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

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Building Tomorrow Together: Mining for a responsible and inclusive future

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on Mining, Minerals, Metals and
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A VOLUNTARY INITIATIVE CREATED THROUGH THE UN IN 2005

79 MEMBER COUNTRIES

DEDICATED TO IMPROVING MINING GOVERNANCE TO HELP ACHIEVE THE UN SUSTAINABLE DEVELOPMENT GOALS.

How do we help governments?

- IN-COUNTRY ASSESSMENTS
- CAPACITY BUILDING
- TECHNICAL ASSISTANCE
- GUIDANCE FOR GOVERNMENTS
- EVENTS & CONFERENCES

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Dominican Republic
Ecuador
El Salvador
Guatemala
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Honduras
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Peru
Suriname
United States of America
Uruguay

AFRICA

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Cameroon
Chad
Congo
Egypt
Eswatini
Ethiopia
Gabon
Ghana
Guinea
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritania
Morocco
Mozambique
Namibia
Niger
Nigeria
Rwanda
Senegal
Sierra Leone
Somalia
South Africa
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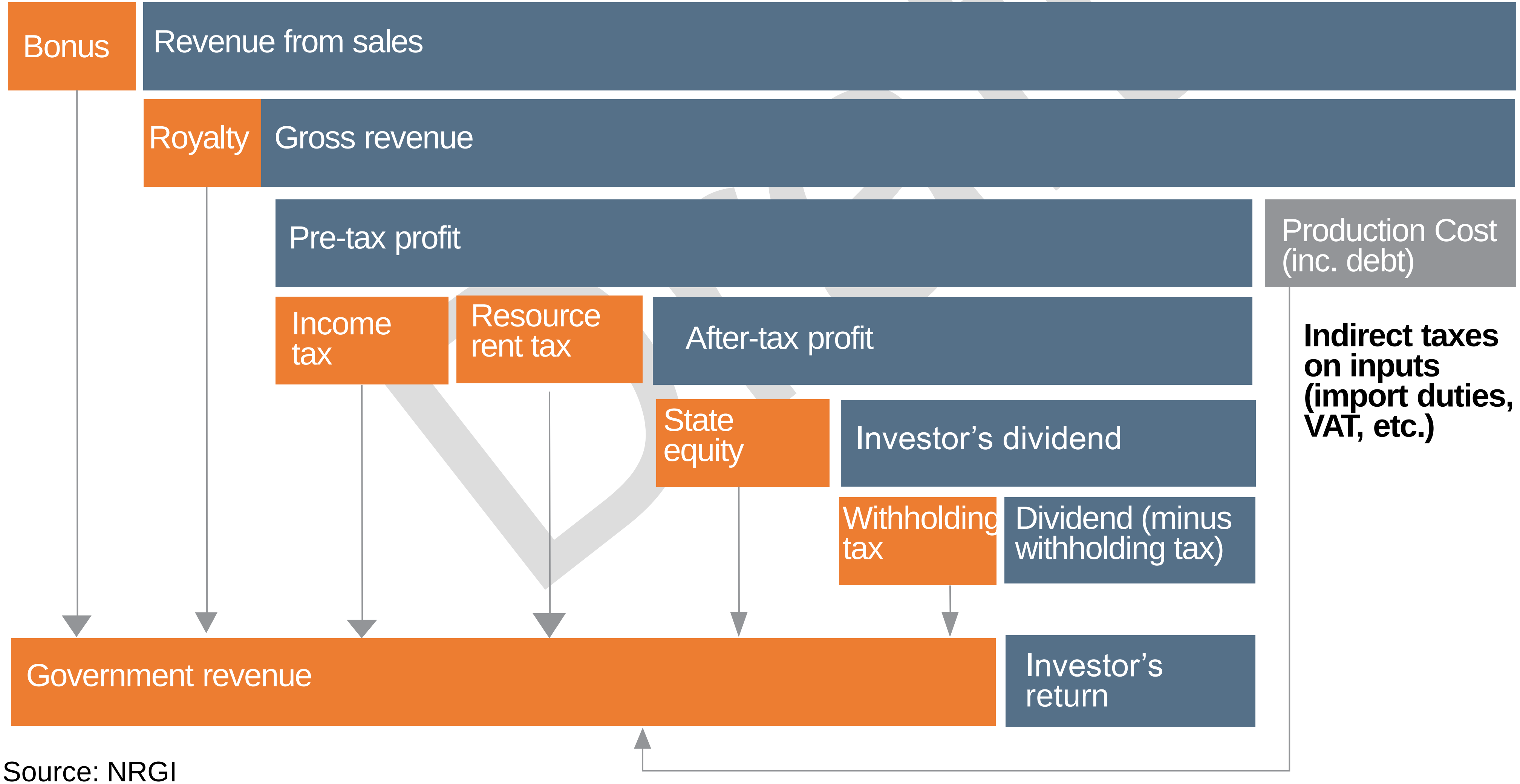
Assessing Payment Regime Options

The ‘Government Take’



Source: NRGI

The Average Effective Tax Rate – defined

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

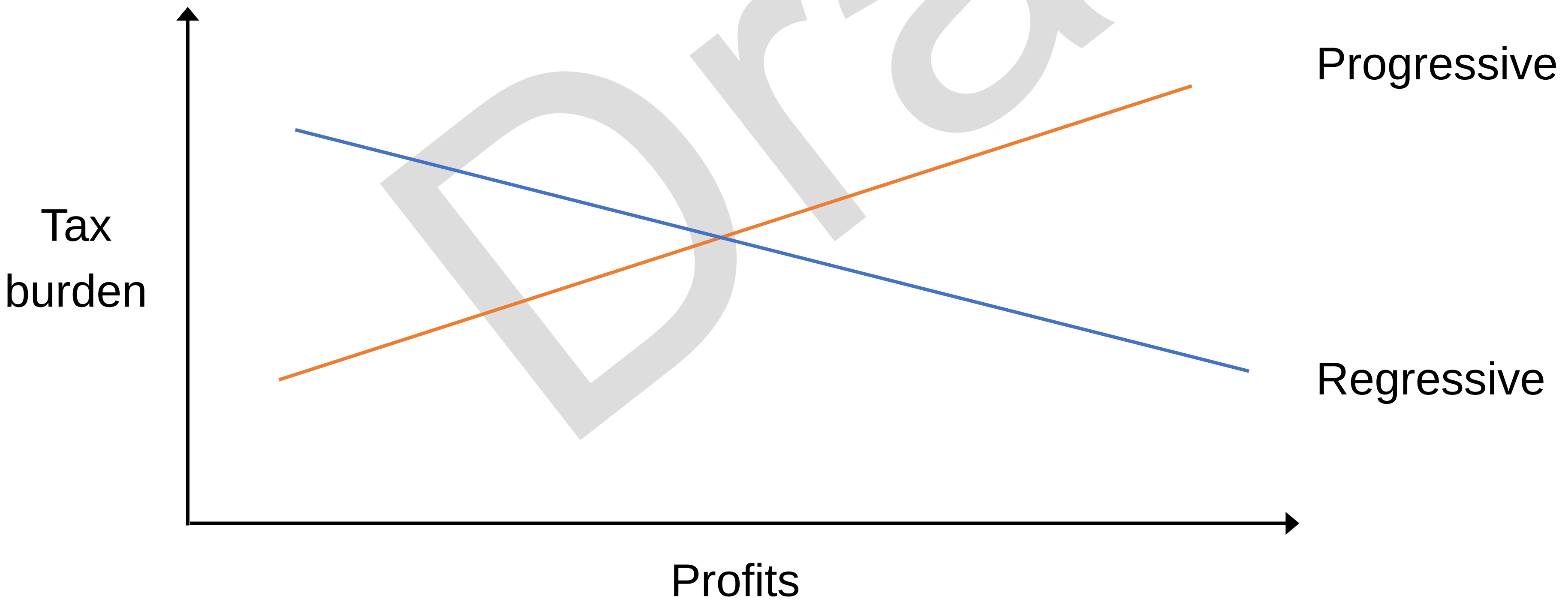
Principles for mining fiscal regime design

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)

Progressive fiscal regime imposes higher taxes as profits increase (and regressive imposes higher taxes as profits decrease)



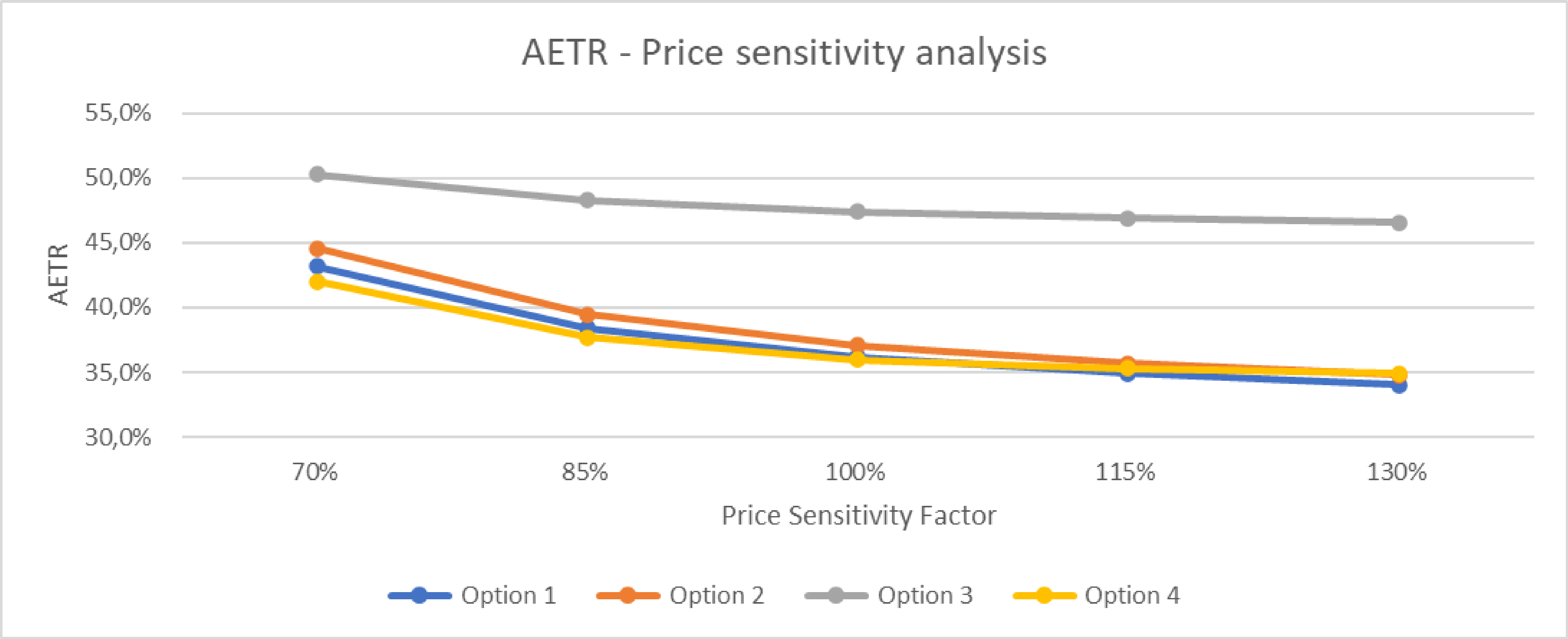
IGF Financial Model

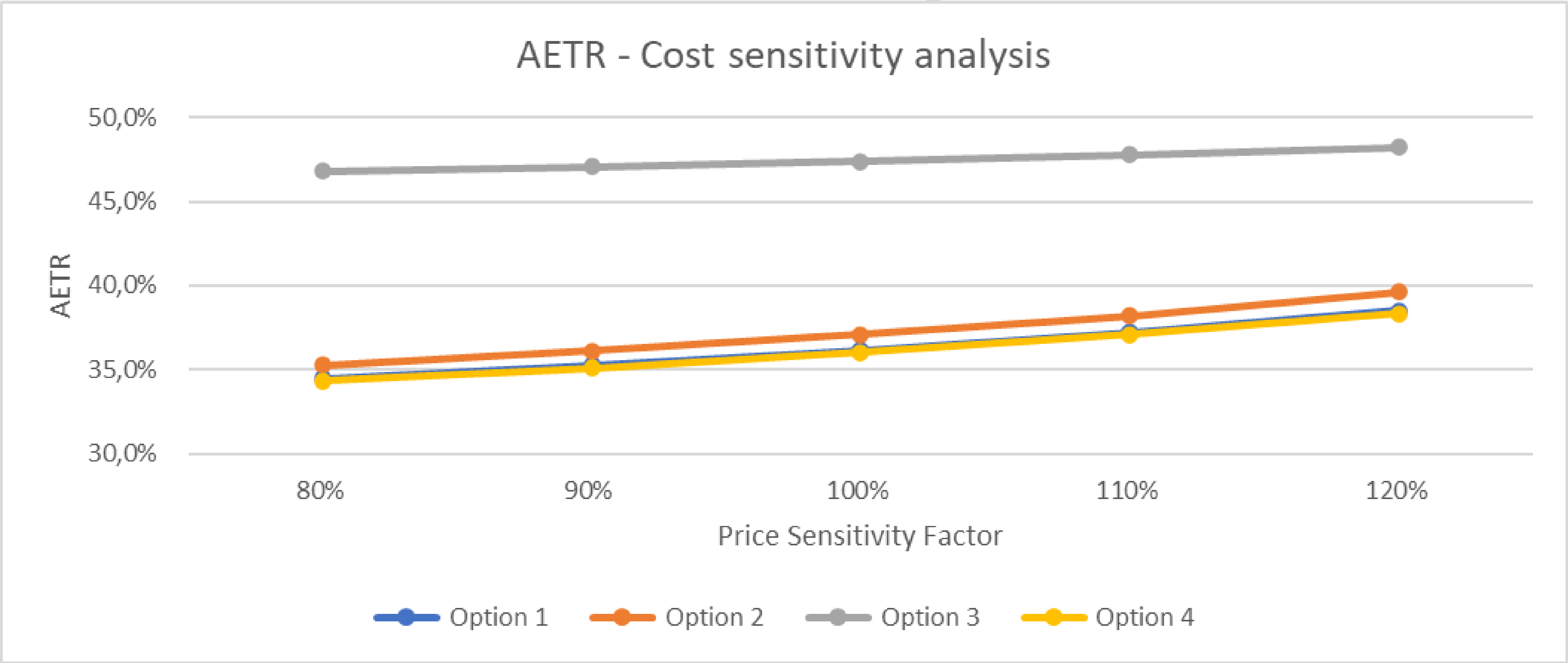
- Revenue and royalty base: the gross value of the contained metals—copper, nickel, cobalt, and manganese (valued with reference to manganese ore)
- CIT rate in sponsoring state = 25%
- Processor IRR = 50% * 10% + 50% * contractor IRR
- 0% WHT on interests, dividends, and 50% of operating services
-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

Quantitative Comparison

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 shareholder %	62.3%	61.4%	51.1%	62.5%
Loan provider %	1.4%	1.4%	1.4%	1.4%
Contractor shareholder IRR (real term CF)	22.2%	22.6%	21.1%	22.7%

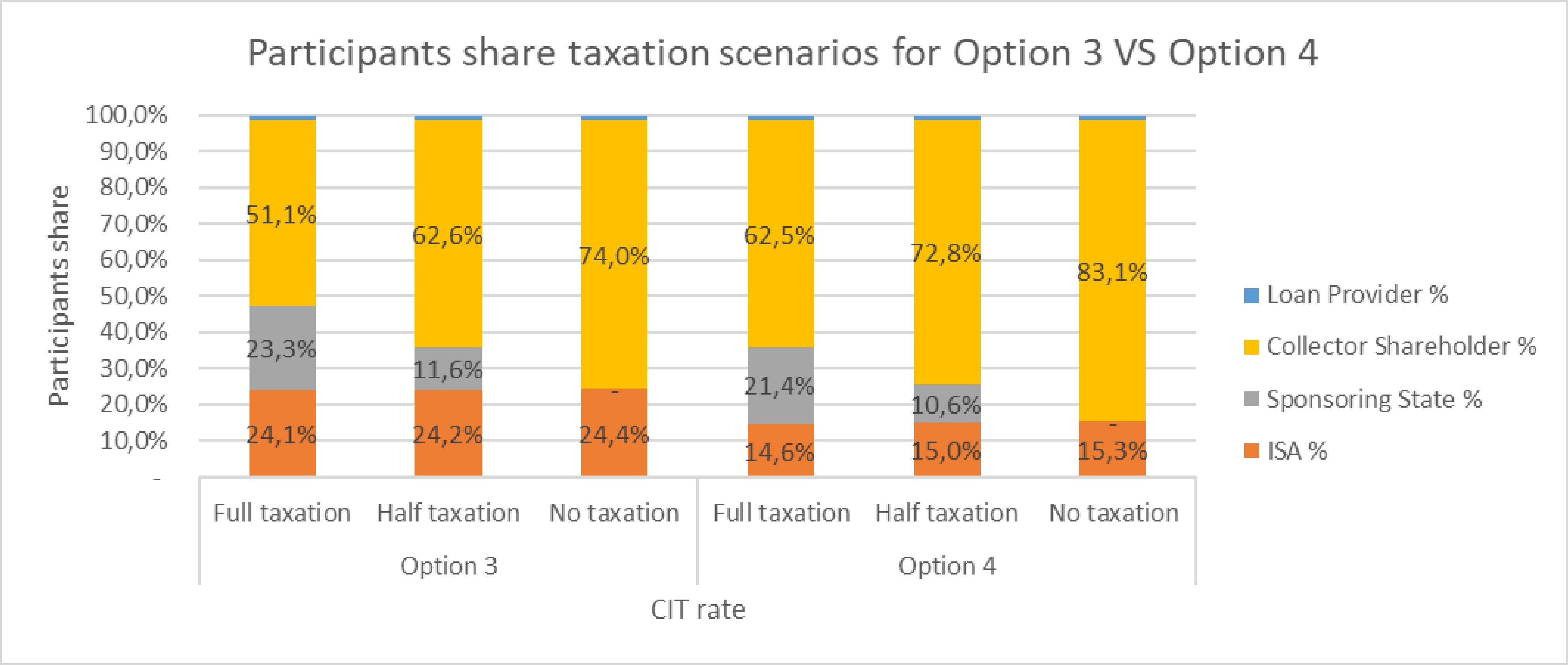

AETR - Price sensitivity analysis
55,0%
50,0%
45,0%
40,0%
35,0%
30,0%
AETR
70%
85%
100%
115%
130%
Price Sensitivity Factor
Option 1
Option 2
Option 3
Option 4



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

Interaction Between the Four Payment Regimes and Sponsoring State Taxes

An equalisation measure is necessary to ensure level playing field with LBM



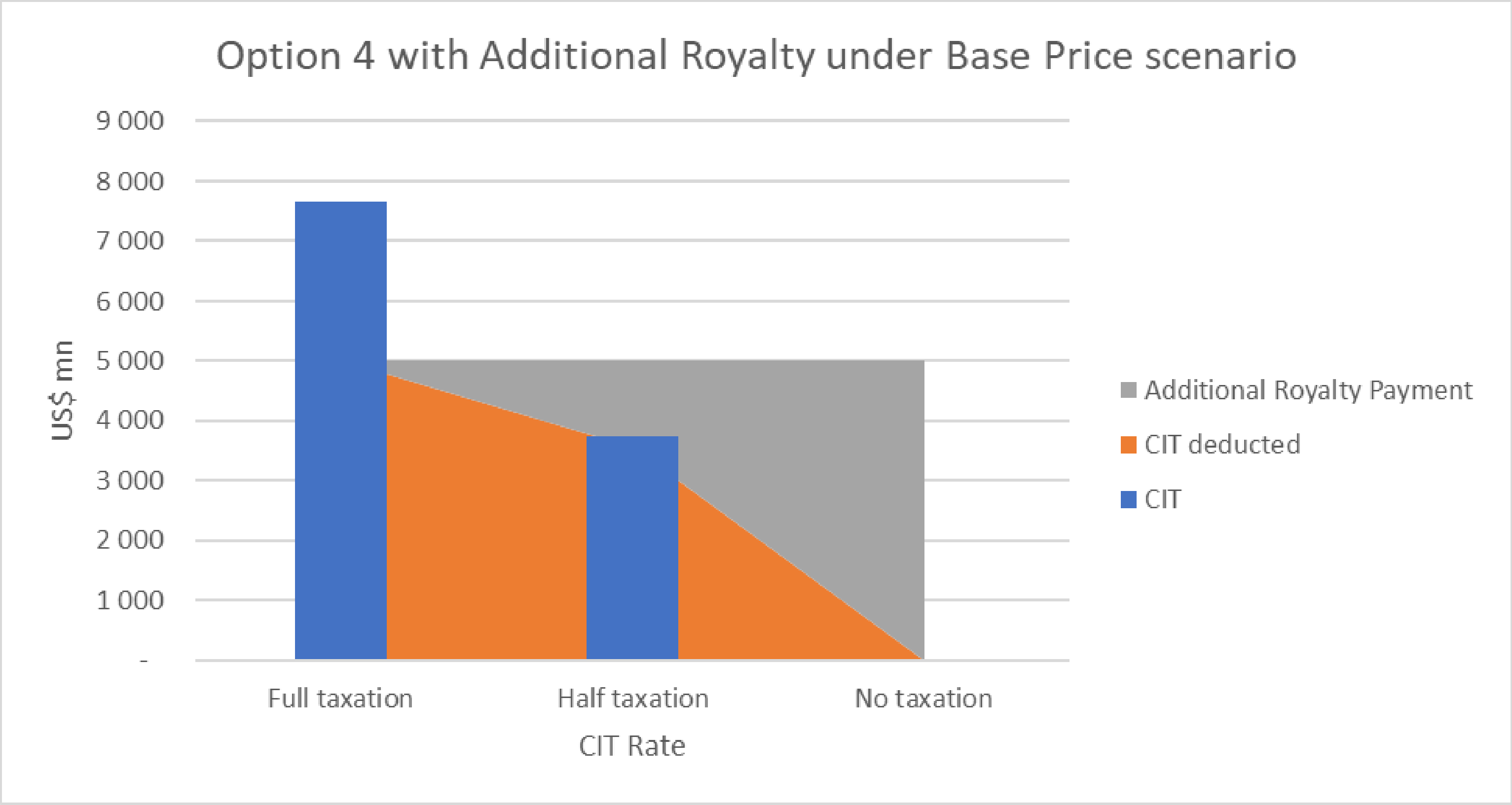
Two options so far

- **Additional Royalty**
  - African Group’s proposal
  - 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 an uplift on negative cashflows
  - Contractors can deduct CIT paid to their sponsoring state in previous years

Additional Royalty

How it works



Additional Royalty

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.

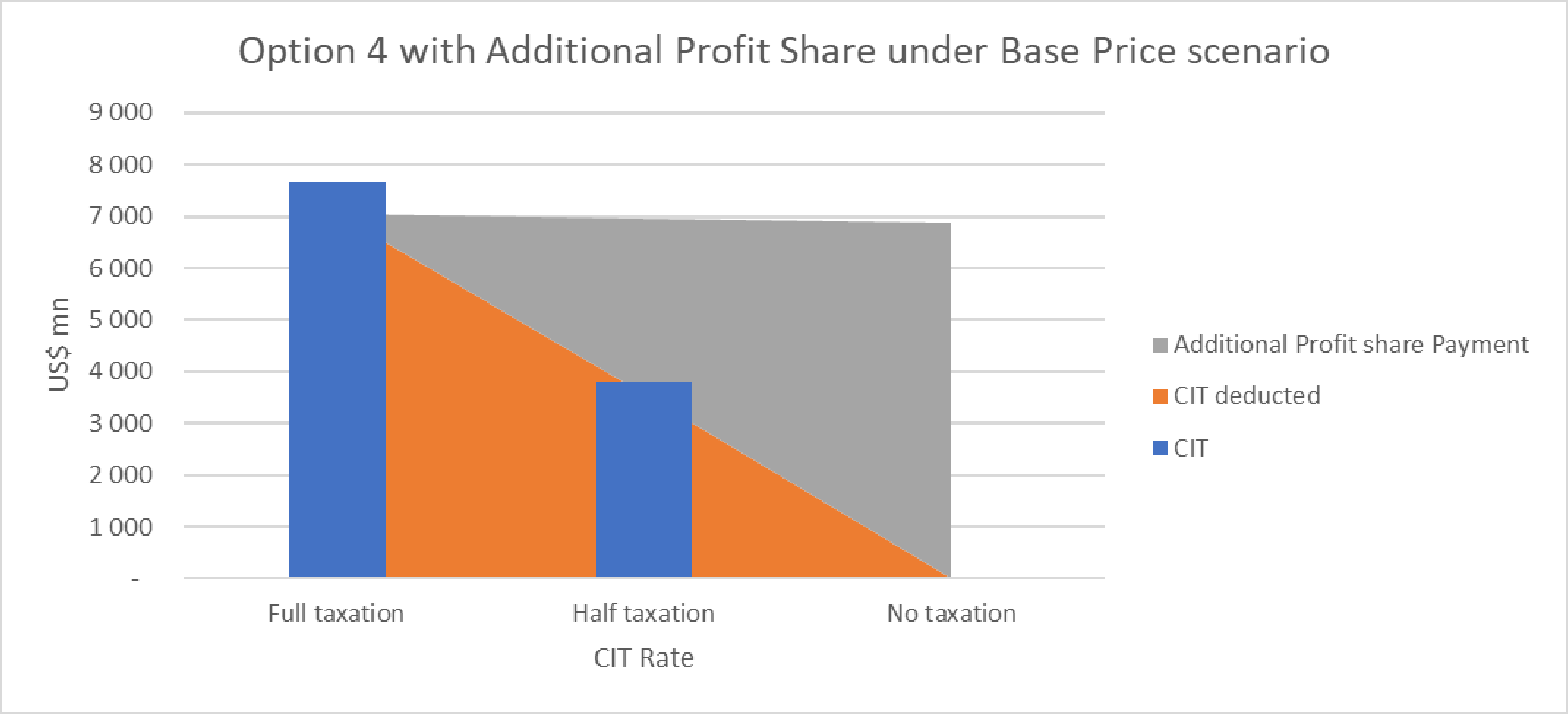
Sensitivity Analysis – additional royalty

- 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.

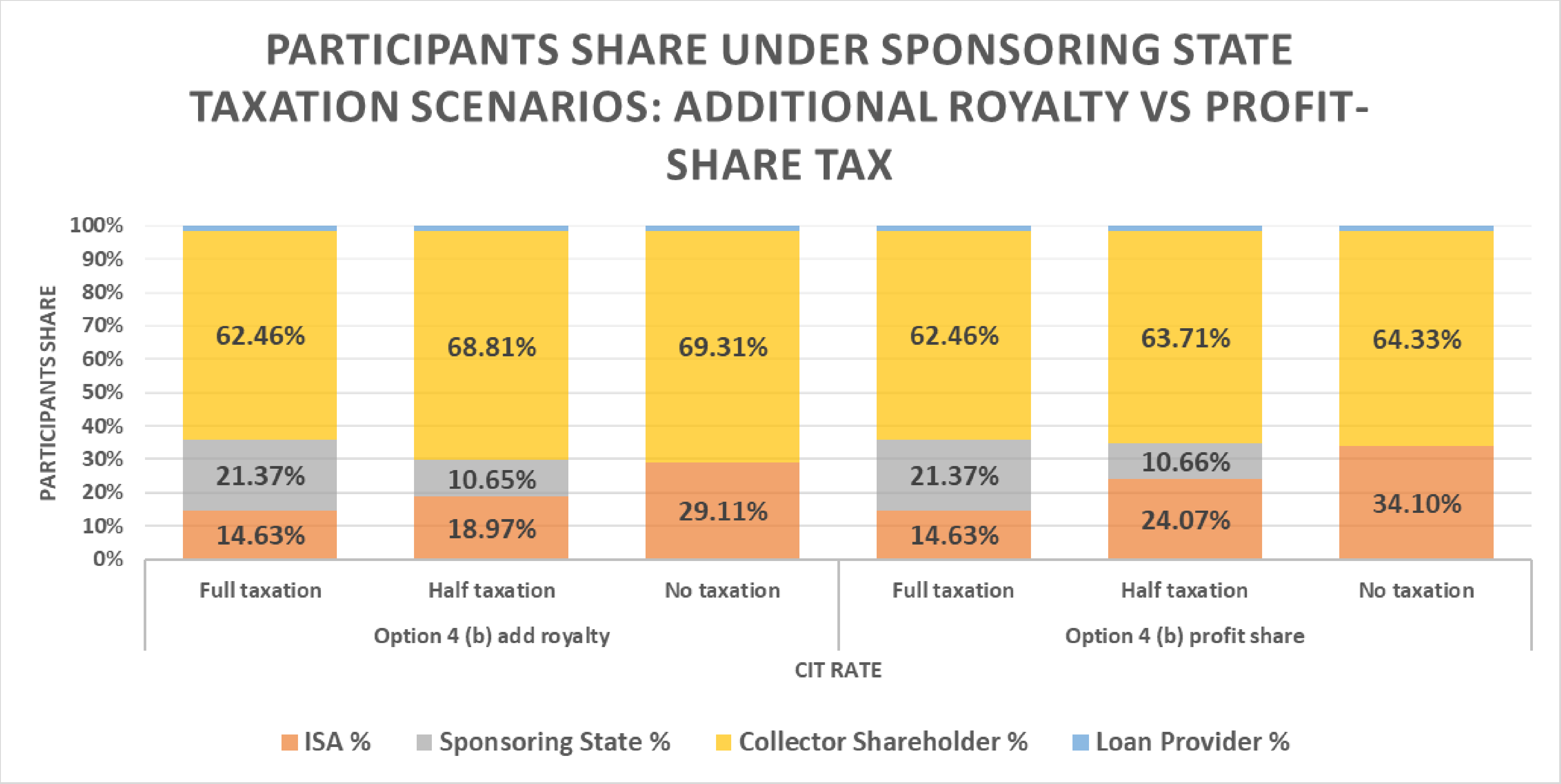
Additional profit share

How it works



Comparing an additional royalty and profit share

Profit share slightly better than additional royalty at equalising



Additional Profit Share

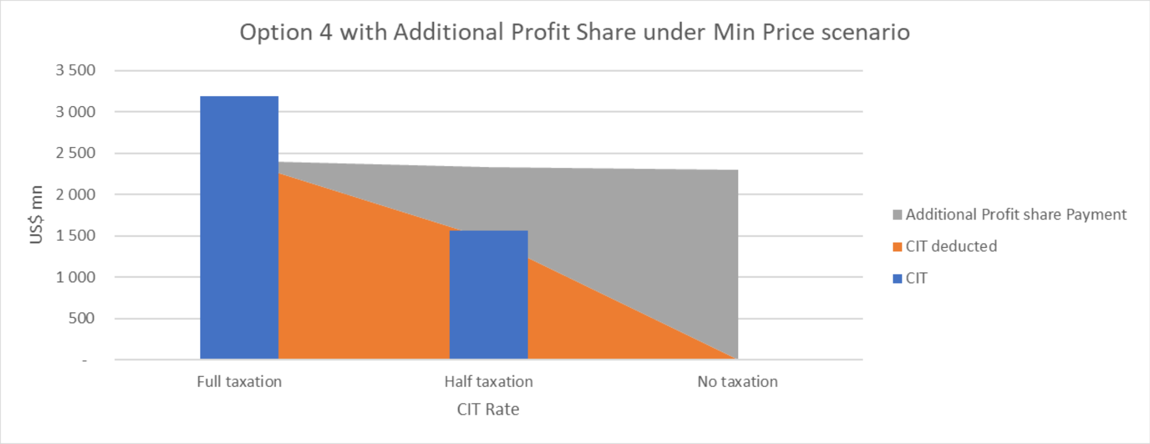
Advantages:

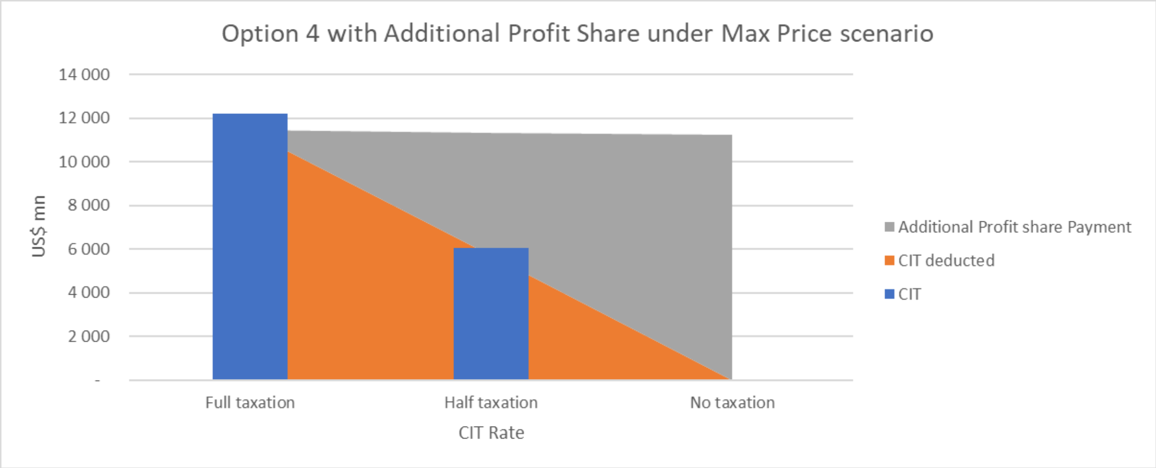
- More efficient – next slide
- Takes effect at the right time
- Likely to be included in the calculation of ETR for the global minimum tax

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

Sensitivity Analysis – additional profit share





- 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.

Addressing key challenges of a profit share

Safeguards

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

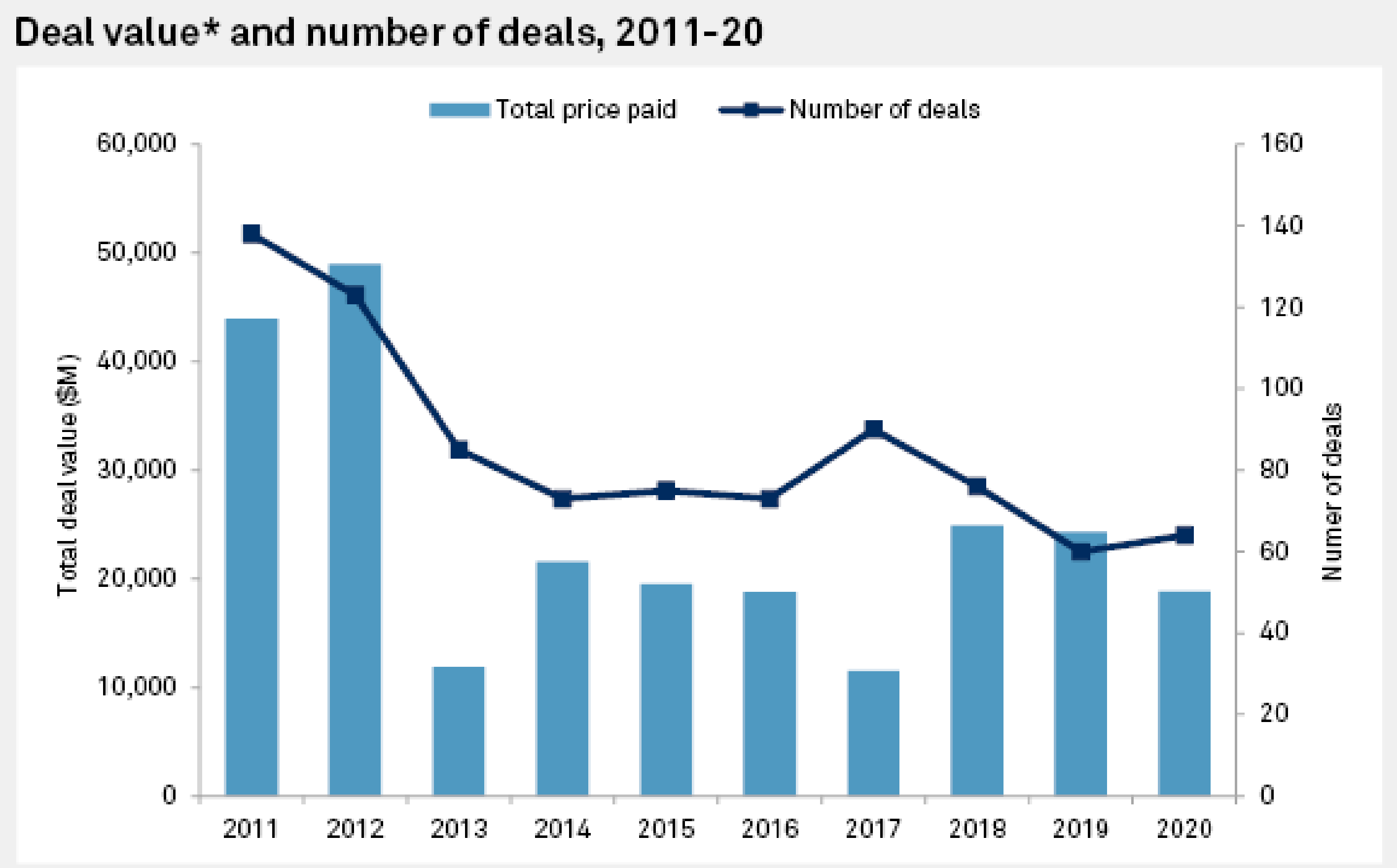
- Technical assistance / capacity building
- Tax Inspectors Without Borders program – direct audit assistance
- Also necessary for tax on transfers

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



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

WHICH 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

MINES

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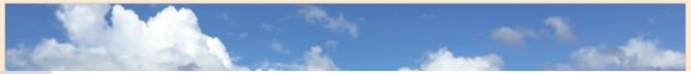
Mis à jour le 30 mars 2020 à 13h03



Economy

Rio, Chinalco in JV deal to develop Africa project

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

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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.

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

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

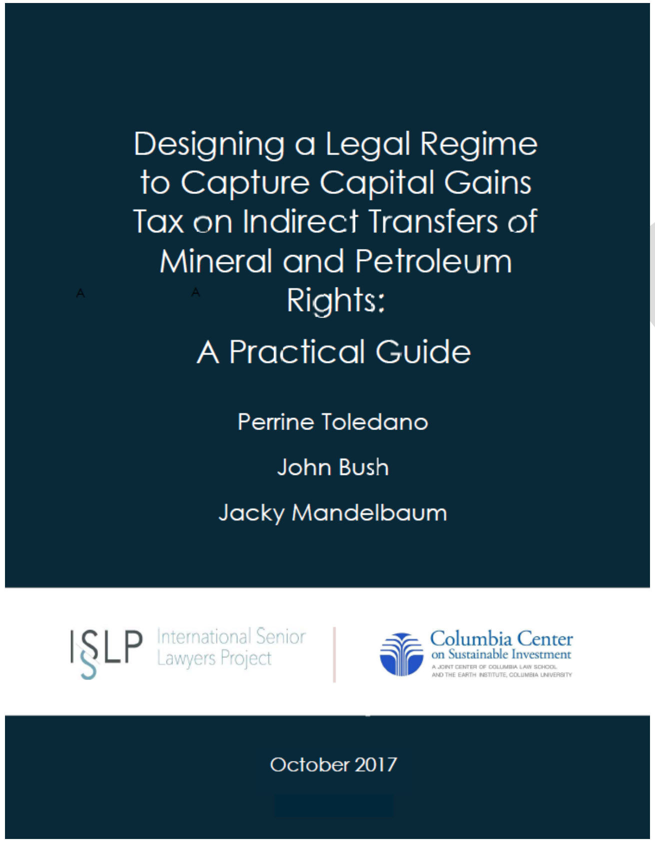
The majority of countries tax capital gains (PwC, 2022).

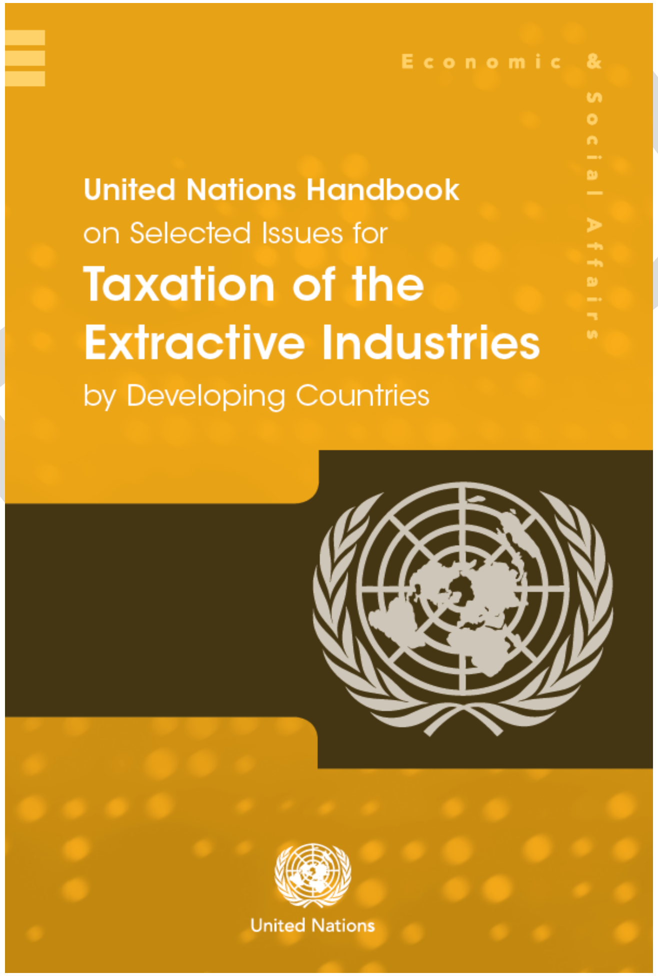
- The survey considered 151 jurisdictions
- 133 of which have rules in their legal systems to tax capital gains.

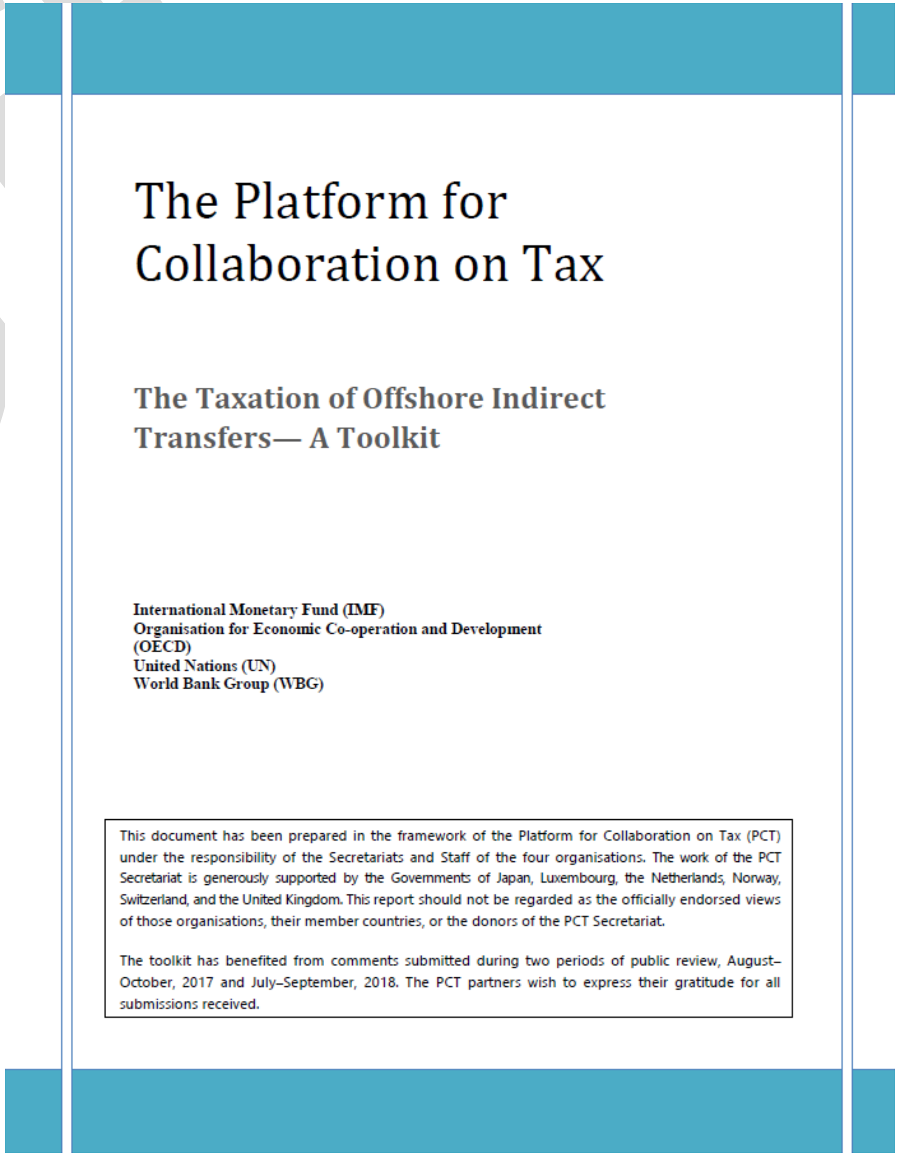
Many countries also tax offshore indirect transfers of mining assets

- 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.

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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