

DESIGNING AN OPTIMUM SHIPPING TAX REGIME BY APPLYING AN UPDATED MULTI-ANALYTICAL FRAMEWORK

by

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Abstract

The thesis observes that taxes may be utilised for purposes other than revenue generation. The thesis submits that sea power should constitute a critical objective for designing an optimal shipping tax regime. This submission is partly based on considering the historical development of the American and British registered merchant fleets. The thesis observes that States compete under certain conditions despite globalisation. Therefore, sea power remains a valid underlying objective. The thesis submits that registered merchant vessels constitute a reasonable indicator for assessing a critical component of a State's sea power. The thesis advances the argument that shipping income should primarily be produced from the navigation of these vessels for carrying goods and passengers by sea. This feature of the maritime adventure supports the exceptional mobility of shipping income and is crucial for promoting a State's sea power. These activities are, therefore, primarily deserving of special tax treatment.

The thesis constructs a Model Analytical Framework to support the design of an optimal shipping tax regime. The Smithian Framework is a key component. The latter is constructed to, broadly, accord with the tax design principles of the G20 States. The thesis utilises the 1998 OECD Framework assessing harmful tax practices and preferential regimes, as updated by BEPS 5, as the other key component. The significance of this other component is that its key factors should be satisfied for designing preferential regimes that have broader legitimacy internationally. The thesis ranks the benchmarked efficiency and simplicity criteria as dominant priorities to counter the high mobility of the particular tax base. The thesis applies super efficiency intensely to better level the playing fields between the local and foreign ship registers. The thesis observes that the substantial activity factor, as updated by BEPS 5, although having the potential to reduce the mobility of the tax base, is unlikely to do so without more. As a model for an optimal shipping tax regime that exhibits uniformity and simplicity extensively and can promote a State's sea power, the thesis recommends the basic Panamanian design incorporating broader features of the Greek regime.

Declaration

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BARRY GRANT HITCHENS
31st December 2021

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Alea jacta est.

Preface

Chapter one is intended to operate as a broad summary and details the essential contents of the different substantive chapters for a reader's convenience. Chapter seven contains the contributions to knowledge and offers a further summary of the conclusions of the thesis.

The thesis contains multiple submissions and observations. Not all of these are of equal weight. Some of these submissions are intended to merely establish a hypothesis that may be explored further in later works where warranted.

Professor Peter Doherty who is an immunologist and Nobel laureate, has called models, ‘‘thought experiments’ that use the best available data to lay out options for policymakers.’ These observations might be extrapolated to the types of models considered in this thesis, and particularly those considered in chapter two. As a caveat, it should be noted that chapter two is intended to constitute only a limited study as it is primarily utilised by the thesis to establish a hypothesis. Some of the analysis and the underlying research of chapter two is also intentionally much more limited than other parts, such as the analysis and research considering the tax policy of China, India, and Japan. However, due to their significant economic expansion enjoyed at different periods in their history, it was considered warranted to refer to their tax policy very briefly, albeit to some extent imperfectly. Their economic history is important as economic expansion is at the heart of the thesis. The thesis is, in part, interested in identifying tax policy that will maintain and aggressively expand the ship register of a sponsoring State.

Nevertheless, chapter two considers, and its conclusions are significantly based upon, the economic models associated with distinguished academics of leading research universities at the international level, such as the *Mirrlees Review*. This model is also significantly referenced

by the South African model considered in chapter two. Further, the relevant model of the OECD that is endorsed by the G20 States and that underlies the 2015 *BEPS* action one, is further briefly considered in chapter two as the final check. These other economic models are likely to be based on ‘the best available data.’

Therefore, it is submitted that the conclusions of chapter two still possess enough credibility and validity for the purposes of the thesis. It should be recalled that the thesis is only interested in establishing the criteria of a good tax system, as broadly endorsed by the G20 States in the 21st century. Therefore, the overall analysis of chapter two is sufficient to answer this part of the research question and establish the necessary hypothesis in chapter two with sufficient credibility. The chapter two hypothesis forms part of the model analytical framework that is constructed in full in chapter three.

Also, at a secondary level, it seems that the simpler lessons that are considered in chapter two, about the nature of a good tax, continue at some level to be substantively ignored by policymakers in the 21st century. Accordingly, its inclusion and re-emphasis here by the thesis appears to be justified on multiple grounds.

Lastly, the recommendations offered by the thesis are by no means perfect or final. They are based, in part, on a common-sense solution, and attempt to strike a difficult balance within an environment of *competing interests* at the international level.

‘*Taxes are the price we pay to live in a civilised society.*’: (Prof. Peter Doherty; 30 April 2022)

‘*Common sense is in spite of, not because of, Education.*’: (Victor Hugo; IMDb; 2022)

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Specialised Terms

BEPS	Base erosion and profit shifting
BEPS 1	Action One of the OECD/G20 Base Erosion and Profit Shifting Project
BEPS 5	Action Five of the OECD/G20 Base Erosion and Profit Shifting Project
Carrier	Shipowners and demise charterers that, as a minimum, technically operate or navigate ships for their business
CM&C	Central management and control
CIGA	Core income-generating activities
DTA	Double Tax Agreement
EU Framework	<i>Commission communication C(2004) 43 — Community guidelines on State aid to maritime transport [2004] OJ C 13/3</i>
JCF	Juridical Connecting Factor
MAF	Model Analytical Framework
Maritime transport activities	Carrying goods and passengers by sea
MTC	OECD Model Tax Convention
1998 Framework	1998 OECD Framework assessing harmful tax practices and preferential regimes
OECD	Organisation for Economic Co-operation and Development
Pareto optimality	The state where promoting one, or more, criteria in a framework disadvantages at least one other related criterion
POEM	The place of effective management
Smithian Framework/Criteria	The criteria of a good tax system as envisaged by Adam Smith, including later versions by others as the particular context determines
Sponsoring State	A State that applies/provides a shipping tax regime
State	A sovereign country

Tax base	Loosely applied to reference the money and equivalent property that can be taxed within a particular sector unless the context indicates otherwise
Tax regime	An individual tax (In contrast to an entire tax system)
UK/Britain/British	The United Kingdom of Great Britain and Northern Ireland unless the historical context implies otherwise
US/America/American	United States of America
Updated 1998 Framework	1998 OECD Framework assessing harmful tax practices and preferential regimes, as updated by BEPS 5 (or Action 5) of the OECD / G20 BEPS Project
Updated Smithian Framework	As developed, ranked, and applied as part of MAF, the Smithian Framework will be referred to as the Updated Smithian Framework
USF	The Updated Smithian Framework

Chapter 1: Introduction

1.1 The Rationale Underlying the Thesis

Broad-brushed criticisms enthusiastically touted by politicians submitting that business entities fail to carry their fair share of the fiscal load was the original motivation for assessing whether the proposition has any substantial validity within the shipping context.¹ Despite several international initiatives over the years to purportedly find methods to realise more substantive levels of equity in taxation, it seems apparent that there are still industries in the twenty-first century that are, as a general observation, only taxed minimally.² The shipowning and ship operating industry is one such industry that generally operates in a low tax environment.³ The OECD has observed in a past report that ‘a large percentage of the world’s fleet operates with little or no direct tax on its activities.’⁴

Thus, as one of its aims, the thesis will endeavour to evaluate whether there is any real legitimacy for the special tax treatment applied by the different domestic tax systems to tax shipping income. At first glance, the issue might appear somewhat black and white. However,

¹ Tom Bergin, ‘How Greek shipowners talk up their role, and why that costs Athens millions’, *Reuters* (online), 25 November 2015 < <https://www.reuters.com/investigates/special-report/eurozone-greece-shipping/>>; See, eg, Chris Isidore, ‘Elon Musk calls Elizabeth Warren ‘Senator Karen’ in fight over taxes’, *CNN Business* (online) (15 December 2021), <<https://edition.cnn.com/2021/12/15/investing/elon-musk-elizabeth-warren-taxes/index.html>>; See, eg, Elizabeth Warren, ‘New Report from Senator Warren: Tax Dodgers: How Billionaire Corporations Avoid Paying Taxes and How to Fix It’ (Press Releases, 18 NOVEMBER 2021) < <https://www.warren.senate.gov/newsroom/press-releases/new-report-from-senator-warren-tax-dodgers-how-billionaire-corporations-avoid-paying-taxes-and-how-to-fix-it>>.

² OECD, ‘Consolidated Application Note: Guidance in Applying the 1998 Report to Preferential Tax Regimes’ (Report, 2004) [319] (*‘OECD Consolidated Application Note’*) < www.oecd.org/ctp/harmful/30901132.pdf>; OECD, ‘Harmful Tax Competition: An Emerging Global Issue’ (Report, 1998) [95]-[96] (*‘OECD 1998 Report’*) < <http://dx.doi.org/10.1787/9789264162945-en>>; See generally OECD, ‘Progress in Identifying and Eliminating Harmful Tax Practices’ (Report, 2000) 24 (*‘2000 Report’*); Terence Dwyer, ‘Taxation: The Lost History’ (2014) 73(4) *The American Journal of Economics and Sociology* 664, 671; Clinton Alley and Duncan Bentley, ‘A Remodelling of Adam Smith’s Tax Design Principles’ [2005] *ePublications@bond* 579, 590 <http://epublications.bond.edu.au/law_pubs/45>; Vito Tanzi and Howell H Zee, ‘Tax Policy for Emerging Markets: Developing Countries’ (2000) 53(2) *National Tax Journal* 299, 300; Roy W Bahl and Richard M Bird, ‘Tax Policy in Developing Countries: Looking Back and Forward’ (2008) 61(2) *National Tax Journal* 279, 284-9; Michael A Livingston, ‘From Mumbai To Shanghai, with a Side Trip to Washington: China, India, and the Future of Progressive Taxation in an Asian-Led World’ (2010) 11(2) *Theoretical Inquiries in Law* 539, 543; Subhajit Basu, *Global Perspectives on E-Commerce Taxation Law* (Ashgate, 2007) 139; Miranda Stewart et al, ‘A stocktake of the tax system and directions for reform: five years after the Henry Review’ (Tax and Transfer Policy Institute Report, Australian National University, February 2015) 151 - 154.

³ *OECD Consolidated Application Note*, above n 2, [319].

⁴*Ibid.*

the subject matter is inherently complex as it has an interdisciplinary nature, demonstrates international and domestic law dimensions and entails competing State interests – among other factors.⁵

Further, the shipping industry overall comprises many different role-players.⁶ Entities in a maritime cluster might carry on different business activities like ship navigation and crewing, marine insurance, damage adjustment, brokerage, shipbuilding, and the commercial employment of vessels.⁷ Therefore, a relevant secondary enquiry is to identify the particular role-players and business activities in the particular industry that should be eligible for special tax treatment if and where, one is warranted. A related enquiry should assess whether shipping income as a construct corresponds with the particular income-producing activities deserving of concessional tax treatment.

It will be demonstrated that the main role-players primarily requiring special tax treatment are shipowning and operating entities deriving shipping income as somewhat re-defined by the thesis.⁸ Their core business activities are generally executed to a significant degree on the high seas offering both risks and rewards.⁹ One such reward inherent to the international business

⁵ ICS and WSC, ‘Treatment of Shipping in the UN Model Double Taxation Convention Between Developed and Developing Countries’ (Communication to the United Nations Committee of Experts on International Cooperation in Tax Matters, 2012) 4-7 <<https://www.ics-shipping.org/wp-content/uploads/2021/02/2013-01-ICS-and-WSC-Submission-on-Treatment-of-Shipping-in-the-UN-Model-Double-Taxation-Convention-Between-Developed-and-Develo.pdf>>; *Commission communication C(2004) 43 — Community guidelines on State aid to maritime transport* [2004] OJ C 13/3, C13/3 - C13/5 (‘EU Framework’) <[http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0117\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0117(01)&from=EN)>.

⁶ ICS and WSC, above n 5, 4-7; *EU Framework* OJ C 13, 6- 7; Alan E Branch and Michael Robarts, *Branch’s Elements of Shipping* (Routledge, 9th ed, 2014) 290-291; Ira Breskin, *The Business of Shipping* (Cornell Maritime Press, 9th ed, 2018) 237.

⁷ *State aid SA.33828 (2012/E, 2011/CP) – Tonnage tax scheme and other tax relieves provided in Law No 27 of 19 April 1975 as amended* [18 Dec 2015] C(2015) 9019 final, 27, 37, 40 (‘EU/Greece Communication’) <https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_33828>.

⁸Ibid 40-1.

⁹ *EU Framework* OJ C 13, 3- 7; *Communication from the Commission providing guidance on State aid to ship management companies* [2009] OJ C 132/6, 6 - 7 (‘EU Ship Management Communication’) <<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:132:0006:0009:EN:PDF>>; Branch and Robarts, above n 6, 459-60.

of carrying goods and passengers by sea is operating more easily around the constraints imposed by States like territorial borders and domestic laws.¹⁰ Thus, the thesis will argue that one of the inherent attributes supporting a special tax treatment is the capacity of the relevant tax base to exhibit exceptional mobility.¹¹ However, the unique mobility is not necessarily produced from only one factor. The thesis will demonstrate that the mobility of the tax base generally stems from several factors, including structuring shipping activities in different ways to realise legitimate commercial objectives.

Thus, any attempt to approach the topic using an overly simplistic and one-dimensional approach will be fraught with artificiality and have little utility for practice. Therefore, the thesis will adopt a more holistic method, albeit within the constraints of the current project, by considering the subject matter more broadly and from an interdisciplinary perspective in establishing and evaluating the significant considerations underlying the taxation of shipping income.

The primary objectives of the thesis are two-fold. Firstly, to develop a *Model Analytical Framework* that will better inform the design of an optimal shipping tax regime. Secondly, to identify and develop further, where appropriate, the optimum shipping tax regime. Accordingly, the current project may be formulated into the following research question:

1.2 Research Question

What statutory formula should be utilised by States in their legal framework to tax the shipping income of shipowning and ship operating entities at the domestic level that, firstly evidences

¹⁰ *EU Framework* OJ C 13, 3- 5; Branch and Robarts, above n 6, 293.

¹¹ *Ibid.*

the best alignment with the criteria of a good tax system in the twenty-first century, and that secondly, overcomes the unique obstacles associated with taxing such entities?

The thesis in undertaking the prosecution of the research question will separate the analysis into three main divisions:

1.2.1 Division I: Constructing the *Model Analytical Framework*

In the first division, as contained in chapters two and three, the thesis will critically consider and develop further, where relevant, two analytical frameworks. The two frameworks will constitute the two core components of the *Model Analytical Framework* ('MAF').¹² MAF will be employed by the thesis together with any other significant considerations to design an optimal shipping tax regime. As a caveat, it should be noted that chapter two is intended to constitute *only a limited study* as it is primarily utilised by the thesis to establish a hypothesis. This hypothesis forms an integral component of MAF.

Chapter two will critically identify, assess and develop further, where appropriate, the criteria of a good tax system ('*the Smithian Framework*'). Whilst chapter three will examine the application of the 1998 OECD Framework assessing harmful tax practices and preferential regimes, as updated by BEPS 5 ('Action 5') of the OECD/G20 BEPS Project ('the Updated 1998 Framework').¹³

¹² Alley and Bentley, above n 2, 586; OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Addressing the Tax Challenges of the Digital Economy, ACTION 1' (Final Report, 2015) 20-1 ('*OECD BEPS Action 1*') <<http://dx.doi.org/10.1787/9789264241046-en>>; OECD Consolidated Application Note, above n 2, 78 [284]; OECD 1998 Report, above n 2, 26-35.

¹³ OECD Consolidated Application Note, above n 2, 78 [284]; OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5' (Final Report, 2015) 19-23 ('*OECD BEPS Action 5*') <<http://dx.doi.org/10.1787/9789264241190-en>>.

Division one addresses the following specific objectives:

- **To identify, critically consider, and develop further, where appropriate, the criteria of a good tax system as broadly endorsed by the G20 States in the 21st century**

The modern criteria of a good tax system originate from the 1776 publication of Adam Smith entitled *The Wealth of Nations*.¹⁴ However, the *Smithian Framework* as a construct does not exhibit an immutable set of factors.¹⁵ The *Smithian Framework* has demonstrated a degree of variance over time in its different versions. This disparity and flexibility in its form is not necessarily a flaw as it offers tax design projects both advantages and disadvantages.¹⁶ Thus, through the contributions of later works, the criteria of the *Smithian Framework* have, in varying degrees, changed by adaptation, addition, and possibly even misattribution.¹⁷

To begin with, chapter two will undertake the analysis of the *Smithian Framework* at a more general level. Additionally, the thesis will consider certain features that may naturally be incorporated into the *Smithian Framework* for better supporting the design of an optimum shipping tax regime. In so doing, the thesis will examine the *Smithian Framework's* primary attributes as it is vital for establishing a *Model Analytical Framework* with components that function harmoniously.

In chapter two, the first approach will involve identifying the criteria of the *Smithian Framework* that are, in substance, common to both the original version and selected subsequent

¹⁴ Edwin Cannan (ed), *An Inquiry into the Nature and Causes of the Wealth of Nations by Adam Smith* (Methuen, vol II, 3rd ed, 1922) 310; Alley and Bentley, above n 2, 586.

¹⁵ Alley and Bentley, above n 2, 582.

¹⁶ Ibid.

¹⁷ Ibid 586-7; James Mirrlees et al, *Tax By Design* (Oxford University Press, 2011) 22 ('*The Mirrlees Review*') <<https://www.ifs.org.uk/publications/5353>>; Clifford W Cobb, 'Editor's Introduction & Chapter-by-Chapter Summary and Commentary' (2014) 73(4) *The American Journal of Economics and Sociology* 627, 631-2.

versions applied in specific tax design projects of selected G20 States. The main aim of the enquiry is to identify a version of the *Smithian Framework* that is likely to garner the broad support of the G20 States.

For approach one, the analysis will generally be structured as follows:

- a) The original version of the *Smithian Framework* will briefly be considered.
- b) Benchmarks will then be constructed for the criteria of the *Smithian Framework* that are considered by the general literature as the common criteria across its different versions.
- c) The benchmarks will thereafter be assessed against the more recent versions of the *Smithian Framework* as applied in selected G20 States. The said versions of the following G20 States will be considered in varying degrees: Australia, Canada, China, India, Japan, South Africa, the United Kingdom, and the United States of America. The method for selecting the G20 States was somewhat random and is detailed more explicitly in chapter two.
- d) The criteria demonstrated to be substantively common across the different versions of the *Smithian Framework*, as applied in the selected G20 States, will be treated here as the general criteria of a good tax system as broadly endorsed by the G20 States in the 21st century.
- e) As a secondary enquiry, the thesis will consider whether other criteria should be treated as common criteria of the *Smithian Framework* as broadly endorsed by the G20 States in the 21st century.

The thesis will utilise a second approach to validate and confirm the results of approach one by briefly considering a recent version of the *Smithian Framework* employed by a relevant international organisation.

- a) Here consideration will be given to the version of the *Smithian Framework* employed under *Action One of the OECD/G20 Base Erosion and Profit Shifting Project* ('*BEPS 1*').¹⁸ The OECD/G20 *BEPS* Project is, on the whole, especially relevant to the enquiry as it expressly references the direct participation of the G20 States.¹⁹ Therefore, the *BEPS 1* version of the *Smithian Framework* may legitimately be treated as broadly endorsed by the G20 States in the 21st century.²⁰ It may be applied as a reasonable measure for verifying the results produced under approach one.

Further, the relevance of the *BEPS 1* version of the *Smithian Framework* may also be sourced in its subject matter as it evaluates taxes for digital activities.²¹ Digital activities are ostensibly similar to shipping activities as both tax bases may demonstrate mobility.²² However, their mobility is not necessarily the same.²³ Thus, their comparability as mobile tax bases will be explored briefly in chapter five.²⁴ Nonetheless, any overlap in their mobility further supports the relevance of the *BEPS 1* version.

¹⁸ *OECD BEPS Action 1*, above n 12, 20-1.

¹⁹ *OECD BEPS Action 1*, above n 12, 17-18; OECD, *What is BEPS?* (2019) BEPS <<https://www.oecd.org/tax/beps/about/#history>>; *OECD BEPS Action 5*, above n 13, 3, 61. 'With the adoption of the BEPS Action Plan (OECD, 2013), G20 countries joined the OECD countries on an equal footing in the FHTP work'. : at 61.

²⁰ *Ibid.*

²¹ *OECD BEPS Action 1*, above n 12, 11, 19-22; 64.

²² *Ibid.*

²³ Department of the Environment, Transport and the Regions, UK Government, 'British shipping: Charting a new course' (DETR Paper, 1998) 16 ('*1998 DETR Report*'); *OECD BEPS Action 1*, above n 12, 11, 64.

²⁴ *Ibid.*

- **To critically evaluate the 1998 Framework as updated by BEPS 5 (*'The Updated 1998 Framework'*)**

The primary contribution of Action Five of the OECD/G20 Base Erosion and Profit Shifting Project (*'BEPS 5'*) to the *1998 Framework* is enhancing the substantial activity and transparency factors/criteria.²⁵ The *1998 Framework* is especially relevant to constructing a *Model Analytical Framework ('MAF')* as it is specifically intended to examine shipping tax regimes.²⁶

The *1998 Framework* considers the distorting consequences of harmful tax competition arising between States.²⁷ The harmful tax competition forming its focus is from preferential tax regimes enacted in sponsoring States applying to geographically mobile activities.²⁸ The OECD has determined that particular activities of shipowners and ship operators constitute relevant geographically mobile activities.²⁹ Thus, shipping tax regimes are generally included within the *1998 Framework's* scope.³⁰

In chapter three, the analysis will be structured as follows:

- a) The thesis will rank the criteria of the *Smithian Framework* (as settled in chapter two) in an order of priorities that firstly supports the design of an optimum shipping tax regime, and secondly, complements the *Updated 1998 Framework*. As developed, ranked, and applied in *MAF*, this particular version of the *Smithian Framework* will be referred to as the *Updated Smithian Framework ('USF')*.

²⁵ *OECD BEPS Action 5*, above n 13, 19-23; *OECD 1998 Report*, above n 2, 26-35.

²⁶ *OECD Consolidated Application Note*, above n 2, 86. 'Application of factors in the 1998 Report to shipping regimes.'

²⁷ *OECD BEPS Action 5*, above n 13, 11-2; *OECD Consolidated Application Note*, above n 2, [316].

²⁸ *Ibid.*

²⁹ *OECD Consolidated Application Note*, above n 2, [316].

³⁰ *Ibid* 86.

- b) The thesis will, in varying degrees, critically evaluate specific factors/criteria of the *Updated 1998 Framework* that may better support the design of an optimum shipping tax regime and, where appropriate, make recommendations.
 - c) The *EU Framework* that the EU applies to assess member States' shipping tax regimes will further be employed as a comparative tool, including briefly re-assessing shipping income.³¹ The comparative analysis is intended to identify weaknesses in specific constructs applied in the design of shipping tax regimes.
- **To construct a *Model Analytical Framework* ('MAF') that assesses shipping tax regimes more comprehensively and better supports the design of an optimum shipping tax regime**

The *Updated Smithian Framework* ('USF') and the *Updated 1998 Framework* will jointly operate as the two main components of the *Model Analytical Framework* ('MAF'). The thesis's core aim is to construct a *Model Analytical Framework* to support the design of an optimal shipping tax regime.

A crucial part of *MAF*'s construction is to establish how the individual frameworks are applied, can be applied, and should be applied at the theoretical level and in practice. These preliminary assessments may facilitate the identification of key benefits that may be carried forward and preserved or deficiencies that may, where necessary, be remedied, in designing an optimal shipping tax regime.

³¹ *EU Framework* OJ C 13, 3- 5.

The thesis will utilise the *Updated 1998 Framework* as *MAF*'s dominant Framework. Thus, the *Updated Smithian Framework* should yield to the *Updated 1998 Framework* where a significant conflict arises. The significance of the *Updated 1998 Framework* is that non-compliance with its primary factors may result in enacting shipping tax regimes domestically that are illegitimate internationally.³² Accordingly, the *Updated 1998 Framework* operates somewhat like a set of minimum standards that should be complied with in designing an optimum shipping tax regime.³³

The main objective of *MAF* is to guide and instruct the design of an optimum shipping tax regime for a sponsoring State. The thesis will demonstrate that the *Updated Smithian Framework* provides a crucial contribution to *MAF* in this regard, albeit within the parameters of the *Updated 1998 Framework*.

1.2.2 Division II: Sea Power as a Critical Policy Objective

The work in chapter four is fundamental to further justify the legitimacy of the *USF*'s construction, as developed in chapter two and prioritised in chapter three.³⁴ The thesis will demonstrate that sea power is an additional and critical underlying factor that justifies the adoption of a special regime for taxing the shipping income of shipowning and ship operating entities.

³² *OECD BEPS Action 5*, above n 13,3, 21; OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Harmful Tax Practices - 2018 Progress Report on Preferential Regimes, Inclusive Framework on BEPS, Action 5' (Progress Report, 2019) 3, 13, 15 ('*2018 OECD Progress Report*') <<https://doi.org/10.1787/9789264311480-en>>; *OECD 1998 Report*, above n 2, [95]-[96]; See generally *2000 Report*, above n 2, 24.

³³ *Ibid.*

³⁴ Cobb, above n 17, 648; Dwyer, above n 2, 764-9; K W Asprey and Ross Waite Parsons, 'Full Report January 31 1975' (Australian Commonwealth Taxation Review Committee, 31 January 1975) [3.25], [3.26] ('*Asprey Review*'); *The Mirrlees Review*, above n 17, 32.

In 1999, Lord Alexander of Weedon, briefed by the British government, opined that sea power is one of the more compelling grounds for adopting a unique design for a shipping tax regime.³⁵

Alfred Thayer Mahan was a prominent academic and senior officer in the US Navy who made a significant contribution to the study of sea power through his treatise entitled *Influence of Sea Power Upon History: 1660-1783*.³⁶ Mahan's particular conception of sea power is noteworthy as it influenced the policy of former US administrations.³⁷

Accordingly, chapter four will examine sea power as a critical policy objective for designing a shipping tax regime. The chapter will demonstrate that sea power should be assessed through a registered and active merchant fleet and a naval fleet. The chapter will, chronologically, consider the history of the British and American ('USA') merchant fleets in investigating the legitimacy of promoting sea power in a shipping tax regime. Firstly, the relevance of the American and British merchant fleets includes their rankings at different periods in recent history as the largest active merchant fleets globally.³⁸ Thus their significant size makes them both reasonable case studies to determine the general conditions that support the development of a robust merchant fleet. Secondly, Britain and the US demonstrated the most significant sea power in recent history as they respectively enjoyed at different periods both the largest

³⁵ Lord Robert Scott Alexander, 'Independent Enquiry into a Tonnage Tax' (A report by Lord Alexander of Weedon QC, H M Treasury, 1999) 16 [49] – [50]; See generally Michael Asteris, 'Merchant shipping: The fourth arm of Defence?' (1993) 138(2) *The RUSI Journal* 66, 70-71.

³⁶ Christopher J McMahon, 'The U.S. Merchant Marine: Back to the Future?' (2016) 69(1) *Naval War College Review* 87, 91.

³⁷ Paul Westermeyer, 'A Brief Introduction to the History of Maritime Strategy' in Paul Westermeyer (ed), *The Legacy of American Naval Power: Reinvigorating Maritime Strategic Thought - An Anthology* (USMC, 2019) 3, 12.

³⁸ Louise Butcher, 'Shipping: UK policy' (Standard Note: SN/BT/595; House of Commons Library; 23 February 2010) 2-4; Paul Westermeyer, 'The Ascendance of American Maritime Power: A Historical Perspective Culminating at Guadalcanal' in Paul Westermeyer (ed), *The Legacy of American Naval Power: Reinvigorating Maritime Strategic Thought - An Anthology* (USMC, 2019) 17, 19; McMahon, above n 36, 92-4; Asteris, above n 35, 67; See generally BBC History, *WW2 People's War: Timeline 1939 – 1945, Fact File: Merchant Navy* (15 October 2014) < <https://www.bbc.co.uk/history/ww2peopleswar/timeline/factfiles/nonflash/a6652091.shtml>>; Imperial War Museums, *A Short History Of The Merchant Navy* < <https://www.iwm.org.uk/history/a-short-history-of-the-merchant-navy>>: 'Britain's merchant fleet was the largest in the world during both world wars.'

merchant and naval fleets globally.³⁹ The chapter will submit that market forces should not be allowed to determine the fate of a State's merchant fleet as it is an essential factor of its sea power.⁴⁰

Chapter four will briefly consider specific legislative programmes of past British and American administrations enacted to support and protect their respective merchant fleets. In so doing, the chapter will demonstrate that a robust registered merchant fleet requires an appropriate level of consistent or stable State support.⁴¹ The chapter will demonstrate that State support may take various forms, including applying a cabotage regime to specific sea routes, employing various State subsidies and offering tax concessions.⁴² The chapter will demonstrate that one of the leading factors contributing to the decline of a State's registered and active merchant fleet is high costs, including relatively high taxes and crewing costs.⁴³ Chapter four will ultimately establish that an optimal shipping tax regime has a vital role in facilitating a robust merchant fleet and, in so doing, promoting a State's sea power.

Chapter four will also briefly consider the rise of open registers. Open registers have generally outperformed their more-traditional counterparts, such as the American and British ship registers.⁴⁴ In particular, the chapter will briefly consider the two open registers that have ranked as the largest two-ship registers in the first two decades of the 21st century.⁴⁵

³⁹ Ibid; George W Baer, 'U.S. Naval Strategy 1890-1945' (1991) 44(1) *Naval War College Review* 6, 8.

⁴⁰ See especially Asteris, above n 35, 67, 70-1; See especially Dwyer, above n 2, 764 [3.6].

⁴¹ Asteris, above n 35, 70-1; McMahon, above n 36, 97, 106.

⁴² Ibid.

⁴³ Stelios Panagiotou and Helen Thanopoulou, 'Tonnage Tax revisited: The case of Greece during a shipping crisis and an economic crisis period' (Working Paper, July 2019, Bank of Greece) 6-7; Alexander, above n 35, 3 [vi], 7 [8]; See also *The Mirrlees Review*, above n 17, 44-5.

⁴⁴ See Table C; Alexander, above n 35, 8 [12]; McMahon, above n 36, 97.

⁴⁵ See Table C; Francisco Piniella, Juan Ignacio Alcaide and Emilio Rodríguez-Díaz, 'The Panama Ship Registry: 1917-2017' (2017) 77 *Marine Policy* 13, 13 - 5.

Like previous works, ship registers will be ranked by considering their registered and active merchant deadweight tonnage as a percentage of the corresponding global tonnage.⁴⁶ Previous works have favoured the measure as a more meaningful indicator of a State's sea power as expressed through merchant tonnage.⁴⁷

The thesis will demonstrate that the viability of a State's registered and active merchant fleet may depend on multiple factors. Therefore, the thesis will submit that State support should be broadly conceptualised to manage the different factors effectively, requiring intervention.⁴⁸ However, by conceptualising State support broadly, an optimal shipping tax regime should be designed to complement the other measures optimally.⁴⁹

The thesis will treat States as entities that essentially compete internationally. The treatment is based on the observation that, despite increasing levels of globalisation, international State collaboration, nonetheless, demonstrates a tendency to significantly break down under particular global conditions, including emergencies and significant conflict.⁵⁰ Thus, to the extent that States operate in a competitive environment, sea power will remain a critical concern for securing a State's national security.⁵¹ Further, interstate competitiveness will be established as an additional factor that may support the exceptional mobility of a merchant fleet.

⁴⁶ See especially Asteris, above n 35, 66-7, 70; See especially McMahon, above n 36, 104.

⁴⁷ Ibid.

⁴⁸ See, eg, McMahon, above n 36, 97.

⁴⁹ Ibid.

⁵⁰ See, eg, McMahon, above n 36, 91, 101 -2, 104; See, eg, Amy Gunia, 'How Coronavirus Is Exposing the World's Fragile Food Supply Chain – and Could Leave Millions Hungry' *Time Magazine* (New York) 8 May 2020 <<https://time.com/5820381/coronavirus-food-shortages-hunger/>>; See, eg, Matina Stevis-Gridneff and Monika Pronczuk, 'E.U. Vaccine Shortages Snowball Into a Crisis' *The New York Times* (New York) 27 January 2021 <<https://www.nytimes.com/live/2021/01/27/world/covid-19-coronavirus>>.

⁵¹ Ibid.

Chapter four will ultimately establish that the normal income tax regimes of the 20th century and the tonnage tax regimes at the beginning of the 21st century have not adequately promoted American and British sea power. Accordingly, the thesis will identify and develop an optimal shipping tax regime in part two of chapter five. Such a regime is one that is more likely to support the rejuvenation and expansion of a registered and active merchant fleet as a critical factor of sea power.⁵²

1.2.3 Division III: Formulating an Optimum Shipping Tax Regime

As contained largely in chapter five, the third division of the thesis is, broadly, divided into two main parts. In addition, chapters six and seven constitute two further auxiliary parts.

1.2.3.1 Chapter Five's Part One: General Considerations

Part one addresses the following specific objectives:

- **To enhance the *USF*'s application further, where appropriate, for optimally managing the tax base's exceptional mobility and better-promoting sea power**

The thesis primarily submits here that the *USF* should be applied to realise a super efficiency, where appropriate, in designing and applying an optimum shipping tax regime.⁵³

- **To resolve weaknesses in taxing shipping income by adopting a holistic approach**

The thesis adopts a systemic approach by treating shipping tax regimes as merely one component of a more extensive system.⁵⁴ Thus, the thesis adopts a holistic approach in

⁵² See especially Asteris, above n 35, 71; See especially McMahon, above n 36, 106.

⁵³ See especially Dwyer, above n 2, 764; *Asprey Review*, above n 34, [3.25] - [3.26]; *The Mirrlees Review*, above n 17, 32.

⁵⁴ *The Mirrlees Review*, above n 17, 2, 28, 35.

evaluating the design of a shipping tax regime by considering the broader system for optimally addressing weaknesses in raising taxes on shipping income.⁵⁵

In particular, the thesis considers the critical interaction between the juridical connecting factors, as one regime in the broader system, and a shipping tax regime as the other. The fine-tuning of the juridical connecting factors are critically considered and advanced as a preferred option for resolving substance-over-form concerns in taxing shipping income.

The preliminary solutions recommended for realising substance, more optimally, in shipping taxation may also instruct the development of the substantial activity criterion, as applied by the Updated 1998 Framework.⁵⁶

- **To design a shipping tax regime as a component of a broader State support programme**

The thesis demonstrates that State support for the relevant role-players can materialise in various ways.⁵⁷ Generally, the primary objective of State support is to ensure that a local ship operator (and the like) can operate as a sustainable business despite aggressive foreign competition and an exceptionally mobile tax base.⁵⁸ The thesis will submit that the other components of a broader state support programme may also be necessary to adequately support a registered and active merchant fleet. Therefore, an optimal shipping tax regime should be conceptualised as one that functions compatibly with any other components.⁵⁹

⁵⁵ Ibid 35 [2.2.1]; Neville Mitchell et al, 'Review Of Corporate Tax Residency' (A Report to the Treasurer, Board of Taxation, July 2020) 9, 19, 34 (*The Mitchell Review*) <<https://taxboard.gov.au/consultation/corporate-tax-residency-review>>.

⁵⁶ *The Mitchell Review*, above n 55, 19, 42.

⁵⁷ Asteris, above n 35, 70-1; McMahon, above n 36, 97, 106.

⁵⁸ Clarence G Morse, 'A study of American Merchant Marine Legislation' (1960) 25(1) *Law and Contemporary Problems* 57, 63. <<https://scholarship.law.duke.edu/lcp/vol25/iss1/5/>>

⁵⁹ See, eg, McMahon, above n 36, 97: 'tale of two fleets'.

- **To briefly compare digital services as a tax base with maritime transport activities**

The thesis will briefly consider specific features of the two industries for distinguishing them from each other. The thesis will ultimately submit that maritime transport activities exhibit much higher mobility as a tax base – among other considerations. In so doing, the thesis will caution against simply applying fiscal solutions to the shipping context devised for other mobile industries, like digital services, as they will not necessarily be relevant nor appropriate for designing an optimum shipping tax regime.

1.2.3.2 Chapter Five’s Part Two: Identifying an Optimum Regime

Part two addresses the following specific objectives:

- **To evaluate the different types of shipping tax regimes against the *MAF***

The tax literature categorises modern shipping tax regimes into the following four broad categories: (1) tonnage tax regimes;⁶⁰ (2) exemption regimes;⁶¹ (3) lifting tax or freight regimes;⁶² and (4) normal corporate tax regimes with or without special tax concessions.⁶³ In part two of chapter five, the thesis will critically evaluate the first three types of shipping tax

⁶⁰HM Revenue & Customs, *Tonnage Tax Manual*, 19 July 2016 <<https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual>>; Janne Juusela, ‘Tonnage Tax Reform’, *International Tax Review* (online), 1 December 2009; ITR Correspondent, ‘Irish Tax Regime for Shipping Operations’, *International Tax Review* (online), 20 March 2015.

⁶¹Les Nielson and Michele Brennan, *Shipping Reform (Tax Incentives) Bill 2012 [and] Tax Laws Amendment (Shipping Reform) Bill 2012*, No 146 of 2011–12, 7 June 2012, 12; Ian Farmer, ‘Australia: Tax Reform to Shipping Industry’, *International Tax Review* (online), 1 April 2012; National Treasury of South Africa, *Explanatory Memorandum on the Taxation Laws Amendment Bill 2013*, 24 October 2013 [5.6].

⁶² LexisNexis, *Silke on South African Income Tax* (at SI 68, March 2021) [6.38] (‘*Silke*’); Australian Taxation Office, *Income Tax: The Scope of and Nature of Payments Falling within Section 129 of the Income Tax Assessment Act 1936*, TR2006/1, 8 March 2006.

⁶³ See generally Alexander, above n 35, 10 [21].

regimes.⁶⁴ An optimal shipping tax regime must vigorously promote efficiency and simplicity as instructed by the *USF*. However, since the fourth regime generally tends to produce poorer outcomes for promoting efficiency and simplicity, it is not considered in detail in chapter five.⁶⁵ In justifying its unsuitability, part two of chapter five will detail specific disadvantages with the fourth regime as assessed by previous research. However, the fourth regime is critically examined to some extent in chapter four during the historical analysis of the 20th century.

An optimal shipping tax regime should promote the sea power of a sponsoring State as a critical objective and be sensitive to the special mobility of the tax base.⁶⁶ Thus, the chapter five enquiry's primary objective is to identify a tax regime that will optimally protect the relevant tax base and support its further development within the constraints of the *Updated 1998 Framework*.⁶⁷ Since sea power is in part assessed by considering a State's merchant fleet, a State with a robust and expanding merchant fleet is more likely to demonstrate a more substantial sea power than one whose fleet is in perpetual decline - all other things being equal.⁶⁸

Thus, within the constraints of the present enquiry, chapter five assesses the first three types of shipping tax regimes against the most relevant criteria of *MAF*. In undertaking this objective, the thesis will consider the shipping tax regimes of the following selected States: Panama, Liberia, Greece, The United Kingdom, Australia and South Africa - including China very briefly. Both the Panamanian and Liberian regimes have been selected as their registered

⁶⁴ It may be argued that the exemption regime (somewhat like the Dutch Tonnage Tax Model) is technically part of the fourth regime. However, the thesis will treat it as a separate regime in structuring the paper.

⁶⁵ *Ibid* 10 [21], [23] – [24], 11 [26] – [27].

⁶⁶ *Ibid* 3 [vi], 7 [8], 8 [12], 16 [49] – [50]; Asteris, above n 35, 67, 70-1; McMahon, above n 36, 104, 106.

⁶⁷ Dwyer, above n 2, 748; *The Mirrlees Review*, above n 17, 22; Panagiotou and Thanopoulou, above n 43, 6-7.

⁶⁸ Alexander, above n 35, 16 [49] – [50]; Asteris, above n 35, 67, 70-1; McMahon, above n 36, 104, 106.

merchant fleets have been ranked recently as the largest merchant fleets globally.⁶⁹ The Greek regime has been selected as a relevant example of a Greek tonnage tax model. Its relevance may, to some degree, be associated with the success of the Greek ship register that has demonstrated a better resilience in maintaining tonnage.⁷⁰ The UK regime is also considered. It is an example of the Dutch tonnage tax model, and its significance is also tied to the previous ranking of the British fleet as the largest merchant fleet globally.⁷¹ Therefore, UK shipping policy is insightful for designing an optimum shipping tax regime. Further, the Australian and South African regimes are relevant as examples of exemption and freight or lifting tax regimes.⁷²

- **To briefly consider the State practice of utilising more than one shipping tax regime at the domestic level**

Ring-fencing issues as assessed by the *Updated 1998 Framework* will very briefly be considered under this heading.⁷³

- **To propose a model that may be utilised as an optimum shipping tax regime**

The thesis will identify and develop a model shipping tax regime that is essentially a hybrid. It will incorporate complementary features of the Panamanian and Greek tonnage tax regimes. The thesis will submit that such a hybrid regime is more likely to optimise efficiency and simplicity, as instructed by the *USF*. Thus, the model regime should better

⁶⁹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13 – 5.

⁷⁰ Peter Marlow and Kyriaki Mitroussi ‘EU Shipping Taxation: The Comparative Position of Greek Shipping’ (2008) 10 *Maritime Economics & Logistics* 185, 195; See Table C.

⁷¹ Marlow and Mitroussi, above n 70, 195, 200; Butcher, above n 38, 2-4; Asteris, above n 35, 67; McMahon, above n 36, 92 -3; See generally Imperial War Museums, above n 38.

⁷² Nielson and Brennan, above n 61, 12; National Treasury of South Africa, above n 61, [5.6]; *Silke*, above n 62, [6.38], [6.56]; Micah Burch, ‘Australia’ in Guglielmo Maisto (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 216.

⁷³ See generally *OECD 1998 Report*, above n 2, 26 [62].

manage the exceptional mobility innate to maritime transport activities and better promote the sea power of a sponsoring State, as expressed through its registered merchant tonnage.

1.2.3.3 The OECD's Proposed Two Pillar Solution

The third division of the thesis also includes two auxiliary parts in the form of chapter six and chapter seven.

Chapter six briefly considers the OECD's *proposed* two pillar solution. In particular, chapter six is specifically concerned with the potential impact that this framework may have on a model shipping tax regime, as recommended by the thesis. However, as a caveat, it should be noted that, as at the time of writing this thesis, this proposed framework is, to some significant extent, still a work in progress. In considering this additional framework, the thesis further explores the basic corporate and business structures that are utilised in the shipping industry.

Chapter seven provides a further summary of the conclusions of the thesis. It also contains the contributions to knowledge and suggests areas of potential research.

1.3 Underpinning Legal Framework and Research Methodology

The English Shipping law will be the law generally applied by the thesis to consider shipping contracts. It is selected due to its relevance and practical significance. It is commonly applied in practice as the preferred law of the contract, and a significant volume of shipping business

is transacted through London.⁷⁴ Further, English law may be classified as a better-developed shipping law than other legal systems.⁷⁵ Its advanced development may, in part, be attributed to the former size of the English merchant fleet. It was once ranked as the largest fleet globally for an extended period.⁷⁶ Thus, the significant size of its merchant fleet necessitated the development of a suitably advanced law to regulate it.⁷⁷

Further, the research for the thesis is performed utilising a somewhat hybrid research method. A doctrinal method is employed to the extent that the subject matter involves developing, analysing, and constructing the law.⁷⁸ The doctrinal method generally comprises of two overarching steps, namely (1) locating legal sources to identify the current ‘objective reality’⁷⁹ and (2) constructing and assessing the texts.⁸⁰ The first part of the method may be categorised as a quantitative process and the second part as a qualitative process.⁸¹

⁷⁴ See generally *EU/Greece Communication C(2015) 9019 final*, 37; For example, more than a fifth (21%) of international marine insurance premiums have at times been written through London, and around 40% of the global chartering market has similarly occurred in London. Similarly, the UK has in the era before Brexit at times accounted for around 9% of the world loan book in the sector and Lloyd’s Register of London has been ranked the second largest ship classification society in the world making up 18% of the world’s fleet: at 37; See also Julian Cooke et al, *Voyage Charters* (Informa, 4th ed, 2014) [1.27] - [1.49].

⁷⁵ Hilton Staniland, ‘The Implementation of the Admiralty Jurisdiction Regulation Act In South Africa’ [1985] *Lloyd’s Maritime & Commercial Law Quarterly* 462, 462 -3 [1]; See generally Hilton Staniland, ‘What is the law to be applied to a charterparty dispute?’ (1992) 109(3) *The South African Law Journal* 528, 531-4; Hilton Staniland, ‘Should Foreign Maritime Liens Be Recognised?’ (1991) 108 *South African Law Journal* 293, 298-9; John Hare, *Shipping Law & Admiralty Jurisdiction in South Africa* (Juta, 2nd ed, 2009) 730-734; But see Michael Wagener, ‘South African Admiralty and its English Origins-Will it Jump or Must it be Pushed?’ (2005) 36 *Journal of Maritime Law & Commerce* 61, 72.

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

⁷⁸ Terry Hutchinson and Nigel Duncan, ‘Defining and Describing What We Do: Doctrinal Legal Research’ (2012) 17 *Deakin Law Review* 84, 118.

⁷⁹ *Ibid* 110.

⁸⁰ *Ibid.*

⁸¹ *Ibid* 116.

The thesis will adopt a purposive approach to the construction of statutory law.⁸² A more comprehensive set of contextual factors may legitimately be consulted within a purposive approach, including the underlying historical factors and relevant policy objectives.⁸³

Further, the thesis utilises the historical research method to some degree for investigating the historical record, which includes:⁸⁴

- The objective writing of history incorporates the narration and the interpretation of the facts and the logical conclusions that may be drawn therefrom, based on historical facts that are carefully selected from source materials with varying degrees of credibility. An element of subjectivity is inherent to the research process as it includes the interpretation of the historical facts by an author that value judgements and other subjective factors may influence.
- The extent and quality of the source material are also essential in ascertaining an accurate depiction of the historical facts. Establishing the credibility of a source is a crucial component of the historical research method. Sources should ideally be credible, reliable and historic.
- The systematic arrangement of the raw material and the final construction thereof constitute the final two parts of the historical method involving synthetic operations and the corresponding exposition thereof.

The thesis further utilises an economics research method to some degree in constructing and applying *MAF*, which may include in varying degrees critically evaluating economic

⁸² Christo Botha, *Statutory Interpretation: An Introduction for Students* (Juta, 5th reprinted edition, 2013) 97 – 109; CCH, *Australian Master Tax Guide Tax Year-End* (65th ed, 2019) [1.350] (*‘Master Tax Guide 2019’*); R L Deutsch et al, *The Australian Tax Handbook* (Thomson Reuters, 2018) [1-250]; *Silke*, above n 62, [2.1]; See generally G E Devenish, *Interpretation of Statutes* (Juta, 1st ed, 1992) 25 - 55.

⁸³ *Ibid.*

⁸⁴ K N Chitnis, *Research Methodology in History* (Atlantic, 1990) 1-3.

theory that underpins relevant policy, data handling, estimation, inference, and interpretation.⁸⁵

⁸⁵ See generally Mark Blaug, *The Methodology of Economics: Or how economists explain* (Cambridge, 2nd ed, 1992) xii-xxviii; See generally Darren Grant, *Methods of Economic Research: Craftsmanship and Credibility in Applied Microeconomics* (Springer, 2018) 1-7; Dinesh S Hegde (ed), *Essays on Research Methodology* (Springer, 2015) 1-24.

Chapter 2: Constructing the *Updated Smithian Framework* ('USF')

Chapter two will identify, critically assess and define the criteria of a good tax system at the general level that is broadly accepted by the G20 States in the 21st century (from now on referred to in this chapter as the “*Smithian Framework*”). As constructed here, the criteria of the *Smithian Framework* will be prioritised in chapter three. The thesis will employ the *Updated Smithian Framework*, as constructed and prioritised, to complement the other mandatory criteria of the *Updated 1998 Framework* for constructing a *Model Analytical Framework*.⁸⁶ The thesis will ultimately use the *Model Analytical Framework* for designing an optimal shipping tax regime. The construction of a *Model Analytical Framework* is an integral and significant part of the work of this thesis. The first part of this chapter is orientated at setting out a broad overview of the *Smithian Framework* to establish a conceptual basis for anchoring the subsequent analysis.

2.1 Introduction

2.1.1 The Smithian Framework’s Nature

It is generally accepted that the Smithian Framework, as it exists in its prototypical form, was first proposed in the celebrated work of Adam Smith entitled *The Wealth of Nations*.⁸⁷ However, previous research suggests that a good tax system as an idea predates Adam Smith and may be traced back earlier to Confucius.⁸⁸

In considering the Smithian Framework, difficulties may be experienced with a lack of uniform terminology.⁸⁹ Inconsistencies with terminology may be identified when comparing the

⁸⁶ *OECD BEPS Action 5*, above n 13, 19-23.

⁸⁷ Cannan, above n 14, 310; Najeeb Memon, ‘Prioritizing Principles of a Good Tax System for Small Businesses in Informal Economies’ (2010) 25 *Australia Tax Forum* 57, 67; Hanneke Du Preez, *A Construction of the Fundamental Principles of Taxation* (PhD Thesis, University of Pretoria, 2015) 4-5, 211.

⁸⁸ Du Preez, above n 87, 3, 52.

⁸⁹ Alley and Bentley, above n 2, 582-3, 586; See also Cannan, above n 14, 310; John McLaren (ed), *Advanced Taxation Law: Cases Commentary and Questions* (Thomson Reuters, 2015) [1.15]; *The Mirrlees Review*, above

criteria of different versions.⁹⁰ Different versions demonstrate different criteria.⁹¹ And even where the criteria of different versions exhibit the same form, they are not necessarily the same in substance.⁹² It, therefore, becomes essential to have clear and consistent terminology for facilitating the identification of substantial differences in the criteria of the different versions.⁹³

The Smithian Framework's criteria have also been conceptualised as principles of policy in contrast to legal principles.⁹⁴ Previous works have referred to the criteria by different denominations, including aims,⁹⁵ canons,⁹⁶ checklist of desirable properties,⁹⁷ principles,⁹⁸ criteria,⁹⁹ characteristics,¹⁰⁰ goals,¹⁰¹ maxims,¹⁰² constraints,¹⁰³ values,¹⁰⁴ objectives, and outcomes.¹⁰⁵

In particular, one approach, the Alley and Bentley paradigm, conceptualises the criteria of the *Smithian Framework* as the values of a tax system.¹⁰⁶ Thus, the criteria as values operate as

n 17, 22; Dennis Davis et al, 'Macro Analysis of the Tax System and Inclusive Growth in South Africa: An Analytical Framework for the Davis Tax Committee' (Final Report, The Davis Tax Committee, 2016) 14, 82 ('*Davis Final Report*') < <https://www.taxcom.org.za/library.html> >; Canada, Royal Commission on Taxation, *The Use of the Tax System to Achieve Economic and Social Objectives* (1966) vol 2, 4 ('*Carter Report*'); Ken Henry et al, 'Australia's Future Tax System: Report to the Treasurer, December 2009' (Consolidated Final Report, Commonwealth of Australia, 2010) 17 ('*The Henry Review*') < www.taxreview.treasury.gov.au >.

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² *Henry Review*, above n 89, 17; Donald J Rousslang, 'Principles of Sound Tax Policy for Hawaii' (Report Prepared for the 2015-2017 Hawaii Tax Review Commission, 28 December 2017) 6, 8-9.

⁹³ Alley and Bentley, above n 2, 586-8; Memon, above n 87, 67.

⁹⁴ Alley and Bentley, above n 2, 586.

⁹⁵ *Asprey Review*, above n 34, [3.6].

⁹⁶ Alley and Bentley, above n 2, 586.

⁹⁷ *The Mirrlees Review*, above n 17, 22; McLaren, above n 89, [1.15]; Alley and Bentley, above n 2, 586; Memon, above n 87, 67; Graeme S Cooper, 'An Optimal or Comprehensive Income Tax' (1994) 22 *Federal Law Review* 414, 420-1.

⁹⁸ Du Preez, above n 87, 3, 33; Memon, above n 87, 67; Alley and Bentley, above n 2, 581.

⁹⁹ *Asprey Review*, above n 34, [3.6]; Memon, above n 87, 67; Alley and Bentley, above n 2, 581.

¹⁰⁰ Memon, above n 87, 67.

¹⁰¹ *Carter Report*, above n 89, 17; Ken Messere, *Tax Policy in OECD Countries: Choices & Conflicts* (IBFD Publications, 1993) 110; Alley and Bentley, above n 2, 581; Cooper, above n 97, 420-2.

¹⁰² Cannan, above n 14, 310; Du Preez, above n 87, 3.

¹⁰³ Cooper, above n 97, 420 -1.

¹⁰⁴ Alley and Bentley, above n 2, 582.

¹⁰⁵ *The Mirrlees Review*, above n 17, 22; *Carter Report*, above n 89, 17; Alley and Bentley, above n 2, 581.

¹⁰⁶ Alley and Bentley, above n 2, 582-5; Memon, above n 87, 67.

separate constructs from a tax system's purposes or ultimate objectives.¹⁰⁷ In contrast, *The Mirrlees Review* conceptualises the criteria as the ultimate objectives of a tax system.¹⁰⁸ Hence, a discrepancy may exist between different works conceptualising the Smithian Framework.

However, discrepancies between different works might simply be a matter of the *Smithian Framework* having the inherent capacity to take on different abstractions and forms depending upon a particular enquiry's objectives. Thus, its criteria might, legitimately, serve as a tax system's values and ultimate objectives. Notwithstanding the above, applying non-standardised terminology may hinder the ability to draw easy comparisons between different works.¹⁰⁹

2.1.2 Subjective Factors

The value judgements of high-level decision-makers in governments, academics and think tanks - among others - have been observed to influence the selection and development of the criteria of the Smithian Framework's different versions.¹¹⁰ However, different decision-makers may subscribe to different ideologies and may be moved by different goals and aspirations.¹¹¹ Consequently, subjective factors may affect their value judgements and

¹⁰⁷ Ibid.

¹⁰⁸ *The Mirrlees Review*, above n 17, 22-3.

¹⁰⁹ Alley and Bentley, above n 2, 581.

¹¹⁰ Messere, above n 101, 109; Alley and Bentley, above n 2, 581, 582; R A Musgrave, 'The Carter Commission Report' (1968) 1(1) *The Canadian Journal of Economics* 159, 160-1; James R White, 'Understanding the Tax Reform Debate: Background, Criteria, & Questions' (Report, United States Government Accountability Office, September 2005) 4; Du Preez, above n 87, 5; See also *The Mirrlees Review*, above n 17, 36, 139; Graeme S Cooper, 'Themes and Issues in Tax Simplification' (1993) 10 *Australian Tax Forum* 417 in Simon James (ed), *Taxation: Critical Perspectives on the World Economy* (Routledge, 2002) 238; 263-5: where Cooper considers the various participants in the tax reform process.

¹¹¹ Ken Messere, Flip de Kam and Christopher Heady, *Tax Policy: Theory and Practice in OECD Countries* (Oxford University Press, 1st ed, 2003) 16 [2.3.4], [2.3.5]; White, above n 110, 4-5; Alley and Bentley, above n 2, 581, 582, 583; Stewart et al, above n 2, iv; Du Preez, above n 87, 5.

decision-making, which may, in turn, influence the construction of a version of the Smithian Framework.¹¹²

Other external role-players that may indirectly participate in tax policy development, and thus influence a version of the Smithian Framework, include lobbyists, promoting special interests, and wealthy donors of political parties.¹¹³ Therefore, external role-players may also introduce subjectivity and irrationality into the tax development process.¹¹⁴

Other subjective factors that may influence a version's construction include an individual's broader psyche.¹¹⁵ Likewise, cultural factors should also not be discounted entirely.¹¹⁶

Further, the impact of international organisations, *in whatever form*, like the United Nations, OECD, World Bank, WTO, and IMF, should not be underestimated.¹¹⁷

Thus, it is reasonable to postulate that a version's construction is affected, to some extent, by a non-scientific methodology.¹¹⁸ Accordingly, subjective factors appear to be responsible to

¹¹² Ibid.

¹¹³ Chris Evans, 'Reflections on the Mirrlees Review: An Australasian Perspective' (2011) 32(3) *Fiscal Studies* 375, 391-2; Paul Johnson and Gareth Myles, 'The Mirrlees Review' (2011) 32(3) *Fiscal Studies* 319, 323.

¹¹⁴ Ibid.

¹¹⁵ Messere, above n 101, 109.

¹¹⁶ Livingston, above n 2, 546; Ania Loomba, *Colonialism/ Postcolonialism: The New Critical Idiom* (Routledge, 3rd ed, 2015) 62-3.

¹¹⁷ Dwyer, above n 2, 671; Alley and Bentley, above n 2, 590; Tanzi and Zee, above n 2, 300; Bahl and Bird, above n 2, 284-9; Livingston, above n 2, 543; Basu below n 2, 139; Miranda Stewart, 'Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries' (2003) 44(1) *Harvard International Law Journal* 139, 150 – 154: Stewart considers the influence of academics on tax reform projects in developing and transitioning States.

¹¹⁸ Du Preez, above n 87, 4-6, 98; Herman Oliphant, 'Facts, Opinions, and Value—Judgments' (1932) 10 *Texas Law Review* 127, 131; Alley and Bentley, above n 2, 584. Oliphant defines the scientific method as follows, 'it impersonalises the observation it seeks to the degree required by the particular purpose for which the results of that observation are to be used.'

some degree – whatever that is- for the variation exhibited by the different versions of the Smithian Framework.¹¹⁹

2.1.3 Objective Factors & Relevance

Tax systems are inherently dynamic, as evidenced by frequent statutory tax amendments.¹²⁰ However, significant changes to tax policy appear to result from a plethora of objective factors, including significant technological advances,¹²¹ macroeconomic challenges,¹²² the occurrence of pandemics,¹²³ and significant changes in the social and demographic factors of a State.¹²⁴ In particular, 21st-century tax systems demonstrate increasing adaptation to accelerated globalisation¹²⁵ and the widespread use of electronic transactions, including cryptocurrencies and advances in artificial intelligence.¹²⁶ Previous research has identified that globalisation has had significant consequences for domestic tax systems, including declining income tax rates and dwindling tax bases.¹²⁷ Accordingly, 21st-century tax projects, like the *BEPS* project, have been promoted, internationally, to protect domestic tax bases more adequately from base

¹¹⁹ Alley and Bentley, above n 2, 580, 582.

¹²⁰ Business Council of Australia, *The Future of Tax: Australia's Current Tax System* (September 2014) 11; Alley and Bentley, above n 2, 580.

¹²¹ *The Henry Review*, above n 89, 11; Messere, de Kam and Heady, above n 111, 18 [2.3.9].

¹²² Messere, de Kam and Heady, above n 111, 16 [2.3.4].

¹²³ Bert Hofman, 'The Global Pandemic' (2020) 16 *Horizons: Journal of International Relations and Sustainable Development* 60, 66.

¹²⁴ *The Henry Review*, above n 89, 3,5; Messere, de Kam and Heady, above n 111, 18 [2.3.6]; Messere, above n 101, 27; Alley and Bentley, above n 2, 580; Bahl and Bird, above n 2, 289.

¹²⁵ *The Henry Review*, above n 89, 8; Messere, de Kam and Heady, above n 111, 18 [2.3.9]; Alley and Bentley, above n 2, 585; Business Council of Australia, above n 120, 3; Business Council of Australia, *Realising Our Full Potential: Tax Directions for a Transitioning Economy* (March 2016) 3; Bahl and Bird, above n 2, 289; Johnson and Myles, above n 113, 326-7.

¹²⁶ Alley and Bentley, above n 2, 590; see generally Basu, above n 2, 1. See generally Ryan Abbott and Bret Bogenschneider, 'Should Robots Pay Taxes? Tax Policy in the Age of Automation' (2018) 12 *Harvard Law and Policy Review* 145, 150; See generally *OECD BEPS Action 1*, above n 12, 11-2, 44.

¹²⁷ Messere, de Kam and Heady, above n 111, 3 [1.5]; Peter Egger, Sergey Nigai, Nora Strecker, 'The impact of globalisation on tax structures in OECD countries (21 May 2016) VoxEu.org: CEPR's Policy Portal <<https://voxeu.org/article/too-much-globalisation-can-be-taxing>> ; Johnson and Myles, above n 113, 326-7.

erosion.¹²⁸ Consequently, objective factors appear to significantly influence tax policy, including constructing a specific version of the Smithian Framework.¹²⁹

However, a striking attribute of the *Smithian Framework* is its enduring capacity to remain relevant in the 21st century, despite it first being published in 1776.¹³⁰ Its relevance has persisted despite major societal and technological advances, including the corresponding evolution of domestic tax systems.¹³¹ Clear evidence of its continued relevance may be found in major 21st-century tax-review projects of G20 States that continue to reference and develop it.¹³²

2.1.4 What is a Good Tax?

A good tax functions optimally.¹³³ Optimal functioning may occur when a tax substantially realises its underlying objectives within a particular environment as intended, while complying with any relevant constraints.¹³⁴ Previous research has submitted that the Smithian Framework's ultimate purpose is to assess a tax regime or system against the critical attributes of a good tax.¹³⁵ Thus, a good tax regime ideally aligns perfectly with the Smithian Framework's criteria. However, the *Smithian Framework* may, to some degree, operate at Pareto optimality.¹³⁶ Thus, applying the *Smithian Framework* in practice usually involves

¹²⁸ *OECD BEPS Action 1*, above n 12, 11-2, 28; *OECD BEPS Action 5*, above n 13, 3, 11.

¹²⁹ White, above n 110, 4-5; Du Preez, above n 87, 4-5; Messere, de Kam and Heady, above n 111, 12 [2.3], 18 [2.3.9]; *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 22-3.

¹³⁰ Cannan, above n 14, 310.

¹³¹ Alley and Bentley, above n 2, 582.

¹³² Alley and Bentley, above n 2, 582.

¹³³ *Ibid*; See generally Cooper, above n 97, 414-7, 420.

¹³⁴ Alley and Bentley, above n 2, 586; Memon, above n 87, 67; Cooper, above n 97, 417-22.

¹³⁵ Du Preez, above n 87, 26, 33-4; Alley and Bentley, above n 2, 580, 586; *The Mirrlees Review*, above n 17, 21-2, 35.

¹³⁶ Sean Ingham, *Pareto-optimality: social sciences* (2019) Encyclopedia Britannica < <https://www.britannica.com/topic/Pareto-optimality> >; Dwyer, above n 2, 753; Alley and Bentley, above n 2, 582.

balancing competing elements by prioritising Smithian criteria and underlying policy objectives.

Taxes are said to have the following three broad underlying objectives or purposes - particularly under the Alley and Bentley paradigm:¹³⁷

- 1) Financing State government activities.¹³⁸
- 2) Advancing social purposes, like income and wealth redistribution and environmental preservation.¹³⁹
- 3) Promoting economic objectives, like unemployment reduction and stimulating economic growth.¹⁴⁰

2.1.5 Quasi Misalignments

A multiplicity of factors may hinder the achievement of underlying fiscal objectives, including the substantive and procedural limitations imposed by a State's legal framework and the political and socioeconomic conditions prevailing in a State.¹⁴¹ The risk of competing policy objectives may also increase by pursuing an increasing number in conditions like limited resources.¹⁴²

¹³⁷ Alley and Bentley, above n 2, 582-3; *Carter Report*, above n 89, 4. Cooper, above n 97, 417, 419; Brian Galle, 'Tax Fairness' (2008) 65 *Washington and Lee Law Review* 1323, 1327.

¹³⁸ Cooper, above n 97, 417-8; Vito Tanzi and Howell Zee, 'Tax Policy for Developing Countries' (2001) 27 *Economic Issues* 1, 1; Alley and Bentley, above n 2, 582-3; *Carter Report*, above n 89, 10; *Asprey Review*, above n 34, [3.3]; *The Henry Review*, above n 89, 17; James Mirrlees et al, 'The Mirrlees Review: Conclusions and Recommendations for Reform' (2011) 32(3) *Fiscal Studies* 331, 331.

¹³⁹ Cooper, above n 97, 418-20; Alley and Bentley, above n 2, 583, 585; See generally Kerrie L Unsworth, Sally V Russel and Matthew C Davis, *Is Dealing with Climate Change a Corporation's Responsibility? A Social Contract Perspective* (18 August 2016) National Center for Biotechnology Information 2 <<https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4988990/>>; *The Henry Review*, above n 89, 17.

¹⁴⁰ Cooper, above n 97, 419; Bahl and Bird, above n 2, 290; Alley and Bentley, above n 2, 583; Tanzi and Zee, above n 138, 4.

¹⁴¹ Memon, above n 87, 67; Cooper, above n 97, 417-22; Evans, above n 113, 391-2; Johnson and Myles, above n 113, 323.

¹⁴² Cooper, above n 97, 419; Alley and Bentley, above n 2, 583-5; *Asprey Review*, above n 34, [3.6]; *The Mirrlees Review*, above n 17, 35-9; A misalignment is defined as a 'bad or imperfect alignment; an instance of

The occurrence of competing priorities may similarly be accommodated in the Smithian Framework's application as it may operate at Pareto optimality and demonstrate misalignments.¹⁴³ Three types of misalignments may be identified.¹⁴⁴ Firstly, an intra-systemic misalignment is where two criteria operate in an inverse correlation within a specific context.¹⁴⁵ Secondly, an inter-systemic misalignment is where a conflict arises between a tax regime/system and a criterion.¹⁴⁶ Thirdly, an intra-nuclear misalignment is where a criterion has distinct constituent elements, and the individual elements can align differently.¹⁴⁷

In applying the Smithian Framework, the occurrence of misalignments allows a user to make informed decisions about the merits of a specific policy.¹⁴⁸ Misalignments may be managed by giving different Smithian criteria and their corresponding policy objectives different priorities or weights.¹⁴⁹ Thus, criteria and objectives deemed less critical may be given lower priorities in addressing misalignments.¹⁵⁰ The subordination of particular criteria and objectives may be counted as part of the cost of prioritising others.¹⁵¹

Previous research has submitted that it is not practical to create, in advance, a standardised hierarchy of Smithian criteria intended to have general application.¹⁵² Instead, a specific

this.': *Oxford English Dictionary* Online (Oxford University Press, March 2019) 'misalignment' ('OED'). Certain reports that develop a particular version of the *Smithian Framework* specifically reference the word 'misalignment'. See *Davis Final Report*, above n 89, 35, 85.

¹⁴³ Ingham, above n 136; Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8, 753, 757, 955; Alley and Bentley, above n 2, 582.

¹⁴⁴ *Asprey Review*, above n 34, [3.6].

¹⁴⁵ *Carter Report*, above n 89, 17; Memon, above n 87, 67; Alley and Bentley, above n 2, 582.

¹⁴⁶ Alley and Bentley, above n 2, 582, 584; Stewart et al, above n 2, 2; Memon, above n 87, 67.

¹⁴⁷ *Asprey Review*, above n 34, [3.6] – [3.15]; *The Mirrlees Review*, above n 17, 23, 34; *The Henry Review*, above n 89, 80, 104; Evans, above n 113, 388; See generally Rousslang, above n 92, 8.

¹⁴⁸ Alley and Bentley, above n 2, 582, 584-5.

¹⁴⁹ *Carter Report*, above n 89, 17; Memon, above n 87, 58-9, 67; Alley and Bentley, above n 2, 582, 584-5.

¹⁵⁰ *Ibid.*

¹⁵¹ *Ibid.*

¹⁵² *Carter Report*, above n 89, 17.

ordering should be undertaken on a case-by-case basis as different tax design projects may have unique policy objectives and priorities.¹⁵³ However, as an exception, specific Smithian criteria may be treated as more critical than others in constructing a good tax. Their ordering may be assumed to be of a higher priority by default.¹⁵⁴ A universal example may be the core of the original Smithian certainty criterion.¹⁵⁵

2.1.6 A Systemic Application

The *Smithian Framework* generally works best at assessing tax systems as a whole instead of assessing individual regimes in isolation of the broader system.¹⁵⁶ Generally, individual regimes do not operate independently but as integrated elements.¹⁵⁷ Thus, provided a *system* promotes the full complement of Smithian criteria as intended, individual regimes may focus on specific criteria to the detriment of others.¹⁵⁸ Accordingly, not every good tax regime in a system must promote all the Smithian criteria.¹⁵⁹

Thus, evaluating individual taxes is still an essential exercise in applying the *Smithian Framework* as different tax bases are not equally successful at bearing a particular tax.¹⁶⁰ Therefore, different bases may require taxes with different priorities and criteria mixes to make them less likely to erode.¹⁶¹

¹⁵³ Ibid.

¹⁵⁴ Ibid.

¹⁵⁵ Cannan, above n 14, 311; *Carter Report*, above n 89, 17; Alley and Bentley, above n 2, 600; Cooper, above n 97, 438, 442.

¹⁵⁶ *Asprey Review*, above n 34, [3.2]; *The Mirrlees Review*, above n 17, 26; Johnson and Myles, above n 113, 320, 324; Mirrlees et al, above n 138, 333; Rousslang, above n 92, 5; Stewart et al, above n 2, 5.

¹⁵⁷ *The Mirrlees Review*, above n 17, 26; Johnson and Myles, above n 113, 320, 324; Mirrlees et al, above n 138, 333.

¹⁵⁸ Evans, above n 113, 385; Mirrlees et al, above n 138, 333; Johnson and Myles, above n 113, 324.

¹⁵⁹ *The Mirrlees Review*, above n 17, 26; Johnson and Myles, above n 113, 320, 324; Mirrlees et al, above n 138, 333.

¹⁶⁰ Cobb, above n 17, 627-8, 631-2, 646-7; Dwyer, above n 2, 664, 747-8, 794, 955; *The Henry Review*, above n 89, 39-40, 48, 51; Stewart et al, above n 2, 6, 21-2, 64-6; Evans, above n 113, 388; *The Mirrlees Review*, above n 17, 22-3, 29-31.

¹⁶¹ *The Henry Review*, above n 89, 48, 51; Stewart et al, above n 2, 6, 21-2, 64-6; *OECD BEPS Action 1*, above n 12, 20-1; Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

2.2 APPROACH ONE

The above theory will now be applied as a conceptual foundation to support the identification and development of the Smithian criteria that may be treated as the criteria of a good tax system that the G20 States broadly recognise in the 21st century. The first approach that the thesis will employ is to identify the criteria, if any, that are common to both the original version and selected subsequent versions of the Smithian Framework. Specific later versions that will be considered include versions utilised in recent tax-reform projects in selected G20 States. The thesis will treat the criteria identified as substantially common across the assessed versions as the general criteria of a good tax system that the G20 States broadly recognise in the 21st century.

The second approach applied to confirm the results for approach one will consider a recent version of the *Smithian Framework* constructed by a relevant international organisation.

2.2.1 The Three Analytical Steps of Approach One

Approach one will be executed by performing the following three steps:

Firstly, the original Smithian Framework's criteria will briefly be considered as a relevant starting point. It constitutes the foundational work that is further developed or re-imagined by later works.¹⁶²

¹⁶² Alley and Bentley, above n 2, 586; Du Preez, above n 87, 5, 68, 78; *The Mirrlees Review*, above n 17, 22-3.

The second and third steps are orientated on the following proposition, which is generally found in the tax literature, and that submits that the following three criteria are standard across the different Smithian versions:¹⁶³

- Equity or Fairness.¹⁶⁴
- Simplicity.
- Efficiency.

The three criteria will be referred to here as the *exemplars* for ease of reference. The general proposition about the prevalence of the exemplars may, however, be impugned to the extent that it suffers from the following deficiencies:

- (1) Particular works fail to cite authority for the proposition.¹⁶⁵
- (2) The form or substance of one or more exemplars in one work does not necessarily match the form or substance of the corresponding criteria in another work.¹⁶⁶
- (3) Misconceptualisations may exist about the substance of one or more criteria as they originally were constructed.¹⁶⁷

Accordingly, the second and third analytical steps consider the above proposition's validity concerning the exemplars' prevalence. In particular, step two will establish a general construct or model for each exemplar. The general construct will, roughly, be ascertained by applying

¹⁶³ Anthony Stokes and Sarah Wright, 'Does Australia Have A Good Income Tax System' (2013) 12(5) *International Business & Economics Research Journal* 533, 533; Bert Brys, Stephen Matthews and Jeffrey Owens, 'Tax Reform Trends in OECD Countries' (Taxation Working Papers No 1, OECD, 2011) 15; Stewart et al, above n 2, 1; Alley and Bentley, above n 2, 580; Memon, above n 87, 67; Du Preez, above n 87, 212; Cooper, above n 97, 421; Chuen-mei Fan, 'An International Perspective on Tax Reform Strategies' (1991) 8 *Australian Tax Forum* 539, 540.

¹⁶⁴ The term 'fairness' might be used as an alternative instead of equity because certain works: (1) Specifically reference fairness; (2) Fairness is broader than equity or equality – see, eg, *The Mirrlees Review*, above n 17, 22-3, 33-4; (3) Other works exclude equity in their Smithian Framework. See for example Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

¹⁶⁵ Stokes and Wright, above n 163, 533; Brys, Matthews and Owens, above n 163, 15.

¹⁶⁶ Alley and Bentley, above n 2, 581-2, 586-7; *The Henry Review*, above n 89, 17; *Carter Report*, above n 89, 7, 18-19; *The Mirrlees Review*, above n 17, 22-3.

¹⁶⁷ Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

the attributes that the broader literature generally recognises as the essential constitution of a relevant criterion. A criterion appearing in a publication will be determined relevant by perusing its form and substance to assess whether it is legitimately comparable. The general constructs as established will be referred to as the benchmarks. The thesis will use the benchmarks:

- (1) To serve as the essential conceptual basis for a criterion.
- (2) To facilitate identifying, in step three, common criteria that are substantially the same, even though particular versions of the *Smithian Framework* of selected States may apply different forms for their criteria.

Step 2 is an essential exercise as terminology is not always applied consistently in this area of research, which can be confusing, particularly for tax professionals that do not have an economics background.¹⁶⁸ As a secondary enquiry for step 2, the thesis will consider, similarly, whether any other criteria are common criteria.

Step 3 will involve comparing the benchmarks with the criteria of specific versions of the *Smithian Framework* as applied in selected G20 States. Alternatively, the fiscal policy of certain States will, roughly, be considered against the benchmarks. Further, step 3 will similarly consider whether other criteria may be recognised as common across the particular versions under review.

¹⁶⁸ Alley and Bentley, above n 2, 581-2, 586-7; *The Henry Review*, above n 89, 17; *Carter Report*, above n 89, 7, 18-19; *The Mirrlees Review*, above n 17, 22-3.

2.2.2 Step One: The Original *Smithian Framework*

The original *Smithian Framework* exhibits the following four criteria:¹⁶⁹

- i Equality
- ii Certainty
- iii Convenience of Payment
- iv Economy in Collection

2.2.2.1 Equality - The Smithian Equivalent to Fiscal Fairness

The Smithian criterion of equality is quintessentially described as follows:

The subject of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. ... In the observation or neglect of this maxim consists, what is called equality or inequality of taxation.¹⁷⁰

Smith is conventionally understood as constructing his equality criterion by requiring an appropriate correlation between tax capacity and tax liability.¹⁷¹ Therefore, an inherent component of the equality criterion is the ability to pay.¹⁷² Accordingly, convention interprets the ability to pay as a concept orientated on affordability.¹⁷³

¹⁶⁹ Cannan, above n 14, 310; Dwyer, above n 2, 747-8; McLaren, above n 89, [1.15]; Alley and Bentley, above n 2, 586.

¹⁷⁰ Cannan, above n 14, 310.

¹⁷¹ Ibid; Musgrave, above n 110, 160-1. Du Preez, above n 87,68; Cooper, above n 97, 423; Alley and Bentley, above n 2, 607; But see Dwyer, above n 2, 747; But see Cobb, above n 17, 627-8. Dwyer opines that convention has interpreted the extract's meaning out of context.

¹⁷² Ibid.

¹⁷³ Cobb, above n 17, 627-8; Dwyer, above n 2, 747-8.

2.2.2.2 Certainty and Its Absolute Priority in a Hierarchy of Criteria

The Smithian criterion of certainty requires taxes to be certain instead of being arbitrary.¹⁷⁴

The certainty criterion is orientated on three core matters or elements, namely:

- a) the due date of payment,
- b) the available payment methods, and
- c) the exact amount owing.¹⁷⁵

Smith opines that the above three elements should, absolutely, be objectively clear and plain in designing a good tax.¹⁷⁶ The element under item c is arguably the most critical.¹⁷⁷ Thus, the three core elements should be treated as inherent attributes of a good tax.¹⁷⁸ Accordingly, they should automatically rank above the other Smithian criteria, including equality.¹⁷⁹ Smith submits that a tax deficient in one or more of the three core elements may create opportunities to incubate corruption and unfair practices and encourage tax avoidance and evasion.¹⁸⁰

2.2.2.3 Smithian Equivalents for Simplicity and Efficiency

Convenience of Payment is a criterion matching the imposition of tax liability and tax collection with a timing and method convenient to taxpayers.¹⁸¹ The Economy in Collection criterion requires the costs of a tax system (or regime) to be as negligible as is practicable and in proportion to the benefit derived from it.¹⁸²

¹⁷⁴Cannan, above n 14, 310.

¹⁷⁵Cannan, above n 14, 310; McLaren, above n 89, [1.15].

¹⁷⁶Cannan, above n 14, 310-1.

¹⁷⁷ Ibid 311.

¹⁷⁸ Ibid.

¹⁷⁹ Ibid.

¹⁸⁰ Ibid.

¹⁸¹ Ibid 311; McLaren, above n 89, [1.15].

¹⁸² Ibid.

Smith opines that a tax system's costs may be categorised into one of the following four types:¹⁸³

- a) High-remuneration demands arising from a tax that requires a large workforce which is labour intensive.¹⁸⁴ It may be observed that this particular cost is merely a specific instance of administering a tax system. Accordingly, the category might be more broadly re-constructed as administrative costs.¹⁸⁵
- b) Interfering with taxpayers' entrepreneurial efforts and reducing the capital available for investment.¹⁸⁶ It is submitted that this particular cost overlaps with the costs associated with modern-day fiscal efficiency, as described further below.¹⁸⁷
- c) Imposing excessive penalties for wrongdoing by taxpayers, thereby erasing or significantly diminishing capital and cancelling its corresponding benefits for the economy.¹⁸⁸
- d) Imposing frequent tax audits and other examinations on taxpayers, thereby exposing them to unnecessary trouble, vexation and oppression.¹⁸⁹ This particular cost is a specific instance of taxpayers' compliance costs.¹⁹⁰

Further, as Smith mentions vexation explicitly, it is submitted that Smith viewed compliance-like costs as costs that are not necessarily only measurable in money directly.¹⁹¹ Smith explicitly states that 'though vexation is not, strictly speaking, expense, it is certainly

¹⁸³ Cannan, above n 14, 311-2.

¹⁸⁴ Ibid 311; Stewart et al, above n 2, 10-11.

¹⁸⁵ Stewart et al, above n 2, 10-11.

¹⁸⁶ Cannan, above n 14, 311.

¹⁸⁷ Alley and Bentley, above n 2, 592, 612, 616; See also Cooper, above n 97, 438, 441; *The Mirrlees Review*, above n 17, 23, 29, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9; Musgrave, above n 110, 171-2; AICPA Tax Division, 'Tax Policy Concept Statement 1, Guiding principles of good tax policy: A framework for evaluating tax proposals' (Tax Policy Concept Statement; Association of International Certified Professional Accountants, 2017) 5; *The Henry Review*, above n 89, 13, 73, 171-2, 176.

¹⁸⁸ Cannan, above n 14, 311.

¹⁸⁹ Ibid 312; Stewart et al, above n 2, 10-11.

¹⁹⁰ Ibid.

¹⁹¹ Cannan, above n 14, 312.

equivalent to the expense at which every man would be willing to redeem himself from it'.¹⁹² Therefore, the Smithian idea of administrative and compliance costs as more broadly reconstructed, which are generally two sides of the same coin, may extend to costs that do not necessarily sound in money directly.

It will be demonstrated below that all three exemplars are broadly and substantively present in the original Smithian Framework. In particular, it will be demonstrated that equity corresponds with the conventional understanding of Smithian equality.¹⁹³ Further, it will be demonstrated that simplicity and efficiency broadly correspond with Convenience of Payment and Economy in Collection.¹⁹⁴ However, the original Smithian criteria might be criticised as somewhat rudimentary or incomplete compared to the criteria of more recent versions.¹⁹⁵

2.2.3 Step Two: Benchmarking the Exemplars

The thesis will now construct a benchmark for each exemplar as described above.

2.2.3.1 Benchmarking Equity

It has been said that 'unless a tax system is generally accepted as fair, the fundamental purpose of taxation is lost for if fairness is not considered relevant there are certainly simpler means for the government to secure command over goods and services'.¹⁹⁶ Thus, it is not uncommon for a version of the *Smithian Framework* to incorporate a criterion that addresses

¹⁹² Ibid.

¹⁹³ Cobb, above n 17, 627-628, 631-2, 646-7; See generally Dwyer, above n 2, 747-8; Musgrave, above n 110, 160; Cannan, above n 14, 310; *Asprey Review*, above n 34, [3.7]; Du Preez, above n 87, 68; Alley and Bentley, above n 2, 607; Cooper, above n 97, 423, 426; See also Rousslang, above n 92, 3.

¹⁹⁴ *Asprey Review*, above n 34, [3.20]; See especially Alley and Bentley, above n 2, 592, 612, 616; See also Cooper, above n 97, 438, 441; *The Mirrlees Review*, above n 17, 22-3, 29, 40-1.

¹⁹⁵ *The Mirrlees Review*, above n 17, 22.

¹⁹⁶ *Carter Report*, above n 89, 17.

some level of fiscal fairness.¹⁹⁷ Such a criterion is usually called the criterion of equity.¹⁹⁸ However, other versions might refer to it as fairness or even the distributional outcome.¹⁹⁹ Specific versions may also adopt a broader conceptualisation of fiscal fairness.²⁰⁰ Equity as a name is generally preferred over equality as fairness may require the unequal tax treatment of persons.²⁰¹

Conventionally, equity is directed at establishing a fair division of the tax burden across a State's taxpayers.²⁰² Likewise, the concept also comprises two core abstractions: horizontal and vertical equity.²⁰³ Horizontality demands that persons that share similar circumstances should be treated similarly.²⁰⁴ Whilst verticality demands that persons that occupy different circumstances should be treated differently.²⁰⁵ The abstractions are broadly mathematically quantified in the literature as follows: For horizontality, persons with similar income levels ought to incur similar tax liabilities;²⁰⁶ For verticality, persons with higher income levels ought to incur higher tax liabilities.²⁰⁷ Further, the two abstractions might be said to accord with Smithian equality where they are underpinned by the ability to pay, which is orientated

¹⁹⁷ *Asprey Review*, above n 34, [3.7]; Alley and Bentley, above n 2, 600, 603; Stokes and Wright, above n 163, 533; *OED*, above n 142, 'equity'; Du Preez, above n 87, 160, 166; *Carter Report*, above n 89, 17, 19.

¹⁹⁸ Alley and Bentley, above n 2, 586-7; Du Preez, above n 87, 161, 166; Cooper, above n 97, 437-8; *The Henry Review*, above n 89, 17.

¹⁹⁹ *Ibid*; *The Mirrlees Review*, above n 17, 22.

²⁰⁰ *The Mirrlees Review*, above n 17, 22, 33-4.

²⁰¹ Du Preez, above n 87, 161, 166; Cooper, above n 97, 437-8.

²⁰² *Carter Report*, above n 89, 17, 19; *Asprey Review*, above n 34, [3.6]; Alley and Bentley, above n 2, 600; Du Preez, above n 87, 160; Cobb, above n 17, 627-8; Dwyer, above n 2, 747-8.

²⁰³ Rousslang, above n 92, 3; *Asprey Review*, above n 34, [3.7]; Stokes and Wright, above n 163, 533; Alley and Bentley, above n 2, 601; see generally Du Preez, above n 87, 161. For a further discussion on whether horizontality is an independent element: see heading 2.2.4.1.1

²⁰⁴ *Asprey Review*, above n 34, [3.7]; Alley and Bentley, above n 2, 601; See also *Carter Report*, above n 89, 10, 19; Du Preez, above n 87, 161-2, 166-7; See also Galle, above n 137, 1324; See generally *The Mirrlees Review*, above n 17, 24; Rousslang, above n 92, 4; See also *OECD BEPS Action 1*, above n 12, 21.

²⁰⁵ *Ibid*.

²⁰⁶ *Asprey Review*, above n 34, [3.7]; Cannan, above n 14, 310; Stokes and Wright, above n 163, 533-4; See generally Alley and Bentley, above n 2, 601; Du Preez, above n 87, 161; Cooper, above n 97, 428, 436.

²⁰⁷ *Ibid*.

on affordability.²⁰⁸ However, although generally supported, the ability to pay paradigm is not universally supported.²⁰⁹

It is not necessarily a straightforward exercise to obtain a valid and objective account of equity by legally (or otherwise) defining it and mathematically quantifying it.²¹⁰ Fairness is a concept that may be complex and somewhat subjective.²¹¹ It may be dynamic in time and space.²¹² Therefore, quantifying the ability to pay the tax through the lens of some form of income may demonstrate certain deficiencies that limit an endeavour's capacity to promote genuine fiscal fairness.²¹³ A particular formulation of income, measured at specific points in time, will not necessarily produce an accurate indicator of the actual economic reality of a person.²¹⁴ Moreover, the project of realising real fiscal fairness may be perceived as unfair, impractical or even politically inexpedient.²¹⁵

The Dwyer paradigm may provide an alternative theoretical basis for dispensing with or subordinating equity (particularly equity abstracted vertically) in configuring a Smithian Framework.²¹⁶ The Dwyer paradigm reimagines core aspects of the *Smithian Framework* and, in so doing, removes various constraints imposed by the distributional outcome.²¹⁷

²⁰⁸ Cobb, above n 17, 627-628, 631-2, 646-7; See generally Dwyer, above n 2, 747-8; Musgrave, above n 110, 160; Cannan, above n 14, 310; *Asprey Review*, above n 34, [3.7]; Du Preez, above n 87, 68; Alley and Bentley, above n 2, 607; Cooper, above n 97, 423, 426; See also Rousslang, above n 92, 3

²⁰⁹ Ibid.

²¹⁰ *Asprey Review*, above n 34, [3.7-8]; Alley and Bentley, above n 2, 600, 604, 607; Stokes and Wright, above n 163, 357; See also Du Preez, above n 87, 100, 161-2; Cooper, above n 97, 428, 437; *The Mirrlees Review*, above n 17, 69-71.

²¹¹ Ibid; Rousslang, above n 92, 2.

²¹² *Carter Report*, above n 89, 17; See generally *Asprey Review*, above n 34, [3.13].

²¹³ *Asprey Review*, above n 34, [3.7-8]; Du Preez, above n 87, 161; See also Alley and Bentley, above n 2, 604, 607; Cooper, above n 97, 427-8, 438; See also Louis Kaplow, 'An Optimal Tax System' (2011) 32(3) *Fiscal Studies* 415, 417.

²¹⁴ Ibid.

²¹⁵ *Asprey Review*, above n 34, [3.7-8]; Du Preez, above n 87, 161, 164 180, 196-7: note the discussion on the subjectivity that colours fairness and the social contract theory; Cooper, above n 97, 432; Evans, above n 113, 391; Rousslang, above n 92, 2.

²¹⁶ Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

²¹⁷ Ibid.

However, the Dwyer paradigm's essential outcome is not necessarily unique. It is not uncommon for some versions of the *Smithian Framework* to omit or subordinate equity as abstracted vertically for assessing particular taxes.²¹⁸

2.2.3.1.1 Reimagining the Ability to Pay Concept

Dwyer reconstructs the ability to pay concept by reorientating it substantively on protecting tax bases.²¹⁹ Thus, the question becomes, does this ... tax tend to destroy or diminish the base upon which it is levied?²²⁰ In so doing, Dwyer reorientates it mainly on other aspects of fiscal fairness, like tax neutrality, tax incidence and shifting.²²¹ However, this alternate construction contradicts conventional wisdom for equity, which primarily focuses on horizontality and verticality.²²² The thesis will demonstrate that the Dwyer formulation can still provide some degree of horizontality, where appropriate.²²³ Further, the Dwyer construct may reduce Pareto optimality for the *Smithian Framework* to the extent that verticality, operating in an inverse correlation with other criteria, is ignored.²²⁴

Neutrality may simply be conceived at this point in the discussion as the attribute of not influencing the behaviour of capital and labour.²²⁵ The discussion under the efficiency benchmark will expand this.

²¹⁸ *OECD BEPS Action 1*, above n 12, 20-1; *The Henry Review*, above n 89, 17-8, 25, 39-40; Evans, above n 113, 388.

²¹⁹ Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

²²⁰ *Ibid.*

²²¹ Dwyer, above n 2, 747- 8; See generally Stewart et al, above n 2, 4; *The Mirrlees Review*, above n 17, 27, 33-4.

²²² *Ibid.*

²²³ See heading 2.2.4.1.1; See generally *The Mirrlees Review*, above n 17, 23, 29, 40-1.

²²⁴ Ingham, above n 136; Cobb, above n 17, 639; 648; Dwyer, above n 2, 681-2, 741, 747-8, 892-3; Alley and Bentley, above n 2, 582.

²²⁵ *Ibid.*; Cobb, above n 17, 646; 648; Dwyer, above n 2, 748, 752, 764, 774.

Tax incidence is an economic concept that evaluates where the burden of taxation falls.²²⁶ In other words, who bears the actual financial brunt of the tax, irrespective of who is required to discharge it legally?²²⁷ Thus, a distinction needs to be made between economic incidence (who bears the actual financial brunt), legal incidence (who, in law, is required to discharge the liability) and the incidence as perceived by public opinion.²²⁸ They do not necessarily always converge at one point in a system.²²⁹ Shifting is an economic concept that evaluates the displaceability of the financial burden of a tax from one entity to another.²³⁰

Therefore, as reimagined by Dwyer, neutrality may be conceptualised as the key abstraction of the ability to pay (or -now-bear) paradigm.²³¹ Dwyer also argues in support of the paradigm that its alternate construction accords better with what Smith envisaged.²³²

Thus, the ability to pay paradigm with a reorientated focus on protecting tax bases may be of greater utility for designing taxes for mobile bases that demonstrate a higher risk of base erosion.²³³ Neutrality generally requires an inverse correlation between taxes/verticality and base mobility.²³⁴ In other words, a tax base with more mobility should be subjected to less tax to achieve the stamp of a good tax.²³⁵ Thus, in designing specific taxes, considerations of verticality should, generally, be ignored in applying this alternate formulation of the ability to pay.²³⁶

²²⁶ See generally *Davis Final Report*, above n 89, 42, 87; See also *The Mirrlees Review*, above n 17, 27.

²²⁷ Stewart et al, above n 2, 4.

²²⁸ Ibid; see generally *OECD BEPS Action 1*, above n 12, 22.

²²⁹ Stewart et al, above n 2, 4.

²³⁰ Ibid.

²³¹ Dwyer, above n 2, 747-8.

²³² Ibid.

²³³ Cobb, above n 17, 631, 648-9; Dwyer, above n 2, 667-8, 672, 703; 747-8, 751-2, 764, 768; *1998 DETR Report*, above n 23, 16.

²³⁴ Cobb, above n 17, 629, 631, 648; Dwyer, above n 2, 664, 667, 672-3, 728, 732-3, 747-8, 752, 764, 776, 908, 955.

²³⁵ Ibid. See also the discussion under the efficiency benchmark.

²³⁶ Cobb, above n 17, 631-2; Dwyer, above n 2, 747-8.

2.2.3.1.2 Closing Submissions

Despite any imperfections associated with a criterion of equity, there is still significant support and political will in the 21st century, for awarding it a significant weighting, in prioritising the *Smithian Framework* for a tax system as a whole.²³⁷ However, any such weighting is to some extent dictated by value judgements and other subjective factors.²³⁸ Support for adopting a preferential ordering for equity is also based on considerations like vertical equity positively correlating with societal perceptions of fairness.²³⁹ The latter is, in turn, said to positively correlate with higher tax compliance²⁴⁰ and the health and longevity of a political and social system.²⁴¹

Consequently, the thesis will orient the benchmarked equity criterion on Smithian equality as constructed conventionally.²⁴² The criterion's essential core will comprise the ability to pay paradigm as abstracted horizontally and vertically.²⁴³ Nonetheless, the Dwyer formulation of the ability to pay provides a theoretical alternative for dispensing with verticality for taxes applying to mobile bases like shipping income.

²³⁷ *The Mirrlees Review*, above n 17, 22-3; *Carter Report*, above n 89, 17; Alley and Bentley, above n 2, 600; Cooper, above n 97, 438, 442; Musgrave, above n 110, 160.

²³⁸ Alley and Bentley, above n 2, 582.

²³⁹ Alley and Bentley, above n 2, 603, 606; Du Preez, above n 87,100; *Carter Report*, above n 89, 17, 19.

²⁴⁰ *The Mirrlees Review*, above n 17, 33; *Davis Final Report*, above n 89, 42, 65; Du Preez, above n 87, 137, 161; Alley and Bentley, above n 2, 606, 608.

²⁴¹ *Carter Report*, above n 89, 17.

²⁴² Cobb, above n 17, 627-8, 631-2; Dwyer, above n 2, 747-8.

²⁴³ *OECD BEPS Action 1*, above n 12, 21.

2.2.3.2 Benchmarking Fiscal Simplicity

The underlying subject matter of a simplicity criterion, like the equity criterion, may be complex.²⁴⁴ Therefore, establishing a standard or universal definition and a corresponding, objective and accurate measurement for simplicity is not necessarily straightforward.²⁴⁵

2.2.3.2.1 The Costs Approach to a Criterion of Simplicity

Several versions of the *Smithian Framework* merely construct the simplicity criterion by orientating it on a tax's administrative and compliance costs.²⁴⁶ Accordingly, the simplest tax is, ideally, one where the administrative and compliance costs are nominal to non-existent when measured against the total revenue produced by a tax.²⁴⁷

A perusal of the broader literature will demonstrate that an expansive definition of compliance costs may be employed.²⁴⁸ Compliance costs might generally cover any costs that a taxpayer bears to comply with tax law obligations, including: any monetary expenses directly and indirectly incurred over and above the primary tax liability; the time expended; the psychological stress experienced; and the mental and physical effort required to discharge the relevant tax law obligations satisfactorily.²⁴⁹

²⁴⁴ *Asprey Review*, above n 34, [3.19]; Cooper, above n 110, 240-2.

²⁴⁵ Alley and Bentley, above n 2, 614; See generally Cooper, above n 110, 241-2: where Cooper considers various definitions of fiscal simplicity.

²⁴⁶ *The Mirrlees Review*, above n 17, 22; *Asprey Review*, above n 34, [3.20]; See also Cooper, above n 110, 238.

²⁴⁷ *Asprey Review*, above n 34, [3.20]; But see Cooper, above n 110, 247.

²⁴⁸ Stewart et al, above n 2, 11; Alley and Bentley, above n 2, 611; *Asprey Review*, above n 34, [3.20]; *The Henry Review*, above n 89, 169: *The Henry Review* defines compliance costs as, 'expenses incurred in meeting the requirements of legislation or regulations. Compliance costs include a wide range of monetary and non-monetary costs'; See also generally Cooper, above n 110, 241-2, 260; At 241-2: where 'effort' and 'level of ease' are included as relevant costs; William G Gale and Janet Holtzblatt, 'The Role of Administrative Issues in Tax Reform: Simplicity, Compliance and Administration' (Draft Paper, December 2000) 3; White, above n 110, 45-7; 'Compliance costs are borne by taxpayers and include the financial cost and time individuals and entities spend complying with their tax obligations. This encompasses the costs of engaging tax agents and accountants to assist with managing and planning tax affairs.': Stewart et al, above n 2, 11.

²⁴⁹ *Ibid.*

The above formulation is comprehensive, including costs that do not necessarily sound in money.²⁵⁰ What's more, the expansive formulation comprises costs that would, generally, be considered irrelevant under an income tax regime's deduction formula - and the like.²⁵¹ For example, private expenses and non-quantifiable items, which are generally not income tax-deductible, may, nonetheless, fall within the concept's scope, like accounting for one's effort and time.²⁵² It has been observed that compliance costs continue to constitute a significant issue for taxpayers.²⁵³ Further, empirical evidence demonstrates that compliance costs can be regressive.²⁵⁴ Moreover, there is nothing new in adopting a broad and generous idea of compliance costs. This expansive approach to them may be traced back to the original version of the Smithian Framework, particularly the criterion of Economy in Collection, as considered above.²⁵⁵

Likewise, administrative costs may, broadly, be defined as the costs incurred to design, operate, manage, enforce, and update a tax system, including: processing tax returns and payments; providing taxpayer assistance; auditing activities; and salary and infrastructure costs.²⁵⁶ Further, there are grounds for including waste arising from inefficiencies.²⁵⁷

²⁵⁰ Cooper, above n 110, 241; White, above n 110, 45-7.

²⁵¹ *Master Tax Guide 2019*, above n 82, [11-550], [16-010], [16-040], [16-850]; See generally Gale and Holtzblatt, above n 248, 3; But see *Carter Report*, above n 89, 12-13; But see Mirrlees et al, above n 138, 335.

²⁵² *Ibid.*

²⁵³ Stewart et al, above n 2, 11.

²⁵⁴ Stewart et al, above n 2, 11.

²⁵⁵ Cannan, above n 14, 311-2.

²⁵⁶ Stewart et al, above n 2, 10; See especially White, above n 110, 49-52; Alley and Bentley, above n 2, 612; *Asprey Review*, above n 34, [3.20]. For instance, operationally, a tax that is more labour intensive will generally have higher administrative costs as an increased wage bill; Cooper, above n 110, 241-2: where administration costs are conceptualised as including less effort to enforce and less resources to assist taxpayers to comply; Gale and Holtzblatt, above n 248, 3; But see Rousslang, above n 92, 6-7; 'Administration costs include the costs to government of designing, operating and changing the tax system.' : Stewart et al, above n 2, 10.

²⁵⁷ Stewart et al, above n 2, 10; See generally Cooper, above n 110, 243.

Thus, a simpler tax produces lower administrative and compliance costs in proportion to its total revenue.²⁵⁸ Under this particular formulation, simplicity may overlap with two specific costs under Economy in Collection, among others - potentially.²⁵⁹ Therefore, the modern simplicity criterion may be a repackaging of Economy in Collection to some extent.²⁶⁰

2.2.3.2.2 The Relationship between Simplicity and Certainty

As formulated on costs, the simplicity criterion shares a close and interrelated relationship with the Smithian criterion of certainty.²⁶¹ A core aspect of Smith's certainty criterion is the requirement that the tax liability is objectively clear and plain.²⁶² Thus, where the tax liability is less certain, one might expect increased compliance costs, like paying additional professional fees, for obtaining the necessary expertise to overcome the uncertainty.²⁶³ An increase in compliance costs due to a decrease in certainty will also decrease simplicity, where simplicity is orientated on administrative and compliance costs.²⁶⁴ Conversely, greater certainty may correspond with lower administrative and compliance costs and, thus, greater simplicity.²⁶⁵

2.2.3.2.3 A Narrower Formulation for a Criterion of Simplicity

Some versions of the *Smithian Framework* demonstrate a narrow construction for the simplicity criterion.²⁶⁶ Thus, for example, it may be orientated on the semantic formulation

²⁵⁸ *Asprey Review*, above n 34, [3.20]; Cooper, above n 110, 239.

²⁵⁹ Cooper, above n 110, 243; White, above n 110, 45-7.

²⁶⁰ Firstly, under at least two of the four types of costs (namely, categories one and four) the Smithian model covers costs that correspond with administrative and compliance costs. Secondly, Smithian costs, cover waste and penalties, that likewise may correspond with a wider understanding of administrative and compliance costs.

²⁶¹ *Asprey Review*, above n 34, [3.20]; Cooper, above n 110, 241-3; at 243 Cooper opines that the Smithian idea of certainty may merely be an aspect of simplicity.

²⁶² Cannan, above n 14, 310; Cooper, above n 110, 241-3.

²⁶³ *Asprey Review*, above n 34, [3.20]; Cooper, above n 110, 241-2.

²⁶⁴ *Ibid.*

²⁶⁵ *Asprey Review*, above n 34, [3.20]; Cooper, above n 110, 243, 268.

²⁶⁶ Alley and Bentley, above n 2, 597-8; Cooper, above n 110, 239.

employed to express a tax rule.²⁶⁷ In other words, it might be directed at the understandability of a tax rule.²⁶⁸ It has been suggested that ‘simplicity outlines the need for a tax law to be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner’.²⁶⁹ Nonetheless, by employing a costs approach for simplicity, understandability can also be covered, albeit indirectly.²⁷⁰

Furthermore, simplicity formulated on the narrower subject matter of understandability may, nonetheless, continue to have implications for a Smithian criterion of certainty.²⁷¹ For example, it might be postulated that the more understandable something is, the more certain, it becomes.²⁷² However, it may prove challenging in law to consistently achieve an optimal correlation between simplicity, which assesses understandability, and certainty.²⁷³ It is submitted that a positive correlation between simplicity, as formulated here, and certainty is not necessarily absolute or guaranteed in all circumstances.²⁷⁴ A law drafted broadly and concisely may be more understandable but not universally certain.²⁷⁵

Further, certainty is never guaranteed in attributing a legal meaning to a legal provision *ex curia* - irrespective of its understandability.²⁷⁶ The judiciary enjoys the final authority to transform a legal rule from a general legal principle in abstract form into a specific and concrete one.²⁷⁷

Thus, the legislature is not required to cover every type of situation that a rule may encounter

²⁶⁷ Alley and Bentley, above n 2, 597, 612; Cooper, above n 110, 239-41, 255.

²⁶⁸ Cooper, above n 110, 241, 255.

²⁶⁹ Alley and Bentley, above n 2, 612, 614.

²⁷⁰ Alley and Bentley, above n 2, 597; Cooper, above n 110, 242.

²⁷¹ Cooper, above n 110, 242-3, 255-6.

²⁷² Ibid.

²⁷³ Alley and Bentley, above n 2, 599.

²⁷⁴ Ibid 610.

²⁷⁵ Ibid 598-9; John F Avery Jones, ‘Tax Law Rules or Principles’ (1996) *British Tax Review* 580 in Simon James (ed), *Taxation: Critical Perspectives on the World Economy* (Routledge, 2002) 275, 285-8; Cooper, above n 110, 242, 244-5, 256.

²⁷⁶ Botha, above n 82, 161-2, 165; Cooper, above n 110, 243, 257-9; Alley and Bentley, above n 2, 598.

²⁷⁷ Ibid.

in advance.²⁷⁸ Thus, they do not have to draft overly comprehensive legal rules.²⁷⁹ Nonetheless, a situation may arise that warrants more comprehensive and certain rules to the detriment of their understandability.²⁸⁰ Therefore, focusing primarily on understandability is not always appropriate or of benefit.²⁸¹

Therefore, orientating the simplicity criterion on costs avoids the enquiry becoming focused slavishly on making rules understandable. This outcome is preferable, as it is not always advantageous to promote understandability primarily.²⁸² Thus, the costs approach may ensure that the criterion has greater flexibility and utility.²⁸³ Further, it might be artificial to adopt a narrower formulation for a subject matter, like simplicity, with varying complexity.²⁸⁴

2.2.3.3 A Distinct Certainty Criterion

Specific works treat simplicity and certainty as two different criteria to the extent that certainty is focused on the rule-making process, whilst simplicity is orientated on administrative and compliance costs.²⁸⁵ However, an alternate approach identified in the literature is to house them under one criterion.²⁸⁶ The advantage of the latter approach is that their close relationship may make it prudent to consider them simultaneously.²⁸⁷

²⁷⁸ Botha, above n 82, 161-2; Cooper, above n 110, 257-8.

²⁷⁹ Ibid.

²⁸⁰ Jones, above n 275, 285-8; Cooper, above n 110, 242, 244-5, 256; Alley and Bentley, above n 2, 598-9.

²⁸¹ Ibid.

²⁸² Ibid.

²⁸³ Alley and Bentley, above n 2, 597-8; Cooper, above n 110, 239-1, 243, 247.

²⁸⁴ Cooper, above n 110, 240-1.

²⁸⁵ Alley and Bentley, above n 2, 597-9.

²⁸⁶ Cooper, above n 110, 243.

²⁸⁷ Alley and Bentley, above n 2, 599.

Notwithstanding the above, the thesis prefers treating them as two separate criteria for the benchmarks. Firstly, Adam Smith stressed the fundamental and absolute importance of the core attributes of Smithian certainty.²⁸⁸ Secondly, specific issues may not receive appropriate treatment by applying a costs approach to both criteria. Thirdly, specific concerns, like transparency and stability, might be more naturally addressed under a separate certainty criterion.²⁸⁹

Thus, as constructed here, the benchmark for certainty will primarily include the three core matters of Smithian certainty as its essential minimum. Its scope will be particularised further at the periphery, as required, by other secondary elements. The peripheral crystallisations should ideally address secondary certainty concerns.²⁹⁰

2.2.3.3.1 Final Submissions

In summary, the thesis prefers adopting a benchmark for the simplicity criterion that is orientated broadly on administrative and compliance costs.²⁹¹ Further, the thesis favours adopting a separate benchmarked criterion for certainty.²⁹²

²⁸⁸ Cannan, above n 14, 310-11.

²⁸⁹ Ibid; White, above n 110, 45-9; Rousslang, above n 92, 8-9; *The Henry Review*, above n 89, 17; Fiscal Policy Institute, 'New York City Taxes— Trends, Impact and Priorities for Reform' (Report, 13 January 2015) 9. Other secondary elements for certainty may include: accountability; consistency; reliability and; dependability.

²⁹⁰ Cannan, above n 14, 310; Rousslang, above n 92, 8-9; Catherine Soanes and Angus Stevenson (eds), *Concise Oxford English Dictionary* (Oxford University Press, 11th revised ed, 2006), 231; See also *OED*, above n 142, 'certain'; White, above n 110, 45-8; Joyce Bigbee et al, 'Principles of a High Quality State Revenue System' (Fiscal Policy Report updated 4th edition, National Conference of State Legislatures, June 2017) [principle 9] <<https://www.ncsl.org/research/fiscal-policy/principles-of-a-high-quality-state-revenue-system.aspx#foreword>>. As a caveat, the more populated with secondary elements a criterion becomes, the greater is the risk that one or more elements might be overlooked or understated in any application. Therefore, a conservative approach is preferable.

²⁹¹ The costs approach to simplicity gives better recognition to the subject matter's complex and multifaceted attributes. The main goal that directs simplicity under a costs approach is costs reduction. A real benefit of the costs approach is that it allows for simplicity to be pursued even where it would otherwise not be practical nor prudent to do so if a narrow focus for the criterion was adopted.

²⁹² The benchmark for certainty despite having greater specificity at the periphery, might be free of the necessity to resolve priorities internally at the secondary level. The crystallised secondary elements all essentially promote fiscal certainty.

2.2.3.4 Benchmarking Fiscal Efficiency

It has, generally, been suggested that ‘economists define an efficient tax system as one that meets revenue needs while minimising the distorting effects of taxes on private decisions to work, save, consume and invest.’²⁹³ Thus, efficiency may be constructed as a criterion that analyses some form of waste generated by or associated with a tax system/regime.²⁹⁴

2.2.3.4.1 A Specially Defined Focus

A unique focus should be established for a benchmarked efficiency criterion to avoid duplicating subject matter for criteria. Noting that specific versions of the *Smithian Framework* have applied the subject matter of the simplicity criterion as benchmarked as part of their formula for their efficiency criterion.²⁹⁵

2.2.3.4.2 Neutrality

One option for constructing waste is to formulate neutrality in one of three ways:²⁹⁶

- 1) Firstly, to reference the interference/distortion that a tax has on the choices/behaviour of capital and labour.
- 2) Secondly, to refer to a uniform tax treatment.
- 3) Thirdly, to reference both concepts - as appearing under items 1 and 2.

²⁹³ Stewart et al, above n 2, 4.

²⁹⁴ *Asprey Review*, above n 34, [3.24]; Du Preez, above n 87, 77.

²⁹⁵ Rousslang, above n 92, 6-8; White, above n 110, 45; *Asprey Review*, above n 34, [3.24].

²⁹⁶ See especially Alley and Bentley, above n 2, 592, 612, 616; See also Cooper, above n 97, 438, 441; *The Mirrlees Review*, above n 17, 23, 29, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9; Musgrave, above n 110, 171-2; AICPA Tax Division, above n 187, 5; *The Henry Review*, above n 89, 13, 73, 171-2, 176; ‘The [Carter] Report submits that ‘a tax structure designed to achieve horizontal equity also achieves neutrality’: Musgrave, above n 110, 171. Therefore, neutrality constructed as uniformity alone does not necessarily provide a sufficiently unique focus for efficiency.

The thesis will adopt a broader approach for constructing its benchmark for efficiency.²⁹⁷ The benchmarks are models intended to apply as general constructs that demonstrate a criterion's essential essence as roughly recognised in the broader literature. Thus, where a tax regime does not interfere with the economic choices/behaviour of taxpayers, it may be described as efficient.²⁹⁸ This particular attribute also appears as a cost for Smith's original Economy in Collection criterion.²⁹⁹ In applying neutrality as adopted here, specific works promote item 1 (distortions) primarily, whilst item 2 (uniformity) is merely applied as a secondary factor.³⁰⁰ The thesis will, likewise, adopt this application from now on.

2.2.3.4.3 A Basis for Adopting Neutrality as Constructed

As constructed, neutrality might be justified on several grounds, including a postulation that assumes that taxpayers' behaviour is generally directed at maximising productivity.³⁰¹ Hence, neutrality violations may be justified where that assumption proves invalid, and any increase in costs like a reducing tax base is considered warranted.³⁰²

A further theoretical basis might be found in the work of Alley and Bentley.³⁰³ They advance the argument that neutrality as uniformity is essential as it constitutes a foundational and integral concept vis-à-vis the construct of comprehensive income.³⁰⁴

²⁹⁷ Alley and Bentley, above n 2, 592, 612, 616; Cooper, above n 97, 438, 441; Musgrave, above n 110, 171; *The Mirrlees Review*, above n 17, 23, 29, 40-1.

²⁹⁸ *Asprey Review*, above n 34, [3.24].

²⁹⁹ See the category b costs listed above. Also, Dwyer submits that Smith recognised a concept of neutrality as 'the avoidance of a tax-induced wedge between price and cost ... [or what may be referred to as] tax-induced distortions.': Cobb, above n 17, 646- 8; Dwyer, above n 2, 748, 751-2, 764, 774.

³⁰⁰ See especially *The Mirrlees Review*, above n 17, 22-3, 29, 40-1.

³⁰¹ *Asprey Review*, above n 34, [3.24]; Rousslang, above n 92, 10; But see Cooper, above n 97, 438, 441; See generally *The Mirrlees Review*, above n 17, 29: it quantifies distortions using deadweight loss.

³⁰² *Asprey Review*, above n 34, [3.25], [3.26].

³⁰³ *Ibid.*

³⁰⁴ Alley and Bentley, above n 2, 592; Rousslang, above n 92, 10-11; Treasury, 'Report on Australia's Future Tax System' (Architecture of Australia's Tax and Transfer System, Report No 6, Australian Commonwealth

Likewise, Dwyer may provide a basis for promoting neutrality as constructed here. As a critical component of a good tax, Dwyer generally concentrates on minimising tax distortions to protect tax bases.³⁰⁵

2.2.3.4.4 Positive Anti-Neutrality

A tax system/regime may be employed for purposes other than revenue generation.³⁰⁶ Thus, the outcomes arising from a lack of neutrality should not be evaluated by merely considering the revenue generation function. Tax design accepts as legitimate the abandoning of neutrality (whether as minimising tax distortions or uniformity) to achieve other policy objectives beneficial to the greater public good.³⁰⁷

However, deviations or exceptions to neutrality (or Positive Anti-Neutrality) should ideally be applied within the confines of predetermined controls.³⁰⁸ Otherwise, specific departures might not be warranted as they cause unnecessary waste and insufficient advantage.³⁰⁹ Relevant controls may include: firstly, applying deviations as a tax design measure of last resort; secondly, for a limited time; thirdly, to achieve clear, express, and quantifiable objectives; and fourthly, as a measure that is subject to periodic review.³¹⁰ Thus, good tax design generally

Government, 2008) 216 ('*Report No 6*'); Cf M Govinda Rao, 'The Tyranny of the Status Quo: The Challenge of Reforming Indian Tax System' (Preliminary draft of the paper presented at Twelfth India Policy Forum Conference, New Delhi, 14–15 July 2015) 6; See generally Musgrave, above n 110, 160-2. Comprehensive income may be employed for delineating and quantifying a tax base. The construct finds common utilisation in tax design projects. The concept advocates that both consumption and net accretions to savings within a specific time be taxed, and in so doing, it generally advances a taxation that is comprehensive and uniform. Thus, uniformity is achieved by employing the same tax treatment irrespective of the receipt's nature. Thus, it avoids potential distortions from adopting different tax treatments for different receipts. See generally Cooper, above n 97, 414-15; *Report No 6*, above n 304, 216

³⁰⁵ Dwyer, above n 2, 747. See generally *The Mirrlees Review*, above n 17, 29.

³⁰⁶ Alley and Bentley, above n 2, 582-3; *Carter Report*, above n 89, 4. Cooper, above n 97, 417, 419.

³⁰⁷ *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 32.

³⁰⁸ *Ibid* [3.26].

³⁰⁹ *The Mirrlees Review*, above n 17, 29, 32, 40-1.

³¹⁰ *Asprey Review*, above n 34, [3.26].

requires that taxes are constructed neutrally, and thus, more efficiently.³¹¹ Nonetheless, as considered below, Positive Anti-Neutrality as a tax design technique will be particularly relevant for constructing an optimal shipping tax regime.

2.2.3.4.5 Final Submissions

Therefore, the benchmark for efficiency will promote the broader construction of neutrality, as detailed above.

2.2.3.5 The Three Exemplars as Benchmarked

In summary, the simplicity and efficiency exemplars as benchmarked incorporate particular components of the Smithian criterion of Economy in Collection in varying degrees. Thus, the simplicity and efficiency benchmarks jointly accommodate the subject matters of the different criteria under the original Smithian version, other than equality and certainty.³¹² The equity benchmark is orientated on the essential minimum of Smithian equality as conventionally constructed. Furthermore, the thesis has adopted an approach that treats simplicity and certainty as two different criteria, with the certainty benchmark incorporating the original Smithian certainty core.

³¹¹ *Asprey Review*, above n 34, [3.26]; *The Mirrlees Review*, above n 17, 40-1.

³¹² Convenience of Payment requires the charging and collection of taxes to be performed at a time and via a method convenient for taxpayers (See heading 2.2.2.3 above) Thus, it's essentially a criterion focusing on making it easier to discharge a tax liability. Where discharging a tax liability is easier, this should generally register as a reduction in compliance costs. Therefore, Convenience of Payment may similarly be accommodated by the simplicity benchmark.

2.2.4 Step Three: Applying the Benchmarks

The thesis will now execute the third step. The assessment will consider whether the exemplars as benchmarked are in substance present across selected versions of the Smithian Framework. Recent versions of the *Smithian Framework* associated with selected G20 States will now be considered. The purpose of the analysis is to assess the validity of the postulation that asserts that the exemplars constitute the most common criteria across the different versions of the Smithian Framework. The thesis will additionally assess at a secondary level whether any other criteria may be classified as standard criteria, including the certainty criterion as benchmarked.

The thesis has somewhat randomly selected a sample of eight G20 States from a designated list of States.³¹³ The following G20 States will be considered: Australia, Canada, China, India, Japan, South Africa, the United Kingdom, and the United States of America. The selection, however, intentionally includes three States in Asia.³¹⁴ The latter States have been selected as they have experienced significant economic growth in their post-World War II and post-colonial development. Accordingly, their tax policy is of specific interest to the present enquiry, involving identifying a shipping tax regime that does not erode its tax base.³¹⁵ The

³¹³ The designated list employed to select the States ranks them according to having the largest economies globally. Focusconomics, 'The World's Top 10 Largest Economies' (8 November 2018) <<https://www.focus-economics.com/blog/the-largest-economies-in-the-world>>: The selected States were ranked as follows: (1) USA; (2) China; (3) Japan; (5) UK; (6) India, and; (10) Canada.

Despite neither appearing on the list, Australia and South Africa have also been selected as the thesis studies their shipping tax regimes. The sample of States constitutes about 40% of the total number of G20 States.

³¹⁴ Ibid.

³¹⁵ Yawei Zhang, 'Individual Income Tax Reform and Wealth Redistribution in China' (2014) 7(4) *Journal of Politics and Law* 112, 112; Bert Brys et al, 'Tax Policy and Tax Reform in the People's Republic of China' (Taxation Working Paper No 18, OECD, 2013) 4, 6-7; Vasanthi Monsingh Peter, Ian A Kerr and Michael Thorpe, 'Tax Policy in India' (2002) 24(1) *Asian Journal of Public Administration* 111, 111, 116-7; Hiromitsu Ishi, 'Historical Background Of The Japanese Tax System' (1988) 29(1) *Hitotsubashi Journal of Economics* 1,14; Hiroshi Kaneko, 'The Japanese Income Tax System and the Disparity of Income and Wealth among People in Japan' (Paper presented at a Sho Sato Conference on Tax Law, Social Policy, and the Economy, University of California, Berkeley, March 2009) 4; Fan, above n 163, 543, 549; Minoru Nakazato and J Mark Ramseyer, 'Tax Law Hiroshi Kaneko and the Transformation of Japanese Jurisprudence' (2010) 58 *The American Journal of Comparative Law* 721, 721, 724-5, 727; Stewart, above n 117, 158, 172, 186.

thesis also prefers avoiding an exclusively Western-centric analysis in considering the exemplars.³¹⁶

The analysis under step three will be broken up into two parts: The first part will consider roughly the broader tax policy of the selected Asian States. The second part will consider the criteria of recent versions of the *Smithian Framework* associated with the remaining selected G20 States.

The OECD has submitted that the exemplars, with particular reference to equity and simplicity, have played a role in shaping the tax policy of the selected G20 States – among others.³¹⁷ The underlying report also mentions a criterion of transparency.³¹⁸ Transparency is constructed as a criterion that considers understandability regarding a tax system's operation.³¹⁹ Thus, as packaged in the OECD report, the transparency criterion seems in substance to align with the benchmarked certainty criterion, particularly at its peripheral level.³²⁰ The simplicity benchmark may also address transparency where the analysis is cost orientated.

³¹⁶ Stewart, above n 117, 149, 173-8.

³¹⁷ Brys, Matthews and Owens, above n 163, 15.

³¹⁸ Ibid.

³¹⁹ Ibid.

³²⁰ The approach of the thesis may entail treating understandability issues under simplicity as benchmarked where costs are relevant, and under the corresponding certainty criterion where it is not appropriate to directly consider costs.

2.2.4.1 Step Three Part One: The Asian States

2.2.4.1.1 Equity Reimagined Predominantly through Horizontality

Equity is broadly recognised in the literature as a critical criterion that assesses the fairness of a tax system.³²¹ Stewart opines that the primary objective conventionally pursued through a criterion of equity is a redistribution of income between the taxpayers of a State.³²² In accomplishing this outcome, policymakers have generally allowed verticality to dominate the criterion.³²³ Accordingly, the classical approach to equity focuses exclusively or mainly on the vertical abstraction.³²⁴ Nonetheless, and despite some opposition, tax design projects do not universally and equally promote the vertical abstraction.³²⁵ Thus, horizontality, constructed as an independent abstraction, may be promoted, where appropriate, above verticality, as an option for addressing intra-systemic misalignments.³²⁶

In designing an optimal shipping tax regime, a significant issue will be addressing the intra-systemic misalignment arising between efficiency and verticality.³²⁷ Thus, the promotion of the horizontal abstraction, and the corresponding subjugation of the vertical abstraction, may allow for the benchmarked efficiency criterion to be applied more compatibly with equity.³²⁸

³²¹ See generally Yuhua Qiao, 'An Evaluation of China's Tax System: Insights for Future Reform' (2007) 4(1-2) *Chinese Public Administration Review* 37, 37-8; Fan, above n 163, 540, 544; Regarding the philosophical theories for equity, see generally Jean-Yves Duclos, 'Innis Lecture: Equity and Equality' (2006) 39(4) *The Canadian Journal of Economics* 1073, 1086; See also Fan, above n 163, 544.

³²² Stewart, above n 117, 185.

³²³ Ibid.

³²⁴ Fan, above n 163, 544; Galle, above n 137, 1324-7; Stewart, above n 117, 171; But see Cobb, above n 17, 646-8; But see Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5.

³²⁵ Fan, above n 163, 544; Galle, above n 137, 1325-8; Rousslang, above n 92, 3-5; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Stewart, above n 117, 185.

³²⁶ Fan, above n 163, 539-40; 544; Rao, above n 304, 8; Rousslang, above n 92, 4; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5.

³²⁷ Fan, above n 163, 540, 542, 544-5, 547.

³²⁸ Ibid.

Thus, a tax design project may recognise equity as conventionally abstracted, to some degree, whilst more optimally addressing a misalignment.³²⁹

Suppose verticality was required as an absolute rule to dominate the equity criterion in all circumstances. In that case, it might unnecessarily limit the range of fiscal outcomes that may practically be achieved where a dominant promotion of equity is broadly required.³³⁰ Further, as the *Smithian Framework* may operate to some degree at Pareto optimality, it may be complex to address specific intra-systemic misalignments appropriately.³³¹ Notably, verticality may reduce a tax's efficiency by increasing its distortions.³³² Thus, although verticality is a critical function for realising distributive fairness, it should not be applied religiously in constructing all individual taxes.³³³ Verticality may not affect different tax bases equally by progressively increasing tax rates.³³⁴ Thus, good tax design generally establishes an inverse correlation between base mobility and verticality for more mobile tax bases.³³⁵ This rule of thumb is particularly relevant for shipping tax regimes as shipping income may exhibit high mobility.³³⁶

Hence, if horizontality is constructed as a distinct element, this may better align equity, as still somewhat conventionally abstracted, with other Smithian criteria.³³⁷ This horizontal orientation is particularly relevant where efficiency is prioritised as a dominant criterion in

³²⁹ Ibid.

³³⁰ *The Mirrlees Review*, above n 17, 22-3; Stewart et al, above n 2, 4-6; Fan, above n 163, 540-1, 544-5.

³³¹ Ingham, above n 136; Dwyer, above n 2, 753; Alley and Bentley, above n 2, 582.

³³² Stewart et al, above n 2, 4-6; Fan, above n 163, 540-1, 544-5; *The Mirrlees Review*, above n 17, 23.

³³³ *The Mirrlees Review*, above n 17, 22-3; *The Henry Review*, above n 89, 29-30; Dwyer, above n 2, 747-8, 892.

³³⁴ Ibid.

³³⁵ Cobb, above n 17, 629, 631, 648; Dwyer, above n 2, 664, 667, 672-3, 728, 732-3, 747-8, 752, 764, 776, 908, 955.

³³⁶ *1998 DETR Report*, above n 23, 16; McMahon, above n 36, 104-6.

³³⁷ Cobb, above n 17, 627, 631-2; Dwyer, above n 2, 664, 747-8, 752; See generally Stewart et al, above n 2, 4.

conditions where efficiency negatively correlates with verticality, like increasing base mobility.³³⁸

In particular, a harmonisation between equity and efficiency may be achieved as follows:

1. By recognising the independence of horizontality and allowing it to dominate the equity criterion where appropriate.³³⁹
2. By simultaneously diminishing verticality, either in whole or in part, as appropriate.³⁴⁰
3. Thus, equity's primary emphasis is essentially orientated to fiscal uniformity.³⁴¹
4. By accepting that the efficiency criterion is primarily focused on minimising tax distortions.³⁴²
5. By recognising that fiscal uniformity generally supports minimising tax distortions.³⁴³
6. By accepting that a natural convergence may arise between efficiency and horizontality to the extent that they both essentially promote an overlapping uniformity.³⁴⁴
7. By promoting efficiency through uniformity, horizontality may also indirectly be promoted.³⁴⁵
8. Thus, equity orientated on horizontality may align better with efficiency.³⁴⁶

³³⁸ Ibid.

³³⁹ *The Mirrlees Review*, above n 17, 33-41; 160; 162; Fan, above n 163, 544; Galle, above n 137,1325-8; Rousslang, above n 92, 3-5; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Stewart, above n 117, 185.

³⁴⁰ Ibid; *The Mirrlees Review*, above n 17, 22-3.

³⁴¹ *The Mirrlees Review*, above n 17, 34; Alley and Bentley, above n 2, 592, 601; Cobb, above n 17, 631, 646; Dwyer, above n 2, 747-8.

³⁴² Cobb, above n 17, 631, 646-8, 650, 660; Dwyer, above n 2, 664, 667-8, 728, 747-8, 752, 764; *The Mirrlees Review*, above n 17, 22-3, 40-1.

³⁴³ *The Mirrlees Review*, above n 17, 23, 34, 40-1; Alley and Bentley, above n 2, 592, 601; See generally Musgrave, above n 110, 160-1; See generally Cooper, above n 97, 414-15; Cobb, above n 17, 631, 646-8, 650, 660; Dwyer, above n 2, 664, 667-8, 728, 747-8, 752, 764.

³⁴⁴ Ibid.

³⁴⁵ *The Mirrlees Review*, above n 17, 23, 34, 40-1; Fan, above n 163, 540-2, 544-5, 547; Galle, above n 137,1325-8.

³⁴⁶ Ibid.

In support of the above approach, previous research submits that where tax design is focused on income distribution, the focus of the equity criterion should be directed primarily on its vertical abstraction.³⁴⁷ However, if the tax aims to stimulate economic growth by, for example, prioritising efficiency over equity, the focus of the equity criterion should primarily be on its horizontal abstraction.³⁴⁸

Severely or inappropriately taxing entities, including individuals, where base mobility is a concern, can obstruct the inward flow of necessary skilled labour and capital into a State.³⁴⁹ This obstruction may negatively affect the economic growth of a State.³⁵⁰ Thus, previous research advises that a more horizontal tax with lower tax rates (among other things) may be more optimal for stimulating economic growth by prioritising efficiency and subjugating verticality to some degree.³⁵¹ By adopting a more flexible approach to equity, policymakers can still pursue equity, whilst simultaneously responding to issues like protecting and growing particular tax bases.³⁵²

Systemically prioritising efficiency over verticality has been recognised in varying degrees as a legitimate tax design practice in the fiscal policy of the selected Asian States.³⁵³ Their recent

³⁴⁷ Fan, above n 163, 540-1, 544-5; But see Rao, above n 304, 8: ‘The general presumption is that ... direct taxes should be designed to reduce inequalities and therefore, the traditional approach is to design highly progressive personal income tax systems and levy high rates on corporate incomes. This has, however, come into serious questioning.’

³⁴⁸ Fan, above n 163, 540-2, 544-5, 547; Rousslang, above n 92, 4-5; Galle, above n 137, 1327-8; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Stewart et al, above n 2, 85-6.

³⁴⁹ Stewart et al, above n 2, 1, 4-6, 18, 25, 83; Fan, above n 163, 542-3; Rao, above n 304, 8.

³⁵⁰ Ibid.

³⁵¹ Fan, above n 163, 541, 546-9; Rousslang, above n 92, 4-5; Peng Zhan, Shi Li and Xiaojing Xu, ‘Personal Income Tax Reform in China in 2018 and Its Impact on Income Distribution’ (2019) 27(3) *China & World Economy* 25, 30; Rao, above n 304, 8.

³⁵² Fan, above n 163, 544-5.

³⁵³ Ibid 540-1, 543, 549; Stewart, above n 117, 150-1, 158, 172, 185-6; Zhang, above n 315, 112-3; Brys et al, above n 315, 4, 6-7; Peter, Kerr and Thorpe, above n 315, 111, 116-7, 127; Ishi, above n 315, 14; Kaneko, above n 315, 4; Nakazato and Ramseyer, above n 315, 721, 724-5, 727.

economic history demonstrates a willingness to promote efficiency at the expense of verticality to build (or build back) their economies.³⁵⁴

2.2.4.1.1.1 China

In China, income tax design features elements geared towards introducing fairness.³⁵⁵ Some academics opine that fiscal fairness is, however, restricted to taxing the income of Chinese individuals.³⁵⁶ However, there is also evidence that equity considerations have played some role in designing other taxes in the Chinese system, like taxes on companies.³⁵⁷

For example, tax reform initiatives spanning several years have had a progressive effect in eliminating the different tax treatments applied to different companies (or enterprises) recognised in Chinese law. Tax differentiation occurred depending upon whether an entity was state-owned (an SOE) versus private and local versus foreign.³⁵⁸ Thus, the different enterprises are now subjected to a more uniform Chinese tax treatment.³⁵⁹ Applying a uniform tax treatment introduces some horizontality in taxing enterprises.³⁶⁰

³⁵⁴ Ibid

³⁵⁵ Zhang, above n 315, 112-3; Zhan, Li and Xu, above n 351, 25-6, 28

³⁵⁶ Ibid; But see Qiao, above n 321, 42.

³⁵⁷ Wanda Tseng et al, 'Economic Reform in China: A New Phase' (Occasional Paper 114, IMF, 1994) kindle location 815, 838-80, 956, 1057, 1065, 1067, 1075.

³⁵⁸ Ibid; See generally State Taxation Administration of the People's Republic of China, *China Enterprise Income Tax (EIT)* (2019) < <http://www.chinatax.gov.cn/eng/c101280/c5099666/content.html>>; PWC *Overview of PRC Taxation System* (2003-2019) <<https://www.pwccn.com/en/services/tax/accounting-and-payroll/overview-of-prc-taxation-system.html>>

³⁵⁹ Ibid.

³⁶⁰ Ibid.

Hence, the Chinese system demonstrates horizontality.³⁶¹ Additionally, the system employs progressive tax rates for certain types of income.³⁶² Thus, the progressivity establishes some verticality.³⁶³ Accordingly, the benchmarked equity criterion has, on the whole, played some influence in constructing the modern Chinese tax system.³⁶⁴ However, the Chinese tax system may be criticised as systemically favouring horizontality at verticality's expense to achieve particular policy objectives.³⁶⁵

2.2.4.1.1.2 India

Similarly, there is evidence that tax policy in India has been designed by taking both horizontal and vertical considerations into account as constructed conventionally.³⁶⁶ For example, the *Kelkar Report* explicitly references conventional horizontal and vertical equity repeatedly in

³⁶¹ Zhan, Li and Xu, above n 351, 26-8, 31-4; Zhang, above n 315, 113, 118; See generally Qiao, above n 321, 42; See generally PWC, China, People's Republic of Individual - Taxes on Personal Income (28 June 2019) <<http://taxsummaries.pwc.com/ID/Peoples-Republic-of-China-Individual-Taxes-on-personal-income>>; See generally Lee Burns and Richard Krever 'Individual Income Tax' in Victor T Thuronyi (ed), *Tax Law Design and Drafting* (IMF, 1998) vol 2, 1: A schedular income tax is one in which separate taxes are imposed on different categories of income.'; Regarding the personal income tax regime, which employs a schedular tax design, there is evidence that the Chinese regime may infringe somewhat upon horizontality. The tax rates vary for the different types of income. This is particularly problematic in so far as the personal income tax regime in China is viewed by certain academics as 'the only viable tax that can narrow inequality.': Zhan, Li and Xu, below n 364, 28. The regime may be classified as a hybridised (or, what has been referred to, as a semi-dual) system. It generally taxes different types of income differently, but selected types are grouped together under specific constructs like comprehensive income, which are then taxed uniformly. See generally Brys et al, above n 315, 37, 41-2.'

³⁶² Zhan, Li and Xu, above n 351, 26, 31-4; Zhang, above n 315, 113-4. State Taxation Administration of the People's Republic of China, *Tax types* (30 July 2019) There is evidence that vertical equity is somewhat restricted, as it is, essentially, only applied to a limited number of income-types, and only a very limited number of taxpayers are caught in the highest tax brackets. Therefore, although their comprehensive income category (and business income, however it has lower tax rates) is taxed using progressive tax rates, other income streams, like interest and dividends are taxed at a flat rate, such as, for example, 20%.

³⁶³ Ibid.

³⁶⁴ Zhang, above n 315, 112-3; Zhan, Li and Xu, above n 351, 26-8.

³⁶⁵ State Taxation Administration of the People's Republic of China, *Tax system* <<http://www.chinatax.gov.cn/eng/c101270/c101271/c5094511/content.html>>; Zhan, Li and Xu, above n 351, 30; Zhang, above n 315, 118; Qiao, above n 311, 44; Brys et al, above n 315, 13, 32, 42, 47.

³⁶⁶ Vijay L Kelkar et al, Submission to Department of Finance and Company Affairs of India, *Report of the Task Force on Direct Taxes*, December 2002, 4-6, 11, 23, 24, 69, 91, 102 ('*Kelkar Report*'); Peter, Kerr and Thorpe, above n 315, 113, 127.

assessing the Indian tax system's fairness.³⁶⁷ Hence, the benchmarked equity criterion has, as a whole, also played varying roles at times in constructing the Indian tax system.

2.2.4.1.1.3 Japan

Equity, as benchmarked, has also influenced taxes in Japan.³⁶⁸ After World War II, the Japanese income tax system, first introduced in 1887, was replaced by an American-styled regime.³⁶⁹ The latter regime prioritised equity.³⁷⁰ Further, recent publications of the Ministry of Finance of Japan, including their Tax Commission, expressly reference three primary criteria, including equity.³⁷¹ Hence, the equity benchmark has on occasion shaped the Japanese tax system to some degree.

³⁶⁷Ibid. Specific Indian academics refer to the criterion of equity in their research when analysing the Indian tax system. Rao, above n 304, 5, 8, 10; Peter, Kerr and Thorpe, above n 315, 113; Nishant Ghuge, 'Indian Tax Structure- An Analytical Perspective' (2015) 3(9) *International Journal in Management and Social Science* 242, 246-7. There appears to be some support for favouring horizontality: Rao, above n 304, 5-8, 10; M Govinda Rao, 'Tax Reform in India: Achievements and Challenges' (2000) 7(2) *Asia-Pacific Development Journal* 59, 60-1, 72; *Kelkar Report*, above n 348, 24, 66-7, 69, 75, 170; Peter, Kerr and Thorpe, above n 348, 111, 127

³⁶⁸ Kaneko, above n 315, 3-4; Fan, above n 163, 539-40, 543, 549; See generally Carl S Shoup, 'Tax Reform in Japan' (1990) 7 *Australian Tax Forum* 411.

³⁶⁹ Ibid; Stewart, above n 117, 149, 150-1, 179, 185; Nakazato and Ramseyer, above n 315, 724-5, 727; Ishi, above n 315, 12-3.

³⁷⁰Ibid.

³⁷¹ Tax Bureau of the Japanese Ministry of Finance, *Comprehensive Handbook of Japanese Taxes* (2010) 4, 11, 14, 15 ('*Handbook of Japanese Taxes*'); The Tax Commission (Japan), *A Sustainable Tax System for Japan's Aging Society*, midterm report (June 2003) 13, 14, 17, 20 ('*Japanese Tax Commission 2003 Report*'); Ministry of Finance Japan, *Learn about the Significance and Role of Taxes* (June 2018) 3 <https://www.mof.go.jp/english/tax_policy/publication/tax008/index.htm>.

2.2.4.1.2 Simplicity

2.2.4.1.2.1 China

A major Chinese modernisation project addressed tax administration, including reducing administrative and compliance costs as conceptualised broadly.³⁷² The modernisation efforts have included simplifying processes and structures by, for instance, reducing the number of taxes³⁷³ and brackets.³⁷⁴ The latter changes should also favourably impact the corresponding cost implications.³⁷⁵ Thus, as benchmarked, simplicity has moulded Chinese tax reform.

2.2.4.1.2.2 India

The simplicity benchmarked criterion has, likewise, shaped Indian tax reform.³⁷⁶ For instance, the *Kelkar Report* recommended simplifying the structures and processes of the Indian tax system,³⁷⁷ which may be expected to reduce the related administrative and compliance costs.³⁷⁸ Further, the *Kelkar report* in specific instances promotes simplicity over equity for managing

³⁷² John Brondolo and Zhiyong, Zhang, 'Tax Administration Reform in China: Achievements, Challenges, and Reform Priorities' (Working Paper, IMF, 2016) 6-7, 9; At 6: 'The overriding objective for the tax administration reforms was to achieve sustainable increases in tax revenue by improving taxpayers' compliance.' A wide understanding of administration and compliance was represented, including their corresponding costs implications, through factors like reducing time and increasing ease.

³⁷³ Ibid 11.

³⁷⁴ Zhan, Li and Xu, above n 351, 35.

³⁷⁵ Ibid; Brondolo and Zhang, above n 375, 11, 52-7; Qiao, above n 321, 43.

³⁷⁶ Peter, Kerr and Thorpe, above n 315, 113, 115; *Kelkar Report*, above n 366, 5. 'Our proposals to simplify and enhance transparency of the tax system would thus in fact help individual taxpayers, by reducing their compliance costs.': at 5; See generally G Thimmaiah, 'Tax Reform in India: An Evaluation' (1994) 6(4) *Journal of Indian School of Political Economy* 780, 781-2.

³⁷⁷ *Kelkar Report*, above n 366, 5, 18, 21, 78, 79, 128, 210: One simplification example, among others, includes removing the distinction between 'ordinary residents' and 'residents' for applying the Indian income tax system on a world-wide basis.

³⁷⁸ Ibid; For more recent recommendations on Indian tax administration, see generally Indian Tax Administration Reform Commission of 2013 in Alastair Thomas et al, 'Taxation and Investment in India' (Economics Department Working Papers No 1397, OECD, 2017) 37-38.

misalignments and references certainty.³⁷⁹ Additionally, specific research papers by Indian academics refer to simplicity in their analysis of the Indian tax system.³⁸⁰ Thus, the benchmarked simplicity criterion has played some role in Indian Tax reform.

2.2.4.1.2.3 Japan

Likewise, the benchmarked simplicity criterion has influenced Japanese tax reform.³⁸¹ Recent publications of the Ministry of Finance of Japan, and their Tax Commission, expressly reference simplicity.³⁸² Their simplicity criterion has focused on simplifying the structures and processes of their tax system and making it more understandable.³⁸³ It is submitted that the simplicity and certainty benchmarks can jointly and appropriately accommodate these objectives.³⁸⁴

³⁷⁹ *Kelkar Report*, above n 366, 104, 170, 226: This promotion may have, partly, been achieved by favouring the horizontal abstraction in resolving intra-nuclear misalignments. An example being applying flat tax rates to selected income types of particular entities instead of progressive tax rates. See at 104: The employment of a less progressive tax by keeping tax brackets to a minimum and thereby making it more horizontal and less progressive. Moreover, the *Kelkar Report* considers issues of certainty: at Ibid 15-6, 121, 140, 161-2. For example, the *Kelkar Report* recommends the employment of an 'all-in-one-go' approach to implementing corporate tax reform in contrast to a phased-in or staggered approach. It is considered that the former approach would have better outcomes for certainty.

³⁸⁰ Peter, Kerr and Thorpe, above n 315, 113, 115; Rao, above n 304, 5-6, 8, 12; Rao, above n 367, 60-1; Ghuge, above n 367, 246-7; See generally Alastair Thomas et al, 'Taxation and Investment in India' (Economics Department Working Papers No 1397, OECD, 2017) 32, 37-8, 40.

³⁸¹ Michael J O'Keefe, 'Japanese Tax Law: A Canadian Perspective' (1996) 20 *Univ British Columbia Law Review* 401, 425.

³⁸² *Handbook of Japanese Taxes*, above n 371, 4, 11, 14, 15; *Japanese Tax Commission 2003 Report*, above n 371, 9, 14; Ministry of Finance Japan, above n 371, 3.

³⁸³ Ibid.

³⁸⁴ Ibid. Certainty would consider matters that are not addressed *directly* through costs, as required by the project, like understandability.

2.2.4.1.3 Efficiency

2.2.4.1.3.1 China

Efficiency, as benchmarked, has played a significant role in shaping tax policy in China.³⁸⁵ The criterion is referred to primarily as neutrality in the relevant source material.³⁸⁶ Efficiency has been one of the main drivers in designing the Chinese Enterprise Income Tax Law (EITL)³⁸⁷ A central objective of the EITL is to provide a neutral tax treatment, irrespective of whether the entity is a domestic or foreign investment enterprise.³⁸⁸ The efficiency criterion has also influenced other parts of the Chinese tax system.³⁸⁹

2.2.4.1.3.2 India

Likewise, efficiency has played a role in guiding tax reform in India.³⁹⁰ For example, the *Kelkar report* recommended adopting a uniform tax treatment for financial instruments irrespective of their maturities.³⁹¹ This measure was intended to address the tax system's interference with taxpayers' choices when selecting instruments with different maturities.³⁹²

³⁸⁵ Antony Ting and Xiliang Ge, 'China's Enterprise Income Tax System: Policy Objectives and Key Design Features' (2014) 29 *Australian Tax Forum* 611, 613, 627; Qiao, above n 321, 43.

³⁸⁶ Ting and Ge, above n 385, 613: 'The policy objective of neutrality dictates that ideally a tax system should not interfere with a taxpayer's decisions on allocation of resources. For instance, a tax system should not affect business decision regarding the choice between different forms of business structure. Neutrality represents the economic concept of efficiency which should guide the allocation of resources in a society to minimise wastage'.

³⁸⁷ *Ibid*; Regarding previous reforms see generally Wanda Tseng et al, above n 357.

³⁸⁸ Ting and Ge, above n 385, 613, 616.

³⁸⁹ Zhang, above n 315, 112; Zhan, Li and Xu, above n 351, 30; Qiao, above n 321, 43. Higher taxes on high-income groups, like large business owners and scientific researchers may impact their contribution negatively and therefore tax incentives (among other things) have been applied to reduce their impact. It has been roughly observed in the thesis that the personal income tax system in China favours horizontality to some significant degree. This preference may support a greater systemic emphasis on efficiency.

³⁹⁰ *Kelkar Report*, above n 366, 3, 93; See also Peter, Kerr and Thorpe, above n 315, 113, 114-5; Rao, above n 367, 60-1, 64, 72; Rao, above n 304, 5-6, 8, 9; Thimmaiah, above n 376, 781: The *Chelliah Report* applied efficiency as one of its guiding criteria.

³⁹¹ *Kelkar Report*, above n 366, 93.

³⁹² *Ibid*.

2.2.4.1.3.3 Japan

Efficiency has also played a prominent role in specific tax-reform initiatives in Japan.³⁹³

After World War II, the Japanese gradually modified the American-styled income tax regime.³⁹⁴ The effect of the Japanese modification was to give priority to efficiency over equity systemically.³⁹⁵ A primary objective for adopting the modified prioritisation was stimulating economic growth.³⁹⁶ Further, recent publications of the Japanese Ministry of Finance, and their Tax Commission, have also referenced neutrality as a key criterion.³⁹⁷

2.2.4.1.4 In Summary

The brief assessment roughly demonstrates the following for the three Asian States under review:

- Firstly, all three benchmarked exemplars (and the certainty benchmark) have played some role in constructing their taxes.
- Secondly, on occasion, their fiscal policy demonstrates a practice to prioritise efficiency over verticality.³⁹⁸

³⁹³ Ishi, above n 315, 14; Kaneko, above n 315, 4; Fan, above n 163, 543, 549; Nakazato and Ramseyer, above n 315, 721, 724-5, 727.

³⁹⁴ Kaneko, above n 315, 4; Fan, above n 163, 543, 549; Stewart, above n 117, 149, 150-1, 158, 172, 179, 185-6; Nakazato and Ramseyer, above n 315, 721, 724-5, 727; Ishi, above n 315, 12-4.

³⁹⁵ Ibid.

³⁹⁶ Ibid.

³⁹⁷ *Handbook of Japanese Taxes*, above n 371, 4, 11, 14, 15, 17; *Japanese Tax Commission 2003 Report*, above n 371, 6, 7, 9, 13, 14; Ministry of Finance Japan, above n 371, 3. The Japanese criterion of neutrality corresponds roughly with the benchmarked criterion of efficiency.

³⁹⁸ Julie Cassidy, Man Hung Alvin Cheng 'Reshaping the Financial Regulatory Framework in China: Improving the Individual Income Tax on Securities Trading' (2016) 6(1) *Journal of Chinese Tax and Policy* 2, 3-4, 16-7; Adrian Sawyer, 'Individual Income Tax Reform in China: Reflections on New Zealand's Experience' (2016) 6(1) *Journal of Chinese Tax and Policy* 53, 79-80.

2.2.4.2 Part Two of Step Three: Assessing Selected Versions

The thesis will now briefly consider the criteria mix of recent versions of the *Smithian Framework* associated with the following G20 States: Australia; South Africa; the United Kingdom; Canada; and the United States of America.

2.2.4.2.1 The Australian Version

The Henry Review is a recent major tax review project that updated the Australian version of the Smithian Framework.³⁹⁹ The updated Australian version comprises the following criteria:⁴⁰⁰

- i Equity
- ii Efficiency
- iii Simplicity
- iv Sustainability
- v Policy Consistency

From a quick perusal of the form of the criteria, it seems apparent that the exemplars are included within the full complement.⁴⁰¹ However, the critical issue is whether the substance of the relevant criteria matches the substance of the corresponding benchmarks.

³⁹⁹ *The Henry Review*, above n 89, 17; Stewart et al, above n 2, 1; Business Council of Australia, above n 120, 11. The last major review in Australia predating *The Henry Review*, considering the criteria of the Australian version was the *Asprey Review*, above n 34.

⁴⁰⁰ *The Henry Review*, above n 89, 17; Stewart et al, above n 2, 1; Evans, above n 113, 388; Du Preez, above n 87, 75-6; See generally Alley and Bentley, above n 2, 586-8.

⁴⁰¹ *The Henry Review*, above n 89, 17. See items i, ii and iii here above.

2.2.4.2.1.1 Equity

It is submitted that the Australian equity criterion tracks the benchmark.⁴⁰² It is underpinned by the ability to pay and quantified by a conventional measure of income formulated on a somewhat comprehensive basis.⁴⁰³ The conventional abstractions of equity are present.⁴⁰⁴ However, verticality has primarily been limited to taxing individuals.⁴⁰⁵ Further, *The Henry Review* considers that it may sometimes be better to preserve minor degrees of inequity for individual regimes, where appropriate, to realise systemic simplicity better.⁴⁰⁶ Like a significantly inequitable one, a complex system can expose individuals with less economic power to undue hardship and prejudice.⁴⁰⁷ However, *The Henry Review* reaffirms the importance of equity as a critical criterion.⁴⁰⁸

⁴⁰² Ibid 17, 29; Stewart et al, above n 2, 6.

⁴⁰³ *The Henry Review*, above n 89, 17, 23, 24, 25-6, 30, 32, 42, 80; Stewart et al, above n 2, 3-4, 6-7, 9; ‘personal income, assessed on a more comprehensive base.’: at 26; Nonetheless, and despite any express statements that might suggest otherwise, it may be incorrect to hold that *The Henry Review* applies verticality exclusively to individuals. For example, it proposes an expansion of tax concessions for small business entities, and in so doing, it may apply some form of verticality there.

⁴⁰⁴ *The Henry Review*, above n 89, 17, 16, 17, 30, 80, 173, 177; Stewart et al, above n 2, 6-7. Verticality finds concrete expression in their proposals. An example includes advocating for individual tax rates to be progressive (albeit reduced in number).

⁴⁰⁵ *The Henry Review*, above n 89, 16, 25-6, 29, 37, 40; Evans, above n 113, 388; Stewart et al, above n 2, 6-8; See generally *Carter Report*, above n 89, 11; See also Mirrlees et al, above n 138, 334-5. Express acknowledgement for the proposition may be found in the following quotation: ‘The personal tax structure should be the sole means of delivering progressivity in the tax system’: at 29. The *Carter Report* opines that the ability to pay is generally restricted to personal income tax. Thus, vertical equity and wealth redistribution cannot, generally speaking, be achieved by employing other taxes, like sales tax and corporate income taxes.

⁴⁰⁶ *The Henry Review*, above n 89, viii (4.4), xix; 15-6, 21, 29, 30-1, 80; For instance, express acknowledgement for the proposition may be found in the following quotations: ‘All FBT exemptions should be reviewed to determine their continuing appropriateness, and consideration should be given to excluding fringe benefits from tax where the costs of compliance outweigh equity and tax integrity considerations’: at 30; ‘Policy settings should be coherent and reflect a greater emphasis on simplicity and transparency than is presently evident’: at 16; ‘Significant among the causes of complexity are the pursuit of finely calibrated equity and efficiency outcomes’: at 21.

⁴⁰⁷ Ibid.

⁴⁰⁸ *The Henry Review*, above n 89, 29.

2.2.4.2.1.2 Simplicity

The updated Australian version locates administrative and compliance costs under efficiency.⁴⁰⁹ Thus, its simplicity criterion ostensibly concentrates on two other aspects.⁴¹⁰ Firstly, it focuses on making a tax system easier to understand; and secondly, it focuses on simplifying matters of compliance.⁴¹¹ However, the above two aspects may have indirect implications for administrative and compliance costs.⁴¹² Thus, they may be accommodated by the simplicity benchmark.

In particular, *The Henry Review* recommends making the structures and processes less complex.⁴¹³ This initiative is intended to increase understandability.⁴¹⁴ Thus, increases in understandability may produce decreases in relevant costs.⁴¹⁵ Subject matters not orientated directly on administrative and compliance costs may, where appropriate, be directly accommodated by the certainty benchmark.

Further, *The Henry Review* promotes a more dominant ranking for simplicity.⁴¹⁶ The favourable ranking includes considerations like technological advances that may allow simplicity to be more easily realised.⁴¹⁷

⁴⁰⁹ Ibid 17; See also Rousslang, above n 92, 6.

⁴¹⁰ *The Henry Review*, above n 89, 17.

⁴¹¹ Ibid 2, 17, 21.

⁴¹² Ibid; Stewart et al, above n 2, 9-10.

⁴¹³ *The Henry Review*, above n 89, 80, 104; Evans, above n 113, 388; See generally Rousslang, above n 92, 8.

⁴¹⁴ *The Henry Review*, above n 89, 29-30, 80, 104. For example, *The Henry Review* recommends that a larger zero percent tax-bracket be applied as a tax-free threshold as it is simpler to understand. Moreover, as an example of simplicity in process, *The Henry Review* recommends that reporting obligations be aligned with natural existing records and information systems.

⁴¹⁵ Ibid; Evans, above n 113, 388; See generally Rousslang, above n 92, 8.

⁴¹⁶ *The Henry Review*, above n 89, 16, 21, 24.

⁴¹⁷ Ibid 11, 15, 24, 30-1, 69, 71; Stewart et al, above n 2, 11-2.

2.2.4.2.1.3 Efficiency

The Henry Review adopts neutrality as a core element of its efficiency criterion that is generally equivalent in its construction to the benchmarked criterion.⁴¹⁸ Under the Australian version, neutrality addresses economic efficiency and distortions.⁴¹⁹ *The Henry Review* provides the following definition for efficiency, including economic efficiency:⁴²⁰

Efficiency means making the best use of resources. Technical or productive efficiency means producing as many goods and services as possible from a given set of inputs. Allocative or economic efficiency means putting productive resources (like labour, land, or capital) to their highest-value use and distributing goods and services to consumers in a way that best satisfies consumer needs and wants.

Distortions are defined as follows:⁴²¹

Any action or thing that reduces economic efficiency. Distortions generally arise when private action (such as price-fixing by a cartel), or public action (such as a tax imposed by government), changes an individual's or firm's behaviour.

The Henry Review observes that different taxes may have different efficiency implications.⁴²² In particular, corporate taxes may generate more significant distortions because of greater capital mobility.⁴²³ The mobility may be supported by various factors, including globalisation and technological advances.⁴²⁴ *The Henry Review* adopts a pragmatic approach to corporate income tax.⁴²⁵ *The Henry Review* submits that high and uncompetitive corporate tax rates may be fiscally inefficient.⁴²⁶ They may stifle economic activity by discouraging investment and

⁴¹⁸ *The Henry Review*, above n 89, 17.

⁴¹⁹ *Ibid* vii, 13, 73, 171-2, 176; Stewart et al, above n 2, 4.

⁴²⁰ *The Henry Review*, above n 89, 171.

⁴²¹ *Ibid* 170.

⁴²² *Ibid* 13, 17, 18, 25, 39-40, 48-9, 51; Stewart et al, above n 2, 6.

⁴²³ *The Henry Review*, above n 89, 18, 39-40; Stewart et al, above n 2, 21-2, 64-6.

⁴²⁴ Stewart et al, above n 2, 21-2, 64-6.

⁴²⁵ *The Henry Review*, above n 89, 17-8, 25, 39-40; Evans, above n 113, 388.

⁴²⁶ *Ibid*.

entrepreneurial efforts, which are generally more mobile.⁴²⁷ *The Henry Review* submits that corporate income tax may have the most significant adverse effect on economic growth.⁴²⁸ Therefore, as one of its recommendations, *The Henry Review* suggests a re-adjustment downwards of the corporate income-tax rates to make them more competitive than other States and thus, less fiscally-inefficient.⁴²⁹ Further, *The Henry Review* notes that policy instability may increase uncertainty and waste by reducing economic efficiency.⁴³⁰

2.2.4.2.1.4 Sustainability and Policy Consistency

The Henry Review's version contains sustainability and policy consistency as additional criteria.⁴³¹ Sustainability assesses the structural durability and flexibility of a system by assessing how well it:⁴³²

- Firstly, meets *the primary purposes of revenue generation and environmental sustainability*, despite functioning within a dynamic environment (including policy fluidity).
- Secondly, *adjusts to changing circumstances* without infringing the efficiency and equity criteria.

The criterion of policy consistency essentially focuses on constructing a tax system that:⁴³³

- Firstly, comprises fiscal rules that are overall in harmony systemically.

⁴²⁷ Ibid.

⁴²⁸ *The Henry Review*, above n 89, 18, 39-40; Stewart et al, above n 2, 6.

⁴²⁹ *The Henry Review*, above n 89, 39-40; Stewart et al, above n 2, 6; Evans, above n 113, 388.

⁴³⁰ *The Henry Review*, above n 89, 17.

⁴³¹ Ibid.

⁴³² Ibid; Stewart et al, above n 2, 1, 9, 22. '[Sustainability] includes the ability for tax revenues to be sustainable and to recover in the face of external shocks.': Stewart et al, above n 2, 9.

⁴³³ *The Henry Review*, above n 89, 17.

- Secondly, has purposes that are aligned with the objectives of a State's government, without prejudicing the raising of revenue.

Policy consistency is merely a peripheral crystallisation of the benchmarked certainty criterion.⁴³⁴ The extent that a tax system aligns with certainty would depend partly upon the consistency of its fiscal policy.⁴³⁵

2.2.4.2.1.5 Benchmarking Sustainability

The sustainability criterion might be treated as a unique criterion covering a different subject matter. However, the Australian criterion may demonstrate a somewhat narrower construction. Key purposes underlying a system may extend beyond revenue generation and environmental preservation.⁴³⁶ Thus, the thesis will reformulate the criterion more broadly in benchmarking it.

The benchmark for sustainability will evaluate the structural durability, reliability and flexibility of a system by assessing the extent that it:

- Firstly, *meet its primary purposes, including revenue generation*, despite functioning within a dynamic environment (including policy fluidity).
- Secondly, *adjusts to changing circumstances* without infringing the Smithian Framework's criteria, particularly the top priorities.

⁴³⁴ Stewart et al, above n 2, 9: 'Dramatic swings of policy direction generate significant uncertainty for individuals and businesses, and this may undermine economic prosperity.'

⁴³⁵ Ibid.

⁴³⁶ Cooper, above n 97, 418-20; Alley and Bentley, above n 2, 583, 585.

2.2.4.2.1.6 Final Submissions

Equity, simplicity and efficiency as constructed by *The Henry Review* correspond with the joint subject matters of the exemplars as benchmarked. Thus, the benchmarked exemplars are substantively present in the updated Australian version. The certainty benchmark is also substantively present and a unique criterion of sustainability. The thesis more broadly reconstructs the latter as a further benchmark.

2.2.4.2.2 The South African Version

The South African version of the *Smithian Framework* was revisited in the *Davis Report*.⁴³⁷

The *Davis Report* applies the following criteria for assessing South African taxes:⁴³⁸

- **Efficiency** (Economic and Administrative)
- **Equity**, Fairness
- **Transparency** and Certainty
- Flexibility / **Buoyancy**

From a perusal of the underlying report, all three benchmarked exemplars and the benchmarked criteria of certainty and sustainability may be established as substantively present.⁴³⁹ The South African efficiency criterion, somewhat like its Australian counterpart, appears to cover the subject matters of both the efficiency and simplicity benchmarks.⁴⁴⁰ Buoyancy corresponds with the benchmarked sustainability criterion, as both criteria broadly assess a

⁴³⁷ *Davis Final Report*, above n 89, 14; Dennis Davis et al, 'Macro Analysis of the Tax System and Inclusive Growth in South Africa: An Analytical Framework for The Davis Tax Committee' (Executive Summary of the Final Report, The Davis Tax Committee, 2016) 4-6 ('*Davis Report Executive Summary*') < <https://www.taxcom.org.za/library.html> >.

⁴³⁸ *Davis Final Report*, above n 89, 14, 24, 82-4, 95; But see *Davis Report Executive Summary*, above n 437, 2, 4-8; But see Du Preez, above n 87, 76.

⁴³⁹ *Davis Final Report*, above n 89, 14, 82.

⁴⁴⁰ *Davis Final Report*, above n 89, 82; *The Henry Review*, above n 89, 17.

regime's/system's ability to realise its purposes.⁴⁴¹ Thus, although the South African version somewhat borrows from *The Mirrlees Review* ('the UK version'), it also incorporates aspects present in the updated Australian version.⁴⁴² Although, specific differences may be detected between the UK and South African ('SA') versions.⁴⁴³ For example, the equity criterion is ostensibly applied much more narrowly in the SA version.⁴⁴⁴ The SA version appears to employ one equity criterion more conventionally formulated.⁴⁴⁵ Nonetheless, the SA equity criterion essentially corresponds with the benchmark.⁴⁴⁶

2.2.4.2.3 The UK Version

A recent and comprehensive reassessment of the UK version of the *Smithian Framework* was undertaken by *The Mirrlees Review*.⁴⁴⁷ Its primary objective, which is particularly relevant to the present enquiry, was 'to set out the principles on which a 21st-century tax system should be based'.⁴⁴⁸ Its further significance is that its criteria and tax design paradigm have been somewhat featured in the reports updating the versions of other States.⁴⁴⁹ Therefore, as initially intended, it has a broader application in relation to the G20 States.⁴⁵⁰

The Mirrlees Review submits that although the *Smithian Framework* has 'near-universal support', it opines that the original version has several deficiencies, including:⁴⁵¹

⁴⁴¹ *Davis Final Report*, above n 89, 14; *The Henry Review*, above n 89, 17.

⁴⁴² *Davis Final Report*, above n 89, 23, 82, 96-8; *Davis Report Executive Summary*, above n 437, 2, 4-8; *The Henry Review*, above n 89, 17.

⁴⁴³ *Davis Final Report*, above n 89, 14, 83, 95; *Davis Report Executive Summary*, above n 437, 2, 4-7.

⁴⁴⁴ *Ibid.*

⁴⁴⁵ *Ibid.*

⁴⁴⁶ *Ibid.*

⁴⁴⁷ *The Mirrlees Review*, above n 17, 1.

⁴⁴⁸ *Ibid.*; *The Henry Review* was also concerned with what a tax system should look like in the 21st century: See Evans, above n 113, 385; Johnson and Myles, above n 113, 319.

⁴⁴⁹ *Davis Report Executive Summary*, above n 437, 2, 4-7.

⁴⁵⁰ *Ibid.*; *The Mirrlees Review*, above n 17, v, 1; Johnson and Myles, above n 113, 320.

⁴⁵¹ *The Mirrlees Review*, above n 17, 22.

- 1) It is not comprehensive as required for modern tax regimes/systems.
- 2) It does not help resolve misalignments and orders of priorities.

2.2.4.2.3.1 Two Major Goals

It is helpful to consider the main objectives of *The Mirrlees Review* as it allows for:⁴⁵²

- Better contextual understanding of the overall version.
- Increased awareness of what is driving the analysis and recommendations.

Accordingly, the following underlying objectives may be identified:⁴⁵³

- ‘to identify reforms that would make the tax system more efficient,
- while raising roughly the same amount of revenue as the current system and
- while redistributing resources to those with high needs or low incomes to roughly the same degree’.

Accordingly, a key objective is, broadly, to improve efficiency for a particular revenue and redistribution level.⁴⁵⁴

2.2.4.2.3.2 The Updated UK Version’s Criteria

The essence of the Mirrlees enquiry is to consider a system’s impact on *a desired distributional outcome* by considering the following four factors/criteria (included here as ‘the first list’):⁴⁵⁵

- 1) The negative effects of the system on welfare and *economic efficiency* – they should be minimized.
- 2) *Administration and compliance costs* —all things equal, a system that costs less to operate is preferable.

⁴⁵² Ibid 2.

⁴⁵³ Ibid 2 (bullets added); Kaplow, above n 213, 416.

⁴⁵⁴ *The Mirrlees Review*, above n 17, 2, 23; Evans, above n 113, 385.

⁴⁵⁵ *The Mirrlees Review*, above n 17, 22-3 [2.1]; 35.

- 3) *Fairness other than in the distributional sense*—like the fairness of procedure, avoidance of discrimination, and fairness concerning legitimate expectations.
- 4) *Transparency*—a tax system that people can understand is preferable to one that taxes by ‘stealth’.

The above four factors are conceptualised as the ‘objectives’, ‘goals’ and ‘ultimate outcomes’ of a system.⁴⁵⁶ This particular understanding should be contrasted with the Alley and Bentley paradigm, which conceptualises the Smithian Framework's criteria, as the underlying values of a tax system.⁴⁵⁷ The Mirrlees factors, including the distributional outcome, may be treated as the Smithian criteria populating the updated UK version.⁴⁵⁸

Therefore, if the above four factors, as detailed in the first list, were renamed according to their benchmark counterparts, the exercise would, roughly, generate the following list of renamed criteria; utilising the exact ordering of the first list and matching the Mirrlees factors substantively with their corresponding benchmarks:⁴⁵⁹

- 1) Efficiency
- 2) Simplicity
- 3) Horizontality (including other attributes of fiscal fairness but excluding verticality as the latter appears to operate as a separate factor).⁴⁶⁰
- 4) Certainty

With the addition of the distinct distributional outcome/factor as verticality, all three benchmarked exemplars may be treated as substantively present.⁴⁶¹ Verticality and efficiency

⁴⁵⁶ Ibid.

⁴⁵⁷ Alley and Bentley, above n 2, 582-5.

⁴⁵⁸ *The Mirrlees Review*, above n 17, 22-3; 35; Evans, above n 113, 386; Du Preez, above n 87, 75-6; See generally Alley and Bentley, above n 2, 586-8.

⁴⁵⁹ Ibid.

⁴⁶⁰ *The Mirrlees Review*, above n 17, 22-3, 33-4.

⁴⁶¹ Ibid 22-3 [2.1]; 35.

are applied as critical criteria in the underlying enquiry.⁴⁶² The benchmarks of certainty and simplicity are jointly wide enough to accommodate the transparency criterion. The former benchmark is relevant when the enquiry is directly orientated on matters other than costs. Further, the UK version adopts a more comprehensive conceptualisation of fairness.⁴⁶³ It goes beyond the parameters of the benchmark, which is constructed somewhat more conventionally.

2.2.4.2.3.3 Systemic and Longer-Term Premises

The Mirrlees Review adopts two essential underlying premises: Firstly, evaluating a tax, by applying the Smithian Framework, is ideally conducted on a system-wide basis.⁴⁶⁴ Thus, the paradigm emphasises the systemic nature of taxes.⁴⁶⁵ The systemic approach impliedly accepts that individual taxes are not necessarily required to comply with all the Smithian criteria.⁴⁶⁶ Thus, it has been submitted that ‘[i]t tends to be optimal to employ each [individual tax] to address that [criterion/goal] to which it is best suited, leaving other [criteria/goals] to other [taxes]’.⁴⁶⁷ Nonetheless, the effect of the entire system is essential.⁴⁶⁸ It should reflect the desired calibration as assessed by the systemic ranking of the Smithian criteria.⁴⁶⁹ A systemic ranking would be expected to include the entire criteria complement.⁴⁷⁰ A second underlying premise is that the *Smithian Framework* should be applied with a longer-term vision.⁴⁷¹

⁴⁶² Evans, above n 113, 386; *The Mirrlees Review*, above n 17, 2, 22-3; See generally Kaplow, above n 213, 416.

⁴⁶³ *The Mirrlees Review*, above n 17, 22-3, 33-4.

⁴⁶⁴ *Ibid* 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324. ‘[Thus,] the way in which personal taxes and corporate taxes join up, for example, matters enormously for efficiency such that one really shouldn’t be considering the structure of either one in isolation’: at 324.

⁴⁶⁵ *The Mirrlees Review*, above n 17, 2; Johnson and Myles, above n 113, 320, 324; Mirrlees et al, above n 138, 333.

⁴⁶⁶ Evans, above n 113, 385; Mirrlees et al, above n 138, 333; Rousslang, above n 92, 5.

⁴⁶⁷ Johnson and Myles, above n 113, 324; See generally Kaplow, above n 213, 416.

⁴⁶⁸ Evans, above n 113, 385; Mirrlees et al, above n 138, 333; Johnson and Myles, above n 113, 324.

⁴⁶⁹ *Ibid*.

⁴⁷⁰ *Ibid*.

⁴⁷¹ Mirrlees et al, above n 138, 331; *The Mirrlees Review*, above n 17, 44. The second premise may realise less fragmentation and over time produce better outcomes.

2.2.4.2.3.4 A Dichotomous Approach for Equity

In formulating an equity criterion, the approach of treating the horizontal abstraction as a distinct and somewhat dichotomous element to the vertical abstraction may find further legitimacy under *The Mirrlees Review*.⁴⁷² This dichotomous construction may better support the design of specific taxes as not every tax is required to promote verticality.⁴⁷³

Support for such a formulation may, firstly, be located in the express words of the underlying report of *The Mirrlees Review*, including the following extract:⁴⁷⁴

Whether the tax system is seen as ‘fair’ is not simply a question of redistribution [i.e., *verticality*]. Fairness of procedure, fairness with respect to legitimate expectations, and fairness in treating similar people similarly [i.e., *horizontality*] also matter.

The above extract (as one example from the report) may advance the legitimacy of a distinct existence for the horizontal abstraction.⁴⁷⁵ Support may, secondly, be located in the structural design of the updated UK version.⁴⁷⁶ Its *Smithian Framework* includes two separate criteria for fairness/equity.⁴⁷⁷

- Firstly, the ‘*desired distributional*’ factor counts as one criterion focused on verticality.⁴⁷⁸

⁴⁷² *The Mirrlees Review*, above n 17, 33-4; 160; 162; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Fan, above n 163, 539-40, 544; Rao, above n 304, 3-5, 8; Rousslang, above n 92, 3-5; Galle, above n 137, 1325-8; See generally Musgrave, above n 110, 161.

⁴⁷³ Johnson and Myles, above n 113, 324; See generally Kaplow, above n 213, 416.

⁴⁷⁴ *The Mirrlees Review*, above n 17, 33 [2.1.4]. (brackets added).

⁴⁷⁵ *Ibid* 33-4.

⁴⁷⁶ *Ibid* 22.

⁴⁷⁷ *Ibid*.

⁴⁷⁸ *Ibid*.

- Secondly, the criterion of ‘*fairness (other than in the distributional sense)*’ counts as another criterion covering horizontality that emphasises uniformity – among other attributes.⁴⁷⁹

2.2.4.2.3.5 Efficiency

The Mirrlees Review identifies economic efficiency as the chief limiting factor for tax design.⁴⁸⁰ Thus, a system that is generally neutral but with some verticality is conceptualised ideally as a good tax system.⁴⁸¹ Further, economic efficiency and welfare are cast side-by-side as positive and negative corollaries.⁴⁸²

Thus, a good tax system ought to limit the adverse effects on economic efficiency and promote the positive effects on welfare.⁴⁸³ However, at the broader level, the report makes it clear that:⁴⁸⁴

[they] want a tax system that does not unnecessarily discourage economic activity, that achieves distributional objectives, and that is fair, transparent, and administratively straightforward.

Thus, irrespective of any critical focus on verticality and efficiency, the report requires a good tax system to, nevertheless, evidence the other criteria to some degree.⁴⁸⁵

2.2.4.2.3.6 Quasi Misalignments

The report opines that optimal tax theory may provide solutions to some of the issues encountered in managing misalignments and ranking priorities.⁴⁸⁶

⁴⁷⁹ Ibid 22; 33-4.

⁴⁸⁰ Ibid 23.

⁴⁸¹ Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

⁴⁸² *The Mirrlees Review*, above n 17, 23.

⁴⁸³ Ibid; See generally Rousslang, above n 92, 7-8, 12.

⁴⁸⁴ *The Mirrlees Review*, above n 17, 35; See generally Mirrlees et al, above n 138, 332-3.

⁴⁸⁵ Ibid

⁴⁸⁶ *The Mirrlees Review*, above n 17, 35; Evans, above n 113, 391.

2.2.4.2.3.7 Other Auxiliary Factors

The Mirrlees Review distinguishes factors/criteria from guidelines/rules of thumb.⁴⁸⁷ The criteria are conceptualised as the ultimate goals.⁴⁸⁸ In contrast, the guidelines are conceptualised as auxiliary factors that may support achieving the ultimate goals.⁴⁸⁹ The guidelines comprise neutrality, simplicity and stability.⁴⁹⁰ *The Mirrlees Review* postulates that neutral, simple and stable tax systems are more likely to realise their goals.⁴⁹¹ However, the report cautions that the guidelines do not necessarily achieve the ultimate goals in their own right.⁴⁹² It is, therefore, regarded as a prudent practice to adhere to the guidelines only where it is practical to do so, but disregard them where they prove to be inappropriate.⁴⁹³

2.2.4.2.3.8 Neutrality

As a rule of thumb, neutrality requires that similar activities are treated fiscally similarly.⁴⁹⁴ It is submitted that by adopting this guideline, where appropriate, the following outcomes may, generally, be expected:

- 1) Minimising distortions.⁴⁹⁵
- 2) Achieving better levels of simplicity and fairness.⁴⁹⁶

⁴⁸⁷ *The Mirrlees Review*, above n 17, 35.

⁴⁸⁸ *Ibid.*

⁴⁸⁹ *Ibid.*

⁴⁹⁰ *Ibid* 22-3.

⁴⁹¹ *Ibid.*

⁴⁹² *Ibid.*

⁴⁹³ *Ibid* 39-4; But see Evans, above n 113, 385.

⁴⁹⁴ *The Mirrlees Review*, above n 17, 34, 40; Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

⁴⁹⁵ *The Mirrlees Review*, above n 17, 40.

⁴⁹⁶ *Ibid* 41.

Distortions are generally quantified as deadweight losses generated by a system.⁴⁹⁷ A key objective is to minimise deadweight loss.⁴⁹⁸ Thus, in summary, whereas efficiency is orientated on distortions, the rule of thumb requires applying the same tax treatment to similar activities to accomplish uniformity.⁴⁹⁹

The Mirrlees Review expands on controlling Positive Anti-Neutrality or, generally, deviations from neutrality. It submits that deviations should only be permitted with good and justifiable reasons.⁵⁰⁰ Thus, a deviation should, generally, only be employed where there is a high degree of proof that the *overall* benefits arising from the deviation warrant its adoption.⁵⁰¹ By employing deviations, a tax system may be utilised to discourage behaviour that is considered undesirable (like damaging the environment) and promote behaviour that is considered beneficial (like research and development).⁵⁰² Nonetheless, *The Mirrlees Review* submits that deviations should be treated cautiously.⁵⁰³ Any advantages therefrom should be weighed against the corresponding increase in complexity.⁵⁰⁴ The following justification is provided for setting the bar relatively high, for applying deviations from neutrality:⁵⁰⁵

defining and policing boundaries between differently taxed activities is fraught with difficulty: it increases administrative and compliance costs and creates perverse incentives to dress up one kind of activity as another. Hence, the hurdle for departing from neutrality should be high, requiring a strong and clear justification.

⁴⁹⁷ Ibid 29.

⁴⁹⁸ Ibid.

⁴⁹⁹ Ibid; Evans, above n 113, 385.

⁵⁰⁰ *The Mirrlees Review*, above n 17, 40-1; Evans, above n 113, 385; But see Rousslang, above n 92, 13.

⁵⁰¹ *The Mirrlees Review*, above n 17, 30, 40-1; Evans, above n 113, 385.

⁵⁰² Mirrlees et al, above n 138, 333.

⁵⁰³ Ibid.

⁵⁰⁴ Ibid 333-4.

⁵⁰⁵ Ibid.

Evans opines that deviations should have a more limited application by adopting the Mirrlees approach.⁵⁰⁶ Nonetheless, deviations or Positive Anti-Neutrality will play an essential role here in designing an optimal shipping tax regime. Further, like the broader efficiency construct of *The Mirrlees Review*, the efficiency benchmark incorporates uniformity as an auxiliary factor.

2.2.4.2.3.9 Simplicity and Stability

The Mirrlees Review preferences simplicity as a guideline where appropriate.⁵⁰⁷ It postulates that simple tax systems are more likely to realise the goals of efficiency, simplicity and certainty.⁵⁰⁸ Hence, the report submits that departures from simplicity should, likewise, require relatively strong grounds.⁵⁰⁹ Tax design should start from a presumption favouring simplicity.⁵¹⁰ Further, the above guideline may similarly be included within the scope of the simplicity benchmark.

The certainty benchmark may accommodate the stability guideline, where the enquiry is not directly focused on costs.⁵¹¹ *The Mirrlees Review* submits that stability as a guideline does not necessarily mean a tax system should remain stagnant.⁵¹² However, any changes should align with a process and strategy that promotes overall certainty.⁵¹³ Albeit, as an ideal and all things equal, stability favours a tax system that exhibits fewer significant changes over shorter

⁵⁰⁶ Evans, above n 113, 385. See especially Mirrlees et al, above n 138, 333-4; But see Rousslang, above n 92, 13.

⁵⁰⁷ *The Mirrlees Review*, above n 17, 42.

⁵⁰⁸ Ibid.

⁵⁰⁹ Ibid 43.

⁵¹⁰ Ibid 43.

⁵¹¹ Evans, above n 113, 386.

⁵¹² *The Mirrlees Review*, above n 17, 44.

⁵¹³ Ibid.

periods.⁵¹⁴ Additionally, stability concerns may overlap somewhat with the enquiry associated with the sustainability benchmark.⁵¹⁵

2.2.4.2.3.10 Final Conclusion

Thus, the benchmarked exemplars with the certainty and sustainability benchmarks are in varying degrees substantively present in the updated UK version.

2.2.4.2.4 The Canadian Version

The Carter Commission undertook a major review of the Canadian tax system.⁵¹⁶ Its report (*'Carter Report'*) articulated the following broad objectives/goals (included here as list one):⁵¹⁷

- 1) To maximise the current and future output of goods and services desired by Canadians.
- 2) To ensure that this flow of goods and services is distributed equitably among individuals or groups.
- 3) To protect the liberties and rights of individuals through the preservation of representative responsible government and the maintenance of the rule of law.
- 4) To maintain and strengthen the Canadian federation.

⁵¹⁴ Ibid.

⁵¹⁵ See generally *The Henry Review*, above n 89, 17.

⁵¹⁶ Trevin Stratton, '50 Years of Cutting and Pasting: Modernising Canada's Tax System' (Report, Canadian Chamber of Commerce, February 2019) 3; Chartered Professional Accountants Canada, 'Canada Needs A Tax Review' (Summary Document; 2019) <<https://www.cpacanada.ca/en/the-cpa-profession/about-cpa-canada/key-activities/public-policy-government-relations/policy-advocacy/cpa-canada-tax-review-initiative>>; Du Preez, above n 87, 75; Alley and Bentley, above n 2, 586.

⁵¹⁷ *Carter Report*, above n 89, 7, 18-19.

These broad objectives/goals were, in turn, elaborated by more specific goals.⁵¹⁸ Previous research has submitted that the following factors may be treated as the criteria of the Canadian version, as inferred from the *Carter Report* (included here as list two):⁵¹⁹

- 1) Neutrality
- 2) Equity
- 3) Simplicity
- 4) Transparency and Accountability
- 5) Certainty
- 6) Flexibility

From a perusal of the second list, all three exemplars appear to be present in form.

2.2.4.2.4.1 Equity

The Canadian equity criterion corresponds substantively with the equity benchmark as they both exhibit the following essential characteristics:⁵²⁰

- 1) They both include vertical and horizontal abstractions, as conventionally constructed.
- 2) They are underpinned by the ability to pay.
- 3) The importance of the criterion's priority is recognised where appropriate.

⁵¹⁸ *Carter Report*, above n 89, 8-11, 13-4, 16, 18-9.

⁵¹⁹ Alley and Bentley, above n 2, 586; *Carter Report*, above n 89, 17; Du Preez, above n 87, 75.

⁵²⁰ *Carter Report*, above n 89, 10-12, 17, 19; Musgrave, above n 110, 160.

The *Carter Report* submits that verticality can only be accomplished through taxes engineered structurally on the ability to pay as applied conventionally.⁵²¹ This submission may be referenced to legitimise restricting verticality primarily to personal income taxes.⁵²²

2.2.4.2.4.2 Efficiency

The Canadian neutrality criterion corresponds with the efficiency benchmark as they are both essentially orientated on minimising distortions and promoting uniform tax treatments.⁵²³ Further, deviation controls follow a somewhat similar approach as previous works as they generally are only permitted as the exception and where the advantages outweigh the related costs.⁵²⁴

2.2.4.2.4.3 Simplicity, Certainty and Sustainability

The Canadian criteria of simplicity, certainty and transparency and accountability are essentially covered by the joint subject matters of the simplicity and certainty benchmarks.⁵²⁵ Flexibility is also broadly similar to the sustainability benchmark.⁵²⁶

2.2.4.2.4.4 Final Conclusion

Thus, the benchmarks are roughly, substantively present in the Canadian version, constructed by the Carter Commission.

⁵²¹ *Carter Report*, above n 89, 11; Musgrave, above n 110, 160, 161, 163; See also Mirrlees et al, above n 138, 334-5; But see Rousslang, above n 92, 4-5.

⁵²² Rousslang, above n 92, 4-5; *The Henry Review*, above n 89, 16, 25-6, 29, 37, 40; See also Mirrlees et al, above n 138, 334-5.

⁵²³ *Carter Report*, above n 89, 8-9, 11, 13; Musgrave, above n 110, 171-2; See also Rousslang, above n 92, 3.

⁵²⁴ *Carter Report*, above n 89, 8-9; But see Musgrave, above n 110, 178.

⁵²⁵ Alley and Bentley, above n 2, 586; *Carter Report*, above n 89, 13-6, 19.

⁵²⁶ *Carter Report*, above n 89, 16.

2.2.4.2.5 Specific US Versions

Generally, different versions of the *Smithian Framework* appear to be applied by different government levels and entities in the United States of America ('US').⁵²⁷ The following list sets out several versions, although the list is not intended to be comprehensive:⁵²⁸

- The 2005 US Government Accountability Office Criteria for a Good Tax System.⁵²⁹
- The 2007 National Conference of State Legislatures Principles of a High-Quality State Revenue System.⁵³⁰
- The 2011 US Joint Committee on Taxation Document on the Federal Tax Treatment of Individuals.⁵³¹
- The 2015 Report on New York City Taxes —Trends, Impact and Priorities for Reform.⁵³²
- The 2015-2017 Rousslang Report Prepared for the Hawaii Tax Review Commission.⁵³³
- The 2017 AICPA Principles of Good Tax Policy.⁵³⁴

The table below roughly compares the criteria of the above US versions with the benchmarks.

⁵²⁷ AICPA Tax Division, above n 187, 3-5; See generally Annette Nellen, 'Policy Approach to Analyzing Tax Systems' College of Business San José State University 1, 7 <http://www.cob.sjsu.edu/nellen_a/TaxReform/PolicyApproachToAnalyzingTaxSystems.pdf>.

⁵²⁸ See generally Nellen, above n 527, 7; AICPA Tax Division, above n 187, 7.

⁵²⁹ White, above n 110, 24-49.

⁵³⁰ Bigbee et al, above n 290.

⁵³¹ Joint Committee on Taxation, 'Federal Tax Treatment of Individuals' (Document JCX-43-11, 12 September 2011) 3.

⁵³² Fiscal Policy Institute, above n 289, 9.

⁵³³ Rousslang, above n 92, 3, 6-9.

⁵³⁴ AICPA Tax Division, above n 187, 3.

Table A: A Rough Comparative Tabulation of Selective US Versions’ Criteria

Benchmarked Criteria as Constructed by the Thesis	Comparative Analysis Particulars	2005 US Government Accountability Office: Criteria for a Good Tax System	2007 National Conference of State Legislatures Principles of a High-Quality State Revenue System	2011 US Joint Committee on Taxation (‘JCT’) Analysis Criteria	2015-2017 Hawaii Tax Review Commission	2017 AICPA Principles of Good Tax Policy⁵³⁵	The 2015 Report on New York City Taxes—Trends, Impact and Priorities for Reform⁵³⁶
Equity	Indicating Equivalent Criteria	Equity ⁵³⁷	Treats individuals equitably ⁵³⁸	Is the tax system fair? (i.e., horizontally and vertically) ⁵³⁹	Fairness (i.e., horizontal and vertical equity) ⁵⁴⁰	Equity and fairness	Fairness (i.e., horizontal and vertical equity)
Efficiency	Indicating Equivalent Criteria	Economic Efficiency ⁵⁴¹	<ul style="list-style-type: none"> • Balanced variety of revenue sources (i.e., essentially economic neutrality)⁵⁴² • Responsive to interstate and international economic competition⁵⁴³ • Minimizes its involvement in 	Does the tax system promote or hinder economic efficiency? (i.e., in relation to distortions) ⁵⁴⁵	Neutrality: Economic Efficiency ⁵⁴⁶	Neutrality Economic growth and efficiency	<ul style="list-style-type: none"> • Economic neutrality and diversification • Balances tax burden and economic development concerns

⁵³⁵ AICPA Tax Division, above n 187, 3.

⁵³⁶ Fiscal Policy Institute, above n 289, 9-11.

⁵³⁷ White, above n 110, 26-34.

⁵³⁸ Bigbee et al, above n 290, [principle 4].

⁵³⁹ Joint Committee on Taxation, above n 531, 3.

⁵⁴⁰ Rousslang, above n 92, 3-6.

⁵⁴¹ White, above n 110, 35-44.

⁵⁴² Bigbee et al, above n 290, [principle 3].

⁵⁴³ Ibid [principle 7].

⁵⁴⁵ Joint Committee on Taxation, above n 531, 3.

⁵⁴⁶ Rousslang, above n 92, 6-7, 9-11.

Benchmarked Criteria as Constructed by the Thesis	Comparative Analysis Particulars	2005 US Government Accountability Office: Criteria for a Good Tax System	2007 National Conference of State Legislatures Principles of a High-Quality State Revenue System	2011 US Joint Committee on Taxation ('JCT') Analysis Criteria	2015-2017 Hawaii Tax Review Commission	2017 AICPA Principles of Good Tax Policy ⁵³⁵	The 2015 Report on New York City Taxes—Trends, Impact and Priorities for Reform ⁵³⁶
			spending decisions and makes any such involvement explicit ⁵⁴⁴				
Simplicity	Indicating Equivalent Criteria	<ul style="list-style-type: none"> • Simplicity⁵⁴⁷ • Administrability⁵⁴⁸ 	<ul style="list-style-type: none"> • Facilitates taxpayer compliance⁵⁴⁹ • Promotes fair, efficient & effective administration⁵⁵⁰ 	Is the tax system simple? (i.e., in the sense of costs) ⁵⁵¹	Simplicity: Efficiency ⁵⁵²	<ul style="list-style-type: none"> • Convenience of payment (i.e., as formulated by Smith) • Effective tax administration (i.e., in the sense of costs) • Simplicity • Minimum tax gap 	<ul style="list-style-type: none"> • Administrative efficiency and ease of compliance
Certainty	Indicating Equivalent Criteria	Transparency ⁵⁵³	<ul style="list-style-type: none"> • Accountable to taxpayers (i.e., explicit not hidden)⁵⁵⁴ • Comprises elements that are 	N/A	Stability: Efficiency (structural stability: reduces uncertainty) ⁵⁵⁶	<ul style="list-style-type: none"> • Certainty (i.e., as formulated by Smith) • Transparency and visibility 	Accountable to taxpayers (more transparent and accountable)

⁵⁴⁴ Ibid [principle 8].

⁵⁴⁷ White, above n 110, 45-47.

⁵⁴⁸ Ibid 49-52.

⁵⁴⁹ Bigbee et al, above n 290, [principle 5].

⁵⁵⁰ Ibid [principle 6].

⁵⁵¹ Joint Committee on Taxation, above n 531, 3.

⁵⁵² Rousslang, above n 92, 6, 8-9.

⁵⁵³ White, above n 110, 47-49.

⁵⁵⁴ Bigbee et al, above n 290, [principle 9].

⁵⁵⁶ Rousslang, above n 92, 6, 9.

Benchmarked Criteria as Constructed by the Thesis	Comparative Analysis Particulars	2005 US Government Accountability Office: Criteria for a Good Tax System	2007 National Conference of State Legislatures Principles of a High-Quality State Revenue System	2011 US Joint Committee on Taxation ('JCT') Analysis Criteria	2015-2017 Hawaii Tax Review Commission	2017 AICPA Principles of Good Tax Policy ⁵³⁵	The 2015 Report on New York City Taxes—Trends, Impact and Priorities for Reform ⁵³⁶
			complementary ⁵⁵⁵ (i.e., in harmony: more or less comparable to the Australian criterion of policy consistency)			<ul style="list-style-type: none"> • Accountability to taxpayers 	
Sustainability	Indicating Equivalent Criteria Indicating Any Other Peculiar Criteria that are Noteworthy	N/A	Revenue Reliability involving stability, certainty and sufficiency ⁵⁵⁷ (i.e., generally comparable to the benchmarked criterion of sustainability. Also has features of certainty)	N/A	Stability: Efficiency (adjusts to a dynamic environment/ revenue reliability) ⁵⁵⁸ (i.e., generally comparable to the benchmarked criterion of sustainability)	<ul style="list-style-type: none"> • Information Security. • Appropriate government revenues. (i.e., generally comparable to the benchmarked criterion of sustainability) 	Adequacy and reliability (i.e., generally comparable to the benchmarked criterion of sustainability)

⁵⁵⁵ Ibid [principle 1].

⁵⁵⁷ Bigbee et al, above n 290, [principle 2].

⁵⁵⁸ Rousslang, above n 92, 6, 9.

A perusal of the above table should indicate that the benchmarks appear to accommodate the common criteria across the selected American versions roughly.⁵⁵⁹ The AICPA version incorporates a novel criterion of ‘Information Security’.⁵⁶⁰ It focuses explicitly on protecting taxpayer information from unintended and improper disclosure.⁵⁶¹ With the increased prevalence of cyber-attacks, a criterion that addresses such occurrences may provide additional advantages for 21st-century tax systems.⁵⁶²

2.2.4.2.6 Conclusions: Approach One

All the benchmarks appear, roughly, to be substantively present (albeit in varying degrees) in the reviewed versions of the *Smithian Framework* of the selected G20 States. On occasion, the selected Asian States have favoured the horizontal abstraction systemically in prioritising efficiency for stimulating their economies.⁵⁶³ Further, good tax design adopts a systemic approach to applying the Smithian Framework.⁵⁶⁴ Thus, not every tax is required to promote the full Smithian criteria complement.⁵⁶⁵ Similarly, support may be found in the literature for treating horizontality as a distinct element; it is recognised that not every individual tax is required to promote verticality.⁵⁶⁶ Further, Positive Anti-Neutrality (or deviations more

⁵⁵⁹ Nellen, above n 527, 7; AICPA Tax Division, above n 187, 3-5; Du Preez, above n 87, 75; Alley and Bentley, above n 2, 586. The table in the report also shows the comparability between the American criteria as they appear in selected different versions of the Smithian Framework. There is, roughly, repeated references to verticality and horizontality, the ability to pay, administrative and compliance costs, fiscal certainty and minimising tax distortions: see generally AICPA Tax Division, above n 187, 4.

⁵⁶⁰ AICPA Tax Division, above n 187, 3.

⁵⁶¹ Ibid.

⁵⁶² See generally Tom Livingstone, ‘Cyber-attacks: Australia the sixth most targeted country in world’, *9News* (online), 14 July 2020 < <https://www.9news.com.au/national/cyber-attacks-australia-sixth-most-hacked-country-in-world-new-data-reveals/4a762e06-9342-4c8a-a7af-1632a1d1042a>>

⁵⁶³ See, eg, Kaneko, above n 315, 4; See, eg, Ishi, above n 315, 12-4.

⁵⁶⁴ *The Mirrlees Review*, above n 17, 2, 28, 35.

⁵⁶⁵ Ibid.

⁵⁶⁶ Fan, above n 163, 540-2, 544-5, 547; Rousslang, above n 92, 4-5; Galle, above n 137, 1327-8; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5.

generally) may, with necessary controls, be legitimately and exceptionally applied in designing good taxes to achieve critical outcomes.⁵⁶⁷

Therefore, roughly, it may be concluded that the benchmarked exemplars with the certainty and sustainability benchmarks constitute the common criteria in general across the different versions of the Smithian Framework, as applied by the G20 States in the 21st century.

⁵⁶⁷ *Asprey Review*, above n 34, [3.26]; *The Mirrlees Review*, above n 17, 40-1.

2.3 APPROACH TWO

2.3.1.1 Selecting the Relevant Criteria Mix: Approach Two

The second approach applied briefly to confirm the results of approach one is to consider a recent version of the *Smithian Framework* of a relevant international organisation. For the version to be especially relevant, it should ideally be generally endorsed by the G20 States in the 21st century. The international organisation considered particularly relevant is the OECD. The OECD has operated as a successful international vehicle for guiding tax policy internationally, including the tax policy of the G20 States.⁵⁶⁸ In particular, the OECD/G20 Base Erosion and Profit Shifting Project (OECD/G20 *BEPS* Project) may be consulted.⁵⁶⁹ It explicitly references the participation of the G20 States.⁵⁷⁰ Thus, the OECD/*BEPS* version, reported in Action One, may legitimately be treated as generally endorsed by the G20 States in the 21st century.⁵⁷¹

Action One considers the digital economy, which is a mobile tax base.⁵⁷² Thus, considering shipping income also suffers from mobility concerns, as described below, the particular version may even be of greater relevance to the current enquiry.

⁵⁶⁸ Dwyer, above n 2, 936; Stewart, above n 117, 140; See generally Alley and Bentley, above n 2, 590; See generally Tanzi and Zee, above n 2, 300; See generally Bahl and Bird, above n 2, 284-9; See generally Livingston, above n 2, 543; See generally Basu above n 2, 139.

⁵⁶⁹ *OECD BEPS Action 1*, above n 12, 19.

⁵⁷⁰ *Ibid* 17-18; OECD, *What is BEPS?* (2019) BEPS < <https://www.oecd.org/tax/beps/about/#history> >; *OECD BEPS Action 5*, above n 13, 3, 61.

⁵⁷¹ *OECD BEPS Action 1*, above n 12, 20-1.

⁵⁷² *Ibid* 11, 64.

The criteria of the OECD/*BEPS* version of the *Smithian Framework* are considered here below in Table B. The first column lists the benchmarked criteria. The second column lists the corresponding criteria of the OECD/*BEPS* version.

Table B: Comparative Tabulation of the Criteria of the OECD/*BEPS* Version

The Benchmarked Criteria from Approach One	OECD/<i>BEPS</i> Criteria⁵⁷³
Equity	Equity
Efficiency	Neutrality
Simplicity	Efficiency Effectiveness and Fairness
Certainty	Certainty and Simplicity
Sustainability	Flexibility

2.3.1.2 Brief Observations under Approach Two

The OECD/*BEPS* neutrality criterion essentially matches the efficiency benchmark as they are both orientated on distortions and uniformity.⁵⁷⁴ The OECD/*BEPS* efficiency criterion is the essential equivalent of the simplicity benchmark, directly considering administrative and compliance costs.⁵⁷⁵ The OECD/*BEPS* criterion of certainty and simplicity corresponds with the certainty benchmark to the extent a non-costs approach is adopted.⁵⁷⁶ The simplicity benchmark may consider the same subject matter indirectly through the relevant costs where more appropriate. The certainty benchmark's core accommodates essential certainty considerations.⁵⁷⁷ Other secondary aspects like understandability or more straightforward

⁵⁷³ Ibid 20-1.

⁵⁷⁴ Ibid.

⁵⁷⁵ Ibid.

⁵⁷⁶ Ibid.

⁵⁷⁷ Ibid.

formulas and processes may be accommodated by the certainty benchmark's periphery where required.⁵⁷⁸

The OECD/*BEPS* criterion of effectiveness and fairness is orientated on tax enforceability, minimising tax avoidance and evasion, and optimising revenue generation.⁵⁷⁹ To the extent that the OECD/*BEPS* criterion has implications for administrative and compliance costs, it might be accommodated under the simplicity benchmark.⁵⁸⁰ The non-cost issues may be treated under the certainty benchmark. However, other aspects, like optimising revenue generation, may be better accommodated under benchmarks like the sustainability benchmark.⁵⁸¹

The OECD/*BEPS* flexibility criterion essentially corresponds with the sustainability benchmark. Both criteria consider the structural durability of a regime within a dynamic environment and the realisation of its underlying objectives, such as achieving the desired revenue level.⁵⁸² The benchmarked criterion is, however, engineered somewhat broader. Further, the OECD/*BEPS* equity criterion essentially matches the equity benchmark; further, the OECD/*BEPS* equity criterion appears to have a reduced status in this OECD/*BEPS* version of the Smithian framework.⁵⁸³ This lower status or priority may be inferred from the specific ordering adopted for the criteria as appearing in the underlying report that, among other things, emphasises specific criteria over equity.⁵⁸⁴

⁵⁷⁸ Ibid.

⁵⁷⁹ Ibid.

⁵⁸⁰ Ibid.

⁵⁸¹ Ibid.

⁵⁸² Ibid 21.

⁵⁸³ Ibid.

⁵⁸⁴ Ibid 20-1.

In summary, the benchmarks essentially correspond with the OECD/*BEPS* criteria roughly. Thus, approach two generally confirms the results of approach one.

2.4 Final Conclusions

The thesis has demonstrated that the criteria of a good tax system as generally accepted by the G20 States in the 21st century roughly comprise the following five criteria as benchmarked:

- Equity
- Simplicity
- Efficiency
- Certainty
- Sustainability

The original Smithian core for certainty should rank by default as the top criterion in ordering priorities for a Smithian Framework.⁵⁸⁵ Otherwise, priorities should generally be determined on a case-by-case basis.⁵⁸⁶ Further, promoting conventional equity goals should be approached systemically.⁵⁸⁷ A systemic understanding of taxes provides better flexibility for checking conventional equity goals against efficiency and simplicity outcomes in constructing individual taxes more optimally.⁵⁸⁸ An optimal tax regime achieves its underlying objectives without eroding its tax base.⁵⁸⁹ Therefore the tax base should, as a minimum, demonstrate the capacity to bear the tax sustainably for the tax to be recognised as optimal.⁵⁹⁰ Critical support in

⁵⁸⁵ Cannan, above n 14, 310-1.

⁵⁸⁶ *Carter Report*, above n 89, 17; Alley and Bentley, above n 2, 582, 584-5.

⁵⁸⁷ *The Mirrlees Review*, above n 17, 2, 22-3, 28, 35.

⁵⁸⁸ *Ibid*; *The Henry Review*, above n 89, viii (4.4), xix; 15-6, 21, 29, 30-1, 80; See generally Cobb, above n 17, 646-8; See generally Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5.

⁵⁸⁹ Alley and Bentley, above n 2, 586; Memon, above n 87, 67; Cooper, above n 97, 417-22.

⁵⁹⁰ See especially Dwyer, above n 2, 747-8.

designing an optimal tax regime may be provided by an appropriately prioritised Smithian Framework.⁵⁹¹

⁵⁹¹ Du Preez, above n 87, 26, 33-4; Alley and Bentley, above n 2, 580, 586; *The Mirrlees Review*, above n 17, 21-2, 35.

Chapter 3: Devising *MAF*: The *Model Analytical Framework*

3.1 Applying Chapter Two's Conclusions

The previous chapter settled what may be treated as the criteria of a good tax system as generally accepted by the G20 States in the 21st century. Chapter two identified the following criteria, as benchmarked by the thesis: 1) equity (abstracted vertically and horizontally), 2) efficiency, 3) simplicity, 4) certainty and 5) sustainability.

The Smithian Framework's worth might, in part, be established from the Alley and Bentley paradigm that conceptualises its criteria as the underlying values of a tax system.⁵⁹²

Accordingly, there may be advantages to adopting a more inclusive approach for identifying its criteria. Applying greater inclusivity may deliver more legitimate Smithian criteria, potentially better representing the diversity of fiscal values found in the different G20 States.⁵⁹³

The converse would be to apply an approach limited to western-centric ideas and experiences that should not necessarily, be blindly endorsed.⁵⁹⁴

3.1.1 Ranking the Priorities for the *USF*

Chapter two observed that the Chinese, Indians and Japanese at times systemically demoted verticality.⁵⁹⁵ In so doing, they adopted a more extensive and dominant promotion of efficiency, fiscally, to build wealth and increase their economies' size.⁵⁹⁶ This efficiency-

⁵⁹² Alley and Bentley, above n 2, 582-5.

⁵⁹³ Livingston, above n 2, 541; Loomba, above n 116, 62-3.

⁵⁹⁴ Ibid.

⁵⁹⁵ Zhan, Li and Xu, above n 351, 32-3; Zhang, above n 315, 113; Rao, above n 304, 5-8, 10; Rao, above n 367, 60-1, 72; *Kelkar Report*, above n 366, 24, 66-7, 69, 75, 170; Peter, Kerr and Thorpe, above n 315, 111, 127; Ishi, above n 315, 14; Kaneko, above n 315, 4; Fan, above n 163, 543, 549; Nakazato and Ramseyer, above n 315, 721, 724-5, 727; Stewart, above n 117, 158, 172, 186.

⁵⁹⁶ Ting and Ge, above n 385, 613, 627; See generally Qiao, above n 321, 43; *Kelkar Report*, above n 366, 3, 93; See also Peter, Kerr and Thorpe, above n 315, 113, 114-5; Rao, above n 367, 60-1, 64, 72; Rao, above n 304, 5-6, 8, 9; Thimmaiah, above n 376, 781; Ishi, above n 315, 14; Kaneko, above n 315, 4; Fan, above n 163, 543, 549; Nakazato and Ramseyer, above n 315, 721, 724-5, 727.

centric approach to tax design has demonstrated positive outcomes in significantly expanding their economies and related tax bases.⁵⁹⁷

The Dwyer paradigm's reconstruction of the *Smithian Framework* essentially pivots it on preserving tax bases.⁵⁹⁸ Similarly, major tax projects in selected Western States have, on occasion, concentrated on efficiency outcomes for designing specific taxes by adopting a systemic approach to tax design.⁵⁹⁹ The latter approach accepts that not all individual taxes must promote verticality.⁶⁰⁰ It is based on the premise that different tax bases are not equal in sustaining particular fiscal purposes, such as income redistribution.⁶⁰¹ Therefore, as may be inferred from the above three approaches, good tax design restricts verticality to bases that can bear it.⁶⁰²

Taxes may interfere with the choices/behaviour of labour and capital through high and progressive tax rates - among other methods.⁶⁰³ In chapter two, the efficiency benchmark was primarily orientated on tax distortions or interference; in particular, fewer distortions demonstrate a higher efficiency.⁶⁰⁴ Previous research advises that tax bases with greater

⁵⁹⁷ Qiao, above n 321, 37, 44; Brys et al, above n 315, 4, 6-7; Ghuge, above n 367, 246-7; Rao, above n 367, 62; See generally Ryotaro Komiya, 'The Supply of Personal Savings', in Ryotaro Komiya (ed), *Postwar Economic Growth in Japan* (University of California Press, Berkeley, 1966).

⁵⁹⁸ Cobb, above n 17, 646-8; Dwyer, above n 2, 672, 747-8; 751-2, 764, 774; See generally Evans, above n 113, 385; See generally Mirrlees et al, above n 138, 333.

⁵⁹⁹ *The Mirrlees Review*, above n 17, 2, 28-9, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324.

⁶⁰⁰ *The Henry Review*, above n 89, 18, 17, 25, 39-40; Evans, above n 113, 385, 388; Mirrlees et al, above n 138, 333.

⁶⁰¹ *The Henry Review*, above n 89, 13, 17; Stewart et al, above n 2, 4-6; *Carter Report*, above n 89, 11; Musgrave, above n 110, 160, 161, 163; See also Mirrlees et al, above n 138, 334-5; But see Roussslang, above n 92, 4-5.

⁶⁰² *The Henry Review*, above n 89, 16-8, 25-6, 29, 37, 39-40; *The Mirrlees Review*, above n 17, 29-30; Evans, above n 113, 388.

⁶⁰³ Ting and Ge, above n 385, 613; Alley and Bentley, above n 2, 592, 612, 616; See also Cooper, above n 97, 438, 441; *The Mirrlees Review*, above n 17, 23, 29, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9; Musgrave, above n 110, 171-2; AICPA Tax Division, above n 187, 5; *The Henry Review*, above n 89, 13, 73, 171-2, 176.

⁶⁰⁴ *The Henry Review*, above n 89, vii, 13, 73, 171-2, 176; Stewart et al, above n 2, 4; *The Mirrlees Review*, above n 17, 29-30; Dwyer, above n 2, 751-2; Cobb, above n 17, 646- 8.

mobility may experience more significant distortions resulting in base erosion.⁶⁰⁵ Therefore, verticality (which may produce distortions) is ideally restricted to less mobile tax bases.⁶⁰⁶ Thus, good tax design generally promotes a positive correlation between efficiency and tax base mobility.⁶⁰⁷ Conversely, an inverse correlation is generally advised as a rule of thumb between verticality and base mobility.⁶⁰⁸

Applying these correlations as guidelines may appropriately address intra-systemic misalignments between efficiency and vertically where base mobility is a concern.⁶⁰⁹ Managing the priorities of different Smithian criteria and their corresponding misalignments is generally a necessary task in tax design.⁶¹⁰ A tax system, in general, may have multiple underlying purposes where one or more are mutually exclusive in specific conditions.⁶¹¹ The Smithian Framework's application accommodates this balancing of underlying purposes as it may operate at Pareto optimality under identical conditions.⁶¹²

The thesis will demonstrate that shipping income, as the relevant tax base, is exceptionally mobile. Accordingly, there is a higher risk of producing distortions by applying higher or inappropriate taxes.⁶¹³ These distortions generally diminish a State's shipping activities that produce its shipping income.⁶¹⁴ Thus, base deterioration (and potentially even annihilation) is

⁶⁰⁵ Ibid; Panagiotou and Thanopoulou, above n 43, 7.

⁶⁰⁶ *The Mirrlees Review*, above n 17, 29-30, 40-1; *The Henry Review*, above n 89, 16, 25-6, 29, 37, 40; Stewart et al, above n 2, 6-8.

⁶⁰⁷ Ibid.

⁶⁰⁸ Ibid.

⁶⁰⁹ Ibid.

⁶¹⁰ *Carter Report*, above n 89, 4, 17; Memon, above n 87, 58-9, 67; Alley and Bentley, above n 2, 582-5; Cooper, above n 97, 417, 419.

⁶¹¹ Ibid.

⁶¹² Ingham, above n 136; Alley and Bentley, above n 2, 582-5.

⁶¹³ Panagiotou and Thanopoulou, above n 43, 7; Alexander, above n 35, 3 [vi], 4[x], 5[xv]; Stewart et al, above n 2, 21-2, 64-6; *The Henry Review*, above n 89, 17-8, 25, 39-40; Evans, above n 113, 388; *The Mirrlees Review*, above n 17, 29-30; Dwyer, above n 2, 747-8, 751-2; Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

⁶¹⁴ Panagiotou and Thanopoulou, above n 43, 6-7; Alexander, above n 35, 3 [vi], 4[x], 5[xv]; See Table C.

a significant concern.⁶¹⁵ Accordingly, the thesis ranks the efficiency criterion as its foremost priority in ordering the *USF* to protect the relevant domestic tax base.

Where taxes erode or destroy tax bases through distortions, this phenomenon is conveniently termed here Negative Anti-Neutrality. Conversely, where tax distortions increase a tax base, this is referenced as Positive Anti-Neutrality. Taxes may be configured to achieve multiple purposes, including encouraging general or specific economic activity.⁶¹⁶ Accordingly, the thesis will demonstrate that an optimum shipping tax regime as a minimum should avoid Negative Anti-Neutrality, and promote, where appropriate, Positive Anti-Neutrality.⁶¹⁷

Further, the reconfiguration of the equity criterion may, to some degree, address specific intra-systemic misalignments arising between efficiency and equity where base mobility is a concern.⁶¹⁸ Chapter two postulated that horizontality might be a distinct abstraction for addressing intra-nuclear misalignments between equity's two constituent abstractions.⁶¹⁹ The reconfiguration exercise orientates equity predominantly or exclusively on horizontality, redirecting it essentially on uniformity.⁶²⁰ The vertical abstraction is simultaneously diminished or disregarded.⁶²¹ The reconfiguration harmonises efficiency and equity better for tax bases with greater mobility where both criteria are orientated on uniformity.⁶²²

⁶¹⁵ Ibid.

⁶¹⁶ Cobb, above n 17, 648; Dwyer, above n 2, 764-9; Asprey Review, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 29, 32, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9.

⁶¹⁷ Ibid; *OECD Consolidated Application Note*, above n 2, [319].

⁶¹⁸ Fan, above n 163, 540-1, 544-5; Galle, above n 137, 1325-8; Rousslang, above n 92, 3-5; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Stewart, above n 117, 185; See generally Musgrave, above n 110, 161; *The Henry Review*, above n 89, 18, 39-40; Stewart et al, above n 2, 21-2, 64-6.

⁶¹⁹ Ibid.

⁶²⁰ Ibid.

⁶²¹ Ibid.

⁶²² Ibid.

Scholars broadly view fiscal fairness as an essential value that requires advancement in tax design.⁶²³ Accordingly, the reconfiguration may further legitimise an efficiency-centric approach in designing an optimal shipping tax regime, apart from any systemic considerations. The promotion of uniformity may also produce lower administrative and compliance costs by generally reducing a system's complexity.⁶²⁴ Thus, as a dominant abstraction for equity, horizontality may support dominant rankings for both the efficiency and simplicity criteria.⁶²⁵

Likewise, the simplicity criterion should be ranked prominently or strongly in the *USF* for designing an optimal shipping tax regime. Its promotion complements efficiency where base mobility is a concern.⁶²⁶ Lower taxes (resulting from a stronger efficiency promotion) should positively correlate with lower administrative and compliance costs (or higher simplicity).⁶²⁷ Good tax design would generally avoid applying a relatively expensive tax regime that operates in a low tax environment.⁶²⁸ Recent tax design projects even prefer a higher ranking for simplicity where base mobility is less of a concern.⁶²⁹ This preference to advance simplicity may in part be attributed to advances in modern technology.⁶³⁰

3.1.2 The Preliminary Conclusions

Accordingly, the following order of priorities should be applied in the *USF* for designing an optimum shipping tax regime (applying a descending order): efficiency, simplicity and

⁶²³ *Carter Report*, above n 89, 17; *The Mirrlees Review*, above n 17, 22-3, 33-4, 40; Alley and Bentley, above n 2, 600; Cooper, above n 97, 438, 442; Musgrave, above n 110, 160.

⁶²⁴ *The Henry Review*, above n 89, 29-30, 80, 104; *The Mirrlees Review*, above n 17, 34, 40, 42-4.

⁶²⁵ *Ibid.*

⁶²⁶ *Asprey Review*, above n 34, [3.20]; Cooper, above n 110, 239; Cannan, above n 14, 311-2; Rousslang, above n 92, 6-9; *The Mirrlees Review*, above n 17, 22-3, 42-4; *The Henry Review*, above n 89, viii (4.4), xix; 11, 15-6, 21, 24, 29, 30-1, 69, 71, 80.

⁶²⁷ *Ibid.*

⁶²⁸ *Ibid.*; Alexander, above n 35, 3 [vi], 4[x], 5[xv].

⁶²⁹ *The Mirrlees Review*, above n 17, 2, 21-3, 35; Johnson and Myles, above n 113, 324-5; *The Henry Review*, above n 89, 11, 29-31, 41, 69, 80.

⁶³⁰ *Ibid.*

horizontality. The vertical abstraction is disregarded in constructing equity for designing a shipping tax regime. The preliminary order of priorities is finalised under heading 3.8.2 below. The thesis will first consider the *Updated 1998 Framework* and its impact on the *USF* before delivering a final order of priorities applicable to shipping tax regimes.

3.2 The OECD as a Limiting Factor on Shipping Tax Design

International role-players like the OECD may significantly influence tax design in the modern age.⁶³¹ Tax regimes of OECD States, in particular, are required to align with OECD frameworks.⁶³² However, specific frameworks have wider applicability beyond the OECD States.⁶³³ Tax design projects that misalign with necessary OECD frameworks may cause States to enact regimes that are, to some degree, illegitimate at the international level.⁶³⁴ Serious misalignments may expose offending tax regimes to defensive measures supported by the OECD platform.⁶³⁵ States may be required to take specific actions to address defensive measures like amending or abolishing their regimes.⁶³⁶ Accordingly, an optimum shipping tax regime must align with relevant OECD frameworks to have broader legitimacy.⁶³⁷ Thus, the thesis will analyse specific OECD frameworks for constructing a *Model Analytical Framework* ('*MAF*'). *MAF* will incorporate any necessary OECD elements.⁶³⁸ The OECD elements incorporated should allow *MAF* to evaluate shipping tax regimes more comprehensively.

⁶³¹ Dwyer, above n 2, 671; Alley and Bentley, above n 2, 590; Tanzi and Zee, above n 2, 300; Bahl and Bird, above n 2, 284-9; Livingston, above n 2, 543; Basu above n 2, 139; Stewart, above n 117, 151, 154.

⁶³² *OECD BEPS Action 5*, above n 13, 15; *OECD 1998 Report*, above n 2, 2-3, 8, 10-11.

⁶³³ *Ibid.*

⁶³⁴ *OECD BEPS Action 5*, above n 13, 3, 21; *2018 OECD Progress Report*, above n 32, 3, 13, 15; *OECD 1998 Report*, above n 2, [95]-[96]; See generally *2000 Report*, above n 2, 24.

⁶³⁵ *Ibid.*; Like: denying deductions, imposing withholding taxes at substantial rates or reversing the onus of proof for specific payments to particular States: See generally *OECD 1998 Report*, above n 2, 59 - 62; But regarding certain negative affects of defensive measures on States trying to impose same see generally *OECD 1998 Report*, above n 2, 37 [87]- [89].

⁶³⁶ *OECD BEPS Action 5*, above n 13, 3, 21; *2018 OECD Progress Report*, above n 32, 3, 13, 15; *OECD 1998 Report*, above n 2, [95]-[96]; See generally *2000 Report*, above n 2, 24.

⁶³⁷ *Ibid.*

⁶³⁸ See generally *OECD BEPS Action 5*, above n 13, 11-12; *OECD 1998 Report*, above n 2, 3, 8.

In particular, the OECD's *Updated 1998 Framework* will be examined. It comprises:

- The *1998 OECD Framework assessing harmful tax practices and preferential regimes* ('*1998 Framework*').⁶³⁹
- The Action Five enhancements from the *OECD-G20 Base Erosion Profit Shifting Project* ('*BEPS 5*').⁶⁴⁰

The *1998 Framework* considers whether a regime is a harmful preferential regime.⁶⁴¹ A harmful preferential regime erodes specific tax bases of *other* States illegitimately by, for example, artificially distorting the location of capital and services or undermining the application of horizontal equity between States.⁶⁴² The particular relevance of the *1998 Framework* for shipping tax regimes may be found in its focus on geographically mobile activities that are particularly susceptible to harmful preferential regimes.⁶⁴³ The OECD explicitly includes relevant activities of shipowning and ship operating entities within the scope of 'a geographically mobile activity'.⁶⁴⁴ Therefore, domestic shipping tax regimes may fall within the *1998 Framework's* scope.⁶⁴⁵ The *1998 Framework* has attained greater relevance in the 21st century through the *BEPS* project.⁶⁴⁶ Its *Updated 1998 Framework* generally applies to the OECD and the G20 States alike.⁶⁴⁷ Domestic statutory enactment is the primary method for implementing the *Updated 1998 Framework's* corresponding measures.⁶⁴⁸

⁶³⁹ *OECD 1998 Report*, above n 2, 25-6.

⁶⁴⁰ *OECD BEPS Action 5*, above n 13, 23, 45.

⁶⁴¹ *Ibid* 19; *OECD 1998 Report*, above n 2, 25-6

⁶⁴² *OECD BEPS Action 5*, above n 13, 11; *OECD 1998 Report*, above n 2, 3, 7-8, 16.

⁶⁴³ *OECD BEPS Action 5*, above n 13, 11; *OECD 1998 Report*, above n 2, 3, 7-9.

⁶⁴⁴ *OECD BEPS Action 5*, above n 13, 11, 19; *OECD 1998 Report*, above n 2, 3, 7-9, 14; *OECD Consolidated Application Note*, above n 2, [316].

⁶⁴⁵ *Ibid*.

⁶⁴⁶ *OECD BEPS Action 5*, above n 13, 3; *2018 OECD Progress Report*, above n 32, 38.

⁶⁴⁷ *Ibid*.

⁶⁴⁸ *OECD BEPS Action 5*, above n 13, 3; *2018 OECD Progress Report*, above n 32, 3, 13; *2000 Report*, above n 2, 24.

The thesis will utilise the *Updated 1998 Framework* as its base framework. *MAF* promotes its significance as a set of minimum standards to achieve broader regime legitimacy.⁶⁴⁹ Thus, the *USF*'s application should yield to the *Updated 1998 Framework* where necessary. However, the *USF*'s subordination should, ideally, not affect its overall effectiveness as a critical component of *MAF*.

3.3 The EU Approach, The Tax Base and Special Mobility

A further instrument will be examined to enhance the broader analysis with a greater comparative dimension, namely *The EU Community Guidelines on State Aid to Maritime Transport* ('*EU Framework*').⁶⁵⁰ The *EU Framework* may offer a different approach or perspective to the one offered by the OECD that may enrich the overall analysis. Any complementary or beneficial innovations may be incorporated into *MAF*'s construction or application where appropriate.

In particular, the *EU Framework* will be used for comparatively assessing the relevant income-producing activities underlying shipping income. The analysis naturally overlaps with the fifth primary factor of the *Updated 1998 Framework* since the latter is concerned with connecting a sponsoring State with relevant income-producing activities.

The thesis will advance a uniform approach in conceptualising shipping income to reduce the risk of tax avoidance from tax mismatches and the like.⁶⁵¹ Adopting a uniform approach in

⁶⁴⁹ Ibid.

⁶⁵⁰ *EU Framework* OJ C 13.

⁶⁵¹ See generally OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2' (Final Report, 2015) 11 ('*OECD BEPS Action 2*') <<http://dx.doi.org/10.1787/9789264241138-en.>>.

constructing the tax base supports efficiency, simplicity and certainty outcomes. These outcomes will prove essential for an industry that does not necessarily operate within any one State's borders.⁶⁵² In particular, the thesis will broadly adopt the OECD's approach to defining shipping income. However, the thesis will refine or further develop the construct by considering the EU's approach. The chapter will also explore critical variables that support the mobility of the relevant income-producing activities.

3.4 The 1998 Framework

The general enquiry associated with the *1998 Framework* essentially comprises a three-step analytical process.⁶⁵³ The enquiry's essence may be established from the following three questions:⁶⁵⁴

- 1) **Question One:** Is a regime within the scope of the FHTP's⁶⁵⁵ work, and is it preferential?
- 2) **Question Two:** Is a preferential regime potentially harmful by considering four primary factors/criteria and eight secondary factors/ criteria?
- 3) **Question Three:** Is a preferential regime actually harmful by considering its economic effects?

The three questions will now be considered in further detail.⁶⁵⁶

⁶⁵² 2018 OECD Progress Report, above n 32, 30; *The Mirrlees Review*, above n 17, 22-3, 34, 39-44; Cobb, above n 17, 646-8; Dwyer, above n 2, 747- 748.

⁶⁵³ *OECD BEPS Action 5*, above n 13, 19; *OECD 1998 Report*, above n 2, 25-35.

⁶⁵⁴ *Ibid.*

⁶⁵⁵ The OECD Forum on Harmful Tax Practices.

⁶⁵⁶ *OECD BEPS Action 5*, above n 13, 19; *OECD 1998 Report*, above n 2, 25-35.

3.4.1 Question One

Two matters require assessment here.⁶⁵⁷

- **Firstly, it should be investigated whether the particular regime raises taxes on activities and industries that fall within the scope of the FHTP.**⁶⁵⁸ For the present enquiry, it is sufficient to note that the scope covers the category of geographically mobile activities.⁶⁵⁹ This category is primarily concerned with corporate taxation and business income.⁶⁶⁰ This treatment should be contrasted with the EU approach covering entities other than companies like individuals.⁶⁶¹ The OECD's conclusion that the maritime transport sector has geographically mobile activities is particularly relevant.⁶⁶² Accordingly, regimes that raise taxes on specific income of shipowning and ship operating entities are relevant regimes for answering question one in the affirmative.⁶⁶³
- **Secondly, it should be assessed whether the regime is preferential.**⁶⁶⁴ Preference means providing some form of tax preference, benefit or advantage, compared to the general domestic tax treatment.⁶⁶⁵ The 'preference' concept is conceptualised widely, including reduced tax rates, narrower tax bases, and more favourable terms for paying taxes.⁶⁶⁶ Even a small degree of favourability in tax treatment is sufficient to be regarded as preferential.⁶⁶⁷ The regime must be preferential as assessed within the

⁶⁵⁷ Ibid.

⁶⁵⁸ Ibid.

⁶⁵⁹ Ibid; *2018 OECD Progress Report*, above n 32, 13.

⁶⁶⁰ *OECD BEPS Action 5*, above n 13, 19; *2018 OECD Progress Report*, above n 32, 38.

⁶⁶¹ *EU Framework OJ C 13*, 5.

⁶⁶² *OECD Consolidated Application Note*, above n 2, [316].

⁶⁶³ *OECD BEPS Action 5*, above n 13, 19.

⁶⁶⁴ Ibid; *2018 OECD Progress Report*, above n 32, 13.

⁶⁶⁵ *OECD BEPS Action 5*, above n 13, 19.

⁶⁶⁶ Ibid.

⁶⁶⁷ Ibid.

broader domestic tax system of a State and not in comparison with the position applied in other States.⁶⁶⁸

3.4.2 Question Two

After a relevant regime is judged preferential, the next step is to assess whether it is potentially harmful.⁶⁶⁹ In this next step, the four primary factors and eight secondary factors are considered (as constructed by the original *1998 Framework*).⁶⁷⁰ The function of the secondary factors is to amplify the enquiry where necessary, as considered below.⁶⁷¹ Amplification may be required where the primary factors prove, by themselves, to be insufficient.⁶⁷² Further, a type of quasi presumption of harmfulness might be said to arise once the two-legged test under question two is passed.⁶⁷³

The *1998 Framework's* primary factors originally comprise the following four criteria:⁶⁷⁴

1) ***Primary Factor One: No or low effective tax rates***

- The regime imposes no or low effective tax rates on income derived from relevant activities from shipowning and ship operating. (Geographically mobile activities).

2) ***Primary Factor Two: Improper ring-fencing***

- The regime is ring-fenced from the domestic economy of the sponsoring State.

⁶⁶⁸ Ibid.

⁶⁶⁹ *OECD BEPS Action 5*, above n 13, 20; *2018 OECD Progress Report*, above n 32, 13-4.

⁶⁷⁰ Ibid; *OECD Consolidated Application Note*, above n 2, [332] - [333]; But see *2018 OECD Progress Report*, above n 32, 13; 'The criteria set out in the 1998 Report ... are still used by the Forum on Harmful Tax Practices ('FHTP') to determine whether a preferential regime within the scope of the FHTP's work is potentially harmful.': *2018 OECD Progress Report*, above n 32, 37.

⁶⁷¹ *OECD BEPS Action 5*, above n 13, 20; *OECD 1998 Report*, above n 2, 30 [68]; *OECD Consolidated Application Note*, above n 2, [331] - [333].

⁶⁷² Ibid.

⁶⁷³ *OECD BEPS Action 5*, above n 13, 20-1.

⁶⁷⁴ Ibid; *OECD 1998 Report*, above n 2, [61] - [67]; But see *2018 OECD Progress Report*, above n 32, 13-4, 37.

- 3) ***Primary Factor Three: Transparency deficiency***
 - The regime lacks transparency.
- 4) ***Primary Factor Four: Information exchange deficiency***
 - There is no effective exchange of information.

The secondary factors of the original *1998 Framework* consist of the following eight criteria:⁶⁷⁵

- 1) The tax base is artificially defined.
- 2) International transfer pricing principles are breached.
- 3) Foreign source income is tax-exempt in the resident State.
- 4) Negotiable tax rates and tax bases.
- 5) Secrecy provisions.
- 6) *Access to a wide network of tax treaties.*⁶⁷⁶
- 7) *The regime is promoted as a tax minimisation vehicle.*⁶⁷⁷
- 8) *The regime encourages operations and arrangements that are purely tax-driven and involve no substantial activities.*⁶⁷⁸

The first primary factor is engineered as a gateway or minimum threshold for the question two analysis.⁶⁷⁹ Thus, for question two, the first primary factor constitutes the first leg of the enquiry.⁶⁸⁰ Accordingly, the second leg is not required unless the threshold requirement is met.⁶⁸¹ Once the first leg is passed, a regime will only be treated as potentially harmful where

⁶⁷⁵ *OECD BEPS Action 5*, above n 13, 20; *OECD 1998 Report*, above n 2, [68] – [79]; But see *2018 OECD Progress Report*, above n 32, 13, 37, 39.

⁶⁷⁶ Secondary factors six and seven have subsequently been abolished as they are considered less helpful: *2018 OECD Progress Report*, above n 32, 39.

⁶⁷⁷ *Ibid.*

⁶⁷⁸ See the analysis concerning the new fifth primary factor here below: heading 3.5.

⁶⁷⁹ *OECD BEPS Action 5*, above n 13, *2018 OECD Progress Report*, above n 32, 13-14.

⁶⁸⁰ *OECD 1998 Report*, above n 2, [59]; *2018 OECD Progress Report*, above n 32, 13-14.

⁶⁸¹ *Ibid.*

one or more of the remaining primary factors are satisfied.⁶⁸² Thus, the second leg of the enquiry involves an assessment of each of the remaining three primary factors and, only where necessary, one or more of the eight secondary factors.⁶⁸³ The secondary factors ‘do not on their own indicate that a regime is potentially harmful’.⁶⁸⁴ They merely support the enquiry in establishing one or more primary factors.⁶⁸⁵ One or several secondary factors may be relied upon.⁶⁸⁶ Further, the enquiry is not restricted to the secondary factors, as any relevant information may be considered.⁶⁸⁷

3.4.3 Question Three

The third question involves deciding whether a regime treated as potentially harmful, as a result of implicating the tests in the first two questions, is actually harmful.⁶⁸⁸ The core issue here is whether the regime has created harmful economic effects?⁶⁸⁹ The assessment of this issue may involve a further three considerations:⁶⁹⁰

- 1) Does the regime shift activity to the sponsoring State instead of establishing significant new activity? (*‘the activity-shifting dimension’*).
- 2) Are the investment and income not commensurable with the related activities in the sponsoring State? (*‘the non-proportionate activities dimension’*).
- 3) Is the preferential regime the primary motivation for locating the activities in the sponsoring State? (*‘the dominant reason dimension’*).⁶⁹¹

⁶⁸² *OECD BEPS Action 5*, above n 13, 21; *2018 OECD Progress Report*, above n 32, 13-14, 51.

⁶⁸³ *Ibid*; *OECD 1998 Report*, above n 2, [59].

⁶⁸⁴ *2018 OECD Progress Report*, above n 32, 39, 51.

⁶⁸⁵ *Ibid*.

⁶⁸⁶ *Ibid*.

⁶⁸⁷ *Ibid* 51.

⁶⁸⁸ *OECD BEPS Action 5*, above n 13, 21; *2018 OECD Progress Report*, above n 32, 15.

⁶⁸⁹ *Ibid*.

⁶⁹⁰ *OECD BEPS Action 5*, above n 13, 21; But see *2018 OECD Progress Report*, above n 32, 15 [5].

⁶⁹¹ See generally *OECD 1998 Report*, above n 2, 35 [82] – [84].

The regime may be treated as a harmful preferential regime, where all three questions are answered in the affirmative by relying on economic data;⁶⁹² this last step is outside the scope of the thesis. Any remedial action may include:⁶⁹³

- Allowing a sponsoring State within a specific time frame to abolish the regime or remove any features that create the harmful effect.
- Relying on defensive measures by other States to counter the effects of the harmful regime while diplomatically continuing to encourage the sponsoring State to modify or remove its regime.

3.5 The Updated Primary Factor Five (The regime fails to require substantial activities)

BEPS 5 is intended to modernise the *1998 Framework* by promoting the eighth secondary factor as a new fifth primary factor – among other enhancements.⁶⁹⁴ The factor is, however, promoted in a modified form.⁶⁹⁵ The *1998 Framework* originally conceptualised substantial activity within the context of tax-driven operations.⁶⁹⁶ The absence of substantial activity was applied to signal deficiencies, like providing a sufficient legal and commercial environment, and adequate economic advantages.⁶⁹⁷ It is acknowledged that the substantial activity assessment may be complex to undertake in practice.⁶⁹⁸ Its advantages should be weighed against the corresponding administrative and compliance costs.⁶⁹⁹

⁶⁹² *OECD BEPS Action 5*, above n 13, 21; *2018 OECD Progress Report*, above n 32, 15.

⁶⁹³ *Ibid.*

⁶⁹⁴ *OECD BEPS Action 5*, above n 13, 23; *2018 OECD Progress Report*, above n 32, 13.

⁶⁹⁵ *Ibid.*

⁶⁹⁶ *Ibid* 23 [24]; *OECD 1998 Report*, above n 2, 24 [55], 79 [34].

⁶⁹⁷ *Ibid.*

⁶⁹⁸ *Ibid* 24 [55], 34 [81].

⁶⁹⁹ *OECD 1998 Report*, above n 2, 34 [80]; OECD, ‘OECD/G20 Base Erosion and Profit Shifting Project: Harmful Tax Practices - 2017 Progress Report on Preferential Regimes, Inclusive Framework on BEPS, Action 5’ (Progress Report, 2017) 42 [10] (‘*2017 OECD Progress Report*’) <<http://dx.doi.org/10.1787/9789264283954-en>>.

A key reason for justifying the upgrade to the *1998 Framework* is to better realise substance in international taxation.⁷⁰⁰ A key objective is to reduce/avoid the artificial shifting of income from mobile activities to a sponsoring State and away from other States where value is generated.⁷⁰¹

In particular, the fifth primary factor assesses value and substantial activity through the prism of core income-producing activities.⁷⁰² These activities depend on the nature of the particular industry, including identifying the relevant underlying business activities that produce the relevant income.⁷⁰³

The ultimate consequence of upgrading the substantial activity criterion is that it operates as a primary factor for the *Updated 1998 Framework*. Therefore, the criterion is now sufficient in its own right for satisfying the second leg of question two.⁷⁰⁴ It is now equally important compared with the other three remaining primary factors.⁷⁰⁵ Shipping tax regimes may theoretically avoid implicating the fifth primary factor by restricting their access to core income-producing activities located locally.⁷⁰⁶ However, the realisation of the desired restriction may be complex to achieve in practice.⁷⁰⁷ To exacerbate matters, States do not

⁷⁰⁰ *OECD BEPS Action 5*, above n 13, 23.

⁷⁰¹ *Ibid*; *OECD 1998 Report*, above n 2, 34 [81]. BEPS Actions 8-10 and Action 13 further ‘give jurisdictions tools to prevent profit-shifting to preferential regimes that may have little substance’: *2017 OECD Progress Report*, above n 699, 39.

⁷⁰² *Ibid*; *2018 OECD Progress Report*, above n 32, 14.

⁷⁰³ *OECD BEPS Action 5*, above n 13, 37 [70], 37 [73], 39 [84] – [85]; *2017 OECD Progress Report*, above n 699, 21, 41; OECD, ‘Model Tax Convention on Income and on Capital 2017’ (Full Version, 2019) C(8)-1 [4] - C(8)-2 [4] (*‘OECD Model Tax Convention’*) <<http://dx.doi.org/10.1787/g2g972ee-en>>.

⁷⁰⁴ *OECD BEPS Action 5*, above n 13, 23; *OECD Consolidated Application Note*, above n 2, [331]-[3]; *2018 OECD Progress Report*, above n 32, 14.

⁷⁰⁵ *OECD BEPS Action 5*, above n 13, 23; *OECD Consolidated Application Note*, above n 2, [331]-[3]; *2018 OECD Progress Report*, above n 32, 14.

⁷⁰⁶ *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

⁷⁰⁷ *2000 Report*, above n 2, 14; *2017 OECD Progress Report*, above n 699, 21.

necessarily demonstrate equal exuberance for combatting income shifting, particularly where they enjoy its benefits.⁷⁰⁸

3.5.1 Attributes Exacerbating Base Mobility

The international business of shipowning and operating has particular attributes that may support its unique high mobility as a tax base.⁷⁰⁹ When considered individually, these variables are not necessarily all unique to the shipping sector, such as utilising complex corporate structures.⁷¹⁰ However, the cause of this unique mobility is likely to arise from the joint effect of multiple variables.⁷¹¹ Additionally, it might be considered whether the variable of sea power, as explored specifically in chapter four, is likely to play a prominent role in further enabling and supporting this unique mobility. One might even postulate that the variable of sea power is the primary factor that maintains this special mobility in the 21st century – (the comments under heading 5.2.11 below may also be noted in this regard). It may be complex to work out precisely if the special mobility is primarily caused by sea power, or whether the special mobility and sea power enjoy a different relationship. However, both factors do play an important part in designing shipping tax policy - as will be considered below. Putting aside sea power, at this point of the analysis, the more industry specific attributes or variables will now be considered.

Firstly, one significant variable that may be identified is the extraterritorial dimension of the key business activities.⁷¹² The carriage of goods and passengers by sea may occur outside the

⁷⁰⁸ *2017 OECD Progress Report*, above n 699, 42 [9].

⁷⁰⁹ *2000 Report*, above n 2, 14; *2017 OECD Progress Report*, above n 699, 21; *1998 DETR Report*, above n 23, 16 [61].

⁷¹⁰ *1998 DETR Report*, above n 23, 16 [61].

⁷¹¹ *Ibid.*

⁷¹² *OECD Consolidated Application Note*, above n 2, 80; *2000 Report*, above n 2, 14; *2017 OECD Progress Report*, above n 699, 21; *1998 DETR Report*, above n 23, 16 [61].

jurisdiction of any one particular State.⁷¹³ The situation occurs when a vessel is in transit on the high seas.⁷¹⁴ The high seas are a geographical area independent of the sovereignty of States.⁷¹⁵ Hugo Grotius propounded the principle in his seminal treatise of *Mare Liberum*, first published in 1609.⁷¹⁶ Article 89 of *UNCLOS* codifies the principle internationally.⁷¹⁷ It expressly states that ‘no State may validly purport to subject any part of the high seas to its sovereignty’.⁷¹⁸

Secondly, the carriage of goods and persons by sea may contractually be underpinned by shipping contracts exhibiting novel or fiscally beneficial attributes.⁷¹⁹ Relevant shipping contracts may be classified as affreightment contracts or hybrid service contracts; the carriage of goods by sea has traditionally utilised two primary instruments, namely the charterparty and the bill of lading.⁷²⁰ In general, shipping enterprises may be broken down into five main sectors: liner shipping (where the transportation of cargo utilises transportation contracts with customers as shippers that are evidenced by a bill of lading); passenger shipping (including cruises and ferries, that utilises a passenger booking system); tankers (where transportation services are provided under time and voyage charters, and where a significant number of tank

⁷¹³ 2017 OECD Progress Report, above n 699, 21; 2018 OECD Progress Report, above n 32, 30; OECD Consolidated Application Note, above n 2, 80. It is assuming that the carriage of goods and passengers on the high seas is a key income-producing activity, which is answered in the affirmative below.

⁷¹⁴ Ibid.

⁷¹⁵ Watt, Edward and Richard Coles, *Ship Registration: Law and Practice* (Informa, 3rd ed, 2019) 1[1.2].

⁷¹⁶ See generally Knud Haakonssen (ed), *The Free Sea: Hugo Grotius* (Liberty Fund, 2004) xiv - xvii.

⁷¹⁷ *United Nations Convention on the Law of The Sea*, opened for signature 10 December 1982, 1833 UNTS 3 (entered into force 16 November 1994) (‘*UNCLOS*’) <<https://treaties.un.org/Pages/showDetails.aspx?objid=0800000280043ad5>>.

⁷¹⁸ Ibid.

⁷¹⁹ Breskin, above n 6, 117; Stewart C Boyd et al, *Scrutton on Charterparties and Bills of Lading* (Sweet & Maxwell, 21st ed, 2008) 1-3 [A1] – [A2]; Hare, above n 75, 574 [13-1.2], 697 [15-3.2], 760 [16-5].

⁷²⁰ Paul Todd, *Principles of the Carriage of Goods by Sea* (Routledge, 2016) 4 [1.2]; Bernard Eder et al, *Scrutton on Charterparties and Bills of Lading* (Sweet & Maxwell, 24th ed, 2019) 445 [17-001]; See also Terence Coghlin et al, *Time Charters* (Informa, 7th ed, 2014) 1 [I.4] – [I.5], 3 [I.9]; But see Todd, above n 720, 4 [1.2]; A Bill of Lading may merely evidence a contract of affreightment – being one of its functions: See generally Boyd et al, above n 719, 1-3 [A1] – [A2]; Hare, above n 75, 697 [15-3.2].

operators run their enterprises by means of pools that share income in proportion to tonnage contributed to the pool), bulk shipping (that involves the carriage of grains, raw materials, metals and other commodities in the holds of ships, and where these enterprises operate in a similar manner to tankers), and offshore shipping (involving the provision of shipping services, including providing transportation under various charter agreements).⁷²¹

The opportunity to utilise complex transactions underpinned by chains of specialised contracts which vary in size gives shipowners and operators further opportunity to structure their transactions artificially.⁷²² At the same time, artificial arrangements may also support tax base mobility and the shifting of income to low tax jurisdictions.⁷²³ For example, time and voyage charterparties were utilised as crucial elements in *the Malayan Shipping case*, which is considered in chapter five, to shift income away from Australia.⁷²⁴ Other shipping contracts like demise charterparties may also be used in tax exploitation schemes, as considered further below.

Thirdly, the legal structure that a shipping enterprise or business utilises to conduct its operations, like companies, trusts⁷²⁵ or group structures, may likewise support base mobility and profit shifting.⁷²⁶ The OECD has found that creating intricate structures is relatively easy

⁷²¹ See generally World Shipping Council et al, 'OECD/G20 Inclusive Framework on BEPS - Public Consultation Document (12 October 2020 – 14 December 2020) Report on the Pillar One Blueprint and Report on the Pillar Two Blueprint' (Submission paper to the OECD Centre for Tax Policy and Administration, 14 December 2020) [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 8, 10-3: The shipping industry has submitted that most shipping companies are only active in one sector, but there are some enterprises that are active in two or more sectors.: at 8; See also below n 2393.

⁷²² Ibid 740 [16-3.1]. An example of tax avoidance by exploiting shipping transactions is referenced under demise charterparties – 3.5.3.11.

⁷²³ See, eg, *Malayan Shipping Company Ltd v FCT (1946) 71 CLR 156* <<https://www.ato.gov.au/law/view/document?docid=JUD/71CLR156/00002>>.

⁷²⁴ Ibid.

⁷²⁵ See generally Branch and Robarts, above n 6, 293 [14.8].

⁷²⁶ OECD, 'Ownership and Control of Ships' (Report: Maritime Transport Committee, March 2003, OECD Publishing) 3 ('OCS Report'). Significant structures include private companies and international business corporations (IBCs): at 10. Other vehicles include trusts, foundations, and partnerships: at 10-11; See also below

and comparatively inexpensive.⁷²⁷ The OECD has observed that whilst ship registers may support outcomes like shipowner anonymity, the critical variable is not necessarily the ship register but the applied corporate structures.⁷²⁸ This observation essentially gives further credence to the postulation advanced that it is the combined or pooled effect of the variables supporting the special base mobility.

For example, States that offer traditional ship registers (*'traditional States'*) ordinarily prohibit foreign shipowners from entering (or registering) their vessels on those registers.⁷²⁹ Nonetheless, the prohibition is not necessarily absolute. For example, a foreign company in a foreign State might potentially use a locally incorporated entity in a local State to circumvent the prohibition.⁷³⁰ In so doing, the local entity might be structured as a wholly-owned subsidiary of the foreign parent company.⁷³¹ This corporate group structure may allow the foreign parent company to indirectly use the ship register of the local State in situations where the subsidiary may enter its vessels on it.⁷³² Thus, the foreign company can circumvent this foreign ownership prohibition and indirectly use the traditional ship register in these circumstances without directly establishing a substantial presence locally.⁷³³

Other corporate devices may similarly be utilised as crucial elements in tax avoidance schemes.⁷³⁴ For example, in the *Malayan Shipping case*, considered in chapter five, nominee directors were applied as strategic elements of a tax avoidance plan to shift shipping income

n 2997 and accompanying text; See generally Branch and Robarts, above n 6 [14.4]; See generally Breskin, above n 6, 149, 187.

⁷²⁷ *OCS Report*, above n 726, 3.

⁷²⁸ *Ibid.*

⁷²⁹ Watt and Coles, above n 715, 30 [3.8] – [3.9]; *OECD Consolidated Application Note*, above n 2, 79; Hare, above n 75, 202. See the discussion about ship registration below.

⁷³⁰ *Ibid.*

⁷³¹ *Ibid.*

⁷³² *Ibid.*

⁷³³ Watt and Coles, above n 715, 30 [3.8] – [3.9]; *The Mitchell Review*, above n 55, 15 [2.2].

⁷³⁴ *OCS Report*, above n 726, 3, 8-9: common mechanisms include bearer shares, nominee shareholders and nominee directors.

away from Australia.⁷³⁵ Likewise, tax minimisation schemes may use nominee shareholders and bearer shares.⁷³⁶

Fourthly, intermediaries and subcontractors like ship management firms may support tax base mobility for shipping income.⁷³⁷ They allow relevant business activities of a shipowner (or ship operator) to be fragmented and performed by separate enterprises in one or more geographical locations.⁷³⁸ Thus, a shipowner may effectively outsource one or more of its business activities to other enterprises like ship management firms.⁷³⁹ Breskin observes that outsourcing can take multiple forms.⁷⁴⁰ In 2015, *Lloyd's List* approximated that ten to twelve per cent of the eighty-thousand commercial ships operating worldwide were managed by three-hundred-and-fifty active ship management enterprises.⁷⁴¹ Thus, these intermediaries play a significant role in the industry. However, tax minimisation is not necessarily the dominant objective for utilising them.⁷⁴² Other purposes include addressing onerous administrative responsibilities and operating businesses in a more streamlined or profitable manner.⁷⁴³ Further, ship management firms offer investors that own or finance vessels without having the requisite technical shipping expertise with essential services.⁷⁴⁴

⁷³⁵ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156. See also *OCS Report*, above n 726, 9 [38] – [39].

⁷³⁶ *OCS Report*, above n 726, 8 [32] – [34]. Bearer shares are negotiable instruments that grant ownership of a company to the person who *physically possesses* the instrument.

⁷³⁷ *Ibid* 9 [40] – [44].

⁷³⁸ Breskin, above n 6, 238, 353; *OCS Report*, above n 726, 9 [40] – [44].

⁷³⁹ Breskin, above n 6, 238, 353.

⁷⁴⁰ *Ibid* 353. Outsourced functions usually cover technical management/operating control of the vessel but may also include one or more of the following functions: crewing and crew training, financial services, insurance, consultation, new construction supervision, chartering, accounting, sale and purchase of vessels, bunkering, and compliance with certification requirements: see Branch and Robarts, above n 6[14.6].

⁷⁴¹ Breskin, above n 6, 349.

⁷⁴² *Ibid*.

⁷⁴³ *Ibid*.

⁷⁴⁴ *Ibid*.

Additionally, in adapting to changing market conditions, shipowning enterprises may operate their own vessels and manage the ships of other entities.⁷⁴⁵ Shipowning enterprises may also establish operational alliances, vessel sharing arrangements, and the like, with other shipowning enterprises.⁷⁴⁶ Therefore, discounting corporate group structures, a shipowner's business may, nevertheless, exhibit various complex and interconnected layers.⁷⁴⁷ Ship management firms and operational alliances may serve as integral and substantive business plan elements.⁷⁴⁸ However, the additional complexity may likewise increase the risk of tax base mobility and profit shifting.⁷⁴⁹ The general shipping tax implications associated with utilising enterprises like ship management firms are considered below.

Fifthly, the flexibility and ease of registering ships in foreign jurisdictions of choice may support base mobility.⁷⁵⁰ Both the international law and the domestic laws of States mandate that all ships fly a flag of a State.⁷⁵¹ Article 92 of *UNCLOS* provides internationally that, '[s]hips shall sail under the flag of one State only, and shall be subject to its exclusive jurisdiction on the high seas'.⁷⁵² Article 91 of *UNCLOS* states that '... [s]hips have the [State's nationality] whose flag they are entitled to fly'.⁷⁵³ Thus, the ostensible significance of a ship's flag may be equated with an individual's passport.⁷⁵⁴ The flag evidences a vessel's nationality and enables it to legally enter and depart a State's ports.⁷⁵⁵ However, the actual significance of

⁷⁴⁵ Branch and Robarts, above n 6, 291.

⁷⁴⁶ ICS and WSC, above n 5, 5-6; See generally Breskin, above n 6, 187-190; Branch and Robarts, above n 6, 290 [14.5]; See also *OECD Model Tax Convention*, above n 703, C(8)-2 [6]- C(8)-3 [7]. See generally ICS and WSC, above n 5, 5-6; 'Because of the capital-intensive nature of the shipping business, and because economies of scale have driven the industry towards ... [using] larger vessels ... to optimize fuel efficiency, it is cost-prohibitive for carriers to offer stand-alone services in many markets': at ICS and WSC, above n 5, 5.

⁷⁴⁷ *OCS Report*, above n 726, 9 [40] – [44].

⁷⁴⁸ Branch and Robarts, above n 6, 290 [14.5]; Breskin, above n 6, 350-1.

⁷⁴⁹ *OCS Report*, above n 726, 9 [40] – [44].

⁷⁵⁰ *Ibid* 7 [23] – [24].

⁷⁵¹ *Ibid* 6 [20]; Hare, above n 75, 199, 202.

⁷⁵² *UNCLOS*.

⁷⁵³ *Ibid*.

⁷⁵⁴ Hare, above n 75, 199, 202.

⁷⁵⁵ *Ibid*; see also Watt and Coles, above n 715, 2 [1.3].

a vessel's flag, and the flag State's corresponding exclusive jurisdiction, may be less than it first appears.⁷⁵⁶ A connection between a shipowner and flag-State may be relatively easy to establish.⁷⁵⁷ Thus, the established connection may be a relatively weak one, depending on the requirements of the particular ship register.⁷⁵⁸

The vessels' proper entry in a State's ship register is the precondition for a vessel flying the State's flag.⁷⁵⁹ Some States permit ships under bareboat/demise charterparties to be registered in two States.⁷⁶⁰ However, in the latter situation, the vessel is still only allowed to fly the flag of one State.⁷⁶¹ The primary registration is generally cancelled or suspended (at least for specific purposes) during the life of the demise charterparty.⁷⁶² Nonetheless, tax base mobility may be supported further by secondary registration options.⁷⁶³ However, flags and their corresponding registers are not all equal. Different types of ship registers produce different connections.

3.5.2 The Different Types of Ship Registers

Ship registers may broadly be divided into three groups:

1. Traditional registers:

⁷⁵⁶ Watt and Coles, above n 715, 32-3 [3.13] – [3.15]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3.1].

⁷⁵⁷ Ibid.

⁷⁵⁸ Ibid; *OCS Report*, above n 726, 7 [23]- [24]; *OECD Consolidated Application Note*, above n 2, 80 [291].

‘[T]he [required] link seems to arise ex post facto, being expressed in terms of the jurisdiction and control exercised by the flag State over the ship after the grant of registration. ... Such registration may be regarded as a mere documentary formality, a rubber-stamp by a secretariat or civil servant, but is nonetheless genuine in its procedure and outcome.’: Watt and Coles, above n 715, 32 [3.13]. ‘[T]he linkage requirement has been widely accepted as being met by nothing more than a commercial, fee-for-service relationship between the owner and the Flag State.’: *OCS Report*, above n 726, 7 [23].

⁷⁵⁹ *OCS Report*, above n 726, 6 [20]; See also Watt and Coles, above n 715, 3 [1.6] – [1.7]; Hare, above n 75, 199, 202.

⁷⁶⁰ Watt and Coles, above n 715, 62 [5.1], 63 [5.4]; 89 [7.7], 120 [10.9]; Hare, above n 75, 199, 741 [16-3.1].

⁷⁶¹ Watt and Coles, above n 715, 63 [5.2] - [5.4].

⁷⁶² Ibid.

⁷⁶³ But see Watt and Coles, above n 715, 65 [5.11].

a. Traditional ship registers generally impose additional requirements for crewing and vessel ownership.⁷⁶⁴ The additional requirements generally establish a stronger link between a vessel and its flag State.⁷⁶⁵ Ownership requirements may mandate that individual owners be citizens of the flag State, and juridical or legal owners be incorporated in that State.⁷⁶⁶ Further, crewing conditions may include citizenship requirements, particular qualification and training requirements, minimum wage provisions, and the like.⁷⁶⁷ Although generally viewed as more onerous and less competitive, traditional registers may, nonetheless, be supported more sustainably by utilising protectionist devices, like cabotage rules (as described further under ring-fencing).⁷⁶⁸

2. Open registers:

a. Open registers or flags of convenience (as they may more pejoratively be referred to) offer their flags to shipowners globally.⁷⁶⁹ They tend to establish the weakest connection with a vessel.⁷⁷⁰ Their advantages generally include less onerous registration requirements, attractive fiscal concessions, and business-friendly crewing requirements, such as removing nationality and minimum wage conditions.⁷⁷¹ However, the OECD has acknowledged that specific open

⁷⁶⁴ *OECD Consolidated Application Note*, above n 2, 79; Hare, above n 75, 202; See generally Rhea Rogers, *Ship registration: a critical analysis* (Masters Dissertation, World Maritime University, 2010) 20-1.

⁷⁶⁵ Watt and Coles, above n 715, 30 [3.8] – [3.9].

⁷⁶⁶ *OECD Consolidated Application Note*, above n 2, 79.

⁷⁶⁷ *Ibid.*

⁷⁶⁸ *Ibid.*

⁷⁶⁹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13; Watt and Coles, above n 715, 45 [4.2].

⁷⁷⁰ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; *OCS Report*, above n 726, 7 [23]-[24]; Watt and Coles, above n 715, 27 [3.1], 32-3 [3.13] – [3.15].

⁷⁷¹ *OECD Consolidated Application Note*, above n 2, 79; Hare, above n 75, 202-4; EU Framework OJ C 13, C13/3; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; See generally ITF Seafarers, *What are FOCs?* (2020) <<https://www.itfseafarers.org/en/focs/what-are-focs>>; See generally Rogers, above n 764, 28-9.

registers may be treated as ‘quality registers’.⁷⁷² They provide efficient services and high control standards both at the level of operations and the environment.⁷⁷³ Open registers are generally established in developing States.⁷⁷⁴

3. Second registers:

- a. Second registers may broadly be subdivided into two groups:
 - i. Firstly, offshore registers - offered by territories having varying degrees of power over the flag State.⁷⁷⁵
 - ii. Secondly, international registers - attached directly to the State offering them.⁷⁷⁶

Second registers, like traditional registers, typically require a significant economic or ownership link with the State offering them, like a vessel’s management or its beneficial ownership.⁷⁷⁷ Their primary advantage may be the relaxation of some crewing conditions for a vessel.⁷⁷⁸ Accordingly, the quality of the connection that they create may be somewhere between a traditional register and an open register.⁷⁷⁹ However, they generally provide many advantages that open registers offer.⁷⁸⁰

⁷⁷² *OECD Consolidated Application Note*, above n 2, 80; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6.

⁷⁷³ *OECD Consolidated Application Note*, above n 2, 80; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6; Watt and Coles, above n 715, 22 [2.28].

⁷⁷⁴ Watt and Coles, above n 715, 48 [4.8], 58 [4.37].

⁷⁷⁵ EU Framework OJ C 13, 5.

⁷⁷⁶ *Ibid.*

⁷⁷⁷ *OECD Consolidated Application Note*, above n 2, 81; Hare, above n 75, 204-5; See generally Rogers, above n 764, 41-2.

⁷⁷⁸ *Ibid.*

⁷⁷⁹ Watt and Coles, above n 715, 58 [4.37].

⁷⁸⁰ *Ibid.*

The marked expansion of open ship registers in the 21st century is yet another variable that supports base mobility as they are more prone to establish weaker links between flag States and vessels.⁷⁸¹ In contrast to traditional and second registers, open registers generally allow ship registration irrespective of where a vessel is beneficially owned, managed and controlled.⁷⁸² The Panamanian register is a noteworthy example of an open ship register.⁷⁸³ It has been ranked globally as the largest ship register for a consecutive number of years.⁷⁸⁴ The looser connection produced by the Panamanian register may be evidenced in the observation that access to it is very easy.⁷⁸⁵ Nonetheless, despite having stronger connections, traditional ship registers are not immune to tax exploitation schemes.⁷⁸⁶

Accordingly, ship registration as a factor may support base mobility in varying degrees.⁷⁸⁷ Particularly where ship registration encourages nominal ownership and economic links with a sponsoring State.⁷⁸⁸ The OECD has acknowledged that ‘because shipowners operate in conditions where national boundaries are largely irrelevant, it is relatively easy [for such

⁷⁸¹ EU Framework OJ C 13, 4; *OECD Consolidated Application Note*, above n 2, 79-81; Hare, above n 75, 202-3; See generally Lloyds List, *Top 10 flag states 2019* (3 Dec 2019) <

<https://lloydslist.maritimeintelligence.informa.com/LL1129840/Top-10-flag-states-2019>>; See generally ITF Seafarers, *What are FOCs?* (2020) < <https://www.itfseafarers.org/en/focs/what-are-focs>>; See generally ITF Seafarers, *Current registries listed as FOCs* (2020) < <https://www.itfseafarers.org/en/focs/current-registries-listed-as-focs>>; Rogers, above n 764, 28. Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5. ‘Nowadays, access to the Panamanian registry is very easy, a registry fee based on tonnage is the only charge made and the manning of ships by non-nationals is freely permitted.’: Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

⁷⁸² Hare, above n 75, 202-3; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13; *OECD Consolidated Application Note*, above n 2, 80; See generally ITF Seafarers, *What are FOCs?* (2020) < <https://www.itfseafarers.org/en/focs/what-are-focs>>.

⁷⁸³ Watt and Coles, above n 715, 48 [4.8], 222 [21.2]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-4.

⁷⁸⁴ *Ibid*; See generally Lloyds List, *Top 10 flag states 2019* (3 Dec 2019); See generally ITF Seafarers, *What are FOCs?* (2020); See generally ITF Seafarers, *Current registries listed as FOCs* (2020). At the end of 2019, Lloyds List recorded that it had 9,367 vessels flying its flag. The measurement was about 4,486 ships in front of China, occupying the following.

⁷⁸⁵ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

⁷⁸⁶ *OCS Report*, above n 726, 7 [28], 15 [91].

⁷⁸⁷ *OECD Consolidated Application Note*, above n 2, 80; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

⁷⁸⁸ *OCS Report*, above n 726, 7 [23]-[24]; Watt and Coles, above n 715, 27 [3.1], 32-3 [3.13] – [3.15]; Hare, above n 75, 202-3. The basis of the pretended offshore registrations of the two forfeiture cases involving respectively *The Sceptre* and *The Annandale* in 1876 and 1877, were evading tax and avoiding flag state control’: Hare, above n 75, 202-3.

entities] to register abroad, thus avoiding onerous domestic systems'.⁷⁸⁹ However, the thesis has demonstrated that multiple variables may support base mobility for shipping income.

Thus, in designing an optimal shipping tax regime, the risk of an imperfect alignment between the territorial jurisdiction where income is taxed and the geographical territory where the key activities are performed is real and needs to be considered.⁷⁹⁰ Thus, it may be expected that applying the fifth primary factor of the *Updated 1998 Framework* to shipowning entities may be less straightforward than in other mobile industries.

3.5.3 Relevant Proxies / Quasi Proxies

In addressing obstacles for applying the fifth primary factor, *BEPS 5* adopts specific proxies to represent or complement (to some extent) the income-producing activities that produce shipping income.⁷⁹¹ The objective is to make it simpler to link extraterritorial income-producing activities with a sponsoring State.⁷⁹² Thus, a substantial activity determination may be supported by applying proxies such as the following:

1. Adequate and relevant operating expenditure in the sponsoring State.⁷⁹³
2. An adequate number of employees with necessary qualifications/skills in the sponsoring State.⁷⁹⁴

⁷⁸⁹ *OECD Consolidated Application Note*, above n 2, 80.

⁷⁹⁰ *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

⁷⁹¹ *OECD BEPS Action 5*, above n 13, 9, 24-5, 37; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

⁷⁹² *Ibid*; *OECD BEPS Action 5*, above n 13, 9, 24-5, 37.

⁷⁹³ *2018 OECD Progress Report*, above n 32, 14, 40; *2017 OECD Progress Report*, above n 699, 40. Further, States that provide such preferential regimes must also have a transparent mechanism to review taxpayer compliance with the fifth primary factor: *2017 OECD Progress Report*, above n 699, 42.

⁷⁹⁴ *Ibid*.

3. Satisfying relevant legal (including corporate law obligations) and regulatory compliance requirements in the sponsoring State, like ship registration obligations and IMO⁷⁹⁵ regulations and customs and manning requirements.⁷⁹⁶

It may be speculated that the third proxy might have a significant impact in practice.⁷⁹⁷ For example, the Panamanian register has been described as having relatively easy ship registration requirements.⁷⁹⁸ These requirements provide shipowning entities with easy access to the register and its corresponding shipping tax regime.⁷⁹⁹ Nonetheless, this tax regime appears to have ostensibly passed the primary factor five determination.⁸⁰⁰ Thus, this outcome may demonstrate that this enquiry may be satisfied despite the promotion of a weaker economic connection by a regime.⁸⁰¹ This outcome would arise where the third proxy is accorded a more significant weighting. This issue is explored further under heading 5.2.5.

⁷⁹⁵ International Maritime Organisation <<https://www.imo.org/>>.

⁷⁹⁶ *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30. Moreover, the sponsoring State, in line with the third primary factor of transparency (as detailed further below), must ensure that their shipping tax regime is supported, in law and practice, by the collection of all relevant data. Consistent and regular data collection is essential for monitoring the entities that access the benefits of the regime, to ensure that they continue to comply with the substantial activity criterion.

⁷⁹⁷ Watt and Coles, above n 715, 32-3 [3.13] – [3.15]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3.1]; *2017 OECD Progress Report*, above n 699, 21.

⁷⁹⁸ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3.1].

⁷⁹⁹ *Ibid.* The Panamanian tax regime is considered in detail in chapter five.

⁸⁰⁰ *2018 OECD Progress Report*, above n 32, 20 [16],30; *2017 OECD Progress Report*, above n 699, 21.

⁸⁰¹ Watt and Coles, above n 715, 32-3 [3.13] – [3.15]; *The Mitchell Review*, above n 55, 15 [2.2]; *OCS Report*, above n 726, 7 [23]- [24]; *OECD Consolidated Application Note*, above n 2, 80 [291].

3.5.4 Shipping Income's Relevant Business Activities

3.5.4.1 The OECD G20 BEPS 5 List

The core income-producing activities as identified by *BEPS 5* for legitimising the application of a shipping tax regime *could include*:⁸⁰²

1. managing the crew (including hiring, paying, and overseeing crew members);
2. hauling and maintaining ships;
3. overseeing and tracking deliveries;
4. determining what goods to order and when to deliver them; and
5. organising and overseeing voyages.

3.5.4.2 Harmonising Maritime Transport Activities

The *EU Framework* conceptualises a maritime transport activity as the main income-producing activity that generates shipping income.⁸⁰³ A maritime transport activity is defined as ‘the transport of goods and persons by sea’.⁸⁰⁴ Accordingly, under the *EU Framework*, the carriage of goods and persons by sea constitutes the primary business activity that produces shipping income.⁸⁰⁵ The OECD essentially adopts the same conceptualisation for shipping income.⁸⁰⁶

⁸⁰² *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41. The phrase ‘could include’ may indicate that the list is not a closed list but may be expanded to include other relevant activities: see generally Devenish, above n 82, 227-31.

⁸⁰³ *EU Framework* OJ C 13, 5; *State aid SA.33829 (2012/C) – Maltese tonnage tax scheme and other State measures in favour of shipping companies and their shareholders* [19 Dec 2017] C(2017) 8734 final, 10 (‘*EU/Maltese Communication*’).

⁸⁰⁴ *EU Framework* OJ C 13, 5 [2]; See also *EU/Maltese Communication* C(2017) 8734 final, 10 [3. (46) (a)]; See generally Dennis Weber and Maurits van de Sande, ‘Tonnage Tax and EU law’ in Maisto Guglielmo (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 49 [3.2.3.3.], 50 [3.2.4.1].

⁸⁰⁵ *OECD Consolidated Application Note*, above n 2, 84 [308]; See also *OECD Model Tax Convention*, above n 703, C(8)-1 [4] - C(8)-2 [4]; *EU Framework* OJ C 13, 5; *EU/Maltese Communication* C(2017) 8734 final, 10, 39.

⁸⁰⁶ *OECD Model Tax Convention*, above n 703, C(8)-1. Likewise the same primary approach is followed under the *United Nations Model Double Taxation Convention*: See generally Ekkehart Reimer and Alexander Rust (eds), Klaus Vogel on Double Taxation Conventions (Wolters Kluwer, online, June 2019 Last Reviewed) art 8, General Issues, [9] (‘*Klaus Vogel*’).

Further, the *EU Framework* treats specific activities as maritime transport activities by analogy.⁸⁰⁷ Also, specific exclusions are established for the concept.⁸⁰⁸

However, differences may occur at the peripheral level between the EU and OECD approaches.⁸⁰⁹ The *EU Framework* may, for example, require more exacting requirements for specific business activities.⁸¹⁰ A reason for differences arising at the secondary level between instruments may pertain to their unique underlying policy objectives. For example, the *EU Framework* is uniquely directed at maintaining and increasing the size of merchant fleets that fly the flags of EU States.⁸¹¹ Thus, the *EU Framework* primarily requires that shipping tax regimes' benefits be linked to a vessel's entry in an EU State's register.⁸¹² In contrast, the two

⁸⁰⁷ *EU/Maltese Communication C(2017) 8734 final*, 39. 'The Commission has also decided that certain activities, even if they do not fall, or only partially fall, within the definition of maritime transport, can be subject, by analogy with maritime transport ... This is the case for rescue and marine assistance vessels and for cable-laying, pipeline-laying, crane and research vessels, given that they require similarly qualified staff and are similarly exposed to international competition.'; *EU/Maltese Communication C(2017) 8734 final*, 39-40. 'See e.g., recital 47 of Commission decision of 27 April 2010 in case N 714/2009, the Netherlands - Extension of the tonnage tax scheme to cable layers, pipeline layers, research vessels and crane vessels, OJ C 158, 18/6/2010, p. 2.'; *EU/Maltese Communication C(2017) 8734 final*, 16.

⁸⁰⁸ *EU/Maltese Communication C(2017) 8734 final*, 17, 54. The 2012 Rules on Internal Procedure specifically exclude from the tonnage tax scheme "vessels the main purpose ... is to provide goods or services normally provided on land (e.g., floating hotel, supermarket or restaurant)" and floating or cruising casinos: at 17.

⁸⁰⁹ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; *EU Ship Management Communication OJ C 132*, 6 [1] - [2.1], 7[4]. *EU Framework OJ C 13*, 7. See the discussion on ship management entities below as an instance.

⁸¹⁰ *OECD Model Tax Convention*, above n 703, C(8)-2 [6]; *EU/Maltese Communication C(2017) 8734 final*, 5, 48-9.

⁸¹¹ *EU Framework OJ C 13*, 3 - 5.

⁸¹² *Ibid* 5, 12 (item 1): '[M]ember States' registers' should be understood as meaning registers governed by member State's law applying to their territories forming part of the European Community' at C13/12. *EU Framework OJ C 13*, 5- 6, 12 (item 3). A member States' register is defined to include all traditional registers of member States, and specific second registers of member States, where the latter are located in territories, sufficiently falling under the jurisdiction of the EU, such as the Canary Islands register: *EU Framework OJ C 13*, 5, 12 (items 1 and 2). Further, the *EU Framework* recognises two exceptions to the above condition, requiring a link between the vessel and the register of a member State.'; *EU Framework OJ C 13*, 5- 6. The *EU Framework* further leaves the door open for extending its scope by adopting flag neutral measures if exceptionally required: at C13/6.

OECD Frameworks considered are chiefly directed at addressing harmful tax practices⁸¹³ or international juridical double taxation.⁸¹⁴

Setting aside minor discrepancies, applying a uniform approach in critical areas is advantageous.⁸¹⁵ It should be appreciated that a particular sea voyage in international transit may attract the application of multiple instruments.⁸¹⁶ Thus, in cases where significant inconsistencies arise from the joint application of two or more instruments, the conflict can impede the optimal functioning of the supply chain.⁸¹⁷ It may be irrelevant whether inconsistencies arise simultaneously or at different stages of a sea voyage.⁸¹⁸ It ought to be appreciated that a sea voyage may traverse the high seas and the territorial waters⁸¹⁹ of multiple States.⁸²⁰ The matter becomes even more critical when it is appreciated that maritime transport is the mainstay of global trade.⁸²¹

⁸¹³ 2018 OECD Progress Report, above n 32, 14; OECD BEPS Action 5, above n 13, 11, 23; OECD 1998 Report, above n 2, 3, 7-9, 26-9. In comparison, the Updated 1998 Framework is not concerned with growing particular flags. It is focused on protecting tax bases of other (or non-sponsoring) States: OECD BEPS Action 5, above n 13, 11.

⁸¹⁴ OECD Model Tax Convention, above n 703, II [1] – [3]. ‘International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.’: at [1].

⁸¹⁵ ICS and WSC, above n 5, 1-5; Reimer and Rust, above n 806, art 8, [2]. For a comparison between the OECD Model and the United Nations Model: see Reimer and Rust, above n 806, art 8, [3].

⁸¹⁶ ICS and WSC, above n 5, 1-5; Reimer and Rust, above n 806, art 8, [2], [10]. ‘It is the opinion of the global shipping industry that the OECD model should serve as the inspiration for the discussions at the UN level’: ICS and WSC, above n 5, 1-2.

⁸¹⁷ Ibid.

⁸¹⁸ Ibid.

⁸¹⁹ UNCLOS art 2(1); See generally Encyclopaedia Britannica, ‘Territorial waters: international law’ (2019) <<https://www.britannica.com/topic/territorial-waters>>; See generally Philip Baker (ed), Sweet & Maxwell, *Double Taxation Conventions* (at R.31: October 2018) [8B.05] regarding the inclusion of the continental shelf.

⁸²⁰ Ibid; ICS and WSC, above n 5, 1-5.

⁸²¹ Maritime UK, ‘State Of The Maritime Nation 2019’ (Report, 2019) 3; ICS and WSC, above n 5, 1; 1998 DETR Report, above n 23, 4. Approximately 90% of global trade is transported by sea. : ICS and WSC, above n 5, 1; OECD, *Ocean shipping and shipbuilding The Ocean* <<https://www.oecd.org/ocean/topics/ocean-shipping/>> ; ‘Since more than 80 per cent of world merchandise trade by volume is carried by sea.’: UNCTAD, *Review of Maritime Transport 2020* (United Nations; 2020) 20; ‘Around 80 per cent of global trade by volume and over 70 per cent of global trade by value are carried by sea and are handled by ports worldwide.’ : UNCTAD, *Highlight (2018) Review of Maritime Transport 2018* <<https://unctad.org/webflyer/review-maritime-transport-2018>>.

Thus, shipping income as a critical fiscal concept should be conceptualised consistently across different instruments.⁸²² The benefits of a more straightforward approach include keeping administrative and compliance costs to a better minimum in adherence with simplicity.⁸²³ Likewise, efficiency that generally favours neutrality is more optimally supported.⁸²⁴ Further, a uniform approach across different instruments is less likely to create tax mismatches and, in turn, lessen the risk of tax avoidance.⁸²⁵

Additionally, a more uniform treatment across multiple instruments may better facilitate the general stability of the global supply chain.⁸²⁶ Its proper functioning is a critical factor for safeguarding the general security of individual States.⁸²⁷ The global supply chain provides States with necessary imports, among other things.⁸²⁸ A State's dependency on the global supply chain for goods and materials arises from factors like over-reliance on globalisation and its inability to source or produce them within its jurisdictional borders.⁸²⁹

Therefore, in synchronising different instruments, the *BEPS 5* List ought to be applied within the primary parameters of a maritime transport activity, as essentially constructed by the EU and OECD.⁸³⁰ Accordingly, the *BEPS 5* List should be treated as enumerating the individual

⁸²² *The Mirrlees Review*, above n 17, 22-3, 39-44.

⁸²³ *Ibid*; ICS and WSC, above n 5, 4-5.

⁸²⁴ *The Mirrlees Review*, above n 17, 22-3, 39-44.

⁸²⁵ See generally *OECD BEPS Action 2*, above n 651, 11.

⁸²⁶ ICS and WSC, above n 5, 1-5.

⁸²⁷ UNCTAD, above n 821, 19-23; McMahon, above n 36, 92, 104-5; ICS and WSC, above n 5, 1.

⁸²⁸ *Ibid*. The disruptions to the global supply chain by the COVID-19 crisis in 2020 well illustrates the importance of its proper functioning. See generally UNCTAD, above n 821, 19-23. For further examples, see also the global supply chain disruptions occasioned by World War I and the Anglo-Boer War. See McMahon, above n 36, 92.

⁸²⁹ *Ibid*; See generally Amy Gunia, 'How Coronavirus Is Exposing the World's Fragile Food Supply Chain – and Could Leave Millions Hungry' *Time Magazine* (New York) 8 May 2020 <<https://time.com/5820381/coronavirus-food-shortages-hunger/>>; Matina Stevis-Gridneff and Monika Pronczuk, 'E.U. Vaccine Shortages Snowball Into a Crisis' *The New York Times* (New York) 27 January 2021 <<https://www.nytimes.com/live/2021/01/27/world/covid-19-coronavirus>>.

⁸³⁰ *EU Framework* OJ C 13, C13/5; *OECD Consolidated Application Note*, above n 2, 84 [308]; *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; ICS and WSC, above n 5, 2; *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

components of a maritime transport activity that are sufficient in their own right for identifying the necessary value or substantial activity in a State, which is required for legitimising the application of a shipping tax regime.⁸³¹

It is not novel to treat supply chain components as representing distinct values for raising taxes.⁸³² Value-Added Taxation ('VAT') essentially operates by taxing the increase in value as supplies move through a supply chain.⁸³³ Thus, the supply of providing transport by sea may similarly be broken down into distinct components of value.⁸³⁴ It might be surmised that in a perfect world, the *BEPS 5* List would be constructed to restrict States from applying direct fiscal treatments (whether preferential or not) where the necessary value is not associated with their jurisdiction.⁸³⁵

⁸³¹ *OECD BEPS Action 5*, above n 13, 37, 39; *2017 OECD Progress Report*, above n 699, 21, 41. 'such regimes would only be found to meet the substantial activity requirement if they also granted benefits only to qualifying taxpayers to the extent those taxpayers undertook the core income generating activities required to produce the type of business income covered by the preferential regime.': *OECD BEPS Action 5*, above n 13, 37 [71]; '[T]he substantial activity requirement should also establish a link between the income qualifying for benefits and the core activities necessary to earn the income. ... [t]hese activities may not require anything to link them to income because service activities could be seen as contributing directly to the income that receives benefits.': *OECD BEPS Action 5*, above n 13, 37 [72]. But see *OECD Progress Report*, above n 106, 21 [Shipping regimes].

⁸³² See generally *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126 per Hill J 'The genius of a system of value added taxation, of which [Australian] ... GST is an example, is that while tax is generally payable at each stage of commercial dealings ('supplies') with goods, services or other "things", there is allowed to an entity which acquires those goods, services or other things as a result of a taxable supply made to it, a credit for the tax borne by that entity by reference to the output tax payable as a result of the taxable supply. ... The system of input tax credits thus ensures that while GST is a multi-stage tax, there will ordinarily be no cascading of tax. It ensures also that the tax will be payable, by each supplier in a chain, only upon the value added by that supplier.'

⁸³³ *Ibid.*

⁸³⁴ *Ibid.*; *OECD BEPS Action 5*, above n 13, 23 [24], 37 [71]-[72]; *2017 OECD Progress Report*, above n 699, 21.

⁸³⁵ *OECD BEPS Action 5*, above n 13, 37 [71]-[72].

However, the *BEPS 5* List operates within the context of direct taxation.⁸³⁶ VAT, in comparison, is a form of indirect taxation that is transactionally based.⁸³⁷ In contrast, direct taxation raises taxes on income (and deemed⁸³⁸ income).⁸³⁹ The application of a direct tax may ordinarily be somewhat straightforward.⁸⁴⁰ It may essentially involve charging tax on the global income of entities⁸⁴¹ sufficiently present in a jurisdiction.⁸⁴² Sufficient presence would typically include factors like residing in a State⁸⁴³ or creating a company in a State.⁸⁴⁴

However, raising direct taxes on entities becomes somewhat less straightforward with mobile activities like a maritime transport activity.⁸⁴⁵ The complexity associated with the latter arises from its high mobility as a tax base.⁸⁴⁶ The unique mobility is produced by various attributes that are not necessarily all unique to shipping.⁸⁴⁷ However, a particularly unique variable is its extraterritorial dimension.⁸⁴⁸

Thus, the utility of the *BEPS 5* List may be its facility to provide sponsoring States with an internationally recognised framework to sufficiently link an extraterritorial maritime transport

⁸³⁶ 2018 *OECD Progress Report*, above n 32, 26 [61]; *OECD Consolidated Application Note*, above n 2, 82 [300] – [301], 85 [311], 86 [316] – [317]; *OECD BEPS Action 5*, above n 13, 23 [24]; *The Mitchell Review*, above n 55, 19. See the enquiry for the first primary factor that is concerned with taxing income.

⁸³⁷ See generally *Master Tax Guide 2019*, above n 82, [34.000]; See generally LexisNexis, *VAT in South Africa* (at SI 30 – February 2021) [2.1].

⁸³⁸ Like net capital gains and the assessable gross-up on dividends under a franking credit system.

⁸³⁹ *Master Tax Guide 2019*, above n 82, [1.280], [21-000]; Silke, above n 62, [1.2]; Deutsch et al, above n 82, [1-110].

⁸⁴⁰ *Ibid.*

⁸⁴¹ Examples of such taxpaying persons/entities are individuals and companies.

⁸⁴² See generally the *The Mitchell Review*, above n 55, 15 [2.1] – [2.3]; *Master Tax Guide 2019*, above n 82, [1.280], [21-000]; Silke, above n 62, [1.2]; Deutsch et al, above n 82, [1-110]. Ignoring territorial taxation (or source basis) for the moment to better streamline the essential argument.

⁸⁴³ *Master Tax Guide 2019*, above n 82, [21-010].

⁸⁴⁴ *Ibid* [21-040]; See generally the *The Mitchell Review*, above n 55, 15 [2.1] – [2.3].

⁸⁴⁵ 2017 *OECD Progress Report*, above n 699, 21 [Shipping regimes]; *OECD Consolidated Application Note*, above n 2, 79-82.

⁸⁴⁶ 1998 *DETR Report*, above n 23, 16 [61].

⁸⁴⁷ *Ibid.*

⁸⁴⁸ 2017 *OECD Progress Report*, above n 699, 21 [Shipping regimes]; See generally B R Bamford, *The Law of Shipping And Carriage in South Africa* (Juta, 2nd ed, 1973) 9; Hilton Staniland, ‘Shipping’ in *LAWSA* (LexisNexis Butterworths, 1st Reissue, 2006) vol 25(2) [133]; *UNCLOS* art 89.

activity with its jurisdiction.⁸⁴⁹ The connection may be established where a State can demonstrate that one or more of the core activities or individual components (as set out in the *BEPS 5 List*) have occurred within its jurisdiction.⁸⁵⁰ By establishing the necessary connection, a State may show that value or substantial activity has been produced in its territory.⁸⁵¹ This demonstration of substantial activity permits a sponsoring State to apply its preferential shipping tax regime without implicating the fifth primary factor of the *Updated 1998 Framework*.⁸⁵²

Yet, the issue becomes more complex as shipping tax regimes are by themselves insufficient to raise shipping taxes legitimately.⁸⁵³ A sponsoring State requires, in addition to a valid shipping tax regime, a corresponding taxing right.⁸⁵⁴ Where a sponsoring State concludes/enacts a bilateral instrument based on the *OECD Model Tax Convention* ('*MTC*'), the resident sponsoring State is generally given the exclusive right to apply a shipping tax regime.⁸⁵⁵ Thus, once a State is treated as a resident State, it is entitled to tax the global income of a resident entity.⁸⁵⁶ It is, generally, irrelevant whether it taxes the income preferentially or not.⁸⁵⁷ Likewise, it may be irrelevant whether the income is connected to activities that substantially connect it with the resident State.⁸⁵⁸

⁸⁴⁹ *OECD BEPS Action 5*, above n 13, 23 [24], 37 [71]-[72].

⁸⁵⁰ *Ibid* 37 [71]-[72], 39 [84] – [85].

⁸⁵¹ *Ibid* 23 [24].

⁸⁵² *Ibid*.

⁸⁵³ *The Mitchell Review*, above n 55, 40 [5.21], 69-74; *Silke*, above n 62, [5.1]; *Master Tax Guide 2019*, above n 82, [21-000]; *OECD Consolidated Application Note*, above n 2, 86 [313]- [315]; Socrates Leptos-Bourgi, Erwin van den Bree and Jeroen Boonacker, 'Choosing your course: Corporate taxation of the shipping industry around the globe' (PwC Transportation & Logistics International Tax Publication, 2015) 12.

⁸⁵⁴ *The Mitchell Review*, above n 55, 15 [2.1] – [2.3]; 40 [5.21], 69-74; *OECD Model Tax Convention*, above n 703, M-30, C(8)-1; Reimer and Rust, above n 806, art 8, [1].

⁸⁵⁵ *OECD BEPS Action 5*, above n 13, 23 [24]; Reimer and Rust, above n 806, art 8, [1].

⁸⁵⁶ *OECD Model Tax Convention*, above n 703, C(8)-1 [1], C(4)-10 [21].

⁸⁵⁷ *Ibid*.

⁸⁵⁸ *The Mitchell Review*, above n 55, 15 [2.2] – [2.3], 73. The incorporation test may be referenced here as an example.

Thus, in applying the fifth primary factor, it might be problematic to effectively and simply restrict the operation of a shipping tax regime in proportion to the value/substantial activity associated with a jurisdiction.⁸⁵⁹ The resident State generally has the exclusive right to tax all the income of its residents.⁸⁶⁰ Therefore an exclusive taxing right does not necessarily align optimally with a piecemeal or fragmented approach to recognising substantial activity in taxing shipping income.⁸⁶¹ Once a State has an exclusive taxing right, it generally taxes the corresponding income as it deems appropriate.⁸⁶² Under those circumstances, it might be impractical to impose additional limitations on a shipping tax regime's legitimacy to tax specific streams of shipping income.⁸⁶³ Such an approach may increase non-taxation.⁸⁶⁴ Irrespective of its disadvantages, a preferential tax may still be a tax.⁸⁶⁵ It cannot be assumed that a non-preferential treatment will be applied in the alternative by a sponsoring resident State where its preferential one is treated as illegitimate. States are ultimately sovereign entities that cooperate internationally and exercise policymaking ultimately in their national interest.⁸⁶⁶ A fragmented approach also seems in violation of simplicity as benchmarked.

Thus, in applying the BEPS 5 List, a looser and systemic approach might be more advantageous to simplify the tax treatment and apply substantial activity more effectively.⁸⁶⁷ Such an approach may also correspond well with the construction of the *BEPS 5* List as an open list.⁸⁶⁸

A looser approach might be where a State merely has to locate in its jurisdiction one relevant

⁸⁵⁹ *OECD BEPS Action 5*, above n 13, 23 [24], 37 [71]-[72].

⁸⁶⁰ *OECD Model Tax Convention*, above n 703, C(8)-1 [1]; Reimer and Rust, above n 806, art 8, [1].

⁸⁶¹ Reimer and Rust, above n 806, art 8, [10].

⁸⁶² *OECD Model Tax Convention*, above n 703, C(8)-1 [1]; Reimer and Rust, above n 806, art 8, [1].

⁸⁶³ Presumably excluding income that is derived from activities that are not substantial.

⁸⁶⁴ See generally *The Mitchell Review*, above n 55, 13-4 [1.7], 38 [5.15].

⁸⁶⁵ See the specific discussion on the Panamanian, UK and Greek shipping tax regimes here below.

⁸⁶⁶ Commonwealth of Australia, *National Sovereignty in a Globalising World*: Parl Paper No 38 (2002), https://www.aph.gov.au/About_Parliament/Senate/Powers_practice_n_procedures/pops/pop38/rabkin; Ben Wellings 'Taking Back Control: Parliament, Sovereignty and Brexit' (Research Paper No 69, Parliamentary Library, Commonwealth of Australia, 2018).

⁸⁶⁷ See generally *The Mitchell Review*, above n 55, 41 [5.30] - [5.31], 42 -3 [5.32], [5.36].

⁸⁶⁸ *OECD BEPS Action 5*, above n 13, 39 [84]-[85]. Note the word 'could' in introducing the list.

component of a core-income producing activity of an entity (as established from the *BEPS 5* List). By accomplishing this step, the sponsoring State should legitimately be able to tax (whether preferential or not) the total income of an entity arising from that core income-producing activity as a whole.⁸⁶⁹

Further, the juridical connecting factors should be enhanced under a looser and systemic approach to the *BEPS 5* List. Resident-resident double tax conflicts may constitute a good illustration for applying substantial activity more effectively and simply.⁸⁷⁰ It might be envisaged that for a State to be awarded an exclusive taxing right to shipping income, it should, as one of the prerequisites, demonstrate that it has a more significant economic connection with the shipping income than the other resident State.⁸⁷¹ In so doing, taxing rights would be awarded to the resident State that can demonstrate the stronger connection. This outcome may align better with simplicity and realise substance in shipping taxation more effectively. Thus, the thesis prefers a loose and systemic approach in applying the *BEPS 5* List.⁸⁷² Chapter five will consider the interaction between the juridical connecting factors and shipping tax regimes in greater detail.

⁸⁶⁹ Ibid; *2017 OECD Progress Report*, above n 699, 21 [Shipping regimes]; See generally *The Mitchell Review*, above n 55, 41 [5.30] - [5.31], 42 -3 [5.32], [5.36].

⁸⁷⁰ The exclusive taxing right is given to the State with the stronger economic connection in a bilateral situation— which can be applied more effectively than leaving the matter of substantial activity largely within the discretion of one State.

⁸⁷¹ *OECD BEPS Action 5*, above n 13, 39 [84]-[85]; *2017 OECD Progress Report*, above n 699, 21 [Shipping regimes]; See generally *The Mitchell Review*, above n 55, 41 [5.30] - [5.31], 42 -3 [5.32], [5.36].

⁸⁷² *The Mitchell Review*, above n 55, 7-8, 40 [5.21]; *The Mirrlees Review*, above n 17, 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324.

3.5.4.3 The OECD's Approach to Shipping Income

Shipping income under article 8 of the *OECD Model Tax Convention* ('MTC') means income 'directly obtained ... from the transportation of passengers [and] cargo by ships ...'.⁸⁷³ Two peripheral categories of business activities are also recognised under the *MTC* as producing shipping income, in acknowledging that undertaking maritime transport activities may be complex.⁸⁷⁴ They comprise:⁸⁷⁵

- A. activities directly connected with any ship transport operation; and⁸⁷⁶
- B. activities that are not directly connected with the operation of ships provided they are ancillary to such operation.⁸⁷⁷

Subcategory "A" activities are those business activities *directly connected* with transporting passengers and cargo by ship.⁸⁷⁸ They are carried on *primarily* to support the main income-producing operation, like necessary activities.⁸⁷⁹ The word *primarily* means: 'to a great or the greatest degree; for the most part; mainly.'⁸⁸⁰ Consequently, any such business activities would also produce shipping income.⁸⁸¹

⁸⁷³ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; Baker, above n 819, (at R2: March 2002) 8-2/1; Likewise the same approach is followed under the United Nations Model Double Taxation Convention. See generally Reimer and Rust, above n 806, art 8, [9].

⁸⁷⁴ Reimer and Rust, above n 806, art 8, [9]; Likewise, the same general scheme is followed under the United Nations Model Double Taxation Convention. See generally Reimer and Rust, above n 806, art 8, [9].

⁸⁷⁵ Baker, above n 819, (at R2: March 2002) 8-2/1 'It also covers other classes of profits which by reason of their close relationship may be placed in the same category': at 8-2/1.

⁸⁷⁶ The *MTC* applies the term of "*international traffic*" to remove some sea carriage from the concept "*any transport by a ship*". See Article 3 of the *OECD Model Tax Convention*, above n 703, M(10) [e]. The term essentially results in certain profits falling outside the scope of art 8 for excluded sea routes.

⁸⁷⁷ *OECD Model Tax Convention*, above n 703, C(8)-1 [4] - C(8)-2 [4]; Baker, above n 819, (at R2: March 2002) 8-2/1-8-2/2.

⁸⁷⁸ *OECD Model Tax Convention*, above n 703, C(8)-2 [4].

⁸⁷⁹ *Ibid.*

⁸⁸⁰ *OED*, above n 142, 'primarily (adv)'.

⁸⁸¹ *Ibid.*

Subcategory B activities are those business activities that are not required for transporting passengers and cargo by ship.⁸⁸² They are activities that may only make a minor contribution.⁸⁸³ Nonetheless, where they are so closely related to the main activity, they may be treated as ancillary activities also producing shipping income.⁸⁸⁴ For example, the leasing and short term storage of containers may be directly connected with or ancillary to carrying goods by sea.⁸⁸⁵

Thus, a general alignment exists between the *EU Framework* and *MTC* to the extent they essentially construct shipping income.⁸⁸⁶ They both utilise the carriage of passengers and goods by sea as their core business activity that produces shipping income.⁸⁸⁷ Further, they both recognise various peripheral activities that produce shipping income.⁸⁸⁸

3.5.5 Eligible Ships and Peripheral Activities

Maritime transport activities, as constructed, generally controls the types of vessels qualifying for EU preferential shipping tax treatment.⁸⁸⁹ However, the *EU Framework* also recognises several exceptions to the general construction.⁸⁹⁰

For example, the *EU Framework* generally allows tugboats to obtain preferential tax treatment under a shipping tax regime of an EU Member State where it undertakes maritime transport activities.⁸⁹¹ In particular, the *EU Framework* includes towage as an activity that may be treated

⁸⁸² *OECD Model Tax Convention*, above n 703, C(8)-2 [4]; ICS and WSC, above n 5, 6-7.

⁸⁸³ *Ibid.*

⁸⁸⁴ *Ibid.*

⁸⁸⁵ *OECD Model Tax Convention*, above n 703, C(8)-3 [9].

⁸⁸⁶ *Ibid.*; *EU Framework* OJ C 13, C13/5.

⁸⁸⁷ *Ibid.*

⁸⁸⁸ *Ibid.*

⁸⁸⁹ Weber and Van de Sande, above n 804, 50 [3.2.4.1].

⁸⁹⁰ *Ibid.* For example, research and crane vessels.

⁸⁹¹ *Ibid.* There are other requirements like flag requirements that must be complied with. See generally *EU/Maltese Communication* C(2017) 8734 final, 15, 42.

as a maritime transport activity under specific circumstances.⁸⁹² The *EU Framework* explicitly includes ‘towing at sea of [barges], oil platforms [and other immobile vessels]’ as eligible towage activities that constitute maritime transport activities.⁸⁹³ Therefore a critical requirement is that the vessel enjoying the towage activity is immobile whether by design or technical fault.⁸⁹⁴ Thus, the *EU Framework* explicitly excludes towing in ports, assisting *self-propelled* vessels to reach port, and the like, as eligible towage activities.⁸⁹⁵ For a tugboat to enjoy preferential EU tax treatment, the eligible towage activities, constituting maritime transport activities, must be more than 50% of the entire annual towage activity.⁸⁹⁶ Further, in calculating the annual percentage, any wait times should be apportioned on a proportional basis between maritime and non-maritime transport activities.⁸⁹⁷

In contrast, the *EU Framework* excludes dredging as a maritime transport activity.⁸⁹⁸ A deep-sea dredger is a vessel with the functional ability to dredge and extract materials from the seabed.⁸⁹⁹ Thus, unlike towage, dredging and extracting activities (‘*excluded activities*’) will absolutely fail the EU definition of a maritime transport activity.⁹⁰⁰ Nonetheless, where dredger vessels carry extracted material by sea,⁹⁰¹ apart from performing excluded activities, they may be eligible for EU preferential tax treatment for that carriage component, which is a maritime

⁸⁹² *EU Framework* OJ C 13, 5, 7; *EU/Maltese Communication* C(2017) 8734 final, 15, 42.

⁸⁹³ *EU Framework* OJ C 13, 7; *EU/Maltese Communication* C(2017) 8734 final, 15, 42. ‘This would *inter alia* include towing barges between ports or between a port and an offshore installation/structure or towing of vessels which due to a technical failure cannot sail on their own’: *EU/Maltese Communication* C(2017) 8734 final, 42.

⁸⁹⁴ *Ibid.*

⁸⁹⁵ *EU Framework* OJ C 13, 7; *EU/Maltese Communication* C(2017) 8734 final, 15, 42.

⁸⁹⁶ *Ibid.*

⁸⁹⁷ *EU Framework* OJ C 13, 7.

⁸⁹⁸ *Ibid.*; *EU/Maltese Communication* C(2017) 8734 final, 41-2.

⁸⁹⁹ *Ibid.*; See generally Central Dredging Association, *Deep-Sea Mining Information Portal* <<https://www.dredging.org/resources/ceda-publications-online/deep-sea-mining-information-portal>>; See generally Rohde Nielsen, *Deep-Sea Dredger* <<http://rohde-nielsen.com/fleet/deep-sea-dredgers>>.

⁹⁰⁰ *EU Framework* OJ C 13, 7; *EU/Maltese Communication* C(2017) 8734 final, 41-2.

⁹⁰¹ Particular reference is made to transporting extracted materials at deep sea. But see *EU/Maltese Communication* C(2017) 8734 final, 41-2.

transport activity.⁹⁰² However, to qualify, the dredger must undertake such maritime transport activities for more than 50% of their operational time per annum.⁹⁰³

The *MTC* does not define a ship in its body or its commentary.⁹⁰⁴ However, the *MTC* does provide that a ship should not be treated as immovable property for its purposes.⁹⁰⁵ Further, the *MTC* advises that guidance on the meaning of ship may be sought from the domestic law of a State party where appropriate and as directed by its article 3(2).⁹⁰⁶ *Klaus Vogel* advocates that a broad meaning should be adopted for ‘ship’ in applying article 8 of the *MTC*.⁹⁰⁷ Thus, a vessel should be treated as a ship if it is designed for transport in international traffic and used for water navigation, irrespective of whether it carries things on or under the water.⁹⁰⁸ *Klaus Vogel* submits that it should also be irrelevant for article 8 whether the vessel is motor-driven or not.⁹⁰⁹

Klaus Vogel submits that ‘transport’ as used in the international traffic definition⁹¹⁰ contained in article 3(1)(e) of the *MTC* includes operating towing vessels on the basis of German authority.⁹¹¹ (For now, international traffic may be understood, roughly, as any transport by a ship, other than a non-source State’s vessel plying simply between the ports of a source State).⁹¹² Thus, if this submission proves true more broadly, a towage vessel’s income might

⁹⁰² *EU Framework* OJ C 13, C13/7; *EU/Maltese Communication* C(2017) 8734 final, 41-2. There are other requirements like flag requirements that generally must be complied with.

⁹⁰³ *Ibid.* ‘In the case of dredging, maritime transport is defined by Section 3.1 of the Maritime Guidelines as “the transport at deep sea of extracted materials” and excludes “extractions or dredging as such” ...’: *EU/Maltese Communication* C(2017) 8734 final, 41-2.

⁹⁰⁴ Reimer and Rust, above n 806, art 8, [28].

⁹⁰⁵ *OECD Model Tax Convention*, above n 703, M-25 [6(2)]; Reimer and Rust, above n 806, art 8, [13].

⁹⁰⁶ Reimer and Rust, above n 806, art 8, [28].

⁹⁰⁷ *Ibid.* [29].

⁹⁰⁸ *Ibid.*

⁹⁰⁹ *Ibid.*

⁹¹⁰ The term “international traffic” firstly means ‘any transport by a ship or aircraft’.

⁹¹¹ Reimer and Rust, above n 806, art 8, [31]: German BFH of 11 April 1990, BFH I R 163/87, BStBl. II 783 (1990).

⁹¹² *OECD Model Tax Convention*, above n 703, M-10; See chapter 5 where this particular feature is considered in more detail.

be covered by article 8 through an expanded interpretation of ‘international traffic.’⁹¹³ This submission demonstrates that the *MTC*’s article 8 has the capacity to enjoy a more comprehensive understanding of shipping income.⁹¹⁴

Likewise, the *MTC*’s article 8 appears to have the capacity to support a broader definition of a ‘ship’ compared to the *EU Framework*. Unlike the *EU Framework*, the *MTC*’s commentary also expressly advises that States may decide bilaterally in a double tax agreement that the income derived from dredging and hauling activities on the high seas may be treated as article 8 income.⁹¹⁵

3.5.6 Ship Management Enterprises

The *EU Framework* extends preferential shipping tax regimes to *pure ship management enterprises* (which is used here to reference entities undertaking outsourced work exclusively and operating vessels *technically* like a *carrier*).⁹¹⁶ (*Carrier* for the thesis means, specially,⁹¹⁷ shipowners and demise charterers that, as a minimum, technically operate or navigate ships for their business). Ships have significant capital demands that may require innovative financing arrangements where shipowners utilise the services of an independent technical operator.⁹¹⁸

⁹¹³ Reimer and Rust, above n 806, art 8, [31]; But see below n 3149.

⁹¹⁴ *OECD Model Tax Convention*, above n 703, C(8)-6 [18]; Reimer and Rust, above n 806, art 8, [31].

⁹¹⁵ *Ibid.*

⁹¹⁶ *EU Framework* OJ C 13, 7; See also *EU Ship Management Communication* OJ C 132, 6.

⁹¹⁷ It should be noted that in common shipping parlance ‘carrier’ may refer to ‘a term of old and familiar meaning, ... the term is defined to mean the party on whose behalf the bill of lading has been signed, that is, *the party contracting to carry the goods*’: *The Starsin* [2003] 1 Lloyd’s Rep 571, 578 [14] (per Lord Bingham) (House of Lords) (emphasis added). Thus ‘carrier’ in shipping documents may reference the owner, demise charterer or time charterer. See also Coghlin, above n 720, 10 [I.41], 11 [I 48], 389 [21.1] – [21.2], 391 [21.7], 21.11[392]; Lord Hobhouse refers to the middle time charterer (or lessor for want of a bad word) in a chain of time charters as the carrier or despondent owner in the *Hill Harmony*, where the shipowner COSCO entered into a time charter with Whistler (the appellants) who sub time chartered the vessel to Kawasaki who sub time chartered her to Tokai. See generally *Hill Harmony* [2001] 1 Lloyd’s Rep 147, 147, 153, 156 (House of Lords). See generally Eder et al, above n 720, 3 [1-007 (n14)]. But see generally Coghlin, above n 720, 2 [I.6]; But see Eder et al, above n 720, 4 [1-011].

⁹¹⁸ Branch and Robarts, above n 6, 292; Breskin, above n 6, 264-286; See also *WSC et al Submission Paper to the OECD*, above n 721, 2.

Investment entities owning vessels and entities from other industries preferring the use of their own vessels may lack the technical expertise to navigate their vessels.⁹¹⁹ Ships are, also, diverse in type and different vessels may require different technical proficiencies that are not all practically available in-house.⁹²⁰ Smaller shipping enterprises may, additionally, rely on outside technical support to remain competitive and sustainable.⁹²¹ Therefore, ship management enterprises may play a vital role in supporting the maintenance and growth of a ship register's tonnage in the 21st century, by offering specialised technical know-how and experience to particular shipowners.⁹²²

Ship management activities may be classified into three broad categories, namely: (a) technical management, (b) crew management and (c) commercial management.⁹²³ Technical management is broadly concerned with a vessel's seaworthiness and compliance with technical, security, and safety requirements.⁹²⁴ Crew management involves, generally, all matters pertaining to the crew.⁹²⁵ In contrast, managing a vessel commercially may involve

⁹¹⁹ Branch and Robarts, above n 6, 289-295; Breskin, above n 6, 265-267; *OCS Report*, above n 726, 3, 10-14; Constantine G Papavizas, 'Public Company Jones Act Citizenship' (2015) 39(2) *Tulane Maritime Law Journal* 383, 386-7, 404-6.

⁹²⁰ *Ibid.*

⁹²¹ See generally Alexander, above n 35, 10 [24].

⁹²² Branch and Robarts, above n 6, 290-291; Breskin, above n 6, 237; *OCS Report*, above n 726, 5; *EU Ship Management Communication* OJ C 132, 7.

⁹²³ Reimer and Rust, above n 806, art 8, [12]; *EU Ship Management Communication* OJ C 132, 6 [2.2].

⁹²⁴ *EU Ship Management Communication* OJ C 132, 6 [2.2] In particular, the technical manager is responsible for making decisions on 'the repair and maintenance of a ship': *EU Ship Management Communication* OJ C 132, 6 [2.2]; '[T]o be eligible, ship managers [must] assume from the owner the full responsibility for the vessel's operation, as well as take over from the owner all the duties and responsibilities imposed by the ISM Code. Should ship managers also provide other specialised services, even related to vessel operation, separate accounting for such activities, which do not qualify for the tax relief schemes, should be ensured.': *EU Framework* OJ C 13, 7. See also *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156 (per Lord Hobhouse) (House of Lords).

⁹²⁵ *EU Ship Management Communication* OJ C 132, 6 [2.2] '[S]uch as selecting and engaging suitably qualified seafarers, issuing payrolls, ensuring the appropriateness of the manning level of ships, checking the certifications of seafarers, providing for seafarers' accident and disability insurance coverage, taking care of travel and visa arrangements, handling medical claims, assessing the performance of the seafarers and, in some cases, training them': *EU Ship Management Communication* OJ C 132, 6 [2.2]. There are additional requirements for crew managers pertaining to (a) training and (b) employment conditions: see *EU Ship Management Communication* OJ C 132, 8 [6].

promoting and securing the sale of a vessel's tonnage capacity.⁹²⁶ In particular, the latter may cover activities like time and voyage chartering, including accepting cargo (or passenger) bookings, marketing, and appointing agents.⁹²⁷

Apart from demonstrating category (a) or (b) activities, an EU ship management enterprise should satisfy other conditions to qualify as a beneficiary of a preferential shipping tax regime.⁹²⁸ Conditions establishing an economic link between the EU and a vessel or its corresponding enterprise may be viewed as examples of applying a substantial activity requirement.⁹²⁹ What's more, the *EU Framework* prohibits ship management entities from utilising the same proportion of the tax base as applied to *carriers*.⁹³⁰ Thus, the *EU Framework* generally treats a ship management enterprise as having a different turnover to a *carrier* in relation to a particular vessel.⁹³¹ Accordingly, the *EU Framework* may offer guidance for applying a shipping tax regime to entities other than *carriers*, where the former and latter entities have an overlapping tax base in relation to the same vessel. However, the EU's particular policy objectives should always be borne in mind when considering its specific tax treatments, as considered below.

⁹²⁶ *EU Ship Management Communication* OJ C 132, 6 [2.2].

⁹²⁷ *Ibid* 6 [2.2]; *EU/Maltese Communication* C(2017) 8734 final, 16, 48 [286].

⁹²⁸ *EU Ship Management Communication* OJ C 132, 7 - 8 [5]; See also Weber and Van de Sande, above n 804, 49 [3.2.3.3].

⁹²⁹ *EU Ship Management Communication* OJ C 132, 7 - 8 [5]. (1) '[There must be the necessary economic link such as] ship management is carried out in the territory of one or more member States and that mainly Community nationals are employed in land-based activities or on ships.' (2) '[At least] two thirds of the tonnage of the managed ships is managed from the territory of the Community.' (3) 'All the ships and crews they manage comply with international standards and Community law requirements.' (4) 'The flag-share requirement, as laid down in the eighth paragraph of Section 3.1 of the Guidelines applies to ship management companies.' (5) There are additional requirements for crew managers, pertaining to (a) training and (b) employment conditions: *EU Ship Management Communication* OJ C 132, 8 [6].

⁹³⁰ *Ibid* 9 [7].

⁹³¹ *Ibid*. 'The tax-base to be applied to ship management companies should be approximately 25 % (in terms of tonnage or notional profit) of that which would apply to the shipowner for the same ship or tonnage' 'The shipowner, if eligible, remains liable for the whole tonnage tax': at 9 [7].

3.5.6.1 Ship Operations: Crewing & Technical Management

More specifically, *the EU Framework* allows pure ship management enterprises, as described above, to be eligible for preferential shipping tax treatment to the extent that they perform either or both (a) [technical management] and (b) [crew management] functions.⁹³² Ship management is viewed as a ‘standard core activity’ of ship navigators.⁹³³ Thus, in undertaking a sea transport operation, ship managers that perform both the (a) and (b) functions for a vessel are said to ‘step into the shoes of a classic *carrier*’.⁹³⁴ In advancing efficiency and horizontality outcomes for shipping tax regimes, the *EU Framework* applies a neutral tax treatment, irrespective of whether or not these essential sea transport services are performed in-house by *carriers* or are directly contracted out to specialised third parties.⁹³⁵

However, from a perusal of past case authority, it appears that the *EU Framework* may not necessarily align with the *MTC* in this instance. On its face, article 8(1) of the *MTC* refers to ‘profits of an enterprise ... from the operation of ships ...’.⁹³⁶ Thus, article 8(1) ostensibly requires some link between profits/income and ship operations.⁹³⁷ However, the *MTC*’s explanatory commentary for article 8(1) seems to endorse a broader approach for constructing

⁹³² *EU Ship Management Communication* OJ C 132, 6 [1] - [2.1], 7[4]; *EU Framework* OJ C 13, 7. In particular, the *EU Framework* makes the following provisions: ‘Ship management companies may qualify for aid only in respect of vessels for which they have been assigned the entire crew and technical management. In particular, in order to be eligible, ship managers have to assume from the owner the full responsibility for the vessel’s operation, as well as take over from the owner all the duties and responsibilities imposed by the ISM Code. Should ship managers also provide other specialised services, even related to vessel operation, separate accounting for such activities, which do not qualify for the tax relief schemes, should be ensured.’: *EU Framework* OJ C 13, 7 [3.1]. The *EU Ship Management Communication* subsequently amended the above position. See generally *EU Ship Management Communication* OJ C 132, 7 [4].

⁹³³ *EU Ship Management Communication* OJ C 132, 7 [3]; See generally Weber and Van de Sande, above n 804, 48-9 [3.2.3.3].

⁹³⁴ *EU Framework* OJ C 13, C13/7. (as define above, carrier/s for the thesis means, specially, shipowners and demise charterers that technically operate or navigate ships for their business).

⁹³⁵ *The Mirrlees Review*, above n 17, 34, 40; *EU Ship Management Communication* OJ C 132, C 132/7[3]. But see *EU Ship Management Communication* OJ C 132, 9 [7]. ‘In case ship management companies subcontract part of their activity to third parties, the latter are not eligible to State aid.’

⁹³⁶ *OECD Model Tax Convention*, above n 703, M-30 art 8(1).

⁹³⁷ *Ibid* M-30 art 8(1).

the article to some extent.⁹³⁸ The *MTC*'s commentary advises that income directly obtained by an enterprise from undertaking maritime transport activities on vessels 'that it operates' is primarily income for article 8 purposes (or shipping income), irrespective of whether the vessels are 'owned, leased or *otherwise*' at the enterprise's disposal.⁹³⁹ This italicised catch-all phrase may be broad enough to cover vessels operated in a more comprehensive sense.⁹⁴⁰ However, the italicised words are qualified in the commentary by the words 'that it operates.'⁹⁴¹ Therefore, the key issue is what does operating ships in this fiscal context denote?

Past legal authority, within a Canadian income tax context in general, and a double tax agreement in particular, appears to adopt a narrower construction for defining the phrase 'ship operations'.⁹⁴² In *Furness Withy & Co v Minister of National Revenue*,⁹⁴³ the Canadian Supreme court considered what was meant by the words 'to operate ships' in a double tax agreement; the derivative in issue there appeared as 'derives from operating ships.'⁹⁴⁴ The case concerned a bilateral double tax agreement that preceded the *MTC*.⁹⁴⁵ Nonetheless, the case

⁹³⁸ Ibid C(8)-1 [4].

⁹³⁹ Ibid (emphasis added).

⁹⁴⁰ *OECD Model Tax Convention*, above n 703, C(8)-2 [6]; CF *OECD Model Tax Convention*, above n 703, C(8)-2 [5]; *EU Ship Management Communication* OJ C 132, 6 [2.2]. In other words, 'promoting and securing the sale of a vessel's tonnage capacity'.

⁹⁴¹ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]. To quote the full statement: 'The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or *otherwise at the disposal* of the enterprise) *that it operates*': (emphasis added).

⁹⁴² *Furness Withy* 1966 CarswellNat 297 [16] (Exchequer Court of Canada) ('*Furness Withy EC*'). See also Reimer and Rust, above n 806, art 8 [12]; See also Weber and Van de Sande, above n 804, 145 [7.3.4].

⁹⁴³ 1966 CarswellNat 297 [12].

⁹⁴⁴ Ibid [13],[15]; See also *Furness Withy* 1968 CarswellNat 257 [5] (Supreme Court) ('*Furness Withy SC*').

⁹⁴⁵ *Furness Withy EC* 1966 CarswellNat 297 [1]; 'Article V of the Agreement of June 5, 1946 between Canada and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.' For the OECD *MTC* history see generally Reimer and Rust, above n 806, [Introduction - OECD MC Commentary: A. Historical background. 4] - [6]. 'The Council of the OECD adopted, on 30 July 1963, a Recommendation concerning the avoidance of double taxation and called upon the Governments of member countries, when concluding or revising bilateral conventions between them, to conform to that Draft Convention.' See also Reimer and Rust, above n 806, art 8 [5]. 'The OECD MC 1977 Comm. on Article 8, was largely based on the OECD MC 1963 Comm'.

may be relevant authority for the *MTC*'s article 8 as an equivalent phrase in the form of 'from the operation of ships' is applied there.⁹⁴⁶

In *Furness Withy*,⁹⁴⁷ the court held that the *carrier* that 'employed the vessel' was the only entity 'operating the vessel.'⁹⁴⁸ From the outset, the court observed that to 'operate ships' might have two possible meanings.⁹⁴⁹ Firstly, it might reference 'physically directing the working of a ship.'⁹⁵⁰ It is thought here that this sense references the taxpayer who *directly manages and performs* the technical and navigational ship functions.⁹⁵¹ Thus, it might cover a shipowner, a demise charterer, and even a ship manager (depending upon the specific arrangement in issue).⁹⁵² This understanding of the court's decision is arrived at when literal weight is given to the words 'physically' and 'actively carries out.'⁹⁵³ Also, the court observed that only one person could occupy such a role at a particular time, thus supporting this understanding of the words.⁹⁵⁴ It can only cover the *carrier* and the ship management company on a mutually exclusive basis because it references the entity that *directly* and actually performs the relevant functions.⁹⁵⁵

⁹⁴⁶ *OECD Model Tax Convention*, above n 703, M-30. 'Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State'.

⁹⁴⁷ *Furness Withy EC* 1966 CarswellNat 297 [12].

⁹⁴⁸ *Ibid* [15], [19]. 'On the otherhand if the references are to *operation in the sense of employment* by an owner or charterer for the purpose of earning profit therefrom.': at [15] (emphasis added).

⁹⁴⁹ *Ibid* [13], [15].

⁹⁵⁰ *Ibid*. [15] (emphasis added).

⁹⁵¹ *Ibid*; See also *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159.

⁹⁵² *Furness Withy EC* 1966 CarswellNat 297 [15].

⁹⁵³ *Ibid*. 'Thus if the words are used in the sense of *physically* directing the working of a ship they might at times refer to direction by an owner or charterer who *actively carries out* the functions and at other times to direction by a manager or agent for him depending on the extent of his authority and the range of the functions carried out by him. But they could not refer to the owner and to the manager or agent at the same time for ex hypothesi in this sense the words refer only to the person *physically* directing the working of the ship.' (emphasis added).

⁹⁵⁴ *Ibid*.

⁹⁵⁵ *Ibid* [15], [18].

The court in *Furness Withy*⁹⁵⁶ viewed the second sense of operating a ship as referring to a carrier's⁹⁵⁷ employment of a vessel for deriving income therefrom.⁹⁵⁸ In differentiating the vessel's employment from its navigation, Lord Hobhouse, in the *Hill Harmony*,⁹⁵⁹ similarly describes a vessel's employment as denoting the exploitation of its earning capacity or its economic aspect.⁹⁶⁰ Thus, the employment of a vessel is a well-worn technical term that is broadly applied in English case law.⁹⁶¹

In *Furness Withy*, the court ultimately concluded that 'operating vessels' should be understood fiscally as employing a vessel.⁹⁶² The court opined that the advantages of adopting such an approach included avoiding a fragmented fiscal treatment for shipping income that creates complex apportionment issues, and limiting the special tax treatment to enterprises that demonstrate the necessary mobility.⁹⁶³ The achievement of this latter aim is, however, debatable.⁹⁶⁴ Accordingly, the court ultimately decided that a third party that performs functions for a shipowner would not be covered as, to quote the court, 'the operation of the ship is not [theirs] at all but that of [the] principal.'⁹⁶⁵

⁹⁵⁶ Ibid [12].

⁹⁵⁷ It is however arguable that the charterer as carrier in this context includes a time charterer (potentially contrary to what the court may have intended in the outcome).

⁹⁵⁸ Ibid [15]; See generally *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156 (per Lord Hobhouse).

⁹⁵⁹ [2001] 1 Lloyd's Rep 147, 159 (per Lord Hobhouse).

⁹⁶⁰ Ibid.

⁹⁶¹ *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28] (Queen's Bench Division: Commercial Court).

⁹⁶² *Furness Withy EC* 1966 CarswellNat 297 [12].

⁹⁶³ Ibid [16], [19] – [21], [23]. 'I am of opinion that ... the expression from operating ships in Article V of the Agreement refers to one whose functions with respect to the ship are merely those of a manager or agent for another or others whether generally or in a particular geographical area, or of a manager or agent and stevedore combined, and that this is the legal position no matter how extensive the authority exercised by him as such manager or agent or the services rendered by him may be.' See also *Furness Withy SC* 1968 CarswellNat 257 [8], [10].

⁹⁶⁴ Ship operations defined as 'employment' may also cover time charterers that do not necessarily have the same mobility as shipowners and demise charterers. The *EU Framework* also sees the former as mere commercial managers. See below.

⁹⁶⁵ *Furness Withy EC* 1966 CarswellNat 297 [15].

The principal is the role-player that is directly concerned with using the vessel in a particular way to make money. Thus, the court required that a taxpayer demonstrate a direct link between the income derived and the exploitation of a vessel's earning capacity for the taxpayer to be regarded as deriving income from operating a vessel.⁹⁶⁶ *Klaus Vogel* accepts this interpretation as correct as the publication states that for 'an enterprise to be considered operating a vessel, it 'must bear the entrepreneurial risk' for a vessel's 'capacity utilization.'⁹⁶⁷

In contrast, a third party, such as a ship management enterprise, may only perform certain operational functions outsourced to them by *carriers*.⁹⁶⁸ The former's direct income-earning activity is instead geared toward producing income from any such outsourced work.⁹⁶⁹ They do not control the exploitation of a vessel's earning capacity. Thus, they may only be indirectly connected with producing income from such exploitation.⁹⁷⁰ Accordingly, to the extent that pure ship management enterprises are not treated as 'operating vessels', in the second sense, they are excluded from the scope of article 8 of the *MTC*.⁹⁷¹

Thus, an amendment to article 8 of the *MTC* has been considered necessary in the literature.⁹⁷² Lawyers have proposed expressly extending article 8 profits derived from operating ships '[to]

⁹⁶⁶ Ibid.

⁹⁶⁷ Reimer and Rust, above n 806, art 8 [31].

⁹⁶⁸ Ibid [12], [31]; *EU Framework* OJ C 13, 7.

⁹⁶⁹ Ibid.

⁹⁷⁰ Reimer and Rust, above n 806, art 8 [12]; Letter from Rolf Giesecke of Rödl & Bartling GmbH in Hamburg to OECD, 'Proposed Changes To The OECD Model Tax Convention Dealing With The Operation Of Ships And Aircraft In International Traffic', 17 April 2014, 3 -4 [1.2], 13; Georg Kofler, 'Article 8 OECD Model: Time for a Change?' in Maisto Guglielmo (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 129, 145 [7.3.4], 147 [7.4].

⁹⁷¹ Ibid.

⁹⁷² Giesecke, above n 970, 4 [1.2]; The proposed amendment is replicated and generally affirmed in the following publications: Reimer and Rust, above n 806, art 8, [12]; Kofler, above n 970, 145 [7.3.4], 147 [7.4].

include profits of enterprises [that] perform the different tasks of operating a ship for ... shipping enterprises, such as crewing, technical and commercial management.⁹⁷³

It should, however, be appreciated that exploiting a vessel's earning capacity is a very different function to the vessel's technical and crew management as generally promoted by the *EU Framework*.⁹⁷⁴ It should be recalled that the *EU Framework* treats ship management enterprises that undertake both of these latter functions as stepping into the shoes of a classic shipowner in relation to a vessel's operation.⁹⁷⁵

The English shipping law also appears to broadly align with the *EU Framework* to the extent that it supports this particular understanding of a *classic* shipowner.⁹⁷⁶ Lord Hobhouse confirms that ship operations are generally divided into two main functions for analysing contracts of affreightment and time charters.⁹⁷⁷ Firstly, the function of employing a vessel for exploiting its earning capacity.⁹⁷⁸ Secondly, the function of navigating a vessel or undertaking its seamanship.⁹⁷⁹ Lord Hobhouse holds that whilst the second function remains with the *carrier* under both time and voyage charters, the first function shifts from the *carrier* to the charterer under time charters.⁹⁸⁰ Thus, a basic voyage charter is merely a contract of affreightment where the *carrier* is the party that directly transports the goods by both navigating and employing the

⁹⁷³ Giesecke, above n 970, 4 [1.2].

⁹⁷⁴ *EU Ship Management Communication* OJ C 132, C132/6 [2.2]. 'Profits derived by an enterprise from the transportation ... otherwise than by ships that it operates ... are covered.': (emphasis added); See time and voyage charterparties below. See also Baker, above n 819, R.2: March 2002, [8B.07]; See generally *ITC 1048* (1964) 26 SATC 226 and the discussion about it below.

⁹⁷⁵ *EU Framework* OJ C 13, 7.

⁹⁷⁶ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159 (per Lord Hobhouse). The case is considered in some detail here below under time and voyage charters.

⁹⁷⁷ *Ibid.*

⁹⁷⁸ *Ibid* 156, 159; See also *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28] (Queen's Bench Division: Commercial Court); Coghlin, above n 720, 1-2 [I.5], 646 [35.8]; Eder et al, above n 720, 444 [17-001].

⁹⁷⁹ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 159-160; Coghlin, above n 720, 646 [35.8]; Eder et al, above n 720, 445 3 [1-007].

⁹⁸⁰ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.5]; Eder et al, above n 720, 444 [17-001].

vessel.⁹⁸¹ In a time charter, it may be debatable whether the *carrier* is the party directly carrying the goods as it merely navigates the vessel but does not employ it.⁹⁸²

Thus, as the vessel's employment does not always stick to the shipowner in these situations, it seems that stepping into a typical shipowner's shoes might better reference the navigation function as it appears to be inherent to the activities of a classic shipowner.⁹⁸³ The navigation function generally sticks to the *carrier* irrespective of whether an affreightment contract or a time charter is concluded for transporting goods by sea.⁹⁸⁴ Thus the navigation function may be treated as the essential function underpinning the carriage of goods/persons by sea.

Multiple grounds may be referenced for defining the 'operation of a ship' for article 8 to mean the navigation function.⁹⁸⁵ Three examples are provided below.

- Article 8's commentary explicitly confirms that profits derived by *carriers* from transporting goods under time and voyage charters are eligible profits for its

⁹⁸¹ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 157; See also *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28]; see generally *Intercontainer Interfrigo Sc (Icf) v Balkenende Oosthuizen Bv And Another* [2010] 2 Lloyd's Rep 400, 405 [31] – [37] (European Court Of Justice); See also Eder et al, above n 720, 445 [17-001]; But see Todd, above n 720, 4 [1.2]. 'Though it does not relate (directly at least) to cargo, both time and voyage charters usually envisage the carriage of goods, and are therefore, I suggest, properly categorised as contracts for the carriage of goods by sea.' See also Boyd et al, above n 719, 1 [A1], 3 [A3]. Cf 'A time charter is not ... a charterparty [that is a contract of carriage]: the owner does not agree to carry goods from and to specific or nominated ports, but rather to make the vessel and her crew available to the charterer, in return for hire, as a means for the charterer to transport goods. ... Mr Bignall pointed out that the charterer under this or any other time charter would be free not to use the vessel to carry cargoes at all. This largely theoretical possibility does not assist. The main purpose of the charter will, save in exceptional cases, be *to enable goods to be carried. But it is not sufficient that the main purpose of the contract is the carriage of goods in this sense.* That was so in the ICF case. *What matters is that the charterparty is not in nature an undertaking by the owner to carry goods, but an undertaking by the owner to make available to the charterer a vessel and crew for the latter to employ in transporting goods.*': *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28] (emphasis added). See also similar sentiments about time charters by Lord Hobhouse in the *Hill Harmony* [2001] 1 Lloyd's Rep 147, 157.

⁹⁸² *Ibid.*

⁹⁸³ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 646 [35.8]; Eder et al, above n 720, 3 [1-007]; 445.

⁹⁸⁴ *Ibid.*

⁹⁸⁵ The term is considered in further detail here below under time and voyage charters.

purposes.⁹⁸⁶ Thus, article 8's commentary appears to treat voyage and time charters uniformly.⁹⁸⁷ Therefore, it seems logical that the commentary is impliedly referencing an inherent attribute that is shared by these two charters.⁹⁸⁸ The commentary also explicitly mentions demise charters in the converse; thus, it further emphasises a uniform treatment for time and voyage charters.⁹⁸⁹ However, the *carrier* only enjoys the employment function under voyage charters, but not under time charters.⁹⁹⁰ In contrast these two charters both award the function of navigating the vessel to the *carrier*.⁹⁹¹ Thus, in treating these two charters uniformly, the commentary may impliedly favour the navigation function to effectively differentiate between time and voyage charters on the one end and demise charters on the other end. This uniform treatment may similarly instruct the meaning given to the phrase 'operation of ships' by allowing the navigation function to control its meaning as the common and stickier attribute.

- In *Furness Withy*,⁹⁹² the court may have attempted to tie the relevant ship operation's identity with an attribute that sticks more tightly to a *carrier*'s essential function. It should be considered that the court intended to avoid fragmenting the fiscal approach and to restrict special tax treatments to mobile activities that were unique.⁹⁹³ Thus, as the navigation function and not the employment function may be the more mobile activity that remains with a classic shipowner, irrespective of the type of non-demise

⁹⁸⁶ *OECD Model Tax Convention*, above n 703, C(8)-2 [5]. 'Profits obtained by leasing a ship or aircraft on charter fully equipped, crewed and supplied must be treated like the profits from the carriage of passengers or cargo.' See also Reimer and Rust, above n 806, art 8, [17], [37], [38].

⁹⁸⁷ *OECD Model Tax Convention*, above n 703, C(8)-2 [5] -[6].

⁹⁸⁸ *OECD Model Tax Convention*, above n 703, C(8)-2 [5]; See also Reimer and Rust, above n 806, art 8, [37].

⁹⁸⁹ *OECD Model Tax Convention*, above n 703, C(8)-2 [5].

⁹⁹⁰ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.5]; Eder et al, above n 720, 444 [17-001].

⁹⁹¹ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28]; Eder et al, above n 720, 445 3 [1-007] – [1-008]; Coghlin, above n 720, 646 [35.8].

⁹⁹² *Furness Withy SC* 1968 CarswellNat 257 [10]; See also *Furness Withy EC* 1966 CarswellNat 297 [15], [21].

⁹⁹³ *Ibid.*

charter that is utilised, operating a ship, based on this reasoning, should instead reference the navigation function.⁹⁹⁴ Otherwise, mere commercial managers of vessels like time charterers may have access to preferential fiscal treatment where it is *generally* not warranted.⁹⁹⁵ They are generally not equivalent to *carriers* as they do not necessarily have the same mobility; neither do they make a direct contribution to a flag's tonnage nor directly support its essential maritime know-how.⁹⁹⁶

- The *EU Framework* generally promotes the navigation function.⁹⁹⁷

Therefore, it is respectfully submitted that the court in *Furness Withy*⁹⁹⁸ may have erred in its ultimate conclusion that references the vessel's employment as denoting the relevant ship operation for applying a double tax agreement.⁹⁹⁹ It is humbly submitted that the navigation function appears, generally, to align better with policies that are directed at associating unique tax treatments with the unique attributes of the shipping industry.¹⁰⁰⁰

Should the navigation function be adopted, then the entity that navigates the vessel is the entity that operates it for the *MTC*'s article 8. However, it is conceded that the vessel's exploitation remains a relevant issue for article 8.¹⁰⁰¹ The vessel must be exploited in a particular way for

⁹⁹⁴ Ibid.

⁹⁹⁵ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28]; Eder et al, above n 720, 445 3 [1-007] – [1-008]; Coghlin, above n 720, 646 [35.8].

⁹⁹⁶ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159; *EU/Maltese Communication C*(2017) 8734 final, 4 [2.1.2.2], 48 [7.2.1.5 (286)]; *EU Ship Management Communication OJ C* 132, 6 [1] - [2.2], 7[4]. *EU Framework OJ C* 13, 7; *Withy EC* 1966 CarswellNat 297 [20].

⁹⁹⁷ *EU Framework OJ C* 13, 7. 'In some cases ship managers are assigned both technical and crewing management of vessels. In this case they act as classic 'shipowners' as far as transport operations are concerned.'

⁹⁹⁸ *Furness Withy SC* 1968 CarswellNat 257 [5], [10]; See also *Furness Withy EC* 1966 CarswellNat 297 [15], [19].

⁹⁹⁹ Ibid.

¹⁰⁰⁰ *EU Framework OJ C* 13, 7; Reimer and Rust, above n 806, art 8 [37]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28]; Eder et al, above n 720, 445 3 [1-007] – [1-008]; Coghlin, above n 720, 646 [35.8].

¹⁰⁰¹ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; See also Reimer and Rust, above n 806, art 8, [37];

the *MTC*'s article 8 to apply.¹⁰⁰² The commentary advises that a vessel must primarily be exploited for carrying goods or passengers by sea.¹⁰⁰³ Thus, leaving aside operating ships by navigating them, article 8 appears to also require a link between profits and the activity of carrying goods or persons by sea.¹⁰⁰⁴ However, the solution here doesn't have to be complicated. It is submitted that when the *carrier* navigates a vessel, it should automatically be treated as earning profits from the exploitation of that vessel because the navigation function is the most critical function enabling that exploitation.¹⁰⁰⁵ Simply put, if there is no navigation, then there can be no exploitation. This submission is, of course, qualified by the proviso that the vessel is in fact exploited as required by article 8; the vessel is used for carrying goods and passengers by sea. Hence, the identity of the party that contractually controls its employment should primarily be irrelevant for the purposes of article 8. The navigation function enables the employment and is thus the critical element of the ship operation that deserves special fiscal treatment. By favouring the navigation function, key role-players like pure ship management enterprises that undertake the technical and crew management of vessels are treated in-scope as operating vessels for article 8 – provided of course that the vessel is exploited as discussed above.¹⁰⁰⁶

Additionally, the ordinary grammatical meaning of the English version of article 8 of the *MTC* merely references 'profits ... from the operation of ships.'¹⁰⁰⁷ The language appears to be loose

¹⁰⁰² Ibid. 'The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships': at *OECD Model Tax Convention*, above n 703,C(8)-1 [4].

¹⁰⁰³ Ibid.

¹⁰⁰⁴ Ibid.

¹⁰⁰⁵ Reimer and Rust, above n 806, art 8 [37]; Over emphasis on the exploitation function in constructing the necessary links for article 8 may otherwise also allow commercial managers of ships to have recourse to article 8, like time charterers. And time charterers do not necessarily enjoy the same mobility as shipowners and demise charterers (among other things) that legitimises special fiscal treatment: see generally *Furness Withy EC* 1966 CarswellNat 297 [20]- [21]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159.

¹⁰⁰⁶ *EU Framework OJ C* 13, 7.

¹⁰⁰⁷ *OECD Model Tax Convention*, above n 703, M-30.

enough to accommodate a more flexible and generous nexus between shipping income, maritime transport activities, and operating ships by navigating them.¹⁰⁰⁸

Thus, the *MTC* has the potential to align better with the EU approach if operating ships means navigating ships.¹⁰⁰⁹ Otherwise, the *MTC* might be out of step with modern-day shipping practice.¹⁰¹⁰ It would exclude pure ship management enterprises that perform critical and technically-based functions for *carriers*.¹⁰¹¹

Also, it is worth repeating here some of the concerns raised against adopting a more generous scope for article 8, including: fragmenting the fiscal approach to shipping income, thereby conflicting with long-standing international practice; producing complex apportionment issues; and only targeting the unique attributes deserving of a peculiar fiscal treatment.¹⁰¹² Some of these issues have been addressed by other instruments like the *EU Framework*, by devising specific apportioning methods.¹⁰¹³ Also, some of these concerns appear to be ignored by policymakers to the extent that time charterers are given article 8 eligibility primarily by merely employing a vessel.¹⁰¹⁴ Further to the extent that *Furness Withy*¹⁰¹⁵ is distinguishable on the facts and the decision is restricted to outsourced *commercial* management activities, the *ratio decidendi* may not be directly relevant to crew and technical management activities.¹⁰¹⁶ The

¹⁰⁰⁸ Ibid C(8)-2 [5] - [6]; Reimer and Rust, above n 806, art 8, [37], [39], [40], [45].

¹⁰⁰⁹ *EU Ship Management Communication* OJ C 132, 6 [1] - [2.2], 7[4]; *EU Framework* OJ C 13, 7.

¹⁰¹⁰ Ibid.

¹⁰¹¹ Ibid; Reimer and Rust, above n 806, art 8, [12]; Kofler, above n 970, 145 [7.3.4], 147 [7.4]; *OCS Report*, above n 726 9 [40] – [44]; *EU Ship Management Communication* OJ C 132, 7 [3]; Breskin, above n 6, 238, 353.

¹⁰¹² *Furness Withy EC* 1966 CarswellNat 297 [16], [19] – [21], [23]. See also *Furness Withy SC* 1968 CarswellNat 257 [8], [10].

¹⁰¹³ *EU Ship Management Communication* OJ C 132, 9 [7].

¹⁰¹⁴ *Harmony* [2001] 1 Lloyd's Rep 147, 156.

¹⁰¹⁵ 1968 CarswellNat 257.

¹⁰¹⁶ *Furness Withy EC* 1966 CarswellNat 297 [4], [10], [18], [23]. 'The functions carried out by the appellant's Canadian branch offices for these ships covered a range which included everything both of an administrative and of a trading nature ... including in some ports ... stevedoring services, and ... the finding and booking of

decision was also not considering article 8 of the *MTC* and, therefore, might be distinguishable on this further ground.¹⁰¹⁷

In considering the *BEPS 5* List, the critical issue is the observation that the tax base carved out by article 8 may not necessarily demonstrate uniformity with the tax base applied by shipping tax regimes, like EU shipping tax regimes.¹⁰¹⁸ Thus, if the article 8 tax base was to be imposed on the fifth primary factor's scope, it may, *prima facie*, produce clashes with shipping tax regimes as applied in multiple States. Therefore, the *MTC*'s article 8 tax base should be treated cautiously before applying it to other instruments like the *Updated 1998 Framework*. However, a significant conflict between the *Updated 1998 Framework* and the *MTC* may be a non-issue in cases where the *BEPS 5* List is applied on a more compartmentalised basis, as considered here.¹⁰¹⁹

3.5.6.2 Ship Operations: Commercial Management

The *EU Framework* treats commercial management or category (c) activities performed by ship management enterprises (that perform this outsourced work, as their exclusive business activities) as non-eligible activities.¹⁰²⁰ Accordingly, preferential EU shipping tax regimes should, primarily, exclude as beneficiaries these ship management enterprises that perform these activities.¹⁰²¹

cargo for the ships and attending and participating in the rate setting and other activities of the Canada-United Kingdom eastbound freight conference of which the companies concerned were members.'; see also *Furness Withy SC* 1968 CarswellNat 257 [2], [4]-[5], [7], [8], [10] – [11].

¹⁰¹⁷ *Furness Withy EC* 1966 CarswellNat 297 [1].

¹⁰¹⁸ *EU Framework* OJ C 13, 7; *OECD Model Tax Convention*, above n 703, M-30.

¹⁰¹⁹ *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

¹⁰²⁰ *EU Framework* OJ C 13, C13/7[3.1]; *EU Ship Management Communication* OJ C 132, 6 [1], 7 [4].

¹⁰²¹ *Ibid.*

In this case, article 8(1) of the *MTC* may adopt a somewhat comparable tax treatment with the *EU Framework*.¹⁰²² This submission seems valid even though the *MTC* may presently apply a blanket non-eligibility for all ship management enterprises – irrespective of the outsourced activities that they perform.¹⁰²³

Under the *EU Framework*, these commercial ship management enterprises occupy a fiscal position somewhat similar to pure time and voyage charterers, to the extent that there is no crew and technical management.¹⁰²⁴ This comparability is explicitly acknowledged in EU reports, where ‘pure commercial managers’ of vessels are referred to as entities that ‘enter into transportation contracts’ like ‘*time or voyage [charterparties]*’ and ‘rely on other [entities] to deliver the service.’¹⁰²⁵

In *Furness Withy*, the Canadian Supreme Court ostensibly decided that the income from outsourced commercial management activities was not covered under a double tax agreement’s shipping article.¹⁰²⁶ It should be borne in mind that the provision in that case is essentially comparable to article 8(1) of the *MTC*.¹⁰²⁷ The case was considering services such as managing agency and stevedoring services, including the finding and booking of cargo for ships.¹⁰²⁸

¹⁰²² Baker, above n 819, R.2: March 2002, [8B.08].

¹⁰²³ Reimer and Rust, above n 806, art 8, [12]; Kofler, above n 970, 145 [7.3.4], 147 [7.4].

¹⁰²⁴ *EU/Maltese Communication* C(2017) 8734 final, 4 [2.1.2.2], 48 [7.2.1.5 (286)]. ‘The Maritime Guidelines as interpreted by the Commission in its previous decisions allow voyage/time charterers *and similar commercial operators of ships*.’ (emphasis added).

¹⁰²⁵ *Ibid* 4 [2.1.2.2] (emphasis added).

¹⁰²⁶ *Furness Withy SC* 1968 CarswellNat 257.

¹⁰²⁷ See the analysis above.

¹⁰²⁸ *Furness Withy EC* 1966 CarswellNat 297 [4], [10], [18], [23]. ‘The functions carried out by the appellant’s Canadian branch offices for these ships covered a range which included everything both of an administrative and of a trading nature ... including in some ports ... stevedoring services, and ... the finding and booking of cargo for the ships and attending and participating in the rate setting and other activities of the Canada-United Kingdom eastbound freight conference of which the companies concerned were members.’; see also *Furness Withy SC* 1968 CarswellNat 257 [2], [4]-[5], [7], [8], [10] – [11]. See generally Boyd et al, above n 719, 55. Stevedoring consists of activities directly connected with cargo loading and unloading, wharf stacking and storing, terminal and facility cargo receiving and delivering.: Safe Work Australia, *Stevedoring (cargo handling)* < <https://www.safeworkaustralia.gov.au/stevedoring> >. Note too, the duties of time and voyage charterers briefly mentioned below.

However, it is arguable based on the particular facts, as considered further below (under heading 3.5.8), that the income in that case should be eligible *on a secondary basis* for article 8(1) treatment, as income produced from *directly connected or auxiliary activities*.¹⁰²⁹

3.5.7 Demise/Bareboat Charterparties

Considering the *EU Framework* treating particular ship management enterprises as beneficiaries of preferential shipping tax regimes, it seems reasonable to expect that demise or bareboat charterers ought to receive a similar preferential fiscal treatment.¹⁰³⁰ In a simple demise charterparty arrangement, the two parties are the shipowner as lessor (who's chartering-out their vessel) and the charterer as a sort of quasi lessee (who's chartering-in the vessel). The key issue is whether the demise charterer may qualify as a beneficiary like a classic shipowner where they both carry passengers or goods by sea?

3.5.7.1 Their Unique Legal Attributes

Under English law, a demise charterparty is treated as a ship lease or the hire of a chattel.¹⁰³¹ *Wharton's Law-Lexicon* records in an earlier edition (but somewhat amended in later editions) that the word demise means 'a grant by lease; ... [and] [t]he operative word 'demise' in a lease implies an absolute covenant on the part of the lessor, or person leasing, for the lessee's quiet enjoyment during the term, which, however, may be, and usually is, qualified by a more limited

¹⁰²⁹ *Furness Withy EC* 1966 CarswellNat 297 [2], [5], [18]; *OECD Model Tax Convention*, above n 703, C(8)-2 [4.1], [4.2], C(8)-2 -C(8)-3 [6] – [8]; Reimer and Rust, above n 806, art 8, [40], [45]; But in relation to time and voyage chartering activities see Reimer and Rust, above n 806, art 8, [39].

¹⁰³⁰ Cooke et al, above n 74, 1.1; Hare, above n 75, 738; But see *EU/Greece Communication* C(2015) 9019 final, 27, 40.

¹⁰³¹ *Ibid*; Boyd et al, above n 719, 55 [A28], 58 [A29 (1)]; Mark Davis, *Bareboat Charters* (Informa, 2nd ed, 2005) 2 [1.5]; Gerard McMeel, 'Charterparties and the modern law of penalties' in Barış Soyer and Andrew Tettenborn (eds) *Charterparties Law, Practice And Emerging Legal Issues* (Informa, 1st ed, 2018) 297; Hare, above n 75, 738, 741 [16-3.1].

express covenant.’¹⁰³² *Black’s Law Dictionary* similarly defines ‘demise’ as ‘[t]he conveyance of an estate¹⁰³³ usu. for a term of years, a lease.’¹⁰³⁴ Thus, ‘demise’ is generally used for a typical lease in Anglo-American law. *Black’s Law Dictionary* further defines a bareboat charter as ‘[a] charter under which the shipowner surrenders possession and control of the vessel to the charterer, who then succeeds to many of the shipowner’s rights and obligations.’¹⁰³⁵ *Black’s Law Dictionary* uses the words ‘bareboat charter’ and ‘demise charter’ interchangeably in referring to the particular charterparty.¹⁰³⁶ However, *A Dictionary of Law by Oxford* appears to distinguish a bareboat charter from a demise charter as it states that ‘a bareboat charter may end with the hirer acquiring title in the vessel; in this case it is known as a charter for demise or demise charter.’¹⁰³⁷ Nonetheless, *Scrutton* presently sets out three primary uses for bareboat or demise charters, with finance being only one.¹⁰³⁸ Further, Todd explains that their general application is more limited nowadays to financing vessels as time charters have become more favoured as a means for chartering-in tonnage capacity (among other things).¹⁰³⁹

¹⁰³² JM Lely (ed), *Wharton’s Law-Lexicon: Forming an Epitome Of The Law Of England* (Soule And Bugbee, 7th ed, 1883) 247 [demise]; But see A S Oppé (ed), *Wharton’s Law Lexicon: Forming an Epitome Of The Law Of England* (Sweet & Maxwell, 14th ed, 1938) 318 [demise]. ‘[A] grant; it is applied to an estate either in fee or for term of life or years, but most commonly to the latter; it is used in writs for any estate. -2 Inst. 483. The operative word ‘demise’ in a lease implies a covenant on the part of the lessor for the lessee’s quiet enjoyment during the term.’

¹⁰³³ An estate, as defined in English property law, is a concept that in principle denotes something less than full ownership as, ‘in strict legal theory, the Crown has ownership of all land in England and Wales ... [Accordingly, for others it merely denotes a period for which] tenure will last’: Jonathan Law and Elizabeth A Martin (eds), *Oxford Dictionary of Law* (OUP, 7th ed, 2009) 206 (*‘Oxford Law Dictionary’*).

¹⁰³⁴ Bryan A Garner, *Black’s Law Dictionary* (Thomson West, 11th ed, 2019) 544 (*‘Black’s Law Dictionary’*) (emphasis added); Bryan A Garner (ed), *Black’s Law Dictionary* (Thomson West, 8th ed, 2004) 464 (*‘Black’s Law Dictionary’*). The only difference in the definitions as used here between the two editions is a minor punctuation change.

¹⁰³⁵ *Black’s Law Dictionary*, above n 1034, 294 [bareboat charter]; *Black’s Law Dictionary*, above n 1034, 250 [bareboat charter].

¹⁰³⁶ *Ibid* [demise charter].

¹⁰³⁷ Jonathan Law (ed), *A Dictionary of Law* (Oxford, 9th ed, 2018) [bareboat charter] (*‘Oxford Law Dictionary’*). ‘A form of boat or ship hire in which the hirer assumes full control and possession of the vessel, pays all charges and expenses, and provides master and crew. A bareboat charter may end with the hirer acquiring title in the vessel; in this case it is known as a charter for demise or demise charter.’

¹⁰³⁸ Eder et al, above n 720, 3-4 [1.009]. See also Todd, above n 720, 151 [10.2]; But see Boyd et al, above n 719, 58 [A29(1)] where *Scrutton* in an earlier edition appears to impugn or doubt the submission that a bareboat charterparty may properly qualify as a finance lease.

¹⁰³⁹ Todd, above n 720, 151 [10.2]; See for example *Elder Dempster & Co v Paterson, Zochonis & Co* [1924] AC 522 where a shipowning enterprise requiring extra tonnage capacity for their West African trade chartered-in a vessel by time charter. Here the shipowner of the chartered-in vessel was treated as the charterer’s agent in

Notwithstanding the above, prominent legal works generally treat the ‘demise’ descriptor as interchangeable with the ‘bareboat’ descriptor in referencing the particular charterparty.¹⁰⁴⁰ Thus, the thesis will, likewise, use the descriptors interchangeably whilst preferencing the ‘demise’ descriptor for convenience.

The demise charterer is generally treated as a de facto owner or quasi shipowner during the demise charterparty’s currency since the charterer acquires many of the shipowner’s rights and obligations.¹⁰⁴¹ Thus, the demise charterer is recognised in law as the vessel’s legal owner *pro hâc vice* or *pro tempore* for multiple purposes during the charterparty’s currency.¹⁰⁴² Lord Herschell uses the former Latin phrase to describe the demise charterer in *Baumwoll Manufactur Von Carl Scheibler v Furness*.¹⁰⁴³

The case concerned the issue of whether a bill of lading signed by the master (or captain) of a vessel under a demise charterparty made the shipowner or the demise charterer legally responsible for the loss of cotton carried on board the vessel.¹⁰⁴⁴ Lord Herschell expressed the opinion that ‘by the charterparty the charterer has become, *pro hâc vice* and during the term of the charter, the owner of the vessel, when one is considering the rights and liabilities which

relying on the bill of lading to escape liability for cargo damage resulting from bad stowage. : at 534. See also M Davis, above n 1031, 2 [1.6], 3[1.8]; See generally Simon Baughen, ‘Lease finance and demise charters – lessors’ risks’ and liabilities’ in Barış Soyer and Andrew Tettenborn (eds) *Ship Building, Sale And Finance* (Informa, 2016) 188 [12.1]. ‘An alternative to financing the purchase of a ship by a loan secured by a mortgage is through lease financing. This will generally be used for tax reasons whereby the lender can obtain the benefit of capital allowances on the vessel and is thereby able to reduce the cost of the loan.’

¹⁰⁴⁰ M Davis, above n 1031, 1 [1.1]; Eder et al, above n 720, 3-4 [1.009]; Boyd et al, above n 719, 55 [A28]; *Black’s Law Dictionary*, above n 1034, 250 [bareboat charter], [demise charter]; Cooke et al, above n 74, 3 [1.1]; Coghlin, above n 720, 2 [I.6]; Guenter Treitel and FMB Reynolds, *Carver on Bills of lading* (Sweet & Maxwell, 2nd ed, 2005) [4.031]; Hare, above n 75, 738 [16-3.1]; Thomas J Schoenbaum, *Admiralty and Maritime Law* (West, 1994) 630 [§ 9-1].

¹⁰⁴¹ Eder et al, above n 720, 4 [1.009]; *Black’s Law Dictionary*, above n 1034, 250 [bareboat]; Boyd et al, above n 719, 55 [A28]; Hare, above n 75, 741; M Davis, above n 1031, [1.1].

¹⁰⁴² *Black’s Law Dictionary*, above n 1034, 250 [bareboat]; Hare, above n 75, 741[16-3.1]; Schoenbaum, above n 1040, 630-1 [§ 9-1]; Eder et al, above n 720, 4 [1.009]; M Davis, above n 1031, 1 [1.1], 4 [1.10].

¹⁰⁴³[1893] AC 8, 16 (House of Lords).

¹⁰⁴⁴ *Ibid* 10-14 The bills of lading contained no reference to the charterparty, and the shippers had no notice of its terms.

arise from the acts of the master and crew of the vessel.’¹⁰⁴⁵ Accordingly, the signing of the bill of lading by the vessel’s master did not make the shipowner contractually liable.¹⁰⁴⁶ It instead made the demise charterer liable.¹⁰⁴⁷ Thus, the demise charterer was treated in law as the vessel's owner for determining the legal implications resulting from the master’s signature as the demise charterer was in possession and control of the vessel.¹⁰⁴⁸

The demise charterer pays the shipowner remuneration in the form of hire to obtain full possession and control of the vessel.¹⁰⁴⁹ Once a vessel is chartered-out on a demise charter, the demise charterer is generally responsible for both the vessel’s employment and navigation¹⁰⁵⁰ (including safety and repair).¹⁰⁵¹ In contrast, the shipowner usually does not have any substantial obligations in relation to the vessel during the currency of the agreement.¹⁰⁵² Thus, the demise charterer is required to make contributions generally like: providing for the crewing of the vessel (who are contracted as the demise charterer’s employees);¹⁰⁵³ accepting

¹⁰⁴⁵ Ibid 16. ‘But there may be two persons at the same time in different senses not improperly spoken of as the owner of a ship. The person who has the absolute right to the ship, who is the registered owner, the owner (to borrow an expression from real property law) in fee simple, may be properly spoken of, no doubt, as the owner; but at the same time he may have so dealt with the vessel as to have given all the rights of ownership for a limited time to some other person, who, during that time, may equally properly be spoken of as the owner. When there is such a person, and that person appoints the master, officers, and crew of the ship, pays them, employs them and gives them the orders, and deals with the vessel in the adventure, during that time all those rights which are spoken of as resting upon the owner of the vessel, rest upon that person who is, for those purposes during that time, in point of law to be regarded as the owner. When that distinction is once grasped it appears to me that all the difficulties that have been raised in this case vanish. There is nothing in your Lordships' judgment, as I apprehend, which would detract in the least from the law as it has been laid down with regard to the power of a master to bind an owner, or with regard to the liabilities which rest upon an owner. The whole difficulty has arisen from failing to see that there may be a person, who, although not the absolute owner of the vessel, is, during a particular adventure, the owner for all those purposes.’: at 17.

¹⁰⁴⁶ Ibid 16-20.

¹⁰⁴⁷ Ibid.

¹⁰⁴⁸ Ibid; See also Treitel and Reynolds, above n 1040, [4.031]; Baughen, above n 1039, 189 [12.2.1]; Hare, above n 75, 738, [16-3.1]; See generally Bamford, above n 848, 20-1.

¹⁰⁴⁹ Eder et al, above n 720, 3-4 [1.009]-[1.010]; Todd, above n 720, [10.5]; Hare, above n 75, 738, 741; Boyd et al, above n 719, 55 [A28]; Schoenbaum, above n 1040, 630-1 [§ 9-1]; Cooke et al, above n 74, 3 [1.1]; See generally Bamford, above n 848, 20-1; M Davis, above n 1031, 2 [1.3], 3 [1.9].

¹⁰⁵⁰ ‘Employment’ and ‘navigation’ as technical terms in a charterparty are defined below under time and voyage charters.

¹⁰⁵¹ M Davis, above n 1031, 3 [1.7], 4 [1.13]; Eder et al, above n 720, 4 [1.009].

¹⁰⁵² Ibid.

¹⁰⁵³ *Manufactur Von Carl Scheibler v Furness* [1893] AC 8, 16 (House of Lords); Eder et al, above n 720, 3-4 [1.009]; Boyd et al, above n 719, 55, 58.

responsibility for the vessel's maintenance;¹⁰⁵⁴ providing supplies and incurring all running costs;¹⁰⁵⁵ and undertaking other shipowner obligations (including insurance¹⁰⁵⁶ and ISM code obligations).¹⁰⁵⁷ Further, towage and salvage are generally for the demise charterer's sole benefit.¹⁰⁵⁸ Certain standard form demise charterparties even allow for a vessel to be placed on a dual register as a chartered-in vessel, on the proviso that it is permitted by both flags of the owner¹⁰⁵⁹ and the demise charterer.¹⁰⁶⁰ The word 'bare' in 'bareboat charterparty' quintessentially implies the absence of the master and crew.¹⁰⁶¹ However, scholars opine that the charterparty may continue to be treated as a demise charterparty under English law, even where a proportion of the shipowner's crew remain on board, provided the charterer takes full possession and control of the vessel.¹⁰⁶² Accordingly, the crucial test in English law essentially appears to be one of possession and control of the whole ship.¹⁰⁶³

¹⁰⁵⁴ Todd, above n 720, [10.5]. Accordingly, there is generally no off-hire clause. 'Thus, the obligation to maintain the vessel (typically in a state of good repair and efficient operating condition with unexpired classification at all times throughout the period) falls upon the charterers, and the owners are typically entitled to redelivery at the end of the period "in the same or as good structure, state and condition and class, fair wear and tear excepted" as on delivery.': at 154 [10.5]; See also M Davis, above n 1031, 2-3 [1.7].

¹⁰⁵⁵ Eder et al, above n 720, 4 [1.009]; M Davis, above n 1031, 2-3 [1.7], 4 [1.13].

¹⁰⁵⁶ The demise charterer may be required to take out hull insurance on the ship. The charterers may make insurance claims and carry out repairs, but if a total loss occurs the insurance payments are generally made to the owners, who redistribute proceeds according to the parties' respective interests. See generally Todd, above n 720, 154 [10.5]; See also M Davis, above n 1031, 2-3 [1.7]; 4 [1.13].

¹⁰⁵⁷ Hare, above n 75, 538-9, 738, 741-3; Boyd et al, above n 719, 55, 58-9; *Black's Law Dictionary*, above n 1034, 8th ed, 250; See generally David W Robertson, Steven F Friedell and Michael F Sturley, *Admiralty and Maritime Law in the United States* (Carolina Academic Press, 2001) 377; See generally Bamford, above n 848, 20-1; See generally *Oxford Law Dictionary*, above n 1033, 163: 'The lease itself'; 'As far as the assessment of fault is concerned, the ISM Code is now perhaps the most important industry standard against which the actions of a shipowner may be adjudged prudent'.: Hare, above n 75, 538-9.

¹⁰⁵⁸ See generally Todd, above n 720, 154 [10.5].

¹⁰⁵⁹ I.e., the register on which the owner has registered the vessel. For example, bareboat chartered vessels are registered in Malta but may fly another flag: *EU/Maltese Communication* C(2017) 8734 final, 13.

¹⁰⁶⁰ Hare, above n 75, 741; M Davis, above n 1031, 3 [1.7]. The charterer may even have the right to change the vessel's name, fly its own house flag or paints its own house colours on the vessel.

¹⁰⁶¹ Eder et al, above n 720, 3 [1.009]; Boyd et al, above n 719, 55-6; M Davis, above n 1031, 1 [1.1], 2 [1.4], 4 [1.11]; Hare, above n 75, 738, 741.

¹⁰⁶² *Ibid.* Cf the treatment for ship management enterprises under the EU Framework 'Ship management companies may qualify for aid only in respect of vessels for which they have been assigned the entire crew and technical management. *EU Framework* OJ C 13, 7.

¹⁰⁶³ *Manufactur Von Carl Scheibler v Furness* [1893] AC 8, 14; See also Eder et al, above n 720, 4 [1.010]; Boyd et al, above n 719, 55-6; M Davis, above n 1031, 3-4 [1.9] – [1.12], 4 [1.13]; Hare, above n 75, 738-9. 'Was it a "demise" of the ship, or if not strictly speaking a demise was it an agreement which put the vessel *altogether* out of the power and control of the then owner, and vested that power and control in the charterers, so that during the time that this hiring lasted she must be regarded as the vessel of the charterers, and not as the vessel of the owner?' *Manufactur Von Carl Scheibler v Furness* [1893] AC 8, 14 (emphasis added).

3.5.7.2 Assessing Fiscal Uniformity

It should be appreciated that pure ship management enterprises' activities (as defined above) and those of demise charterers (i.e. the quasi lessee chartering-in the vessel) may overlap significantly in particular instances. Considering the seamanship *essentialia* of a demise charterparty, both the demise charterer and the pure ship management enterprise may perform maritime transport activities like a classic shipowner by assuming responsibility for the crew and technical management or navigation of a vessel.¹⁰⁶⁴

The *EU Framework* treats the crew and technical management activities of vessels engaged in maritime transport activities as core activities that produce shipping income, irrespective of the party that performs them.¹⁰⁶⁵ Suppose a ship management enterprise obtains access to a preferential shipping tax regime under those conditions. In that event, the demise charterer ought to likewise have access.¹⁰⁶⁶ Where tax laws demonstrate uniformity, they ensure that enterprises undertaking the same key activities receive the same tax treatment.¹⁰⁶⁷ Accomplishing that uniformity promotes both efficiency and horizontality as the former underpins the latter two.¹⁰⁶⁸

Thus, in advancing uniformity, the *EU Framework* treats the income from maritime transport activities of a vessel secured through a demise charter as eligible income for preferential shipping tax regimes.¹⁰⁶⁹ The income is generated from the same activities that qualify for

¹⁰⁶⁴ *EU Framework* OJ C 13, 7; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 159; But see *Furness Withy EC* 1966 CarswellNat 297 [15].

¹⁰⁶⁵ *EU Ship Management Communication* OJ C 132, 7 [3] – [4]. But see 9 [7]. 'In case ship management companies subcontract part of their activity to third parties, the latter are not eligible to State aid.'

¹⁰⁶⁶ *The Mirrlees Review*, above n 17, 34, 39-40.

¹⁰⁶⁷ *EU Ship Management Communication* OJ C 132, 6 - 7; *EU/Maltese Communication* C(2017) 8734 final, 5, 48-9; *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; *EU/Greece Communication* C(2015) 9019 final, 27, 36-7.

¹⁰⁶⁸ *The Mirrlees Review*, above n 17, 34, 39-40; Dwyer, above n 2, 667, 747-8, 764.

¹⁰⁶⁹ *OECD Model Tax Convention*, above n 703, C(8)-1 [4].

preferential shipping tax treatment when performed by classic shipowners.¹⁰⁷⁰ Both the shipowner and demise charterer carry passengers or goods by sea for profit onboard vessels that they can both navigate and employ.¹⁰⁷¹

What's more, the *MTC* adopts a comparable fiscal position.¹⁰⁷² The *MTC* advises in its commentary that whether a vessel is owned or leased is irrelevant for article 8's application.¹⁰⁷³ Thus, where a vessel is chartered-in on a bareboat basis and performs maritime transport activities, the income derived by the demise charter from that vessel's use is eligible for article 8 treatment.¹⁰⁷⁴ Accordingly, the *EU Framework* aligns with the *MTC* in this instance.¹⁰⁷⁵

3.5.7.3 Tax Avoidance Schemes

Demise charterparties should, nonetheless, be treated with some caution in managing tax avoidance risks.¹⁰⁷⁶ The thesis has advanced the argument that legal arrangements underpinning maritime transport activities may be structured convolutedly and artificially to increase a transaction's overall opaqueness.¹⁰⁷⁷ One of the main underlying objectives for the opacity may be to obfuscate the beneficial ownership of a vessel.¹⁰⁷⁸ Thus, demise charterparties with their quasi ownership attributes can be used by tax planners in creative

¹⁰⁷⁰ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 159; *Furness Withy EC 1966 CarswellNat* 297 [15]; *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41; *OECD Model Tax Convention*, above n 703, C(8)-1 [4].

¹⁰⁷¹ *Ibid.*

¹⁰⁷² *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; Reimer and Rust, above n 806, art 8, [39].

¹⁰⁷³ *Ibid.*

¹⁰⁷⁴ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; Reimer and Rust, above n 806, art 8, [37], [39]. See also the discussion above in relation to defining ship operations as the navigation of a vessel.

¹⁰⁷⁵ *EU/Greece Communication C(2015) 9019 final*, 27, 36-7; *EU/Maltese Communication C(2017) 8734 final*, 16, 48-9; *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; 'In all mentioned [chartering] cases, the tonnage tax beneficiary stays under the obligation to maintain/increase the share of EEA-flagged tonnage of its own fleet (owned vessels or chartered in on a bareboat basis)': *EU/Maltese Communication C(2017) 8734 final*, 49.

¹⁰⁷⁶ Hare, above n 75, 740 [16-3.1].

¹⁰⁷⁷ *Ibid.*

¹⁰⁷⁸ *Ibid.*

ways, similar to nominee directors, in structuring tax avoidance schemes.¹⁰⁷⁹ A pertinent case illustrating the point is referenced in Professor John Hare's book, where he considers demise charterparties.¹⁰⁸⁰ The relevant particulars of the case may be established in part from the following quote:

Canary shipowners, under the advice of innovative lawyers and tax consultants, set about structuring a chain of ownership which was as difficult for creditors to unravel as it was for the fiscus of the flag to evaluate for the assessment of income tax and other shipping dues. The demise charter became the vehicle through which true ownership of the vessel was often camouflaged ... yet debt and tax evasion were not the sole motivations.¹⁰⁸¹

Thus, although demise charterparties exhibit certain attributes that may support tax exploitation schemes, their unique characteristics may, nonetheless, serve genuine commercial objectives.¹⁰⁸² One such bona fide commercial purpose is to manage tonnage availability in accordance with market fluctuations.¹⁰⁸³

The shipowning sector is particularly exposed to market volatility due to the high capital and operational costs of maritime transport activities.¹⁰⁸⁴ Other factors that exacerbate the effects of market changes include high levels of foreign competition and prolonged downturns.¹⁰⁸⁵ Smaller enterprises are also generally more vulnerable to market fluctuations.¹⁰⁸⁶ Thus, tonnage flexibility provides shipowning entities with the ability to adapt to changing market

¹⁰⁷⁹ Hare, above n 75, 740 [16-3.1]; See generally *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

¹⁰⁸⁰ Hare, above n 75, 740 [16-3.1].

¹⁰⁸¹ *Ibid.*

¹⁰⁸² *Ibid.*; *EU/Greece Communication* C(2015) 9019 final, 27; See generally *EU/Maltese Communication* C(2017) 8734 final, 19, 29, 44 – 45 [264].

¹⁰⁸³ *EU/Maltese Communication* C(2017) 8734 final, 19 [97 (b)]; 44 – 45 [264].

¹⁰⁸⁴ *Ibid.* 29 [170]; Asteris, above n 35, 67; McMahon, above n 36, 103; Breskin, above n 6, 22, 53, 62-3, 113; Branch and Robarts, above n 6, 293 [14.8].

¹⁰⁸⁵ McMahon, above n 36, 103; Asteris, above n 35, 67; Breskin, above n 6, 22, 53, 62-3; Alexander, above n 35, 7 [8].

¹⁰⁸⁶ *1998 DETR Report*, above n 23, 28-9 [123]; Alexander, above n 35, 10-11 [24].

conditions more successfully.¹⁰⁸⁷ That adaptability supports business viability in the medium to long term.¹⁰⁸⁸

The objective of entering a protected foreign market may constitute another bona fide commercial purpose for utilising a demise charterparty.¹⁰⁸⁹ Thus, demise charterparties, like their time and voyage counterparts, may serve multiple valid business purposes.¹⁰⁹⁰ Further, it would be incorrect to focus on demise charterparties exclusively in considering tax avoidance. The other types of charterparties have also been exploited in artificial schemes in the past.¹⁰⁹¹

3.5.7.4 Shipowners' Tax Treatment

The *EU Framework* applies certain safeguards to combat the unnecessary employment of demise charterparties.¹⁰⁹² The performance of maritime transport activities is generally an essential requirement of a preferential shipping tax regime in the EU.¹⁰⁹³ Further, the *EU Framework* does not, generally, treat chartering-out a vessel on a bareboat basis as a maritime transport activity.¹⁰⁹⁴ Therefore, pure¹⁰⁹⁵ ship lessors or shipowners who primarily earn hire¹⁰⁹⁶ from demise charterparties do not ordinarily receive preferential shipping tax treatment as considered here.¹⁰⁹⁷ In this regard, the identity of the lessee or demise charterer is irrelevant.¹⁰⁹⁸

¹⁰⁸⁷ *EU/Maltese Communication* C(2017) 8734 final, 19 [97 (b)]; 44 – 45 [264]; Asteris, above n 35, 67; Hare, above n 75, 740.

¹⁰⁸⁸ *Ibid.*

¹⁰⁸⁹ *EU/Maltese Communication* C(2017) 8734 final, 29 [168].

¹⁰⁹⁰ *Ibid* 30 [5.6.4], 48 [7.2.1.5.].

¹⁰⁹¹ See *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; *Malayan Shipping* considered in chapter five may be referenced as a case that demonstrates the latter.

¹⁰⁹² *EU/Greece Communication* C(2015) 9019 final, 27-8.

¹⁰⁹³ *Ibid* 27.

¹⁰⁹⁴ *Ibid.*

¹⁰⁹⁵ Specially referencing the case where chartering-out by demise charterparty is a primary business activity for someone like a shipowner who earns hire therefrom.

¹⁰⁹⁶ 'Hire' is not unique to demise charters as time charters also refer to 'hire'. Voyage charters however refer to 'freight': See generally Boyd et al, above n 719, 56.

¹⁰⁹⁷ *EU/Greece Communication* C(2015) 9019 final, 27.

¹⁰⁹⁸ *Ibid*; *EU/Maltese Communication* C(2017) 8734 final, 44.

Thus, considerations like whether the lessee is a shipping company or a final user of a recreational vessel are immaterial.¹⁰⁹⁹ However, the *EU Framework* provides two exceptions where chartering-out on a bareboat basis may still generate hire for the lessor that is eligible for preferential shipping tax treatment. The two exceptions where hire may be treated as shipping income are namely:¹¹⁰⁰

- 1) Where it occurs on an intra-group basis. The corporate group is treated as undertaking the maritime transport activity.¹¹⁰¹ Accordingly, any intra-group leasing structure is, therefore, non-consequential.¹¹⁰²
- 2) Where it constitutes merely an auxiliary activity of an enterprise. To rank as an auxiliary activity, the following conditions, as restated here generally, must be complied with by genuine shipowning entities:¹¹⁰³
 - a. The demise charterparty must be necessitated by a temporary excess in tonnage capacity.
 - b. The temporary excess must relate to the enterprise's main business, which must be performing maritime transport activities.
 - c. The duration of the charterparty should not exceed three years.
 - d. The proportion of the chartered-out capacity on demise should not exceed a maximum percentage of the total fleet that receives preferential tax treatment, which should be (for example) no higher than 50% as a ceiling.

¹⁰⁹⁹ Ibid.

¹¹⁰⁰ *EU/Greece Communication* C(2015) 9019 final, 27-8.

¹¹⁰¹ Ibid. 'Intra-group bare-boat chartering out transactions were unconditionally accepted in the Irish tonnage tax decision (N504/0264) and the French tonnage tax decision (N737/0265)': *EU/Greece Communication* C(2015) 9019 final, 28.

¹¹⁰² Ibid.

¹¹⁰³ *EU/Greece Communication* C(2015) 9019 final, 27-8; *EU/Maltese Communication* C(2017) 8734 final, 16-9, 44-5; See generally below n 2787.

The Maltese tonnage tax regime was assessed as violating the *EU Framework* in a past determination because hire from pure leasing activities was eligible for preferential shipping tax treatment without restriction.¹¹⁰⁴ In other words, the violation took the form of allowing ‘all revenue from bareboat chartering out [to be] eligible.’¹¹⁰⁵

Article 8(1) of the *MTC* generally excludes income derived from demise charterparties from qualifying as shipping income unless the leasing activity is only ancillary to the primary business of operating vessels for performing maritime transport activities.¹¹⁰⁶ Thus, where the leasing of vessels constitutes the primary business activity of the enterprise, the hire derived therefrom will not be eligible for article 8 treatment as the vessel is not operated as required by the article.¹¹⁰⁷ Determining whether a leasing activity is an auxiliary activity depends on considerations like its duration, frequency and economic significance to the enterprise.¹¹⁰⁸ Accordingly, a good alignment exists here between the EU and the OECD instruments.¹¹⁰⁹ They both essentially allow the hire from a demise charterparty to be treated as shipping income, provided the leasing activity is merely an auxiliary activity.¹¹¹⁰

¹¹⁰⁴ *EU/Maltese Communication* C(2017) 8734 final, 44. ‘See in particular Commission decision of 17.07.2013 in the Spanish tax lease case SA.21233, OJ L 114 of 16.04.2014; Commission decision of 20.12.2011 in the Finnish tonnage tax case N448/2010, recital 32, OJ C 220 of 25.07.2012, p. 1; Commission decision of 1 April 2015 in the Croatian tonnage tax case SA. 37912, recitals 86f, OJ C 142 of 22 April 2016, p. 6.’: at 44-5.

¹¹⁰⁵ *Ibid* 4.

¹¹⁰⁶ *OECD Model Tax Convention*, above n 703, C(8)-1 [4.2], [5]; Reimer and Rust, above n 806, art 8, [17], [38].

¹¹⁰⁷ *Ibid*.

¹¹⁰⁸ Reimer and Rust, above n 806, art 8, [38]. See also Australian Taxation Office, ‘Income tax: the taxation treatment of ship and aircraft leasing profits under the ships and aircraft articles of Australia’s tax treaties’ (Tax Ruling, TR 2008/8) [24], [105], [145] (‘*ATO TR 2008/8*’).

¹¹⁰⁹ *EU/Maltese Communication* C(2017) 8734 final, 4, 16-9, 44-5; *EU/Greece Communication* C(2015) 9019 final, 27-8; *OECD Model Tax Convention*, above n 703, C(8)-1 [4.2], [5]; Reimer and Rust, above n 806, art 8, [17], [38].

¹¹¹⁰ *Ibid*

Generally, the *MTC* treats the hire from a bareboat charterparty as business profits when the leasing activity is not auxiliary.¹¹¹¹ Madigan opines that a shipowner that contracts as lessor under a demise charterparty is essentially earning passive income in the form of rental from personal property.¹¹¹²

3.5.8 Time and Voyage Charterparties

Demise charterparties as ship leases must be distinguished from their time and voyage counterparts.¹¹¹³ Time and voyage charterparties are essentially service contracts by the shipowner to the charterer.¹¹¹⁴ In comparison, demise charterparties contain no such service component.¹¹¹⁵ Thus, in *Sea and Land Securities v William Dickinson*,¹¹¹⁶ MacKinnon LJ opined that a time charter is substantively a service contract by asserting that:

The modern form of time charterparty is, in essence, one by which the shipowner agrees with the time charterer that during a certain named period he *will render services* by his servants and crew to carry the goods which are put on board his ship by the time charterer.¹¹¹⁷

Likewise, in the subsequent case of *The Laconia*,¹¹¹⁸ Lord Wilberforce, in distinguishing a time charter, emphasised the service component in his speech where he stated that:

¹¹¹¹ *OECD Model Tax Convention*, above n 703, C(7)-1, C(8)-1 [4.2], [5]; Reimer and Rust, above n 806, art 8, [17], [38]. *Klaus Vogel* notes that the hire from a bareboat charterparty might also be treated as royalties and fall under Article 12 if the *DTA* includes the use or right to use of industrial, commercial or scientific equipment in its royalties' definition.

¹¹¹² Richard E Madigan, *Taxation of the Shipping Industry* (Cornell Maritime Press, 1971) 38.

¹¹¹³ Todd, above n 720, 5 [1.3], 148 [10.1].

¹¹¹⁴ *Ibid* 148 [10.1], 153 [10.5].

¹¹¹⁵ *Ibid* 5 [1.3], 148 [10.1].

¹¹¹⁶ [1942] 2 KB 65 (Court of Appeal).

¹¹¹⁷ *Ibid* 69.

¹¹¹⁸ *Mardorf Peach & Co Ltd v Attica Sea Carriers Corporation of Liberia (The "Laconia")* [1977] 1 Lloyd's Rep 315 (House of Lords).

[T]he description of a time charter as a hire or demise of a ship is very misleading: all that the owner does, in fact, is to agree to provide services, those of the master and the crew (whose wages the owner has-punctually-to pay) in sailing the ship for the charterers' purposes,¹¹¹⁹

Lord Wilberforce's understanding of the time charter's essential nature as a service contract was quoted with approval in the more recent case of *The Astra*.¹¹²⁰ However, unlike demise and voyage charters, time charters appear not to have been widely used until about the end of the nineteenth century, when steamships were beginning to replace sailing ships.¹¹²¹ Thus, like voyage charters, and unlike demise charters, time charters are less risky instruments for shipowners as shipowners retain overall possession and control of their vessels and remain responsible for their navigation¹¹²² and safety.¹¹²³ Accordingly, time charters have to some extent replaced demise charters in modern shipping practice as hybrid instruments.¹¹²⁴ The retention of the shipowner's control and possession, which is a signature hallmark of time and voyage charters, is effectively evidenced through the vessel's crew, who are the shipowner's employees and who ultimately operate the vessel for the shipowner.¹¹²⁵ *Scrutton* describes the characteristic control in the following terms:¹¹²⁶

In this case, notwithstanding the temporary right of the charterer to have his goods loaded and conveyed in the vessel, the ownership and also the possession of the ship remain in the original owner through the master and crew, who continue to be his servants.

¹¹¹⁹ *Ibid* 319.

¹¹²⁰ *Kuwait Rocks Co V Amn Bulkcarriers Inc (The "Astra")* [2013] 2 Lloyd's Rep 69, 79 [40] (The Commercial Court); See also *Whistler International Limited v. Kawasaki Kisen Kaisha Limited* [2001] 1 AC 638 where Lord Bingham observed that: '[t]he complexity of a time charterparty derives partly from the fact that ownership and possession of the vessel, which remain in the owner, are separated from use of the vessel, which is granted to the charterer, and partly from the peculiar characteristics and hazards of carriage by sea.'

¹¹²¹ Todd, above n 720, 5 [1.3]; 148 [10.1], 149-151 [10.2]; See also *Sea and Land Securities v William Dickinson* [1942] 2 KB 65, 69.

¹¹²² *Hill Harmony* [2001] 1 Lloyd's Rep 147, 159 (House of Lords).

¹¹²³ Todd, above n 720, 151 [10.2]; See also Eder et al, above n 720, 3 [1.007] - [1.008]; Boyd et al, above n 719, 55, 59-60; Cooke et al, above n 74, 3; Hare, above n 75, 741, 746, 751, 755.

¹¹²⁴ Todd, above n 720, 148 [10.1].

¹¹²⁵ Boyd et al, above n 719, 55.

¹¹²⁶ *Ibid*.

However, unlike time charters, which are more sophisticated service contracts by sea, basic voyage charters are more like affreightment contracts or carriage contracts.¹¹²⁷ The essential characteristic of an affreightment contract is carrying goods by sea or furnishing a ship for that purpose in exchange for remuneration.¹¹²⁸ The particular carrying activity performed by a *carrier* under an affreightment contract generally comprises the vessel's navigation *and* employment, as discussed further below (*carrier* for the thesis means, specially, shipowners and demise charterers that, as a minimum, technically operate or navigate ships for their business).¹¹²⁹

Generally, the shipowner's remuneration is calculated differently depending upon whether the contract is a time charter or voyage charter.¹¹³⁰ *Scrutton* advises that a time charter's hire, which is the shipowner's remuneration under that contract, is generally calculated at a daily or monthly rate payable in advance either on a monthly, semi-monthly or fortnight basis.¹¹³¹ Nonetheless, the word 'hire' as applied in a time charterparty should be interpreted cautiously.¹¹³² The word appears to be borrowed from the older demise form but does not imply

¹¹²⁷ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 157; See also *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28]; See generally *Intercontainer Interfrigo Sc (Icf) v Balkenende Oosthuizen Bv And Another* [2010] 2 Lloyd's Rep 400, 405 [31] – [37]; See also Eder et al, above n 720, 2 [1.006], 445 [17-001]; See also Boyd et al, above n 719, 1 [A1], 3 [A3]; But see Todd, above n 720, 4 [1.2]: 'Though it does not relate (directly at least) to cargo, both time and voyage charters usually envisage the carriage of goods, and are therefore, I suggest, properly categorised as contracts for the carriage of goods by sea.'; Cf 'A time charter is not ... a charterparty [that is a contract of carriage]: the owner does not agree to carry goods from and to specific or nominated ports, but rather to make the vessel and her crew available to the charterer, in return for hire, as a means for the charterer to transport goods. ... The main purpose of the charter will, save in exceptional cases, be *to enable goods to be carried*. But it is not sufficient that the main purpose of the contract is the carriage of goods in this sense. ... What matters is that the charterparty is not in nature an undertaking by the owner to carry goods, but an undertaking by the owner to make available to the charterer a vessel and crew for the latter to employ in transporting goods.': *The Wisdom C* [2014] 2 Lloyd's Rep 198, 206 [28] (emphasis added); See also similar sentiments about time charters by Lord Hobhouse in the *Hill Harmony* [2001] 1 Lloyd's Rep 147, 157; Todd opines that a charterparty is ordinarily a contract for the use of an entire vessel; For certain types of hybrid voyage charters: see generally Cooke et al, above n 74, 3.

¹¹²⁸ Boyd et al, above n 719, 1.

¹¹²⁹ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156-7, 159 (per Lord Hobhouse) (House of Lords); See also Eder et al, above n 720, 445 [17-001]; See also Coghlin, above n 720, 1 [I.4] – [I.5], 3 [I.9].

¹¹³⁰ Boyd et al, above n 719, 60.

¹¹³¹ *Ibid*; See also Eder et al, above n 720, 450 [17.013].

¹¹³² Coghlin, above n 720, 4 [I.15]; See also Eder et al, above n 720, 3 [1.007]; *The Nanfri* [1978] 2 Lloyd's Rep 132, 140.

leasing in the sense of transferring the ship's possession and control.¹¹³³ Nonetheless, Coghlin elaborates that an essential feature of a time charter, like a demise charter, is applying a time basis for calculating the payment for the ship's services.¹¹³⁴ A rate is ordinarily applied for each time unit that is shorter than the time charterparty's whole period.¹¹³⁵ The time unit is ordinarily fixed as a day.¹¹³⁶ Rainey observes that the hire is normally paid in advance to fund the shipowner's expenses in operating the vessel for the charterer.¹¹³⁷

On the other hand, a typical voyage charterparty refers to the shipowner's remuneration as freight.¹¹³⁸ Freight is frequently applied as two payments.¹¹³⁹ Freight is generally calculated based on the quantity of the goods loaded/in taken¹¹⁴⁰ or discharged/delivered.¹¹⁴¹ Cooke elaborates that measures like the goods' weight, volume or units shipped are usually applied to calculate freight.¹¹⁴² Specific trades customarily apply published scales in fixing freight.¹¹⁴³

¹¹³³ *Sea and Land Securities v William Dickinson* [1942] 2 KB 65, 69; Coghlin, above n 720, 4 [I.15]; Todd, above n 720, 148 [10.1]; See also Eder et al, above n 720, 3 [1.007], 4 [1-011].

¹¹³⁴ Coghlin, above n 720, 4 [I.15]; See also Boyd et al, above n 719, 56 [A28].

¹¹³⁵ Coghlin, above n 720, 4 [I.15], [37.57]; For example: 'Subject as herein provided, Charterers shall pay for the use and hire of the vessel at the rate of United States Dollars ____ per day, and pro rata for any part of a day, from the time and date of her delivery (local time) to Charterers until the time and date of redelivery (local time) to Owners.' [37.57].

¹¹³⁶ *Ibid.*

¹¹³⁷ Simon Rainey, 'Interrupting the lifeblood': The Owner's remedies for non-payment of hire after Spar Shipping' in Barış Soyer and Andrew Tettenborn (eds) *Charterparties Law, Practice And Emerging Legal Issues* (Informa, 1st ed, 2018) 3; Coghlin, above n 720, [I.6], [I.15]; Eder et al, above n 720, 450 [17-012] - [17.013].

¹¹³⁸ Coghlin, above n 720, 2 [I.7]; See also Cooke et al, above n 74, [13.1]; See also Eder et al, above n 720, 3 [1.008]; Todd, above n 720, 6 [1.4].

¹¹³⁹ Eder et al, above n 720, 423 [16-003], 437[16-046], 438[16-048]; But see Coghlin, above n 720, [I.7]; See also Cooke et al, above n 74, [13.52].

¹¹⁴⁰ Coghlin, above n 720, 2 [I.7]; Cooke et al, above n 74, 306 [13.4], 306-7 [13.6] -[13.8]; Eder et al, above n 720, 424 [16-005] 429 [16-017]; See generally Todd, above n 720, 106 [7.4]. 'It was established ... [in] *De Silvale v Kendall* that if the contract of carriage stipulates that freight is to be paid in advance, once it is paid it cannot be recovered, even if ship and cargo are totally lost on the voyage, and no cargo at all delivered.' Here the freight risk would be on the charterer.

¹¹⁴¹ Coghlin, above n 720, 2 [I.7]; See also Cooke et al, above n 74, 306 [13.4], 307-8 [13.9]; See also Todd, above n 720, 6 [1.4]; 102 [7.2], 106 [7.4]; See also Eder et al, above n 720, 3 [1.008], 423 [16-003]; Freight at common law is earned and payable on delivery, and is calculated on the cargo delivered, subject to the charter's terms. Freight earned and payable on delivery is more common in the tanker trade, whereas advance freight is more common for dry cargo: See generally Todd, above n 720, 102 [7.2]; See also Cooke et al, above n 74, 305 [13.2].

¹¹⁴² Cooke et al, above n 74, 309 [13.13]; Eder et al, above n 720, 436 [16-041] - [16-044].

¹¹⁴³ Cooke et al, above n 74, 309 [13.13]; Eder et al, above n 720, 435 [16-038].

However, other voyage charters may more rarely determine freight as an overall fixed sum known as a lumpsum freight that has been said to resemble hire.¹¹⁴⁴ That fixed amount is generally agreed in advance and independent of the weight of the cargo loaded.¹¹⁴⁵

Thus, time charters and demise charters are period charters where the charterer pays the shipowner hire.¹¹⁴⁶ Even so, a demise charter is uniquely a lease of a ship and thus, hire is paid in this instance for full possession and control of the vessel.¹¹⁴⁷ Demise hire is ordinarily recorded on a lumpsum basis in the contract but may be calculated on a daily rate or a share in the profits of the vessel's trading.¹¹⁴⁸ Under the *Barecon 2017 Standard Bareboat Charter Party*, hire is payable in advance every thirty running days for the duration of the demise charter.¹¹⁴⁹ However, there is also reference in the literature to payments being set at 15 day or monthly intervals.¹¹⁵⁰ A demise charterparty is usually for an extended period of not less than a year.¹¹⁵¹ However, their duration may, in principle, also be for a particular voyage, which is rare nowadays.¹¹⁵²

Thus, despite a typical voyage charter applying for the duration of a voyage and a typical time charter applying for a period of time, multiple variations may be identified in practice where

¹¹⁴⁴ Cooke et al, above n 74, 310 [13.19]; M Davis, above n 1031, 64 [12.1]; See also Eder et al, above n 720, 3 [1.008], 429 [16-017]; Boyd et al, above n 719, 60 [A30]; Todd, above n 720, 6 [1.4], 105 [7.3].

¹¹⁴⁵ Todd, above n 720, 105 [7.3]. Here the shipowner ordinarily provides a number of cubic metres for the charterer's use.

¹¹⁴⁶ Todd, above n 720, 148 [10.1].

¹¹⁴⁷ M Davis, above n 1031, 64 [12.1]; McMeel, above n 1031, 297; Eder et al, above n 720, 3 [1.009], 5 [1.013]; Hare, above n 75, 738, 741 [16-3.1(b)]; Boyd et al, above n 719, 55 [A28], 58 [A29]; Todd, above n 720, 148 [10.1].

¹¹⁴⁸ M Davis, above n 1031, 64 [12.1]; Hare, above n 75, 742 [16-3.1(i)]; See BIMCO, Barecon 2017 box 17, cl 15(b) < <https://www.bimco.org/contracts-and-clauses/bimco-contracts/barecon-2017>>. A lumpsum amount is recorded in box 17 that requires payment at set intervals.

¹¹⁴⁹ BIMCO, Barecon 2017 box 17 and pt2 [cl 15]; M Davis, above n 1031, 65 [12.3] – [12.5].

¹¹⁵⁰ See generally Evi Plomaritou, 'A Review of Shipowner's & Charterer's Obligations in Various Types of Charter' (2014) 4 *Journal of Shipping and Ocean Engineering* 307, 317; William Tetley, *International maritime and admiralty law* (Cowansville, 2002) 167.

¹¹⁵¹ Hare, above n 75, 738 [16-3.1].

¹¹⁵² Eder et al, above n 720, 3 [1.009]; Boyd et al, above n 719, 55 [A28].

these distinctive attributes become blurred.¹¹⁵³ Notwithstanding the above, technical differences remain between time and voyage charters.¹¹⁵⁴ Firstly, in a voyage charter, the shipowner is the party who primarily bears the risk of delay, whilst generally,¹¹⁵⁵ it is the charterer who bears it in a time charter.¹¹⁵⁶ This particular attribute arises since hire, in a time charter, is paid on a time basis, irrespective of the number of voyages completed and the quantity of cargo carried within the agreed period.¹¹⁵⁷ Conversely, in a voyage charter, as freight is ordinarily calculated on cargo quantity and not on time, the shipowner is the party in the contract that mainly bears the disadvantage where voyage times are unexpectedly extended.¹¹⁵⁸ Secondly, the time charterer, but not the voyage charterer, is the party that exploits the vessel's earning capacity by directing its employment;¹¹⁵⁹ the vessel's employment is a function that remains with the shipowner in a voyage charter.¹¹⁶⁰ This second technical

¹¹⁵³ Coghlin, above n 720, 2-3 [I.8]; Cooke et al, above n 74, 310 [13.19]; Todd, above n 720, 5 [1.3]; *The Democritos* [1976] 2 Lloyd's Rep 149, 154; Todd expresses the opinion that a voyage charter may be for a period of consecutive voyages whilst a time charter may be for a single voyage and thus such characteristics should not be decisive in distinguishing them. For example, in *The Democritos* [1976] 2 Lloyd's Rep 149 the case concerned a charterparty in the New York Produce Exchange Time Charter form, where the vessel owners let her to the charterers from the time of delivery at Durban "for about a trip via port or ports via the Pacific, duration about 4 to 6 months." (emphasis added). Though the contract expressly anticipated a single voyage, it was confirmed by the court that it was a time charter.: at 151.

¹¹⁵⁴ Eder et al, above n 720, 3 [1.007] -[1.008]; Todd, above n 720, 5 [1.3]; *The Doric Pride* [2006] 2 Lloyd's Rep 175, 179 (per Lord Justice Rix) (Court of Appeal); *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156 (per Lord Hobhouse) (House of Lords); *The Gregos* [1995] 1 Lloyd's Rep 1, 4 (per Lord Mustill) (House of Lords); See generally Hare, above n 75, 746, 751, 737-8, 746, 751.

¹¹⁵⁵ Subject to contrary agreement of course.

¹¹⁵⁶ Eder et al, above n 720, 3 [1.007] -[1.008]; Coghlin, above n 720, [I.7]; *The Doric Pride* [2006] 2 Lloyd's Rep 175, 179 (per Lord Justice Rix) (Court of Appeal); *The Gregos* [1995] 1 Lloyd's Rep 1, 4 (per Lord Mustill) (House of Lords); See also Eder et al, above n 720, 3 [1.007]; See also Todd, above n 720, 5-6 [1.3] - [1.4], 148 [10.1]. 'In those cases there are classic expositions to be found of the essential difference between any time charter, whether for a long period or for a trip, on the one hand and voyage charters on the other. The essential point is, for present purposes, that under a voyage charter the risk of delay on an approach voyage is the owner's risk, the charterer is only at risk once the vessel becomes an arrived ship and goes on demurrage, whereas under a time charter the risk of delay is fundamentally on the charterer, who remains liable to pay hire in all circumstances unless the charterer can bring himself within the plain words of an off-hire provision.': *The Doric Pride* at 179 'Where the charter-party is for a period of time rather than a voyage, and the remuneration is calculated according to the time used rather than for the service performed, the risk of delay is primarily on the charterer. For the shipowner, so long as he commits no breach and nothing puts the ship off-hire, his right to remuneration is unaffected by a disturbance of the charterer's plans.': *The Gregos*[1995] 1 Lloyd's Rep 1, at 4.

¹¹⁵⁷ Todd, above n 720, 5-6 [1.3] - [1.4].

¹¹⁵⁸ Ibid.

¹¹⁵⁹ *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156 (House of Lords); See also Todd, above n 720, 149 [10.1], 207-8 [13.3]; See also Eder et al, above n 720, 3 [1.007] - [1.008].

¹¹⁶⁰ Eder et al, above n 720, 3 [1.008]; Coghlin, above n 720, [I.7]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 154, 159.

difference between the two charterparties is described by Lord Hobhouse in *The Hill Harmony*¹¹⁶¹ as follows:¹¹⁶²

Under a voyage charter the owner or disponent owner is using the vessel to trade for his own account. He decides and controls how he will exploit the earning capacity of the vessel, what trades he will compete in, what cargoes he will carry. He bears the full commercial risk and expense and enjoys the full benefit of the earnings of the vessel. A time charter is different. The owner still has to bear the expense of maintaining the ship and the crew. He still carries the risk of marine accidents and has to insure his interest in the vessel appropriately. But, in return for the payment of hire, he transfers the right to exploit the earning capacity of the vessel to the time charterer. The time charterer also agrees to provide and pay for the fuel consumed and to bear the disbursements which arise from the trading of the vessel.

Madigan similarly confirms this particular characteristic of a time charter within the American fiscal context.¹¹⁶³ Accordingly, suppose the different types of charterparties were positioned on a continuum, representing pure leases on the one side and pure contracts of affreightment on the other. In that case, the following ordering might be expected. Demise charterparties as pure leases would be located on the one end, whilst basic voyage charterparties¹¹⁶⁴ like carriage contracts would occupy a position on the other end, and time charterparties¹¹⁶⁵ as hybrid service contracts would appear somewhere between the other two.¹¹⁶⁶

International shipping taxation adopts a somewhat similar binary distinction between time and voyage charters on the one hand, and demise charters.¹¹⁶⁷ However, the thesis acknowledges that a sound argument may be made on efficiency considerations advocating for a greater preferential tax treatment for time charterers. Time charters are more sophisticated instruments

¹¹⁶¹ [2001] 1 Lloyd's Rep 147.

¹¹⁶² Ibid 156.

¹¹⁶³ Madigan, above n 1112, 37-8; But see Boyd et al, above n 719, 55.

¹¹⁶⁴ For voyage charters: see generally Boyd et al, above n 719, 60; See also Eder et al, above n 720, 3 [1.008].

¹¹⁶⁶ Hare, above n 75, 746, 751, 737-8, 746, 751; *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156-157.

¹¹⁶⁷ Reimer and Rust, above n 806, art 8, [37] – [38]; See generally Todd, above n 720, 4 [1.2].

than voyage charters and more widely used in the 21st century than demise charters.¹¹⁶⁸ Time charterers, unlike voyage charterers, may be more enmeshed with carrying goods by sea.¹¹⁶⁹ Unlike voyage charterers, time charterers control the vessel's employment.¹¹⁷⁰ Unlike voyage charterers, they also have additional responsibilities for the vessel's operation, like incurring costs for bunkers and other trading disbursements.¹¹⁷¹ However, in so far as special fiscal treatment is necessarily linked to the inherent attributes of a classic shipowner, its extension to time chartering should still be treated as more exceptional than general.¹¹⁷²

3.5.8.1 Charterers' Tax Treatment

The *EU Framework* allows time and voyage charterers to benefit from preferential shipping tax regimes under restricted conditions.¹¹⁷³ Their eligibility is more exceptional than the general tax treatment given to *carriers* (as defined above).¹¹⁷⁴ The *EU Framework* appears to require compliance with two main conditions to establish general eligibility.¹¹⁷⁵ Firstly the business activity must primarily be a maritime transport activity - as defined.¹¹⁷⁶ Secondly, the enterprise must promote certain or *notable*¹¹⁷⁷ objectives.¹¹⁷⁸

¹¹⁶⁸ *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156-157; Todd, above n 720, 148 [10.1], 151 [10.2]; See also Eder et al, above n 720, 3 [1.007] - [1.008].

¹¹⁶⁹ *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159; Eder et al, above n 720, 3 [1.007].

¹¹⁷⁰ *Ibid.*

¹¹⁷¹ Coghlin, above n 720, [I.7]; See also Eder et al, above n 720, 3 [1.007]; Todd, above n 720, 149 [10.1]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 154, 156-7; For voyage charters see generally Cooke et al, above n 74, 3 [1.1], 5 [1.5].

¹¹⁷² *EU/Maltese Communication* C(2017) 8734 final, 4 [2.1.2.2], 48 [7.2.1.5 (286)]; *Furness Withy EC* 1966 CarswellNat 297 [20].

¹¹⁷³ *EU/Maltese Communication* C(2017) 8734 final, 48-9, 60; *EU/Greece Communication* C(2015) 9019 final, 5, 36-7; Weber and Van de Sande, above n 804, 53 [3.2.4.4].

¹¹⁷⁴ *Ibid.*; *EU Framework* OJ C 13, 5 [2], [2.2], 6 - 7 [3.1].

¹¹⁷⁵ *EU Framework* OJ C 13, 5 [2], [2.2].

¹¹⁷⁶ *Ibid* 5 [2]; See also *EU/Maltese Communication* C(2017) 8734 final, 10 [3. (46) (a)]. A *maritime transport activity* is defined as 'the transport of goods and persons by sea': see heading 3.5.4.2 above.

¹¹⁷⁷ *EU/Maltese Communication* C(2017) 8734 final, 48 [7.2.1.5. (286)].

¹¹⁷⁸ *EU Framework* OJ C 13, 5 [2.2]; See also *EU/Maltese Communication* C(2017) 8734 final, 48 [7.2.1.5. (286)].

Caution should be exercised in constructing the *EU Framework* in isolation of its corresponding State aid decisions. The latter have been observed to modify the former, which varies to some degree from one case to another.¹¹⁷⁹ Thus, the *EU Framework* and the more recent, Maltese State aid decision (among others) are jointly referenced here.

By registering vessels in an EU Member State's register, the second condition is satisfied by promoting a primary objective.¹¹⁸⁰ However, where the enterprise has a mixed fleet with some vessels flying foreign flags, fleet eligibility may still be obtained on an exceptional basis.¹¹⁸¹ In the latter case, other requirements must be satisfied, including demonstrating that the relevant activities substantially contribute to the EU's economic activity and employment.¹¹⁸²

The *EU Framework* does not expressly mention time and voyage charterers.¹¹⁸³ However, they are referenced in several State aid decisions.¹¹⁸⁴ It has been submitted that providing such enterprises with unrestricted access to preferential shipping tax regimes may be counterproductive to accomplishing the *EU Framework's* objectives.¹¹⁸⁵ Thus, access is generally limited to instances promoting two notable objectives: EU flag development and relevant know-how preservation.¹¹⁸⁶ These two objectives are generally established where a fleet of ships meets certain specifications.¹¹⁸⁷ The fleet should generally adhere to certain limits in cases where it comprises vessels chartered-in by time and voyage charters.¹¹⁸⁸ The Maltese

¹¹⁷⁹ Weber and Van de Sande, above n 804, 50 [3.2.4], 53-4 [3.2.4.4].

¹¹⁸⁰ *EU Framework* OJ C 13, 6 - 7 [3.1].

¹¹⁸¹ *Ibid.*

¹¹⁸² *Ibid.*

¹¹⁸³ Weber and Van de Sande, above n 804, 50 [3.2.4], 53-4 [3.2.4.4].

¹¹⁸⁴ *Ibid* 53-4 [3.2.4.4]; *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5. (286)- (287)]; *EU/Greece Communication* C(2015) 9019 final, 27, 36-7 [4.2.2].

¹¹⁸⁵ *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5. (285)]; *EU Framework* OJ C 13, 5 [2.2]; Weber and Van de Sande, above n 804, 54 [3.2.4.4].

¹¹⁸⁶ *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5. (286)]; *EU/Greece Communication* C(2015) 9019 final, 36-7 [4.2.2 (168)].

¹¹⁸⁷ *Ibid.*

¹¹⁸⁸ *Ibid.*

limits have generally been set at 75% and 80% for such chartered-in tonnage.¹¹⁸⁹ The fleet's remaining tonnage should generally comprise vessels owned and EU flagged or crewed and technically managed by the relevant enterprise.¹¹⁹⁰ Thus, an EU enterprise performing maritime transport activities may augment its fleet as required with tonnage chartered-in by time and voyage charters without prejudicing its preferential tax treatment provided the particular limits are satisfied.¹¹⁹¹ However, pure time and voyage charterers are excluded as beneficiaries of preferential EU shipping tax regimes ('pure time and voyage charterers' are used here to reference cases where a fleet is exclusively made up of tonnage chartered-in by time and voyage charters).¹¹⁹²

Requiring a direct link between a particular vessel operation, in performing a maritime transport activity, and a regime's eligibility may justifiably exclude beneficiaries like:

- (1) pure ship lessors (like shipowners, who are parties to basic demise charters);¹¹⁹³
- and
- (2) commercial managers of vessels or mere shippers (like pure time and voyage charterers).¹¹⁹⁴

A shared attribute between these two charters under item 2 is that the vessel's crewing and navigational responsibilities are not with the charterer.¹¹⁹⁵ Therefore, these charterers do not carry goods by sea by technically managing and crewing vessels as is critical; it was observed

¹¹⁸⁹ *Ibid.*

¹¹⁹⁰ *Ibid.*

¹¹⁹¹ *Ibid.*

¹¹⁹² *Ibid.*

¹¹⁹³ *EU/Maltese Communication* C(2017) 8734 final, 4 [2.1.2.1.], 44 [7.2.1.2. (261)]; *EU/Greece Communication* C(2015) 9019 final, 27, [4.2.1.4. (131)].

¹¹⁹⁴ *Hill Harmony* [2001] 1 Lloyd's Rep 147, 157.

¹¹⁹⁵ *EU/Maltese Communication* C(2017) 8734 final, 4 [2.1.2.2.], 48-9 [7.2.1.5. (286)]; *EU/Greece Communication* C(2015) 9019 final, 36-7 [4.2.2 (168)]; *EU Framework* OJ C 13, 7 [3.1]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156, 159.

above that the *EU Framework* generally excludes commercial ship management activities as eligible activities.¹¹⁹⁶ Similarly, as mere lessors, shipowners under item 1 are not directly involved with carrying goods by sea through crewing and navigating vessels; they essentially only derive passive income in the form of rent from mere leasing activities.¹¹⁹⁷ Thus, the restricted eligibility of demise ship lessors and time and voyage charterers, as applied by the *EU Framework*, is reasonable on uniformity grounds.¹¹⁹⁸

However, the exceptional eligibility of vessels acquired through time and voyage charterparties allows the tax law to reflect the real-world complexities of managing tonnage capacity in line with market conditions.¹¹⁹⁹ Different contractual arrangements adopted by ship operating entities to genuinely augment their tonnage capacity, as required by the market, should not prejudice their tax treatment where the enterprise is, on the whole, promoting relevant objectives.¹²⁰⁰ Thus, the benchmarked efficiency, simplicity and horizontality criteria justify eligibility for time and voyage charterers provided it is limited.¹²⁰¹ In so doing, the *EU Framework* strikes a pragmatic compromise.¹²⁰²

However, a disparity may exist between the *EU Framework* and the *MTC* as time and voyage charterers, as ostensibly advanced by *Klaus Vogel*, appear to have general eligibility under the *MTC*'s article 8 (like demise charterers).¹²⁰³ The *MTC* advises in its commentary that the

¹¹⁹⁶ *EU Framework* OJ C 13, 7 [3.1]: 'Should ship managers also provide other specialised services, even related to vessel operation, separate accounting for such activities, which do not qualify for the tax relief schemes, should be ensured.'; *EU Ship Management Communication* OJ C 132, 6 [1], 6 [2.2], 7 [4]; *EU/Maltese Communication* C(2017) 8734 final, 48 [7.2.1.5. (286)].

¹¹⁹⁷ *EU/Maltese Communication* C(2017) 8734 final, 44 [7.2.1.2. (261)]; *EU/Greece Communication* C(2015) 9019 final, 27, [4.2.1.4. (131)].

¹¹⁹⁸ *The Mirrlees Review*, above n 17, 34, 39-41.

¹¹⁹⁹ ICS and WSC, above n 5, 1-2, 5-6; Todd, above n 720, 297 [17.1.6].

¹²⁰⁰ Ibid; *EU Framework* OJ C 13, 5 [2], [2.2]; *The Mirrlees Review*, above n 17, 34, 39-41.

¹²⁰¹ *The Mirrlees Review*, above n 17, 22-3, 34, 39-44.

¹²⁰² *EU/Maltese Communication* C(2017) 8734 final, 30 [5.7.(174)].

¹²⁰³ Reimer and Rust, above n 806, art 8, [39].

income primarily covered under article 8 is income ‘directly obtained ... from [carrying] ... passengers or cargo by ships ... (*whether owned, leased or otherwise at the [enterprise’s disposal]*) that it operates...’.¹²⁰⁴ The words ‘leased or otherwise at the [enterprise’s disposal ...]’ (as paraphrased here) is broad enough to cover time and voyage charterers.¹²⁰⁵ Nonetheless, the words ‘*it operates*’ should limit the scope of the passage, mirroring the actual provision, by requiring the taxpayer to either navigate or employ the vessel.¹²⁰⁶ Thus, as voyage charterers can do neither of these two functions, it is submitted that they should, as a minimum, be excluded from article 8(1) eligibility as a *general* rule, as they occupy a station similar to mere shippers.¹²⁰⁷ Similarly, where the vessel’s operation is further restricted to its navigational aspect, as advanced by the thesis above, time charterers ought to, likewise, be *generally* excluded.¹²⁰⁸

However, the *MTC*’s commentary later advises that ‘[p]rofits derived by an enterprise from [transporting] passengers or cargo *otherwise than by ships ... that it operates ...* are covered ... to the extent that such transportation is directly connected with the operation, by that enterprise, of ships ... or is an ancillary activity.’¹²⁰⁹ Thus, in cases where the charterer is not operating a vessel as required, this further paragraph advises that they may still be covered exceptionally.¹²¹⁰ Therefore, the income earned from tonnage obtained from time and voyage charters may qualify here for article 8 treatment, provided it is an ancillary activity (or a directly

¹²⁰⁴ *OECD Model Tax Convention*, above n 703, C(8)-1 [4] (emphasis added).

¹²⁰⁵ Reimer and Rust, above n 806, art 8, [39].

¹²⁰⁶ *Furness Withy* SC 1968 CarswellNat 257 [8], [10]; *Furness Withy EC* 1966 CarswellNat 297 [16], [19] – [21], [23]; Reimer and Rust, above n 806, art 8, [17]; *The Hill Harmony* [2001] 1 Lloyd’s Rep 147, 159.

¹²⁰⁷ *The Hill Harmony* [2001] 1 Lloyd’s Rep 147, 156-157, 159; Coghlin, above n 720, 1-2 [I.4] – [I.5], 2 [I.7], 342 [19.24]; Reimer and Rust, above n 806, art 8, [12],[17]; Todd, above n 720, 149 [10.1], 207-8 [13.3]; See also Eder et al, above n 720, 3 [1.007] - [1.008], 445 [17-001]; Cooke et al, above n 74, 3 [1.1], 276 [12.4], 1079-80 [85.269] – [85.271]; Boyd et al, above n 719, 55, 59-60; Hare, above n 75, 741, 746, 751, 755.

¹²⁰⁸ *The Hill Harmony* [2001] 1 Lloyd’s Rep 147, 156, 159; Coghlin, above n 720, 1-2 [I.4] – [I.5], 342 [19.24], 342-3 [19.27] – [19.29]; See also Eder et al, above n 720, 3 [1.007] - [1.008].

¹²⁰⁹ *OECD Model Tax Convention*, above n 703, C(8)-2 [6] (emphasis added).

¹²¹⁰ *Ibid*; *The Hill Harmony* [2001] 1 Lloyd’s Rep 147, 156; Coghlin, above n 720, 1-2 [I.4] – [I.5], 2 [I.7]; Reimer and Rust, above n 806, art 8, [40].

connected one) of the enterprise, which primarily operates vessels as required for transporting goods or passengers by sea.¹²¹¹ It may be argued that the commentary by this later advice impliedly promotes exceptional eligibility for time and voyage charterers.

The *MTC*, in this latter instance, aligns better with the *EU Framework*. However, the *MTC* does not specify additional fleet structuring requirements for eligibility like the *EU Framework*.¹²¹² The distinction here may be attributed to the *MTC* having no comparable policy objectives, like promoting a particular State's ship register and developing the shipping industry of a particular State.¹²¹³

In *Furness Withy*, the Canadian Supreme Court adopted a narrow shipping tax treatment for commercial ship management services (including time and voyage chartering activities).¹²¹⁴ In particular, the case concerned general agency and stevedoring activities and the finding and booking of cargo for ships.¹²¹⁵ In *Furness Withy*, the court decided that income from commercial management services provided to vessels of other entities was not derived from operating a ship, as was required for eligibility by the particular double tax agreement.¹²¹⁶ Thus,

¹²¹¹ *OECD Model Tax Convention*, above n 703, C(8)-2 [6]; Reimer and Rust, above n 806, art 8, [17], [37]; *The Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.4] – [I.5], 2 [I.7]; Todd, above n 720, 149 [10.1], 207-8 [13.3]; See also Eder et al, above n 720, 3 [1.007] - [1.008].

¹²¹² *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5]; *OECD Model Tax Convention*, above n 703, C(8)-1 - C(8)-8.

¹²¹³ *OECD Model Tax Convention*, above n 703, I-1 [1] – [3]; *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5]; *EU Framework* OJ C 13, 5 [2.2].

¹²¹⁴ *Furness Withy EC* 1966 CarswellNat 297 [23], [24], *Furness Withy SC* 1968 CarswellNat 257 [10]; *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5]; *EU Ship Management Communication* OJ C 132, 6 [2.2].

¹²¹⁵ *Furness Withy EC* 1966 CarswellNat 297 [4],[7], [9],[17], [19]; *Furness Withy SC* 1968 CarswellNat 257 [7]. Time and voyage charterers may be responsible for loading and unloading activities. See generally Coghlin, above n 720, 11 [I.48] – [I.49]. See also Cooke et al, above n 74, 355 [14.1], 357 [14.8], 359 [14.16], 364-5 [14.36] –[14.37]; Also, stevedoring consists of activities directly connected with cargo loading and unloading. : Safe Work Australia, Stevedoring (cargo handling) < <https://www.safeworkaustralia.gov.au/stevedoring> >.

¹²¹⁶ *Furness Withy EC* 1966 CarswellNat 297 [15], [19], [23], [24]; *Furness Withy SC* 1968 CarswellNat 257 [10] – [11].

operating a vessel for eligibility merely covered income from servicing an entity's own vessels and not income from servicing another entity's vessels.¹²¹⁷

The court decided against the taxpayer despite it primarily operating its own vessels as required for carrying goods by sea.¹²¹⁸ The case essentially concerned services provided to the taxpayer's vessels and the vessels of third parties.¹²¹⁹ Thus, a different result may arise if the case was reconsidered under the current *MTC*.¹²²⁰ In the latter instance, the taxpayer in issue should be recognised as earning shipping income by operating vessels (by employing and navigating them) for carrying goods by sea. Thus, the *MTC*'s article 8(1) requirements should primarily be satisfied for these activities.¹²²¹ In that event, the other income produced from servicing the vessels of other entities should be exceptionally eligible for article 8(1) treatment.¹²²² The other income should be treated as income from directly connected or ancillary activities in operating vessels for carrying goods by sea.¹²²³

A Rhodesian case, namely *ITC 1048*,¹²²⁴ may be consulted in supporting a more generous application for ancillary activities under article 8(1) of the *MTC*.¹²²⁵ In this case, an airline (a UK enterprise) organised transport for its passengers on ships operated by another enterprise in cases where its passenger's itinerary comprised multiple legs.¹²²⁶ The court held that the

¹²¹⁷ *Furness Withy EC* 1966 CarswellNat 297 [19], [23] -[24]; *Furness Withy SC* 1968 CarswellNat 257 [10] – [11].

¹²¹⁸ *Furness Withy SC* 1968 CarswellNat 257 [7] – [8], [10]; *Furness Withy EC* 1966 CarswellNat 297 [2] -[3], [6], [23] -[24].

¹²¹⁹ *Ibid.*

¹²²⁰ *OECD Model Tax Convention*, above n 703, C(8)-2 [6].

¹²²¹ *Furness Withy SC* 1968 CarswellNat 257 [7] – [8], [10]; *Furness Withy EC* 1966 CarswellNat 297 [2] -[3], [6], [23] -[24].

¹²²² *OECD Model Tax Convention*, above n 703, C(8)-2 [4], [4.1], [4.2], C(8)-2 -C(8)-3 [6] – [8]; See also Reimer and Rust, above n 806, art 8, [45].

¹²²³ *Ibid.*; But see Reimer and Rust, above n 806, art 8, [39].

¹²²⁴ (1964) 26 SATC 226.

¹²²⁵ *Ibid.* 227-8; See also Reimer and Rust, above n 806, art 8, [40].

¹²²⁶ *ITC 1048* (1964) 26 S.A.T.C 226, 227.

commission derived by the airline for arranging transport on another enterprise's vessels was derived from its business of operating aircraft and was, therefore, eligible for special tax treatment.¹²²⁷ Thus, the commission from the other activities was treated in the same way, fiscally, as the income derived from its primary business activity of carrying passengers by air.¹²²⁸ The court opined that the other transport was merely incidental to the main enterprise of operating aircraft.¹²²⁹ Two key findings underpinned the decision that the commission was merely derived from ancillary activities.¹²³⁰ Firstly, the commission was relatively only small.¹²³¹ Secondly, the airline was prohibited from acting primarily as a booking agent by its industry rules.¹²³²

Accordingly, in both cases, the enterprises operated vessels, as required, for performing relevant transport activities.¹²³³ In the former case, commercial management services (like cargo bookings) were provided to the enterprises' vessels and the vessels of other entities.¹²³⁴ In the latter case, commercial management services (like passenger bookings) were likewise provided to the enterprise's vessels and the vessel's of another entity in servicing common passengers.¹²³⁵ Unlike the first case, the second case treats the income from servicing another

¹²²⁷ Ibid 228.

¹²²⁸ Ibid.

¹²²⁹ Ibid.

¹²³⁰ Ibid 227-8.

¹²³¹ Ibid 228. '[I]t would appear from the evidence of [airline's] manager that during the years in question the number of seapassages arranged for its clients formed an almost infinitesimal proportion of the number of airpassages arranged.'

¹²³² Ibid 227. Further shipping companies would likewise approach the airline where their passengers required air transport. The airline 'itself is also approached from time to time by shipping companies for an airbooking for passengers who have first approached the shipping company for an air/sea passage and in such circumstances the [airline] also receives from the shipping company 7 per cent on any airpassage moneys involved.'

¹²³³ *Furness Withy SC* 1968 CarswellNat 257 [7]; *Furness Withy EC* 1966 CarswellNat 297 [2] -[3], [6], [19], [24]; *ITC 1048* (1964) 26 S.A.T.C 226, 227-8.

¹²³⁴ *Furness Withy SC* 1968 CarswellNat 257 [7]-[8]; *Furness Withy EC* 1966 CarswellNat 297 [2]-[4], [6], [23] - [24].

¹²³⁵ *ITC 1048* (1964) 26 S.A.T.C 226, 227-8.

entity's vessels as eligible income from an ancillary activity.¹²³⁶ Thus, the second case appears to correspond better with the current *MTC* commentary.¹²³⁷

Conversely, it might be argued (whether successfully or not) that the second case agrees with the first case to the extent that the second case merely concerns an enterprise that is servicing its own business in arranging the other transport for its passengers.¹²³⁸ Thus applying this latter approach, the second case might be treated as a situation where income was not directly derived from servicing another enterprise's vessels.¹²³⁹ Therefore, the second case may better align with the first case's decision to the extent that the income from the other activities, in the second case, is merely derived from servicing its own enterprise.¹²⁴⁰

However, in favour of the former approach, the other enterprise, in the second case, is the entity that pays the airline its commission for finding passengers.¹²⁴¹ Therefore, the airline might be treated as providing services directly to another entity for payment, with the service merely indirectly benefitting its passengers.¹²⁴² Alternatively, and notwithstanding the above, the latter approach may be advanced to the extent that the airline is merely acting as the agent for its

¹²³⁶ *ITC 1048* (1964) 26 SATC 226, 227-8; *Furness Withy SC* 1968 CarswellNat 257 [8], [10]-[11]; *Furness Withy EC* 1966 CarswellNat 297 [19], [23] - [24].

¹²³⁷ *ITC 1048* (1964) 26 SATC 226, 228; *OECD Model Tax Convention*, above n 703, C(8)-2 [4], [4.1], [4.2], C(8)-2 - C(8)-3 [6]. They both support shipping tax treatment on an exceptional or limited basis for that other income. The two cases might, however, be distinguished based on the size of the other activities. However, the OECD commentary confirms that supplementary activities may be eligible for article 8(1) treatment either as auxiliary or directly connected activities. Thus, such a distinction on the facts is not necessarily an impediment to adopting a broader application in both cases.

¹²³⁸ *ITC 1048* (1964) 26 S.A.T.C 226, 228; *Furness Withy SC* 1968 CarswellNat 257 [8], [10]; *Furness Withy EC* 1966 CarswellNat 297 [18] - [19], [23]-[24].

¹²³⁹ *Ibid.*

¹²⁴⁰ *Ibid.*

¹²⁴¹ *ITC 1048* (1964) 26 SATC 226, 227-8. 'During the year ended 31st March, 1960, appellant [the airline enterprise] arranged certain seapassages for its customers with the UnionCastle Company and received from that company £137 by way of commission, calculated in the manner set out above. During the year ended 31st March, 1962, appellant received the sum of £61 in this manner from the UnionCastle Company.'

¹²⁴² *Ibid.*

passengers in making the bookings and thus, only has an indirect, or more remote, relationship with the other enterprise.¹²⁴³

The fact that the *EU Framework* allows significantly high ceilings for covering tonnage chartered-in by time and voyage charterparties is not necessarily a problem for applying article 8(1) of the *MTC*.¹²⁴⁴ Apart from ostensibly treating such charterers as generally eligible (which the thesis finds problematic), the commentary further clarifies that eligibility may be obtained exceptionally.¹²⁴⁵

3.5.8.2 Objectives underlying the EU and OECD Frameworks

One of the main objectives of the *EU Framework* in providing preferential shipping tax treatment is to maintain and increase the number of vessels registered under EU States' flags.¹²⁴⁶ In contrast, the *MTC* is primarily geared at allocating taxing rights in managing juridical double tax conflicts between States internationally.¹²⁴⁷ Accordingly, differences in tax treatments between the two instruments may, to some degree, be attributed to their different policy objectives.¹²⁴⁸

3.5.8.3 Shipowners' Tax Treatment

¹²⁴³ Ibid 227. '[Its] sometimes requested to arrange passages for its own air passengers on an air/sea interchange basis.' 'If it is available appellant obtains a deposit from its client and forwards this deposit to the shipping line. Later the appellant obtains the whole amount of the air and sea passages from its client and appellant then sends an 'exchange order' to the shipping line which issues its own tickets for the sea journey.

These are handed by appellant to its client.' Also: '[U]nder IATA rules, [the airline is]entitled to charge a commission on any sea passage placed by it *on behalf of clients* who require an air/seajourney, at the rate of 7 per cent.' (emphasis added).

¹²⁴⁴ *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5].

¹²⁴⁵ *OECD Model Tax Convention*, above n 703, C(8)-2 [4].

¹²⁴⁶ *EU Framework* OJ C 13, 5 [2.2]; *EU/Maltese Communication* C(2017) 8734 final, 5, 48-9.

¹²⁴⁷ *OECD Model Tax Convention*, above n 703, I-1.

¹²⁴⁸ See the extra conditions as imposed by the *EU Framework* on time and voyage charterers, in contrast to the *MTC*'s position, as is considered here above.

From the shipowner's perspective, the hire and freight derived from time and voyage charterparties respectively are treated by the *EU Framework* as eligible shipping income.¹²⁴⁹ This result occurs because the shipowner (or demise charterer) is essentially the party there that is technically operating the vessel, which essentially underpins the performance of the maritime transport activities.¹²⁵⁰ In both time and voyage charterparties, the *carrier* performs the crewing and the navigational functions of the vessel.¹²⁵¹ The *EU Framework* applies a uniform tax treatment to shipowners, demise charterers and ship management enterprises that perform the same key functions.¹²⁵² Thus, the tax treatment demonstrates uniformity as it applies a similar treatment to the same activities irrespective of the party performing them.¹²⁵³

Furthermore, preferential shipping tax treatment may be available under the *EU Framework* to the shipowner and the time or voyage charterer simultaneously. In these circumstances, both parties are simultaneously eligible under the same charterparty and for the same vessel.¹²⁵⁴ However, the time and voyage charterer would only obtain eligibility exceptionally.¹²⁵⁵

Equally, under the *MTC*, where the shipowner (or demise charterer) derives income under a time and voyage charterparty, in performing maritime transport activities, that income is eligible for article 8 treatment.¹²⁵⁶ The *MTC* commentary expressly advises that where a shipowner (or demise charterer) '[leases] a ship ... on charter fully equipped, crewed and supplied,' the profits derived therefrom is eligible for article 8 treatment.¹²⁵⁷ The words 'fully

¹²⁴⁹ *EU Ship Management Communication* OJ C 132, 6 - 7; *EU/Maltese Communication* C(2017) 8734 final, 5, 48-9; Boyd et al, above n 719, 55-6; *EU/Greece Communication* C(2015) 9019 final, 27, 36-7; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156-7, 159.

¹²⁵⁰ *Ibid.*

¹²⁵¹ *Ibid.*

¹²⁵² *Ibid.*

¹²⁵³ *The Mirrlees Review*, above n 17, 39-41.

¹²⁵⁴ *EU/Maltese Communication* C(2017) 8734 final, 5, 48-9; See generally Madigan, above n 1112, 38.

¹²⁵⁵ *Ibid.*

¹²⁵⁶ *OECD Model Tax Convention*, above n 703, C(8)-1 [4], C(8)-2 [4.2], [5];

¹²⁵⁷ *Ibid* C(8)-2 [5]; Reimer and Rust, above n 806, art 8, [17], [37].

equipped, crewed and supplied’ generally references both a time and voyage charterparty.¹²⁵⁸ However, the word ‘lease’ as applied there is not strictly correct as these contracts in English law are generally treated as hybrid service contracts or quasi carriage contracts.¹²⁵⁹

From a time and voyage charterer’s perspective, article 8(1) of the *MTC* may similarly cover their income. Eligibility might be secured generally, ostensibly,¹²⁶⁰ or in the alternate, exceptionally, where the charterparty is directly connected with or ancillary to the relevant enterprise.¹²⁶¹ Thus, somewhat like the *EU Framework*, both parties to a time and voyage charterparty may, under the *MTC*, be eligible for special shipping tax treatment. However, the thesis prefers exceptional eligibility for time and voyage charterers.

Further, both parties to a demise charterparty may similarly be eligible for special tax treatment under the *MTC* and *EU Framework*.¹²⁶² However, the shipowner is the party there that only has exceptional access.¹²⁶³

Therefore, although broadly demonstrating a good general alignment, the *MTC* and the *EU Framework* also evidence significant discrepancies in carving out the relevant tax base for shipping income. Thus, the *MTC*’s tax base does not necessarily align in all cases with the tax

¹²⁵⁸ Reimer and Rust, above n 806, art 8, [37]; See also Eder et al, above n 720, 3 [1-007] - [1-008]; See also Coghlin, above n 720, 1 [I.4], 7 [I.28] – [I.29].

¹²⁵⁹ *Hill Harmony* [2001] 1 Lloyd’s Rep 147, 157; See also Eder et al, above n 720, 3-4 [1-007] - [1-009], 445 [17-001]; See also Coghlin, above n 720, 1 [I.4] – [I.5], 3 [I.9].

¹²⁶⁰ Reimer and Rust, above n 806, art 8, [39].

¹²⁶¹ *OECD Model Tax Convention*, above n 703, C(8)-2 [6]; Reimer and Rust, above n 806, art 8, [40] – [45].

¹²⁶² *EU Ship Management Communication* OJ C 132, 7; *EU/Maltese Communication* C(2017) 8734 final, 4, 16-9, 44-5, 48-9; *EU/Greece Communication* C(2015) 9019 final, 27-8, 36-7; *OECD Model Tax Convention*, above n 703, C(8)-1 [4], C(8)-2 [4.2], [5].

¹²⁶³ *OECD Model Tax Convention*, above n 703, C(8)-1 [4], C(8)-2 [4.2], [5]; *EU/Maltese Communication* C(2017) 8734 final, 44.

bases of domestic shipping tax regimes. This discrepancy should be borne in mind when developing the substantial activity requirement as promoted by *BEPS 5*.

3.5.9 Final Submissions

The relevance of the *EU Framework* and article 8 of the *MTC* to the enquiry, as a whole, and the fifth primary factor, in particular, is their capacity to support the identification of the relevant taxpayers and underlying business activities for designing a shipping tax regime. Generally, as a distinct tax base, shipping income has a particular identity in international tax law.¹²⁶⁴ The classic shipowner and carrying goods and passengers by sea (or, in other words, performing maritime transport activities) constitute the central role-player and business activity, respectively, in demarcating the tax base.¹²⁶⁵ However, as the focus moves away from the central role-player and business activity, discrepancies arise between instruments in their shipping tax treatments.¹²⁶⁶

Maritime transport activities constitute a critical component of the global supply chain.¹²⁶⁷ Thus, in 2021, merchant tonnage shortages (arising, among other things, from States locking down their residents to manage COVID-19)¹²⁶⁸ have significantly affected the global supply

¹²⁶⁴ *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; *EU Framework* OJ C 13, 5 [2]; Reimer and Rust, above n 806, art 8, [9], [16]-[17]; *OECD Consolidated Application Note*, above n 2, 84 [308], 85 [311], 86 [313].

¹²⁶⁵ *Ibid.*

¹²⁶⁶ *EU Framework* OJ C 13, 7 [3.1]; *EU/Maltese Communication* C(2017) 8734 final, 48-9 [7.2.1.5]; Reimer and Rust, above n 806, art 8, [12], [35], [39].

¹²⁶⁷ ICS and WSC, above n 5, 1-3; See generally *1998 DETR Report*, above n 23, 4 [1]; Maritime UK, above n 821, 3, 46.

¹²⁶⁸ See generally McMahon, above n 36, 92-3.

chain, where demand has outstripped supply, causing significant price increases and good's shortages.¹²⁶⁹

Maritime transport activities may also have unique mobility as a tax base as they may generally be performed outside the borders of any particular State.¹²⁷⁰ However, their exceptional mobility may be attributed to a combination of different underlying factors.¹²⁷¹ Further, a particular sea route may attract the application of multiple instruments.¹²⁷²

Thus, a certain level of harmonisation between different international and domestic instruments is generally necessary to support the optimal functioning of the carriage of goods and persons by sea and, in turn, the global supply chain and reduce the risk of tax mismatches and tax avoidance.¹²⁷³ Accordingly, there are compelling grounds for adopting a uniform approach for defining and treating shipping income. Generally, shipping fiscal policy should be geared towards prioritising efficiency and simplicity.¹²⁷⁴

Nonetheless, different underlying policy objectives of different instruments will inevitably produce some variation in shipping tax treatments. However, the aim should ideally be to keep such discrepancies to a minimum. For example, there are mismatches in certain shipping tax treatments at the peripheral level between the EU and the OECD frameworks.¹²⁷⁵ Some of these

¹²⁶⁹ David Cloughton, Kellie Hollingworth, and Kath Sullivan, 'Sea freight costs may have peaked, but more ships are needed to bring them down', ABC News (online), 14 Oct 2021 < <https://www.abc.net.au/news/rural/2021-10-14/sea-freight-costs-stabilising/100535856> >.

¹²⁷⁰ 2018 OECD Progress Report, above n 32, 30.

¹²⁷¹ 1998 DETR Report, above n 23, 16 [61]; Alexander, above n 35, 7 [8].

¹²⁷² Reimer and Rust, above n 806, art 8, [7]; ICS and WSC, above n 5, 1-3.

¹²⁷³ ICS and WSC, above n 5, 2; OECD Consolidated Application Note, above n 2, 85 [312]; OCS Report, above n 726, 3; Hare, above n 75, 740 [16-3.1].

¹²⁷⁴ Alexander, above n 35, 4 [x], 5 [xiv]; McMahon, above n 36, 97, 106; Maritime UK, above n 821, 52; *The Mirrlees Review*, above n 17, 22-3, 34, 39-44; Cobb, above n 17, 646-8; Dwyer, above n 2, 747- 748.

¹²⁷⁵ EU Framework OJ C 13, 7 [3.1]; EU/Maltese Communication C(2017) 8734 final, 48-9 [7.2.1.5]; Reimer and Rust, above n 806, art 8, [12], [35], [39].

mismatches may be attributed to the former emphasising the navigational function of the ship operation, whilst the latter ostensibly emphasising the employment function for determining eligibility for shipping tax treatment.¹²⁷⁶ The thesis favours the navigational function as it aligns better with a shipowner's (including a quasi shipowner's) inherent attributes demonstrating unique mobility.¹²⁷⁷

Establishing the correct tax base provides a better framework for establishing the correct core activities for applying the fifth primary factor of the *Updated 1998 Framework*. In turn, establishing essential core activities predicts better substantive connections between shipping tax regimes and their users.¹²⁷⁸ The core activities should not be ascertained in a vacuum and should be applied less stringently as advanced here.¹²⁷⁹ In establishing better substantive connections, the fifth primary factor has the theoretical potential to counter weaker connections arising from factors, like flagging out to open ship registers that may promote in their jurisdictions only a nominal business presence.¹²⁸⁰

However, applying the fifth primary factor to the shipowning and ship operating sector may not be as straightforward as applying it to other sectors that demonstrate tax base mobility.¹²⁸¹

The thesis prefers adopting a systemic approach, fiscally, for promoting stronger economic links between shipping tax regimes and their eligible users. The general practice in shipping

¹²⁷⁶ Reimer and Rust, above n 806, art 8 [12], [17], [31]; *EU Framework* OJ C 13, 7 [3.1]; *EU/Maltese Communication* C(2017) 8734 final, 48-9; *Furness Withy EC* 1966 CarswellNat 297 [15], [19]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156-7, 159.

¹²⁷⁷ *Furness Withy EC* 1966 CarswellNat 297 [20]- [21].

¹²⁷⁸ *OECD BEPS Action 5*, above n 13, 23-4, 37 [70], 37 [73], 39 [84] – [85].

¹²⁷⁹ *Ibid* 37 [70], 37 [73], 39 [84] – [85]; *2017 OECD Progress Report*, above n 699, 41; *OECD Model Tax Convention*, above n 703, C(8)-1 [4]; *EU Framework* OJ C 13, 5 [2]; Reimer and Rust, above n 806, art 8, [9], [16]-[17]; *OECD Consolidated Application Note*, above n 2, 84 [308], 85 [311], 86 [313].

¹²⁸⁰ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; *OCS Report*, above n 726, 3, 7 [23]-[24]; Watt and Coles, above n 715, 27 [3.1], 32-3 [3.13] – [3.15]; *OECD BEPS Action 5*, above n 13, 23.

¹²⁸¹ *OECD BEPS Action 5*, above n 13, 9, 24-5, 37; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

tax has also preferred avoiding a fragmented fiscal approach.¹²⁸² Thus, a systemic approach for addressing weak economic links, between regimes and their users, supports a less rigorous approach for the fifth primary factor as the juridical connecting factors may also be called upon to promote substantial activity. This outcome produces a more efficient and simple fiscal treatment by not fragmenting it unnecessarily.¹²⁸³

3.6 Enhancing Transparency

As a primary factor, transparency may constitute an essential measure in combatting the opaqueness associated with the shipping industry. Generally, the *1998 Framework* requires compliance with the following two conditions:¹²⁸⁴

- *Clear applicatory advice in administrative practices:*
 - Firstly, a tax administration should set out the requirements for applying a regime clearly to taxpayers and in a way that they may be relied upon in disputes with the tax administration.
- *Access to information about a shipping tax regime:*
 - Secondly, information about a regime, including specific instances of its application in respect of specific taxpayers, should be readily available to the tax administrations of other States.

It has been observed that a failure to comply with the above transparency standards is likely to increase the risk of harmful tax competition as non-transparent regimes provide greater

¹²⁸² Reimer and Rust, above n 806, art 8, [7]; *Furness Withy EC* 1966 CarswellNat 297 [20]- [21].

¹²⁸³ *The Mitchell Review*, above n 55, 7-8, 40 [5.21]; *The Mirrlees Review*, above n 17, 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324.

¹²⁸⁴ *OECD 1998 Report*, above n 2, 27, 28 - 9 [63]. 'Non-transparency may arise from the way in which a regime is designed and administered. Non-transparency is a broad concept that includes, among others, favourable application of laws and regulations, negotiable tax provisions, and a failure to make widely available administrative practices.' at 27 [Box II (c)].

opportunities for the exercise of variable and subjective tax treatments.¹²⁸⁵ Whether these tax treatments are corrupt or not, they may, nonetheless, all contribute to horizontal inequity.¹²⁸⁶

Action 5 of *BEPS* endeavours to further enhance the transparency of shipping tax regimes by improving the tax ruling systems of States within the project of advancing the reciprocal interchange of information between the tax administrations of different States.¹²⁸⁷ It has been observed that the framework only applies to private rulings.¹²⁸⁸ However, public rulings are considered by a best practices model.¹²⁸⁹

An obligation to spontaneously exchange information about cross-border private rulings concerning regimes arises where the three conditions of the following test are satisfied:¹²⁹⁰

- 1) The matter falls within the scope of the FHTP's work.
- 2) The regime is preferential.

¹²⁸⁵ *OECD 1998 Report*, above n 2, [63].

¹²⁸⁶ *Ibid.*

¹²⁸⁷ *OECD BEPS Action 5*, above n 13, 45; See generally *OECD 1998 Report*, above n 2, [64], [106]-[110]. 'The ability or willingness of a country to provide information to other countries is a key factor in deciding upon whether the effect of a regime operated by that country has the potential to cause harmful effects.': *OECD 1998 Report*, above n 2, [64]; See also *2018 OECD Progress Report*, above n 32, 38.

¹²⁸⁸ *OECD BEPS Action 5*, above n 13, 47-8. A ruling is defined as, 'any advice, information or undertaking provided by a tax authority to a specific taxpayer, or group of taxpayers, [about] their tax situation and on which they are entitled to rely.': *OECD BEPS Action 5*, above n 13, 47. Two broad categories of rulings may be identified: general rulings (or what may be termed 'public rulings') and taxpayer-specific rulings ('private rulings'). : *Master Tax Guide 2019*, above n 82 [24.520]. Generally, a private ruling applies to a specific taxpayer and may be relied upon in managing their unique tax affairs.: See generally *Master Tax Guide 2019*, above n 82, [24.560].

¹²⁸⁹ *OECD BEPS Action 5*, above n 13, 48; See generally *Master Tax Guide 2019*, above n 82, [24.540].

¹²⁹⁰ *OECD BEPS Action 5*, above n 13, 46-7. What follows here is a very brief overview of the work of *BEPS 5* within the context of improving transparency. The key underlying principle driving the enhanced transparency project is to advance fiscal certainty and predictability. This aim demonstrates an overlap between the primary factor of transparency and the Smithian criterion of certainty as benchmarked. The project of improving transparency has, in turn, been implemented in three ways under Action 5 of *BEPS*: 1) The construction of a framework that regulates the exchange of compulsory spontaneous information in relation to private rulings of a tax administration of a State. 2) The adoption of a broad approach to the above framework that requires the exchange of compulsory spontaneous information in all instances where the absence of such an exchange may give rise to *BEPS* concerns. Thus, the application of such a framework is not merely limited to rulings linked to preferential regimes. Such rulings constitute but one of a class of six categories of relevant rulings that are caught by such a framework. 3) The development of a best practices model that guides the design and functioning of a ruling system. The application of the guide further covers public rulings. *OECD BEPS Action 5*, above n 13, 45-8.

3) The first primary factor under the *1998 Framework* is satisfied.

The FHTP's work covers regimes applying to geographically mobile activities.¹²⁹¹ The maritime transport sector constitutes such an activity.¹²⁹² Thus, shipping tax regimes fall within the scope of this work. Therefore, condition one is satisfied as shipping tax regimes are relevant regimes.¹²⁹³ Secondly, shipping tax regimes generally apply a more favourable tax treatment than the general tax treatment domestically.¹²⁹⁴ Thus, a shipping tax regime will ordinarily satisfy condition two.¹²⁹⁵ Thirdly, shipping tax regimes generally apply little or no direct taxes.¹²⁹⁶ Thus, condition three will also, ordinarily, be satisfied.¹²⁹⁷ Therefore, where private rulings that have cross-border implications are given for shipping tax regimes, an obligation will, spontaneously, arise ordinarily to exchange information with the tax administrations in other relevant States.¹²⁹⁸ Generally, States may utilise rulings in the shipping context to attract internationally mobile capital.¹²⁹⁹ Any such employment may constitute a harmful tax practice.¹³⁰⁰

Apart from its essential core, the benchmarked certainty criterion may contain transparency as a peripheral element.¹³⁰¹ Thus, the *Updated 1998 Framework* overlaps with the *Updated Smithian Framework* as they may both cover particular aspects of certainty.¹³⁰²

¹²⁹¹ *OECD BEPS Action 5*, above n 13, 46-7.

¹²⁹² *OECD Consolidated Application Note*, above n 2, [316].

¹²⁹³ *Ibid.*

¹²⁹⁴ *Ibid.*

¹²⁹⁵ *Ibid* [318].

¹²⁹⁶ *Ibid.*

¹²⁹⁷ *Ibid.*

¹²⁹⁸ *OECD BEPS Action 5*, above n 13, 49; *OECD Consolidated Application Note*, above n 2, [316].

¹²⁹⁹ *OECD BEPS Action 5*, above n 13, 46-7; *OECD Consolidated Application Note*, above n 2, [316].

¹³⁰⁰ *Ibid.*

¹³⁰¹ Cannan, above n 14, 310; White, above n 110,45-9; Rousslang, above n 92, 8-9; *The Henry Review*, above n 89, 17; Fiscal Policy Institute, above n 289, 9.

¹³⁰² *Ibid.*

3.7 The 1998 Framework's Specific Application to Shipping Taxes

The OECD application note particularly relevant to shipping tax regimes is the *2004 Consolidated Application Note*.¹³⁰³ It considers the *1998 Framework's* application to shipping tax regimes.¹³⁰⁴ In particular, it considers the four original primary factors and three especially relevant secondary factors.¹³⁰⁵ The thesis will also briefly consider these factors within the shipping context as it applies them as integral constituents of *MAF*.¹³⁰⁶ *BEPS 5* has subsequently updated the *1998 Framework* to include a fifth primary factor and enhance the transparency primary factor.¹³⁰⁷ Additionally, certain secondary factors have subsequently been deleted.¹³⁰⁸

3.7.1 First Primary Factor (No or Low Tax Rates)

Both standard and effective tax rates may be relevant in establishing the first primary factor.¹³⁰⁹

The first secondary factor (artificial tax base), second secondary factor (breaching transfer pricing principles), and fourth secondary factor (negotiable rates and bases) are particularly relevant for determining the first primary factor.¹³¹⁰ The *1998 Framework* advises that a zero

¹³⁰³ *2000 Report*, above n 2, [12]–[13]; *OECD Consolidated Application Note*, above n 2, [10], [316].

During the period commencing from about the year 2000 and spanning up to about the year 2004, generic guidance in the form of “application notes” were made available, to better support States, in applying the criteria of the 1998 framework.: *OECD BEPS Action 5*, above n 13, 15. A 2000 Report noted that the application notes would be drafted at the general level. Further, the application notes would identify the attributes that might more ordinarily be problematic for certain types of tax regimes, in relation to the *1998 Framework*. : *2000 Report*, above n 2, [12]–[13].

¹³⁰⁴ *OECD Consolidated Application Note*, above n 2, [316].

¹³⁰⁵ *Ibid* [317].

¹³⁰⁶ It is beyond the research question to undertake a deeper economic analysis and therefore some of the factors will be of limited value for this project.

¹³⁰⁷ *OECD BEPS Action 5*, above n 13, 23, 45.

¹³⁰⁸ *2018 OECD Progress Report*, above n 32, 13, 41; But see *OECD BEPS Action 5*, above n 13, 19-20; *OECD 1998 Report*, above n 2, [61].

¹³⁰⁹ *2018 OECD Progress Report*, above n 32, 51.

¹³¹⁰ *Ibid*.

or low effective tax rate arises typically for shipping tax regimes in one of two ways, namely:¹³¹¹

1. applying a significantly low standard tax rate; or
2. defining the tax base peculiarly.

A shipping tax regime may satisfy the ‘no or low effective tax rate’ requirement in multiple ways, including employing reduced tax rates and accelerated depreciation provisions.¹³¹² A State’s intention or objective is also not relevant to the enquiry.¹³¹³

The OECD has observed that favourable fiscal regimes are one of the primary incentives States employ to attract shipowning companies.¹³¹⁴ Accordingly, the OECD submits that ‘this has led to [a] situation where a large percentage of the world’s fleet operates with little or no direct tax on its activities.’¹³¹⁵ Therefore, implicit in this submission is the assumption that many shipping tax regimes will trigger the first primary factor.¹³¹⁶ A similar submission underpins the *EU Framework*.¹³¹⁷

Suppose the first leg of question two of the *1998 Framework* is passed (as may ordinarily be the case). In that instance, a regime may be treated as potentially harmful, only where one or more of the remaining primary factors are implicated, as supported where required by relevant secondary factors.¹³¹⁸ Consequently, it is not problematic that a shipping tax regime triggers the first primary factor (apart from other considerations like having an obligation to exchange

¹³¹¹ *OECD Consolidated Application Note*, above n 2, [318]; *OECD 1998 Report*, above n 2, [61].

¹³¹² *OECD Consolidated Application Note*, above n 2, [318].

¹³¹³ *Ibid* [319].

¹³¹⁴ *Ibid*.

¹³¹⁵ *Ibid*.

¹³¹⁶ *Ibid*.

¹³¹⁷ *EU Framework* OJ C 13, 6.

¹³¹⁸ *OECD BEPS Action 5*, above n 13, 21.

private rulings automatically in promoting transparency).¹³¹⁹ Leg two of question two must also be satisfied before a regime may be considered potentially harmful.¹³²⁰

Thus, the first primary factor does not by itself treat Positive Anti-Neutrality disapprovingly or prohibit it. Likewise, taxes may be designed legitimately to encourage a particular desired activity (i.e., Positive Anti-Neutrality) under the *Smithian Framework*.¹³²¹ Accordingly, as the *Updated Smithian Framework* and the *Updated 1998 Framework* do not necessarily prohibit Positive Anti-Neutrality, a further synergy exists between them.

¹³¹⁹ *OECD Consolidated Application Note*, above n 2, [319]; *OECD 1998 Report*, above n 2, 27, [62]; *2018 OECD Progress Report*, above n 32, 13-14.

¹³²⁰ *Ibid.*

¹³²¹ Cobb, above n 17, 648; Dwyer, above n 2, 764-9; *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 29, 32, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9.

3.7.2 Second Primary Factor (Ring-Fencing)

The second primary factor considers ring-fencing.¹³²² Ring-fencing involves limiting a tax regime's scope to prevent it from interfering with the sponsoring State's domestic economy.¹³²³

The second secondary factor (breaching transfer pricing principles) and third secondary factor (exempting foreign-sourced income) are auxiliary matters potentially relevant for establishing the second primary factor.¹³²⁴ Ring-fencing may be achieved in various ways to restrict the scope of a shipping tax regime.¹³²⁵ For instance, a shipping tax regime might, generally, implement ring-fencing by:¹³²⁶

- a) excluding the sponsoring State's tax residents from its scope; or
- b) denying its users access to the sponsoring State's domestic market.

Denying domestic market access may take different forms.¹³²⁷ Firstly, (and more directly) the shipping tax regime might prohibit its users from participating in the relevant domestic market.¹³²⁸ Secondly, (and more indirectly) the shipping tax regime might cancel or otherwise effectively exclude shipping tax benefits of its users that are sufficiently present in the sponsoring State's domestic market.¹³²⁹ However, ring-fencing, as appearing under items a) and b) above, is not necessarily present where non-residents are exempt from tax.¹³³⁰

¹³²² *OECD 1998 Report*, above n 2, 27.

¹³²³ *Ibid.*

¹³²⁴ *2018 OECD Progress Report*, above n 32, 51-52.

¹³²⁵ *OECD 1998 Report*, above n 2, 27.

¹³²⁶ *Ibid* [62]; *OECD Consolidated Application Note*, above n 2, [320]; *2018 OECD Progress Report*, above n 32, 53.

¹³²⁷ *OECD 1998 Report*, above n 2, [62]; *OECD Consolidated Application Note*, above n 2, [322]; *2018 OECD Progress Report*, above n 32, 14, 54.

¹³²⁸ *Ibid.*

¹³²⁹ *Ibid.*

¹³³⁰ *Ibid.*

Legitimate cases include situations where the exemption is part of the general structure of a State's tax system or resolves double taxation.¹³³¹

The goal behind ring-fencing is to either fully or partially shield a domestic economy of a sponsoring State from its shipping tax regime.¹³³² Thus, ring-fencing may impliedly suggest that a regime is harmful.¹³³³ It may serve as a defensive tactic of a sponsoring State by protecting its domestic market from its regime's negative or eroding tax distortions.¹³³⁴ Accordingly, ring-fencing facilitates the international promotion of efficiency negatively by safeguarding the domestic tax base from these adverse outcomes.¹³³⁵ In other words, the regime only aims to interfere adversely with the tax bases of *other* (non-sponsoring) States at the international level.¹³³⁶

A natural synergy exists between the *Updated Smithian Framework* and the *Updated 1998 Framework* as they essentially both protect tax bases.¹³³⁷ However, the *USF* is geared at primarily protecting the sponsoring State's shipping tax base.

Thus, ring-fencing might appear in a shipping tax regime by:

- i. preventing a sponsoring State's resident taxpayers (who hold a relevant interest in a shipowning entity that uses that regime) from also enjoying that regime's benefits by cancelling them.¹³³⁸ Alternatively, such residents may simply fail to have eligibility

¹³³¹ *Ibid.*

¹³³² *OECD 1998 Report*, above n 2, 27 [62]; *2018 OECD Progress Report*, above n 32, 14, 53.

¹³³³ *OECD 1998 Report*, above n 2, 26-7; *2018 OECD Progress Report*, above n 32, 14.

¹³³⁴ *Ibid.*

¹³³⁵ *The Mirrlees Review*, above n 17, 22-3, 28-30, 40-43; *OECD 1998 Report*, above n 2, 26-7; *2018 OECD Progress Report*, above n 32, 14.

¹³³⁶ *Ibid.*

¹³³⁷ Dwyer, above n 2, 747-8; 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 23, 29-30, 40-43; *OECD 1998 Report*, above n 2, 8.

¹³³⁸ *OECD Consolidated Application Note*, above n 2, [320]-[321].

directly.¹³³⁹ A more explicit instance of ring-fencing is where resident taxpayers are prohibited from holding an interest in an eligible entity.¹³⁴⁰

- ii. limiting its application to shipping routes between two points outside a sponsoring State.¹³⁴¹ However, the OECD recognises exceptions here, like landlocked States.¹³⁴²

3.7.2.1 Cabotage Rules

A distinction must be made between legitimate cabotage rules and illegitimate ring-fencing practices.¹³⁴³ The term cabotage originates from the French root word meaning ‘to sail coastwise or by the cape.’¹³⁴⁴ Generally, cabotage rules require that goods transported on certain sea routes and between ports within a particular State must be carried on vessels flying that State’s flag.¹³⁴⁵ Thus, the use of a State’s domestic sea routes is exclusively restricted to the registered merchant ships of that State.¹³⁴⁶ Cabotage is generally accepted globally as one of the legitimate measures States may employ to support their registered merchant fleet.¹³⁴⁷

Ordinarily, cabotage rules should not cause ring-fencing problems, provided international sea routes are not taxed more favourably than domestic ones.¹³⁴⁸ Thus, normally, the second primary factor should not be implicated where tax uniformity is respected.¹³⁴⁹ This instance is generally another synergy between the *Updated Smithian Framework* and the *Updated 1998*

¹³³⁹ Ibid.

¹³⁴⁰ Ibid.

¹³⁴¹ Ibid [322].

¹³⁴² Ibid.

¹³⁴³ Ibid.

¹³⁴⁴ Breskin, above n 6, 48.

¹³⁴⁵ Ibid.

¹³⁴⁶ Ibid.

¹³⁴⁷ Ibid 43. ‘Such laws, while clearly protectionist, are not covered by international trade rules administered by the World Trade Organization (WTO) because merchant shipping is specifically excluded.’: at 49.

¹³⁴⁸ *OECD Consolidated Application Note*, above n 2, [323].

¹³⁴⁹ Ibid; *The Mirrlees Review*, above n 17, 34, 40; *OECD 1998 Report*, above n 2, 8.

Framework.¹³⁵⁰ They both promote uniformity, generally, whether as efficiency or horizontality.¹³⁵¹ Thus, different tax treatments for substantially different activities will, generally, not cause ring-fencing issues.¹³⁵² Therefore, in designing a shipping tax regime, a rule of thumb for avoiding ring-fencing concerns is to promote tax uniformity for different sea routes and substantially similar activities.¹³⁵³

The OECD considers multiple issues for assessing whether shipping activities are substantially the same.¹³⁵⁴ Further, a distinction between implicit (indirect) ring-fencing and defacto ring-fencing is required.¹³⁵⁵ The ring-fencing must be present explicitly (directly) or implicitly (indirectly).¹³⁵⁶ However, the second primary factor does not assess de facto ring-fencing.¹³⁵⁷ Further, regimes that apply only to transactions in foreign currency do not necessarily cause ring-fencing issues.¹³⁵⁸ However, other factors must, first, be assessed, such as whether residents of a sponsoring State may access the regime and whether the foreign currency is freely available to such residents.¹³⁵⁹

¹³⁵⁰ *Ibid.*

¹³⁵¹ *Ibid.*

¹³⁵² *OECD Consolidated Application Note*, above n 2, [323]- [324].

¹³⁵³ *Ibid.*

¹³⁵⁴ *OECD Consolidated Application Note*, above n 2, [325] – [326]. The relevant issues may be divided into two broad groups. A) The first group is orientated around two main issues: 1) The type of vessels in question. 2) The nature of the operations in question. B) The second group concerns the natural and inherent characteristics of certain States that uniquely affect their domestic shipping markets and that naturally differentiates them from their international counterparts.

¹³⁵⁵ *2018 OECD Progress Report*, above n 32, 39, 54.

¹³⁵⁶ *Ibid.* ‘[E]xplicit ring-fencing occurs when a regime by its own terms excludes access ... Implicit ring-fencing occurs when a regime does not exclude access ... in the letter ... but instead through administrative or legal barriers ... De facto ring-fencing, ... occur[s] when, even in the absence of any administrative or legal barriers, resident taxpayers still make up only a small percentage of the taxpayers benefiting from the regime.’: at 54.

¹³⁵⁷ *Ibid* 39, 53-5.

¹³⁵⁸ *Ibid* 39, 55-6.

¹³⁵⁹ *Ibid.*

3.7.3 Third Primary Factor (Transparency)

The third primary factor may overlap in varying degrees with the benchmarked certainty criterion essentially and peripherally by both criteria having implications for things like the rule of law and narrower transparency issues, respectively.¹³⁶⁰ The second secondary factor (breaching transfer pricing principles) and fourth secondary factor (negotiable rates and bases) are particularly relevant for implicating the third primary factor.¹³⁶¹ The specific issues receiving attention under the third primary factor include:¹³⁶²

- the inconsistent application of tax laws;
- negotiable tax provisions; and
- the wide availability of tax rulings.

Transparency extends to a sponsoring State having the ability to obtain information:¹³⁶³

- about the ownership interests of shipowning entities established in their jurisdiction;
and
- for verifying that cross-border transactions between entities (including associate and connected entities) comply with the arm's length principle in cases where a shipping tax regime's benefits are accessed.

¹³⁶⁰ Cannan, above n 14, 310; Rousslang, above n 92, 8-9; Soanes and Stevenson, above n 290, 231; See also *OED*, above n 142, 'certain'; White, above n 110, 45-9; Bigbee et al, above n 290 [principle 9]; *OECD Consolidated Application Note*, above n 2, [328].

¹³⁶¹ *2018 OECD Progress Report*, above n 32, 52.

¹³⁶² *OECD Consolidated Application Note*, above n 2, [327].

¹³⁶³ *Ibid.*

Transparency essentially requires that a tax system function normally, properly and abide by the rule of law.¹³⁶⁴ Thus, tax rulings should align with tax laws, and tax laws should be applied consistently, impartially and correctly.¹³⁶⁵

3.7.3.1 The Significance of Proper Record-Keeping Obligations

Where shipping tax regimes employ notional profits to compute the tax, there is an increased risk of breaching transparency.¹³⁶⁶ Infringements may arise where information is not readily available because of insufficient record-keeping obligations.¹³⁶⁷ The specific issue is whether the tax administration in the sponsoring State can get hold of the relevant information on intra-group transactions to ensure that the arm's length principle is not breached.¹³⁶⁸ Therefore, shipping tax regimes will breach the transparency criterion where a State's tax laws fail (in one way or another) to impose necessary record-keeping obligations.¹³⁶⁹

3.7.4 Fourth Primary Factor (Information Exchange)

The fourth primary factor addresses the exchange of information.¹³⁷⁰ To some extent, the third and fourth primary factors are interrelated.¹³⁷¹ The fifth secondary factor (concerning secrecy provisions) is particularly relevant for implicating the fourth primary factor.¹³⁷² Thus, where sponsoring States won't or can't exchange relevant information about entities benefiting from

¹³⁶⁴ Ibid [328].

¹³⁶⁵ Ibid.

¹³⁶⁶ Ibid [327], [334].

¹³⁶⁷ Ibid [327].

¹³⁶⁸ Ibid.

¹³⁶⁹ Ibid; *2018 OECD Progress Report*, above n 32, 14.

¹³⁷⁰ *OECD Consolidated Application Note*, above n 2, [329].

¹³⁷¹ Ibid [334].

¹³⁷² *2018 OECD Progress Report*, above n 32, 52.

their shipping tax regimes, the OECD characterises these occurrences as significant indicators for harmful tax practices.¹³⁷³

3.7.5 Relevant Secondary Factors

The secondary factors are generally intended to amplify the enquiry for establishing or implicating the primary factors where necessary.¹³⁷⁴ One or more of the following five secondary factors may be relevant for implicating certain primary factors within the context of shipping tax regimes, as mentioned above:¹³⁷⁵

1. Defining a tax base artificially (the first secondary factor).
2. Breaching international transfer pricing principles (the second secondary factor).
3. Exempting foreign-sourced income (the third secondary factor).
4. Negotiable rates and bases (the fourth secondary factor).
5. Secrecy provisions (the fifth secondary factor).

However, the *2004 Consolidated Application Note* focuses particularly on the first, second and fifth secondary factors, and these will be briefly considered further.¹³⁷⁶

3.7.5.1 The First Secondary Factor

The first secondary factor is concerned with tax bases that are artificially defined.¹³⁷⁷ The first secondary factor has been used within the context of shipping tax regimes to support

¹³⁷³ *OECD Consolidated Application Note*, above n 2, [329]; *2018 OECD Progress Report*, above n 32, 14.

¹³⁷⁴ *OECD Consolidated Application Note*, above n 2, [331].

¹³⁷⁵ *Ibid* [317]; *2018 OECD Progress Report*, above n 32, 51-2.

¹³⁷⁶ *OECD Consolidated Application Note*, above n 2, [317].

¹³⁷⁷ *Ibid* [332] - [333]; See also *2018 OECD Progress Report*, above n 32, 52.

establishing the first primary factor (No or Low Tax Rates).¹³⁷⁸ Artificialities in the shipping tax base may be created when:¹³⁷⁹

- a) expenses are deducted in cases where the corresponding shipping income is non-assessable;¹³⁸⁰
- b) deemed expenses are deducted that are not incurred;
- c) unduly generous reserve charges are allowed, or the tax base for certain activities is otherwise limited; and
- d) excessive tax incentives are allowed, which exceed what is necessary to achieve the underlying purposes.

The first secondary factor may be ignored where the first primary factor is implicated or established without having to consult the former.¹³⁸¹

3.7.5.2 The Second Secondary Factor

The second secondary factor is concerned with breaching international transfer pricing principles.¹³⁸² As is done in tonnage tax regimes, applying notional profits may have particular transfer pricing risks.¹³⁸³ These risks may have implications for primary factor three (Transparency) and primary factor four (Information Exchange).¹³⁸⁴ Good tax practices for minimising such risks include:

- a) ensuring that the law requires necessary record-keeping for accessing information for verification purposes; and

¹³⁷⁸ *OECD Consolidated Application Note*, above n 2, [332] - [333].

¹³⁷⁹ *Ibid.*

¹³⁸⁰ A further issue that might be considered here is whether deductions should be limited where shipping income is taxed at extremely low rates.

¹³⁸¹ *OECD Consolidated Application Note*, above n 2, [332] - [333].

¹³⁸² *Ibid* [334].

¹³⁸³ *Ibid.*

¹³⁸⁴ *Ibid.*

- b) incorporating the arm's length principle directly into a shipping tax regime in cases where it is otherwise absent from a State's general tax law.¹³⁸⁵

3.7.5.3 The Fifth Secondary Factor

The fifth secondary factor concerns secrecy provisions.¹³⁸⁶ This secondary factor is particularly relevant for implicating the fourth primary factor (Information Exchange).¹³⁸⁷ Where secrecy laws are enacted that obstruct access to information about a shipping tax regime, such an occurrence would be a significant indicator that a regime is harmful.¹³⁸⁸

3.8 The Construction of a *Model Analytical Framework*

In summary, the primary policy underlying the *1998 Framework* is to combat harmful tax practices on the international stage and within the context of geographically mobile activities, including shipowners' activities.¹³⁸⁹ Harmful tax practices might, simply, be conceptualised as shipping tax regimes that implicate one or more of the remaining primary factors (primary factors two to five) of the *Updated 1998 Framework*.¹³⁹⁰ However, harmful tax practices may be considered more comprehensively by their various adverse consequences, including:¹³⁹¹

- a) The erosion of non-sponsoring States' tax bases internationally.
- b) The distortion of the location of capital and services.
- c) The tax burden shifting to less mobile tax bases, such as labour, property and consumption.¹³⁹²

¹³⁸⁵ Ibid.

¹³⁸⁶ Ibid [335].

¹³⁸⁷ Ibid.

¹³⁸⁸ Ibid.

¹³⁸⁹ *OECD BEPS Action 5*, above n 13, 11; *OECD Consolidated Application Note*, above n 2, [316].

¹³⁹⁰ *OECD BEPS Action 5*, above n 13, 15, 19-21; *OECD 1998 Report*, above n 2, [61].

¹³⁹¹ *OECD BEPS Action 5*, above n 13, 11.

¹³⁹² Dwyer, above n 2, 747-8, 794, 955.

d) An increase in administrative and compliance costs.¹³⁹³

However, the OECD advises that its work here is not a comprehensive fiscal policy-making exercise.¹³⁹⁴ Thus, the *Updated 1998 Framework* is not intended to interfere with a State's sovereignty by harmonising taxes across different States like dictating particular tax rates.¹³⁹⁵

Shipping tax regimes that avoid implicating the remaining primary criteria of the *Updated 1998 Framework* may ostensibly be expected to have an application that is somewhat more substantive and efficient at the international level.¹³⁹⁶ Thus, they should have better credibility internationally.¹³⁹⁷

In this regard, the OECD advises that its work on harmful tax practices concerns 'reducing the distortionary influence of taxation on the location of mobile ... activities, thereby encouraging ... free and fair tax competition.'¹³⁹⁸ Thus, a key purpose is to establish a more level playing field between States internationally.¹³⁹⁹

The *USF's* benchmarked efficiency criterion is primarily concerned with minimising negative tax distortions eroding sponsoring States' tax bases.¹⁴⁰⁰ Therefore, a natural synergy exists between the *Updated 1998 Framework* and the *Updated Smithian Framework* as they both

¹³⁹³ Thus, the aim of the *Updated 1998 Framework* is to also increase simplicity and reduce its corresponding costs as these may have implications for a harmful tax practice.

¹³⁹⁴ *OECD BEPS Action 5*, above n 13, 11.

¹³⁹⁵ *Ibid.*

¹³⁹⁶ *Ibid* 15, 19-21; *OECD 1998 Report*, above n 2, [61].

¹³⁹⁷ *OECD BEPS Action 5*, above n 13, 16, 21; *2018 OECD Progress Report*, above n 32, 13.

¹³⁹⁸ *Ibid.*

¹³⁹⁹ *Ibid.*

¹⁴⁰⁰ Dwyer, above n 2, 747-8; 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 22-3, 29-30, 39-43.

strongly promote efficiency. Similar observations may be made for other *USF* criteria benchmarked by the thesis, like simplicity.¹⁴⁰¹

Therefore, in supporting the design of a shipping tax regime, the two frameworks appear to operate as valuable counterparts of one model, each having unique enquiries. Avoiding the implication of the remaining primary factors of the *Updated 1998 Framework* is not necessarily a mutually exclusive exercise with promoting *USF* objectives. The latter primarily promotes protecting a *sponsoring* State's shipping tax base. The former, broadly, requires a tax regime to be substantively connected with its users and apply transparently and without ring-fencing for protecting *non-sponsoring* States' shipping tax bases.¹⁴⁰²

A sponsoring State should ideally be able to apply efficiency or a super efficiency, like Positive Anti-Neutrality, by, for example, applying very low effective tax rates to relevant activities in their jurisdiction that provide real value without implicating the remaining primary factors.¹⁴⁰³ Thus, a sponsoring State can still provide shipping tax treatments that protect its tax base despite having to do so openly and by only rewarding economic activity that is legitimately connected with its jurisdiction.¹⁴⁰⁴ It is submitted that there is enough flexibility in the parameters of the remaining primary factors of the *Updated 1998 Framework* for a sponsoring State to promote efficiency in the *USF* as required.¹⁴⁰⁵

¹⁴⁰¹ A similar argument may be made for simplicity to the extent that the aim of the *Updated 1998 Framework* is to reduce relevant costs as particular costs may be a consequence of a harmful tax practice which the said framework is designed to minimise or eradicate. The benchmarked criteria of efficiency and equity (as abstracted horizontally) are, for example, recognised to some extent under the second primary factor. Also, under the third and fourth primary factors, particular aspects of certainty are promoted.

¹⁴⁰² Dwyer, above n 2, 747-8, 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 22-3, 29-30, 39-43; *OECD BEPS Action 5*, above n 13, 16, 21; *2018 OECD Progress Report*, above n 32, 13.

¹⁴⁰³ *OECD BEPS Action 5*, above n 13, 11, 21, 23; *OECD 1998 Report*, above n 2, 27. Super efficiency as a concept is considered further in chapter 5; See also Dwyer, above n 2, 764. See generally *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 29-32, 39-43.

¹⁴⁰⁴ *Ibid.*

¹⁴⁰⁵ *Ibid.*

Thus, the utility of the *Smithian Framework* is its capacity to support the design of a shipping tax regime that functions optimally.¹⁴⁰⁶ Optimal functioning is essentially all about achieving policy objectives sustainably and consistently.¹⁴⁰⁷ For example, let us assume, hypothetically, that a direct tax is raised on shipowners by applying the normal corporate tax rate and system.¹⁴⁰⁸ Let us also assume that the regime does not trigger the first primary factor of the *Updated 1998 Framework*.¹⁴⁰⁹ In these circumstances, the regime is not classified *prima facie* as a harmful preferential regime at the international level.¹⁴¹⁰ Thus, the regime ostensibly applies appropriately internationally. Nonetheless, domestically, the regime may still operate in a manner that misaligns significantly with the *Updated Smithian Framework*. Thus, the regime may fail to protect the sponsoring State's tax base domestically. Thus, despite the regime operating appropriately internationally, it may still function inadequately domestically.¹⁴¹¹ Thus, the solution may be found in the combined effect of the two frameworks where a better prospect is had at identifying an optimum shipping tax regime.

3.8.1 Finalising the Ranking of Criteria for the *USF*

The preliminary conclusions from heading 3.1.2 may now be brought forward. In particular, the thesis will consider the ordering of the benchmarked criteria of certainty and sustainability. For the *Updated Smithian Framework*, the certainty criterion operates as a fundamental and absolute criterion at its core. The core concerns critical matters involving the rule of law that

¹⁴⁰⁶ Alley and Bentley, above n 2, 580, 586; *The Mirrlees Review*, above n 17, 21-2, 35, 39-45; Du Preez, above n 87, 26, 33-4; *The Henry Review*, above n 89, 17.

¹⁴⁰⁷ *Ibid.*

¹⁴⁰⁸ *OECD Consolidated Application Note*, above n 2, [318].

¹⁴⁰⁹ *Ibid.* Nor would it, generally, implicate part two of question one under the *1998 Framework* as it would not be preferential.

¹⁴¹⁰ *OECD BEPS Action 5*, above n 13, 9.

¹⁴¹¹ Dwyer, above n 2, 747-8, 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 23, 29-30, 40-43.

requires specific attention.¹⁴¹² However, less critical objectives of the benchmarked certainty criterion at the periphery may be adequately promoted by the *Updated 1998 Framework*.¹⁴¹³ One example may be transparency.¹⁴¹⁴

Further, where attributes of certainty are promoted in the remaining primary factors of the *Updated 1998 Framework*, they should, naturally, outrank the *Updated Smithian Framework's* certainty criterion where there is a conflict.¹⁴¹⁵ The *Updated 1998 Framework's* tests must be passed where necessary for a regime to be legitimate internationally.¹⁴¹⁶

In prioritising the *USF*, any peripheral attributes of the certainty criterion should roughly rank after simplicity and horizontality. Overall, they may be less critical as they may have been applied elsewhere in *MAF*.¹⁴¹⁷ Simplicity should be ranked before these peripheral attributes. A good shipping tax should prioritise cost reduction, particularly as it is likely to apply in a low tax environment.¹⁴¹⁸ Horizontality may also be promoted as tax uniformity indirectly by promoting efficiency, foremostly, and would, thus, naturally outrank these peripheral attributes.¹⁴¹⁹ Adopting the above ordering allows peripheral certainty concerns to be controlled by their cost implications. This outcome seems reasonable for a regime that may be geared at raising only nominal taxes.

¹⁴¹² Cannan, above n 14, 311-2.

¹⁴¹³ *OECD BEPS Action 5*, above n 13, 19; *OECD 1998 Report*, above n 2, [61].

¹⁴¹⁴ *Ibid.*

¹⁴¹⁵ *OECD Consolidated Application Note*, above n 2, [327], [329], [334]. Albeit that the fundamental aspects of certainty due to their particular nature, should not create any alignment issues with the base framework, and may therefore be ignored within this context.

¹⁴¹⁶ *OECD BEPS Action 5*, above n 13, 16, 21; *2018 OECD Progress Report*, above n 32, 13.

¹⁴¹⁷ Cannan, above n 14, 311; *OECD Consolidated Application Note*, above n 2, [319]; *The Mirrlees Review*, above n 17, 22-3, 39-44.

¹⁴¹⁸ *Ibid.*

¹⁴¹⁹ *The Mirrlees Review*, above n 17, 34, 39-40; Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

Lastly, as a criterion, sustainability measures the ongoing achievement of fiscal purposes, as supported by the priorities of the *Updated Smithian Framework*.¹⁴²⁰ Sustainability will be particularly relevant for shipping tax regimes that apply super efficiency, like Positive Anti-Neutrality, to protect specific tax bases. These applications should be supported with necessary controls.¹⁴²¹ Therefore, as a criterion with a monitoring function, it seems reasonable to allocate sustainability the last position in the hierarchy as it does not concern matters of first resort.¹⁴²²

Therefore, in summary, ignoring the benchmarked certainty criterion's core attributes, the following ranking for the *Updated Smithian Framework's* criteria is recommended, as a rough rule of thumb, in designing an optimal shipping tax regime:

1. Efficiency;
2. Simplicity;
3. Horizontally;
4. Peripheral Certainty Aspects;¹⁴²³ and
5. Sustainability.¹⁴²⁴

3.8.2 The Full Set of Criteria of the *Model Analytical Framework* ('MAF')

Therefore, *MAF*, as constructed by the thesis, comprises the following criteria:

Class A: - Five primary factors of the *Updated 1998 Framework*:¹⁴²⁵

¹⁴²⁰ *The Henry Review*, above n 89, 17-8; *OECD Consolidated Application Note*, above n 2, [319]; Cobb, above n 17, 648; Dwyer, above n 2, 764-9; *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 29, 32, 40-1; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; *Carter Report*, above n 89, 8-9.

¹⁴²¹ *Ibid.*

¹⁴²² *The Henry Review*, above n 89, 17-8; *The Mirrlees Review*, above n 17, 44-5.

¹⁴²³ Cannan, above n 14, 310-1; *The Mirrlees Review*, above n 17, 21-3, 29, 40-3; Evans, above n 113, 385, 388; Mirrlees et al, above n 138, 333; *The Henry Review*, above n 89, 17-8, 25, 39-40; Dwyer, above n 2, 747-8.

¹⁴²⁴ Fan, above n 163, 540-1, 544-5; Stewart et al, above n 2, 1, 9, 22; Cannan, above n 14, 310; Rouslang, above n 92, 8-9; Soanes and Stevenson, above n 290, 231; See also *OED*, above n 142, 'certain'; White, above n 110, 45-9; Bigbee et al, above n 290 [principle 9].

¹⁴²⁵ *2018 OECD Progress Report*, above n 32, 13, 40-41; *OECD BEPS Action 5*, above n 13, 19; *OECD 1998 Report*, above n 2, [61].

- 1) No-or-low Effective Tax Rates;
- 2) Improper Ring-fencing;
- 3) Transparency;
- 4) Information Exchange; and
- 5) Substantial Activity.

Class B: Five secondary factors of the *Updated 1998 Framework* (as required):¹⁴²⁶

- 1) Artificial Tax Base Definition;
- 2) Breaching International Transfer Pricing Principles;
- 3) Exempting Foreign Source Income;
- 4) Negotiable Tax Rates and Tax Bases; and
- 5) The Existence of Secrecy Provisions.

Class C: Other Economic Factors of the *Updated 1998 Framework* (not considered by the thesis):¹⁴²⁷

- 1) Activity-shifting;
- 2) Non-Proportionate Activities; and
- 3) Dominant Reason.

Class D: The Criteria of the *Updated Smithian Framework* ('USF'):

- 1) Certainty (Core attributes);
- 2) Efficiency;
- 3) Simplicity;

¹⁴²⁶ 2018 OECD Progress Report, above n 32, 13, 41; But see OECD BEPS Action 5, above n 13, 19-20; OECD 1998 Report, above n 2, [61].

¹⁴²⁷ OECD BEPS Action 5, above n 13, 21; But see 2018 OECD Progress Report, above n 32, 15 [5].

- 4) Horizontality;
- 5) Certainty (peripheral attributes - as required); and
- 6) Sustainability.

These class A and D criteria constitute the critical criteria of *MAF* for the thesis.

Chapter 4: Sea power as a Vital Objective in Designing Shipping Tax Regimes

4.1 An Overview

Perhaps, in his treatise, *The Life of Reason: Reason in Common Sense*, George Santayana, a 20th-century American philosopher, articulated the issue best when he asserted that, ‘[t]hose who cannot remember the past are condemned to repeat it.’¹⁴²⁸ Unfortunately, it is an adage that, although well-worn in the literature, seems ominously pertinent to 20th-century shipping fiscal policy.¹⁴²⁹

The primary aim of chapter four is to consider the broader historical context and underlying public policy concerns that led up to the enactment of the first specialised shipping tax regimes in Anglo-American law. The UK and US are good cases to examine.¹⁴³⁰ Both Sates possessed the most prominent naval and registered trading fleets globally at specific points in recent history.¹⁴³¹ Therefore, the events surrounding the development and decline of their respective registered trading fleets may be of particular interest in better understanding the various factors supporting a robust registered trading fleet.

The analysis will demonstrate that previous miscalculations in developing 20th-century Anglo-American shipping fiscal policy played a significant role in eroding the corresponding shipping tax bases.¹⁴³² Chapter four will consider whether any impediments of a bygone century associated with taxing shipowning entities persist as residual obstacles in the modern era. The analysis will demonstrate that sea power is a relevant policy concern in assessing the

¹⁴²⁸ George Santayana, *The Life of Reason: Reason in Common Sense* (Scribner’s, 1905) 284; Matthew Caleb Flamm, *George Santayana (1863—1952)* Internet Encyclopedia of Philosophy; <<https://iep.utm.edu/santayana/>>; See generally Ivar Jonsson, *A Quote for History: Historical Words, Uttered by the Famous, Infamous and Forgotten* (CreateSpace, 2016) 13.

¹⁴²⁹ McMahon, above n 36, 94-5, 97; Madigan, above n 1112, 3; Baer, above n 39, 21; Butcher, above n 38, 2-4; Asteris, above n 35, 67.

¹⁴³⁰ Ibid.

¹⁴³¹ Ibid.

¹⁴³² Panagiotou and Thanopoulou, above n 43, 6-7; McMahon, above n 36, 106; Asteris, above n 35, 71.

significance of a State's registered trading fleet. Further, the analysis will consider whether government support is necessary for establishing and maintaining a robust registered trading fleet.

It is beyond the scope of the thesis to provide an overly comprehensive historical analysis. The thesis attempts to present enough historical facts instead, as is sufficient, for instructing (and equally defending) the design of a model shipping tax regime.

The analysis in chapter four will essentially demonstrate three key points: (1) Irrespective of the naval strength of a State (and the broader armed forces), a sufficiently sized registered merchant fleet is a vital component of a State's sea power.¹⁴³³ (2) Developing a robust registered trading fleet does not naturally happen without appropriate and continuous government intervention.¹⁴³⁴ (3) A crucial component of government support is applying an appropriate shipping tax regime.¹⁴³⁵

4.2 Sea Power: A Vital Policy Objective

Sea power might broadly be viewed as a State's capacity to use the seas in defiance of its competitors.¹⁴³⁶ Sea power is assessed through two main types of fleets of ships.¹⁴³⁷ Firstly, the

¹⁴³³ McMahan, above n 36, 104-6; Asteris, above n 35, 71.

¹⁴³⁴ Ibid.

¹⁴³⁵ Panagiotou and Thanopoulou, above n 43, 6-7; McMahan, above n 36, 106; Asteris, above n 35, 71; *EU Framework* OJ C 13, 3; *OECD Consolidated Application Note*, above n 2, 80 [291]; Alexander, above n 35, 4 [x].

¹⁴³⁶ See generally Geoffrey Till, *Seapower: A Guide for the Twenty-First Century* (Routledge, 4th ed, 2018) [1.3]; The Editors of Encyclopaedia Britannica, 'Sea power' (2016) Encyclopaedia Britannica <<https://www.britannica.com/topic/sea-power>>; McMahan, above n 36, 91; Baer, above n 39, 6-8; Westermeyer, above n 38, 18; See generally Martin E B France, *Mahan's Elements of Sea Power Applied to The Development of Space Power* (Report, National Defense University National War College Washington, DC, 2000) 6.

¹⁴³⁷ This is not an absolute categorisation as fishing vessels, for example, have also in the past been used by States in particular missions.

naval fleet of a State constitutes one such fleet.¹⁴³⁸ The naval fleet may be defined in short as, ‘[t]he whole body of warships belonging to a ruler, state, or nation.’¹⁴³⁹ Secondly, a registered trading fleet or merchant marine of a State constitutes the other fleet.¹⁴⁴⁰ As a term mainly associated with the Americans (i.e. the US), the merchant marine may be defined as ‘the trading fleet of a nation; the merchant navy.’¹⁴⁴¹ Similarly, as a term primarily associated with the British, the merchant navy may be defined as ‘[a]ll of the trading and commercial ships registered in a country (usually excluding fishing vessels)¹⁴⁴² as opposed to those involved in military activity.’¹⁴⁴³

The main objective of sea power has been to protect friendly shipping from an attack by hostile forces and restrict and destroy an opponent’s shipping—both mercantile and military.¹⁴⁴⁴ Mahan (who is ‘venerated’ by some (including certain US Presidents) as a leading 19th-century theorist on sea power) conceptualised it as a multifaceted concept containing multiple factors and elements affecting a nation’s security, prosperity and influence in the world.¹⁴⁴⁵ Nonetheless, there are conflicting schools of thought about a trading fleets exact role within the broader doctrine of sea power.¹⁴⁴⁶

¹⁴³⁸ *OED*, above n 142, ‘navy, n’.

¹⁴³⁹ *Ibid.*

¹⁴⁴⁰ *OED*, above n 142, ‘merchant marine, n’.

¹⁴⁴¹ *Ibid.*

¹⁴⁴² But see Asteris, above n 35, 67.

¹⁴⁴³ *OED*, above n 142, ‘merchant navy, n’.

¹⁴⁴⁴ *Ibid.*

¹⁴⁴⁵ Till, above n 1436, [1.4]; Westermeyer, above n 37, 12; France, above n 1436, 6; For a comprehensive consideration of the idea of sea power see generally Till, above n 1436, [1.3], [1.4].

¹⁴⁴⁶ John J Clark, ‘Military Sea Power and the Merchant Marine: An Historical Critique’ (1967) 19(2) *Political Science* 43, 43; McMahon, above n 36, 91; Till, above n 1436, [1.3], [1.4].

4.3 Competing Schools of Thought on Sea Power

Different opinions may be identified even within the Mahanian school of sea power concerning the relationship between a State's trading fleet and its naval fleet.¹⁴⁴⁷ Mahan broadly hypothesised that the success of a State's naval fleet is inherently tied to the success of its trading fleet.¹⁴⁴⁸ In 1890, Mahan published his treatise *The Influence of Sea Power upon History, 1660-1783*.¹⁴⁴⁹ In that work, Mahan expressed the following opinion on the nature of the relationship between the two fleets:

The necessity of a navy ... *springs, therefore, from the existence of a peaceful shipping*, and disappears with it, except in the case of a nation which has aggressive tendencies, and keeps up a navy merely as a branch of the military establishment ... When for any reason sea trade is again found to pay, a large enough shipping interest will reappear to compel the revival of the war fleet.¹⁴⁵⁰

Till observes that Mahan does not offer an exact definition of sea power.¹⁴⁵¹ Thus, it has been said that '[w]hat [Mahan] meant by the phrase has largely to be inferred.'¹⁴⁵² Some scholars interpret Mahan more literally as meaning that the trading fleet is '*the*' source of the naval fleet.¹⁴⁵³ However, others merely interpret Mahan as conceptualising the merchant fleet as '*a*' source of the naval fleet.¹⁴⁵⁴

¹⁴⁴⁷ Ibid.

¹⁴⁴⁸ Clark, above n 1446, 43; 'Sea power, in its military sense, is the offspring, not the parent of commerce . . . Both from the military and economic view, an extensive maritime commerce is a primal necessity to a country aspiring to become a naval power?': John D Hayes, 'Sine Qua Non of US. Sea Power: The Merchant Ship' (1965) 91(3) *United States Naval Institute Proceedings* 28 <<https://www.usni.org/magazines/proceedings/1965/march>>; Baer, above n 39, 6; McMahan, above n 36, 91.

¹⁴⁴⁹ A T Mahan, *The Influence of Sea Power upon History, 1660-1783* (Cambridge University Press, 1889, Digitally Reprinted 2010); Baer, above n 39, 6; Norman Friedman, 'Transformation a Century Ago' in Paul Westermeyer (ed), *The Legacy of American Naval Power: Reinvigorating Maritime Strategic Thought - An Anthology* (USMC, 2019) 21, 25; McMahan, above n 36, 91.

¹⁴⁵⁰ Mahan, above n 1449, 26, Clark, above n 1446, 43; McMahan, above n 36, 91; Asteris, above n 35, 67. (Italics added for emphasis).

¹⁴⁵¹ Till, above n 1436, [1.3].

¹⁴⁵² Ibid.

¹⁴⁵³ Clark, above n 1446, 43-4.

¹⁴⁵⁴ McMahan, above n 36, 91: 'Geoffrey Till ... observes that "Mahan even came close to saying this was the reason navies existed in the first place".': at 91; See generally Till, above n 1436, 100.

Latter scholars may broadly see the development of maritime trade (including a state's merchant fleet) as a natural consequence of a State that creates trade to accumulate wealth.¹⁴⁵⁵ The State wishing to protect its vessels and trade lanes will, in turn, need a naval fleet.¹⁴⁵⁶ Therefore, in a world of competing interests, the State with the most powerful navy will also be the wealthiest and most powerful.¹⁴⁵⁷

Broader agreement exists between scholars where Mahan is interpreted as conceptualising the merchant fleet as a critical factor of the sea power of a State.¹⁴⁵⁸ Thus, Till submits that 'sea power also includes the non-military aspects of sea-use (including, merchant shipping, fishing, marine insurance, shipbuilding and repair), since these contribute to naval power, and since they can also influence the behaviour of other people in their own right.'¹⁴⁵⁹ However, not all non-military components of sea power are of equal worth.¹⁴⁶⁰ Thus, Asteris cautions that specific merchant vessels are, in particular, more useful than others in supporting an active military operation.¹⁴⁶¹

However, other scholars, like Clark, assert that the naval fleet has a separate genesis from a State's merchant fleet.¹⁴⁶² Thus, Clark opines that '[i]f the 'classical hypothesis' (that the economic basis and necessity for military sea power springs from commercial shipping) be correct (when adopting a more literal interpretation of Mahan), then military sea power would not thrive independently of the merchant marine, and one might reasonably anticipate, that the

¹⁴⁵⁵ Ibid.

¹⁴⁵⁶ Ibid.

¹⁴⁵⁷ Ibid.

¹⁴⁵⁸ Ibid; See generally *1998 DETR Report*, above n 23, 7.

¹⁴⁵⁹ Till, above n 1436, [1.3].

¹⁴⁶⁰ Asteris, above n 35, 67.

¹⁴⁶¹ Ibid; For example, he asserts that '[t]rading ships of over 500 grt constitute the category of greatest defence use': at 67.

¹⁴⁶² Clark, above n 1446, 45-6; But see McMahon, above n 36, 91.

rise and fall of naval power, would roughly correlate with the fortunes of maritime commerce.’¹⁴⁶³ Nonetheless, Clarke concedes that ‘equally, the hypothesis may be true for some nations and not others, or be valid for one historical era but not for another.’¹⁴⁶⁴

Notwithstanding the above, Clarke concedes that a State’s merchant fleet may support the armed forces in times of crisis.¹⁴⁶⁵ Asteris opines that a State’s merchant fleet may broadly fulfil the following functions during a crisis:¹⁴⁶⁶

1. supporting and supplementing the naval fleet;¹⁴⁶⁷
2. participating in reinforcement and supply operations; and
3. transporting essential civilian goods and services.

4.4 What the Historical Record May Evidence

Thus, as a minimum, there appears to be broad consensus for conceptualising a merchant fleet as a factor of sea power.¹⁴⁶⁸ Numerous instances evidencing the importance of a merchant fleet as a factor of a State’s sea power may be referenced from historical research. Thus, for example, Soviet merchant ships during the cold war played an essential role in the sea presence of the

¹⁴⁶³ Clark, above n 1446, 43-4; Clark opines that, ‘If we examine more closely the rise and fall of the maritime states, one lesson clearly emerges: potentially dominant sea power resides not with the nation which launches the largest merchant fleet per se, but with the state that buttresses the sea-faring propensity with balanced economic growth ... Thus, when England led the world in industrial power, she also possessed the world’s most powerful Navy ... We conclude, therefore, that sea power emerges from the total economic capacity and national aspirations of a people and not as the ‘offspring’ of commercial shipping’: at 44-5.

¹⁴⁶⁴ *Ibid* 44.

¹⁴⁶⁵ *Ibid*.

¹⁴⁶⁶ Asteris, above n 35, 67.

¹⁴⁶⁷ Asteris concedes that not all types of merchant vessels are useful for defence purposes: Asteris, above n 35, 67.

¹⁴⁶⁸ Clark, above n 1446, 44; Alexander, above n 35, 16 [49]; Asteris, above n 35, 67; McMahon, above n 36, 91; Till, above n 1436, [1.3], 100; ‘To keep our subject in perspective, let us freely admit the need for some form of auxiliary shipping to supplement the task of the formal naval organisation ... Yet to admit that the merchant service can provide a vital complement to sea power in the exigencies of conflict is quite different from the assertion that the source of sea power lies in the merchant navy’: Clark, above n 1269, 44.

former Soviet Union.¹⁴⁶⁹ Further, it has been said that ‘[t]he history of the [British] Royal Navy records heroic sagas of merchant and fishing vessels, acting as armed cruisers, troop transports, supply ships, patrol craft, and anti-submarine units.’¹⁴⁷⁰

In particular, the 1982 Falkland’s conflict is a good and recent historical illustration, evidencing the value of the merchant marine as a critical factor of British sea power.¹⁴⁷¹ The Falkland’s conflict was almost exclusively a British operation.¹⁴⁷² It has been said that the quick and effective logistical support provided by the merchant marine to the British State during the Falkland’s conflict *enabled* the British armed forces to effectively be employed about 12 875 kilometres away from the British Isles and almost 6 437 kilometres away from a friendly port.¹⁴⁷³ In the Falkland’s conflict, 55 merchant vessels crewed by civilians supported the British armed forces.¹⁴⁷⁴ The logistical support provided by the British merchant fleet involved transporting troops, transporting ammunition and other necessities like water, and employing vessels as hospital ships and repair facilities.¹⁴⁷⁵ In particular, two cruise ships, namely the Queen Elizabeth II and the Canberra, were employed as troop carriers in the mission.¹⁴⁷⁶ Sir John Fieldhouse, the Commander of the Falkland’s Islands Task Force, has been recorded as saying:

¹⁴⁶⁹ Ibid.

¹⁴⁷⁰ Clark, above n 1446, 44.

¹⁴⁷¹ Asteris, above n 35, 68; Encyclopedia Britannica Eds, *Falkland Islands War* (2020) Encyclopedia Britannica < <https://www.britannica.com/event/Falkland-Islands-War>>.

¹⁴⁷² Asteris, above n 35, 69.

¹⁴⁷³ Ibid 66, 69; ‘Logistic support was vital as well, because the armed forces of both countries had operated at their maximum ranges’: Encyclopedia Britannica Eds, *Falkland Islands War* (2020) Encyclopedia Britannica < <https://www.britannica.com/event/Falkland-Islands-War>>.

¹⁴⁷⁴ Asteris, above n 35, 68; ‘Only five per cent of [British] trading ships and ten per cent of British crews were needed to support the armed forces’: at 69.

¹⁴⁷⁵ Ibid 68.

¹⁴⁷⁶ Encyclopedia Britannica Eds, *Falkland Islands War* (2020) Encyclopedia Britannica < <https://www.britannica.com/event/Falkland-Islands-War>>.

¹⁴⁷⁶ Asteris, above n 35, 69.

I cannot say too often or too clearly how important has been the Merchant Navy's contribution to our efforts. Without the ships taken up from trade, the operation could not have been undertaken, and I hope this message is clearly understood by the British nation.¹⁴⁷⁷

4.5 A Very Brief Overview of the Development of British Sea Power

Mahan opined that 'all empires revolved around sea control with the British Empire ... being the greatest and most obvious example.'¹⁴⁷⁸ Alfred the Great of Wessex, who launched ships to repel Viking invasions, first used organised sea power in England.¹⁴⁷⁹ As rudimentary direct taxes from AD 410 to 1066, specific gelds financed the Anglo-Celtic Isles' fleets during the Anglo-Saxon period.¹⁴⁸⁰ Thus, in times of imminent peril, every shire was required to contribute a ship (and its equipment) for naval resistance to the enemy in proportion to the number of hundreds it contained.¹⁴⁸¹ Any monies collected were treated as the shipgeld.¹⁴⁸² Different gelds were periodically levied for different purposes until they fell into disuse sometime after AD 1162.¹⁴⁸³ Up to the 13th century, English naval operations were

¹⁴⁷⁷ Ibid 68-9.

¹⁴⁷⁸ Westermeyer, above n 37, 12.

¹⁴⁷⁹ Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>.

¹⁴⁸⁰ Stephen Dowell, *A History of Taxation and Taxes in England From the Earliest Times to the Present Day* (Longmans, 1884) vol 1, book 1, 5-11; The taxes that were relied upon to maintain the fleets in the Anglo-Celtic Isles at that point in history, after the withdrawal of the Romans, included various types of gelds, applied during the Anglo-Saxon period of AD 410 to AD 1066: see generally David F Burg, *A World History of Tax Rebellions* (Routledge, 2004) 199 [1634-1639]; Frank Barlow, *William I: king of England* (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/William-I-king-of-England>>; Encyclopedia Britannica, *Danegeld Anglo-Saxon tax* (2020) < <https://www.britannica.com/topic/Danegeld>>.

¹⁴⁸¹ Dowell, above n 1480, 10.

¹⁴⁸² Ibid 11; see generally Burg, above n 1480, 199 [1634-1639]; A further tax that appeared was referred to as ship money, levied on counties and towns as an alternative to providing ships for the navy: Burg, above n 1480, 199 [1634-1639].

¹⁴⁸³ Dowell, above n 1480, 11; Frank Barlow, *William I: king of England* (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/William-I-king-of-England>>; Encyclopedia Britannica, *Danegeld Anglo-Saxon tax* (2020) < <https://www.britannica.com/topic/Danegeld>>; Another geld levied in Britain was called the Danegeld, an impost that was applied from about AD 991 during the reign of King Ethelred II, for raising monies to effectively pay off the pirates or the Vikings of the Northern Sea, and in so doing protect the Anglo-Saxon settlements. In its initial form, the tax base of the Danegeld consisted of a hide of land. A hide of land was a unit that consisted of about 120 acres of land. The tax was assessed at a rate of about 1 to 4 shillings per hide, as the occasion required. The Danegeld was levied as a source of revenue periodically until 1016. It has been asserted that the danegeld should however be distinguished from the heregeld, as the latter was an annual tax raised to pay Danish mercenaries, which was levied between 1012 to 1051. In AD 1051, the heregeld

domestically orientated, defensive and temporary.¹⁴⁸⁴ However, a transformation in English naval operations occurred after Normandy was lost to France and trade was expanded to Spain and Portugal.¹⁴⁸⁵ Initially, there was little difference between the design of a merchant and a naval vessel.¹⁴⁸⁶ Thus, it may not be easy to precisely pinpoint in history when England started to have a distinguishable merchant fleet.¹⁴⁸⁷ However, what seems clear is that the literature on the subject seems to accept that by about 1450, such a fleet existed.¹⁴⁸⁸

During the 14th century, indirect taxes in the form of tariffs, like tunnage and poundage, were levied by the Crown, in consultation with mariners and merchants, for the English coasts' defence and expanding English shipping.¹⁴⁸⁹ In 1303, King Edward I appears to be the first English monarch to raise a tax on ships based on tons burthen.¹⁴⁹⁰ King Edward III subsequently raised a tax on each 'tun' of imported wine.¹⁴⁹¹ These 14th-century indirect taxes might be treated as primitive precursors of the modern-day tonnage tax of the 20th and 21st centuries.¹⁴⁹²

appears to have been abolished by Edward the Confessor. However, the geld was again revived by William the Conqueror, and to some extent endured, until it fell into disuse sometime after AD 1162: See generally Dowell, above n 1480, 5-12; Burg, above n 1480, 199 [1634-1639].

¹⁴⁸⁴ Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica <<https://www.britannica.com/topic/Royal-Navy>>.

¹⁴⁸⁵ Ibid.

¹⁴⁸⁶ M Oppenheim, 'The Royal and Merchant Navy under Elizabeth' (1891) 6(23) *The English Historical Review* 465, 467; See generally Richard Woodman, *The History of the Ship: The Comprehensive story of seafaring from the earliest times to the present day* (Bloomsbury, e-book ed, 2012) [location 692-712].

¹⁴⁸⁷ Butcher, above n 38, 2.

¹⁴⁸⁸ Ibid.

¹⁴⁸⁹ See generally W M Ormrod, 'The Origins of Tunnage and Poundage: Parliament and the Estate of Merchants in the 14th Century' (2009) 28(2) *Parliamentary History* 209, 209-10; See generally W M Ormrod, 'Finance and Trade under Richard II' in A Goodman and JL Gillespie (eds) *Richard II: The Art of Kingship* (Oxford, 1999), 155-86; see generally Encyclopedia Britannica Eds, *Tonnage and poundage English history* (2016) Encyclopedia Britannica <<https://www.britannica.com/topic/tonnage-and-poundage>>: 'Tonnage was a fixed subsidy on each tun (cask) of wine imported, and poundage was an ad valorem (proportional) tax on all imported and exported goods.'

¹⁴⁹⁰ Ibid.

¹⁴⁹¹ Ibid.

¹⁴⁹² See generally Maritime Archaeology Trust, *How Tonnage Is Applied to Ships* (2020) <<https://maritimearchaeologytrust.org/tonnage-applied-ships/>>.

Henry VIII is credited with building a fleet of fighting ships and establishing a naval administration.¹⁴⁹³ Further, the first detailed list of large merchant vessels in England may be traced back to 1560, commissioned during the reign of Queen Elizabeth I (AD 1558 to 1603).¹⁴⁹⁴ Successive governments used these merchant vessels' lists to assess the sufficiency of merchant tonnage for military and mercantile purposes.¹⁴⁹⁵ Thus, already from an early age, the governing authorities treated English merchant tonnage as a factor of sea power.

In 1560, England continued to rank low compared to the other maritime powers of that age.¹⁴⁹⁶ Thus, despite England having a more significant naval fleet by that time, its merchant fleet, in comparison, was still small by European standards.¹⁴⁹⁷ It has been asserted that:

if the Spanish Armada had come at the beginning of Elizabeth's reign, instead of in the latter part of it ... it would have attacked an England deficient not merely in naval strength, but even more, in the supporting merchant ships, and in the crews to man either.¹⁴⁹⁸

Under Elizabeth I, the navy was developed as England's critical defence and would become the means by which the British Empire was extended around the globe.¹⁴⁹⁹ In accomplishing that objective, Queen Elizabeth I levied a ship writ.¹⁵⁰⁰ The ship writ was then strictly a war impost.¹⁵⁰¹ Additionally, various statutory measures were enacted during this period to

¹⁴⁹³ Oppenheim, above n 1486, 465; See generally Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>.

¹⁴⁹⁴ See also Oppenheim, above n 1486, 466; See also Ralph Davis, *The Rise of the English Shipping Industry in the Seventeenth and Eighteenth Centuries* (Liverpool University Press, 2012) 1.

¹⁴⁹⁵ Oppenheim, above n 1486, 466, 478.

¹⁴⁹⁶ Davis, above n 1494, 2.

¹⁴⁹⁷ Ibid; See generally Butcher, above n 38, 2.

¹⁴⁹⁸ Davis, above n 1494, 2.

¹⁴⁹⁹ Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>; See also Oppenheim, above n 1486, 466.

¹⁵⁰⁰ Burg, above n 1480, 199 [1634-1639].

¹⁵⁰¹ Ibid; John S Morrill, Elizabeth I: queen of England and Scotland (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/Elizabeth-I>>; Burg, above n 1480, 199 [1634-1639]; David Mathew, James I: King of England and Scotland (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/James-I-king-of-England-and-Scotland>>.

stimulate the expansion of the English trading fleet.¹⁵⁰² These measures were diverse, including cabotage rules (as considered in chapter 3), tariff exemptions and penalty tariffs.¹⁵⁰³ Accordingly, the development of the English trading fleet did not occur spontaneously and by the dictates of natural market forces. However, it required intentional and sustained government intervention, including appropriately calibrated fiscal policy.

A novel example of such a measure required all imported wine and woad as a general rule to be carried on English vessels under pain of forfeiture.¹⁵⁰⁴ A further example is found in a regulation that Henry VIII enacted promoting the build of larger merchant vessels.¹⁵⁰⁵ It continued to be applied during the Elizabethan age.¹⁵⁰⁶ It entitled a bounty of 5 shillings per ton to the builders of ships of 100 tons and upwards.¹⁵⁰⁷ Further, shipowners were prohibited from selling their vessels to foreign powers.¹⁵⁰⁸

The expansion in English commerce, such as growth in fisheries and the coal trade, also played a role in the English merchant fleet's expansion.¹⁵⁰⁹ Thus, measures were also enacted more broadly to stimulate economic activity.¹⁵¹⁰ For example, the English government, by regulation, intervened to increase domestic demand for fish by prohibiting for three days per week under penalty the domestic use of other meat.¹⁵¹¹ Similarly, the demand for fish exports

¹⁵⁰² Oppenheim, above n 1486, 471-2.

¹⁵⁰³ *Ibid.*

¹⁵⁰⁴ *Ibid.* 472.

¹⁵⁰⁵ *Ibid.*

¹⁵⁰⁶ *Ibid.*

¹⁵⁰⁷ *Ibid.*

¹⁵⁰⁸ *Ibid.*

¹⁵⁰⁹ Davis, above n 1494, 3.

¹⁵¹⁰ Oppenheim, above n 1486, 471.

¹⁵¹¹ *Ibid.*

was stimulated by the government exempting specific tariffs on the outward carriage of fish transported on English vessels.¹⁵¹²

Surveys conducted in 1577 and 1582 revealed that the merchant fleet was expanding with trading vessels of different types and sizes.¹⁵¹³ England's sea power was thus on the rise.¹⁵¹⁴ The defeat of the Spanish Armada in 1588 by the English naval fleet may be cited as evidence of this expanding sea power.¹⁵¹⁵

King James I, who reigned on the English throne from AD 1603 to 1625, similarly levied ship money as a war impost and persisted with specific measures to stimulate the growth of the trading fleet.¹⁵¹⁶ From 1614 to 1616, English shipping experienced a brief downturn, allegedly due to Dutch competition. However, the Privy Council quickly responded to the call of English shipowners for support by introducing appropriate measures to neutralise the foreign competition and restore the industry's upward trend in growth.¹⁵¹⁷ The ship survey of 1629 showed a significant expansion in merchant tonnage since 1582.¹⁵¹⁸ Thus the continual growth in English merchant tonnage required decisive, effective and timeous adjustments in the government support programme to ensure that the English trading fleet remained protected from foreign competition and interference.

¹⁵¹² Ibid.

¹⁵¹³ Ibid 472, 477-94; Davis, above n 1494, 1-2, 6-7; Butcher, above n 38, 2.

¹⁵¹⁴ Davis, above n 1494, 1-2; Butcher, above n 38, 2; See generally Ben Johnson, *The Spanish Armada* (2020) Historic UK < <https://www.historic-uk.com/HistoryUK/HistoryofEngland/Spanish-Armada/>>.

¹⁵¹⁵ Ibid.

¹⁵¹⁶ Burg, above n 1480, 199 [1634-1639]; Oppenheim, above n 1486, 472; Davis, above n 1494, 8; David Mathew, *James I: King of England and Scotland* (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/James-I-king-of-England-and-Scotland>>.

¹⁵¹⁷ Davis, above n 1494, 8-9.

¹⁵¹⁸ Ibid 9.

In 1628, Charles I, who reigned from AD 1625 to 1649, attempted to levy ship writs, albeit more frequently, and as a general revenue-raising exercise that excluded parliamentary input.¹⁵¹⁹ However, the monarchy encountered increasing parliamentary resistance.¹⁵²⁰ To resolve the matter, the English court subsequently held that ‘when the whole kingdom is in danger the king could legally impose such a tax for defense, and that he could be sole judge of when such a danger existed and how to prevent or avoid it.’¹⁵²¹ In November 1640, parliament was, however, reconvened after an extended hiatus, whereafter it passed legislation invalidating the monarchical power to levy taxes as ship writs.¹⁵²² Between 1642 to 1651, the military forces were placed under Parliament’s control during the English Civil Wars.¹⁵²³ Nonetheless, Charles II named the maritime armed forces ‘the Royal Navy.’¹⁵²⁴ Between 1629 to 1637, the merchant fleet continued to expand in size.¹⁵²⁵ However, with the advent of the English Civil War, no further ship surveys were conducted until 1702.¹⁵²⁶

¹⁵¹⁹ Burg, above n 1480, 199 [1634-1639]; Maurice Ashley, *Charles I: king of Great Britain and Ireland* (2020) Encyclopedia Britannica < <https://www.britannica.com/biography/Charles-I-king-of-Great-Britain-and-Ireland> >.

¹⁵²⁰ Burg, above n 1480, 199 [1634-1639]; In 1628 the petition of right was passed by the House of Commons restricting the Monarch’s ability to levy taxes. Charles I, subsequently, assented to the Petition of Right as a private bill, and the House of Lords ordered the printing thereof as assented. However, in attempting to later revoke his former assent, Charles I prorogued Parliament and ordered that the 1500 copies of the Petition of Right be destroyed. Nevertheless, Charles I continued in his quest to source additional revenue for the ostensible purpose of increasing the size of the navy, despite failing to obtain the involvement and approval of Parliament in raising taxes. Therefore, in 1634, Charles I employed the services of a Mr William Noy, a lawyer, who made a public case, for extending the Monarchical power of levying ship writs, to include instances of “anticipated future conflicts”. In support of the argument, Noy referred to past precedent involving the monarch levying the Danegeld and other ship gelds of the Anglo-Saxon era. In line with the legal advice, a first ship writ was raised on 20 October 1634, and a second ship writ was raised on 18 August 1635. The writs were, however, met with increasing opposition. Therefore, the King approached the law courts in February 1636 to decide whether the King possessed the power in English law to levy such taxes: See generally Burg, above n 1480, 199 [1634-1639].

¹⁵²¹ Burg, above n 1480, 200 [1634-1639]. As a result, thereof, Charles proceeded to levy a third ship writ in August 1636, a fourth ship writ in September 1637, a fifth ship writ in 1638, and a sixth ship writ in November 1639: See generally Burg, above n 1480, 200 [1634-1639].

¹⁵²² Ibid; What is more, although parliament was originally summoned to purportedly resolve a tax issue, the session nevertheless persisted thereafter, and culminated in the civil war known as the Great Rebellion. The civil war ultimately resulted in Parliament achieving paramountcy over the monarchy, in the governance of Great Britain, together with the early demise and execution of Charles I: See generally Burg, above n 1480, 200 [1634-1639].

¹⁵²³ Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>.

¹⁵²⁴ Ibid.

¹⁵²⁵ Davis, above n 1494, 11.

¹⁵²⁶ Ibid.

In the late 1640s, with the temporary abolition of the Monarchy, multiple protections were lost for English merchant shipping.¹⁵²⁷ As a result, various inroads were made by foreign merchant vessels.¹⁵²⁸ However, the problem of Dutch shipping competition was solved by restarting the protections for English shipping and by war.¹⁵²⁹ Thus, for example, the Navigation Ordinance of 1651 prohibited foreign vessels' from participating in specific English and colonial trade routes.¹⁵³⁰ Accordingly, this particular decline in the English trading fleet's expansion, corresponding with the removal of State protections by changing governmental administrations, highlights the necessity of providing appropriate State protection that is consistent, stable and reliable.

In the 18th century, the Royal Navy successfully out-competed the French navy to achieve maritime supremacy.¹⁵³¹ Both England and France employed their merchant fleets to support the Anglo-French Wars.¹⁵³² Despite the many wars, at this juncture, the English merchant fleet was in a strong position to support the war efforts as it had significantly expanded during the 18th century.¹⁵³³ Colonial development in the 18th century and the multiple protections enacted for English merchant shipping were crucial factors driving this expansion.¹⁵³⁴ The protections established a monopoly within English colonial trade for the English trading fleet.¹⁵³⁵ Davis speculates that if the French had applied their protectionist measures to their merchant fleet as robustly as the English, this action might have tipped the sea power scales in the French's favour.¹⁵³⁶ This alternate outcome may have significantly changed the trajectory of world

¹⁵²⁷ Ibid.

¹⁵²⁸ Ibid.

¹⁵²⁹ Ibid 12.

¹⁵³⁰ Ibid.

¹⁵³¹ Ibid 377; Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica <<https://www.britannica.com/topic/Royal-Navy>>.

¹⁵³² Davis, above n 1494, 377; Butcher, above n 38, 2.

¹⁵³³ Butcher, above n 38, 2; see also Davis, above n 1494, 39-40, 375.

¹⁵³⁴ Davis, above n 1494, 377-8.

¹⁵³⁵ Ibid 377.

¹⁵³⁶ Ibid 378.

history.¹⁵³⁷ Accordingly, the positive correlation between a successful naval fleet of a State and its merchant fleet constitutes evidence of the merchant fleet's standing as a critical component of a State's sea power.

The Great War with France was also significant for direct taxation, including modern shipping taxes. The British government used the said war to justify introducing a 'short-lived' war income tax.¹⁵³⁸ This tax was the first income tax in Great Britain.¹⁵³⁹

By about the second half of the 19th century, Britain was the primary industrial power on the world stage and enjoyed the largest merchant marine and the most powerful navy globally.¹⁵⁴⁰

In the late 19th and early 20th centuries, the increasing preference by States to enact income and corporate taxes, more broadly, established the foundation for specialised shipping tax regimes

¹⁵³⁷ Ibid 378.

¹⁵³⁸ Stephen Dowell, *A History of Taxation and Taxes in England: From the Earliest Times to the Present Day* (Longmans, 1884) vol 2, book 2, 201-20: Generally, Stephen Dowell records that the Great War proved more costly for Britain than all preceding wars taken together. The Great War references the English war with revolutionary France, as declared by the French against the British on 1st February 1793, including the subsequent Napoleonic Anglo-French war. As a result of the debt that accumulated from the war with France, in December 1798, the then British Prime Minister, William Pitt, proposed a graduated income tax of one – twentieth to one-tenth on incomes over 60 pounds per year. The tax constituted the first income tax in English history. Up to that point in history, the land taxes had merely targeted income in the form of rents. This new tax marked a major shift in the whole approach to direct taxation. Taxes would now generally be levied on income in contrast to focusing largely on consumption. The war income tax bill was passed by the English parliament on 9 January 1799. It has, however, been said that '[d]eep-seated resistance to and resentment of the war income tax nevertheless proved strong and enduring, with many expressing alarm over the commissioner's and surveyor's invasive powers to investigate the perceived subversion of liberties, and the presumed monarchical prying into private affairs'. A criticism that some might say remains true of the very nature of income tax to this day. The war income tax was subsequently repealed, and the British Parliament issued an order that all records of the commissioner be expunged – albeit that the expungement was not as thorough as some might have expected; See generally Encyclopedia Britannica eds, *Napoleonic Wars European history* (2020) Encyclopedia Britannica < <https://www.britannica.com/event/Napoleonic-Wars>>.

¹⁵³⁹ Dowell, above n 1538, 201-20.

¹⁵⁴⁰ Greg Kennedy, 'Maritime Strength and the British Economy, 1840-1850' (1997) 7(2) *The Northern Mariner* 51, 51, 61-2, McMahon, above n 36, 89; See generally Richard Woodman, *A History of the British Merchant Navy: Masters Under God: Makers of Empire, 1817-1884* (Sharpe Books, 2018); See generally Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>: The achievement of supremacy of sea power by the British for the rest of the 19th century, may further be evidenced by the Pax Britannica, which was the long period of relative peace that persisted from the balance of power that was achieved between the major European states, as supported by British sea power.

to be developed thereafter by States like Panama and Greece, and later, the Netherlands.¹⁵⁴¹ Developing States, like Panama and Liberia, would apply an exceptionally efficient shipping tax regime as a critical component of their open ship register system.¹⁵⁴² In the 20th century, open registers would eventually outcompete traditional ship registers generally for merchant tonnage, as will be considered here by studying the British and US registered trading fleets.¹⁵⁴³

4.6 The 20th Century British Merchant Marine

For a significant part of the 20th century, the Royal Navy retained its ranking as the world's most powerful navy.¹⁵⁴⁴ However, after World War II, the Royal Navy was eclipsed by the US Navy, which now occupied the top position globally.¹⁵⁴⁵ During World War II, the British merchant marine similarly played a critical role in supporting the war effort.¹⁵⁴⁶ And for a short period after that, it still enjoyed a post-war dominance.¹⁵⁴⁷ In 1949, the British merchant marine was given the official name of 'Merchant Navy' by King George V to recognise its meritorious

¹⁵⁴¹ Marlow and Mitroussi, above n 70, 195, 198, 200-1; Michail Tegos, 'Greece' in Guglielmo Maisto (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 443; Olaf M Merk, 'Quantifying tax subsidies to shipping' (2020) 22 *Maritime Economics & Logistics* 517, 520; Vlada Zhykharieva, Liudmyla Shyriaieva, and Olga Vlasenko, 'Current Trends of Protectionism In Shipping Industry' (2019) 14(2) *Transport Problems* 91, 95-6; Dowell, above n 1538, 201-20; J S Seidman, Seidman's Legislative History of Federal Income Tax Laws: 1938-1861 (Lawbook Exchange, 2004) 983, 1008; Sheldon D Pollack, 'Origins of the Modern Income Tax, 1894-1913' (2013) 66 (2) *The Tax Lawyer* 295, 297-8, 318-9, 323, 327-8; see generally Bernhard Grossfeld and James D. Bryce, 'A Brief Comparative History of the Origins of the Income Tax in Great Britain, Germany and the United States' (1983) 2 *The American Journal of Tax Policy* 211, 221-223: Income tax was reintroduced into Great Britain in 1842.

1853

¹⁵⁴² Butcher, above n 38, 5; Constantine G Papavizas and Lawrence I Kiern, 'U.S. Maritime Legislative Developments' (2005) 36(3) *Journal of Maritime Law and Commerce* 379, 384; Le T Thuong, 'Flags of Convenience to Captive Ship Registries' (1987) 27(2) *Transportation Journal* 22, 24; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁵⁴³ Butcher, above n 38, 5-8.

¹⁵⁴⁴ Baer, above n 39, 8.

¹⁵⁴⁵ See generally Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>.

¹⁵⁴⁶ See Butcher, above n 38, 2-4; Asteris, above n 35, 67.

¹⁵⁴⁷ Ibid.

contribution to the war effort.¹⁵⁴⁸ The honour may be treated as further evidence of the significant contribution of the merchant fleet to British sea power.

However, from about 1966 and onwards, the UK registered fleet, measured in deadweight tonnage and as a percentage of the global fleet, failed to rank as the largest fleet globally.¹⁵⁴⁹ Further, from about 1975 and onwards, it would experience a sustained post-war decline.¹⁵⁵⁰ In relative terms, Woodman asserts that ‘by 1997 it [had] virtually disappeared.’¹⁵⁵¹ In absolute terms, it is a view that is not necessarily correct.¹⁵⁵² Nonetheless, there appears to be broad agreement that from about the mid-1970s and onwards, the UK’s registered merchant fleet, measured in deadweight tonnage and as a percentage of the global fleet, has overall demonstrated a persisting contraction.¹⁵⁵³

Multiple factors have been cited for its decline.¹⁵⁵⁴ Factors considered in previous works have included causes like the following: globalisation, technological advances, political factors, foreign cabotage rules, decolonisation and the establishment of new competitor States, inadequate government support, inefficient government bureaucracy, changing trade patterns,

¹⁵⁴⁸ Butcher, above n 38, 4, 23.

¹⁵⁴⁹ Ibid; See Table C; ‘The UK fleet was ... in relative decline: between 1948 and 1970 British-owned tonnage as a percentage of world tonnage shrunk from 22.4 per cent to 8.3 per cent.’: Butcher, above n 38, 4.

¹⁵⁵⁰ See especially *1998 DETR Report*, above n 23, 8-9; Alexander, above n 35, 8 [10]; Asteris, above n 35, 67.

¹⁵⁵¹ Woodman, above n 1486, [location 7587, 7614].

¹⁵⁵² Alexander, above n 35, 8; See especially *1998 DETR Report*, above n 23, 4, 9-10; Butcher, above n 38, 4, 23; See generally UNCTAD, *Review of Maritime Transport 1999* (United Nations; 1999) 44; Alexander generally opines that the size of the UK shipping industry as at 1998 is still significant, albeit that the analysis takes a somewhat wider view, by including UK shipowners of foreign registered vessels, as opposed to merely limiting the analysis to the size of the UK registered fleet: Alexander, above n 35, 8; ‘UK DETR in their 1998 report, assert that, ‘[t]he UK shipping industry is the fourth or fifth biggest service-sector exporter for the UK – larger than telecommunications, films and television, or computer services.’: *1998 DETR Report*, above n 23, 4.

¹⁵⁵³ Asteris, above n 35, 67; Butcher, above n 38, 4, 23; See Table C.

¹⁵⁵⁴ Woodman, above n 1486, [location 6102- 7587, 7614]; see generally Thuong, above n 1542, 23; Asteris, above n 35, 67: Other factors identified are: new technologies, shifting trade patterns, protracted recessions resulting in excess capacity and falling freight rates, high operating costs and low returns, the loss in fiscal incentives for firms investing in new vessels, poor management, inflexible labour unions.

the increasing dominance of air-passenger services, the stubbornness of British labour, and fierce competition ostensibly promoted by foreign open ship registers.¹⁵⁵⁵

Nonetheless, it would be incorrect to assume that the British government provided no significant support to its merchant fleet during the post-World War II period, including fiscal support. The decline of the British trading fleet over a specific period, considered as a percentage of the global merchant fleet, initially demonstrates instances where better government support was applied. Better (but still insufficient) government support positively correlates with growth (albeit insufficient to retain its top ranking), stagnation and a more gradual contraction. Thus, in 1975, despite the British trading fleet no longer ranking as the world's largest trading fleet, it had continued to demonstrate growth by totalling about 50 million deadweight tons.¹⁵⁵⁶ However, the fleet's growth halted from about the mid-1970s. It thereafter demonstrated a persistent overall contraction in size, considered as a percentage of the global merchant fleet, which has endured until the end of the 20th century. These trends are demonstrated in Table C below.

The British shipping industry was still protected from foreign market forces during the mid-1970s and up to about 1984, when protections for the industry were significantly reduced.¹⁵⁵⁷

Government support measures from about 1952 to 1984 included generous investment

¹⁵⁵⁵ See especially *1998 DETR Report*, above n 23, 9-10, 12-3, 16, 18, 29; See especially Butcher, above n 38, 3,5, 7-9; Woodman, above n 1486, [location 7587, 7614]; Davis, above n 1494, 377; 'British seafarers were simply too expensive in the face of foreign competition.': at [location 7614]; See generally in respect of the U.S context, Breskin, above n 6, 512-4; Papavizas and Kiern, above n 1542, 384; Thuong, above n 1542, 24; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁵⁵⁶ Asteris, above n 35, 67; Butcher, above n 38, 5, 23; Alexander, above n 35, 8 [10], But see Table C.

¹⁵⁵⁷ Asteris, above n 35, 67, 71; Butcher, above n 38, 4; Marlow and Mitroussi, above n 70, 199; A C Paixao and P B Marlow, 'A review of the European Union shipping policy' (2001) 28(2) *Maritime Policy & Management* 187, 191; Alexander, above n 35, 8 [10], [13]; *1998 DETR Report*, above n 23, 3; See generally Richard B Goode *et al* (eds), *Income tax* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/income-tax/Policy-issues#ref71964> >.

allowances, like a 100% first-year capital allowance.¹⁵⁵⁸ However, in 1984, the 100% allowance's revocation appears to have exacerbated the pace of the decline of the UK registered merchant fleet. Two years after its revocation, tonnage measured as UK directly-owned vessels dropped by 20%.¹⁵⁵⁹ An even sharper decline is demonstrated when UK merchant tonnage is measured as *registered* tonnage.¹⁵⁶⁰ For 1985, UK merchant tonnage measured as registered deadweight tonnage and as a percentage of global tonnage was 3.28% (21 795 / 664 800).¹⁵⁶¹ This measurement demonstrates a sharp fall for 1987 to 1.85% (11 676 / 632 348).¹⁵⁶² Accordingly, in the two years following the 100% capital allowance's revocation, there is roughly a decrease in UK registered merchant tonnage by about 44%.¹⁵⁶³

From about 1984 to 1997, the British government displayed some disinterest in subsidising and protecting its merchant fleet.¹⁵⁶⁴ During this period, market forces were more readily permitted to direct its fate.¹⁵⁶⁵ The British government's lack of enthusiasm might aptly be demonstrated in the industry's treatment as a 'sunset industry' by Margaret Thatcher, the Prime Minister at that time.¹⁵⁶⁶ Yet, despite any such dour forecasts, global tonnage continued to expand, on

¹⁵⁵⁸ Ibid.

¹⁵⁵⁹ Alexander, above n 35, 9 [17], 12 [31]; See Butcher, above n 38, 8.

¹⁵⁶⁰ See Table C; UNCTAD, *Review of Maritime Transport 1985* (United Nations; 1986) [Annex III] 1, 4; UNCTAD, *Review of Maritime Transport 1987* (United Nations; 1988) [Annex III] 81, 83; Figures are rounded-up where appropriate and presented in Thousand Dead-Weight Tonnage).

¹⁵⁶¹ Ibid.

¹⁵⁶² Ibid.

¹⁵⁶³ Ibid.

¹⁵⁶⁴ Woodman, above n 1486, [location 7587, 7614]; Marlow and Mitroussi, above n 70, 199; Asteris, above n 35, 71; *1998 DETR Report*, above n 23, 3; See especially Butcher, above n 38, 6-10; But see Alexander, above n 35, 8 [13], 9 [18]; In 1993, the then Minister of State for Aviation and Shipping, Lord Caithness, expressed such disinterest as follows: 'We are well aware of the shipping industry's concerns about the assistance given by other governments to their international shipping competitors primarily in the form of direct and indirect subsidies. To follow the example set by other nations would lead to an ever-increasing spiral of state aids and market-distorting subsidies which would be detrimental to free trade. That would not be in the best interests of any competitive industry. We shall continue to press hard in the EC and OECD the case for eliminating those practices': Butcher, above n 38, 10.

¹⁵⁶⁵ Woodman, above n 1486, [location 7587, 7614]; Asteris, above n 35, 71; Butcher, above n 38, 7; Papavizas and Kiern, above n 1542, 384; Alexander, above n 35, 9 [18]; Thuong, above n 1542, 24; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁵⁶⁶ Woodman, above n 1486, [location 7587, 7614]; See also Alkis John Corres, 'Greek Maritime Policy and the Discreet Role of Shipowners' Associations' in Athanasios A Pallis (ed), *Maritime Transport: The Greek*

average, as the 20th century was closing.¹⁵⁶⁷ This reduction in government support was also met with retrospective regrets of ‘missed opportunities’ when it was considered that 95% of the UK’s external trade in weight¹⁵⁶⁸ was arriving and leaving by sea by the late 1990s.¹⁵⁶⁹ Conversely, UK registered merchant tonnage continued to decline sharply, and contractions of 85% are roughly demonstrated for 1991, when its 1991 size is compared with its 1975 peak size.¹⁵⁷⁰

In the 20th century, certain UK governments periodically experimented with different government support measures to stabilise and stimulate the UK trading fleet.¹⁵⁷¹ Some measures were more successful and generous than others and included the following: rollover tax relief (introduced in 1994); higher rates of depreciation (25% on a reducing balance basis); a reduction in employer National Insurance Contributions for particular seafarers; providing a part-subsidy for the air-fare of British seafarers (the Crew Relief Costs Scheme introduced in

Paradigm (Elsevier, 2007) vol 21, 221, 233; Cf Alexander, above n 35, 9 [16]; For example, coastal cabotage protection was revoked (allegedly for the benefit of local oil companies), leaving the UK shipping industry to unsuccessfully fend off external market forces: Corres, above n 1566, 233.

¹⁵⁶⁷ Alexander, above n 35, 7 [8]; 1998 *DETR Report*, above n 23, 3, 7; See Table C.

¹⁵⁶⁸ Including 77% in value.

¹⁵⁶⁹ 1998 *DETR Report*, above n 23, 4, 6; Butcher, above n 38, 5-10.

¹⁵⁷⁰ UNCTAD, *Review of Maritime Transport 1991* (United Nations; 1992) 84-7; UNCTAD, *Review of Maritime Transport 1975* (United Nations; 1977) 56-62; See Table C ; But see Asteris, above n 35, 66-7 (where a higher rate of contraction is recorded); Butcher, above n 38, 7; Papavizas and Kiern, above n 1542, 384; Thuong, above n 1542, 24; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; Nonetheless, there is also evidence that, during that same period of contraction, there was some shift towards registers in the UK Crown Dependencies and British Dependent Territories, including Hong Kong, Monsterrat, St Helena, Anguilla, Gibraltar, Turks & Caicos Islands, Bermuda, Cayman Islands, Falkland Islands and British Virgin Islands: Asteris, above n 35, 66.

¹⁵⁷¹ 1998 *DETR Report*, above n 23, 13-4; Butcher, above n 38, 9; Other UK government enquiries/ reports into shipping included: Viscount Rochdale, ‘Committee of Inquiry into Shipping’ (Report, Cmnd 4337, May 1970); Transport Committee, ‘Decline in the UK-registered Merchant Fleet’ (First Report of session 1987-88, Vol III, HC 303, 27 May 1988); ‘Government Observations on the First Report of the Transport Committee session 1987-88’ (Second Special Report of 1987-88, HC 681, 26 October 1988); Department of Transport, ‘British Shipping: Challenges and Opportunities’ (Report by a Joint Working Party, HMSO, September 1990); DETR, ‘A New Deal for Transport: Better for Everyone’ (White paper, Cm 3950, July 1998), ETRA Committee, ‘The Future of the UK Shipping Industry’ (Twelfth report of session 1998-99, HC 172, 26 May 1999): see generally Butcher, above n 38, 4-16; See also the Merchant Shipping Act of 1988 that contained certain focus areas, namely: ship registration, including fishing vessel registration; measures to establish a Merchant Navy Reserve and to assist with the training of seafarers and with the cost of providing relief crews; and measures to improve maritime safety: Butcher, above n 38, 9-10.

1988); wage cost support as a foreign-earnings deduction for seafarers;¹⁵⁷² training support (introduced in 1988 and revised thereafter); and implementing specific deregulatory measures, like relaxing officer nationality regulations (introduced in 1995).¹⁵⁷³

However, the overall and persisting contraction in the registered fleet's size is hard evidence that the later 20th-century support measures were significantly inadequate. Unlike the past monarchs, more modern UK governments have misunderstood the industry's dynamics and worth. Therefore, government policy has failed to arrest the decline in the industry satisfactorily.¹⁵⁷⁴

The UK's fiscal measures of the late 1990s, like roll-over relief and higher depreciation rates, have benefitted some shipping companies, particularly those with larger fleets. Thus, shipping companies that have continued to reinvest in new vessels have demonstrated an effective corporate tax rate of zero or close to zero.¹⁵⁷⁵ Further, the estimated effective tax rate for the industry as a whole in the late 1990s was 1.5%.¹⁵⁷⁶ Therefore, these fiscal measures of the late 20th century could, under certain conditions, deliver generous tax concessions to its beneficiaries.¹⁵⁷⁷ Thus, the issue may be instead whether the support is appropriate for the broader shipowning and ship operating industry and whether it can effectively level the playing fields between local and foreign competitors.¹⁵⁷⁸

¹⁵⁷² See especially Butcher, above n 38, 9, 13.

¹⁵⁷³ Alexander, above n 35, 8 [13], 10 [21], 33; *1998 DETR Report*, above n 23, 13-4; Butcher, above n 38, 9; Marlow and Mitroussi, above n 70, 199.

¹⁵⁷⁴ Alexander, above n 35, 8 [13], 9 [18]; *1998 DETR Report*, above n 23, 13-4; Asteris, above n 35, 71.

¹⁵⁷⁵ Alexander, above n 35, 3, 10 [21] – [24], 13-4 [38]; *1998 DETR Report*, above n 23, 28 [123] – 29 [123]; Asteris, above n 35, 71.

¹⁵⁷⁶ *Ibid.*

¹⁵⁷⁷ *Ibid.*

¹⁵⁷⁸ Alexander, above n 35, 7 [8], 10 [24].

Government support measures like deferred tax liabilities and their particular disadvantages have continued to impede stabilising and growing the UK registered trading fleet.¹⁵⁷⁹ Lord Alexander has described the UK's government support to the shipping industry of the late 1990s as measures 'introduced on an empirical, almost haphazard, basis, apparently without any detailed consideration of whether they were the most cost-effective form of support for the industry.'¹⁵⁸⁰ This observation is in stark contrast with the 14th-century monarchical practice, where effective measures were enacted in consultation with the broader industry.¹⁵⁸¹ Considering the poor results returned by late 20th century UK shipping policy, it might be fair to submit that policymakers have failed to appreciate the unique dynamics of the industry, like its unique mobility and aggressive foreign competition.¹⁵⁸² It might even be argued that the merchant fleet's significance as a component of UK sea power has to some extent been forgotten, in devising UK shipping fiscal policy for the later parts of the 20th century.¹⁵⁸³

Further, the contraction in the British merchant marine's size has naturally also resulted in a corresponding decline in British seafarers (or, more simply put, the availability of British sea jobs and local sea expertise).¹⁵⁸⁴ It has been opined that this reduction in local skills and technical expertise might even be more challenging to resolve in times of emergencies than tonnage shortages.¹⁵⁸⁵

¹⁵⁷⁹ Ibid 3, 9 [18], 13-4 [38]; *1998 DETR Report*, above n 23, 13-4. Roll-over corporate tax relief does not theoretically represent a permanent loss of tax revenue to the State, as the rolled-over balancing charge will reduce the tax relief given (in the form of capital allowances) to the new vessel that is purchased in the place of the old vessel: *1998 DETR Report*, above n 23, 14.

¹⁵⁸⁰ Alexander, above n 35, 14 [39]; *1998 DETR Report*, above n 23, 14; Butcher, above n 38, 7.

¹⁵⁸¹ Ormrod, above n 1489, 209-10; Ormrod, above n 1489, 155-86.

¹⁵⁸² Alexander, above n 35, 3, 7 [8], 9 [18], 13-4 [38]-[39].

¹⁵⁸³ Ibid 14 [39], 16 [49]; Woodman, above n 1486, [location 7587, 7614].

¹⁵⁸⁴ Asteris, above n 35, 67; See also Alexander, above n 35, 8 [11]; See generally *1998 DETR Report*, above n 23, 6, 8, 11-2.

¹⁵⁸⁵ Asteris, above n 35, 67; See also Alexander, above n 35, 9 [16].

In the late 1980s, specific concerns were raised about whether the British merchant marine could still adequately support the armed forces during a national emergency.¹⁵⁸⁶ In August 1990, this concern was tested in Operation GRANBY,¹⁵⁸⁷ concerning the Iraqi invasion of Kuwait.¹⁵⁸⁸ Operation GRANBY should be compared to the 1982 Falklands War. The British armed forces successfully prosecuted the 1982 war by primarily (if not solely) relying on the logistical support of the British merchant marine.¹⁵⁸⁹ In stark contrast, and only nine or so years later, Operation GRANBY was now executed by the British armed forces with almost no British merchant marine participation.¹⁵⁹⁰

The UK's contribution to the Coalition against Iraq logistically required moving about 15 000 vehicles and 40 0000 tonnes of freight from the British Isles (and Europe) to the Gulf.¹⁵⁹¹ About 90 per cent of that consignment was carried by sea on 110 chartered merchant vessels.¹⁵⁹² Only five UK merchant vessels participated in the operation.¹⁵⁹³ Thus, Asteris observes that, for the first time in modern British history, the UK was almost totally dependent on foreign merchant vessels for its sealift requirements in a crisis.¹⁵⁹⁴

However, Asteris concedes that the deficiency in the availability of British trading vessels for this particular mission was not of major concern.¹⁵⁹⁵ The peculiarities of the operation resulted in the availability of sufficient foreign tonnage from the global market to support UK sealift

¹⁵⁸⁶ Asteris, above n 35, 69; See especially Butcher, above n 38, 6-7; see generally Alexander, above n 35, 9 [16]; See generally *1998 DETR Report*, above n 23, 7.

¹⁵⁸⁷ Operation GRANBY was the name given to the British deployment in the Persian Gulf War: Asteris, above n 35, 69.

¹⁵⁸⁸ Asteris, above n 35, 69; Encyclopedia Britannica Eds, *Persian Gulf War* (2020) Encyclopedia Britannica.

¹⁵⁸⁹ Asteris, above n 35, 69; Encyclopedia Britannica Eds, *Falkland Islands War* (2020) Encyclopedia Britannica.

¹⁵⁹⁰ Asteris, above n 35, 69.

¹⁵⁹¹ *Ibid.*

¹⁵⁹² *Ibid.*

¹⁵⁹³ *Ibid.*

¹⁵⁹⁴ *Ibid.*

¹⁵⁹⁵ *Ibid.*

demands.¹⁵⁹⁶ However, it has been submitted that it would be overly optimistic to assume that there will always be sufficient foreign tonnage readily available on the open market to adequately support future missions of the British armed forces.¹⁵⁹⁷ The Defence Committee of the House of Commons after Operation GRANBY made the following grim observations about the British merchant marine's ability to provide adequate support for similar operations:

If there had been insufficient non-UK ships, ..., or if the governments concerned had been unwilling to have their ships used in such an operation, the UK would in practice have had difficulties in mounting the sealift without them, using only the resources of the UK merchant fleet.¹⁵⁹⁸

Out of an assortment of factors cited for the British trading fleet's stubborn decline,¹⁵⁹⁹ the preference of shipowners to utilise foreign ship registers, like open registers (considered in chapter three), has received increasing attention for driving the 20th-century contraction in UK tonnage.¹⁶⁰⁰ The British ship register's underperformance has been attributed, in part, to higher costs and other bureaucracy that has deterred shipowners from utilising the local ship register; this feature has, significantly, favoured cheaper and more business-friendlier foreign alternatives.¹⁶⁰¹ Higher costs have, particularly, materialised in higher crewing costs and higher taxes compared to the equivalents suffered at open registers in foreign jurisdictions.¹⁶⁰² Thus,

¹⁵⁹⁶ Ibid; The peculiarities colouring the particular operation included, firstly, an abnormal amount of time to execute the sealift, about 6 months, and secondly, other States not politically obstructing the availability of foreign vessels on the open market, generally, as the conflict had the approval of the United Nations: Asteris, above n 35, 69.

¹⁵⁹⁷ Asteris, above n 35, 69.

¹⁵⁹⁸ Ibid.

¹⁵⁹⁹ Ibid 67; *1998 DETR Report*, above n 23, 12-3, 16, 28-9; see generally Woodman, above n 1486, [location 7587, 7614].

¹⁶⁰⁰ Asteris, above n 35, 67; See especially Butcher, above n 38, 5; see generally Papavizas and Kiern, above n 1542, 384; see generally Thuong, above n 1542, 23-4; see generally Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; see especially *1998 DETR Report*, above n 23, 13, 28-9; Alexander, above n 35, 3, 5, 7 [8], 9 [18], 11 [25]- [26], 13-4 [38]; See Table C.

¹⁶⁰¹ Asteris, above n 35, 67; See especially Butcher, above n 38, 5-8; *1998 DETR Report*, above n 23, 9-10, 13, 18, 28-9; Alexander, above n 35, 7 [8], 9 [18], 11 [26], 13-4 [38]. Greater bureaucracy may increase administrative and compliance costs and, in turn, decrease simplicity as benchmarked.

¹⁶⁰² Ibid; Panagiotou and Thanopoulou, above n 43, 7.

a significant deficiency of the British register, here, was its failure to adequately promote efficiency and simplicity as benchmarked.

In 2000, after consulting with various role-players, including the shipping industry, the British government introduced a tonnage taxation closely based on the Dutch model as an alternative to normal corporate taxation.¹⁶⁰³ The underlying purpose of the tonnage tax was to make the domestic register more appealing and support more broadly the reduction of costs better, and in the process, create a more level playing field between the British shipping industry and its foreign counterparts.¹⁶⁰⁴

4.7 American Sea Power and The US Merchant Marine

4.7.1 The Period Spanning from 1776 to 1914

4.7.1.1 Post-Independence Expansion

In 1776, after US independence, Congress passed a 1792 law defining the US merchant fleet by reserving the US flag for US-built vessels owned by US citizens.¹⁶⁰⁵ Congress almost immediately began providing government support to its trading fleet.¹⁶⁰⁶ In 1789, one of its first measures was to provide for a 10 percent reduction in tariffs on imported goods carried by US merchant vessels.¹⁶⁰⁷ This government support was essential for facilitating the

¹⁶⁰³ Marlow and Mitroussi, above n 70, 200; Butcher, above n 38, 14; Alexander, above n 35, 3, 5, 11 [25], 13-4 [38] – [9]; *1998 DETR Report*, above n 23, 13, 28-9.

¹⁶⁰⁴ Marlow and Mitroussi, above n 70, 201; Alexander, above n 35, 3, 7 [8], 9 [18], 11 [26], 13-4 [38]; *1998 DETR Report*, above n 23, 13, 28-9.

¹⁶⁰⁵ Federal Maritime Commission, *Virgin Islands Trade Study: An Economic Analysis* (1979) VIII-2; Subsequent legislation furthering cabotage rules include the 1920 Act: see generally Morse, above n 58, 60. Encyclopedia Britannica Eds, *Declaration of Independence: United States history* (2020) Encyclopedia Britannica <<https://www.britannica.com/topic/Declaration-of-Independence>>.

¹⁶⁰⁶ McMahan, above n 36, 88; Madigan, above n 1112, 4.

¹⁶⁰⁷ *Ibid*; (the first US Congress).

expansion of the American trading fleet.¹⁶⁰⁸ In 1789, when support was first provided, US merchant vessels carried only 23% of the US's international trade.¹⁶⁰⁹ However, by 1800, eleven years after introducing support, that figure had remarkably increased to 89%, demonstrating an increase of 66% of US trade that was now transported on US trading vessels.¹⁶¹⁰ During this era, government support was also fiscally provided through mail subsidies.¹⁶¹¹ A mail subsidy was an additional payment provided for carrying US mail.¹⁶¹²

Apart from fiscal support, other measures applied as part of the US government support programme included cabotage laws.¹⁶¹³ In 1780, Congress passed a law generally prescribing that only US-built vessels would receive federal licenses for transporting goods on US coastwise trade routes.¹⁶¹⁴ Other legislation enacted by Congress in 1808 and 1817 effectively banned foreign-flagged vessels from operating on US domestic trade routes.¹⁶¹⁵ Thus, like the English approach, the US government support programme from early on applied a creative mix of measures to support its trading fleet.

However, similar to the British trading fleet's experience, Madigan opines that multiple factors supported the post-US independence growth of the American trading fleet.¹⁶¹⁶ Madigan references diverse factors like accelerated immigration, the discovery of gold,¹⁶¹⁷ and an increase in US exports.¹⁶¹⁸ McMahon similarly acknowledges that the American merchant fleet's expansion in size during this pre-Civil War era was facilitated by other

¹⁶⁰⁸ McMahon, above n 36, 88.

¹⁶⁰⁹ Ibid 88-9; Madigan, above n 1112, 2.

¹⁶¹⁰ Ibid.

¹⁶¹¹ Madigan, above n 1112, 2, 4; McMahon, above n 36, 91.

¹⁶¹² Ibid 4.

¹⁶¹³ Ibid; McMahon, above n 36, 88, 90-1.

¹⁶¹⁴ Federal Maritime Commission, above n 1605, VIII-2.

¹⁶¹⁵ Ibid; McMahon, above n 36, 88-9; Madigan, above n 1112, 4.

¹⁶¹⁶ Madigan, above n 1112, 2.

¹⁶¹⁷ See also McMahon, above n 36, 90; 'The 1840s Gold Rush to California was essentially a maritime event: only a tiny percentage of "forty-niners" travelled west by wagon train': at 90.

¹⁶¹⁸ Madigan, above n 1112, 2.

factors, besides government support, like less foreign competition and inferior land-transport alternatives.¹⁶¹⁹ Likewise, employing wood in constructing US merchant vessels contributed to the American trading fleet's growth.¹⁶²⁰ It was a raw material that was in abundance and less expensive to obtain than materials like iron.¹⁶²¹

Nonetheless, despite multiple factors at play, the American merchant fleet's expansion, like the British trading fleet's development, did not happen spontaneously and without appropriately calibrated government intervention.¹⁶²² Thus, higher tariff duties on foreign vessels carrying US trade and mail subsidy payments were the fiscal components of that US government support programme appropriate in that period to complement the other factors.¹⁶²³ These measures were retained in one form or another (perhaps inflexibly and inappropriately) until the *Merchant Marine Act of 1920*. (The latter statute is commonly known as the *Jones Act*).¹⁶²⁴

However, a successful programme does not necessarily mean that it was perfectly implemented.¹⁶²⁵ For example, there were several scandals associated with the mail subsidy payments.¹⁶²⁶ Nonetheless, they were sufficiently implemented in that period to adequately meet the US trading fleet's expansion demands.

¹⁶¹⁹ McMahon, above n 36, 89-90. 'Roads were poor or non-existent, and railroads were few and far between. People mostly traded and travelled by sea or on inland waterways.': at 90.

¹⁶²⁰ Ibid; See generally Peter Goodwin, 'The Influence of Iron on Ship Construction: 1660 to 1830' (Paper presented at Third International Conference on the Technical Aspects of the Preservation of Historic Vessels, San Francisco, 20-23 April 1997).

¹⁶²¹ Ibid.

¹⁶²² Ibid; McMahon, above n 36, 91; Oppenheim, above n 1486, 471-2.

¹⁶²³ Madigan, above n 1112, 4; McMahon, above n 36, 91.

¹⁶²⁴ Ibid.

¹⁶²⁵ McMahon, above n 36, 91.

¹⁶²⁶ Ibid.

4.7.1.2 The Post-Civil War Period

With the waging of the American Civil War between 1861 to 1865 and the increasing passivity of the US government towards its registered trading fleet, the American trading fleet experienced a contraction in size for reasons, including the destruction of vessels and their reflagging.¹⁶²⁷ The trading fleet's stubborn decline continued after the war and persisted until the outbreak of World War I.¹⁶²⁸

Factors contributing to the US trading fleet's extended lack of growth included factors like: the progressive dominance of steam propulsion and building materials like iron¹⁶²⁹ and steel, highlighting the increasing obsolescence of the US registered trading fleet;¹⁶³⁰ the favouring of alternate transport like developing the US railways to the disadvantage of the trading fleet; misguided government policy requiring US shipowners to purchase vessels from local firms despite their builds becoming increasingly outdated; and¹⁶³¹ strong foreign competition from the British trading fleet.¹⁶³² Thus, not all factors driving its decline are easily dispensed on grounds like limited resources and war consequences.¹⁶³³ Inefficient and rigid government policy may also be cited as factors. An example of the latter includes treating shipowners as traitors that had reflagged their vessels during the American Civil War to protect them from

¹⁶²⁷ Ibid 2; But see, McMahon, above n 36, 89 who submits that the decline had already started in the 1850's; Warren W Hassler et al (eds), *American Civil War* (2020) Encyclopedia Britannica <<https://www.britannica.com/event/American-Civil-War>>; Because of the Confederate States sinking Union commercial ships, northern shipowners wanted protection for their ships from the Union Navy, but the federal government failed to assist them. Therefore, many owners reflagged their vessels to neutral States to protect them: McMahon, above n 36, 89.

¹⁶²⁸ McMahon, above n 36, 89; Madigan, above n 1112, 2.

¹⁶²⁹ See generally Goodwin, above n 1620.

¹⁶³⁰ Many vessels were in poor condition too because of the damage sustained from the Civil War: McMahon, above n 36, 90.

¹⁶³¹ US shipowners wanted authorisation to buy foreign steamships as the US shipbuilding industry was still building wooden ships; the latter strongly opposed the request, so it failed politically. Many American shipowners subsequently went bust: McMahon, above n 36, 89.

¹⁶³² Madigan, above n 1112, 2; McMahon, above n 36, 89; Baer, above n 39, 7-8; Baer notes that there was no real government interest in the US to stimulate its trading fleet: Baer, above n 39, 8; McMahon submits that by the 1860s, the era of wooden sailing vessels had already past: McMahon, above n 36, 89.

¹⁶³³ McMahon, above n 36, 90.

damage, and in so doing, preventing them from re-registering their vessels as US trading ships.¹⁶³⁴

4.7.1.3 Early Shipping Taxes?

The US federal government derived its tax revenue mainly from tariffs during this period.¹⁶³⁵

Thus, the 20th and 21st-century shipping tax regimes were not required for this pre-income tax era.¹⁶³⁶

In 1862, the first US income tax was levied under the Lincoln administration to discharge the debt incurred from the Civil War.¹⁶³⁷ This particular income tax was generally restricted to individuals and expired in 1872.¹⁶³⁸ In 1894, a further US income tax was enacted and extended to cover corporations broadly.¹⁶³⁹ However, in 1895, in the case of *Pollock v Farmer's Loan & Trust Company*, the US Supreme Court invalidated this latter income tax on constitutional grounds.¹⁶⁴⁰ Yet, in 1909 and 1913, corporate and personal income taxes were re-enacted, and the US Constitution was amended to authorise their application.¹⁶⁴¹ After these enactments, income taxes became a permanent feature of the US federal tax system.¹⁶⁴²

¹⁶³⁴ Ibid.

¹⁶³⁵ Pollack (2013), above n 1541, 297-8, 306, 309-10, 315; '[the tariff being] a collection of duties ... imposed on imported goods and products.': at 297.

¹⁶³⁶ Papavizas and Kiern, above n 1542, 384; Thuong, above n 1542, 24; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁶³⁷ Seidman, above n 1541, 1036-43; Sheldon D. Pollack, 'The First National Income Tax, 1861-1872' (2014) 67(2) *The Tax Lawyer* 1, 11-12; Pollack (2013), above n 1541, 295, 306, 316, 319; IRS, *Historical Highlights of the IRS* (28 Feb 2020) <<https://www.irs.gov/newsroom/historical-highlights-of-the-irs>>; Kimberly Amadeo, *U.S. Corporate Income Tax Rate, Its History, and the Effective Rate* (31 Aug 2020) the balance <<https://www.thebalance.com/corporate-income-tax-definition-history-effective-rate-3306024>>; Amy Fontinelle, *A Brief History of Taxes in the U.S.* (2 Apr 2020) <<https://www.investopedia.com/articles/tax/10/history-taxes.asp#citation-2>>; Mike Patton, *A Brief History Of The Individual And Corporate Income Tax* (31 Oct 2015) Forbes <<https://www.forbes.com/sites/mikepatton/2015/10/31/a-brief-history-of-the-individual-and-corporate-income-tax/?sh=5d84a00a66b5>>; Ellen Terrell, *History of the US Income Tax* (2012) The Library of Congress <https://www.loc.gov/rr/business/hottopic/irs_history.html>.

¹⁶³⁸ Pollack (2013), above n 1541, 297.

¹⁶³⁹ Seidman, above n 1541, 1019; Pollack (2013), above n 1541, 306.

¹⁶⁴⁰ Pollack (2013), above n 1541, 307.

¹⁶⁴¹ Seidman, above n 1541, 983, 1008; Pollack (2013), above n 1541, 318-9, 323, 327-8.

¹⁶⁴² Ibid.

4.7.1.4 A Stubborn Post-Civil War Decline

After the American Civil War, 32.2% of US international trade was still carried on American merchant vessels.¹⁶⁴³ However, by 1900, this figure had more than halved; only 14% of American imports and exports were now carried by US merchant vessels.¹⁶⁴⁴ This downward trend continued; by 1910, this figure was now only 10%.¹⁶⁴⁵ In 1912, Congress tried to arrest the decline of the American trading fleet by promoting the maritime industry.¹⁶⁴⁶ Nonetheless, the contraction persisted, and so by 1914, only 8 % of US imports and exports were now carried on US vessels.¹⁶⁴⁷

The American trading fleet's decline may, in part, be attributed to political apathy and inadequate or counterproductive government policies¹⁶⁴⁸ in regulating and supporting it.¹⁶⁴⁹

McMahon describes this political apathy in the following words:

Nothing worked, because the political will in Washington did not exist to support a U.S. ... merchant marine, and the American public at large perceived no particular value in [such a] ... fleet.¹⁶⁵⁰

4.7.1.5 Advancing Sea Power Less Optimally

The US government's indifference towards its trading fleet should be contrasted with its treatment of its naval fleet.¹⁶⁵¹ Between 1815 and 1861, the US Naval fleet achieved an increasing global presence¹⁶⁵² in small squadrons of gunboats and cruisers deployed in foreign

¹⁶⁴³ McMahon, above n 36, 90.

¹⁶⁴⁴ Baer, above n 39, 8.

¹⁶⁴⁵ Madigan, above n 1112, 2.

¹⁶⁴⁶ Ibid.

¹⁶⁴⁷ McMahon, above n 36, 90.

¹⁶⁴⁸ McMahon opines that competing political interests in the post-Civil War years caused many government programmes that were still in place for stimulating the industry to fail: McMahon, above n 36, 90.

¹⁶⁴⁹ Baer, above n 39, 8; McMahon, above n 36, 89-90; Madigan, above n 1112, 2, 4.

¹⁶⁵⁰ McMahon, above n 36, 90.

¹⁶⁵¹ Baer, above n 39, 8.

¹⁶⁵² Baer, above n 39, 8.

ports to protect American trade and citizens.¹⁶⁵³ In 1883, the US Navy entered a revival that included building new steel cruisers and managing its obsolescent wooden fleet.¹⁶⁵⁴ However, Friedman opines that at this point, ‘[t]his revival was clearly a limited effort; the Navy was anything but the focus of national policy.’¹⁶⁵⁵ Nonetheless, by 1890, the US Secretary of the Navy, Benjamin Tracy, advanced its expansion by calling for an offensive battle strategy.¹⁶⁵⁶ The US Congress, in that year, enacted legislation authorising the construction of three first-line battleships.¹⁶⁵⁷ Mahan opined that the world was entering a new sea period characterised by concentrated battlefleets.¹⁶⁵⁸ Thus, the US government advanced American sea power by developing its Navy. However, it simultaneously failed to expand its registered trading fleet adequately. Therefore, its sea power demonstrated critical deficiencies.

4.7.1.6 The 1898 Spanish-American War

The Spanish-American War of 1898 is a good example of US sea power that was critically deficient.¹⁶⁵⁹ Whilst, at this point, the US Navy enjoyed several modern warships, a severe shortage of domestic sealift was experienced.¹⁶⁶⁰ Thus, it was necessary to charter-in and purchase foreign merchant vessels to resupply the naval vessels, causing long delays in the military operations.¹⁶⁶¹ Nonetheless, the ultimate success of the US Naval operation in the Spanish-American War may be treated as validating Mahan's conception of sea power.¹⁶⁶²

¹⁶⁵³ Ibid; Encyclopedia Britannica Eds, *The United States Navy* (2019) Encyclopedia Britannica < <https://www.britannica.com/topic/The-United-States-Navy>>; See generally C I Hamilton, ‘Naval Power and Diplomacy in the Nineteenth Century’ (1980) 3(1) *Journal of Strategic Studies* 77 < <https://www.tandfonline.com/doi/abs/10.1080/01402398008437037>>.

¹⁶⁵⁴ Friedman, above n 1449, 21, 24; Encyclopedia Britannica Eds, *The United States Navy* (2019) Encyclopedia Britannica < <https://www.britannica.com/topic/The-United-States-Navy>>.

¹⁶⁵⁵ Ibid.

¹⁶⁵⁶ Baer, above n 39, 6.

¹⁶⁵⁷ Ibid.

¹⁶⁵⁸ Ibid 6-7.

¹⁶⁵⁹ Madigan, above n 1112, 2; Baer, above n 39, 10.

¹⁶⁶⁰ McMahan, above n 36, 91-2.

¹⁶⁶¹ McMahan, above n 36, 91-2.

¹⁶⁶² Baer, above n 39, 10.

Specific factors played to the advantage of the US in this particular operation, which cannot be ignored when assessing its sea power, like foreign merchant tonnage availability and the Spanish fleet's deficiencies.¹⁶⁶³ Thus, the Spanish-American War highlighted American sea power vulnerabilities stemming from deficiencies with its registered trading fleet.¹⁶⁶⁴ Thus, Mahan was proved correct by asserting that a State's sea power must be conceptualised to directly include its merchant trading fleet.¹⁶⁶⁵ This theory of sea power would again be validated in the events surrounding the Anglo Boer War.¹⁶⁶⁶

4.7.1.7 The Anglo-Boer War

Between 1899 and 1902, the Anglo-Boer War was waged in South Africa.¹⁶⁶⁷ As a result, to bolster its war effort, the British government requisitioned its merchant vessels carrying American international trade.¹⁶⁶⁸ This requisitioning caused US goods to be stranded on docks in American ports.¹⁶⁶⁹ Freight rates for American trade increased sharply.¹⁶⁷⁰ Thus, the unexpected shortages in foreign merchant tonnage critically disadvantaged the US economy.¹⁶⁷¹ A sufficiently sized American trading fleet may have prevented this situation from arising.

¹⁶⁶³ McMahan, above n 36, 92.

¹⁶⁶⁴ Ibid.

¹⁶⁶⁵ Ibid 91-2.

¹⁶⁶⁶ Ibid 92.

¹⁶⁶⁷ Ibid.

¹⁶⁶⁸ Encyclopedia Britannica Eds, *South African War: British-South African history* (2019) Encyclopedia Britannica < <https://www.britannica.com/event/South-African-War>>; McMahan, above n 36, 92.

¹⁶⁶⁹ McMahan, above n 36, 92.

¹⁶⁷⁰ Ibid.

¹⁶⁷¹ Ibid.

On the other hand, by 1900, the US naval fleet had significantly increased in size and was now recorded in *Jane's Fighting Ships*¹⁶⁷² as the second most powerful navy globally.¹⁶⁷³ However, despite achieving such a favourable listing, the undersized US merchant fleet continued to limit the US Navy's operational reach.¹⁶⁷⁴ Thus, a more accurate assessment of American sea power would consider its naval and trading fleets.¹⁶⁷⁵ In contrast, Britain possessed the largest naval and trading fleets at that point.¹⁶⁷⁶ Therefore, Britain substantively occupied the top position globally in sea power.¹⁶⁷⁷

4.7.2 The Period Spanning from 1914 to 1945

4.7.2.1 World War I

Political-will endured for advancing the US naval fleet.¹⁶⁷⁸ By 1915, the issue for Congress was no longer whether to approve ships¹⁶⁷⁹ but rather how many new vessels to approve.¹⁶⁸⁰ US foreign trade continued to expand in the period leading up to World War I; however, the less expensive sea carriage offered by foreign merchant vessels was preferred by American businesses.¹⁶⁸¹ In 1914, with the outbreak of World War I, European governments withdrew their merchant vessels from servicing US international sea routes.¹⁶⁸² As 90% of American

¹⁶⁷² See generally Louis H. Bolander, 'Jane's Fighting Ship' (1948) 74(549) *United States Naval Institute Proceedings* 1384 < <https://www.usni.org/magazines/proceedings/1948/november>>; 'The first edition of *Jane's All the World's Fighting Ships* was published in England by the firm of Sampson, Low, Marston & Company in November 1897. And every year from that date to the present..., the public has had an opportunity to obtain the very latest information on the tonnage, ..., and other details ... of the navies of the world. To say, "I saw it in *Jane's*," is almost equivalent to saying that the subject matter in hand is beyond argument.': at 1384-5.

¹⁶⁷³ Friedman, above n 1449, 21.

¹⁶⁷⁴ McMahan, above n 36, 92.

¹⁶⁷⁵ Ibid.

¹⁶⁷⁶ Baer, above n 39, 8; McMahan, above n 36, 89; See generally Encyclopedia Britannica Eds, *Royal Navy: British naval force* (2020) Encyclopedia Britannica < <https://www.britannica.com/topic/Royal-Navy>>.

¹⁶⁷⁷ Ibid.

¹⁶⁷⁸ Baer, above n 39, 11-2; Westermeyer, above n 38, 18-9; Friedman, above n 1449, 26-32; Encyclopedia Britannica Eds, *The United States Navy* (2019) Encyclopedia Britannica < <https://www.britannica.com/topic/The-United-States-Navy>>.

¹⁶⁷⁹ Capital ship refers to a navy's larger warships: Friedman, above n 1449, 21.

¹⁶⁸⁰ Friedman, above n 1449, 21.

¹⁶⁸¹ McMahan, above n 36, 92.

¹⁶⁸² Madigan, above n 1112, 2; McMahan, above n 36, 92.

international trade was carried on foreign-flagged vessels, this withdrawal caused significant disruption to the US economy.¹⁶⁸³ These events re-emphasised the necessity of maintaining an adequately sized American trading fleet.¹⁶⁸⁴

During the Great War, the US navy's primary task, with the support of the British, was carrying two million US soldiers safely to another continent.¹⁶⁸⁵ If one was available, this job might have been left to a sufficiently sized American registered trading fleet, thus freeing the naval fleet to pursue other strategic objectives.¹⁶⁸⁶ British support was available as they continued to enjoy the largest naval and merchant fleets globally at this time.¹⁶⁸⁷ Thus, the US naval fleet operated primarily as a transport service during World War I by practising defensive sea control measures of convoy and mining.¹⁶⁸⁸

4.7.2.2 The 1916 Stimulus Package

Under the administration of US President Woodrow Wilson, Congress passed the *Shipping Act of 1916*.¹⁶⁸⁹ The Wilson administration grasped the necessity of developing both merchant and naval fleets to leverage US seapower.¹⁶⁹⁰ Morse describes the *Shipping Act of 1916* as “the first comprehensive US program” to stimulate the US merchant shipping industry.¹⁶⁹¹ The statute had the effect of revoking the previous mail subsidies and establishing a Shipping Board to directly support the development of the US merchant marine.¹⁶⁹²

¹⁶⁸³ Ibid.

¹⁶⁸⁴ McMahon, above n 36, 92.

¹⁶⁸⁵ Baer, above n 39, 13; Westermeyer, above n 38, 18-9.

¹⁶⁸⁶ Asteris, above n 35, 69.

¹⁶⁸⁷ Westermeyer, above n 38, 19.

¹⁶⁸⁸ Baer, above n 39, 13.

¹⁶⁸⁹ Madigan, above n 1112, 2; McMahon, above n 36, 93; Encyclopedia Britannica Eds, *Woodrow Wilson* (2020) Encyclopedia Britannica < <https://www.britannica.com/facts/Woodrow-Wilson>>.

¹⁶⁹⁰ Baer, above n 39, 13; Friedman, above n 1449, 22; Morse, above n 58, 57.

¹⁶⁹¹ Morse, above n 58, 57.

¹⁶⁹² Madigan, above n 1112, 3; McMahon, above n 36, 93.

The statute imposed measures on merchant shipowners like limiting contractual freedom to transfer ownership and control of vessels to foreign purchasers and re-flag them offshore.¹⁶⁹³ By the time the Board was established, it was apparent that the US would be participating in World War I.¹⁶⁹⁴ The Board, therefore, exercised its powers in preparation for war.¹⁶⁹⁵ The Shipping Board was given broad powers¹⁶⁹⁶ in consultation with the American President to source a merchant fleet for the requirements of US commerce and for adequately supporting the State's military arm.¹⁶⁹⁷ Sourcing of vessels included obtaining them by construction, purchase or chartering-in, with powers to make necessary repairs and improvements where required.¹⁶⁹⁸

In October 1917, the board requisitioned the entire US merchant marine.¹⁶⁹⁹ Under the Board's leadership, an Emergency Fleet Corporation was created in that same year to oversee a vast shipbuilding programme.¹⁷⁰⁰ More than three billion dollars was appropriated for ship construction.¹⁷⁰¹ The Board arranged for over 1700 merchant ships to be constructed.¹⁷⁰² The scheme was ostensibly successful.¹⁷⁰³ The size of the US merchant marine was increased to over 15 600 000 gross tons.¹⁷⁰⁴ The US trading fleet was now ranked second globally and was now only outsized by the British merchant marine.¹⁷⁰⁵

¹⁶⁹³ Morse, above n 58, 58-9.

¹⁶⁹⁴ McMahon, above n 36, 93.

¹⁶⁹⁵ *Ibid.*

¹⁶⁹⁶ Including, powers to, generally, sell vessels acquired by it to US citizens, and even to indirectly operate such vessels through a corporation: See generally Morse, above n 58, 57-8.

¹⁶⁹⁷ Madigan, above n 1112, 3; Morse, above n 58, 57.

¹⁶⁹⁸ *Ibid.*

¹⁶⁹⁹ McMahon, above n 36, 93.

¹⁷⁰⁰ *Ibid.*

¹⁷⁰¹ *Ibid.*

¹⁷⁰² *Ibid.*

¹⁷⁰³ Madigan, above n 1112, 3.

¹⁷⁰⁴ *Ibid.*

¹⁷⁰⁵ *Ibid.*; But see, McMahon, above n 36, 93.

In championing the expansion of American sea power globally, the Wilson administration proposed the *Naval Bill of 1916*.¹⁷⁰⁶ Wilson became a key advocate for promoting the American naval fleet.¹⁷⁰⁷ Wilson's objectives may in part be established from his words when he said, in reference to Great Britain, '[l]et us build a bigger Navy than hers and do what we please!'¹⁷⁰⁸

American participation in the Great War was, however, short-lived, and only 107 merchant vessels were delivered before the armistice in November 1918.¹⁷⁰⁹ The remaining ships on order were built by about 1922, and some American shipowners bought them at discounted prices.¹⁷¹⁰ Madigan opines that mass hysteria replaced an orderly merchant shipbuilding process with the US entering World War I.¹⁷¹¹ Thus, the post-war effect was a large American trading fleet with defective and deficient vessels.¹⁷¹²

4.7.2.3 The 1920 Stimulus Package

Despite the US government revising its stimulus measures,¹⁷¹³ several factors in this post-war climate continued to drive the American trading fleet's decline, including the residual consequences of the war shipbuilding programme, foreign competition, and a struggling domestic shipbuilding industry.¹⁷¹⁴

¹⁷⁰⁶ Baer, above n 39, 13; Friedman, above n 1449, 22.

¹⁷⁰⁷ Ibid.

¹⁷⁰⁸ Ibid.

¹⁷⁰⁹ McMahan, above n 36, 93.

¹⁷¹⁰ Ibid; Madigan, above n 1112, 5.

¹⁷¹¹ Madigan, above n 1112, 3.

¹⁷¹² Ibid.

¹⁷¹³ Re: the *Merchant Marine Act of 1920* and *The Merchant Marine Act of 1928*.

¹⁷¹⁴ Madigan, above n 1112, 3; See generally McMahan, above n 36, 93.

The *Merchant Marine Act of 1920* ('1920 Act') offered American registered trading vessels revised support.¹⁷¹⁵ Section 24 of the *1920 Act* provided that 'all mails of the United States shipped or carried on vessels shall, if practicable, be shipped or carried on American-built vessels documented under the laws of the United States.'¹⁷¹⁶ Additionally, cabotage rules were enacted under the 1920 programme for domestic sea routes.¹⁷¹⁷ Section 11 of the *1920 Act* created a construction loan fund over five years¹⁷¹⁸ set at a maximum of \$ 125 000 000 to support the construction of new vessels.¹⁷¹⁹ A limited tax exemption on the income of certain funds deposited in a special construction fund was also made available.¹⁷²⁰ However, despite all these measures, it appears that not a single vessel was built for seagoing carriage between 1922 to 1928.¹⁷²¹

The development of the British merchant marine demonstrates that successful government support is sensitive to the industry's needs and calibrated appropriately.¹⁷²² It must be willing to promote a Positive Anti-Neutrality vigorously where necessary.¹⁷²³ Appropriate calibration is underpinned by sustainability (as benchmarked) and requires ongoing flexibility by adjusting

¹⁷¹⁵ Madigan, above n 1112, 5; See also Morse, above n 58, 59; The statute might be said to have two broad purposes. (1) 'To sell, to American citizens if possible, the large fleet of World-War-I-built merchant ships then in the hands of the Government.' (2) 'To develop and maintain a sufficient American merchant marine "ultimately to be owned and operated privately by citizens of the United States.': at 59.

¹⁷¹⁶ Morse, above n 58, 60.

¹⁷¹⁷ Morse, above n 58, 61; The enactment 'generally [prohibited] the transportation by water of merchandise between points in the United States, its districts, territories, and possessions in any vessel other than one built in and documented under the laws of the United States and owned by persons who are American citizens. A similar provision prohibits the transportation of passengers between ports or places in the United States in a foreign vessel.': at 61.

¹⁷¹⁸ From income generally earned from selling and operating vessels.: Morse, above n 58, 60.

¹⁷¹⁹ Madigan, above n 1112, 5; Morse, above n 58, 60.

¹⁷²⁰ *Ibid.*

¹⁷²¹ Madigan, above n 1112, 5.

¹⁷²² Oppenheim, above n 1486, 471-2; Davis, above n 1494, 8-9; Alexander, above n 35, 14 [39]; *1998 DETR Report*, above n 23, 14; Butcher, above n 38, 7.

¹⁷²³ *Ibid.*; *The Mirrlees Review*, above n 17, 22-3, 39-44; Cobb, above n 17, 646; Dwyer, above n 2, 767; *Asprey Review*, above n 34, [3.25], [3.26].

support as circumstances change¹⁷²⁴. Stability as a component of certainty requires consistency with key policy objectives.¹⁷²⁵

Measures that may have been optimal for conditions in earlier periods may not necessarily work in later periods where different conditions prevail. For example, foreign competition after US independence was not necessarily a critical concern; this, however, changed in later periods.¹⁷²⁶ Therefore, appropriate government support requires a measure of flexibility and innovative adaptability. US support packages also appeared to retain or reintroduce measures from earlier periods, like mail subsidies, that were not necessarily the best option for conditions in later periods.¹⁷²⁷ Positive Anti-Neutrality was also applied less vigorously overall in designing taxes.¹⁷²⁸ Policy stability was also an issue as different US administrations failed to apply similar key objectives in addressing US sea power.¹⁷²⁹

4.7.2.4 The Rise of the Open Ship Registers

In the 20th century, open registers would, progressively, become slick competitors for traditional ship registers and out-compete them for merchant tonnage.¹⁷³⁰ In 1919, a small Canadian vessel named ‘the Belen Quezada’ (partly under US ownership and involved with carrying rum) was one of the first vessels to be re-flagged to the Panamanian register in a scheme devised to circumvent the American prohibition laws.¹⁷³¹ Therefore, as a more easily

¹⁷²⁴ *The Henry Review*, above n 89, 17.

¹⁷²⁵ *The Mirrlees Review*, above n 17, 44.

¹⁷²⁶ McMahan, above n 36, 89-90, 93; Madigan, above n 1112, 3.

¹⁷²⁷ Madigan, above n 1112, 2, 4, 5; McMahan, above n 36, 91, 93; See also Morse, above n 58, 61.

¹⁷²⁸ Madigan, above n 1112, 5; Morse, above n 58, 60.

¹⁷²⁹ Baer, above n 39, 13, 15-8; Friedman, above n 1449, 22; Westermeyer, above n 38, 19.

¹⁷³⁰ McMahan, above n 36, 95; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13; *OECD Consolidated Application Note*, above n 2, 80; Rogers, above n 764, 19.

¹⁷³¹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13; Rogers, above n 764, 19; Cindy Lazenby, ‘SOS: The Call Sign of the ‘Ships Of Shame’ (1997-1998) 4(1) *Deakin Law Review* 73, 74; Adam Green, ‘Panama’s laundry service: The tax haven has been offering expert stain removal ever since the opening of the Panama Canal’ *The Economist* (online) (6 April 2016) < <https://www.economist.com/1843/2016/04/06/panamas->

accessible register, the Panamanian register from its inception provided shipowners with the opportunity to circumvent domestic laws of other jurisdictions by exploiting the unique mobility of sea carriage. However, in a complex world of competing State interests, States like the US have on occasion supported specific open registers, like the Panamanian register, to further their own policy objectives, like retaining effective control over the Panama canal, among others.¹⁷³²

4.7.2.5 The 1928 Stimulus Package

The *Merchant Marine Act of 1928* ('1928 Act') enacted additional support measures like establishing a new mail subsidy programme.¹⁷³³ However, this measure proved to be unsuccessful.¹⁷³⁴ The *1928 Act* increased the size of the construction loan fund introduced by the *1920 Act*.¹⁷³⁵ Even so, the *1928 Act* imposed additional obligations on vessels enjoying specific fiscal incentives like imposing crewing restrictions, limiting shipowners' freedom for 20 years for reflagging US vessels, and providing for the expropriation or compulsory use of vessels by the US government in crises.¹⁷³⁶ Where a vessel was expropriated or requisitioned,

laundry-service>; See also Elizabeth R DeSombre, *Flagging Standards: Globalization and Environmental, Safety, and Labor Regulations at Sea* (MIT Press, 2006) 73.

¹⁷³² Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14-5 [2]; See also Thuong, above n 1542, 24; See also McMahon, above n 36, 104; See also DeSombre, above n 1731, 73-4: 'U.S. officials could, under some circumstances, register ships for the Panamanian registry: ... Of particular importance was that by treaty Panama was militarily dependent on the United States for its defense; ships registered in Panama would thus be under U.S. protection.'

¹⁷³³ McMahon, above n 36, 93; Madigan, above n 1112, 5; See also Morse, above n 58, 61: 'The Merchant Marine Act of 1928 ... [authorised] the Postmaster General to enter into contracts with American citizens for terms not to exceed ten years. A statutory schedule of vessel classifications and compensation was set out to apply to payments for ocean-mail service. For instance, vessels capable of maintaining a speed of eighteen knots at sea in ordinary weather and of a gross registered tonnage of not less than 12,000 tons were Class 3 vessels and entitled to eight dollars per nautical mile. ... In addition, the ocean-mail contracts ... provided for a fixed minimum number of trips a year, at regular intervals, over a prescribed route, with vessels of prescribed types, sizes, and speeds, as determined by the needs of each particular service. Vessels, to be eligible for mail contracts, had either to be constructed according to plans and specifications approved by the Secretary of the Navy with particular reference to ... conversion into an auxiliary naval vessel or to otherwise be useful ... in time of ... emergency.'

¹⁷³⁴ McMahon, above n 36, 93; Madigan, above n 1112, 5.

¹⁷³⁵ Madigan, above n 1112, 5; Morse, above n 58, 61: The amendment 'enabled loans to be made therefrom for equipping, reconditioning, remodelling, or improving vessels as well as for constructing vessels.'

¹⁷³⁶ Morse, above n 58, 61.

the statutory programme provided for paying only the fair actual value of the vessel or its use at the acquisition time, irrespective of the grounds and risks involved, and disallowed claims for consequential damages.¹⁷³⁷

Despite fiscal stimulus measures, like mail subsidies and construction loans, the active component of the US merchant marine by 1935 measured a paltry 35% of its former size in 1921.¹⁷³⁸ These support measures have been criticised as failing to meet the essential needs of the industry.¹⁷³⁹

After World War I, the Shipping Board was incapable of providing optimal support as it did not have the necessary political authority and funding at its disposal.¹⁷⁴⁰ Like with previous government support, these measures proved inappropriate for this period. McMahon sums up the conundrum as follows:

[b]y the mid-1930s, the condition of the U.S. Merchant Marine was dire. ... The numbers and types of vessels were totally inadequate to handle even a tiny portion of U.S. trade, let alone sustain the nation or its military in a national emergency.¹⁷⁴¹

4.7.2.6 Unstable Policy

The expansion of the US naval fleet during this post-war era also experienced political interference.¹⁷⁴² The Warren Harding, Calvin Coolidge, and Herbert Hoover US

¹⁷³⁷ Madigan, above n 1112, 3-5.

¹⁷³⁸ Ibid 3; McMahon, above n 36, 93; See generally NPS, *Liberty Ships and Victory Ships, America's Lifeline in War (Teaching with Historic Places)* (2020) < <https://www.nps.gov/articles/liberty-ships-and-victory-ships-america-s-lifeline-in-war-teaching-with-historic-places.htm> >.

¹⁷³⁹ McMahon, above n 36, 93.

¹⁷⁴⁰ Ibid.

¹⁷⁴¹ Ibid.

¹⁷⁴² Baer, above n 39, 15-8; Westermeyer, above n 38, 19.

administrations¹⁷⁴³ (spanning from 1920 to 1933) adopted a somewhat different idea about US sea power.¹⁷⁴⁴ They generally preferred to manage the naval strength of competing States instead through diplomatic channels.¹⁷⁴⁵ Therefore, policy instability arising from the effect of different administrations may obstruct sea power's optimal advancement, whether as a naval fleet, merchant fleet or both.

In 1935, President Franklin D. Roosevelt (whose administration lasted from 1933 to 45)¹⁷⁴⁶ comprehensively revised US policy concerning sea power to drastically change course and reverse the American trading fleet's decline.¹⁷⁴⁷ On 4 March 1935, Roosevelt sent the *1935 Message* and Two Reports to Congress.¹⁷⁴⁸ Various considerations were outlined in assessing the past failings of previous government support programmes.¹⁷⁴⁹

The *1935 Message* acknowledged that providing support as loans for shipbuilding was not successful.¹⁷⁵⁰ Disadvantages with the loan programme included difficulties with their repayment.¹⁷⁵¹ Likewise, it considered the failings of the mail subsidy programme.¹⁷⁵² It observed that under normal ocean rates, the government would have paid about \$3 000 000 to carry mail by sea.¹⁷⁵³ However, it observed that the programme cost the US government about

¹⁷⁴³ Encyclopedia Britannica Eds, *Warren G. Harding: president of United States* (2020) Encyclopedia Britannica <<https://www.britannica.com/biography/Warren-G-Harding>>; Encyclopedia Britannica Eds, *Calvin Coolidge: president of United States War* (2020) Encyclopedia Britannica <<https://www.britannica.com/biography/Calvin-Coolidge>>; Encyclopedia Britannica Eds, *Herbert Hoover: president of United States* (2020) Encyclopedia Britannica <<https://www.britannica.com/biography/Herbert-Hoover>>.

¹⁷⁴⁴ Baer, above n 39, 15-8; Westermeyer, above n 38, 19.

¹⁷⁴⁵ Baer, above n 39, 15-8.

¹⁷⁴⁶ Frank Freidel (ed), *Franklin D. Roosevelt* (2020) Encyclopedia Britannica <<https://www.britannica.com/biography/Franklin-D-Roosevelt>>.

¹⁷⁴⁷ Madigan, above n 1112, 3, 5; McMahon, above n 36, 93; Morse, above n 58, 62.

¹⁷⁴⁸ Morse, above n 58, 62; See generally Franklin D Roosevelt, 'Message from President of the United States Transmitting Views and Two Reports on Subject of Adequate Merchant Marine' (H R Doe 8, 74th Cong 1st Sess. 1-3, 1935).

¹⁷⁴⁹ *Ibid.*

¹⁷⁵⁰ Morse, above n 58, 63.

¹⁷⁵¹ *Ibid.*

¹⁷⁵² *Ibid.*

¹⁷⁵³ *Ibid.*

\$30 000 000 to carry mail by sea.¹⁷⁵⁴ The difference of \$27 000 000 was considered merely a subsidy, and it impugned the concealment.¹⁷⁵⁵ The *1935 Message* in considering appropriate remedial action called for a more simple and transparent subsidy programme in providing government support; support that would, more effectively, be formulated to offset the cost differential between American and foreign shipping.¹⁷⁵⁶ Thus, it submitted that the programme should promote a register's competitiveness on three fronts:

It should cover first the difference in the cost of building ships; second, the difference in the cost of operating ships; and finally, it should take into consideration the liberal subsidies that many foreign governments provide for their shipping. Only by meeting this threefold differential can we expect to maintain a reasonable place in ocean commerce for ships flying the American flag, and at the same time maintain American standards ...¹⁷⁵⁷

Therefore, a key objective underpinning the revised programme was to create a more efficient, simple and horizontal environment between American and foreign ship registers.¹⁷⁵⁸ Its basis was to treat the American merchant marine as a strategic State asset critical for national security, which required appropriate protection from market forces and foreign State interference.¹⁷⁵⁹ Thus, government policy aimed to remedy cost differences between the local and foreign registers, responsible for making it unattractive for enterprises to operate US vessels and build them in US shipyards.¹⁷⁶⁰ Therefore, the proposed stimulus package intended to counterbalance higher local costs with efficient and more straightforward government support measures, like direct operating subsidies.

¹⁷⁵⁴ Ibid.

¹⁷⁵⁵ Ibid.

¹⁷⁵⁶ Ibid; McMahon, above n 36, 93; Madigan, above n 1112, 5.

¹⁷⁵⁷ Morse, above n 58, 63.

¹⁷⁵⁸ Madigan, above n 1112, 5, Morse, above n 58, 63.

¹⁷⁵⁹ McMahon, above n 36, 93; Morse, above n 58, 63-4; Madigan, above n 1112, 3, 5.

¹⁷⁶⁰ Ibid.

4.7.2.7 The 1936 Stimulus Package

The *1935 Message* underpinned the enactment of the *Merchant Marine Act of 1936* ('1936 Act'), which endures to this day (albeit in somewhat amended form).¹⁷⁶¹ This statute sets out the essential policy of the US government in relation to its registered trading fleet.¹⁷⁶²

46 USC § 50101 currently provides as follows (which broadly aligns with the original text of s101 of the *1936 Act*):

- (a) Objectives. —It is necessary for the national defense and the development of the domestic and foreign commerce of the United States that the United States have a merchant marine—
- (1) sufficient to carry the waterborne domestic commerce and a substantial part of the waterborne export and import foreign commerce of the United States and to provide shipping service essential for maintaining the flow of the waterborne domestic and foreign commerce at all times;
 - (2) capable of serving as a naval and military auxiliary in time of war or national emergency;
 - (3) owned and operated as vessels of the United States by citizens of the United States;
 - (4) composed of the best-equipped, safest, and most suitable types of vessels constructed in the United States and manned with a trained and efficient citizen personnel; and
 - (5) supplemented by efficient facilities for building and repairing vessels.
- (b) Policy. — It is the policy of the United States to encourage and aid the development and maintenance of a merchant marine satisfying the objectives described in subsection (a)¹⁷⁶³

The enactment essentially codifies the policy of treating the American merchant fleet as a necessary component of US sea power.¹⁷⁶⁴ Thus, its special treatment has a rational-legal basis

¹⁷⁶¹ Ibid; See generally NPS, *Liberty Ships and Victory Ships, America's Lifeline in War (Teaching with Historic Places)* (2020) < <https://www.nps.gov/articles/liberty-ships-and-victory-ships-america-s-lifeline-in-war-teaching-with-historic-places.htm> >.

¹⁷⁶² Madigan, above n 1112, 3.

¹⁷⁶³ *Shipping*, 46 USC § 50101 (2022); JUSTIA US Law, 46 U.S.C. § 50101 (2018) <<https://law.justia.com/codes/us/2018/title-46/subtitle-v/part-a/chapter-501/sec-50101/>>; U.S. Government Information (govinfo), 46 U.S.C. 50101 - Objectives and policy (2011) GPO <<https://www.govinfo.gov/app/details/USCODE-2011-title46/USCODE-2011-title46-subtitleV-partA-chap501-sec50101/summary>>; For the relevant text of the *1936 Act*: McMahon, above n 36, 93; See also Morse, above n 58, 63; See generally USMM.org, *Merchant Marine Act, 1936* <<http://www.usmm.org/mmact1936.html#mma1>>.

¹⁷⁶⁴ Madigan, above n 1112, 3; Morse, above n 58, 63-4.

by ensuring that its capacity to meet specific service demands of the State is maintained.¹⁷⁶⁵

Madigan opines that ‘this law became the final decision that the policy of the United States would be to maintain a large and adequate fleet and to that end, provided substantial incentives in the form of subsidies to both the operating and building segments of the industry.’¹⁷⁶⁶ Morse observes that the policy statement ‘recognizes that aside from national defense, the entire American economy benefits from the maintenance of a healthy merchant marine.’¹⁷⁶⁷

Thus, apart from establishing an adequately sized merchant fleet, the policy also promotes maintaining strategic domestic infrastructure and skilled expertise to support the operation, repair and replacement of merchant vessels.¹⁷⁶⁸ This necessity of supporting the broader shipping industry acknowledges that ships do not operate, repair and replace themselves in emergencies.¹⁷⁶⁹ Asteris submits that even if the required vessels were successfully secured on the open market during a crisis, the availability of ‘highly trained and committed’ crew to operate them might not be as easy to accomplish.¹⁷⁷⁰

The *1936 Act* introduced new support measures.¹⁷⁷¹ The statute provided a facility for the trade-in of old vessels to encourage the modernisation of the US trading fleet.¹⁷⁷² An operating differential subsidy was made available to US ship operators who plied certain foreign sea routes.¹⁷⁷³ A construction differential subsidy was also made available to the

¹⁷⁶⁵ Ibid.

¹⁷⁶⁶ Ibid.

¹⁷⁶⁷ Ibid.

¹⁷⁶⁸ Ibid.

¹⁷⁶⁹ Ibid.

¹⁷⁷⁰ Asteris, above n 35, 67.

¹⁷⁷¹ Madigan, above n 1112, 5.

¹⁷⁷² Morse, above n 58, 68-9.

¹⁷⁷³ Madigan, above n 1112, 5; Morse, above n 58, 70-4; Subsidised ship operators were generally not allowed either directly or indirectly to operate on domestic sea routes: Morse, above n 58, 72; There were also mechanisms for clawing back a portion of the operating subsidy should average profits reach a certain level over a 10-year period: Morse, above n 58, 73.

shipbuilding industry.¹⁷⁷⁴ The subsidies operated subject to various limits in line with their underlying policy objectives.¹⁷⁷⁵ The US government also bore the cost to equip specific merchant vessels with certain defence features.¹⁷⁷⁶

Generally, certain tax concessions were available to subsidised and non-subsidised ship operators where monies were used for fleet modernisation.¹⁷⁷⁷ For example, one of the tax concessions provided was a Construction Reserve Fund ('*CRF*').¹⁷⁷⁸ Certain ship operators were entitled to deposit the following amounts into the *CRF*: (a) proceeds from the sale of vessels; (b) indemnities for the loss of vessels; (c) earnings derived from the operation of US vessels, including income from incidental services; and (d) interest or other earnings on amounts previously deposited.¹⁷⁷⁹

The *CRF* was available to operators plying foreign and domestic sea routes.¹⁷⁸⁰ Its apparent benefit was the option to defer a gain from the disposal of a vessel.¹⁷⁸¹ However, Morse opines that the scheme was not necessarily of real benefit.¹⁷⁸² Since the tax base of the new vessel was to be reduced by the unrecognised gain, any subsequent deductions, as applied under the normal income tax system, would also be reduced, resulting effectively in a subsequent increase in income tax.¹⁷⁸³ For eligibility for this deferral, the monies deposited in the *CRF* had to be used within a specific time frame for acquiring a new vessel.¹⁷⁸⁴ Further, there was no tax

¹⁷⁷⁴ Madigan, above n 1112, 5; Morse, above n 58, 65.

¹⁷⁷⁵ Morse, above n 58, 65.

¹⁷⁷⁶ *Ibid.*

¹⁷⁷⁷ Madigan, above n 1112, 5; Morse, above n 58, 69-75.

¹⁷⁷⁸ McMahon, above n 36, 93; Madigan, above n 1112, 5.

¹⁷⁷⁹ Madigan, above n 1112, 5; Morse, above n 58, 69.

¹⁷⁸⁰ *Ibid.*; However, Morse opines that, '[s]ince section 607 of the Act requires an operator in American foreign commerce *who is receiving an operating-differential subsidy* to establish a "capital reserve fund" and a "special reserve fund" these operators do not establish construction reserve funds.' (emphasis added)

¹⁷⁸¹ Morse, above n 58, 69.

¹⁷⁸² *Ibid.*

¹⁷⁸³ *Ibid.* 69-70.

¹⁷⁸⁴ *Ibid.*; Madigan, above n 1112, 5.

benefit in depositing earnings in the *CRF* and deriving income on deposits, except in the form of an exemption from the prohibition against the unreasonable accumulation of funds.¹⁷⁸⁵

Section 607 of the *1936 Act* required US operators, who enjoyed receiving operating-differential subsidies, to establish a capital reserve fund and a special reserve fund for depositing certain monies for specific and limited business purposes.¹⁷⁸⁶ If used for those purposes, the deposited income would be treated as exempt income.¹⁷⁸⁷

Other support measures available included mortgage and war risk insurance by the Federal government and a cargo preference for carrying foreign aid.¹⁷⁸⁸ The *1936 Act* also established a United States Maritime Commission to implement the statutory provisions and underlying policy.¹⁷⁸⁹

4.7.2.8 World War II

World War II erupted shortly after the *1936 Act*'s enactment.¹⁷⁹⁰ This war would prove to be a crucial test for the effectiveness of the Roosevelt policy on sea power. It would provide a good opportunity to broadly assess the robustness of the American merchant marine and its underlying policy in a crisis.

¹⁷⁸⁵ Morse, above n 58, 70.

¹⁷⁸⁶ Morse, above n 58, 74; Madigan, above n 1112, 5. For example, the capital reserve fund was generally only to be used for purchasing replacement and extra vessels for essential foreign sea routes, reconstructing ships, or for liquidating certain indebtedness: Morse, above n 58, 74.

¹⁷⁸⁷ Madigan, above n 1112, 5.

¹⁷⁸⁸ Madigan, above n 1112, 5; Morse, above n 58, 76-80.

¹⁷⁸⁹ Morse, above n 58, 64; Madigan, above n 1112, 5; Its first chairman was Joseph P Kennedy, US President John F Kennedy's father.

¹⁷⁹⁰ Madigan, above n 1112, 3.

The German war strategy advanced by Admiral Karl Donitz was simple: ‘The sinking of ships was the only thing that mattered.’¹⁷⁹¹ In essence, the strategy involved sinking more merchant vessels than what the Allies could replace.¹⁷⁹² Up to 1943, the Donitz war strategy crucially supported Germany’s success in fighting the war in the Atlantic.¹⁷⁹³ Favouring the German war strategy was the UK’s inability to keep pace with the demand for building replacement merchant vessels.¹⁷⁹⁴ Nonetheless, the United States demonstrated the capacity to successfully meet any shortfalls in replacing merchant vessels where the UK failed.¹⁷⁹⁵ Thus, the Americans demonstrated the ability to build more merchant ships than the German attack submarines (or the ‘U-boats’) could ultimately destroy.¹⁷⁹⁶ In May 1943, Donitz lost, and the Allies won the battle for the Atlantic.¹⁷⁹⁷

Immediately after the war, the American ship register enjoyed the largest merchant marine globally.¹⁷⁹⁸ From 1939 to 1945, the United States had built over 5500 merchant vessels to support its war effort.¹⁷⁹⁹ Its war building programme was labelled ‘the greatest shipbuilding program in US history.’¹⁸⁰⁰ Apart from carrying supplies during World War II, the merchant marine transported 7 639 491 troops by sea from US ports.¹⁸⁰¹ Thus, the Allies' success may be attributed, in part, to the contribution provided by the US merchant marine and its broader infrastructure that was readily available at short notice.¹⁸⁰² Baer expresses this sentiment much

¹⁷⁹¹ Baer, above n 39, 20.

¹⁷⁹² Ibid.

¹⁷⁹³ Ibid.

¹⁷⁹⁴ Ibid.

¹⁷⁹⁵ Ibid.

¹⁷⁹⁶ Ibid 20-1.

¹⁷⁹⁷ Ibid 21.

¹⁷⁹⁸ McMahan, above n 36, 94-5; Madigan, above n 1112, 3; Baer, above n 39, 21; ‘By the end of World War II, the United States controlled 70 percent of the existing merchant shipping tonnage in the world.’: McMahan, above n 36, 94.

¹⁷⁹⁹ Madigan, above n 1112, 3; Baer, above n 39, 21; McMahan, above n 36, 94.

¹⁸⁰⁰ Baer, above n 39, 21.

¹⁸⁰¹ Ibid 22.

¹⁸⁰² Madigan, above n 1112, 3; Baer, above n 39, 21; USMM.org, *U.S. Merchant Marine in World War II* (2007) <<http://www.usmm.org/ww2.html>>.

more emphatically by opining that ‘tonnage was the key to winning the war in all theatres.’¹⁸⁰³ Conversely, it has been asserted that ‘Japan lost the Pacific War ... on the date that her merchant losses exceeded all possibility of replacement.’¹⁸⁰⁴ World War II also supported the further expansion of the US naval fleet.¹⁸⁰⁵

However, like the events after World War I, the US trading fleet proved too large for peacetime conditions after World War II.¹⁸⁰⁶ Thus, the United States Maritime Commission, under the authority of the *Merchant Ship Sales Act of 1946*, offered over 4000 vessels for sale to both local and foreign buyers.¹⁸⁰⁷ Subsequent advancements in ship design and technology made particular vessels obsolete more quickly, like the Liberty vessels.¹⁸⁰⁸ Therefore, an accelerated expansion for a merchant fleet, although vital for short term war purposes, is not necessarily optimal in the long term for sustainably establishing a registered and active trading fleet.

4.7.3 The Period Spanning from 1945 to 2004

4.7.3.1 The Expansion of Open Ship Registers

During the 1950s and 1960s, the US trading fleet gradually contracted from its peak size after World War II.¹⁸⁰⁹ By 1964, its active component (measuring roughly 14 230 DWT)¹⁸¹⁰ had declined to just over half the size of the British trading fleet (measuring roughly 27 244

¹⁸⁰³ Baer, above n 39, 21.

¹⁸⁰⁴ Ibid 23.

¹⁸⁰⁵ Ibid 19-20, 22, 25.

¹⁸⁰⁶ Madigan, above n 1112, 3.

¹⁸⁰⁷ Ibid; McMahon, above n 36, 94-5: ‘The intent of the Ship Sales Act was to enable allied countries to recover from the war. ... some ... ended up flagged in Panama and Liberia.’

¹⁸⁰⁸ Ibid; USMM.org, *Liberty Ships built by the United States Maritime Commission in World War II* (2002) <<http://www.usmm.org/libertyships.html>>; See generally L A Sawyer and W H Mitchell, *Liberty Ships: The History of the Emergency Type Cargo Ships Constructed in the United States During the Second World War* (Cornell Maritime Press; 1970); See generally Greg H Williams, *The Liberty Ships of World War II: A Record of the 2,710 Vessels and Their Builders, Operators and Namesakes, with a History of the Jeremiah O'Brien* (McFarland, 2014).

¹⁸⁰⁹ McMahon, above n 36, 95.

¹⁸¹⁰ Figures are rounded-up where appropriate and presented in Thousand Dead-Weight Tonnage.

DWT).¹⁸¹¹ Also, in 1964, its stake was only 7.5% in the active global merchant fleet.¹⁸¹² By 1970, this had declined further to about 4.9%.¹⁸¹³ Thus, by 1970, the 1936 stimulus package proved inadequate for maintaining a sufficiently sized American trading fleet.¹⁸¹⁴ One of the significant factors contributing to the mobility of merchant vessels was the increasing prominence of open registers after World War II.¹⁸¹⁵ Until the late 1940s, only Panama and Honduras offered an open register.¹⁸¹⁶ However, from about 1948 and with the assistance of the Americans, Liberia also started offering an open ship register.¹⁸¹⁷ Edward Stettinius, a businessman and former US Secretary of State, promoted the establishment of the Liberian registry.¹⁸¹⁸ The Americans treated the Liberian register as a necessary Cold War measure for establishing a readily mobilised fleet to counter the Soviet Union's expansion.¹⁸¹⁹ By 1968, the Liberian register was ranked as the largest ship register globally and eclipsed the UK register.¹⁸²⁰

4.7.3.2 The 1970 Stimulus Package

In 1970, Congress passed an additional set of support measures.¹⁸²¹ The Nixon administration championed the *1936 Act's* revision to modernise an ageing fleet better and stimulate the local shipbuilding industry in critical decline.¹⁸²² Section 607 of the *1936 Act* was

¹⁸¹¹ See Table C below; UNCTAD, *Review of Maritime Transport 1968* (United Nations; 1969) 11.

¹⁸¹² *Ibid.*

¹⁸¹³ UNCTAD, *Review of Maritime Transport 1970* (United Nations; 1971) 40-44; In 1970, the active component of the U.S. trading fleet was 4.9% of the global fleet (16 110 DWT/ 326 121 DWT).

¹⁸¹⁴ McMahon, above n 36, 95.

¹⁸¹⁵ *Ibid.*; Thuong, above n 1542, 23; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15: 'The Panama register doubled its tonnage from the beginning of World War II to 1947, it gained [considerably] ... from the transfer of ... "Liberty-Class" ships.'

¹⁸¹⁶ Thuong, above n 1542, 24; But see Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; See also DeSombre, above n 1731, 73.

¹⁸¹⁷ DeSombre, above n 1731, 73.

¹⁸¹⁸ *Ibid.*

¹⁸¹⁹ *Ibid.*

¹⁸²⁰ UNCTAD, above n 1811, 11; See Table C.

¹⁸²¹ McMahon, above n 36, 95; Madigan, above n 1112, 47.

¹⁸²² Madigan, above n 1112, 47; The Library of Congress, *Chronological List of Presidents, First Ladies, and Vice Presidents of the United States* (2019) < https://www.loc.gov/rr/print/list/057_chron.html>.

significantly amended.¹⁸²³ Its revision now simply allowed subsidised *and non-subsidised* operators/shipowners of US registered vessels to access a capital construction fund ('CCF').¹⁸²⁴ In addition to certain liner vessels, the fund could also be used for constructing and reconstructing certain bulk carriers.¹⁸²⁵ The eligible monies¹⁸²⁶ deposited would enjoy a federal income tax deferral.¹⁸²⁷ Caras submits that the CCF effectively provided taxpayers with a government interest-free loan in proportion to the deferral.¹⁸²⁸

The fund was generally divided into the following three accounts:

1. The capital account (comprising non-taxable earnings, like depreciation, 85% of dividend income, exempt bond interest and deposited amounts equal to the tax basis of vessels sold).
2. The capital gain account (comprising net long-term capital gains on particular vessels and other assets sold meeting a six-month deposit requirement).
3. The ordinary income account (comprising the remaining balance of deposits).¹⁸²⁹

The scheme provided for qualified and unqualified withdrawals.¹⁸³⁰ Qualified withdrawals were intended for purchasing, constructing and reconstructing certain eligible vessels, barges and containers, and reducing any corresponding principal liability.¹⁸³¹

¹⁸²³ Madigan, above n 1112, 47; C G Caras, 'U.S. Maritime Administration Financing Procedures Available for New Ship Construction' (1981) 36(4) *The Business Lawyer* 1887, 1892.

¹⁸²⁴ Madigan, above n 1112, 47; Caras, above n 1823, 1892.

¹⁸²⁵ Madigan, above n 1112, 47; 'The eligible vessels include those registered and built in the United States and operated in [U.S.] foreign or non-contiguous domestic commerce. Certain foreign built vessels may also be eligible in some situations.': at 47.

¹⁸²⁶ 'A limit of 50 percent of the earnings from eligible vessels will be the maximum that the Secretary [of Commerce] can require an operator to deposit for any one year. The maximum which an operator can deposit will be the sum of (1) earnings from [scheme] vessels; (2) tax depreciation ... allowed on account of [scheme] vessels; (3) gain on [disposing scheme] vessels, and (4) investment income from such fund.': Madigan, above n 1112, 47; See generally Caras, above n 1823, 1892-3.

¹⁸²⁷ Madigan, above n 1112, 47; Caras, above n 1823, 1892.

¹⁸²⁸ Caras, above n 1823, 1892.

¹⁸²⁹ Madigan, above n 1112, 47; Caras, above n 1823, 1893.

¹⁸³⁰ Ibid.

¹⁸³¹ Ibid.

Qualified withdrawals were required to be applied against these accounts in the following order:

- a) Firstly, from the capital account (offering no reduction in the tax basis of the acquisition).
- b) Secondly, from the capital gain account (offering a partial reduction in the tax basis of the acquisition, like 62.5% of the withdrawal for companies).
- c) Thirdly, from the ordinary income account (offering a reduction in the tax basis of the acquisition to the full extent of the withdrawal).¹⁸³²

In utilising qualified withdrawals, certain tax basis adjustments had to be recognised for the assets acquired depending upon the account from which the monies were withdrawn.¹⁸³³ In contrast, non-qualified withdrawals were taxable in the withdrawal year, and interest was applied at a specific rate calculated from when the funds were first deposited.¹⁸³⁴ The payment of interest was only required if there was a profit in the withdrawal year, and interest would not necessarily be charged on the total amount withdrawn.¹⁸³⁵ The ordering of the accounts would also be reversed for non-qualified withdrawals and start with the ordinary income account.¹⁸³⁶

Madigan submits that the scheme encouraged qualified withdrawals unless losses were available.¹⁸³⁷ Madigan opines that a key outcome of the revision was extending a substantial

¹⁸³² Madigan, above n 1112, 47-8; Caras, above n 1823, 1893-4.

¹⁸³³ Caras, above n 1823, 1894.

¹⁸³⁴ Madigan, above n 1112, 48.

¹⁸³⁵ *Ibid.*

¹⁸³⁶ *Ibid.*

¹⁸³⁷ *Ibid.*

part of the 1936 scheme to non-subsidized shipowners.¹⁸³⁸ Nonetheless, despite the 1970 revision, the active component of the American trading fleet continued to demonstrate a contraction in size.¹⁸³⁹ The 1970 amendment may be criticised for failing to promote efficiency and simplicity vigorously in its fiscal treatment. It remained overly complicated and unattractive compared to more efficient and simpler alternatives in foreign States.¹⁸⁴⁰

A significant development occurred in the shipping industry from about the 1970s with the broader application of containerisation.¹⁸⁴¹ As time passed, containerisation would usher in a more seamless ‘door-to-door’ system of multimodal transport, providing in principle new opportunities for applying taxes, like freight and lifting taxes.¹⁸⁴² Thus, in time, increasing integration between the different transport modes would occur for transporting goods.¹⁸⁴³ That integration would, in turn, better facilitate the handling and tracking of goods by technology, making it theoretically simpler and easier to apply uniform taxes globally.¹⁸⁴⁴

4.7.3.3 The 1975 and 1986 Tax Amendments

In 1975, Congress enacted an amendment applying income tax to American companies’ unrealised foreign shipping income.¹⁸⁴⁵ However, the 1975 enactment permitted a tax deferral where the foreign shipping income was used for particular purposes.¹⁸⁴⁶ However, in 1986, a further amendment was passed abolishing this deferral.¹⁸⁴⁷

¹⁸³⁸ Ibid; See generally McMahon, above n 36, 95; Other amendments included, extending the operational differential subsidy to bulk carriers, irrespective of their service, route or line; eliminating clawing back, and simplifying the determination for the subsidy: Madigan, above n 1112, 48.

¹⁸³⁹ McMahon, above n 36, 95; UNCTAD, above n 1570, 56-62; See Table C below.

¹⁸⁴⁰ Alexander, above n 35, 3 [v] – [vii].

¹⁸⁴¹ Woodman, above n 1486, [Location 7901]; Breskin, above n 6, 499-500, 514; McMahon, above n 36, 96; Branch and Robarts, above n 6, 342.

¹⁸⁴² *Silke*, above n 62, [6.38]; ICS and WSC, above n 5, 4-5.

¹⁸⁴³ Branch and Robarts, above n 6, 342; See generally Breskin, above n 6, 498-9.

¹⁸⁴⁴ Breskin, above n 6, 511-2, 517; Branch and Robarts, above n 6, 371-3.

¹⁸⁴⁵ Papavizas and Kiern, above n 1542, 385 [2].

¹⁸⁴⁶ Ibid 385-6.

¹⁸⁴⁷ Ibid 386.

A goal behind the 1975 amendment was to encourage shipowners to increase their tonnage under the US ship register.¹⁸⁴⁸ However, the 1980s may more broadly be characterised as a period under the Reagan administration where US government support for its shipping industry was progressively removed.¹⁸⁴⁹ Thus, by 1990, as operating subsidies expired, the US ship register likewise experienced multiple vessel withdrawals.¹⁸⁵⁰ The result of the hands-off policy by the Reagan administration, reminiscent of the Thatcher administration, was that the American stake in the active global trading fleet further contracted to roughly 3.6% by 1991.¹⁸⁵¹

The 1975 amendment was misguided to the extent that it failed to appreciate that a global shipping company may require a mixture of local and foreign fleets in its portfolio to remain optimally competitive as a whole in the face of aggressive foreign competition.¹⁸⁵² Therefore, increasing taxes on its foreign shipping business may affect the entire business's sustainability despite the availability of local incentives.¹⁸⁵³ The 1975 and 1986 amendments overall increased taxes on the shipping income of American companies.¹⁸⁵⁴ In so doing, certain efficiency and simplicity gains were reversed that had been achieved.¹⁸⁵⁵ Thus, American fiscal policy demonstrated a step backwards in promoting efficiency and simplicity

¹⁸⁴⁸ Ibid; RG Edmonson, *Could tax relief be on the horizon* (2004) J.O.C. < https://www.joc.com/maritime-news/could-tax-relief-be-horizon_20040620.html>.

¹⁸⁴⁹ McMahan, above n 36, 96-7; Breskin, above n 6, 63: 'The last operating subsidies [of this period] expired in 1997.'

¹⁸⁵⁰ McMahan, above n 36, 97.

¹⁸⁵¹ UNCTAD, above n 1570, 84-7; See Table C below; (considered by registered active deadweight tonnage and as a percentage of the corresponding global tonnage).

¹⁸⁵² Papavizas and Kiern, above n 1542, 385-6; Edmonson, above n 1848, (online); Alexander, above n 35, 14 [39], 24 [88] – [89]; Morse, above n 58, 65; See generally *1998 DETR Report*, above n 23, 14; See generally Butcher, above n 38, 7; See generally Ormrod, above n 1489, 209-10; See generally Ormrod, above n 1489, 155-86.

¹⁸⁵³ Ibid.

¹⁸⁵⁴ Papavizas and Kiern, above n 1542, 385-6; Edmonson, above n 1848, (online).

¹⁸⁵⁵ Cobb, above n 17, 646-8; Dwyer, above n 2, 674, 747-8; *The Mirrlees Review*, above n 17, 22-3, 39-45.

more vigorously in shipping taxation. The ultimate result was an accelerated decline for the American ship register.¹⁸⁵⁶

4.7.3.4 The Persian Gulf War

A concerning consequence of the registered merchant fleet's contraction for American sea power was demonstrated in 1991 with the outbreak of the Persian Gulf War.¹⁸⁵⁷ The United States was forced to obtain about two-thirds of its sealift requirements by chartering-in foreign vessels to undertake the military operation effectively.¹⁸⁵⁸ In so doing, instances occurred where particular foreign vessels refused to deliver cargo for the US military in the Persian Gulf Operation.¹⁸⁵⁹ McMahon submits that the substantial reliance on foreign trading vessels for the strategic and commercial demands of the US places its national security in a tenuous position.¹⁸⁶⁰ This scenario becomes an increasing concern as the US and its allies become less globally dominant.¹⁸⁶¹ McMahon asserts that the particular missions' success in obtaining merchant tonnage may not necessarily be as easily repeated in the future where different conditions prevail, like where merchant vessels are more likely to be damaged or destroyed.¹⁸⁶² Besides these factors, other factors like foreign political interference may similarly obstruct US efforts to charter-in foreign trading vessels.¹⁸⁶³

¹⁸⁵⁶ UNCTAD, above n 1570, 84-7; See Table C below; Edmonson, above n 1848, (online); Papavizas and Kiern, above n 1542, 385-6. (considered by registered active deadweight tonnage and as a percentage of the corresponding global tonnage)

¹⁸⁵⁷ Asteris, above n 35, 69; McMahon, above n 36, 97.

¹⁸⁵⁸ Asteris, above n 35, 69; McMahon, above n 36, 101.

¹⁸⁵⁹ McMahon, above n 36, 101.

¹⁸⁶⁰ McMahon, above n 36, 87-8, 104-6.

¹⁸⁶¹ *Ibid* 104.

¹⁸⁶² *Ibid* 101.

¹⁸⁶³ *Ibid* 104.

4.7.3.5 The 1996 Maritime Security Program

In 1996, under the Clinton administration, a renewed political appreciation for the value of an American merchant fleet culminated with the enactment of the *Maritime Security Program* ('MSP').¹⁸⁶⁴ The programme re-emphasised the time-tested policy of adequate State support for developing a registered trading fleet.¹⁸⁶⁵ State support was generally introduced in the form of subsidies.¹⁸⁶⁶ The policy aimed to subsidise a specific type and number of merchant vessels that would best support the sealift requirements of the American navy.¹⁸⁶⁷ It has been observed that not all merchant vessels are equal in meeting the sealift requirements for a military operation.¹⁸⁶⁸ In 2003, the *MSP* was re-authorised¹⁸⁶⁹ with amendments.¹⁸⁷⁰

4.7.3.6 The 2004 Tax Reforms

However, like the UK, a special shipping tax regime would not be enacted in the US until the beginning of the 21st century.¹⁸⁷¹ In about 2005, under the George W Bush administration, certain American shipowners were finally offered the choice of a Dutch styled tonnage tax

¹⁸⁶⁴ McMahon, above n 36, 97; Breskin, above n 6, 63-4: The *MSP* was enacted by the *Maritime Security Act 1996*; The *MSP* subsidy was increased in 2015.

¹⁸⁶⁵ Ibid; Papavizas and Kiern, above n 1542, 380; See also Andrew Gibson and Arthur Donovan *The Abandoned Ocean* (University of South Carolina Press, 2000): The *Maritime Security Act of 1996* ('MSA 96') repealed the operating differential subsidy programme.

¹⁸⁶⁶ Ibid.

¹⁸⁶⁷ Breskin, above n 6, 63, McMahon, above n 36, 97.

¹⁸⁶⁸ Asteris, above n 35, 67; McMahon, above n 36, 96; Breskin, above n 6, 63.

¹⁸⁶⁹ Congress raised the yearly subsidy payment and the number of vessels qualified to participate; The programme allowed a number of different types of vessels to participate useful to the military and created the National Defense Tank Vessel Construction Program, which subsidized the construction of privately owned US-flagged product tankers in the US. In 2011, the *MSP* was renewed until 2025: See generally Breskin, above n 6, 63-4; See also Papavizas and Kiern, above n 1542, 380-3.

¹⁸⁷⁰ Breskin, above n 6, 63; See also Papavizas and Kiern, above n 1542, 380-3.

¹⁸⁷¹ The White House, *George W. Bush* (2020) < <https://www.whitehouse.gov/about-the-white-house/presidents/george-w-bush/>>; See generally United States House of Representatives, *Congress Profiles: 108th Congress (2003–2005)* (December 11, 2020) History Art and Archives < <https://history.house.gov/Congressional-Overview/Profiles/108th/>>.

regime.¹⁸⁷² Initially, fiscal measures broadly like these promoting efficiency and simplicity more vigorously were mainly utilised by States applying the open ship register model.¹⁸⁷³

Although demonstrating better efficiency and simplicity outcomes, the US federal tonnage tax system did not apply them optimally. It retained questionable complexities like deferring a capital gain under certain reinvestment conditions on the disposal of a qualifying asset.¹⁸⁷⁴

Conversely, income tax on a US company's unrealised foreign shipping income was abolished.¹⁸⁷⁵ It has been submitted that the amendments of 1975 and 1986 applying taxes to unrealised foreign shipping income were responsible to some significant degree for the accelerated decline of the American trading fleet in the closing of the 20th century.¹⁸⁷⁶

Therefore, their reversal may claw back significant efficiency and simplicity gains lost.¹⁸⁷⁷

4.7.4 In Summary: The US Merchant Fleet

McMahon submits that the second decade of the 21st century is a “tale of two [American] fleets.”¹⁸⁷⁸ He asserts that cabotage laws have ensured that American trading vessels plying US domestic sea routes are generally in a sustainable condition.¹⁸⁷⁹ Cabotage rules have sufficiently shielded them from having to compete with foreign vessels operating at lower costs.¹⁸⁸⁰ However, an overall decline is demonstrated for American trading vessels plying international sea routes outside of major war-building programs.¹⁸⁸¹ McMahon observes that

¹⁸⁷² Papavizas and Kiern, above n 1542, 383; Oxton Law (online), ‘The New U.S. Tonnage Tax (2005)’, March 2005 < <https://www.oxtonlaw.com/the-new-us-tonnage-tax>>; Marlow and Mitroussi, above n 70, 195, 200; See also *Internal Revenue Code*, 26 USC § 1352 to 1359 (2022).

¹⁸⁷³ Papavizas and Kiern, above n 1542, 384; See also *Internal Revenue Code*, 26 USC § 1352 to 1359 (2022).

¹⁸⁷⁴ *Ibid* 385.

¹⁸⁷⁵ *Ibid* 386.

¹⁸⁷⁶ *Ibid*; See generally Edmonson, above n 1848, (online).

¹⁸⁷⁷ *Ibid*; Alexander, above n 35, 24 [90], 29 [1], 31 [97].

¹⁸⁷⁸ McMahon, above n 36, 97.

¹⁸⁷⁹ *Ibid*.

¹⁸⁸⁰ *Ibid*.

¹⁸⁸¹ *Ibid*.

in the second decade of the 21st century, the American merchant marine carries less than 2 percent of the United States' international commerce.¹⁸⁸² He further opines that the 'international' fleet is generally completely reliant on State support to stay afloat due to foreign vessels operating at lower costs.¹⁸⁸³

At World War II's end, the American merchant marine was ranked the largest trading fleet globally.¹⁸⁸⁴ However, just before the commencement of the 1996 support programme, its 1995 stake, measured in deadweight tonnage and as a percentage of the active component of the global trading fleet, had fallen sharply to about 2.89%.¹⁸⁸⁵ Subsequent support measures, like subsidies in 1996 and a Dutch-based tonnage tax regime in 2004, have been unsuccessful in arresting the overall decline.¹⁸⁸⁶ Consequently, by 2010, its stake had further dropped to roughly 1%.¹⁸⁸⁷ The 2020 stake of roughly 0.58% demonstrates a further contraction of about 40% compared to its 2010 size.¹⁸⁸⁸ These trends are demonstrated in Table C below.

Therefore, the US merchant marine has, on the whole, and outside of accelerated war building, demonstrated a stubborn decline since its high-water mark at the end of World War II.¹⁸⁸⁹ Factors steering its development after American independence, like a lack of foreign competition and readily available cheaper building materials, are generally irrelevant for the 21st century.¹⁸⁹⁰ The introduction of income/corporate taxes and the establishment of low-cost

¹⁸⁸² Ibid 97-8; See also UNCTAD, *Review of Maritime Transport 1995* (United Nations; 1996) 143-47; UNCTAD, *Review of Maritime Transport 2010* (United Nations; 2010) 184-88; UNCTAD, above n 821, 44; See Table C below.

¹⁸⁸³ McMahan, above n 36, 98.

¹⁸⁸⁴ Ibid 94-5; Madigan, above n 1112, 3; Baer, above n 39, 21.

¹⁸⁸⁵ UNCTAD, above n 1882, 143-47; See Table C below.

¹⁸⁸⁶ McMahan, above n 36, 106.

¹⁸⁸⁷ UNCTAD, above n 1882, 184-88.

¹⁸⁸⁸ UNCTAD, above n 821, 44.

¹⁸⁸⁹ McMahan, above n 36, 94-5; Madigan, above n 1112, 3; Baer, above n 39, 21; UNCTAD, above n 1882, 143-47; UNCTAD, above n 1882, 184-88; UNCTAD, above n 821, 44; See Table C below.

¹⁸⁹⁰ Madigan, above n 1112, 2; McMahan, above n 36, 89-90, 97-8.

ship registers, like the modern open ship register, have also contributed to shipowners falling out of love with traditional ship registers like the American register.¹⁸⁹¹

The decline of the American registered trading fleet at any historical point should be understood by considering the full range of protections and incentives available (like lower taxes, subsidies and cabotage rules) together with the conditions prevailing at that time.¹⁸⁹² It is only after undertaking such an assessment that an appropriate shipping tax regime can be identified and calibrated to support the necessary level of competitiveness required to adequately equalise the playing fields between the local and foreign ship registers.¹⁸⁹³

Shifting State policy about sea power has also impeded the growth of the American merchant fleet.¹⁸⁹⁴ Fiscal policy that fails to address stability adequately may be unsuccessful in enacting a regime attractive to industry as business enjoys some level of certainty.¹⁸⁹⁵

A reason for the somewhat disinterested approach towards the registered trading fleet by particular US federal administrations may be their failure to grasp its worth as a direct component of a State's sea power.¹⁸⁹⁶ The US navy has been ranked as the most powerful navy globally since World War II.¹⁸⁹⁷ Therefore, it seems reasonable to conclude that the

¹⁸⁹¹ Ibid.

¹⁸⁹² Ibid.

¹⁸⁹³ McMahan, above n 36, 93; Morse, above n 58, 63; Madigan, above n 1112, 5.

¹⁸⁹⁴ Baer, above n 39, 15-8; McMahan, above n 36, 93, 99-100; Papavizas and Kiern, above n 1542, 385-6; Woodman, above n 1486, [location 7587, 7614]; Corres, above n 1566, 233; Madigan, above n 1112, 3, 5, 47; Morse, above n 58, 63-5; Caras, above n 1823, 1892-3; Edmonson, above n 1848, (online).

¹⁸⁹⁵ Papavizas and Kiern, above n 1542, 385-6; Edmonson, above n 1848, (online); Alexander, above n 35, 14 [39]; *1998 DETR Report*, above n 23, 14; Butcher, above n 38, 7; Ormrod, above n 1489, 209-10; Ormrod, above n 1489, 155-86.

¹⁸⁹⁶ Baer, above n 39, 15-8; Westermeyer, above n 38, 19; McMahan, above n 36, 91-2, 101; Madigan, above n 1112, 2, 5; Morse, above n 58, 63-4; Asteris, above n 35, 68-70.

¹⁸⁹⁷ Michael M McCrea, Karen N Domaby1 and Alexander F Parker, *The Offensive Navy Since World War II: How Big and Why, A Brief Summary* (2020) Naval History and Heritage Command (U.S. Navy) <<https://www.history.navy.mil/research/library/online-reading-room/title-list-alphabetically/o/the-offensive-navy-since-world-war-ii-how-big-and-why-a-brief-summary.html>>; But see U.S. Department of Defence, 'Military and Security Developments Involving the People's Republic of China 2020' (Annual Report to Congress; 2020)

advancement of sea power has been a critical imperative of successive US federal governments.¹⁸⁹⁸ However, past wars and emergencies have historically highlighted the naval fleet's logistical limits and reliance on merchant vessels.¹⁸⁹⁹

Accelerated merchant fleet renewal restricted to major conflicts has been observed to have disadvantages.¹⁹⁰⁰ Apart from the wastage that may be minimised better in calmer times, this practice increases the risk that the domestic infrastructure and skills required to support and replace merchant vessels at short notice is not sufficiently maintained in the long term.¹⁹⁰¹ History demonstrates that accelerated war-time shipbuilding does not necessarily produce merchant vessels of the same standard as peace-time shipbuilding.¹⁹⁰² Therefore, as a minimum, it seems prudent to maintain a sufficiently-sized active trading fleet and corresponding domestic infrastructure that is appropriate for peace-time requirements and adequate for initially managing an unexpected crisis.¹⁹⁰³ Ships do not sail, repair and replace themselves.

The COVID-19 pandemic of 2020 is a stark warning.¹⁹⁰⁴ Multiple States were inappropriately prepared as past assumptions about global collaboration and the like, proved somewhat false

VII; Christopher Woody, *These are the 10 biggest navies in the world* (2018) Business Insider Australia <<https://www.businessinsider.com.au/biggest-navies-in-the-world-2018-4?r=US&IR=T>>.

¹⁸⁹⁸ Ibid.

¹⁸⁹⁹ McMahan, above n 36, 91-2, 101; Asteris, above n 35, 69.

¹⁹⁰⁰ Asteris, above n 35, 67; McMahan, above n 36, 97, 101, 103, 105; Baer, above n 39, 20-1.

¹⁹⁰¹ Ibid.

¹⁹⁰² Madigan, above n 1112, 3; McMahan, above n 36, 95.

¹⁹⁰³ McMahan, above n 36, 105-6; see generally Asteris, above n 35, 69 -71.

¹⁹⁰⁴ Prabhjote Gill, 'Canada has enough COVID-19 vaccine doses to cover each citizen five times over while the fate of 67 poor countries remains undecided', *Business Insider India* (online) 9 December 2020 <<https://www.businessinsider.in/science/health/news/canada-has-enough-covid-19-vaccine-doses-to-cover-each-citizen-five-times-over-while-the-fate-of-67-poor-countries-remains-undecided/articleshow/79645493.cms>>; Andreas Rinke and Sabine Siebold, 'Germany secured 50 million vaccine doses from CureVac, BioNTech on top of EU supplies' *Reuters* (online) 9 January 2021 <<https://www.reuters.com/article/us-health-coronavirus-vaccine-germany/germany-secured-50-million-vaccine-doses-from-curevac-biontech-on-top-of-eu-supplies-document-idUSKBN29D1WU>>; Matthew Dalton and Eric Sylvers, 'Europe's Covid-19 Vaccination Campaign Off to Slow, Uneven Start' *The Wall Street Journal* (online) 7 January 2021 <<https://www.wsj.com/articles/europes-covid-19-vaccination-campaign-off-to-slow-uneven-start-11610015400>>; D Guan et al, 'Global supply-chain effects of

amid a crisis. These false assumptions have led to many States experiencing shortages as they lack the domestic infrastructure to provide for local demand.¹⁹⁰⁵

In the 20th century, the failure of US fiscal policy to support the active and registered trading fleet's growth may, in part, be attributed to a misguided policy. A policy that applies relatively higher and more complicated taxes to an industry that has unique mobility and that can operate elsewhere tax-free generally.¹⁹⁰⁶ Thus, shipowners may operate wherever with relative ease whilst still delivering the same services internationally.¹⁹⁰⁷

Thus, it appears self-defeating to raise corporate/income taxes on a tax base unsuited to bear them, primarily producing base erosion.¹⁹⁰⁸ Further, a special tax regime will not necessarily support a reversal in the decline in registered tonnage, irrespective of other measures offered.¹⁹⁰⁹ The American trading fleet has continued to contract despite the US introducing a Dutch-based tonnage tax.¹⁹¹⁰ These poor results may, partly, be attributed to inadequately promoting efficiency and simplicity. In chapter 5, the thesis will further consider the Dutch model.

A registered and active merchant fleet is, generally, vital for a State's national security as it is a critical component of sea power.¹⁹¹¹ Thus, a State should generally prioritise its protection.

COVID-19 control measures' (2020) 4 *Natural Human Behaviour* 577-587 <<https://doi.org/10.1038/s41562-020-0896-8>>.

¹⁹⁰⁵ Ibid.

¹⁹⁰⁶ Papavizas and Kiern, above n 1542, 385-6; Edmonson, above n 1848, (online); Alexander, above n 35, 7 [8].

¹⁹⁰⁷ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3]; McMahon, above n 36, 97-8, 105-6; See generally Edmonson, above n 1848, (online); Papavizas and Kiern, above n 1542, 385-6; Lazenby, above n 1731, 74; Thuong, above n 1542, 23; Dwyer, above n 2, 747-8; *1998 DETR Report*, above n 23, 16.

¹⁹⁰⁸ McMahon, above n 36, 97-9, 105-6; Papavizas and Kiern, above n 1542, 385; See generally Edmonson, above n 1848, (online); Asteris, above n 35, 67, 71; Butcher, above n 38, 5-8; *1998 DETR Report*, above n 23, 9-10, 13, 18, 28-9; Alexander, above n 35, 7 [8], 9 [18], 11 [26], 13-4 [38]; UNCTAD, above n 821, 44; UNCTAD, above n 1882, 184-88; UNCTAD, above n 1882, 143-47; See Table C below.

¹⁹⁰⁹ Papavizas and Kiern, above n 1542, 383-5 [1]; Oxtan Law, above n 1872, (online).

¹⁹¹⁰ Ibid; See Table C below.

¹⁹¹¹ McMahon, above n 36, 97-9, 100-1, 105-6; Asteris, above n 35, 71; Thuong, above n 1542, 23; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; Marlow and Mitroussi, above n 70, 201.

In the 20th and 21st centuries, the failure to apply appropriate fiscal measures in government support packages may be a case of utilising “bad” taxes: taxes that are overly complex; too inefficient; that suffer from instability; and concessions that are not aggressive enough in implementing Positive Anti-Neutrality.¹⁹¹²

Perhaps its decline has on occasion failed to arouse the concern of American policymakers as they harbour the belief that the US can always rely on merchant tonnage from allies and open registers, like the Liberian, Panamanian or Marshall Islands’ ship registers.¹⁹¹³ The historical analysis has demonstrated that the Americans have, on occasion, played a significant part in developing open registers like these to further their objectives.¹⁹¹⁴ However, McMahon is not convinced that merchant tonnage from these registers will always be as forthcoming in a future crisis where the global dominance of the US is uncertain.¹⁹¹⁵ The US, or its allies, is no longer the obvious dominant superpower globally, and significant competitor States have, over time, increased their influence over States like Panama.¹⁹¹⁶

4.8 Chapter Four’s Final Observations

Traditional ship registers, like the US and British ship registers, which were once the largest globally, continue to decline in the 21st century.¹⁹¹⁷ The contraction has been observed by considering the deadweight tonnage of an active and registered merchant fleet over time and

¹⁹¹² McMahon, above n 36, 97-8, 105-6; Asteris, above n 35, 70-1; Papavizas and Kiern, above n 1542, 385; See generally Edmonson, above n 1848, (online); Marlow and Mitroussi, above n 70, 201; See generally Alexander, above n 35, 14 [39]; *1998 DETR Report*, above n 23, 14; See generally Butcher, above n 38, 7; See Table C.

¹⁹¹³ McMahon, above n 36, 104; DeSombre, above n 1731, 73-4; See generally Robert C Kiste, Marshall Islands (10 March 2021) Encyclopedia Britannica < <https://www.britannica.com/place/Marshall-Islands>>.

¹⁹¹⁴ DeSombre, above n 1731, 73-4.

¹⁹¹⁵ McMahon, above n 36, 104; But see Butcher, above n 38, 9; But see Alexander, above n 35, 9, [17].

¹⁹¹⁶ *Ibid.*

¹⁹¹⁷ See Table C; UNCTAD, above n 821, 44; UNCTAD, above n 1882, 184-88; UNCTAD, above n 1882, 143-47; Maritime UK, above n 821, 52; McMahon, above n 36, 97-8; Oxford Economics, ‘The economic contribution of the UK shipping industry’ (Final Report; Winter 2007) 8; Oxford Economics, ‘The economic impact of the UK Maritime Services Sector’ (Final Report; February 2013) 19.

as a percentage of the corresponding global fleet.¹⁹¹⁸ Overall, the deterioration has remained unabated despite a re-emphasis on government support, including introducing Dutch-based tonnage tax regimes in the UK and US at the beginning of the 21st century.¹⁹¹⁹

Thus, the UK government has recently demonstrated a renewed eagerness to reconsider its shipping tax regime.¹⁹²⁰ In a 2019 industry report, it was stated that:

the proportion of UK flagged vessels in the tonnage tax has ... fallen. At its peak, around 95 companies had joined the scheme, and most vessels were UK flagged. Today only 71 company groups remain, with a total of 713 vessels and only 268 (38%) of these are UK registered.¹⁹²¹

A unique characteristic of the merchant fleet is its high mobility as a tax base.¹⁹²² The high mobility is exacerbated, in part, due to the prevalence of open registers that have become the largest ship registers in the 21st century.¹⁹²³ Modern open ship registers are offered predominantly by developing States (albeit sometimes with the support from States like the US) and provide shipowners with the option to operate in a low-cost environment, including lower wage costs, lower taxes and reduced bureaucracy.¹⁹²⁴ In 2020, the Panamanian open

¹⁹¹⁸ *Ibid.*

¹⁹¹⁹ Maritime UK, above n 821, 52; McMahon, above n 36, 97-8; Papavizas and Kiern, above n 1542, 383.

¹⁹²⁰ Maritime UK, above n 821, 52.

¹⁹²¹ *Ibid.*

¹⁹²² Alexander, above n 35, 7 [8]; *1998 DETR Report*, above n 23, 16; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3].

¹⁹²³ See Table C below; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; *1998 DETR Report*, above n 23, 3, 12-4; 16, 28-9; Alexander, above n 35, 7 [8]; McMahon, above n 36, 99; Butcher, above n 38, 5, 7-8; UNCTAD, above n 821, 44; UNCTAD, above n 1882, 184-88; UNCTAD, above n 1882, 143-47; 'As of 1 January 2015, the Panama Registry is in charge of managing the world's largest ship registry with over 8000 registered vessels, which accounts for 352 million deadweight tonnage (DWT), representing 20.13% of the world fleet': Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁹²⁴ DeSombre, above n 1731, 73-4; See especially Panagiotou and Thanopoulou, above n 43, 7; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-6; *OECD Consolidated Application Note*, above n 2, 80; *1998 DETR Report*, above n 23, 3, 13-4; McMahon, above n 36, 99; Lazenby, above n 1731, 74; Butcher, above n 38, 5, 7-8; See generally Kiste, above n 1913; 'The shipping boom of the 1950s which produced high profits also produced high taxes. Many ship owners looked to other countries where there was minimal taxation, or none at all, to register their vessels. Also, freedom of operation because of less stringent labour legislation requirements, lack of currency exchange and investment controls, and the apparently less stringent safety requirements have also

register, with roughly a 16% stake in the active global trading fleet, ranked as the largest ship register worldwide.¹⁹²⁵ Likewise, with a 13 % stake, the Liberian open register ranked then as the second-largest ship register globally.¹⁹²⁶ Further, the number of States offering open registers has increased over time.¹⁹²⁷ Thus, where traditional ship registers, like the US, have demonstrated a reduction in their stake over time, the opposite proves true for open registers and others, like the Chinese ship register.¹⁹²⁸

Like its American counterpart, the British ship register has, in the 21st century, continued to demonstrate a persistent overall contraction in merchant tonnage in proportion to the active global trading fleet.¹⁹²⁹ In 1995, its stake was 1.16%.¹⁹³⁰ By 2020, this stake had declined to 0.58%.¹⁹³¹ Thus, open registers appear to be out-competing specific key registers successfully.¹⁹³² This decline has occurred despite the simultaneous expansion, overall, in global merchant tonnage.¹⁹³³ These trends are demonstrated in Table C below. This decline

been given as reasons for the registration of ships under flags of convenience.’: Lazenby, above n 1731, 75; But see regarding standards: *OECD Consolidated Application Note*, above n 2, 80; Lazenby further notes that ‘today, monetary considerations remain one of the major incentives for the registration of vessels under flags of convenience.’: Lazenby, above n 1731, 75; See generally Thuong, above n 1542, 23.

¹⁹²⁵ UNCTAD, above n 821, 44; See Table C below.

¹⁹²⁶ *Ibid.*

¹⁹²⁷ Thuong, above n 1542, 23; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; UNCTAD, above n 821, 44; UNCTAD, above n 1882, 42, 188; For a list of States with open registers see ITF Seafarers, above n 784.

¹⁹²⁸ See Table C below.

¹⁹²⁹ Maritime UK, above n 821, 52; *1998 DETR Report*, above n 23, 8 [23]; McMahon, above n 36, 97-8; See Table C.

¹⁹³⁰ UNCTAD, above n 1882, 143-47; *1998 DETR Report*, above n 23, 9; See Table C.

¹⁹³¹ UNCTAD, above n 1882, 44; Maritime UK, above n 821, 52; See Table C.

¹⁹³² *Ibid.*

¹⁹³³ Maritime UK, above n 821, 3, 5, 46; *1998 DETR Report*, above n 23, 7 [18], See Table C; ‘The OECD forecast the global maritime economy to double in size to \$3 trillion in the next ten years.’: Maritime UK, above n 821, 3. Also shipping continues to be ‘a fundamental enabler’ of British global trade in the 21st century, as 95% of all goods are carried by ship and through ports, amounting to over £500bn: Maritime UK, above n 821, 3.

has, in part, also been observed to coincide with the application of inefficient and overly complicated direct taxes.¹⁹³⁴ Policy instability has also impeded growth.¹⁹³⁵

The necessity of a State keeping an appropriately sized registered merchant fleet that may readily be mobilised during times of global crises is demonstrated by the historical record.¹⁹³⁶

The decline of a local trading fleet does not necessarily only sound in economic terms but may create a severe deficiency in the sea power of a State.¹⁹³⁷ Furthermore, shipping has been said to be more environmentally sustainable than other transportation modes like aviation.¹⁹³⁸ Thus, protecting a local shipping tax base may provide multiple benefits.

Irrespective of the strength of a State's naval fleet, deficiencies in a local registered trading fleet may expose the naval fleet and broader armed forces to logistical vulnerabilities in executing operations.¹⁹³⁹ Whilst the global system is operating under regular stress, the significance of a registered merchant fleet as a factor of a State's sea power might be less obvious to politicians and their electorate.¹⁹⁴⁰

However, China appears to have grasped the significance of a local merchant fleet for optimally leveraging sea power. Thus, it continues to expand its merchant fleet, whilst the merchant fleets

¹⁹³⁴ 1998 *DETR Report*, above n 23, 13-4 [43]; Alexander, above n 35, 3 [vi], 14 [39]; McMahon, above n 36, 105-6; Asteris, above n 35, 70-1; Papavizas and Kiern, above n 1542, 385; See generally Edmonson, above n 1848, (online); Butcher, above n 38, 7-8; Panagiotou and Thanopoulou, above n 43, 6-7.

¹⁹³⁵ Alexander, above n 35, 3, 10 [23], 11 [25], 13-4 [38]-[39]; 1998 *DETR Report*, above n 23, 28-9 [123]; McMahon, above n 36, 105-6; Maritime UK, above n 821, 52; Asteris, above n 35, 70-1; *The Mirrlees Review*, above n 17, 44.

¹⁹³⁶ Asteris, above n 35, 67, 69, 71; McMahon, above n 36, 100, 104, 106; Baer, above n 39, 20-1; Butcher, above n 38, 6-7.

¹⁹³⁷ *Ibid*; See generally Maritime UK, above n 821, 3-5.

¹⁹³⁸ 1998 *DETR Report*, above n 23, 6 [10]-[11]; Maritime UK, above n 821, 47; But see Alexander, above n 35, 15-6 [48]; Michael J Coren, 'Shipping is overtaking aviation in emission reductions', *Quartz* (online), 3 October 2019 < <https://qz.com/1719707/shipping-is-overtaking-aviation-in-emission-reductions/>>; See generally Oxford Economics (2007 report), above n 1917, 15.

¹⁹³⁹ Asteris, above n 35, 67, 69, 71; McMahon, above n 36, 100, 104, 106; Baer, above n 39, 20-1; Butcher, above n 38, 6-7.

¹⁹⁴⁰ McMahon, above n 36, 99-100.

of certain key Western States continue to contract in proportionate size.¹⁹⁴¹ In 2020, the Chinese register's stake in the active global merchant fleet was about 4.85%.¹⁹⁴² This stake is larger than the corresponding combined stakes of the American and British ship registers.¹⁹⁴³ The Chinese commitment to sea power has also resulted in its navy outsizeing the US navy.¹⁹⁴⁴

The historical record demonstrates that a trading fleet as a factor of a State's sea power is far too significant to allow it to be eroded by foreign market forces.¹⁹⁴⁵ Thus, sea power should be the foremost policy concern in designing a model shipping tax regime.¹⁹⁴⁶ However, as taxes generally constitute only one component of a stimulus package to the industry, other measures, like subsidies and cabotage rules, should also be considered when designing and applying a shipping tax regime.¹⁹⁴⁷ As the practice of the British monarchs of antiquity demonstrates, developing a robust registered merchant fleet does not occur at the behest of market forces.¹⁹⁴⁸ It requires appropriate and consistent State support for its development.¹⁹⁴⁹ It has been submitted that without State support in the 21st century, registered trading fleets, like the American and British fleets, would, over time, virtually disappear in the face of fierce foreign competition.¹⁹⁵⁰

¹⁹⁴¹ Maritime UK, above n 821, 52; McMahon, above n 36, 101-2; U.S. Department of Defence, above n 1897, VII; Asteris, above n 35, 69, 71; *1998 DETR Report*, above n 23, 8 [23], UNCTAD, above n 821, 44; UNCTAD, above n 1882, 184-88; UNCTAD, above n 1882, 143-47; UNCTAD, above n 1570, 84-7; UNCTAD, above n 1560, [Annex III] 1-20; UNCTAD, above n 1570, 56-62; See Table C.

¹⁹⁴² UNCTAD, above n 821, 44; See Table C.

¹⁹⁴³ *Ibid.*

¹⁹⁴⁴ U.S. Department of Defence, above n 1897, VII; Woody, above n 1897, (online).

¹⁹⁴⁵ *1998 DETR Report*, above n 23, 6 [8], 7 [14]-[16]; Butcher, above n 38, 6; McMahon, above n 36, 99-101; 104-6; Asteris, above n 35, 69, 71.

¹⁹⁴⁶ Alexander, above n 35, 16 [49]; McMahon, above n 36, 106; Asteris, above n 35, 69, 71.

¹⁹⁴⁷ *1998 DETR Report*, above n 23, 6 [8], 7 [14]-[16]; Butcher, above n 38, 6; McMahon, above n 36, 99-101; 104-6; Asteris, above n 35, 69, 71.

¹⁹⁴⁸ Ormrod, above n 1489, 209-10; Ormrod, above n 1489, 155-86; Oppenheim, above n 1486, 472, 477-94; Davis, above n 1494, 1-2, 6-7; Butcher, above n 38, 2; Corres, above n 1566, 233; McMahon, above n 36, 99-101; *1998 DETR Report*, above n 23, 8 [23], McMahon, above n 36, 97-8.

¹⁹⁴⁹ *Ibid.*

¹⁹⁵⁰ See especially Alexander, above n 35, 3 [vi], 4 [x], 7[8], 12, 13[8], 31 [97]; Woodman, above n 1486, [location 7587, 7614]; Maritime UK, above n 821, 52; McMahon, above n 36, 97-8; See generally Edmonson, above n 1848, (online).

The 20th and 21st centuries demonstrate that normal income/corporate taxes are generally unsuitable for taxing shipping income.¹⁹⁵¹ Thus, despite their design being tweaked with modifications, like tax deferrals,¹⁹⁵² generous capital allowances¹⁹⁵³ and tonnage tax formulas,¹⁹⁵⁴ they tend to continue facilitating base erosion.¹⁹⁵⁵ These tax regimes suffer from terminal inefficiency and complexity.¹⁹⁵⁶ Thus, in chapter 5, the thesis will advocate for an optimal shipping tax regime that *primarily* operates independently of these tax regimes.

In closing, policymakers have stubbornly continued to apply the normal income/corporate tax regime in one form or another to raise taxes on shipping income, despite these regimes failing overall to operate sustainably.¹⁹⁵⁷ Hence, George Santayana's sage observation continues to ring ominously true in the history of the British and American registered trading fleets.¹⁹⁵⁸

¹⁹⁵¹ Alexander, above n 35, 3 [vi], 13[8]; *1998 DETR Report*, above n 23, 7, 13-4; Maritime UK, above n 821, 52; Asteris, above n 35, 71; See generally Edmonson, above n 1848, (online); McMahan, above n 36, 97-8, 105-6; See Table C.

¹⁹⁵² Alexander, above n 35, 10 [21]; Caras, above n 1823, 1892.

¹⁹⁵³ Alexander, above n 35, 10 [21], 11 [25]; Asteris, above n 35, 70-1.

¹⁹⁵⁴ Papavizas and Kiern, above n 1542, 383-5 [1]; Alexander, above n 35, 4 [xi]; Maritime UK, above n 821, 52.

¹⁹⁵⁵ Cobb, above n 17, 627-8; Dwyer, above n 2, 747-8.

¹⁹⁵⁶ Alexander, above n 35, 3 [vii], 10 [23] – [24], 13 [38]; *The Mirrlees Review*, above n 17, 22-3, 29-30, 34, 40-4; Maritime UK, above n 821, 52; See Table C.

¹⁹⁵⁷ See Table C below; Papavizas and Kiern, above n 1542, 383-5 [1]; Maritime UK, above n 821, 52; McMahan, above n 36, 106.

¹⁹⁵⁸ Santayana, above n 1428, 284.

Table C: Merchant Fleets by Flag of Registration (in Thousands Dead-Weight Tonnage) ¹⁹⁵⁹

Total Tonnage	1964	%	1968	%	1975	%	1985	%	1991	%	1995	%	2010	%	2020	%
Australia	-	0.00	987	0.38	1 621	0.30	3 094	0.47	3 805	0.56	3 976	0.54	2 171	0.17	-	0.00
China	-	0.00	1 030	0.39	4 247	0.78	15 918	2.39	20 428	2.99	24 934	3.39	45 157	3.54	100 086	4.85
Greece	10 098	5.29	11 072	4.22	37 542	6.87	55 356	8.33	44 011	6.44	52 065	7.08	67 629	5.30	68 632	3.33
Hong Kong	-	0.00	1 232	0.47	594	0.11	11 333	1.70	10 849	1.59	15 257	2.08	74 513	5.84	201 361	9.77
India	-	0.00	2 887	1.10	6 281	1.15	10 761	1.62	10 359	1.52	11 614	1.58	14 970	1.17	17 339	0.84
Japan	14 368	7.53	27 998	10.68	64 479	11.80	63 451	9.54	38 175	5.59	28 784	3.92	17 707	1.39	40 323	1.96
Marshal Islands (before 2010 included in US)	-		-		-		-		-		-		77 827		261 806	
Liberia	22 519	11.80	40 781	15.56	126 054	23.08	113 552	17.08	94 808	13.87	97 889	13.32	142 121	11.14	274 786	13.33
Norway	21 455	11.24	30 976	11.82	45 597	8.35	25 721	3.87	41 071	6.01	32 867	4.47	20 811	1.63	-	0.00
Panama	-	0.00	8 121	3.10	22 162	4.06	67 267	10.12	76 258	11.16	109 514	14.90	288 758	22.63	328 950	15.95
South Africa	-	0.00	501	0.19	651	0.12	673	0.10	284	0.04	294	0.04	126	0.01	-	0.00
United Kingdom	27 244	14.27	29 563	11.28	53 422	9.78	21 795	3.28	7 839	1.15	8 558	1.16	20 176	1.58	11 962	0.58
United States	14 230	7.45	17 173	6.55	15 606	2.86	23 043	3.47	24 566	3.59	21 243	2.89	12 792	1.00	11 985	0.58
Globally	190 897	100	262 070	100	546 260	100	664 800	100	683 513	100	734 917	100	1 276 137	100	2 061 944	100

¹⁹⁵⁹ UNCTAD, *Review of Maritime Transport 2020* (United Nations; 2020) 44; UNCTAD, *Review of Maritime Transport 2010* (United Nations; 2010) 184-88; UNCTAD, *Review of Maritime Transport 1995* (United Nations; 1996) 143-47; UNCTAD, *Review of Maritime Transport 1991* (United Nations; 1992) 84-7; UNCTAD, *Review of Maritime Transport 1985* (United Nations; 1986) [Annex III] 1-20; UNCTAD, *Review of Maritime Transport 1975* (United Nations; 1977) 56-62; UNCTAD, *Review of Maritime Transport 1968* (United Nations; 1969) 11; But see UNCTADSTAT, *Merchant fleet by flag of registration and by type of ship, annual* (2020) United Nations < <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=93>>. Generally, includes vessels of 100 GT and above, excluding the Great Lakes fleets of the United States and Canada and the United States Reserve Fleet. ** Cells with a dash represent no data for the particular State from the source that is relied upon. 42 532 146/798 995 409 = 5.3

Chapter 5: Designing an Optimal Shipping Tax Regime

5.1 Part A: General Considerations about Shipping Tax Regimes

5.1.1 *MAF*, Exceptional Mobility & Sea Power: A Case for Super Efficiency

The research has currently established that in the first two decades of the 21st century, significant ship registers, like the American and British ship registers, have continued to contract in size despite the US and UK enacting special tonnage tax regimes.¹⁹⁶⁰ This observation has, in part, been achieved by considering the *active* deadweight tonnage of a State's *registered* trading fleet as a percentage of the corresponding global fleet. These percentages are established for particular points over a period of about 55 years in Table C above.

Generally, registered and active deadweight merchant tonnage has been treated by previous research as an appropriate measure for evaluating shipping fiscal policy and sea power.¹⁹⁶¹ This measure may provide a reasonable general assessment of a merchant fleet as a key factor of sea power.¹⁹⁶² It considers total carrying capacity that may be a significant factor for the logistical sealift requirements of a military operation.¹⁹⁶³ It may also provide a reasonable assessment of a fleet that demonstrates the following key attributes: (1) a fleet that, at short notice, may be mobilised more reliably; (2) a fleet that is sufficiently under a State's direct control; and (3) a fleet that is more efficient to maintain and keep modernised as technology

¹⁹⁶⁰ See Table C above; Papavizas and Kiern, above n 1542, 383; Maritime UK, above n 821, 52; McMahon, above n 36, 97-8.

¹⁹⁶¹ Asteris, above n 35, 66-7, 70-1; McMahon, above n 36, 104-6.

¹⁹⁶² *Ibid.*

¹⁹⁶³ *Ibid.*; Britannica Encyclopedia, *tonnage* (2019) < <https://www.britannica.com/technology/tonnage>>.

advances.¹⁹⁶⁴ However, certain vessels are better than others in supporting a military operation.¹⁹⁶⁵ Therefore the above measure provides only a general assessment.

Previous legal advice has thought that sea power constitutes a more compelling rationale for adopting a special shipping tax treatment.¹⁹⁶⁶ In assessing sea power, previous research has submitted that a measure should be employed that considers a more robust control nexus between a relevant merchant fleet and a sponsoring State.¹⁹⁶⁷ Thus, an appropriate nexus might be demonstrated by a fleet whose vessels are entered in a State's ship register.¹⁹⁶⁸

Vessels that fly a State's flag assume its nationality and are under its protection whilst plying the high seas.¹⁹⁶⁹ Therefore, these vessels owe a greater allegiance to the State whose flag they fly. Such vessels may, potentially, be less prone to foreign political interference and market forces.¹⁹⁷⁰ Thus, their availability might be more reliable, including their requisitioning, because they can be more closely regulated and controlled by the particular State.¹⁹⁷¹ That control may also ensure their condition is more satisfactory, whether by appropriate crewing, equipping or maintenance.¹⁹⁷²

Conversely, a reserve fleet may have multiple disadvantages compared to an active trading fleet.¹⁹⁷³ Such disadvantages may include considerations like the continuing financial burden and operating responsibilities that the State must bear, and the risk that its modernisation and

¹⁹⁶⁴ Asteris, above n 35, 70-1; McMahan, above n 36, 104-6; But See Butcher, above n 38, 9; But see Alexander, above n 35, 9 [17].

¹⁹⁶⁵ McMahan, above n 36, 96; Asteris, above n 35, 67; Breskin, above n 6, 63-4; See also Papavizas and Kiern, above n 1542, 380-3.

¹⁹⁶⁶ Alexander, above n 35, 15 [46] 16 [49].

¹⁹⁶⁷ McMahan, above n 36, 104-6; Asteris, above n 35, 66-7, 70-1.

¹⁹⁶⁸ *Ibid.*

¹⁹⁶⁹ *UNCLOS* arts 91 and 92.

¹⁹⁷⁰ McMahan, above n 36, 103-6.

¹⁹⁷¹ *Ibid.*

¹⁹⁷² *Ibid.*; Asteris, above n 35, 66-7, 70-1.

¹⁹⁷³ Asteris, above n 35, 70-1.

broader infrastructure are not sufficiently maintained.¹⁹⁷⁴ The broader infrastructure should serve as a sustainable peace-time essential minimum that may be expanded more readily in a crisis for accelerated ship production and operation.¹⁹⁷⁵ Ships do not sail, repair and replace themselves.

Through historical analysis, chapter four demonstrates the importance of promoting sea power for safeguarding a State's national security.¹⁹⁷⁶ A critical component of a State's sea power is its active trading fleet.¹⁹⁷⁷ The historical record illustrates what may ensue when a State's merchant fleet is neglected.¹⁹⁷⁸ Examples that may be referenced include the Anglo Boer War and World War I that evidenced critical disruptions due to the US being overly reliant on foreign merchant tonnage.¹⁹⁷⁹ In these instances, foreign merchant tonnage was pulled from international sea routes servicing the US leading to perishable cargo and the like being deserted at US ports for extended periods.¹⁹⁸⁰ Thus, a sufficiently sized registered merchant fleet may allow a State to have better access to more reliable sea carriage, particularly in cases where it is in high demand during global crises.¹⁹⁸¹ Thus, sea power can facilitate the securitisation of vital sea routes and their corresponding supply chains, essential for providing necessary food items, medicines and other essential goods to a State.¹⁹⁸² In contrast to air transport, sea transport may also be more environmentally sustainable.¹⁹⁸³

¹⁹⁷⁴ Ibid; McMahon, above n 36, 103-6.

¹⁹⁷⁵ Asteris, above n 35, 70-1; McMahon, above n 36, 103-6; Madigan, above n 1112, 3; Baer, above n 39, 21; USMM.org, *U.S. Merchant Marine in World War II* (2007) <<http://www.usmm.org/ww2.html>>.

¹⁹⁷⁶ Alexander, above n 35, 16 [49]; Asteris, above n 35, 71; McMahon, above n 36, 106.

¹⁹⁷⁷ Ibid.

¹⁹⁷⁸ McMahon, above n 36, 92-3; Madigan, above n 1112, 2; Asteris, above n 35, 68-9; Baer, above n 39, 20-2.

¹⁹⁷⁹ McMahon, above n 36, 92-3; Madigan, above n 1112, 2.

¹⁹⁸⁰ Ibid.

¹⁹⁸¹ Asteris, above n 35, 68-9, 71; McMahon, above n 36, 92-3, 106.

¹⁹⁸² Ibid.

¹⁹⁸³ Maritime UK, above n 821, 46; Alexander, above n 35, 15-6 [48]; *1998 DETR Report*, above n 23, 2-3.

Other examples include World War II, the Falkland's crisis and the Persian Gulf War, which similarly demonstrate the significance of an appropriately sized trading fleet for adequately promoting a State's sea power.¹⁹⁸⁴ Thus, the historical record presents a convincing case for promoting a State's sea power, in part, by maintaining a sufficiently sized and active registered trading fleet.¹⁹⁸⁵ Also, it would be somewhat naive to assume that major wars have been successfully waged by merely relying on a naval fleet.¹⁹⁸⁶ Trading fleets may play an essential role in military operations by providing critical sealift.¹⁹⁸⁷ Also, in the 21st century, the importance of sea trade is acknowledged through the significant volume and quantity of goods carried by sea, constituting the vast majority.¹⁹⁸⁸

The 2020 COVID-19 pandemic is a more recent twenty-first-century illustration where States tend to exhibit greater nationalistic tendencies and monopolise scarce resources to the detriment of other States in response to a global emergency.¹⁹⁸⁹ Thus, the pandemic serves as another example where inter-State cooperation may be more limited under abnormal conditions. Thus, in servicing critical national demands, it may be to the advantage of an individual State to maintain a certain level of domestic capacity, in contrast, to merely outsourcing it as the market [and foreign States] may dictate.¹⁹⁹⁰ Maintaining reasonable domestic capacity includes ensuring sufficient access to an active merchant fleet.¹⁹⁹¹ Thus,

¹⁹⁸⁴ Baer, above n 39, 20-2; Madigan, above n 1112, 2-3; Asteris, above n 35, 68-9; McMahon, above n 36, 92-3, 97.

¹⁹⁸⁵ Ibid.

¹⁹⁸⁶ Ibid.

¹⁹⁸⁷ Ibid.

¹⁹⁸⁸ Maritime UK, above n 821, 3, 46; *1998 DETR Report*, above n 23, 4 [1]; ICS and WSC, above n 5, 1-3.

¹⁹⁸⁹ Marco Hafner *et al*, *COVID-19 and the cost of vaccine nationalism* (2020) Santa Monica, CA: RAND Corporation < https://www.rand.org/pubs/research_reports/RRA769-1.html>; BBC News, *Coronavirus: WHO criticises EU over vaccine export controls* (30 January 2021) < <https://www.bbc.com/news/world-europe-55860540>>; Ben Hall, Miles Johnson and Martin Arnold, *Italy wonders where Europe's solidarity is as coronavirus strains show* (14 March 2020) Financial Times < <https://www.ft.com/content/d3bc25ea-652c-11ea-b3f3-fe4680ea68b5>>; Mogomotsi Magome, *South Africa's president criticizes 'vaccine nationalism'* (26 January 2021) Associated Press < <https://apnews.com/article/global-trade-coronavirus-pandemic-virtual-worlds-africa-south-africa-44cd765d5a95635887c3119e2756164b>>.

¹⁹⁹⁰ Ibid.

¹⁹⁹¹ Asteris, above n 35, 70; McMahon, above n 36, 96-7.

even in a modern and globalised world, such a policy objective remains essential.¹⁹⁹²

Accomplishing such an objective ensures that a State is more readily equipped to withstand tonnage shortages arising at short notice and from abnormal or unexpected occurrences, particularly in cases where international cooperation is not functioning within normal parameters.¹⁹⁹³ Therefore, in promoting a registered merchant fleet, sea power should, generally, be a primary policy objective underlying a State's shipping fiscal policy.

The decline of tonnage for traditional ships registers may be attributed to the tax base demonstrating abnormally high mobility.¹⁹⁹⁴ This mobility might be an inherent feature of owning and operating sea-going vessels.¹⁹⁹⁵ It may be demonstrated by the ever-increasing trend to reflag vessels in open registers.¹⁹⁹⁶ Nonetheless, a multiplicity of factors may, in varying degrees, be responsible for this special mobility.¹⁹⁹⁷ Some of these factors may not necessarily be unique to shipping.¹⁹⁹⁸ Further, it may be their collective effect that supports this unique mobility.¹⁹⁹⁹ However, factors or attributes such as the following may be unique to shipping:

- a. Operating vessels on the high seas, which is a space that does not belong to any one State.²⁰⁰⁰ Thus, vessels plying in that space will fall under the jurisdiction and protection of the State whose flag it flies.²⁰⁰¹ Thus, the place where the primary

¹⁹⁹² Asteris, above n 35, 71; McMahon, above n 36, 103-4.

¹⁹⁹³ Ibid; Alexander, above n 35, 16 [49].

¹⁹⁹⁴ 1998 *DETR Report*, above n 23, 9-10, 12-3, 16, 18, 29; Woodman, above n 1486, [location 6102- 7587, 7614]; Asteris, above n 35, 67; Thuong, above n 1542, 23-4; Butcher, above n 38, 3,5, 7-9; Davis, above n 1494, 377; Breskin, above n 6, 512-4; Papavizas and Kiern, above n 1542, 384; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15.

¹⁹⁹⁵ Ibid, *OECD Consolidated Application Note*, above n 2, 80 [291]; 2017 *OECD Progress Report*, above n 699, 21.

¹⁹⁹⁶ Ibid.

¹⁹⁹⁷ Ibid.

¹⁹⁹⁸ 1998 *DETR Report*, above n 23, 16.

¹⁹⁹⁹ 1998 *DETR Report*, above n 23, 16.

²⁰⁰⁰ *UNCLOS* arts 89 and 92.

²⁰⁰¹ Ibid.

business activities are physically carried out may be unique to the extent they physically occur in a ‘neutral’ space.²⁰⁰²

- b. The flag State does not generally have to be tied to any particular jurisdiction (Ignoring protected sea routes and the like).²⁰⁰³ Thus it may be argued that it is primarily a matter for the shipowner’s discretion.²⁰⁰⁴
- c. In contrast to traditional ship registers, the occurrence of open registers offers shipowners the opportunity to conduct their businesses in an environment with lower costs and bureaucracy, including lower fiscal and labour costs.²⁰⁰⁵ Thus, ship owners in these environments may have significant advantages over businesses utilising traditional ship registers.²⁰⁰⁶
- d. Shipping is a risky, competitive, specialised and expensive adventure.²⁰⁰⁷ Owning and operating vessels is a capital-intensive business.²⁰⁰⁸ It may involve high capital and revenue costs, thin profit margins, a market prone to volatility and fierce foreign competition.²⁰⁰⁹
- e. Insufficient government support for traditional registers producing a non-competitive business environment affecting the viability of its shipowning businesses.²⁰¹⁰ The

²⁰⁰² Ibid; *2017 OECD Progress Report*, above n 699, 21.

²⁰⁰³ *OECD Consolidated Application Note*, above n 2, 79-80; Thuong, above n 1542, 23-4; Butcher, above n 38, 3,5, 7-9; Breskin, above n 6, 48, 512-4; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-6; *1998 DETR Report*, above n 23, 9-10, 12-3, 16, 18, 29; Morse, above n 58, 60-1.

²⁰⁰⁴ *OECD Consolidated Application Note*, above n 2, 79-80; Thuong, above n 1542, 23-4; Butcher, above n 38, 3,5, 7-9; Breskin, above n 6, 48, 512-4; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-6; *1998 DETR Report*, above n 23, 9-10, 12-3, 16, 18, 29; Morse, above n 58, 60-1.

²⁰⁰⁵ *OECD Consolidated Application Note*, above n 2, 79-80; Thuong, above n 1542, 23-4; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-6; Butcher, above n 38, 5; Marlow and Mitroussi, above n 70, 190; *1998 DETR Report*, above n 23, 3, 12-4, 16; Maritime UK, above n 821, 52; See Table C above.

²⁰⁰⁶ Ibid.

²⁰⁰⁷ *1998 DETR Report*, above n 23, 16; Asteris, above n 35, 66-7, 67; Breskin, above n 6, 96-7, 264, 299; Branch and Robarts, above n 6, 292-295.

²⁰⁰⁸ Ibid.

²⁰⁰⁹ Ibid; Alvin Lee, *Managing shipping’s ever-increasing vessel size... and shrinking margins* (28 August 2019) Singapore Management University < <https://news.smu.edu.sg/news/2019/08/28/managing-shippings-ever-increasing-vessel-size-and-shrinking-margins>>.

²⁰¹⁰ Marlow and Mitroussi, above n 70, 190; *OECD Consolidated Application Note*, above n 2, 79-80; *1998 DETR Report*, above n 23, 3, 12-4, 16; McMahon, above n 36, 93; Morse, above n 58, 63; Madigan, above n 1112, 5; *EU Framework OJ C* 13, 3.

non-competitiveness arises from higher operating costs at these registers and by a State's failure to sufficiently protect the registered trading fleet from foreign competition operating at substantially lower costs.²⁰¹¹

Thus, several factors may jointly produce the abnormally high mobility unique to shipping.²⁰¹² As defined in chapter three, maritime transport activities were identified as the particular shipping activities that primarily demonstrate abnormally high mobility and produce what may, fiscally, be classified as shipping income.²⁰¹³ Therefore, shipping income ranks as the corresponding tax base, requiring special tax treatment.²⁰¹⁴

Against sea power and unique base mobility, the thesis will briefly revisit the *Model Analytical Framework* ('MAF') for identifying an optimal shipping tax regime for taxing shipping income. A central premise of chapter three was that the benchmarked efficiency criterion should be prioritised foremostly in ordering the *Updated Smithian Framework* ('USF'). This ordering was considered necessary where a base exhibits abnormally high mobility like shipping income.²⁰¹⁵ Thus, the *USF* would promote efficiency as its top priority.²⁰¹⁶ Further, simplicity was ordered as the second top priority for the *USF*, as it naturally supports efficiency outcomes.²⁰¹⁷ Equity as abstracted horizontally, and the peripheral attributes of certainty, were roughly promoted as third and fourth priorities.²⁰¹⁸

²⁰¹¹ Ibid.

²⁰¹² 1998 *DETR Report*, above n 23, 16.

²⁰¹³ *EU Framework* OJ C 13, 5; *OECD Model Tax Convention*, above n 703, C(8)-1 [4].

²⁰¹⁴ Ibid.

²⁰¹⁵ Stewart et al, above n 2, 21-2, 64-6; *The Henry Review*, above n 89, 17-8, 25, 39-40; *The Mirrlees Review*, above n 17, 29-30; Dwyer, above n 2, 747, 751-2; Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

²⁰¹⁶ Ibid.

²⁰¹⁷ Rousslang, above n 92, 6, 8-9; *The Mirrlees Review*, above n 17, 22-3, 35, 40-2; *The Henry Review*, above n 89, viii (4.4), xix; 11, 15-6, 21, 24, 29, 30-1, 69, 71, 80.

²⁰¹⁸ Fan, above n 163, 540-2, 544-5, 547; Rousslang, above n 92, 4-5, 8-9; Galle, above n 137, 1327-8; Cobb, above n 17, 646-8; Dwyer, above n 2, 683, 748, 751-2, 764-9, 774-5; Stewart et al, above n 2, 85-6; Cannan, above n 14, 310; White, above n 110, 45-9; *The Henry Review*, above n 89, 17; Fiscal Policy Institute, above n 289, 9; Soanes and Stevenson, above n 290, 231; See also *OED*, above n 142, "certain"; Bigbee et al, above n 290 [principle 9].

For *MAF's Updated 1998 Framework*, the more complex criteria that may be encountered for designing shipping tax regimes are: (a) the substantial activity primary factor; (b) the ring-fencing primary factor; and (c) the transparency primary factor – considered more broadly (which overlaps to some degree with Smithian certainty).

The substantial activity primary factor, broadly, requires an eligible business operation or enterprise to have a substantial connection with a sponsoring State before the latter may apply concessional tax treatment to the former.²⁰¹⁹ The ring-fencing primary factor, broadly, requires a regime to apply a uniform tax treatment to domestic and foreign activities/entities.²⁰²⁰ The transparency primary factor, broadly, concerns openness, objective and rational tax treatments, and information access.²⁰²¹

However, *MAF* on its own does not necessarily adequately consider all the objectives that should be promoted in designing an optimal shipping tax regime. In particular, *MAF* does not necessarily directly consider or sufficiently address policy imperatives like sea power.²⁰²² Thus, *MAF* may exhibit weaknesses in its application in identifying an optimal shipping tax regime without additional inputs. Accordingly, maritime transport activities may acquire a more significant value as a tax base by considering inputs like sea power (besides the more banal economic considerations).²⁰²³

²⁰¹⁹ *OECD BEPS Action 5*, above n 13, 23; *OECD Consolidated Application Note*, above n 2, [331]-[3]; *2018 OECD Progress Report*, above n 32, 14.

²⁰²⁰ *OECD 1998 Report*, above n 2, 27 [62]; *OECD Consolidated Application Note*, above n 2, [320]; *2018 OECD Progress Report*, above n 32, 53.

²⁰²¹ *OECD 1998 Report*, above n 2, [63]; *OECD Consolidated Application Note*, above n 2, [328].

²⁰²² McMahan, above n 36, 104-6; Till, above n 1436, [1.3]; Baer, above n 39, 6-8; Westermeyer, above n 38, 18; Asteris, above n 35, 67.

²⁰²³ *1998 DETR Report*, above n 23, 6 [8], 7 [14]-[16]; Butcher, above n 38, 6; McMahan, above n 36, 99-101; 104-6; Asteris, above n 35, 69, 71.

Accordingly, sea power may constitute a further significant reason for prioritising efficiency foremostly in the *USF*.²⁰²⁴ However, sea power may not only support the current order of priorities in the *USF*, primarily directed at protecting a mobile tax base. It may also serve as an additional ground and weight for promoting an extraordinary efficiency outcome where appropriate.

An extraordinary efficiency outcome might require a super efficiency. One that would be achieved by the sponsoring State adopting fiscal measures that are somewhat exceptional. Both Negative and Positive Anti-Neutrality may, where appropriate, be implemented more aggressively. Nonetheless, any such exceptional treatment must still demonstrate an alignment with *MAF*, particularly its *Updated 1998 Framework*. Otherwise, the sponsoring State risks designing and implementing an illegitimate shipping tax regime internationally, to the extent that it fatally misaligns with the latter framework.

Super efficiency as an application is not necessarily a novel idea. A similar approach has been recognised as a plausible solution in previous works.²⁰²⁵ Adam Smith himself appeared to have accepted that market forces have their limits in achieving optimum solutions, and State intervention may sometimes be necessary.²⁰²⁶ Thus, for example, where monopolies arise, whether from public or private activity, they may, in both instances, be counterproductive to achieving optimum productivity.²⁰²⁷

²⁰²⁴ Ibid; Stewart et al, above n 2, 21-2, 64-6; *The Henry Review*, above n 89, 17-8, 25, 39-40; Evans, above n 113, 385, 388; *The Mirrlees Review*, above n 17, 29-30; Dwyer, above n 2, 747, 751-2; Mirrlees et al, above n 138, 333.

²⁰²⁵ Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

²⁰²⁶ Ibid.

²⁰²⁷ Ibid.

Thus, super neutrality may reference applying appropriate fiscal interference to ensure that resources are optimally used.²⁰²⁸ In chapters two and three, the thesis considered Positive Anti-Neutrality generally. The term was applied to reference the condition where fiscal measures encourage particular economic activity/ behaviour.²⁰²⁹ Thus, Positive Anti-Neutrality is similar to the ‘super neutrality concept.’²⁰³⁰ They both reference fiscal interference for encouraging specific outcomes.²⁰³¹ However, super neutrality may also cover interferences that punish specific behaviours - apart from rewarding them.²⁰³²

Some lobbyists have used capitalism and free-market principles to argue against State support for the shipping industry.²⁰³³ Certain governments have even ostensibly endorsed such arguments by steering tax reform in a direction that allows market forces to determine its fate more significantly.²⁰³⁴ However, to the extent that Adam Smith recognises super neutrality as a legitimate measure, it seems that such arguments may be theoretically unsound.²⁰³⁵

Therefore, whilst prioritising efficiency generally as neutrality, efficiency may also be applied exceptionally under specific controls. This exceptional application may aggressively promote Positive Anti-Neutrality as a super efficiency that encourages or rewards particular behaviour underpinning a local ship register’s expansion.

²⁰²⁸ Ibid.

²⁰²⁹ *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 23, 28-32; 39-41; Alley and Bentley, above n 2, 592, 612, 616; Cooper, above n 97, 438, 441.

²⁰³⁰ Ibid; Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

²⁰³¹ Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

²⁰³² Ibid.

²⁰³³ Corres, above n 1566, 233; Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

²⁰³⁴ Woodman, above n 1486, [location 7587, 7614]; McMahon, above n 36, 96-7; Breskin, above n 6, 63.

²⁰³⁵ Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

Super efficiency may be associated with efficiency as benchmarked, as they both consider tax distortions.²⁰³⁶ Both may be concerned with protecting tax bases, whether through neutrality or Positive Anti-Neutrality.²⁰³⁷ However, in the former instance, protection is generally through non-interference, whilst the latter is exceptionally achieved by encouraging particular behaviour.²⁰³⁸ Applying efficiency, as super efficiency, might be expected to counterbalance better the exceptional mobility inherent to the business of owning and operating vessels and, in turn, more optimally protect the corresponding tax base for sea power purposes.

The thesis will consider the different shipping tax regimes against the *USF*'s priorities, including super efficiency. Shipping tax regimes as normal and special regimes have not always successfully supported a reversal in the decline in merchant tonnage.²⁰³⁹ Thus, there appears to be a compelling case for promoting a super-efficiency more aggressively and broadly in a shipping tax regime's design and application to better support growth in the merchant tonnage of a register.

5.1.2 The Juridical Connecting Factors' Importance

5.1.2.1 A System-Wide Approach to Tax Design

In line with *The Mirrlees Review*'s approach, the thesis, likewise, adopts a systemic approach for considering taxes, including designing an optimum shipping tax regime.²⁰⁴⁰ Thus, irrespective of their different formulations, shipping tax regimes are, to some degree, treated by the thesis as constituting one of many components in an interactional and dynamic

²⁰³⁶ *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 23, 28-32; 39-41; Alley and Bentley, above n 2, 592, 612, 616; Cooper, above n 97, 438, 441.

²⁰³⁷ *Ibid*; Cobb, above n 17, 631, 646-7, 648, 650; Dwyer, above n 2, 747, 764-9, 802.

²⁰³⁸ *Ibid*.

²⁰³⁹ See Table C above; McMahon, above n 36, 104-6; Maritime UK, above n 821, 52.

²⁰⁴⁰ *The Mirrlees Review*, above n 17, 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324; *OECD Consolidated Application Note*, above n 2, [334].

system.²⁰⁴¹ Therefore, the entire tax system should still be considered for designing a suitable shipping tax regime.²⁰⁴² A holistic approach to tax design may better avoid redundancies and prevent exacerbating a system's overall inefficiency and complexity.²⁰⁴³ Hence, other regimes like the juridical connecting factors ('*JCFs*'), general anti-avoidance rules, and transfer pricing provisions might more optimally manage specific tax issues.²⁰⁴⁴

Thus, a shipping tax regime should not necessarily be designed as an overly comprehensive one-stop-shop.²⁰⁴⁵ This submission is particularly pertinent where a regime operates as part of a well-developed tax system.²⁰⁴⁶ Hence, in conceptualising the design of a shipping tax regime, the OECD recognises that it is legitimate to 'outsource' the management of specific tax issues to other regimes within the greater tax system.²⁰⁴⁷ However, as controlled by the *USF*, any outsourcing in designing a shipping tax regime should not adversely affect the *USF's* priorities, including its efficiency and simplicity outcomes.²⁰⁴⁸ This point will be explored further in raising taxes on shipping income internationally. In so doing, the critical interaction between the juridical connecting factors, as one regime and a shipping tax regime as the other, will be analysed. In particular, the thesis will assess whether certain deficiencies

²⁰⁴¹ *Ibid.*

²⁰⁴² *Ibid.*

²⁰⁴³ *Ibid.*

²⁰⁴⁴ See, for example, *Channel Pastoral Holdings Pty Ltd v Commissioner of Taxation* [2015] FCAFC 57 where the Australian Federal Court holds that a tax system should be treated holistically. In particular, the Court held that the Australian general anti-avoidance regime (GAAR) could still apply to a subsidiary that is covered by a tax consolidation regime. Thus, the former might in appropriate circumstances override the latter in managing tax avoidance issues. Thus, weaknesses with the single entity principle may be remedied by the GAAR; See also *OECD Consolidated Application Note*, above n 2, [334].

²⁰⁴⁵ *OECD Consolidated Application Note*, above n 2, [334]; Johnson and Myles, above n 113, 324; Kaplow, above n 213, 416.

²⁰⁴⁶ *Ibid.*

²⁰⁴⁷ *Ibid.*

²⁰⁴⁸ Alley and Bentley, above n 2, 580; Evans, above n 113, 385; Mirrlees et al, above n 138, 333; Johnson and Myles, above n 113, 324; Kaplow, above n 213, 416.

with the *JCFs* should be resolved by further developing the *JCF* regime or enhancing the design of a shipping tax regime.

5.1.2.2 The OECD's Art 8: The Juridical Connecting Factors ('*JCF*'s')

For resolving juridical double tax conflicts, Article 8(1) of the *OECD Model Tax Convention* ('*MTC*') contains the model mechanism for allocating the taxing right of shipping income to a State; this mechanism may be incorporated into a State's bilateral Double Tax Agreement ('*DTA*').²⁰⁴⁹ As a tax base, shipping income was broadly considered in chapter three through the lens of different international instruments. Article 8(1)'s default connecting factor or *JCF* allocates the exclusive taxing right of shipping income to the resident State.²⁰⁵⁰ Accordingly, the identity of any one or more States that a vessel might have visited on a particular sea voyage, or whether the *carrier* has a permanent establishment in any of those States, are considerations that are generally irrelevant to an article 8(1) enquiry.²⁰⁵¹ Likewise, an article 23 determination is made redundant.²⁰⁵² *Klaus Vogel* observes that because a single voyage can involve visits to multiple ports of foreign States, applying a permanent establishment principle to shipping income may produce complexities in efficiently allocating shipping income to source States.²⁰⁵³ Thus a preference for simplicity over equity between States is

²⁰⁴⁹ *OECD Model Tax Convention*, above n 703, M-30, C(8)-1; Reimer and Rust, above n 806, art 8, [1]; Baker, above n 819, R.2: March 2002, 8-1 - 8-2. Such conflicts may take the following forms: Residence-residence conflicts; Source-source conflicts; Residence-source conflicts. See generally Lynette Olivier (ed), *International Tax: A South African Perspective* (Siber Ink, 2003) 25.

²⁰⁵⁰ *Ibid*; Reimer and Rust, above n 806, art 8, [1], [10], [15] (by virtue of the words 'shall be taxable only'); Baker, above n 819, R.2: March 2002, 8-1 - 8-2; Before obtaining eligibility to apply article 8, article 1 and article 4 must be satisfied to establish the relevant taxpayer as a resident of a Contracting State: Reimer and Rust, above n 806, art 8 [11].

²⁰⁵¹ Reimer and Rust, above n 806, art 8, [1] – [2], [9] – [10], [16]; Baker, above n 819, R.2: March 2002, 8-2, 8-2/1. Whether a State is designated the resident State of an entity will, in applying article 4 at first instance, depend upon the domestic laws of the States in question. Although article 4 contains various tie breaker rules at the second instance to ensure that only one State may ultimately qualify as a resident State, for applying article 8(1) of the *MTC*.

²⁰⁵² Reimer and Rust, above n 806, art 8, [10]. Article 23 contains the methods (being the exemption or credit methods) for resolving double taxation where two States can tax the income.

²⁰⁵³ Reimer and Rust, above n 806, art 8, [10].

preferred by awarding the exclusive right to the resident State for taxing shipping income.²⁰⁵⁴

The alternate formula for article 8(1) of the *MTC* allocates the exclusive right to tax shipping income to the State where the entity's place of effective management is located.²⁰⁵⁵

However, article 8(1)'s special taxing right is not absolute but limited to vessels operating in international traffic as defined under the *MTC*.²⁰⁵⁶ Article 3(1)(e) of the *MTC* establishes an exception to the article 8 tax treatment through an exclusion present in the definition of international traffic.²⁰⁵⁷ Therefore, an exception to article 8's special tax treatment is essentially created that excludes some sea voyages from article 8's scope.²⁰⁵⁸ This article 8 exception essentially finds application where a vessel's voyage meets the following geographical requirements:

- It occurs *solely between places* in a single non-resident State (or a source State).²⁰⁵⁹

This geographical requirement may be satisfied where the vessel's place of departure and the place of arrival *both occur* in the same source State (or in other words, where there is merely a 'domestic sea voyage').²⁰⁶⁰ However, for this exception to apply, the vessel should, during this domestic sea voyage, have no intermediate visit at a port in any other State.²⁰⁶¹

²⁰⁵⁴ *OECD Model Tax Convention*, above n 703, M-30, C(8)-1; Reimer and Rust, above n 806, art 8, [1]; Baker, above n 819, R.2: March 2002, 8-1 - 8-2; But see heading 6.1.2 and 6.1.3.

²⁰⁵⁵ *OECD Model Tax Convention*, above n 703, M-30, C(8)-1; Reimer and Rust, above n 806, art 8, [1], [2.8], [15].

²⁰⁵⁶ *OECD Model Tax Convention*, above n 703, M-30; Reimer and Rust, above n 806, art 8, [1], [12] – [13].

²⁰⁵⁷ *OECD Model Tax Convention*, above n 703, M-10, C(3)-2 – C(3)-4; Baker, above n 819, R.2: March 2002, 8-2; That definition applies not only to Art 8 but also to Arts 13(3), 15(3) and 22(3): Reimer and Rust, above n 806, art 8, [13].

²⁰⁵⁸ *Ibid.*

²⁰⁵⁹ *Ibid.*

²⁰⁶⁰ *Ibid.*

²⁰⁶¹ *Ibid.*

In cases where this article 8 exception or exclusion applies, article 7 of the *MTC* manages the allocation of taxing rights.²⁰⁶² Article 7 controls the taxing rights of general business income.²⁰⁶³ Thus, where article 7 applies, the income generated by maritime transport activities is treated like any other general business income.²⁰⁶⁴ However, for this exceptional tax treatment to find application, the maritime transport activity must constitute a primary or sufficiently standalone activity.²⁰⁶⁵ In other words, it must not have an adequate connection with any other sea transport in international traffic that falls within the scope of article 8 of the *MTC*.²⁰⁶⁶

Therefore, where sea vessels are not engaged in international traffic, the taxing right of income generated by maritime transport activities is controlled under the *MTC* by article 7.²⁰⁶⁷ Generally, article 7 allocates the exclusive taxing right of business income to the resident State.²⁰⁶⁸ However, an exception in the article 7 tax treatment operates where a foreign entity has a permanent establishment in a source State.²⁰⁶⁹ In such cases, where a permanent establishment as recognised by article 5 of the *MTC* is found to exist, the source State enjoys a non-exclusive right to tax a certain portion of the foreign entity's business income.²⁰⁷⁰

²⁰⁶² *OECD Model Tax Convention*, above n 703, M-27, C(7)-1, C(8)-3 [7]; Reimer and Rust, above n 806, art 8, [17].

²⁰⁶³ *OECD Model Tax Convention*, above n 703, M-27, C(7)-1. Article 7 operates to the extent that the profits are not subject to other provisions of the Convention, such as article 8.: at C(7)-1.

²⁰⁶⁴ *Ibid*; Reimer and Rust, above n 806, art 8, [17].

²⁰⁶⁵ *OECD Model Tax Convention*, above n 703, M-27, C(7)-1, C(8)-2 [6]: 'Profits derived by an enterprise from the transportation of passengers or cargo *otherwise than by ships or aircraft that it operates in international traffic* are covered by the paragraph to the extent that such transportation is *directly connected with the operation, by that enterprise, of ships or aircraft in international traffic or is an ancillary activity*' (emphasis added).

²⁰⁶⁶ *Ibid*.

²⁰⁶⁷ *Ibid* M-10, M-27, C(3)-2 – C(3)-4, C(7)-1; Baker, above n 819, R.19: October 2010, 7-24; Reimer and Rust, above n 806, art 8, [13], [17] –[18].

²⁰⁶⁸ *Ibid*.

²⁰⁶⁹ *Ibid*.

²⁰⁷⁰ *Ibid*.

Accordingly, under the *MTC* two key conditions must be satisfied for a foreign State to have the right to tax income generated by a foreign entity's maritime transport activities:

- Firstly, the exclusion in article 3(1)(e) of the *MTC* should operate as considered above.²⁰⁷¹
- Secondly, the foreign entity should have a permanent establishment in the relevant foreign State.²⁰⁷²

Some *DTA*'s might apply a modified version of the exception in article 3(1)(e) of the *MTC*.²⁰⁷³ Under this modification, the exclusion may instead apply to the voyage of the individual things on board a vessel (as ostensibly enacted by referencing 'transport by a ship').²⁰⁷⁴ This modification is, in contrast, to simply considering the voyage of the vessel as a whole for applying the exclusion (as ostensibly enacted by merely referencing 'a ship').²⁰⁷⁵ Further, apart from article 7 and article 8, other articles of the *MTC* might be relevant for certain types of income derived by *carriers*.²⁰⁷⁶ Thus, article 13(3) of the *MTC* that applies along the same lines as article 8(1), controls the allocation of the relevant taxing right of capital gains from the disposal of sea going vessels (or any other relevant moveable property).²⁰⁷⁷ Further, articles 10, 11, and 12 might apply to investment (or passive) income, where the income is not sufficiently connected with a maritime transport activity.²⁰⁷⁸

²⁰⁷¹ *Ibid.*

²⁰⁷² *Ibid.*; But see heading 6.1.2.

²⁰⁷³ *Ibid.*

²⁰⁷⁴ *Ibid.*

²⁰⁷⁵ *Ibid.*

²⁰⁷⁶ Baker, above n 819, R.2: March 2002, [8B.01] 8-2; But see Baker, above n 819, R.2: March 2002, 8-2/2.

²⁰⁷⁷ *Ibid.*; *OECD Model Tax Convention*, above n 703, M-43.

²⁰⁷⁸ *OECD Model Tax Convention*, above n 703, M-10, C(8)-4; Baker, above n 819, R.9: September 2005, 8-5.

5.1.2.3 Resident-Resident Tie Breaker Rules

In managing resident-resident double tax conflicts for shipping, article 4(3) of the *MTC* (as updated) is likely to contain the relevant tie-breaker rule.²⁰⁷⁹ This particular rule operates in cases where entities other than individuals are involved; a scenario more likely to be encountered in practice as ships are generally directly held by companies.²⁰⁸⁰ Article 4(3) of the *MTC* instructs that such conflicts should be approached on a case-by-case basis.²⁰⁸¹ Further, any resolution should be reached by mutual agreement of the appropriate agencies of the State parties of the *DTA*.²⁰⁸² In reaching such an agreement, an assessment is required of the following three factors:²⁰⁸³

- The place of incorporation.
- The place of effective management ('*POEM*').
- Any other relevant factors.

Notwithstanding the above, the *MTC* confirms that *DTAs* may, in the alternate, continue to apply *POEM* solely for a tie-breaker.²⁰⁸⁴ The Australian and South African *DTA* is one where the alternate tie-breaker rule is applied for entities other than individuals.²⁰⁸⁵

²⁰⁷⁹ *OECD Model Tax Convention*, above n 703, M-15, C(4)-1, C(4)-10 - C(4)-12; See generally Branch and Robarts, above n 6, 289-290, 292-295.

²⁰⁸⁰ *Ibid.*

²⁰⁸¹ *OECD Model Tax Convention*, above n 703, M-15, C(4)-10 - C(4)-12. The commentary further details specific factors that should be considered in the determination, including, 'where the meetings of the person's board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person's headquarters are located, which country's laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc.': *OECD Model Tax Convention*, above n 703, C(4)-11 [24.1].

²⁰⁸² *Ibid.*

²⁰⁸³ *Ibid.*

²⁰⁸⁴ *OECD Model Tax Convention*, above n 703, C(4)-12.

²⁰⁸⁵ *Agreement between the Government of Australia and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, and Protocol*, Australia – South Africa, signed July 1999, [1981] ATS 18 (entered into force 21 December 1999) art

Article 4(3)'s tie-breaker mechanism will fail where these agencies cannot designate one of the two States as the resident State for the *DTA*.²⁰⁸⁶ The entity will remain a dual resident for the broader *DTA* in those circumstances.²⁰⁸⁷ Thus, bilateral relief, like *DTA* exemptions, will be limited by any agreement these agencies reach.²⁰⁸⁸ Although, where the tie-breaker mechanism fails, the entity may still apply any relevant tax relief available in the domestic laws of one or both of the relevant States.²⁰⁸⁹

Thus, predicting in advance the outcome of this tie-breaker treatment involving mutual agreement suffers from uncertainty.²⁰⁹⁰ This treatment should be contrasted with applying *POEM* as the tie-breaker.²⁰⁹¹ The former is less certain than the latter due to the increased number of variables applied.²⁰⁹²

5.1.2.4 The *JCF*'s General Application

In exploring the systemic interaction between juridical connecting factors ('*JCFs*') and shipping tax regimes, the thesis will now consider specific applications of different *JCFs*. The discussion will demonstrate that the *JCF*'s should ideally be developed further to address certain substance over form deficiencies in shipping taxation. An alternative approach is to expect the design of a shipping tax regime to provide a more comprehensive solution. However, the thesis submits that such an alternative is, generally, not practicable. It may

4(4) ('*Australia-South Africa DTA*'). 'Whereby reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident solely of the Contracting State in which its place of effective management is situated': at art 4(4).

²⁰⁸⁶ *OECD Model Tax Convention*, above n 703, C(4)-12 [24.4].

²⁰⁸⁷ *Ibid.*

²⁰⁸⁸ *Ibid.*

²⁰⁸⁹ *Ibid*; *Master Tax Guide 2019*, above n 82, [21-670], [22-140]; Olivier, above n, 2049, 25, 30.

²⁰⁹⁰ *OECD Model Tax Convention*, above n 703, C(4)-11.

²⁰⁹¹ *Ibid* C(4)-12.

²⁰⁹² *Ibid* C(4)-11.

require shipping tax regimes to provide extraordinary functions and negatively affect their capacity to align optimally with the *USF*.²⁰⁹³ It is common to observe that shipping tax regimes, as distinct regimes in a tax system, do not ordinarily manage the taxing rights of States.²⁰⁹⁴ Thus, any absurdity of claiming otherwise may allow this analysis to illustrate the point particularly well.

The *place of effective management* ('*POEM*') is a concept that is particularly pertinent to shipping taxation.²⁰⁹⁵ It is applied as a *JCF*²⁰⁹⁶ specifically for shipping income in the *MTC*, and applied as a *JCF* more generally in the domestic laws of certain States.²⁰⁹⁷ South Africa and Switzerland are two States that apply *POEM* as a *JCF* domestically.²⁰⁹⁸ In particular, the *MTC* allows *POEM* to be applied as a *JCF* for shipping income as an alternate formulation for article 8 and article 4.²⁰⁹⁹ However, there is no universally accepted definition for *POEM*.²¹⁰⁰ Although, the OECD commentary somewhat suggests a meaning that the law courts of certain States have on occasion referenced.²¹⁰¹

²⁰⁹³ Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 12; Johnson and Myles, above n 113, 324; Kaplow, above n 213, 416.

²⁰⁹⁴ *Ibid.*

²⁰⁹⁵ *OECD Model Tax Convention*, above n 703, M-30, C(8)-1; *Income Tax Act 58 of 1962* (South Africa) sub-s 1(1); *Oceanic Trust Co Ltd v C: SARS* (2012) 74 SATC 127; *Silke*, above n 62, [5.2E]; OECD, *Switzerland-Tax-Residency* <<https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/Switzerland-Tax-Residency.pdf>>.

²⁰⁹⁶ *Ibid.*

²⁰⁹⁷ *Ibid.*

²⁰⁹⁸ *Ibid.*

²⁰⁹⁹ *OECD Model Tax Convention*, above n 703, M-18, C(4)-12 [24.5]; *Australia-South Africa DTA* art 4(3).

²¹⁰⁰ *Silke*, above n 62, [14.42].

²¹⁰¹ *OECD Model Tax Convention*, above n 703, M-10, C(4)-10 [22], C(4)-11 [24.1], [24] C(4)-25; *Bywater Investments Ltd v FCT* [2016] HCA 45, [168] (Gordon J) <<https://www.ato.gov.au/law/view/document?docid=JUD/2016ATC20-589/00002>>; *Oceanic Trust Co Ltd v C: SARS* (2012) 74 SATC 127, [50], [54]; *Commissioners For Revenue and Customs and Smallwood* [2010] EWCA Civ 778 [17]-[18], [19], [25], [43], [46] – [48], [50] – [51], [60] – [63], [67], [70] – [71], [73]. ('*Smallwood*') <<https://www.bailii.org/>>; See also the case at first instance: *Trevor Smallwood and Mary Caroline Smallwood, Trustees of The Trevor Smallwood Trust v HM Revenue and Customs* [2008] UKSPC 669 [119], [121], [123]-[124], [130] ('*Smallwood v HM Revenue and Customs*') <<https://www.casemine.com/judgement/uk/5a8ff79860d03e7f57eafe09>>; The *MTC* does not necessarily define the place of effective management.: at M-10. However, the commentary references the place of effective management as 'the place where the company, etc. was actually managed.': at [22] C(4)-10. The commentary

A substitute *JCF* that may be applied domestically as an alternative to *POEM* is ‘*central management and control*’ (*CM&C*).²¹⁰² Although, as a caveat, whether the *CM&C* is essentially equivalent to *POEM* in a jurisdiction hinges on the underlying meaning that is given to it.²¹⁰³ Thus, in the Australian case of *Bywater Investments Ltd*,²¹⁰⁴ Gordon J expresses the *obiter* comment that *POEM* and the *CM&C* are two different concepts appearing in two different instruments.²¹⁰⁵ Yet, on the particular case’s facts, their application exhibits a remarkably good alignment.²¹⁰⁶

The special commissioners in the earlier case of *Smallwood v HM Revenue and Customs* ventured a more comprehensive study of *POEM* and the *CM&C*.²¹⁰⁷ This case decided that *POEM* as an article 4 tie-breaker for the *MTC* for resident-resident double tax conflicts would not necessarily produce the same results as the *CM&C*.²¹⁰⁸ Applied domestically, the *CM&C* is primarily concerned with allocating a taxing right primarily within the context and interests of one State.²¹⁰⁹ However, the *Smallwood* case established no clear substantial difference in

as it presently is updated goes on to reference relevant factors such as, ‘where the meetings of the person’s board of directors ... are usually held, ...’: [24.1] C(4)-11. See generally Baker, above n 819, R.3: September 2002, 4-2/9 for the concept, as it was previously found in the commentary; But see also Olivier, above n, 2049, 17 where it states that the place of incorporation test is easy to manipulate; But see *OECD Model Tax Convention*, above n 703, [24.5] C(4)-12, where it is reported that some States continue to express confidence in their formulation of the place of effective management. At first instance in *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [130] the court held that, ‘[a]ccordingly, ..., we should approach the issue of *POEM* as considering in which state the real top level management ... is found.’; See also, ‘We believe “effective” should be understood in the sense of the French effective (*siège de direction effective*) which connotes real, French being the other official version of the Model.’: *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [112]; See also *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73]; *Contra* OECD, *Switzerland- Tax-Residency*, above n 2095.

²¹⁰² *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [111], [124]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73]; Silke, above n 62, [14.42]; Deutsch et al, above n 82, [2-150]; *Wood v Inspector of Taxes* [2006] STC 443, [6] < <https://www.casemine.com/judgement/uk/5a8ff7b260d03e7f57eb14d9>>.

²¹⁰³ *Ibid.*

²¹⁰⁴ *Bywater Investments Ltd v FCT* [2016] HCA 45, [89].

²¹⁰⁵ *Ibid* [163].

²¹⁰⁶ *Ibid.* [101] – [103], [110] – [111], [113], [116], [139], [163] - [169], [183].

²¹⁰⁷ *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [108]-[130]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73].

²¹⁰⁸ *Smallwood v HM Revenue and Customs* [2008] UKSPC 669 [111], [124]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73].

²¹⁰⁹ *Ibid.*

principle between these two concepts.²¹¹⁰ Therefore, from a perusal of the above two cases, the following broad observations might be noted in ascertaining any fundamental distinctions between these two *JCFs*:

The two *JCFs* may, in principle, be viewed abstractly as substantially the same.²¹¹¹ However, *POEM* as a tie-breaker might not, as a result of the particular context, and objectives of the underlying enquiry, produce the same results as those produced by the *CM&C*.²¹¹² *POEM* as an article 4 tie-breaker is essentially applied within a juridical double tax conflict between two States to remedy double taxation.²¹¹³ Thus, even if both States were to satisfy the *CM&C* domestically, the State that demonstrates the closer connection with the entity relative to the other would be the one that satisfies *POEM* as the tie-breaker.²¹¹⁴ Therefore, although the *JCFs* are ostensibly the same in principle, as considered in a vacuum, a critical factor that may distinguish them is the context in which they operate, including the underlying objectives of their enquiries.²¹¹⁵

Accordingly, it is legitimate in English law to treat *POEM* and the *CM&C*, as ostensibly equivalent concepts, abstractly, when divorced from their specific operating contexts in progressing the present enquiry. Further, to simplify matters and avoid unnecessary complications, the current enquiry will be restricted to the *CM&C* as applied in Australia since the facts pertinent here are derived from an Australian case. However, the primary

²¹¹⁰ *Ibid* [109], [112], [124], [130], [140], [143], [145].

²¹¹¹ *Ibid* [109], [124], [130]; *Bywater Investments Ltd v FCT* [2016] HCA 45, [101] – [103], [110] – [111], [113], [116], [139], [163] - [169], [183].

²¹¹² *Bywater Investments Ltd v FCT* [2016] HCA 45, [101] – [103], [110] – [111], [113], [116], [139], [163] - [169], [183]; *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [111]-[112]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73].

²¹¹³ *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [112], [123], [130]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73]; *OECD Model Tax Convention*, above n 703, C(4)-25 [24].

²¹¹⁴ *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [111]-[112]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73].

²¹¹⁵ *Ibid*.

conclusions produced here are broadly relevant for all *JCFs*. The ultimate aim here is to consider the systemic interaction between a *JCF* regime and a shipping tax regime.

The Australian High Court in *Bywater Investments Ltd*²¹¹⁶ has approached the *CM&C* as an enquiry based on fact and substance.²¹¹⁷ Thus, the enquiry's essential focus is on locating the high-level decisions for an entity (like a company).²¹¹⁸ The location of an entity's organ, like a board of directors, which is ordinarily responsible for making these decisions, is not necessarily always decisive.²¹¹⁹ The enquiry should be orientated to consider a situation's underlying reality.²¹²⁰ Thus, the Australian law ostensibly takes a substance over form approach for locating these high-level decisions.²¹²¹

For example, this substance over form approach would theoretically treat the high-level decisions of a company's accountant as significant for locating the *CM&C*'s where the accountant is based in cases where the board of directors merely rubber-stamps these decisions.²¹²² Further, the location of the day-to-day core business activities and where the day-to-day supervision occurs by higher-level managers are factors that bear less relevance to the *CM&C* as generally applied in Australia.²¹²³

²¹¹⁶ *Bywater Investments Ltd v FCT* [2016] HCA 45.

²¹¹⁷ *Ibid*, *Bywater Investments Ltd v FCT* [2016] HCA 45, [27], [28], [45], [76], [77], [84],[87], [123] <<https://www.ato.gov.au/law/view/document?docid=JUD/2016ATC20-589/00001>>; See generally Australian Taxation Office, *Bywater Investments Ltd & Ors v Commissioner of Taxation* (2016) Decision Impact Statement <<https://www.ato.gov.au/law/view/document?docid=%22LIT%20FICD%20FS134andS135of2016%200001%22>>; *Master Tax Guide 2019*, above n 82, [21-040].

²¹¹⁸ *Ibid*; *The Mitchell Review*, above n 55, 22 [3.4]; Australian Taxation Office, 'Income tax: central management and control test of residency' (Tax Ruling, TR 2018/5) [10]-[11] ('*ATO TR 2018/5*').

²¹¹⁹ *Ibid*, *Bywater Investments Ltd v FCT* [2016] HCA 45, [27], [28], [45], [76], [77], [84],[87], [123] <<https://www.ato.gov.au/law/view/document?docid=JUD/2016ATC20-589/00001>>; See generally Australian Taxation Office, above n 2117; *Master Tax Guide 2019*, above n 82, [21-040].

²¹²⁰ *Ibid*.

²¹²¹ *Ibid*; *The Mitchell Review*, above n 55, 22 [3.4].

²¹²² *Ibid*.

²¹²³ *Bywater Investments Ltd v FCT* [2016] HCA 45; *ATO TR 2018/5*, above n 2118, [12]-[13]; Deutsch et al, above n 82, [2-150]; *Master Tax Guide 2019*, above n 82, [21-040].

Thus, this substance over form approach, applied to the *CM&C*, primarily considers only one aspect of a business (namely, the place best associated with the entity's high-level decisions).²¹²⁴ Thus, the enquiry may be overly narrow.²¹²⁵ Consequently, this application may produce abnormalities in allocating the taxing rights of shipping income to States, particularly as maritime transport activities demonstrate exceptional mobility as a tax base.²¹²⁶ Remember that this base is also unique as a significant part of the key business activities may be physically performed outside States' borders.²¹²⁷ Thus, it might seem counterintuitive to restrict a substance over form enquiry, as applied by the *CM&C*, to merely one aspect of a business.²¹²⁸ A narrower focus for the *CM&C* may be less successful in achieving an optimal substance over form result.²¹²⁹

Also, adopting a narrower substance over form approach for an individual *JCF* might expose the entire *JCF* regime to vulnerabilities where weaknesses remain unresolved.²¹³⁰ This condition may occur irrespective of whether a *JCF* regime consists of one or more *JCFs*.²¹³¹ *POEM* and the *CM&C* are usually utilised domestically with other *JCFs*,²¹³² like the incorporation test or the entity's place of incorporation/registration (i.e., legal domicile).²¹³³ Other *JCF's* that may be utilised include the place of residence of the underlying majority ownership interests²¹³⁴ or the place where a particular property is situated.²¹³⁵ Nonetheless,

²¹²⁴ *Bywater Investments Ltd v FCT* [2016] HCA 45, [27], [28], [45], [76], [77], [84],[87], [123]; *The Mitchell Review*, above n 55, 18 [2.8]- 20 [2.11]; 22 [3.4]; *The Mitchell Review*, above n 55, 22 [3.5]- 30 [3.31]; 37 [5.13].

²¹²⁵ *Ibid.*

²¹²⁶ *1998 DETR Report*, above n 23, 16; Alexander, above n 35, 3, 7 [8]; McMahon, above n 36, 106; *2017 OECD Progress Report*, above n 699, 21.

²¹²⁷ *Ibid.*

²¹²⁸ *The Mitchell Review*, above n 55, 15 [2.3]- 30 [3.31]; 37 [5.13].

²¹²⁹ *Ibid.*

²¹³⁰ *Ibid.*

²¹³¹ *Ibid.*

²¹³² *The Mitchell Review*, above n 55, 15 [2.2]; OECD, *Switzerland- Tax-Residency*, above n 2095.

²¹³³ OECD, *Switzerland- Tax-Residency*, above n 2095.

²¹³⁴ *The Mitchell Review*, above n 55, 15 [2.3]; *Master Tax Guide 2019*, above n 82, [21-040], *Silke*, above n 62, [5.2E]; Deutsch et al, above n 82, [2-150]; Olivier, above n, 2049, 16-22, 310-2.

²¹³⁵ See *Australian Income Tax Assessment Act 1997*, s-sub 995.1(1) [resident trust for CGT purposes, (b)].

the *JCFs* all have a common objective domestically, irrespective of their different formulations.²¹³⁶ This objective is to establish whether an entity is a resident of a State so that the State can tax it on its worldwide income.²¹³⁷ However, some *JCF*'s achieve this objective primarily by focusing on formalities²¹³⁸ like the incorporation test.²¹³⁹

Thus, where a *JCF regime* employs a *JCF*, applying a narrower substance over form test, with another *JCF*, primarily geared at considering formalities, its overall result may, to some degree, be one of form over substance.²¹⁴⁰ Hence, despite the regime ostensibly emphasising a substance over form approach for one or more *JCFs*, the opposite outcome might, nonetheless, dominate when the *JCF regime* is considered as a whole.²¹⁴¹ A deficiency that may be identified with such a *JCF regime* is its greater vulnerability to artificial exploitation, particularly where taxpayers artificially skew the enquiry more easily in their favour.²¹⁴² Some tax bases, like shipping income, with high mobility and a unique business environment, demonstrate an even greater risk of these tax avoidance schemes.²¹⁴³

The weaknesses of a *JCF regime* that over-emphasises formalities may be illustrated by considering the *Malayan Shipping case*²¹⁴⁴ – as one example.²¹⁴⁵ The deficiency may occur

²¹³⁶ *OECD Model Tax Convention*, above n 703, C(4)-10; Olivier, above n, 2049, 16-22; 311; Baker, above n 819, R.3: September 2002, [4B.01] 4-2.

²¹³⁷ *Ibid.*

²¹³⁸ *The Mitchell Review*, above n 55, 7, 10, 15 [2.2], 35 [5.1], 38 [5.14] – [5.16].

²¹³⁹ *Ibid* 15 [2.2].

²¹⁴⁰ *Ibid* 15 [2.2]; 18 [2.6]; 20; 20 [2.11]; 22 [3.4]; 36 [5.7] – 37 [5.9] 38 [5.14] – [5.16]; *Bywater Investments Ltd v FCT* [2016] HCA 45, [27], [28], [45], [76], [77], [84],[87], [123] <

<https://www.ato.gov.au/law/view/document?docid=JUD/2016ATC20-589/00001>>

²¹⁴¹ *Ibid.*

²¹⁴² *The Mitchell Review*, above n 55, 37 [5.10].

²¹⁴³ *Ibid* 28 [3.23]; 37 [5.13], 40 [5.21]; 69-70; *1998 DETR Report*, above n 23, 16; Alexander, above n 35, 3, 7 [8]; McMahon, above n 36, 106; Stewart et al, above n 2, 21-2, 64-6; See also *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; *2017 OECD Progress Report*, above n 699, 21.

²¹⁴⁴ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²¹⁴⁵ *The Mitchell Review*, above n 55, 28 [3.23], 37 [5.10], 37 [5.13], 38 [5.14], 40 [5.21], 69-70.

from greater differentiation²¹⁴⁶ produced by a *JCF* regime since differentiation promotes complexity.²¹⁴⁷ This complexity may reduce a regime's efficiency and simplicity.²¹⁴⁸ This outcome may hinder achieving more optimal substance over form results.²¹⁴⁹

Thus, a *CM&C* test formulated primarily on one business attribute may expose the entire *JCF* regime to greater tax avoidance risks.²¹⁵⁰ This outcome may occur as it ignores other aspects, like key business activities.²¹⁵¹ By additionally applying these other attributes, this remedy may reduce the risk of tax exploitation.²¹⁵² Astutely increasing the scope of a *JCF* regime to cover other key attributes might reduce its differentiation.²¹⁵³ A reduction in fragmentation should likewise reduce a regime's complexity.²¹⁵⁴ A lower complexity may better support the regime's overall integrity.²¹⁵⁵

Formulating a *JCF* primarily to consider one attribute may present additional difficulties in the modern age.²¹⁵⁶ High-level decisions, for example, may now be conducted anywhere in the world with relative ease or in the virtual environment.²¹⁵⁷ This business flexibility is supported by technologies like Zoom and Skype – among others.²¹⁵⁸ Thus, technological advances may further exacerbate deficiencies in substance that a *JCF* may demonstrate if the

²¹⁴⁶ In the sense that splintered business attributes obstruct a *JCF*'s application (however that is achieved) as they are artificially located elsewhere, thus facilitating artificial tax planning exercises.

²¹⁴⁷ *The Henry Review*, above n 89, viii (4.4), xix, 15-6, 21, 29, 30-1, 80; Evans, above n 113, 385; Mirrlees et al, above n 138, 333.

²¹⁴⁸ *Ibid.*

²¹⁴⁹ *The Mitchell Review*, above n 55, 15 [2.2], 18 [2.6], 20 [2.11], 37 [5.10], 38 [5.14], 40 [5.21].

²¹⁵⁰ *Ibid* 22 [3.4], 28 [3.23], 37 [5.10] 37 [5.13], 38 [5.14], 40 [5.21].

²¹⁵¹ *Ibid.*

²¹⁵² *Ibid* 7, 9, 13 -14 [1.7], 27 [3.22]; 33 [4.5], 36 [5.6], 37 [5.10], 40 [5.21].

²¹⁵³ *Ibid* 22 [3.4], 28 [3.23], 37 [5.10] 37 [5.13], 38 [5.14], 40 [5.21]; *The Henry Review*, above n 89, viii (4.4), xix, 15-6, 21, 29, 30-1, 80.

²¹⁵⁴ *Ibid.*

²¹⁵⁵ *Ibid.*

²¹⁵⁶ *The Mitchell Review*, above n 55, 24 [3.13] – 25 [3.15], 37 [5.10].

²¹⁵⁷ *Ibid.*

²¹⁵⁸ *Ibid.*

overall regime is orientated too narrowly.²¹⁵⁹ It may also exacerbate the mobility of shipping income as a tax base.

Hence, a substance over form approach may be realised better by broadening a *JCF*'s scope like the *CM&C*.²¹⁶⁰ An appropriate economic link might be one such factor that beneficially broadens the *CM&C* enquiry.²¹⁶¹ This increased thoroughness may also align a *JCF* regime more optimally with a shipping tax regime that complies with *MAF*'s fifth primary factor.²¹⁶² The fifth primary factor requires a shipping tax regime's design to promote a measure of substance.²¹⁶³ This substance imperative is accomplished by requiring a shipping tax regime to demonstrate that the user/business operation has an appropriate economic link with the sponsoring State.²¹⁶⁴ The economic link is assessed by considering the place where value is generated.²¹⁶⁵ This factor is, in turn, concretised as core income-generating activities as considered in chapter three.²¹⁶⁶

Thus, better policy consistency may systemically be achieved by incorporating an economic link in both *JCF* and shipping tax regimes.²¹⁶⁷ Such an outcome is significant when it is appreciated that both regimes are integral for successfully applying taxes to shipping income.²¹⁶⁸ The one regime allocates a taxing right to shipping income.²¹⁶⁹ The other regime raises the actual taxes on shipping income.²¹⁷⁰ Thus, the optimum application of a shipping

²¹⁵⁹ *Ibid.*

²¹⁶⁰ *Ibid.* 7, 9, 13 -14 [1.7], 15 [2.2], 33 [4.5].

²¹⁶¹ *Ibid.*

²¹⁶² *OECD BEPS Action 5*, above n 13, 23, 37 [71], 39 [84] – [85].

²¹⁶³ *Ibid.*

²¹⁶⁴ *Ibid.*; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 14, 30.

²¹⁶⁵ *OECD BEPS Action 5*, above n 13, 3, 23 [24].

²¹⁶⁶ *Ibid.* 37 [71], 39 [84] – [85].

²¹⁶⁷ *The Mitchell Review*, above n 55, 33 [4.5]; *OECD BEPS Action 5*, above n 13, 23, 37 [71], 39 [84] – [85].

²¹⁶⁸ *OECD BEPS Action 5*, above n 13, 23, 37 [71], 39 [84] – [85]; *The Mitchell Review*, above n 55, 28 [3.23], 33 [4.5], 37 [5.10], 37 [5.13], 38 [5.14], 40 [5.21], 69-70. See also *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²¹⁶⁹ *Ibid.*

²¹⁷⁰ *Ibid.*

tax regime is, in turn, dependent to some extent upon the optimum application of a *JCF* regime.²¹⁷¹ Apart from having an optimal shipping tax regime, a State cannot apply taxes to the corresponding income without enjoying an effective taxing right.²¹⁷²

However, as presently applied by the *Bywater case*, the *CM&C* may allocate shipping income's taxing right to a sponsoring State, irrespective of whether or not the relevant taxpaying entity has a sufficient economic link with the sponsoring State.²¹⁷³ Such a result is at odds with the imperative that a shipping tax regime should promote some substance.²¹⁷⁴ Accordingly, an incongruence in tax policy may exist between these two regimes as applied in Australia.²¹⁷⁵

This policy inconsistency might be addressed by enhancing a shipping tax regime to remedy the deficiencies in the *JCF* regime. Alternatively, the *JCF* regime may be developed to better realise substance over form in allocating taxing rights of shipping income.²¹⁷⁶ The thesis prefers the latter approach. It is submitted that this latter approach would promote simplicity and certainty better in designing a shipping tax regime.²¹⁷⁷ Shipping tax regimes do not ordinarily manage taxing rights.²¹⁷⁸ Thus, it is simpler to enhance the *JCF* regime further where necessary.²¹⁷⁹ This option avoids overcomplicating the design of a shipping tax regime

²¹⁷¹ *Ibid.*

²¹⁷² *The Mitchell Review*, above n 55, 6, 15 [2.1].

²¹⁷³ *Ibid* 20, 20 [2.11]; *ATO TR 2018/5*, above n 2118, [12]-[13]; Deutsch et al, above n 82, [2-150]; *Master Tax Guide 2019*, above n 82, [21-040].

²¹⁷⁴ *OECD BEPS Action 5*, above n 13, 23, 37 [71], 39 [84] – [85]; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 14, 30.

²¹⁷⁵ *The Mitchell Review*, above n 55, 20, 20 [2.11]; *OECD BEPS Action 5*, above n 13, 23, 37 [71], 39 [84] – [85].

²¹⁷⁶ *The Mitchell Review*, above n 55, 7, 9, 15 [2.2], 33 [4.5].

²¹⁷⁷ *The Mirrlees Review*, above n 17, 22-3, 40-2.

²¹⁷⁸ Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 12; In the sense that splintered business attributes obstruct a *JCF*'s application (however that is achieved) as they are artificially located elsewhere, thus facilitating artificial tax planning exercises.

²¹⁷⁹ *Ibid.*

with extraordinary components.²¹⁸⁰ Thus, this issue demonstrates that an optimum shipping tax regime is not a panacea for resolving all significant issues plaguing the taxation of shipping income.²¹⁸¹

5.1.2.5 Malayan Shipping Company Ltd v FCT

Thus, a deficiency with a *JCF* regime may be that it exhibits a high differentiation.²¹⁸² This condition may support an overly fragmented approach for treating variables, like:

- a) the place where the entity (owning the vessel) is registered/incorporated;²¹⁸³
- b) the place where the *CM&C/POEM* occurs – (as high-level decisions);²¹⁸⁴
- c) the place where the primary business activities are physically performed;²¹⁸⁵
- d) the place where the vessel itself is registered; and²¹⁸⁶
- e) the place where the majority underlying ownership interests of the entity owning the vessel is situated.²¹⁸⁷

²¹⁸⁰ *Ibid*; *The Mitchell Review*, above n 55, 21 [3.1], 24 [3.13], 32 [4.3], 33 [4.5].

²¹⁸¹ *The Mitchell Review*, above n 55, 6-7, 37 [5.10].

²¹⁸² *Ibid* 6-7, 13 [1.7], 27 [3.22], 34 [4.9], 37 [5.10], 38 [5.14]; See also *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156 < <https://www.ato.gov.au/law/view/document?docid=JUD/71CLR156/00002>>.

²¹⁸³ *Master Tax Guide 2019*, above n 82, [21-040], Deutsch et al, above n 82, [2-150]; *The Mitchell Review*, above n 55, 7, 15 [2.2], 35 [5.1], 38 [5.14] – [5.16], 50 [6.1].

²¹⁸⁴ *Master Tax Guide 2019*, above n 82, [21-040], Deutsch et al, above n 82, [2-150]; *Bywater Investments Ltd v FCT* 2016 (2016) 104 ATR 82; *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [111]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73]; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; See generally *De Beers Consolidated Mines Ltd v Howe* (1906) AC 455; *Koitaki Para Rubber Estates v FCT* (1942) 6 ATD 42; *The Mitchell Review*, above n 55, 13 [1.7], 18 [2.8], 27 [3.22], 28 [3.23], 34 [4.9], 36 [5.7], 37 [5.10].

²¹⁸⁵ *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

²¹⁸⁶ *OECD Consolidated Application Note*, above n 2, 80; Hare, above n 75, 199; *UNCLOS* arts 89 and 92.

²¹⁸⁷ *Master Tax Guide 2019*, above n 82, [21-040], Deutsch et al, above n 82, [2-150]; *The Mitchell Review*, above n 55, 7, 10, 15 [2.3].

These variables might provide taxpayers with increased opportunities in certain conditions for structuring schemes artificially when haphazardly separated from each other.²¹⁸⁸ What's more, any outcomes produced by these variables at the domestic level might also be reversed if a particular article 4 tie-breaker rule is employed.²¹⁸⁹ Thus, the broader issue suffers from various complexities. The thesis will now consider the *Malayan Shipping case*²¹⁹⁰ involving artificial legal arrangements and structures within the shipping context for exploiting the differentiation promoted by the *JCF* regime in issue.

The case concerned the Malayan Shipping company ('MS') incorporated in Singapore.²¹⁹¹ The sole business of MS for the relevant tax year involved securing tonnage by time chartering a vessel called the Elsa.²¹⁹² The Elsa was a tanker registered in Norway.²¹⁹³ The Elsa was subchartered by MS to Mr S through several voyage charterparties.²¹⁹⁴ The vessel was utilised by Mr S to carry goods by sea.²¹⁹⁵ The agents based in the UK facilitated the conclusion of the time charterparties for MS.²¹⁹⁶ The voyage charterparties were concluded between MS and Mr S with the direct assistance of the two nominee directors in Singapore.²¹⁹⁷ The directors merely acted in line with Mr S's instructions, as facilitated by MS's articles of association.²¹⁹⁸ Mr S was based in Australia and acted as the Managing

²¹⁸⁸ *The Mitchell Review*, above n 55, 6-7, 13 [1.7], 27 [3.22], 34 [4.9], 37 [5.10], 38 [5.14]; See also *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; *Master Tax Guide 2019*, above n 82, [21-040], Deutsch et al, above n 82, [2-150]; *Bywater Investments Ltd v FCT* 2016 (2016) 104 ATR 82, *Smallwood v HM Revenue and Customs* [2008] UKSPC 669, [111]; *Smallwood* [2010] EWCA Civ 778 [70] – [71], [73]; See generally *De Beers Consolidated Mines Ltd v Howe* (1906) AC 455; *Koitaki Para Rubber Estates v FCT* (1942) 6 ATD 42.

²¹⁸⁹ *Ibid.*

²¹⁹⁰ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156 <

<https://www.ato.gov.au/law/view/document?docid=JUD/71CLR156/00002>>.

²¹⁹¹ *Ibid.* Its registered office was located in Singapore.

²¹⁹² *Ibid.*

²¹⁹³ *Ibid.*

²¹⁹⁴ *Ibid.*

²¹⁹⁵ *Ibid.*

²¹⁹⁶ *Ibid.*

²¹⁹⁷ *Ibid.*

²¹⁹⁸ *Ibid.*

Director of MS.²¹⁹⁹ He was also effectively its sole shareholder.²²⁰⁰ The UK agents' activities were similarly controlled by Mr S.²²⁰¹ Mr S was also directly and personally involved with the day-to-day activities of MS.²²⁰² These activities included organising the financing of the time charters' hire, assisting with drafting contracts, instructing the UK agents and Singaporean directors, and overall acting as MS's managing agent.²²⁰³

The court attributed variable a (its place of incorporation/registration) to Singapore.²²⁰⁴

Variable b (where its central management and control is situated) was attributed to Australia.²²⁰⁵ On the facts, Mr S, based in Australia, was the entity making the high-level decisions for MS.²²⁰⁶ He was the *only* person controlling its entire business.²²⁰⁷ Thus, variable b is soundly attributable to Australia as the high-level decisions of MS were made in Australia.²²⁰⁸ However, locating the State where the company's physical business activities were based (referenced as variable c) proved somewhat more complex.²²⁰⁹

Apart from variable b, variable c was ostensibly an additional requirement required by the particular *JCF* regime in the case to establish the *CM&C*.²²¹⁰ However, on the facts, the company argued that its business activities consisted solely of concluding

²¹⁹⁹ *Ibid.*

²²⁰⁰ *Ibid.*

²²⁰¹ *Ibid.* 'The whole of the preliminary instructions to the shipping agents in London were given by Mr. Sleight from Melbourne, and the first charter-party had been completed and the tanker delivered to the company at Bahrein before the directors of the company in Singapore had any knowledge of the business.'

²²⁰² *Ibid.*

²²⁰³ *Ibid.*

²²⁰⁴ *Ibid.*

²²⁰⁵ *Ibid.*

²²⁰⁶ *Ibid.*

²²⁰⁷ *Ibid.*; See also *The Mitchell Review*, above n 55, 70.

²²⁰⁸ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁰⁹ *Ibid.*; See also *The Mitchell Review*, above n 55, 70.

²²¹⁰ *The Mitchell Review*, above n 55, 68; *Income Tax Assessment Act 1939* (Cth) sub-s 6(1); ATO TR 2018/5, above n 2118, [6]; Australian Taxation Office, 'Income tax: am I carrying on a business of primary production?' (Tax Ruling, TR 97/11) ('*ATO TR 97/11*'); *Silke*, above n 62, [14.43].

charterparties.²²¹¹ Thus, its business was located where the contracts were concluded.²²¹² These charterparties were concluded in Singapore.²²¹³ Thus, the scheme's objective was to ensure that variables a, b and c were located outside Australia.²²¹⁴ Key to achieving this result was establishing the two nominee directors in Singapore.²²¹⁵ It was necessary to ensure that these directors as principals were utilised for concluding key contracts outside Australia.²²¹⁶ Thus the scheme aimed to locate both the business activities and the high-level decisions in Singapore, where the two nominee directors were based for ensuring that the *CM&C* would occur at all times outside Australia.²²¹⁷

However, the court ostensibly adopted a substance over form approach for applying the *CM&C*.²²¹⁸ It found that these high-level decisions were made in Australia, where Mr S was based.²²¹⁹ However, MS could still avoid the *CM&C* from applying, provided the court accepted that variables b and c occurred in two different States.²²²⁰ The *JCF* regime ostensibly required both variables to be located in Australia for the *CM&C* to give Australia a taxing right.²²²¹ Thus, the scheme could still obstruct the *JCF*'s application, where it successfully fragmented the variables between different States.²²²²

²²¹¹ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156 <<https://www.ato.gov.au/law/view/document?docid=JUD/71CLR156/00002>>.

²²¹² *Ibid.*

²²¹³ *Ibid.*

²²¹⁴ *Ibid.*

²²¹⁵ *Ibid.*

²²¹⁶ *Ibid.*

²²¹⁷ *Ibid.*

²²¹⁸ *The Mitchell Review*, above n 55, 70; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²¹⁹ *Ibid.*

²²²⁰ *Ibid.*

²²²¹ *The Mitchell Review*, above n 55, 68; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²²² *The Mitchell Review*, above n 55, 37 [5.13], 70; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

Nonetheless, the scheme was defeated as variables b and c were conflated by the court whilst prioritising variable b for the enquiry.²²²³ Thus, arguably laying the basis in Australian law for variable c to automatically (or mechanically) be located where variable b is established.²²²⁴ However, this conflation in the particular case might also be reconsidered by treating the agents and nominee directors as look-through elements (applying deeming provisions, legal fictions and the like, where necessary, to achieve this outcome), which is further explored below.²²²⁵

Thus, the *Malayan Shipping* approach arguably results in variable c becoming superfluous, rendering the approach potentially problematic.²²²⁶ It essentially ignores the place where the primary business activities are physically performed.²²²⁷ It is worth pondering whether the general anti-avoidance rule may not have been a better option for defeating the artificiality of the scheme instead of diminishing the value of variable c as an independent factor.²²²⁸

The conflation of variables b and c may, more broadly, achieve less optimal results in reducing the fragmentation of variables that support the structuring of transactions artificially to avoid tax.²²²⁹ Concerns about the diminishment of variable c have subsequently proved

²²²³ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; See also *The Mitchell Review*, above n 55, 70.

²²²⁴ *The Mitchell Review*, above n 55, 40 [5.21], 69-74; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²²⁵ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; The Editors of Encyclopaedia Britannica, *legal fiction* (2018) Britannica Encyclopedia < <https://www.britannica.com/topic/legal-fiction> >.

²²²⁶ *The Mitchell Review*, above n 55, 20, 40 [5.21], 69-74; *ATO TR 2018/5*, above n 2118, [8]; Deutsch et al, above n 82, [2-150]; *Master Tax Guide 2019*, above n 82, [21-040]; *Income Tax Assessment Act 1939* (Cth) sub-s 6(1).

²²²⁷ *Ibid.*

²²²⁸ *The Mitchell Review*, above n 55, 20, 40 [5.21], 69-74; See generally *Master Tax Guide 2019*, above n 82, [30-110], [30-120].

²²²⁹ *The Mitchell Review*, above n 55, 20, 37 [5.10].

legitimate.²²³⁰ Nonetheless, the approach adopted by the *Malayan Shipping case* has received broader judicial acceptance subsequently as a general principle in Australia.²²³¹

5.1.2.6 Core Income Generating Activities ('CIGA')

Variable c in the *Malayan Shipping case*²²³² was constructed as *carrying on a business* ('COB').²²³³ However, the *Malayan Shipping* approach to variable c is only one of two approaches in the Australian tax literature.²²³⁴ Thus, variable c has also been treated as a distinct variable for the particular *JCF* that requires satisfaction in addition to variable b.²²³⁵ The latter approach also involves identifying where the primary business activities are physically located.²²³⁶ Yet even under this latter approach for variable c, the high-level decisions have dominated the enquiry for certain types of income-producing activities, like maritime transport activities.²²³⁷

Thus, in constructing variable c as a distinct factor for applying the *CM&C*, the thesis recommends replacing *carrying on a business* ('COB') with *core income-generating activities* ('CIGA').²²³⁸ *CIGA* is already applied to shipping tax regimes by the fifth primary factor through *BEPS 5* (considered in chapter 3).²²³⁹ Thus, it may prove more straightforward

²²³⁰ Ibid 20, 40 [5.21], 69-74.

²²³¹ Ibid 40 [5.21], 70-3; ATO TR 2018/5, above n 2118, [8]; Deutsch et al, above n 82, [2-150]; *Master Tax Guide 2019*, above n 82, [21-040]; But see, Australian Taxation Office, 'Income tax: residence of companies not incorporated in Australia - carrying on business in Australia and central management and control' (Tax Ruling, TR 2004/15) ('*ATO TR 2004/15*').

²²³² *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²³³ Ibid; *The Mitchell Review*, above n 55, 40 [5.21].

²²³⁴ *The Mitchell Review*, above n 55, 19-20.

²²³⁵ Ibid 39 [5.20]; For a South African perspective, see *Silke*, above n 62, [14.43]. Cf *Spriggs v Commissioner of Taxation* [2009] HCA 22 [76].

²²³⁶ *The Mitchell Review*, above n 55, 39 [5.20].

²²³⁷ Ibid 28 [3.23], 39 [5.20]–40 [5.21].

²²³⁸ Ibid 7, 19-20, 33 [4.5]; *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

²²³⁹ *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

and certain, to incorporate *CIGA* as an element in certain *JCFs*, instead of the *COB*.²²⁴⁰ This approach may enhance policy consistency systemically, as the *JCF* regime may operate in better concordance with its corresponding shipping tax regime.²²⁴¹ There is, however, further merit in treating *CIGA* as a unique concept. Any impediments that variable c exhibits as *carrying on a business* (‘*COB*’) may also be resolved more simply by adopting a new construction that has a clean slate.²²⁴² Thus, there are advantages for treating the *COB* and *CIGA* as two different concepts in the tax law.²²⁴³

Legitimacy for treating the two concepts differently may be sought from statutory interpretative techniques, like the rule that generally requires treating different words with different legal meanings, outside of direct legislative intervention.²²⁴⁴ Further, in developing *CIGA*, certain legal fictions and proxies might be incorporated to bolster the effectiveness of the *JCF*.²²⁴⁵ To some extent, such an approach has already been promoted by *BEPS 5* for applying its fifth primary factor.²²⁴⁶ However, the thesis recommends that existing proxies be enhanced where appropriate with other legal fictions for creatively advancing *CIGA* as a robust anti-avoidance measure. Thus, the *Malayan Shipping case*²²⁴⁷ might be resolved more simply by applying *CIGA* as a novel concept and enhancing it with specific proxies and legal fictions.²²⁴⁸ An objective would be to reconstruct the underlying enquiry so that variable c is

²²⁴⁰ *The Mitchell Review*, above n 55, 7, 19-20, 33 [4.5]; *The Mirrlees Review*, above n 17, 40-2.

²²⁴¹ *The Mitchell Review*, above n 55, 7, 19-20, 33 [4.5]; *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

²²⁴² *The Mitchell Review*, above n 55, 40 [5.21]; *The Mirrlees Review*, above n 17, 40-2; ‘[T]here is a view that indicates that the threshold requirement for merely “carries on business” is quite low.’: *The Mitchell Review*, above n 55, 39 [5.21].

²²⁴³ *The Mitchell Review*, above n 55, 39 [5.19] - [5.20], 40 [5.21]; See also, *OECD BEPS Action 5*, above n 13, 11.

²²⁴⁴ Devenish, above n 82, 217-218; *Silke*, above n 62, [14.42].

²²⁴⁵ *OECD BEPS Action 5*, above n 13, 9, 23-5, 37; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

²²⁴⁶ *Ibid.*

²²⁴⁷ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁴⁸ *Ibid.*

given substantial weight.²²⁴⁹ The ultimate goal is to ensure that artificial schemes are defeated more simply.²²⁵⁰ The outcome should ultimately reduce differentiation produced by a *JCF* regime.²²⁵¹

By applying *CIGA* as a separate requirement of an individual *JCF* (where appropriate), its adhesiveness may potentially be strengthened.²²⁵² The thesis prefers this *JCF* modification.²²⁵³ *CIGA*, unlike the general anti-avoidance rule, may be developed as a measure of first resort to promote certainty and simplicity more optimally in allocating taxing rights of shipping income.²²⁵⁴

Thus, the *CIGA* enquiry should be developed as one primarily based on fact.²²⁵⁵ However, the integrity of the *JCF* may be enhanced by supplementing the *CIGA* enquiry where necessary with particular proxies and legal fictions.²²⁵⁶ These supplements might better avoid minimising variable *c*, as occurred in the *Malayan Shipping case*.²²⁵⁷ The application of proxies and legal fictions is also not unconventional or absurd. Similar complements are applied elsewhere in the tax law, like the source rules,²²⁵⁸ particularly the deemed source rules.²²⁵⁹ Thus, proxies and legal fictions, like the place where payment occurs, are readily

²²⁴⁹ *The Mitchell Review*, above n 55, 9, 13 [1.7], 39.

²²⁵⁰ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁵¹ *The Mitchell Review*, above n 55, 9, 13 [1.7], 39; *OECD BEPS Action 5*, above n 13, 9, 23-5, 37.

²²⁵² *The Mitchell Review*, above n 55, 34 [4.9], 37 [5.9], 44 [5.42].

²²⁵³ *Ibid*; *Master Tax Guide 2019*, above n 82, [30-110].

²²⁵⁴ *The Mitchell Review*, above n 55, 35, 42-3; Stewart et al, above n 2, 9; *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 44.

²²⁵⁵ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; *The Mitchell Review*, above n 55, 40, [5.27], 41 [5.30]; See generally *Nathan v Federal Commissioner of Taxes* (1918) 25 CLR 183, 189 –190 (Isaacs J); *Master Tax Guide 2019*, above n 82, [21-070].

²²⁵⁶ *The Mitchell Review*, above n 55, 37 [5.10], 43 [5.36]; *OECD BEPS Action 5*, above n 13, 9, 23-5, 37.

²²⁵⁷ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁵⁸ *Master Tax Guide 2019*, above n 82, [21-070]; Deutsch et al, above n 82, [2-220]; *Silke*, above n 62, [5.3]; See also *The Mitchell Review*, above n 55, 42; See generally *First National Bank of Southern Africa Ltd v CIR* (2002) 3 SA 375 (SCA).

²²⁵⁹ *Ibid*; see generally *Silke*, above n 62, [3.33].

employed at the domestic level to simplify locating the source of certain types of passive income.²²⁶⁰ Thus, in streamlining the allocation of taxing rights of shipping income, a similar approach might be applied to the facts of the *Malaysian Shipping case*.²²⁶¹

In the *Malaysian Shipping case*, the company's main business was making the charterparties in Singapore.²²⁶² Thus, the making of the contracts is ostensibly the *CIGA* (or *core income-generating activities*) of MS.²²⁶³ Thus, variable b's and c's conflation might be dispensed with more simply by ultimately treating the UK agents and directors as look-through elements.²²⁶⁴ This type of approach was considered in the *Lilyvale Hotel case*,²²⁶⁵ where Perram J observed that:

a person does not cease to carry out an activity because he or she carries out the activity through an agent. The whole point of the law of agency involves the attribution of the activities in fact carried out by one person to the legal account of another. Were it otherwise, the fact that bus companies employ drivers to operate buses on their behalf would mean that the bus companies are not bus operators, a conclusion which is neither plausible nor palatable.²²⁶⁶

Thus, a look-through approach may merely ignore matters of form (like the ostensible location of the conclusion of the contracts) and instead recognise the reality of the situation by focusing primarily, for example, upon the place where the real intellect and control underlying these formalities is situated.²²⁶⁷ This treatment would be particularly useful in

²²⁶⁰ Ibid.

²²⁶¹ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁶² Ibid.

²²⁶³ Ibid; *The Mitchell Review*, above n 55, 40, [5.27], 41 [5.30]; *Master Tax Guide 2019*, above n 82, [21-070].

²²⁶⁴ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; See generally, regarding the law of agency, Edwin Peel, *The Law of Contract* (Thomson, 15th ed, 2020) [17.1.1]; [17.3.1]; [17.4.1].

²²⁶⁵ *Lilyvale Hotel Pty Ltd v FCT* [2009] FCAFC 21, [56].

²²⁶⁶ Ibid.

²²⁶⁷ Ibid; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

cases like the *Malayan Shipping* case where agents and nominee directors are artificially employed for tax avoidance.²²⁶⁸

Thus, to streamline the process and simplify it for tax authorities whilst discouraging artificial tax planning, these agents and nominee directors should be treated by *CIGA* as look-through elements, with the aid of legal fictions and deeming provisions where necessary to achieve this outcome. A rebuttable presumption that reasonably burdens the taxpayer to prove otherwise should also be applied.²²⁶⁹ Proxies and other legal fictions may enhance the underlying enquiry by establishing factual triggers to promote simplicity. These triggers may identify *prima facie*, elements of concern like potential nominee directors.

Thus, under certain conditions and triggers (not considered in detail here), the activities of elements like nominee directors might mechanically be deemed to be situated at the place where the apparent principal or controlling authority is situated.²²⁷⁰ In such instances, the onus would be on the taxpayer to rebut the presumption by tendering sufficient evidence in court to prove otherwise.²²⁷¹ By adopting such an approach for the above case, the *prima facie* result should be that the charterparties are treated in law as having been concluded in Australia.²²⁷² As indicated, proxies and other legal fictions should be applied as triggers where appropriate to simplify the underlying enquiry. It is submitted that a rebuttable presumption may also promote transparency in the process and combat the obscurity present

²²⁶⁸ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁶⁹ *Lilyvale Hotel Pty Ltd v FCT* [2009] FCAFC 21, [56]; *OECD BEPS Action 5*, above n 13, 9, 23-5, 37; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30; See generally Stephen Colbran et al, *Civil Procedure: Commentary and Materials* (LexisNexis, 6th ed, 2015) [12.2.16]; See generally Peel, above n 2264, [17.4.1(2)].

²²⁷⁰ *Ibid.*

²²⁷¹ See generally Colbran et al, above n 2269, [12.2.16].

²²⁷² *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; See generally Peel, above n 2264, [17.4.1(2)].

in shipping. Sound commercial reasons would have to be established for, legally, treating directors more usually.²²⁷³ No such reasons are present in the above case.²²⁷⁴

The end result of treating these agents and directors as look-through elements is that variables b and c should both be located in Australia. Thus, the requirements of the particular *JCF* should be met without having to resort to watering down variable c, as was arguably done in the *Malayan Shipping* case.²²⁷⁵ Thus, *CIGA* may be developed to achieve substance over formalities, more optimally, in establishing taxing rights of shipping income.²²⁷⁶

It is correct to point out that the same outcome might be achieved by employing a general anti-avoidance rule ('*GAAR*').²²⁷⁷ However, a *GAAR* is usually applied as a measure of last resort.²²⁷⁸ And thus, it would not necessarily be the best approach for promoting certainty and simplicity in the enquiry from the outset.²²⁷⁹ Further, *CIGA* might be conceptualised in part as a specific anti-avoidance rule that applies on a more usual basis.²²⁸⁰ Thus, in developing *CIGA* as a distinct and novel concept, any deficiencies associated with *carrying on a business* ('*COB*') and *GAAR* may more optimally be addressed.²²⁸¹

Locating the relevant business activities in Australia by employing proxies, legal fictions, rebuttable presumptions, and look-through elements in developing *CIGA* becomes even more

²²⁷³ Colbran et al, above n 2269, [12.2.16].

²²⁷⁴ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁷⁵ *The Mitchell Review*, above n 55, 19-20; 37 [5.10], 69-70.

²²⁷⁶ *Ibid* 40, [5.27], 41 [5.30]; *OECD BEPS Action 5*, above n 13, 9, 23-5, 37; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30.

²²⁷⁷ *Master Tax Guide 2019*, above n 82, [30-170], [30-180]; See generally *Federal Commissioner of Taxation v Spotless Services Ltd* (1996) 34 ATR 183.

²²⁷⁸ *Master Tax Guide 2019*, above n 82, [30-110], [30-120], [31-030].

²²⁷⁹ *Ibid*.

²²⁸⁰ *Ibid* [30-130], [30-180]; *OECD BEPS Action 5*, above n 13, 9, 23 [24] – [25], 39 [84] – [85]; *The Mitchell Review*, above n 55, 44 [5.42].

²²⁸¹ *The Mitchell Review*, above n 55, 36-7 [5.7] 40 [5.21], 68-74; *OECD BEPS Action 5*, above n 13, 23.

compelling when the broader facts of the *Malayan Shipping* case are considered.²²⁸² The company did not have any bank accounts in Singapore.²²⁸³ Mr S derived commission as a general agent for the company.²²⁸⁴ Thus, the broader facts may even implicate one or more of the existing proxies of the fifth primary factor of *MAF*,²²⁸⁵ like operating expenditure and key employees.²²⁸⁶

5.1.2.7 Revisiting the *BEPS 5* List

To satisfy the fifth primary factor of *MAF*, certain key attributes of a relevant shipping business must be associated with a sponsoring State in one way or another.²²⁸⁷ It may be possible on the facts of the *Malayan Shipping case*²²⁸⁸ to associate one or more of these attributes with Australia.²²⁸⁹ Thus, for example, the attribute of organising and supervising sea voyages (as applied by the *BEPS 5* List) may be regarded as having been performed in Australia by treating the relevant agents and directors as look-through elements.²²⁹⁰ Attributes like tracking deliveries may likewise be linked with Australia.²²⁹¹

The *BEPS 5* List's attributes might be expanded or supported with other attributes.²²⁹² The *BEPS 5* List is not a closed list.²²⁹³ Thus, other attributes or considerations might additionally be utilised, where relevant, for *CIGA* and the fifth primary factor, including.²²⁹⁴

²²⁸² *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁸³ *Ibid.*

²²⁸⁴ *Ibid.*

²²⁸⁵ *OECD BEPS Action 5*, above n 13, 9, 24-5, 37, 39.

²²⁸⁶ *2018 OECD Progress Report*, above n 32, 14, 30, 40; *2017 OECD Progress Report*, above n 699, 21, 40.

²²⁸⁷ *Ibid.*

²²⁸⁸ *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁸⁹ *Ibid.*

²²⁹⁰ *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 21, 41; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156.

²²⁹¹ *Ibid.*

²²⁹² *OECD BEPS Action 5*, above n 13, 39; *2017 OECD Progress Report*, above n 699, 41.

²²⁹³ *Ibid.*

²²⁹⁴ *The Mitchell Review*, above n 55, 42 [5.32].

1. the location of the assets employed in the conduct of the core business activity of the company;
2. the size of the company in a locality;
3. the sophistication of the company's corporate governance practices;
4. any separation between high-level and strategic top management and operational control of the business;
5. the composition of the company's board and any additional roles held by directors; and
6. the distinction between activities that are core to the conduct of the business and those that are preliminary or ancillary, such as general support functions.

Further, there is scope to argue that variable d (the place where the vessel is registered) is relevant to some extent for establishing *CIGA*.²²⁹⁵ Variable d may be treated as a matter covered by the third proxy.²²⁹⁶ This proxy is applied by the fifth primary factor of *MAF* for establishing *CIGA*.²²⁹⁷

In summary, the main income-producing activities in the *Malayan Shipping* case was, directly, the conclusion of the charterparties and, indirectly, the underlying transportation of goods by Sea.²²⁹⁸ However, although the actual income-generating activities were, in reality, done by the vessel at sea, none of these activities, in fact, took place in Australia.²²⁹⁹ Therefore, it is conceded that some element of artificiality is inherently present in the enquiry. No State independently exercises jurisdiction over a vessel plying the high seas, and maritime transport activities may at times occur on the high seas.²³⁰⁰ Thus, some level of artificiality is

²²⁹⁵ 2017 OECD Progress Report, above n 699, 21; 2018 OECD Progress Report, above n 32, 30; OECD BEPS Action 5, above n 13, 9, 23-5, 37, 39.

²²⁹⁶ Ibid.

²²⁹⁷ Ibid.

²²⁹⁸ Ibid.

²²⁹⁹ Ibid.

²³⁰⁰ UNCLOS arts 89 and 92; 2017 OECD Progress Report, above n 699, 21; 2018 OECD Progress Report, above n 32, 30; *Malayan Shipping Company Ltd v FCT* (1946) 71 CLR 156; *EU Framework* OJ C 13, 5.

necessary to attribute these income-producing activities to a sponsoring State. The OECD accepts that the enquiry will suffer from some artificiality by, in part, establishing proxies.²³⁰¹

5.1.2.8 Particular Approaches for Introducing *CIGA*

Therefore, to maintain policy consistency systemically between a shipping tax regime and a *JCF* (whether at the domestic or international level), variable c, as *CIGA*, should be incorporated as an essential requirement of a *JCF*.²³⁰² Such a modification might also better support the adhesiveness of the particular *JCF* and make it less vulnerable to artificial manipulation.²³⁰³

This modification has been recommended for the Australian tax law in the form of coupling variables c and b and variables c and e for particular *JCFs*.²³⁰⁴ However, the Australian reforms might be deficient as *JCFs* promoting variable a (the place where the company is registered), and *POEM* (as contained in *DTA* 's) appear to have been left unaltered.²³⁰⁵

However, article 8(1) of the *MTC* in its present form covers, by default, all *JCFs* that might be employed in the domestic law of a State for establishing an entity's tax-law residence.²³⁰⁶

Accordingly, the default position should result in a more comprehensive enquiry since the enquiry for allocating taxing rights of shipping income will no longer necessarily be restricted to a narrow variable like *POEM*.²³⁰⁷ In its present form, Article 8(1) read with

²³⁰¹ 2017 OECD Progress Report, above n 699, 21; 2018 OECD Progress Report, above n 32, 30; OECD BEPS Action 5, above n 13, 9, 23-5, 37, 39.

²³⁰² OECD BEPS Action 5, above n 13, 23 [24] – [25], 37, 39; The Mitchell Review, above n 55, 36-7 [5.7], 39, 40 [5.21]; 40 [5.24]; 41 [5.30] – [5.31]; 42 [5.35].

²³⁰³ OECD BEPS Action 5, above n 13, 23 [24] – [25]; The Mitchell Review, above n 55, 9, 13, 34 [4.9].

²³⁰⁴ The Mitchell Review, above n 55, 9-10, 39, 47.

²³⁰⁵ Ibid 7, 9-10, 13, 50-2. A coupling of variable (a) with variable (c) might, in certain conditions, better promote a substance over form approach, in applying variable (a) as a *JCF*. The artificiality that occurred in the *Malayan Shipping case*, in relation to Singapore, might more successfully be discouraged.

²³⁰⁶ OECD Model Tax Convention, above n 703, M-15, M-30, C(4)-10 – C(4)-11, C(8)-1.

²³⁰⁷ Ibid.

Article 3(1)(d) of the *MTC* merely references ‘*an enterprise carried on by a resident of a Contracting State*.’²³⁰⁸ This formulation, in turn, indirectly and broadly incorporates into the enquiry all *JCFs* applied domestically for establishing a relevant entity’s residence.²³⁰⁹

Further, a broader enquiry is now also required by default at the article 4(3) tie-breaker level of the *MTC* by incorporating an expanded set of variables.²³¹⁰ This set of variables is also not a closed set as it references ‘any other relevant factors.’²³¹¹ Thus, this flexibility to apply ‘*any other relevant factors*’ should be utilised to incorporate a necessary economic link like *CIGA* into the enquiry at the international level.²³¹² In accomplishing this outcome, *DTA*’s may be applied more consistently with shipping tax regimes to the extent they both promote the fifth primary factor of *MAF*.²³¹³

Accordingly, in designing a model shipping tax regime that aligns with the fifth primary factor of *MAF*, States ought to reconsider their juridical connecting factors (‘*JCFs*’). It is submitted that greater simplicity and certainty is achieved by harmonising different but related enquiries where appropriate.²³¹⁴ The exercise might further be expanded to cover other regimes in a tax system.²³¹⁵ Therefore, the overall efficacy of a model shipping tax regime cannot be considered in isolation from the broader system.²³¹⁶ A tax system is, importantly, a “system.”²³¹⁷ And therefore, a shipping tax regime’s efficacy depends to some

²³⁰⁸ *Ibid* M-10 M-30, C(4)-2 [8], C(8)-1.

²³⁰⁹ *Ibid* M-30, C(8)-1.

²³¹⁰ *Ibid* M-15, C(4)-10, C(4)-11.

²³¹¹ *Ibid* M-15, C(4)-10, C(4)-11.

²³¹² *Ibid*.

²³¹³ *OECD BEPS Action 5*, above n 13, 9, 23-5, 37, 39; *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 44.

²³¹⁴ *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 44; Stewart et al, above n 2, 9.

²³¹⁵ *OECD Consolidated Application Note*, above n 2, 90 [334].

²³¹⁶ *Ibid*; *The Mirrlees Review*, above n 17, 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324.

²³¹⁷ *The Mirrlees Review*, above n 17, 2, 28, 35; Evans, above n 113, 385; Johnson and Myles, above n 113, 320, 324; Alley and Bentley, above n 2, 605-6.

degree on the optimal interaction of the system's different components.²³¹⁸ A shipping tax regime should also not be expected to address broader tax issues in its design necessarily. Some of these issues are more optimally addressed by enhancing other regimes in the system. However, the thesis is presently focused on assessing the taxing formula of a shipping tax regime. Therefore, other regimes in the broader system will, generally, not be addressed further.

5.1.2.9 Country-Specific Reservations

The position detailed above for *JCFs* depicts their general application internationally and ignores country-specific reservations. Thus, for example, South Africa has reserved the right to apply article 8(1) of the *MTC* to certain profits derived from demise charterparties, particularly where such activities are merely incidental to maritime transport activities.²³¹⁹ In contrast, India reserves the right to apply article 12 of the *MTC* to profits derived from demise charterparties.²³²⁰ Nonetheless, article 12 of the *MTC* is more usually concerned with allocating taxing rights of royalties.²³²¹

5.1.2.10 Simplicity as a Vital Check

Thus, special consideration should be given to the broader tax system in designing a shipping tax regime to avoid incorporating redundant and conflicting components in its design.²³²² In particular, a shipping tax regime is not ordinarily required to manage issues like transfer pricing, thin capitalisation and the allocation of taxation rights, among others.²³²³ The *USF*

²³¹⁸ *Ibid.*

²³¹⁹ *OECD Model Tax Convention*, above n 703, P(8)-2; P(8)-4; P(8)-5.

²³²⁰ *Ibid* P(8)-2.

²³²¹ *Ibid* M-41.

²³²² *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 44.

²³²³ See generally *OECD Consolidated Application Note*, above n 2, 90 [334].

supports such an approach as incorporating unnecessary components in a design would particularly breach the benchmarked criterion of simplicity.²³²⁴ Nonetheless, it is submitted that the *MTC* (and its equivalents) is relevant for designing a shipping tax regime to the extent that it enables the current approach utilised by States worldwide by providing them with the necessary control by awarding the resident State the exclusive right to tax the particular tax base – as will be explored to some degree further here below.

5.1.3 A Comprehensive Approach for State Support

A shipping tax regime cannot always be expected to protect its corresponding tax base on its own adequately. The historical analysis demonstrated that the policy objective of better balancing the playing fields between the ship registers of different States is not necessarily easily achieved.²³²⁵ Thus, the endeavour may be complex, requiring a holistic and novel approach.²³²⁶ Taxes and employment costs are two significant costs identified by the literature as requiring attention in establishing a more equal playing field between different ship registers.²³²⁷ Thus, tax concessions may not be sufficient on their own as the problem is not necessarily merely a fiscal one. Accordingly, it is not unsurprising that States have opted to apply several measures, apart from tax-friendly shipping tax regimes, to better mitigate

²³²⁴ *Asprey Review*, above n 34, [3.20]; Jones, above n 275, 285-8; Cooper, above n 110, 242, 244-5, 256; *The Henry Review*, above n 89, 17; *The Mirrlees Review*, above n 17, 42-4.

²³²⁵ Madigan, above n 1112, 3; Morse, above n 58, 63; McMahon, above n 36, 97; Breskin, above n 6, 63; Marlow and Mitroussi, above n 70, 201; Alexander, above n 35, 3, 7 [8], 9 [18], 11 [26], 13-4 [38]; *1998 DETR Report*, above n 23, 13, 28-9; Mark Brownrigg et al, 'Developments in UK shipping: the tonnage tax' (2001) 28(3) *Maritime Policy & Management* 213, 214, 218-9; *OECD Consolidated Application Note*, above n 2, [290], [294] - [295]; UK Ship Register, *World-class shipowners from across the globe now eligible to join UK flag* (16 May 2019) Maritime & Coastguard Agency < <https://www.ukshipregister.co.uk/news/world-class-shipowners-from-across-the-globe-now-eligible-to-join-uk-flag/>>.

²³²⁶ *Ibid.*

²³²⁷ Papavizas and Kiern, above n 1542, 384; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; *OECD Consolidated Application Note*, above n 2, 80; 1998 McMahon, above n 36, 99; Lazenby, above n 1731, 74; Butcher, above n 38, 5-8; Asteris, above n 35, 67; *1998 DETR Report*, above n 23, 3, 9-10, 13-4, 18, 28-9; Alexander, above n 35, 7 [8], 9 [18], 11 [26], 13-4 [38]; Marlow and Mitroussi, above n 70, 197.

significant cost differentials arising between local and foreign ship registers.²³²⁸ Other aids that may be applied as part of a broader programme of State support include measures like:

a) relaxing restrictions on crewing and ownership

(A more recent example of this reform has been demonstrated by the UK Ship Register. However, the easing of specific restrictions on ownership²³²⁹ and crewing²³³⁰ has arguably converted the UK register into a single international ship register²³³¹ in place of a more traditional one.²³³² Thus, ship owners from designated States, like Panama, China, the United States, all Commonwealth States²³³³ - among others, are now generally entitled to use the register);²³³⁴

b) subsidising employment costs - among other revenue and capital costs

(Labour costs may be reduced by utilising several direct and indirect measures, other than allowing local businesses to meet crewing requirements by employing foreign nationals that are less expensive or more vulnerable to exploitation.²³³⁵ Measures that may be utilised include providing exemptions from income tax for relevant

²³²⁸ 1998 *DETR Report*, above n 23, 13-4; Butcher, above n 38, 9; Madigan, above n 1112, 3; 5; Morse, above n 58, 70-4.

²³²⁹ UK Ship Register, above n 2325.

²³³⁰ See exclusions created by the *National Minimum Wage Act 1998*, s1, s 40 read with *The Merchant Shipping (Registration Of Ships) (Amendment) (EU Exit) Regulations 2019*.

²³³¹ UK Ship Register, above n 2325: 'The UK Flag is an International Register (not limited to nationally based companies).'

²³³² *OECD Consolidated Application Note*, above n 2, 19, [296-7]; UK Department of Transport, 'Seafarers in the UK Shipping Industry: 2019' (Statistical Release, 11 December 2019) 1, 5-6 ('*Seafarers Statistical Release*'); UK Ship Register, *Certificates of Equivalent Competency* (2021) Maritime & Coastguard Agency <<https://www.ukshipregister.co.uk/seafarer/certification/certificates-of-equivalent-competency/>>; Maritime UK, above n 821, 52; 1998 *DETR Report*, above n 23, 13 [37-8]; 24 [99-104]; 26 [111-114]; Norton Rose Fulbright, *Changes to the UK Ship Register: Widened eligibility and bareboating out* (2019) <<https://www.nortonrosefulbright.com/en-lu/knowledge/publications/05c92701/changes-to-the-uk-ship-register-widened-eligibility-and-bareboating-out>>; UK Ship Register, above n 2325; See also *The Merchant Shipping (Registration Of Ships) (Amendment) (EU Exit) Regulations 2019*.

²³³³ The Commonwealth, *Member countries* (2021) Commonwealth Secretariat <<https://thecommonwealth.org/member-countries>>.

²³³⁴ Norton Rose Fulbright, above n 2332; UK Ship Register, above n 2325; See also *The Merchant Shipping (Registration Of Ships) (Amendment) (EU Exit) Regulations 2019*.

²³³⁵ *OECD Consolidated Application Note*, above n 2, 80 [291]; See generally ITF, *Red listing Philippines-based manning agent 'Able Maritime' first step to stopping seafarer exploitation* (21 Oct 2021) <<https://www.itfglobal.org/en/news/red-listing-philippines-based-manning-agent-able-maritime-first-step-stopping-seafarer>>.

employment income, offering various training programmes, and providing employment-related subsidies like subsidising repatriation costs);²³³⁶

c) facilitating more accessible ship financing;²³³⁷

d) levying specific tariffs and duties - where legitimate

(like raising them either on goods carried on foreign vessels or on registered vessels repaired in foreign States);²³³⁸

e) strategically applying cabotage rules for domestic coastal routes; and²³³⁹

f) improving the easiness of acquiring and maintaining a ship registration

(such as applying modern technology simply and efficiently and removing any unnecessary, burdensome bureaucracy).²³⁴⁰

5.1.4 Shipping Versus Digital Services

Shipping income demonstrates an extraordinary tax base mobility.²³⁴¹ Its specific features and causes have been considered elsewhere in the thesis. Further, the OECD accepts this extraordinary mobility as a somewhat inherent characteristic of carrying goods and persons internationally by sea.²³⁴² Likewise, the OECD accepts that shipping tax regimes will, generally, operate domestically to promote efficiency.²³⁴³ Thus, shipping tax regimes raising low-to-zero-tax rates are not treated, without more, as *prima facie* harmful.²³⁴⁴ The regime

²³³⁶ See generally Merk, above n 1541, 517 – 518; Papavizas and Kiern, above n 1542, 380; *1998 DETR Report*, above n 23, 24 [99-104]; 24, [102-4], 25 [106- 109], 33-4.

²³³⁷ Papavizas and Kiern, above n 1542, 390.

²³³⁸ *Ibid* 383, 386, McMahon, above n 36, 88-9, 91.

²³³⁹ Breskin, above n 6, 48; Morse, above n 58, 61.

²³⁴⁰ *OECD Consolidated Application Note*, above n 2, 80 [291], [293]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15 [3.1].

²³⁴¹ *1998 DETR Report*, above n 23, 16.

²³⁴² *OECD Model Tax Convention*, above n 703, C(3)-2 [5]. The definition of the term “international traffic” is based on the principle set forth in paragraph 1 of Article 8 that the right to tax profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic resides only in that State *in view of the special nature of the international traffic business.*: at C(3)-2 [5] (emphasis added).

²³⁴³ *OECD Consolidated Application Note*, above n 2, 86-7 [319]; see also generally *OECD BEPS Action 1*, above n 12, 20-1.

²³⁴⁴ *Ibid*; But see *2018 OECD Progress Report*, above n 32, 38 [11].

must also, ostensibly, interfere illegitimately with the tax bases of non-sponsoring or foreign States.²³⁴⁵ Illegitimate interferences may be facilitated by regimes configuring their scopes to cover artificial activity or excluding sponsoring States' local economies from their scope.²³⁴⁶

The OECD endorses a special tax treatment for shipping income at the international level, as demonstrated by the *MTC*'s article 8.²³⁴⁷ Thus, unlike general business income, the *MTC* applies a special formula for assigning taxing rights of shipping income.²³⁴⁸ The special tax treatment is also not limited to the *MTC* internationally.²³⁴⁹ A long-standing inter-State practice exists based on reciprocity for treating shipping income uniquely.²³⁵⁰ Thus, shipping income's special treatment is a time-honoured and broadly approved practice at the domestic and international levels.²³⁵¹

Therefore, any work seriously advocating a more demanding fiscal treatment for shipping income would have to present a compelling case to challenge this entrenched special treatment.²³⁵² This special treatment successfully supported the UK merchant fleet in becoming the largest fleet globally for an extended period, affecting the outcome of several major wars.²³⁵³ This special treatment was promoted by Queen Elizabeth I of England, who intensified State support measures that significantly accelerated the expansion of the English

²³⁴⁵ *OECD 1998 Report*, above n 2, 27; *OECD BEPS Action 5*, above n 13, 20-1, 23.

²³⁴⁶ *Ibid.*

²³⁴⁷ *OECD Model Tax Convention*, above n 703, M-30 [art 8]; Reimer and Rust, above n 806, art 8[1]-[2], [6], [16]-[17].

²³⁴⁸ *Ibid.*

²³⁴⁹ EU Framework OJ C 13, 4; See also Reimer and Rust, above n 806, art 8, [1], [3] – [40]; See also *2017 OECD Progress Report*, above n 699, 21.

²³⁵⁰ Reimer and Rust, above n 806, art 8, [1], [6].

²³⁵¹ *Ibid.*; *OECD Consolidated Application Note*, above n 2, 86-7 [319].

²³⁵² Oppenheim, above n 1486, 471-2; Butcher, above n 38, 14; Alexander, above n 35, 3, 5, 11 [25], 13-4 [38] – [9]; *1998 DETR Report*, above n 23, 13, 28-9; McMahon, above n 36, 93; Morse, above n 58, 63; Madigan, above n 1112, 5.

²³⁵³ Butcher, above n 38, 2-4, 23; Davis, above n 1494, 1-2; McMahon, above n 36, 89; Davis, above n 1494, 377-8.

merchant fleet.²³⁵⁴ This special treatment continues to be strategically applied in the 21st century by other States, like China, to expand their merchant fleets in promoting their sea power.²³⁵⁵ This treatment also supports simplicity in international taxation by avoiding inefficient and complex fragmentation.²³⁵⁶

A primary policy objective for maintaining and expanding a national trading fleet is to increase a State's sea power.²³⁵⁷ The historical record provides hard proof of the advantages that may be gained by States that leverage a certain level of sea power.²³⁵⁸

The necessity for sea power is essentially underpinned by the observation that a State is an entity that may compete with other States in certain conditions to further its unilateral interests.²³⁵⁹ Thus, even in the 21st century, States on occasion demonstrate behaviours that are nationalistic and prejudicial to the interests of other States.²³⁶⁰ For instance, the EU

²³⁵⁴ Oppenheim, above n 1486, 471-2, 477-94; Davis, above n 1494, 1-2, 6-7; Butcher, above n 38, 2.

²³⁵⁵ McMahon, above n 36, 93, 101-2; Morse, above n 58, 63; Madigan, above n 1112, 5.

²³⁵⁶ *Furness Withy EC* 1966 CarswellNat 297 [16], [19] – [21], [23].

²³⁵⁷ McMahon, above n 36, 93; Morse, above n 58, 63; Madigan, above n 1112, 5; *1998 DETR Report*, above n 23, [12], [14] - [16], [99].

²³⁵⁸ Davis, above n 1494, 377-8; McMahon, above n 36, 91; Baer, above n 39, 20; Asteris, above n 35, 71; Alexander, above n 35, 9 [16]; *1998 DETR Report*, above n 23, 42. 'A strong and active fleet and well-trained seafaring personnel are vital complements to the UK's armed services.'

²³⁵⁹ McMahon, above n 36, 91; Asteris, above n 35, 67, 69; Till, above n 1436, [1.3]; Baer, above n 39, 20.

²³⁶⁰ Paul Sandle et al, 'EU Blames AstraZeneca as Vaccine Battle With UK Deepens', *Reuters* (online), 22 March 2021 < <https://www.usnews.com/news/world/articles/2021-03-22/as-vaccine-battle-with-uk-deepens-eu-blames-astrazeneca>>; Annabelle Dickson, 'UK tells EU to act like 'grown-ups' amid vaccine export row', *Politico* (online), 21 March 2021 < <https://www.politico.eu/article/uk-eu-grow-up-coronavirus-vaccine-export-blockade-threats/>>; Laurence Norman and Jenny Strasburg, 'Vaccine Fight Between EU and U.K. Threatens to Escalate', *The Wall Street Journal* (online), 22 March 2021 < <https://www.wsj.com/articles/vaccine-fight-between-eu-and-u-k-threatens-to-escalate-11616444756>>; Geraldine Wong Sak Hoi, 'What Switzerland can do about the US-China rivalry', *The Associated Press* (online), 16 March 2021 < <https://www.swissinfo.ch/eng/what-switzerland-can-do-about-the-us-china-rivalry/46449368>>; The Western Australian, *China takes aim at AUKUS, claims subs program is 'extremely irresponsible'* (5 Nov 2021) <<https://thewest.com.au/business/china-takes-aim-at-aukus-claims-subs-program-is-extremely-irresponsible-c-4443780>>; Sky News Australia, *Britain and France squabble over fishing rights* (30 Oct 2021) < <https://www.skynews.com.au/world-news/united-kingdom/britain-and-france-squabble-over-fishing-rights/video/8151059b8bdf7f7bd3d056f72d5d8b71>> ; CNN, *France's Macron says Australian Prime Minister lied to him on submarine deal* (1 Nov 2021) < <https://edition.cnn.com/2021/10/31/australia/macron-morrison-australia-france-submarine-deal-intl-hnk/index.html>>; Aljazeera, *COP26: Obama criticises China and Russia for 'lack of urgency'* (8 Nov 2021) < <https://www.aljazeera.com/news/2021/11/8/obama-hits-russia-china-for-lack-of-urgency-on-climate>>.

recently considered banning COVID-19 vaccine exports to the UK.²³⁶¹ Whilst Australian and American policy increasingly perceives China as a threatening competitor.²³⁶² Not to mention the ostensible disengagement of China and Russia with COP26, whilst the French clash with the British and the Australians, over fishing rights and cancelled submarines, respectively, among other examples.²³⁶³

Therefore, any project promoting a significant change in shipping fiscal policy by relying on comparisons with other industries should ensure that the relevant industries are, *in fact*, sufficiently similar. Another industry attracting attention for its ability to transact more easily around domestic borders is the digital services industry.²³⁶⁴ The latter provides services like web stores and digital streaming services.²³⁶⁵ The OECD has described the mobility of the digital services industry in the following terms:

[t]he ability to centralise infrastructure at a distance from a market jurisdiction and conduct substantial sales into that market from a remote location, combined with increasing ability to conduct substantial activity with minimal use of personnel, generates potential opportunities to achieve BEPS by fragmenting physical operations to avoid taxation.²³⁶⁶

Nonetheless, it is submitted that a *prima facie* case can be made for distinguishing maritime transport activities from digital services.²³⁶⁷ They may be distinguished both in terms of

²³⁶¹ *Ibid.*

²³⁶² *Ibid.*

²³⁶³ *Ibid.*

²³⁶⁴ *OECD BEPS Action 1*, above n 12, 64- 68.

²³⁶⁵ *OECD BEPS Action 1*, above n 12, 94 [241], 100-17.

²³⁶⁶ *Ibid* 86 [204].

²³⁶⁷ *1998 DETR Report*, above n 23, [12], [14] - [16], [61], [99]; Alexander, above n 35, 3, 7 [8], 8 [10], 9 [18], 10[23]; McMahon, above n 36, 91, 93, 106; *OECD Consolidated Application Note*, above n 2, 86-7 [319]; Morse, above n 58, 63.

operational attributes and purpose.²³⁶⁸ Two major distinguishing factors (apart from the more banal economic considerations, like high capital costs) are:

- the extraordinary mobility demonstrated by maritime transport activities; and²³⁶⁹
- the merchant fleet of a State constituting a *direct component* of its sea power.²³⁷⁰

Digital services' main income-generating activities are not physically performed, in part, on the high seas and outside the borders of all States.²³⁷¹ Nor are they executed under a flag State's jurisdiction that may more easily be changed at the business owners discretion.²³⁷² Providing digital services to a foreign or source State by another State's resident entity is much more dependent on that source State's infrastructure.²³⁷³ This dependency may have a more permanent quality.²³⁷⁴ Thus, in delivering digital services to a source State, property and services may be required in the source State on a more continuous basis, like computer servers,²³⁷⁵ uninterruptible power supplies and cooling sources.²³⁷⁶ Thus, digital services may demonstrate a stronger connection with their source States.²³⁷⁷ The OECD acknowledges this particular attribute to the extent that, unlike maritime transport activities, the *MTC's* permanent establishment concept still applies to digital services.²³⁷⁸

²³⁶⁸ Ibid; Cf *OECD BEPS Action 1*, above n 12, 64 - 68.

²³⁶⁹ *1998 DETR Report*, above n 23, 16 [61]; Alexander, above n 35, 3, 7 [8]; McMahon, above n 36, 106; Cf *OECD BEPS Action 1*, above n 12, 64- 68.

²³⁷⁰ Till, above n 1436, [1.3]; *OECD Consolidated Application Note*, above n 2, 86-7 [319]; Alexander, above n 35, 3, 7 [8], 8 [10], 9 [18], 10[23]; *1998 DETR Report*, above n 23, [12], [14] - [16], [99]; 42; McMahon, above n 36, 91, 93, 106.

²³⁷¹ *OECD BEPS Action 1*, above n 12, 46 [100], 47 [101], 64 [151], 65-7; Alexander, above n 35, 3[iii], 7 [8], 8 [10], 9 [18], 10[23].

²³⁷² Ibid.

²³⁷³ *OECD BEPS Action 1*, above n 12, 38 [69], 46 [100], 48 [106], 64- 67, 68 [162] – [163].

²³⁷⁴ Ibid.

²³⁷⁵ Ibid 46 [100]- 47 [101], 68 [162] – [163], 87 [210], 88, 90 [223], 94 [241], 100-17.

²³⁷⁶ Ibid 46 [100]- 47 [101], 68 [162] – [163], 87 [210], 88, 90 [223], 94 [241], 100-17.

²³⁷⁷ Ibid.

²³⁷⁸ *OECD Model Tax Convention*, above n 703, M-19, M-27, C(5)-24, C(5)-49 - C(5)-52; *OECD BEPS Action 1*, above n 12, 27, 87 [210], 88 [217], 94 [241], 100-17.

The following basic example may be referenced to illustrate this stronger connection that digital services may demonstrate with source States: A source State may suffer from persistent power outages. This condition may inhibit a foreign digital-service provider from delivering their services to their customers in this source State on a continuous and high-quality basis.²³⁷⁹

Yet, in the absence of a reliable power supply in this source State, a ship will, nonetheless, continue to ply the high seas and carry her goods, unaffected, for delivery to this source State.²³⁸⁰ In the final leg of the shipping operation, where delays occur from work stoppages at the source State's port due to power outages, this inefficiency does not *directly* affect the primary business activity of carrying goods and persons by sea to the source State.²³⁸¹ Thus, the source State's infrastructure is only relied on at specific stages of a shipping operation to complete auxiliary operations, like embarking and disembarking goods and passengers, which the *carrier* may not even be contractually responsible for.²³⁸² Further, with the advent of drones and other technological developments, the loading and unloading operations may become increasingly less dependent on source State infrastructure.²³⁸³ Moreover, ship operators may even avoid a particular State's ports altogether and favour a neighbouring

²³⁷⁹OECD BEPS Action 1, above n 12, 46 [100]- 47 [101], 68 [162] – [163], 87 [210], 88, 90 [223], 94 [241], 100-17.

²³⁸⁰Alexander, above n 35, 7 [8]; OECD Consolidated Application Note, above n 2, 86-7 [291], [316].

²³⁸¹Breskin, above n 6, 434; The Maritime Executive, 'Delays are Growing with Increasing Reports of Rollover Cargo Worldwide', (online), 24 March 2021 < <https://www.maritime-executive.com/article/delays-are-growing-with-increasing-reports-of-rollover-cargo-worldwide>>; Dan Ronan, 'Congestion, Slowdown at Ports Cause Growing Concern', *Transport Topics* (online), 2 December 2020 < <https://www.ttnews.com/articles/congestion-slowdown-ports-cause-growing-concern>>.

²³⁸²Time and voyage charterers may be responsible for loading and unloading activities: See generally Coghlin, above n 720, 11 [I.48] – [I.49]; See also Cooke et al, above n 74, 355 [14.1], 357 [14.8], 359 [14.16], 364-5 [14.36] – [14.37], 376 [15.1]; CF Sebastian Moss, *Australia to mandate that government data is stored in Australia: Just not in Global Switch data centers* (15 June 2021) Data Centre Dynamics Ltd < <https://www.datacenterdynamics.com/en/news/australia-to-mandate-that-government-data-is-stored-in-australia/>>; Caroline Leigh, *Is Your Data Stored On Australian Soil? If Not, Your Business Could Be At Risk* (30 Jan 2020) ThinkSmart Software < <https://www.thinksmartsoftware.com/blog/is-your-data-stored-on-australian-soil-if-not-your-business-could-be-at-risk>>.

²³⁸³CNBC, *Amazon wins FAA approval for Prime Air drone delivery fleet* (31 Aug 2020) < <https://www.cnn.com/2020/08/31/amazon-prime-now-drone-delivery-fleet-gets-faa-approval.html>>.

State's ports.²³⁸⁴ The latter situation may require road or rail transport to a greater degree at a premium to the residents of a State whose ports are strategically avoided.²³⁸⁵

Thus, these two different services in the above illustration do not appear to exhibit the same degree of interruption. Therefore, they are not necessarily reliant on the source State's infrastructure to the same degree. The vessel uses the source State's infrastructure more temporarily to complete certain auxiliary operations.²³⁸⁶ Similarly, a vessel might use a neighbouring State's port instead of the source State's port for repairs and bunkers.²³⁸⁷

Conversely, foreign digital-service providers may continuously require computer servers (and the like) housed nearby in data centres.²³⁸⁸ This equipment may be physically based in the source State's territory.²³⁸⁹ Its nearby location may be required to improve the quality of the digital services of a source State.²³⁹⁰ However, cloud servers, utilising equipment based in neighbouring States, may, in principle, allow foreign service providers the capacity to circumvent a source State's infrastructure to some degree.²³⁹¹ Nonetheless, a source State's domestic laws might impose restrictions on the storage of certain information in foreign jurisdictions, thereby somewhat limiting the mobility of certain digital services.²³⁹²

²³⁸⁴ Business Insider SA, *Ships are starting to bypass SA ports as Transnet tells customers and staff of 'sabotage'* (27 Jul 2021) < <https://www.businessinsider.co.za/transnet-admits-it-was-hacked-as-ships-start-skipping-south-africas-ports-2021-7> >; Matthew Hill and Borges Nhamirre, *South African Industrial Hub Has Found a Faster Route to the Sea* (8 Jun 2021) Bloomberg < <https://www.bloomberg.com/news/articles/2021-06-08/south-african-industrial-hub-has-found-a-faster-route-to-the-sea> >.

²³⁸⁵ Ibid.

²³⁸⁶ Ibid.

²³⁸⁷ Breskin, above n 6, 378; Branch and Robarts, above n 6, 393; Port of Rotterdam, 'Rotterdam Bunker Port', *Transport Topics* (online), 25 March 2021 < <https://www.portofrotterdam.com/en/shipping/sea-shipping/other/rotterdam-bunker-port> >; See generally Ascenz, 'Reliable Bunkering Practices Enhanced by New Technologies' (White Paper, 2019).

²³⁸⁸ *OECD Model Tax Convention*, above n 703, M-19 [art 5], C(5)-50 [126].

²³⁸⁹ *OECD BEPS Action 1*, above n 12, 38 [69], 46 [100], 48 [106], 68 [162] – [163].

²³⁹⁰ Ibid 68 [162] – [163].

²³⁹¹ Ibid.

²³⁹² *Silke*, above n 62, [6.38]

In contrast, a foreign ship on a tramp service, for example, may only call into a port of a source State infrequently and briefly.²³⁹³ Once this vessel leaves the territorial waters of the source State, the *carrier* might have no further connection whatsoever with that source State.²³⁹⁴

Accordingly, from the brief analysis above, it appears that a *prima facie* case may be advanced to sufficiently distinguish maritime transport activities from digital services to warrant the former's special fiscal treatment.²³⁹⁵ Consequently, there are sound reasons for prioritising the benchmarked efficiency criterion, foremostly and vigorously, to support a special fiscal treatment for maritime transport activities. Their unique mobility and significance for a State's national security are key considerations underpinning their special tax treatment.²³⁹⁶

5.2 Part B: Identifying an Optimum Shipping Tax Regime

5.2.1 The Different Types of Shipping Tax Regimes

Shipping tax regimes may be separated into the following four categories:

- 1) Normal income tax regimes with special features like generous capital allowances and rollovers.²³⁹⁷
- 2) Tonnage tax regimes (whether incorporated as part of a normal income tax regime or applied separately).²³⁹⁸

²³⁹³ Alexander, above n 35, 7 [8]; *1998 DETR Report*, above n 23, 16 [61]; Breskin, above n 6, 88; Dimitrios Banas, 'Clarkson study sheds light on tramp shipping', *ECSA* (online), <<https://www.ecsa.eu/index.php/news/clarkson-study-sheds-light-tramp-shipping>>.

²³⁹⁴ *Ibid.*

²³⁹⁵ *The Mirrlees Review*, above n 17, 40.

²³⁹⁶ *Ibid.*

²³⁹⁷ Papavizas and Kiern, above n 1542, 383; Alexander, above n 35, 10.

²³⁹⁸ Alexander, above n 35, [25] – [44]; Marlow and Mitroussi, above n 70, 195.

- 3) Normal income tax regimes that exempt shipping income (exemption regimes).²³⁹⁹
- 4) Lifting tax, freight tax and user tonnage tax regimes.²⁴⁰⁰

Shipping tax regimes may operate as one component of several measures implemented by a State to support its local shipping industry.²⁴⁰¹ A primary objective underlying this State assistance is to support local ship owners to operate sustainably in the face of foreign competition.²⁴⁰² Sea power and extraordinary tax base mobility are key factors legitimising this State support.²⁴⁰³

States are entities that may compete with each other on the global stage where their interests clash. Thus, despite globalisation, sea power remains relevant. Thus, in promoting sea power, shipping tax regimes should prioritise efficiency and simplicity, dominantly, in line with the *USF* for protecting the tax base. A super efficiency should also be applied where appropriate to, optimally, counter the exceptional mobility of the base.

The success of several State support programmes has been evaluated here by considering the level of deadweight tonnage on a sponsoring State's ship register at particular times.²⁴⁰⁴ However, not all vessels may be useful for promoting sea power directly.²⁴⁰⁵ Nonetheless, they all may promote sea power indirectly (to some extent) by supporting the broader, local

²³⁹⁹ *Silke*, above n 62, [6.56].

²⁴⁰⁰ *Ibid* [14.33]; Burch, above n 72, 216.

²⁴⁰¹ Papavizas and Kiern, above n 1542, 380-3; Madigan, above n 1112, 3; McMahon, above n 36, 106; Alexander, above n 35, 3 [iv], 5 [xiv].

²⁴⁰² Madigan, above n 1112, 3, 5; Morse, above n 58, 63.

²⁴⁰³ Madigan, above n 1112, 3; McMahon, above n 36, 106; Asteris, above n 35, 71; *1998 DETR Report*, above n 23, 7 [14] – [17], 16 [61], 42; see especially Alexander, above n 35, 3, 7 [8], 15 [45], 15 [46], 15-6 [48], 16 [49] – [50], 19 [66] – [67], 19-2 [69], 20 [72].

²⁴⁰⁴ Asteris, above n 35, 67-9; McMahon, above n 36, 100-1; Alexander, above n 35, 16 [49]; Marlow and Mitroussi, above n 70, 201; Panagiotou and Thanopoulou, above n 43, 7; But see Alexander, above n 35, 3 [viii], 9 [17].

²⁴⁰⁵ Asteris, above n 35, 67; McMahon, above n 36, 95-6, 103.

shipping industry essential for operating and maintaining vessels. Ships do not sail, repair and replace themselves.

A State's ship register has been preferred to assess merchant sea power as the sponsoring State may have better control over these vessels.²⁴⁰⁶ Accordingly, the thesis has likewise utilised the size of a sponsoring State's ship register in assessing fiscal outcomes generally.

The thesis has observed that traditional ship registers, such as the US and UK registers, have demonstrated an overall contraction in the past 55 years.²⁴⁰⁷ Other ship registers, such as the Panamanian and Liberian registers, have, in contrast, shown a robust expansion overall.²⁴⁰⁸ The Chinese register has demonstrated a slower expansion over the same period.²⁴⁰⁹ This result is, nonetheless, a positive increase overall. The Greek register has demonstrated more success in slowing merchant tonnage decline and maintaining it.²⁴¹⁰ However, where Greek tonnage has demonstrated a more substantial decline, this outcome may correspond with extraordinary circumstances, including the 2009 Greek (government-debt) crisis, and extraordinary fiscal policy interventions.²⁴¹¹

A shipping tax regime that applies as one of several measures should be calibrated appropriately to account for the entire programme's effects.²⁴¹² Therefore, different sea routes

²⁴⁰⁶ Asteris, above n 35, 66, 68, 70; McMahon, above n 36, 95-6, 100-1, 104-5.

²⁴⁰⁷ See Table C above; Asteris, above n 35, 67; *1998 DETR Report*, above n 23, 8-9; Maritime UK, above n 821, 52; McMahon, above n 36, 97-8, 106.

²⁴⁰⁸ See Table C above; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; UNCTAD, above n 821, 44; Juan David Morgan, *The Shipping Law Review: Panama*, *The Law Reviews* (13 June 2022) [Regulation (iii)] <<https://thelawreviews.co.uk/title/the-shipping-law-review/panama>>; Richard Meade, *Liberia on track to overtake Panama as world's largest flag*, *Lloyd's List* (5 August 2022) <<https://lloydlist.maritimeintelligence.informa.com/LL1141848/Liberia-on-track-to-overtake-Panama-as-worlds-largest-flag>>.

²⁴⁰⁹ See Table C above.

²⁴¹⁰ *Ibid*; Marlow and Mitroussi, above n 70, 192.

²⁴¹¹ *Ibid*.

²⁴¹² McMahon, above n 36, 97-8.

may require different levels of fiscal support, depending upon other measures in force such as cabotage rules.²⁴¹³ Thus, the success or failure of a support package cannot necessarily be attributed solely to a shipping tax regime.²⁴¹⁴

Nonetheless, past research has demonstrated that taxes constitute a significant factor in determining the health and viability of a State's ship register.²⁴¹⁵ Kavussanos and Tsekrekos observe an inversely proportional relationship between providing favourable shipping taxes and flagging out; thus, 'the higher the tax benefit for switching to a flag of convenience, the lower the switching threshold level for flagging out.'²⁴¹⁶ Accordingly, local taxation levels, compared to foreign ones, are a primary factor influencing the decision of shipowners to stay or go.²⁴¹⁷ Thus, there is real merit in identifying an optimum shipping tax regime as it may constitute a vital component of any package of support measures to the industry.

Normal income tax regimes will, generally, not be considered further below. They are broadly viewed as regimes that produce inferior results to their counterparts in realising better efficiency and simplicity outcomes.²⁴¹⁸ Accordingly, they are less relevant to designing an optimum shipping tax regime. An optimum regime must vigorously promote efficiency and simplicity.²⁴¹⁹ Thus, in chapter four, it was observed that where a State's support package included a normal income tax regime, albeit tweaked with special features, it failed to regenerate the registered tonnage of the sponsoring State.²⁴²⁰ Accordingly, at the beginning of

²⁴¹³ Ibid; Ring-fencing may, however, be an issue here.

²⁴¹⁴ McMahon, above n 36, 97-8.

²⁴¹⁵ See especially Panagiotou and Thanopoulou, above n 43, 7; Lazenby, above n 1731, 75; *1998 DETR Report*, above n 23, 13 [40] – [42]; Alexander, above n 35, 4 [x]; Papavizas and Kiern, above n 1542, 385-6.

²⁴¹⁶ Panagiotou and Thanopoulou, above n 43, 6-7; But see Alexander, above n 35, 20 - 21 [74].

²⁴¹⁷ Ibid.

²⁴¹⁸ Alexander, above n 35, 10 [24]; 11 [27], 12 [30] - [31], 13-4 [38], 20 [72] – [73]; Papavizas and Kiern, above n 1542, 385-6.

²⁴¹⁹ Alexander, above n 35, 11 [25].

²⁴²⁰ Morse, above n 58, 69-71; Madigan, above n 1112, 3-5, 47-8; McMahon, above n 36, 95-6, 106; Alexander, above n 35, 4 [x], 11 [25]; See also See Table C above.

the 21st century, both the US and the UK supplemented their normal income tax regimes with tonnage tax regimes to better protect the relevant tax base.²⁴²¹ The tonnage tax regimes were adopted to reverse the decline in merchant tonnage.²⁴²² Shipowners generally perceive normal income tax regimes as less desirable options - irrespective of low effective tax levels that may be enjoyed by some shipowners.²⁴²³

Historically, shipping concessions offered under normal income/corporate tax regimes include:

- providing qualifying vessels with higher rates for capital allowances; and²⁴²⁴
- providing special rollovers for deferring income tax from selling qualifying vessels.²⁴²⁵

However, the following disadvantages (among others) are associated with these normal income tax regimes.²⁴²⁶

- They breach horizontal equity by penalising smaller shipping companies as the incentives tend to favour shipping entities with larger fleets that can maximise tax concessions.²⁴²⁷
- They fail to produce more optimal simplicity and certainty levels as income tax as a regime suffers from inherent complexity; that complexity, in turn, encourages complex and opaque tax planning projects that promote artificial tax-driven investments and diversified groups.²⁴²⁸

²⁴²¹ Marlow and Mitroussi, above n 70, 200; Butcher, above n 38, 14.

²⁴²² Papavizas and Kiern, above n 1542, 383-4.

²⁴²³ Alexander, above n 35, 11 [25].

²⁴²⁴ Ibid 10 [21], 11 [25]. Including a 25% or (in the past) 100% depreciation rate.

²⁴²⁵ Ibid 10 [21], 13 [38]. Through roll-over relief of balancing charges.

²⁴²⁶ Ibid 10 [23].

²⁴²⁷ Ibid 10 [24]; *The Mirrlees Review*, above n 17, 34.

²⁴²⁸ Alexander, above n 35, 10 [23], 13 [38]; *The Mirrlees Review*, above n 17, 22, 29-30, 40-43.

- They breach efficiency by raising deferred tax liability provisions that may negatively affect an entity's financial standing, which may operate as a significant disincentive for attracting investment and financing opportunities.²⁴²⁹
- They breach efficiency as they are generally perceived as commercially unfavourable.²⁴³⁰ This attribute alone may rank as a significant disadvantage in light of the special mobility enjoyed by the sector.²⁴³¹

Thus, the thesis will focus on the remaining types of shipping tax regimes. The tonnage tax regimes of Panama, Liberia, Greece, and the UK will be considered as these regimes together, broadly, cover the three main tonnage tax models that are, generally, utilised globally.²⁴³² Australia and South Africa are also good case studies as they utilise both exemption and freight or lifting tax regimes in their jurisdictions; in contrast, China and the United States apply user tonnage tax regimes that will also briefly be considered.²⁴³³ The thesis will promote a hybrid regime based on the Panamanian and Greek regimes as a good model for designing an optimum shipping tax regime.

5.2.2 An Introduction to Tonnage Taxes

Tonnage taxes may, generally, appear as one of three forms, namely:²⁴³⁴

²⁴²⁹ Alexander, above n 35, 10 [21] – [22]; 13 [38]; *The Mirrlees Review*, above n 17, 22, 29-30, 40-43.

²⁴³⁰ Alexander, above n 35, 11 [25], 31 [97]; *The Mirrlees Review*, above n 17, 22, 29-30, 40-43.

²⁴³¹ *Ibid.*

²⁴³² Marlow and Mitroussi, above n 70, 196, 200. See China's 'user tonnage tax' regime under 5.2.11; See Maltese and Cypriot tonnage tax regimes under 5.2.7.

²⁴³³ Deloitte, *Shipping Tax Guide: Greece, Australia, Cyprus, Denmark, Indonesia, Italy, Luxembourg, Malta, Philippines, Singapore, Thailand, UK, Vietnam* (2015) 19 ('2015 Deloitte Shipping Tax Guide') 27; *Silke*, above n 62, [6.38], [6.56]; Burch, above n 72, 216.

²⁴³⁴ Marlow and Mitroussi, above n 70, 195, 198, 200-1; Panagiotou and Thanopoulou, above n 43, 6, 20; See also Kofler, above n 970, 510; Edward Watt and Richard Coles, *Ship Registration: Law and Practice* (Informa, 2nd ed, 2009) [22.33] – [22.34]; Zhykharieva, Shyriaieva and Vlasenko, above n 1541, 95; *Contra* Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 6-7, 27, 32.

- The more rudimentary model found in specific open registers such as Panama and Liberia²⁴³⁵ (However, the tonnage tax idea predates the *modern* open ship register, first established in Panama in about 1925.²⁴³⁶ The thesis has managed to trace the ostensible origins of tonnage taxation, as it was in a previous era and within the constraints of the current project, all the way back to its application in the UK in about 1303);²⁴³⁷
- The Greek model first applied in Greece (its origins have been traced back to about 1939.²⁴³⁸ The Greek regime, as it exists in its present form, was enacted in 1975 and is ostensibly protected by the Greek Constitution);²⁴³⁹ and
- The Dutch model first introduced in the Netherlands in 1996 (it is generally the preferred model by developed States as it retains its direct links with an income tax regime).²⁴⁴⁰

Alternatively, tonnage taxes might be subdivided into two categories, namely:²⁴⁴¹

- one featuring a formula that calculates shipping income for a normal income tax regime²⁴⁴² (It may be somewhat akin to a capital gains tax formula that calculates a net capital gain for inclusion in an income tax calculation.²⁴⁴³ The Dutch model falls under

²⁴³⁵ Ibid.

²⁴³⁶ Ibid.

²⁴³⁷ Francisco J Montero Llacer, 'Open registers: past, present and future' (2003) 27 *Marine Policy* 513, 515-6; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14; See also Chapter 4.

²⁴³⁸ Marlow and Mitroussi, above n 70, 196; Tegos, above n 1541, 443; Panagiotou and Thanopoulou, above n 43, 3-6, 20; Merk, above n 1541, 520; But see Anna Merika, Anna Triantafyllou, and George Zombanakis, 'Wage and tax competitiveness: The case of Hellenic shipping (2019) *Transportation Research Part A* 255, 258.

²⁴³⁹ *The Constitution of Greece of 1975* art 107; Panagiotou and Thanopoulou, above n 43, 9; Tegos, above n 1541, 443; Marlow and Mitroussi, above n 70, 196; For a brief historical discussion see generally Kofler, above n 970, 443. See generally Geena Papantonopoulou (ed) *Greek Law Digest: Taxation of Ships* (Nomiki Bibliothiki, 2016) 497.

²⁴⁴⁰ Marlow and Mitroussi, above n 70, 198; Panagiotou and Thanopoulou, above n 43, 6, 20; Merk, above n 1541, 520; Zhykharieva, Shyriaieva and Vlasenko, above n 1541, 95-6.

²⁴⁴¹ Marlow and Mitroussi, above n 70, 195, 200-1; Panagiotou and Thanopoulou, above n 43, 6, 20; See also Kofler, above n 970, 510; Watt and Coles, above n 2434, [22.33] – [22.34]; Zhykharieva, Shyriaieva, and Vlasenko, above n 1541, 95. *Contra* Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 6-7, 27, 32.

²⁴⁴² Ibid; Merk, above n 1541, 520.

²⁴⁴³ *Master Tax Guide 2019*, above n 82, [11-000].

this category.²⁴⁴⁴ The UK tonnage tax regime will be considered as a specific and more recent example of the Dutch model);²⁴⁴⁵ and

- one featuring a regime designed as a separate and *somewhat* standalone tax regime²⁴⁴⁶ (This category includes both advanced and more primitive variants.²⁴⁴⁷ The Greek, Panamanian and Liberian regimes will be considered as specific examples of the Greek model).²⁴⁴⁸

The tonnage tax regimes of Panama, Liberia, Greece and the UK were compared and contrasted in the 2008 work of Marlow and Mitroussi (*‘the 2008 work’*).²⁴⁴⁹ In 2019, the 2008 work was broadly updated and extended by Panagiotou and Thanopoulou (*‘the 2019 work’*).²⁴⁵⁰ The thesis will broadly reference the conclusions from the above two works in re-considering the matter. In short, the 2008 work was based on the following general assumptions:

- The research considered newly built vessels as test subjects, with the further assumption that they were registered on a first-time basis and would remain on a ship register for 15 years. (The 2019 work uses vessels that are four years old in its original analysis, and 15 years old in its revised analysis.)²⁴⁵¹

²⁴⁴⁴ Marlow and Mitroussi, above n 70, 195, 200-1; Panagiotou and Thanopoulou, above n 43, 6, 20; See also Kofler, above n 970, 510.

²⁴⁴⁵ Marlow and Mitroussi, above n 70, 195, 200.

²⁴⁴⁶ Marlow and Mitroussi, above n 70, 195, 200-1; Panagiotou and Thanopoulou, above n 43, 6, 20; See also Kofler, above n 970, 510.

²⁴⁴⁷ Ibid; See also the Maltese and Cypriot tonnage tax regimes under 5.2.7.

²⁴⁴⁸ Panagiotou and Thanopoulou, above n 43, 6; Marlow and Mitroussi, above n 70, 195-6, 200-1.

²⁴⁴⁹ Marlow and Mitroussi, above n 70, 195-6, 202-4.

²⁴⁵⁰ Panagiotou and Thanopoulou, above n 43, 4; ‘The tax rates and brackets in the year 2018 for the Greek and other regimes are collected In our research, we compare the tonnage tax regimes across traditional EU maritime nations (Greece, Germany, the Netherlands, the UK), new 2004 EU member States (Cyprus and Malta) and main open registries in the world fleet (Panama, Marshall Islands and Liberia).’: at 11; See also Zhykharieva, Shyriaieva, and Vlasenko, above n 1541, 95-6 where other States such as Japan and the United States are considered; See also Merk, above n 1541, 522.

²⁴⁵¹ Marlow and Mitroussi, above n 70, 202; Panagiotou and Thanopoulou, above n 43, 7, 12, 22; Cf Panagiotou and Thanopoulou, above n 43, 12: ‘The size and age of each vessel have been set to be representative of the respective characteristics of the Greek-owned fleet.’; See also Panagiotou and Thanopoulou, above n 43, 22: where the ranking of tonnage tax cost for a 4-year-old and 15-year-old vessel is considered.

- The 2007-year was set as year one for the study. (The 2019 work uses the 2018-year as its tax year.)²⁴⁵²
- Five sea-going vessels with different sizes were considered, namely:²⁴⁵³
 - a bulk carrier – vessel 1;²⁴⁵⁴
 - a tanker – vessel 2;²⁴⁵⁵
 - two container ships of different sizes – vessels 3 and 4;²⁴⁵⁶ and
 - a VLCC – vessel 5.²⁴⁵⁷
- Three different discount rates were utilised.²⁴⁵⁸
- For the different tonnage tax regimes of the selected States, the present value of tonnage taxes was calculated over 15 years for each test subject.²⁴⁵⁹
- The different regimes were ultimately ranked according to the favourability of the tax results produced.²⁴⁶⁰ In particular, they were ranked from 1 (which represented the smallest or most favourable tax result) to 5 (which represented the highest or least favourable tax result).²⁴⁶¹

²⁴⁵² Marlow and Mitroussi, above n 70, 202; Panagiotou and Thanopoulou, above n 43, 7, 11, 18; ‘The tax rates and brackets in the year 2018 for the Greek and other regimes are collected.’: at 11.

²⁴⁵³ Marlow and Mitroussi, above n 70, 201-2; Panagiotou and Thanopoulou, above n 43, 7, 12, 22; ‘[A]t least one vessel per main market [bulker, tanker, container ship, LNG, and VLCC] is selected.’: at 12.

²⁴⁵⁴ Bulk carrier: 38,845 grt; 25,444 nrt; 75,499 dwt; (The 2019 work uses a bulk carrier: 44,114 gt; 27,557 nt).

²⁴⁵⁵ Tanker: 58,156 grt; 31,033 nrt; 103,622 dwt; (The 2019 work uses a tanker: 63,485 gt; 35,025 nt).

²⁴⁵⁶ Container ship 3: 66,086 grt; 30,853 nrt; 67,480 dwt; (The 2019 work uses a Container ship: 55,400 gt; 28,400 nt); Container ship 4: 89,097 grt; 55,204 nrt; 99,503 dwt; (The 2019 work uses a LNG: 113,037 gt; 36,562 nt).

²⁴⁵⁷ VLCC: 158,475 grt; 95,332 nrt; 299,700 dwt; (The 2019 work uses a VLCC: 162,330 gt; 112,075 nt).

²⁴⁵⁸ Marlow and Mitroussi, above n 70, 202; Panagiotou and Thanopoulou, above n 43, 7. The following discount rates were employed: 5, 10 and 15 percent.

²⁴⁵⁹ Marlow and Mitroussi, above n 70, 201-3; Panagiotou and Thanopoulou, above n 43, 7; Cf Panagiotou and Thanopoulou, above n 43, 12, 22: ‘A sensitivity analysis is performed in relation to the age of the vessels, using a younger vessel (of up to 4 years) and an older one (of 15-years) in order to assess the effect of age within those registries.’: at 12.

²⁴⁶⁰ Marlow and Mitroussi, above n 70, 202-3.

²⁴⁶¹ *Ibid*; The 2008 work also considered the tonnage tax regime applied in the Netherlands. Thus 5 States were considered in total. The Netherlands’ regime is also an example of a Dutch model (Albeit the original one). The fiscal results produced for the Netherlands’ regime by the 2008 work will be ignored here, as they are similar to the results generated for the UK regime (which is yet another more recent example of a Dutch model). The Dutch model as a specific type of tonnage tax regime generally occupies the last spots in the 2008 analysis (spots 4 (Dutch) and 5 (UK)). The only exception to this observation in the 2008 work is the first test case, where the Greek regime delivers the worst tax result (spot 5). The 2019 update used a similar ranking system

5.2.3 The Basic Tonnage Tax Model: The Panamanian Regime

Firstly, it may be beneficial to consider the shipping tax regimes utilised in Panama and Liberia. As the top ship registers globally, these two States have for an extended period continued to dominate global rankings measured in deadweight tonnage.²⁴⁶² This strategy is in keeping with the sentiments of Lord Alexander QC, who submitted that ‘it is vital to have regard to the fiscal regimes in other countries if [a State] want[s] to maintain a successful shipping industry [locally].’²⁴⁶³

The 2008 work concluded that the more basic tonnage tax regime in Panama was overall ranked in the first position.²⁴⁶⁴ It generally produced the smallest tax results for the five vessels under consideration.²⁴⁶⁵ Except for two cases, the Liberian regime produced the second smallest tax results.²⁴⁶⁶ However, the larger vessels, like the container ship (vessel 4), and the VLCC (vessel 5), were two cases where more favourable fiscal outcomes were achieved under the Greek regime.²⁴⁶⁷ Further, the 2019 work concluded that the fiscal rankings, as established by the 2008 work, broadly remained unchanged for the Panamanian and Liberian regimes as of 2018.²⁴⁶⁸

but applied it from 1 (cheapest tax result) to 9 (most expensive tax result), as it considered additional States. The additional States will similarly be ignored here; See Panagiotou and Thanopoulou, above n 43, 22.

²⁴⁶² See Table C above; See also Richard Meade, *Liberia on track to overtake Panama as world's largest flag*, Lloyd's List (5 August 2022) < <https://lloydslist.maritimeintelligence.informa.com/LL1141848/Liberia-on-track-to-overtake-Panama-as-worlds-largest-flag> >.

²⁴⁶³ Alexander, above n 35, 7 [8].

²⁴⁶⁴ Marlow and Mitroussi, above n 70, 202-3.

²⁴⁶⁵ Panagiotou and Thanopoulou, above n 43, 7.

²⁴⁶⁶ Marlow and Mitroussi, above n 70, 202-3.

²⁴⁶⁷ Ibid.

²⁴⁶⁸ Panagiotou and Thanopoulou, above n 43, 12, 22.

The Panamanian tonnage tax regime primarily adopts a more rudimentary calculation.²⁴⁶⁹ It essentially utilises merely one variable and one rate.²⁴⁷⁰ Scholars have treated it as a regime consisting of two simple components: An annual tax and an annual consular rate or fee.²⁴⁷¹ However, other works treat it as a regime comprising a single component, namely the annual tax.²⁴⁷²

Nonetheless, a vessel that registers under the Panamanian flag may expect to incur several statutory charges.²⁴⁷³ Firstly, a vessel will incur a once-off registration fee.²⁴⁷⁴ Secondly, a vessel will have a recurring annual fee.²⁴⁷⁵ The size of the vessel determines both fees.²⁴⁷⁶

Further, the recurring annual fee comprises four components: An annual tax, an annual consular rate, an annual inspection fee, and an annual investigation fee.²⁴⁷⁷ The last component is broken up into two further subcomponents.²⁴⁷⁸

²⁴⁶⁹ *Law 4 of 1983*, arts 3, 4 (Panama); See also Panama Consulate in California, ‘Vessel Registration Fees’ (Document, downloaded: 2022) 1-2; Panama Consulate in Hamburg, ‘New Discounts 01.09.2014’ (Document, downloaded: 2022) 1; Panama Marine Authority, ‘Administration Fees’ (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2-3; Panama Maritime Authority, ‘Registration Fees & Taxes’ (Document, Consulate of Panama in London, downloaded: 2021) 1; See Chen Lee & Asociados, *Flag Fees* (accessed 2022) < <https://www.chenleeyasociados.com/tarifas-por-abanderamiento.html> >; See Marine Online, *Ship Register Draft Quotation* (2022) <<https://marineonline.com/panama/calculator>>; See generally Icaza, Gonzalez-Ruiz and Aleman, ‘Panama Ship Registry Guide And Procedure’ (Document, 2020) 4 -5 <<https://www.icalaw.com/areas/maritime-and-admiralty/>>; See generally Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) < <http://consulatepanama.com>>; Panagiotou and Thanopoulou, above n 43, 12, 20; Watt and Coles, above n 2434, 261 [22.33] – 262 [22.34]; See generally *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149(2) that refers to ‘the annual and consular tax payable (de descuento en el impuesto anual y consular del tercer año).’; *Contra* art 149(7); Cf Marlow and Mitroussi, above n 70, 200; Dirección General de Marina Mercante, ‘Nombres de Tipos de Documentos Débito utilizados en la aplicación’ (Document, Panama registry, downloaded 2022) 1 < <https://www.panamaregistry.com.pa/>>.

²⁴⁷⁰ *Ibid*; See Table D below.

²⁴⁷¹ *Law 4 of 1983*, arts 3, 4 (Panama); Panagiotou and Thanopoulou, above n 43, 12, 20; Watt and Coles, above n 2434, 261 [22.33] – 262 [22.34]; Marlow and Mitroussi, above n 70, 200.

²⁴⁷² Thuong, above n 1542, 23; See also Panama Consulate in California, ‘Vessel Registration Fees’ (Document, downloaded: 2022) 1.

²⁴⁷³ *Law 19 of 1992*, art 2 (Panama); *Law 4 of 1983*, arts 3 - 6 (Panama); Thuong, above n 1542, 23; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; See also above n 2469; See also Table E below.

²⁴⁷⁴ *Law 19 of 1992*, art 2 (Panama); See also above n 2469; See also Table E below.

²⁴⁷⁵ *Law 4 of 1983*, arts 3 - 6 (Panama); See also above n 2469; See also Table E below.

²⁴⁷⁶ *Law 19 of 1992*, art 2 (Panama); *Law 4 of 1983*, arts 3 - 6 (Panama); See also above n 2469; See also Table E below.

²⁴⁷⁷ *Law 4 of 1983*, arts 3 - 6 (Panama); See also above n 2469; See also Table E below.

²⁴⁷⁸ *Law 4 of 1983*, art 6 (Panama); See also above n 2469; See also Table E below.

What's more, some works even appear to reference the full recurring annual fee as the elements of the Panamanian tonnage tax regime.²⁴⁷⁹ Yet, in the broader literature, there is even a school of thought that would either expressly, or by omission and implication, question whether the recurring annual fee is, in whole or in part, even a tax proper or just a service charge.²⁴⁸⁰

Panagiotou and Thanopoulou use the annual tax amount and the annual consular rate in their calculations as the relevant components of the Panamanian tonnage tax regime.²⁴⁸¹ This characterisation seems reasonable as the Panamanians, on occasion, represent it likewise in their literature.²⁴⁸²

Generally, in calculating the annual tax amount, a stable rate of 0.10 USD is applied to each net ton.²⁴⁸³ In addition, for vessels that are greater than 15 000 GRT, the annual consular rate

²⁴⁷⁹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; But see Marlow and Mitroussi, above n 70, 200; But see Thuong, above n 1542, 23.

²⁴⁸⁰ Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 6-7, 27, 32; Watt and Coles, above n 715, [21.21]; But see Watt and Coles, above n 2434, [22.33] – [22.34]; See generally Kofler, above n 970, 510; See below n 2536.

²⁴⁸¹ Panagiotou and Thanopoulou, above n 43, 20; See also Watt and Coles, above n 2434, [22.33] – [22.35]; See also Marlow and Mitroussi, above n 70, 200.

²⁴⁸² *Law 4 of 1983*, arts 3 - 4 (Panama); See also *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 where the discount is generally applied to the recurring components of the annual tax and the annular consular rate; See also Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1; See especially Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2; See also above n 2469.

²⁴⁸³ *Law 4 of 1983* art 3; See also Panama Consulate in California, 'Vessel Registration Fees' (Document, downloaded: 2022) 1; Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2; Chen Lee & Asociados, *Flag Fees* (accessed 2022) < <https://www.chenleeyasociados.com/tarifas-por-abanderamiento.html> >; See also Marine Online, *Ship Register Draft Quotation* (2022) < <https://marineonline.com/panama/calculator> >; See also Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) < <http://consulatepanama.com> >; Panagiotou and Thanopoulou, above n 43, 12, 20; Watt and Coles, above n 2434, [22.33] – [22.34]; Marlow and Mitroussi, above n 70, 200; But see Panama Maritime Authority, 'Registration Fees & Taxes' (Document, Consulate of Panama in London, downloaded: 2021) 1; Dirección General de Marina Mercante, 'Nombres de Tipos de Documentos Débito utilizados en la aplicación' (Document, Panama registry, downloaded 2022, but undated) 1 < <https://www.panamaregistry.com.pa/> >; *This rate has remained constant or stable for the different periods as considered by the different works referenced here.

is, generally, set as a stable fixed amount of 3,000 USD.²⁴⁸⁴ Additionally, specific reductions, such as discounts and exemptions, might be applied to the above two amounts at the calculation's secondary level to reduce liability further.²⁴⁸⁵ Examples of discounts that may be referenced, include fleet discounts, loyalty discounts, no-PSC detention discounts, and new-build discounts.²⁴⁸⁶

For example, article 149(2) of *Law No 57 of 2008* provides that:

Newly built vessels with a gross tonnage equivalent to or greater than 30,000 GRT, but less than 100,000 GRT shall be given a discount of forty percent (40%) in relation to the registration fee, annual tax and annual consular rate payable in the first year of their registration in the Merchant Marine; a discount of twenty five percent (25%) in relation to the annual tax and annual consular rate payable in the second year; and a discount of fifteen percent (15%) in relation to the annual and consular tax payable in the third year.²⁴⁸⁷

Under the *2008 Law*, discount rates are set anywhere from 5 % to 60 %.²⁴⁸⁸ However, specific rates may be adjusted upwards further, where necessary, as provided in the said law,

²⁴⁸⁴ *Law 4 of 1983* art 4; See also Panama Consulate in California, 'Vessel Registration Fees' (Document, downloaded: 2022) 1; Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2; Chen Lee & Asociados, *Flag Fees* (accessed 2022) < <https://www.chenleeyasociados.com/tarifas-por-abanderamiento.html> >; See also Marine Online, *Ship Register Draft Quotation* (2022) <<https://marineonline.com/panama/calculator>>; See also Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) < <http://consulatepanama.com>>; Panagiotou and Thanopoulou, above n 43, 12, 20; Watt and Coles, above n 2434, [22.35]; Marlow and Mitroussi, above n 70, 200; *This amount has remained constant or stable for the different periods as considered by the different works referenced here.

²⁴⁸⁵ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 149 - 151; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1; Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) < <http://consulatepanama.com>>.

²⁴⁸⁶ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 149-151; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16, 18-9; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1; See generally Icaza, Gonzales-Ruiz and Aleman, above n 2469, 4-5.

²⁴⁸⁷ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 (2). Artículo 149 (2) Ley 57 De 2008 (Panama) 'Tratándose de naves de nueva construcción, si la nave tiene un tonelaje bruto igual o superior a 30,000 TRB, pero inferior a 100,000 TRB, se le otorgará un cuarenta por ciento (40%) de descuento en la tasa de registro, impuesto anual y tasa anual consular aplicable al primer año de su registro en la Marina Mercante; un descuento de veinticinco por ciento (25%) en el impuesto anual y tasa anual consular en el segundo año, y quince por ciento (15%) de descuento en el impuesto anual y consular del tercer año.'

²⁴⁸⁸ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 149 – 151; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; Icaza, Gonzales-Ruiz and Aleman, above n 2469, 5; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1.

to maintain the competitiveness of the register.²⁴⁸⁹ Such adjustments may involve specific discounts with rates reaching 100% in some instances and for specific charges.²⁴⁹⁰ Further, full exemptions may be available for specific components of the recurring annual fee.²⁴⁹¹

Stability of rates is guaranteed for fixed periods such as twenty years on registration.²⁴⁹² This latter feature aligns particularly well with certainty. It contrasts starkly with other tax regimes, such as income tax regimes that are more dynamic.²⁴⁹³ This particular feature may also be an instance where efficiency, simplicity and certainty outcomes are simultaneously promoted.

An example found on the Panamanian government website may be referenced here to demonstrate the Panamanian tonnage tax calculation.²⁴⁹⁴ However, it has, somewhat, been modified here to illustrate the regime's application more simply.²⁴⁹⁵ This said example employs a new container ship as its test subject, which demonstrates the following dimensions: 92,727 GRT and 60,492 NRT.²⁴⁹⁶ For ease of reference, the said container ship will be named the MV Kapstadt.²⁴⁹⁷ By applying the formula to a vessel of these dimensions, a gross tonnage tax of US\$ 9,049.20 is calculated.²⁴⁹⁸

²⁴⁸⁹ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 [*postremum* paragraph]; See also, for example, *Resolution No.106-56-DGMM* (Panama) dated 14 August 2014 published on 26 August 2014 ('*Panama Resolution No.106-56-DGMM*'); Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1.

²⁴⁹⁰ *Panama Resolution No.106-56-DGMM*; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1.

²⁴⁹¹ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 (7).

²⁴⁹² Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; Chen Lee & Asociados, *Flag Fees* (accessed 2022) <<https://www.chenleeyasociados.com/tarifas-por-abanderamiento.html>>.

²⁴⁹³ *The Mirrlees Review*, above n 17, 44.

²⁴⁹⁴ Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>.

²⁴⁹⁵ *Ibid.*

²⁴⁹⁶ *Ibid.*

²⁴⁹⁷ The ship applied here as the test vessel for this thesis is merely fictional.

²⁴⁹⁸ See Table D below.

The thesis uses ‘gross’ to designate the result before recognising any reductions.²⁴⁹⁹ The thesis treats the reductions as applying at the calculation’s secondary level.²⁵⁰⁰ It is submitted that more variation is likely to occur in the tax results at the secondary level of the calculation.²⁵⁰¹ Hence, transparency may be more of an issue there, to the extent that it is concerned with opaque treatments.²⁵⁰² Thus, the primary factor of transparency should be borne in mind to avoid breaches in applying reductions. Similarly, as different vessels may be awarded different discounts and exemptions, this treatment may (if applied inappropriately) breach specific primary factors, including ring-fencing and transparency; these factors emphasise uniformity, and objectivity and consistency, respectively.²⁵⁰³ However, where any tax distortions achieve positive objectives domestically, such as promoting newer or safer vessels, this outcome may be an instance of Positive Anti-Neutrality.²⁵⁰⁴

The gross tax liability may better represent the formula’s essential character, as it corresponds better with its product. However, the gross tax charge may have less relevance in practice for the actual liability that is ultimately raised. The gross tax amount ignores the application of reductions, which may have a significant downward effect on the final charge. Thus, discrepancies between the gross and net amounts might be a case of diluting the actual tax results.

²⁴⁹⁹ Merriam-Webster, *Gross* (2021) <<https://www.merriam-webster.com/dictionary/gross>>.

²⁵⁰⁰ *General Merchant Marine Law* No 57 of 6 August 2008 (Panama) arts 149 - 151; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>; Panama Consulate in Hamburg, ‘New Discounts 01.09.2014’ (Document, downloaded: 2022) 1.

²⁵⁰¹ *General Merchant Marine Law* No 57 of 6 August 2008 (Panama) art 149; Cf *Panama Resolution No. 106-56-DGMM*.

²⁵⁰² *Ibid*; *OECD Consolidated Application Note*, above n 2, [327]; *OECD 1998 Report*, above n 2, [63]; *OECD BEPS Action 5*, above n 13, 45.

²⁵⁰³ *General Merchant Marine Law* No 57 of 6 August 2008 (Panama) arts 149 - 151; Panama Consulate in Hamburg, ‘New Discounts 01.09.2014’ (Document, downloaded: 2022) 1; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16,18-9.

²⁵⁰⁴ See Table C above; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16,18-9; Panama Maritime Authority, *The Panama Ship Registry Continues to Improve the Performance of Its Fleet In Relation To International Compliance* (2022) <<https://amp.gob.pa/notas-de-prensa/el-registro-de-buques-de-panama-sigue-en-busca-de-mejorar-el-rendimiento-de-su-flota-en-relacion-con-el-cumplimiento-internacional/>>.

By applying a more moderate discount, the charge is reduced to a net amount of US\$5,429.52.²⁵⁰⁵ However, this tax liability requires the vessel to receive a 40% discount in year one of its registration because it is a new build.²⁵⁰⁶ However, for certain periods, a more generous discount may be available for equivalent cases.²⁵⁰⁷ For convenience, the primary and secondary levels of the tonnage tax calculation are set out here below in Table D. Table E repeats the calculation. However, the additional components of the recurring annual charge are included.²⁵⁰⁸ The additional charges slightly increase the annual recurring charges by US\$ 3,514.76 to US\$ 8,944.28.

²⁵⁰⁵Table D below.

²⁵⁰⁶ *General Merchant Marine Law No 57 of 6 August 2008 (Panama) art 149 (2)*; But see for example, *Panama Resolution No.106-56-DGMM*; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1.

²⁵⁰⁷ *Ibid.*

²⁵⁰⁸ See Table E below.

Table D: Calculating Total Tonnage Tax Liability ²⁵⁰⁹

Vessel Type	Container (Cargo) Ship
GRT / NRT	92,727 / 60,492
Art 3 Law 4 of 1983: Annual Tax of \$0.10 per NRT or part thereof	\$6,049.20
Art 4 Law 4 of 1983: Annual Consular fee: vessels < 15 000 GRT	\$3,000.00
Gross tonnage tax charge in year one	\$9,049.20
Art 49(2) Law 57 of 2008: Apply a 40% discount for 1st year of new builds. But see, for example, Resolution No.106-56-DGMM (valid for a particular time), which would apply a discount rate of 85% to the Annual Consular fee, thus increasing the total discount by a further \$1,350.00.	\$3,619.68
Total net tonnage tax liability in year one	\$5,429.52

Table E: Calculating Total Tonnage Taxes and Fees ²⁵¹⁰

Vessel Type	Container (Cargo) Ship
GRT / NRT	92,727 / 60,492
Art 3 Law 4 of 1983: Annual Tax of \$0.10 per NRT or part thereof	\$6,049.20
Art 4 Law 4 of 1983: Annual Consular fee: vessels < 15 000 GRT	\$3,000.00
Art 5 Law 4 of 1983: Annual inspection fee: vessels < 15 000 GRT	\$1,200.00
Art 6 Law 4 of 1983: Annual Investigation Fee (AIF):	
AIF Other vessels < 10 000 GRT	\$500.00

²⁵⁰⁹ Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>; See also above n 2469.

²⁵¹⁰ Ibid.

Vessel Type	Container (Cargo) Ship
AIF All vessels \$0.03 per NRT or part thereof	\$1,814.76
Gross annual charge in year one	\$12,563.96
Art 49(2) Law 57 of 2008: Apply a 40% discount for the 1st year of new builds [(\$6,049.20+\$3,000.00) x 40%] But see Resolution No.106-56-DGMM, (valid for a particular time), which would apply a discount rate of 85% to the Annual Consular fee, thus increasing the total discount by a further \$1,350.00.	\$3,619.68
Total net annual recurring liability	\$8,944.28
Art 2 of Law 19 of 1992: Add once-off gross registry fee	\$6,500.00
Art 49(2) Law 57 of 2008: Apply a 40% discount for the 1st year of new builds. But see Resolution No.106-56-DGMM, (valid for a particular time), which would apply a discount rate of 85% to the registry fee, thus increasing the total discount by a further \$2,925.00.	\$2,600.00
Total net once-off registry fee	\$3,900.00
Total discount applied (\$3,619.68 + \$2,600.00)	-\$6,219.68
Total first year liability (\$8,944.28+ \$3,900.00)	\$12,844.28

5.2.4 The Basic Tonnage Tax Model: The Liberian Regime

The Liberian tonnage tax regime adopts the same basic design as its Panamanian counterpart.²⁵¹¹ Panagiotou and Thanopoulou utilise two components of the ship register's annual recurring tonnage fees to represent the Liberian tonnage tax regime.²⁵¹² This approach seems to accord with how the Liberians also represent their tonnage tax regime in

²⁵¹¹ Panagiotou and Thanopoulou, above n 43, 19; Marlow and Mitroussi, above n 70, 195-6, 200-1.

²⁵¹² Ibid.

practice.²⁵¹³ Thus, for vessels demonstrating a size of 14,000 NRT and above, the two components of the tonnage tax regime, as described by the Liberians, are the annual tonnage tax of \$0.11 for each NRT, and a fixed amount of \$3,900.²⁵¹⁴ Further, like its Panamanian equivalent, the Liberian tonnage tax regime offers specific reductions like discounts and exemptions at the secondary level.²⁵¹⁵ Thus, the observations made at the secondary level for the Panamanian calculation are also generally relevant for the Liberian formula. Further, other components of the annual recurring charge, such as inspection charges, are again ignored in characterising the Liberian tonnage tax regime.²⁵¹⁶

Therefore, under the Liberian regime, the MV Kapstadt, which has a 92,727 GRT and a 60,492 NRT, may expect to incur a gross tonnage tax charge of US\$ 10,554.12 (60,492 x 0.11 + 3,900). In contrast, the Panamanian regime produced a gross charge of US\$ 9,049.20.²⁵¹⁷ Thus, even under this basic case study, the Panamanian regime demonstrates a smaller gross tax result before factoring discounts and exemptions into the equation. However, the more favourable tax result is not attributable to any unique design features. Both regimes are in their design essentially the same, but tax results differ due to lower rates and smaller fixed amounts.²⁵¹⁸

²⁵¹³ Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; Cf Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 01/21, 2021) 2 [1.0], 2 [1.2]; Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 01/12, 2005) 2 [1.2]. The rate at the time of the 2008 and 2019 works were marginally less: first, the annual tonnage tax of \$0.10 per NRT, and second, a fixed amount of \$3,800; * The 2022 rates and amounts are utilised by the thesis as officially set out by the Liberians.

²⁵¹⁴ Ibid.

²⁵¹⁵ Kofler, above n 970, 513; Liberian Registry, *Liberia’s Partnership Program for Eco-Upgrade Financing* (2021) < <https://www.liscr.com/eco-upgrade>>. See the exemption for laid up vessels: Kofler, above n 970, 513.

²⁵¹⁶ Marlow and Mitroussi, above n 70, 200-1; Panagiotou and Thanopoulou, above n 43, 19; Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 07/22, 2022) 1.0 [1.0], 2 [1.2].

²⁵¹⁷ See Table D above; Cf Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2].

²⁵¹⁸ Ibid.

5.2.5 Observations about the Basic Tonnage Tax Models

Thus, the more basic standalone tonnage tax model, employed in Panama and Liberia, generally demonstrates a particularly good alignment with the *USF*. Both regimes are connected with two of the largest ship registers globally.²⁵¹⁹ Thus, it seems as a minimum that they are not eroding their corresponding tax bases.²⁵²⁰ However, the thesis has observed that a healthy ship register depends on so much more than merely an appropriate fiscal setting. Nonetheless, as previous research has demonstrated that a strong link exists between taxes and flagging out, it seems reasonable to submit that a shipping tax regime can significantly affect the size of its tax base.²⁵²¹ Therefore, there are reasonable grounds for submitting that the above two regimes are successfully promoting super efficiency. They promote, albeit, at times, quite aggressively Positive Anti-Neutrality. This promotion is achieved particularly at the secondary level of their formula. The relative simplicity of the overall design is also a welcome change to the inordinate complexity generally associated with income tax regimes. Further, the tonnage tax is a final and mandatory tax to the extent that Liberia and Panama impose no other direct taxes on the corresponding shipping income.²⁵²²

²⁵¹⁹ See Table C above; See also Richard Meade, *Liberia on track to overtake Panama as world's largest flag*, Lloyd's List (5 August 2022) < <https://lloydslist.maritimeintelligence.informa.com/LL1141848/Liberia-on-track-to-overtake-Panama-as-worlds-largest-flag> >; Merk, above n 1541, 523; Panagiotou and Thanopoulou, above n 43, 11; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14; Watt and Coles, above n 715, [21.2].

²⁵²⁰ Ibid.

²⁵²¹ Panagiotou and Thanopoulou, above n 43, 6-7; Guglielmo Maisto, 'Article 8: International Transport and Other Operations' in Pasquale Pistone (ed), *Global Tax Treaty Commentaries* (IBFD, 2019) [1.1.2.4.1].

²⁵²² Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14-5. The Panamanian income tax system is merely a source-based system, and therefore income derived from overseas activities are not taxed in Panama. In particular, the income returned from the international maritime commerce of Panamanian flagged ships are not subject to income taxation in Panama. Taxes only have to be paid on a vessel's tonnage under a system of tariffs. Concerning Liberia, see generally Watt and Coles, above n 715, [17.18]. See generally Kofler, above n 970, 504 [18.2].

In January 2019, the OECD in advancing the objectives of its Updated 1998 Framework assessed the Panamanian and Liberian shipping tax regimes.²⁵²³ The OECD has concluded that both regimes demonstrate no harmful tax effects.²⁵²⁴ Thus, they do not contravene the *Updated 1998 Framework*, including its new fifth primary factor promoting substantial activities.²⁵²⁵

However, the OECD's report appears not to specify the details of the tonnage tax regimes assessed.²⁵²⁶ It merely references a 'shipping regime' in general.²⁵²⁷ It is noteworthy that the broader literature treats the Panamanians (like the Liberians) as employing more than one relevant regime for shipping income.²⁵²⁸ Some publications ignore the basic tonnage tax models when considering the shipping tax regimes of these States.²⁵²⁹ Thus, if the above tonnage tax regimes are not treated as relevant shipping tax regimes, the OECD may have ignored them.²⁵³⁰ Accordingly, the important issue that requires consideration is whether the basic tonnage tax regimes count as taxes and, if so, whether they are equivalent to taxes on income and capital.²⁵³¹ The significance of the latter is that the *1998 Framework* is primarily intended to assess business income and corporate taxation within the context of certain

²⁵²³ *2018 OECD Progress Report*, above n 32, 20 [16], 30.

²⁵²⁴ *Ibid.*

²⁵²⁵ *Ibid.*

²⁵²⁶ *Ibid.*; Cf Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7; See generally Watt and Coles, above n 715, [17.18], [21.21].

²⁵²⁷ *Ibid.*

²⁵²⁸ See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 32, 27; See generally Watt and Coles, above n 715, [17.18], [21.21]; See generally Kofler, above n 970, 510; see also Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 01/21, 2021) 2 [1.0], 2 [1.2]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14.

²⁵²⁹ See especially Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 27; 32; See also Watt and Coles, above n 715, [21.21]; But see Watt and Coles, above n 715 [17.18].

²⁵³⁰ Reimer and Rust, above n 806, art 8, [11].

²⁵³¹ *Ibid.*; *OECD Model Tax Convention*, above n 703, M(8) [art 2]; *OECD 1998 Report*, above n 2, [17]-[18].

mobile activities, including shipping.²⁵³² Therefore it is not concerned with taxes in general, such as indirect and personal taxes.²⁵³³

Where a tonnage tax regime is designed as an integrated (optional) alternative for computing taxable profits under a normal income/corporate tax regime (such as the UK regime),²⁵³⁴ the tonnage tax is, generally, more readily accepted in the broader literature as an equivalent to a corporate/income tax.²⁵³⁵ However, Maisto opines that in cases where the tonnage tax is applied as a compulsory tax, and operates separately and in place of the normal income/corporate tax regime (such as the Greek tonnage tax regime), its character, as an income tax equivalent, may evidence greater uncertainty.²⁵³⁶ Nonetheless, there appear to be cogent grounds that may be advanced for treating the Greek tonnage tax regime as a proper tax, and in particular, a legitimate equivalent to income/corporate tax.²⁵³⁷ Thus, as the Panamanian and Liberian regimes essentially adopt the same core or basic design as the Greek regime, albeit in a more rudimentary form, it seems reasonable to submit that they too should be characterised as taxes, and in particular, income tax equivalents.²⁵³⁸

²⁵³² *OECD 1998 Report*, above n 2, 8-9 [6] – [8], 11 [17]-[18]; *OECD BEPS Action 5*, above n 13, 19 [12]; *2017 OECD Progress Report*, above n 699, 7 [13]; But see *2018 OECD Progress Report*, above n 32, 38 [11].

²⁵³³ *Ibid.*

²⁵³⁴ *Finance Act 2000* (UK) c 17, s 82, sch 22 paras 1(1), 3(1); But see Zigurds G Kronbergs, ‘United Kingdom’ in Guglielmo Maisto (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 657-8 [22.5.1].

²⁵³⁵ Reimer and Rust, above n 806, art 8, [11]; Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; Kronbergs, above n 2534, 657 [22.5.1]; Alastair Munro, *UK Tax Treaties* (LexisNexis, 2013) 12.

²⁵³⁶ *Law 27 of 1975*, arts 2, 6 (Greek Republic); Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; Tegos, above n 1541, 451-2 [16.3.1]; See also *EU/Greece Communication* C(2015) 9019 final, 4[15] – [16]; See especially OECD, ‘The OECD’s Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries’ (Report, OECD, 2006) 5 (‘*2006 OECD Progress Report*’) <www.oecd.org/ctp/harmful/37446434.pdf>.

²⁵³⁷ *Ibid.*; See also below n 2615; Cf Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11.

²⁵³⁸ *Law 4 of 1983*, arts 3 - 4 (Panama); Cf *Law 27 of 1975*, arts 2, 6 (Greek Republic); See also above n 2469; See also Table D above; Cf Table F and G below.

Thus, the OECD may have merely used the term ‘shipping regime’ broadly in its reports to also cover tonnage taxes, whether they are more rudimentary or more advanced.²⁵³⁹ The thesis will continue its analysis based on the hypothesis that this latter position is correct.

Notwithstanding the above, for applying the Updated 1998 Framework (and the like), the issue of whether a particular charge is a legitimate equivalent to a corporate tax on business income is a relevant and important consideration; particularly in cases where these technicalities can be artificially exploited (whether intended or not) so that particular tax models are effectively protected from scrutiny. An outcome where these charges are ignored by the Updated 1998 Framework may be particularly problematic in cases where the State itself promotes these charges as comparable taxes to attract vessels to its ship register.²⁵⁴⁰

Therefore, the thesis submits that there are compelling integrity grounds for including all three tonnage tax models within the scope of the *Updated 1998 Framework*. By adopting a broad and generous conception of direct shipping taxes, all taxes that are intended to behave like corporate taxes, including their capacity to produce international distortions, may be assessed on a more equal footing for their harmful effects. The alternative course is to promote a somewhat diluted application of the *Updated 1998 Framework* by favouring a narrower scope for it.

Nonetheless, it is beyond the brief of the thesis to undertake a more detailed analysis of the *Updated 1998 Framework*. The thesis is predominantly concerned with identifying a suitable

²⁵³⁹ See especially *2006 OECD Progress Report*, above n 2536, 5 [16]: this report explicitly references the Greek tonnage tax regime ‘Shipping Regime (Law 27/75)’; Cf *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 6, 30, 57.

²⁵⁴⁰ See for example Liberia Maritime Authority, ‘Consolidated List of Fees and Charges for Official Documents and Services’ (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; Panama Marine Authority, ‘Administration Fees’ (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2; See generally Icaza, Gonzales-Ruiz and Aleman, above n 2469, 4-5.

model shipping tax regime that broadly meets international requirements whilst advancing the *USF*'s priorities.

However, for the sake of completeness, what should be mentioned is that it may be relatively easy to register a vessel under the Panamanian flag.²⁵⁴¹ The significance of vessel registration is that when vessels are registered there, their owners will, generally, be required to pay the relevant tonnage dues, including the above tonnage taxes.²⁵⁴² In particular, article 3 of the *2008 Law* provides that any individual or legal entity irrespective of nationality and domicile may register a vessel under the Panamanian flag.²⁵⁴³

Apart from the more usual obligations in respect of registering and operating vessels under an open register, including certification, ship maintenance, seaworthiness and crewing (among other things), no other relevant obligations promoting a greater physical business presence are required in Panama.²⁵⁴⁴ Notably, article 102 of the *2008 Law* merely requires a local presence through Panamanian attorneys; nonetheless, due to the unique characteristics of maritime transport activities, the OECD and the shipping industry may to some extent

²⁵⁴¹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; Watt and Coles, above n 715, [21.4] – [21.7], [21.15], [21.26]; Juan David Morgan, *The Shipping Law Review: Panama*, *The Law Reviews* (13 June 2022) [Regulation (iii)] <<https://thelawreviews.co.uk/title/the-shipping-law-review/panama>>; Icaza, Gonzales-Ruiz and Aleman, above n 2469, 5-7; See generally Panama Maritime Authority, *Foreign Service* (2022) <<https://amp.gob.pa/servicios/marina-mercante/abanderamiento-de-naves/servicio-exterior/#subtitle2/>>.

²⁵⁴² *Law 4 of 1983*, arts 3, 4 (Panama); See also Panama Consulate in California, 'Vessel Registration Fees' (Document, downloaded: 2022) 1-2; Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2-3; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6.

²⁵⁴³ *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 3. However, there are other sections in the said statute that might limit the scope of the Panamanian flag, on a case-by-case basis and at the discretion of the relevant authority, such as article 5; See generally Watt and Coles, above n 715, [21.4] – [21.8]; See generally Icaza, Gonzales-Ruiz and Aleman, above n 2469, 4.

²⁵⁴⁴ See generally *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 6, 8, 13, 19, 102, 114, 118; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6, 18-21; Watt and Coles, above n 715 [21.8] – [21.10]; See generally Icaza, Gonzales-Ruiz and Aleman, above n 2469, 5-7; Juan David Morgan, *The Shipping Law Review: Panama*, *The Law Reviews* (13 June 2022) [Regulation (iii)] <<https://thelawreviews.co.uk/title/the-shipping-law-review/panama>>.

endorse these minimal activities, as sufficient to establish substantial activities as required by BEPS 5.²⁵⁴⁵ Therefore, the *Updated 1998 Framework's* primary factor of substantial activities may have less impact in promoting stronger economic connections in practice between sponsoring States and shipping tax regimes; particularly in cases where a very low threshold is applied by adopting a minimalist approach.

Accordingly, the objectives of the substantial activities' criterion may have a better prospect of being realised in practice through the *JCF's*, as considered above under heading 5.1.2. Nonetheless, it is submitted, that the presence of even these minimal substantial activities, as considered here in the case of Panama, and irrespective of any imperfections, support the argument for categorising this basic tonnage tax model as an income/corporate tax equivalent. Similar observations may, broadly, be made for Liberia.²⁵⁴⁶

5.2.6 The Greek Tonnage Tax Model: The Greek Regime

The 2008 work demonstrated that the Greek tonnage tax regime as tested in 2007 was ranked overall in the middle compared with the two regimes that adopted a more rudimentary

²⁵⁴⁵ *General Merchant Marine Law No 57 of 6 August 2008 (Panama)* arts19, 102: Art 102 in particular provides that, 'the owners of every vessel registered in the Merchant Marine shall appoint as their resident agent an attorney or a firm of attorneys qualified to practice their profession in Panama.'; Watt and Coles, above n 715, [21.8]; [21.26]; *2018 OECD Progress Report*, above n 32, 30: 'The determination further [considers] whether the regime was designed to ensure that the qualifying taxpayer handles all corporate law and regulatory compliance of the shipping company with *any additional obligations within the jurisdiction such as ship registration including compliance with International Maritime Organisation ("IMO") regulations, customs and manning requirements (noting the various regulatory requirements for shipping identified in the Consolidated Application Note) consistent with the IMO definition.*': at 30 (emphasis added); See also World Shipping Council et al, 'OECD/G20 Inclusive Framework on BEPS - Public Consultation Document (12 October 2020 – 14 December 2020) Report on the Pillar One Blueprint and Report on the Pillar Two Blueprint' (Submission paper to the OECD Centre for Tax Policy and Administration, 14 December 2020) 4-6, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 4 ('*WSC et al Submission Paper to the OECD*') < <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/12/joint-shipping-oecd-consultation-submission.pdf> >: 'There are certain legal or other constraints affecting how the shipping business is organised but the most significant are the requirements to qualify for special shipping tax regimes.': at [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 4.

²⁵⁴⁶ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; see generally Watt and Coles, above n 715, [17.4]-[17.8], [17.12]- [17.16], [17.19]- [17.20], [17.22].

construction and the other two that utilised the Dutch design.²⁵⁴⁷ In particular, the Greek regime generally achieved an average score of about 3 out of 5.²⁵⁴⁸ However, the bulk carrier (vessel 1), exhibiting the smallest GRT of the five vessels, was the only vessel that produced the poorest fiscal outcome under the Greek regime.²⁵⁴⁹ Therefore, it may be observed that the vessel's size (and volume) plays a critical factor in determining the favourability of a gross tax result under the Greek regime.²⁵⁵⁰ Furthermore, the tax results of the Greek regime, on the whole, generally deteriorated where the 2008 study was revised by adjusting the age variable so that older vessels were applied as test subjects.²⁵⁵¹ Therefore, the vessel's age similarly plays a critical factor in the favourability of the tax result.²⁵⁵² The 2019 work concluded that the fiscal rankings for the Greek regime, as retested for the 2018 year, had significantly deteriorated.²⁵⁵³ In the latter study, the Greek regime occupied the last position.²⁵⁵⁴ Generally, it returned the most expensive tax results under the 2019 study, particularly for the four-ship registers of interest to the thesis.²⁵⁵⁵

Size and age variables play a significant role in determining gross tonnage tax liability under the Greek regime.²⁵⁵⁶ Both variables are required to calculate the tonnage tax for category A vessels (or 'first-class vessels' (πλοίων πρώτης κατηγορίας), which is the term used by the

²⁵⁴⁷ Marlow and Mitroussi, above n 70, 203.

²⁵⁴⁸ Ibid.

²⁵⁴⁹ Ibid.

²⁵⁵⁰ Ibid.

²⁵⁵¹ Ibid 203-4.

²⁵⁵² Ibid.

²⁵⁵³ Panagiotou and Thanopoulou, above n 43, 13, 22.

²⁵⁵⁴ Ibid.

²⁵⁵⁵ Ibid.

²⁵⁵⁶ *Law 27 of 1975*, art 6; *EU/Greece Communication C(2015) 9019 final*, 6 [24]; Tegos, above n 1541, 446; Papantonopoulou, above n 2439, 492; See generally Merika, Triantafyllou and Zombanakis, above n 2438, 262 [4.4]; Panagiotou and Thanopoulou, above n 43, 8, 18; Marlow and Mitroussi, above n 70, 196-7, 205-6; See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11; Deloitte, *Shipping Tax Guide: Greece, Cyprus, Luxembourg, Malta, Singapore, UK* (2013) 13 ('*Deloitte Shipping Tax Guide*') <<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Energy-and-Resources/dttl-ER-Shipping-Tax-Guide-6countries.pdf>>.

Greek Independent Public Revenue Authority).²⁵⁵⁷ The following types of vessels are included under category A - to name a few examples:

- a) engine-propelled cargo ships, tankers and refrigerator ships with gross tonnage equal to or exceeding 3,000 tonnes;
- b) iron-hulled cargo ships for dry and liquid loads and refrigerator ships with gross tonnage exceeding 500 tonnes but no more than 3,000 tonnes, whose itinerary includes calls at foreign ports or which ply between foreign ports; and
- c) passenger ships the itineraries of which include calls at foreign ports or plying between foreign ports.²⁵⁵⁸

The category that a vessel is assigned to by the regime determines the rates that are applied in undertaking the tonnage tax calculation.²⁵⁵⁹ Category B is the second class of vessels established under the Greek regime that contains the smaller motor-propelled vessels that are omitted from category A;²⁵⁶⁰ examples of these vessels include, fishing vessels, sailing boats and general small craft.²⁵⁶¹ Category B vessels will not be considered here further. These vessels are less relevant for performing maritime transport activities and promoting the sea power of a State; it is these objectives (among others) that are primary issues in designing a model shipping tax regime.

²⁵⁵⁷ Ibid; Greek Republic Independent Public Revenue Authority (Ανεξάρτητης Αρχής Δημοσίων Εσόδων), ‘Providing instructions for the implementation of the provisions of article 146 of Law 4808/2021 (A’101) regarding the increase of tax amounts and contributions of first-class ships of Law 27/1975 (A’77), with an adjustment of tax rates and their contribution for the five years 2021 to 2025, as applicable’ (Circular E.2052/ July 21, 2022) 2 [1] (‘Circular 2052’) < <http://www.aade.gr/>>.

²⁵⁵⁸ Law 27 of 1975, art 3; EU/Greece Communication C(2015) 9019 final, 4 [12] - [13]; Papantonopoulou, above n 2439, 492; Tegos, above n 1541, 445; Marlow and Mitroussi, above n 70, 205-6. For a detailed list of vessels see generally Tegos, above n 1541, 445.

²⁵⁵⁹ Law 27 of 1975, art 6; EU/Greece Communication C(2015) 9019 final, 4 [12], 6 [24]; Papantonopoulou, above n 2439, 492; Tegos, above n 1541, 445-6; Marlow and Mitroussi, above n 70, 196-7; See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11.

²⁵⁶⁰ Law 27 of 1975, art 3; EU/Greece Communication C(2015) 9019 final, 4 [14]; Papantonopoulou, above n 2439, 492; Tegos, above n 1541, 445-6; Marlow and Mitroussi, above n 70, 196-7; See generally Orbitax, *Greek Ship Taxation Regime Amendments for 2020* (2020) < <https://www.orbitax.com/news/archive.php/Greek-Ship-Taxation-Regime-Ame-40925>>.

²⁵⁶¹ Ibid.

The following result is produced by applying the above vessel categorisation to the thesis's test vessel, the MV Kapstadt, which is a new container ship of 92,727 GRT and 60,492 NRT:²⁵⁶² This vessel falls under subparagraph (a) of category A, as it is an engine-propelled cargo ship with a gross tonnage exceeding 3,000 tonnes.²⁵⁶³

The next step (as applied by the thesis) is to work out the gross tonnage tax amount by multiplying the gross tonnage by the *appropriate* rates fixed for category A vessels.²⁵⁶⁴ The Greek regime employs five (somewhat stable) regressive rates corresponding with five progressive gross tonnage brackets.²⁵⁶⁵ Thus, the Greek model differs from its Panamanian and Liberian counterparts; these more basic models employ a uniform rate per net tonnage to calculate the gross tax liability.²⁵⁶⁶

Under the category A standard rates, the MV Kapstadt, which has a 92,727 GRT, produces a taxable tonnage of 89 181.²⁵⁶⁷ The calculation's breakdown is as follows: $([10,000 \times 1.2] + [10,000 \times 1.1] + [20,000 \times 1] + [40,000 \times 0.9] + [12,727 \times 0.8]) = 89, 181$.²⁵⁶⁸

²⁵⁶² *Law 27 of 1975*, art 3; *EU/Greece Communication C(2015) 9019 final*, 4 [12] - [13]; Papantonopoulou, above n 2439, 492; Tegos, above n 1541, 445; Panagiotou and Thanopoulou, above n 43, 18; Marlow and Mitroussi, above n 70, 196-7.

²⁵⁶³ *Ibid.*

²⁵⁶⁴ *Law 27 of 1975*, art 6; See especially Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11; *EU/Greece Communication C(2015) 9019 final*, [27]; Papantonopoulou, above n 2439, 492-3; Tegos, above n 1541, 445-6; Panagiotou and Thanopoulou, above n 43, 18; Marlow and Mitroussi, above n 70, 196-7; See also *2015 Deloitte Shipping Tax Guide*, above n 2433, 8 -9; Cf *Deloitte Shipping Tax Guide*, above n 2556, 14.

²⁵⁶⁵ *Ibid.*

²⁵⁶⁶ *Law 4 of 1983 art 3 (Panama)*; See also Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; *Deloitte Shipping Tax Guide*, above n 2556, 14-5; Panagiotou and Thanopoulou, above n 43, 12, 19-2, 22; Marlow and Mitroussi, above n 70, 200-1.

²⁵⁶⁷ *Law 27 of 1975*, art 6; See also *Law 4336 of 2015*, art 2(2)(d)(4); See especially Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11; See generally *Deloitte Shipping Tax Guide*, above n 2556, 14.

²⁵⁶⁸ *Ibid.* (12,000 + 11,000 + 20,000 + 36,000 + 10, 181 = 89, 181). The calculation is explained in further detail here below.

Table F: Class “A” Vessels: Calculating Taxable Tonnage

Gross Tonnage	B: Standard Rates ²⁵⁶⁹	C: Reduced Rates ²⁵⁷⁰
100-10,000	1.2	1.2
10,001-20,000	1.1	1.1
20,001-40,000	1.0	1.0
40,001-80,000	0.9	0.45
Exceeding 80,001	0.8	0.2

However, Greek flagged vessels exceeding 1 500 tonnes (and certain foreign-flagged vessels) are usually eligible for reduced rates where article 13 of Legislative Decree 2687/1953 applies to the case.²⁵⁷¹ These reduced rates are listed comparatively in column C of Table F.

The lower rates are applied in relation to the last two progressive tonnage brackets.

Therefore, the reduced rates will in reality only apply to larger vessels.

Under the reduced rates, the MV Kapstadt produces a taxable tonnage of 63, 545.²⁵⁷² The calculation’s breakdown is as follows: ([10,000 x 1.2] + [10,000 x 1.1] + [20,000 x 1] +

²⁵⁶⁹ *Law 27 of 1975*, art 6; Papantonopoulou, above n 2439, 493; Tegos, above n 1541, 446; George S Mavraganis Email to Barry Hitchens 15 April 2021; Marlow and Mitroussi, above n 70, 196; See also 2015 *Deloitte Shipping Tax Guide*, above n 2433, 8-9, 11; Cf *Deloitte Shipping Tax Guide*, above n 2556, 14, 16.

²⁵⁷⁰ Ships registered under the Greek flag after the entry into force of *Law 27 of 1975*, art 6 and taxed under this law and whose registration with the Greek vessel registry is effected under *Legislative Decree 2687/1953* art 13 (relating to foreign capital investment incentives); *EU/Greece Communication C(2015) 9019 final*, 7 [27]; Tegos, above n 1541, 447; Papantonopoulou, above n 2439, 495; Panagiotou and Thanopoulou, above n 43, 18; Marlow and Mitroussi, above n 70, 197; See also Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11.

²⁵⁷¹ *Law 27 of 1975*, arts 1, 6, 25, 26, 26A; *Legislative Decree 2687 of 1953*, art 13; See also 2015 *Deloitte Shipping Tax Guide*, above n 2433, 8 – 13; Cf *Deloitte Shipping Tax Guide*, above n 2556, 14 -19; Tegos, above n 1541, 446-7; Papantonopoulou, above n 2439, 494.

²⁵⁷² *Law 27 of 1975*, art 6; *Legislative Decree 2687 of 1953*, art 13; See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11.

$[40,000 \times 0.45] + [12,727 \times 0.2] = 63,545$).²⁵⁷³ A reduction in taxable tonnage in the amount of 25 636 is produced by applying these reduce rates.

The next step (as applied by the thesis) requires multiplying the taxable tonnage (calculated under the previous step) by specific USD (age-related) rates.²⁵⁷⁴ The updated rates in *Circular 2052* are applied in column B of Table G here below.²⁵⁷⁵ Likewise, the appropriate corresponding reduced USD rates are applied in column C of Table G.²⁵⁷⁶ The MV Kapstadt is a new container ship. Therefore, the USD rates of the first age bracket, covering years zero to four, will apply to it.

The MV Kapstadt produces a gross tonnage tax of US\$ 136 090 ($89,181 \times 1.526$). This is achieved by having a standard taxable tonnage of 89,181 and applying the standard USD rate of the first age bracket. However, under the reduced USD rates, a gross tonnage tax of US\$ 32,344 ($63,545 \times 0.509$) is produced. Thus, a significant reduction in gross tonnage tax is achieved equalling US\$ 103,746 where the reduced USD rates are applied instead of the standard USD rates.

²⁵⁷³ Ibid. ($12,000 + 11,000 + 20,000 + 18,000 + 2,545 = 63,545$). The calculation is explained in further detail here below.

²⁵⁷⁴ *Law 27 of 1975*, art 6; See also *EU/Greece Communication C(2015) 9019 final*, 7 [27]; Tegos, above n 1541, 446; Papantonopoulou, above n 2439, 493; George S Mavraganis Email to Barry Hitchens 15 April 2021; See especially Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11.

²⁵⁷⁵ Ibid.

²⁵⁷⁶ *Law 27 of 1975*, art 6; *Legislative Decree 2687 of 1953*, art 13; Cf Tegos, above n 1541, 446-7; Cf Papantonopoulou, above n 2439, 494; Cf Marlow and Mitroussi, above n 70, 196-7.

Table G: Class “A” Vessels: Age-Related Rates (US dollars / gross tonnage)**

Age of vessel in years	B: Standard Rates ²⁵⁷⁷	C: Reduced Rates ²⁵⁷⁸
0 ²⁵⁷⁹ - 4	1.526	0.509
5-9	2.736	0.912
10-19	2.678	0.893
20-29	2.534	0.845
30 and over	1.958	0.653

²⁵⁷⁷ Ships registered under the Greek flag after the entry into force of *Law 27 of 1975*, art 6 and taxed under this law; See especially *Circular 2052*, above n 2557, 2; See generally Papantonopoulou, above n 2439, 493; See generally Tegos, above n 1541, 446; *2015 Deloitte Shipping Tax Guide*, above n 2433, 10; George S Mavraganis Email to Barry Hitchens 15 April 2021.

**The rates set out in Table G are the 2022 USD rates as appearing in the official Greek tax *Circular 2052*; the thesis prefers avoiding the use of the tax rates for the 2020 to 2021 tax years as they may have been impacted in one or more States by the global COVID-19 pandemic, and this exceptional event may distort the corresponding tax results. It should be noted that *Circular 2052* advises that the 2020 USD rates were applied for 2021 tonnage tax payments; however, the 2022 rates are calculated *as if* the 2021 rates were increased as normal; *Circular 2052* advises that through a special law provision (article 146 of law 4808/2021) the imposition of the automatic increase in the tonnage tax payments was suspended for 2021. Therefore, the rates applied in 2020 were also applied for calculating *the tonnage tax payments* for 2021. Accordingly, this 4% that was not applied to the tonnage tax liability in 2021, will be clawed back in subsequent years. The aim is that at the end of this 5-year period that the rates are back to normal as they would have been had the suspension not occurred for 2021. For 2022, the tonnage tax is calculated as if the suspension had not taken place. Therefore, the amount of tax that will be collected for 2022 and 2023, will represent amounts that are calculated as if the suspension had not occurred in 2021. The rate increases (suspended for 2021) will in reality be paid in the 2024 and 2025 years. Thus, the same calculation process applies for 2024 and 2025 as adopted in 2022 and 2023. But in these latter years the 4% that was not collected in 2021 will also be added to the tax payments for these years: See especially *Circular 2052*, above n 2557, 2 [1] – [3]; Panagiotou and Thanopoulou utilise the adjusted reduced rates for the 2018 year in their research; By repeating the calculation under step two, using the rates as applied by Panagiotou and Thanopoulou, the following result is produced: US\$ 29, 103 (63, 545 x 0.458).

²⁵⁷⁸ Ibid; Ships registered under the Greek flag after the entry into force of *Law 27 of 1975*, art 6 and taxed under this law and whose registration with the Greek vessel registry is effected by *Legislative Decree 2687/1953*, art 13; See especially *Circular 2052*, above n 2557, 3; Papantonopoulou, above n 2439, 494; Tegos, above n 1541, 447; Panagiotou and Thanopoulou, above n 43, 18; Marlow and Mitroussi, above n 70, 197; See *EU/Greece Communication C(2015) 9019 final*, 7 [26]; See also *2015 Deloitte Shipping Tax Guide*, above n 2433, 10 -11; Cf Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 11.

²⁵⁷⁹ Year zero is the next year, after the year during which the vessel is commercially exploited for the first time. See Tegos, above n 1541, 446. The calculation of the age of the vessel commences on 1 January of the year following the year the vessel is delivered for commercial use. See *Deloitte Shipping Tax Guide*, above n 2556, 19; See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 10 -11.

As a caveat, it should be noted that annual adjustments need to be considered for applying these USD rates to later years to calculate the correct USD tax amount, such as a 4% increase.²⁵⁸⁰

Specific discounts and exemptions are also available under *Law 27/1975*.²⁵⁸¹ Thus, the gross tonnage tax amount for category A vessels may be reduced by 50% for all vessels plying regular voyages between Greek and foreign ports or exclusively between two foreign ports.²⁵⁸² Further, category A vessels that are Greek built and fly the Greek flag are tax-exempt until six years old.²⁵⁸³ Similarly, Greek-registered category A vessels that are younger than 20 years and that have certain improvements or repairs (such as reconstruction work, replacing the propulsion system, or even general repairs) done in Greece may be tax-exempt for a maximum of six years (whether these years run consecutively or not).²⁵⁸⁴ Roughly, this

²⁵⁸⁰ See especially *Circular 2052*, above n 2557, 2 [1] -[3]; Cf *Deloitte Shipping Tax Guide*, above n 2556, 14-6; Tegos, above n 1541, 446; Papantonopoulou, above n 2439, 492; George S Mavraganis Email to Barry Hitchens 15 April 2021; Panagiotou and Thanopoulou, above n 43, 18; See above n 2577.

²⁵⁸¹ *Law 27 of 1975*, arts 5, 7, 13; See especially Greek Republic Independent Public Revenue Authority (Ανεξάρτητης Αρχής Δημοσίων Εσόδων), ‘Providing clarifications and instructions regarding reductions from the first-class ship tax and exemptions from it, according to implementation of the provisions of articles 5 and 7 of Law 27/1975 (Government Gazette Α’ 77) and of those defined in case D’ of condition 12 of the approval acts registration of Greek-flagged ships issued pursuant to article 13 of n.d. 2687/1953 (Government Gazette Α’ 317)’ (Circular E.2029/ March 11, 2020) 1 – 4, 7-8 (‘*Circular 2029*’); *2015 Deloitte Shipping Tax Guide*, above n 2433, 11, 13; Cf *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 13; Papantonopoulou, above n 2439, 495-6; Tegos, above n 1541, 447-8.

²⁵⁸² *Law 27 of 1975*, art 7(1)(b); *Circular 2029*, above n 2581, 3 [2(b)], 7-8, 12, 15-6; ‘Για πλοία τα οποία εκτελούν δρομολόγια σε τακτικές γραμμές μεταξύ ελληνικών και ξένων λιμένων ή μόνο μεταξύ ξένων λιμένων όπως και για τα κρουαζιερόπλοια, προβλέπεται η καταβολή του οφειλόμενου φόρου μειωμένου κατά ποσοστό 50%.’: at 3 [2(b)]; EU/*Greece Communication C(2015) 9019 final*, 8 [31]; See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 11, 13; Cf *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 13; Tegos, above n 1541, 447; * It should be noted that this ‘regular service reduction under art 7(1)(b) may be used together with a ‘purchase of supplies reduction’ to get a greater reduction in the final net tonnage tax liability: *Circular 2029*, above n 2581, 7-8, 15-6.

²⁵⁸³ *Law 27 of 1975*, art 7(1)(a); *Circular 2029*, above n 2581, 3 [2(a)]: ‘Για τα ναυπηγούμενα στην Ελλάδα πλοία με ελληνική σημαία παρέχεται απαλλαγή από τον φόρο μέχρι συμπλήρωσης ηλικίας έξι (6) ετών.’; EU/*Greece Communication C(2015) 9019 final*, 8 [34(a)]; Tegos, above n 1541, 447.

²⁵⁸⁴ *Law 27 of 1975*, art 7(1)(c); *Circular 2029*, above n 2581, 4 [2(c)]; EU/*Greece Communication C(2015) 9019 final*, 8-9 [34(b)]: ‘γ. Για πλοία ηλικίας κάτω των είκοσι (20) ετών που υφίστανται ανακατασκευή ή μετασκευή ή αντικατάσταση του συστήματος προώσεως ή άλλων μηχανημάτων, καθώς και πάσης φύσεως συμπληρώσεις και γενικά επισκευές, εφόσον οι εργασίες αυτές εκτελούνται στην Ελλάδα και οι δαπάνες των εργασιών αυτών καλύπτονται με εισαγωγή ξένου συναλλάγματος, απαλλάσσονται του φόρου κατ’ αντιστοιχία ενός έτους φορολογικής απαλλαγής προς δαπάνη εκατό χιλιάδων (100.000) δολαρίων Η.Π.Α.’: *Circular 2029*, above n 2581, 4 [2(c)].

latter exemption is determined by allocating one year for every 100, 000 US dollars spent on Greek ‘repairs’; the 100, 000 USD threshold per year might be satisfied by utilising more than one expenditure item.²⁵⁸⁵ However, this exemption is capped at 50% of the total cost of the repairs.²⁵⁸⁶ There are also other exemptions available not listed here; *circular 2029* considers the various exemptions and reductions (in addition to the provisions set out above) and provides advice on the manner in which they may be granted and substantiated in practice.

The Greek tonnage tax regime operates as a compulsory and final tax.²⁵⁸⁷ Thus, no other taxes, such as corporate/income tax and withholding tax apply to the shipping income returned from the vessel’s operation.²⁵⁸⁸ This special treatment is not only available to the entity deriving the shipping income directly (including all capital gains realised at the level of the shipowner/shipping company and their shareholders).²⁵⁸⁹ The exemption is also available to other role-players that indirectly enjoy the relevant shipping income, such as shareholders and ship management companies.²⁵⁹⁰ One might say that this income tax exemption, which is granted by applying the tonnage tax regime to a vessel, is a somewhat blanket exemption that becomes a quasi-inherent characteristic of the shipping income.²⁵⁹¹ The exemption might, figuratively, be described as attaching to the shipping income as a mollusc attaches to a ship's

²⁵⁸⁵ *Ibid.*

²⁵⁸⁶ *Ibid.*

²⁵⁸⁷ *Law 27 of 1975*, art 2; EU/*Greece Communication C(2015) 9019 final*, 4 [15] – [16]: ‘Pursuant to Article 2 of *Law 27/1975* income derived from the operation of the ship is exempted from income tax and is subject to tonnage tax instead.’: at 4 [15]; Papantonopoulou, above n 2439, 492, 494, 496; Tegos, above n 1541, 443-4; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9; Pursuant to *Law 27 of 1975*, art 29, this exemption also covers inheritance tax in relation to vessels or underlying shares: EU/*Greece Communication C(2015) 9019 final*, 5 [17], 19 [95]- [96]; A similar tax treatment may apply to insurance receipts: See generally Papantonopoulou, above n 2439, 492, 494, 496.

²⁵⁸⁸ *Law 27 of 1975*, art 2; EU/*Greece Communication C(2015) 9019 final*, 4 [15] – [16].

²⁵⁸⁹ *Law 27 of 1975*, arts 1, 2, 29 (simply considering here Greek flagged vessels; Cf arts 25, 26, 26A); See especially EU/*Greece Communication C(2015) 9019 final*, 4 [16] – 5 [19], 15 [71]; See Tegos, above n 1541, 444; Papantonopoulou, above n 2439, 492, 494, 496; Cf *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

²⁵⁹⁰ *Law 27 of 1975*, arts 1, 2, 4, 25, 26, 29; EU/*Greece Communication C(2015) 9019 final*, 4 [16] – 6 [21], 18 [90] – 19 [92]; Tegos, above n 1541, 444; Papantonopoulou, above n 2439, 492, 494, 496.

²⁵⁹¹ *Ibid.*

hull.²⁵⁹² Thus, once the tonnage tax is applied to the vessel, its actual shipping income becomes tax-exempt; this exemption then travels with the shipping income as it is transferred between eligible entities.²⁵⁹³

Broadly, the income tax exemption applies generously covering multiple recipients and various types of income.²⁵⁹⁴ Thus it is, generally, irrelevant, for example, whether the income is received directly as shipping income, or indirectly as a dividend.²⁵⁹⁵ Further, factors, such as the residence or nationality of the entity deriving the receipt or whether the entity is an individual or some other legal structure, are, generally, all irrelevant for the exemption.²⁵⁹⁶

Accordingly, the Greek shipping tax treatment may be strongly aligned with uniformity.²⁵⁹⁷ It may similarly demonstrate simplicity and certainty.²⁵⁹⁸ Its application does not, generally, discriminate between different legal structures utilised in law.²⁵⁹⁹ Thus, administrative and compliance costs may be less as the differentiation in tax treatments is reduced. Generally, the treatment remains the same²⁶⁰⁰ irrespective of whether a vessel is held directly by an individual or indirectly through a company or chain of interposed companies.²⁶⁰¹ Establishing tax uniformity for different ownership levels and legal structures is a simple and effective

²⁵⁹² Staniland, above n 75, 293, 293.

²⁵⁹³ *Law 27 of 1975*, arts 1, 2, 4, 25, 26, 29; *EU/Greece Communication C(2015) 9019 final*, 4 [15]- 6 [21]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; Cf *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

²⁵⁹⁴ *Ibid.*

²⁵⁹⁵ *Ibid.*; See especially *EU/Greece Communication C(2015) 9019 final*, 18 [90] – 19 [92].

²⁵⁹⁶ *Ibid.*; See especially *EU/Greece Communication C(2015) 9019 final*, 4 [16], 9 [35] – [36].

²⁵⁹⁷ *The Mirrlees Review*, above n 17, 34, 40; Alley and Bentley, above n 2, 592, 612, 616.

²⁵⁹⁸ *The Mirrlees Review*, above n 17, 22-3, 42-4; Stewart et al, above n 2, 10-11; Alley and Bentley, above n 2, 611-2; *Asprey Review*, above n 34, [3.20]; *The Henry Review*, above n 89, 17, 169.

²⁵⁹⁹ *Law 27 of 1975*, arts 1, 2, 26, 29; *EU/Greece Communication C(2015) 9019 final*, 4 [15]- 4[16], 5[18], 6[21]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; Cf *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

²⁶⁰⁰ *The Mirrlees Review*, above n 17, 22-3, 42-4; Stewart et al, above n 2, 10-11; Alley and Bentley, above n 2, 611-2; *Asprey Review*, above n 34, [3.20]; *The Henry Review*, above n 89, 17, 169.

²⁶⁰¹ *Law 27 of 1975*, arts 1, 2, 26; *EU/Greece Communication C(2015) 9019 final*, 5 [18], 6 [21], 18 [90] – 19 [92]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

method of promoting efficiency vigorously in a regime.²⁶⁰² This design attribute may be particularly useful for tax bases, like maritime transport activities, that are highly mobile.²⁶⁰³ Other significant efficiency features include exempting capital gains derived from selling vessels that are tonnage tax subjects.²⁶⁰⁴ Likewise, the exemption applies to transferring shares of Greek and foreign companies that own vessels (Greek or foreign-flagged) that enjoy the tonnage tax.²⁶⁰⁵

The tonnage tax regime is primarily geared at imposing tax liability on the owners of vessels that fly the Greek flag, irrespective of the owner's nationality and residence.²⁶⁰⁶ However, the regime may also cover the owners of vessels that fly foreign flags on the basis that a Greek ship management company manages the vessel.²⁶⁰⁷ Ship management companies established in Greece under article 25 of *Law 27 of 1975*, are jointly liable with the Greek or foreign shipowning entities for paying the tonnage tax.²⁶⁰⁸ However, the Greek ship management company will similarly enjoy an exemption from tax for its income derived from a vessel subjected to tonnage tax.²⁶⁰⁹ In cases where foreign tonnage tax is applied to vessels flying a foreign flag, and this same vessel is also liable to tonnage tax in Greece, the foreign tonnage tax may be treated as a credit for Greek tonnage tax.²⁶¹⁰ Further, article 26A of *Law 27 of*

²⁶⁰² Dwyer, above n 2, 747-8; 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 22-3, 29-30, 40-1; *The Henry Review*, above n 89, vii, 13, 17-8, 25, 39-40, 48, 51, 73, 170-2, 176.

²⁶⁰³ Panagiotou and Thanopoulou, above n 43, 5,7; McMahon, above n 36, 106; Asteris, above n 35, 71; *1998 DETR Report*, above n 23, 7 [14] – [17], 16 [61], 42; Alexander, above n 35, 3, 7 [8], 15 [45], 15 [46], 15-6 [48], 16 [49] – [50], 19 [66] – [67], 19-2 [69], 20 [72].

²⁶⁰⁴ *Law 27 of 1975*, arts 1, 2; EU/*Greece Communication C(2015) 9019 final*, 5 [18], 15 [71]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

²⁶⁰⁵ *Law 27 of 1975*, arts 2, 26 [11]; EU/*Greece Communication C(2015) 9019 final*, 5 [19], 6 [21], 19 [94] – [95]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496.

²⁶⁰⁶ *Law 27 of 1975*, arts 1, 2; EU/*Greece Communication C(2015) 9019 final*, 4 [15]- [16], 5 [18], 5 [20], 9 [35] – [36]; Tegos, above n 1541, 443; Papantonopoulou, above n 2439, 492, 494.

²⁶⁰⁷ *Law 27 of 1975*, arts 2, 4, 25, 26; EU/*Greece Communication C(2015) 9019 final*, 4 [16], 5 [20], 9 [36]; Papantonopoulou, above n 2439, 493-4; Tegos, above n 1541, 444.

²⁶⁰⁸ EU/*Greece Communication C(2015) 9019 final*, 4 [16], 5 [20], Papantonopoulou, above n 2439, 492, 494; Tegos, above n 1541, 444.

²⁶⁰⁹ EU/*Greece Communication C(2015) 9019 final*, 5 [20]; Tegos, above n 1541, 444.

²⁶¹⁰ *Ibid.*

1975 provides that owners of non-Greek EU and EEA²⁶¹¹ flagged vessels used in domestic and international transport (but for the latter, limited to vessel up to 500 GT) are similarly eligible for Greek tonnage tax.²⁶¹²

5.2.7 Contrasting the Greek and Panamanian Tonnage Tax Models

The OECD has assessed the Greek tonnage tax regime.²⁶¹³ The regime has not been identified as producing harmful tax effects.²⁶¹⁴ Thus, the observations made about the Panamanian and Liberian OECD assessments may similarly be referenced for the Greek regime.

However, certain differences require special noting between the Greek regime, and the Panamanian and Liberian regimes. The Greek tonnage tax regime is, more widely, recognised or treated in the broader literature as a legitimate income tax equivalent.²⁶¹⁵ Further, the Greek regime has a more complex design than the other two more-basic regimes.²⁶¹⁶ However, in fairness, the Greek regime manifests a greater complexity even against other

²⁶¹¹ EEA meaning European Economic Area.

²⁶¹² *EU/Greece Communication C(2015) 9019 final*, 4 [16]; Papantonopoulou, above n 2439, 494. The regime has also been likewise extended to bareboat charterers see Evgenia Kousathana, *Greece introduces amendments to the taxation of ships* (2020) Hellenic Shipping News < <https://www.hellenicshippingnews.com/greece-introduces-amendments-to-the-taxation-of-ships/>>.

²⁶¹³ OECD, *OECD announces progress made in addressing harmful tax practices* < <https://www.oecd.org/tax/oecd-announces-progress-made-in-addressing-harmful-tax-practices-beps-action-5.htm>>; OECD, 'Harmful Tax Practices - Peer Review Results: Inclusive Framework on BEPS: Action 5' (Update, OECD, 2020) 1, 3-5, 6-8, 8[4], 18-9 < <https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf>>; *2018 OECD Progress Report*, above n 32, 9[2] – [4], 17[15], 19-20, 20[16], 30, 34; *2017 OECD Progress Report*, above n 699, 13[8], 14[2], 15[14], 16, 16[15], 21, 23[18], 39[2], 43[14]; *OECD BEPS Action 5*, above n 13, 61 [143], 64 [149]; See especially *2006 OECD Progress Report*, above n 2536, 5 [16].

²⁶¹⁴ *Ibid.*

²⁶¹⁵ Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11, 13; See also *EU/Greece Communication C(2015) 9019 final*, 4[15] – [16]; See especially *2006 OECD Progress Report*, above n 2536, 5 [16]; Note also the specific types of tax regimes that are considered by the OECD's *1998 Framework*: See headings 3.2 and 3.4.1 above; Cf Munro, above n 2535, 12; See generally above n 2613.

²⁶¹⁶ *Law 27 of 1975*, art 6 (Greek Republic); *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; *EU/Greece Communication C(2015) 9019 final*, 4 [12], 6 [24]; Papantonopoulou, above n 2439, 492-494; Tegos, above n 1541, 446-7.

regimes applying the Greek model, like the Cypriot and Maltese regimes.²⁶¹⁷ In particular, the Cypriot and Maltese regimes demonstrate a more straightforward formula.²⁶¹⁸ They both omit the second step of the Greek formula applying age-related rates.²⁶¹⁹

Nonetheless, the Greek, Panamanian and Liberian regimes all have at their core a similar taxing formula.²⁶²⁰ Their formulas all charge a final and compulsory tax by multiplying tonnage by one or more rates.²⁶²¹ However, the Panamanian and Liberian regimes (i.e. in short, the former regimes) calculate the gross tax amount by utilising a more straightforward method.²⁶²² They multiply one constant rate by the vessel's net tonnage²⁶²³ (ignoring the

²⁶¹⁷ Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 13; *EU/Greece Communication* C(2015) 9019 final, 6-7; *EU/Maltese Communication* C(2017) 8734 final, 6 [21] – [22], 21; Deloitte, *Cyprus Tonnage Tax System: Questions and Answers* (2020) 46-7 ('*Deloitte Cypriot Shipping Tax Guide*'); See generally *Deloitte Shipping Tax Guide*, above n 2556, 32, 65.

²⁶¹⁸ *Ibid.*

²⁶¹⁹ *Ibid.*

Table n 2619: Basic Cypriot Gross Tonnage Tax Formula as of 2020					
Net Tonnage	0 – 1,000	1,000 – 10,000	10,001 – 25,000	25,001 – 40,000	> 40,000
per 100 units of NT	€36.50	€31.03	€20.08	€12.78	€7.30
Gross tonnage tax due = €5,868.01 (+/- US\$ 7,098,61): Re MV Kapstadt, that has a 60,492 NRT	€91.25	€698.17	€3,012.00	€1,917.00	€149.59

Cyprus has been ranked previously as about the 12th largest register globally by dead-weight tonnage: Watt and Coles, above n 715, [12.2].

²⁶²⁰ *Law 27 of 1975*, art 6 (Greek Republic); *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11; Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>; Cf Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 01/21, 2021) 2 [1.0], 2 [1.2]; Panagiotou and Thanopoulou, above n 43, 12, 19-2; Watt and Coles, above n 2434, [22.33] – [22.34]; Marlow and Mitroussi, above n 70, 200-1.

²⁶²¹ *Ibid.*

²⁶²² *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; See also Panama Consulate in California, 'Vessel Registration Fees' (Document, downloaded: 2022) 1-2; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1; Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2-3; Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>; Cf Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 01/21, 2021) 2 [1.0], 2 [1.2]; Panagiotou and Thanopoulou, above n 43, 12, 19-2; Watt and Coles, above n 2434, [22.33] – [22.34]; Marlow and Mitroussi, above n 70, 200-1.

²⁶²³ *Ibid.*

addition of mere fixed amounts).²⁶²⁴ Thus, the former regimes generally utilise a one-step approach.²⁶²⁵

In contrast, the Greek model in principle considers two variables in calculating its gross tax result: gross tonnage and the vessel's age.²⁶²⁶ These two variables are applied through a set of five progressive tonnage brackets and age brackets.²⁶²⁷ Each bracket fixes a range for each variable.²⁶²⁸ Each bracket range corresponds with a unique rate.²⁶²⁹ Thus, in contrast to the other two basic regimes, the Greek calculation applies two rates in two distinct steps for calculating the gross tax result.²⁶³⁰

Thus, the Greek regime establishes an inversely proportional relationship in step one by the progressive ordering of the gross tonnage brackets and the corresponding regressive ordering of the rates.²⁶³¹ This relationship attributes a lower taxable tonnage to a vessel where the higher tonnage brackets are applied due to a vessel's larger size.²⁶³² This inversely proportional setting is a common design feature in tonnage tax regimes that adopt the Greek model.²⁶³³ However, the age brackets in step two are ordered progressively with their

²⁶²⁴ Ibid; See generally *EU/Maltese Communication C(2017) 8734 final*, 6.

²⁶²⁵ Ibid.

²⁶²⁶ *Law 27 of 1975*, art 6 (Greek Republic); See also *Circular 2052*, above n 2557, 3; Papantonopoulou, above n 2439, 492-494; Tegos, above n 1541, 446-7; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11, 13; *EU/Greece Communication C(2015) 9019 final*, 3[11], 6[24], 7; *Deloitte Shipping Tax Guide*, above n 2556, 14-5.

²⁶²⁷ Ibid.

²⁶²⁸ Ibid.

²⁶²⁹ Ibid.

²⁶³⁰ Ibid.

²⁶³¹ *Law 27 of 1975*, art 6 (Greek Republic); See also *Circular 2052*, above n 2557, 3; Panagiotou and Thanopoulou, above n 43, 18; Papantonopoulou, above n 2439, 492-3; Tegos, above n 1541, 445-6.

²⁶³² Ibid.

²⁶³³ *Law 27 of 1975*, art 6 (Greek Republic); *Deloitte Cypriot Shipping Tax Guide*, above n 2617, 46; See Tables 1CT and F here above; *EU/Maltese Communication C(2017) 8734 final*, 6 [21]; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11, 7, 13.

corresponding rates – albeit imperfectly.²⁶³⁴ Thus, higher age brackets applying to older vessels will generally produce higher gross tax amounts.²⁶³⁵

Nonetheless, the Greek regime applies the age brackets generously and simply.²⁶³⁶ The regime starts counting time at year zero, which is simply fixed to commence on the 1st of January.²⁶³⁷ This date is recognised after the year the vessel is first delivered for commercial exploitation.²⁶³⁸ Thus, year zero may, in practice, be deferred for about one full calendar year.²⁶³⁹ Thus, shipowners may obtain a ‘further’ tax-free year.²⁶⁴⁰ This benefit may be achieved by receiving a vessel at the beginning of a calendar year so that roughly a whole year can be enjoyed before the regime starts counting time.²⁶⁴¹

Thus, this tax-free period arises because the regime adopts a simple treatment for time.²⁶⁴²

Thus, the progression to the next age bracket, which commences at year five and introduces a higher rate, may only occur after about six full-calendar years.²⁶⁴³ For vigorously promoting efficiency and simplicity, adopting a more straightforward treatment for time is a feature that complements a regime that produces lower taxes.²⁶⁴⁴ This feature should be contrasted with the methods applied by normal income tax regimes to recognise time.²⁶⁴⁵ The latter regimes

²⁶³⁴ *Law 27 of 1975*, art 6 (Greek Republic); Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11, 13. However, the rates become somewhat regressive as brackets three to five are reached.

²⁶³⁵ *Ibid.*

²⁶³⁶ *Law 27 of 1975*, art 6 (Greek Republic); See also *Circular 2052*, above n 2557, 3; See especially *Deloitte Shipping Tax Guide*, above n 2556, 13, 19; Tegos, above n 1541, 446. In contrast, the first two digits of a vessel’s permanent identification IMO number, details the year when the keel was first laid. See generally IMO, *IMO identification number schemes* (IMO Ship Identification Number Scheme: Circular letter No.1886/Rev.5) < <https://www.imo.org> >.

²⁶³⁷ *Ibid.*

²⁶³⁸ *Ibid.*

²⁶³⁹ *Ibid.*

²⁶⁴⁰ *Ibid.*

²⁶⁴¹ *Ibid.*

²⁶⁴² *Ibid.*

²⁶⁴³ *Ibid.*

²⁶⁴⁴ *The Mirrlees Review*, above n 17, 22-3, 29-30; 42-4; *The Henry Review*, above n 89, viii (4.4), xix; 15-7, 21, 29, 30-1, 80, 104, 169; *Asprey Review*, above n 34, [3.20].

²⁶⁴⁵ *Income Tax Act 58 of 1962* s11 (e) (South Africa); Cf *Income Tax Assessment Act 1997* s40-70, s40-75 (Cth) (Australia); *Master Tax Guide 2019*, above n 82, [17-560]; *Silke*, above n 62, [8.117].

generally demonstrate greater complexity in applying time to guard against tax avoidance and inequity.²⁶⁴⁶ For example, greater complexity is demonstrated by requiring the pro-rating of time as applied daily.²⁶⁴⁷

The ingenuity of the Greek taxing formula is that it encourages newer and larger vessels by taxing those characteristics more favourably.²⁶⁴⁸ The promotion of these characteristics is particularly important.²⁶⁴⁹ Vessels that demonstrate these attributes may be more environmentally friendly and more useful in directly expanding the sea power of a State.²⁶⁵⁰

Under the reduced Greek rates, the thesis's test vessel, the MV Kapstadt (a new vessel with a 92,727 GRT), produces a gross tonnage tax amount of US\$ 32, 344.²⁶⁵¹ However, if this same vessel is taxed as a 15-year-old vessel, applying these reduced Greek rates, a gross tonnage tax amount of US\$ 56, 745 is delivered.²⁶⁵² Thus, the increase in age produces an increase in the gross tonnage tax in the amount of US\$ 24, 401. In contrast, the basic regimes simply deliver a uniform gross tax result to the extent they ignore a vessel's age.²⁶⁵³

²⁶⁴⁶ Ibid.

²⁶⁴⁷ Ibid.

²⁶⁴⁸ *Law 27 of 1975*, art 6 (Greek Republic); Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 11, 13; Papantonopoulou, above n 2439, 493-495; Tegos, above n 1541, 446-7; *Deloitte Shipping Tax Guide*, above n 2556, 14-6, 19.

²⁶⁴⁹ Asteris, above n 35, 67; *1998 DETR Report*, above n 23, 6 [10] – [11], 7 [14] – [16], 30 [129].

²⁶⁵⁰ Ibid.

²⁶⁵¹ *Law 27 of 1975*, art 6 (Greek Republic); See also *Circular 2052*, above n 2557, 3; Under the Greek regime's discounted rates. See Tables F and G here above.

²⁶⁵² *Law 27 of 1975*, art 6 (Greek Republic); See also *Circular 2052*, above n 2557, 2-3; See Tables F and G here above. Step one: $([10,000 \times 1.2] + [10,000 \times 1.1] + [20,000 \times 1] + [40,000 \times 0.45] + [12,727 \times 0.2]) = 63,545$ taxable tonnage). Step two: $(63,545 \times 0.893 = \text{US\$ } 56,745)$.

²⁶⁵³ *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; See also Panama Consulate in California, 'Vessel Registration Fees' (Document, downloaded: 2022) 1-2; Panama Consulate in Hamburg, 'New Discounts 01.09.2014' (Document, downloaded: 2022) 1; Panama Marine Authority, 'Administration Fees' (Document, Consulate of Panama in Hamburg, downloaded: 2022) 2-3; Consulate of Panama in Toronto, *Maritime Services: Vessel Registration* (accessed 2022) <<http://www.consulatepanama.com>>; Cf Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 01/21, 2021) 2 [1.0], 2 [1.2]; Panagiotou and Thanopoulou, above n 43, 12, 19-2; Watt and Coles, above n 2434, [22.33] – [22.34]; Marlow and Mitroussi, above n 70, 200-1.

Notwithstanding the above, by producing a tax of US\$ 32, 344, the Greek regime produces a much more expensive gross tax result for the MV Kapstadt even when it is treated as a new vessel. In contrast, the Liberian and Panamanian regimes produce gross tax results respectively of US\$ 10,554.12 and US\$ 9,049.20. Therefore, these latter regimes produce much smaller gross tax results.²⁶⁵⁴

Further, for calculating the *net tonnage tax result*, the application of discounts, reductions, and exemptions (and the like) require some additional consideration. Under the reduced Greek rates, a *net tax result* of US\$ 16, 172 is delivered for the test vessel, the MV Kapstadt, where she is treated as a new vessel.²⁶⁵⁵ The lower net tax result is achieved by applying a 50% discount to the gross tax result.²⁶⁵⁶ The discount is available for Greek and foreign-registered vessels that, broadly, undertake regular sea routes between Greek and foreign ports or exclusively between foreign ports.²⁶⁵⁷

The corresponding net result under the Panamanian regime is US\$5,429.52.²⁶⁵⁸ This result may be achieved by using a 40% discount available for the first registration year of a new build that satisfies a 30,000 GRT minimum tonnage threshold.^{2659*} Thus, compared to its Greek counterpart, the Panamanian regime may, in certain cases, deliver a smaller tax result even after applying discounts and exemptions. Furthermore, more generous discounts may be available under the Panamanian regime in cases where a 50% discount rate is applied.²⁶⁶⁰

²⁶⁵⁴ Ibid; *Contra* Table n 2619 here above.

²⁶⁵⁵ USD 32, 344 x 50% = USD 16, 172; See above n 2578 and n 2582.

²⁶⁵⁶ *Law 27 of 1975*, art 7(1)(b); See especially *Circular 2029*, above n 2581, 3 [2(b)], 7-8, 12, 15-6; *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 13; Papantonopoulou, above n 2439, 495; Tegos, above n 1541, 447.

²⁶⁵⁷ Ibid.

²⁶⁵⁸ See Table D above; *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 (2).

²⁶⁵⁹ Ibid; *Including satisfying the < 100,000 GRT maximum threshold.

²⁶⁶⁰ See for example, *Panama Resolution No.106-56-DGMM*.

However, the Greek 50% discount is not limited by time.²⁶⁶¹ Further, the Greek regime may offer certain vessels exemptions that equal 100% of the gross tax amount that may remain in force until the vessel is six years of age.²⁶⁶² Thus, it is plausible to conceive that the Greek regime may, in other instances, deliver a marginally better nominal tax result than its Panamanian rival. Thus, the outcome in reality is dependent on the particular facts of a case, and the Panamanian discounts in force at that time.²⁶⁶³

Thus, irrespective of the greater complexity demonstrated in the Greek formula, the regime may, nevertheless, deliver a nominal tax result somewhat akin to its Panamanian counterpart.²⁶⁶⁴ The Greek ship register has, on average, experienced an overall gradual decline in registered tonnage over the first two decades of the 21st century.²⁶⁶⁵ The decline appears to be somewhat more pronounced between 2010 and 2020.²⁶⁶⁶ However, it is fair to observe that any recent decline in Greek registered tonnage may be attributed to exceptional causes.²⁶⁶⁷ Nonetheless, the above decline, in Greek registered tonnage, may be contrasted

²⁶⁶¹ *Law 27 of 1975*, art 7(1); See especially *Circular 2029*, above n 2581, 3 [2(b)], 7-8, 12, 15-6; *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 13; Papantonopoulou, above n 2439, 495; Tegos, above n 1541, 447.

²⁶⁶² *Ibid*; As a caveat, it should be noted that this ‘regular service reduction under art 7(1)(b) may also in eligible cases be used together with a ‘purchase of supplies reduction’ to get even a greater reduction in the final net tonnage tax liability: *Circular 2029*, above n 2581, 7-8, 15-6

²⁶⁶³ See for example, *Panama Resolution No.106-56-DGMM*.

²⁶⁶⁴ *Law 27 of 1975*, art 7(1); See especially *Circular 2029*, above n 2581, 3 [2(b)], 7-8, 12, 15-6; *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 13; Papantonopoulou, above n 2439, 495; Tegos, above n 1541, 447.

²⁶⁶⁵ See Table C above; Hellenic Statistical Authority, ‘Greek Merchant Fleet: March 2020 (Provisional data)’ (Press Release, 19 May 2020) 1; See also UNCTAD, *Review of Maritime Transport 2000* (United Nations; 2000) 129: [Greek Fleet in DWT in 2000: 5.3% (42 532 146/ 798 995 409)]; Marlow and Mitroussi, above n 70, 192-3; Panagiotou and Thanopoulou, above n 43, 8.

²⁶⁶⁶ *Ibid*.

²⁶⁶⁷ Tegos, above n 1541, 449; See generally Papantonopoulou, above n 2439, 496; Panagiotou and Thanopoulou, above n 43, 10: Greece experienced a sovereign debt crisis in about 2010. Post Greece’s sovereign debt crisis, the Greek government and the shipping industry reached consensus as enacted by law that provided for voluntary contributions calculated on tonnage by shipping companies for the period spanning from about 2014-2017. This was in addition to a previous once-off levy that was raised as a result of the above crisis. These contributions are without prejudice to the tonnage tax regime. The voluntary contributions have been extended, and subsequently replaced by a type of dividend tax contribution for later years. Therefore, it is fair to observe that shipping companies in Greece have paid tax, in amounts above the tonnage tax for the above period. These extra “tax payments” may also be contributing to the registers more pronounced decline as demonstrated in the second decade of the 21st century; See also Table C above; See also UNCTAD, above n

with the overall increase in registered tonnage enjoyed by States like Panama and Liberia over this same period.²⁶⁶⁸ These latter two States have been ranked respectively as the two top registers recently.²⁶⁶⁹ Thus, these poorer results delivered by the Greek regime may to some degree impugn the application of a more complex taxing formula in cases where efficiency and super efficiency objectives are required to be promoted.

This concern about the Greek formula's complexity may be legitimised further when it is considered that it may, on occasion, deliver roughly more or less the same nominal tax results as the basic regimes.²⁶⁷⁰ However, under the Greek regime, it is fair to observe that older vessels suffer, broadly, higher gross-and-net tax amounts than younger vessels.²⁶⁷¹ Further, full exemptions that are available annually may be limited to younger vessels.²⁶⁷² Therefore, for promoting certain outcomes (such as newer builds), the Greek regime may raise more favourably and precisely these tonnage taxes on younger vessels.²⁶⁷³

However, the basic regimes can roughly achieve an equivalent net tonnage tax outcome by aligning discounts and exemptions with variables that promote similar objectives. Discounts are already applied in Panama and Liberia in varying degrees by considering factors such as the age and the safety record of a vessel.

2665, 129: [Here the Greek fleet was measured in DWT in 2000, in comparison to corresponding global tonnage, as follows: 5.3% (42 532 146/ 798 995 409)].

²⁶⁶⁸ See especially Table C above; Merk, above n 1541, 523; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13.

²⁶⁶⁹ Ibid.

²⁶⁷⁰ *Law 27 of 1975*, arts 6, 7(1)(b); (Greek Republic); *Circular 2029*, above n 2581, 3 [2(b)], 7-8, 12, 15-6; *Circular 2052*, above n 2557, 2-3; Cf *Law 4 of 1983*, arts 3, 4 (Panama); *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 149 – 151; Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2].

²⁶⁷¹ *Law 27 of 1975*, arts 6, 7(1)(a); (Greek Republic); *Circular 2029*, above n 2581, 3 [2(a)]; *Circular 2052*, above n 2557, 2-3; Note the difference in tax results for the MV Kapstadt: above n 2652.

²⁶⁷² *Law 27 of 1975*, art 7(1)(a); (Greek Republic); *Circular 2029*, above n 2581, 3 [2(a)].

²⁶⁷³ Ibid.

5.2.8 Observations for a Model Shipping Tax Regime

In summary, the key observations and submissions that may be noted for identifying a model shipping tax regime are as follows:

- High mobility is an inherent attribute of maritime transport activities producing shipping income.²⁶⁷⁴
- A substantial activity criterion as introduced by *BEPS 5* may potentially resolve this occurrence to some minor extent.²⁶⁷⁵
- Past research has demonstrated that taxes can have a significantly adverse effect on registered tonnage.²⁶⁷⁶
- Sea power, in particular, is an important policy objective that legitimises State support for maintaining a robust merchant fleet.²⁶⁷⁷
- Ship registers that demonstrate expansion in the 21st century generally enjoy nominal taxes on shipping income.²⁶⁷⁸
- A model shipping tax regime should prioritise efficiency and simplicity as its two foremost objectives as ordered under the *USF* (including efficiency in the form of a super efficiency) to adequately protect and stimulate the relevant shipping tax base.²⁶⁷⁹

²⁶⁷⁴ Panagiotou and Thanopoulou, above n 43, 3, 7; *1998 DETR Report*, above n 23, 16 [61].

²⁶⁷⁵ OECD, 'Harmful Tax Practices - Peer Review Results: Inclusive Framework on BEPS: Action 5' (Update, OECD, 2020) 1, 3-5, 6-8, 8[4], 18-9; *2018 OECD Progress Report*, above n 32, 9[2] – [4], 17[15], 19-20, 20[16], 30, 33-4, *2017 OECD Progress Report*, above n 699, 13[8], 14[2], 15[14], 16, 16[15], 21, 23[18], 39[2], 43[14]; *OECD BEPS Action 5*, above n 13, 23, 39 [84] – [85], 61 [143], 64 [149]; See especially *2006 OECD Progress Report*, above n 2536, 5.

²⁶⁷⁶ Panagiotou and Thanopoulou, above n 43, 7; *1998 DETR Report*, above n 23, 13 [40] – [42]; Alexander, above n 35, 4 [x]; Papavizas and Kiern, above n 1542, 385-6.

²⁶⁷⁷ Madigan, above n 1112, 3; McMahon, above n 36, 106; Asteris, above n 35, 71; *1998 DETR Report*, above n 23, 7 [14] – [17], 16 [61], 42; See especially Alexander, above n 35, 3, 7 [8], 15 [45], 15 [46], 15-6 [48], 16 [49] – [50], 19 [66] – [67], 19-2 [69], 20 [72].

²⁶⁷⁸ See Table C above; Panagiotou and Thanopoulou, above n 43, 7, 12; Marlow and Mitroussi, above n 70, 20-1, 204; Alexander, above n 35, 4 [x], 7 [8].

²⁶⁷⁹ Alexander, above n 35, 3 [vi], 22 [81].

- The significant success of the Panamanian and Liberian ship registers in expanding merchant tonnage are key outcomes favouring the adoption of a model shipping tax regime that essentially incorporates a similar fiscal approach.²⁶⁸⁰

Thus, in light of the above considerations, the thesis prefers a simple taxing formula for designing a model shipping tax regime; the desired net tax result should be exceptionally low or even zero in promoting efficiency and super efficiency.²⁶⁸¹ A taxing formula that produces more precise tax differentiation, such as the Greek regime, may be unnecessary for a nominal tax environment, particularly where the gross tax result is significantly diluted at the formula's secondary level.²⁶⁸²

Simplicity requires that a regime that produces nominal tax results is designed to be highly cost-effective and easy to administer.²⁶⁸³ Thus, a formula that unnecessarily produces higher tax differentiation and thereby increases costs in a low tax environment would generally conflict with simplicity outcomes.²⁶⁸⁴ For designing a model shipping tax regime, this low tax environment requires a vigorous promotion of simplicity as prioritised by the *USF*.²⁶⁸⁵

However, it is conceded that there may be some potential advantages in having a formula that can provide limited differentiation in the tax result. A minimal level of differentiation may

²⁶⁸⁰ Ibid; Asteris, above n 35, 67; *1998 DETR Report*, above n 23, 8-9; Maritime UK, above n 821, 52; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; UNCTAD, above n 821, 44.

²⁶⁸¹ *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2]; Alexander, above n 35, 4 [x]; See especially *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 13; Tegos, above n 1541, 447; Panagiotou and Thanopoulou, above n 43, 7, 12; Marlow and Mitroussi, above n 70, 200-1, 204.

²⁶⁸² *Law 27 of 1975*, arts 6, 7(1); (Greek Republic); *EU/Greece Communication C(2015) 9019 final*, 6-8.

²⁶⁸³ *Asprey Review*, above n 34, [3.20]; Stewart et al, above n 2, 10- 1; Alley and Bentley, above n 2, 611-2; *The Henry Review*, above n 89, 17, 169.

²⁶⁸⁴ Mirrlees et al, above n 138, 332-3; *The Mirrlees Review*, above n 17, 22-3; 35,43; *The Henry Review*, above n 89, 2, 17, 169; Stewart et al, above n 2, 10; See especially White, above n 110,49-52; Alley and Bentley, above n 2, 612; *Asprey Review*, above n 34, [3.20].

²⁶⁸⁵ Alexander, above n 35, 3 [vi], 22 [81].

give policymakers some flexibility in adjusting taxing levels, where appropriate, to promote specific objectives better.²⁶⁸⁶ In particular, there is merit in fiscally favouring vessels of a specific size and type for sea power, and newer and safer vessels for environmental purposes.²⁶⁸⁷ Likewise, there is merit in fiscally penalising vessels as they reach certain age thresholds or breach specific safety or environmental standards.²⁶⁸⁸ However, a constraint for applying differentiation measures as controlled by simplicity is preserving the overall cost-effectiveness of the taxing formula.²⁶⁸⁹

Thus, the formula applied in Liberia and Panama serves as a good basis for designing a more efficient and more straightforward regime.²⁶⁹⁰ The 2008 and 2019 works studying tonnage tax regimes mentioned above were conducted about ten years apart.²⁶⁹¹ Nonetheless, they both demonstrated that the basic models exhibited better stability on average in their tax results.²⁶⁹²

The basic model might, somewhat, be developed further to take a State's particular circumstances and wider tax system into account.²⁶⁹³ Different fiscal objectives may still be promoted by employing a simpler taxing formula.²⁶⁹⁴ However, the differentiation possible under the Greek regime would not be replicated as easily or precisely under a more

²⁶⁸⁶ *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 32.

²⁶⁸⁷ Asteris, above n 35, 67; McMahon, above n 36, 96, 103; Papantonopoulou, above n 2439, 495; *General Merchant Marine Law No 57 of 6 August 2008 (Panama)* arts 149 – 151; Maritime UK, above n 821, 28.

²⁶⁸⁸ *Ibid.*

²⁶⁸⁹ Mirrlees et al, above n 138, 332-3; *The Mirrlees Review*, above n 17, 35, *The Henry Review*, above n 89, 17; *Asprey Review*, above n 34, [3.20].

²⁶⁹⁰ *Law 4 of 1983*, arts 3, 4 (Panama); Liberia Maritime Authority, 'Consolidated List of Fees and Charges for Official Documents and Services' (Marine Notice ADM-003, revision 07/22, 04/2022) 1.0 [1.2].

²⁶⁹¹ Panagiotou and Thanopoulou, above n 43, 7; 12; Marlow and Mitroussi, above n 70, 200-1, 204; See generally Table C above.

²⁶⁹² *Ibid.*

²⁶⁹³ See for example *General Merchant Marine Law No 57 of 6 August 2008 (Panama)* arts 149 – 151.

²⁶⁹⁴ *Ibid.*; *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 32.

straightforward taxing formula. This outcome is not necessarily problematic as higher tax differentiation is not necessarily ideal or warranted in a nominal tax environment.²⁶⁹⁵

In particular, the following two actions may be applied in adapting the basic model:

- 1) Employing a higher uniform standard tax rate at the primary level (this action would allow for greater tax differentiation in the net result at the secondary level).
- 2) Establishing a limited set of tiered discounts and exemptions at the secondary level (for a model shipping tax regime, simplicity would only allow a limited number of discounts and exemptions;²⁶⁹⁶ simplicity as a key control requires keeping tax differentiation to a minimum to reduce costs).²⁶⁹⁷

These two actions may be illustrated by applying them to the test vessel, the MV Kapstadt. The MV Kapstadt is a new build with a 92,727 GRT and a 60,492 NRT. Under the reduced Greek rates, this vessel incurs a gross tonnage tax amount of US\$ 32, 344. These rates also support a corresponding net amount of US\$ 16, 172. The thesis has demonstrated that in cases where this vessel is retaxed as a 15-year-old vessel, with everything else remaining constant, this same vessel produces a higher gross tonnage tax amount of US\$ 56, 745. In these latter circumstances, the vessel also incurs a corresponding net tonnage tax amount of US\$ 28,372.

It is submitted that the above two net tax results can still be achieved roughly by adapting the basic model to take the vessel's age into account, albeit by delivering the tax differentiation

²⁶⁹⁵ *Asprey Review*, above n 34, [3.20]; Stewart et al, above n 2, 10 - 1; Alley and Bentley, above n 2, 611-2; *The Henry Review*, above n 89, 17, 169; *The Mirrlees Review*, above n 17, 43.

²⁶⁹⁶ *Ibid.*

²⁶⁹⁷ *Ibid.*

with less precision. Thus, to achieve similar net tax results roughly by employing a more straightforward taxing formula, the following two actions may be applied:²⁶⁹⁸

1) Apply a higher single and uniform (or flat) standard tax rate of 50%:

(US\$ 30, 246 (60, 492 x 50%). [Equivalent net Greek result: US\$ 28, 372]).

2) Apply a 50% age discount for vessels that are seven years of age or younger:²⁶⁹⁹

(US\$ 15, 123 (30, 246 x 50%). [Equivalent Greek result: US\$ 16, 172]).

Notwithstanding the above, the thesis, *as a minimum*, recommends a lower net tax result for certain vessels to bring tax concessions in line with those of the largest registers to level the playing fields better. It should be remembered that the Panamanian net tax result for the above test vessel was calculated as US\$ 5,429.52.²⁷⁰⁰ Also, other factors, such as lower employment costs enjoyed at certain foreign registers, may require even more significant tax concessions and other support measures to level the playing fields effectively. Thus, in these circumstances, shipping taxes should simply be reduced to zero, *as a minimum*, where appropriate in promoting efficiency and simplicity.

Further, the thesis would recommend a lock-in that would generally apply for a fixed period, such as for intervals of 10 years, to cover discounts and exemptions, in addition to applying it to the standard tax rate.²⁷⁰¹ A lock-in is already applied to the tax rate by the Panamanian regime.²⁷⁰² Lock-ins would better realise stability in the underlying tax policy over an

²⁶⁹⁸ See Tables F and G.

²⁶⁹⁹ This age is simply and loosely based upon the Greek practice, as an illustration, that awards certain vessels a full exemption until they are 6 years of age: *Law 27 of 1975*, art 7(1)(a); *Circular 2029*, above n 2581, 3 [2(a)]; *EU/Greece Communication C(2015) 9019 final*, 8 [34(a)]; Tegos, above n 1541, 447; *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 13; Panagiotou and Thanopoulou, above n 43, 7, 12; Marlow and Mitroussi, above n 70, 200-1, 204.

²⁷⁰⁰ See Table D; See also Table n 2619.

²⁷⁰¹ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 12, 20.

²⁷⁰² *Law 4 of 1983*, arts 3, 4 (Panama); Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16.

extended period and, in so doing, simultaneously achieve better certainty, including transparency.²⁷⁰³ The 2019 work observed that the variability in the UK tonnage tax results, as tested at different time intervals, was mainly due to fluctuations in the normal tax rate.²⁷⁰⁴

More flexibility might be provided in a basic formula by applying a fixed amount as a balancing figure that can be varied at more frequent intervals. One example is the Panamanian Annual Consular amount.²⁷⁰⁵ It is submitted that the fixed amount may be exempt from any lock-ins. Exemptions and discounts might also not apply in certain circumstances, despite the application of a lock-in, like where specific safety standards are infringed, or *serious* tax avoidance is identified.²⁷⁰⁶

A model shipping tax regime should be designed to deliver nominal tax results to promote efficiency vigorously. It should also align well with simplicity, and stability and transparency as peripheral aspects of certainty.²⁷⁰⁷

Further, the Greek tonnage tax regime has ingenious features that may complement a basic taxing formula as they may support the promotion of efficiency and simplicity further. These features may be particularly useful where the State in question that seeks to employ such a basic model utilises an income tax system that, unlike Panama, taxes on a worldwide basis.²⁷⁰⁸ Thus, an example of such a feature is the simple imposition of the tax liability

²⁷⁰³ *The Mirrlees Review*, above n 17, 44; See also Panagiotou and Thanopoulou, above n 43, 13 [3].

²⁷⁰⁴ Panagiotou and Thanopoulou, above n 43, 13 [3].

²⁷⁰⁵ *Law 4 of 1983*, art 4 (Panama); Panagiotou and Thanopoulou, above n 43, 7, 19-20; Marlow and Mitroussi, above n 70, 200-1. For a further example of a more complex regime that uses fixed amounts, see EU/Maltese Communication C(2017) 8734 final, 6 [21].

²⁷⁰⁶ See generally *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149 (8); Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16.

²⁷⁰⁷ *The Mirrlees Review*, above n 17, 40-4; Cannan, above n 14, 310; White, above n 110, 45-9; Rousslang, above n 92, 8-9; *The Henry Review*, above n 89, 17; Fiscal Policy Institute, above n 289, 9.

²⁷⁰⁸ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14-5.

primarily on the shipowner.²⁷⁰⁹ Further, paying tonnage tax for a vessel should result in all of the shipping income as defined derived from that vessel for a relevant year having a straightforward and generous tax-exempt status.²⁷¹⁰ Thus, the exemption should apply, irrespective of whether the vessel's ownership interests are held directly or indirectly.²⁷¹¹ Likewise, the regime should treat income and capital receipts uniformly.²⁷¹² Unlike exemption regimes applied in Australia and South Africa (considered below), this exemption should bypass the complexities encountered where the regime utilises one or more components of a normal income tax regime.²⁷¹³

The alternative is to provide a more limited exemption, producing a more limited number of tax-free receipts and relying on anti-avoidance and ring-fencing features to a greater degree to guard against any misuse.²⁷¹⁴ However, *The Henry Review* concludes that simplicity should be prioritised in a 21st-century tax system, even for personal income tax regimes that generate much higher revenue levels.²⁷¹⁵ Otherwise, tax administrations are obliged to utilise extra resources for administering and policing overly complex regimes.²⁷¹⁶ This consequence is even less justifiable in shipping where only nominal tax revenue is produced.²⁷¹⁷ Any extra complexity is likely to increase costs disproportionately and erode the tax base as it is highly mobile.²⁷¹⁸

²⁷⁰⁹ *Law 27 of 1975*, arts 1-2, 4; *EU/Greece Communication C(2015) 9019 final*, 4 [15]-[16], 5 [20]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492-4; *Deloitte Shipping Tax Guide*, above n 2556, 13, 18-9.

²⁷¹⁰ *Law 27 of 1975*, arts 1-2, 4, 25-26, 29; *EU/Greece Communication C(2015) 9019 final*, 4 [15]-[16], 5 [18] - [20], 6 [21]; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492-4; *Deloitte Shipping Tax Guide*, above n 2556, 13, 18-9.

²⁷¹¹ *Ibid.*

²⁷¹² *Ibid.*

²⁷¹³ *Law 27 of 1975*, art 2; *EU/Greece Communication C(2015) 9019 final*, 4 [15].

²⁷¹⁴ See, for example, the UK tonnage tax regime under heading 5.2.9; See also the Australian and South African exemption regimes under heading 5.2.10.

²⁷¹⁵ *The Henry Review*, above n 89, viii (4.4), xix; 15-6, 21, 29, 30-1, 80.

²⁷¹⁶ *Ibid* 17; *The Mirrlees Review*, above n 17, 22-3; 35.

²⁷¹⁷ Alexander, above n 35, 4 [x]; Panagiotou and Thanopoulou, above n 43, 7; 12; Marlow and Mitroussi, above n 70, 200-1, 204; See also Table C.

²⁷¹⁸ Panagiotou and Thanopoulou, above n 43, 5,7; *1998 DETR Report*, above n 23, 7 [14] – [17], 16 [61].

Further, a ship management company based in a sponsoring State that undertakes qualifying activities for a vessel enjoying tonnage tax should occupy a similar tax-free position as the shipowner for any income derived for performing relevant activities.²⁷¹⁹ However, in cases where a ship management company benefits from a tonnage tax regime, it should be jointly liable with a shipowner for outstanding tonnage tax.²⁷²⁰ Joint liability would be relevant when a shipowner has failed to discharge one or more tonnage tax payments by a particular due date.²⁷²¹ A tax administration is placed in a better position as a debt collector where joint liability is imposed on both parties.²⁷²² They can select the party that is easier to proceed against in obtaining the outstanding tonnage tax amount.²⁷²³ A simpler treatment, such as the one detailed here, has several advantages for a regime that delivers only nominal tax results. Importantly, it may be expected to align strongly with simplicity by delivering a more effortless, cheaper, and straightforward administration.

Thus, the general tax design lessons that may be gleaned from the Greek regime include the observation that shipping tax treatments should be applied uniformly, generously and simply.²⁷²⁴ Higher levels of uniformity may be achieved by applying tax differentiation conservatively.²⁷²⁵ Thus, a regime may be designed to align more strongly with efficiency and simplicity.²⁷²⁶ Effectively realising these features require a better fiscal sensitivity to the

²⁷¹⁹ *Law 27 of 1975*, arts 1-2, 4, 25-26; *EU/Greece Communication C(2015) 9019 final*, 4 [15]-[16], 5 [20]; Tegos, above n 1541, 444; Papantonopoulou, above n 2439, 492, 494; *Deloitte Shipping Tax Guide*, above n 2556, 13, 18-9.

²⁷²⁰ *Ibid.*

²⁷²¹ *Ibid.*

²⁷²² *Ibid.*

²⁷²³ See generally Audine Bartlett, *Did you know what joint, several and joint and several liability mean?* (2005) Clayton Utz <<https://www.claytonutz.com/knowledge/423/july>>.

²⁷²⁴ *The Mirrlees Review*, above n 17, 34, 40; Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-20.

²⁷²⁵ Mirrlees et al, above n 53, 333-4; Dwyer, above n 2, 667, 747-8, 764; *The Mirrlees Review*, above n 17, 23, 29-30, 40-3.

²⁷²⁶ *Ibid.*; *The Henry Review*, above n 89, 80, 104; Evans, above n 113, 388; See generally Rousslang, above n 92, 8.

practicalities of running a modern-day shipping business.²⁷²⁷ Astutely applying any such sensitivity is likely to control negative tax distortions more optimally.²⁷²⁸

5.2.9 The Dutch Tonnage Tax Model: The UK Regime

The 2008 work demonstrated that the English tonnage tax regime, as tested in 2007, was generally ranked in the last position.²⁷²⁹ On the whole, it returned the most expensive tax results when compared with the other regimes that adopted either a basic model or a more advanced Greek tonnage tax model.²⁷³⁰ In the 2019 work, the UK regime generally returned better tax results than its Greek counterpart.²⁷³¹ However, the variability in the UK tonnage tax results was generally attributed by the 2019 work, to the downward trajectory of the UK standard corporate tax rate.²⁷³²

The UK tonnage tax regime is a classic example of the Dutch tonnage tax model.²⁷³³ It has been described as a regime that, at its core, mirrors the Dutch tonnage tax regime.²⁷³⁴ Tax regimes based on the Dutch model calculate an equivalent for taxable profits by applying a tonnage tax formula that, broadly, exhibits a similar level of complexity as those falling under the Greek model.²⁷³⁵ However, the Dutch model demonstrates certain features that makes it

²⁷²⁷ *EU Ship Management Communication* OJ C 132, 6 - 7; See generally Breskin, above n 6, 238.

²⁷²⁸ *The Henry Review*, above n 89, vii, 13, 73, 171-2, 176; Stewart et al, above n 2, 4; *The Mirrlees Review*, above n 17, 29, 40.

²⁷²⁹ Marlow and Mitroussi, above n 70, 203-205.

²⁷³⁰ *Ibid.*

²⁷³¹ Panagiotou and Thanopoulou, above n 43, 13 [3].

²⁷³² *Ibid.*

²⁷³³ *Finance Act 2000* (UK) c 17, s 82, sch 22 paras 3(1), 4; Cf *Dutch Income Tax Act 2001*, arts 3.22, 3.23; Kronbergs, above n 2534, 643-50 [22.3.2.2]; Taco Mooren and Ton Stevens, 'Netherlands' in Guglielmo Maisto (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 547 - 550 [19.2.2.1]; Cf *Internal Revenue Code*, 26 USC § 1352 - 3 (United States).

²⁷³⁴ Marlow and Mitroussi, above n 70, 198-200.

²⁷³⁵ *Ibid.*; See especially *Finance Act 2000* (UK) c 17, sch 22 paras 3 - 4; See especially HMRC, *Tonnage Tax Manual* (2021) [TTM01300] ('*HMRC Tonnage Tax Manual*') < <https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual/ttm01300>>; Cf *Dutch Income Tax Act 2001*, arts 3.22, 3.23; Cf *Law 27 of 1975*, art 6 (Greek Republic); See generally *Western Ferries (Clyde) Ltd v Revenue & Customs* [2011] UKFTT 243 [7] -

inherently different from the Greek model. For example, the Dutch model utilises the normal corporate/income tax regime to tax the fictitious profits calculated by the tonnage tax formula.²⁷³⁶

The observations of the 2019 work are confirmed here in the tonnage tax result obtained under the UK regime for the MV Kapstadt; the UK net tax result demonstrates a slightly

[13], [180], [215]: At [180] the relevant part of the report by Lord Alexander is referred to by the said court in considering whether the appellants operated qualifying ships under the UK tonnage tax regime; See also Alexander, above n 35, 25 [92(b)]; The first step in calculating the notional or tonnage tax profit is to determine the daily profit for each qualifying ship. The following regressive rates apply, rounded down to the nearest multiple of 100 tons:

Table n 2735: UK Tonnage Tax		
Net Tons	GBP / NT	The MV Kapstadt [60,492 NRT] A 'qualifying ship' under the UK regime is primarily a seagoing ship with a gross tonnage of at least 100 tons plied for the carriage of passengers or goods by sea. The MV Kapstadt is a qualifying vessel.
For each 100 tons up to 1, 000 tons	GBP 0.60	10 x 0.60 = 6
For each 100 tons between 1,000 and 10,000 tons	GBP 0.45	90 x 0.45 = 40, 5
For each 100 tons between 10, 000 and 25, 000 tons	GBP 0.30	150 x 0.30 = 45
For each 100 tons above 25, 000 tons	GBP 0.15	354 x 0.15 = 53.1
Total Tonnage Tax Profit Per Day		GBP 144.60
365 days in an accounting period (Assuming the vessel was operated for the whole of the period)		GBP 144.60 x 365 = GBP 52, 779
Apply the Normal Corporate Tax Rate		GBP 52, 779 x 19% (rates as of 2022**) = <u>GBP 10, 028. 01</u> And converted into USD: USD 13,838 (*1 GBP= 1.38 USD @ May 3, 12.02 AM UTC)
		*Foreign Currency Exchange Data provided by Morningstar for Currency and Coinbase for Cryptocurrency
Comparable Net Tonnage Tax Liability under the Greek Regime		USD 32, 344 x 50% = USD 16, 172

Where there is more than one qualifying vessel, there must be an adding up of the tonnage tax profits which are calculated for each qualifying vessel for a period. The total tonnage tax profit for a period is ultimately taxed under the normal corporation tax rate.

²⁷³⁶ *Finance Act 2000* (UK) c 17, s 82, sch 22 para 3; See also *Dutch Income Tax Act 2001*, arts 3.22, 3.23; See generally *Internal Revenue Code*, 26 USC § 11, 1352, 1353; Cf *Law 27 of 1975*, arts, 2, 6 (Greek Republic); See generally Marlow and Mitroussi, above n 70, 198, 200.

cheaper outcome than the comparable Greek tonnage tax liability.²⁷³⁷ The difference calculated by the thesis in the Greek and UK tonnage tax amounts for the MV Kapstadt is about USD 2,334.²⁷³⁸

Nonetheless, a broad criticism that may be raised against the Dutch tonnage tax model (as a group) is that it marries, or at least tries to reconcile, two very different taxing approaches. One approach, underlying the more classical tonnage tax regime, is underpinned by a higher fiscal simplicity and efficiency, and is primarily geared at preserving a tax base.²⁷³⁹ The other approach, underlying a normal income tax regime, is intrinsically rooted in a much more complex tax design, and is primarily (or more significantly) geared at producing sustainable revenue streams for a State.²⁷⁴⁰ Accordingly, it is submitted that the Dutch tonnage tax model is, generally, disadvantaged by the weaknesses that arise from applying these two, somewhat, conflicting regimes as one hybrid regime.

Examples of these weaknesses may be demonstrated by referencing the following attributes of the Dutch tonnage tax model as enacted in the UK (this is not intended to be a closed list):

- a) A tax rate that applies independently of the specific objectives of a tonnage tax regime that may significantly affect the final tax outcome.²⁷⁴¹

²⁷³⁷ See Table n 2735 here above; See also *Finance Act 2000* (UK) c 17, sch 22 para 4; See also HMRC Tonnage Tax Manual, above n 2735, [TTM01200], [TTM01300], [TTM01340]; **HMRC, *Guidance: Rates and allowances for Corporation Tax* (2022) Gov.UK < <https://www.gov.uk/government/publications/rates-and-allowances-corporation-tax>; Cf *Law 27 of 1975*, arts, 2, 6 (Greek Republic); Kronbergs, above n 2534, 645-6; See also heading 5.2.6; Panagiotou and Thanopoulou, above n 43, 13 [3]; See generally *Western Ferries (Clyde) Ltd v Revenue & Customs* [2011] UKFTT 243 [215(4)].

²⁷³⁸ Ibid; USD 16, 172 (Greek) – USD 13,838 (UK)= USD 2334.

²⁷³⁹ *Law 27 of 1975*, arts 6, 7 (Greek Republic); *Law 4 of 1983*, arts 3, 4 (Panama); Tegos, above n 1541, 446; Papantonopoulou, above n 2439, 492; See generally Alexander, above n 35, 3 [vi], 9 [17], 22 [81]; See generally *Western Ferries (Clyde) Ltd v Revenue & Customs* [2011] UKFTT 243 [215(4)].

²⁷⁴⁰ *Finance Act 2000* (UK) c 17, s 82, sch 22 paras 3(1), 4; Cf *Dutch Income Tax Act 2001*, arts 3.22, 3.23; Cooper, above n 97, 417-8; Alley and Bentley, above n 2, 582-3; *Carter Report*, above n 89, 10; *Asprey Review*, above n 34, [3.3]; *The Henry Review*, above n 89, 17.

²⁷⁴¹ *Finance Act 2000* (UK) c 17, sch 22 para 3; Cf *Dutch Income Tax Act 2001*, art 3.22 (1); Cf *Internal Revenue Code*, 26 USC § 11, 1352, 1353; See especially Panagiotou and Thanopoulou, above n 43, 13 [3].

- b) Increased proliferation of ring-fencing and other anti-avoidance measures to prevent unintended mixing; their objective is to keep shipping and non-shipping income elements separate to prevent the exploitation of the preferential part of the hybrid regime.²⁷⁴² Tax avoidance may arise, for example,²⁷⁴³ in cases where shipping expenses are offset against non-shipping income.²⁷⁴⁴ It submitted that the proliferation of these rules, which vary in complexity, is somewhat at odds with the core idea underlying a tonnage tax regime.²⁷⁴⁵ Ideally, these regimes should vigorously promote efficiency and simplicity as demonstrated by the regimes adopting a more typical Greek-model design.²⁷⁴⁶
- c) Other key complexities arise by applying a one-foot-in and one-foot-out approach.²⁷⁴⁷ For example, financial ship lessors in the UK have enjoyed access to generous capital

²⁷⁴² *Finance Act 2000* (UK) c 17, sch 22 parts VII, VIII, IX, X and XI; Alexander, above n 35, 21 [79], 28 [92(i)], 29 [92(n)], 30 [93]; See also Kronbergs, above n 2534, 646. Once a tonnage tax company utilises the UK tonnage tax regime, its tonnage tax activities for that regime are treated for UK corporation tax as if they are a separate trade, called a 'tonnage tax trade': See generally *Finance Act 2000* (UK) c 17, sch 22 para 53(1). A tonnage tax company is defined under *Finance Act 2000* (UK) c 17, sch 22 para 2 (1) as a company 'or group [for] which a tonnage tax election has effect.' The shipping profits of a tonnage tax company are defined under *Finance Act 2000* (UK) c 17, sch 22 para 44(1): These profits are its shipping income as further defined under para 44(2) and 'so much of its chargeable gains as is effectively excluded from the charge to tax by the provisions of Part VIII of the said Schedule [of the above Act].' (emphasis added); Part VIII of the said schedule contains the special ring-fencing provisions for non-eligible capital gains and losses; Furthermore, there are detailed ring-fencing rules excluding the availability of capital allowances for capital expenditure expended on ships and other assets for a tonnage tax trade: See generally *Finance Act 2000* (UK) c 17, sch 22 parts IX and X. Additionally, ring-fencing provisions are required to prevent the set-off of losses and other deductions against the profit as calculated by the tonnage tax regime: See generally *Finance Act 2000* (UK) c 17, sch 22 paras 3(2), 55, 56, 57; Further, Part XI of sch 22 of the above Act contains the special rules for offshore activities. For completeness purposes, it should be noted that essentially, tonnage tax activities of a tonnage tax company are set out under *Finance Act 2000* (UK) c 17, sch 22 para 45(1) as, '(a) its core qualifying activities (see paragraph 46), (b) its qualifying secondary activities to the extent that they do not exceed the permitted level (see paragraph 47), and (c) its qualifying incidental activities (see paragraph 48).' The core qualifying activities are '(a) its activities in operating qualifying ships, and (b) other ship-related activities that are a necessary and integral part of the business of operating its qualifying ships.': *Finance Act 2000* (UK) c 17, sch 22 para 46 (1). 'A company's activities in operating qualifying ships means the activities mentioned in paras 19(1)(a) to (d) by virtue of which the ship is a qualifying ship.': *Finance Act 2000* (UK) c 17, sch 22 para 46 (2). Generally, the effect of para 19 is that the regime primarily covers maritime transport activities as defined by the thesis, including (among other things) towage and salvage activities carried out at sea; Cf below n 2800.

²⁷⁴³ For other instances of possible tax avoidance, in relation to foreign shipping income, see generally Alexander, above n 35, 25[91] See generally *Finance Act 2000* (UK) c 17, sch 22 para 49.

²⁷⁴⁴ Alexander, above n 35, 25[91]; See generally *Finance Act 2000* (UK) c 17, sch 22 paras 3(2), 55, 56, 57.

²⁷⁴⁵ Alexander, above n 35, 3 [vi], 22 [81]; See especially *Law 27 of 1975*, arts 1, 6 (Greek Republic).

²⁷⁴⁶ *Ibid.*

²⁷⁴⁷ *Ibid* 22 [80]; See also *The Commissioners Revenue and Customs v Unicorn Tankships (428) Limited* [2021] UKUT 109 (TCC): The case considered the interpretation of *Finance Act 2000* (UK) c 17, sch 22 para 85, and in particular, whether a company leaving a tonnage tax regime may have liability for a balancing charge under the *Capital Allowances Act 2001* on the sale of assets following exit; this is an illustration of a complexity that

allowances that reduce their net tax liability under the corporate income tax system.²⁷⁴⁸ In turn, these ship lessors have relayed this fiscal benefit to ship lessees as lower interest charges.²⁷⁴⁹ However, where these transactions are taxed under a hybridised regime, problems may be encountered in reconciling competing attributes.²⁷⁵⁰

One option for reconciling these competing attributes is to entirely or partly disallow the capital allowance for the lessor, where the lessee is a beneficiary of the hybrid tonnage tax regime.²⁷⁵¹ However, the disallowance may produce a negative tax distortion.²⁷⁵² It may increase the interest charge for the corresponding ship lessee.²⁷⁵³ Thus, even though the lessee directly enjoys a lower tonnage tax liability, it may indirectly suffer an increase in financing costs.²⁷⁵⁴ This situation arises because the lessor indirectly shifts its increased tax burden onto the lessee by charging the lessee a higher interest rate to offset the higher income tax liability arising from the removal of the capital allowance.²⁷⁵⁵ Thus, the lower tax liability that this lessee directly enjoys under the hybrid tonnage tax regime is indirectly cancelled to some extent by the displacement of income/corporate tax.²⁷⁵⁶ Thus, as a hybrid, these two regimes may demonstrate some degree of mutual exclusivity in promoting efficiency and simplicity outcomes.²⁷⁵⁷ Such inefficiency may cause the tonnage tax regime to seriously

may occur in applying a tonnage tax regime that is significantly intertwined with the framework of a normal income tax regime; the legislation appears to have failed to consider the matter which is not surprising considering the various issues that may present themselves in practice in trying to marry two different regimes as one; See also the earlier decision of the court in *Unicorn Tankships (428) Limited v HMRC* [2019] UKFTT 689 (TC).

²⁷⁴⁸ Alexander, above n 35, 22 [80].

²⁷⁴⁹ Ibid.

²⁷⁵⁰ Ibid 22 [80] – 24 [87].

²⁷⁵¹ Ibid 22 [80] – 24 [87], 28 – 29 [92(j)]; See also *Finance Act 2000* (UK) c 17, sch 22 para 89 (1); See also HMRC, *Tonnage Tax Manual* (2021) [TTM 10001] (*'HMRC Tonnage Tax Manual'*) <<https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual/ttm10000>>: 'The legislation does not abolish capital allowances for non tonnage tax companies that lease ships to tonnage tax companies, but it does place restrictions on the availability of allowances.'; See generally Kronbergs, above n 2534, 638, 649-50.

²⁷⁵² Alexander, above n 35, 22 [80], 23[85], 24 [87].

²⁷⁵³ Ibid.

²⁷⁵⁴ Ibid 22 [80] – 24 [87].

²⁷⁵⁵ Ibid.

²⁷⁵⁶ Ibid.

²⁷⁵⁷ Ibid 22 [80], 23[85], 24 [87].

misalign with efficiency, as benchmarked. Bearing in mind that the *USF* generally requires efficiency to be promoted foremostly and in the form of a super efficiency where appropriate.²⁷⁵⁸

Alternatively, the second option is to allow financial lessors of ships to have continued access to capital allowances.²⁷⁵⁹ Although, extensive anti-avoidance provisions may now be required to protect the integrity of the hybrid regime.²⁷⁶⁰ Thus, the second option may cause the regime to misalign to some degree with simplicity.²⁷⁶¹ This misalignment is problematic, as a shipping tax regime should vigorously promote simplicity.²⁷⁶² Where a regime produces higher costs and only generates nominal revenue, this attribute infringes on one of the core characteristics of a good tax system.²⁷⁶³

These two options, however, miss the crux of the conundrum. A problematic treatment should, to some degree, be expected as the hybrid promotes conflicting underlying objectives simultaneously in its application.²⁷⁶⁴ Thus, where these different taxing formulas, promoting different outcomes, apply to different parties in a single transaction, one party is potentially bound to benefit whilst the other suffers. These situations encourage tax shifting and potentially reward an unintended recipient.²⁷⁶⁵ Thus, the hybrid regime may fail to adequately support the intended tax base in these circumstances.²⁷⁶⁶

²⁷⁵⁸ Ibid 3 [vi], 22 [80], 23[85], 24 [87].

²⁷⁵⁹ Ibid 22 [81], 23[85] – [86], 24 [86] - [87].

²⁷⁶⁰ Ibid.

²⁷⁶¹ Ibid 22 [81].

²⁷⁶² Ibid.

²⁷⁶³ Cannan, above n 14, 311; *The Mirrlees Review*, above n 17, 22-3, 40-4.

²⁷⁶⁴ Alexander, above n 35, 22 [80] – 24 [87].

²⁷⁶⁵ Ibid.

²⁷⁶⁶ Maritime UK, above n 821, 52; See also Table C above.

A more straightforward and efficient approach would apply uniformity more generously through the simpler application of a separate regime.²⁷⁶⁷ A separate regime may more optimally promote particular objectives.²⁷⁶⁸ A separate application avoids marrying two regimes that are, to some degree, mutually exclusive.²⁷⁶⁹

The Greek *model* may offer a solution to avoid the inefficient shifting of income tax to a tonnage taxpayer.²⁷⁷⁰ This solution, in part, requires the tonnage tax to be applied as a final tax with generous and simple tax exemptions.²⁷⁷¹ This approach establishes a better uniformity and reduces the risk of tax shifting.²⁷⁷² In particular, the tonnage tax should be applied to one key entity.²⁷⁷³ After this application, the underlying eligible shipping income should be treated as fully tax-exempt even where it is relayed to other key income recipients.²⁷⁷⁴ Adopting such a tax treatment ensures that a regime aligns better with efficiency and simplicity as the *USF* prioritises.²⁷⁷⁵ Lord Alexander, in principle, recommends promoting uniformity for shipping tax.²⁷⁷⁶ It is, however, submitted that the recommendation should be applied more aggressively in promoting a super efficiency.

²⁷⁶⁷ *Law 27 of 1975*, arts 1, 2, 25, 26, 29 (Greek Republic); Tegos, above n 1541, 444; *Deloitte Shipping Tax Guide*, above n 2556, 12-3, 18-9.

²⁷⁶⁸ *Law 27 of 1975*, art 1, 2 (Greek Republic).

²⁷⁶⁹ Alexander, above n 35, 3 [vi]; 9 [17]; *1998 DETR Report*, above n 23, 7 [14] – [16]; Cooper, above n 97, 417-8; Alley and Bentley, above n 2, 582-3; *Carter Report*, above n 89, 10; *Asprey Review*, above n 34, [3.3]; *The Henry Review*, above n 89, 17.

²⁷⁷⁰ *Law 27 of 1975*, art s1, 2, 4, 25, 26 (Greek Republic); Tegos, above n 1541, 444; *Deloitte Shipping Tax Guide*, above n 2556, 12-3, 18-9.

²⁷⁷¹ *Ibid.*

²⁷⁷² *The Mirrlees Review*, above n 17, 22-3, 28-32, 34, 40-1; *The Henry Review*, above n 89, 17, 20, 80, 104; Dwyer, above n 2, 748, 758.

²⁷⁷³ *Law 27 of 1975*, arts 1, 2, 25, 26 (Greek Republic); Tegos, above n 1541, 444; *Deloitte Shipping Tax Guide*, above n 2556, 12-3, 18-9.

²⁷⁷⁴ *Ibid.*

²⁷⁷⁵ *The Mirrlees Review*, above n 17, 22-3; 34, 40-4; *The Henry Review*, above n 89, 17, 80, 104.

²⁷⁷⁶ Alexander, above n 35, 24 [88] -25 [91].

Likewise, local and foreign shipping income, as derived by a relevant entity, should similarly be treated uniformly.²⁷⁷⁷

On average, the UK registered merchant fleet has continued to decline in size, as a percentage of the global fleet, despite the enactment of the UK tonnage tax regime.²⁷⁷⁸ Thus, at best, applying the Dutch model may have merely slowed down the decline in UK registered merchant tonnage.²⁷⁷⁹ Accordingly, the decline may demonstrate that the Dutch tonnage tax model has failed to adequately support the protection of the relevant tax base.²⁷⁸⁰ The UK government is once again considering amending its tonnage tax regime to reverse this decline of UK tonnage.²⁷⁸¹ In considering any future amendments, it should be borne in mind that Lord Alexander, in his report, emphasises the importance of applying a shipping tax treatment efficiently, simply and with certainty.²⁷⁸² However, a hybridised regime appears to be less successful in optimally demonstrating these outcomes.

Nonetheless, the UK regime may promote a more substantial economic connection between its users and the UK jurisdiction.²⁷⁸³ Only qualifying companies (and groups) can benefit from the regime.²⁷⁸⁴ A qualifying company is defined as, firstly, a company liable to pay UK

²⁷⁷⁷ Ibid 24 [88] -25 [91], 29 [92(k-1)]; See also *Finance Act 2000* (UK) c 17, sch 22 para 49(2); See also HMRC, *Tonnage Tax Manual* (2021) [TTM 06400] ('*HMRC Tonnage Tax Manual*') <<https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual/ttm06400>>: 'Distributions received from an overseas company (that is, a company that is not resident in the UK) may be 'relevant shipping income' (see TTM06020) in the hands of a tonnage tax company if certain conditions are met.'; See generally Kronbergs, above n 2534, 646 - 7.

²⁷⁷⁸ Maritime UK, above n 821, 52; See also Table C above.

²⁷⁷⁹ See also Table C above; See generally Marlow and Mitroussi, above n 70, 199 - 200.

²⁷⁸⁰ Ibid; See especially Panagiotou and Thanopoulou, above n 43, 7; Lazenby, above n 1731, 75; *1998 DETR Report*, above n 23, 13 [40] - [42]; Alexander, above n 35, 3 [vi], 4 [x], 8 [14], 11 [25] - [26]; See generally Papavizas and Kiern, above n 1542, 385-6.

²⁷⁸¹ Maritime UK, above n 821, 52; See generally Table C above.

²⁷⁸² Alexander, above n 35, 3 [vi], 22 [81]; See generally *The Mirrlees Review*, above n 17, 22-3, 28-32, 40-1.

²⁷⁸³ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1); See also HMRC, *Tonnage Tax Manual* (2021) [TTM 03001] ('*HMRC Tonnage Tax Manual*') <<https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual/ttm03001>>; Kronbergs, above n 2534, 643.

²⁷⁸⁴ Ibid.

corporation tax.²⁷⁸⁵ Secondly, the company must operate qualifying ships.²⁷⁸⁶ Thirdly, the strategic *and* commercial management of these ships must be situated in the UK; this concept or test is not defined in the statute, but the HMRC offers a definition for it in their *Tonnage Tax Manual*.²⁷⁸⁷ Thus, the UK regime may demonstrate a more optimal alignment with *MAF*'s substantial activity factor, based on the approach adopted by the HMRC in constructing this concept or test.²⁷⁸⁸

However, this closer alignment is not only supported by these management activities as required, but may also be supported by one or more of the other requirements stipulated for a qualifying company.²⁷⁸⁹ For example, the regime is also restricted to normal UK corporate taxpayers, thus incorporating the more conventional juridical connecting factors.²⁷⁹⁰ In contrast, it has been observed that the Greek and Panamanian tonnage tax regimes apply, to

²⁷⁸⁵ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1)(a): 'it is within the charge to corporation tax'; *Deloitte Shipping Tax Guide*, above n 2556, 88; Alexander, above n 35, 27 [92(e)]; But see Kronbergs, above n 2534, 643-4, in relation to permanent establishments.

²⁷⁸⁶ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1)(b); The term 'operate' has a specific statutory meaning that restricts its application to ship owners and certain charterers: See generally Kronbergs, above n 2534, 644; See also *Finance Act 2000* (UK) c 17, sch 22 para 18 (1).

²⁷⁸⁷ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1)(c): 'those ships are strategically and commercially managed in the United Kingdom'; See especially HMRC, *Tonnage Tax Manual* (updated 3 August 2022) [TTM03800],[TTM03810] < <https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual> > : Here the HMRC opines that 'this is not the same as the 'central management and control' test [considered under heading 5.1.2.4 here above] relevant to determining whether a company is resident in the UK ... As the strategic and commercial management test is not defined [in the legislation], HMRC adopt an interpretation which takes into account the different strands of management activity that might be considered relevant. ... The test is ... aimed at ensuring that there is ... a substantial contribution to economic activity and employment, with evidence of economic links including details of vessels owned and operated, nationals employed on ships and in land-based activities and investments in fixed assets (ships and supporting assets) ': at [TTM03800]; However, '[t]he strategic management test displays features in common with the central management and control test for corporate residence, operating at a high level of decision making.': at [TTM03810]; See generally Kronbergs, above n 2534, 643-4; See generally *Euroceanica (UK) Ltd v Revenue & Customs* [2013] UKFTT 313 [67] < <https://www.bailii.org>>: where it was held that over capacity does not mean 'under capacity of management ability'; See generally above n 1103.

²⁷⁸⁸ *Ibid*; *OECD BEPS Action 5*, above n 13, 23, 39 [84] – [85]; *2017 OECD Progress Report*, above n 699, 13[8], 14[2], 15[14], 21.

²⁷⁸⁹ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1)(c); HMRC, *Tonnage Tax Manual* (updated 3 August 2022) [TTM03001]; Kronbergs, above n 2534, 643-4.

²⁷⁹⁰ *Finance Act 2000* (UK) c 17, sch 22 para 16 (1); HMRC, *Tonnage Tax Manual* (updated 3 August 2022) [TTM03001]; Kronbergs, above n 2534, 643; *Deloitte Shipping Tax Guide*, above n 2556, 88.

some degree, their flags as juridical connecting factors;²⁷⁹¹ these other connecting factors may be less onerous to the extent that it has been observed that it may be relatively easy to register a vessel under certain flags, such as the Panamanian flag.²⁷⁹² Therefore, these UK requirements for a qualifying company may, in concert, support the UK regime in establishing a more meaningful economic link between its users and the UK jurisdiction.

Lastly, the UK tonnage tax regime demonstrates certain additional ship owner obligations, including a ten-year lock-in, generally, and specific training requirements.²⁷⁹³ These additions may increase the costs imposed on shipowners.²⁷⁹⁴ Any attribute that increases costs is likely to misalign with efficiency and simplicity, despite its basis, and ultimately facilitate base erosion.

5.2.10 The Exemption Regimes: Australia & South Africa

At its heart, the exemption regime largely entails the non-application of an income tax regime to in-scope shipping income derived by certain entities, provided that certain requirements are satisfied.²⁷⁹⁵ The extent to which the exemption is applied uniformly and simply across different entities and income types will determine how well it promotes the *USF*'s key objectives.²⁷⁹⁶ In the case of Australia, its exemption regime demonstrates instances where it

²⁷⁹¹ *Law 27 of 1975*, arts 1, 25, 26 (Greek Republic); *Law 4 of 1983* arts 3, 4 (Panama); *General Merchant Marine Law No 57 of 6 August 2008* art 102 (Panama); See especially *EU/Greece Communication C(2015) 9019 final*, 4 [16], 9 [35] – [36]; *2017 OECD Progress Report*, above n 699, 21; Tegos, above n 1541, 452 [16.3.2]; Papantonopoulou, above n 2439, 492; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15; Watt and Coles, above n 715, [21.4] – [21.7], [21.15], [21.23], [21.26].

²⁷⁹² *Ibid.*

²⁷⁹³ *Finance Act 2000* (UK) c 17, sch 22 para 13 (1), (1A), part IV; Kronbergs, above n 2534, 644, 649; But note, in relation to a tonnage tax election made on or after 1 April 2022, the period is now reduced to eight years: *Finance Act 2000* (UK) c 17, sch 22 para 13 (1A).

²⁷⁹⁴ *Ibid.*; For an example of another unintended cost that may arise, see generally above n 2747.

²⁷⁹⁵ Kofler, above n 970, 214; *Master Tax Guide 2019*, above n 82, [10-883]; See *2015 Deloitte Shipping Tax Guide*, above n 2433, 19; *Silke*, above n 62, [6.56].

²⁷⁹⁶ *2015 Deloitte Shipping Tax Guide*, above n 2433, 27; Dwyer, above n 2, 747-8; 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 34, 40-41; See below n 2798; For example, Australian capital gains tax will not apply where an entity disposes of a qualifying vessel, that has the necessary certificate, and

is significantly less efficient and more complex than the Greek tonnage tax model.²⁷⁹⁷ At best, the shipping exemption in Australia may be a partial one.²⁷⁹⁸ Therefore, in cases where exempt shipping income is distributed as dividends (noting, also, the extended meaning of the word ‘paid’ in the *ITAA36*), Australian resident shareholders might, nevertheless, be required to pay tax on the dividend under the normal Australian income tax regime.²⁷⁹⁹ Likewise, not all article 8 shipping income may be exempt; for example, the income derived from operating tugboats and undertaking harbour towage activities is not exempt, and a strict statutory income ratio must be satisfied to obtain the exemption for auxiliary shipping income.²⁸⁰⁰

where that vessel was used to produce exempt income, as provided under the relevant concession: *2015 Deloitte Shipping Tax Guide*, above n 2433, 31.

²⁷⁹⁷ *Tegos*, above n 1541, 443-4; *Papantonopoulou*, above n 2439, 492, 494, 496; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9.

²⁷⁹⁸ See especially *Australian Income Tax Assessment Act 1997* (Cth), ss 11-15, 51-100 (*‘ITAA 97’*); See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 27-31. *In particular*, ‘an entity’s *ordinary income *derived during an income year (the present year), or *statutory income for the present year, is exempt from income tax to the extent that it is from *shipping activities that: (a) relate to a vessel for which the entity has a *shipping exempt income certificate for the present year; and (b) take place on a day (a certified day) to which the certificate applies.’: *ITAA 97* s 51-100(1); In relation to generally defining statutory income, see, for e.g., *ITAA 97* ss 6.10, 10.5, 40-285 (capital allowances), 102.5 (capital gains), 207.20(1) (franking credits) read with *ITAA36* s 44.1 (dividends); See also *ITAA 97* s 51-105 that defines *shipping activities* as *core shipping activities* and *incidental shipping activities*; See also *ITAA 97* ss s 51-110, 51-115 that further elaborates on these concepts. Essentially, core shipping activities are defined as, ‘activities directly involved in operating a vessel to carry *shipping cargo or *shipping passengers for consideration.’: *ITAA 97* ss s 51-110 (1); But see *Shipping Reform (Tax Incentives) Act 2012* (Cth) ss 8, 9(2), 10 (*‘SRTIA’*): Vessel in-scope requirements are set out under s 10 of *SRTIA*; Also, management requirements are set out under s 6 of *SRTIA*; See further *ITAA 97* s 51-100(2) that additionally limits the application of the exemption under *ITAA 97* s 51-100(1); ‘A *shipping exempt income certificate* is a certificate issued under section 8 that sets out the matters in paragraphs 8(2)(a) and (b): *SRTIA* s9(2).

²⁷⁹⁹ *Australian Income Tax Assessment Act 1936* (Cth), ss 6(1), 44; *Patcorp Investments Ltd v FCT* (1976) 6 ATR 420; *Condell v FCT* 2007 ATC 4404; See also *Australian Income Tax Assessment Act 1997* (Cth), ss 51-100(1), 205 30, 207.20(1); But see *ITAA36* ss 128B(3)(ga) [exemption from withholding tax is applied], 128D [distribution treated as non-assessable non-exempt income for income tax]; See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 27.

²⁸⁰⁰ *Shipping Reform (Tax Incentives) Act 2012* (Cth) s 10(4)(f) and (g); See above n 911; See also *Australian Income Tax Assessment Act 1997* (Cth), s 51-100(2); See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 29; Kofler, above n 970, 215; ‘If the total incidental shipping income is more than 0.25% of the total core shipping income in the year then none of the income from incidental shipping activities will be exempt’: *ITAA97* s 51-100(2); Cf below n 3150; Cf above n 2742.

Conversely, the thesis has demonstrated that the Greek regime evidences a more generous and simpler treatment in relation to applying tax exemptions and related concessions to in-scope entities and income.²⁸⁰¹

In contrast to the Australian exemption regime, the South African equivalent may *on its face* adopt a somewhat simpler or more basic statutory design.²⁸⁰² Firstly, this observation proves true to the extent that no strict statutory income ratios must be satisfied to obtain an exemption for auxiliary shipping income.²⁸⁰³ Secondly, the South African regime may, (at least to some degree) deliver its wider concessions more simply and in the form of an exemption; this outcome may be observed for distributions paid out as dividends by South African resident companies to local resident shareholders; generally, Australian resident shareholders (as opposed to foreigners) are subjected to a credit system in relation to dividend income paid to them by Australian resident companies.²⁸⁰⁴ Thirdly, as the South African statute defines international shipping income somewhat loosely and generally, the definition may support a meaning that coincides closely with shipping income as broadly conceptualised by the *MTC*'s article 8. Fourthly, the simultaneous and alternative operation

²⁸⁰¹ Tegos, above n 1541, 443-4; Papantonopoulou, above n 2439, 492, 494, 496; *Deloitte Shipping Tax Guide*, above n 2556, 12-4, 18-9; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14-5.

²⁸⁰² *Income Tax Act 58 of 1962* (South Africa) ss 12Q(1) - 12Q(3); *Silke*, above n 62, [6.56]; See below n 2803.

²⁸⁰³ *Income Tax Act 58 of 1962* (South Africa) s 12Q(2)(a): 'There must be exempt from normal tax any international shipping income of any international shipping company' (emphasis added); *International shipping income* under s 12Q(1) *ITA62* is merely defined as, 'the receipts and accruals of a person derived from international shipping mainly from the operation of one or more ships contemplated in paragraph (a) of the definition of South African ship' (emphasis added); In turn *international shipping* under s 12Q(1) *ITA62* means the conveyance for compensation of passengers or goods by means of the operation of a South African ship *mainly engaged in international traffic* (emphasis added); *International shipping company*" is defined under s 12Q(1) *ITA62* as 'a company that is a resident that operates one or more South African ships that are utilised in international shipping.'; South African ship" means under s 12Q(1) *ITA62* a ship— (a) which is registered in [South Africa] in accordance with Part 1 of Chapter 4 of the *Ship Registration Act*, 1998 (Act No. 58 of 1998); or (b) another ship or ships used temporarily in lieu of the ship contemplated in paragraph (a) by virtue of that ship being subject to repair or maintenance; See also above n 2800.

²⁸⁰⁴ *Income Tax Act 58 of 1962* (South Africa) s 12Q(3): 'The rate of dividends tax contemplated in section 64E that is paid by an international shipping company on the amount of any dividend derived from international shipping income must not exceed zero per cent of the amount of that dividend'; See also above n 2803; Further, Local South African dividends' (other than dividends paid or declared by a headquarter company) are generally exempt from income tax by *ITA62* s 10(1)(k)(i); See however the provisos in relation to the exceptions to this general rule; See also above n 2799.

of the wider income tax regime, based on the failure of a particular case to meet in-scope requirements for the exemption, might be, somewhat, less of an issue due to the more basic design of the South African statutory formula; however, that design may promote greater uncertainty as it is exposed to a greater degree of judicial interpretation.²⁸⁰⁵ Nonetheless, the South African and Australian exemption regimes are similar as their primary scope is limited to corporate shipowners.²⁸⁰⁶

Also, any additional obligations that are imposed on shipowners, which exceed the more usual obligations imposed under the open ship register system, may indirectly neutralise the tax incentives of an exemption regime.²⁸⁰⁷ For example, in Australia, certain management and training requirements must be satisfied to be eligible for the exemption.²⁸⁰⁸ Accordingly, any additional costs, such as more expensive training (and other employment) requirements, may effectively cancel the attractiveness of the exemption.²⁸⁰⁹ Therefore, although the regime may appear to deliver a zero income tax result on its outward appearance, it may nevertheless impose a higher cost burden on its beneficiaries.²⁸¹⁰

²⁸⁰⁵ *Income Tax Act 58 of 1962* (South Africa) s 12Q(2)(b): ‘*Any capital gain* or capital loss in respect of any year of assessment of any *international shipping company* determined in respect of a *South African ship* engaged in international shipping must be disregarded in determining the aggregate capital gain or aggregate capital loss of that *international shipping company*.’ (emphasis added); Cf above n 2798; See generally *Deloitte Shipping Tax Guide*, above n 2433, 31: ‘(CGT) will not apply when an entity ceases to hold a qualifying vessel covered by a certificate to the extent that [the] vessel was used to produce exempt income under the shipping exempt income concession (i.e. it was used other than for a taxable purpose)’; Note also, the Australian regime provides accelerated depreciation of eligible vessels via a 10 year cap where the entity holds a certificate that is *not a shipping exempt income certificate*: *ITAA97* s 40-102(4)(item 10); *SRTIA* s 9(2); See similarly *ITAA97* s 40-362 in relation to roll-over relief for holders of vessels covered by certificates under the *SRTIA*.

²⁸⁰⁶ *Income Tax Act 58 of 1962* (South Africa) s 12Q(1): By virtue of the definition of an international shipping company: See above n 2803; See also Australian *ITAA 97* s 51-100(1) read with *Shipping Reform (Tax Incentives) Act 2012* (Cth) ss 8(1)(a): the entity must be a constitutional corporation as defined in s 51(xx) of the Australian Constitution. This is in turn defined as ‘*foreign corporations*, and trading or financial corporations formed within the limits of the Commonwealth’; The South African definition requires a *resident* company: above n 2803; See generally *2015 Deloitte Shipping Tax Guide*, above n 2433, 27-8; Kofler, above n 970, 214.

²⁸⁰⁷ *2015 Deloitte Shipping Tax Guide*, above n 2433, 27- 9; Kofler, above n 970, 214-5; *Master Tax Guide 2019*, above n 82, [10-883]; Watt and Coles, above n 715 [21.8] – [21.10], [21.16] – [21.19], [21.26], [21.28].

²⁸⁰⁸ *Shipping Reform (Tax Incentives) Act 2012* (Cth) ss 5, 6, 8(2); *Shipping Reform (Tax Incentives) Regulation 2012*; *2015 Deloitte Shipping Tax Guide*, above n 2433, 27- 9; Kofler, above n 970, 214-5; *Master Tax Guide 2019*, above n 82, [10-883].

²⁸⁰⁹ *Ibid.*

²⁸¹⁰ *Ibid.*

Likewise, in cases where exemption regimes apply the wider normal income tax regime simultaneously and alternatively, in relation to out of scope shipping activities and income, this feature, when incorporated on a more liberal and generous basis, may cause these regimes to promote efficiency and simplicity poorly.²⁸¹¹ To deliver the objectives of the *USF* adequately, shipping tax regimes should avoid hybrid designs that incorporate the components of the wider income tax regime.²⁸¹² However, the exemption regime, as designed in Australia and South Africa is technically, merely the utilisation of certain components of a normal income tax regime, albeit only at some minor level. Therefore, the exemption regime's ability to promote the *USF*'s objectives optimally may, potentially, be doomed for failure from the outset as the wider income tax regime may still apply directly and indirectly to cases to some significant extent.

A further disadvantage of the exemption regime may be demonstrated to the extent that it cannot apply different tax treatments to different vessels as effectively as a tonnage tax formula.²⁸¹³ This feature may be necessary for promoting specific objectives more effectively through a more precise and differentiated tax treatment. For example, an exemption regime cannot as easily as a tonnage formula provide vessels of different ages with different concessional treatments; other objectives that may require differentiated tax treatments for their promotion, include environmental and safety standards.²⁸¹⁴ However, it is conceded that these outcomes can still be promoted in the eligibility or in-scope criteria of an exemption regime, albeit less, precisely, and targeted.²⁸¹⁵

²⁸¹¹ 2015 *Deloitte Shipping Tax Guide*, above n 2433, 30; Kofler, above n 970, 216.

²⁸¹² Alexander, above n 35, 3 [vi], 22 [81].

²⁸¹³ Papantonopoulou, above n 2439, 494; Tegos, above n 1541, 447; Panagiotou and Thanopoulou, above n 43, 18; Marlow and Mitroussi, above n 70, 197; *General Merchant Marine Law No 57 of 6 August 2008* (Panama) art 149.

²⁸¹⁴ *Ibid.*

²⁸¹⁵ 2015 *Deloitte Shipping Tax Guide*, above n 2433, 27-9; Kofler, above n 970, 214-5.

In Australia (a 2012 enactment) and South Africa (a 2014 enactment), the exemption regime has demonstrated limited success in aggressively stimulating the corresponding tax base.²⁸¹⁶ Their enactment has roughly resulted in a retention of their pre-introduction tonnage levels, measured as a percentage of global tonnage.²⁸¹⁷ Thus, the introduction of these shipping tax regimes has not significantly expanded the tonnage of the corresponding registers – albeit that in these jurisdictions they may have prevented the further deterioration of tonnage levels. However, as a caveat, these results cannot be understood properly without also considering other State support measures that may be available in these jurisdictions, together with any other relevant factors.

5.2.11 Freight Tax, Lifting Tax and User Tonnage Tax Regimes

A freight or lifting tax may be imposed on the outward carriage of a foreign ship.²⁸¹⁸ In particular, this tax may be calculated as a percentage of the *gross amount* earned on carrying

²⁸¹⁶ Ibid; *Silke*, above n 62, [6.56]; See Table C above; UNCTADSTAT, *Merchant fleet by flag of registration and by type of ship, annual* (2020) United Nations <<http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=93>>.

Fleets	2012	%	2014	%	2015	%	2017	%	2020	%
Global	1 537 484		1 694 519		1 753 092		1 868 174		2 068 970	
Australian	1 816	0.12	1 782	0.11	1 938	0.11	1 911	0.10	2 422	0.12
South African	1 028	0.07	1 480	0.09	1 661	0.09	1 670	0.09	2 247	0.11

²⁸¹⁷ Ibid.

²⁸¹⁸ *Income Tax Act 58 of 1962* s 33(1) (South Africa); *Australian Income Tax Assessment Act 1936* (Cth), s 129; *Silke*, above n 62, [14.33]; Australian Taxation Office, ‘Income tax: the application of the ships and aircraft article of Australia’s tax treaties to taxable income derived under section 129 of the Income Tax Assessment Act 1936 by a non-resident shipowner or charterer’ (Tax Ruling, TR 2014/2) [4]-[5] (‘*ATO TR 2014/2*’); Australian Taxation Office, ‘Income Tax: The Scope of and Nature of Payments Falling within Section 129 of the Income Tax Assessment Act 1936’ (Tax Ruling, TR 2006/1) [72], [74] (‘*ATO TR 2006/1*’); *2015 Deloitte Shipping Tax Guide*, above n 2433, 26; Burch, above n 72, 216; See also *Bowes v Shand* (1877) 2 A.C. 455, 463, 470 where ‘shipped’ was generally interpreted as ‘put on board a ship’; Cf *Australian Income Tax Assessment Act 1936* (Cth), s 129: ‘passengers, live-stock, mails or goods shipped in Australia.’: (emphasis added); Cf *Silke*, above n 62, [14.33]: [South African lifting tax] applies *only to outbound traffic*.’: (emphasis added); See generally *Ocean Steamship Company Limited v. Federal Commissioner of Taxation* (1918) 25 CLR 412, 414; See also *Income Tax Act 58 of 1962* s 33(1) (South Africa) : ‘embarks passengers or loads livestock, mails or goods in the Republic.’.

passengers embarked or livestock, mails and goods loaded in the jurisdiction of a sponsoring State; as the taxbase may extend, albeit within practicable and justifiable limits, beyond the ordinary concepts of freight and fares, lifting tax or even perhaps ‘shipped tax’ might be a better technical descriptor for it.²⁸¹⁹ States like Australia and South Africa employ these types of taxes.²⁸²⁰ The current rates of the Australian and the South African lifting taxes are five and ten percent, respectively.²⁸²¹ However, these taxes may be rendered inoperable by reciprocal State exemptions.²⁸²² Thus, residents of a foreign State (‘B’) may be exempt from the lifting tax of the sponsoring State (‘A’).²⁸²³ Similarly, the residents of the sponsoring

²⁸¹⁹ *Income Tax Act 58 of 1962* s 33(1) (South Africa); *Australian Income Tax Assessment Act 1936* (Cth), s 129; *Silke*, above n 62, [14.33]; See also *ATO TR 2014/2* above n 2818, [4]–[5]; See also *ATO TR 2006/1*, above n 2818, [57], [72], [74], [75], [87], [93], [104]; See generally *Union Steamship Co. of New Zealand v. Federal Commissioner of Taxation* (1924) 35 CLR 209, 215, 219-220; *Bowes v Shand* (1877) 2 A.C. 455, 463, 470; *Ocean Steamship Company Limited v. Federal Commissioner of Taxation* (1918) 25 CLR 412, 414; For a brief discussion on the idea of freight, see also heading 3.5.8; For example, ‘[t]he tax base may cover a [gross] payment made by a ‘shipper’ under a ‘bill of lading’ [(or similar instrument)] and by a ‘shipper charterer’ in those cases where the goods are carried by a ship which is under a ‘charterparty’, be it a ‘time charterparty’ or ‘voyage charterparty’’: *ATO TR 2006/1*, above n 2818, [75], [76], [82], [87], [93], [96], [100]; But see at [97]; See generally *Wehner v. Dene SS. Co.* [1905] 2 KB 92, 99 where it was observed by Channell J that, ‘although the owner has the right to demand the bill of lading freight from the holder of the bill of lading because the contract is the owner’s contract, yet the owner has also, of course, contracted by the charterparty that for the use of his ship he will be satisfied with a different sum, which will also in the great majority of cases be less than the total amount of the bills of lading freights; and, therefore, if the owner were himself to demand and receive the bills of lading freight, as he might do if he chose, he would still have to account to the charterer or the sub-charterer, as the case might be, for the surplus remaining in his hands after deducting the amount due for hire of the ship under the charterparty. Of course, in practice an agent is usually appointed to receive the bill of lading freight, though not necessarily, because the captain may receive it himself; and under this charterparty the captain has to appoint as agent any person whom the charterers may select, which is a very reasonable arrangement, because if the business goes smoothly and the charterparty hire is duly paid, the charterers are the persons really interested in receiving the bill of lading freight. But, if I am right as to the bill of lading contract being with the owner, then it seems to me to follow that the agent appointed to receive the bill of lading freight becomes by the very act of appointment the agent of the shipowner to receive the freight for him, and the agent’s receipt binds the shipowner.’; See also *Tradigrain v. King Diamond Marine Limited* [2000] 2 Lloyd’s Rep 319: ‘Nevertheless, just as it is necessary to take into consideration the fact that a bill of lading is a negotiable instrument and will in due course come into the hands of a transferee, so also in my judgment it is necessary to give weight to the circumstances and context in which a shipowner typically allows his bill of lading freight to be negotiated by and paid to his time charterer. The classic exposition is that of Mr Justice Channell in *Wehner v. Dene* [1905] 2 KB 92 at 99 ... Now, since those days, the collection of freight is for the most part of course no longer carried out by the master, or by agents at the port, but by direct payments between banks, and charterparties typically contain provisions relating to the bank account to which payment should be made.’

²⁸²⁰ *Income Tax Act 58 of 1962* s 33(1) (South Africa); *Australian Income Tax Assessment Act 1936* (Cth), s 129.

²⁸²¹ *Ibid.*

²⁸²² *Silke*, above n 62, [14.33]; *2015 Deloitte Shipping Tax Guide*, above n 2433, 26; Burch, above n 72, 216; These types of taxes are prevalent especially in Latin America and in some parts of Asia and Africa: See generally *WSC et al Submission Paper to the OECD*, above n 2545, [Annex (‘Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study’)] 22-3; See also *Shipping*, 46 USC § 60304 (2022).

²⁸²³ *Ibid.*

State ('A') may be exempt from the lifting tax of the foreign State ('B').²⁸²⁴ These exemptions may be provided through bilateral agreements or by unilateral State measures.²⁸²⁵

Lifting taxes may align particularly well with simplicity if formulated correctly. As taxes, they may be easier to administer; this outcome may prove true, particularly in relation to tax collection as a ship may be detained in a port until the tax is paid.²⁸²⁶ Further, the administration of a lifting tax may piggyback on a pre-existing tax framework, such as the customs taxation framework of a State, thereby once more, strongly promoting simplicity.²⁸²⁷

A user tonnage tax raised on foreign vessels using a sponsoring State's ports might, at some level, be considered somewhat equivalent to a lifting tax.²⁸²⁸ The user tonnage tax is

²⁸²⁴ Ibid.

²⁸²⁵ Ibid; See also *Income Tax Act 58 of 1962* s 10(1)(cG) (South Africa): 'the receipts and accruals of any person who is not a resident, which are derived by such person from carrying on business as the owner or charterer of any ship ... , if a similar exemption or equivalent relief is granted by the country of which such person is a resident, to any resident in respect of any tax imposed in that country on income which may be derived by such person from carrying on in such country any business as owner or charterer of any ship'; See also below n 2830; See also *ATO TR 2014/2* above n 2818, [6], [10], [15], [25]: 'However, in determining the Australian tax liability of a treaty partner resident, it is also necessary to consider the applicable tax treaty. In relevant circumstances, an applicable treaty can relieve a treaty partner resident of their tax liability in relation to section 129 income.': at [6]; See generally Australian Taxation Office, 'Income tax: the taxation treatment of ship and aircraft leasing profits under the ships and aircraft articles of Australia's tax treaties' (Tax Ruling, TR 2008/8) [8] – [10]; See generally *Internal Revenue Code, 26 USC* § 883(a)(1).

²⁸²⁶ *Income Tax Act 58 of 1962* s 33 (2) (South Africa): 'the principal officer of customs at the port ... where such ship ... is being cleared shall have power to detain the clearance until such payment is made.': at s33(2)(c); See also *Australian Income Tax Assessment Act 1936* (Cth), s 135; Cf *Shipping, 46 USC* § 60301 - 60303 (2022); See also *Customs Duties, 19 CFR* § 4.20 (c), (f) and (g), § 4.23 (2022) (United States).

²⁸²⁷ Ibid.

²⁸²⁸ Na Li, 'Mainland China and Hong Kong SAR' in Guglielmo Maisto (ed), *Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties* (IBFD, 2017) vol 15, 332; Provisional Regulation of Vessel's Tonnage Tax of the People's Republic of China 2011; Vessel Tonnage Law of the People's Republic of China 2018: Nadine Cheng, *The Vessel Tonnage Tax Law of the People's Republic of China (Mainland China)* (2017) Lee Tsai & Partners < <https://www.leetsai.com/other-areas/the-vessel-tonnage-tax-law-of-the-peoples-republic-of-china-mainland-china> > ; ECOLEX, *Vessel Tonnage Tax Law of the People's Republic of China* (2017) < <https://www.ecolex.org/details/legislation/vessel-tonnage-tax-law-of-the-peoples-republic-of-china-lex-faoc172978/> >: 'This Law consists of 22 Articles. Vessel tonnage tax shall be paid in accordance with this Law on vessels that enter the domestic ports of the People's Republic of China from overseas ports. The taxable items and tax rates for tonnage tax shall be governed by the Table of Taxable Items and Tax Rates for Tonnage Tax attached to this Law. The amount of tonnage tax payable shall be calculated by multiplying the net tonnage of a vessel by the applicable tax rate. Article 9 provides for the vessels which shall be exempt from tonnage tax, including fishing vessels.'

calculated on the tonnage of a vessel; China and the United States, for example, are States that apply these imposts.²⁸²⁹

Double tax agreements may not cover these user tonnage taxes.²⁸³⁰ Their exclusion from these instruments is said to be justified in part because they do not refer to income or commercial profits of ships but are more like property or user taxes or charges.²⁸³¹

It might be postulated that the Panamanian and Liberian tonnage tax regimes are somewhat comparable to these user tonnage taxes. This submission does not necessarily have merit. For example, the Panamanian and Liberian regimes may be distinguishable based on their promotion of a minimum level of substantial activities (albeit, in the form of a basic flag connection) that must be demonstrated before an entity can use their tonnage tax regimes.²⁸³²

²⁸²⁹ Ibid; For an American example: *Shipping*, 46 USC § 60301 - 60303 (2022); See also *Customs Duties*, 19 CFR § 4.20 - 4.21 (2022): ‘a regular tonnage tax or duty of 2 cents per net ton, not to exceed in the aggregate 10 cents per net ton in any 1 year, shall be imposed at each entry on all vessels which shall be entered in any port of the United States from any foreign port or place in North America, Central America, the West Indies, the Bahama Islands, the Bermuda Islands, the coast of South America bordering on the Caribbean Sea (considered to include the mouth of the Orinoco River), or the high seas adjacent to the U.S. or the above listed foreign locations, and on all vessels (except vessels of the U.S., recreational vessels, and barges, as defined in § 2101 of Title 46) that depart a U.S. port or place and return to the same port or place without being entered in the United States from another port or place, and regular tonnage tax of 6 cents per net ton, not to exceed 30 cents per net ton per annum, shall be imposed at each entry on all vessels which shall be entered in any port of the United States from any other foreign port... (c) A vessel shall also be subject on every entry from a foreign port or place, whether or not regular tonnage tax is payable on the particular entry, to the payment of a special tonnage tax and to the payment of light money at the rates and under the circumstances specified in the following table ...’: at § 4.20; The exemptions from the above US user tonnage taxes are set out under § 4.21 - 4.22; Cf *Internal Revenue Code*, 26 USC § 1352 - 1359 (2022); See also heading 4.7.3.6.

²⁸³⁰ Li, above n 2828, 332: Chinese tax treaties have historically not covered these types of charges; Cf Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; But see *Silke*, above n 62, [14.33]: ‘Certain foreign shipping ... concerns are exempt from South African taxes in terms of double taxation agreements entered into with foreign countries. The provisions of s 33 [the South African lifting tax provisions] do not apply to these concerns.’

²⁸³¹ Ibid.

²⁸³² See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 7, 27; 32; See also Watt and Coles, above n 715, [21.21]; But see Watt and Coles, above n 715 [17.18]; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6.; Further the favourable application or applicatory capacity or workability of the *MTC*’s article 8 may affect the nature of the domestic tax as an income tax.: see Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; See also above n 2790; See also below n 3192 and below n 3196.

It is submitted that whether a taxing formula is based on gross freight, or some broader equivalent, or even tonnage for levying the impost should not necessarily affect the essential nature of the charge as an income tax equivalent without more. This submission is valid to the extent that income taxes may sometimes calculate profits in special ways, such as applying a tonnage formula to calculate notional or fictitious profits. Also, whether these special shipping tax regimes are integrated as part of a normal income tax regime (such as Dutch tonnage-tax-model regimes) or are constructed as standalone regimes that operate separately (such as the basic and Greek tonnage tax models), should again not necessarily make a significant difference as to their true nature as income tax equivalents.²⁸³³ However, a key factor that may again be referenced in distinguishing these different shipping taxes (albeit now more broadly) may be their ability to promote some level of substantial activities. Mere freight or lifting taxes and user tonnage taxes (such as the Chinese tonnage tax) may fail to demonstrate this essential outcome; it should be remembered that for (direct tax) shipping tax regimes, this outcome is now required by *BEPS 5* to some degree.

Nonetheless, it is undeniable that lifting taxes may demonstrate other advantageous characteristics that allow them to align strongly with efficiency and simplicity; for example they may be applied more easily as obligations that are unavoidable in relation to utilising a corresponding port.²⁸³⁴ Thus, the special mobility that makes it somewhat difficult to raise taxes on international maritime transport activities might, broadly, be resolved more simply and naturally by adopting the following two-point action plan:²⁸³⁵ Firstly, applying a more sophisticated framework of lifting or shipped taxes on a global basis. Secondly, abolishing

²⁸³³ Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1]; Tegos, above n 1541, 451-2 [16.3.1].

²⁸³⁴ *Income Tax Act 58 of 1962* s 33 (2) (South Africa); See also *Australian Income Tax Assessment Act 1936* (Cth), s 135; See also *Customs Duties, 19 CFR* § 4.20 (c), (f) and (g), § 4.23 (2022) (United States); *Silke*, above n 62, [14.33].

²⁸³⁵ Maisto, *Global Tax Treaty Commentaries*, above n 2521, [1.1.2.4.2.1].

the current (direct tax) shipping tax regimes (and the *MTC* [and its equivalents] that support and enable them.

However, the above broad action plan as a total solution for establishing more efficient, simple, and equitable shipping taxes globally would require a joint and effective response at the international level. This cooperation may not be realistically achievable at present. Competing State interests may discourage one or more key States from effectively participating in such a joint response. These State interests may favour the prioritisation of the sea power of these States over specific fiscal objectives.²⁸³⁶ Further, the joint application of a uniform system of shipping taxes globally will not necessarily revitalise traditional ship registers as open registers are not competitive on fiscal grounds alone.²⁸³⁷

5.2.12 A Dualistic Domestic Approach to Shipping Taxes

Certain states may apply more than one shipping tax regime in their jurisdiction. For example, the UK provides the option of a normal income tax regime and an alternative tonnage tax regime for taxing relevant shipping income.²⁸³⁸

MAF's second primary factor controlling ring-fencing may be of increased relevance in these situations.²⁸³⁹ Thus, to avoid implicating the second primary factor, as a rule of thumb,

²⁸³⁶ See generally Aljazeera, *Biden says China, Russia failed to lead at COP26 climate summit* (2 Nov 2021) <<https://www.aljazeera.com/news/2021/11/2/biden-says-china-russia-failed-to-lead-cop26-climate-summit>>; Mark Howden, *Australia's refusal to sign a global methane pledge exposes flaws in the term 'net-zero'* (3 Nov 2021) *The Conversation* <<https://theconversation.com/australias-refusal-to-sign-a-global-methane-pledge-exposes-flaws-in-the-term-net-zero-170944>>; But see ABC, *More than 100 countries reach global deal for 15 per cent minimum corporate tax rate. What will it mean?* (9 Oct 2021) <<https://www.abc.net.au/news/2021-10-09/global-minimum-tax-deal-oecd-explainer/100527120>>.

²⁸³⁷ *OECD Consolidated Application Note*, above n 2, 80; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6.

²⁸³⁸ Alexander, above n 35, 25 [92(a)]; See also Papavizas and Kiern, above n 1542, 384.

²⁸³⁹ *OECD Consolidated Application Note*, above n 2, [322] – [323].

uniformity should generally be promoted in taxing substantially similar activities and different sea routes.²⁸⁴⁰

5.3 Conclusion: Broad Specifications of an Optimum Regime

The thesis favours a systemic approach for applying the substantial activity factor to a shipping tax regime.²⁸⁴¹ An optimal shipping tax regime should not be expected to operate in isolation.²⁸⁴² Thus, a tax system's juridical connecting factors have a complementary role in promoting substantial activity for shipping taxes.²⁸⁴³ However, as ostensibly promoted by the fifth primary factor of *MAF*, substantial activity without more is not likely to reduce the mobility of shipping income produced from maritime transport activities.

Further, an optimal shipping tax regime is only one of several measures that a State may apply to protect and revitalise its registered merchant tonnage.²⁸⁴⁴ The ship registers of foreign States attract tonnage by promoting lower costs that include costs other than taxes. Nonetheless, previous research has demonstrated that an efficient shipping tax regime constitutes a key component of a State's support programme.²⁸⁴⁵ Thus, an optimal shipping tax regime is a crucial element of these programmes and should promote, where appropriate, a super efficiency to better level the playing fields between registers of different States.²⁸⁴⁶

²⁸⁴⁰ Ibid [322] – [323]; *OECD 1998 Report*, above n 2, 8, [62]; Dwyer, above n 2, 747-8; 751-2; Cobb, above n 17, 627-8, 646-8; *The Mirrlees Review*, above n 17, 34, 40-41.

²⁸⁴¹ *The Mirrlees Review*, above n 17, 2-3, 28, 35.

²⁸⁴² Ibid.

²⁸⁴³ *The Mitchell Review*, above n 55, 19, 42 [5.35].

²⁸⁴⁴ See heading 5.1.3.

²⁸⁴⁵ Panagiotou and Thanopoulou, above n 43, 6-7.

²⁸⁴⁶ Cobb, above n 17, 648; Dwyer, above n 2, 764-9.

In promoting efficiency and simplicity, the thesis favours a more uniform and straightforward taxing formula for an optimal shipping tax regime.²⁸⁴⁷ A design that operates independently of an income tax regime is favoured to avoid the former being disadvantaged by the latter's complexity and incompatible underlying objectives. The prima facie results of formulas that primarily utilise the income tax regime (or similar regimes) in one way or another have been considered elsewhere in the thesis; these results are presented in Table C and Table n 2816. These results have generally demonstrated less optimal growth or a decline in tonnage. Thus, as a rough observation, it may be submitted that whether the income tax regime has introduced generous capital allowances, special tonnage tax formulas, or even complex exemption formulas, the corresponding registered fleets under review have generally failed to demonstrate a similar expansion in the late 20th and early 21st centuries as the fleets of States enjoying a separate regime.

Further, it has been observed that in promoting a super efficiency, the ideal tax result should generally be exceptionally low or zero, which may be adjusted in particular instances to achieve certain outcomes.²⁸⁴⁸ Simplicity also requires that a regime producing only nominal tax results should demonstrate lower administrative and compliance costs in proportion to the revenue raised.²⁸⁴⁹

Unlike a simple or bare exemption from tax, there are advantages to having a taxing formula that can provide limited but effective tax differentiation. Minimal differentiation may give

²⁸⁴⁷ *The Mirrlees Review*, above n 17, 22-3, 39-45.

²⁸⁴⁸ Alexander, above n 35, 4 [x]; See especially *Deloitte Shipping Tax Guide*, above n 2556, 17, 20; Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 13; Kofler, above n 970, 447; *EU/Greece Communication C(2015) 9019 final*, 8; Panagiotou and Thanopoulou, above n 43, 7; 12; Marlow and Mitroussi, above n 70, 200-1, 204.

²⁸⁴⁹ *Asprey Review*, above n 34, [3.20]; Stewart et al, above n 2, 10- 1; Alley and Bentley, above n 2, 611-2; *The Henry Review*, above n 89, 17, 169.

policymakers some flexibility in slightly adjusting taxing levels where appropriate, to encourage specific outcomes better, such as younger, safer, and larger vessels.²⁸⁵⁰ Apart from promoting certain environmental and safety objectives, this tax design feature may be essential as chapter four has observed that the sea power of a State is more optimally promoted by vessels that demonstrate particular features.

It is submitted that the basic tonnage tax model applied in Liberia and Panama serves as a good starting basis for designing an optimal shipping tax regime that may promote the sea power of a State more optimally. In the first two decades of the 21st century, the registered merchant tonnage of these two States, considered on a global basis has, on an ongoing basis, demonstrated the best expansion.²⁸⁵¹ Further, for adapting the basic tonnage tax model, the thesis recommends the following two actions as a minimum:

- 1) The employment of a higher uniform standard tax rate at the primary level of the formula. This action allows for greater differentiation in the tax result as applied at the secondary level of the formula.
- 2) The establishment of a more streamlined and stable set of *limited* exemptions and reductions at the secondary level of the formula.

Other design features that may be considered include the employment of a lock-in that would generally apply for a fixed period, such as a ten-year interval, covering several elements, including discounts, exemptions and the tax rate.²⁸⁵² Lock-ins would better realise stability in the tax result over an extended period and, in so doing, promote certainty more optimally for

²⁸⁵⁰ *Asprey Review*, above n 34, [3.25], [3.26]; *The Mirrlees Review*, above n 17, 32.

²⁸⁵¹ Panagiotou and Thanopoulou, above n 43, 7; 12; Marlow and Mitroussi, above n 70, 200-1, 204; See also Table C.

²⁸⁵² Piniella, Alcaide and Rodríguez-Díaz, above n 45, 16; See generally Leptos-Bourgi, Van den Bree and Boonacker, above n 853, 12, 20.

advancing the regime's attractiveness.²⁸⁵³ If required as a necessary compromise, a balancing figure as an additional fixed amount, which may be varied periodically, may provide further flexibility in the formula.

The Greek tonnage tax regime demonstrates other features that may enhance this basic model's broader efficiency and simplicity outcomes. These features may prove particularly useful where the State in question raises income taxes (and the like) on its residents on a worldwide basis.²⁸⁵⁴

These design features include demonstrating the outcome that the payment of tonnage tax for a vessel in any year results in its shipping income as defined enjoying a generous and more straightforward tax exemption for that year. This exemption should apply irrespective of whether eligible beneficiaries derive the income directly as shipping income or indirectly as dividends.²⁸⁵⁵ The exemption should promote simplicity vigorously. Unlike the exemption regimes (applied in Australia and South Africa), and the Dutch tonnage tax model (applied in the UK), that both demonstrate greater complexity by inherently relying on and simultaneously applying several key elements of a normal income tax (or similar) regime.²⁸⁵⁶

Thus, the general design rule gleaned from the Greek model for designing an optimal shipping tax regime is to apply shipping tax treatments uniformly and simply, more generously. Design features should also exhibit a fiscal sensitivity to the practicalities of running a viable modern-day shipping business.²⁸⁵⁷ Therefore, the preferential treatment

²⁸⁵³ *The Mirrlees Review*, above n 17, 44; See also Panagiotou and Thanopoulou, above n 43, 13 [3].

²⁸⁵⁴ Piniella, Alcaide and Rodríguez-Díaz, above n 45, 14-5.

²⁸⁵⁵ *Ibid.*

²⁸⁵⁶ *The Mirrlees Review*, above n 17, 34, 39-44; Cobb, above n 17, 646 [3.2]; Dwyer, above n 2, 747-8 [3.2], 764 [3.6].

²⁸⁵⁷ *EU Ship Management Communication OJ C 132*, 6 - 7; See generally Breskin, above n 6, 238.

should extend to entities other than shipowners and ship operators. By adopting these actions, a regime may align more strongly with efficiency and simplicity, and better protect against base erosion.²⁸⁵⁸

Unlike digital services, maritime transport activities may be uniquely mobile and crucial for supporting a State's national security more directly;²⁸⁵⁹ a registered merchant fleet is a direct component of a State's sea power.²⁸⁶⁰ Further, an optimal shipping tax regime should apply, on a primary basis, a preferential tax treatment to the shipping income produced from the navigation activities of these registered vessels. It is these activities that may be more mobile and that directly support the expansion of a registered fleet. It is submitted that it is irrelevant whether taxes are, in reality, collected from this base for revenue generation. It was observed in chapter two that taxes have multiple functions. Revenue generation constitutes only one of these functions.

Thus, in general, an optimal shipping tax regime should promote a State's sea power as its primary objective, by supporting the expansion of the registered merchant tonnage of the sponsoring State. However, the expansion of a registered merchant fleet will have various secondary benefits. Thus, as this tax base expands, the State may, as a secondary outcome, increase its collection of nominal shipping taxes. Furthermore, normal income/corporate tax collections may also be expected to increase. More ships will require a larger supporting sector that may be taxed more normally as they suffer from less mobility. Ships do not sail, repair, and replace themselves.

²⁸⁵⁸ Alexander, above n 35, 22 [80], 23[85], 24 [87]; *The Mirrlees Review*, above n 17, 22-3; 34, 39-45; *The Henry Review*, above n 89, viii (4.4), xix; 15-6, 21, 29, 30-1, 80.

²⁸⁵⁹ McMahan, above n 36, 106; Asteris, above n 35, 71; Alexander, above n 35, 7 [8], 16 [49].

²⁸⁶⁰ McMahan, above n 36, 104-6; Asteris, above n 35, 66-7, 70.

In summary, an optimal shipping tax regime should vigorously promote efficiency and simplicity. In general, sea power should constitute a primary objective underlying this regime. A hybrid tax design, incorporating features of the basic and Greek tonnage tax models, may serve as a good basis for accomplishing these outcomes.

Chapter 6: The OECD's Two Pillar Solution & its Potential Impact on a Model Tax Regime

6.1 BEPS 2.0: The OECD's Two Pillar Framework

6.1.1 A Brief History

Subsequent to the BEPS 1.0 action plans that were published in final form in 2015, the OECD and G20 States have continued to work together to control its implementation and expand its inclusivity.²⁸⁶¹ To further these ultimate goals, the OECD in 2016 established the OECD/G20 Inclusive Framework on BEPS (*IF*), for establishing a platform for States to participate more equally in its Committee on Fiscal Affairs (and other subsidiary bodies).²⁸⁶²

²⁸⁶¹ OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint, Inclusive Framework on BEPS' (OECD, 2020) 3 ('*OECD Pillar 1 Blueprint*') <<https://doi.org/10.1787/beba0634-en>>; See also KPMG, *BEPS 2.0: What You Need to Know* (137881-G/March 2022) 1 ('*KPMG BEPS 2.0 Flyer*') <<https://home.kpmg/xx/en/home/insights/2022/03/beps-2-0-what-you-need-to-know.html>>.

²⁸⁶² *Ibid* 3, 10. See KPMG, *Summary Document on Pillar One and Pillar Two* (2020) <<https://assets.kpmg/content/dam/kpmg/ie/pdf/2020/01/ie-pillar-one-pillar-two-oecd-31-jan-2020.pdf>>; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 1; See Deloitte, *Tax Insights Pillar One / Pillar Two Statement finalised by OECD Snapshot* (Australia 2021/18) ('*Deloitte Two Pillar Paper*') <<https://www2.deloitte.com/content/dam/Deloitte/au/Documents/tax/deloitte-au-tax-insights-18-pillar-1-2-statement-finalised-111021.pdf>>: Since about 2017, the 140 member States of IF have been developing a 'two-pillar' approach to address the tax challenges associated with digitalising the economy. On the back of a March 2017 mandate by the G20 Finance Ministers in Germany, the Digital Economy OECD Task Force of IF published a 2018 March *Interim Report: 'Tax Challenges Arising from Digitalisation'*, which recognised the need for a global solution. A January 2019 OECD Policy Note set out two Pillars and four approaches to be explored further. An OECD public consultation paper on the digital economy was issued on 13 February 2019. The OECD published a 31 May 2019 Programme of Work paper, emphasising the necessity for agreement on the architectural framework of a unified approach for taxing the digital economy. On 9 October 2019, for progressing this work, the OECD sought feedback on a proposed outline for a unified approach in building consensus. The paper did not set out a consensus position for IF but was merely a Secretariat proposal. Following this proposal, in January 2020 IF agreed upon an outline of the architecture of a "Unified Approach" as the basis for negotiating Pillar One. In October 2020, two blueprint documents were published by the OECD on Pillar One and Pillar Two. These recommendations were not, however, all carried forward in later documents. In June and July 2021, political agreement on key aspects of the Two Pillar Solution was finally achieved by the G7, G20, and many IF member States. On 8 October 2021, IF published a Statement on the agreed components of the two-pillar solution that had secured the necessary endorsement of 136 of its member States. This publication updated IF's statement issued in July 2021. See also *KPMG BEPS 2.0 Flyer*, above n 2861, 1 that sets out a useful diagrammatic representation of the above key developments; See OECD, '*OECD/G20 Base Erosion and Profit Shifting Project: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*' (OECD, 8 October 2021) 1 ('*OECD Two Pillar Solution Statement*') <<https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>> 1; OECD, 'Members of the OECD/G20 Inclusive Framework on BEPS joining the October 2021 Statement on a Two-Pillar Solution to Address the Tax challenges Arising from the Digitalisation of the Economy as of 4 November 2021' (OECD, 4 November 2021) <<https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-october-2021.pdf>>: By 4 November 2021, the above October 2021 Statement was endorsed by 137 IF member States. By the end of December 2021, Pillar Two's OECD draft model rules were published; The European Commission has, subsequently, expanded these model rules for its jurisdiction.

The OECD has observed that the increasing digitalisation of business activities whilst improving service delivery and demonstrating other efficiencies has created challenges for raising effective or what may be termed ‘good’ taxes.²⁸⁶³ Resolving these issues has been one of the main issues for the OECD/G20 Base Erosion and Profit Shifting (‘*BEPS*’) Project. In progressing this aim, the BEPS project produced the 2015 BEPS Action 1 final Report (‘*BEPS One*’).²⁸⁶⁴ *BEPS One* observed that the economy as a whole was digitalising and, therefore, it would be impractical to ring-fence a distinct digital economy.²⁸⁶⁵ Therefore, IF members subsequently advanced a two-pillar framework (‘*BEPS 2.0 proposals*’), based on a consensus solution, for addressing the tax challenges resulting from an increasing digitalised and globalised world.²⁸⁶⁶

However, despite the project’s initial aims, the framework’s ultimate scope extends well beyond raising taxes on business models that are highly digitalised.²⁸⁶⁷ In short, Pillar One seeks to modify the international income tax system so that it applies more optimally to new business models by enhancing and expanding profit allocation and nexus rules within the context of general business profits.²⁸⁶⁸ Broadly, where Pillar One finds application, a source State is (to some extent) no longer necessarily restricted by the usual international tax rules that require a minimum physical presence in the source State before that source State can legitimately tax a foreign entity’s relatable revenue.²⁸⁶⁹ By implementing these changes, Pillar One’s objective is to essentially enlarge the taxing rights of certain source States

²⁸⁶³ *OECD Pillar 1 Blueprint*, above n 2861, 10, 19 [22].

²⁸⁶⁴ *Ibid*; See also *OECD BEPS Action 1*, above n 12, 1.

²⁸⁶⁵ *Ibid*.

²⁸⁶⁶ *OECD Pillar 1 Blueprint*, above n 2861, 3, 10, 19 [22]; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 1-2.

²⁸⁶⁷ *OECD Two Pillar Solution Statement*, above n 2862, 1 [Scope]; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 1; See also KPMG, *Pillar One: Profit allocation and nexus* (137784A-G/ November 2021) (‘*KPMG Pillar One Paper*’) < <https://home.kpmg/xx/en/home/insights/2020/10/beps-2-0-pillar-one-and-pillar-two.html>>.

²⁸⁶⁸ *OECD Pillar 1 Blueprint*, above n 2861, 3, 11, 19 [22] – [23].

²⁸⁶⁹ *Ibid*; *KPMG BEPS 2.0 Flyer*, above n 2861, 2; *KPMG Pillar One Paper*, above n 2867, 1.

internationally.²⁸⁷⁰ Broadly, this is, ostensibly, achieved under Pillar One by allowing source States (or market jurisdictions) to tax a qualifying foreign entity’s income at source irrespective of its physical presence in the source State, provided a certain threshold of eligible source revenue may be treated as generated by that foreign entity in the source State.²⁸⁷¹ By achieving a compromise between the different *IF* member States, a key underlying aim of the OECD is to abolish unilateral State measures in the form of digital services taxes.²⁸⁷² Further, Pillar Two seeks to limit international tax competition between States by establishing a global minimum effective corporate tax rate.²⁸⁷³

6.1.2 Pillar One’s Basic Components

The original blueprint for Pillar One sorted its underlying architecture into three main components.²⁸⁷⁴ Firstly, a new taxing right for eligible source States or market jurisdictions over a share of an MNE’s residual profit calculated primarily at the group level (‘Amount A’).²⁸⁷⁵ Secondly; a fixed return for certain baseline marketing and distribution activities occurring physically in that source State, in accordance with the arm’s length principle (‘Amount B’).²⁸⁷⁶ Thirdly, processes to improve tax certainty through enhanced dispute prevention and resolution mechanisms.²⁸⁷⁷

²⁸⁷⁰ *OECD Pillar 1 Blueprint*, above n 2861, 11, 19 [22] – [23].

²⁸⁷¹ *Ibid.*

²⁸⁷² *Ibid.*; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 1.

²⁸⁷³ *OECD Pillar 1 Blueprint*, above n 2861, 3.

²⁸⁷⁴ *Ibid.* 11.

²⁸⁷⁵ *Ibid.*

²⁸⁷⁶ *Ibid.*; See also *KPMG Pillar One Paper*, above n 2867, 1: The development of standard remuneration for in-county “baseline” marketing and distribution activities was deferred pending further work which is expected to be finalised by the end of 2022.

²⁸⁷⁷ *Ibid.*

By October 2021, Pillar One’s underlying architecture was further revised with these later revisions now having received the endorsement of the majority of IF member States.²⁸⁷⁸ The underlying architectural scope was now focussed on an in-scope multinational enterprise (‘MNE’).²⁸⁷⁹ Broadly, this concept targets an MNE (or ‘group’,²⁸⁸⁰ as defined in the draft model rules) approached at the level of an ultimate parent entity (‘UPE’)²⁸⁸¹ that meets two threshold tests: Firstly, the UPE/group must have total revenues²⁸⁸² for the relevant period²⁸⁸³ that are greater than EUR 20 billion (‘the global revenue/revenue test’).²⁸⁸⁴ Secondly, the Pre-Tax Profit Margin of the UPE/group in the relevant period as measured against its total revenues must be greater than 10 per cent (‘the profitability test’).²⁸⁸⁵ This profit margin in the latter test is calculated as a percentage by generally dividing the group’s financial accounting profit (or loss)²⁸⁸⁶ for the relevant period by the total revenues for that period.²⁸⁸⁷

²⁸⁷⁸ *OECD Two Pillar Solution Statement*, above n 2862, 1.

²⁸⁷⁹ *Ibid*; See also OECD, ‘Progress Report on Amount A of Pillar One: Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy’ (OECD, July 2022) 8, 10 (‘*Amount A Progress Report*’) < <https://www.oecd.org/tax/beps/progress-report-on-amount-a-of-pillar-one-july-2022.pdf>.>; See also OECD, ‘Public Consultation Document Pillar One – Amount A: Draft Model Rules for Domestic Legislation on Scope’ (OECD, April 2022) 2-3 (‘*OECD Scope Draft Model Rules*’).

²⁸⁸⁰ Group is defined as ‘[a]. the collection of Group Entities whose assets, liabilities, income, expenses and cash flows are included in the Consolidated Financial Statements of a UPE, or would be included if the UPE had prepared Consolidated Financial Statements; or [b]. an Entity, other than an Excluded Entity, an Investment Fund that is not a UPE or a Real Estate Investment Vehicle that is not a UPE, that is not a part of another Group provided that the Entity satisfies the revenue test and profitability test in Article 1(2).’: *Amount A Progress Report*, above n 2879, 22 [7.4]

²⁸⁸¹ It should be noted that ‘the Model Rules on Scope apply at the level of a Group, in accordance with the general design of Amount A. The concept of a Group is specifically prescribed for Amount A purposes and, broadly, is defined by reference to an Ultimate Parent Entity (UPE) that is set at a level where Consolidated Financial Statements are commonly prepared under financial accounting standards: *OECD Scope Draft Model Rules*, above n 2879, 2-3; See also *Amount A Progress Report*, above n 2879, 23 [7.6].

²⁸⁸² ‘Revenues of a Group for a Period means the revenues reported in the Consolidated Financial Statements of the Group for the Period prepared in accordance with an Acceptable Financial Accounting Standard, subject to [certain] ... adjustments.’: *Amount A Progress Report*, above n 2879, 24 [7.14].

²⁸⁸³ ‘Period means a reporting period with respect to which the UPE of a Group prepares Consolidated Financial Statements’: *OECD Scope Draft Model Rules*, above n 2879, 16; *Amount A Progress Report*, above n 2879, 29 [7.47].

²⁸⁸⁴ *OECD Scope Draft Model Rules*, above n 2879, 3, 5, 8-10; *Amount A Progress Report*, above n 2879, 10.

²⁸⁸⁵ *Ibid*.

²⁸⁸⁶ ‘Financial Accounting Profit (or Loss) means the profit or loss set out in the Consolidated Financial Statements of the UPE of the Covered Group taking into account all income and expenses of the Covered Group except for those items reported as Other Comprehensive Income.’: *Amount A Progress Report*, above n 2879, 23 [7.9].

²⁸⁸⁷ *OECD Scope Draft Model Rules*, above n 2879, 3, 5, 8-10; *Amount A Progress Report*, above n 2879, 10; *OECD Two Pillar Solution Statement*, above n 2862, 1, *Deloitte Two Pillar Paper*, above n 2862, 2; *KPMG BEPS 2.0 Flyer*, above n 2861, 2.

In about the year 2030, the potentiality exists for the threshold of the revenue test to be lowered to €10 billion.²⁸⁸⁸ Thus, in summary, where an MNE or group satisfies both the revenue and profitability tests, it will meet the requirements of an in-scope MNE or what is designated in the model rules as a ‘Covered Group’, and thereby fall within Pillar One’s Scope.²⁸⁸⁹

The *April 2022 draft Model Rules on Scope* incorporated, more broadly, two additional secondary tests within the profitability test’s main framework to better promote Pillar One’s neutrality and stability.²⁸⁹⁰ The underlying aim was to exclude a UPE with a volatile profitability by removing it from Pillar One’s scope.²⁸⁹¹ This outcome was intended to provide some alleviation from the framework’s administrative and compliance burden.²⁸⁹² These latter two tests provided, on a permanent rolling basis, that the profitability must exceed the 10% threshold in at least two of the four prior periods (*‘the prior period test’*) and on average across the four prior periods and the current period (*‘the average test’*).²⁸⁹³ However, the subsequent revision of Pillar One’s draft model rules in July 2022, may have somewhat diminished the ambit of these additional secondary tests; in this latest revision, they are reformulated to merely apply to cases where the group was not a Covered Group in the two consecutive periods immediately preceding the period.²⁸⁹⁴

A nexus test with two quantitative or derivation thresholds is a further key component of Pillar One’s framework.²⁸⁹⁵ Its function is to determine whether a source State/market

²⁸⁸⁸ *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

²⁸⁸⁹ *Amount A Progress Report*, above n 2879,10 [1.2].

²⁸⁹⁰ *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

²⁸⁹¹ *Ibid.*

²⁸⁹² *Ibid.*

²⁸⁹³ *Ibid.*

²⁸⁹⁴ *Amount A Progress Report*, above n 2879,10-11.

²⁸⁹⁵ *Ibid.* 8,10, 13; *OECD Two Pillar Solution Statement*, above n 2862, 1; See also *KPMG Pillar One Paper*, above n 2867, 1; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 5.

jurisdiction is eligible for an Amount A taxing right.²⁸⁹⁶ More specifically, it provides the minimum threshold for establishing a taxable nexus.²⁸⁹⁷ The first quantitative threshold links a UPE/Covered Group with a source State where it derives at least EUR 1 million in revenues from that source State.²⁸⁹⁸ A second quantitative or derivation threshold of EUR 250 000 is utilised for smaller source States with GDPs below EUR 40 billion.²⁸⁹⁹

The nexus test operates in conjunction with specific revenue sourcing rules.²⁹⁰⁰ These sourcing rules determine the identity of the jurisdiction where the derivation of the particular revenue of a Covered Group/in-scope MNE may be located.²⁹⁰¹ The revenue sourcing rules are based upon a reliable method that consists of reliable indicators and allocation keys as defined in the model rules.²⁹⁰² Revenues must be sourced according to a specific revenue category.²⁹⁰³ The appropriate category may be determined by considering the ordinary or predominant character of a transactions from which the revenue is derived.²⁹⁰⁴ The predominant character of a transaction is, in turn, essentially determined by the substance of a transaction, and in accordance with other prescribed guidelines.²⁹⁰⁵

In Pillar One's underlying revised architecture, the source State/market jurisdiction is, for revenue sourcing purposes, constructed as the end market jurisdiction where goods and

²⁸⁹⁶ Ibid.

²⁸⁹⁷ Ibid.

²⁸⁹⁸ *Amount A Progress Report*, above n 2879, 8, 13; *OECD Two Pillar Solution Statement*, above n 2862, 1; *KPMG Pillar One Paper*, above n 2867, 1.

²⁸⁹⁹ Ibid.

²⁹⁰⁰ Ibid.

²⁹⁰¹ Ibid.

²⁹⁰² *Amount A Progress Report*, above n 2879, 8, 13, 64, 75, 77. 'Indicator' means information (other than an Allocation Key) that identifies the source of Revenues.: at 64; Cf 'Enumerated Reliable Indicator', 'Another Reliable Indicator', and an 'Alternative Reliable Indicator'.

²⁹⁰³ Ibid 13, 64.

²⁹⁰⁴ Ibid.

²⁹⁰⁵ Ibid 64 [1.2].

services are used or consumed.²⁹⁰⁶ Nonetheless, the revenue category of transport services, as appearing in the July 2022 draft rules, clearly has the potential to apply to article 8 shipping income.²⁹⁰⁷

The transport services revenue category contains the following revenue sourcing rule for the multimodal carriage of goods:

- ii. half of the Revenues derived from providing Cargo Transport Services are treated as arising in the Jurisdiction of the Place of Origin of the Cargo Transport Service; and half in the Jurisdiction of the Place of Destination.²⁹⁰⁸

Further, Transport Services as a revenue category is divided by the detailed revenue sourcing rules for the Amount A taxing right into Air Transport Services and Non-Air Transport Services.²⁹⁰⁹ Thus, Pillar One adopts a somewhat different categorisation to the *MTC*, to the extent that international shipping and air transport income are treated under different categories.²⁹¹⁰

As with Air Transport Services, Non-Air Transport Services is again subdivided into Passenger Non-Air Transport Services and Cargo Non-Air Transport Services.²⁹¹¹ The subcategory of ‘Cargo Non-Air Transport Services’ is presently formulated in the following terms:

²⁹⁰⁶ *OECD Two Pillar Solution Statement*, above n 2862, 2; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 5; See also *Amount A Progress Report*, above n 2879, 8: where they are defined as ‘jurisdictions in which goods or services are supplied or consumers are located.’

²⁹⁰⁷ *Amount A Progress Report*, above n 2879, 14.

²⁹⁰⁸ *Ibid* 14, 80 [6.53]; Note also in relation to its item i: ‘Revenues derived from providing Passenger Transport Services are treated as arising in the Jurisdiction of the Place of Destination of the Passenger Transport Service.’: at 14; See also reference to ‘ship, train, bus, truck or other vessel.’: at 80 [6.53].

²⁹⁰⁹ *Ibid* 64, 70-1.

²⁹¹⁰ *OECD Model Tax Convention*, above n 703, M-30; *OECD Pillar 1 Blueprint*, above n 2861, 56 [158] – [159]; Reimer and Rust, above n 806, art 8, [1].

²⁹¹¹ *Amount A Progress Report*, above n 2879, 70-1; 79 – 80.

any service, other than Cargo Air Transport Services, for the carriage of cargo from one location to another and includes transactions that supplement²⁹¹² those services provided by the Covered Group and that would not be entered into by the Covered Group but for the services they supplement.²⁹¹³

Thus, as concepts, there is an overlap between Cargo Non-Air Transport Services and maritime transport activities as they both cover the carriage of goods.²⁹¹⁴ However, the major difference between these two concepts is that maritime transport activities as a concept is exclusively concerned with the sea transport mode.²⁹¹⁵ This conceptual overlap is made clear in the definition of Cargo Non-Air Transport Services by virtue of its expansive language in the form of ‘any [transport] service’.²⁹¹⁶ Further, the definition for the Place of Origin for Non-Air Transport Services and the related definition for the Place of Destination for Non-Air Transport Services, respectively, specifically include a reference to the place of loading and the place of unloading of cargo in relation to a ship.²⁹¹⁷ Therefore, it seems plain that the July 2022 version of the draft model rules include, in the revenue category of transport services, shipping income from maritime transport activities.

It should be noted that the definition for the term ‘Place of Destination for Non-Air Transport Services’ specifically excludes transit stops.²⁹¹⁸ Transit stops are defined as ‘an intermediate place where ... the cargo is unloaded to facilitate [its] onward transport ... by or on behalf of the Covered Group.’²⁹¹⁹ Therefore, the States where these intermediate stops occur may be

²⁹¹² See the definition for Revenues from Supplementary Transactions: at 77 [1.25]; ‘The Covered Group may source Revenues derived from Supplementary Transactions in accordance with the revenue sourcing rule that applies to the Revenues that they supplement’: at 64 [1.1].

²⁹¹³ *Ibid* 79 [6.39].

²⁹¹⁴ *Ibid*.

²⁹¹⁵ *Ibid*; See the reference to ‘ship, train, bus, truck or other vessel.’: at 80 [6.51], [6.53].

²⁹¹⁶ *Ibid*.

²⁹¹⁷ *Ibid* 80 [6.51], [6.53].

²⁹¹⁸ *Ibid*.

²⁹¹⁹ *Ibid* 81.

ignored in identifying the source States/market jurisdictions that may be associated with the derivation of shipping income.

A Cargo Non-Air Transport Allocation Key determines the relevant revenue of a market jurisdiction by means of a fixed formula that calculates the revenue percentage share for the particular market jurisdiction.²⁹²⁰ The revenue percentage share utilises as factors the weight or volume of cargo transported by a Covered Group/in-scope MNE for a period.²⁹²¹ This revenue percentage share is calculated for a jurisdiction by determining the sum of the volume or weight (as appropriate) of cargo transported in a Period by a Covered Group from a Place of Origin in a Jurisdiction and the volume or weight of cargo transported by them to a Place of Destination in that Jurisdiction, divided by the sum of the volume or weight of cargo transported by them globally.²⁹²² The allocation key establishes a coefficient that may be applied to the relevant revenues as defined.²⁹²³ In performing this prorating as prescribed, these revenues are associated with a relevant jurisdiction in proportion to the calculated percentage share.²⁹²⁴

This particular source enquiry may, nevertheless, be controlled to some degree by the actual facts and circumstances of the case – albeit that these reality-based factors are probably more relevant to revenue sourcing categories where factually-sensitive indicators are applied in place of mechanical allocation keys.²⁹²⁵ This distinction is potentially somewhat similar to

²⁹²⁰ Ibid 71, 79; Also, revenues from passenger non-air transport services are treated as being derived in the market jurisdiction of the place of destination using the Passenger Non-air Transport Allocation Key.: at 71.

²⁹²¹ Ibid 79.

²⁹²² Ibid.

²⁹²³ Ibid 24 [7.14]. 79.

²⁹²⁴ Ibid 79.

²⁹²⁵ *OECD Two Pillar Solution Statement*, above n 2862, 2; *Amount A Progress Report*, above n 2879, 13 [4.2], 14 [4.4], 64 [2.1]; *Master Tax Guide 2019*, above n 82, [21-060], [21-070], [22-020], [22-030]; ‘*Except where an Allocation Key is applicable, Revenues must be sourced in a manner that accounts for differences among Jurisdictions in the goods, content, property, products and services sold, licensed or otherwise alienated and provided by the Covered Group, their quantities and their prices.*’: at *Amount A Progress Report*, above n 2879,

the distinction between true source and deemed source income taxation enquiries, present in certain common law jurisdictions.²⁹²⁶ The *July 2022 draft model rules* makes the allocation key mandatory for transport services.²⁹²⁷

Thus, in summary, for a source State to be eligible for an amount A taxing right, it must demonstrate that a particular revenue category of a Covered Group/in-scope MNE is sufficiently associated with their jurisdiction by applying the relevant revenue sourcing rule and meeting the applicable quantitative threshold.²⁹²⁸

Pillar One's profit allocation rules allocates 25% of a Covered Group's profit in excess of 10% of the group's revenues to an *eligible* source State.²⁹²⁹ The allocation is made in proportion to the amount of revenues that a group generates in a particular jurisdiction.²⁹³⁰

In cases where a Covered Group's residual profits are already taxed by an eligible source State, a marketing and distribution profits safe harbor is expected to limit the residual profits that are subject to an Amount A tax liability.²⁹³¹

13 4[2] (emphasis added); But see 'Revenues must be sourced *using a Reliable Method based on the Covered Group's specific facts and circumstances*: at 14[4.4] (emphasis added); But see 'Revenues must be sourced using Reliable Indicators, or, *if the conditions in paragraph 6 are met, an Allocation Key*.': at 64 [2.1] (emphasis added).

²⁹²⁶ *Master Tax Guide 2019*, above n 82, [21-060], [21-070], [22-020], [22-030].

²⁹²⁷ *Amount A Progress Report*, above n 2879, 64 [2.1], 65 [2.6]: 'unless the Revenues are from Transport Services, in which case the prescribed Allocation Key must be used in all cases.'

²⁹²⁸ *OECD Two Pillar Solution Statement*, above n 2862, 2; *Deloitte Two Pillar Paper*, above n 2862, 2; *KPMG BEPS 2.0 Flyer*, above n 2861, 2.

²⁹²⁹ *Amount A Progress Report*, above n 2879, 8; *KPMG BEPS 2.0 Flyer*, above n 2861, 2.

²⁹³⁰ *Ibid.*

²⁹³¹ *Ibid.*; *KPMG Pillar One Paper*, above n 2867, 1.

The amount A taxing right increases the risk of double taxation to the extent that it operates as an overlay to the existing international taxation system.²⁹³² It is anticipated that relieving jurisdictions will be responsible for eliminating double taxation by providing an exemption or credit.²⁹³³ In the July 2022 model rules, the mechanism utilised for identifying relieving jurisdictions applies a quantitative formula that consider factors like payroll, depreciation, and elimination profit (the latter being similar to Pillar Two's GloBE income).²⁹³⁴ A waterfall approach is used to identify relieving jurisdictions.²⁹³⁵ An objective of the framework, as constructed in the above rules, is to impose the obligation to eliminate double taxation on jurisdictions where a Covered Group earns its residual profits.²⁹³⁶

Therefore, broadly, the Pillar-One taxing right may be viewed as a significant gain for source taxation internationally.²⁹³⁷ As alluded to earlier, without the Pillar-One taxing right, a source State is required to satisfy the permanent establishment exception under article 7 of the *MTC* to acquire a taxing right to a foreign entity's general business profits.²⁹³⁸ This permanent establishment exception implements a minimum physical-presence threshold internationally that should be satisfied to tax general business profits at source.²⁹³⁹ However as mentioned earlier, modern business models made possible by digitalisation and globalisation allow foreign entities to operate more freely in source States without triggering the traditional permanent establishment exception.²⁹⁴⁰ This occurrence has to some extent diluted the usual

²⁹³² *Amount A Progress Report*, above n 2879, 9, 18, 21[10.2]; *OECD Two Pillar Solution Statement*, above n 2862, 2; EY, *OECD releases Progress Report on Amount A of Pillar One of BEPS 2.0 project: A detailed overview* (15 July 2022) < https://www.ey.com/en_gl/tax-alerts/oecd-releases-progress-report-on-amount-a-of-pillar-one-of-beps-2-0-project-a-detailed-overview>; *Deloitte Two Pillar Paper*, above n 2862, 2.

²⁹³³ *Ibid.*

²⁹³⁴ *Ibid.*

²⁹³⁵ *Ibid.*

²⁹³⁶ *Ibid.*

²⁹³⁷ *KPMG BEPS 2.0 Flyer*, above n 2861, 2.

²⁹³⁸ *Ibid.*; *OECD Pillar 1 Blueprint*, above n 2861, 11, 19 [22]; *OECD Model Tax Convention*, above n 703, C(7)-1.

²⁹³⁹ *Ibid.*

²⁹⁴⁰ *OECD Pillar 1 Blueprint*, above n 2861, 10, 19 [22].

international taxing powers of source States. Pillar One now seeks to remedy this predicament with the provision of the new Amount A taxing right.²⁹⁴¹

6.1.3 Pondering the Ramifications of a Broader Pillar One Inclusion

Specifically excluded from Pillar One's amount A is income derived from business activities in the nature of qualifying extractive and regulated financial services.²⁹⁴² Further, despite a proposal in Pillar One's blueprint recommending a similar exclusion for article 8 shipping income, this latter exclusion has failed to be included in Pillar One's subsequent revisions as at July 2022.²⁹⁴³ Consequently, maritime transport activities that generate article 8 shipping income appear to be included within the general scope of Pillar One's new taxing right at source.²⁹⁴⁴ This tax treatment is starkly different from the *MTC*'s article 8 tax treatment that does not make provision for source taxation in relation to eligible (or article 8) shipping income.²⁹⁴⁵ Source taxation is excluded by the *MTC*'s article 8 by virtue of its omission of the permanent establishment exception.²⁹⁴⁶ Thus, a resident State has an exclusive right to tax article 8 shipping income.²⁹⁴⁷

However, as provided by the *MTC*'s article 3, read with the *MTC*'s article 8, (explored further under heading 5.1.2.2 above) source States have limited taxing rights to non-article 8 or

²⁹⁴¹ *Amount A Progress Report*, above n 2879, 5.

²⁹⁴² *Ibid* 10; *OECD Scope Draft Model Rules*, above n 2879, 2-3: 'Finally, consistent with the Statement, two targeted exclusions are provided under the draft Model Rules: for Extractives and Regulated Financial Services.' (emphasis added); *OECD Two Pillar Solution Statement*, above n 2862, 1 [Scope]; *Deloitte Two Pillar Paper*, above n 2862, 2; See also *KPMG Pillar One Paper*, above n 2867, 1; See also *KPMG BEPS 2.0 Flyer*, above n 2861, 5-6.

²⁹⁴³ *Ibid*; *OECD Pillar 1 Blueprint*, above n 2861, 22 [35], 47 [105].

²⁹⁴⁴ *Ibid*.

²⁹⁴⁵ *OECD Model Tax Convention*, above n 703, M-27, M-30; *OECD Pillar 1 Blueprint*, above n 2861, 56 [158] – [159]; Reimer and Rust, above n 806, art 8, [1], [12] – [13]; *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, See also the discussion above under heading 5.1.2.2.

²⁹⁴⁶ *Ibid*.

²⁹⁴⁷ *Ibid*.

excluded shipping income.²⁹⁴⁸ This limited source taxing right is created by the joint operation of these articles that provides for the exclusion of certain shipping income from article 8's application.²⁹⁴⁹ Consequently, this excluded shipping income falls within the scope of article 7(1) of the *MTC* - like any other general business income.²⁹⁵⁰ In turn, due to the application of the article 7(1) tax treatment, this excluded shipping income has the potential to attract the application of the permanent establishment exception, as formulated under the *MTC*'s article 5.²⁹⁵¹ In cases where the permanent establishment exception applies, the particular source State is given a limited taxing right to the excluded shipping income.²⁹⁵²

Accordingly, it is not surprising that maritime transport activities, *as a whole*, that produce shipping income are not absolutely excluded from the new 'Amount A taxing right', as implemented by Pillar One.²⁹⁵³ These shipping activities are also not absolutely excluded from source taxation under the main international tax framework, as modelled by the *MTC*.²⁹⁵⁴ Therefore, to ensure a measure of consistency between overlaying and overlapping international taxing frameworks, it seems reasonable that an absolute exclusion for shipping income is also not present in the mechanics of Pillar One's 'Amount A taxing right'.²⁹⁵⁵ Pillar One, as currently revised, albeit still in draft form, may nonetheless, introduce a significant change to the international tax framework for shipping income.²⁹⁵⁶ This change may be realised to the extent that shipping income, that would usually escape source taxation under the *MTC*'s framework, may now be exposed to it.²⁹⁵⁷

²⁹⁴⁸ Ibid.

²⁹⁴⁹ Ibid.

²⁹⁵⁰ Ibid.

²⁹⁵¹ Ibid.

²⁹⁵² Ibid.

²⁹⁵³ Ibid.

²⁹⁵⁴ Ibid.

²⁹⁵⁵ Ibid.

²⁹⁵⁶ Ibid.

²⁹⁵⁷ Ibid.

As mentioned above, Pillar One aims to resolve deficiencies in the international tax system stemming from the application of new business models supported by digitalisation and globalisation that allow these business models to evade the permanent establishment exception.²⁹⁵⁸ However, despite the general economy as a whole purportedly digitalising to some degree, it is arguable that the key characteristics of a maritime transport activity, as they appear in the 21st century, have essentially remained unchanged.²⁹⁵⁹ Thus, despite technological advances, a tangible sea-going vessel, like before, essentially still loads goods at one port in one State, and then carries these goods on a voyage over the high seas for delivery at one or more other ports in one or more other States.²⁹⁶⁰ What's more, even the OECD continues to acknowledge that the essential nature of a maritime transport activity that produces article 8 shipping income has at its core remained unaffected by these technological and digital advances.²⁹⁶¹

Therefore, a revision of the international taxing rights of the corresponding shipping income does not seem to be warranted on the grounds of major advances in digitalisation and globalisation of business models in the 21st century.²⁹⁶² It is, thus, questionable whether the Pillar One project, which is essentially addressing deficiencies in these models is the appropriate forum for reconsidering the international tax treatment of article 8 shipping

²⁹⁵⁸ *OECD Pillar 1 Blueprint*, above n 2861, 11 [6], 19 [22] – [23]; See also *OECD Two Pillar Solution Statement*, above n 2862, 1 [Introduction].

²⁹⁵⁹ *WSC et al Submission Paper to the OECD*, above n 2545, 2-3; *OECD Pillar 1 Blueprint*, above n 2861, 56 [157], [160].

²⁹⁶⁰ *WSC et al Submission Paper to the OECD*, above n 2545, 2.

²⁹⁶¹ OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint, Inclusive Framework on BEPS' (OECD, 2020) 40 [110] ('*OECD Pillar 2 Blueprint*') < <https://doi.org/10.1787/abb4c3d1-en> >; *OECD Pillar 1 Blueprint*, above n 2861, 56 [160]; *2018 OECD Progress Report*, above n 32, 30; *2017 OECD Progress Report*, above n 699, 21; *OECD Consolidated Application Note*, above n 2, 80.

²⁹⁶² *Ibid.*

income. It should be remembered that article 8 shipping income is not subject to any permanent establishment exception.²⁹⁶³

Furthermore, unlike the general business income derived from other business models, article 8 shipping income is produced from maritime transport activities that have been, and continues to be, effectively ring-fenced from the rest of an economy.²⁹⁶⁴ This has not only been achieved by the *MTC* framework, but also by the different specialised domestic shipping tax regimes.²⁹⁶⁵ It has been submitted on behalf of the shipping industry that where ancillary business activities form an integrated part of undertaking a maritime transport activity that they are almost always separable.²⁹⁶⁶ What's more, ancillary business activities carried on by a shipping company are generally transport-related business activities that usually produce a revenue for the shipping company that is proportionately smaller than its shipping income.²⁹⁶⁷

As explored in more detail in chapter three, the unique mobility of maritime transport activities that generate article 8 shipping income stems, to a significant degree, from their physical performance on the high seas that occurs outside the jurisdiction of any one State.²⁹⁶⁸ Accordingly, this unique attribute is one of the cogent grounds that supports its special taxing rights internationally as well as its special domestic tax regimes.²⁹⁶⁹ Due to this special mobility, it has been considered ill-conceived to adopt a fragmented approach to the

²⁹⁶³ *OECD Pillar 1 Blueprint*, above n 2861, 56 [160]; *WSC et al Submission Paper to the OECD*, above n 2545, 3.

²⁹⁶⁴ *OECD Pillar 1 Blueprint*, above n 2861, 56 [160]; *WSC et al Submission Paper to the OECD*, above n 2545, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 2.

²⁹⁶⁵ *Ibid.*

²⁹⁶⁶ *Ibid.*

²⁹⁶⁷ *Ibid.*

²⁹⁶⁸ *OECD Pillar 1 Blueprint*, above n 2861, 56 [160]; *2017 OECD Progress Report*, above n 699, 21; *2018 OECD Progress Report*, above n 32, 30; *WSC et al Submission Paper to the OECD*, above n 2545, 2-3; *Furness Withy EC* 1966 CarswellNat 297 [20] – [21].

²⁹⁶⁹ *Ibid.*

international tax treatment of article 8 shipping income.²⁹⁷⁰ Accordingly the resident State's exclusive right to tax article 8 shipping income has been sustained by a long-standing international consensus based on simplicity and certainty.²⁹⁷¹

Furthermore, the Pillar One framework is to some significant degree required to promote simplicity and certainty.²⁹⁷² Therefore, it seems somewhat counter intuitive to unnecessarily introduce unique complexities into its application by expanding its scope to include article 8 shipping income.

As noted earlier under heading 5.1.4, once a ship offloads its cargo at a port in a foreign State, it may never visit that particular State's port again. Therefore, it is debateable whether the above ship's participation in that foreign State's economy warrants that State enjoying a taxing right over that ship's article 8 shipping income on the basis of source. However, these types of cases may merely be of academic interest, to the extent that these source States are unable to satisfy the nexus test's relevant quantitative thresholds – (assuming, also, that the particular MNE is in-scope).²⁹⁷³ However, the risk of source taxation is not completely hypothetical; the detailed revenue-sourcing rules presently extend the concept of a source State to cover the locations where the cargo of a ship is loaded and unloaded.²⁹⁷⁴

Further, unlike once-off tramp services, more regular liner-shipping services that visit a port on a fixed rotational basis may have a greater likelihood of satisfying Pillar One's revenue derivation thresholds.²⁹⁷⁵ Nonetheless, the question that may be posed, is whether the

²⁹⁷⁰ Ibid.

²⁹⁷¹ Ibid.

²⁹⁷² *OECD Scope Draft Model Rules*, above n 2879, 3; *OECD Two Pillar Solution Statement*, above n 2862, 1-2.

²⁹⁷³ *Amount A Progress Report*, above n 2879, 10 [1.2]; 13 [3.1] [3.2].

²⁹⁷⁴ Ibid 13-4, 80 [6.51] [6.53].

²⁹⁷⁵ See generally above n 721 and accompanying commentary in relation to the main sectors in shipping.

increased regularity of a sea carriage service, without more, translates into the shipowner now participating at a sufficient level in the economy of a foreign State? The sufficiency of the participation in the domestic economy of a State is important as it may warrant that State having a taxing right over the corresponding shipping income on the basis of source. The auxiliary activities of loading and unloading goods are only temporarily supported by the infrastructure of a foreign State.²⁹⁷⁶ Further, the loading and unloading activities are contractual obligations that do not necessarily always lie exclusively with the shipowner as the carrier of the goods by sea.²⁹⁷⁷ The other party to the contract of sea carriage may be responsible in whole or in part for these loading and unloading operations.²⁹⁷⁸ Accordingly, it seems questionable whether the loading and unloading operations can, by themselves, constitute core activities that can justifiably confer a taxing right on a source State over a foreign entity's article 8 shipping income. These activities are not always performed by the shipowner as carrier.²⁹⁷⁹ Therefore, it seems doubtful whether these loading and unloading activities are inherently and primarily connected to producing article 8 shipping income, as they are not essential and fixed obligations of a shipowner in undertaking a maritime transport activity as the carrier.

It is the navigation function of the maritime transport activity that sticks to the shipowner as carrier, irrespective of whether a voyage charter, an affreightment contract or even a time charter is concluded.²⁹⁸⁰ It is this critical obligation of the business operation that is also performed substantially outside the jurisdiction of a foreign State, where the loading and

²⁹⁷⁶ See generally Cooke et al, above n 74, 376 [15.1] – 444 [15A.173].

²⁹⁷⁷ Time and voyage charterers may be responsible for loading and unloading activities: See generally Coghlin, above n 720, 11 [I.48] – [I.49]. See also Cooke et al, above n 74, 355 [14.1], 357 [14.8], 359 [14.16], 364-5 [14.36] – [14.37].

²⁹⁷⁸ Ibid.

²⁹⁷⁹ Ibid.

²⁹⁸⁰ *EU Ship Management Communication* OJ C 132, 7 [3] – [4]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 154, 156, 159 (House of Lords); Boyd et al, above n 719, 55; See also Todd, above n 720, 149 [10.1], 207-8 [13.3]; See also Eder et al, above n 720, 3 [1.007] - [1.008], 445; Coghlin, above n 720, [I.7], 646 [35.8].

unloading operations may occur.²⁹⁸¹ Therefore, it seems problematic that a foreign State should have a taxing right over a foreign vessel's article 8 shipping income, merely as a result of it visiting that foreign State's port, and loading and unloading its goods there, without more.

Unlike the employment function that may shift from the shipowner to the time charterer, it is the navigation function of a maritime transport activity that sticks more tightly with the shipowner as the carrier, irrespective of whether a time or voyage charter is concluded; thus, it is this latter function that is more likely to suffer from the unique mobility that is associated with shipping activities.²⁹⁸² It is notable that this latter function is also recognised by the EU as a classic shipowner obligation.²⁹⁸³ Thus, it is submitted that it is this attribute of the maritime adventure that should in reality primarily demarcate the relevant tax base.

It should be recalled that the thesis has advanced the argument here above for a reconstruction of article 8 shipping-income.²⁹⁸⁴ It has been submitted that it should primarily be focused on the navigation function of a maritime transport activity. The advantage of such a reorientation is that it may better support a more optimal ringfencing of the relevant business activities that are firstly, highly mobile, and that secondly, are more closely connected to producing article 8 shipping income.²⁹⁸⁵ In turn, this result may also provide stronger support for the general exclusion of maritime transport activities from the

²⁹⁸¹ *WSC et al Submission Paper to the OECD*, above n 2545, 2; *OECD Pillar 1 Blueprint*, above n 2861, 56 [157]; *2018 OECD Progress Report*, above n 32, 30.

²⁹⁸² *Ibid*; *EU Ship Management Communication OJ C 132*, 7 [3] – [4]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 154, 156, 159 (House of Lords).

²⁹⁸³ *EU Ship Management Communication OJ C 132*, 7 [3] – [4].

²⁹⁸⁴ See heading 3.5.6.1.

²⁹⁸⁵ See generally *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 2; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 154, 156, 159 (House of Lords).

application of Pillar One, by better emphasising the insignificance of mere loading and unloading activities.

The imposition of source taxation on article 8 shipping income may create other complexities, including the potential for administration and compliance costs to spiral upwards unjustifiably.²⁹⁸⁶ An example might be where a single voyage covers multiple stops at different ports that belong to different foreign States. In assessing the tax compliance obligations of an in-scope shipping company, the question that may be asked, is whether this company must now potentially concern itself with all the different foreign States, which are visited by its vessels during their seagoing voyages?²⁹⁸⁷ It would seem overly burdensome to expose a shipping company under these circumstances to the compliance concerns of the Amount A taxing right, particularly as they may be quite intricate.²⁹⁸⁸ Any significant increase in complexity associated with applying the amount A taxing right to article 8 shipping income would also stand in sharp contrast to the simpler and more intuitive approach enjoyed under the *MTC*'s article 8; the latter's tax treatment is simply directed at one State ultimately.²⁹⁸⁹

Additionally, Pillar One's administration and compliance might have to establish special methods to manage the interconnectivity that is present in the shipping industry.²⁹⁹⁰ This

²⁹⁸⁶ *WSC et al Submission Paper to the OECD*, above n 2545, 2-4; *OECD Pillar 1 Blueprint*, above n 2861, 56 [157] – [158].

²⁹⁸⁷ *Ibid.*

²⁹⁸⁸ *Ibid*; See generally ICS and WSC, above n 5, 3-5.

²⁹⁸⁹ *WSC et al Submission Paper to the OECD*, above n 2545, 2-4; *OECD Pillar 1 Blueprint*, above n 2861, 56 [157] – [158].

²⁹⁹⁰ *Amount A Progress Report*, above n 2879, 22 [6]; See generally ICS and WSC, above n 5, 3-6; See generally Breskin, above n 6, 187-190; Branch and Robarts, above n 6, 290 [14.5]; See also *OECD Model Tax Convention*, above n 703, C(8)-2 [6]- C(8)-3 [7]; See also heading 3.5.1.

interconnectivity may take multiple forms, including vessel sharing arrangements by different entities that legitimately supports a shipping enterprise's viability.²⁹⁹¹

Further, an incongruence may arise between the different overlaying international tax frameworks. This may occur to the extent that a domestic shipping tax regime, at residence, taxes notional profits, as enabled or supported by the *MTC*'s article 8, whilst Pillar One's amount A taxing right, taxes the actual accounting profits.²⁹⁹²

Consequently, these, and other peculiarities, may support the exclusion of maritime transport activities from the scope of the Amount A taxing right to better safeguard the latter's simplicity and certainty.²⁹⁹³ Further, maritime transport activities that produce article 8 shipping income may be excluded from Pillar One's scope either directly or indirectly.²⁹⁹⁴ Putting aside any direct exclusion, an indirect exclusion might be achieved by making the mere loading and unloading of cargo at a port of an eligible source State insufficient to constitute a revenue-sourcing-activity without more.

6.1.4 Does the Sector's Attributes make Pillar One a Non-Issue?

However, more broadly, these Pillar One concerns may merely be of academic interest to the extent that shipping entities, engaged with undertaking maritime transport activities, derive a relevant accounting income and profit that does not satisfy the necessary thresholds of an in-scope entity or Covered Group.²⁹⁹⁵ In considering the business structure of a shipping

²⁹⁹¹ Ibid.

²⁹⁹² See generally *OECD Consolidated Application Note*, above n 2, [327], [334]; See also *Amount A Progress Report*, above n 2879, 10 [1.2]; 13 [2.1], 15 [5.1], 23 [7.13] – 24 [7.14].

²⁹⁹³ *OECD Two Pillar Solution Statement*, above n 2862, 1-2.

²⁹⁹⁴ *OECD Pillar 1 Blueprint*, above n 2861, 22 [35]; *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

²⁹⁹⁵ *Amount A Progress Report*, above n 2879, 10 [1.2]; 23 [7.13] – 24 [7.14].

enterprise, it is the group's revenue as a whole that must, generally, be considered for Pillar One, as the amount A taxing right operates usually, but not always, at the group level.²⁹⁹⁶ It appears that, in selecting a business structure, it is not exceptional for shipping enterprises to operate as stand-alone entities.²⁹⁹⁷ However, the option to operate as a member of a conglomerate is a preference that appears to be selected by certain shipping enterprises.²⁹⁹⁸

Further, it has been asserted that the corporate members forming part of these company groups are usually, but not always, involved with transportation-related enterprises.²⁹⁹⁹ The shipping industry has submitted that it is common, but not carved in stone, that the presence of vessels may be established in several jurisdictions, both in the jurisdiction of a parent company and in one or more jurisdictions of its subsidiaries.³⁰⁰⁰ It has also been submitted that in many cases one group member (which is, generally, the parent company) will concentrate its activities on third party customers.³⁰⁰¹ In the enterprise of the carriage of cargo by sea, these customers are said to be almost always unrelated businesses.³⁰⁰² Nonetheless, other business models are also referenced where more than one corporate group member deals with these customers.³⁰⁰³ The sale of shipping services (or what may be described as commercial management activities) may be achieved by using a combination approach that

²⁹⁹⁶ Ibid 8, 10 [1.2]: 'In exceptional cases, a Disclosed Segment may be in scope of Amount A, on a standalone basis, while the Group as a whole is not.': at 8; See generally *OECD Scope Draft Model Rules*, above n 2879, 2-3, 5, 8-10: 'The scope rules are designed to ensure Amount A only applies to large and highly profitable Groups.' 'The concept of a Group is specifically prescribed for Amount A purposes and, broadly, is defined by reference to an Ultimate Parent Entity (UPE) that is set at a level where Consolidated Financial Statements are commonly prepared under financial accounting standards. ... A Group will be in scope of Amount A where it meets two threshold tests.': at 2-3.

²⁹⁹⁷ See generally *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 2, 9, 16; See also above n 726.

²⁹⁹⁸ Ibid.

²⁹⁹⁹ Ibid 2.

³⁰⁰⁰ Ibid 3.

³⁰⁰¹ Ibid.

³⁰⁰² Ibid.

³⁰⁰³ Ibid.

utilises multiple actors.³⁰⁰⁴ These actors may take the form of branch employees, dependent agents located in wholly owned subsidiaries (generally), and unrelated dependent agents.³⁰⁰⁵ It is further submitted by the industry that booking platforms (owned by the shipping company or by a third party) are steadily becoming more common in selling sea transport services.³⁰⁰⁶

In many case, one of the functions of a subsidiary in a corporate group structure may involve chartering vessels that it owns to a parent entity or another corporate group member that deals with these customers.³⁰⁰⁷ Further, the shipping industry holds the general view that a key factor that influences the business structure in the sector is a shipping tax regime as it may require vessels to be flagged in a certain jurisdiction.³⁰⁰⁸ A diagrammatic representation is offered here below, based on a presentation by the shipping industry, depicting how corporate functions in shipping might be divided between group members in a basic business model.³⁰⁰⁹

³⁰⁰⁴ Ibid 4.

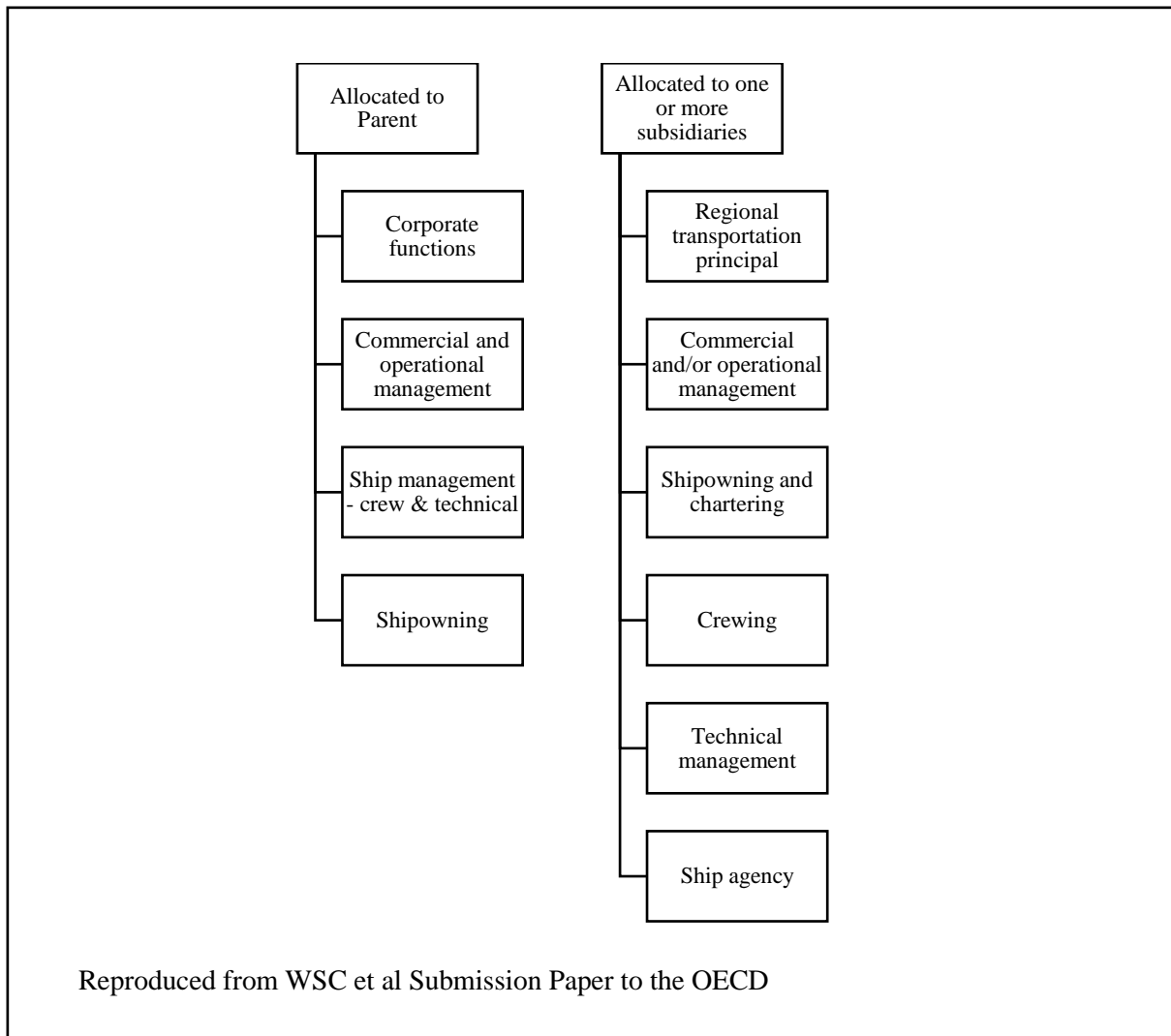
³⁰⁰⁵ Ibid.

³⁰⁰⁶ Ibid.

³⁰⁰⁷ Ibid 3.

³⁰⁰⁸ Ibid 3.

³⁰⁰⁹ Ibid 9.



Apart from issues relating to the general business structure of a shipping enterprise, the shipping industry has also made the following submissions to the OECD about the industry's level of profitability:

Shipping is a very capital-intensive industry, with billions of dollars invested annually in vessels and other maritime equipment. Shipping companies have huge operating expenses annually, including depreciation, labour (such as ship crew, headquarters employees, agencies, crewing agents, and ship management), ship charter expenses, fuel, leasing shipping containers and other cargo handling and transport equipment, terminal and stevedoring expenses, other port expenses, maintenance and drydocking, etc., plus interest expense. International shipping generally is a very low margin and cyclical business. While occasionally there are very profitable years, over 10-year periods almost all shipping sectors have operating losses in a majority of quarters and overall margins in the negative to slightly positive range. A four percent (4%) operating margin in a year

is a very good year. Shipping companies have minimal intangible property; virtually all of their economic return is derived from tangible property and labour employed on the high seas.³⁰¹⁰

The above submission alleging a four percent operating margin as a high threshold for profitability in the sector may be a good indicator that shipping enterprises may fail to satisfy the ten percent profitability test.³⁰¹¹ This conclusion might also be supported by the following submissions: Firstly, the assertion that shipping enterprises and their related business structures are for the most part focused on delivering sea transport activities.³⁰¹² Secondly, the assertion that shipping income is the main income-source of these enterprises.³⁰¹³

Therefore, in cases where these submissions are found to be true, it might be speculated that these enterprises will fail to satisfy the tests for an in-scope entity, and thereby fall outside the scope of Pillar One.³⁰¹⁴ A potential consequence of the failure to provide a direct exclusion to the shipping sector in these circumstances is the promotion of purer business structures in shipping. Purer business structures meaning enterprises and corporate group structures that remain primarily focused on delivering maritime transport activities and that avoid undertaking other non-related business activities that may generate sufficient profits for an enterprise or group such that it is brought into Pillar One's scope.³⁰¹⁵

In cases where shipping enterprises satisfy both the revenue test and the ten percent profitability test as exceptional outcomes, the prior period test and average test may support the continued exclusion of shipping enterprises as in-scope entities.³⁰¹⁶ This outcome is achieved by incorporating these latter tests as subordinate tests within the profitability test's

³⁰¹⁰ *WSC et al Submission Paper to the OECD*, above n 2545, 2.

³⁰¹¹ *Ibid*; *Amount A Progress Report*, above n 2879, 10 [1.2].

³⁰¹² *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 2.

³⁰¹³ *Ibid*.

³⁰¹⁴ *Amount A Progress Report*, above n 2879, 10 [1.2].

³⁰¹⁵ *Ibid*; *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 2.

³⁰¹⁶ *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

main framework and calibrating them to be sufficiently sensitive to the profit volatility of shipping income.³⁰¹⁷ As appearing in a previous draft, these latter subordinate tests with their broader application may prove more optimal in supporting an exclusion for shipping, but with the potential addition of reconstructing the underlying enquiry over a longer time frame, such as ten or so years, to potentially better recognise the longer business cycle that is said to exist in the sector.³⁰¹⁸ Their utility may be particularly significant where they are set to operate on a permanent rolling basis.³⁰¹⁹ Such an exclusion might support the alleviation of any unnecessary administrative and compliance burden more optimally.³⁰²⁰ As revised in a later draft, the prior period and average tests now appear to have a reduced application.³⁰²¹ Nonetheless, they may still be useful in supporting any such exclusion in this narrower form where they apply on a rolling basis in cases where shipping enterprises fail to qualify as in-scope entities for the previous two consecutive periods.³⁰²² Further, the carrying forward of losses from previous periods may also support the exclusion of these enterprises from the application of the Pillar One framework where an appropriate formula is applied for recognising losses.³⁰²³ The ability to realistically recognise losses in applying the revenue and profitability tests and calculating the tax base (where necessary) is particularly meaningful to the shipping industry based on the nature of their business cycle, the capital-intensive nature of their activities, and their high operating costs.³⁰²⁴

³⁰¹⁷ Ibid; *WSC et al Submission Paper to the OECD*, above n 2545, 2.

³⁰¹⁸ Ibid.

³⁰¹⁹ See generally *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

³⁰²⁰ See generally *WSC et al Submission Paper to the OECD*, above n 2545, 3-4; *OECD Pillar 1 Blueprint*, above n 2861, 56 [158].

³⁰²¹ *Amount A Progress Report*, above n 2879, 10 - 11 [1.2].

³⁰²² Ibid; See generally *OECD Scope Draft Model Rules*, above n 2879, 3, 5.

³⁰²³ See generally *Amount A Progress Report*, above n 2879, 13 [2.1], 15 [5.1], 16 [5.3], 23 [7.13], 24 [7.14].

³⁰²⁴ Ibid 10 - 11 [1.2], 13 [2.1], 15 [5.1], 16 [5.3], 23 [7.13], 24 [7.14]; *WSC et al Submission Paper to the OECD*, above n 2545, 5.

6.1.5 Pillar One's Direct Significance for a Model Regime

A key recommendation of the thesis is that a model shipping tax regime should vigorously promote efficiency and simplicity (as benchmarked by the thesis) to primarily promote the sea power of a State.³⁰²⁵ The thesis has also observed that a shipping tax regime does not ordinarily manage the taxing rights of States, and should not do so, to avoid duplication and unnecessary complexity in the design of a shipping tax regime. Accordingly, whether or not the Amount A taxing right applies to article 8 shipping income does not directly affect the current recommendations of the thesis generally, in promoting a particular design for a model shipping tax regime.

The Amount A taxing right is merely part of an overlaying framework.³⁰²⁶ It merely complements the existing international tax framework which is underpinned to some significant extent by the *MTC*'s article 8.³⁰²⁷ It is the *MTC*'s article 8 that is critical for supporting the design of a model shipping tax regime.³⁰²⁸ It awards the residence State exclusive control over article 8 shipping profits.³⁰²⁹ Pillar One is largely concerned with advancing the horizontal equity of certain source States by allocating 25% of an in-scope entity's residual profits.³⁰³⁰

Further it must be borne in mind that there may still be some uncertainty as to the extent to which Pillar One may apply in practice to sea transport activities. Irrespective of the presence of any direct exclusion, one or more meaningful indirect exclusions may be available as

³⁰²⁵ See generally *WSC et al Submission Paper to the OECD*, above n 2545, 4.

³⁰²⁶ *Amount A Progress Report*, above n 2879, 8.

³⁰²⁷ *Ibid*; *OECD Pillar 1 Blueprint*, above n 2861, 56 [158].

³⁰²⁸ *OECD Pillar 1 Blueprint*, above n 2861, 56 [158].

³⁰²⁹ *Ibid*.

³⁰³⁰ *Amount A Progress Report*, above n 2879, 8; *OECD Two Pillar Solution Statement*, above n 2862, 2.

considered briefly above that the shipping sector may utilise to avoid triggering the Pillar One framework.³⁰³¹

Thus, as a model shipping tax regime can still significantly enjoy the advantages of the *MTC*'s article 8 (and its equivalents), this outcome supports the continued validity of the recommendations as submitted by the thesis.³⁰³² Accordingly, there is still validity in submitting that States, and more particularly resident States, should prioritise efficiency and simplicity in the design of a model shipping tax regime to better promote their sea power. The thesis has advanced the argument above that sea power continues to constitute a crucial objective of States in the 21st century.³⁰³³

War and global conflict continue to be a significant risk for States in the 21st century as competition between States persist.³⁰³⁴ As a registered merchant vessel can constitute an important component of a State's sea power, the encouragement of their viability and expansion should be promoted by States.³⁰³⁵ Therefore, States should ensure that these vessels are adequately protected from significant political and market interference. It has

³⁰³¹ See generally *OECD Pillar 1 Blueprint*, above n 2861, 47 [105], 56 [156]; *Amount A Progress Report*, above n 2879, 8, 10 - 11 [1.2].

³⁰³² *Amount A Progress Report*, above n 2879, 8-9; *OECD Pillar 1 Blueprint*, above n 2861, 56 [158].

³⁰³³ See generally *WSC et al Submission Paper to the OECD*, above n 2545, 4.

³⁰³⁴ See generally Samantha Lock, Martin Belam and Nicola Slawson, 'Russia-Ukraine war latest: what we know on day 159 of the invasion' *The Guardian* (online) 2 Aug 2022 <<https://www.theguardian.com/world/2022/aug/01/russia-ukraine-war-latest-what-we-know-on-day-159-of-the-invasion>>; Shannon Tiezzi 'China Suspends Military Dialogues, Climate Change Talks With US: China's new diplomatic "countermeasures" to Pelosi's visit to Taiwan strike at the Biden administration's priority areas for the relationship' *The Diplomat* (online) 5 August 2022 <<https://thediplomat.com/2022/08/china-suspends-military-dialogues-climate-change-talks-with-us/>>; Esme Kirk-Wade and Sanjana Balakrishnan, 'Defence spending pledges by NATO members since Russia invaded Ukraine' (Insight; House of Commons Library; 11 August 2022) <<https://commonslibrary.parliament.uk/defence-spending-pledges-by-nato-members-since-russia-invaded-ukraine/>>; Andreas Rinke and Sabine Siebold, 'Germany secured 50 million vaccine doses from CureVac, BioNTech on top of EU supplies' *Reuters* (online) 9 January 2021 <<https://www.reuters.com/article/us-health-coronavirus-vaccine-germany/germany-secured-50-million-vaccine-doses-from-curevac-biontech-on-top-of-eu-supplies-document-idUSKBN29D1WU>>.

³⁰³⁵ McMahan, above n 36, 97-9, 100-1, 105-6; Asteris, above n 35, 71; Thuong, above n 1542, 23; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 13-5; Marlow and Mitroussi, above n 70, 201.

been observed that a model shipping tax regime may constitute a key component of achieving these objectives.³⁰³⁶

Therefore, in summary, the current model shipping tax regime as recommended by the thesis remains valid and worth considering, despite any potential introduction of an overlaying Pillar One framework.³⁰³⁷

It may be hypothesised that if a sufficient level of reliable and stable State cooperation were possible, a more sophisticated and expansive (or global) freight tax-framework may constitute a better alternative. A framework underpinned by that model may more simply and efficiently implement taxing rights over shipping income more broadly - as briefly considered under heading 5.2.11 above.

Further, in cases where Pillar One enables the taxation of a portion of the actual residual shipping profits at source, whilst a residence State employs a shipping tax regime, as recommended here, which taxes notional profits, the residence State might provide further assistance to its registered fleet where necessary, to protect the outcomes of its domestic shipping tax regime.³⁰³⁸ Such assistance might include measures (whether bilateral or unilateral) such as the residence State crediting the Pillar One foreign tax against the normal income tax of an entity raised on its general business income. Alternatively, the answer might

³⁰³⁶ Panagiotou and Thanopoulou, above n 43, 6-7; *WSC et al Submission Paper to the OECD*, above n 2545, 2-3, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 3 -4.

³⁰³⁷ *Amount A Progress Report*, above n 2879, 8.

³⁰³⁸ *Ibid*; *WSC et al Submission Paper to the OECD*, above n 2545, 4, [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 22-3; See generally Madigan, above n 1112, 3, 5, 48; See generally McMahon, above n 36, 93; See generally Morse, above n 58, 63-4.

include the provision of an additional subsidy by the residence State to their shipping companies to neutralise any prejudicial effects of the Pillar One taxing right.³⁰³⁹

However, as already mentioned above, the taxing rights of States and related issues arising from Pillar One, including crediting foreign taxes, are not ordinarily directly relevant to the design of a model shipping tax regime. Accordingly, these issues will not be considered here any further as they are not directly relevant to the current research question.

6.1.6 Pillar Two's Components

The mechanics of Pillar Two consists of two primary underlying components.³⁰⁴⁰ Firstly, two interlocking domestic rules, namely the Income Inclusion Rule ('IIR') and the Undertaxed Payment Rule ('UTPR'); these rules as a whole constitute the Global Anti-Base Erosion ('GloBE') rules ('GR').³⁰⁴¹ Secondly, a treaty-based rule that goes by the name of the Subject to Tax Rule ('STTR'). The *STTR* allows source States to impose limited source taxation on certain related party payments, subject to tax below a minimum rate; to the extent the *STTR* targets income like interest and royalties, it bears no direct relevance for shipping income.³⁰⁴² The *STTR* is intended to be creditable as a 'covered tax' under the *GR*.³⁰⁴³ The *STTR* will not be considered here any further.

³⁰³⁹ See generally Madigan, above n 1112, 3, 5, 48; See generally McMahon, above n 36, 93; See generally Morse, above n 58, 63-4.

³⁰⁴⁰ *OECD Two Pillar Solution Statement*, above n 2862, 3.

³⁰⁴¹ *Ibid.*

³⁰⁴² *Ibid.*; OECD, *Global Anti-Base Erosion Model Rules (Pillar 2): Frequently Asked Questions* (6 December 2021) 1 ('*Pillar 2's FAQ's*') < <https://www.oecd.org/tax/beps/pillar-two-model-GloBE-rules-faqs.pdf>>: 'developing countries are expected to be able to further protect their tax base through the application of a treaty based Subject to Tax Rule (STTR) which will allow countries to retain their taxing right, which they may have otherwise ceded under a tax treaty, on certain payments made to related parties abroad which often pose BEPS risks, such as interest and royalties.': at 1.

³⁰⁴³ *OECD Two Pillar Solution Statement*, above n 2862, 3.

The *GR* is intended to have the status of ‘an agreement of a common approach’.³⁰⁴⁴ This status means that *IF* members are not required to adopt these rules, but if they choose to do so, they are required to implement and administer them by applying a consistent method that accords with specified outcomes.³⁰⁴⁵ These outcomes are specified under the Pillar Two framework, including the OECD’s Pillar Two model rules and commentary.³⁰⁴⁶ The following extract provides some further details on the essential nature of this consistent method, which is, at least in part, directed at utilising a uniform formula for establishing an effective tax rate:

..., jurisdictions that adopt the GloBE rules will apply an effective tax rate test using a common tax base and a common definition of covered taxes to determine whether an MNE is subject to an effective tax rate below the agreed minimum rate of 15% in any jurisdiction where it operates. Having a common, consistent effective tax rate test as the foundation of the global minimum tax rules ensures a level playing field and puts a floor under tax competition.³⁰⁴⁷

Secondly, this common approach status also means that in cases where the *GR* (including any relevant ordering and safe harbour provisions) is applied by an *IF* member State to an MNE of another *IF* member State, this application is to be accepted by the other State, irrespective of whether or not it adopts the *GR*.³⁰⁴⁸

Broadly, the *GR* is directed at establishing a 15% effective tax rate on a worldwide-basis as a minimum effective tax rate on eligible corporate income.³⁰⁴⁹ The objective here is to eliminate a race to the bottom between States in setting corporate tax rates for attracting

³⁰⁴⁴ *Ibid*; *Pillar 2’s FAQ’s*, above n 3042, 2.

³⁰⁴⁵ *Ibid*.

³⁰⁴⁶ *Ibid*; See also below n 3051.

³⁰⁴⁷ *Pillar 2’s FAQ’s*, above n 3042, 1.

³⁰⁴⁸ *OECD Two Pillar Solution Statement*, above n 2862, 3; *Pillar 2’s FAQ’s*, above n 3042, 2.

³⁰⁴⁹ *OECD Two Pillar Solution Statement*, above n 2862 4; *Pillar 2’s FAQ’s*, above n 3042, 3.

inbound investment.³⁰⁵⁰ The scope of the *GR* captures an *MNE Group* as defined that satisfies a EUR 750 million consolidated revenue threshold in at least two of the four prior fiscal years.³⁰⁵¹ This revenue threshold is said to be somewhat similar to the equivalent applied by *BEPS 13* for country-by-country reporting.³⁰⁵² However, States might have the ability to apply the *IIR* to *MNEs* headquartered in their jurisdiction even if they do not meet this threshold.³⁰⁵³

As the primary rule, the *IIR*, generally, imposes Top-Up Tax (*'TUT'*) on a parent entity based on the low-taxed income of a *Constituent Entity*.³⁰⁵⁴ In particular, the *IIR* is intended to be applied by the parent entity as identified through an ordering mechanism.³⁰⁵⁵ This ordering mechanism generally gives priority to entities closest to the top of the ownership chain (described by the OECD as the *'top-down'* approach).³⁰⁵⁶ The *IIR* imposes a *TUT* in cases where Constituent Entities enjoy an effective tax rate below the minimum rate.³⁰⁵⁷ Broadly, the *UTPR* operates as a secondary rule (or a so-called backstop, as described by the OECD) to deny a deduction (or requires an equivalent adjustment) to the extent that the low-tax income of a *Constituent Entity* is not taxed by the *IIR*.³⁰⁵⁸ To establish whether the *TUT* is applicable, through either the *IIR* or the *UTPR*, a complex calculation may be required for

³⁰⁵⁰ *Ibid.*

³⁰⁵¹ *OECD Two Pillar Solution Statement*, above n 2862 4; *Pillar 2's FAQ's*, above n 3042, 2; See also OECD, 'OECD/G20 Base Erosion and Profit Shifting Project - Tax Challenges Arising from the Digitalisation of the Economy - Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)' (OECD, 14 March 2022) 14, 16 (*'Pillar 2's Commentary'*) < <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf>>; See also OECD, 'OECD/G20 Base Erosion and Profit Shifting Project - Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS' (OECD, 20 December 2021) 8 (*'Pillar 2's Model Rules'*) < <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm> >.

³⁰⁵² *Ibid.*

³⁰⁵³ *OECD Two Pillar Solution Statement*, above n 2862, 4.

³⁰⁵⁴ *Pillar 2's Model Rules*, above n 3051, 11.

³⁰⁵⁵ *Pillar 2's Commentary*, above n 3051, 24.

³⁰⁵⁶ *Ibid.*

³⁰⁵⁷ *Ibid.*

³⁰⁵⁸ *Ibid.*

determining the Effective Tax Rate (*ETR*) of a jurisdiction.³⁰⁵⁹ The rules also provide for a Qualified Domestic Minimum *TUT* that enables States to impose a specific tax in their own jurisdiction to lift the *ETR* on specific profits to the minimum 15% rate, for ensuring that tax payments are not ceded to another State under either the *IIR* or the *UTPR*.³⁰⁶⁰

The OECD categorises the *TUT* under the *GR* as an ‘international alternative minimum tax’ in contrast to a typical direct income tax.³⁰⁶¹ The significance of this categorisation for the thesis, is that the research question is specifically considering shipping taxes that may be categorised as potential equivalents to or alternatives for normal income/corporate taxes. Therefore, international *TUTs* are not within the direct scope of the current research question.

Accordingly, only a brief and limited analysis will be undertaken by the thesis, and specifically in relation to the potential *broad* impact of the *GR* on a model shipping tax regime (as recommended here). The unique attributes of the *TUT* are generally highlighted in the following extract that distinguishes it from a normal income/corporate tax:

This *TUT* does not operate as a typical direct tax on income of an Entity. Rather it applies to the *Excess Profits calculated on a jurisdictional basis* and only applies to the extent those profits are subject to tax in a given year below the Minimum Rate. Rather than a typical direct tax on income, the tax imposed under the GloBE Rules is closer in design to an international alternative minimum tax, that uses standardised base and tax calculation mechanics to identify pools of low-taxed income within an MNE Group and imposes a co-ordinated tax charge that brings the Group’s *ETR* on that income *in each jurisdiction* up to the Minimum Rate.³⁰⁶²

³⁰⁵⁹ Ernst-Jan Bioch, *Pillar Two Observations from a shipping and offshore perspective* (Meijburg, 31 January 2022) [1] (‘Meijburg’).

³⁰⁶⁰ *Ibid* [1.2]; *Pillar 2’s Model Rules*, above n 3051, 23 [4.2.2], 64.

³⁰⁶¹ *Pillar 2’s Commentary*, above n 3051, 8.

³⁰⁶² *Ibid* (emphasis added).

Several key definitions should be considered in determining when an Entity or a collection of Entities may be treated as a Group, and when that Group may be recognised as an *MNE Group*, as defined.³⁰⁶³ It is an *MNE Group* that has the potential to enjoy the application of the *GR*.³⁰⁶⁴ An *MNE Group* is, generally, a group that has at least one entity or permanent establishment located in a State that is different to the State of the Ultimate Parent Entity.³⁰⁶⁵ A broad definition is utilised for defining an entity that may include arrangements such as trusts and partnerships.³⁰⁶⁶ In determining whether there is a *TUT* liability, the calculation examines the *Constituent Entities* of an *MNE Group*.³⁰⁶⁷ A *Constituent Entity* is, broadly, any group entity, including an *Ultimate Parent Entity*, as defined, and any of its subsidiary entities, and their permanent establishments.³⁰⁶⁸ Thus, permanent establishments may generally be treated as separate entities for applying the *GR*.³⁰⁶⁹

On 22 December 2021, the European Commission published a proposed EU Directive to incorporate the Pillar Two rules into EU law.³⁰⁷⁰ It said that these rules in this draft EU Directive generally mirror the OECD's *GR*, but they enjoy a broader scope.³⁰⁷¹ For example, unlike the OECD's construction of an *MNE Group*, this Directive does not limit the concept to cross-border structures but also covers domestic groups.³⁰⁷²

³⁰⁶³ *Pillar 2's Commentary*, above n 3051, 14.

³⁰⁶⁴ *Pillar 2's Commentary*, above n 3051, 24; *Pillar 2's Model Rules*, above n 3051, 8.

³⁰⁶⁵ *Pillar 2's Model Rules*, above n 3051, 8 [1.2.1].

³⁰⁶⁶ *Pillar 2's Commentary*, above n 3051, 24; *Pillar 2's Model Rules*, above n 3051, 8.

³⁰⁶⁷ *Pillar 2's Commentary*, above n 3051, 14, 18, 43; *Pillar 2's Model Rules*, above n 3051, 8.

³⁰⁶⁸ *Pillar 2's Model Rules*, above n 3051, 9, 11; *Pillar 2's Commentary*, above n 3051, 14, 17-8.

³⁰⁶⁹ *Pillar 2's Model Rules*, above n 3051, 9 [1.3.2]: 'A Permanent Establishment that is [treated as] a Constituent Entity ... shall be treated as separate from the Main Entity and any other Permanent Establishment of that Main Entity.'; See also the definition of 'main entity' at 60: 'Main Entity, in respect of a Permanent Establishment, is the Entity that includes the Financial Accounting Net Income or Loss of the Permanent Establishment in its financial statements.'

³⁰⁷⁰ Meijburg, above n 3059, [1.2].

³⁰⁷¹ *Ibid.*

³⁰⁷² *Ibid.*: It requires the Member State of a Constituent Entity applying the IIR, which is usually the jurisdiction of the UPE, to ensure effective taxation at the minimum agreed level, not only of foreign subsidiaries but also of all Constituent Entities resident in that Member State and permanent establishments of the MNE group established in that Member State; See also *Pillar 2's Commentary*, above n 3051, 14: 'These scope rules ensure that smaller Groups and purely domestic Groups remain unaffected by the GloBE Rules.'

The OECD submits that the success of the *GR*, in implementing a minimum corporate tax rate internationally, is not dependent upon a perfect adoption by States globally.³⁰⁷³ It is opined by the OECD that this outcome can still be achieved where these rules are adopted by a critical mass of States.³⁰⁷⁴ This submission is based on the interlocking configuration or feature of these rules.³⁰⁷⁵ This interlocking system is broadly described by the OECD in the following extract:

The GloBE rules incorporate an agreed rule order together with backstop or secondary rules that apply if a country where an MNE is based does not apply the primary rule. For instance, if the country where the MNE is headquartered does not subject the ultimate parent entity of the MNE group to the primary ... IIR, another parent entity in the group, further down in the ownership chain, must apply the IIR under the agreed rule order. If even this does not result in the income of the MNE Group being subject to tax at the 15% minimum tax rate, the further backstop of the UTPR kicks in, which ensures the payment of the minimum tax through a denial of deduction or similar mechanism in all the countries where the MNE has a presence. The interlocking nature of these rules therefore ensures that top-up tax will be collected in jurisdictions that have introduced the GloBE rules even where the MNE operates in or through other jurisdictions that have not implemented the rules.³⁰⁷⁶

A substance based carve-out is available under the *GR* that excludes a certain amount of income from the tax base.³⁰⁷⁷ This excluded income is calculated by reference to a fixed return on assets and payroll expenses in each State.³⁰⁷⁸ Further, modified deferred tax calculations are utilised by these rules for managing timing differences in recognising income and losses.³⁰⁷⁹

³⁰⁷³ *Pillar 2's FAQ's*, above n 3042, 1.

³⁰⁷⁴ *Ibid.*

³⁰⁷⁵ *Ibid.*

³⁰⁷⁶ *Ibid.*

³⁰⁷⁷ *Ibid* 3; Meijburg, above n 3059, [1].

³⁰⁷⁸ *Ibid.*

³⁰⁷⁹ *Pillar 2's FAQ's*, above n 3042, 3.

6.1.7 The Significance of the GloBE Rules ('GR') for Shipping

6.1.7.1 The Shipping Exclusion Step in the GloBE Income Calculation

The calculation of GloBE income or loss for each *Constituent Entity* is controlled by Chapter 3 of the GloBE model rules.³⁰⁸⁰ The calculation's starting point is the financial accounting net income or loss of a *Constituent Entity*.³⁰⁸¹ This income or loss line item must be calculated in accordance with the GloBE model rules' article 3.1.³⁰⁸² Article 3.2 of these model rules then adjusts this amount for differences between financial accounting income and taxable income.³⁰⁸³ Article 3.3 of the rules then makes an exclusion available for eligible shipping income.³⁰⁸⁴ This exclusion also covers eligible ancillary income.³⁰⁸⁵ The commentary submits that the shipping income exclusion is 'based on the scope' of the *MTC*'s Article 8.³⁰⁸⁶ However, this assertion is somewhat impugned by Meijburg to the extent that significant discrepancies may be established between the two international frameworks.³⁰⁸⁷ This exclusionary step neutralises both income and losses and requires a corresponding adjustment to any corresponding tax liability, as detailed in the following extract:

Like the adjustments in Article 3.2, the exclusion for International Shipping Income and Qualified Ancillary International Shipping Income is an adjustment to the Financial Accounting Net Income or Loss. The exclusions are computed on a net basis pursuant to Article 3.3.2 to Article 3.3.5. The adjustment will be a negative amount in the situation where the International Shipping Income or Qualified Ancillary International Shipping Income is positive. The adjustment will be a positive amount in the situation where the International Shipping Income or Qualified Ancillary International Shipping Income is negative. 148. To

³⁰⁸⁰ *Pillar 2's Commentary*, above n 3051, 9, 43.

³⁰⁸¹ *Ibid.*

³⁰⁸² *Ibid.*

³⁰⁸³ *Ibid.*

³⁰⁸⁴ *Pillar 2's Commentary*, above n 3051, 9, 43, 70; See also *Pillar 2's Model Rules*, above n 3051, 18 [3.3.1] – 19 [3.3.5].

³⁰⁸⁵ *Ibid.*

³⁰⁸⁶ *Pillar 2's Commentary*, above n 3051, 9.

³⁰⁸⁷ Meijburg, above n 3059, [1].

the extent an adjustment required by Article 3.3 excludes an amount of income from the GloBE Income or Loss computation, any Covered Taxes associated with that income must also be excluded from Adjusted Covered Taxes pursuant to Article 4.1.3(a).³⁰⁸⁸

6.1.7.2 The Significance of a Permanent Establishment for Shipping

It should be recalled that a *Constituent Entity* may include the *Ultimate Parent Entity* of an *MNE Group*, its subsidiary entities, and their permanent establishments.³⁰⁸⁹ Thus, a permanent establishment is treated as a separate taxable entity or unit for applying the *GR*.³⁰⁹⁰ However, the concept of a permanent establishment is irrelevant for article 8 shipping income as treated under the *MTC* – (as considered above primarily under heading 5.1.2). So, does the inclusion of a permanent establishment as a *Constituent Entity* now mean that a permanent establishment must be considered for applying the *GR* to article 8 shipping income?

A permanent establishment as a concept enjoys the following four-tier definition under article 10.1.1 of the GloBE model rules:

- (a) a place of business (including a deemed place of business)³⁰⁹¹ situated in a jurisdiction and treated as a permanent establishment in accordance with an applicable Tax Treaty in force provided that such jurisdiction taxes the income attributable to it in accordance with a provision similar to Article 7 of the OECD Model Tax Convention on Income and on Capital;
- (b) if there is no applicable Tax Treaty in force, a place of business (including a deemed place of business) in respect of which a jurisdiction taxes under its domestic law the income attributable to such place of business on a net basis similar to the manner in which it taxes its own tax residents;
- (c) if a jurisdiction has no corporate income tax system, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a permanent

³⁰⁸⁸ *Pillar 2's Commentary*, above n 3051, 70.

³⁰⁸⁹ *Pillar 2's Model Rules*, above n 3051, 9, 11; *Pillar 2's Commentary*, above n 3051, 14, 17-8, 209 [96].

³⁰⁹⁰ *Pillar 2's Model Rules*, above n 3051, 9 [1.3.2].

³⁰⁹¹ Included to cover a business presence through things like dependent agents: *Pillar 2's Commentary*, above n 3051, 209 [98].

establishment in accordance with the OECD Model Tax Convention on Income and on Capital provided that such jurisdiction would have had the right to tax the income attributable to it in accordance with Article 7 of that model; or

(d) a place of business (or a deemed place of business) that is not already described in paragraphs (a) to (c) through which operations are conducted outside the jurisdiction where the Entity is located provided that such jurisdiction exempts the income attributable to such operations.³⁰⁹²

This definition sets out four different situations or categories.³⁰⁹³ Thus, for applying the *GR*, a permanent establishment is recognised where one of these four situations is found to exist.³⁰⁹⁴

Category [a] involves a situation where taxing rights of the States in issue are managed by a tax treaty that is in force.³⁰⁹⁵ To satisfy the requirements of this category, this tax treaty must essentially³⁰⁹⁶ control the taxing rights along the lines of the *MTC*'s article 7 – particularly in relation to the source State.³⁰⁹⁷ In this case, the rules' application of a permanent establishment, including whether it exists or not, will mirror the outcomes of a tax treaty.³⁰⁹⁸

Therefore, since category [a] cases will essentially mirror the outcomes of the *MTC*, it may be anticipated in advance that, when the *GR* is applied to eligible shipping income, a permanent establishment in these cases will be found, not to exist.³⁰⁹⁹ This result ensues as eligible shipping income has its taxing rights controlled by the *MTC*'s article 8 and not by the *MTC*'s article 7.³¹⁰⁰ The concept of a permanent establishment is foreign to the *MTC*'s article 8.³¹⁰¹ Accordingly, in these particular shipping situations, a permanent establishment will be

³⁰⁹² *Pillar 2's Model Rules*, above n 3051, 63-64.

³⁰⁹³ *Ibid*; *Pillar 2's Commentary*, above n 3051, 209 [96].

³⁰⁹⁴ *Pillar 2's Commentary*, above n 3051, 209 [96].

³⁰⁹⁵ *Ibid* 209 [97], [100].

³⁰⁹⁶ *Ibid* 210 [102].

³⁰⁹⁷ *Ibid* 209 [97].

³⁰⁹⁸ *Ibid* 209 [97], [99]: 'Determinations by domestic courts and competent authorities are taken into account in this context.': at [99].

³⁰⁹⁹ *Ibid*.

³¹⁰⁰ See heading 5.1.2 above; See also *OECD Model Tax Convention*, above n 703, M-27 [4], M-30, C(8)-1; Reimer and Rust, above n 806, art 8, [1]; Baker, above n 819, R.2: March 2002, 8-1 - 8-2.

³¹⁰¹ *Ibid*.

irrelevant, as enabled by category [a] of its definition, for applying the *GR* to article 8 shipping income.³¹⁰²

The following example, based on an illustration in the relevant OECD commentary, succinctly demonstrates the intended application of this first category within the context of activities falling within the *MTC*'s article 8:³¹⁰³ X Co, a *Constituent Entity* resident in State R, operates sea vessels between the ports of different States for performing maritime transport activities. X Co has an office ('Y') in State S through which it carries on some of its business. Assume that the R-S treaty is based on the *MTC*. Article 5 of this double tax treaty would recognise that X Co has a permanent establishment ('Y') in State S. However, because of article 7(4) and article 8 of the treaty, State S would not be able to tax the profits of Y. In that case, a permanent establishment does not exist for applying the *GR*, in accordance with category [a], irrespective of the fact that it meets the definition of a permanent establishment of the treaty.

The OECD submits that:

there is a longstanding international consensus that the profits of enterprises operating ships or aircraft in international traffic should be taxable only in the jurisdiction in which the enterprise has its residence. This special treatment, which is applied regardless of whether such an enterprise carries on business through foreign permanent establishments, is reflected in Article 8 of both the OECD and United Nations (UN) Model Tax Conventions and in the vast majority of the 3,500+ bilateral tax treaties currently in force.³¹⁰⁴

³¹⁰² Ibid; Meijburg, above n 3059, [2.2].

³¹⁰³ *Pillar 2's Commentary*, above n 3051, 209 – 10 [101].

³¹⁰⁴ *OECD Pillar 1 Blueprint*, above n 2861, 56 [158]; See generally *OECD Pillar 2 Blueprint*, above n 2961, 40 [111].

Based on this submission, it might be expected that a significant number of cases in practice will be treated under category [a] of the definition of a permanent establishment under the GloBE model rules.

Briefly, category [b] is concerned with situations where there is no tax treaty *in force* between the relevant residence and source States.³¹⁰⁵ Here the domestic law of the source State is required to govern the case as stipulated by this category.³¹⁰⁶ This category requires the domestic law of the source State to tax the income, attributable to the place of business located in its jurisdiction, on a net basis and in a way similar to its residents.³¹⁰⁷ In other words, this category references a situation where there is no relevant treaty; and a source State unilaterally applies a definition and taxation rules for a permanent establishment (or a similar concept).³¹⁰⁸ In this case, the *GR* will recognise the existence and treatment of a permanent establishment as authorised by this domestic law.³¹⁰⁹ Thus, under category [b], the *GR* will essentially mirror the unilateral domestic treatment of a source State.³¹¹⁰ Therefore, a permanent establishment may, theoretically, still be relevant for shipping enterprises under this category for the *GR*. This outcome may be delivered to the extent that there is no *MTC*-styled treaty, and the particular domestic law of the source State taxes the shipping income of a branch office located in its jurisdiction.³¹¹¹

However, considering the wide availability of special tax treatments for shipping income in practice, it might be expected that shipping enterprises would avoid setting up businesses in

³¹⁰⁵ *Pillar 2's Commentary*, above n 3051, 210 [103].

³¹⁰⁶ *Ibid* 210 [103], [106].

³¹⁰⁷ *Ibid* 210 [106], [107].

³¹⁰⁸ *Ibid* 210 [103].

³¹⁰⁹ *Ibid*.

³¹¹⁰ *Ibid*.

³¹¹¹ *Ibid*.

jurisdictions where their branch income is exposed to source taxation on a ‘*net basis similar to residents*.’³¹¹² Thus, category b might be less of an issue in practice for applying permanent establishments to eligible shipping income. Unless of course that phrase (or the words) has the elasticity to also cover special tonnage taxes, exemption regimes, and freight regimes that apply due to the absence of an *MTC*-styled treaty - which appears unlikely.³¹¹³ Tonnage taxes may apply on a gross or net basis.³¹¹⁴ Also, these regimes do not tax actual income generated from a branch located in the source jurisdiction, but taxes notional profits of a moveable asset only present in the source jurisdiction for a limited time.³¹¹⁵ However it is conceded that these sea vessels may potentially be associated with a branch office that is located in the source jurisdiction. However, the income that is taxed is still only notional profits. Exemption regimes, on the other hand, do not tax the relevant income on any basis.³¹¹⁶ Whilst freight regimes tax foreign vessels (and not residents) on a gross basis.³¹¹⁷ Therefore, the net basis, actual income, and location prerequisites of category [b] may be interpreted strictly according to their ordinary grammatical meaning to exclude all tonnage tax regimes, exemption regimes and freight regimes from category [b]’s scope.³¹¹⁸

Category [c] applies where a source State has no corporate income tax.³¹¹⁹ In these situations, a hypothetical assessment is required to assess whether a permanent establishment and a taxing right at source may be recognised, as respectively determined by the *MTC*’s articles 5

³¹¹² *OECD Pillar 1 Blueprint*, above n 2861, 56 [158]; See generally *OECD Pillar 2 Blueprint*, above n 2961, 40 [111].

³¹¹³ *Pillar 2’s Commentary*, above n 3051, 70 [146]: ‘The widespread availability of these alternative tax regimes [i.e., tonnage taxes] means that international shipping often operates outside the scope of corporate income tax.’ Therefore, this extract demonstrates that even the OECD may to some extent conceptualise tonnage taxes as a unique tax and distinguishable from normal income taxes.

³¹¹⁴ See headings 5.2.6 and 5.2.9 above.

³¹¹⁵ *Ibid*; See also *Pillar 2’s Commentary*, above n 3051, 210 [107].

³¹¹⁶ See heading 5.2.10.

³¹¹⁷ See heading 5.2.11.

³¹¹⁸ *Pillar 2’s Commentary*, above n 3051, 210 [107].

³¹¹⁹ *Ibid* 210 [108].

and 7.³¹²⁰ The analysis is conducted on a fictional basis that treats the residence and source States as having concluded a treaty that replicates the *last version* of the *MTC*.³¹²¹ Like category [a], category [c]’s treatment may be expected to produce an outcome that mirrors the *MTC*’s approach. Such, an outcome means that the permanent establishment construct is irrelevant for applying the *GR* to article 8 shipping income.

Category [d] establishes the so-called ‘stateless permanent establishment’ as the attributable income is treated on a standalone basis.³¹²² However, it is only relevant for establishing a permanent establishment for the *GR* where a case is not already covered by one of the previous three categories.³¹²³ Broadly, category [d] is concerned with a case where operations are conducted outside the jurisdiction of a State where an entity is located and that State exempts from tax the income attributable to those extraterritorial operations.³¹²⁴ International shipping income could theoretically fall under this category as it is primarily produced by mobile activities occurring largely outside a State’s jurisdiction.³¹²⁵ Further this category would be relevant only where a State applies an exemption regime to the extraterritorial shipping income.³¹²⁶ However, the prevalence of cases falling within the scope of categories [a] to [c] (and in particular category [a]), may make the application of this last category somewhat illusory for eligible shipping income.³¹²⁷

³¹²⁰ Ibid 211 [109] – [110].

³¹²¹ Ibid 211 [110].

³¹²² Ibid 211 [112]: ‘[Stateless] meaning that the income of the PE would be subject to the GloBE Rules on a standalone basis without the ability to blend its income with other Constituent Entities located in [a relevant] jurisdiction.’

³¹²³ Ibid 211 [111] – [112].

³¹²⁴ Ibid; see also at 211 [113]: ‘The requirement under paragraph (d) is that such jurisdiction is exempting the income generated through foreign operations’; See also at 211 [114]: ‘This language is intended to ensure that this paragraph only applies where exemption is attributable to the fact that the operations are treated as conducted by the Constituent Entity outside the jurisdiction.’

³¹²⁵ *OECD Pillar 1 Blueprint*, above n 2861, 56 [157].

³¹²⁶ *Pillar 2’s Commentary*, above n 3051, 211 [111].

³¹²⁷ *OECD Pillar 1 Blueprint*, above n 2861, 56 [158]; See generally *OECD Pillar 2 Blueprint*, above n 2961, 40 [111].

6.1.7.3 Locating Permanent Establishments and Constituent Entities

The location of a permanent establishment is fixed by article 10.3.3 of the GloBE model rules³¹²⁸ These rules provide specific locator controls for each category of the definition of a permanent establishment.³¹²⁹ For example, the locator control for category [a] situates a permanent establishment at the location where it is recognised and taxed as such, under a relevant tax treaty; this location is, essentially, the source State as recognised by the treaty.³¹³⁰ Further, the State where the net-basis taxation is raised, the State where it is physically situated, and the status of statelessness, are respectively applied as controls for categories [b] to [d].³¹³¹

Likewise, under articles 10.3.1³¹³² and 10.3.2, the model rules provide special locator controls for attributing the location of an *entity* to a State.³¹³³ Broadly, the place of creation, place of management, or a similar criterion,³¹³⁴ which establishes the tax residence of an entity at the domestic level, are primarily utilised as controls by the rules for establishing the State where the entity is located.³¹³⁵ In applying this locator control, the tax residence of an entity (as

³¹²⁸ *Pillar 2's Model Rules*, above n 3051, 68 [10.3.3]; *Pillar 2's Commentary*, above n 3051, 223 [189] – [194].

³¹²⁹ *Ibid.*

³¹³⁰ *Ibid.*

³¹³¹ *Ibid.*; *Pillar 2's Commentary*, above n 3051, 221 [172].

³¹³² ‘Article 10.3.1 applies to Constituent Entities that are not PE’: *Pillar 2's Commentary*, above n 3051, 221 [178].

³¹³³ *Pillar 2's Model Rules*, above n 3051, 67 [10.3.1]; See also *Pillar 2's Commentary*, above n 3051, 220 [170] – [171]: ‘Determining the location of an Entity and PE is important for jurisdictional blending and for determining where the Top-up Tax has to be paid.’: at 220 [170]; Also note: ‘The term “jurisdiction” is not defined in Article 10.1 or any other provision in the GloBE Rules. The approach that has been taken is to follow the definition of “Tax Jurisdiction” used for CbCR, and thus a jurisdiction for purposes of the GloBE Rules means a State as well as a non-State jurisdiction which has fiscal autonomy.’: *Pillar 2's Commentary*, above n 3051, 221 [177].

³¹³⁴ As the model rules are intended to give a preference to residence as treated domestically, this phrase should be interpreted broadly to cover other criteria as applied at the domestic level that awards residence to an entity, including the place of effective management: *Pillar 2's Commentary*, above n 3051, 222 [181], 223 [195]; But see at 222 [183].

³¹³⁵ *Pillar 2's Model Rules*, above n 3051, 67 [10.3.1]; See also *Pillar 2's Commentary*, above n 3051, 221 [172]: ‘The principle underlying the rules is to follow the treatment under local law.’

recognised at the domestic level) is intended to be emphasised and prioritised, as confirmed by the commentary in the following extract:

The rules give a priority to tax residence whenever possible. In most cases, an Entity will be a tax resident in a jurisdiction, and that will be its location for the purpose of the GloBE Rules.³¹³⁶

In the absence of such a tax residence, the place of creation of an entity is applied as a control to establish the State where it is located.³¹³⁷

Additionally, tie-breaker rules are made available under article 10.3.4, to manage cases where a *Constituent Entity* (other than a permanent establishment) is situated, by the locator controls, in more than one State.³¹³⁸ Broadly, a resolution of residence as achieved in a relevant tax treaty is given priority here, irrespective of the nature of the tie-breaker rule applied for locating an entity for the *GR*.³¹³⁹ In the absence of such a resolution, the State where the greater covered taxes are paid for a particular fiscal year, *is given priority* within a cascading set of controls, for identifying the location of the entity for the *GR*.³¹⁴⁰

Accordingly, as enjoyed under the *MTC*, a permanent establishment continues, to some significant degree, to be irrelevant as an issue for applying the *GR* to eligible shipping activities.³¹⁴¹ However, this outcome might, to some extent, be easier to anticipate in advance, in cases where a State that hosts branch activities is covered by an appropriate network of tax treaties – (considering the outcomes of categories [b] to [d] of the

³¹³⁶ *Pillar 2's Commentary*, above n 3051, 221 [172].

³¹³⁷ *Ibid* 221 [172], 222 [184]; *Pillar 2's Model Rules*, above n 3051, 67 [10.3.1]; 'This would be the case of Entities created in jurisdictions with no CIT System.': *Pillar 2's Commentary*, above n 3051, 222 [184].

³¹³⁸ *Pillar 2's Model Rules*, above n 3051, 68 [10.3.4]; See also *Pillar 2's Commentary*, above n 3051, 220 [171], 223 [195].

³¹³⁹ *Pillar 2's Model Rules*, above n 3051, 68 [10.3.4]; See also *Pillar 2's Commentary*, above n 3051, 221 [173]; 224 [200], 224 [202].

³¹⁴⁰ *Ibid*; In particular, 'the Entity is located in the place with higher Covered Taxes or higher Substance (calculated under the Substance-based Income Exclusion), in that order. In limited cases, the Entity will be stateless.': *Pillar 2's Commentary*, above n 3051, 221 [173].

³¹⁴¹ *Pillar 2's Commentary*, above n 3051, 209 – 10 [101].

definition).³¹⁴² Also, the location of a *Constituent Entity* for the *GR* will, to some significant degree, coincide with the location of the residence State of an entity, as determined by that State's domestic law and ultimately by a tax treaty.

However, the *MTC*'s updated tie-breaker criteria should be noted here, as it has the potential to introduce a measure of uncertainty as well as the risk of failure into the residence tie-breaking process for corporate entities - as explored under heading 5.1.2, and in particular subheadings 5.1.2.3, and 5.1.2.8. Thus, the practical effect of these locator controls for permanent establishments and entities under the *GR* might be to disadvantage States where these States do not have appropriate treaty networks in place. The absence of an appropriate tax treaty might mean that the tax implications of these controls are less certain for local enterprises that operate there; businesses prefer to run their shops where there is more fiscal certainty. Therefore, apart from concluding appropriate tax treaties, it might be advantageous for States to apply the alternate tie-breaker mechanism in their treaties as it may promote greater certainty in its outcomes - as discussed above.

It is submitted that, at a significant level, the *GR* does not introduce major changes to the underlying international tax framework for eligible shipping activities. This submission is based on the observation that source taxation may still largely be irrelevant under the *GR* for eligible shipping activities. This observation proves true to the extent of the non-application of a permanent establishment as a *Constituent Entity*, and the residence State enjoying the placement of a *Constituent Entity* within its jurisdiction. These outcomes may continue to reinforce the exclusive taxing right of the residence State over eligible shipping income. Therefore, to the extent that the integrity of the exclusive taxing right of a residence State

³¹⁴² Ibid.

remains unaffected by the *GR*, the approach of the *MTC* continues to support and enable a model shipping tax regime as usual.³¹⁴³

6.1.7.4 The Scope of the Shipping Exclusion

Broadly, the construction of shipping income by the *GR*'s shipping exclusion is, at its core, in line with the *MTC*'s article 8.³¹⁴⁴ Within this context, both of these frameworks essentially cover income produced from carrying goods and passengers by sea, internationally,³¹⁴⁵ on vessels that the taxpayer operates.³¹⁴⁶ This construction of shipping income is particularly observed at the primary level of the exclusion ('the primary rule'), contained in article 3.3.2 (a) of the GloBE model rules,³¹⁴⁷ which reads:

International Shipping Income means the net income obtained by a Constituent Entity from: (a) the transportation of passengers or cargo by ships *that it operates* in international traffic, whether the ship is owned, leased or otherwise at the disposal of the Constituent Entity; (b) ...³¹⁴⁸

³¹⁴³ See also Meijburg, above n 3059, [2.2].

³¹⁴⁴ *Pillar 2's Model Rules*, above n 3051, 18 [3.3.2]; *Pillar 2's Commentary*, above n 3051, 70 [147], 71 [151] - 72 [159]; Meijburg, above n 3059, [3.1] – [3.3].

³¹⁴⁵ But see *Pillar 2's Commentary*, above n 3051, 71 [152]: Here the commentary highlights a slight difference in the construction of 'international traffic' as applied by the two frameworks: '[T]he term "international traffic" [for the GloBE rules] means any transport by a ship, except when the ship is operated solely between places within a single jurisdiction (regardless of whether such jurisdiction is the same jurisdiction as the one in which the Constituent Entity is located). This differs slightly from the definition in article 3 of the OECD Model, which adds the qualification "and the enterprise that operates the ship ... is not an enterprise of that State". While *these words* are necessary for ... Article 8 ..., the transport by a ship, when the ship is operated solely between places in a jurisdiction and the Constituent Entity that operates the ship is located in that jurisdiction, would *also* not be considered as international traffic for ... the GloBE Rules.'

³¹⁴⁶ *Ibid.*

³¹⁴⁷ *Pillar 2's Commentary*, above n 3051, 71 [152].

³¹⁴⁸ *Pillar 2's Model Rules*, above n 3051, 18 [3.3.2] (emphasis added); *Pillar 2's Commentary*, above n 3051, 71 [152]; See also paragraphs (b), (c), (e), and (f) of article 3.3.2 of the GloBE model rules that correspond with article 8 of the *MTC*: *Pillar 2's Commentary*, above n 3051, 71 [155], 72 [156], [158], [159]; But see Meijburg, above n 3059, [3.2], [3.2.1] concerning para (f); But see also paragraph (d) of article 3.3.2 of the GloBE model rules: 'Paragraph (d) covers intragroup leasing of ships on a bare boat charter basis, for the use of transportation of passengers or cargo in international traffic, where the Constituent Entity is the lessor and leases out a ship to another shipping enterprise that is a Constituent Entity on charter without crew or master. This income is covered under Paragraph 5 of the Commentary on Article 8 of the OECD Model Tax Convention *only if the leasing (whether or not intragroup) is an ancillary activity* of an enterprise engaged in the international operation of ships. *The leasing of ships on a bare boat charter basis is considered as international shipping income (instead of ancillary) for purposes of the GloBE Rules as an exception, under the condition that the lessee is also a Constituent Entity of the same MNE Group and has International Shipping income.*': *Pillar 2's Commentary*, above n 3051, 72 [157] (emphasis added).

However, unlike the potential flexibility enjoyed under the *MTC*'s article 8, the *GR*'s commentary explicitly confirms that its shipping exclusion does not apply to the profits from towing and dredging activities.³¹⁴⁹ Therefore, to the extent that the *GR*'s exclusion mirrors the *MTC*'s article 8, *Klaus Vogel*'s submission that towing vessels are covered by the *MTC*'s article 8, might, to some degree, turn out to be incorrect.³¹⁵⁰ Thus, significant disparities may become apparent between the two frameworks as the analysis moves away from the exclusion's core and to the more peripheral aspects of its conceptualisation of eligible shipping income.³¹⁵¹ This occurrence may be exacerbated to the extent that certain income specifications in the *GR*'s exclusion operate as part of a closed list, whereas the *MTC*'s article 8 equivalents operate within the context of an open list.³¹⁵²

An example of a disparity at the secondary level that exists between the *MTC*'s article 8, and the *GR*'s shipping exclusion may be demonstrated by referring to paragraph [a] of article 3.3.3 of the *GR*'s model rules. In particular, article 3.3.3 (a) of the GloBE model rules states that:

Qualified Ancillary International Shipping Income means net income obtained by a Constituent Entity from the following activities that are performed primarily in connection with the transportation of passengers or cargo by ships in international traffic: (a) leasing a

³¹⁴⁹ *Pillar 2's Commentary*, above n 3051, 71 [153]; See also above n 913; See also above n 915; See generally above n 892; above n, 898.

³¹⁵⁰ Reimer and Rust, above n 806, art 8, [31]; See also above n 913; But see for example, *Pillar 2's Commentary*, above n 3051, 71 [152], 72 [157].

³¹⁵¹ *Pillar 2's Commentary*, above n 3051, 71 [152], 72 [157],[159], [162], 73 [164], [165], [167], 74 [173]; See also Meijburg, above n 3059, [3.2] – [3.3].

³¹⁵² *Pillar 2's Commentary*, above n 3051, 72-3 [162], 74 [167]: 'The ancillary activities identified in this Article are limited to those explicitly mentioned in the Commentary on Article 8 of the OECD Model Tax Convention (OECD, 2017[1]). To qualify for the exclusion, the income must be obtained ... from the activities listed in Article 3.3.3.': at 72-3 [162] (emphasis added); Cf *OECD Model Tax Convention*, above n 703, C(8)-2 [4.1] (emphasis added): 'Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships ... that it operates in international traffic should be considered to be directly connected with such transportation.'; See also at [4.2] 'Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.'; See also Meijburg, above n 3059, [3.2.1], [3.3 (d)].

ship on a bare boat charter basis to another shipping enterprise that is not a Constituent Entity, provided that the charter does not exceed three years³¹⁵³

It may be observed that this provision adds a safe harbour (or a three-year-maximum time period) to chartering out activities on a demise charter basis.³¹⁵⁴ However, this safe harbour requirement does not appear under the *MTC*'s article 8.³¹⁵⁵ Nonetheless, these safe harbours, are a common feature of shipping tax regimes that apply in the EU - as considered under heading 3.5.7.4 above.³¹⁵⁶

Further, unlike the *MTC*, the *GR* may adopt a more conservative approach for treating capital gains as eligible (or excluded) shipping income.³¹⁵⁷ For example, this outcome may arise in the *GR*'s exclusion from the addition of a one-year holding requirement for sea vessels, and the omission of a reference to the derivation of gains from 'movable property pertaining to the operation of ... ships.'³¹⁵⁸ There are, also, other limitations that may be identified in the *GR*'s exclusion that are absent from the *MTC*'s article 8.³¹⁵⁹

Furthermore, even where the design of the *MTC*'s article 8 and the *GR*'s shipping exclusion correspond essentially in their understanding of eligible shipping income, this does not necessarily mean that the outcomes of the *GR* are any more satisfactory, and exemplify a good tax.³¹⁶⁰ Therefore, despite any possible protestations about the banality of chapter two, it seems that the simple lessons that are considered there, about the attributes of a good tax,

³¹⁵³ *Pillar 2's Model Rules*, above n 3051, 19 [3.3.3].

³¹⁵⁴ *Pillar 2's Commentary*, above n 3051, 73 [163] – [164]; Meijburg, above n 3059, [3.3].

³¹⁵⁵ *Ibid.*

³¹⁵⁶ See also Meijburg, above n 3059, [3.3].

³¹⁵⁷ *Pillar 2's Model Rules*, above n 3051, 18 [3.3.2] (f); *Pillar 2's Commentary*, above n 3051, 72 [159]; *OECD Model Tax Convention*, above n 703, M-43 [art 13.3], C(13)-9; Meijburg, above n 3059, [3.2 (f)] - [3.2.1].

³¹⁵⁸ *Ibid.*

³¹⁵⁹ For example: *Pillar 2's Commentary*, above n 3051, 73 [165] (emphasis added): 'the sale of tickets issued by other *shipping enterprises*'; Cf *OECD Model Tax Convention*, above n 703, C(8)-3 [8] (emphasis added): 'sales of tickets on behalf of *other enterprises*.'; Meijburg, above n 3059, [3.3]; See also *Pillar 2's Model Rules*, above n 3051, 19 [3.3.4] that introduces a cap for ancillary shipping income; *Pillar 2's Commentary*, above n 3051, 74 [172]; Meijburg, above n 3059, [3.3.2].

³¹⁶⁰ See also Meijburg, above n 3059, [3.3].

continue at some level to be substantively ignored by policymakers in the 21st century.

Therefore, its inclusion and emphasis by the thesis appears to be warranted.

The thesis has, with respect, identified possible deficiencies with the *MTC*'s current approach for defining article 8 shipping income - as explored under headings 3.5.6 and 3.5.8. In short, the current treatment appears to overlook some key realities associated with viably undertaking shipping operations in the 21st century.³¹⁶¹ In this regard, 21st century policymakers might learn from the British monarchs of former times, as explored in chapter four, whose policies supported the rise of one of the greatest merchant fleets in history.³¹⁶² These monarchical policies demonstrated a greater sensitivity to the unique needs of the shipping industry.³¹⁶³

It should be recalled that the words 'operating ships' (and its derivatives), as ostensibly defined by the *MTC*'s article 8, emphasises the *employment function* of the ship adventure over the *navigation function*.³¹⁶⁴ However, the employment function firstly, does not correspond with the obligations that stick more tightly to the shipowner as *carrier* under both a voyage and time charterparty, and secondly, does not correspond with the activities that demonstrate a unique mobility, which justifies a preferential shipping tax treatment.³¹⁶⁵ The thesis has submitted here above, that it is the navigation function that evidences these features better; it is the navigation function that should *primarily* demarcate the shipping tax base for

³¹⁶¹ See heading 3.5.6 above; But see *Pillar 2's Commentary*, above n 3051, 72 [158].

³¹⁶² See heading 4.5 above.

³¹⁶³ *Ibid.*

³¹⁶⁴ *Furness Withy EC* 1966 CarswellNat 297 [12]; Reimer and Rust, above n 806, art 8 [31]; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.5]; Eder et al, above n 720, 444 [17-001];

See also heading 3.5.6.1 and 3.5.8 above.

³¹⁶⁵ *Ibid.*

the *MTC*'s article 8 – provided, of course, that the vessel is exploited as required, and irrespective of the party that contractually controls that employment.³¹⁶⁶

The thesis will now consider two examples that both have two scenarios, to illustrate the peculiar outcomes that may result from the approach underlying the *MTC*'s article 8. The peculiarity essentially stems from its ostensible focus on the employment function of the ship adventure.

In example one, both scenarios involve a ship management enterprise that, as a separate entity, provides technical and crewing services to third-party shipowners. However, in scenario one, this ship management enterprise performs these activities as their exclusive business activities.³¹⁶⁷ In scenario one, the income derived by this ship management enterprise is considered not to be in-scope for the *MTC*'s article 8. This outcome arises as that provision, ostensibly, fails to treat that income as income produced from 'operating a ship.'³¹⁶⁸ This outcome materialises, despite this ship management company performing classic shipowner functions.³¹⁶⁹ However, in scenario two, the ship management company *in addition* operates its own vessels for carrying goods by sea, and derives income therefrom. The income from this additional activity in scenario two is primarily within article 8's scope. Thus, the other income derived by the ship management enterprise from the services provided to third-party shipowners (as likewise occurring in scenario one) would now also be covered (under scenario 2) on a secondary basis by the *MTC*'s article 8.³¹⁷⁰

³¹⁶⁶ See heading 3.5.6.1.

³¹⁶⁷ See heading 3.5.6.

³¹⁶⁸ *Furness Withy EC* 1966 CarswellNat 297 [12]; Reimer and Rust, above n 806, art 8 [31]; See also heading 3.5.6.1.

³¹⁶⁹ *EU Framework* OJ C 13, C13/7; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.5]; Eder et al, above n 720, 444 [17-001].

³¹⁷⁰ *OECD Model Tax Convention*, above n 703, M-30, C(8)-2 [6]; *ITC 1048* (1964) 26 SATC 226, 227; See also heading 3.5.8.1.

This alternate outcome enjoyed under scenario two of example one is achieved by the *MTC*'s article 8 bringing into scope on a secondary basis 'profits from activities directly connected with ... [and] ... ancillary to such operation[s].'³¹⁷¹ However, the ship management enterprise performs, in the first and second scenarios of example one, equally important and key functions that critically underpins the employment of the sea vessels. Thus, these ship management activities in both scenarios may be said to be classic shipowner functions.³¹⁷² Accordingly, on the basis of substance, it should not matter whether these core activities are exclusively outsourced or are also performed in-house. Therefore, the article 8 approach appears to demonstrate a possible weakness with its underlying tax design. One concern is that it appears to unjustifiably breach tax neutrality.

Unfortunately, this peculiar tax treatment appears to be entrenched by the *GR* even further as the *GR* is primarily based on article 8's approach.³¹⁷³ The following example by Meijburg may be referenced to illustrate this point:

Here [b]elow, ... [are] two scenarios for the ship management activities of an internationally operating shipping group:

(1) A shipping company operates its vessels from a Constituent Entity in Singapore and benefits from a local tonnage tax. This is covered by the exclusion at the level of the UPE. The Singapore shipping company has a subsidiary in the EU that provides the ship management services, e.g. technical and crewing activities for the vessels owned and operated by its Singapore-based parent. The EU-based shipping company's activities are subject to tonnage tax. The IRR should apply as the effective tax rate is low and the EU Constituent Entity does not fall within the shipping income exclusion of Articles 3.3.1 to 3.3.3 of the Pillar Two rules. As a result, a TuT applies at UPE level (outside the EU) to income generated in the EU.

³¹⁷¹ Ibid.

³¹⁷² *EU Framework* OJ C 13, C13/7; *Hill Harmony* [2001] 1 Lloyd's Rep 147, 156; Coghlin, above n 720, 1-2 [I.5]; Eder et al, above n 720, 444 [17-001].

³¹⁷³ See also Meijburg, above n 3059, [2.2].

(2) In the same scenario as under (1), a competitor in the shipping business decides to work in the EU with a branch instead of a company. Except for this, the set-up is exactly the same as that of its competitor in example (1) (also an office, local employees and ship management services). Due to the application of Article 8 of the relevant tax treaty between the EU Member State and Singapore, the relevant branch (permanent establishment) is overruled, so that all activities and results are allocated to the Singapore-based shipping company. At that level, the services provided by the branch are treated as costs associated with an activity directly benefitting from the shipping exclusion of Pillar Two. As a result, the group effectively owes less tax than in the first scenario.³¹⁷⁴

Thus, it appears that the *GR* will entrench the tax disturbances produced by the *MTC*'s article 8 even further, through the application of its *TUT*. To some significant extent, this outcome occurs, under scenario one of example two, as the *GR* adopts the approach of the *MTC* that emphasises the employment of the vessel, in conceptualising the operation of a ship.³¹⁷⁵

Further, there may be significant commercial and non-tax advantages for using a subsidiary company as opposed to merely a branch office to perform these offshore activities.³¹⁷⁶

Therefore, these divergencies in tax outcome appear again to be disconnected from the substance of the case. This result may again arise from poor tax design to the extent it unjustifiably breaches tax neutrality.

The shipping industry has lobbied against a broad application of the *GR* to shipping income.³¹⁷⁷ One of the grounds, upon which this lobbying has been based, is the concern that the *GR* may create 'competitive distortions and unstable outcomes.'³¹⁷⁸ For example, the

³¹⁷⁴ *Ibid.*

³¹⁷⁵ *Furness Withy EC 1966 CarswellNat 297* [12]; Reimer and Rust, above n 806, art 8 [31].

³¹⁷⁶ *WSC et al Submission Paper to the OECD*, above n 2545, 2 [Annex ('Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study')] 16.

³¹⁷⁷ *WSC et al Submission Paper to the OECD*, above n 2545, 5; See also *OECD Pillar 2 Blueprint*, above n 2961, 40 [112].

³¹⁷⁸ *Ibid.*

companies, in scenarios one and two of example two, are performing exactly the same activities, and these activities are based in the same jurisdictions, but they merely operate through different corporate structures. Yet their tax results are not the same. The company in scenario one is penalised by the *TUT*, whilst the other, in scenario two, escapes that penalty. In this regard, there are concerns raised that the maritime policies of a State may be at risk of being undermined by the *TUT*.³¹⁷⁹ This concern is directed at situations somewhat like example two. In particular, these situations involve a *TUT* that is applied to a *Constituent Entity* in a State A, despite a foreign *Constituent Entity* of the same *MNE Group* in a State B, enjoying an equivalent preferential tax treatment at the domestic level.³¹⁸⁰ Moreover, in cases whether the *GR* diverges from the approach of the *MTC*'s article 8, by significantly limiting what may be treated as eligible shipping income, these additional discrepancies may further exacerbate the peculiar tax outcomes that are already evidenced under the *MTC*'s article 8.

However, these scope issues associated with the *GR* may be more directly relevant to business structuring and tax planning, than to designing a model shipping tax regime at the domestic level.³¹⁸¹ This submission may prove valid to the extent that the *GR* corresponds with the *MTC*'s article 8 approach at the primary level, and does not significantly neutralise the objectives of a domestic shipping tax regime.³¹⁸² The thesis will not explore these matters any further as they are beyond the direct scope of the research question. However, it might be

³¹⁷⁹ *Ibid.*

³¹⁸⁰ *Ibid.*

³¹⁸¹ Meijburg, above n 3059, [2.1] – [2.2]; As an example, note the following extract: ‘for ... internationally operating shipping companies with agencies across the world that decided on [utilising local companies] ... for legal (i.e. non-tax) reasons [in these cases]. For the purposes of Pillar Two, all these companies do not fall within the shipping exclusion of Articles 3.3.1 to 3.3.3 of the Pillar Two rules, but it needs to be established whether the effective tax rate is below 15% at each level. If so, a TuT might apply. If the company had decided to set up agencies via branches rather than local companies, they would not be required to establish whether Pillar Two applies in each jurisdiction. *This has a potential impact on the business model.*’: at [2.2] (emphasis added).

³¹⁸² *Pillar 2's Commentary*, above n 3051, 70 [146]: ‘Including international shipping within the scope of the GloBE Rules would therefore raise policy questions in light of the policy choices of ... [sponsoring States].’

speculated, for completeness purposes, and within the context of the rivalry that exists between States vying for superior sea power, that certain States, or groups of States, might attempt to exploit certain irregularities afflicting the *MTC*'s article 8 and the *GR*.³¹⁸³ In such cases, it is not hard to imagine that appropriately calibrated shipping tax regimes, together with carefully structured foreign conglomerates, may play some part in advancing these aims to neutralise and exploit the outcomes of the OECD's Two Pillar Solution.

6.1.7.5 A Further Substance Test

The *GR* incorporates a substance criterion within the mechanism of its shipping income exclusion.³¹⁸⁴ In particular, article 3.3.6 of the GloBE model rules, requires that a *Constituent Entity* must satisfy this substance criterion to be eligible for the shipping income exclusion.³¹⁸⁵ The substance criterion involves the *Constituent Entity* demonstrating that the strategic *or* commercial management of all ships is effectively carried on from within the jurisdiction where it is located.³¹⁸⁶

Meijburg offers the following opinion about the above substantial activity test:

the concepts of strategic and commercial management are not addressed in Article 8 of the OECD Model Tax Convention and the Commentary on this article. That said, these concepts are well-known within the various EU tonnage tax regimes. In our view, this provision conflicts with the current set-up of internationally operating shipping companies. ...

[For] [e]xample: a Constituent Entity operates an international shipping business in jurisdiction X. A number of vessels of this fleet are fully managed from its branch in jurisdiction Y. Article 8 of the OECD Model Tax Convention applies to this branch, which is

³¹⁸³ See generally Josie Kao, 'Turkey doubles Russian oil imports, filling EU void', *Reuters* (online), 22 August 2022 < <https://www.reuters.com/business/energy/turkey-doubles-russian-oil-imports-filling-eu-void-2022-08-22/> >.

³¹⁸⁴ *Pillar 2's Model Rules*, above n 3051, 19 [3.3.6].

³¹⁸⁵ *Ibid.*

³¹⁸⁶ *Ibid.*

why the relevant income from these vessels is allocated to the Constituent Entity in jurisdiction X. Does the income from the branch not fall within the shipping exclusion?³¹⁸⁷

The meaning of the concepts ‘strategic or commercial management’ is considered, in varying degrees, within the framework of shipping tax regimes in Australia, the EU and the UK.³¹⁸⁸

Thus the *GR*’s substance condition may to some extent borrow features from these domestic approaches.³¹⁸⁹ The commentary further advises that:

the strategic or commercial management of the ships concerned is limited to those deployed in earning International Shipping Income and must be *effectively carried out in the jurisdiction where the Constituent Entity is located* in order to qualify for the exclusion.³¹⁹⁰

This advice may be interpreted to require two conditions. Firstly, it requires that these management functions must be sufficiently connected with earning article 8 shipping income as constructed at the primary level of the definition. This aspect of the substance criterion may have the effect of further restricting the application of the shipping income exclusion, particularly in relation to auxiliary shipping activities. Secondly, it requires that these management functions must be carried out in the jurisdiction where the *Constituent Entity* that delivers them is located. Otherwise, in the absence of satisfying these two conditions, the entity may not be eligible to enjoy the shipping exclusion.

To the extent that these two requirements are promoted, this outcome may prevent shipowning companies from locating ownership and operation functions (and the like) in different entities based in different States. However, as a permanent establishment may be

³¹⁸⁷ Meijburg, above n 3059, [3.3.4].

³¹⁸⁸ See also HMRC, *Tonnage Tax Manual* (updated 3 August 2022) [TTM03810] < <https://www.gov.uk/hmrc-internal-manuals/tonnage-tax-manual/ttm03810>>: ‘The strategic management test displays features in common with the central management and control test for corporate residence, operating at a high level of decision making’; See also heading 5.1.2.4; See also above n 2787 to above n 2789; *EU Ship Management Communication* OJ C 132, 6 [2.2]; See also heading 3.5.6 above.

³¹⁸⁹ *Pillar 2’s Commentary*, above n 3051, 76 [180].

³¹⁹⁰ *Ibid* 76 [181].

ignored as a Constituent Entity generally, for applying the *GR*'s shipping exclusion (as considered above under heading 6.1.7.2), this issue (as set out in the above quotation) ensures, at least, that the concern is directed largely on connecting relevant activities with particular corporate entities and ignoring mere branches.

Furthermore, unlike the *MTC*'s article 8, the *GR* also includes demise charters concluded between entities of the same *MNE* group as activities producing *on a primary basis* article 8 shipping income.³¹⁹¹ Therefore, this feature of the *GR* may support saving the capacity of shipowning companies at some level to spread, in a tax efficient manner, their ownership and operation functions over different entities of a group.

Additionally, the analysis below will (briefly) demonstrate that there is the potential for a lower threshold to be adopted for meeting the (strategic or commercial management activities) substance test. This minimum threshold may further support saving the capacity of shipowning companies at some level to spread, in a tax efficient manner, their ownership and operation functions (and the like) over different entities based in different States.

The commentary further advises that

[t]he mere fact that a vessel is flagged in a particular jurisdiction is not a relevant factor in the determination of whether strategic or commercial management is effectively carried on from within that jurisdiction. However, ..., the requirements imposed by a flag jurisdiction may be relevant to such determination in respect of the jurisdiction where the requisite activities are performed.³¹⁹²

The commentary conceptualises *strategic management* in the following terms:

³¹⁹¹ *Pillar 2's Model Rules*, above n 3051, 18 [3.3.2 (d)]; *Pillar 2's Commentary*, above n 3051, 72 [157].

³¹⁹² *Pillar 2's Commentary*, above n 3051, 76 [182].

Strategic management includes *making decisions on* significant capital expenditure and asset disposals (e.g., purchase and sale of ships), award of major contracts, agreements on strategic alliances and vessel pooling, and the direction of foreign establishments. Relevant factors that demonstrate strategic management include location of decision-makers, including senior management staff, location of company board meetings, location of operational board meetings and residence of directors and key employees.³¹⁹³

The commentary also conceptualises *commercial management* in the following terms:

Commercial management includes route planning, *taking bookings for cargo or passengers*, insurance, financing, personnel management, provisioning and training. Relevant factors that demonstrate commercial management include the number of employees engaged in these activities in the jurisdiction, the nature and extent of the accommodation occupied in the jurisdiction, and the country of residence of key management staff, including company directors.³¹⁹⁴

The *strategic management* somewhat corresponds with an entity's central management & control, as explored in some detail under heading 5.1.2.4.³¹⁹⁵ The commercial management activities correspond *somewhat* with the ship management activities, as considered under headings 3.5.6.2 and 3.5.8; however, it is arguable that this concept also covers certain aspects of a vessel's technical management and crewing. To the extent that this last submission proves false will result in standalone classic shipowner activities, in the form of doing the ship's navigation, as explored under heading 3.5.6.1, falling outside the concept. This latter outcome would be unfortunate as these latter activities are the activities that correspond better with the industry's unique features that justify its preferential tax treatment. In turn, the submissions/criticisms made under heading 6.1.7.4, along the lines that the *GR* further entrenches the weaknesses of the *MTC*'s approach, may to some degree prove true

³¹⁹³ Ibid 76 [183].

³¹⁹⁴ Ibid 77 [184] (emphasis added).

³¹⁹⁵ See also above n 2102; See above n 3187.

here again. These submissions will not be explored here further as they are not necessary for constructing a model shipping tax regime.

However, at a later point in the commentary the significance of the concept of ‘strategic management’ may be diluted to some degree, as the commentary advises as follows:

Under some shipping tax regimes, a management requirement is often applied in conjunction with a flag link, which means that ships and their owners have to abide by the conditions of the flag jurisdiction’s shipping register. Generally, the flag jurisdiction is responsible for making sure that ships flying their flag abide by the international conventions of the International Maritime Organisation and the International Labour Organisation that the flag jurisdiction has ratified, including maritime safety, pollution and other environmental impacts, as well as working conditions. Depending on these requirements a flag link may entail specific duties on the Constituent Entity to ensure that flagged vessels abide by such requirements. *Where these responsibilities are imposed on and managed by a Constituent Entity, this may result in that Constituent Entity having a sufficient level of strategic management that is effectively carried on from within the jurisdiction where it is located.*³¹⁹⁶

It should be remembered that, as a result of the unique characteristics of maritime transport activities, the OECD has to some extent endorsed a minimalistic approach for satisfying the substance criterion as promoted by *BEPS 5*.³¹⁹⁷ In this regard, the more usual obligations involved with registering and operating vessels under an open register, including

³¹⁹⁶ *Pillar 2’s Commentary*, above n 3051, 77 [185] (emphasis added).

³¹⁹⁷ *General Merchant Marine Law No 57 of 6 August 2008 (Panama)* art 19; Watt and Coles, above n 715, [21.8]; [21.26]; See also *2018 OECD Progress Report*, above n 32, 30: ‘The determination further [considers] whether the regime was designed to ensure that the qualifying taxpayer handles all corporate law and regulatory compliance of the shipping company with *any additional obligations within the jurisdiction such as ship registration including compliance with International Maritime Organisation (“IMO”) regulations, customs and manning requirements (noting the various regulatory requirements for shipping identified in the Consolidated Application Note) consistent with the IMO definition.*’: at 30 (emphasis added); See also World Shipping Council et al, ‘OECD/G20 Inclusive Framework on BEPS - Public Consultation Document (12 October 2020 – 14 December 2020) Report on the Pillar One Blueprint and Report on the Pillar Two Blueprint’ (Submission paper to the OECD Centre for Tax Policy and Administration, 14 December 2020) 4-6, [Annex (‘Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study’)] 4 (‘*WSC et al Submission Paper to the OECD*’) < <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/12/joint-shipping-oecd-consultation-submission.pdf> >: There are certain legal or other constraints affecting how the shipping business is organised but the most significant are the requirements to qualify for special shipping tax regimes.’: at [Annex (‘Responses to OECD Secretariat Pillar Two Questions on International Shipping Industry and Case Study’)] 4.

certification, ship maintenance, seaworthiness and crewing (among other things), may ostensibly be sufficient to satisfy *the BEPS 5's* substantial activities test.³¹⁹⁸

It was also observed that in the case of Panama, a local lawyer may perform some of these activities on behalf of a foreign shipping entity.³¹⁹⁹ The significance of this observation is important to the extent that no other activities that promote a greater physical business presence may be required in a jurisdiction to satisfy the *BEPS 5's* substantial activities test.³²⁰⁰

However, in contrast to the *GR*, *BEPS 5* is more directly relevant to controlling the design of a shipping tax regime.³²⁰¹ Nonetheless, despite the differences between these two OECD instruments, the issue that bears considering is this: Whether at the minimum level, the substance criterion of the *GR's* exclusion corresponds with the *BEPS 5's* substance test? *BEPS 5* ostensibly adopts a more minimalistic approach for satisfying its substance requirements. It is, however, beyond the research question to consider this issue any further.

6.1.8 Pillar Two and a Model Shipping Tax Regime

Therefore, in summary, these issues associated with the *GR* may not be directly relevant to designing a model shipping tax regime. It has been observed that the integrity of the *MTC's* article 8 approach largely remains intact at the primary level, despite the introduction of Pillar Two. However, these *GR* issues may be more directly relevant to business structuring and tax planning in the shipping industry. Pillar Two issues may also be relevant in cases where a

³¹⁹⁸ See heading 3.5.3; See generally *General Merchant Marine Law No 57 of 6 August 2008* (Panama) arts 6, 8, 13, 19, 114, 118; Piniella, Alcaide and Rodríguez-Díaz, above n 45, 15-6, 18-21; Watt and Coles, above n 715 [21.8] – [21.10].

³¹⁹⁹ See heading 5.2.5.

³²⁰⁰ *Ibid.*

³²⁰¹ See headings 3.2 and 3.5.

competitor State, or groups of States, seek to exploit the weaknesses of the *GR* as outlined above. Such exploitation may be pursued to reinforce the sea power of these States globally. A model shipping tax regime may be relevant in these cases to the extent that it constitutes a key element of that plan. However, it seems, generally, correct to assert, that the OECD's Two Pillar Solution does not impact a model shipping tax regime directly, particularly at the primary level of conceptualising shipping income as a tax base.

Chapter 7: Contributions to Knowledge & Summary

This thesis is an original contribution to knowledge by accomplishing the following outcomes:

7.1.1 Chapter Two

Chapter two aimed to establish a *Smithian Framework* that can assess tax regimes and systems with principles and criteria broadly accepted by the G20 States in the 21st century. This *Smithian Framework* would constitute one of the *Model Analytical Framework's* components. The thesis would apply the latter to instruct the design of an optimal shipping tax regime. Chapter two established that the *Smithian Framework* should be applied systemically as this application recognises that other regimes in a system may perform certain secondary functions where appropriate. Thus, an optimal shipping tax regime need not be burdened with these secondary functions. The concept of Positive Anti-Neutrality with controls was also introduced. This exceptional application essentially promotes distortions to reward taxpayers, as distinct from punishing them, by promoting more favourable fiscal treatments. The chapter reconfirmed that taxes may be used for purposes other than revenue generation by considering the broader purposes of taxation. Therefore, a purpose should be applied that maximises the potential of the underlying attributes of a particular tax base. The idea of quasi misalignments was also introduced as a secondary feature of the *Smithian Framework* as this framework operates in varying degrees of Pareto optimality as narrowly defined here. Chapter two observed that equity as abstracted vertically demonstrates an intra-systemic misalignment with efficiency for mobile tax bases. The practice of selected Asian States of broadly prioritising efficiency and simplicity to stimulate their economies and develop particular tax bases was briefly considered. This chapter also observed that the OECD and certain western States tend to restrict the application of verticality to less mobile tax bases. In reconciling intra-systemic misalignments between efficiency and verticality for

mobile tax bases, the thesis advanced the submission of treating horizontality and verticality as two distinct aspects of equity.

The thesis benchmarked equity by utilising its conventional vertical and horizontal equity constructs based on the ability to pay. It was observed that the ability to pay might be reorientated to the ability to bear for better protecting mobile tax bases. This application effectively subordinates equity as conventionally constructed in favour of efficiency outcomes. The benchmarked efficiency criterion was orientated on tax distortions, primarily, and uniformity, secondarily. The simplicity benchmark was orientated on administrative and compliance costs broadly conceptualised. The certainty benchmark was constructed with a core and periphery: The core was orientated on fundamental attributes of a good tax system, requiring absolute compliance as they concern the rule of law. The periphery was applied as a somewhat catch-all category to house attributes that cannot be serviced appropriately by a costs approach as promoted by simplicity. Sustainability was benchmarked to assess ongoing fiscal performance in promoting objectives. This sustainability criterion complements Positive Anti-Neutrality applications that utilise controls requiring ongoing monitoring. By analysing recent tax design projects of selected G20 States and the OECD, the thesis established that the G20 States broadly recognise these benchmarked criteria in the 21st century as the general criteria of a good tax system.

7.1.2 Chapter Three

Chapter three aimed to finalise the construction of the *Model Analytical Framework* and consider certain secondary matters, including the mobility of the particular tax base and shipping income as a construct.

The particular ordering of the benchmarked criteria of the *Smithian Framework* was settled. Apart from the core attributes of certainty that should be satisfied as an absolute rule, it was decided that efficiency should enjoy the foremost priority in designing a shipping tax regime as shipping income demonstrates high mobility as a tax base. Simplicity was ranked as a second top priority. Equity as abstracted horizontally and the peripheral certainty attributes were roughly configured as the third and fourth priorities. Sustainability was ranked as the last priority as it evaluates the ongoing achievement of outcomes.

The focus of the *Smithian Framework* as a component of the *Model Analytical Framework* was orientated at protecting the domestic shipping tax base of the sponsoring State. Therefore, to enlarge the scope of the *Model Analytical Framework*, the *1998 OECD Framework assessing harmful tax practices and preferential regimes*, as updated by *BEPS 5*, was incorporated as a second component. This second component equips the *Model Analytical Framework* with the capacity to consider the tax bases of non-sponsoring States and ensures that shipping tax regimes congruent with it will have broader international legitimacy. This second component complements the *Smithian Framework*. It specifically advances the promotion of substantial activities domestically, the uniform treatment of substantially similar activities, and transparency, including the spontaneous exchange of cross-border private rulings under certain conditions. Chapter three submits that a systemic approach should be adopted to optimally achieve substantial activity. Shipping tax regimes have limits in promoting substantial activity. In promoting simplicity, a shipping tax regime should avoid fragmenting the treatment of shipping income, among other considerations. Therefore, it may be more optimal to utilise another regime in a system to enhance substantial activity outcomes.

Chapter three observed that shipping income is primarily treated as income derived from carrying goods and persons by sea (or maritime transport activities). Shipping income was observed to exhibit high mobility as a tax base. The chapter considered various key elements working in concert to facilitate this mobility. Some of these elements were not unique to shipping. However, elements peculiar to maritime transport activities broadly included operating on the high seas and the relative ease of selecting a flag State. In defining shipping income, the navigation of a ship (or its technical management) was considered the activity that should be treated as *primarily* producing shipping income. This activity is inherently linked to the business of owning and operating ships and, therefore, exhibits high mobility. It was considered that the commercial management of ships should only produce shipping income in exceptional circumstances. This treatment would ensure that preferential shipping tax treatment primarily rewards the critical activities that more directly underpin the expansion of a State's ship register.

7.1.3 Chapter Four

Chapter four aimed to consider the promotion of sea power as a primary objective of a shipping tax regime. The chapter considered the historical evolution of the American and British merchant fleets. The thesis broadly observed that a naval fleet has its limits in undertaking military operations, irrespective of its global ranking. Thus, an appropriately sized, equipped and modern trading fleet is essential for supporting the sealift requirements of major military operations. The thesis generally concluded that whilst States continue to compete globally, sea power will remain a valid and necessary objective in the 21st century.

Chapter four observed that a robust merchant fleet does not occur without appropriate State support. Adequate State support included a range of measures, including a preferential

shipping tax regime, direct subsidies and cabotage rules. It was observed that, as a minimum, a critical objective of a preferential shipping tax regime was to ensure that the maritime transport activities of a sponsoring State enjoy a similar fiscal environment to those in foreign States. However, this objective was considered too narrow for a State support programme as a whole. It ignores other reduced foreign costs, such as lower employment costs and a more streamlined bureaucracy.

In supporting a local trading fleet against aggressive foreign competition, this chapter noticed that tweaking an income tax regime with enhanced preferential attributes has its limits in broadly increasing the attractiveness of local fiscal conditions. This limited success in the 20th and 21st centuries was demonstrated by the ongoing contraction of UK and US merchant tonnage.

Chapter four also confirmed the relevance of a sustainability criterion for supporting optimal aid in a dynamic environment by observing that State support levels require ongoing reconsideration and adjustments, including a shipping tax regime's settings.

The issue of foreign competition of a local merchant fleet was observed to be complex. It is not necessarily only the result of regular market forces and foreign States directly acting in their interests. More dominant States have, on occasion, promoted the ship registers of other States, even to the detriment of their local register, to further their foreign policy objectives.

Thus, based on chapter four's analysis, the thesis concluded that sea power should generally constitute a primary objective of a shipping tax regime.

7.1.4 Chapter Five

The aim of chapter five was to recommend a general model for designing an optimal shipping tax regime. The chapter observed that registered and active merchant deadweight tonnage of a sponsoring State, considered as a percentage of the corresponding global tonnage, constitutes a reasonable indicator for evaluating a sponsoring State's merchant sea power. The chapter also observed that super efficiency as Positive Anti-Neutrality should be applied where necessary to better promote the expansion of this merchant tonnage.

In adopting a systemic approach to tax design, chapter five considered the juridical connecting factors as a complementary regime for supporting a shipping tax regime to promote substantial activity. In enhancing the promotion of substantial activity, the thesis recommended treating the concept of core income-generating activities as a unique concept that may be developed better to manage the special mobility of maritime transport activities. The thesis preferred further developing the juridical connecting factors than a shipping tax regime. This treatment allows shipping tax regimes to demonstrate a more straightforward design not burdened with extraordinary functions and facilitates a better congruence with the *Model Analytical Framework's Updated Smithian Framework*.

Apart from any unique demands of a particular time period, the chapter made the general observation that a shipping tax regime should be calibrated to work in tandem with the other measures of a sponsoring State's support programme for the industry. Chapter five also examined digital services as an example of another mobile industry. This latter analysis was intended to highlight to some extent the unique mobility of maritime transport activities. Chapter five demonstrated that the two industries may be differentiated based on their different mobilities and the direct promotion of sea power. The thesis concluded that the

fiscal treatments applied to digital services are not necessarily appropriate for maritime transport activities.

Chapter five considered the success of the Panamanian, Liberian and Greek flags in expanding or retaining merchant tonnage. In keeping with chapter four, chapter five preferred a shipping tax regime that is distinct from a normal income tax regime. Whether in the form of extremely generous capital allowances and rollovers, hybrid tonnage tax formulas, or more complex exemption formulas, these concessions were all observed to be inherently disadvantaged by the normal income tax regime's complexity and competing objectives. An optimal shipping tax regime should exhibit uniformity and simplicity, more broadly and intensely, to demonstrate optimal congruence with the *Updated Smithian Framework* and support the optimal promotion of a sponsoring State's sea power.

A shipping tax regime is more likely to accomplish these outcomes by functioning primarily as a distinct regime. In particular, a regime that functions, primarily, separately from a normal income/corporate tax regime. The thesis submits that the Panamanian, Liberian and Greek tonnage tax regimes should be recognised as equivalents to income/corporate taxes.

Otherwise, these regimes may be overlooked by international instruments reducing the latter's effectiveness in resolving double taxation or promoting substantial activities, among other things. The thesis has observed that the current promotion of substantial activity in shipping tax regimes is unlikely to impact the mobility of maritime transport activities significantly. Chapter five also considered lifting or freight tax as a theoretical alternative for an optimal shipping tax regime. However, its optimal application is not sustainable to the extent that it depends on broader interState cooperation and individual States not acting competitively.

In conclusion, chapter five recommended basing an optimal shipping tax regime on the Panamanian design. It was observed that this basic design could be adapted by applying minimal modifications to achieve better tax differentiation to encourage particular outcomes. Specific design features of the Greek regime were also recommended as further additions, particularly where the sponsoring State raises income taxes on a global basis. In accomplishing these outcomes, a regime may be constructed that vigorously promotes efficiency and simplicity. In turn, it is observed that these attributes may optimally support the promotion of the sea power of a State by encouraging the expansion of its registered merchant tonnage.

7.1.5 Chapter Six

Chapter six briefly considered the impact of the OECD's proposed Two-Pillar Solution on a Model Shipping Tax Regime (as recommended by the thesis). It should be noted that at the time of writing the thesis, the Two-Pillar Framework is still to some significant extent a work in progress, particularly in relation to Pillar One. Therefore, some caution should be applied when considering the conclusions of this part of the work.

The recommendations of the thesis under this chapter are based, in part, on two key sources: Recent and specific submissions made by representatives of the shipping industry, at the international level, to the OECD; and information about shipping taxation offered by the OECD in their two blueprint documents for the Two-Pillar Solution – that are both referenced in the thesis and obtained from searching the internet as usual.

Broadly, it has been observed that, at a primary level, the Two Pillars may have little significance for a model shipping tax regime as recommended here. It has, broadly, been observed that Pillar One introduces a new source taxing right (the Amount A taxing right) internationally for certain residual financial accounting profits. However, it has been pointed out by the thesis that source taxation is, generally, a foreign concept for allocating at the international level the taxing rights of States ultimately over eligible shipping income. Therefore, the thesis has questioned the merits of the decision to remove the shipping exclusion from Pillar One. Nonetheless, it has been observed that the profit margins of the relevant shipping activities may mean that where these activities are conducted through pure shipping MNE's, these entities may fail to satisfy the in-scope requirements of Pillar One. Furthermore, it has been observed throughout the thesis, including chapters five and six, that shipping tax regimes do not ordinarily manage the taxing rights of States. Therefore, these juridical double taxation concerns are not usually directly relevant to the design of a model shipping tax regime at the domestic level.

The thesis has explored, in further detail, some of the unique attributes of shipping enterprises to better understand the significance of Pillar One in relation to the shipping industry. In this regard, the thesis has concluded that the unique attributes of maritime transport activities may make them unsuitable as a tax base for the Amount A taxing right. Tax design concerns, about subjecting maritime transport activities more broadly to this new taxing right, may include breaches of the criteria of efficiency and simplicity as benchmarked here. The thesis has also revisited the recommendation from chapter three that advises for a slight finetuning of the *MTC's* article 8 shipping income at its primary level. This finetuning would refocus the tax base *at its primary level* on the navigation aspect of the maritime adventure. This reorientation may ensure that preferential tax treatments correspond better with the unique

attributes that require this concession. It has been submitted that this reconstruction may further support ringfencing outcomes more optimally for Pillar One and Pillar Two purposes. The thesis has also questioned the wisdom of utilising loading and unloading activities for the revenue sourcing rules of the Amount A taxing right, without more, based on the secondary roles that these activities play in producing article 8 shipping income.

Pillar Two is primarily concerned with establishing a 15% effective tax rate on a worldwide-basis as a minimum effective tax rate on eligible corporate income. The thesis has observed that Pillar Two should at the primary level have little significance for a model shipping tax regime. This outcome is grounded in two key aspects of its design. Firstly, Pillar Two *generally* reinforces the *MTC*'s article 8 approach that ignores source taxation in the form of permanent establishments. Secondly, the GloBE income and loss calculation for each *Constituent Entity* incorporates, as one of its steps, an exclusion for eligible shipping income.

This exclusion is, at its core, in line with the *MTC*'s article 8, as considered in chapters 3 and 5 of the thesis. Thus, both of these frameworks conceptualise eligible shipping income as income primarily produced from carrying goods and passengers by sea, internationally, on vessels that the taxpayer operates.

However, the thesis has advanced the argument throughout its analysis that, at the primary level, the navigation function should control the meaning of the words 'operating ships', as already mentioned above in this summary. However, the thesis has observed that significant disparities may become apparent between the Pillar Two's shipping exclusion and the *MTC*'s article 8, as the analysis moves away from the core and shifts to the more peripheral aspects

of conceptualising eligible shipping income. In particular, the Pillar Two framework seems to adopt a more conservative approach for awarding a concessional tax treatment to auxiliary shipping activities.

Further, the shipping income exclusion of the Pillar Two framework incorporates a substance criterion that may, at some minimum threshold, demonstrate some correspondence with the test promoted by *BEPS 5*. The thesis has further observed that this substance criterion may have the effect of further restricting the application of the shipping income exclusion at the secondary level, particularly in relation to auxiliary shipping activities.

However, the thesis submits that, to the extent that Pillar Two approach yields to the *MTC*'s article 8 approach, it may have little direct significance for designing a model shipping tax regime at the domestic level. Further, even where disparities may be identified between these two approaches, this outcome may be more directly relevant to business structuring and tax planning, than designing a shipping tax regime at the domestic level. The thesis has further observed that the Pillar Two framework may suffer from poor tax design to the extent that its differentiation is not sensitive to the substance of a case. In cases where the Pillar Two rules produce competitive distortions and unstable outcomes within the shipping industry, these deficiencies, and others, may be exploited by competitor States to advance their sea power internationally. In such cases, it is not hard to imagine that appropriately calibrated shipping tax regimes, together with carefully structured foreign conglomerates, may play some part in advancing these aims to neutralise and exploit the outcomes of the OECD's Two Pillar Solution.

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