EU SHIPPING TAXATION: THE TONNAGE TAX REGIME IN QUESTION

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Abstract

The fiscal treatment of shipping business is characterized by the application of the tonnage tax regime. This system, based on a vessel's cargo rather than its profitability, is considered competitive and a *condition sine qua non* for shipowners to register their ships under the flag of a traditional register rather than under a Flag of Convenience. Under the international and the domestic perspective, tonnage tax is a determinant that attracts investment. The international allocation of taxing rights derived from shipping operation, according to Article 8 OECD Model Tax Convention, is influenced by the structure of the domestic tonnage tax of a Contracting State. From a European Union perspective, tonnage tax constitutes fiscal State aid which is permitted. Both the Commission and the Member States' practice have contributed to the considerable expansion of this system in the EU so that today is the standard way of taxation of shipping profits in the EU. Expecting the review of the Commission's State aid Guidelines on maritime transport, the characteristics of the tonnage tax regime are examined. Although the regime is considerably favourable for shipping business, some drawbacks have emerged, due to the economic crisis, raising the question of the application of this system in the EU. Lastly, even if tonnage taxation has lost a part of its importance because of its widespread expansion, it would be a narrow-minded approach for the EU to inhibit its further evolution.

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Introduction

Tonnage tax is a widespread system of taxation of profits accruing from shipping operation. The specificity of this regime is the way it provides for profit computation. Instead of the actual accounting profits, coefficients are used relating to the size of the vessel and in some systems to its age. Therefore, in circumstances of realization of high profits, the effective tax rate may be considerable low.

The tonnage tax systems, although not that competitive as 'open registries', where almost no taxation is being levied, constitute attractive regimes that contribute to the growth of the maritime sector of a state.

An important part of the research concentrated on the way tonnage tax is being applied and the elements which render it a determinant of ship registration or business location is the examination of the international allocation of shipping profits (Chapter 1). Because of the high mobility of the shipping business, the change of residence for tax purposes of a shipping company is determined by the need to minimize the amount of tax due. Therefore, it is important that a specific state not only develops a broad network of tax treaties providing for the shipping profit allocation but opts for a favourable tonnage tax system attracting investment in the maritime sector as well. In this context, Contracting States have developed more than one allocation criteria which, in combination with their domestic tax measures, influence the competitiveness of a tonnage tax system. Even though the place of effective management is provided as a criterion in the wording of Article 8 OECD Model, which regulates the international taxation of shipping, the residence criterion, i.e. the place of residence of the shipping company, is relatively widespread as well.

In the EU context, the Member States should take into account when structuring their tonnage tax system not only their international substance but also their obligations as members of the EU (Chapter 2). The Union with the aim of preventing the distortion of competition between the Member States, has developed State aid rules (Articles 107-109 TFEU). What is of interest is that taxation, which is one of the most characteristic areas of state intervention in the free market, may constitute a form of State aid. In this situation, this taxation should be prohibited unless justified by the Lisbon Treaty provisions (article 107(3) TFEU). Under this context, tonnage tax regimes constitute fiscal state aid which is found compatible with the EU provided certain requirements and conditions are met. These conditions are outlined in the Commissions State aid guidelines. The current guidelines have been issued in 2004 with the intention of being reviewed by 2011. Of particular importance is the fact that both the Member States and the Commission with its decisions have approved tonnage tax systems and their

amendments, although at odds with the 2004 Guidelines. As a consequence, the last years we may observe a considerable expansion of the material and personal scope of application of the tonnage tax systems. In its turn, this expansion will determine the configuration and the anticipated amendments of the new guideline.
In the process of review of the guidelines, the Commission will assess the characteristics of the system and its impact not only in attracting investment but also in generating tax revenue to the Member States. Tonnage tax systems are undoubtedly a business-friendly mode of taxation. With its simple way of profit computation it offers certainty and clarity. In addition, the fact that the eligible entity knows in advance the exact tax due provides it with flexibility while using a competitive and compatible regime of taxation. On the other hand, tax should be paid irrespective of the realization of profits or losses. Therefore, while such a system of taxation may lead to very low effective tax rate in case high profits are realized, this is not the case for companies that have losses. Until now, shipping companies were usually profitable businesses. This fact has changed recently because of the economic crisis of 2008 and its sharp repercussions on the shipping sector increasing, thus, considerably the effective tax rate (Chapter 3).

Together with considering the impact of tonnage tax regime on shipping companies, the Commission will primarily assess its impact on Member States' tax revenues. Generally, tonnage tax deprives states' treasuries from considerable amounts due to this lump sum taxation. Because of this characteristic, some Member States have adopted measures to prevent tax avoidance, the most important of which are the ring-fenced measures. With the intention of limiting the use of the tonnage tax systems' benefits from entities which are not eligible or for income which does not qualify as shipping income, a number of measures have been chosen. However, in an economic crisis environment where the attention of a State is concentrated on the collection of taxes, this favourable regime may work to the detriment of other sectors of the economy from which the essential amounts are going to be gathered.

Against this background, the European Commission has recently initiated the process of review of the State aid guidelines that describe the conditions, under which fiscal State aid may be compatible with EU law, publishing for the first time a public questionnaire in February 2012[2]. Both the content of the questionnaire and the preceding action of the European Union Competition Commissioner, Joaquin Almunia, imply an attitude towards alterations of the regime of shipping taxation in the EU. The eventual repercussions of such a modification are strictly related to the position and importance of tonnage tax system in the EU. This position, which is been discussed and evaluated throughout this work, relates to the way in which

2 Consultation on review of the Community guidelines on state aid to maritime transport, from 14.02.2012 to 14.05.2012.

the EU Member States regulate the taxation of shipping profits domestically complying with the European legislation on State aid and managing to attract worldwide investments on which they have taxing powers according to their tax treaty network. The role, thus, of tonnage tax on the maritime industry and the economy of a particular State is an issue that demands multi-faceted approach and discussion.

1 The international dimension of the tonnage tax regime

Introduction

The shipping industry gathers special features as it is mobile, enables easy registration of ships anywhere in the world and freedom of choice of business location to shipowners. This unique position justifies its special taxation treatment.
This chapter approaches the shipping taxation from its international perspective. Firstly, it deals with the *lex specialis* contained in Article 8 of the OECD Model Convention, which regulates the allocation between the Contracting States of profits from shipping activities, addressing the question of its necessity and appropriateness (see 1.1.). Following this, an attempt to categorize the existing shipping tax regimes into open registries and tonnage tax regimes (see 1.2.) focusing on the two models of the latter found in the EU (see 1.2.1. and 1.2.2.) is being made. Finally, the chapter examines the Greek position as an example of a competitive system of regulation of both domestic and international shipping income (see 1.3.).

All these three sections aim at providing the international practice of taxation of the shipping industry.

1.1 International shipping profit allocation

The international shipping industry has traditionally been characterized by special features as compared to other types of business conduct. Indeed, as an inherently and highly mobile industry[3], also called the most international of industries[4], the greatest part of the shipping activities of a company is carried on "outside the

3 Georgios Matsos, 'Tonnage Tax and Tax Competition' in Antonios M. Antapases, Lia I. Athanassiou, Erik Røsæg (eds), *Competition and Regulation in Shipping and Shipping Related Industries* (Martinus Nijhoff Publishers 2009) 280; Peter Marlow and Kyriaki Mitroussi, 'Shipping Taxation', in Wayne K. Talley (eds) , *The Blackwell Companion to Maritime Economics* (Wiley-Blackwell 2012) 304.

4 Mary R. Brooks and J. Richard Hodgson, *The Fiscal Treatment of Shipping: a Canadian Perspective on Shipping Policy* (Shipping Economics, Research in Transportation Economics, Volume 12 2005) 157.

territory of any particular state"[5] [6]. This extraterritorial element and the consequent expansion of such activities over a number of states, thus, lead to the setting up of permanent establishments in those various states according to the requirements provided for in Article 5 of the OECD Model[7].

Given, thus, these specificities, the application of the permanent establishment principle (Article 7 OECD Model) for the allocation as between the states of business profits derived from shipping would reveal certain difficulties[8]. The existence of various permanent establishments would result, on the one hand, in the difficulty of apportioning the business profits[9] and, on the other hand, in fragmented taxation[10]. In this way, the likelihood of multiple taxation would increase[11] contrary to the aim of the OECD Model[12].

5 Steve Suarez, 'The Taxation of Mobile Activities' [2010] BIFD 45.

6 According to Hund, "[A] single [...] voyage will often involve stops in one foreign State after another [...]", Hund, D., 'The Development of Double Taxation Conventions with Particular Reference to Taxation of International Air Transport' [1982] BIFD 111.

7 Klaus Vogel, *Double taxation conventions: a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation of income and capital with particular reference to German treaty practice* (Kluwer Law and Taxation Publishers 1997) 478.

8 When the League of Nations started its work on international double taxation in 1920, the shipping industry was already experiencing a tax dispute. The British tax authorities levied income tax on foreign shipowners who had offices or agents (PEs) in the UK to book freights in the territory and the US tax authorities claimed as US source any freight collected at US ports and taxed this income accordingly. In order to force towards a more satisfactory apportionment of shipping profits and as a reaction to the so stimulated problem of double taxation several foreign shipping companies lodged complaints and made diplomatic representations to the relevant governments, Guglielmo Maisto, 'The History of Article 8 of the OECD Model Treaty on Taxation of Shipping and Air Transport', [2003] Intertax 232.

9 There was the "risk that if a state sought to tax residents of other states its residents would suffer the same taxation from these other states", Suarez (n 5) 47; John F. Avery Jones, 'The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States', [2006] Bulletin Tax Monitor 220; Hund (n 4) 111 ; Guglielmo Maisto, 'Shipping, Inland Waterways Transport and Air Transport (Article 8 OECD Model Convention)', in Michael Lang (ed), *Source versus Residence* (Kluwer Law International BV 2008) 21.

10 Vogel (n 7) 478.

11 Matsos (n 3) 280.

12 Introduction to the OECD Model paras. 1-3; OECD Commentary of Article 7, para. 18.

With the intention of eliminating these disincentives for the shipping industry both the various states either domestically[13] or bilaterally[14] and the organizations[15] working on the effect of double taxation, highly influenced by the previous States' practice, were oriented towards the adoption of special rules for the regulation of this specific kind of business. This direction is also reflected on the historic evolution of profit allocation derived from the shipping business from 1920, when the League of Nations commenced its work, until the current provision of Article 8 of the OECD Model (see Annex). Stressing the necessity of regulation of the issue through the conclusion of bilateral agreements at its earliest work[16], the League of Nations followed uninterruptedly from 1927, when for the first time a Model in

13 As a result of this multiple taxation experienced by the shipping industry at that time and due to its reactions, the US and the UK governments introduced legislation in 1921 and in 1923 respectively according to which profits of foreign shipping companies were exempted on condition of reciprocity. Japan (1924), Norway (1924), Italy (1925), Canada (1925), France (1926), Belgium (1930) and the Netherlands (1983, reciprocity introduced in 1942) followed with the adoption of similar provisions. Using as a criterion for the granting of the tax exemption either the law of nationality of the enterprise or the law of registration of the vessel, the reciprocity requirement was a determinant for the adoption of the measure of the unilateral relief from other legislatures as well, Maisto (n 8) 232 ; Avery Jones (n 9) 242.

14 Commerce and Navigating Treaties: Italy-Venezuela (1861), Italy-Austria (1878). General treaties only in the early twenties started addressing the issue of the income form the operation of vessels: Hungary-Czechoslovakia (1923) granting the exclusive right to tax to the State in which the centres of management and control of the undertakings are established, Hungary-Germany (1923), Hungary-Austria (1924), Germany-Italy (1925), the treaties concluded in 1925 by the UK with Denmark, Norway, Sweden and Finland, Germany-Italy (1925) and the US-Canada (1928) all granting the residence state the exclusive taxation. Special Treaties on double taxation of shipping in the form of exchange of letters: twelve such agreements between 1922 and 1928. Until 1931 seventeen treaties have been concluded containing shipping articles limiting the right to tax to the state in which the real centre of management is situated and until 1935 this number has risen to fifty-five, Maisto (n 8) 233; Avery Jones (n 9) 242.

15 The 1923 Report on Double Taxation submitted to the Financial Committee of the League of Nations by the four economists, professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, was the first attempt of an international organization to address the issue of double taxation of income from maritime activities and influenced the evolution of the rule. However, although it put an emphasis on the country of registry, the Report did not acknowledge the latter's exclusive right to tax recognizing at the same time the right of the country of domicile to tax a portion of the profits, Maisto (n 8) 235.

16 1923 Taxation Committee of the International Shipping Conference which resolved that all maritime nations should approach each other to establish their relations in shipping taxation; 1924 Sub-Committee for Ports and Maritime Navigation of the League of Nations which recommended the conclusion of international agreements based on reciprocity; 1925 Report of Technical Experts which concluded that the principle of the "real centre of management and control" can be validly applied through bilateral conventions; 1926 International Shipping Conference which suggested the improved view that shipping taxation should be dealt with through the conclusion of double taxation agreements.

the first League of Nations Draft contained an article dealing with shipping[17], until 1946 the "real centre of management" criterion. The only exceptions were the 1933 Draft Convention, in which no relevant provision was included, and the Mexico Model Convention in 1943, in which the State of ships' registration was used as a criterion[18]. The League of Nations was succeeded by the OEEC and the OECD in whose Model Conventions the State in which the "place of effective management" of the undertaking is situated has the exclusive right to tax profits derived from the shipping business.

The current provision of Article 8(1) of the OECD Model reads as follows:

> "Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated"[19].

Despite the fact that no reservation has been entered in article 8 OECD MC by the Member States of OECD, with the exception of Greece[20], we may not find a consistency in the way in which the various states deal with the allocation of shipping profits. The alternative provision for exclusive taxation in the state of residence where the contracting state in which the PoEM of the shipping company is situated does not coincide with the state of residence of the company as a consequence of the fact that the former does not use as a residence criterion the PoEM of the enterprise[21] [22] in combination with the different approaches adopted by the UN and the US MCs constitute proof of this inconsistency.

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17 Avery Jones (n 9) 242.

18 Also in the London Model Convention 1946 the country of fiscal domicile was used as a criterion for the allocation of taxing rights which, however, was deemed to be the country in which the real centre of management was situated.

19 The corresponding provision of the UN Model provides for two alternatives. The alternative A is identical to the OECD Model provision while the second paragraph of the alternative B provides that "profits from the operation of ships in international traffic shall be taxable in the Contracting State in which the place of effective management of the enterprise is situated unless the shipping activities arising from such operation in the other Contracting State are more than casual". On the other hand, the US Model attaches exclusive taxation to the State of the enterprise's residence.

20 See below in 1.3.

21 Commentary para. 2 article 8 OECD MC

22 Vogel (n 7) 490, 'In this scenario, the application of the regular wording of article 8 OECD Model would give rise to double non-taxation as neither the PoEM nor the residence state would be able to tax the shipping enterprise's profits under domestic law and article 8 OECD MC respectively'. The application of DTCs in connection with domestic law could in some cases lead to double non-taxation (Staff working paper, The internal market: factual examples of double non-taxation cases, Consultation document, European Commission, Brussels, TAXUD D1 D(2012)). Regarding the exclusive taxation of article

Given the widespread application of distributive rules, especially the residence criterion, other than the one laid down in article 8 OECD MC[23], the review of the rationale and, as a consequence, the necessity of a specific provision on allocation of shipping profits and of an exclusive rather than a concurrent right to tax shipping income were proposed. As a response to this noticed divergence and with a view to achieving homogeneity in the treaty network and simplicity in the application of the distributive rule, some recommendations have been made towards the replacement of the PoEM criterion with the residence one[24].

Once the shipping profits have been allocated between the Contracting Parties, the individual States may, in their turn, apply their domestic rules for taxation of income derived from shipping activities. The attitude of each State towards the regulation of this economic sector may either attract or deter the influx of investment.

1.2. Tonnage tax models in the European Union

States around the globe may be divided into two groups according to the regime of corporate taxation of the shipping industry they apply domestically. On the one hand, tonnage tax regimes compute the shipping profits of a ship-owning company by reference to a flat charge based on the net tonnage of the ships[25], instead of the normal corporate tax[26], irrespective of the company's actual accounting profits or losses from its shipping operations[27] leading, thus, to law effective tax rate[28]. As Lord Alexander of Weedon commented, '(t)he mechanism seems to be an ingenious device for obtaining virtual tax exemption compatible with international

8, a subject-to-tax test, by analogy to the one provided for in para. 35 of the Commentary of Article 23 OECD MC with respect to cases of concurrent taxation, is being applied in the PoEM state.

23 For a review of the consistency of bilateral conventions with respect to the criterion used for shipping profits allocation, see the Table III in Maisto (n 9) 37. The analysis of these treaties shows that the residence criterion has been adopted by about 50 percent of the treaties.

24 Maisto (n 9) 51.

25 Susan Ball, 'Tonnage tax-an overview', [2000] The Corporate Tax Review 83.

26 *'Shipping Tax Overviews' (*Deloitte February 2006).

27 Nicholas Valenzia, 'State Aid to Maritime Sector-A New Approach', [2008] Shipping and Transport International; Thacker Shardul, 'Tonnage Tax', [2005] International Financial Law Review 20; Leggate, H. & McConville, J., 'Tonnage tax: is it working?' [2005] Maritime Policy & Management 56.

28 This effective tax rate might be of, on average, >1%, when the shipping company has high benefits, *'Choosing a profitable course around the world: Corporate taxation of the Global Shipping Industry'* (PricewaterhouseCoopers 2009).

tax treaty obligations'[29]. On the other hand, Open or International Registers, which are termed as Flags of Convenience (FoC)[30], allow ship registration under more opportune compared to traditional registers conditions in terms of registration fees, working conditions, taxes and cost of labour[31].

As between the top thirty-nine (39) maritime countries in the world, which have adopted tax incentives for their shipping industry, 70% of the global ocean-going fleet[32] and the vast majority of the EU/EEA states[33] have implemented a tonnage tax system[34] converting it from an innovative approach to a global standard for shipping taxation[35]. Although these systems have similar outcomes, we may identify two tonnage tax models, the Dutch (tonnage-based corporation tax) and the Greek model (tonnage tax *stricto sensu*)[36]. Both models estimate the profit of the shipping enterprise taking into account the registered tonnage of the vessel, multiplied by a fixed amount of deemed profit per ton while they differ in the method of calculating this deemed profit[37].

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29 HM Treasury Release (1999), Para. 27. Independent inquiry into a tonnage tax – A report by the Lord Alexander of Weedon QC. London (July).

30 Thirty-four (34) countries have been declared FoCs by the International Transport Workers' Federation's (ITF) Fair Practices Committee, including Panama, Liberia, Malta and Gibraltar, See, International Transport Workers' Federation, Flags of Convenience campaign, FoC Countries, available at www.itfglobal.org/flags-convenience/flags-convenien-183.cfm.

31 Another categorization is, also, proposed into tonnage tax regimes, shipping incentives regimes and tax efficient regimes (See, *'Choosing a profitable course around the world: Corporate taxation of the Global Shipping Industry'*). We use here the former, even though it does not contain all the relevant jurisdictions, as the FoC are the main competitors of the tonnage tax regimes. This datum is indispensable for our analysis in Chapter 3.

32 Marlow (n 3) 304.

33 Eighteen (18) EU/EEA States have introduced a tonnage tax system, *Shipping Industry Almanac* (Ernst and Young 2012). Out of the 15 most important EEA flags (ECSA 2009), 14 of them, representing 98% of all EEA-registered fleet, have implemented a tonnage tax regime, ibid 313.

34 Examples of EU/EEA states not having introduced a tonnage tax regime are Luxembourg and Estonia.

35 Lewarn, B. & Francis, J, 'Salvaging and developing a national flag fleet: A review of the con-temporary maritime policies of some advanced industrial nations', [2009] The Australian Maritime College, 10.

36 Until the recent changes of the Norwegian tonnage tax system, which subsumed it into the Dutch model, the tonnage tax system followed by Norway and Finland constituted a third model, *'Choosing a profitable course: European tonnage tax regimes for the shipping industry'* (PricewaterhouseCoopers 2007).

37 Gemma Martínez Bárbara, 'Tonnage Tax: A Widespread State Aid Regime in the European Union', [2010] European Taxation 306.

1.2.1. Dutch tonnage tax model

The Dutch model, which is also called ''European model'', was introduced on 1 January 1996[38] and is followed by Belgium (2002), Denmark (2002), Finland (2002), France (2003), Germany (1999), Ireland (2003), Italy (2004), Latvia (2002), Lithuania (2007), the Netherlands (1996), Norway (1996), Poland (2007), Slovenia (2009), Spain (2002) and the UK (2000). Except for EU States, also third countries follow this Model, like India, Japan, Republic of Korea, South Africa and the USA. Talking about the tonnage tax based on this model as if it were a separate tax is a misnomer since, although the tax payable is calculated on the basis of notional profit, it is, in fact, a method of computing profits for the purposes of corporation tax[39].

The calculation of shipping-related profits is based on the net registered tonnage of the vessel according to a declining scale, i.e. the more the registered net tonnage of the ship the smaller the amount of fixed profit per day[40], and this deemed daily profit is, then, subject to ordinary corporate income tax rates (CIT) reducing, thus, significantly the effective tax burden of these companies[41]. In order to qualify for the tonnage-based profit calculation, the shipping enterprise should be the owner, co-owner or bareboat or time charterer of a vessel operating in international sea traffic for transportation of people or goods overseas while ship management companies may also qualify under certain conditions[42]. The (co-) owner or charterer shipping company should, also, be engaged in the exploitation of these own vessels[43]. The choice for this optional tonnage-based taxation should be made in the year in which the shipping enterprise earns taxable profit from shipping operation for the first time[44] and applies for ten (10) years (lock up period). The reason for this provision is to avoid a situation in which taxpayers would switch to either the regular or the tonnage-based tax regime when it pleases depending on

38 See the Dutch Law of 21 December 1995, *Staatsblad* 1995, p. 666

39 Ball (n 25) 62.

40 The declining scale is related to the fact that small vessels have higher profit capacity per net ton than large vessels, Paula Kager and Derk Prinsen, 'Tax incentives for Netherlands-based Maritime Shipping Enterprises Reviewed in an International Context' [1996] Intertax 119.

41 *'Choosing a profitable course around the world: Corporate taxation of the Global Shipping Industry'.*

42 *Shipping Industry Almanac.*

43 It should take care of a minimum percentage of the strategic, commercial, technical/nautical or crew management of own vessels

44 The only exception constitutes Belgium, where the option may be made at any time, Shipping Industry Almanac, 26.

the realization of either losses or profits respectively[45]. After this period, deferred tax liabilities disappear while under this regime no additional tax is being levied for capital gains.

1.2.2. Greek tonnage tax model

The Greek model, the oldest in the European Union, goes back to 1939[46] and is followed by Greece (1939), Cyprus (1963) and Malta (1973). The tonnage tax due is not a tax payable on corporate profits but rather a pre-established annual fee calculated on the basis of coefficients related to the age and gross registered tonnage of the vessel. The Greek model is, thus, called tonnage tax *stricto sensu*[47]. This system applies to vessel owners/charterers and ship managers that derive shipping income and covers all shipping activities[48]. It is mandatory for the owners of vessels flying the Cypriot, Maltese[49] and Greek flag[50]. In addition, Cypriot and Maltese tax resident companies owning EU/EEA or third-country registered vessels[51] and Greek registered ship management companies/offices managing foreign-flagged vessels[52] may opt to be taxed under the respective tonnage tax systems. Payment of the tonnage tax results in exemption from any other liability for corporate tax on income derived from shipping activities and for capital gains tax on income, profits or gains derived from the sale or transfer of the ship or the disposal of shares in a shipping company owning, operating or managing a

45 Kager (n 40) 121; Gemma Martinez (n 37) 311.

46 Moraitis, IG., 'Taxation of shipping and of other conjoint activities' [2003] Bulletin of International Chamber of Commerce 9: 1183–1192 (in Greek).

47 For a discussion on the repercussions of such a characterization, see below, Chapter 1, Section 3.

48 *'Choosing a profitable course: European tonnage tax regimes for the shipping industry'* (n 36) 19.

49 The Maltese tonnage tax regime is mandatory with respect to the registration fee and the annual tonnage tax which are payable regardless of whether or not the vessel owner/charterer benefits from the other concessions of the system, *Shipping Industry Almanac*, p. 283, *'Doing Business and Investing in Malta'*, PricewaterhouseCoopers 18.

50 It applies automatically irrespective of the domicile, residence or place of business of the shipowners or ship-owning companies, Peter Marlow and Kyriaki Mitroussi, 'EU Shipping Taxation: The Comparative Position of Greek Shipping' [2008] Maritime Economics & Logistics 196.

51 Under the Merchant Shipping Law (Fees and Taxing Provisions) of 2010, as for third-country registered vessels certain requirements with respect to the share and management of the fleet should be fulfilled, Costas Stamatiou, Cyprus: shipping – taxation, International Company and Commercial Law Review, [2011], 1; Guide to Cyprus Tonnage Tax System, Limassol 2011, Department of Merchant Shipping, Ministry of Communications and Works, 8.

52 Law no. 89/1967, known simply as 'Establishment of Law 89'

qualifying vessel. In addition, distributions of profits to the shareholders are exempt from taxation up to the beneficial owner, provided such profits when in the hands of the shipping company are declared exempt from tax[53].

The way Greece, a worldwide maritime power, regulates taxation of shipping income in a both domestic (tonnage tax system) and international (DTCs) context demands further discussion, not only because of the seniority but also due to the special provisions of the Greek shipping legal and fiscal framework.

1.3. The peculiar Greek position

Greeks have been seafarers for thousands of years and their tradition in international maritime transport precedes the formation of the Greek state in the first half of the 19th century[54]. Today Greece is one of the world's largest shipping nations[55] and Greek shipping is the most dynamic sector of the Greek economy[56]. Apart from being a big maritime force, Greece is also a country of responsibility for global shipping; it participates in all International Organizations, has 23 consular maritime embassies worldwide and the Greek Shipping Registry is among the top ranks of perfect flags. Moreover, with respect to the quality of the Greek registry, according to data of the Paris MOU annual report 2011, the Greek flag is in the White List. Greek shipping remains at the top of the world maritime league for about the last thirty years[57].

The way Greece allocates shipping profits in an international level differs from that proposed by the OECD Model in Article 8: instead of the place of effective management or the alternative provision of place of residence of the shipping enterprise, the place of ship registration is used in the Greek treaty network[58] [59].

53 *Shipping Industry Almanac* 103 (Cyprus), 171 (Greece) and 283 (Malta).

54 Matsos (n 3) 268.

55 Greece owns one seventh of the world's fleet in terms of deadweight tonnage (dwt) (ft. statistical data of Lloyd's Register-Fairplay as of 02/03/2012) and its merchant fleet is the second largest in the world after Japan (Greek Shipping Cooperation Committee, Annual Report 2011-2012).

56 Vessels registered under the Greek Registry rank the Greek flag in the 5th position internationally, and in the 1st among the countries of the EU, Marlow, 'EU Shipping Taxation: The Comparative Position of Greek Shipping' (n 50) 189.

57 Ioannis N. Lagoudis and Ioannis Theotokas, 'Chapter 4 The Comparative Advantage in the Greek Shipping Industry' in *Maritime Transport: The Greek Paradigm* (Research in Transportation Economics, Volume 21, 95–120).

58 Official reservation in the OECD Commentary, article 8, para 35: "In view of its particular situation in relation to shipping, Greece will retain its freedom of action with regard to the provisions in the Convention relating to profits from the operation of ships in international traffic". However, Greece from 1994 'no longer reserves its right with regard to

The relevance of the Greek economy with the shipping industry and the need, thus, to support the attractiveness of the Greek registry justifies this official reservation[60].

According to this provision, registering a ship under the Greek flag suffices in order for the profits of the shipping enterprise derived from this ship to be taxed exclusively in Greece irrespective of the place of the enterprise's effective management, provided this place remains in a tax treaty partner of Greece. Correspondingly, a shipping enterprise with its seat in Greece may change the tax forum of its ships just by changing their flag. The situation is different if the flag of a third, i.e. non-Contracting, state is used: the *lex generalis* of Article 7 will prevail over the *lex specialis* of Article 8 and the concurrent taxation of the permanent establishment principle will apply. Contrary, therefore, to the aim of article 8 OECD Model[61], a shipping enterprise with its seat in Greece may change the tax forum of a ship by choosing the flag of either a Contracting State or a third state, and in the latter situation the place in which to constitute permanent establishments, realizing, in this way, treaty-shopping[62].

Attempting to deal with this problem, some Contracting States have concluded DTCs with Greece including a different approach to shipping profits allocation. Examples of such states constitute Germany and Italy. The DTC with Germany distinguishes between German and Greek enterprises providing for the use of the PoEM criterion in the former case and either the registration criterion or the permanent establishment principle in the latter depending on whether the ship flies a Greek or other flag respectively[63] [64]. Another solution is proposed by the Greek-

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remuneration of crews of [...] ships [operating in international traffic], to capital represented by such ships and by movable property pertaining to the operation of such ships, and to capital gains from the alienation of such ships and assets', Michael Lang, '*Multilateral Tax Treaties: New Developments in International Tax Law'* Series on international Taxation, Kluwer [1998] 62.

59 In the Greek-Spanish DTC a typical provision may be found which reads as follows: ''Profits from the operation of ships in international traffic may be taxed in the Contracting State in which the ships are registered or by which they are documented''.

60 Maisto (n 9) 25; Matsos (n 3) 279.

61 See, section 1.1 above

62 Matsos (n 3) 281.

63 Vogel (n 7) 480.

64 Article V reads: (1) Profits which a resident of the Kingdom of Greece derives from operating ships in international traffic whose port of registry is in the Kingdom of Greece shall be taxable only in that State. (2) Profits from the operation of ships in international traffic accruing to a resident of the Federal Republic of Germany from an enterprise which is managed and controlled in the Federal Republic of Germany shall be taxable only in that State.

Italian DTC which provides for two alternative criteria: the registration criterion and, in case the ship flies neither the Greek nor the Italian flag, the residence of the shipping enterprise criterion[65] [66].

This peculiarity of the Greek tax treaties network could not produce positive effects for the Greek shipping industry unless it was combined with a favourable tonnage tax system.

The Greek tonnage tax system, on which the Greek model[67] is based, is established in Law No. 27/1975 ''on the taxation of ships, imposition of special fee for the development of the mercantile marine, establishment of foreign maritime enterprises and related matters'' and enjoys constitutional protection[68]. Although the inherent stability of this protection provides investors and shipowners with confidence, some issues are raised on the inclusion of this tonnage tax *stricto sensu* under the protection of Double Tax Conventions (DTCs). Not being an income tax strictly speaking, this tax may fall outside the scope of Article 2(1) OECD Model, which covers taxes on income and capital. However, a solution may be found depending on the date of the treaty signature. For tax treaties concluded before 1968, when Law No. 465/1968 replaced a tonnage-based corporate tax system with the current one, we may apply Article 2(4) according to which '[t]he Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention [...] in place of the existing taxes'. With respect, however, to the tax treaties signed after 1968, except for the teleological interpretation of the tonnage tax to qualify as an income tax, an *ad hoc* examination should in any case be followed[69].

The Greek tonnage tax, combining these specificities from a both international and domestic perspective, offers a competitive framework for ship (re-)registration and business (re-)location, thus, justifying the outstanding position of Greece in the worldwide maritime sector.

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65 Matsos (n 3) 282.

66 Article VII reads: 1. Income derived from the operation of a ship in international traffic shall be taxable only in the Contracting State in which the ship is registered. 2. Subject to the provisions of paragraph 1, income derived by an enterprise of a Contracting State from the operation of a ship in international traffic shall be taxable only in that Contracting State

67 See, 1.2.2. above

68 Article 107(1) of the Greek Constitution reads: [...]. The same legal force superior rank is granted to [...] Law No. 27/1975

69 Matsos (n 3) 282-283.

Conclusions on section 1 *(The international dimension of the tonnage tax regime)*

Considering the relative convergence in the way in which the various states, with a specific reference to the EU/EEA Member States, decide to deal domestically with the taxation of shipping industry, we may infer it is time the OECD amends Article 8 to achieve the same convergence in the international level as well.

Reviewing, thus, the international dimension of taxation of shipping income is a prerequisite for two significant conclusions: firstly, that the special character of the shipping industry demands an equally special approach as regards its fiscal treatment and secondly, that it is necessary for an EU Member State which aims both at creating and at maintaining an internationally competitive shipping presence to consider the worldwide competition in this field of economic activity.

2 Shipping Taxation in the European Union

Introduction

Adam Smith wrote in its 'Wealth of Nations' that taxes are a specific part of the cost of the business[70]. As taxation falls under state policy, distortion of competition is very likely to incur as a consequence of the state's fiscal policy[71]. Indeed, due to the lack of harmonization, EU Member States are not prohibited from granting tax advantages[72] which, albeit, are scrutinised by the European Commission and fall under Articles 107-109 TFEU for the prohibition of State Aid.

In this chapter, after examining the conditions under which a tax measure may constitute State aid (See 2.1.), we may review the evolution of the Commission's practice and initiatives in the field of fiscal State aid (See 2.2.). Lastly, through the presentation of some recent cases, the new direction adopted by the Commission is outlined anticipating the new State aid Guidelines (See 2.3.).

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70 An inquiry into the nature and causes of the Wealth of Nations By Adam Smith, An Electronic Classics Series Publication, available at: http://www2.hn.psu.edu/faculty/jmanis/adam-smith/Wealth-Nations.pdf

71 Matsos (n 3) 265.

72 However, in such a situation it is impossible to determine ex ante the amount of aid as the latter depends on the future profitability of the firm taking advantage of such an aid, Phedon Nicolaides, 'Fiscal Aid for Maritime Transport', in Antonios M. Antapases, Lia I. Athanassiou, Erik Røsæg (eds), Competition and Regulation in Shipping and Shipping Related Industries (Martinus Nijhoff Publishers 2009) 228.

2.1. Fiscal State aid

The Treaty of Lisbon's rules on State aid are contained in Articles 107-109 TFEU. Article 107(1) TFEU provides that 'any aid[73] granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market'. The national tax systems are not excluded from the scope of State aid rules[74].

A four cumulative criteria test should be fulfilled for the application of Article 107 TFEU to direct tax measures. First, an advantage should be conferred on a firm or firms. This advantage may consist of any tax incentive representing a relief from the tax burden normally placed on firms[75] deviating from the benchmark tax system[76]. In its notice on the application of State aid rules to measures relating to direct business taxation[77], the Commission has given detailed directions as to what forms of tax provisions and practice can constitute State aid[78]. State aid may, thus, arise through a measure which grants to certain undertakings a reduction in the tax base, e.g. special deductions, accelerated depreciation or tax-free provisions, a reduction in the amount of tax, e.g. reduced or nil tax rates[79] or deferment, cancellation or even special rescheduling of tax debts[80], i.e. every form of relinquishment by a State of its right to recover unpaid tax debts[81].

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73 The concept of aid is wider than that of a subsidy as 'it embraces not only positive benefits (…) but also interventions which (…) mitigate the charges which are normally included in the budget of an undertaking (…)', Case C-30/59, *Steenkolenmijnen Limburg v. High Authority*, Tom O'Shea, *EU Tax Law and Double Tax Conventions* (Avoir Fiscal Limited 2008), 55; Nicolaides (n 72) 226.

74 Case C-182/03 & C-217/03, *Kingdom of Belgium and Forum 187 ASBL v Commission of the European Communities* [2006] ECR I-5479, para. 81

75 Carlo Pinto, *Tax competition and EU law* (Kluwer Law International, 2003) 139.

76 Dr Michael Sanchez Rydelski, 'Distinction between State aid and general tax measures' 150.

77 OJ C 384, December 10, 1998, p.3, hereafter referred to as '1998 Notice'

78 Peter L Vesterdorf and Mogens Nielsen, *State aid law of the European Union* (Sweet and Maxwell 2008)177.

79 Case C-66/02, *Italy v Commission* [2005] ECR I-10901, para 78; Case C-222/04, *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA* [2006] ECR I-289, para 132

80 Commission Decision 92/35/EEC, *Pari Mutuel Urbain*, OJ 1992 L14/35, Case C-295/97, *Industrie Aeronautiche e Meccaniche Rinaldo Piaggio SpA v International Factors Italia SpA (Ifitalia)* [1999] ECR I-3735, para 41

81 Pinto (n 75) 119.

Secondly, this advantage should be financed by the State or through State resources. Although tax incentives do not involve a positive transfer of resources from the State, they constitute State aid by virtue of the fact that they place the person to whom they apply in a more favourable financial situation than other tax payers and result in a loss of income to the State[82].

Thirdly, this type of tax incentive should have the effect of hindering fair competition and affecting trade between Member States. The mere fact that the aid strengthens the firm's position compared with that of competitors in the EU is enough for trade to be considered as affected, irrespective of the size of the firm and its share in the EU market or whether it exports or not[83].

Fourthly, the tax measure should satisfy the selectivity or specificity criterion, i.e. benefit certain undertakings or certain productions, deviating from the ordinary tax regime[84]. A measure which is a logical consequence of the overall structure of the national tax system will not be judged to be selective[85]. On the other hand, it is not necessary that all economic agents benefit equally from a 'general measure'[86]. The assessment of selectivity should, therefore, determine whether, within the context of a particular legal regime, that measure discriminates between situations that are legally and factually comparable[87]. However, a measure may be justified by the nature or general scheme of the system of charges[88] or the logic of the system[89].
In parallel with the Commission's work on fiscal State aid, the Council of the EU adopted the legally non-binding Resolution on a Code of Conduct for business

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82 Conor Quigley, *EC state aid : law and policy* (Hart, 2003) 68-69; Case C-387/92, *Banco Exterior de España SA v Ayuntamiento de Valencia* [1994] ECR I-877, para 14; Case C-6/97, *Italy v Commission* [1999] ECR I-2981, para 16.

83 Klaas-Jan Visser, 'Commission expresses its view on the relation between state aid and tax measures' [1999] EC Tax Review 226-227; Case C-102/87, *France v Commission* [1988] ECR I-4067; Case C-142/97, *Belgium v Commission* [1990] ECR I-959.

84 O'Shea, (n 73) 57; C-393/04 & C-41/05, *Air Liquide Industries Belgium SA v Ville de Seraing and Province de Liège* [2006] ECR I-5293, para 32.

85 Vesterdorf, (n 78) 178.

86 Wolfgang Schon, 'Taxation and State aid Law in the EU', [1999] Common Market Law Review 932.

87 Quigley (n 82) 72; Rydelski (n 76) 151; Case C-428/06 & C-434/06, *Unión General de Trabajadores de La Rioja v Juntas Generales del Territorio Histórico de Vizcaya* [2008] ECR I-6747; Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH* [2011] ECR I-8365.

88 See section 23 et seq. of the 1998 Notice. This was first introduced by the ECJ in 1974, Case C-173/73, *Italy v. Commission*, [1974] ECR 709, para 15.

89 Case C-353/95 P, *Tierce Ladbroke v Commission* [1997] ECR I-7007, paras 33-35.

taxation in 1997[90] with the obligation to examine 'measures which affect (...) in a significant way the location of business activity in the Community'[91] and combat harmful tax competition[92]. In this regard, a group was established in 1998, the Primarolo Group, to assess tax measures that might fall within the Code[93] and submitted its Final Report in 1999[94]. However, as the Commission stated[95], the inclusion of a tax measure as harmful on the Primarolo Group's official list is irrelevant to its characterization as State aid[96].

Exceptionally, State aid is allowed in three cases: 1) investment aid for regional development[97], 2) reduction of environmental taxes[98] and 3) maritime transport[99]. The current Guidelines on State Aid to Maritime Transport provide for three categories of aid: investment, training and fiscal aid mentioning that the latter may take the form of reduced or zero taxation, accelerated depreciation on investment in ships, the right to reserve profits made on the sale of ships or tonnage tax[100]. Although tonnage tax regimes meet all the above-mentioned requirements, they are declared compatible with EU law given their vital role in the development of the European maritime economy, according to Article 107 (3)(c) TFEU, and are 'still justified'[101].

2.2. The evolution of the State Aid Guidelines

More than two decades ago the Commission acknowledged for the first time the need to adopt financial and fiscal measures to combat the decline noticed in the 1970's and 1980's in the maritime sector in Europe and increase the competitiveness of the EU fleet[102]. With the 90% of all trade between the European

90 OJ C 2 of 06.01.1998, p. 2 *et seq.*

91 Point A of the Code of Conduct.

92 For an explanation of the link between State aid and tax competition see M. Monti, 'How State aid affects tax competition', EC Tax Review, [1999] 208-210.

93 Matsos (n 3) 286.

94 Press Release: Brussels (29 February 2000) – Nr: 4901/99.

95 Section 30 of the 1998 Notice.

96 Visser (n 83) 224; Gemma Martinez (n 37) 304.

97 Commission Guidelines on Regional State Aid, 2006/C 54/08.

98 Commission Guidelines on Environmental State Aid, 2008/C 82/01.

99 Guidelines on State Aid to Maritime Transport, 2004/C 13/03.

100 Nicolaides (n 72) 229-230.

101 P. 4, note of the 2004 Guidelines

102 Gemma Martinez (n 37) 301; A future for the Community shipping industry. Measures to improve the operating conditions of Community shipping, COM (89) 266 final, 3 August 1989.

Union and the rest of the world being transported by sea[103], the importance of this sector for the European economy was always uncontested.

Since the 1970's the EU Member States have faced fierce fiscal competition from third countries which do not meet international safety and social rules and follow open registration policies[104]. The competitive character of the latter is determined by a number of cost components[105], like low registration fees, milder fiscal measures, low-tax environment[106], cheap labour costs and lax crew rules[107], enjoying, thus, a significant competitive edge[108].

As a result and in the absence of either international rules to curb that competition or administrative obstacles to removing a ship from a Member State's register[109], shipping companies registered their fleet under Flags of Convenience. This decline[110], caused by the protectionist practices of these countries[111], led individual European states to isolated domestic initiatives for the shipowning companies, including the adoption of a tonnage tax regime.

2.2.1. The 1989 Guidelines[112]

As a reaction to this widespread use of State aid in Europe to inhibit third-country competitors, the Commission issued in 1989 the first guidelines for State aid to maritime transport. The 1989 Guidelines constituted an attempt for divergence between Member States' actions[113] and outlined the conditions under which State aid could be considered compatible with the Internal Market[114]. The two objectives

103 White Paper 'European Transport policy for 2010: time to decide' COM (2001) 370 final of 12 September 2001.

104 Bart Verhelst and Glenn Verstraelen, 'Belgian tax incentives for shipping companies' [2005] European Taxation 571; Brent Springael, 'EC guidelines on State aid to maritime transport and Belgian Maritime Tax Measures', [2005] Intertax 230.

105 Verhelst (n 104) 572.

106 Gemma Martinez (n 37) 302.

107 *'Choosing a profitable course around the world: Corporate taxation of the Global Shipping Industry'*, 7.

108 Springael (n 104) 230.

109 Gemma Martinez (n 37) 302.

110 Between 1970 and 1995, EU fleet's share in the world tonnage declined from 32% to 14% while for 'open registries' increased from 19% to 38%, Verhelst (n 104) 571.

111 Brooks (n 4) 153.

112 See first note in this section.

113 Gemma Martinez (n 37) 305; Verhelst (n 104) 571.

114 'Financial and fiscal measures concerning shipping operations with ships registered in the Community', SEC (89) 921, 3 August 1989; Springael (n 104) 230.

that defined the EU common interest were the maintenance of ships under EU flags and the employment of EU seafarers[115]. Their fulfilment could be achieved through a method establishing a ceiling of aid based on the 'cost handicap', i.e. the hypothetical costs of ships operating under the flag of a low salary Member State[116]. The decline, however, of the EU fleet continued[117] and, after a review of the maritime strategy contained in a Communication in 1996[118], the Commission concluded that the EU shipping policy should be revisited.

2.2.2. The 1997 Guidelines[119]

A widespread extension of the tonnage tax regimes took place in the EU once the Commission issued the new Guidelines in 1997[120] where the first signs of the EU embracing the introduction of such a system as a measure to improve the fiscal policy for shipping were noticed[121]. The initial implementation of this regime from some Member States triggered a domino effect resulting in the adoption of tonnage tax by most of the EU States[122] and representing for the period 2005-2007 almost two-thirds of total transport aid in the EU[123]. Primarolo Group found all these regimes non-harmful after considering especially the global competition in this sector[124]. Surprisingly, though, some Member States[125] considered that 'the measures should be assessed as harmful but that in its deliberations the Council should take account of the issues of competitiveness by requiring rollback only if wider international action was taken on similar measures'[126]. The Guidelines with the view of promoting the EU fleet's competitiveness required a link with an EU flag. Exceptionally, the Commission approved schemes with non-EU flag link provided the strategic and commercial management of the entire fleet of an EU-

115 Gemma Martinez (n 37) 304; Springael (n 104) 230.

116 Gemma Martinez (n 37) 305; Springael (n 104) 230, Marlow, 'EU Shipping Taxation: The Comparative Position of Greek Shipping' (n 50) 190.

117 *'Choosing a profitable course: European tonnage tax regimes for the shipping industry'* 7.

118 COM (96) 81, 13 March 1996, "Towards a new maritime strategy".

119 Community guidelines on State aid to maritime transport (OJ C 205, 5 July 1997).

120 *'Choosing a profitable course: European tonnage tax regimes for the shipping industry'* 7.

121 Marlow EU, 'Shipping Taxation: The Comparative Position of Greek Shipping' (n 50) 191.

122 See above chapter 1.

123 Report from the Commission, State Aid Scoreboard – Autumn 2008 Update, COM (2008) 75, 17 November 2008.

124 Point 63 of the Final Report.

125 Italy, Finland and Sweden according to footnote 41 of the Report.

126 Point 63 of the Report; Matsos (n 4) 287.

based shipowner was carried out from the EU and it contributed to economic activity and employment within the EU[127]. As a consequence, the competitiveness of the EU maritime industry increased representing more than one third of world tonnage[128].

2.2.3. The 2004 Guidelines[129]

In 2004 the Commission supplementing the existing framework adopted new State aid Guidelines with focus on the monitoring of the tonnage tax schemes and the strengthening of the flag link[130]. For the first time, the guidelines provide that only these schemes will be approved that give rise to approximately the same tax-load as the one of the already approved regimes giving, thus, a new dimension to the maximum level of aid[131]. The Commission also widens as compared to 1997 the material and personal scope of the guidelines. With respect to the material scope, the tonnage tax may be applied to EU-flagged tugboats when more than 50% of towage per year constitutes 'maritime transport' and EU-flagged dredgers when transport of extracted materials to deep sea exceeds 50% of annual operating time[132]. As regards the personal scope, the guidelines soften the flag link conditions introducing an EU-flag obligation for the new vessels entered in the fleet only if less than 60% of the undertaking's tonnage is operated under EU flag and its share of EU-flagged tonnage has not decreased from January 2011, i.e. when the guidelines became applicable. The regime may also be extended to ship management companies providing both technical and crewing management[133] and assuming from the owners full responsibility for vessels' operations[134]. According to the 2004 Guidelines, 17 January 2011 is the deadline for their review.

Expecting the new guidelines, a number of recent cases of the European Commission provide for a more liberal approach towards the application of the tonnage tax regimes in the EU.

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127 Springael (n 104) 232; Nicolaides (n 72) 231; Gemma Martinez (n 37) 305.

128 Springael (n 104) 231.

129 Community guidelines on State aid to maritime transport, C13/3 of 17 January 2004, see also note on first section.

130 Springael (n 104) 231.

131 Gemma Martinez (n 37) 307.

132 Gemma Martinez (n 37) 307; Nicolaides (n 72) 231.

133 However, according to the 2009 Communication (C (2009) 132, OJ 11 June 2009), there is no longer a requirement for joint provision of crew and technical management in order for a ship management company to be eligible.

134 Gemma Martinez (n 37) 307; Nicolaides (n 72) 231.

2.3. Towards the new State aid Guidelines

According to the 2004 Guidelines, the Commission will approve only these tonnage tax regimes that are closely aligned with the already existing schemes. The discussion, thus, of the below mentioned four cases is of particular importance not only for their liberal approach towards the 2004 Guidelines but also because they constitute a benchmark for the evolution of the tonnage tax system in the EU in light of the expected guidelines and the Commission's attempt to achieve convergence and uniformity[135].

2.3.1. The Danish case[136]

This case interpreted in a liberal way 'maritime transport' with respect to dredging widening, thus, indirectly the material scope of the Danish tonnage tax[137]. Investigating the extension of the 'Danish International Ship Register regime' to seafarers working on dredgers, the Commission defined maritime transport at odds with section 3.1 of the 2004 Guidelines, which provides for the following definition: 'the transport at deep sea of extracted materials'[138]. Accepting that the transportation of aggregates between a port and an extraction site at sea constitutes maritime transport, more dredgers will manage to reach the 50% threshold of operational time for tonnage taxation eligibility[139].

2.3.2. The Irish case[140]

In 2007 the Irish authorities notified the Commission for their intension to amend their tonnage tax regime with respect to the condition of a maximum percentage in net tonnage of time or voyage chartered-in vessels in order for the qualifying ships of a company to fall under this scheme. In view of a possible complete removal of any time charter limitation, the Commission initiated a formal investigation for the

135 Leggate (n 27) 178.

136 Commission Decision of 13 January 2009 on State aid C 22/07 (ex N 43/07) as regards the extension to dredging and cable-laying activities of the regime exempting maritime transport companies from the payment of the income tax and social contributions of seafarers in Denmark, OJ 14 May 2009.

137 Gemma Martinez (n 37) 308.

138 Nicolaides (72) 236. In addition, according to case C-251/04, *Greece v Commission* [2007] ECR I-67 and Regulations 4055/86 and 3577/92, maritime transport is the carriage of goods or passengers between a port and any other port or off-shore installation.

139 Gemma Martinez (n 37) 309.

140 Commission Decision of 25 February 2009 on the Aid Scheme C 2/08 (ex N 572/07) on the amendment to the maritime tonnage tax system that Ireland is planning to implement, OJ 1 September 2009.

compatibility of this measure with Article 107 (3)(c) TFEU. Although the 2004 Guidelines 'do not mention any limits [...], in its decision making practice the Commission has authorised schemes where companies with a ratio of 1:3 or 1:4 owned to time chartered ships were eligible to tonnage tax'[141]. The Commission in this case without departing from this previous reasoning, still reduced significantly the ratio (1:10) providing for each of the time chartered-in vessels to either fly the EU/EEA flag or be managed from the EU/EEA territory[142].

2.3.3. The Dutch case[143]

In this case the Commission approved[144] two changes notified by the Netherlands. The first measure referred to the application of a much lower tax base for vessels exceeding 50,000 net tonnes reducing the tonnage tax due provided they were first registered under a flag after 31 December 2008 or they were flying a non-EU/EEA flag in the five years preceding the election for the tonnage-based taxation. In order to counterbalance the lack of incentives for the ship management activities, the second measure approved related to the decrease by 75% of the taxable profit for a shipping enterprise that performs the entire crew and technical management of a ship for the owner[145].

2.3.4. The Polish case[146]

In view of the new tonnage tax regime established in Poland[147], the Commission started in 2007 an investigation procedure[148]. First, doubts were expressed with respect to the deduction of social security and health insurance contributions from the tonnage tax base and the tonnage tax amount respectively. In response to the reasoning of the Polish authorities that as all the persons liable for personal income tax were entitled to such deductions so should those who have opted for the tonnage tax regime, the Commission clarified the role of this regime 'to replace rather than to complement the normal taxation systems for shipowners'[149]. Except

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141 Commission's decision to open the investigation, see Nicolaides, p. 235.

142 Gemma Martinez (n 37) 310.

143 N457/2008 Reduction of Tonnage Tax for Large Vessels and Ship Management.

144 C 106/05, 10 March 2009, OJ 8 May 2009.

145 *Shipping Industry Almanac* 307.

146 Commission Decision C 34/07 (ex N 93/2006) related to the introduction of a tonnage tax scheme in favour of international maritime transport in Poland, 18 December 2009. OJ, L 90/15, 10 April 2010.

147 European Commission, Brussels, Press Release IP/09/1967 December 18, 2009.

148 OJ C 300, 12 December 2007.

149 Nicolaides (n 72) 238-239.

for aligning the provisions for tugboats and dredgers with the 2004 Guidelines, the Polish authorities extended the lock-up period from five to ten years implementing the Commission policy of convergence between approved tonnage tax regimes[150].

The Commission should take into consideration these recent cases in the prospective review of the State aid guidelines. Not only the geographic but also the material and personal scope of application of the tonnage tax regime expands paving the way towards even more liberal guidelines and boosting the homogeneity in the Internal Market's maritime sector.

Conclusions on section 2 ('*Shipping Taxation in the European Union*')

European Union's leadership in global shipping, which can be depicted by the fact that EEA shipowners control 40.8% of the world fleet measured in gross tonnage[151], is to a large extend connected to the popularity of the tonnage tax. Due to the practice followed by the Commission, including its decisions and the State aid guidelines, together with its recent Communication 'Strategic goals and recommendations for the EU's maritime transport policy until 2018'[152], the tonnage tax has proved an effective element in reflagging. In anticipation of the new guidelines, we may expect crucial decisions for the tonnage tax and the future of the European maritime sector.

3 Tonnage Tax Regime: Opting In or Out

Introductions

Considering the characteristics of both the international and European dimension of the tonnage tax, we may discuss the position of this system as a tax incentive measure.

This chapter, after a thorough presentation of the elements that may either lead or discourage an eligible entity to opt for tonnage-based taxation and of the features that may either protect against or give rise to a decrease of a state's tax revenue (See 3.1. and 3.2.), intends to fabricate the profile of the tonnage tax regime and make an assessment of its importance for the shipping industry (See 3.3.).

150 Gemma Martinez (n 37) 311; Nicolaides (n 72) 239.

151 ECSA, 2006.

152 Communication from the Commission to the European Parliament, the Council, the European and Social Committee and the Committee of the Regions, COM (2009) 8 final, 21 January 2009.

3.1. Opting In

The alternative regime of shipping taxation, the tonnage tax, was first established as a means of combating the highly competitive 'open registries'. Followed mainly by EU/EEA Member States, this regime gathers a number of elements that try to attract investment.

The tonnage tax regime results in a considerable reduction of the tax burden, especially in years of high profits[153] providing a competitive tax environment[154]. 'The mechanism seems to be an ingenious device for obtaining virtual tax exemption compatible with international tax treaty obligations'[155].

This widespread and business-friendly system offers some key benefits to the shipping companies opting for it. Firstly, the system is simple[156] with respect to computation[157], documentation and expertise required. Thus, it minimises administrative and compliance effort with subsequent cost savings for the qualifying entity[158]. Except for facilitating the everyday management of the company, this simplicity and clarity of the regime offers security towards the tax position of the qualifying entity[159] attracting observers, including potential shareholders or business partners[160].

Secondly, under the regime the level of tax due can be accurately predicted in advance[161]. This certainty reduces the deferred tax provisions in the entity's accounts[162] while it is hardly possible for the taxpayer to commit tax evasion, as

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153 Nicolaides, (n 72) 230.

154 The economic impact of the tonnage tax has been considerable for the UK economy. It is estimated that the UK shipping industry would have supported 81,000 fewer jobs, contributed £6.5 billion less to UK GDP, and generated £1.6 billion less for the Exchequer had the tonnage tax not been implemented. (The economic impact of the UK Shipping Industry, A report for Maritime UK, May 2011, Oxford Economics).

155 Lord Alexander (n 29) Para. 27.

156 Kager (n 40) 124.

157 Gemma Martinez (n 37) 306.

158 Matsos (n 3) 226.

159 Jim Healy, 'Tonnage Tax-A lot of Legislation or Lifeblood to an Industry?', [2008] Irish tax review, 61.

160 Evangelia Selkou and Michael Roe, 'UK tonnage tax: subsidy or special case?', [2002] Maritime Policcy and Management 398.

161 Healy (n 159) 61; Michael Pinto, 'Why tonnage tax makes sense' http://www.business-standard.com/india/news/why-tonnage-tax-makes-sense/146099/ first visited in March, 01 2004; Marlow, 'Shipping Taxation' (n 3) 315; Brooks (n 4) 171.

162 Selkou (n 160) 398.

the tax is calculated based on factors that cannot be hidden, like the tonnage or the age of the vessel[163].

Thirdly, as the tonnage tax becomes an integral part of the ship cost[164], the eligible company has more freedom to pursue its economic activity making financial planning and long-term strategic operations easier[165]. It is more flexible with respect to financing decisions or purchase of vessels[166] driven by commercial rather than taxation considerations[167].

Fourthly, the transparency of the system makes taxation a determinant for flag choice and business location. Contrary to the normal corporate income tax system, in which a number of factors, like the taxable base or the documentation, may affect the business structuring, in tonnage tax a shipping company may easily choose the most favourable tax jurisdiction[168].

Fifthly, the fact that foreign shipping dividends fall under the tonnage tax regime attracts shipping companies with truly global interests and preserves the principle of capital export neutrality, i.e. domestic investors should pay the same amount of tax on the returns from both domestic and foreign investments[169].

Sixthly, an advantage of this system is that the companies remain subject to a corporate income tax and are therefore entitled to tax treaty benefits[170]. Even in the case of the Greek model, which provides for a tonnage tax *stricto sensu*, the regime can be protected under the treaty framework[171].

Finally, this regime offers compatibility and competitiveness with other countries' fiscal regimes because of its low effective tax rates, providing opportunities for

163 Matsos (n 3) 267.

164 ibid 267.

165 Pinto (n 161).

166 Healy (n 159) 398.

167 Discussion Document on the South African Tonnage Tax Proposal, Republic of South Africa, July 2008,18.

168 Matsos (n 3) 267.

169 Mark Brownrigg, 'Developments in UK shipping: the tonnage tax', Maritime Policy and Management [2001] 221.

170 International Bureau of Fiscal Documentation: International Tax Glossary, 4th edition, p 359.

171 See 1.3. give the title of the section.

companies in international partnerships[172] and a level playing field for international competition[173].

Of particular importance are the mechanisms that have been developed from various tonnage tax regimes in order to minimize the risks of tax avoidance. Examples of such measures are the application of the tonnage tax only to certain vessels, the provision of the exact activities carried on from ship management companies in order to be eligible and ring-fences[174].

The aim of the ring-fence measures is to prevent the abuse of the tonnage tax system by companies 'transferring' non-maritime related activities into the maritime sector to take advantage of the lower tax regime[175]. Generally, the ring fence measures constitute a proof of the level of sophistication of a system and through the prevention of tax avoidance they may considerably deter the decrease of a state's revenue.

A tonnage tax regime may, thus, contain provisions that isolate the company's tonnage tax profits from the application of most of the normal corporation tax rules. Relief deduction or set-off of any loss against the amount of a company's tonnage tax profits is not allowed. It is not, thus, possible to have a tonnage tax loss since no reliefs are available to reduce tonnage tax profits. In order to prevent a company or group claiming relief against non-tonnage tax profits for finance costs properly attributable to investments and activities generating tonnage tax profits, there may also be provisions requiring the reallocation of finance costs of mixed activity companies or groups[176].

A tonnage tax company is not subject to liability under the CFC legislation in respect of profits of a CFC if in the relevant accounting period distributions of the CFC made to the tonnage tax company would be relevant shipping income of the latter. However, in order for these distributions to be shipping income, all the income of the overseas company should have been relevant shipping income if it were a tonnage tax company[177].

Special provisions apply to deal with transactions involving a tonnage tax company that are not at arm's length. Their aim is to prevent profits which are taxed as

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172 Mark Brownrigg, 'Tonnage tax: a new beginning' International Maritime Law [2000] 267.

173 Marlow, 'Shipping Taxation' (n 3) 315.

174 Brownrigg, 'Developments in UK shipping: the tonnage tax' (n 169) 219.

175 Selkou (n 160) 396.

176 Ball (n 25) 194-5.

177 ibid 195.

tonnage tax profits being artificially inflated and profits not so charged being artificially reduced[178].

Finally, there are provisions governing the capital allowances position of a tonnage tax company with a view to ensuring that such allowances are not available in respect of an investment in an asset that generates only tonnage tax profits[179].

Therefore, from the perspective of both a company and a state, the tonnage tax plays a critical role in the development and evolution of the shipping industry. However, this is the one side of the coin.

3.2. Opting Out

Before a company elects into a tonnage tax regime, it should consider some drawbacks generated from the overall structure of this system. The most inherent disadvantage of tonnage tax is that taxes are due even if losses are incurred out of the taxpayer's business[180]. In an economic crisis environment and the subsequent downturn which has shocked all the industries, including the maritime transport sector, the provision of a fixed amount of tax regardless of the realization of profits[181], constitutes a considerable burden reducing the attractiveness of the tonnage tax.

Some ring fence measures may also create a negative investment environment. Any losses that have accrued to a tonnage tax company before its entry into tonnage tax are not available for loss relief in any accounting period beginning on or after the company's entry into tonnage tax and are permanently lost. Therefore, if the company's profits, computed on the normal basis, for its ten years in tonnage tax would not be sufficient to use those losses, it is doubtful whether the company should be electing into tonnage tax at all[182]. In the case of a group, the 'one in, all in' principle applies and the calculations will have to be done on a group basis. This is something a group of companies should take into account when computing the tonnage tax to make an election[183].

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178 ibid 197.

179 ibid 193.

180 Dick van Sprundel, Whether or Not Interest Income Should Fall under the Scope of the Tonnage Tax Regime' [2011] European Taxation 515; Nicolaides (n 72) 266.

181 Marlow, 'Shipping Taxation' (n 3) 315; S. Africa. Tonnage tax discussion, 19.

182 Ball (n 25) 194-5.

183 ibid 180

An additional disadvantage is the absence of flexibility resulting from the 10-year period. This is why loss-making companies or companies that expect to suffer substantial losses in the near future will be reluctant to opt for the tonnage tax regime preferring normal taxation[184]. 'Like marriage, a tonnage tax election is a long-term commitment which should not be lightly enterprised'[185], especially in the case of the Greek system which is mandatory.

From a country's viewpoint, a negative effect of general non-taxation of shipping is the fiscally inefficient opportunity cost for countries' treasuries which gives rise to economic and social cost by shifting taxation to other sources[186]. The losers of this system are the treasuries of maritime countries[187]. However, there is the question to which country the loss of tax should be attributed, as equity in shipping may be owned by foreign investors and shipowning equity may be attracted to a location because of its zero tax facilities for shipping. In a longer perspective, international cooperation could bring about a regime of shipping taxation on parity with the taxation of other industries avoiding, thus, the distortion of resource allocation[188].

Politically, it may be the optimal solution for a government that claims its obligation to support the sector. However, from a fiscal viewpoint, it is a taxation policy that lacks rationality and consistency. If specific industries were to enjoy specific taxation, because they bring benefits to the economy, then shipping would not be the only one to take advantage of a favourable treatment. Banking, insurance or energy services have the same importance in some economies. This reasoning raises the question of whether this subsidy for the shipping sector is justified on economic or political grounds given the crucial character of other sectors as well for a country's economic boost. If the latter is true, such a treatment would be discriminatory against other industries[189].

Lastly, although there is no doubt that the tonnage tax 'is working', the system has not contributed to the increase of the number of vessels substantially leading, as a consequence, to a decline of EU nationality seafarers[190]. As a response to that

184 Kager (n 40) 124; *Discussion document* (n 181) 19.

185 Ball (n 25) 180.

186 Kristen Knudsen, 'The economics of zero taxation of the world shipping industry' [1997] Maritime Policy and Management 52; Selkou (n 160) 402-; Brownrigg 'Developments in UK shipping: the tonnage tax' (n 169) 219.

187 Knudsen (n 186) 50.

188 Ibid 52-53.

189 Selkou (n 160) 402.

190 Leggate (n 27) 184-185.

decrease of vessels, the 2004 State aid Guidelines tried to strengthen the link between the flag and the tonnage.

The decision to opt in or out the tonnage tax scheme is based on its above-mentioned features together with the overall structure of the particular shipping business. However, special weight is also given to additional elements determining the shipping business conduct, including labour or safety conditions.

3.3. Synthesis

According to the Ricardian trade theory, in a free and fair global marketplace, a country should maximize its economic efficiency by deploying resources in those sectors in which it holds a comparative advantage[191].

Shipping taxation has played a critical role in the structure and evolution of shipping business as a sector of fundamental importance to both shipowners and policy makers. In a world where economic boost is often strictly associated with international trade given that ships and ports handle 90% of the world's cargo, a flourishing shipping sector is an essential means of transportation. One of the most important incentives has been the introduction of tonnage tax regimes which have been created in order to safeguard national shipping and count until now almost 15 years of successful implementation[192]. The growth and rise of this system in recent years has transformed it into a global standard for shipping taxation applying to 70% of the global ocean-going fleet[193]. The tax incentives provided by this system of taxation of the shipping industry do not serve only as devices for the implementation of the social goals of government policy but also as a means of reversing the decline of the flag registers of the European Community busting national economy and attracting the registration of ships[194].

The Shipping Industry can provide great value and benefits to a national economy, both directly (contribution to the balance of payments, employment of national seafarers) and indirectly (employment opportunities in associated industries, money

191 Brownrigg, 'Developments in UK shipping: the tonnage tax' (n 169) 215.

192 Gemma Martinez (n 37) 311.

193 Lewarn, B. & Francis, J. (2009). Salvaging and developing a national flag fleet: A review of the con-temporary maritime policies of some advanced industrial nations, The Australian Maritime College.

194 According to Stanley S. Surrey, tax incentives in general are inferior to direct subsidies with respect to the achievement of social goals as they are less equitable and more difficult to develop and administer, Stanley S. Surrey, 'Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures', [1970] Harvard Law Review 705-738.

accruing to countries, political benefits)[195]. Support for the shipping industry is equated with support for labour, training opportunities, shipbuilding, ports, marine equipment manufacturers, shipbrokers, academic institutions and, thus, support for the whole economy[196].

The Commission is also of the view that there should be a 'level playing field' for the shipping sector within the European Union[197] and this may happen through the implementation of tonnage tax regimes by the EU/EEA Member States.

However, while tonnage tax system is a *conditio sine qua non* for shipowners not to register their vessels under flags of convenience, it is not an adequate condition[198]. When deciding their country of residence and flag, maritime companies take into account not only corporate tax costs but also wage costs, crew rules, registration procedure, national requirements, standards based on national shipping law[199], mergers and acquisitions, logistics management strategies and liner shipping[200]. The availability of tax incentives may be outweighed and affected by all these factors[201].

> "The success of a shipping policy – whatever that may encompass – does not stem from its fiscal dimension alone, but from the full package of proposals within the policy"[202].

While shipping business is as well affected by factors other than taxation, maybe the mode of taxation is no longer a major issue of the industry as fiscal regimes have become so similar in their impact that there is little or nothing to choose between them[203]. Other factors (wage costs, safety requirements, etc.) may determine the final decision of business location. In 2007 the Greek government relaxed the requirements of nationality of the crew and noticed an increase in tonnage under Greek flag. Therefore, manning requirements may be a more important factor of flag choice than taxation[204]. According to the approach adopted

195 Marlow, 'Shipping Taxation' (n 3) 305.

196 Brownrigg, 'Developments in UK shipping: the tonnage tax' (169) 215-218.

197 See, for example, Commission, "Strategic goals and recommendations for the shipping policy of the European Union up to 2018", 21 January 2009, COM (2009) 8 final.

198 Matsos (n 3) 288.

199 Verhelst (n 104) 572.

200 Marlow 'EU Shipping Taxation: The Comparative Position of Greek Shipping' (n 50) 205.

201 Kager (n 40) 124.

202 Brownrigg, M. (1999, September) Tonnage tax, the UKs choice, speech to UK Chamber of Shipping, Barbican Centre.

203 Marlow, 'Shipping Taxation' (n 3) 317-318.

204 Marlow, 'EU Shipping Taxation: The Comparative Position of Greek Shipping' (n 48) 205.

by the OECD, the availability of more favourable manning and taxation regulations than those that prevail in the OECD, have been the prime reasons for an increasing number of OECD shipowners deciding to register their vessels under non-OECD flags[205].

The tonnage tax regime being an indispensable tax incentive for the protection of the EU/EEA registers, and generally the registers that opt for a tonnage-based taxation, against the massive registration of vessels under flags of convenience, it is not the only determinant. In order to retain its role as an element affecting flag choice, the tonnage tax regime should remain competitive adapting to the continuously demanding challenges of the maritime transport.

Conclusions on section 3 (‘*Tonnage Tax Regime: Opting In or Out*’)

Although the incentives provided offer a business-friendly fiscal environment with parallel prevention of tax avoidance, the 2008 economic crisis has caused the emergence of the inherent drawback of the tonnage tax system, i.e. the taxation even of a shipping company realizing losses.

In addition, the convergence aimed at an EU level, in order to prevent distortion of competition, had the effect of diminishing the role of the tonnage tax as a decisive element of choice of flag or business location. However, this fiscal measure still possesses an outstanding position.

Conclusion

“In a crisis, be aware of the danger, but recognise the opportunity”

John F. Kennedy

In an international, domestic and European perspective the trend is convergence. Internationally, the Contracting States are more and more using the residence criterion as the shipping profits allocation rule and the literature expresses the need for amendment of Article 8 to achieve homogeneity. Domestically, we may identify two tonnage tax models the first of which, the Dutch model, is followed by all the States opting for a tonnage tax system except for Greece, Malta and Cyprus, while a lot of common features and elements of congruity may be found in both models creating, thus, a global tonnage tax system. In Europe, where the vast majority of tonnage tax regimes is concentrated, both the Commission with its

205 Organisation for Economic Co-operation and Development, Directorate for science, technology and industry, division of transport, (2001) Regulatory Issues in International Maritime Transport, OECD, section 4.6, paras. 157-165.

decisions and guidelines and the Member States with their frequent amendment of their tonnage taxes, favour the harmonization of the tonnage tax regime. The extent of the regime's expansion is such that states all around the world scrutinize that system with the intent of adopting a tonnage tax for shipping taxation in their territory.

On the other hand of this convergence, we may find the devaluation of the role of taxation for the determination of ship registration and business location. Indeed, the widespread application of tonnage tax has transformed it from an exceptionally advantageous system into a standard rule. As a consequence, other factors, such as crew rules, safety requirements, obligation to comply with international standards of environmental protection, may affect the choice of a jurisdiction to conduct shipping business. Unfortunately and given the more or less exhaustion of the potentiality of the tonnage tax to become a competitive regime, a race to the bottom has been observed putting into risk human beings and ecosystems.

Influenced by these developments, the European Union tries to react. After the publication of a public questionnaire this year, the review of the State aid guidelines will follow shortly. Expecting their issue, a lot of divergent opinions have been expressed on whether the Commission's position should change and if so towards which direction this shift should go.

Although EU Member States retain their competence regarding direct tax law[206], worldwide competition in the field of shipping transport has led to a partial unregulated 'harmonization' and congruity of the European tonnage tax regimes. This tendency has been favored by Commission attitude and practice. The Commission has always expressed its concern regarding the convergence of the differences in the schemes implemented by the Member States in order to prevent competition within the European Union from being distorted[207]. In this context, according to the 2004 State aid Guidelines the Commission approves schemes that give rise to tax load approximately in line with schemes already approved.

In addition, the extension of the scope of the 2004 guidelines and their expansive interpretation from the Commission (see 2.3.) constitute proof of the unregulated character of this sector and the need to widen continuously the material and personal scope of application of the tonnage tax regime.

In light of the anticipated State aid guidelines, thus, this direction adopted by the Commission and the Member States towards a liberalization, relaxation and

206 This is a mantra found in most cases of the ECJ.

207 Gemma Martinez (n 37) 305.

expansion of the regime should influence the eventual content of this new 'soft law'.

However, there are some views in the 'Competition corridors' of the Commission which oppose to a liberalization of the regime and imply a position that would favour directly the tax revenues of the Member States in an economic crisis environment. Although the European Union Competition Commissioner, Joaquin Almunia, expressed its support to the tonnage tax regime[208], the fact that for the first time the Commission initiated a public consultation[209] and published a questionnaire with hints that the state aid guidelines have led to a subsidy race, depriving the governments of taxation revenue may constitute signs of possible alterations to the regime[210].

In addition, in 2010, after the initiative of José Manuel Barroso, a re-organisation of the Commission's competition services took place. Competition and state aid decisions were transferred from DG MOVE (Commission's Directorate-General for Mobility and Transport) to DG COMP (Commission's Directorate-General for Competition). Possible outcome: dropping of the guidelines and their replacement by individual state aid decisions. Officially DG COPM and DG MOVE will work together but the DG COMP is the most powerful executive ministry in Brussels. No official explanation for this change has been given. However, unofficial reports comment that the reason was that the industry was being treated softly.

The consequences of such a shift will be negative given especially the highly mobile character of the shipping industry and will lead to quite the opposite result, i.e. the massive flagging-out of vessels and shipping companies' relocations with the subsequent costs to the tax revenues of Member States. In March 2010 the Commission Maritime Director, Fotis Karamitsos, talking to the European Parliament Transport Committee, stressed that there should be no change to the maritime state aid rules given the economic crisis as harsher conditions would lead to a return of the flagging out seen in Europe in 1980s and because the situation is too fragile for destabilizing modifications.

In general, we could say that the Commission's attitude to examine national tonnage tax regimes should be regarded as a 'childhood illness'[211] and a narrow-

208 'The EU needs a maritime sector that is competitive at international level and hence allows favourable taxation based on tonnage to prevent companies from relocating' July 2011.

209 Consultation on review of the Community guidelines on state aid to maritime transport, from 14.02.2012 to 14.05.2012.

210 Tonnage Tax Review, Maritime Watch, edited by Justin Stares, available at <http://maritimewatch.eu/articles/1> last visited July 3, 2012.

211 Matsos (n 3) 288.

minded approach. The solutions to this issue could be either the complete abolition of the State aid guidelines leaving to the Member States the freedom to regulate this area with the provision of tax incentives according to the free market rules or a proposal of complete harmonization. By analogy to the constitutional protection and the mandatory character provided for in the Greek tonnage tax guaranteeing stability, homogeneity and efficiency, maybe it is time the European Union abandons the 'soft law' viewpoint and perception and approaches the subject with tools of a more binding character and effect. Such an approach would be the issue of a Directive on tonnage-based taxation system following the overambitious plan provided for in White Paper 'European Transport policy for 2010: time to decide'[212]. This would lead to absolute convergence of all EU Member States' schemes for shipping taxation and prevent distortion of competition within the EU. Fiscal competition will be avoided by ensuring uniformity among the various tonnage tax regimes, as has always been the concern of the Commission.

However, not only the Commission intends to interfere into the shipping sector imposing obligation for a more burdensome for shipping businesses taxation, but also individual States. In Greece this year there were proposals for taxation of shipping profits. 'Shipping is an offshore industry, and any act against it is like shooting yourself in your own foot,' Ted Petropoulos, founder of Petrofin Research, answered to that threat.

Internationally, EU Member States face fierce competition from Flags of Convenience. Although the wording of Article 8 OECD MC in their Double Tax Conventions protects against treaty-shopping practices and tax abuse, the more opportune Greek reservation to the OECD Commentary could be a solution to the flagging-out and a way to counterbalance the EU/EEA ship ownership with the EU/EEA-flagged vessels.

Under the economic crisis environment, the shipping businesses are particularly worried at their corporate strategies and processes. However, the flexibility of the sector may lead to the creation and emergence of new solutions and forms of commercial conduct. The focus should, thus, be on the provision of even more competitive tax incentives to stimulate investment. In this way the competition will be confined in the area of taxation deterring an aggressive race to the bottom in other areas with unacceptable risks to seafarers and the marine and coastal environment.

212 COM(2001) 370 final.

Annex: League of Nations

1923	**Taxation Committee of the International Shipping Conference**	**Resolution**	**Exclusive right in the country of residence (proposal of international approach)**
1924	Sub-Committee for Ports and Maritime Navigation of the Advisory and Technical Committee for Communication and Transit of the LoN	Recommendation	Conclusion of international agreements based on reciprocity to avoid double taxation
1925	Group of Technical Experts	Resolution	Maritime navigation undertakings: real center of management and control subject to reciprocity (exception to the general principle)
1925	Sub-Committee for Ports and Maritime Navigation	Resolution	Real center of management and control (clarification)
1926	International Shipping Conference	Resolution	Exclusive right in the country of residence (double taxation agreements)
1927	Committee of Technical Experts	Draft bilateral convention for the prevention of double taxation	Real center of management (article 5)
1928	General Meeting of Government Experts	Three draft bilateral conventions	Real center of management
1931	Sub-Committee of the Fiscal Committee of the LoN	Draft plurilateral convention	Real center of management
1933	Fiscal Committee of the LoN	Draft convention for the allocation of business income	No relevant provision
1935	Sub-Committee of the Fiscal Committee of the LoN	Revision of the 1933 Draft Convention	Real center of management (first time a separate provision in a draft model convention)

1940	**A Sub-Committee met in The Hague (revise the 1928 draft conventions)**	**Draft Convention**	**Real center of management**
1943	Conference in Mexico	Mexico Model Convention	Exclusive right in the country of residence-only ships registered
1946	Conference in London	London Model Convention	Fiscal domicile, i.e. where the real center of management is situated

OEEC

1957	**Report of Working Party n. 5**	**New Draft of paragraphs 1 and 2 of Annex I**	**Place of effective management**
1957	Committee	Draft Article	Place of effective management
1958	Committee	Draft Article	Place of effective management
1959	Committee	Draft Report (final text of article 5 on the taxation of income from shipping)	Place of effective management
1961	Committee	Draft convention	Place of effective management

OECD

1962	**Fiscal Committee**	**Draft Convention**	**Place of effective management**
1963	Fiscal Committee	Draft double taxation Convention	Place of effective management
1971	Fiscal Committee	Revision of the Articles and Commentaries of the 1963 Draft double taxation Convention	Place of effective management
1977	Fiscal Committee	Model Double Taxation Convention	Place of effective management