MARITIME STRATEGIC EVALUATION FOR ISRAEL 2020/21

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Tax benefits under special tax regimes for the shipping industry[1]

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Introduction

Special tax regimes for the shipping sector exist in various countries in the international tax system. These tax regimes are a type of subsidy offered by the respective state to its maritime sector. The operation of these regimes is intended to assist in attaining objectives such as an increase in shipping operations, refurbishing of commercial fleets, increasing human resources in the area and the like.[2] Processes occurring in the global shipping sector such as international competition, the move to using flags of convenience (FOC) and the increased use of government subsidies, have put pressure on various countries to allocate assistance that also include tax benefits to their shipping industry.[3]

Studies that have examined the use of tax instruments in the international shipping sector support the importance of selecting efficient tax instruments that suit the objectives that have been established. Lessons from from the international system show that the local and international environments and their mutual influences on the tax regime must be closely studied prior to putting a new one in place as well as while it is in effect. Research shows that in certain cases tax benefits for the shipping sector only partially achieved their objectives or even failed, because of, among other reasons, misalignment. For example, it has been claimed that the use of a tonnage tax to significantly strengthen human resources in the British shipping industry did not succeed. It was asserted that the tonnage tax intended to bolster the gross tonnage increase of the fleet from 5.6 million tons to around 12 million within six years. In contrast, the increase in the number of jobs in the same period

1 This paper is based on academic research focusing on 'Special Tax Regimes for the Maritime Sector in the International System'. It is not intended to present complete legal information, and should not be seen as offering legal advice or used as such. Because of space limitations, the paper does not include all the legal issues and complexities in this field.

2 It must be noted that there are cases in which government subsidies are allocated to private shipping companies in order to safeguard or develop a strategic fleet meant to help the state in an emergency, e.g., the U.S. Maritime Security Program (MSP), Maritime Administration, U.S. Department of Transportation. https://www.maritime.dot.gov/national-security/strategic-sealift/maritime-securityprogram-msp

3 ITF (2019), "Maritime subsidies: Do they provide value for money?", International Transport Forum Policy Papers, No. 70, OECD Publishing, Paris.

benefitted seamen coming from countries outside of the European Union.[4] Another example is the use of a tonnage tax as a means of strengthening or maintaining the number of ships registered in a country. In this context, it has been claimed that in certain cases, the broadening of the tonnage tax in the international system weakened to some extent the effect of this tax instrument in achieving the above objective.[5]

The tax instrument mix, which is used to attain objectives, is varied and changes at times from state to state. These tax regimes tend to present benefits such as tax credits, tax exemptions, reduced taxation relative to other sectors, etc. Tax regimes may comprise taxes that are specific to the maritime sector, such as a tonnage tax, and types of taxes that are not unique to the sector such as company tax, employer tax, income tax and value added tax.[6]

This paper will present examples of tax instruments that states use in the maritime sector. In addition, tax benefits given in special regimes to the maritime sector will also be discussed. Likewise, examples of the conditions set by the governments for awarding tax benefits, and the participation in the special tax regimes will be presented. To show examples of the range of methods and instruments, issues in special tax regimes for the shipping industry that exist in Australia and Singapore will be offered. Lastly, a partial list of the policy recommendations that may perhaps assist in states' decision-making processes related to the use of special tax regimes for the shipping industry will be presented.

4 For additional reading about the problems in supporting maritime human resources in Britain using a tonnage tax, see: Gekara, V. (2010), "The stamp of neoliberalism on the UK tonnage tax and the implications for British seafaring", Marine Policy, Vol. 34, pp. 487–494; Leggate, H. and J. McConville (2005), "Tonnage tax: Is it working?", Maritime Policy & Management, Vol. 32:2, pp. 177–186.

5 For additional reading about the decreased effect of tonnage tax in the international system and other problems, see: Bergantino, A. and P. Marlow (1998), "Factors influencing the choice of flag: Empirical evidence", Maritime Policy and Management, Vol. 25:2, pp. 157–174; Marlow, P. and K. Mitroussi (2008), "EU shipping taxation: The comparative position of Greek shipping", Maritime Economics & Logistics, Vol. 10, pp. 185–207; Marlow, P. and K. Mitroussi (2011), "Shipping taxation: Perspectives and impact on flag choice", International Journal for Shipping and Transport Logistics, Vol.3:4, pp. 349–364.

6 For additional reading about tonnage tax models, implications and results of using it, see the following sources: Leggate H. and J McConville (2005), "Tonnage tax: Is it working?", Maritime Policy & Management. 32:2, 177–186; Marlow, P., and Mitroussi, K. (2008), "EU shipping taxation: The comparative position of Greek shipping", Maritime Economics & Logistics, 10(1–2), 185–207.

This paper relates to test cases of states in which special tax arrangements for the maritime sector exist, and does not deal with general state tax regimes that also affect the maritime sector. Due to lack of space, only the main examples drawn from the test cases will be presented, and the complete benefits and existing conditions in each case will not be discussed.

Tax instruments, types of benefits and limitations included in tax regimes for the maritime sector

As noted above, states use a range of tax instruments as part of their tax regimes for the maritime sector. The combination of types of taxes used by states can differ from state to state. The following presents some instruments and benefits that are used, classified for convenience according to capital taxes and company income tax, labor tax and energy tax.

Benefits related to capital and corporate income may be, for example, a tonnage tax for companies that allows them to pay a reduced tax. Many states, e.g., Greece, Norway, and Japan, use different types of tonnage taxes. Additional benefits are different types of reduced corporate or business taxes for entities in the maritime sector and accelerated depreciation on ships and maritime equipment. In addition, states can reduce taxes on dividends, tax deferral in cases of selling of a ship and purchase of another one, reduction or exemption from value added tax on products related to ship operation and the like.[7]

Instruments and benefits that are used in the context of human resources are reduction or exemption from income tax for seamen, foreign earning deduction for seamen, tax benefits for social benefit payments and so forth. For example, Germany, Britain, South Korea and additional countries allowed tax deductions, in certain cases, on seamen's work. Countries such as France, Sweden and Holland reduced taxes or gave tax rebates on salary expenses and social benefit payments. Benefits related to the area of energy also exist in the shipping industry; e.g., reduction or exemption from fuel and electricity taxes, exemption from carbon emission taxes (in those areas where such taxes exist). Countries such as Greece, Australia and Portugal awarded exemptions from the excise tax on fuel for ships that operated according

7 Ernst & Young. Shipping Industry Almanac 2016; Ernst & Young. Worldwide Corporate tax 2019. https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/hc-alert/eyworldwide-corporate-tax-guide-2019.pdf; Ernst & Young. Worldwide VAT, GST and Sales Tax Guide 2019. https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/tax/hc-alert/;ey-2019-worldwide-vat-gst-and-sales-tax-guide.pdf

to conditions established by legislation. Sweden conferred exemptions from carbon emission tax to local commercial shipping operations.[8]

In some countries, limitations and conditions were imposed on tax regimes in the attempt to prevent misuse of benefits and harm to local and international maritime operations. These conditions were intended to help meet, among others, targets and local economic policy, agreements and international limitation, and prevent situations such as the use of the maritime sector for the creation of tax havens.[9] There are many examples of tax benefit limitations. For example, a cap on tax benefits on the income of local seamen only, tax benefits for local corporations and so forth.[10] In some countries in the international system, the limitations on tax regimes are relatively constrained. As a result, and because of other reasons, trends such as a surge to register ships in specific countries and an international race to the bottom in terms of tax benefits are created.

A special tax regime for the Australian maritime industry

Australia, in recent years, carried out reforms in its shipping sector, which included also changing the tax regime and that was intended to reduce blockages and deficiencies in the area.[11] The package of instruments and incentives that emerged following the reform included new tax legislation that can be seen, for example,

8 ITF (2019), "Maritime subsidies: Do they provide value for money?", International Transport Forum Policy Papers, No. 70, OECD Publishing, Paris. Page 9–11, 20, 33; Ernst & Young Shipping Industry Almanac 2016.

9 To read about international activities to reduce damage caused by international tax competition and problematic tax regimes, see: Organisation for Economic Co-operation and Development (OECD). Addressing base erosion and profit shifting. February 12, 2013. Organisation for Economic Cooperation and Development (OECD). Action plan on base erosion and profit shifting. July 19, 2013. https://read.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profitshifting_9789264202719-en#page1

10 One can see examples of limitations and conditions that were imposed by states on tax benefits given to the maritime sector in the following sources: Ernst & Young. Global Oil and Gas Tax Guide 2019. https://www.ey.com/engl/tax-guides/global-oil-and-gas-tax-guide-2019; Ernst & Young, Shipping Industry Almanac 2016.

11 For additional reading on the reasons for the reform, see the following sources: Australia. Parliament of Australia Senate. Farrell, Sen Don (ALP). BILLS – Shipping Reform (Tax Incentives) Bill 2012, Shipping Registration Amendment (Australian International Shipping Register) Bill 2012, Coastal Trading (Revitalising Australian Shipping) Bill 2012, Coastal Trading (Revitalising Australian Shipping) (Consequential Amendments and Transitional Provisions) Bill 2012, Tax Laws Amendment (Shipping Reform) Bill 2012 – Second Reading. 18 June 2012.

in the Shipping Reform (Tax Incentives) Act 2012.[12] Likewise, changes were made regarding the maritime sector in the 1997 Income Tax Assessment Act.[13] The reform was intended, among others, to increase competition in the international arena, to safeguard the state's shipping industry, and to increase the number of jobs in the industry. Australia used regulatory and tax changes to increase the number of ships flying the Australian flag, which was shrinking. In addition, it acted to create conditions for revitalizing the state's commercial fleet, increase the scope of investments in the area, and upgrade and increase the sector's human resources. In contrast to other countries, it chose a model that does not also use a tonnage tax but rather other tax instruments, because, so it claimed, the method it chose is more structured, cost-effective to operate since it uses the existing tax regime, provides certainty to the taxpayer and follows the law.[14] The government published an analysis of the scope of approvals that it issued in 2012–2019 to those eligible for the central tax benefits allowed as part of the reform. The data show lack of use or limited use of the tax benefits. The tax exemption benefit was an exception, relatively speaking, as in 2019, 25 exemptions were issued to ships.[15]

The change in tax legislation focused on the some of the following central benefits. Four of these benefits require that their beneficiaries meet certain conditions and limitations set by law.[16] One of these is an exemption from income tax according to conditions established by law regarding activities conducted on passenger ships and cargo ships. The core activities include, for example, loading and unloading cargo from a ship and so forth. Likewise, an exemption was possible for activities ancillary to the core activities but this covered a relatively minor range of activities, with

12 Australia. Shipping Reform (Tax Incentives) Act 2012. No. 53, 2012. Compilation date: 5 March 2016. https://www.legislation.gov.au/Details/C2016C00434

13 Australia. Income Tax Assessment Act 1997. Subsections 40-102(4) and 40-285(5), sections 40–362 and 51–100 and Subdivision 61-N. Act No. 38 of 1997. Date of Assent 17 Apr 1997. https://www.legislation.gov.au/Series/C2004A05138/Amendments

14 Australia. Parliament of the Commonwealth of Australia. Tax Laws Amendment (Shipping Reform) Bill 2012. Revised Explanatory Memorandum. 2010–2011–2012. Pp 5–8, 14.

15 Australia. DITRDC. Consolidated Information on Certificates and Notices. Last Updated: 3 January, 2020.
https://www.infrastructure.gov.au/maritime/business/tax_incentives/certificates_issued.aspx

16 Australia. DITRDC. Eligibility Requirements for Certificates and Notices.
https://www.infrastructure.gov.au/maritime/business/tax_incentives/eligibility.aspx.
Australia. Shipping Reform (Tax Incentives) Act 2012. No. 53, 2012. Compilation date: 5 March 2016. https://www.legislation.gov.au/Details/C2016C00434

constraints.[17] Getting an income tax exemption was made contingent on satisfying a process that determined conditions and constraints. For example, applicants had to get government approval for an exemption from shipping income tax attesting to the fact that they met a series of conditions related to, among others, operations conducted in Australia, and demands related to human resource training.[18]

The second benefit was the possibility of enabling accelerated depreciation of ten years per ship instead of twenty years, as was the law prior to the reform. The declared purpose of the benefit was to create an incentive to move to using new ships. According to the government, newer ships would decrease problems of safety and environmental pollution, and enable the integration of advanced technologies. This benefit was awarded after getting exemption approval for the ship from the government. A third benefit allowed the deferment of tax payments according to conditions established by the law about profits from selling a ship, which issued it a government certificate of approval for the tax benefit. This benefit was awarded in cases when a new ship was purchased using the profits from the sale of another ship (i.e., roll-over relief), which also required government approval to get the tax benefit. The purchase must be done within a period of time established by law and according to the legislated constraints. The main reason that this benefit was included in the reform, similarly to the accelerated depreciation, was to incentivize the purchase of new ships.[19]

A fourth benefit allowed a refundable tax offset on salaries and other payments as established by law, and that were paid to Australian seamen. This benefit was limited and contingent on meeting a number of conditions. For example, employing a seaman on a ship for a minimum period with government approval as determined by the Shipping Reform Law (Tax Benefits) 2012. The purpose of the benefit was

17 Australia. Department of Infrastructure, Transport, Regional Development and Communications. Shipping Exempt Income Tax Incentive. Last Updated: 18 October, 2018. https://www.infrastructure.gov.au/maritime/business/tax_incentives/ShippingExemptIncomeTaxIncentive.aspx

18 Australia. Department of Infrastructure, Transport, Regional Development and Communications. Additional Requirements for a Shipping Exempt Income Certificate. Last Updated: 21 February, 2017. https://www.infrastructure.gov.au/maritime/business/tax_incentives/additional.aspx

19 Australia. Department of Infrastructure, Transport, Regional Development and Communications. Accelerated Depreciation and Roll–Over Relief. Last Updated: 21 February, 2017. https://www.infrastructure.gov.au/maritime/business/tax_incentives/AcceleratedDepreciationRollOverRelief.aspx

to enable Australian seamen to gain experience.[20] An additional benefit exempted Australian companies from withholding tax on payments for leasing a ship from a foreign entity, as defined by law. There are a number of conditions for this benefit such as the agreement being on a bareboat basis.[21] The purpose of this benefit was to decrease leasing costs of foreign ships for Australian companies. These companies were forced to sign contracts that imposed the withholding tax expense on them. Likewise, the benefit was intended, according to the government, to open up work opportunities for Australian seamen.[22]

Special tax regime for the shipping industry in Singapore

Singapore serves as an international maritime operations center offering a developed maritime industry services such as courier, logistics, financial, legal etc. companies.[23] In Singapore there is a tax regime that has a range of tax instruments related to many areas in the maritime sector beyond the shipping industry. The tax regime includes various tax benefits intended to strengthen the international competitiveness of the maritime industry. Below are several examples of the main tax benefits.[24]

Singapore operates a tax benefit program called Maritime Sector Incentive – MSI. The program has a number of benefit tracks that address various areas in the maritime sector. For example, the track for getting a tax benefit called the Approved International Shipping Enterprise Award (MSI–AIS) is intended to encourage international ship owners and operators to establish their commercial operations base in Singapore. The MSI–AIS tax benefit enables these owners and operators to get an exemption on taxes on certain income as determined by law. For example, they can get an exemption from income from foreign ships operating in international

20 Australia. Department of Infrastructure, Transport, Regional Development and Communications. Tax Incentives–Australian Shipping. Seafarer Tax Offset. https://www.infrastructure.gov.au/maritime/business/tax_incentives/seafarertaxoffset.aspx

21 Bareboat basis is the leasing of a ship without crew and fuel. To read the dictionary definition of this concept, see: Cambridge Dictionary. Bareboat charter. Cambridge University Press. 2020. https://dictionary.cambridge.org/dictionary/english/bareboat-charter

22 Australia. DITRDC. Royalty Withholding Tax Exemption. Last Updated: 21 February 2017. https://www.infrastructure.gov.au/maritime/business/tax_incentives/RoyaltyWitholdingTaxExemption.aspx

23 Lam J.S.L. (2016) Strategy of a transshipment hub: The case of Port of Singapore. In: Lee P.TW., Cullinane K. (eds.) "Dynamic shipping and port development in the globalized economy". Palgrave Macmillan, London. pp. 12–38.

24 For further details about the paragraphs relevant to the maritime sector that appear in Singapore's income tax law, such as paragraph A13 (Exemption of shipping profits) and paragraph F13 (Exemption of international shipping profits), see: Singapore Income Tax Act (ITA). Current version as at 22 Nov 2020. https://sso.agcgov.sg/Act/ITA1947

shipping lanes according to the conditions established by law. The program has additional tracks such as the track that offer benefits when leasing a ship, the Maritime Leasing (MSI–ML) award. There is another track, the Shipping-Related Support Services (MSI–SSS) award, which confers benefits for operations defined as supporting the maritime sector, e.g., courier and logistics companies, shipping agencies and more.[25]

There are a number of additional benefits such as withholding tax exemption. This benefit on interest and certain payments related to purchase financing arrangements or the construction of a ship is given to businesses determined to be eligible. The benefit is contingent on a series of conditions and constraints.[26]

Another benefit is related to companies operating Singapore-registered ships. These companies are eligible for tax benefits on income from operations that occurred outside of the port of Singapore, as delineated in paragraph A13 of the Singapore Income Tax Act. The tax benefit is awarded in cases such as transport of cargo and passengers on ships, towing or maritime rescue operations, profit from selling a Singapore-registered ship and others.[27] Likewise, Singapore offers certain benefits to the maritime sector under the Goods and Services Tax Act, which tariff is equivalent to value added tax.[28]

25 Maritime and Port Authority of Singapore. Maritime Sector Incentive. https://www.mpa.gov.sg/web/portal/home/maritime-companies/setting-up-in-singapore/programmes-tosupport-your-maritime-business/maritime-sector-incentive

26 Maritime and Port Authority of Singapore. Withholding Tax (WHT) Exemption. https://www.mpa.gov.sg/web/portal/home/maritime-companies/setting-up-in-singapore/programmesto-support-your-maritime-business/withholding-tax-exemption Inland Revenue Authority of Singapore. Payments That Are Not Subject to Withholding Tax. Payments for the Charter of Ships. https://www.iras.gov.sg/irashome/Other-Taxes/Withholding-tax/Non-residentcompanies/Payments-That-Are-Not-Subject-to-Withholding-Tax/#title5

27 For further details about the operations and situations that make companies eligible for tax benefits, according to the conditions laid out, see the following source: Inland Revenue Authority of Singapore. Specific industries – Shipping Companies. https://www.iras.gov.sg/irashome/Businesses/Companies/Working-out-Corporate-/Income-Taxes/Specific-industries/Shipping-Companies

28 Inland Revenue Authority of Singapore. GST-registered businesses – Specific business sectors. Marine and Shipping. https://www.iras.gov.sg/irashome/GST/GST-registeredbusinesses/Specific-business-sectors/Marine-and-Shipping; Inland Revenue Authority of Singapore. GST Guide for the Marine Industry. 25 Oct 2019. https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/eTax%20Guide_Guide%20for%20the%20Marine%20Industry_Second%20Edition.pdf

Discussion and significance for Israel

Over the years, the state of Israel awarded certain tax benefits to the Israeli maritime sector.[29] For example, operations that were conducted under the auspices of legislation such as the Law for Encouragement of Capital Investments 1959, which formed the basis for awarding benefits to Israeli ships by the Ministry of Industry and Commerce (MIC), as part of the tax benefit track that included reduced corporate tax, accelerated depreciation and reduced capital gains tax.[30] In addition, in Israel, government support that is not through tax benefits is also available. This support comprises a total of 20 million shekels, for a period of four years, and is intended to support employment of Israeli seamen in Israeli ships (carrying an Israeli flag or Israeli owned), thus requiring that Israeli seamen be employed.[31]

Israel is considering a tax change in the area of shipping along the lines of tonnage tax legislation. The proposed income tax law (Vessel Operation Income Tax by Tonnage), 2018, notes that passage of the aforesaid legislation will bring the law into line with that used around the globe. In the opinion of the Israeli government, the proposed tax regime may help prevent the move of Israeli ships to operations as part of foreign companies. Furthermore, the benefits may motivate foreign shipping companies into becoming Israeli ones, and will advance the establishment of new companies in the industry, as well as strengthen industries ancillary to shipping. It has been claimed that this will bolster international competitiveness and support for maritime training, as well as maintain environmental protection.[32]

Some central issues must be considered when discussing the special tax regime for the shipping industry before creating it and also while implementing it. Below is a list of a number of issues arising from test cases in other countries that used tax regimes

29 To get an impression of the legislative activity, see the following examples: Income Tax Ordinance [New Text], 1961, paragraphs 5, 70–74, (amendment no. 22) 1975 (amendment no. 132) 2002, paragraph 130A (amendment no. 142) 2004, etc.; the Law for the Encouragement of Industry (Taxes) 1969; The Knesset's Economic Affairs Committee, protocol no. 137, proposed Exemption from Tax for Seamen and Vessel Owners Law 1994, June 1994; Income Tax Regulations (Percentage of Depreciation for Ships), 2001.

30 For further reading, see the following source: The Encouragement of Capital Investment Law, 1959. https://main.knesset.gov.il/Activity/Legislation/Laws/Pages/LawPrimary.aspx?t=lawlaws&st=lawlaws&lawitemid=2000780

31 Government decisions, Airport Authority and Improvement of the Competitiveness of Israeli Shipping, government decision no. 3373 of 11 January 2018.

32 For further details about the reasons and objectives of Israel in promoting this law, see the following source: Proposed Income Tax Law (Vessel Operation Income Tax by Tonnage), 2018, 18 July 2018. https://www.nevo.co.il/law_word/law15/memshala-1251.pdf

in this area.[33] The list does not exhaust all the aspects that should be related to when discussing the tax regime but can be a good basis for the examination.

1. It is better for the state to determine what goals it is trying to achieve through the instruments, e.g., tax benefits, that are available to it in terms of the maritime sector and other related factors. Setting goals will allow it to assess the effectiveness of the instruments in achieving the targets and evaluate the changes, to the degree required, that will promote the desired results. A national goal, in the case of Israel, may be, for example, to maintain and strengthen Israel's commercial maritime connectivity that may be called upon in emergencies, through a fleet under Israeli control.
2. An investigation into what is the appropriate tool or the best combination of tools to achieve the goals set by the government should be conducted. Sometimes, instruments that are not tax benefits are more effective and a better means for attaining goals.
3. If tax benefits are to be used, then it should be determined which are the correct eligibility features that should be set that will help meet their intended purpose. Determining the tax benefit features must be done after examining legal, financial, commercial and other aspects that impact the maritime sector's operations. Misidentifying the appropriate features may lead to undesirable results, as noted above.
4. An important issue is the examination of the cost of tax benefits to the state, versus the expected gain. In addition, the other affects of tax benefits on the maritime sector and other factors should also be examined. Sometimes the tax benefits may cause undesirable results that will impact efficient operations negatively.
5. After the tax benefits become effective, the state must examine the level of their success, and adjustment them accordingly. Conducting an impact study on the maritime sector tax regime may help. Similarly, the predicted data, which were used as the basis for the decision to implement tax benefits and determine their features, should be examined to see whether they are appropriate and if not, a new examination should be conducted.
6. Regulatory, economic and other changes in the local and international maritime sector may affect the success of tax benefits over time. Nevertheless, there is also a danger that subsidies, including tax benefits, will create unwanted distortions in the maritime sector. Such changes and possibilities mandate a reexamination of the benefits, and if necessary, they must be modified.

33 An example of recommendations, some of which may help achieve higher quality goals when using subsidies in the maritime sector: ITF (2019), "Maritime subsidies: Do they provide value for money?", International Transport Forum Policy Papers, No. 70, OECD Publishing, Paris. Page 7–8.