



EUROPEAN COMMISSION

Brussels, 11.12.2002
C(2002)4371 fin

**Subject: State aid N 504/2002 – Ireland
Introduction of a tonnage tax**

Sir,

1. PROCEDURE

- (1) By letter of 19 July 2002, the Permanent Representation of Ireland notified the Commission, in accordance with Article 88(3) of the Treaty, of a proposal for the introduction of a Tonnage Tax in Ireland. This notification was registered on 25 July 2002 under No SG(2002) A/7605. By fax of 6 September 2002, the Irish authorities agreed to extend the two-month examination period by one additional month up to 26 October 2002. By letter of 22 November 2002, the Irish authorities provided the Commission with additional commitments to improving the fiscal regime.

2. DETAILED DESCRIPTION OF THE AID

2.1. Title

- (2) Finance Act 2002, Chapter 4: Corporation Tax by inserting Part 24A: Shipping Tonnage Tax and Schedule 18 B: Tonnage Tax into the Taxes Consolidation Act 1997.

2.2. Summary

- (3) The tonnage taxation is a new tax scheme applicable to shipping companies engaged in seagoing transport. Qualifying companies may choose to have their shipping activities taxed on basis of the net tonnage of their fleet instead of on the basis of their actual profits. Qualifying companies must opt for the regime within three years from the date of the entry into force of the legislation. Companies having opted for the tonnage tax must remain subject to this regime for a period of 10 years (tonnage tax period).

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- (4) If several qualifying Irish companies are members of the same group of companies, all of them must opt for the tonnage tax system. Business activities other than those subject to the tonnage tax would be taxed on the basis of the normal provisions of corporate taxation. The law would enter into force after the Commission has approved the present scheme.

2.3. The tonnage tax scheme

- (5) Under the present tonnage tax scheme the amount of tax for qualifying maritime companies¹ is established on the basis of the net tonnage of their qualifying fleet. For each vessel subject to the tonnage tax, the taxable profits pertaining to qualifying activities shall be fixed at a lump sum calculated by reference to its net tonnage as follows, per 100 net tons (NT) and per 24-hour period started, irrespective of whether the vessel is operational or not:

Up to and including 1,000 net tons	€ 1.00 per 100 NT
Between 1,001 and 10,000 net tons	€ 0.75 per 100 NT
Between 10,001 and 25,000 net tons	€ 0.50 per 100 NT
More than 25,000 net tons	€ 0.25 per 100 NT

- (6) The standard Irish corporation tax of 12.5% is then applied to the profits determined in that way.
- (7) As a general rule, no relief, deduction or set-off of any kind is allowed against the amount of the tonnage tax profits. Losses accrued from any period before entry into tonnage tax cannot be used to reduce tonnage tax profits.
- (8) This example concerns a shipping company which operates two qualifying ships of 23,000 tons each.
- (9) First, we should calculate profit per day per ship. This calculation is made by reference to an amount of profit for each 100 tons as follows:
- | | | |
|--|-------------|------------------|
| up to 1,000 tons at € 1 = | 10 * 1.00 = | 10.00 |
| between 1,000 and 10,000 tons at € 0.75 = | 90*0.75 = | 67.50 |
| between 10,000 and 23,000 tons at € 0.50 = | 130*0.50 = | 65.00 |
- This gives a daily profit per ship of € 142.50.
- (10) Second, we should calculate profit per ship for the accounting period. If it is assumed that it is a normal accounting period of a year, one gets a profit per ship for the accounting period of $142.50 * 365 =$ **€ 52,013.00.**
- (11) Third, we should calculate the company's tonnage tax profits. The profit for each ship is aggregated. In the case of our example, the profit for each ship is the same as they are both 23,000 tons. This means that the total tonnage tax profit for the accounting period is $52,013 * 2 =$ **€ 104,026.00.**

¹ See Section 2.8 below.

- (12) Fourth, the tonnage tax is eventually to be calculated by applying the 12.5% rate of the Irish corporation tax to the tonnage tax profits, we get tax of € **13,003.00** for the company (104,026 * 12.5%).

2.4. Expected effects of the aid

2.4.1. Expected contribution to the Irish flag

- (13) Most of the Irish registered merchant fleet is made up of ships operated by the two largest maritime companies: Arklow Shipping that owns 24 Irish and 13 Dutch registered merchant vessels and Irish Continental Group, Ireland's largest international ferry company that operates 4 Irish registered ferries and 13 non-Irish registered merchant vessels on short time charters.
- (14) The Irish authorities expect that the introduction of the proposed tonnage tax would encourage the retention of the merchant ships currently on the Irish Ship Register which at present includes 43 commercial vessels. Some 95% of Ireland's trade is carried by sea. The maintenance of an Irish registered fleet is therefore a national priority for Ireland.
- (15) If the Irish tonnage tax comes into operation with effect from 1 January 2002, the ships operated by those two companies, which are on the Irish Ship Register, will remain on that register. If the tonnage tax does not come into effect, both companies have indicated to the Irish authorities that for purely business reasons (i.e. capital market requirements and the need, under accountancy rules, to provide for deferred taxation in their accounts) they will be forced to reflag in order to maintain their competitiveness and profitability.

2.4.2. Expected contribution to the employment of Community seafarers

- (16) The Irish authorities estimate that some 2,000 workers are directly employed in the Irish shipping industry, with a further 700 indirectly employed workers. The introduction of an Irish tonnage tax will help secure that employment. Any expansion of the Irish Ship Register, or any location of new shipping operations in Ireland to avail of the proposed tonnage tax, will foster this employment.
- (17) The Irish authorities have approved this year the development of a new € 58 million National Maritime College with a view to training seafarers to the STCW 95 standards². An increase in seafarer employment is projected to follow the introduction of the new tonnage tax, and the new college can cater for that extra demand. The end result will be an increase in the number of fully qualified Community seafarers.

² STCW 95 refers to the 1995 amendments to the International Convention on Standards of Training, Certification and Watchkeeping for Seafarers (STCW), 1978. The 1995 amendments, which completely revised the Convention, entered into force on 1 February 1997.

2.5. Budget

- (18) The Irish tonnage tax scheme will be financed by a reduction of State revenues. The Irish authorities estimate that the total tax foregone will amount to about 0.38 million euros per annum over a number of years.

2.6. Duration

- (19) The proposed tonnage tax regime is not of limited duration. Qualifying companies will only have 36 months to apply for the tonnage tax regime. They will then benefit from this more favourable taxation for a 10-year period.

2.7. Eligibility criteria

2.7.1. Qualifying company

- (20) The qualifying company has to be a shipping company which is liable to Irish corporation tax on any profits which accrue to it. It must also operate qualifying ships, but ownership is not a requirement per se. Finally, and most importantly, the company must carry out the strategic and commercial management of these ships in Ireland. Strategic and commercial management is not defined in the Finance Act, as any such definition may prove too restrictive and inflexible. When determining whether the strategic and commercial management is carried out from the Irish territory, the fiscal administration will take into account all elements of management activities relevant to the ships in question.
- (21) To fulfil this criterion, a shipping company must take decisions in Ireland on significant capital expenditure and disposals, although in the case of ship management services this factor will have no relevance, the award of major contracts, agreements on strategic alliances, etc. In assessing these matters, the extent to which foreign-based personnel work under the direction of, and report to, personnel based in Ireland would be taken into account by the Irish authorities. Also important in assessing whether the strategic function is carried out in Ireland will be the location of headquarters, including senior managers and the location of decision-making of both the board of directors and the operational board.
- (22) In the case of commercial management, the fiscal authorities will verify that route planning, the taking of bookings for passengers or cargo, provisioning and catering for ships, personnel management and training, and the technical management of ships, including the taking of decisions on the repair and maintenance of vessels, take place in Ireland. Also relevant might be the maintenance of support facilities such as training centres, terminals, etc. in Ireland and the extent to which foreign offices or branches work under the direction of personnel based in Ireland. The fact that a ship is flagged, classed, insured or financed in Ireland may add further weight to the indicators set out above. But in any case both parts of the test, namely the examination of strategic management and of commercial management, must be passed.
- (23) A qualifying company must therefore meet three criteria:
- be liable to Irish corporation tax;

- operate qualifying ships;
- and have its strategic and commercial management in Ireland.

2.7.2. Qualifying vessels

- (24) A qualifying ship is a seagoing vessel that is engaged in reasonable commercial operations and that complies with all the requirements for navigation at sea imposed by the competent authorities of any country or territory. Acceptance of a ship as seagoing will normally require the ship to be certified as such under the International Load Line or the SOLAS (Safety of Life at Sea) Convention.
- (25) The following kinds of ships are excluded from the definition of a qualifying ship:
- Fishing and fish factory vessels;
 - Recreational vessels³;
 - Harbour, estuary and river ferries;
 - Various types of offshore installations which are not used for the purposes of transporting cargo or passengers by sea;
 - Oil tankers used for the purposes of delivering oil from an offshore oil field to an onshore storage facility;
 - Dredgers, working platforms such as seagoing cranes and cable-laying vessels;
 - Non-ocean-going tugs⁴.
- (26) Another precondition for being eligible for the tonnage tax scheme is that the share of qualifying ships owned by the company itself, calculated on their tonnage, is not less than 25% of the tonnage of all its qualifying ships. It is indeed required for entering and remaining within tonnage tax that a company should not have “chartered in” more than 75% of the net tonnage of the qualifying ships operated by it. In the case of a group, the limit is 75% of the aggregate net tonnage of all the qualifying ships operated by all group members that are qualifying companies. “To charter in a ship” means to rent it with a crew provided by the charterer, in contrast to the definition of the bareboat charter whereby the lessee must man the ship.

³ This provision will not be interpreted to include cruise liners that take individual fare paying passengers. However, it will be interpreted to exclude a vessel, such as a holiday yacht, that is chartered as a whole by its passengers either by a passenger acting alone, passengers acting together or by a third party on behalf of one or more of the passengers. STCW 95 refers to the 1995 amendments to the International Convention on Standards of Training, Certification and Watchkeeping for Seafarers (STCW), 1978. The 1995 amendments, which completely revised the Convention, entered into force on 1 February 1997.

⁴ The Irish authorities have confirmed by letter of November that only services provided at sea by seagoing tugboats are qualifying for tonnage tax, as opposed to those provided within the boundaries of a port.

- (27) However, all ships that have been chartered to the shipping company on bareboat charter terms can be qualifying vessels provided that the company has:
- possession and control of these ships;
 - control over the management of the crew, including the right to appoint the master and the other crew members and the obligation to train them;
 - control over the technical management of the ship, including decisions on its repair and maintenance;
 - control over the safety management, including all equipment and certificates needed;
 - the duty to ensure the supply and the catering for these ships.
- (28) However, the ships chartered out by the qualifying company to a third party which is not part of its company group cannot be considered as qualifying vessels for that company, except if it can be demonstrated that the company has done so for short-term overcapacity reasons and on terms not exceeding a duration of 3 years.

2.7.3. Qualifying activities

- (29) More specifically, earnings from the following qualifying activities or sources can be exempted from corporation tax by opting for the tonnage tax:
- firstly and most importantly, the transport by sea of cargo and passengers in a qualifying ship operated by a qualifying company.
 - towage, salvage and marine assistance services provided at sea by a qualifying ship working mainly at sea and operated by a qualifying company⁵;
 - transport services provided by a qualifying ship operated by the company in connection with other activities carried out at sea, such as diving support, cable-laying, and construction work in the marine environment⁶.
 - the provision by the company operating the qualifying ship of services such as the operation of cinemas, bars and restaurants, shops selling goods for the on board consumption, etc, which are ancillary to the transport of cargo and passengers;
 - the contracting-out or franchising to specialist operators of the on-board services just described;

⁵ It is to be noted that profits from the sale of salvaged goods would not be relevant shipping earnings.

⁶ It will be necessary to apportion the profits or losses from the operation of such vessels between that attributable to transport and that attributable to the other activities. In practice, it is envisaged that any method of apportionment which produces a result which is just and reasonable will be acceptable.

- dividends obtained from a non-resident company and derived from maritime activities if this company operates qualifying ships and if it is controlled by companies established in the Community and if the profits out of which the dividends are paid have been taxed in the country of residence.
- ship-related activities which form an integral⁷ part of the business of operating qualifying ships, including:
 - ship management operations, such as purchasing fuel and hiring crew,
 - commercial management operations such as booking cargo or passengers,
 - administrative and insurance services related to the transport of people or cargo,
 - embarkation and disembarkation of passengers from a qualifying ship operated by the company,
 - loading and unloading of cargo on a qualifying ship operated by the company, including the moving of containers within a port area immediately before or after the voyage,
 - consolidation or breaking of cargo carried on a qualifying ship operated by the company immediately before or after the voyage,
 - rental or provision to customers of containers for goods to be carried on a qualifying ship operated by the company;
- the provision of maritime transport services by research vessels would still remain within tonnage tax.
- the leasing of a qualifying ship where the company retains control over the operation and crewing of the ship;
- ship management services provided in respect of qualifying ships operated by the company.

2.8. Ring-fencing

- (30) Ring-fencing is an essential set of measures aimed at preventing spillover effects in favour of non-qualifying activities.
- (31) There is a general rule under the tonnage tax scheme that no allowances of any kind can be made against the tax owed to the fiscal authorities. Moreover, the tonnage tax must be paid irrespective of the shipping company's actual operating

⁷ By "necessary and integral" is meant activities which are both required for the business of operating the company's qualifying ships and which enable the company to carry on its business of operating those ships.

profit or loss. Operating losses from shipping activities under the tonnage tax scheme cannot be set off against profits from other activities. This also applies in the case of a group of companies being taxed under the rules for joint taxation.

2.8.1. Separate accounting

- (32) The tonnage tax activities of a tonnage tax company are to be treated as a separate trade of the company distinct from all other activities of the company.

2.8.2. Arm's length principle

- (33) The arm's length principle will apply to transactions between qualifying companies and subcontractors for the provision of transport services on shore.
- (34) While there is no general provision in Irish tax legislation or a specific provision in tonnage tax legislation which imposes an arm's length provision in relation to transactions between associated persons, there is Irish case law⁸ which would allow the Irish tax authorities to challenge any pricing arrangements which might be considered as not being based on the arm's length principle. The Irish authorities are committed to specifying very soon in the legislation that goods and services provided to a tonnage tax company by an associated non tonnage tax company, are provided on an arm's length basis and vice versa. A similar provision to apply where a tonnage tax company operates both a tonnage tax trade and a non tonnage tax trade.

2.8.3. Rules on financial expenditure and on thick capitalisation

- (35) Such rules are usually conceived to avoid situations where all the capital has been lodged within the tonnage tax boundaries or where financial expenditure has been incorrectly divided between, and thus attributed to, qualifying and non-qualifying activities.
- (36) No tax allowance can be permitted in respect of the part of the financial net expenditure attributable to tonnage tax activities. Assets taken into account for the qualifying activities will be qualifying ships, fixed assets wholly or partly serving qualifying activities and current and liquid related assets. Only the part of interest expenses and of exchange rate losses relating to non-qualifying activities will be tax deductible.
- (37) Moreover, Ireland has in its tax code a general anti-avoidance provision, which could be used to challenge any attempt at manipulating the capital and debt structure of a tonnage tax company or tonnage tax group. In any case, Ireland is committed to including rules on thick capitalisation in the tonnage tax legislation.

2.8.4. Group of companies

- (38) A group of companies is defined as all the companies controlled by an individual or, when a company is not controlled by any other person, that company and all other companies which that company controls. This definition goes further than the normal definition in Irish law of a group for corporation tax purposes.

⁸ Judgement *Belville Holdings Limited v Cronin* (inspector of taxes) 3 ITR 340.

Provision is also included for construction of various types of references to “group of companies”. “Group of companies” is one of the more important concepts in the tonnage tax. All qualifying companies that are members of a group must elect for the tonnage tax as a group by way of a group election. It is not possible for one group company that qualifies for tonnage tax to stay out and for another group company that qualifies to elect into tonnage tax.

- (39) Under those provisions a person controls a company if he or she is able to control or to acquire control, either directly or indirectly, of the company’s affairs. A person is regarded as having control of a company if the person has or is entitled to acquire:
- the majority of the issued share capital or voting power;
 - enough capital to be entitled to more than 50% of earnings distribution;
 - or enough rights to be entitled to a winding up or otherwise to more than 50% of the distributable assets.
- (40) All qualifying companies in a group must enter the tonnage tax scheme. The Irish authorities do not consider cherry picking an option. The fiscal authorities may enter into arrangements with groups in order to simplify and to streamline the application of the tonnage tax rules in relation to groups, along the following lines.
- (41) If two or more tonnage tax groups, two or more tonnage tax companies or two or more tonnage tax groups and companies merge, the group resulting from the merger is treated as a tonnage tax group as if the resultant group has applied for the tonnage tax scheme. The election is deemed to be effective for a period which corresponds to the longest period of those left for any of the merged groups or companies.
- (42) If a tonnage tax group or company merges with a qualifying non-tonnage tax group or company, the resultant group may opt for the tonnage tax scheme under the assumption that the related tonnage tax period will start from the date of the original election.
- (43) However, if there is a merger between a tonnage tax group or company and a non-qualifying group or company, the resultant group will be considered as a tonnage tax group by virtue of the original election of the group or company.
- (44) If a non-qualifying group or company merges with a qualifying non-tonnage tax group or company, the resultant group may make a tonnage tax election with effect from the date of the merger. Any such election is to be made jointly by all qualifying companies in the merged group within 12 months of the merger.
- (45) If a tonnage tax company ceases to be a member of a tonnage tax group and does not become a member of another tonnage tax group, the company is treated as if it had been a single tonnage tax company as from the date of the original election. If there are two or more companies left in the original group and any of them are still qualifying companies, they are of course to be treated as a tonnage tax group

by virtue of the original group application which continues to be in effect in respect of the remaining group. In the same vein, if a tonnage tax group splits into two or more groups, each of the groups, if it contains a qualifying company, are to be treated as if it had been a single tonnage tax group as from the date of the original election.

2.8.5. Repealing the favourable tax treatment

- (46) A company is expelled from tonnage tax where the fiscal authorities suspect that there is an abuse of the scheme as determined under this section. The power of expulsion is permissive since the expulsion may not be appropriate under certain circumstances.
- (47) A company is excluded from the tonnage tax scheme if the 75% limit referred to in paragraph (26) is breached in any two or more consecutive accounting periods. The power to exclude is a permissive one. If there are mitigating circumstances, such as the loss at sea of a vessel and its temporary replacement by a chartered in vessel, the company need not be excluded. Conversely, if there is evidence of an attempt to infringe the tonnage tax conditions, then the fiscal authorities may decide to exclude the company from the scheme.
- (48) Where a single company is expelled, the tonnage tax election ceases to have effect from the beginning of the accounting period in which the abuse started. In the case of a group, the group election ceases to have effect from whatever date the fiscal authorities specify. But the date cannot be earlier than the start of the accounting period in which a group member entered into the transaction concerned.
- (49) If the preconditions for applying the tonnage tax scheme cease to be fulfilled in the course of the ten-year tonnage tax period, the company is expelled from that scheme. In such a case, past profits over the remainder of the tonnage tax period will be subject to corporation tax.
- (50) The Act provides for disqualification from tonnage tax where a company leaves tonnage tax other than on the expiry of its election. A 10-year exclusion period will apply. Currently, this provision is of little practical application as there is no provision for entry into tonnage tax except by way of election in the initial period or election within 36 months of becoming a qualifying company. Also there is currently no mechanism for re-entry to tonnage tax should a company exit after the expiry of the 10-year election period without making a renewals election. However, the Minister for Finance can provide for additional periods in which a company may elect for tonnage tax. Any company excluded from tonnage tax under this section would not be able to re-enter the regime under any other election procedure that may be provided until the expiry of a 10-year period.

2.9. Flag link

- (51) The proposed Irish tonnage tax regime has no explicit flag link. However, the tonnage tax will apply only to eligible companies that are liable to Irish corporation tax. The currently small number of ships on the Irish Ship Register

would make such a link impractical. Any company opting into the scheme must however manage qualifying ships from Ireland.

- (52) The Irish authorities anticipate that a certain number of operators, currently flagged to third country ship registers, may choose to operate under either the Irish Ship Register, or, the proposed Irish tonnage tax, or both.

2.10. Objective of the aid

- (53) The regime is a tax measure in favour of the shipping industry. It is designed to maintain in existence an Irish registered merchant fleet, to retain employment for Irish seafarers and shore-based personnel in marine related operations and to maintain the competitiveness of Irish based ship operators.
- (54) The Irish Maritime Development Office, the Irish agency responsible for developing shipping and for promoting in particular short sea shipping in Ireland, has estimated that 50% of the shipping sector's contribution to the economy, together with 50% of Irish maritime sector employment could be at risk if a tonnage tax were not to be introduced soon.
- (55) According to the Irish authorities, being a small and open economy, Ireland is heavily dependent on its foreign trade. Operational maritime connections are therefore vital to its economy. The primary objective of this supply security policy is to ensure an adequate functioning of transport, storage facilities and distribution systems in crisis situations.

2.11. Overlap with other schemes

2.11.1. Income tax allowances for seafarers

- (56) A special € 6,350 income tax allowance for seafarers who have been at sea on voyages to or from foreign ports for at least 169 days in a tax year, was introduced in the 1998 Finance Act. It received formal Commission approval in March 1999 (State aid N 102/99 amending aid N 533/98).
- (57) A formal notification under Article 88(3) of the EC Treaty, with a view to reducing the 169-day threshold to 161 days, has been forwarded to the Commission on 14 October 2002. The proposed amendment should have a modest impact on the take-up of the relief in the short term, given the high age profile and the low income tax liabilities of the majority of Irish seafarers. It is hoped in time to review the threshold levels still further and to use the allowance, in conjunction with the new maritime college, to attract young new recruits to seafaring, with few tax allowances.
- (58) In 1999 – 2000, the latest tax year for which final figures are available, 86 claimants received a total € 280,000.

2.11.2. Seafarer Training Grants

- (59) The Department of Communications, Marine and Natural Resources has implemented, through the Nautical Studies Department of the Cork Institute of Technology, a shipboard training subsidy scheme since 1996. The subsidy helps students secure placements on ships as part of their deep-sea cadet training. Some

136 students were assisted under the scheme in 2001 at a total cost of € 263,000, through placements mainly within the United Kingdom deep-sea fleet.

2.11.3. Refund of Pay Related Social Insurance (PRSI)

- (60) This scheme was approved by the Commission in 1999 (case C 86/1997). Under this regime shipowners are refunded Social Insurance contributions that they have made in respect of their seafarers over the previous year. Refunds under this scheme are averaging € 2.5 million per year.

2.12. Commitments by Ireland

- (61) The Irish authorities declared themselves committed to providing the Commission with annual reports on the situation with regard to changes in the Irish registered fleet and seafarer employment on that fleet, together with the number of companies or groups which have applied for tonnage tax.

3. ASSESSMENT OF THE AID

3.1. Existence of aid under Article 87(1) of the EC Treaty

- (62) Under Article 87(1) of the EC Treaty “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”
- (63) Through the application of the tonnage tax scheme the Irish authorities envisage granting subsidies through State resources thereby favouring certain undertakings since the measure is specific to the shipping sector. Such subsidies threaten to distort competition and could affect trade between Member States since such shipping activities are essentially carried out on an internationally level playing field. For this reason, this support measure constitutes State aid within the meaning of Article 87(1) of the Treaty.

3.2. Legal basis for the assessment

- (64) Article 87(2) of the EC Treaty, which provides for aid having a social character, aid making good the damage caused by natural disasters or exceptional occurrences and aid granted to the economy of certain areas of the Federal Republic of Germany, is not applicable in this case.
- (65) Nor is Article 87(3)(a) of the Treaty applicable, which provides for aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment because the measure under consideration affects the maritime industry and is not focused on a particular region or regions.
- (66) Article 87(3)(b) of the Treaty, which provides for aid to promote the implementation of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State, and Article

87(3)(d), which provides for aid to promote cultural and heritage conservation, are not applicable for aid to the maritime transport sector.

- (67) Under Article 87(3)(c), aid to facilitate the development of certain economic activities or of certain economic areas may be considered compatible with the common market, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, and thus provides a possible basis for exemption. In the present case, the Commission considers Article 87(3)(c) to be the appropriate legal basis applicable to the present case.
- (68) In general terms, aid schemes should not be implemented at the expense of other Member States' economies and must not be likely to distort competition between Member States to an extent contrary to common interest. In that respect, the Irish authorities will have to demonstrate in their annual report that this regime has not distorted competition within the Community. State aid must always be restricted to what is necessary to achieve its purpose and be granted in a transparent manner. The cumulative effect of all aid granted by State authorities (including national, regional and local levels) must always be taken into account.
- (69) Aid in favour of the maritime sector must in particular be examined in the light of the 1997 Community guidelines on State aid to maritime transport⁹, referred to hereinafter as the Guidelines. They define State aid schemes that can be introduced to support the Community maritime interests in the pursuit of general objectives, such as:
- safeguarding Community employment (both on board and on shore);
 - improving safety;
 - preserving maritime know-how in the Community and developing maritime skills, to which the present scheme will contribute.

3.3. Earlier decisions concerning similar schemes in other Member States

- (70) The Commission has already approved over the last ten years on the same legal basis several tonnage tax schemes in favour of the maritime sector, with more or less the same built-in provisions:
- the Dutch tonnage tax scheme (case N 738/1995, approved on 20 March 1996);
 - the German tonnage tax scheme (case N 396/1998, approved on 25 November 1998);
 - the UK tonnage tax scheme (case N 790/1999, approved on 2 August 2000);
 - the Spanish tonnage tax scheme (case N 736/2001, approved on 27 February 2002);
 - the Danish tonnage tax scheme (case N 563/2001, approved on 12 March 2002);
 - the Finnish tonnage scheme (case N 195/2002, approval on 16 October 2002).

⁹ Community guidelines on State aid to maritime transport (Official Journal of the European Communities No 97/C 205/05).

3.4. Assessment

- (71) Section 3.1 of the Guidelines specifically mentions tonnage tax schemes as examples of fiscal measures that can be accepted: *“Equally, the system used in certain Member States and third countries of replacing the normal corporate tax system by a tonnage tax is a State aid. Tonnage tax means that the shipowner pays an amount of tax linked directly to the tonnage operated. The tonnage tax will be payable irrespective of the company's actual earnings, or profits or losses made”*. However, the guidelines lay down certain criteria, which must be met for such schemes: *“Consequently, the fiscal advantages mentioned above must be restricted to shipping activities; hence, in cases where a shipowning company is also engaged in other commercial activities, transparent accounting would be required in order to prevent spill over; to non-shipping related activities. This approach would help EC shipping to be competitive, with tax liabilities comparable to levels applying elsewhere in the world, but would preserve a Member State's normal tax levels for other activities and personal remuneration of shareholders and directors”*. The fulfilment of these criteria is analysed below.

3.4.1. Need for the aid

- (72) Manning costs higher than those prevailing in competing third countries and unfavourable corporation taxation are the main factors that weaken the international competitiveness of Irish shipping companies.
- (73) The traditional means of achieving cost reductions used by shipping companies both in Ireland and elsewhere, is the flagging-out of vessels to the open shipping registers of so called "flag of convenience" countries. This measure permits the achievement of double benefits: low manning costs, as well as the possibility to reduce the burden of taxation through the advantageous tax regime of those countries. Several States have responded to the development by introducing parallel registers, in addition to their traditional shipping registers. Thereby they can achieve the double purpose of preventing the flagging-out of vessels owned by domestic shipping companies and of inducing vessels entered in open shipping registers to return to the domestic flag. Those parallel registers permit a reduction of manning costs, the vessel nevertheless remaining under the flag of the country concerned.
- (74) Furthermore, several OECD countries, including a number of EU Member States as stated above, have resorted to special tax measures and to other forms of subsidies in order to improve the competitiveness of their shipping companies, in order to stop further flagging-out and to induce domestic maritime companies to bring back their vessels into the national shipping registers. Commonly applied forms of subsidies for the shipping business are partial tax exemptions for revenues from shipping, the right to make increased depreciation, reserves for the acquisition of vessels and reduced tax rates. The trend is towards a very low actual level of taxation for shipping companies facing international competition. The purpose of the present scheme is therefore to improve the competitiveness of the shipping companies, in so far as it contributes to maintaining the onshore activities related to international maritime trade within the Community.
- (75) According to the Irish authorities, some of the big Irish shipping companies have announced that if no tonnage tax were introduced, they would gradually flag-out

their entire tonnage, thus jeopardising the jobs of Irish seamen. They have also suggested that any new fiscal regime should make it possible to renew the stock of vessels without tax consequences.

3.4.2. Conditions for counterbalancing the absence of a strict flag-link

- (76) Since the Guidelines allow in certain cases the absence of any flag requirement provided that it can be demonstrated that:
- the management of all ships concerned is effectively carried out from within the territory of the Member State;
 - qualifying activities contribute substantially to economic activity and employment within the Community;
 - qualifying vessels comply with Community and international safety standards, including those relating to onboard working conditions.
- (77) The first condition is explicitly provided for in the Finance Act, 2002. The second condition is deemed ex-ante to be met in so far as the Irish authorities expect the repatriation of a certain number of vessels under the Irish flag. The third criterion is fulfilled by an explicit commitment of the Irish authorities in their notification to controlling all qualifying ships, even those not registered in Ireland.

3.4.3. Efficiency of the ring-fencing measures

- (78) The fiscal advantage granted through the tonnage tax is restricted to maritime shipping transport of passengers and cargo and to a certain number of related activities as described above. The scheme excludes any activity which is not related to qualifying shipping activities.
- (79) The explicit exclusion of certain activities such as towage which is not carried out mainly at sea, dredging, commercial port activities, the part of a door-to-door transport chain which is not carried out at sea and any other activity if its purpose is not the commercial carriage of passenger and cargo between different destinations further specifies the boundaries of the tonnage tax scheme.
- (80) Furthermore, the ring-fencing measures provided for in the scheme should guarantee that there would not be spillover effects on activities not covered by the Guidelines.
- (81) On the basis of these provisions the Commission considers that the scheme has set sufficient limitations to meet the Guidelines' criteria.

3.4.4. Compliance with aid ceiling

- (82) It should be first noted that there is no existing aid scheme in Ireland capable of adding to the benefits of the present regime.
- (83) Replacing the normal corporation tax by a tonnage tax is explicitly permitted by the Guidelines on the conditions mentioned above, since the underlying aid does

“not exceed the total amount of taxes... collected from shipping companies¹⁰”. Moreover it should be noted that the rates used to determine the tax on the basis of net tonnage are in the present case slightly higher than those of the other tonnage tax schemes already approved by the Commission¹¹.

- (84) Therefore the Commission considers that the aid ceiling provided for in the Guidelines is respected.
- (85) Anyhow the Commission reminds Ireland of the need to verify that the ceiling will be respected in the case of any future individual aid granted to tonnage tax companies.

3.4.5. Reports

- (86) Ireland agreed to provide the Commission with annual reports on the implementation of the tonnage tax scheme and on its effects on the Community registered fleet and on the employment of EC seafarers, as required by the guidelines.

3.5. Conclusion

- (87) In accordance with the Guidelines, the tonnage tax is a fiscal scheme intended to prevent a foreseeable decline in the Irish-flagged maritime fleet, to preserve maritime know-how in Ireland, to preserve the existing Irish fleet and its commercial and strategic management as well as to preserve significant employment of seafarers in Ireland.
- (88) Furthermore, the tonnage tax would be limited to companies engaged in international transport liable to Irish corporation tax as regards profits derived from qualifying activities carried out on qualified ships.
- (89) For all these reasons, the introduction of the present tonnage tax in Ireland complies with the Guidelines.

4. DECISION.

- (90) The Commission has therefore decided to consider the fiscal scheme to be compatible with the common market on the basis of Article 87(3)(c) of the EC Treaty. Since the Irish authorities have entered into a number of commitments, the Irish authorities have agreed to submit the final version of the legislation to the Commission for review.
- (91) If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the

¹⁰ See Section 10 of the Guidelines.

publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Energy and Transport
Directorate A - General Affairs
B-1049 Brussels
Fax No: ++ 32 2 296 41 04

Yours faithfully,

For the Commission

Loyola de Palacio

Vice-President