Chapter 3.4: International Shipping Exclusion

Learning Objective

After completing this chapter, you will be able to identify qualifying international shipping income, apply the ancillary income cap, and exclude eligible shipping income from GloBE calculations while meeting substance requirements.

Why Shipping Gets Special Treatment

The international shipping industry has unique characteristics that have led many jurisdictions to adopt special tax regimes:

Characteristic	Impact
Capital intensive	Large upfront investment in vessels
Long economic cycles	Ships operate for 20-30 years
Volatile earnings	Charter rates fluctuate significantly
Global mobility	Ships can easily change flag states

Many countries operate **tonnage tax** regimes that tax shipping based on vessel tonnage rather than actual profits. These regimes typically result in effective tax rates of **1-2%**, well below the 15% GloBE minimum.

Without an exclusion: Shipping companies would face Top-Up Tax on virtually all profits, undermining the policy rationale behind tonnage tax regimes.

Article 3.3 solution: Exclude qualifying international shipping income from GloBE calculations entirely.

The Basic Exclusion Rule *(Article 3.3.1)*

What Gets Excluded

For MNE Groups with International Shipping Income:

Item	Treatment
International Shipping Income	**Excluded** from GloBE Income
Qualified Ancillary International Shipping Income	**Excluded** from GloBE Income (up to 50% cap)
International Shipping Losses	**Excluded** from GloBE Loss

Key point: Both income AND losses from qualifying shipping activities are excluded. The exclusion is symmetrical.

Definition: International Shipping Income *(Article 3.3.2)*

Qualifying Activities

International Shipping Income means net income from:

Activity	Description	Reference
(a) Direct transport	Transportation of passengers or cargo by ships in international traffic (owned, leased, or otherwise at disposal)	Art. 3.3.2(a)

Activity	Description	Reference
(b) Slot chartering	Transportation under slot-chartering arrangements	Art. 3.3.2(b)
(c) Time charter out	Leasing a ship on charter fully equipped, crewed, and supplied	Art. 3.3.2(c)
(d) Bareboat to CE	Leasing a ship on bareboat charter to another Constituent Entity	Art. 3.3.2(d)
(e) Pools/joint ventures	Participation in pools, joint businesses, or international operating agencies	Art. 3.3.2(e)

What Does NOT Qualify

Excluded Activity	Reason
Inland waterways	Transport via rivers, canals, lakes within same jurisdiction
Domestic coastal shipping	Ships operating solely between places in one jurisdiction
Aircraft operations	Article 3.3 covers ships only; aircraft covered by separate treaty provisions

Definition: International Traffic

International traffic = Transport by a ship, except when operated **solely** between places within a single jurisdiction.

Route	International Traffic?
Rotterdam → Singapore	**Yes**
Southampton → New York	**Yes**

Route	International Traffic?
Hamburg → Rotterdam	**Yes** (crosses borders)
Liverpool → Southampton	**No** (within UK only)
Up the Thames (London)	**No** (inland, same jurisdiction)

Qualified Ancillary International Shipping Income *(Article 3.3.3)*

What Qualifies

Ancillary activities that are performed **primarily in connection with** international shipping:

Ancillary Activity	Conditions
(a) Bareboat charter to non-CEs	Charter period ≤ 3 years
(b) Ticket sales	Selling tickets issued by other shipping enterprises for domestic leg of international voyage
(c) Container services	Leasing, short-term storage, detention charges for late return
(d) Personnel services	Engineers, maintenance, cargo handlers, catering, customer services to other shipping enterprises
(e) Investment income	From investments made as integral part of shipping business

What Does NOT Qualify as Ancillary

Activity	Why Not Ancillary
Inland transportation	Explicitly excluded to prevent competitive distortion with land logistics providers
Port operations	Separate business from shipping
Shipyard/repair services	Manufacturing/service business
Freight forwarding (land-based)	Not primarily connected to ship operations

The 50% Ancillary Income Cap *(Article 3.3.5)*

The Rule

Qualified Ancillary International Shipping Income cannot exceed 50% of International Shipping Income for all Constituent Entities in a jurisdiction.

Formula

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 Maximum Ancillary Exclusion = International Shipping Income × 50%

If Actual Ancillary Income > Maximum:
    Excluded Amount = Maximum (50% of ISI)
    Excess = Included in GloBE Income
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Worked Example: Ancillary Cap Calculation

Facts: Maritime CE in Singapore

Income Type	Amount (€)
International Shipping Income	70,000,000
Qualified Ancillary Income (actual)	40,000,000
Non-shipping income	15,000,000

Step 1: Calculate 50% cap

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Maximum Ancillary = €70,000,000 × 50% = €35,000,000
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Step 2: Compare to actual

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 Actual Ancillary:  €40,000,000
Maximum Allowed:   €35,000,000
Excess:            €5,000,000
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Step 3: Determine exclusions

Item	Excluded	In GloBE Income
International Shipping Income	€70,000,000	—
Ancillary Income (up to cap)	€35,000,000	—
Ancillary Income (excess)	—	€5,000,000
Non-shipping income	—	€15,000,000
Total GloBE Income		**€20,000,000**

Treatment of Losses *(Article 3.3.1)*

The Symmetry Rule

If International Shipping Income or Qualified Ancillary Income results in a **loss**, that loss is also **excluded** from GloBE calculations.

Why This Matters

Without loss exclusion: - Profitable years: Shipping income excluded (no GloBE benefit) - Loss years: Shipping losses reduce other GloBE Income (benefit retained)

Result: Asymmetric treatment would give shipping companies a permanent advantage.

With loss exclusion: Losses are ring-fenced with shipping income—neither profits nor losses affect the GloBE calculation.

Worked Example: Shipping Losses

Facts: Maritime CE with mixed activities

Item	Amount (€)
Non-shipping income	360,000
International Shipping Loss	(100,000)
Ancillary Shipping Loss	(60,000)

GloBE Income calculation:

Item	Adjustment
Financial Accounting Net Income	200,000
Add back: Excluded Shipping Loss	+100,000

Item	Adjustment
Add back: Excluded Ancillary Loss	+60,000
GloBE Income	**360,000**

Result: The €160,000 shipping losses do not reduce the CE's GloBE Income of €360,000.

Strategic Management Requirement *(Article 3.3.6)*

The Substance Test

To qualify for the shipping exclusion, a Constituent Entity must demonstrate that:

> *"The strategic or commercial management of all ships concerned is effectively carried on from within the jurisdiction where the Constituent Entity is located."*

What Constitutes Strategic Management

Activity	Indicative of Strategic Management
Major capital expenditure decisions	Approving vessel purchases/sales
Asset disposal decisions	Determining when to scrap or sell ships
Awarding major contracts	Chartering agreements, major supplier contracts
Strategic alliances	Pool arrangements, joint ventures
Flag state responsibilities	Maritime safety, environmental compliance
Commercial voyage planning	Route decisions, cargo booking strategy

What Is NOT Sufficient

Activity	Why Insufficient
Brass plate company	No real management presence
Administrative functions only	Invoicing, accounting without decision-making
Vessel registration alone	Flag state without management
Shareholder/board meetings only	Infrequent oversight insufficient

Documentation Evidence

Document Type	Purpose
Board meeting minutes	Evidence of strategic decisions in jurisdiction
Employment records	Key management personnel located in jurisdiction
Contracts signed	Major agreements executed locally
Operational reports	Management reports prepared/reviewed locally
Correspondence	Day-to-day management communications

Interaction with Tonnage Tax Regimes

The Potential Gap

Many tonnage tax regimes have **broader** definitions of qualifying activities than Article 3.3:

Tonnage Tax (Example: UK)	GloBE Article 3.3
International shipping	✓ Covered
Domestic coastal shipping	✗ Not covered
Towage and dredging	✗ Not covered
Offshore support vessels	May not be covered
Cable laying vessels	May not be covered

Risk: Top-Up Tax on Non-Qualifying Activities

Activities that qualify for tonnage tax but **not** for Article 3.3 exclusion: - Remain in GloBE Income - Subject to 15% minimum rate - May trigger Top-Up Tax if tonnage tax ETR < 15%

Practical Implication

MNE Groups with shipping operations should:

1. **Map** all activities against Article 3.3 definitions
2. **Identify** activities in tonnage tax that don't qualify for GloBE exclusion
3. **Calculate** potential Top-Up Tax exposure on non-qualifying activities
4. **Consider** restructuring if exposure is material

Stratos Worked Example

Background

Stratos Group plc acquired a maritime logistics subsidiary, **SG Maritime Holdings BV** (Netherlands), which operates:

- Container vessels in international traffic
- Feeder vessels for domestic Dutch coastal routes
- Container storage and handling facilities

- A vessel management company

Entity Structure

```
SG Maritime Holdings BV (Netherlands)
    │
    ├── SG Shipping International BV (Netherlands)
    │   └── Operates 12 container vessels in international traffic
    │
    ├── SG Coastal Services BV (Netherlands)
    │   └── Operates 3 feeder vessels (Rotterdam-Amsterdam route)
    │
    └── SG Container Services BV (Netherlands)
        └── Container storage, handling, and management
```

Step 1: Classify Income

SG Shipping International BV

Income	Amount (€M)	Classification
Charter income (international routes)	45.0	International Shipping Income
Slot charter revenue	8.0	International Shipping Income
Container detention charges	3.5	Qualified Ancillary
Investment income (working capital)	1.2	Qualified Ancillary
Total	**57.7**	

SG Coastal Services BV

Income	Amount (€M)	Classification
Feeder service revenue (domestic)	12.0	**NOT** International Shipping

SG Container Services BV

Income	Amount (€M)	Classification
Container storage (port facilities)	6.0	**NOT** Shipping (port operations)
Management services to group	2.5	Qualified Ancillary*

*If provided to shipping CEs and primarily connected to international shipping.

Step 2: Apply 50% Ancillary Cap

Netherlands Jurisdiction (combined)

Item	Amount (€M)
International Shipping Income	53.0
Qualified Ancillary Income (actual)	7.2
50% Cap	53.0 × 50% = 26.5

Result: Ancillary income (€7.2M) is below the cap (€26.5M). Full exclusion applies.

Step 3: Calculate GloBE Income

Entity	Total Income	Excluded	GloBE Income
SG Shipping International	€57.7M	€57.7M	€0
SG Coastal Services	€12.0M	€0	€12.0M
SG Container Services	€8.5M	€2.5M*	€6.0M
Netherlands Total	**€78.2M**	**€60.2M**	**€18.0M**

*Management services to group shipping CEs qualify as ancillary.

Step 4: Check Strategic Management

SG Shipping International BV — Assessment

Factor	Evidence	Satisfied?
Capital expenditure decisions	Board approves vessel acquisitions in Amsterdam	✓
Major contracts	Charter parties signed by Dutch management	✓
Key personnel	Fleet manager, commercial director in Netherlands	✓
Operational oversight	Daily operations managed from Rotterdam	✓

Conclusion: Strategic management requirement **satisfied** for SG Shipping International.

Step 5: ETR Calculation (Non-Excluded Income)

Item	Amount (€M)
GloBE Income (non-shipping)	18.0
Adjusted Covered Taxes	2.7
ETR	15.0%

Result: Netherlands ETR exactly at minimum. No Top-Up Tax for non-shipping activities.

7. Documentation Requirements

For Article 3.3 Exclusion

Maintain documentation to support:

Requirement	Documentation
Qualifying income classification	Revenue breakdown by activity type
International traffic	Voyage records showing cross-border routes
Ancillary cap calculation	Workings showing 50% test
Strategic management	Board minutes, management presence evidence
Cost allocation	Methodology for attributing costs to shipping vs non-shipping

Cost Allocation Methodology

All **direct and indirect costs** attributable to shipping income must also be excluded. Document your allocation methodology:

Cost Type	Allocation Approach
Direct vessel costs	100% to shipping income
Crew costs	By vessel assignment
Shared overheads	Revenue-based or time-based allocation
Finance costs	By asset financed

8. Common Pitfalls

Pitfall 1: Assuming All Tonnage Tax Income Is Excluded

Error: Treating all income qualifying for domestic tonnage tax as excluded under Article 3.3.

Problem: GloBE has narrower definition; domestic coastal and certain activities remain in scope.

Pitfall 2: Ignoring the 50% Ancillary Cap

Error: Excluding all ancillary income without checking the 50% limit.

Problem: Excess ancillary income remains in GloBE Income.

Pitfall 3: Forgetting Loss Exclusion Symmetry

Error: Allowing shipping losses to reduce other GloBE Income.

Problem: Losses must be excluded alongside income; no cherry-picking.

Pitfall 4: Insufficient Strategic Management Evidence

Error: Claiming exclusion for ships managed from another jurisdiction.

Problem: Exclusion denied if strategic management not in CE's jurisdiction.

Pitfall 5: Misclassifying Inland Waterway Transport

Error: Treating river barge operations as international shipping.

Problem: Inland waterways within same jurisdiction are explicitly excluded.

Key References

OECD GloBE Model Rules: - Article 3.3.1 — Basic exclusion rule - Article 3.3.2 — International Shipping Income definition - Article 3.3.3 — Qualified Ancillary International Shipping Income