KPMG

Tax alert

Issue 2 | January 2024

Navigating the waters of Base Erosion and Profit Shifting 2.0 Pillar Two Rules in the maritime sector

The list of never-ending challenges faced by the maritime sector — environmental concerns, piracy, volatile freight/charter rates, increasing regulations, among others — is a tale as old as time.

With the introduction of the Base Erosion and Profit Shifting (BEPS) 2.0 Pillar Two Rules (BEPS Pillar Two Rules), the maritime sector is facing a new wave of challenges, specifically on how the rules should be interpreted and implemented. In this tax alert, we set out the practical considerations whilst applying the BEPS Pillar Two Rules to this sector, and its interplay with Singapore's maritime tax incentive regime. To note, the main focus of our analysis is on the Global Anti-Base Erosion (GloBE) Rules which are the key part of the BEPS Pillar Two Rules that have been, or will be, legislated by many jurisdictions. The other part of the BEPS Pillar Two Rules is the Subject-to-tax Rule (STTR), which has yet been enacted in any jurisdiction. Hence, we will only be discussing the STTR briefly at the end of this article.

Singapore maritime tax incentives

As a leading international maritime centre and transhipment hub, Singapore remains at the forefront of the global sea trade network. Its pro-business policies and well-integrated ecosystem of maritime services make Singapore the preferred port for maritime organisations looking to grow in the Asia-Pacific region and beyond.

Unlike some European countries, Singapore does not have a tonnage tax regime (i.e. whereby tax is payable based on the tonnage of the ships) for the maritime sector. However, Singapore has a competitive shipping tax incentive regime (i.e. the Maritime Sector Incentive (MSI) scheme) aimed at helping enterprises in the maritime sector anchor/grow their businesses in Singapore, aside from providing attractive grants and funding for such enterprises. It is worthy to note that the MSI has been assessed by the Forum on Harmful Tax Practices to have satisfied the international standards on countering harmful tax practices under the OECD/G20 BEPS project.

The MSI scheme offers corporate income tax (CIT) exemptions and/or concessionary tax rates on income derived from qualifying shipping activities/shipping-related support services, subject to meeting certain requirements. For example, the MSI – Singapore Registry of Ships and the MSI – Approved International Shipping Enterprise schemes provide for tax exemption (i.e. a 0% CIT rate) on qualifying shipping income as prescribed in the Singapore Income Tax Act 1947 (SITA). However, there are differences between what is considered qualifying shipping income under the SITA vis-à-vis Qualified International Shipping Income (QISI) and Qualified Ancillary International Shipping Income (QAISI) as defined under the GloBE Rules, which we will elaborate further in this article.

What do the GloBE Rules mean for the maritime sector

In principle, the GloBE Rules are designed to ensure a minimum level of taxation for large multi-national enterprises (MNE) groups at an Effective Tax Rate (ETR) of 15% on a jurisdictional basis where the groups operate in. Accordingly, unless the entity or the income is excluded from the scope of BEPS Pillar Two, any tax incentive that offers permanent benefits (e.g. tax exemptions or concessionary tax rates) will potentially be muted in the context of such rules for in-scope MNE groups.

Having said the above, the good news for the maritime sector is that the GloBE Rules do provide exclusion for QISI and QAISI. In essence, these incomes, if qualified, will be excluded from the ETR calculation, which essentially means that there would be no Top-up Tax imposed on such income even if it is not taxed or low-taxed. This is specifically provided in Article 3.3 of the GloBE Rules, often referred to as the ISI exclusion rules.

One may, however, expect that for such exclusion to have been approved by the Inclusive Framework comprising more than 140 jurisdictions, many of which have no or little international maritime activities, to lay down conditions that must be fulfilled before the income can qualify for the exclusion. It is thus not surprising that there are indeed a few critical conditions, each leading to certain practical issues, which we will describe further in this piece.

Practical issue #1: Location of strategic and commercial management

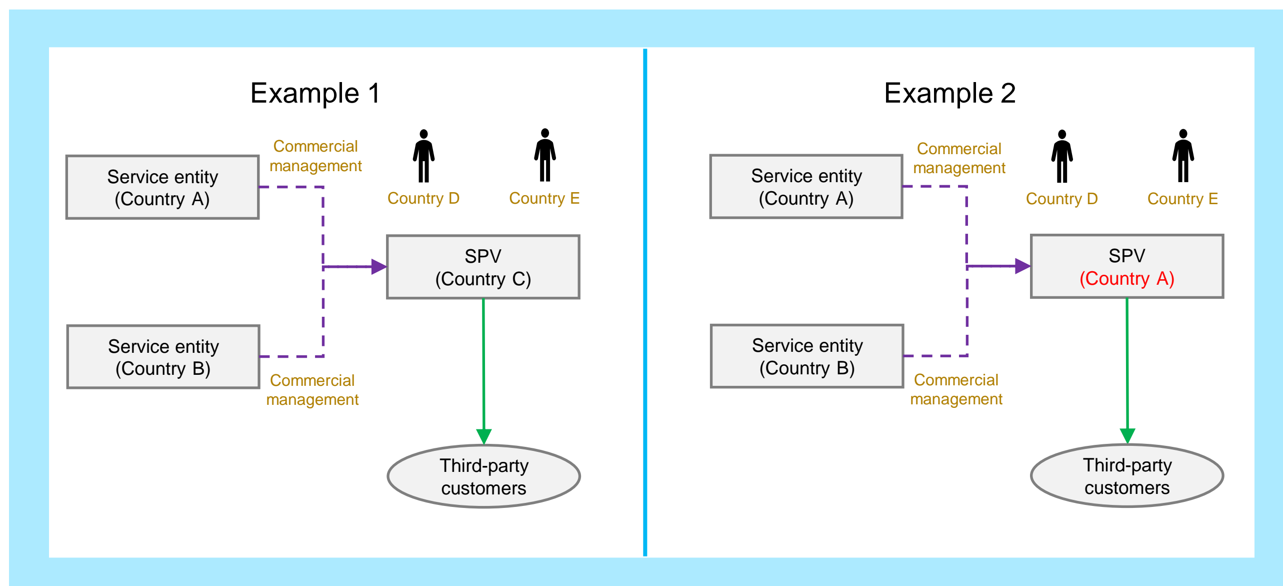
One of the conditions for the ISI exclusion is the substance requirement. Specifically, it requires that the strategic or commercial management of the ship is effectively carried on from within the jurisdiction where the Constituent Entity (that earns the shipping income) is located.

The Commentary to the GloBE Rules (the ‘GloBE Commentary’) published in March 2022 provides additional insights into ‘strategic management’ and ‘commercial management’. Strategic management encompasses significant decisions related to capital expenditure, asset transactions, contract awards, alliances, and ship pooling. Important factors indicating strategic management include the location of decision-makers, including senior management staff, company board meetings, operational board meetings, and the residence of directors and key employees.

Commercial management, on the other hand, involves activities such as route planning, cargo or passenger bookings, insurance, financing, personnel management, provisioning, and training. Factors indicating commercial management include the number of employees engaged in these activities within the jurisdiction and the nature and extent of accommodation provided.

The ask for strategic or commercial management is not something new. Most of the existing shipping regimes (the Singapore MSI, the tonnage tax regimes in the UK or the Netherlands, etc.) also have similar requirements, though these may be interpreted differently in each jurisdiction. If we turn to the GloBE Rules, concerns arise from the lack of guidance and a predictable complexity when the same test is assessed by not one but various tax authorities. How can we then assess whether this substance requirement is met, and perhaps more importantly, make sure that the same interpretation/position is agreed by all the tax authorities to whom this matter may concern, especially when shipping activities typically involve multiple jurisdictions?

The GloBE Rules and Commentaries do not mention any qualitative or quantitative test that can be used to determine if the management is performed in the relevant jurisdiction or jurisdictions. For discussion purpose, let us try to apply this assessment to the two examples set out below:

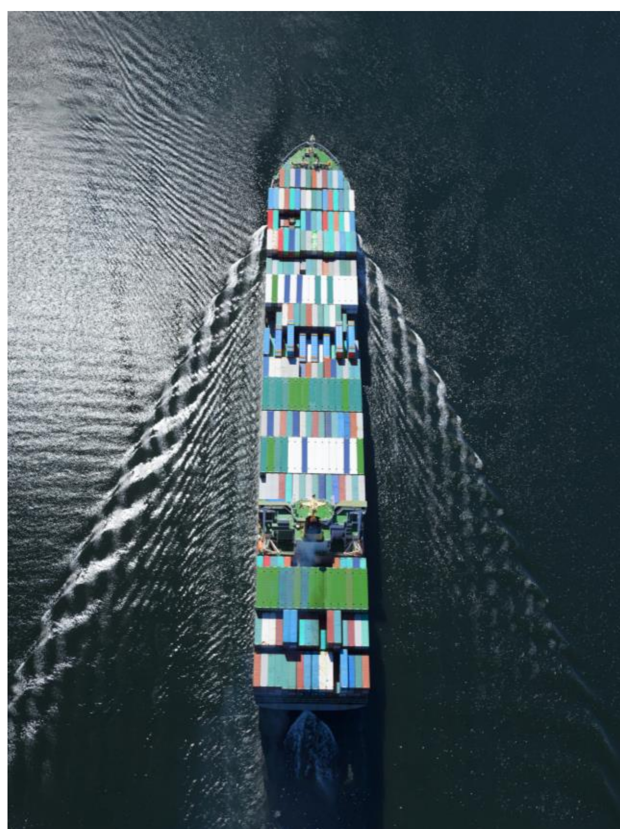


In Example 1, a Special Purpose Vehicle (SPV) located in Country C is the ship owner where the chartering income is recognised. For the ship operation, this is taken care of by two service entities, one located in Country A (in charge of Asia-Pacific and Middle East zones) and one in Country B (in charge of rest of the world). Let us assume all strategic management in relation to the ship concerned is carried out by the group directors comprising one based in Country D and one in Country E. In this case, both the strategic and commercial management of the ship are so scattered that they may not qualify for the GloBE Rules substance test (and likely any existing major shipping regime's substance test if it were to be applied).

In Example 2, there is one change — the SPV is now re-domiciled to Country A, effectively aligning the location of the entity/income with the location of (part of) the commercial management. Operation wise, it is necessary to still maintain the team in Country B to handle part of the commercial management when the ship is in that region, though all under the instruction and supervision of the function head, based in Country A. In this structure, is the GloBE Rules substance test considered met? Absent any permissible threshold, there is a risk that the answer may still potentially be a NO.

As much as we do appreciate the intention of the OECD/IF to keep the rules simple (as one may expect that any facts-and-circumstances assessment would be hard to be consented by all tax authorities involved), perhaps certain simplified ways to accommodate for how the shipping world is being operated should be considered.

That said, before any further guidance is provided, shipping groups within the scope of the GloBE Rules will need to assess the effect of this rule to the management and ownership of their ships and whether their group would satisfy this test.

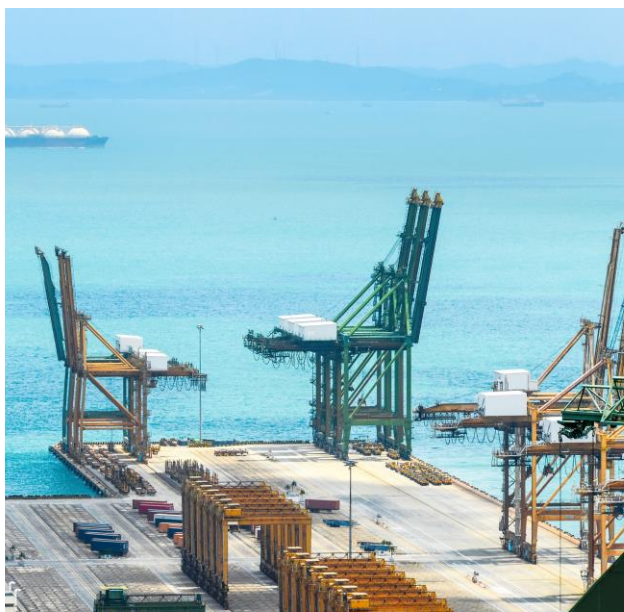


Practical issue #2: Exhaustive lists of qualified excluded income

The primary ISI covers profits derived from ships operating in international traffic. The term ‘international traffic’ 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).

Although we can still see some other non-transportation income being included in the list of QISI, this is far from the coverage of the existing shipping/tonnage tax regimes, which normally allow wider activities ‘performed at sea’ to be included (e.g., Singapore’s MSI schemes). This discrepancy can create troubles for shipping groups, especially those in the offshore sector, where their incomes may be tax exempted or low-taxed currently in the jurisdiction(s) where they are being booked, but yet subject to Top-up Tax under the GloBE Rules.

For discussion purpose, let us imagine the scenario of an offshore service ship such as a cable layer, which travels from Country A with the cable to Country B. In Country B, it lays the cable all the way to Country C. Subsequently, it returns to its port in Country A, transporting engineers from another company and the cable-laying equipment. Determining which parts of this route qualify as international traffic or trying to allocate the relevant income to the different parts of the activity for the purpose of the GloBE Rules can be intricate.



Another scenario where we may expect controversy in assessing QISI is when a ship departs and arrives in two ports of the same jurisdiction, but part of the voyage is in international waters. For example, a cruise liner may well fall within this scenario, although a more important consideration is whether its income should be considered income derived from transportation or something else (e.g. hospitality) for the purpose of the GloBE Rules. The GloBE Commentary does not elaborate further on this point, so it may stand to reason that the interpretation could be relied on the Commentary on Article 8 of the OECD Model Tax Convention, which in itself seems to contain certain nuances.

Looking beyond the primary shipping income, the international shipping exclusion under the GloBE Rules also allows for QAISI. Although this is indeed a plausible design of the rules, one may find it confusing as to what kind of ancillary activities can be considered a QAISI and the reason(s) why the types of activities considered to be QAISI are so narrowly defined in the GloBE Rules.

It is worth noting that paragraph 162 of the GloBE Commentary says, ‘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)’. Then, it goes on to add, ‘to qualify for the exclusion, the income must be obtained by a Constituent Entity from the activities listed in Article 3.3.3 that are performed primarily in connection with the transportation of passengers or cargo by ships in international traffic’. This appears to be a double limitation and effectively narrow QAISI to such few cases that it can easily exclude ‘normal’ ancillary shipping incomes or incomes that are incidental to the shipping business. For instance, income that is derived from ship operation management services, if it goes beyond the provision of ‘engineers, maintenance staff, cargo handlers, catering staff, and customer services personnel’, is now effectively excluded from QAISI.

On top of this, the GloBE Rules also require any QAISI that exceeds 50% of the QISI to be included in the ETR calculation. Given that shipping groups often segment various activities within the value chain into separate entities located in different jurisdictions due to several commercial rationales, one may then expect the 50% cap to result in a much more limited application of QAISI.

Practical issue #3: Mobile assets/crew may not be accounted for Substance-based Income Exclusion (SBIE) purposes

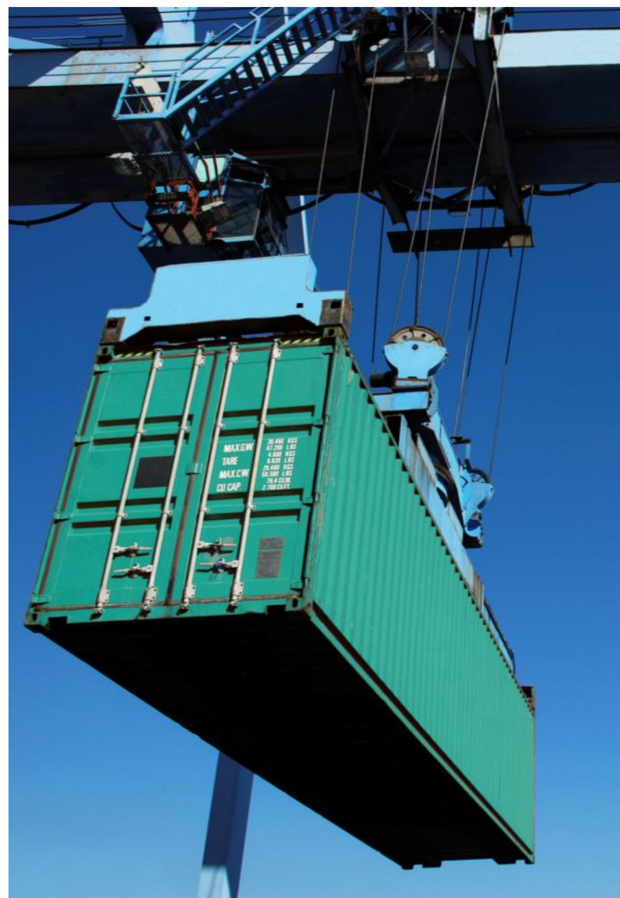
To caveat, this issue will not be a concern for shipping groups whose incomes are entirely excluded as QISI or QAISI. However, for shipping groups that generate non-qualifying income or somehow fail the substance test and must calculate their Top-up Tax exposure, the SBIE issue will then be a concern given the way the GloBE Rules are currently crafted.

In essence, when an MNE group calculates its Top-up Tax amount, it is allowed that certain percentages of its eligible payroll expenditure and tangible asset value could be subtracted from the GloBE Income, therefore effectively mitigating the Top-up Tax liability. This is a very welcoming feature of the GloBE Rules, the policy intent of which is to provide concession on the real substance that an MNE group has in certain jurisdiction because 'these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions'. Following this rationale, the SBIE claim only allows for employees and tangible assets that are located within the same jurisdiction as that of the entity. However, this rationale may not work for international transportation industries such as shipping or airlines. The assets and workforces of these businesses possess unique mobility characteristics that necessitate special consideration within the SBIE framework.

The long-awaited Administrative Guidance issued in July 2023 finally came out with some additional guidance on mobile assets and employees, and it hinges on whether an Eligible Employee or Eligible Tangible Asset is located for more than 50% of its time within the Constituent Entity's jurisdiction. If so, the entirety of the SBIE is allocated to that jurisdiction. Conversely, if less than 50%, only a proportion of the SBIE attributable to that jurisdiction shall be allowed.

This, again, does not seem to work for international shipping or airline groups. One can envisage that a sea-going ship or an air-borne plane (and the crews) will spend most of its time plying in international waters or air, and not be 'located' in any jurisdiction. As a result, the benefit of the SBIE to ship or plane operating companies could still be potentially denied.

Fortunately, the OECD/IF does recognise the need to have special treatments for the SBIE in such cases. It, however, remains to be seen as to what extent this will be factored in, and if yes, whether it can be sufficiently simplified to factor in the additional compliance required. We hope to see more on this in the next tranche(s) of Administrative Guidance to be issued in early 2024.



What other issues may we expect?

We would also like to bring your attention to the Subject-to-Tax Rule (STTR) and its potential impacts on shipping groups in Singapore.

For those who are not familiar with this concept, the STTR is part of the BEPS Pillar Two Rules but separately administered since this is a tax treaty-based rule which allows for the levying of additional tax on several categories of connected party payments. Specifically, the STTR relaxes the tax treaty restrictions which would otherwise apply on source jurisdiction taxation on the listed payments. This permits countries to apply their domestic law taxing provisions to bring the nominal CIT rate up to a minimum of 9%.

Although the rule is quite complex, one may expect that the application and impacts of the STTR would not be that far-reaching for several reasons, particularly on shipping groups.

For the first reason, since the effect of the STTR is to allow the payer jurisdiction to apply a Top-up Tax to bring the tax on the payment up to an agreed minimum rate, how the STTR Top-up Tax works should depend on how each jurisdiction chooses to adopt the rules. If the jurisdiction chooses not to impose or increase the domestic withholding tax rate to give effect to the new Top-up Tax, it may be the case where no Top-up Tax is collected under the STTR at the payer jurisdiction even if a covered payment is made to low-taxed payee jurisdiction.

For the second reason, the STTR will only make changes (relaxation of taxing rights for source countries) in relation to Articles 7 (business profits), 11 (interest), 12 (royalties), and 21 (income not otherwise covered in other articles). In other words, the STTR would not impact income covered under Article 8 (which deals with international shipping and air transport).

That said, not all incomes of a shipping business, or a shipping-related business, may be covered under Article 8. For example, Articles 7 or 12 (not Article 8) typically apply to profits from the leasing of a ship to be used for the transportation of passengers or cargo in international traffic on a bareboat charter basis that is more than ancillary to the operation of an enterprise’s ships in international traffic. The good news is that the STTR does provide specific exemption for bareboat charter, in particular where the income is taxed under a tonnage tax regime in the receiving jurisdiction.

Conclusion

As Singapore's maritime sector grapples with the implications of the BEPS Pillar Two Rules, clarity and alignment between such rules and standard industry practices are vital. The maritime sector's unique characteristics, including its ancillary activities, require clear definitions and guidance for MNE groups in this sector to navigate the regulations effectively. Moreover, the rules have to ensure equitable treatment across the different players in the maritime sector.

Shipping and offshore groups, with a turnover of at least €750m, benefiting from preferential/tonnage tax regimes may thus be impacted by the BEPS Pillar Two Rules as we have discussed in this article above. We recommend that such groups closely monitor the implementation process of such rules and seek help where required.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

Author

Yong Jiahao
Partner
Infrastructure, Government &
Healthcare and Manufacturing, Tax
T: +65 9632 3674
E: jiahaoyong@kpmg.com.sg

Contact us

Ajay K Sanganeria
Partner
Head of Tax
T: +65 6213 2292
E: asanganeria@kpmg.com.sg

BANKING & INSURANCE

Alan Lau
Partner
Head of Financial Services, Tax
T: +65 6213 2027
E: alanlau@kpmg.com.sg

ENERGY & NATURAL RESOURCES AND TELECOMMUNICATIONS, MEDIA & TECHNOLOGY

Gordon Lawson
Partner
Head of Energy & Natural Resources, Tax
T: +65 6213 2864
E: glawson1@kpmg.com.sg

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

Mark Addy
Partner
T: +65 6508 5502
E: markaddy@kpmg.com.sg

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE AND MANUFACTURING

Chiu Wu Hong
Partner
Head of IGH & Manufacturing, Tax
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

Yong Jiahao
Partner
T: +65 6213 3777
E: jiahaoyong@kpmg.com.sg

Toh Boon Ngee
Partner
T: +65 6213 2052
E: btoh@kpmg.com.sg

REAL ESTATE & ASSET MANAGEMENT

Teo Wee Hwee
Partner
Co-Head of Real Estate, Tax, and Head of Asset Management & Family Office
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Anulekha Samant
Partner
Co-Head of Real Estate & Asset Management, Tax
T: +65 6213 3595
E: asamant@kpmg.com.sg

Agnes Lo
Partner
T: +65 6213 2976
E: agneslo1@kpmg.com.sg

Andy Baik
Partner
T: +65 6213 3050
E: andybaik1@kpmg.com.sg

Pearlyn Chew
Partner
T: +65 6213 2282
E: pchew@kpmg.com.sg

Evangeline Hu
Partner
T: +65 6213 2597
E: evangelinehu@kpmg.com.sg

Contact us

TRANSFER PRICING

Felicia Chia
Partner
Head of Transfer Pricing, Tax
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

Denis Philippov
Partner
T: +65 6213 2866
E: denisphilippov@kpmg.com.sg

Yong Sing Yuan
Partner
T: +65 6213 2050
E: singyuanyong@kpmg.com.sg

INDIRECT TAX

Elaine Koh
Partner
T: +65 6213 2300
E: elainekoh@kpmg.com.sg

Sharon Cheong
Partner
T: +65 6213 2399
E: sharoncheong@kpmg.com.sg

Gan Hwee Leng
Principal Consultant
T: +65 6213 2813
E: hweelenggan@kpmg.com.sg

CORPORATE TAX PLANNING & COMPLIANCE

Mak Oi Leng
Partner
Head of Corporate Tax
Planning & Compliance, Tax
T: +65 6213 7319
E: omak@kpmg.com.sg

Audrey Wong
Partner
T: +65 6213 2010
E: audreywong@kpmg.com.sg

Lim Geok Fong
Principal Advisor
T: +65 8118 1129
E: geokfonglim@kpmg.com.sg

TAX GOVERNANCE

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

TAX TECHNOLOGY & TRANSFORMATION

Catherine Light
Partner
T: +65 6213 2913
E: catherinelight@kpmg.com.sg

GLOBAL COMPLIANCE MANAGEMENT SERVICES

Cristina Alvarez-Ossorio
Partner
T: +65 6213 2688
E: cristinaalvarez@kpmg.com.sg

PERSONAL TAX & GLOBAL MOBILITY SERVICES

Murray Sarelius
Partner
Head of Personal Tax &
Global Mobility Services, Tax
T: +65 6213 2043
E: murraysarelius1@kpmg.com.sg

Barbara Kinle
Partner
T: +65 6213 2033
E: bkinle@kpmg.com.sg

Garren Lam
Principal Advisor
T: +65 9728 1502
E: garrenlam@kpmg.com.sg

FAMILY OFFICE & PRIVATE CLIENTS

Teo Wee Hwee
Partner
Head of Asset Management
& Family Office
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Pearlyn Chew
Partner
T: +65 6213 2282
E: pchew@kpmg.com.sg

MANAGED SERVICES

Larry Sim
Partner
Head of Managed Services, Tax
T: +65 6213 2261
E: larrysim@kpmg.com.sg

Contact us

PROPERTY TAX & DISPUTE RESOLUTION

See Wei Hwa
Partner
T: +65 6213 3845
E: wsee@kpmg.com.sg

Leung Yew Kwong
Principal Advisor
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

R&D AND INCENTIVES ADVISORY

Lee Bo Han
Partner
T: +65 6508 5801
E: bohanlee@kpmg.com.sg

TAX – DEALS, M&A

Adam Rees
Partner
T: +65 6213 2961
E: adamrees@kpmg.com.sg

BASE EROSION AND PROFIT SHIFTING (BEPS)

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

Andy Baik
Partner
T: +65 6213 3050
E: andybaik1@kpmg.com.sg

INDIA TAX SERVICES

Bipin Balakrishnan
Partner
T: +65 6213 2272
E: bipinbalakrishnan@kpmg.com.sg

US TAX SERVICES

Andy Baik
Partner
Head of US Tax Desk
T: +65 6213 3050
E: andybaik1@kpmg.com.sg

Joon Choi
Principal Advisor
T: +65 6508 5636
E: joonchoi1@kpmg.com.sg

Nicole Li
Principal Advisor
T: +65 6213 3388
E: nicoleli4@kpmg.com.sg

About our tax alerts

KPMG's tax alerts highlight the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may impact your company. As certain issues discussed herein are time-sensitive, it is advisable to make plans accordingly.

Tax alerts are issued exclusively for the information of clients and staff of KPMG Services Pte. Ltd. and should not be used or relied upon as a substitute for detailed advice or a basis for formulating business decisions. Read more of KPMG in Singapore's insights and perspectives here.

KPMG
12 Marina View, #15-01
Asia Square Tower 2
Singapore 018961
T: +65 6213 3388
F: +65 6225 0984
E: tax@kpmg.com.sg

- Singapore Tax Firm of the Year – International Tax Review Asia-Pacific Tax Awards 2022, 2023
- Singapore Tax Disputes Firm of the Year – International Tax Review Asia-Pacific Tax Awards 2021, 2022, 2023
- Singapore Tax Policy Firm of the Year – International Tax Review Asia-Pacific Tax Awards 2023
- Regional Tax Compliance and Reporting Firm of the Year – International Tax Review Asia-Pacific Tax Awards 2023
- Diversity & Inclusion Firm of the Year – International Tax Review Asia-Pacific Tax Awards 2023

For more details on our tax services, please click here.

© 2024 Copyright owned by one or more of the KPMG International entities. KPMG International entities provide no services to clients. All rights reserved.

KPMG is a global organization of independent professional services firms providing Audit, Tax and Advisory services. KPMG is the brand under which the member firms of KPMG International Limited ("KPMG International") operate and provide professional services. "KPMG" is used to refer to individual member firms within the KPMG organization or to one or more member firms collectively.

© 2024 KPMG Services Pte. Ltd. (Registration No: 200003956G), a Singapore incorporated company and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.