【資料 1-5-1】

14 December 2020

OECD/G20 INCLUSIVE FRAMEWORK ON BEPS -- PUBLIC CONSULTATION DOCUMENT[1]

(12 October 2020 – 14 December 2020)

"Report on the Pillar One Blueprint"[2] and "Report on the Pillar Two Blueprint"[3]

Submission by: the World Shipping Council ("WSC"), the International Chamber of Shipping ("ICS"), the European Community Shipowners' Associations ("ECSA"), and the Cruise Lines International Association ("CLIA")[4]

Introduction

WSC, ICS, ECSA, and CLIA hereby submit to the OECD Centre for Tax Policy and Administration comments on the Pillar One and Pillar Two Blueprints in response to the October 2020 OECD Public Consultation Document. WSC, ICS, ECSA, and CLIA respectfully request that the international shipping industry be carved out from both the Pillar One and the Pillar Two proposals for two primary reasons. First, application to shipping, as the OECD has stated in the Pillar One Blueprint, would be inconsistent with the "longstanding international consensus that the profits of enterprises operating ships … in international traffic should be taxable only in the jurisdiction in which the enterprise has its residence."[5] Second, application to shipping would be inconsistent with, and undermine the purpose of, the enactment by many OECD and other countries, for nontax policy reasons, of OECD and EU approved specific shipping tax regimes intended to bolster the countries' maritime sectors.[6]

In particular, the inclusion of shipping in Pillar Two, and thus a repeal of the current, well-functioning multilateral taxation system applicable to shipping, may have significant consequences:

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[1] OECD (2020), *Public Consultation Document: Reports on the Pillar One and Pillar Two Blueprints* (12 October 2020), https://www.oecd.org/tax/beps/public-consultation-document-reports-on-pillar-one-and-pillar-two-blueprints-october-2020.pdf ("October 2020 OECD Public Consultation Document").

[2] OECD (2020), *Tax Challenges Arising from Digitalisation - Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https:doi.org/10.1787/beba0634-en ("Pillar One Blueprint").

[3] OECD (2020), *Tax Challenges Arising from Digitalisation - Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https:doi.org/10.1787/abb4c3d1-en ("Pillar Two Blueprint").

[4] WSC is the global trade association for the international liner shipping industry. ICS and ECSA are, respectively, the global and European trade associations for shipowners and operators (representing all shipping sectors and trades). CLIA is the global trade association of the cruise passenger transport industry.

[5] Pillar One Blueprint, *supra* note 2, ¶ 158.

[6] As the OECD has stated in the Pillar Two Blueprint, "[i]ncluding international shipping … would therefore raise policy questions in light of the policy choices of these jurisdictions." Pillar Two Blueprint, *supra* note 3, ¶ 111.

1. Significant and complex allocation problems, legal disputes, tax controversies, and unnecessary difficulties of compliance and administration;

2. Undermining the national policies underlying the enactment of numerous specific shipping tax regimes around the world;

3. "Could lead to competitive distortions and unstable outcomes" (as acknowledged in the Blueprint); and

4. Potential low revenue effect of complex application of Pillar Two to shipping.

International Shipping Characteristics

The Blueprint emphasizes the unique features of international shipping when considering the exclusion of any specific sector from Pillar Two. Even though cargo of a typical shipping company can originate in, or be delivered to, over 100 countries, almost all shipping income is earned from services performed and assets employed on the high seas. Shipping is a very capital intensive industry, with billions of dollars invested annually in vessels and other maritime equipment. Shipping companies have huge operating expenses annually, including depreciation, labor (such as ship crew, headquarters employees, agencies, crewing agents, and ship management), ship charter expenses, fuel, leasing shipping containers and other cargo handling and transport equipment, terminal and stevedoring expenses, other port expenses, maintenance and drydocking, etc., plus interest expense. International shipping generally is a very low margin and cyclical business. While occasionally there are very profitable years, over 10-year periods almost all shipping sectors have operating losses in a majority of quarters and overall margins in the negative to slightly positive range. A 4% operating margin in a year is a very good year. Shipping companies have minimal intangible property; virtually all of their economic return is derived from tangible property and labor employed on the high seas. As discussed below, many countries for nontax policy reasons have enacted specific shipping tax regimes (e.g., tonnage taxes or exemptions) to encourage their maritime sectors and to have national (or regional) fleets at their disposal. As a result, most shipping companies do not obtain tax deductions for their huge expenses; there is virtually no "base erosion" in shipping.

Pillar One

The Pillar One Blueprint itself explains perhaps best why international shipping is not included in the scope of the Pillar One "new taxing right."[7] It has long been recognized that the characteristics of international shipping give rise to special income tax considerations.[8] Unlike other businesses, shipping earnings arise from the use of vessels between multiple jurisdictions, much of the time on the high seas, "raising the prospect of either multiple taxation or considerable income allocation challenges."[9] As a result, "there is a longstanding international consensus"[10] that international shipping profits should be taxable only in the country of

[7] Pillar One Blueprint, *supra* note 2, ¶¶ 156-164.
[8] *Id*. ¶ 157.
[9] *Id*.
[10] *Id*. ¶ 158. For over 100 years.

residence. The Pillar One Blueprint goes on to state that this "special treatment"[11] applies even where a shipping company has permanent establishments outside its country of residence, and this is reflected in article 8 of the OECD and UN Model Tax Conventions and "in the vast majority of the 3,500+ bilateral tax treaties currently in force."[12] The reciprocal exemptions provided in these treaties remove "the compliance and administrative burdens (and associated prospect of disputes) that would otherwise arise."[13] The reciprocal shipping income exemptions reflect "a deliberate policy choice, reflecting the *unique*" characteristics described above.[14] The Pillar One Blueprint states that the special circumstances of shipping (and airlines), in which physical operations are conducted in multiple jurisdictions, was what resulted in "the particular policy problem to which the consensus solution was and has remained exclusive residence state taxation."[15] The Pillar One Blueprint concludes that these "same positions continue today … [and] members agree that … shipping businesses be carved out-of-scope" of Pillar One.[16]

WSC, ICS, ECSA, and CLIA agree with this rationale of the Pillar One Blueprint for carving international shipping out of Pillar One. We also believe that there is a separate, albeit related, policy reason for a shipping carve-out. Many countries, for nontax policy reasons, have enacted specific shipping tax regimes to bolster maritime sectors in their respective jurisdictions. Application of Pillar One to international shipping would be inconsistent with, and would undermine the purposes of, these statutes. This is also true of Pillar Two, and the issue will be addressed below.[17]

Pillar Two

The Pillar Two Blueprint addresses international shipping specifically.[18] The Blueprint states that "the *unique* features of the international shipping industry will require further work on whether, and to what extent, the … [Pillar Two] rules should apply" to shipping.[19] WSC, ICS, ECSA, and CLIA respectfully request that international shipping also be carved-out from Pillar Two for essentially the same reasons that it should be carved-out from Pillar One. First, application of Pillar Two to shipping would be inconsistent with the over 100-year consensus of exclusive resident country taxation of shipping income. Second, application of Pillar Two to shipping would be inconsistent with and would undermine the policies that have resulted in specific shipping tax regimes. As the Blueprint states, and as described under Pillar One, the shipping business is in fact "unique."[20] Because of the unique characteristics of international

[11] *Id*.
[12] *Id*.
[13] *Id*.
[14] *Id*. ¶ 159 (emphasis added).
[15] *Id*. ¶ 163.
[16] *Id*.
[17] For more information about requirements to qualify for specific shipping tax regimes, see slide 22 of the attached Annex.
[18] Pillar Two Blueprint, *supra* note 3, ¶¶ 110-112.
[19] *Id*. ¶ 110 (emphasis added).
[20] *Id*.

shipping, we believe carving the shipping business out of Pillar Two would not be unfair to, and would likely not be objected to by, any other business.[21]

Below, we will elaborate on some of the main consequences of including shipping in Pillar Two as well as the justification for maintaining the current multilateral tax system applicable to shipping.

Consequence 1: Significant and complex allocation problems, legal disputes, tax controversies, and unnecessary difficulties of compliance and administration.

All of the reasons enunciated in the Pillar One Blueprint for carving shipping out also apply to Pillar Two. International shipping companies operate in multiple jurisdictions and on the high seas daily, which has resulted in the norm of exclusive residence country taxation of shipping income. Applying Pillar Two's shareholder level income inclusion rule (the "top-up" tax) in and of itself could result in two countries (the countries of residence of both a parent company and a subsidiary) having the right to tax international shipping profits in a manner inconsistent with the international norm of resident country based taxation only. In addition, the Pillar Two "undertaxed payments rule" or the "subject to tax rule" could result in taxation of shipping income in multiple countries, leading to very significant and complex allocation problems and unnecessary difficulties of compliance and administration, which would be made even more difficult because the large majority of shipping income is derived on the high seas.

Consequence 2: Undermining the national policies underlying the enactment of numerous specific shipping tax regimes around the world.

Application of Pillar Two to international shipping would undermine the policies underlying the enactment of numerous specific shipping tax regimes around the world.[22] As stated by the OECD, specific shipping tax regimes have been enacted by many countries for "significant non-tax considerations"[23] in order to bolster their maritime sectors.[24] These countries have determined that a domestic shipping fleet (and related maritime infrastructure) is important to the countries' economies and national security, and that financial incentives, including tax incentives, are needed to maintain employment and maritime know-how and to address strategic and national defense concerns.[25] These policies, under national and

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[21] We understand that, because of how they are regulated and structured, Pillar Two (unlike Pillar One) is not a concern to the airline business.

[22] In a "tonnage tax" regime under a regular corporate income tax statute, all expenses are disallowed and the regular corporate income tax is imposed on a deemed or "notional" amount of net income, based on the tonnage of the vessel. In tonnage tax regimes, shipping companies in loss or low margin years have extremely high effective tax rates (made even higher because some countries, especially in Latin America and Asia, impose gross basis freight taxes). In a shipping income exemption system, all expenses are disallowed and no corporate income tax is imposed.

[23] OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, Action 5 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, ¶ 84, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264241190-en.

[24] The OECD in 2004 provided an excellent summary of these regimes, their purposes, and their operation. OECD (2004), *Consolidated Application Note – Guidance in Applying the 1998 Report to Preferential Tax Regimes*, Chapter VIII: Shipping, https://www.oecd.org/tax/harmful/30901132.pdf.

[25] *Id*. at ¶ 285.

international standards, also address other factors, such as vessel registration, regulatory arrangements, manning requirements, and seafarer training.[26]

Consequence 3: "Could lead to competitive distortions and unstable outcomes" (as acknowledged in the Blueprint).

The Pillar Two Blueprint makes reference to specific shipping tax regimes and acknowledges that including international shipping within the scope of Pillar Two "would therefore raise policy questions in light of the policy choices of these [specific shipping tax regime] jurisdictions."[27] The Blueprint also acknowledges that inclusion of shipping in Pillar Two "could lead to competitive distortions and unstable outcomes."[28] Consider the following not uncommon example: A European parent company has vessels subject to a domestic shipping tax regime and has three foreign subsidiaries subject to their own specific shipping tax regimes (e.g., in the United States, Singapore, or a second European country). The Pillar Two top-up tax proposal could require the European parent country to tax the shipping income of the three foreign subsidiaries, even though the parent company itself is subject to a specific shipping tax regime. This would undermine the maritime and national security policies of the countries of the three subsidiaries, even though the parent company's vessels are subject to essentially the same tax regime as the subsidiaries. This would result in competitive distortions in the industry and could lead to a reduction of the number of ships registered in the countries of the subsidiaries.

Consequence 4: Potential low revenue effect of complex application of Pillar Two to shipping.

The Pillar Two Blueprint indicates that if international shipping were subject to Pillar Two, the revenue effect may be limited because the Pillar Two design contemplates loss carryforwards and a formulaic substance carve-out.[29] To the extent that the revenue effect were in fact limited for these reasons, that is yet another reason to not force shipping companies and tax administrations to have to administer, apply, and enforce the very complicated proposed rules of Pillar Two.[30] And to the extent it were not true,[31] as explained above, it would be at the cost of (1) being inconsistent with the more than 100-year international norm of exclusive resident country taxation of shipping companies and (2) undermining the policies that have led many countries to enact OECD and EU approved specific shipping tax regimes in order to bolster their

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[26] *Id*. By attracting vessels into national ownership, a country also benefits by having increased influence over the standards applicable to the construction and operation of vessels in organizations such as the International Maritime Organization

[27] Pillar Two Blueprint, *supra* note 3, ¶ 111.

[28] *Id*. ¶ 112.

[29] *Id.*

[30] In addition, while the Pillar Two Blueprint is not entirely clear in this regard, it would appear that detailed special rules would be needed for shipping companies because they employ their assets and employees in multiple jurisdictions, as well as on the high seas. *See id.* section 4.3.

[31] For example, (1) because only loss carryforwards and not loss carrybacks are contemplated or (2) because the substance carve-outs for expenses only cover employees and depreciation and not the enormously high operating expenses incurred by shipping companies for ship charter expense, fuel, leasing shipping containers and other cargo handling and transport equipment, terminal and stevedoring expenses, other port expenses, maintenance and drydocking, etc., plus interest.

maritime sectors for the benefit of, for example, increased employment, value creation, or national defense.

Current Shipping Tax Regimes

Last year, the OECD, in approving specific shipping tax regimes under the BEPS Action 5 harmful tax practice survey, stated that "[t]he determination of substantial activity in the context of shipping regimes recognizes the significant core income generating activities within shipping are performed in transit outside the jurisdiction of the shipping regime, and that the value creation attributable to the core income generating activities that occur from a fixed location is more limited than for other types of regimes for mobile business income."[32] The OECD also noted that the specific shipping tax regimes are designed to ensure that taxpayers meet corporate and regulatory obligations, such as International Maritime Organization ship registration and crewing requirements, as well as, e.g., customs requirements.[33]

Finally, we provide examples to illustrate the policies underlying some specific shipping tax regimes. For additional information about the typical structure of an international shipping company, please refer to the case study in the Annex. The European Union has determined that specific shipping tax regimes constitute legitimate state aid and have supported the regimes with the aim of encouraging safe, efficient, secure, and environmentally friendly maritime transport, encouraging the flagging or re-flagging to EU Member States' register, and improving maritime know-how, employment, and working conditions.[34]

In the United States, in addition to a tonnage tax incentive, subsidy payments are made with measures intended to encourage ownership of US flag ships crewed by US citizens for use in times of war or national emergency.[35]

In Singapore, authorities have set in place a variety of frameworks to allow shipping businesses to reliably locate in, and operate with confidence from, Singapore, including stable government policies, a reliable legal system, access to capital markets, a well-respected flag and ship registry, stringent maritime standards and controls (crewing, safety, fueling, environmental, etc.), advanced piracy detection and response initiatives, and shipping tonnage tax and shipping income tax exemption regimes.

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[32] OECD (2019), *Harmful Tax Practices – Peer Review Results: Inclusive Framework on BEPS: Action 5*, at p. 17, https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf.

[33] *Id*.

[34] Commission Communication C (2004) 43 – Community guidelines on state aid to maritime transport, 13 Official Journal of the European Union No. 3 (17 Jan. 2004).

[35] *See* US Dept. of Transp.: Maritime Admin., *Maritime Security Program (MSP)*, https:www.maritime.dot.gov/national-security/strategic-sealift/maritime-security-program-msp (last visited Nov. 5, 2020); S. Rep. No. 104-67 (1995); H.R. Rep. No. 104-229 (1995); H.R. Rep. No. 108-548, at 177 (2004).

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For these reasons, WSC, ICS, ECSA, and CLIA respectfully request that the international shipping industry be carved out from both the Pillar One and the Pillar Two proposals.

Annex

Annex

Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study

14 December 2020

Cruise Lines International Association
International Chamber of Shipping
European Community Shipowners' Associations
World Shipping Council

OVERVIEW

- These slides provide answers to the OECD Secretariat's shipping industry questions of 9 April 2020 and provide a Case Study of an international shipping company.
- Slides 2-4 provide answers to the OECD questions on Structure.
- In respect of the OECD questions on Low-taxed jurisdictions, Substance carve-out, and UPTR:
  - A Case Study (concerning an illustrative shipping company) is provided where these issues are addressed (without specific confidential information). Slides 3 - 6 reference the OECD questions to the relevant slides in the Case Study.

2

OECD Questions on Structure (1)

- **Typically stand-alone business or held as part of a conglomerate?**

  Many shipping companies are stand-alone. Others are part of conglomerates, although usually (but not always) the other companies in the conglomerate are in transportation-related businesses.
  - See Slides 10 - 15.
- **What type of ancillary businesses do you run (finance, insurance, logistics) and how significant are these in comparison to the profits from shipping (are they separable)?**
- The ancillary businesses are typically (but not always) transportation-related. The revenues in the ancillary businesses are typically smaller than the shipping revenues. Where an ancillary business is considered an integrated part of shipping services, it would almost always be separable, and some tonnage tax regimes even provide a limit of revenues from ancillary business that can be covered by the regimes. Some groups provide logistic services to third parties, connected inland transportation, etc.; however, such services are provided by separate entities with income subject to regular corporate income tax that is not international shipping income.
  - See Slide 15.

3

OECD Questions on Structure (2)

- **<u>Do you own the ships out of subsidiaries in different jurisdictions or are they all in the parent (or both)? Is there a connection with where the ship is registered?</u>**

  It is common (but not universal) that there are ships in several jurisdictions, both in a parent company jurisdiction and in one or more subsidiary jurisdictions. In many cases, one company (often, but by no means always, the parent) deals with third party customers. In other cases, more than one affiliate deals with third party customers (which customers, in the case of cargo shipping, are virtually always unrelated businesses). In many cases, ships owned by a subsidiary will be chartered to the parent or another affiliate that deals with third party customers. Special shipping tax regimes enacted by countries to bolster the shipping sector may require that the ships be flagged in certain places (e.g., the EU, Singapore, or the US).

  - See Slides 10 – 15, 17 and 22.

4

OECD Questions on Structure (3)

- **Do you typically sell shipping services direct to customers or through dependent or independent agents in the country of the customer?**

  Shipping services are typically sold through a combination of employees in branches, dependent agents in usually wholly-owned subsidiaries, and unrelated independent agents. Booking via booking platforms (company-owned or third party) is steadily becoming more common.
  - See Slides 10 and 16.

- **What are the legal and other constraints on how you organize your business?**

  There are certain legal or other constraints affecting how the shipping business is organized, but the most significant are the requirements to qualify for special shipping tax regimes.
  - See Slides 17 and 22.

5

OECD questions on Low-taxed jurisdictions, Substance carve-out, & UPTR

- For Low-taxed jurisdiction information, see Slides 27-28.
- For Substance carve-out information, see Slides 18-20 & 33.
- For UPTR information, see Slides 23, 29, & 31.

Case Study of International Shipping Company - Content

- Preliminary considerations/goals/assumptions
- Typical structure of an international shipping company
  - Business structure
  - Juridical structure
  - Tax structure
  - Legal and other constraints
  - Tax constraints
- Effective tax burden
- Effects of Pillar Two
- Conclusion

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Case Study of International Shipping Company - Content

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- Conclusion

The 5 main shipping sectors

- Most shipping companies are only active in one sector, but some in 2 or more. In the latter case there is typically an ultimate parent company overlaying the generic sector structures.
- The principal sectors are:
  - Liner Shipping – transportation of cargo pursuant to transportation contracts with shipper customers, as evidenced by bills of lading.
  - Passenger shipping – cruise and ferries – transportation is provided under passenger bookings.
  - Tankers – transportation services are provided under a time or voyage charter and many tanker operators do business via pools, where income is shared in proportion to tonnage contributed to the pool
  - Bulk – carriage of grains, raw materials, metals, or other commodities in the holds of ships - operates similarly to tankers
  - Offshore shipping – services, including transportation provided under various charter agreements.

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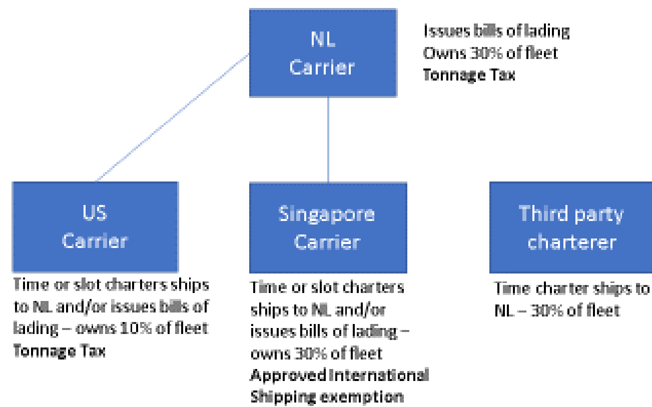
International Shipping Company: business structure

- Parent
  - Corporate Functions
  - Commercial and Operational Management
  - Ship management (crew, technical)
  - Shipowning
- Activities performed by subsidiaries or outsourced to third parties may include:
  - Regional transportation principal
  - Commercial and/or Operational Management
  - Shipowning and chartering
  - Crewing
  - Technical management
  - Shipping agency

10

Liner Shipping



Many liner shipping companies operate ships in the parent company, issuing bills of lading to third party customers, utilizing owned ships as well as ships chartered from subsidiaries and unrelated persons. In many cases, however, more than one affiliate will deal with third party customers (which are virtually always unrelated businesses).

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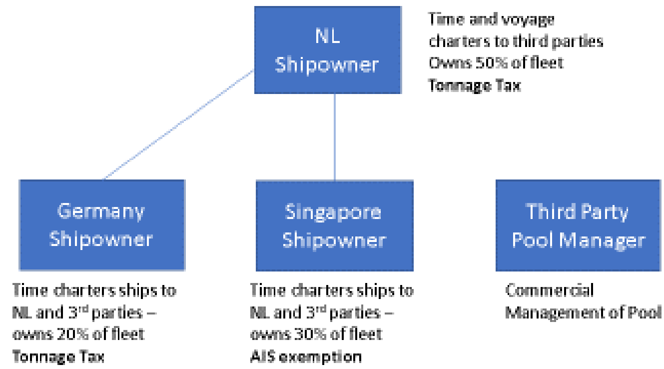
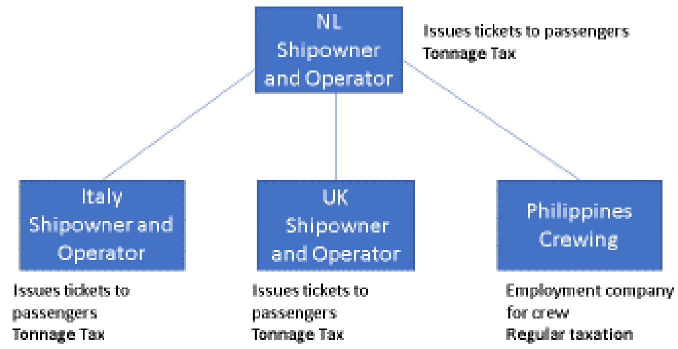
Tankers and Bulk



Tanker and bulk ships are often operated in pools. One of the pool participants is often the manager. This may be the parent company or a separate pool management company.

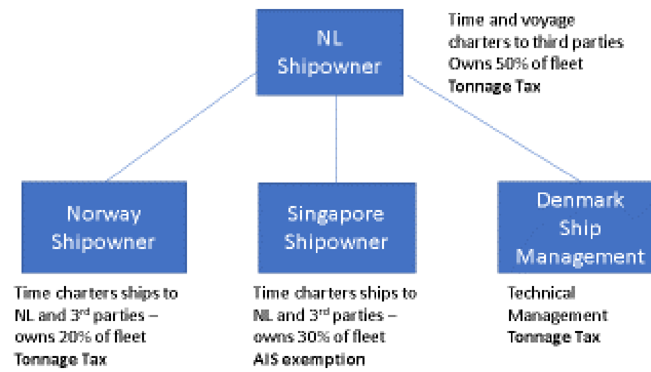
12

Passenger Shipping



13

Offshore Shipping



14

Related Businesses

Many shipping companies are stand-alone. Others are part of conglomerates, although usually (but not always) the other companies in the conglomerate are in transportation-related businesses. The ancillary businesses are typically (but not always) transportation-related. The revenues in the ancillary businesses are typically smaller than the shipping revenues.

Where an ancillary business is considered an integrated part of shipping services, it would almost always be separable, and some tonnage tax regimes even provide a limit of revenues from ancillary business that can be covered by the regimes.

Some groups provide logistic services to third parties, connected inland transportation, etc.; however, such services are provided by separate entities with income subject to regular corporate income tax that is not international shipping income.

15

Sales to Customers

Shipping services are typically sold through a combination of employees in branches, dependent agents in usually wholly-owned subsidiaries, and unrelated independent agents. Booking via booking platforms (company-owned or third party) is steadily becoming more common.

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International Shipping: legal and other constraints on corporate structure

- Limitation of liability risks: use of single ship owning companies in some cases
- Flag requirements/obligations: In some cases, use of ship owning companies solely for commercial reasons
- Trade restrictions and boycotts: limitations on port calls by ships owned by companies resident in or flying the flag of embargoed countries
- Labour (law) restrictions: use of separate crewing companies in various countries particularly for foreign crew members
- Third party lender/financing - leasing/bareboat structures
- Subsidiary shipowning companies charter ships to the parent shipping company or a dedicated group shipowning entity. Drivers are political and commercial risk mitigation, operating cost efficiencies, crewing availability.

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Substance of Shipping Companies (1)

- Shipping companies make huge investments in tangible assets
  - Billions of dollars are invested regularly in ships and other maritime equipment and infrastructure
  - Depreciation expense is a significant percentage of gross revenues.
  - 10% of tangible assets (US GILTI standard) in almost all cases will exceed a shipping company's annual financial profits.
- Virtually all cargo shipping customers are businesses.
- Intangibles are not a significant factor in the industry (other than for tracking and tracing cargo).

Substance of Shipping Companies (2)

- Shipping companies incur billions of dollars of annual expenses, in addition to depreciation.
  - Employee costs, including headquarters, agencies, ship crew, crewing agents, and ship management
  - ship charter expense
  - Bunker (fuel) expense
  - Lube oil expense
  - Expenses for leasing of shipping containers and other cargo handling and transport equipment
  - Terminal and stevedoring expenses
  - Other port expenses
  - Maintenance and upgrades (dry docking)
- Most of these expenses are incurred on the high seas and a smaller proportion in ports and the headquarters.

19

Shipping is a Low Margin Industry

- Shipping is a highly competitive and cyclical business, with low profit margins in almost all sectors.
- There is little room for reducing the enormous expenses detailed in Slide 19.
- As a result, companies shipping cargo regularly incur operating losses, often in half or more of the years in a decade.
- These operating losses are incurred by the companies (parent and/or subsidiary) transacting business with third parties.
  - In some cases both the parent and the subsidiary transact with third parties.
  - In other cases, subsidiaries charter ships to the parent company which transacts with third parties.

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International Shipping: tax aspects (1)

- Application of tax treaties
  - Art. 8 of OECD MTC
  - Permanent establishment issues – art. 7 of OECD MTC
  - Interlinkage with special shipping tax regimes

21

International Shipping: tax aspects (2)

- Application of special shipping tax regimes ("STR")
  - Substance requirements in tonnage tax and exemption regimes
    - STRs are generally only applicable where a major part of the strategic and commercial management is done from the residence country of the shipping company
    - Shipping management normally includes strategic, operational, crewing and technical management
  - Requirements re qualifying ships
    - All STRs have requirements re qualifying ships. Under e.g. the EU Tonnage Tax regimes only transportation ships and similar equipment approved by analogy by the EU commission may qualify
  - Requirements re qualifying income
    - STRs normally are ring-fenced in the sense that only qualifying shipping income is included.
    - Investment income as well as income from bareboat-out/lease-out of ships normally is excluded from the regime.
  - Legal requirements
    - the majority of STRs require the qualifying shipping enterprise to be carried out by domestic entities that are tax residents in the same state as the shipping company.
  - Flag requirements
    - E.g. EU, US, or Singapore flag required for tonnage tax or special shipping tax regime
    - Most flag registers also use substance/residence/register requirements
  - STRs may provide a limit on revenues from an ancillary business that can be covered by the regime.

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International Shipping: tax aspects (3)

- It is almost always the case that both parent and subsidiary shipping companies are in special shipping tax regimes: tonnage tax or international maritime transportation exemption systems.
- Special shipping tax regimes have been approved by both the OECD and the EU as appropriate for countries to encourage shipping sectors where most income is earned on the high seas.
- Tonnage taxable income is always positive - even in loss years.
- Tonnage taxed or exempt shipping regimes give no allowance for tax depreciation.
- Parent companies in special shipping tax regimes do not receive tax deductions for charter hire paid to shipping subsidiaries.

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International Shipping: tax aspects (4)

- Shipping companies in special shipping tax regimes do not receive tax deductions for interest on loans incurred to acquire ships and other maritime equipment.
- There is virtually no tax base erosion under the shipping tax regimes, since there are no royalty payments on core business intangibles, interest is generally not deductible and there is no deduction for intragroup ship charters.
- In many countries, gross basis freight taxes are imposed on foreign shipping companies (especially in Latin America and some parts of Asia and Africa), even in loss years.
- All countries and many local authorities impose port taxes. Generally, taxes of this nature are imposed at higher rates on passenger transport, functioning as a proxy for freight tax.
- Shipping companies may have numerous foreign agency subsidiaries, which are subject to normal corporate tax regimes.
- The tonnage tax, freight tax and port tax charges are fairly constant as they are unaffected by changes in net profit levels, which makes the ETR an inappropriate analytical tool.

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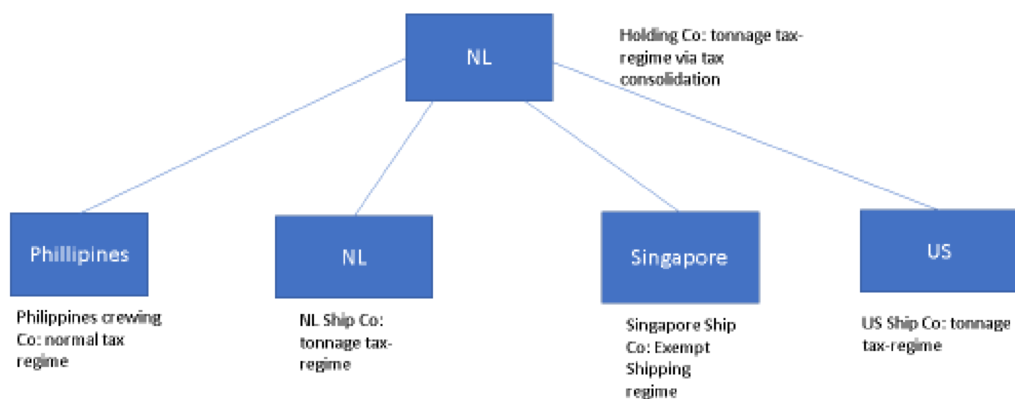
International shipping company: effective tax burden



- Note that many shipping companies utilize crewing companies owned by unrelated persons.

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Effective tax burden (1)

- Nominal corporate income tax rates (2020):
  - Denmark: 22%
  - France: 32%
  - Germany: 29.9%
  - Italy: 27.8%
  - Netherlands: 16.5% (profits up to € 200,000)/25% (profits above €200,000)
  - Philippines: 30%
  - Singapore: 17%
  - UK: 19%
  - US: 21%

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Effective tax burden (2)

- Effective tax rates vary dramatically.
  - Residence country tonnage taxes are imposed on a hypothetical amount of net income, irrespective of profitability.
  - Source country freight taxes are imposed on gross revenues (deductions for expenses are not allowed).
  - Port taxes are imposed on the movement of goods or passengers e.g. based per unit or per passenger.
- If a tonnage tax company has an operating loss, then the tonnage tax is an additional expense, as a freight tax would be.
- If a tonnage tax or exempt company has very low profits in a year, then tonnage, freight and port taxes imposed often result in effective tax rates far in excess of the normal corporate income tax rates.

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Effective tax burden (3)

- If a tonnage tax or exempt company is very profitable in a year, the effective tax rate is very low.
- Many major shipping companies have little to no net income over 5 - 10 year periods or even cumulative operating losses with the result that the effective tax burden is extremely high over the period (even though in some years it is low).
- Shipping companies are subject to port taxes, which are not taken into account in determining effective tax rates in financial statements. In some sectors the port tax costs are very substantial.
- For these reasons ETR (corporate income tax as a percentage of commercial profit) is not a useful instrument for international shipping companies to measure minimum tax rates.

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Effective tax burden: Tonnage Tax regimes, more detail

- Tonnage tax-regimes (or other preferential shipping tax regimes) are ring-fenced regimes (only applicable on qualifying shipping income) with a minimum entrance period: within EEA ship owners must generally stay within the TT-regime for a period of 10 years.
- Within TT-regimes the commercial/tax profit is replaced by a notional tonnage tax profit: this means that costs are not deductible and tax losses do not occur.
- Within EEA, the EU Commission/EFTA authority only accepts TT-rates that do not vary too much from the average TT-rates used by EEA-countries with TT-regimes.
- Within commercial accounting rules (e.g., IAS 12) quite often tonnage taxes, freight taxes, trade taxes, port taxes and withholding taxes (which are regularly used ways of taxing shipping income) do not qualify as income taxes (but as operating expenses) in the statutory financial statements.

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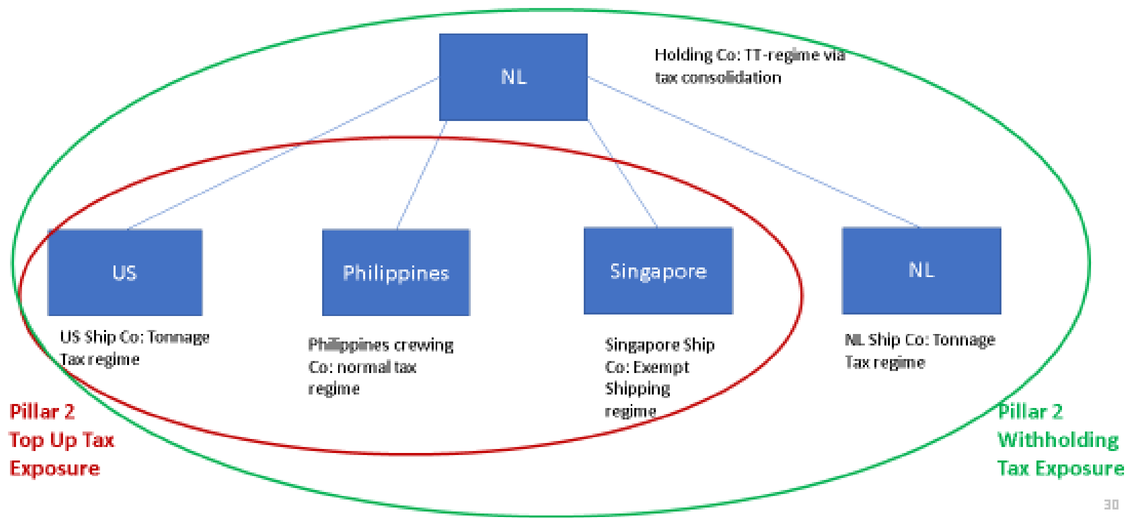
Effects of Pillar Two: (1)



Effects of Pillar Two (2)

- It is almost always the case that the parent shipping company and the foreign shipping subsidiaries are taxed under special shipping tax regimes.
- Both are often low margin, both individually and on a consolidated basis.
  - Where the shipping subsidiary charters its ships to the parent, and does not deal with third party customers directly, the operating margin of the subsidiary will typically be more constant than the parent.
- **There is no tax base erosion:**
  - **The parent does not get a deduction for the charter payment made to the subsidiary.**
  - **Payments of interest to finance ship acquisitions are not deductible.**
  - **There are no royalty payments on core business intangibles.**

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Effects of Pillar Two (3)

- Pillar Two top up tax would inappropriately and arbitrarily undermine the special shipping tax regimes applicable to foreign subsidiaries and distort competition with domestic enterprises.
- The other Pillar Two measures would undermine special shipping tax regimes applicable to both the parent shipping company and subsidiaries.
- The special shipping tax regimes have been approved by the OECD and the EU as appropriate to encourage shipping sectors for income earned primarily on the high seas.
- In the Case Study, the Netherlands' parent company would be incentivized to transfer the ships in the Singapore and US subsidiaries to the Netherlands.
- This would make no sense when both the parent and the subsidiary are taxed in essentially the same way.

Effect of Pillar Two (4)

- Taxing the income of the subsidiaries also would be inconsistent with the 100-year-old principle of residence-based taxation only for shipping companies.
- Shipping companies are not putting intangible assets in tax havens and eroding their tax base via royalties.
- Shipping companies have enormous substance.
    - They make billions of dollars of annual investments in ships and other maritime equipment.
    - They incur extremely high expenses.
        - Employee costs, including headquarters, agencies, ship crew, crewing agents, and ship management
        - ship charter expense
        - Bunker (fuel) and lube oil expense
        - Expenses for leasing of shipping containers and other cargo handling and transport equipment
        - Terminal and stevedoring expenses
        - Other port expenses
        - Maintenance and upgrades (dry docking)
- Shipping companies incur these expenses primarily upon the high seas, while earning very low rates of return in almost all sectors.

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Conclusion

- In conclusion, shipping companies have enormous substance in terms of capital investment in ships and other equipment, they have enormous expenses, they have low rates of return, and they derive almost all of their income on the high seas.
- Shipping companies over time have high effective rates of tax.
- Pillar Two would inappropriately undermine the special shipping tax regimes of countries in which subsidiaries are incorporated, encouraging transfer of ships within consolidated groups even though the parent and subsidiary companies are operating and taxed essentially the same way.
- Pillar Two also would be inconsistent with the 100-year principle of residence-based taxation only of shipping companies.
- For all of the above reasons, we urge that income from the international operation of ships be carved out from Pillar Two.