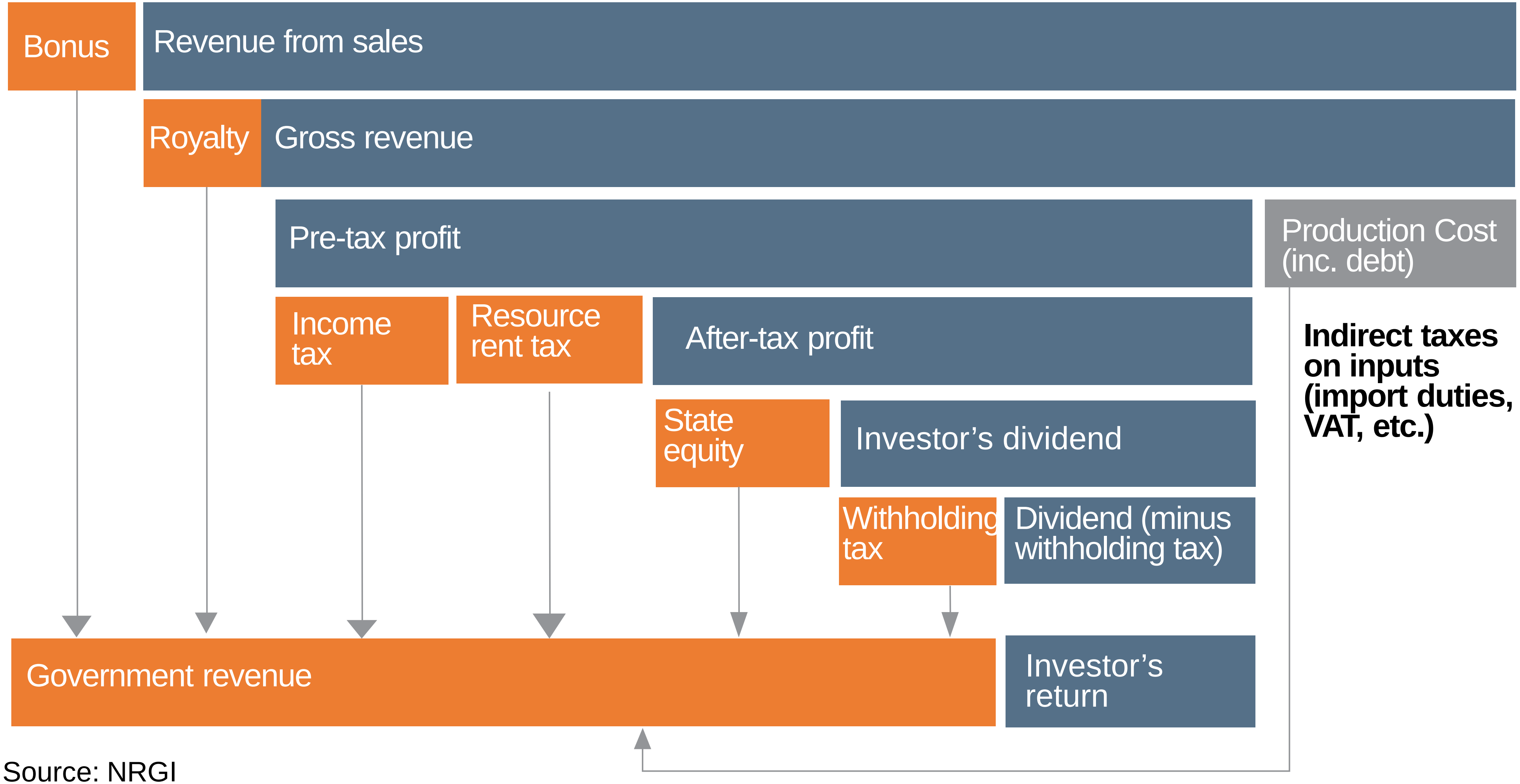
Assessing the Four Payment Options

The 'Government Take'



Source: NRGI

The Average Effective Tax Rate

$$\frac{\text{Total government returns}}{\text{Total pre-tax cashflows}}$$

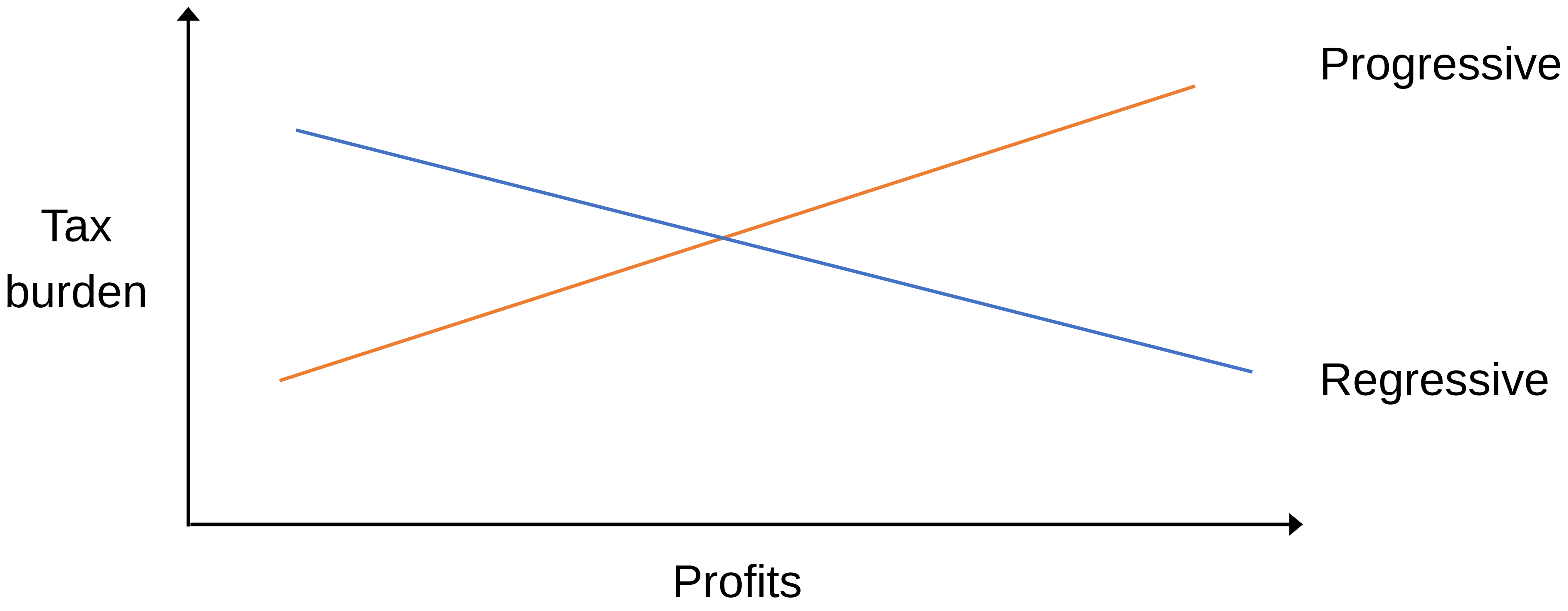
Principles for mining fiscal regime design

Overall goal: maximise revenues from DSM for the benefit of humankind

- **Neutrality**
  - What is an appropriate IRR for DSM?
    - MIT model uses 17.5%; IMF FARI Model uses 12.5%
    - DSM is risky, but rate should decrease over time – justification for a dynamic IRR
- **Progressivity (next slide)**
  - Especially important for critical minerals
  - Chasing prices is not sustainable. Need a flexible system that automatically adapts to changes in profitability.
- **Simplicity**
  - Particularly important considering the time it will take to build up the ISA's tax administration capabilities.
- **Stability**
  - Fiscal stabilization ≠ equal stability. Regime must be financially and politically sustainable.
- **Robustness to profit shifting**
- **Timing of revenues**
  - Less sensitive for DSM than LBM,.

Progressivity (of profit-based taxes)

A progressive fiscal regime imposes higher level of taxes as profits increase (and regressive imposes higher level of taxes as profits decrease)



IGF Financial Model

Key assumptions underpinning the IGF model

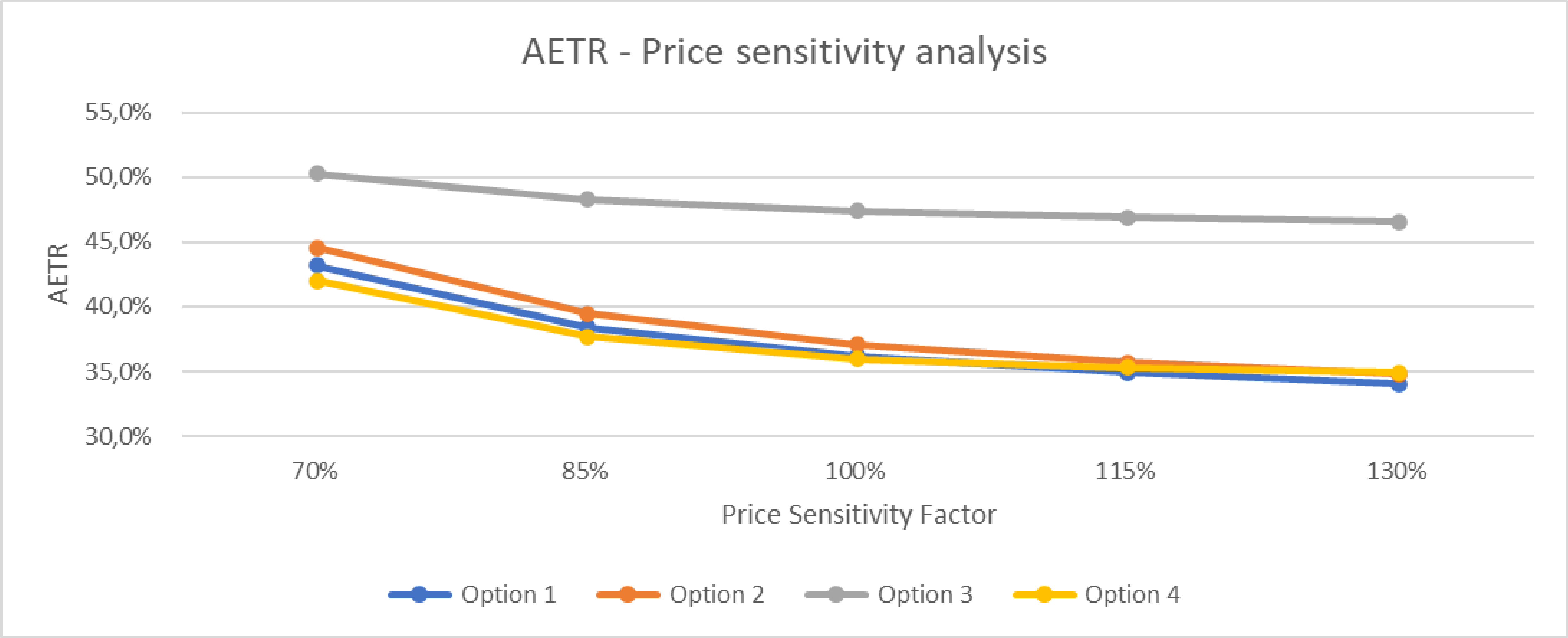
- Revenue and royalty base: the gross value of the contained metals—copper, nickel, cobalt, and manganese (valued with reference to manganese ore)
- CIT rate in sponsoring state = 25%
- Processor IRR = 50% * 10% + 50% * contractor IRR
- 0-10% WHT on interests, dividends, and 50% of operating services
- 60% debt financing from build and design phase

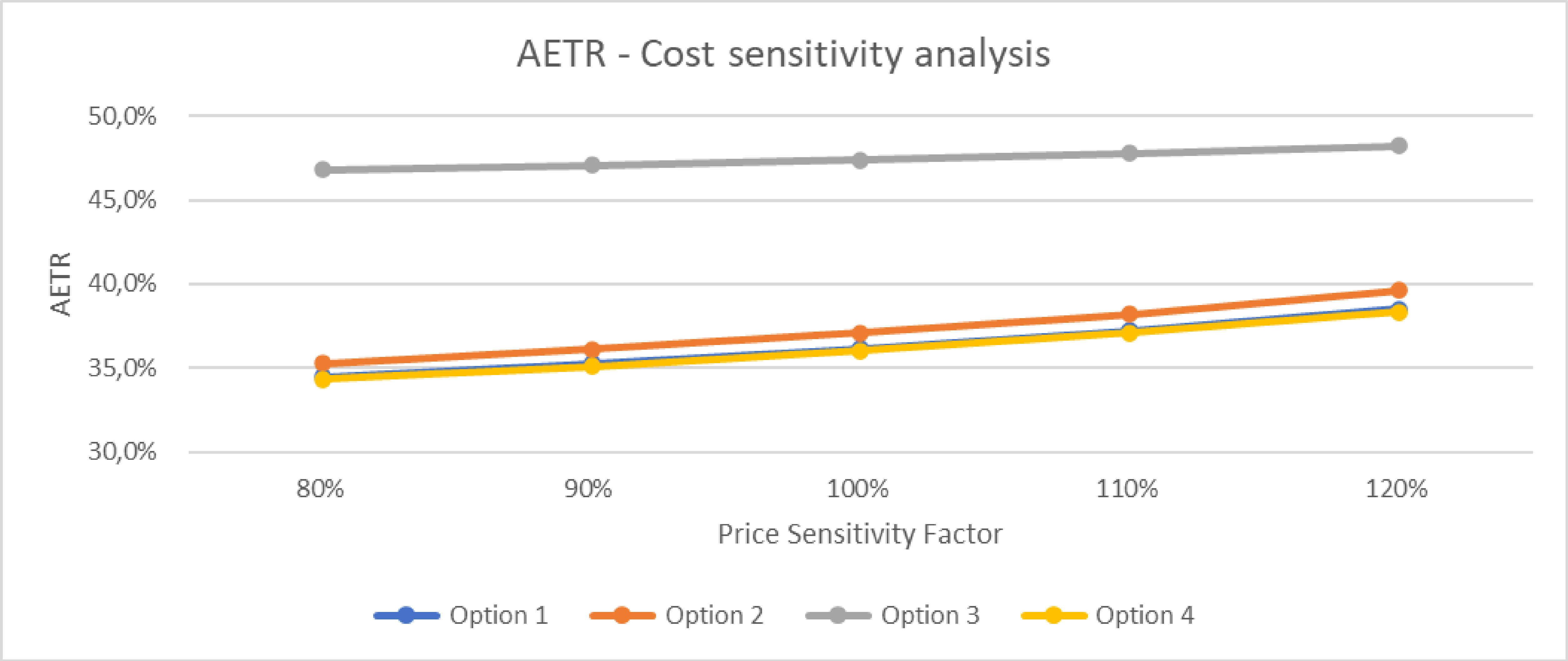
NOTE: Price and costs assumptions have been updated. As a result, DSM appears more profitable and the AETRs of each option look different than under earlier estimates. The OEWG will need to update the rates of payment (other than Option 3) to achieve a theoretical AETR of 47% under the new assumptions.

Quantitative Comparison of the Four Options

Based on IGF Financial Model

Participant cashflows %	Option 1	Option 2	Option 3	Option 4
ISA %	14.9%	16.1%	24.1%	14.6%
Sponsoring state %	21.3%	21.0%	23.3%	21.4%
AETR (ISA and sponsoring state combined)	36.2%	37.1%	47.4%	36.0%
Contractor %	62.3%	61.4%	51.1%	62.5%
Loan provider %	1.4%	1.4%	1.4%	1.4%
Contractor IRR (real term CF)	22.2%	22.6%	21.1%	22.7%


AETR - Price sensitivity analysis
55,0%
50,0%
45,0%
40,0%
35,0%
30,0%
AETR
70%
85%
100%
115%
130%
Price Sensitivity Factor
Option 1
Option 2
Option 3
Option 4


AETR - Cost sensitivity analysis
50,0%
45,0%
40,0%
35,0%
30,0%
AETR
80%
90%
100%
110%
120%
Price Sensitivity Factor
Option 1
Option 2
Option 3
Option 4

Options	Advantages	Disadvantages
Option 1: Fixed rate	• Easier to administer (e.g., no need to monitor price to determine rate). • Lower compliance costs. • Revenue stability.	• Government take would not adjust to reflect changes in profitability.
Option 2: Variable rate (time period)	• Less regressive than a fixed-rate royalty (depends on time-profit correlation). • Easier to administer than Option 4.	• Cliff edges would make it vulnerable to abuse, e.g., high-grading. • Less progressive than Option 4.
Option 3: Variable rate (price-based) and profit share	• Combines an early, predictable source of revenue with a share of the profits. • Most progressive option. Profit share due when a contractor is making profits.	• Profit share may be complex to administer depending on design. • Revenues may be delayed. • Vulnerable to profit-shifting, particularly with respect to costs.
Option 4: Variable-rate royalty (price-based)	• ISA's revenue would increase automatically when prices rise. • Easy to communicate to the public; royalties increase with prices. • Sensitive to a company's profitability, assuming profits track prices.	• More complex to administer; prices must be monitored to determine the rate.

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

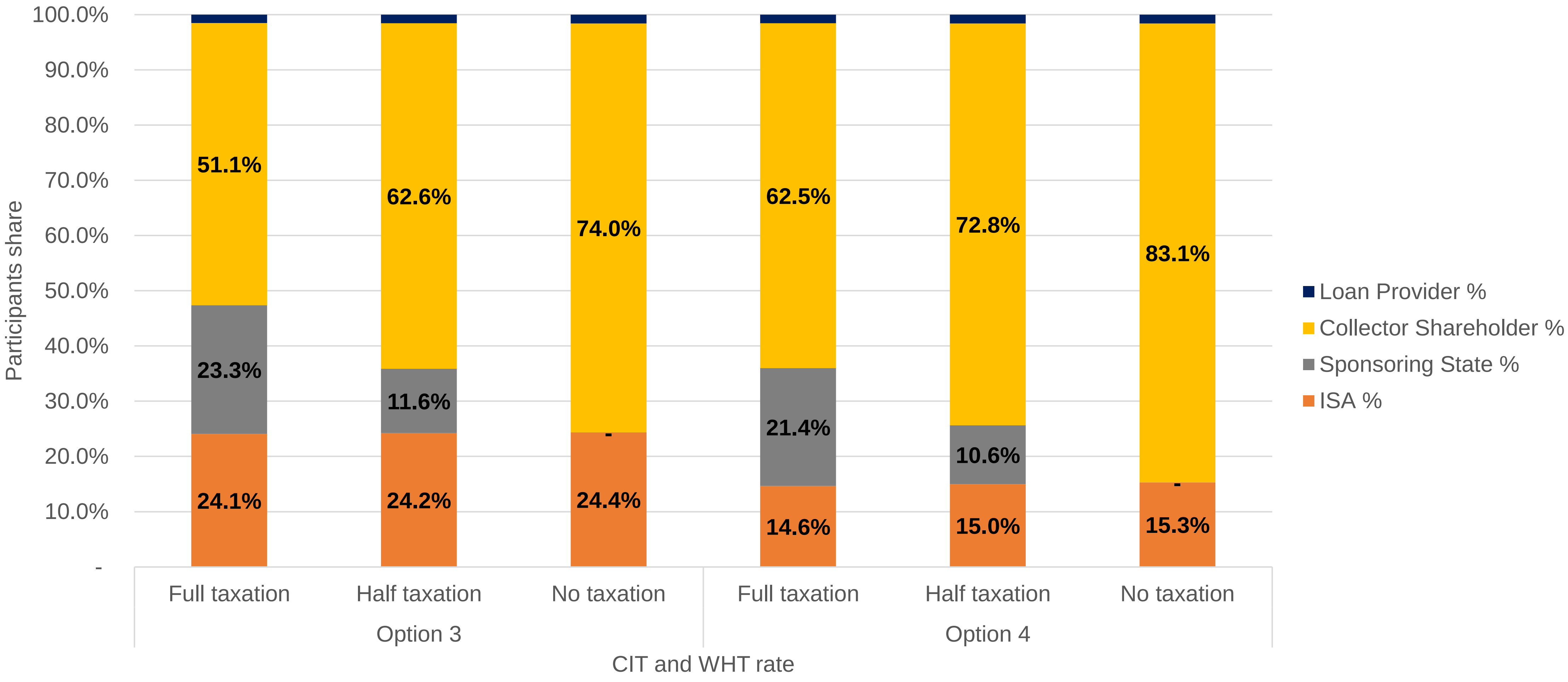
Understanding the impact of Sponsoring State taxes

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



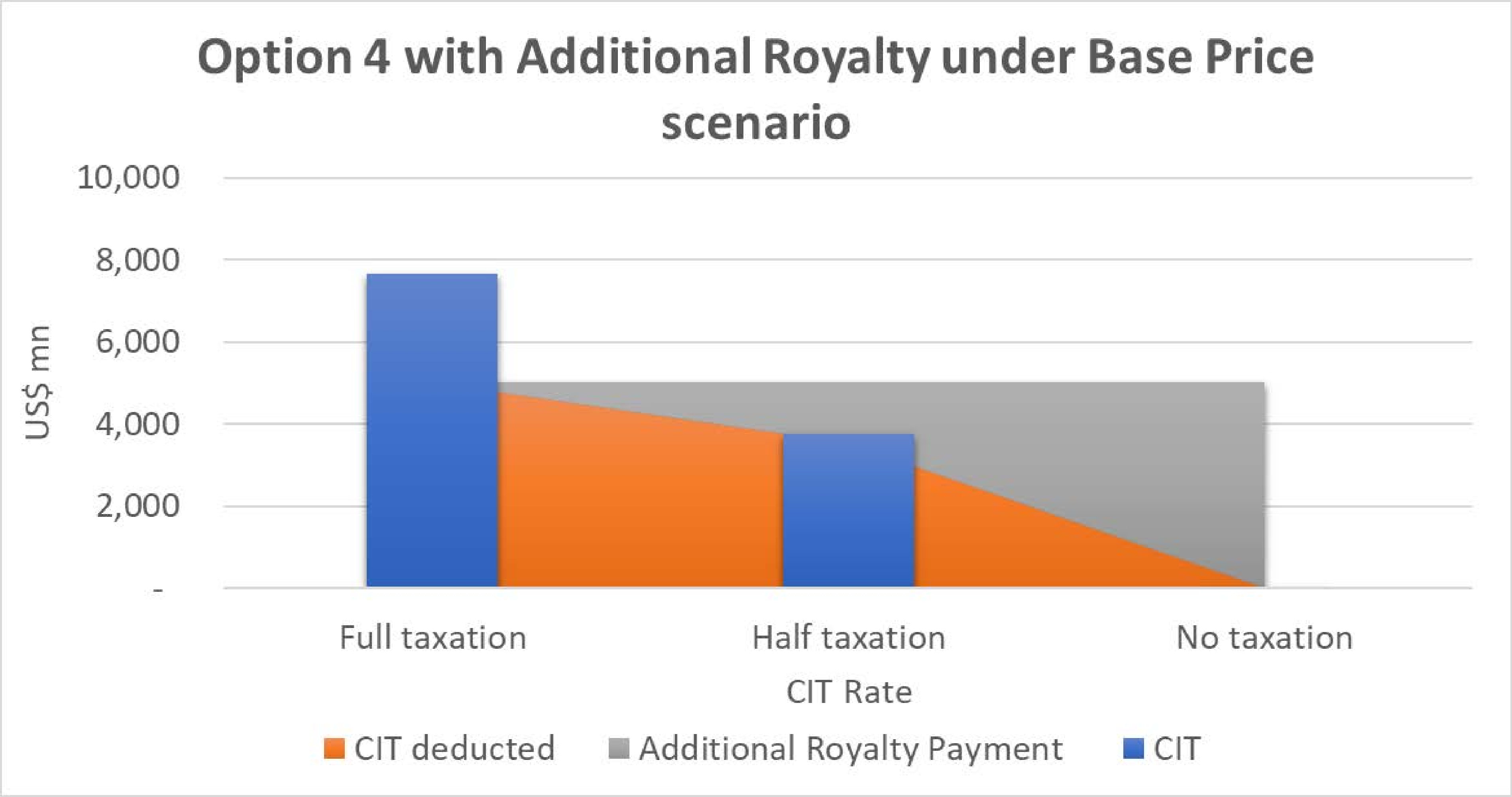
An equalisation measure is necessary to ensure all contractors have a similar AETR

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

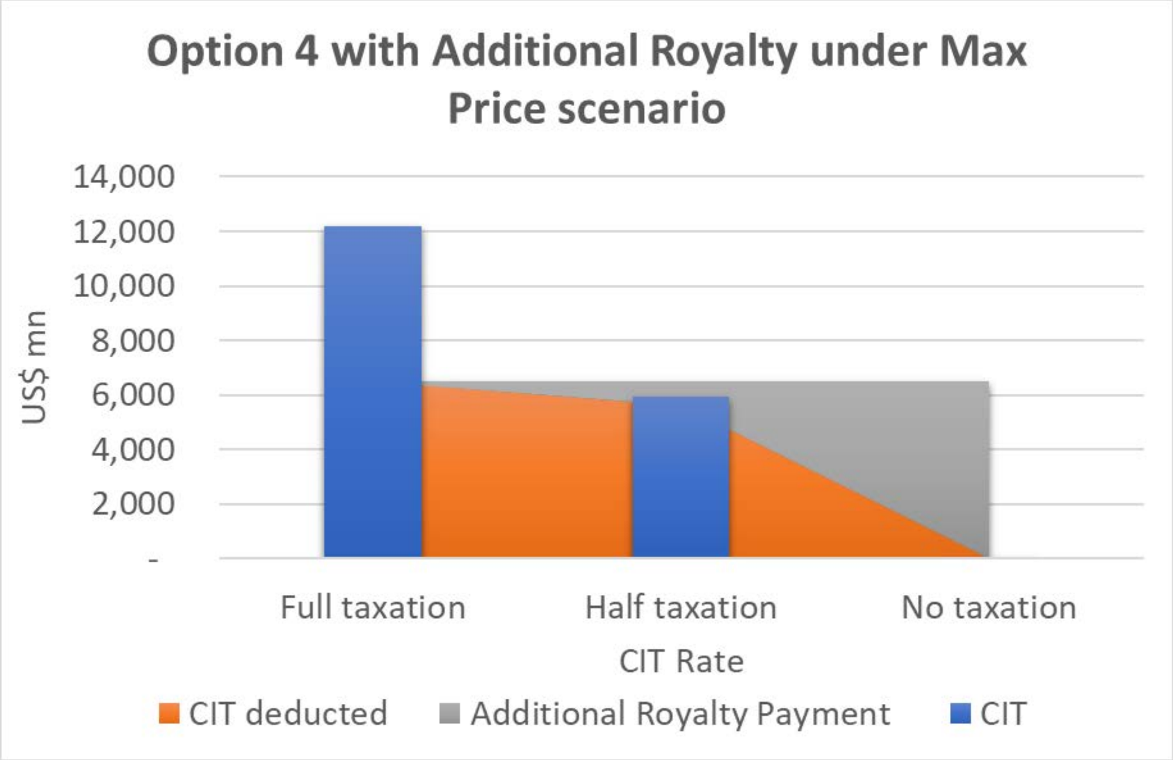
Advantages:

- 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.

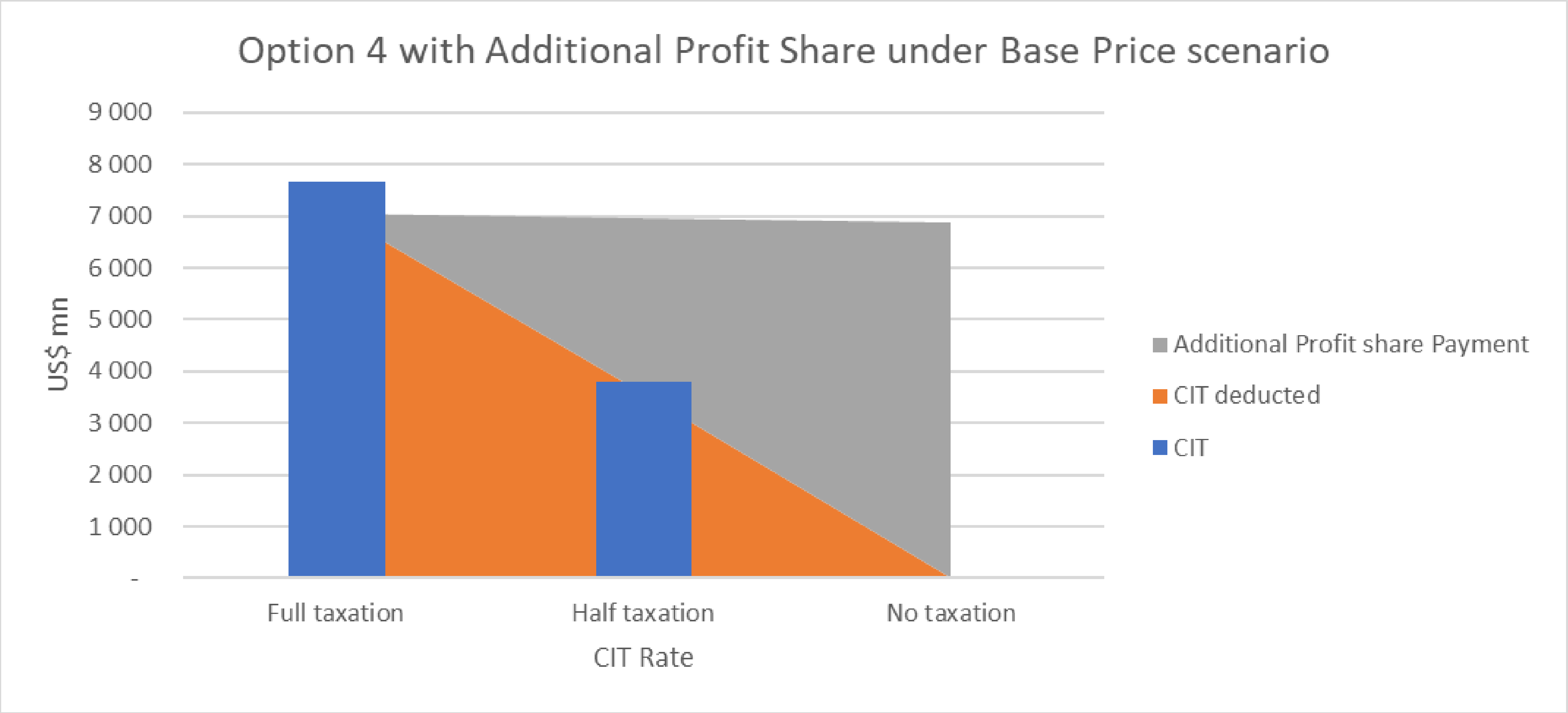
Additional Royalty – sensitivity analysis



- 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.

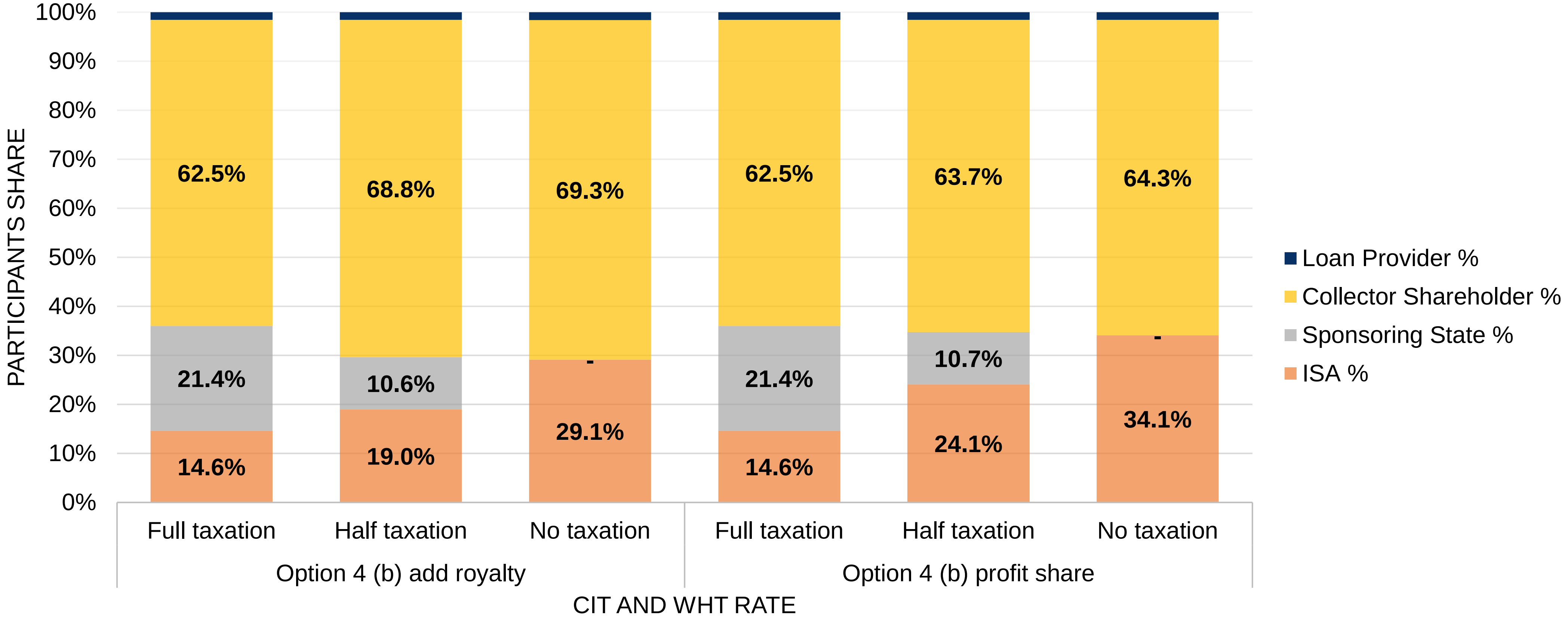
- Higher profits = higher tax = enough CIT to credit against royalty, even if its CIT rate is much lower than 25%.
- Not fulfilling role as equalization measure.

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

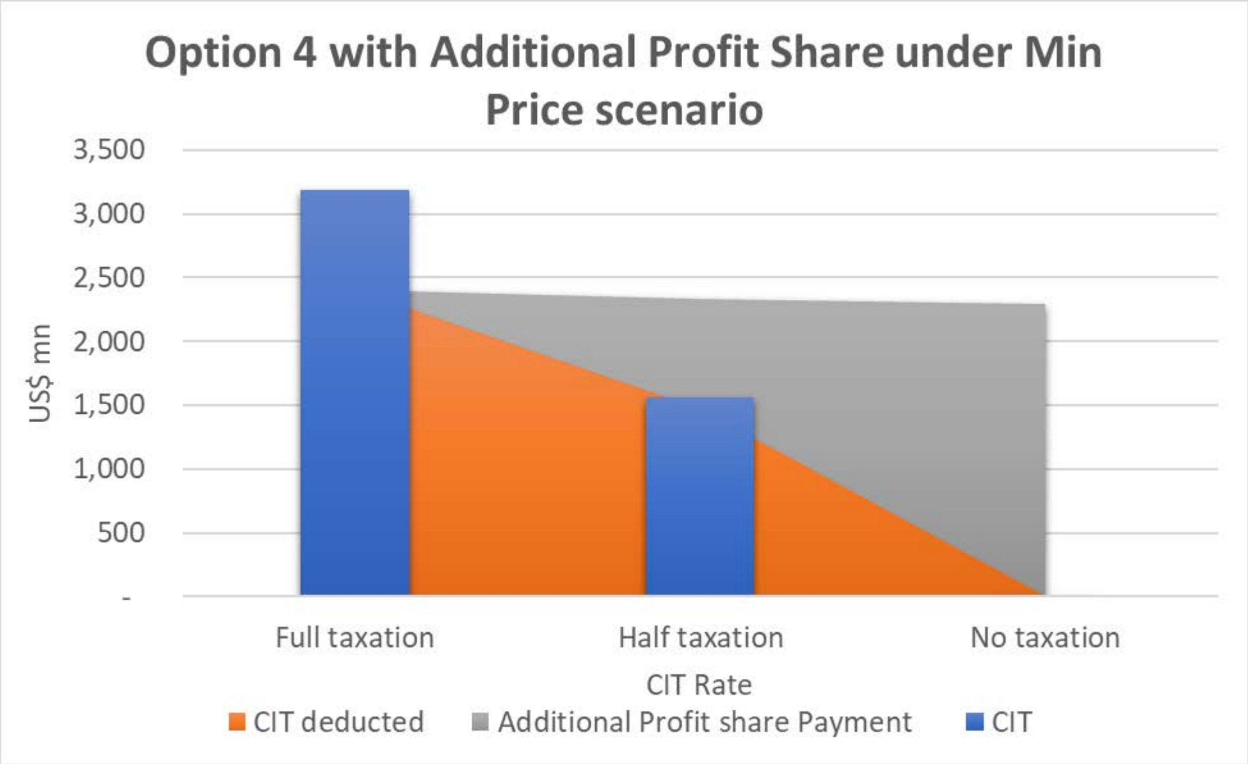
Advantages:

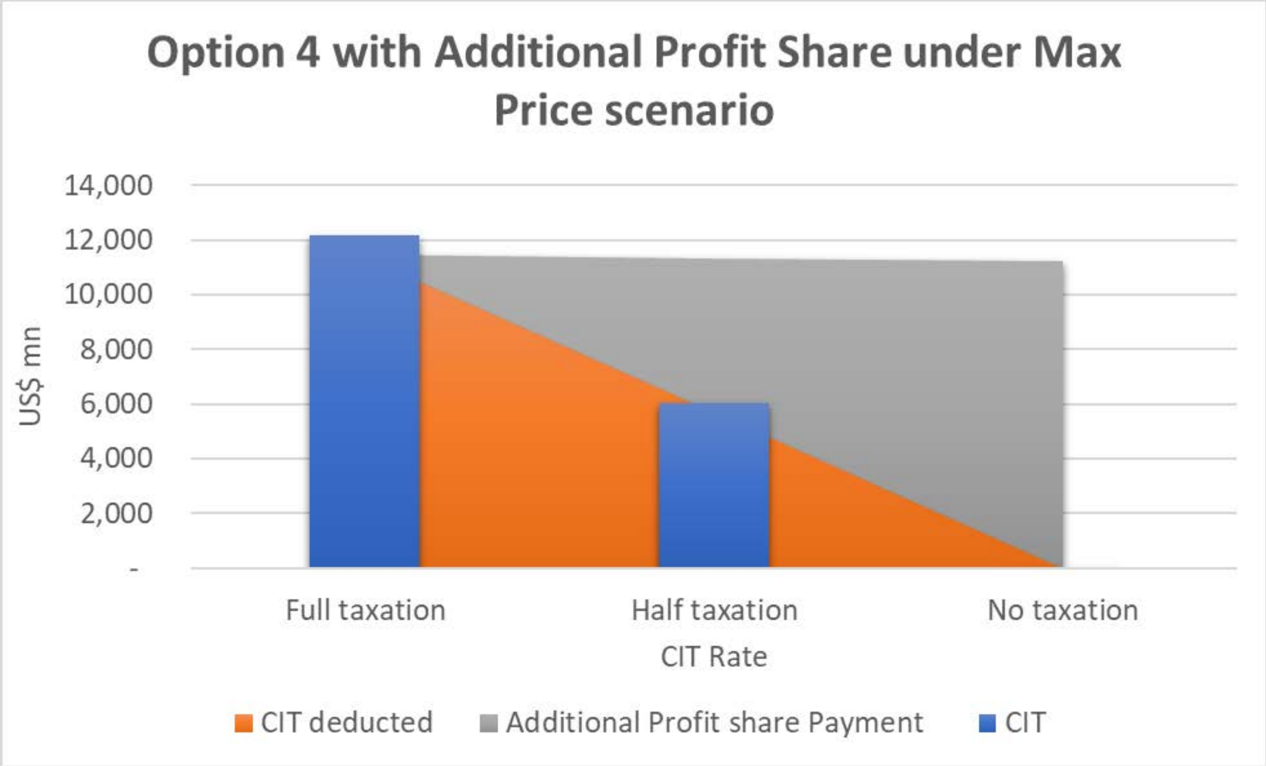
- More efficient – next slide
- Takes effect at the right time
- Likely to be included in the calculation of ETR for the global minimum tax

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

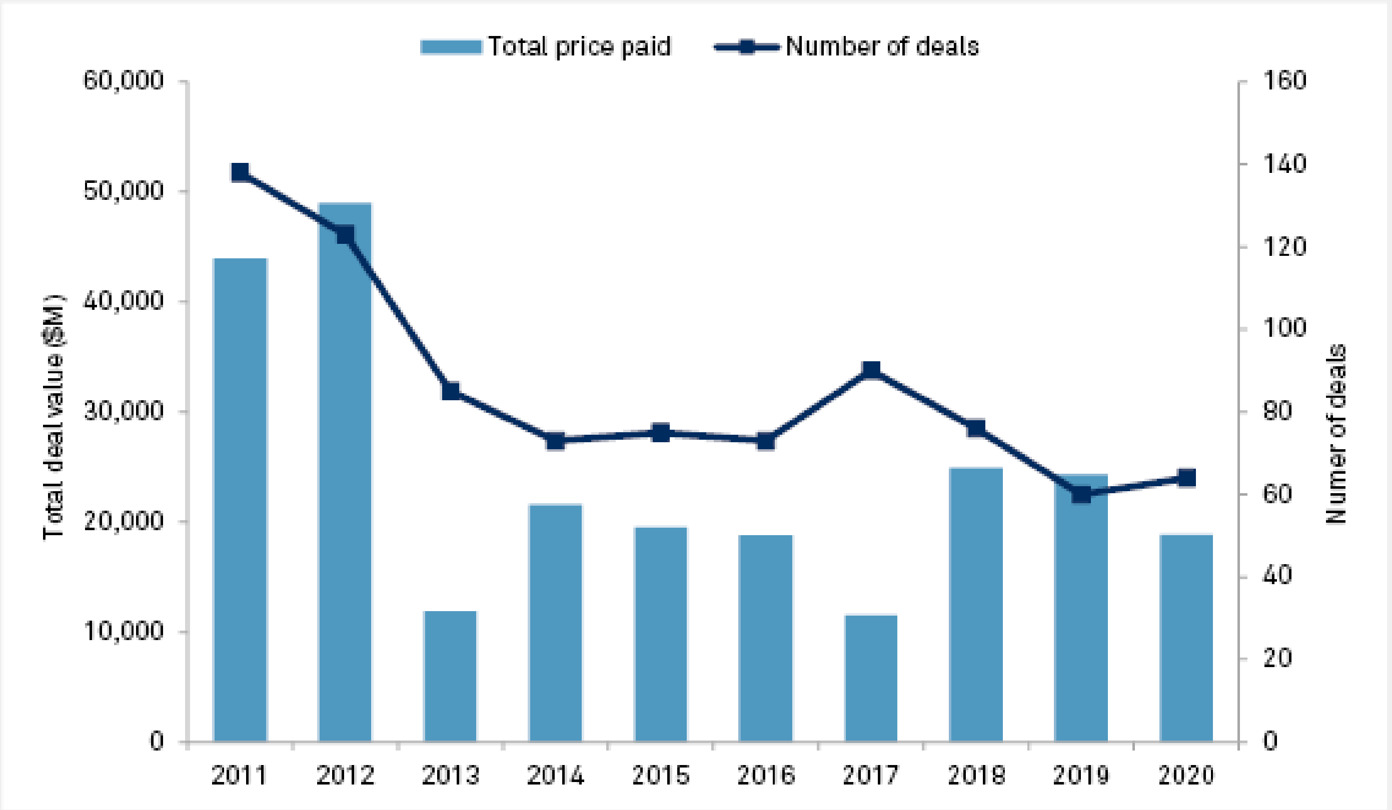
Double taxation

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

Taxation of Transfer of Rights / Assets

MERGERS AND ACQUISITIONS ARE A KEY PART OF THE MINING INDUSTRY

Deal value* and number of deals, 2011-20



Data as of March 18, 2021.
* $10 million minimum deal value.
Includes completed and pending deals as of data compilation date in each following year.
Source: S&P Global Market Intelligence

AND CAN LEAD TO LARGE GAINS

COAL APRIL 8, 2011 / 1:58 AM / UPDATED 10 YEARS AGO

UPDATE 2-Rio Tinto gains control of Riversdale Mining

By Reuters Staff 3 MIN READ

* Rio to accelerate Riversdale's coking coal projects

* Rio to appoint more executives to Riversdale board

* Riversdale shares close at A$16.52 (Adds detail)

SYDNEY, April 8 (Reuters) - Global miner Rio Tinto won control over Riversdale Mining on Friday with a $4 billion offer, allowing the global miner to now dictate development of Riversdale's prized coal mines in Mozambique.

Economy

Rio, Chinalco in JV deal to develop Africa project

(Xinhua)
Updated: 2010-03-19 14:50

Comments(0) Print Mail Large Medium Small

SYDNEY - Rio Tinto, the giant mining company, struck a deal with Aluminum Corporation of China (Chinalco) on Friday to develop the Simandou iron ore reserve in Guinea in West Africa.

The joint venture agreement covers rail and port infrastructure as well as the mine itself, Rio Tinto said in a statement on Friday.

Related readings:
- Don't politicize Rio Tinto trial, China urges
- Chinalco makes fresh overtures to Rio Tinto
- Group of Rio offers additional $25m for Haiti
- Rio Tinto employees charged with bribery

Rio Tinto owns 95 percent of the Simandou project, with another five percent owned by the World Bank.

According to the agreement, Chinalco will acquire a 47 percent interest in the project by providing 1.35 billion Australian dollars in an earn-in basis through sole funding of ongoing development during the next two to three years.

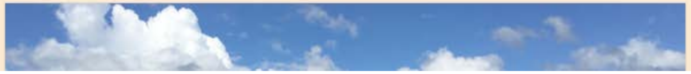
"We have long believed that Rio Tinto and Chinalco could work together on major projects for mutual benefit," Rio Tinto's Chairman Tom Albanese said in a statement.

MINES

Endeavour-Semafo : un mariage à 640 millions d'euros bouleverse les mines africaines

JA RÉSERVÉ AUX ABONNÉS | 24 mars 2020 à 11h47 | Par *Christophe Le Bec*

Mis à jour le 30 mars 2020 à 13h03



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AFRIQUE

09 mai 2016

Freeport-McMoran cède une mine congolaise à un groupe chinois pour 2,6 milliards de dollars

Partager

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SOME OF THOSE GAINS ARE TAXED BY HOST COUNTRIES

E.g., Anglo American – Mitsubishi 2012 sale in Chile

NEWS

Anglo American pays US$1.02bn in taxes for assets sale to Mitsubishi

Bnamericas

Published: Friday, April 13, 2012

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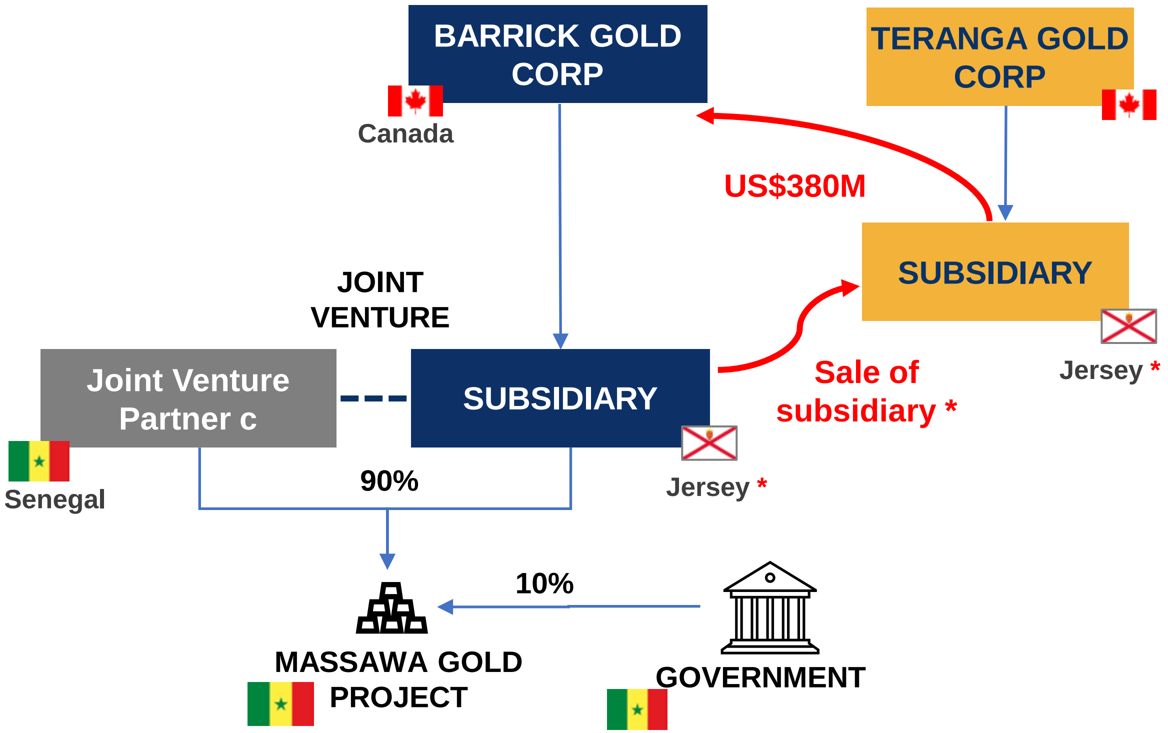
London-based Anglo American (LSE: AAL) has paid US$1.02bn to Chile's general treasury in capital gains tax for the sale of a 24.5% stake in its central Chile assets, known as Anglo American Sur (AAS), to Japan's Mitsubishi. Anglo American sold the stake in AAS to Mitsubishi for US$5.39bn last November. With the payment, total taxes paid by Anglo American in Chile for 2011 total US$1.96bn. The company has paid more than US$5.3bn in taxes in Chile in the last five years. The sale to Mitsubishi is at the center of the

ILLUSTRATION: ACQUISITION OF MASSAWA GOLD MINE, SENEGAL (2020)



(*) Although the domicile of the subsidiary was not disclosed in the press releases, by reviewing the corporate structure of both groups, we believe that the target entity was domiciled in Jersey.

ISA’s right to tax the transfer of rights

Legal basis to tax profits arising from activities taking place in the Area

- Annex 1 of the Implementing Agreement gives the ISA the option to choose a royalty system or combination of a royalty and profit-sharing systems.
  - A capital gains tax represents a share of the profits arising from the sale or transfer of a mining right.

- Section 8(1)(b) also requires that the rates of payment be within the range of those for land-based mining.
  - Tax on the sale or transfer of mining rights is a feature of most land-based fiscal regimes. Not applying such a tax would give DSM a comparative advantage over land-based mining.

Common practice in land-based mining countries

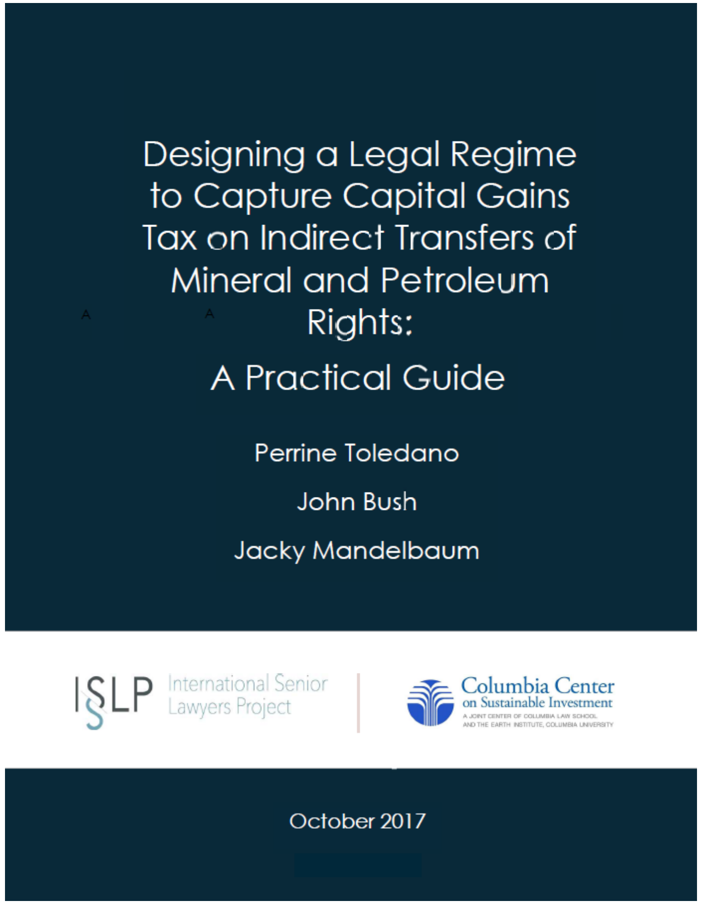
The majority of countries tax capital gains (PwC, 2022).

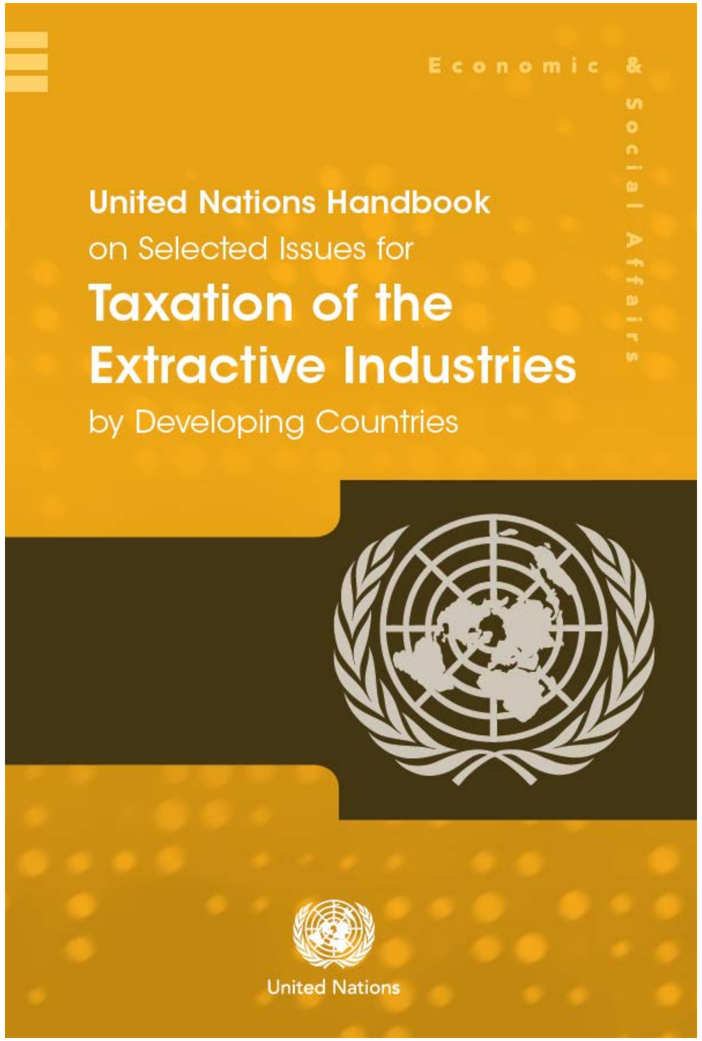
- The survey considered 151 jurisdictions
- 133 of which have rules in their legal systems to tax capital gains.

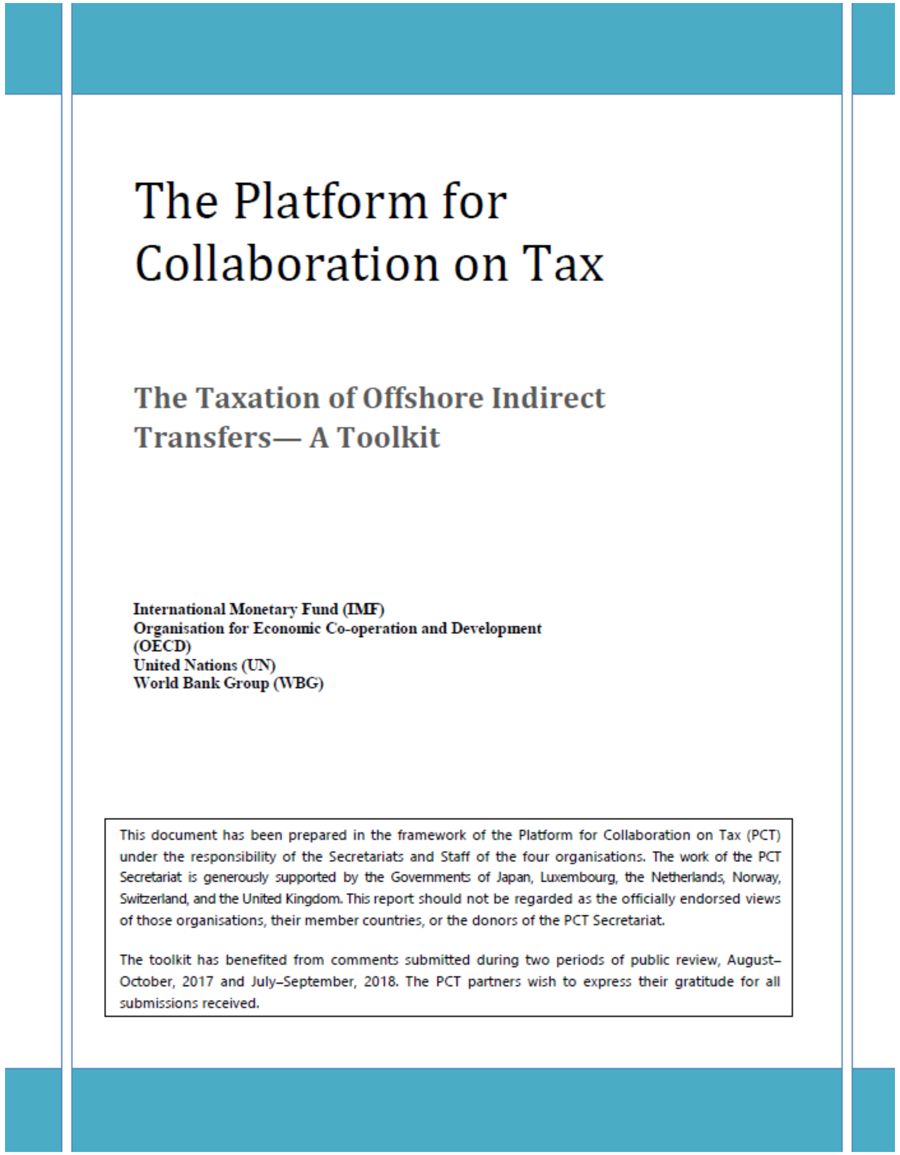
Many countries also tax offshore indirect transfers of mining assets

- IGF has identified at least 27 that have a specific capital gains taxes for the indirect transfer of assets located in their territories. Many are resource-rich.

Common practice in land-based mining countries






The Platform for Collaboration on Tax

The Taxation of Offshore Indirect Transfers— A Toolkit

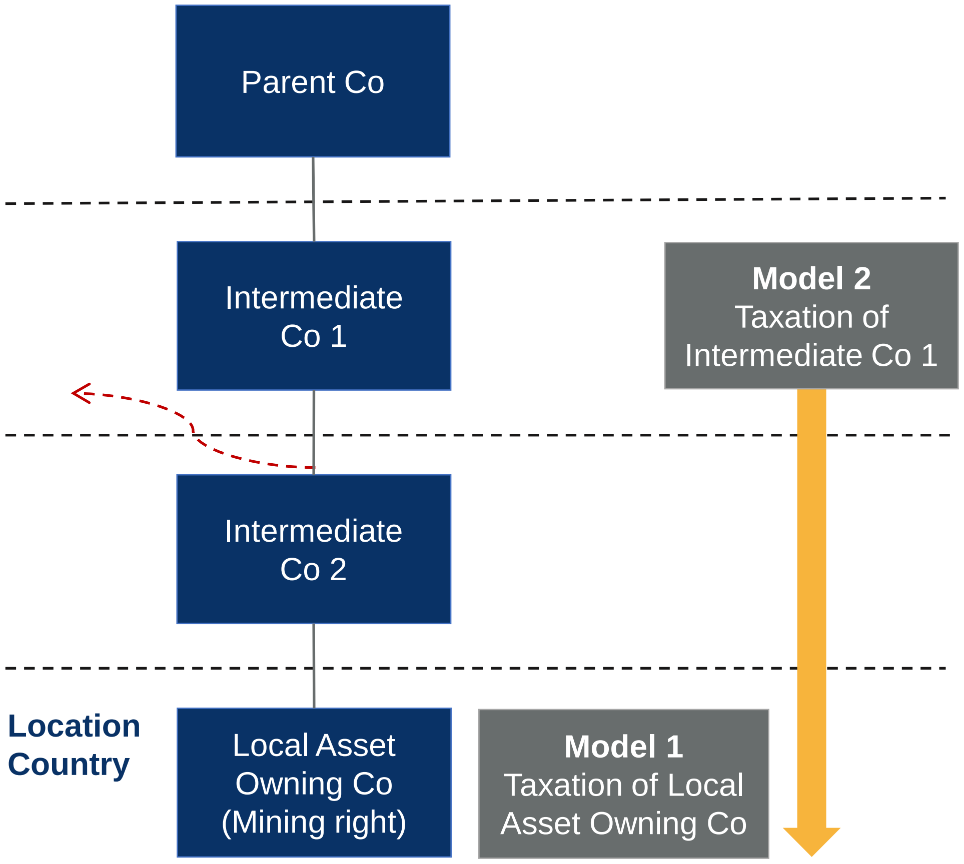
International Monetary Fund (IMF)
Organisation for Economic Co-operation and Development (OECD)
United Nations (UN)
World Bank Group (WBG)

This document has been prepared in the framework of the Platform for Collaboration on Tax (PCT) under the responsibility of the Secretariats and Staff of the four organisations. The work of the PCT Secretariat is generously supported by the Governments of Japan, Luxembourg, the Netherlands, Norway, Switzerland, and the United Kingdom. This report should not be regarded as the officially endorsed views of those organisations, their member countries, or the donors of the PCT Secretariat.

The toolkit has benefited from comments submitted during two periods of public review, August–October, 2017 and July–September, 2018. The PCT partners wish to express their gratitude for all submissions received.

Common practice in land-based mining countries

- Two main models:
  - **<u>Model 1</u>** – taxation of a deemed direct sale by a resident
  - **<u>Model 2</u>** (most used) taxation of the non-resident seller



Considerations on the African Group proposal

- Tax base: gross versus net gains in a transaction?
- Reduce threshold to encompass sales of shares when less than 50% of the value derives from assets located in the Area / pro rata taxation?
- De minimis threshold: what is the right level to only exclude small transactions?
- Definition of taxable assets and immovable property: including licenses themselves, as well as shares and similar interests in entities holding those licenses ?
- Obligation to inform the Authority and update the license with regard to changes in the corporate structure or beneficial ownership? EITI requirements on disclosing beneficial ownership?
- Add the sponsored entity as an additional liable person?
- Anti-fragmentation rule: replace the reference to “the sole opinion of the Authority” with a fixed time period of one to five years, in line with international practice?

THANK YOU

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