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An Amendment to Subsidiary Legislation 234.43 of the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations (2018); through Legal Notice 179 of 2020 on the Flag Link Requirement for the Eligibility of Chartering-in Activities to Tonnage tax, to complement the EU Commission Decision of 19th December 2017.

In accordance with the Regulations for the Degree of LL.M. in International Maritime Law I, the undersigned, do hereby declare that the Maritime Legislative Drafting Project being presented with this declaration is my own personal work and that it has not been previously submitted, or is not concurrently being submitted in candidature for any other degree or diploma.

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Signature of Student

**An Amendment to Subsidiary Legislation 234.43 of the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations (2018); through Legal Notice 179 of 2020 on the Flag Link Requirement for the Eligibility of Chartering-in Activities to Tonnage tax, to complement the EU Commission Decision of 19th December 2017.**

**A Legislation Drafting Project submitted in partial fulfillment of the requirements for the award of the Degree of Master of Laws (LL.M.) in International Maritime Law at the IMO International Maritime Law Institute.**

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## 1. Introduction

### a. A Historical Overview

Taxation has often been used by States as a tool to improve or enhance their competitive and commercial attractiveness in international industries. The manner in which taxes are imposed, on natural or legal persons and their income, is completely dependent upon the national policy of the State. Although some States have used tax incentives as a means of improving their economic position, other States have chosen to apply preferential and unreasonable tax rates to purposely distort competition. Generally, the application of corporate tax is applied to the annual income derived from the profits of a legal entity. However, the application of tax in many maritime States is applied differently for several reasons. Since the shipping industry is inherently based on global trade, shipowners and ship operators tend to register their vessels according to the trading area or conversely to the region that has the most attractive tax and financial regime for the purpose of their enterprise. This is ultimately the main scope behind the tonnage tax system, that is, taxation based not on the annual profits of the shipping organisation but on the net tonnage of the vessel registered under that Flag State Administration. Therefore, tonnage tax is applicable whether the company makes a profit or a loss. Once this tax has been paid, then no further tax is due. This obviously depends on the jurisdiction creating such system of tonnage tax. Tonnage tax has been referred to as a ‘business-friendly tax’ for a number of reasons, mainly and for the purpose of this drafting project, it provides a simple, transparent, certain and efficient method for the calculation of tax, in an industry, whose businesses are renowned for their multi-jurisdictional character. Thus, encouraging simpler operation and management of shipping companies by enhancing their cost and operational effectivity through fiscal certainty.<sup>1</sup>

There are various ways in which the tonnage tax system may apply, some jurisdictions such as the Greece and Malta follow a ‘pure tonnage tax system’, that is, the amount of tonnage tax payable by the shipping company is determined on the basis of the tonnage operated by that shipping entity, in this scenario tonnage tax completely replaces the corporate tax system. On the other hand, other jurisdictions may impose tonnage tax together with corporate tax.<sup>2</sup>

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<sup>1</sup> Antapassis.A, Athanassiou.I.L, Rosaeg.E, ‘*Competition and Regulation in Shipping and Shipping Related Industries*’, Martinus Nijhoff Publishers, Leiden, Boston (2009), Part III, ‘*Tonnage tax and Competition*’, 265.

<sup>2</sup> Ibid. 267.

## b. An Overview of the Maltese Tonnage tax Regime Pre-2018

Malta's strategic, geographical position, its natural harbours and its sound judicial stability and legislative flexibility has allowed it to retain the position as a leading maritime nation worldwide. Back in 1973, the Malta Maritime Authority felt the need to enact the Merchant Shipping Act (MSA),<sup>3</sup> which followed the UK Merchant Shipping Act. This Act provided comprehensive regulations relating to the registration of vessels under the Malta Flag and the operation thereof. The Act also introduced the first notion of tonnage tax, through the definition of an 'exempted ship',<sup>4</sup> this definition held that a ship registered under the Malta Flag, which complied with certain conditions, was exempt from the payment of income tax. These innovations were enacted as a means of attracting merchant shipping organisations to operate merchant shipping vessels through Maltese shipping entities. As aforementioned, the Maltese system of tonnage tax follows the Greek model, meaning that any Maltese shipping organisations operating tonnage tax ships are exempted from the provisions of the Income Tax Act<sup>5</sup> and thus do not apply the 35% corporate tax rate. The taxation due under the MSA 1973 depended on the net tonnage of vessel registered under the Malta Flag and was payable to the Merchant Shipping Directorate in the form of a registration fee. This regime was eventually amended in light of Malta's accession to the European Union (EU) in 2004, through Legal Notice 224 of 2004,<sup>6</sup> so as to comply with the Community Guidelines on State Aid to Maritime Transport.<sup>7</sup>

It was once again fine-tuned in 2010<sup>8</sup> so as to ensure that Malta grants the maximum level of State aid contemplated under the Community Guidelines. Finally, recent amendments were made to the Maltese tonnage tax regime following the European Commission decision on Malta's tonnage tax system that was published on 19<sup>th</sup> December 2017 – more than five years after the investigation procedure was initiated, following a complaint by an 'interested party' in October 2011.<sup>9</sup> On the 1<sup>st</sup> May 2018, Malta implemented the conditions following this decision and the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations entered into force.

Despite Malta's great efforts to enact detailed provisions regulating the amendments brought about through the decision, a lacuna regarding the conditions for certain chartering activities, has been left unregulated and is therefore subject to speculation and uncertainty. It is in fact the purpose of this note, to shed light onto discussions surrounding this lacuna and furthermore, to suggest a possible amendment to Maltese legislation.

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<sup>3</sup> Merchant Shipping Act (1973), Chapter 234 of the Laws of Malta.

<sup>4</sup> Ibid.

<sup>5</sup> The Income Tax Act (1949), Chapter 123 of the Laws of Malta.

<sup>6</sup> Legal Notice 224 of 2004, Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, 2004 of the Merchant Shipping Act, Chapter 234 of the Laws of Malta.

<sup>7</sup> European Commission Communication C(2004) 43, 'Community Guidelines on State Aid to Maritime Transport, (2004/C13/03) of the Official Journal of the European Union.

<sup>8</sup> Legal Notice 83 of 2010, Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, 2010 of the Merchant Shipping Act, Chapter 234 of the Laws of Malta.

<sup>9</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_12\\_843](https://ec.europa.eu/commission/presscorner/detail/en/IP_12_843) (accessed December 2019).

i. General Conditions for the Application of the Maltese Tonnage tax Regime pre- EU Commission Decision.

The Maltese system of tonnage tax forms part of an intricate and sophisticated taxation system and is thus not applied in a vacuum but coincides with a number of other fiscal incentives. As previously mentioned, a shipping organisation opting in to the tonnage tax regime is exempt from income tax derived from shipping activities by a licensed shipping organisation or a ship management company.<sup>10</sup> Further incentives include the exemption of capital gains on the sale of a tonnage tax ship, engaged in genuine shipping activities. The Private Company (Shipping Organisation) Regulations also provides that no duty on documents and transfers are applicable to non-resident shareholders and dividend distributions are also not subject to tax.<sup>11</sup> These are some of the many fiscal benefits attached to a Maltese Shipping Organisation owning a tonnage tax ship that fall outside the purview of the Merchant Shipping Act.

The Maltese tonnage tax regime prior to the EU Commissions decision was mainly regulated by the Merchant Shipping (Taxation and Other Matters relating to Shipping Organisations) Regulations 2010. These Regulations exempted from income tax any income derived from shipping activities by a Maltese licensed shipping organisation as well as any income derived from ship management activities by a ship manager.<sup>12</sup> Therefore, following the Greek model, Malta exempts the actual income derived by shipping organisations, from the provisions of the Income Tax Act and instead charges an annual tonnage tax in the form of a lump sum. The sum is set by fixed rates according to different net tonnage brackets and potential cargo carrying capacity. The standard rates are then adjusted depending on the age of the ship. The standard rate remains the same for ships that are 10 to 15 years old, whereas newer ships benefit from a reduction, older ships are subject to a surcharge.<sup>13</sup>

A shipping organisation or a ship manager must register with the Minister responsible for Finance by submitting to him in writing the following particulars:

- the name of the organisation;
- the address of the registered office of the organisation; and
- the name and tonnage of the ship which it wishes to own or operate as a tonnage tax ship, in the case of a shipping organisation, or for which it has assumed responsibility, in the case of a ship manager.<sup>14</sup>

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<sup>10</sup> The extension of tonnage tax to ship management companies was brought about through Legal Notice 83 of 2010.

<sup>11</sup> Subsidiary Legislation 234.42, Merchant Shipping (Shipping Organisations - Private Companies) Regulations of Chapter 234 of the Laws of Malta, (2004).

<sup>12</sup> Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, 2010 of the Merchant Shipping Act, Chapter 234 of the Laws of Malta, Article 3.

<sup>13</sup> Legal Notice 224 of 2004 (n 6).

<sup>14</sup> Ibid.

As aforementioned, the taxpayer must qualify as a licensed ‘shipping organisation’ under the provisions of the Merchant Shipping (Licensing of Shipping Organisations) Regulations.<sup>15</sup> The vessel must qualify as a ‘tonnage tax ship’ and the income must derive from ‘shipping activities’. Once these conditions have been satisfied and all applicable registration fees and tonnage taxes are paid, then the shipping organisation is exempt from any further taxes on those activities. Nevertheless, to ensure that no abuse is undertaken by the shipping organisations, separate accounts must be kept, clearly distinguishing receipts and payments relating to shipping activities from those relating to other business activities. Nevertheless, the Merchant Shipping (Shipping Organisations, Private Companies) Regulations,<sup>16</sup> provide a transitory provision which exempts shipping organisations from submitting audited accounts to the Malta Business Register.<sup>17</sup>

## ii. Definition of Tonnage Tax Ship – Pre 2018

The classification of a tonnage tax ship has been the main point of contention over the years and one which has led to several amendments to the Merchant Shipping Act. In 1973, the first enactment of the MSA, referred to a tonnage tax ship as an ‘exempted ship’, that is, exempt for the purpose of income tax. During this time, in order to qualify as an exempted ship, applicants would apply to the Minister of Finance through the Registrar General of Shipping, who would endorse the application prior to sending it to the Ministry for their approval.<sup>18</sup>

During Malta’s accession into the European Union, the exempted ship requirement was not considered to be in line with the Community Guidelines on State Aid to Maritime Transport and thus, the Regulations governing fiscal incentives to Maltese shipping organisations were revised and came into force through Legal Notice 224 of 2004.<sup>19</sup> Under the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, 2004 (Tonnage tax Regulations) the concept of tonnage tax was introduced, whereby a tonnage tax ship was defined as,

*...either a ship declared to be a tonnage tax ship by the Minister in terms of article 85A of this Act, or a ship registered under Part II or IIA of the Act of not less than 1000 net tonnage which is owned entirely, chartered, managed, administered or operated by a shipping organisation.*<sup>20</sup>

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<sup>15</sup> Merchant Shipping (Licensing of Shipping Organisations) Regulations, Subsidiary Legislation 234.41, of the Laws of Malta, (2005).

<sup>16</sup> Subsidiary Legislation 234.42 (n 11), Article 168.

<sup>17</sup> These Regulations have also been amended due to the European Commission Decisions. Now shipping organisations must submit an annual declaration to the Commissioner for Inland Revenue as well an Annex to Transport Malta, outlining the main activities, and accounting conditions for each entity. In 2020, amendments to the Shipping Organisation, Private Companies Regulations were enacted, ending the transitory provision thus, now requiring Shipping Organisations to submit audited accounts effective 1<sup>st</sup> January 2021.

<sup>18</sup> The Income Tax Act (n 3).

<sup>19</sup> Legal Notice 224 of 2004 (n 6).

<sup>20</sup> Ibid. Article 2.

Further amendments were introduced to the 2004 Tonnage Tax Regulations, via Legal Notice 83 of 2010 entitled Merchant Shipping (Taxation and Other Matters relating to Shipping Organisations) (Amendment) Regulations 2010 (the amending regulations),<sup>21</sup> published on 16 February 2010. The amending regulations extended their scope and application beyond ownership and chartering of a tonnage tax ship as a Maltese shipping organisation but granted these benefits to any organisation established in a Member State of the European Union or the European Economic Area (EEA) as well as ship management companies.<sup>22</sup> Therefore, any income that is derived from ship management activities will be deemed to constitute income from shipping activities and is therefore exempt from the provisions of the Income Tax Act.

The amending regulations also sought to widen the definition of a tonnage tax ship to include a community ship,<sup>23</sup> that is, any ship registered under the law of a Member State of the European Union or the EEA. The possibility of a community ship to be declared a tonnage tax ship, is allowed subject to the fulfilment of certain conditions.<sup>24</sup> By widening the definition of tonnage tax ship, the exemption from tax under the Income Tax Act in respect of any interest or other income payable to any person in relation to financing of Maltese ships, has been extended to community ships as well as ships, not being Community ships but declared to be tonnage tax ships for the purposes of the maintaining the Flag Link Requirement as well as to entice European flagged shipowners to bring their fleets to the Union.

### iii. Shipping Activities - Pre 2018

For the aforementioned tax incentives to be applicable, the legal person opting out of the corporate tax rate and opting into tonnage tax must be a 'licensed shipping organisation', whose income is solely derived from shipping activities. Under the Tonnage Tax Regulations and the Amending Regulations, shipping activities were widely described to include,

*The international carriage of goods and passengers by sea or the provision of other services to or by a ship as may be ancillary thereto or associated therewith including the ownership chartering or any other operation of a ship engaged in all or any of the above activities or as otherwise may be prescribed.*<sup>25</sup>

Prior to the EU Commission investigation, the Merchant Shipping Act considered all revenue from all chartering activities as eligible to tonnage tax, without qualification. The wide interpretation of shipping activities as well as extensive objects laid down in the definition of shipping organisation found in article 84Z of the Merchant Shipping Act highlight the condition that any income or profits derived from the commercial management of a vessel, whether or not with the responsibility of the crew or their technical management are eligible to tonnage

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<sup>21</sup> Merchant Shipping Tonnage Tax Regulations (n 12).

<sup>22</sup> Ibid. Article 2 and 3(6)(i).

<sup>23</sup> Ibid. Article 2.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid.



tax.<sup>26</sup> The potential of such a wide interpretation being applied, raised concerns from the EU Commission since such wide ranging criteria did not fall in line with the scope of the EU Maritime Transport State Aid Guidelines and may have therefore been the subject of the spill-over effect.

## 2. The EU Commission

### a. The EU Commission Investigation 2012

After a complaint was lodged by an interested party in October 2011, the European Commission requested the Maltese Authorities to submit their position on the tonnage tax scheme and other tax measures. Once further discussions took place, the Commission then initiated the procedure under Article 108(2) under the Treaty on the Functioning of the European Union (TFEU).<sup>27</sup>

The purpose of the investigation was primarily to ensure that no seepage of the benefits granted by the favorable tonnage tax scheme found its way into unrelated sectors. The EU Commission needed to ascertain that a level playing field was being kept by all its Member States, including Malta.<sup>28</sup> This was owing to the fact that the Maltese tonnage tax scheme provided for the payment of fixed tonnage dues on an annual basis, which were calculated according to the net tonnage and age of a vessel. The payment of the said tonnage tax and the applicable registration fees exempted a licensed shipping organisation from income tax, which would otherwise be payable on income arising from shipping activities. All other income, which was not derived from shipping activities was subject to the normal tax rate applicable in terms of the Malta Income Tax Act.

Ultimately, the Commission and the interested parties wanted clarification as to which vessels were eligible to Tonnage tax and which vessels were not. Another unclear situation arose from the situation that the Maltese Maritime Administration was using the term ‘Tonnage tax’ for non-EU maritime entities owning a Maltese flagged vessel.<sup>29</sup> Owing to the fact that foreign entities do not pay tax in Malta, since they are neither resident nor domiciled, nor do they conduct activities that generate income in Malta, the term Tonnage tax used as a reference to payment for the renewal of the Maltese flagged vessel, did not add up. Thus, clarity on the procedure and conditions for application of tonnage tax was required. Finally, the main concern that was raised by the interested party and further examined by the Commission, was whether the aid granted under the Tonnage tax regime, constituted State Aid, and if so, whether it is compatible with rules relating to EU competition and the internal market.

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<sup>26</sup> Ibid Article 85Z.

<sup>27</sup> European Union, Consolidated version of the Treaty on the Functioning of the European Union, 26 October 2012, OJ L. 326/47-326/390; 26.10.2012, Article 108.

<sup>28</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_17\\_5361](https://ec.europa.eu/commission/presscorner/detail/en/IP_17_5361) (accessed December 2019).

<sup>29</sup> EU Commission Decision on State Aid SA.33829 (2012/C), *Maltese tonnage tax scheme and other State measures in favour of shipping companies and their shareholders*, issued on the 19.12.2017.

Several areas were identified, which required discussion and clarification to the EU Commission from the Maltese Transport Authority, the Merchant Shipping Directorate and national stakeholders – of which the Malta Maritime Law Association was heavily involved. Nevertheless, for the purpose of this proposal, the general focus shall be on Maltese flagged vessels and their eligibility to tonnage tax, different types of income and activities of tonnage tax ships, the tonnage tax regime and its applicability to non-core shipping activities as well as the Flag Link Requirement.<sup>30</sup> The scope of elaborating into those specific measures is to draw attention to the lacuna found with respect to chartering-in activities and their criteria and eligibility to tonnage tax. Regarding the Maltese Merchant Shipping Act’s position during the investigation, this has been elaborated on in Part 1(b) of this note.

i. Time/Voyage Chartering

During the Investigation, the EU Commission noted that due to the extensive definition of shipping activities and shipping organisation under Maltese law, it may easily be interpreted to mean that tonnage tax is applicable, not only to the corporation chartering the vessel and carrying goods by sea, but also to the profits of any other enterprise, not directly engaging in pure shipping activities, but that makes a commercial revenue by using these services.

The Commission also noted that time charterparties must be subject to the Flag Link Requirement. This was supplemented by internal guidelines issued by the Maltese Administration with restrictions to time-chartering activities, which upheld the Flag Link Requirement by stipulating a percentage of EU tonnage per fleet. The importance of noting these guidelines is that they allow the reader to fully understand the fundamental issue at play, that is, if a Maritime Authority has issued internal guidelines to determine whether or not a vessel engaging in chartering activities will be eligible to tonnage tax, does this not highlight the need for these guidelines to be published as law, so that any shipowner, already registered with the flag or any shipowner wishing to join the Malta flag will be aware of the fact that chartering-in activities are not absolutely unqualified with regard to the payment of tonnage tax?

The position put forward by the European Community of Shipowners Association<sup>31</sup> highlighted the need to loosen the tight restrictions placed on time and voyage chartering activities owing to the fact that chartering activities play a vital role in trade within the Shipping community and that such activities create variety of employment within the European Community. Their main reservation was that strictly confining these activities, may result in European shipowners flagging out of the Union and re-flagging to a third country who has adopted a more flexible approach, thus limiting the attractiveness of a European Flag.

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<sup>30</sup> Ibid. Section 1 and 2.

<sup>31</sup> Ibid. Clause 5.6.4.

## ii. The Flag Link Requirement

As aforementioned, the 2010 Amendment Regulations to the Merchant Shipping Act extended the eligibility of tonnage tax to Community ships, or entities incorporated in any EU or EEA Member State. Moreover, under article 85A(2) of the Merchant Shipping Act, as amended by L.N 2010, a non-Community flagged ship was also eligible to Tonnage tax if certain conditions were met that provided a link to the European Union. This was obtained by ascertaining that if the shipping organisation had a percentage (60%) of its fleet that is registered in the EU, or a percentage of tonnage of the overall fleet owned by the European Shipping Organisation, any other vessels that were not registered in the Community would still be eligible to tonnage tax. The notion of the Flag Link Requirement is evidenced through the Maritime State Aid Guidelines.<sup>32</sup> This principle holds that although the Community recognises the importance of a competitive fiscal position between the Members States of the Community and third States, through tax relief schemes, such schemes must evidence a connection to the Community before State aid is to be granted. The Guidelines stipulate the manner in which one may achieve this link, either through the prevalence of a shipowners fleet flying the flag of any Member State of the Union, or if a percentage of the fleet is flagged with the Community but the ‘strategic and commercial management’ of all the vessels are carried out from within the territory of the Union and thus contribute to the overall economic wealth of the Community.

Furthermore, if a Member State intends on employing this scheme into their national system, they must demonstrate this link by providing vessel details and all connections to the Community. Once this has been approved, the Member State is then obliged to prepare a report under Chapter 12, relaying compliance to all the conditions to the Flag Link Requirement. This must include details relating to the minimum 60% of tonnage under a Community Flag, as well as compliance with the relevant safety and security standards, crew conditions and environmental considerations. Non-compliance to the above will not entitle the shipping organisation to benefit from any form of tax relief granted under State Aid rules.<sup>33</sup>

Finally, the above conditions and benefits must only be strictly applied to shipping activities. Therefore, if a shipowner participates in any other commercial activity, it is pertinent that separate accounts are kept in a transparent manner, clearly distinguishing between the income earned from shipping activities and any other income.<sup>34</sup>

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<sup>32</sup> European Commission Communication C(2004) 43 (n 7), Clause 3.1, 13/6.

<sup>33</sup> Ibid. Clause 3.1, p.13/7.

<sup>34</sup> Ibid. Clause 3.1, p.13/8.

## b. The EU Commission Decision 2017

In EU Law, a decision of the European Commission is ‘binding in its entirety’ and is binding only on the State to whom it is addressed<sup>35</sup>. The EU Commission has the power to initiate a formal investigation procedure on a specific Member State when it has doubts or if a complaint has been lodged, raising questions to the compatibility of specific domestic legislation to the EU State Aid Rules. State aid is defined as ‘an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities.’<sup>36</sup>

After over five years of assessment, the EU Commission through its decision confirmed that the aid granted under the Maltese tonnage tax regime constitutes State aid.<sup>37</sup> The Commission commented on a number of measures which did not provide adequate safeguards to protect the interests of the internal market, these included the maintenance of the Flag Link Requirement and time and voyage chartering activities.<sup>38</sup> Having said this, the Commission endorsed the measures that the Maltese Administration committed to in the Annex attached to the EU decision.<sup>39</sup> The Commission also confirmed that once such measures are implemented within the stipulated period from the date of the decision, then such measures will fall in line with the EU State Aid Rules and will thus be compatible with the rules governing the internal market.<sup>40</sup>

They validated the amended tonnage tax scheme, as a fit legislation to provide tax relief that is sufficient to address the global market of competition and ensures the maintenance of maritime employment within the EU. This was further supported by the EU’s position on maritime transport through the 2004 Guidelines on State aid to Maritime Transport.<sup>41</sup> This document addresses the risk of the re-domiciliation of EU entities or re-flagging of EU vessels to tax havens outside the EU, by allowing member States to adopt fiscal incentives that improve the environment for shipping companies engaging in maritime transport, throughout the EU.<sup>42</sup>

Through the 2004 Maritime State Aid Guidelines,<sup>43</sup> the Commission specified the activities that are eligible for such fiscal incentives and under what conditions such entities would be compatible. The basis of which are founded in the Flag Link Requirement. Generally, if a European shipping organisation would like to benefit from the tonnage tax scheme, then it must have a minimum percentage of its fleet flying the flag of an EU or EEA member State. The 2004 Guidelines, also allow tax reductions for maritime transport deriving from freight, hire or the transport of passengers. Ultimately in its Decision, the European Commission ruled that

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<sup>35</sup> Treaty on the Functioning of the European Union (n 27), Article 288.

<sup>36</sup>[https://ec.europa.eu/competition/state\\_aid/overview/index\\_en.html#:~:text=Therefore%2C%20the%20Treaty%20generally%20prohibits,aid%20complies%20with%20EU%20rules.](https://ec.europa.eu/competition/state_aid/overview/index_en.html#:~:text=Therefore%2C%20the%20Treaty%20generally%20prohibits,aid%20complies%20with%20EU%20rules.) (accessed July 2020).

<sup>37</sup> EU Commission Decision on State Aid (n 29), Clause 8.

<sup>38</sup> EU Commission Decision on State Aid (n 29), Recital 348.

<sup>39</sup> Ibid. Annex Commitments provided by Malta.

<sup>40</sup> Ibid. Recital 349.

<sup>41</sup> European Commission Communication C(2004) (n 7).

<sup>42</sup> [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_17\\_5361](https://ec.europa.eu/commission/presscorner/detail/en/IP_17_5361) (accessed December 2020).

<sup>43</sup> European Commission Communication C(2004) (n 7).

unrestricted State aid was to be eliminated and that Malta must commit itself to limit its scheme to core activities relating to maritime transport.<sup>44</sup>

i. Time/Voyage Chartering Activities

After five years of deliberation, the Commission noted that the unrestricted eligibility of time or voyage charterers to Tonnage tax was not in line with the EU Maritime State Aid Guidelines.<sup>45</sup> It nevertheless noted that these activities can qualify for tax relief as long as they contribute to the development of the EU shipping industry, that is, if they maintain the Flag Link Requirement through ‘*the development of the EU flag or the preservation of EU know-how or a combination of the two*’.<sup>46</sup> The Commission referred to the decision given in the Lithuanian tonnage tax investigation<sup>47</sup> whereby it held that if a time or voyage chartered entity engaging chartering-in activities is one, who does not employ crew or operate the technical management of the vessel, then it may still qualify for tonnage tax if the tax recipient has at least 20% of the total tonnage taxed fleet that engages in the employment and technical management of other vessels and their crew in the Union. The Commission provided that another solution would be to restrict the activities of time or voyage chartering to outside the EU or EEA area to 75% of the total tonnage of the tonnage tax recipients’ fleet. To the contrary, the final option would be to flag at least 25% of the total fleet into the EU or EEA area – for the conditions to be satisfied, the EU entity would either need to own, operate or bareboat in any of these vessel to its fleet.<sup>48</sup>

3. The Maltese Tonnage Tax Regulations 2018

Although the Commission confirmed the applicability of the Maltese tonnage tax scheme to the overall European Union regime governing this area. This was only so if Malta explicitly reflected certain restrictions in its national legislation to circumvent any abuse of the system that may lead to a spill over effect resulting in indirect tax avoidance or tax evasion within the EU as well as those measures that may run contrary to anti-competition rules of the Union. Therefore, Malta complied with its obligations under the decision and amended the 2010 Amending Regulations through Legal Notice 128 of 2018<sup>49</sup> – through the enactment of this amendment the aid granted under the Maltese tonnage tax scheme is completely compatible with the internal market.

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<sup>44</sup> EU Commission Decision on State Aid (n 29), Clause 8.

<sup>45</sup> Treaty on the Functioning of the European Union (n 27), Article 3(1)(c).

<sup>46</sup> Ibid. Recital 286.

<sup>47</sup> Ibid. Recital 286, Footnote 137.

<sup>48</sup> Ibid. Recital 286.

<sup>49</sup> Legal Notice 128 of 2018, Amendment to the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, 2010 of the Merchant Shipping Act, Chapter 234 of the Laws of Malta.

Through Subsidiary Legislation 234.43,<sup>50</sup> Malta explicitly reflected the terms of the Maritime State Aid Guidelines and restricted tonnage tax application to vessels solely engaged in genuine, core shipping activities, that is, those engaged in the international carriage of goods or passengers by sea and also eliminated a number of vessels from the wide variety of vessels that were eligible before the decision – namely, those vessels engaged in pure maritime transport such as general cargo, car carriers, bulk carriers, container and passenger vessels, are exempt from the provisions of the Income Tax Act. This exemption is subject to compliance with certain administrative conditions, for example the payment of the relevant tonnage tax fees to the Maltese Maritime Authority as well as a declaration stating that the such owner or operator wishes to ‘opt in’ to the tonnage tax regime,<sup>51</sup> maintenance of separate accounts and submission of detailed Compliance Declaration to the Maritime Authority - this must detail the vessels operations and includes operating income and expenditure of the shipping organisation and information relating to chartering-in activities, coupled by a solemn declaration to the Inland Revenue Department,<sup>52</sup> these measures are meant to ring fence activities subject to the exemption from non- exempted ones. It is through the above administrative measures that the lacuna to be discussed below is most prevalent. Without published conditions for qualification of chartering-in activities, shipowners are unable to determine their tax position until the next financial year.

Legal Notice 128 also made significant changes to the term shipping organisation, which is now to be referred to as a ‘genuine shipping organisation’, this *‘means a shipping organisation which, has assumed risks and responsibilities related to the operation of a tonnage tax ship or to the carrying out of shipping activities.’*<sup>53</sup>

On the other hand, the definition of ‘shipping activities’ extended its scope to,

- a. *the international carriage of goods or passengers by sea in terms of the EU Maritime State Aid Guidelines and such other activities that have been approved or considered as eligible for tonnage tax purposes by the European Commission;*
- b. *such activities as are integral or directly linked to the business of operating tonnage tax ships, when carried out in conjunction with activities described in paragraph (a) above;*
- c. *ancillary activities qualifying in terms of regulation 7 hereof, when carried out in conjunction with activities described..*

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<sup>50</sup> Subsidiary Legislation 234.43, Merchant Shipping (Taxation and other matters relating to Shipping Organisations) Regulations (2018), Chapter 234 of the Laws of Malta.

<sup>51</sup> Transport Malta, Merchant Shipping Directorate, Merchant Shipping Notice - MS Notice 143.

<sup>52</sup> Transport Malta, Merchant Shipping Directorate, Merchant Shipping Notice- MS Notice 150 – Regulation 4 of the Tonnage tax Regulations 2018.

<sup>53</sup> Legal Notice 128 of 2018 (n 49), Article 3.

Finally, and most importantly, the updated Tonnage tax Regulations provide clarification on the meaning of the ‘operation of a tonnage tax ship’. It can be assumed that the purpose for clarifying this term is in order for it to act as a restriction to time or voyage chartering activities and thus make them eligible to tonnage tax under certain conditions. However, despite the clarification as the ‘*operation of such ship in any shipping activities, whether under charter or under any other commercial arrangement...*’ the drafters of the amendment regulation seemed to have placed their focus solely on stipulating the conditions for bareboat chartering out activities, whilst completely omitting any reference to time or voyage charter activities from the Regulation.

a. The Lacuna

Through an analysis of the decision given by the European Commission in 2018, one may note that the overall consideration imposed by the EU Commission is that every shipping organisation whether as an owner or operator, must have a stronger link to the European Union. Through its decision it is clear that the Flag Link Requirement must ultimately determine the Maltese Shipping Entity’s eligibility to tonnage tax.

In spite of the Maltese Administrations’ positive efforts to unify its laws and bring them in line with the conditions imposed by the EU Commission through its Decision – the Malta Flag Administration left the qualification of ‘chartering-in activities’ as shipping activities, unanswered and unclassified. This created a lacuna since there is no guideline or system of calculation for the purpose determining the tax status on income derived from chartering activities, whether by local practitioners for their clients, or for the industry itself. When determining the taxable position of a subject person, the criteria to tax is usually public so that local practitioners can advise their clients on the average amount of tax to be paid on the profits of the company – by doing so, ship owners or operators would be able to plan their business operations for that year and determine whether or not they shall be eligible to tonnage tax, prior to engaging in chartering activities. They may also, prima facie, clearly determine whether or not the Malta Flag is the best option for their particular enterprise. As it stands, owners engaging in chartering-in activities, have absolutely no guidance to the above matters.

The argument of no legitimate expectation or legal certainty was in fact raised by the EU Commission itself in Clause 7.3 of the Decision.<sup>54</sup> The recovery section of the Decision highlights the importance of providing legal certainty when determining the conditions to qualify for existing aid in order to allow the State or any beneficiary to be granted a substantive legitimate expectation to the benefits they could retain if they comply with certain published conditions.

By amending the existing regulations, to include clear definitions and qualifying criteria for ‘chartering-in activities’, which according to the EU Commission are to be determined through the Flag Link Requirement, then potential ship owners, operators, managers and other

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<sup>54</sup> EU Commission Decision on State Aid (n 29), Clause 7.3.

interested parties will have the the knowledge necessary to assess their operations beforehand and thus be in a position to determine their tax position prior to engaging in any charterparty agreements. As it stands, although a Maltese flagged vessel owned or operated by a Maltese Shipping Organisation has been acknowledged as a tonnage tax ship, and has paid its annual tonnage tax to the Maltese Administration, the organisation would not, until the following year – know whether or not it is subject to corporate tax or tonnage tax on the income derived from chartering-in activities.

The present lacuna lies, not only in the lack of stipulated criteria to determine the Flag Link Requirement for a Maltese Shipping Organisation engaging in basic maritime trade, through time or voyage contracts of carriage, but it also results from the lack of transparency and clarity of the law in the determination of qualifying criteria. If a shipowner, operator or ship manager is unaware of the fact that a percentage of his chartering-in activity must be with another EU entity or that he must trade within the EU area or employ EU crew, and he decides to engage in chartering-in activities for three years with an Asian enterprise for example, then the shipowner may be subjected to 35% on the income earned from the hire or freight rates, whilst believing that the only tax due is what was paid upon renewal of the Maltese vessels certificate of registry. This level of uncertainty will not bode well on the Maltese system with the overall shipping industry.

#### 4. Enacting Provisions on ‘Chartering-in Activities’ to Remedy the Lacuna

Through an amendment to Subsidiary Legislation 234.43, Merchant Shipping (Taxation and other matters relating to Shipping Organisations) Regulations<sup>55</sup>, via Legal Notice 179 of 2020, the lacuna will be remedied by inserting provisions clearly regulating chartering-in activities. This will guide practitioners, owners and any person with an interest on how to apply or qualify chartering-in activities to conditions of tonnage tax – This will be known as Merchant Shipping (Taxation and other matters relating to Shipping Organisations) (Amendment) Regulations 2020.

Regulation 6A shall be introduced as ‘Chartering-in Activities’ to complement the definition of ‘operation’ under regulation 3. The definition of ‘operation’ under regulation 3 shall be amended to include a reference to article 6A, the reason being is that, although the initial definition of ‘operation’ includes, ‘*...the operation of such ship in any shipping activity, whether under charter or any commercial arrangement.*’<sup>56</sup> the provisos following, only refer to conditions and flag link restrictions for bareboat chartering activities yet, it completely omits any reference to other chartering activities. By amending the main text of the Regulations, the conditions on chartering-in will become practically accessible whereas, as it presently stands, there is absolutely no guidance to its application.

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<sup>55</sup> Subsidiary Legislation 234.43, Merchant Shipping (Taxation and other matters relating to Shipping Organisations) Regulations (2018), Chapter 234 of the Laws of Malta.

<sup>56</sup>Ibid., Article 2.



The conditions for chartering-in activities and their eligibility to tonnage tax shall be further developed through a Schedule to the main Regulations, labelled Schedule II (Regulation 6A) and titled ‘Chartering-in Activities’. The purpose for the insertion of the Schedule is to ensure that the conditions set out in the EU Commission decision, are transparent and will serve to benefit shipowners or operators who choose to comply with the Flag Link Requirements, namely by contributing to a maritime objective governed by the State Aid Guidelines through the development of the EU flag or the preservation of EU know how, or a combination of the two.

This Schedule will further detail all eligibility criteria and shall detail the intricacies of the Flag Link Requirement for the purpose of determining the percentage of EU Tonnage and the conditions precedent for the activities of an EU fleet to benefit from tonnage tax. By shedding light onto this lacuna, shipowners, operators and local practitioners shall be aware of the restrictions placed on their trading activities and shall have clear guidance on the Malta Flag Administration’s position on the matter. Doing so, will provide transparency and clarity to shipowners or operators and will therefore allow them to consider these requirements when determining their trading areas or trading partners. A procedure shall also be laid down whereby, shipping organisations that are commercially operating ‘chartered-in ships’, shall inform the Flag Administration of the conditions of their activities, thus creating legal certainty and a strong basis to determine their tax status.

The Schedule shall then include a means of calculation on the basis to tax, this can act as reliable guidance for practitioners to refer to when determining the tax status of their clients, be it for tonnage tax or income tax purposes. Finally, the Annex shall further determine the chargeable taxable period for each financial year on the income derived from chartering-in activities. Highlighting this fundamental criterion will also bring the Declaration in lieu of a tax return as well as the Annual Compliance Declaration<sup>57</sup> in line. Presently, both Declarations contradict each other and place local practitioners in an ethically questionable position, since they are obliged to sign a solemn declaration on behalf of their clients, stating that ‘the activities of the organisation fall within the purport of the Regulations’ (referring to the Tonnage Tax Regulations). The issue that this brings to the fore is that since the Regulation does not cater for chartering-in activities, then a local practitioner declaring this without having determined the tax status of that organisation for the financial year, may be held liable for false declarations. Thus, determining the taxable status of the shipowners or charterers when engaging in chartering activities will leave no room for uncertainty in interpreting the provisions governing these activities, which further consolidates the recommendations made by the EU Commission.

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<sup>57</sup> Subsidiary Legislation 234.43 (n50).

**MERCHANT SHIPPING ACT**  
**(CAP. 234)**

**Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations)**  
**(Amendment) Regulations, 2020.**

IN exercise of the powers conferred by articles 84Z(9) and 374 of the Merchant Shipping Act, the Minister for Transport, Infrastructure and Capital Projects, with the concurrence of the Minister of Finance, have made the following amendments to the existing Regulations:

1. (1) The title of these regulations is the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) (Amendment) Regulations, 2020 and these regulations shall be read and construed as one with the Merchant Shipping (Taxation and Other Matters Relating to Shipping Organisations) Regulations, hereinafter referred to as "the principal regulations".

Citation.

S.L. 234.43.

(2) These regulations shall come into force on the 1 September 2020.

(3) The purpose of these amendment regulations are to complement the existing legislation by enacting provisions to qualify chartering-in activities of licensed shipping organisations, as was approved by the European Commission in its Decision on State Aid SA.33829 (2012/C) issued on the 19 December 2017.

2. Regulation 3 of the principal regulations shall be amended as follows:

In sub-regulation (1) thereof, immediately after the clause, “‘operation’ in respect of a tonnage tax ship includes the operation of such ship in any shipping activities, whether under charter or under any other commercial arrangement” there shall be added the words “qualifying in terms of regulation 6A hereof...”

Amends Regulation 3 of the principal regulations.

3. Immediately after Regulation 6 of the principal regulations there shall be inserted the following new regulation:

**6A. (1)** ‘Chartering-in activities’ refer to those activities entered into under a contract of carriage, by a shipping organisation acting as a tonnage tax beneficiary, where the shipping organisation, whether as a single company or a group company, shall be the named charterer.

Adds new Regulation 6A to the principal regulations.

(2) ‘chartered-in ship’ refers to those ships that are chartered-in to a genuine shipping organisation and are fully equipped and manned by other organisations. Provided that the income generated from these activities shall be eligible to tonnage tax according to the qualifications laid down in Schedule II.

4. The Schedule (Regulation 7) of the principal regulations shall be amended as follows:
- (1) The Title ‘Schedule’, shall be renamed ‘Schedule I’.
5. Immediately after ‘Schedule I’ of the principal regulations there shall be added the following ‘Schedule II’.

Amends  
Schedule  
(Regulation 7)  
of the principal  
regulations to  
‘Schedule I’.

**Schedule II**  
**(Regulation 6A)**

Adds new  
‘Schedule II’ to  
the principal  
regulations.

**Chartering-in Activities**

**(1)** For the purpose of these regulations if a ship is chartered-in:

‘Chartered  
-in ship’

- a) to a shipping organisation forming part of the same group, then said ship shall not be considered as ‘chartered-in’ by that organisation for the purpose of applying the below qualifying tests.
- b) from an organisation that is not established or operated from a Member State of the Union, then said ship shall be considered to be a ‘chartered-in ship’ for the purpose of applying the below qualifying test.

**(2)** If the shipping organisation is a genuine shipping organisation and demonstrates, to the satisfaction of the Registrar-General, that the ship was chartered-in due to short-term over-capacity and the term of the charter does not exceed one (1) year, then the activities may qualify for tonnage tax. The term ‘short-term over-capacity’ shall refer solely to ships chartered-in by the shipping organisation for the purposes of carrying out its own shipping activities.

‘Short-  
term over-  
capacity’

**(3)** Any income derived by a licensed shipping organisation from chartering-in activities, whether under time or voyage charter, shall be exempt from the Income Tax Act provided that:

‘Condition  
s for the  
exemption  
from the  
Income  
Tax Act’

- a) the charterer is a shipping organisation, as defined in Regulation 3 hereof;
- b) the conditions contained in these regulations, particularly sub-regulation 5(3) are complied with;
- c) the shipping organisation has paid to the Registrar-General an annual tonnage tax on every tonnage tax ship owned or operated by the shipping organisation under the Malta Flag, to be determined according to Registration Fees as prescribed under Article 6 of the Merchant Shipping Act or as the Minister may prescribe from time to time; and
- d) the charterer satisfies at least one of the following conditions and assumes an obligation to maintain or increase the share of the EEA-flagged tonnage to its fleet:
- i. the charterer has in its fleet, vessels for which the chartering entity itself ensures at least 20% of the crew and technical management are European Union or EEA nationals;

‘flag-link  
requiremen  
t’

- ii. the charterer has in its fleet at least 25% of its owned or bareboat chartered vessels under an EU or EEA Flag;
- iii. the charterer has not more than 75% of its fleet as non-EEA flagged or under time or voyage charter;
- iv. the charterer has at least 50% of the vessels chartered in that trade or operate within the EU Area; or/and
- v. in the event that a charterer is part of a group, not more than 75% of the aggregate net tonnage of the group shall be chartered in.

Provided that if the charterer does not reach the thresholds provided under this regulation, then the charterer shall be deemed to be a non-qualifying charterer and shall be taxed according to the rules laid down in the Income Tax Act and the Income Tax Management Act.

**(4)** The chartering-in activities referred to in this regulation shall be submitted to the Registrar-General for his assessment through the procedure laid down in regulation 5(4) of these Regulations. The charterer must prove to the satisfaction of the Registrar-General, that the qualifying conditions stated above have been met.

‘Annual  
Assessment’

Provided that where the shipping organisation has not met the qualifying chartering-in criteria, the income accrued from chartering-in activities shall not be eligible for tonnage tax and the relative provisions of the Income Tax Act and Income Tax Management Act shall apply for the purpose of determining the taxable income derived from those activities.

Provided further that upon the annual financial review of the shipping organisation, if the director/s of the organisation become aware that for financial year in review the qualifying conditions for chartering-in activities were not met, then the directors shall file the necessary income tax return and shall not apply the provisions under these regulations.

**(5) (a)** For the purpose of determining the basis to tax as stipulated under sub-regulation 4 of this regulation, the director/s should take into consideration the following requirements to determine whether the activities of the shipping organisation are eligible to tonnage tax or not:

‘Eligibility  
Requirements’

- i. the shipping organisation has complied with the general requirements provided in these regulations.
- ii. the shipping organisation has complied with the qualifying criteria under sub-regulation 3 of regulation 6A.
- iii. separate accounts are kept by the shipping organisation to distinguish between qualifying activities and non-qualifying activities.

**(b)** If the requirements under this provision apply, an annual declaration, signed by a Director shall be submitted to the Flag Administration in accordance with sub-regulation 4 of regulation 5 outlining the details of these activities.

‘Annual  
Declaration’

(c) The shipping organisation shall not apply the conditions of sub-regulation 4 of regulation 5 if it has derived any income other than income from shipping activities. In this circumstance, an income tax return shall be submitted to the Commissioner for Inland Revenue distinguishing between income generated from shipping activities and any other income.

‘Obligation to file an  
Income Tax Return’