

SHIPPING: GLOBAL TAX REFORM

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OECD rules designed to implement a global minimum corporate tax rate for very large multinational groups have now been published and are expected to come into force around the world in 2023. Shipping income was expected to be outside of the rules. The detailed rules do not provide a blanket “shipping industry exemption” but require that certain shipping income streams can fall outside of the rules if the strategic or commercial management of the vessel earning the income is carried on in the ship operator’s home jurisdiction.

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WHERE ARE WE NOW?

The short answer is “not quite where we expected to be”.

Global plans to introduce a “minimum effective tax rate” for very large groups (known as the “GloBE” rules) have been agreed politically and now even exist in written form. The changes should be effective in 2023.

Shipping had expected a sector exemption. The draft rules reveal something really rather different.

What was seen as a threat to the onshore tonnage tax regimes now appears to be an opportunity.

WHAT ARE THE REFORMS?

Groups with revenues in excess of €750m a year are within the scope of the GloBE rules. These groups must assess their tax exposure in the countries where they have a taxable presence. Put bluntly, if the effective tax rate applied to the profits in that country is below 15%, a company higher up the group structure must pay a “top up tax” to make up the difference. If your profits in your subsidiary are going to be taxed at 15% somewhere, a very low tax rate ceases to be so attractive and, in theory, more tax is paid onshore.

DOES SHIPPING GET SPECIAL TREATMENT?

Sort of. Following what was perceived as successful lobbying, it seemed that shipping in “international traffic” was to be left out of the scope of the rules. One hundred years of light-touch tax policy towards shipping was seemingly still acceptable. But the written rules provide for specific factual exemptions and not for the sector or industry exemption expected.

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WHAT DO THE RULES SAY?

The shipping exemption only applies where the “strategic or commercial management” of a vessel takes place in the jurisdiction we are testing.

This is a phrase borrowed from EU tonnage tax rules with most regimes requiring some variation on the idea that an adequate level of “strategic *and* commercial management” of a fleet should take place in the jurisdiction providing the tax benefit. It is an undefined, flexible concept, well-suited to adapting to apply equally well to shipping groups with four ships and those with four hundred. But this helpful flexibility means the term does not provide certainty. It is a deliberately undefined concept, which is perhaps unhelpful when trying to apply a tax rule globally.

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SO THAT IS WHY TONNAGE TAX REGIMES MAY BE WINNERS HERE?

Yes. If you are in, for example, UK tonnage tax or Singapore’s shipping tax incentives, you must already have some substantial element of strategic and commercial management of your fleet in the jurisdiction. The GloBE rules seem to require only one or the other and so the tonnage tax systems have a head start.

We do not, however, know what the rule-makers want the term to mean. Do they want all strategic decisions to be made in the country? Is technical management part of commercial management? Do board members flying into a country to hold

strategy-setting board meetings in a hotel four times a year carry out strategic management? Guidance and national tax authority practices are going to be key.

WHAT ABOUT OFFSHORE CENTRES?

Whilst economic substance rules were intended to ensure there were no tax incentives without local substance, that has not been the real-life outcome.

In certain offshore jurisdictions it is likely not a practical option for ship owning companies to have either strategic or commercial management taking place in those jurisdictions. So large groups utilising such companies may have a GloBE issue to solve.

It should be remembered that these rules will only impact the largest shipping groups. It is further expected that the rules will focus on vessel management rather than flagging, such that it may be possible to flag vessels in one jurisdiction with acceptable management somewhere else. There are likely still opportunities for the main offshore flags to remain relevant even to the bigger operators.

WHAT NEXT?

Those already in scope because of their revenues need to engage with the detail of the rules. Shipping is still a special case within these rules but is not as special as we thought.

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The publication of guidance on the intended meaning of “strategic or commercial management” is the next major step but for now we can likely conclude that it is onshore tonnage tax and shipping tax incentive regimes who will see the limitations on the shipping exemption as an opportunity.

ARE THERE OTHER CHANGES HAPPENING?

Once the difficult task of global implementation of the GloBE rules is complete, an easy next step for the rule-makers is to lower the economic threshold and capture groups below the €750m figure. If tax structuring in a group with €750m of annual revenues is not ok, why is the same tax structure in a group with €650m of annual revenues acceptable? A form of mission-creep may drag in more groups.

The EU is looking at the use of shell companies and we may also see pressure on the scope of the international traffic article in double tax treaties (there are hints of this in the GloBE rules).

On the positive side, onshore shipping tax regimes may seize the opportunity to capitalise on their designation as acceptable tax planning and seek to attract those forced onshore with beneficial changes to their domestic rules. The UK is already on that track with further enhancements to UK tonnage tax expected this year.

Other countries will react to the 15% minimum tax rate – a new “race to the bottom” may arise where we head up from zero and see how low a positive tax is acceptable. The UAE has made an early bid with the introduction of a 9% corporate tax rate – an example of a previously zero-tax jurisdiction positioning itself as a suitable home for those driven out of other zero-tax jurisdictions.

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