Technical Working Group Report on Equalisations Measures

16/08/23

Would no equalisation measure and a higher base royalty effectively capture resource rent?

• Impact of No Equalisation Measure

- Base royalty rates chosen to give “fair” ETR = 42.6%, for contractors paying 25% CIT
  - These rates result in ETR = 24.9% for contractors paying no CIT

- Base royalty rates need to double for contractors paying no CIT to reach “fair” ETR level
  - However, these royalty rates result in unfair high ETR = 55.1% for contractors paying 25% CIT
  - Royalty rates and average ETR are outside fair ranges identified in previous studies of land-based mining for contractors paying 25% CIT

Results in absence of an equalisation measure?

	Rates set to achieve ETR = 42.6% assuming **25% CIT**		Rates set to achieve ETR = 42.6% assuming **0% CIT**	
	Contractors paying 25% CIT	Contractors paying 0% CIT	Contractors paying 25% CIT	Contractors paying 0% CIT
1st Period Royalty Rate	2.5%	2.5%	2.5%	2.5%
2nd Period Royalty Rates	4.5% -9.5%	4.5% -9.5%	**9% - 19%**	**9% - 19%**
ETR	42.5%	**24.8%**	**55.1%**	42.6%
Lifetime Royalty Revenue (undiscounted)	$3,682 million	$3,682 million	$7,148 million	$7,148 million
Contractor IRR	15.9%	17.4%	14.9%	16.4%

Options:

1. Charge royalty rates far above normal experienced in land-based mining
2. Forgo significant resource rents that could be obtained from collectors paying no CIT
3. **Implement an equalisation system**

Preferred Option: Hybrid Additional Royalty and Top Up Profit Share (1)

What is it:

“Contractor will pay the additional royalty provided for in Regulation [R] unless an Independent Auditor confirms:

a.) the Contractor does not have any Exemptions from sponsoring corporate income tax or any other sponsoring state tax;

b.) the Contractor does not receive any Subsidy from the Sponsoring State or any other state; **and**

c.) the Contractors has met the requirements of the Top-Up Profit Share provided for under Regulation [R]. “

Preferred Option: Hybrid Additional Royalty and Top Up Profit Share (2)

Explanation of Top Up Profit Share Component

- provides that a Contractor pays an additional amount to the ISA if the taxes that it and all its related entities involved in mining operations pay to all states are less than 25% of the profits from mining operations.
- the amount of the equalization payment would be the difference between the equivalent of 25% of profits and the amount of taxes paid.
- this equalization measure would use OECD GloBe definitions of profits and taxes, which would simplify tax administration and audit, and allow the ISA to lean on a growing body of international tax audit expertise in this area.

Preferred Option 1: Hybrid Additional Royalty and Top Up Profit Share

Why did we choose this option:

- Demotivates tax avoidance and subsidies in sponsoring state,
- Provides minimum revenue for sponsoring state (amount payable under CIT and other taxes), which was not the case for initial top up profit share,
- Better at equalisations and fairer to contractor and authority than additional royalty only
- Better at demotivating profit shifting between jurisdictions than additional profit share
- Builds on existing definitions of covered taxes, profits and costs under OECD GloBe

Weaknesses:

- There is still some uncertainty around the implementation of OECD Globe, subsidies in non-sponsoring state and unknown potential work arounds from GloBe; and
- Defining and implementing the concept of the mining perimeter.
- There continues to be a risk of transfer mispricing.

Possible Option 2 Additional Profit Share

Why did we choose this option:

- better at equalisation regardless of whether costs are higher or lower than forecast under ISA financial model;
- results in a similar structure to land-based mining payment regimes – royalty and profit share; and
- fairer to both the ISA and Contractors under a range of cost scenarios.

What we did to strengthen this option:

- reviewed allowable costs and amended to include mineral transport and exploration costs specific to exploitation mine site;
- reduced scope for transfer pricing, by, for related party transactions providing a net back approach for the nodule transfer price, limiting deduction of intra-group services, and limiting intellectual property; and
- provision for contractors to contests a cost limited according the above rules if they can prove that the cost accrued with a transfer price consistent with OECD transfer pricing rules.

Weaknesses:

- Complexity but at level envisaged by UNCLOS's option for a profit share and similar to that accepted by many low-income land-based mining jurisdictions;
- not possible to eliminate all transfer mispricing risk as is the case with any profit share; and
- possible discrepancy between profits as defined under CIT and profits as defined by additional profit share.

Work for tomorrow

- We will spend this afternoon going through the details and text for the wider group’s preferred equalisation measure.
- We will submit draft text for that equalisation by the 1st September 2023
- Also, a gentle reminder that draft text does exist (see annexes to the Equalisation Measures Working Group: Briefing Note) for the equalisation measures, so we will be building on that to provide detailed text for the preferred option.