



Deep-Sea Minerals

Briefing, September 2024

A Profit Share on the Transfer of Rights for Deep-seabed Mining

Background

The United Nations Convention on the Law of the Sea (UNCLOS) provides that the International Seabed Authority (ISA) regulates deep-seabed mining in the area beyond national jurisdiction (the Area).

The ISA has granted 22 exploration licences to contractors.¹ To date the ISA has not issued any exploitation licences and there has been no commercial mining in the Area. The 168 state parties of the ISA are currently negotiating the Exploitation Regulations. An important part of the Exploitation Regulations is the payment regime, which will determine what payments contractors must make to the ISA.

It is a likely scenario that the rights to conduct deep-seabed mining activities will be transferred from one entity to another. A transfer of rights could occur *directly*, via the contractor selling its exploitation licence, or *indirectly*, via the parent company/owner of the contractor selling the contractor (or a share in the contractor) to another entity.

Both direct transfers and indirect transfers can result in substantial profits. Thus, a key question is: should the ISA receive a share of the profits from either of these types of transfers?

A submission by the African Group and Canada to the ISA provides for the Draft Exploitation Regulations to include a profit share on the direct transfer of rights and a profit share on the indirect transfer of rights.² In the Draft Exploitation Regulations,³ the profit shares on transfers are provided for in draft regulations 23.6.bis and 23.6.ter. Draft regulation 23.6.ter refers to a standard, submitted by Canada, the text of which is provided on page 372 of the Draft Exploitation Regulations, Compilation of Proposals.⁴

This Briefing Note concentrates on examining the arguments for and against profit shares on transfers.⁵ It does not examine the details of the specific profit share mechanisms proposed by Canada, other than when the details of that proposal specifically relate to the general arguments for and against profit shares on transfers.

For more information on any of the issues raised in this advisory note, or other deep-sea mineral matters, please contact Alison Swaddling at a.swaddling@commonwealth.int

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Arguments against a Profit Share on the Transfer of Rights

1. UNCLOS does not explicitly mandate that there should be a profit share on transfers. As it is silent on this matter, it is arguable that such a profit share should not be included in the Exploitation Regulations.
2. Transferring a licence does not involve the physical loss of resources from the Area. The ISA will still receive revenues from a royalty and/or profit share when the contractor undertakes commercial mining and resources are removed from the Area.
3. The profits from an indirect transfer may derive from sources other than the exploitation (or exploration as the case may be) licence. The value of the transfer may partly derive from the contractor's mining equipment, staff expertise and/or intellectual property as well as from the licence.
This argument is, however, of little relevance to the profit share on indirect transfers provided by Canada's submission, as that profit share is only levied on the portion of profits from the transfer that are attributable to the exploitation licence.
4. The contractor will be resident for tax purposes in a sponsoring state, which may give the sponsoring state the right to tax the transfer. The ISA and sponsoring state both charging the same transfer could lead to double taxation (the same profits being taxed twice), which would be unfair to the contractor and may inhibit investment in the Area.
5. The ISA may lack the capacity to administer and audit profit shares on transfers.

Arguments for a Profit Share on the Transfer of Rights

1. UNCLOS Article 136 provides that: 'The Area and its resources are the common heritage of mankind.' In the absence of profit shares on transfers, a contractor (or its parent company) may make many millions or even billions of dollars from transferring its licence without the ISA or humankind receiving any revenue. This may be considered inconsistent with the principle that deep-seabed mining is for

the benefit of mankind and may be difficult to explain to the public, who may question why state parties agreed to Exploitation Regulations that allow contractors to make substantial profits without humankind sharing in those profits.

2. Although UNCLOS and the Implementing Agreement do not explicitly mandate that the ISA should levy a profit share on transfers, the following articles do provide support for such a fiscal imposition.
 - a. Article 136 provides that: 'The Area and its resources are the common heritage of mankind.' Contractors profiting from transferring access to resources in the Area without humankind sharing in these profits may be regarded as inconsistent with the wording and spirit of this article.
 - b. Article 137(2) provides that: 'All rights in the resources of the Area are vested in mankind as a whole, on whose behalf the Authority shall Act.' It is arguable that if the ISA allows licences to explore or exploit resources in the Area to be transferred for profit without mankind sharing in those profits it is not acting in the best interests of, or on behalf of, humankind.
 - c. Article 140 provides that: 'Activities in the Area shall [...] be carried out for the benefit of mankind as a whole..' Profits from transfers ultimately derive from either past (e.g. past mining proving the profitability of mining) or expected future (e.g. the exploitation licence conferring the right to future mining) activities in the Area, and thus humankind should benefit by sharing in these profits.
 - d. Article 140(2) provides that: 'The Authority shall provide for the equitable sharing of financial and other economic benefits derived from activities in the Area.' Profits from transfers ultimately arise due to past or expected future activities in the Area and can only be shared if the ISA receives a share of these profits from a profit share on transfers.

- e. The Implementing Agreement Section 8(1)(b) provides that: 'The rates of payments under the system shall be within the range of those prevailing in respect of land-based mining...' Given that land-based mining regimes commonly levy taxes on transfers, this section arguably provides support for ISA profit shares on transfers; and
- f. The Implementing Agreement Section 8(1)(c) provides that: 'Consideration should be given to the adoption of a royalty system or a combination of a royalty and profit-sharing system.' This clearly provides the option of a profit share. Profits from transfers are a component of, and contribute to, overall profits and thus this section provides scope for the Exploitation Regulations to include a profit share on transfers.
3. It is well established that the principal taxing/profit-sharing right on profits arising from licences to mine and other immovable property is in the jurisdiction where the property (in this case the mineral deposit) is located. For example, the UN Model Tax Convention Article 6 provides that: '1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.'
4. The risk of double taxation of transfers may be limited as all sponsoring states (that we are aware of) grant unilateral tax relief, normally a foreign tax credit on any tax paid on transfers in a foreign jurisdiction. Such unilateral tax relief, if granted, would mean that transfers would not be subject to double taxation.
- Sponsoring states often have formal requirements for granting foreign tax credits, including payment certificates, information about the tax/profit share and the tax/profit share being provided for under law.

The proposal by Canada clearly has the intention to ensure that a contractor paying the transfer profit share to the ISA would qualify for a foreign tax credit in the sponsoring state. For example, Canada's proposal mandates that the ISA provides a payment certificate to the contractor.

However, while it seems fairly clear that a contractor would benefit from sponsoring states providing unilateral tax relief, caution should be exercised in drawing a definitive conclusion on this matter for all sponsoring state jurisdictions. Tax legislation in many sponsoring states was likely drafted without a detailed consideration of profit shares on transfers in the Area. In some sponsoring states, it may be arguable that a provision such as 'a tax credit shall be provided for taxes paid in a foreign territory' would not be applicable to a profit share paid to the ISA as the Area might not fall under the definition of foreign territory. While such a narrow interpretation would go against the sponsoring state's policy objective of providing unilateral relief from double taxation, certainty could be provided by sponsoring state tax authorities providing a formal opinion on whether profit shares on activities in the Area would qualify for a foreign tax credit. In addition, in many sponsoring states, there may be scope for the government to interpret existing legislation as providing a foreign tax credit for profit shares in the Area and/or for regulations and/or guidance to be amended to make this point clearer.

5. Constraints on the ISA's capacity to audit and administer a transfer profit share should not be overstated. The ISA, as the principal regulator of an industry that may make profits of many billions of dollars, will inevitably have to build capacity in profit share administration and other financial matters. Land-based mining jurisdictions, including those in developing countries, have commonly sought to tax transfers, and the ISA, as an international organisation paying competitive salaries and recruiting internationally, is arguably well placed to build profit share administration capacity compared to such countries.

Conclusion

State parties may wish to consider whether they would be comfortable with a situation whereby a contractor makes substantial profits from transferring a licence and humankind does not share in these profits. If state parties are uncomfortable with such a situation, then a profit share on transfers, as proposed by Canada and the African Group, is required.

UNCLOS and the Implementing Agreement do not explicitly mandate that there shall be a profit share on transfers. However, there are many articles and sections that provide support for such a transfer, and it could be considered consistent with UNCLOS and the Implementing Agreement for the Exploitation Regulations to provide for profit shares on transfers.

Endnotes

- 1 See: International Seabed Authority, 'Exploration Contracts', <https://www.isa.org.jm/exploration-contracts/>.
- 2 This submission built on earlier work by the African Group.
- 3 See: Draft regulations on exploitation of mineral resources in the Area, Consolidated text, ISBA/29/C/CRP.1, 16 February 2024, https://www.isa.org.jm/wp-content/uploads/2024/02/Consolidated_text.pdf.
- 4 See: Draft regulations on exploitation of mineral resources in the Area, Compilation of proposals, ISBA/29/CCRP.3, 3 June 2024, https://www.isa.org.jm/wp-content/uploads/2024/06/ISBA_29_C_CRP.3-Compilation_of_Proposals.pdf.
- 5 To date, discussions at the ISA have concentrated on profits from transferring exploitation licenses. The profit shares on transfers proposed by Canada would only bite on profits from transfers of exploration licenses if the ISA amended the Exploration Regulations. To date the ISA has not discussed amending the Exploration Regulations to include such a provision.



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