T20 Policy Brief

Task Force 03
REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

The Way of the Water: Defining a Global Tax Policy for Oceanic Resources

Francesca Amaddeo, Dr., Lecturer-researcher, University of Applied Sciences, Lugano (Switzerland)
Marco Greggi, Full Professor of Tax Law, University of Ferrara (Italy)

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Abstract

The exploitation of ocean resources has been under discussion since the Seventies and, with it, the need for proactive policies addressing the protection of natural resources due to the increasingly observable impacts of climate change, environmental degradation, and the resulting loss of biodiversity.

The UN defines oceans as the «next great economic frontier» and several issues emerging from this understanding have been addressed so far. Tax policies are still undetermined, although they might play a role in the matter, allowing developing States to raise revenue by charging profits made by MNEs in the exploration of their waters.

The need for a fairer redistribution of wealth and taxing power amongst States, tabled by prominent organizations and international groups (UN, BRICS) is however clashing with an obsolete set of rules, based on the dichotomy Residence-Source State, which favours developed countries. The G-20, under the leadership of Brazil, should act swiftly, tabling principles addressing the redistribution of tax revenue and allocation of the power to tax oceanic resources. Thus, this proposal suggests to:

● Clarify the extension of the taxing right in the Exclusive Economic Zone of the high seas. The G-20 should intervene, stating that the power to tax in these areas should mirror the principles of the Montego Bay Treaty, and be attributed to the country whose coastal line the sea is adjacent to. This would grant many States, most notably developing countries, an extra-jurisdiction to tax and the possibility to raise more revenues, particularly addressing MNEs which are exploiting resources tax-free so far.

● Address the allocation of taxing rights on different income in cross-border circumstances, possibly introducing a new nexus rule dealing with the harvesting of ocean resources. It could be the occasion to introduce a new tax Treaty addressing this scenario or, as a second-best solution, to properly amend the UN Tax Model Convention

concerning the blue economy, including oceanic resources-based income. This would help in pursuing a fairer and more cooperative tax approach to the blue economy.

Diagnosis of the issue

Through Sustainable Development Goals (SDGs) defined by the UN 2030 Agenda, growth strategies, domestic resource mobilization and sustainable exploitation of natural resources, tax fairness and transparency are closely related. The main aim of our proposal is to strengthen the link between a sustainable exploitation of natural resources, specifically from the ocean, and taxation.

Natural resources are characterized by their implicit scarcity with few remarkable exceptions, such as solar power, winds and sea tides.

Taxation has to be sustainable in terms of the environment and shaped in a way to address social injustices and inequalities. A proper international tax policy for the exploitation of natural resources may actually help in achieving either goal.

Despite this, revenue from environmentally related taxes in the ocean economy accounts for 0.6%, of total environmentally related tax revenue (OECD, 2021).

For years, the international legal system has been missing a coherent and commonly accepted pattern for the cross-border exploitation of high seas resources, intended as both biological and mineral ones (that is, for instance, fisheries and oil and gas underneath the soil).

International treaties and regulations have basically addressed the respect of qualified wildlife forms (such as whales) on the brink of extinction, none of them have property regulated their sustainable exploitation. A common framework and taxonomy to define taxation principles in the sustainable oceanic economy is crucial. Some tax treaties deal with natural resources, including their exploitation *(i)* in the definition of the jurisdiction, *(ii)* in the cross-border taxation of immovable property, and *(iii)* while encompassing the permanent establishment issue.

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Notwithstanding this, it is still too infrequent and vague. It requires a common standard to be applied worldwide to be effective. Moreover, specific provisions addressing oceanic resources are deemed to be necessary since their taxation requires a change in the current paradigm.

This lack of understanding has eventually determined two outcomes:

(1) The possibility to exploit common goods ended up in the hands of those capable of doing that (for instance MultiNational Enterprise - MNEs - with the technology and the capital to harvest high seas) to the detriment of the less developed countries whose only option was to buy the food collected by the MNEs (WEF, 2022).

Additionally, (2) the lack of possibility to charge tax on these super-profitable activities which, as a consequence, generates two negative externalities:

a) The first consists of the uneven distribution of the power to exploit these resources (which are taken for free under the First-Come, First-Served (FCFS) paradigm).
b) The second is the one considered in the following pages: that is the lack of a coherent tax policy in the matter. Less developed countries are currently not only deprived of the power to exploit the ocean's natural resources due to a lack of clear-cut rules, but also by the power to tax those doing that as the traditional criteria are unfit to address this kind of business.

While the first of the two issues demands a complicated consensus, difficult to be achieved amongst the States in this historical moment due to the different positions of several members, a new paradigm for the apportionment of the taxing power might be envisaged.

The G20's role

The G20 represents 80% of the world's GDP, 75% of global trade, 60% of the world's population; comprises 45% of the world's coastline and 21% of its Exclusive Economic Zones. During the last presidencies, the G20 has taken the path of improving a sustainable ocean economy, engaging in collaborations with international entities, such as the Standford Center for Ocean Solutions (COS) and the World Economic Forum (WEF). There is a strong call for pursuing such initiatives.

Under the Brazilian presidency, it could be the occasion to strengthen the intervention encompassing tax issues, so far ignored.

Proposed recommendations

Current international tax rules are essentially land-locked and actually, there is an upstream problem concerning the assignment of taxing rights. Even the rules addressing high seas logistics and shipments business (as Art. 8 UN Tax Model) always assume a connection with the relevant territory. The international community is addressing international taxation in an unprecedented way. The need for a fairer redistribution of wealth and taxing power among States, tabled by prominent organizations and international groups such as the UN, BRICS and others are clashing with a well-established set of rules that date back to the League of Nations position in the matter (1923). The aftermath of this enduring conflict is evident to everyone, as the complexity of overtaking traditional rules and practices is to the detriment of developing countries. The conflict, however, is in dealing with earth-based resources, it does not concern the wealth that lies beneath the surface of the seas and the oceans. In such a vast area of the world, international law rules are clear (such as the Montego Bay Convention), but their extension to taxation is anything but certain. Thus, the power to tax States is justified and exercised according to territorial patterns, and it has always been so. A State may tax a business as long as the business is resident in its territory or has a fixed place of business (the so-called «*permanent establishment* test»).

Currently, international tax law is regulated by an intricate pattern of double taxation conventions of a bilateral nature.

It is reasonable to say that a new multilateral understanding of the power to tax has to be introduced via a multilateral convention.

The present proposal recommends the drafting a multilateral convention which allows the extension of the power to tax States on the high seas. Such a multilateral convention should introduce the power to tax on the EEZ (Exclusive Economic Zones) and the pertinent high seas to the States adjacent to them. A second-best *scenario* would be based on the implementation of specific articles to be added to the current UN Model convention.

The new power to tax should be granted whenever a third state business crosses international boundaries to exploit or make use of the resources there located. This proposal will also encompass the creation of a new nexus rule, also encompassing the permanent establishment notion. Academic literature has spent decades in understanding and fine tuning this concept and recently it has been adapted to embrace a new form of business: that of digital. Yet none of these interpretive proposals (both academic and practice oriented) have ever considered the case of sea-oriented businesses. This proposal recommends to:

● Extend the power to tax the States to all the seas that extend over the Exclusive Economic Zones (EEZ) of the States facing seas and oceans, possibly extended beyond that, if conditions are, to reach the high seas. These extensions would be made according to a pattern to be identified via discussions.

● Relax the notion of permanent establishment, in order to cover all the possible ways to exploit waterways and water surfaces, including the animals living there. The new, water-oriented idea of permanent establishment should move from the understanding that the very same nation of fixity or stability of a business facility, when referred to the water, should be reimagined and relaxed in order to cover ships and other hardware routinely sued for the exploitation of natural resources worldwide.

A problem might emerge regarding a possible conflict between this new treaty and the already existing conventions signed by the countries and consistent with the traditional set of rules. This problem is not as relevant as it seems *prima facie* and that, in any case, it might easily be overtaken.

First of all, treaties currently in force are consistent with the traditional limit to the taxing power of the States (that is, land-based either according to the residence or to the source). There is the necessity to expand the power to tax to areas never considered before: an uncharted (water) territory. In such a *terra incognita* there are no rules currently applicable and, as a consequence, no conflict of taxation laws as nobody can be considered as resident there and no traditional source rule is applicable

Should this *scenario* take place, the treaty should override the current set of rules as happened with the multilateral convention proposed by the OECD in the framework of the BEPS project.

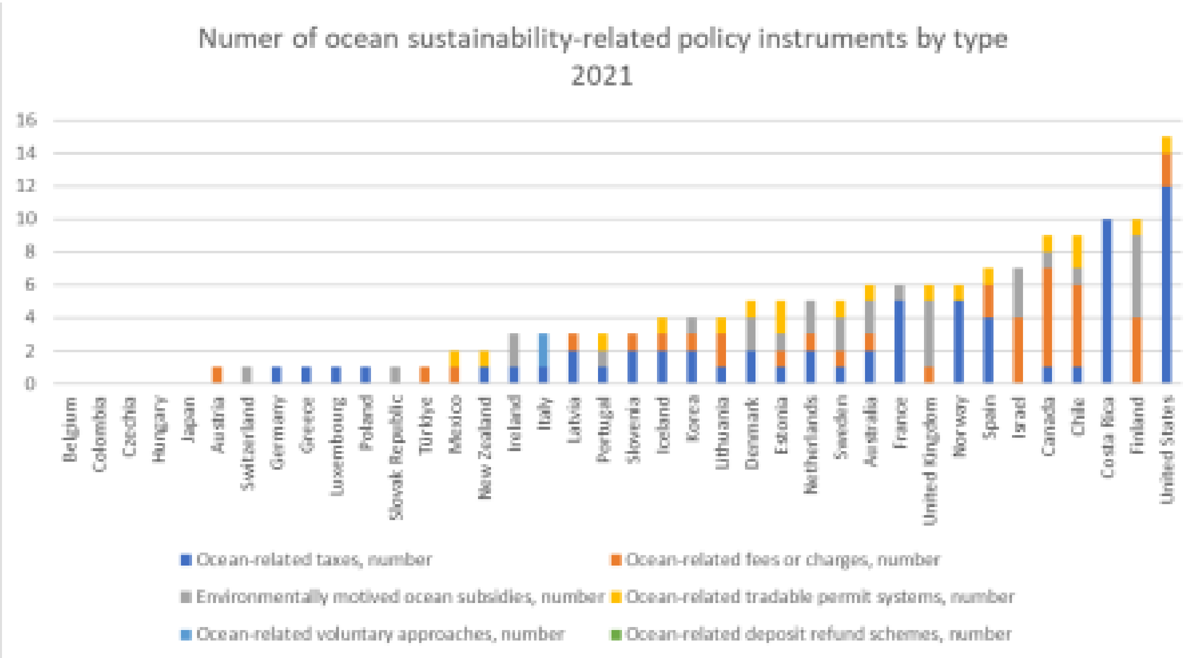
What is suggested here is to introduce a multilateral convention providing:

- A shared taxonomy of oceanic economic resources;
- A shared taxonomy of macro-category of taxes applied to oceanic resources;
- A set of rules concerning the allocation of taxing powers within involved States, specifically:
    - Expanding the notion of permanent establishment;
    - Preventing the abuse of the convention.

Explore scenarios of outcomes

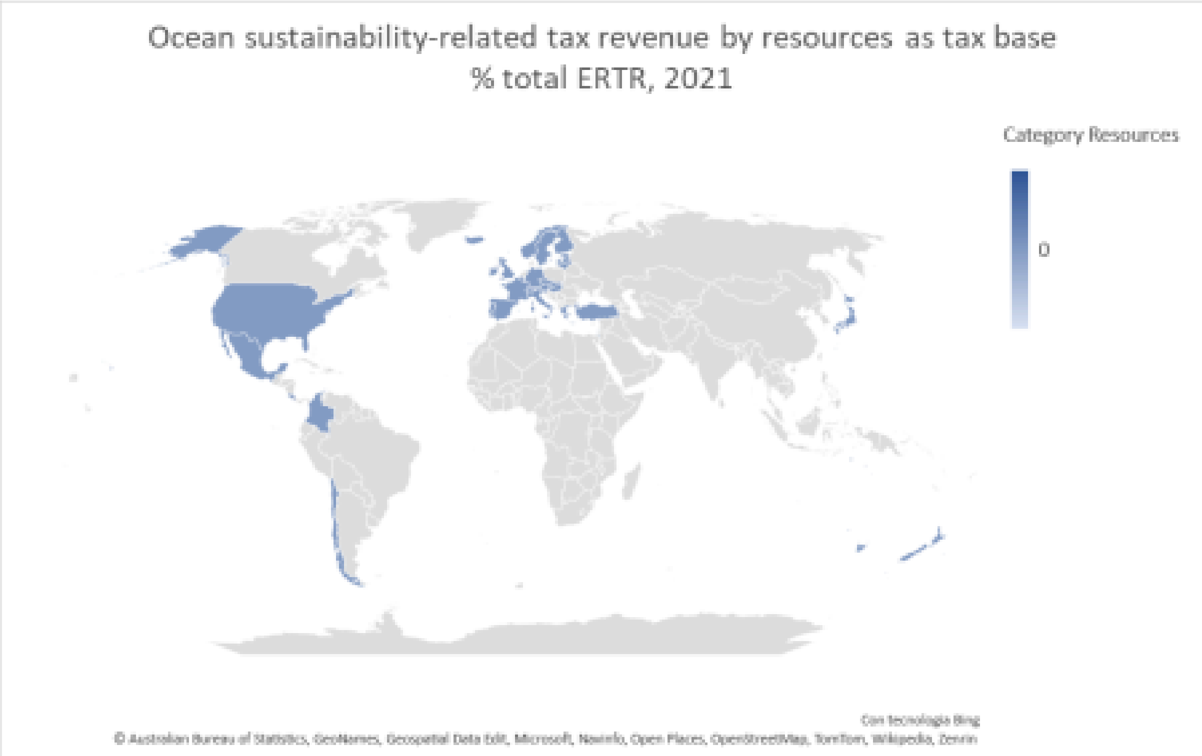
The proposal is fiscal by design and aims at affecting the power to tax of States of the international community. Should the proposal be implemented, it would not adjust the use of natural resources and would not directly help a more sustainable exploitation of the sea. Yet taxation, fees, and charges are crucial tools in improving ocean sustainability. This proposal, therefore, has the virtue of improving from singular national measures to a harmonized and international approach.

According to the OECD report (2021) and the latest study "*Eight lessons learned from comparing ocean economy measurement strategies across countries*" (OECD, 2024), each jurisdiction is actually working on its own domestic framework. As a result, in the OECD area, ocean-sustainability-related taxes raised USD 5.2 billion in 2020. This level has been stable since 2000 even if similar taxes have been increasingly implemented.



Data Source: OECD, "Sustainable Ocean Economy", *OECD Environment Statistics* (database), https://doi.org/10.1787/4c44ff65-en.

Several countries implemented sustainability-related tax measures, but the tax revenue from that still represents the smallest part of their overall revenue. It is reasonable to link such a result to the absence of an international tax tool as described.



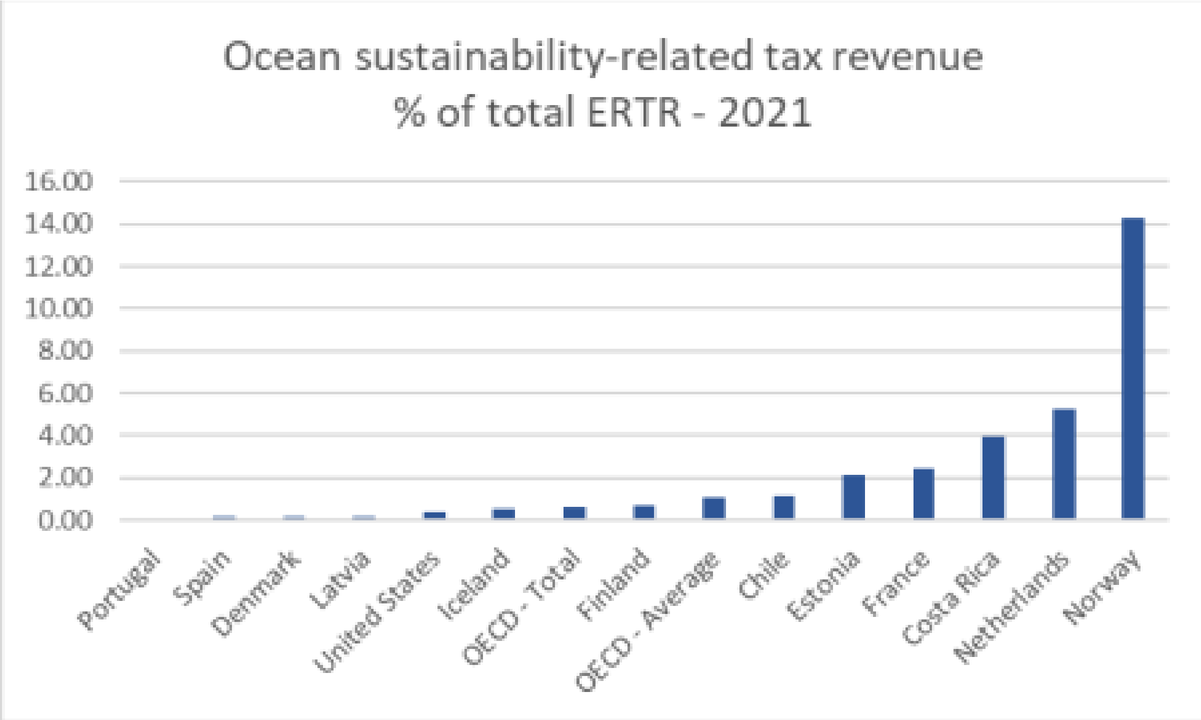
Data Source: OECD, "Sustainable Ocean Economy", *OECD Environment Statistics* (database), https://doi.org/10.1787/4c44ff65-en.

The use of multilateral instruments is relatively recent in the international taxation scenario but there is already evidence (such as in the case of exchange of information) that they can be crucial in improving cooperation and reciprocal support between States.

Furthermore, it would drastically increase fairness in taxation, redistribution of wealth, and social justice, eventually clarifying the boundaries of the individual power to tax of countries (most of which are developing States).

The increase in revenue via the expansion of their power to tax would make available further resources to these States, eventually providing them with the investments needed to improve the overall welfare and public services where necessary.

According to the OECD, the share of ocean-related tax revenue in total. Environmentally Related Tax Revenue (ERTR) is higher in Norway (14.3%), while the OECD average is around 1.1%.



Data Source: OECD, "Sustainable Ocean Economy", *OECD Environment Statistics* (database), https://doi.org/10.1787/4c44ff65-en.

Unfortunately, the data currently available is not sufficient to simulate the potential increase in tax revenue.

Expanding the State's power to tax would also entail another consequence for the extracted resources: most notably, an increase in their price for an amount depending on the elasticity of the demand for such goods (Samuelson, P. A., Nordhaus, W. D. (2001). Economics. UK: McGraw-Hill, in particular at pages 78 and 83).

Although expanding the power to tax would affect income tax only, one probable outcome of such a decision would be to make it more expensive to use the aforesaid resources. This policy decision would possibly entail an increase in the price of the materials and fisheries, with an inflationary effect.

The extraordinary nature of such a tax would allow the adoption of a lower rate, in order to strike a balance between the need to reallocate revenue and the need to preserve the reasonableness of prices.

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