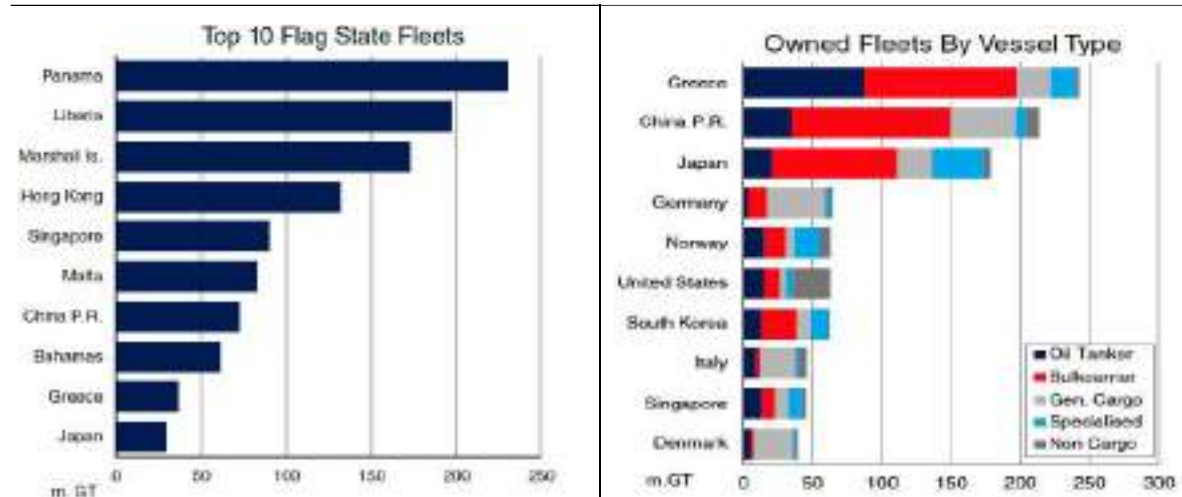


A direct impact of development of open registry is the response by a national or ‘closed’ registry by creating ‘offshore’ or ‘second’ registry’, also called ‘international registry’. These registries typically involve a traditional closed national registry which has set up another registry, often at a different geographical location within its jurisdiction, which has less onerous requirements of crewing, taxation etc., while attempting to strike a balance between safety and providing more options to the owners. An example of international register is the Danish International Register, which provides for flexible crewing, more options for class and a competitive ‘tonnage tax regime’.

Figure 18: Fleets in Top-10 FOC and Top-10 Beneficial Flag States (August 2021)



Source: Clarksons' Research, August 2021

Figure 19: Comparative Regimes of India-Flag and Key Open Registries

#	Flag	POEM	Crew	Class	Tax	Enforcement
1	Panama / FOC / Open Register	Optional	No Restrictions	No Restrictions	Nil	Easy
2	Malta / FOC / Open Register	Optional	No Restriction	No Restrictions	Nil	Easy
3	Singapore / International Registry / 2 nd Register – Offshore Register	Activity Requirement	No Restrictions / Min Intl crewing standards	International Association of Classification Societies - Class	Tonnage Tax / Approved Incentive Scheme (AIS)	Easy
4	International Registry / Danish International Ship Register	Activity Requirement	Master Danish/EU – can be waived/Min Intl crewing std / Local union agreement	International Association of Classification Societies	Tonnage Tax / No Registration charges	Easy
5	India / National	Compulsory	Indian Crew Only / Indian Union Ag / Indian manning standard	Indian Register of Shipping with dual registration with IACS	Tonnage Tax / Restrictions	Difficult
6	United States / National	Compulsory	US Crew only / US crew agreement / US Crewing standard	ABS only / American built tonnage only	Corporate tax	Easy

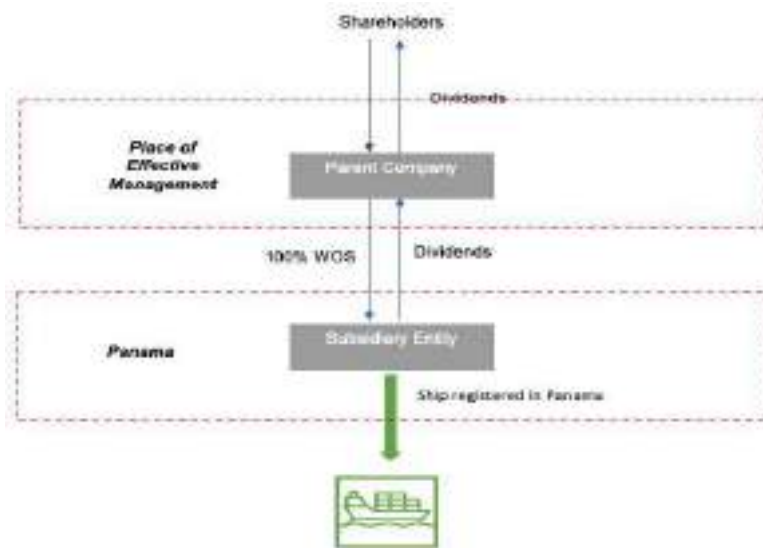
• **Flags and Impact of Taxation on Global Shipping Structures**

(a) **Ship-owners – Flag and Taxation**

The *raison-juste* for developing open registries was higher taxation in ship-owning countries. As economies developed, tax structures changed to respond to different monetary conditions.

At the same time, it was understood that global transportation was a service which could be provided from any jurisdiction and therefore, ship-owning countries developed a unique tax structure, with innovative tax incentives and exemptions, for shipping companies involved in international trade to register their ships with open flag registry while continuing to operate from ‘developed shipping hub’. The system of open registry was developed in order to disconnect the tax and regulatory regime of their country with ship-owning, especially when inflationary pressures were increasing local taxation and egregiously globally, third-world country seafarers were fast replacing European ones. The tax structures range from full exemption from all taxes to tax incentives for ship-leasing companies (e.g., Hong Kong). Appendix A gives the details of exemptions for a shipping company domiciled in its respective jurisdiction and involved in international shipping. The usual structure is for the parent company domiciled in a ‘hub’ to establish a Wholly-owned Subsidiary (WoS) in an open flag state (e.g., Panama), with dividend transfers from WoS (not taxed in ‘hub’ jurisdiction), which also is the Place of Effective Management (POEM) of tonnage. Tax incentives are felt to be so essential that OECD recently excluded shipping from a proposed minimum tax of 15% on all multi-national enterprises operating from signatory countries.

Figure 20: Unique Tax Structure of Open Registries



(b) Ship Operators – Tax Deductible at Source (TDS)

Unlike ship-owning, tax on ship operators is not linked to the flag of the vessel chartered by them. Focus is on tax in the jurisdiction ship operators are domiciled, including income tax and withholding tax. WHT on payments of charter hire and any interest payments are the most important of all, as it is a tax on the turnover of the entity, rather than profits. Established commercial shipping hubs expressly exempt payment of charter hire from WHT.

4. INDIA SHIPPING

The growth of Indian-flag shipping tonnage has not kept pace with the growth of Indian trade needs. This has led to more than 93 per cent of Indian origin or destination international cargoes, and about 39 per cent of total Indian cargoes (including coasting and offshore fields), being carried on foreign-flagged ships, with an annual freight outgo of about USD 75bn. Participation of Indian tonnage in global cross trades is negligible, with hardly any freight and other receivables.

4.1. Development of Indian shipping since independence:

Stage 1: From 1959 to until 1992, Indian shipping was synonymous with Transchar, the chartering arm of Ministry of Surface Transport. Sale and purchase of commodities was channelised through state trading companies like MMTC and STC. Their shipping requirements were attended to by a panel of Indian brokers of Transchar, as shipping was on the restricted list for foreign investment. Transchar chartered vessels only on voyage basis (the most basic form of chartering) on L1 under spot tenders. Prior to 1959, the imports of grains, fertilisers, sugar and other necessities had been handled by ‘India Supply Mission’ offices in London and Washington. **There was no long-term freight management nor attempts to time-charter vessels to bring down the freight.**

Figure 21: Development of Indian Shipping

	DISINTEGRATION 1950 TRANSCHART	CREATIVITY 1952 INDIAN TRADING FIRMS SET UP OVERSEAS SUBSIDIARIES	CREATIVITY 1954 INDIAN SHIPPING AGENTS / IN-HOUSE VESSEL OPERATIONS	INVESTMENT 1958 INDIAN VESSEL OPERATIONS: CONTINUED EXPANSION	2019
	TRANSCHART	UNIT EXPOSURE TO GLOBAL CHARTERING: - KUMAR GUJRAL LTD, LONDON - FIC GLOBAL PVT LTD, SINGAPORE - KUMAR GUJRAL, DUBAI - SVS SINGAPORE (SVA) - TRINEL, DUBAI	UNIT EXPOSURE TO GLOBAL CHARTERING: - JALSHI CHONGAL / SEKHAR GROUP - JRM BULK, SINGAPORE - TEL DUBAI - ACT/PAFOS SHIPPING, DUBAI - SMITHA DIEPZAS, DUBAI - FLAMING BULK, SINGAPORE - T&L INC, SINGAPORE	CONTINUED EXPANSION OF OPERATIONS: - BANARPOLE, SINGAPORE - GOUDARJI, SINGAPORE (SINGHARON) - KHALI, DUBAI (KENTON/KEY) - FEMORE, DUBAI - SINGAPORE SHIPPING, SINGAPORE (SVC)	
Restricted chartering based on L1 bidding.	Formation of India-centric Indian-owned trading firms	Indian trading companies (especially iron-ore companies) flush with funds	Indian trading companies continue to consolidate	Large industrial companies like Tata, ACC, SAIL, over 'reverse-auction' system for freighting	
Standardised charter party – limited knowledge of shipping practices	First cautious steps towards vessel chartering and simple time chartering	Reduced dependence on banks leads to Indian 'shipping intermediaries' to commence vessel operating	Indian ship operating companies continue to expand outside India, esp. in Dubai & Singapore	Lack of trained manager and poor global perception of companies based in India reinforce foreign hub	
Disconnect from world shipping practices of vessel operating, finance, hedging, law	Due to chartering & FOREX restrictions, companies form hubs in Dubai & Singapore. (F&B Reg Ch. 8 Rule 88 13/18)	With trading hubs already established in Singapore and Dubai, operators follow them and strengthen the hubs	2003 High court ruling imposing withholding tax on charter hire spelled end for operation in India.	Indian ship operators continue to make Dubai and Singapore their hubs	
Traditional shipowners with equity operate with India-centric focus.	Few companies buy ships for tax benefits – (I) ship stabilisers / India Cement / Seame / SMC – were exit.	A few cash-rich iron-ore traders buy ships like MSP, SRS / (I) steel / (I) bulk. Few like Adani / Tata linked to UMPPs – all expensive purchases	Introduction of tonnage tax in 2004 and including shipping in OGL has no impact on owners in India as 'eco system' 'hub' missing.	Overall Shipping ecosystem continues to be poor, with little Indian capital in shipping, few international owners & players	

Stage 2: Reforms of 1991-92 allowed Indian companies to import and export without intervention of state trading enterprises. Many private firms started with a cautious approach to chartering operations from Dubai, Singapore and London, due to insufficient knowledge and skillset for time chartering, doing mainly basic voyage chartering. A few firms stayed with inhouse cargos only in time chartering. **Given the restrictions in India for foreign**

outward remittances and prior DG Shipping / INSA approval, firms moved chartering offices to overseas locations, principally to Dubai and Singapore.

Stage 3: The credit super-cycle of 2003-07 placed cash in the hands of Indian shipping entities, including stevedoring companies. Dubai and Singapore rapidly expanded their hubs for Indian shipping. Knowledge of local ports and relationship with traders / exporters / importers allowed these operators to scale up quickly. India-China iron ore trade fuelled Singapore as a major trading and shipping hub, with Indian traders, operators and banks in trade finance. However, in India, uncertainty on WHT on charter hire remittance continued, while remittances' regulations and prior DG/INSA approvals did not encourage Indian enterprise to seize the opportunities. **The ecosystem of shipbrokers, marine insurance companies, maritime lawyers, thus established their base in Dubai or Singapore.**

Stage 4: The consolidation of Indian business in Dubai and Singapore continued. Indian markets lack depth in manpower and knowledge as most offices have moved out. Some foreign operators who were left in India, such as Norden and Oldendorff, also eventually moved out of India to Dubai. Some ship operators operate offices in Navi Mumbai and Noida due to cost considerations and to develop local Indian manpower. **Overall, the Indian eco system for shipping remains weak and under-developed.**

4.2. Indian Shipping Today – Ship-Owning

• The Indian fleet

According to Clarksons' Register, Indian tonnage currently totals about 16mn GT with 1,887 vessels and valued at USD 9.1bn or INR 70,000 crore. Another 32 are on order valued about USD 1.1bn (INR 825 crore), which is about INR 26 crore per vessel on order.

A substantial part of India-controlled tonnage is Indian flagged, due to the combined effect of cabotage and 'right of first refusal (ROFR)' available to PSUs and also because dividend from overseas subsidiary is taxed in India. In spite of introduction of 100% FDI in shipping, tonnage tax regime and various incentives like ROFR for Indian cargoes and coastal cargo reservations, there is no appreciable increase in Indian-flagged tonnage. Indian-flag vessels currently in Indian registry of DG Shipping were accessed from the website of DG Shipping.

Figure 22: India-controlled tonnage in international trade, average-size >10,000 dwt

Rank	Owner Group	Total Ships	Total DWT	Avg Size DWT	Age	POEM	Key Aspects
1	Shipping Corporation of India	133	5,358,159	40,592	18.34	India	PSU
2	Great Eastern Shipping	65	3,739,285	57,527	12.28	India	Listed in BSE
3	Seven Islands Shipping	20	1,155,250	57,762	18.17	India	Coastal/PSU trade
4	Adani Group	60	992,235	20,671	10.95	Dubai	International Trade
5	Tolani Group	14	799,001	57,071	15.81	Singapore	International Trade
6	Apeejay Shipping	9	594,569	66,063	16.77	India	Coastal/Flagged out
7	Sanmar Group	9	556,489	61,832	20.27	India	Coastal/PSU trade
8	Pallonji & Co	22	539,404	24,518	11.64	India	Singapore flagged
9	Reliance Industries	32	365,593	11,793	19.31	India	Coastal
10	Essar	28	234,214	8,364	22.61	India	Coastal

However, the tonnage shrinks substantially to 14mn DWT and 392 ships if only ocean-going vessels above the size of 10,000 DWT are considered. Of this, almost 5.3mn DWT and 133 vessels belong to SCI, which is undergoing divestment. Many vessels of the fleet listed above are flagged outside India or controlled overseas. Apart from above, sizeable Indian-controlled tonnage is either flagged out or POEM of vessels is outside India.

- **Analysis of Ship Registration and Indian Flag – Issues and Incentives**

Three acts govern the registration of ships in India: Merchant Shipping Act, 1958 (MSA); Coasting Vessels Act, 1838 (CVA); and Inland Vessels Act, 1917 (IVA).

Seagoing ships not fitted with mechanical means of propulsion are registered with Mercantile Marine Department (MMD) under CVA. Mechanically propelled inland vessels, which includes dumb vessels towed by mechanically propelled vessels, are not permitted to proceed on a voyage or to be used in any service unless they are registered under IVA. Seagoing ships fitted with mechanical means of propulsion of fifteen tons net and above can be registered under Part V of MSA.

Part V of MSA and Registration of Ships Rules, 1960, regulate the registration of an Indian ship. Section 22 of MSA requires that for a vessel to be recognized as an Indian ship, she would have to be registered under MSA. Part V of MSA deals exclusively with registration of Indian ships; Part XV deals with registration of sailing vessels; and Part XVA deals with registration of fishing boats.

Ships are required to be registered only at ports designated as Ports of Registry. At present, Mumbai, Kolkata, Chennai, Cochin, Kandla, Visag, Port Blair and Mormugao have been designated as ports of registry, and Principal Officers of Mumbai, Kolkata, Chennai, Cochin and Kandla, and the surveyor in charge of Vizag, Port Blair and Mormugao have been designated as Registrars of Indian Ships. These Officers are required to maintain a complete record of ships on the register indicating the status of the ship on a particular date.

The Provisional Registration of a ship can be done on the same day as delivery is taken at any foreign port by presenting the Protocol of Delivery and Acceptance and the Bill of Sale for a ship that is built or acquired out of India by a person qualified to own an Indian ship. The owner or master of the ship would have to apply to the Indian consular officer at the port where the ship is located, or at the nearest port, for the issue of a Provisional Certificate of Indian Registry for the ship, and that officer, on production of satisfactory proof of ownership, would grant the provisional registration certificate. Such a Provisional Certificate has all the force of a certificate of registry. The Provisional Certificate is valid for six months or until the arrival of the ship at an Indian port of the registrar concerned, whichever is earlier. The final registration of the ship at a port of registry in India must be effected during the period of validity of the Provisional Certificate. Procedurally, the Registrar of Ships at the Port of Registry in India maintains a page in the Register for the provisional registration of a ship. At the Permanent Registration of the ship, the data are entered on the same page by simply replacing the word Provisional with Permanent. The serial number of the ship granted during provisional registration remains the same. The date of registry is entered in two parts: that is (i) the date of provisional registration and (ii) the date of permanent registration.

In terms of the link between ship registration and flagging, it is seen that a vessel can be registered under the flag of India only if all ten shares of the vessel are held by an Indian entity. It is mandatory that the vessel must wholly belong to an Indian individual/corporation. Joint ownerships are permitted on the condition that all the owners are Indians. While MSA does not specifically prevent an Indian vessel from flagging out, it does require an Indian flag vessel to have its POEM in India. DG, Shipping has also allowed flagging of ships owned by Indian entities outside India, which ships shall be treated in a new category of 'Indian controlled ships'.

An Indian Shipping Company (ISC) has the option to fly a foreign flag and continue its status as India-controlled tonnage only if:

- It is an India-registered shipping company
- At least 50% of its fleet is India-flagged
- Each vessel of foreign flag has at least 50% Indian crew, provided that foreign crew requirements of flag state are met
- Additional cadet / crew structured training slots for each vessel of foreign flag on India coasting and offshore fields to meet requirements of tonnage tax regime
- No negative list of foreign flags has been notified by DG Shipping
- Classification Society will be as per foreign flag state (India-flagged vessels follow the Indian Register of Shipping (IRS) which may include option of joint registration)
- Such ships are eligible for priority over non-Indian ships and are given the ROFR next in hierarchy after Indian-flagged ships.

The above conditions have proven onerous and India-controlled tonnage has not seen the anticipated growth. The issues indicated by stakeholders with Indian-flag vessels are broadly summarised below:

- India tonnage is relatively small and risk of requisition of India flag is high currently
- Restrictions on nationality of crew, mandatorily all Indian, is not viable.
- WHT on salaries of crew on Indian ships
- Higher minimum crewing standards than international norms add to the cost
- Higher relative wages, crew unions
- Uncompetitive tonnage tax regime, although tax rate though prescribed long back, per se may not be prohibitive (tonnage tax reserve fund and Indian crew/cadet training requirements are onerous)
- Financing restrictions:
 - Inadequate local funding
 - Delay in mortgage registration and type of mortgage
- Delays relating to arrest and sale of vessels and cumbersome Indian judicial system
- Flag administration needs overhaul to meet international benchmarks

• **Tonnage Tax**

A tonnage tax is a specific tax for the shipping sector that replaces a regular corporate income tax. The tax base is the net tonnage that a shipping company operates. The most common system consists of tonnage tax schemes with formulas for calculating a fictional profit, the "tonnage tax profit", on which regular corporate tax rates are applied. A different model is

applied in Greece, Cyprus, Malta, Norway and Croatia where special tax rates are applied to ships according to their tonnage such that both tax base and tax rate are different than what the regular corporate income tax would have been. Tonnage tax is levied independently of the actual accounting profits or losses from the exploitation of a vessel.

The tonnage tax has become one of the main maritime subsidy mechanisms in recent decades. While Greece has had a tonnage tax since 1957, many European countries started to introduce a tonnage tax after the Netherlands put one in place in 1996 besides other countries like Japan, South Korea and India. Most of these schemes were motivated by declining competitiveness of the domestic shipping sector, and associated decline in the number of vessels carrying the national flag. Many tonnage tax schemes aim to encourage the repatriation of parts of the shipping fleets that re-flagged to open registries or FOCs. Most tonnage tax schemes, though not all such as of Greece, are optional, so that shipping firms can choose whether they want the regular corporate tax to be applied or tonnage tax regime. Various tonnage tax schemes require firms to fly the national flag, but there are many exemptions. For example, under the EU Maritime Guidelines, shipping companies benefiting from a tonnage tax scheme must generally maintain or increase the share of EEA flag vessel in their fleet. If they do not fulfil that condition, they can no longer include non-EEA flag vessels. This “share requirement” does not apply if the shipping firm operates at least 60% of its tonnage under the flag of an EU member state. Some countries impose additional conditions, e.g. the training of seafarers. In UK, firms are only eligible for tonnage tax benefits if they meet a minimum training obligation, that is, to train or facilitate training of cadets. Some tonnage tax schemes differentiate according to environmental performance (Norway, Portugal), age of the ship (Cyprus) or ship type (Greece). Various countries without tonnage tax have other corporate tax exemptions for shipping companies.

The structuring of India’s tonnage tax scheme is apparently a key reason why India-controlled tonnage flies non-Indian-flags:

- Company opting for Tonnage Tax regime is required to credit 20% of its book profits derived from the business to the Tonnage Tax Reserve Account (section 115-VT of ITA).
- Amounts transferred to the Reserve Account cannot be distributed as dividends nor utilized for purchase of any asset outside India. Given the highly volatile market in vessel valuation, it is a major ask from ship-owning companies to lock in a share of their profits for eight years and use the funds for vessel acquisition only, within the stipulated time.
- Reserves must necessarily be utilized for purchase of ship within 8 years and such asset cannot be sold for 3 years from its purchase. This is irrespective of market conditions, priority of the company, and shareholder objectives.
- Interest income on Reserves is subject to tax as ‘other income’ under section 56 of ITA.
- Regime prescribes minimum training requirement in respect of trainee officers as specified by DG Shipping¹³ under section 115-VU of ITA.
- Non-compliance of any of the conditions results in exclusion from the regime for 10 years as per the provisions of section 115-VQ of ITA.
- Tax regime does not provide from any exemption from capital gain tax on sale of ships. This is a major additional expense for India-based owners as most commercial hubs for international shipping for complete exemption from capital gain tax.

Committee has also received feedback from stakeholders ranging from issues like perceived late registration of mortgage to total amount of mortgage which can be registered. Most owners with Indian capital with ships involved in international trade have shifted the capital and POEM outside India.

It is concluded that Indian-flag be made the flag of choice for vessels involved in international trade for India-IFSC vessels. This can be done by adopting the correct tonnage tax structure and giving options to the users without compromising on safety and security standards, while furthering the employment of Indian seafarers. Some of the options presented by ‘international registries’ like Singapore, Danish International Register etc. may be studied. A strong, effective, proactive and responsive flag administration is sure to ensure that Indian flag is the preferred flag for vessels plying in international trade.

- **Incentives for Indian-flagged vessels**

Presently, there are two major incentives currently for Indian-flagged tonnages:

- **ROFR for Indian flag vessels for bulk import cargoes and associated freight subsidy (DGS Circular No.2 of 2021)**

In Part XIV of MSA entitled ‘Control of Indian ships and ships engaged in Coasting Trade’, the provisions of Section 406 deal with Indian ships and chartered ships to be licensed and while Section 407 deals with licensing of ships for coasting trade in India. The licence is to be granted under Section 406 by DG Shipping for taking to sea from a port or place within and outside India of Indian or other ship by a citizen of India or a company or a co-operative society, and under Section 407 to a ship other than Indian ship or a ship chartered by a citizen of India or a company or a co-operative society for engaging in coasting trade of India.¹⁴

Pursuant to above, DG Shipping promulgated ‘Shipping development Circular 02 of 2002’ on 08-11-2002. ROFR was extended to all import/export cargo though INSA. INSA was granted two working days (except for certain categories of ships where the limit is one working day) to match the lowest bid submitted by a foreign flag vessel.¹⁵ The impact of this provision on Indian shipping is discussed in detail in ship chartering section of the report.

Under the provisions of Circular No. 2 of 2021, the terms for granting license were limited to import tenders only, and chartering of vessels for export of cargo from India was exempted from licensing. Thus, an Indian-flagged vessel has ROFR within a price band of 20 percent, to match the L1 bidder in an international import tender by any importer in India. There are provisions for Indian-owned Indian-flagged vessel and for Indian-built vessels for priority.¹⁶

There is a further incentive for Indian-flag vessels bidding for PSU cargoes in the form of subsidy ranging from 5 per cent to 15 per cent depending on the age of the vessel and the difference between the quotes by L1 and eligible Indian ships during the bid process. The total subsidy over five years is estimated to be INR 1,624 crore. The impact of this provision is discussed in the ship chartering (public sector) section of the Report.

- **Reservation of Coastal Cargo for India-flagged tonnage and Cabotage**

Ministry of Ports, Shipping, and Waterways has vide its various policies, been seeking to encourage the use of Indian-flagged vessels.

As per India's cabotage policy, only Indian-flagged vessels or vessels chartered by an Indian person (i.e. citizen/ company/ co-operative society) operating under a valid license, issued by DG, Shipping under Section 406 or 407 of MSA as the case may be, can carry, *inter alia*, cargo or passengers from one Indian port to another. Foreign-flagged vessels are permitted to carry cargo or passengers only if (i) Indian-flagged vessels of similar specifications are not available, or (ii) if such Indian-flagged vessels of similar specifications, though available, cannot match the price at which the foreign-flagged vessel is available. The license is generally granted for a period of 2-3 years and has to be renewed thereafter.

Before an application for Section 406/407 License is made by an Indian charterer of a foreign flagged vessel, it must be established that no Indian-flag vessel which can meet the specifications and freight of the foreign-flag vessel seeking the license, is available. If an Indian vessel of the same specifications and freight is available for chartering purposes, then the Indian charterer cannot charter a foreign-flag vessel. SDC Circular No. 2 of 2002 provides for ROFR for Indian-flag vessels for all coastal cargoes controlled by both PSUs and private sector companies.

In order to encourage flagging in India and promote the Make-in-India initiative, ROFR for chartering of vessels in open/global tenders, is exercised in the following order, in compliance with DG Shipping's guidelines:

- (i) Indian-built, Indian-flagged and Indian-owned
- (ii) Foreign-built, Indian-flagged and Indian-owned
- (iii) Indian-built, foreign-flagged and foreign-owned.

Provided that all vessels flying the flag of India (i.e., registered in India) up to the date of issue of new circular by DG Shipping, shall be deemed to be Indian-built vessels and will fall in the first category above.

However, in 2018, three General Orders were issued permitting foreign-flag vessels (a) to transport export-import laden containers as well as empty containers, (b) for movement of agriculture, horticulture, fisheries, and animal husbandry commodities, and (c) for movement of fertilizers between two or more Indian ports along the coast without a licence or ROFR to Indian container ships. The objective was to reduce transshipment of India's export-import containers through Colombo port, reduce freight costs for Indian industry, exporters and importers, and increase coastal shipping, while also promoting India's agriculture sector.

In terms of the directions of change, the Draft Merchant Shipping Bill, 2020 uploaded for comments of stakeholders, reveals that in order to promote the use of Indian vessels, it is proposed to widen the eligibility criteria for ownership of Indian-flagged vessels and permit dual-flagging, by permitting registration of vessels chartered on bareboat-cum-demise basis. Moreover, the Draft Bill, proposes to do away with the requirement of procuring a chartering license for Indian-flagged vessel altogether. However, revisions to the Bill are being drafted.

Among the issues which make the Indian-flag uncompetitive for international trade, it is seen that there are only four categories of vessels predominantly register under Indian-flag;

- PSU-controlled
- India-listed and funded in India with heavy dependence on PSU cargoes / ROFR

- Heavy dependence on coastal cargoes
- Foreign-owned and purposely flagged to be on long-term charter with oil PSUs. This category has especially seen noticeable activity off late, with companies opening office in India in order to comply with the requirements of India-flag. Their vessels are placed on long-term charter to Indian oil PSUs for coastal or ‘shuttle model’ of international trade/ liftings thereby ruling out the possibility of any other Indian-flag vessel exercising ROFR against their time-chartered oil tonnage. [This is elaborated in the PSU chartering section of the Report.]

Thus, a very small percentage of Indian-flagged vessels and those with POEM in India participate in global cross trades and trade not controlled by Indian entities. Majority of Indian-flag tonnage and those with POEM in India are engaged in coastal trade, port, offshore field activities, dredging or related brown-water activities. For the Indian economy to truly benefit from shipping and be recognized as a major player in global shipping, it is vital that Indian-flagged ships, and more importantly, ships with POEM in India, prominently and predominately participate in international trades. **A ‘blue water’ merchant fleet controlled by India is an economic imperative.**

It would appear evident that the current incentives have not succeeded in their objective of attracting tonnage to the Indian-flag in any meaningful manner. The restrictions on chartering by Indian entities could be harming the Indian economy by deterring them from grasping the opportunities to trade freely in an open market to obtain the best freight and manage their freight risks. **The answer for Indian-flag lies in engendering a strong proactive, commercially-oriented flag management and putting in place a flag regime that provides a competitive tonnage tax regime while also providing optionality to owners on a range of issues like crewing, class etc.** The measures suggested for building Indian-Flag brand-consciousness in this Report also refer in this regard.

4.3. Ship Chartering

As noted in the section on historical perspectives of Indian shipping, ship chartering in India was mostly controlled by Transchart till the liberalization of imports in 1991-92. However, PSUs continued to be tied up with Transchart till the organization was abolished in 2015 and the control for chartering was handed over to respective PSUs.

Both PSUs and private sector undertakings needed to submit a range of documents to RBI for obtaining permission for effecting remittances. More often than not, this led to delays in remittance of freight / charter hire payments from India, with resulting denting of image of performance efficiencies of Indian charterers. Besides, it added a layer of needless scrutiny.

- **Private Sector**

A major incentive provided to Indian-Flag vide Circular No. 02 of 2002 of DG Shipping, mandates ROFR to INSA through licensing of all foreign-flag vessels chartered by any Indian entity. The Circular allows up to two working days to INSA to revert with either declining the cargo or offering matching freight with Indian flagged tonnage.

Commercial shipping is a highly-networked fast-paced business. Tramp-shipping, both dry and tankers, operate through brokers worldwide who connect ship owners with charterers.

Often, the best freight is obtained at the very last minute and just before the weekends, as vessels which are still not fixed for cargoes tend to compromise on rates at that time. The inability of Indian entities to confirm vessels at such short notice without approvals from DG Shipping/ INSA had a definite effect on their ability to obtain the best freight from markets.

This was realized early by shipping desks of Indian traders. The first migration of chartering business to overseas jurisdictions was seen in mid-1990s. By setting up a WoS in Dubai or Singapore and setting up a chartering desk there, traders were able to avoid both requirements of DG Shipping/ INSA approval and of RBI procedures for remittances of hire/ freight/ demurrage/ settlement, uncertainties and delays from which affected their market reputation. Indian companies based overseas slowly established themselves as 'reputed' charterers, while those still chartering out of India, although experienced and skilled, continued to suffer from delays. During the iron ore boom of 2004-05, most of the Indian iron ore traders also relocated their offices outside India in order to circumvent the onerous chartering requirement.

Promulgation of FEMA in 1999 eased the requirement for documents for remittance of freight and hire payments, but by then Dubai and Singapore had already established competing shipping hubs, replete with the complete eco system of brokers, lawyers, financiers and other players needed to charter vessels. Subsequent DG circulars removed the requirement of DG Shipping/ INSA approval for exports by Indian entities, but it was perhaps a case of 'too little-too late' for Indian shipping.

As on date, there are few India-based private charterers, mostly from end-user industry engaged in coastal trade or in meeting in-house international trade requirements. Almost without exception, these entities charter only on voyage basis and use the 'reverse auction method' of electronic evaluation of bids. Many of them have POEM in India but contractually nominate an entity in Singapore or Dubai for ease of doing business and transactions.

- **Public sector**

While the export sector has been liberalized, import of bulk commodities by PSUs still require providing ROFR to Indian-flag vessels and up to 20% price preference. Globally, national PSUs, especially oil sector companies, have maintained strong presence in shipping.¹⁷

As seen earlier in Indian tonnage section, oil PSU tenders are extremely lucrative for older tonnages, as vessels classed with IRS cannot be rejected on the criteria of age. This has opened an avenue for shipping companies to flag their old tankers in Indian-flag and place them on long-term charter on cost-plus basis to Indian oil PSUs. The cost of maintaining an establishment in India, cost of Indian-flag and their margins are all in built in the charter rate to oil PSUs, effectively resulting in oil companies paying for these added costs.

The oil companies need to have some tonnage under their control for effective international lifting and coastal trade, but if they take non-Indian flag on charter, they can either be left idle and unable to lift their own cargo if an Indian flag vessel was to bid for the cargo, or be completely removed from coastal trade if an Indian flagged vessel was to bid for coastal cargoes. Thus, Indian oil PSUs are willy-nilly forced to pay the additional cost in order to maintain a fleet of Indian-flag vessels to avoid their time-chartered vessels losing out under ROFR to Indian-flagged tonnage. Evaluating the data of tenders floated by a major oil PSU for the last two years shows that Indian-flagged fixtures could be awarded in about 20% of

the cases, of which half were direct fixtures and the other half on ROFR basis, that is, ROFR served only 10% of total tendered fixtures. When a tender in which the bid was matched under ROFR was examined, the final freight rate determined under ROFR by Indian-flag vessel was 35% higher than that of the foreign-flagged L1. In another case, the freight rate bid, unmatched under ROFR, was 42% higher than the foreign-flagged L1. These signal the extent of additional freight costs for crude oil, which would be passed on to the manufacturing and consuming economic segments of India.

As we have seen earlier, managing freight for a large company is a complex mix of owned, time chartered, spot-chartered tonnage, aided by freight and bunker derivatives to create an effective hedge. However, given the current restrictions on the length of time charter for a PSU (3 years) and the restriction of chartering India flag vessels, PSUs resort to simple spot voyage charter for a majority of their import requirement.

Given the volumes of both dry bulk and liquid cargoes moved by PSUs, it is critical that they strengthen the value chain by including long-term charters for global operations and ship-owning. It has been argued that Indian oil companies are not ‘traders’ but ‘refiners’ and ‘distributors’, but given the lack of any major assets, Indian oil PSUs have to be look at as traders with a single captive market. PSUs should ideally enter into long-term offtake agreements with producer companies and develop the capability to ship worldwide in order to fulfil the lifting commitments. An example is British Petroleum, which has shipping expertise to manage and ship global liftings on the strength of its shipping presence.¹⁸ A similar trend is noticed in companies involved in the steel sector overseas.

PSUs also face another hurdle to effectively manage their shipping expenses. As a part of its policy to promote control of shipping, the government has correctly provided guidelines for PSUs to sell on C&F and buy on FOB, whenever possible. By buying on FOB basis for imports, the Indian PSU effectively controls the freight and can benefit from it.

However, it is equally possible that sometime, the seller of goods has better ship arrangement, or a long-term chartered or owned vessel provides better shipping terms. In such an event, for contracting the shipments on C&F basis, the PSU is required to obtain two waivers – one from the administrative ministry concerned and another from the shipping ministry. Given that the person in the system likely to know most about market conditions and rates offered is the freight desk of the PSU, this creates unnecessary procedural delays for the PSU to act quickly and in a commercial manner. For PSUS to effectively move up the shipping value chain, it is important for them to develop various commercial and technical expertise related to commercial shipping. Interface with global shipping is also important, as is the ability to network extensively with brokers, ship owners and other participants in shipping value chain. Given that GIFT IFSC is envisaged as a hub for maritime activities, it would be beneficial for PSUs to shift their chartering activity to a ‘freight desk’ office at GIFT city. This will also facilitate time chartering of vessels and ship acquisitions planned by PSUs.

- **Indian coastal trades**

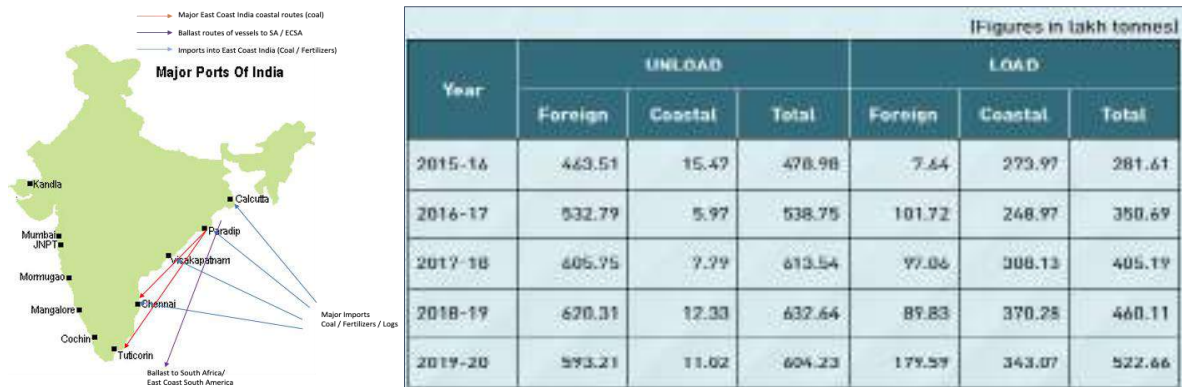
Coastal cargo, both by private sector entities and PSUs, is reserved for Indian-flagged vessels. The shipping development circular 02 of 2002 sets out the procedure for obtaining a ‘coastal license’ when Indian-flagged ships are unable to perform the coastal business.

As with license for chartering of import cargo, the procedure for obtaining the license is time consuming. Two working days are to be provided for INSA to confirm non-availability of Indian tonnage, after which DG Shipping issues the coastal license. Further, the best deals in bulk spot shipping markets are obtained when owners are under pressure to fix – typically on weekends or after vessels have completed cargo operations. Here, speedy decisions would lead to obtaining an optimal rate.

Many PSUs, like oil companies, charter Indian-flag vessels on long term basis to cover their coastal requirement, preferring to pay for ballast leg to the load port (which effectively doubles the freight cost) rather than charter on spot basis.

A good example of how the industry pays more for coastal cargoes is Paradip Port, which is a major loading area for coastal bulk cargoes, with movement of iron ore and coal along the west and east coasts in India. In 2020, the port handled over 35mn tons of coastal cargo. Paradip is also a major port for import of coal and fertilizers. There are many ports near Paradip which are also major import hubs, including Chittagong in Bangladesh. Given that large number of vessels are available near the port, availability of vessels should not be an issue. However, due to the delays associated with fixing a coastal vessel, most of these vessels ballast out to South Africa or east coast South America (during grain-loading season), ignoring the short coastal run which is actually in their ballast leg. This is typically because the tonnage is not able to get the approvals in time.

Figure 23: Paradip Part: International and Coastal Cargoes



Cabotage laws are commonplace and found in some 40 countries – a figure revised later from 91 countries – by the International Transport Workers’ Federation (ITWF) Task Force in its 2018 Report on Cabotage Laws of the World. The laws are geared towards protecting local shipping industries, ensuring the retention of skilled maritime workers, preserving maritime knowledge and technology, promoting safety, and bolstering national security. Many definitions of cabotage exist currently at national, regional and international levels alongside both restrictions of foreign activity and their waivers in domestic coastal trades.

Globally, coastal cargoes account for 12-15 percent of domestic cargoes. In India, with 160mn metric tonnes, it is only 7 percent. There is an urgent need to increase available tonnage for coastal trade and also reduce its freight cost, which is also higher on account of levying of import duty on bunkers besides running segments on ballast. Thus, this can readily be achieved by enabling India-IFSC tonnage, which stands with investments in Indian

tonnage ownership and/or chartering from India-offshore, to participate in coasting, port and offshore field activities without discrimination and at par with DTA tonnage.

4.4. Ship Operating

With technological innovations and availability of capital, a new class of players emerged in shipping. These were ‘ship operators’, equivalent of non-vessel owning cargo carriers (NVOCCs) in container trade. Just as NVOCCs don’t own containers and ships but lease them for carriage of goods contracted by them, ship-operators lease ships to carry the bulk cargoes contracted by them. The owners provide the ship and crew, while the ship-operator as the charterer pays for all voyage-related expenses and pays a daily hire for the time for which the ship is hired.

Figure 24: Ship Operator: Comparative costs by Charter Type

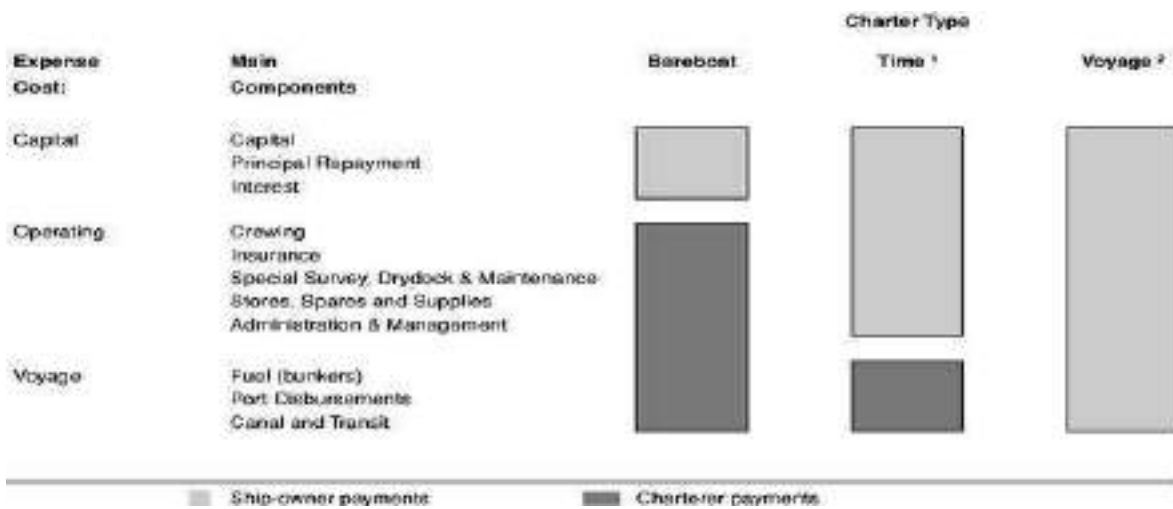
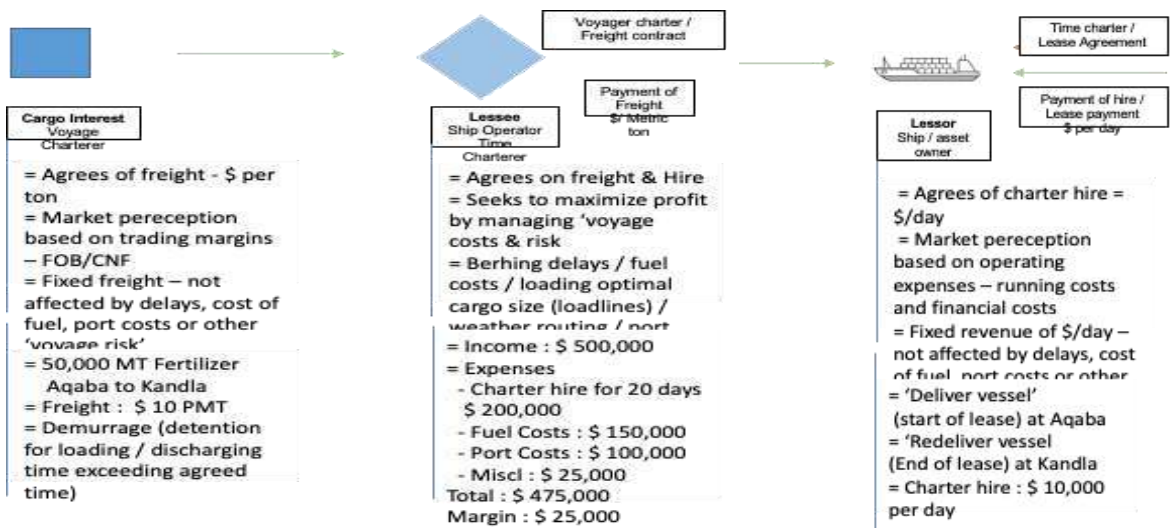


Figure 25: Ship Operator: Comparative costs by various elements of Charter Type



In this example,

- A ship operator ‘books’ a cargo of 50,000 mt of fertilizers from Aqaba to Kandla at USD 10 per metric ton, with total income of USD 500,000.

- He then ‘charters’ a vessel from a vessel owner for ‘one-trip charter’ from Aqaba to Kandla at USD 10,000 per day. Given that total duration including loading-unloading will be 20 days, his total expense on charter hire is USD 200,000.
- He has procured bunkers (fuel) at total fuel cost of USD 150,000 and port charges (both ports) will be USD 100,000. With USD 25,000 miscellaneous expenses, his total expenses including hire payment is USD 475,000, affording him a profit margin of USD 25,000.

Ship operators usually also ‘book’ cargoes forward and later ‘fix’ vessels in order to perform the contract (‘short’ on tonnage). They may also take vessels on long-term charter and fix cargoes for multiple shipments (Contract of Affreightment, CoA). On larger-sized vessels, there is an active market in freight derivatives based on indices of the Baltic Exchange, and many operators actively trade in paper as a part of their business. Most large ship-owners now maintain an active ‘ship operating’ desk, as do many commodity-trading firms.

Globally, commodity-trading has been the main foundation for growth of ship operating. Ship operators working in freight desk of trading firms slowly moved out to venture into their own operations to serve multiple clients and the ship operator industry was born in mid-1980s in South Korea, Japan and many other Asian countries.

In India, ship leasing could not evolve naturally due to canalization of bulk cargoes through government entities like Transchart. From 1959 till it was abolished in 2015, Transchart did not lease any vessel except for specialised tonnages. All vessels were fixed on ‘voyage charter’ using ‘L1’ system of tendering. This system is similar to one adopted by IOC and other oil and non-oil PSUs after the control of chartering was handed over to them in 2015.

Pure Indian ship-operators made their first appearance during the credit boom of 2004-05, when high commodity prices placed excess liquidity in the hands of Indian shippers and suppliers. Many Indian intermediaries, like stevedoring companies and cargo consolidators, moved into ship leasing as pure ship operators. Since the chartering desks of most trading houses had already shifted out to Dubai or Singapore, the operators followed them there, further strengthening the clusters. These hubs were quick to develop local financing and other incentives, hastening the flow of shipping entities from India to these hubs.

The situation is further complicated as legally, there is no clarification on treatment of charter hire for the purposes of WHT. While other global hubs specifically exclude payment of charter hire from WHT, the charter hire payable from India is subject to a WHT and in effect means a tax on turnover of ship operator.

An eco-system which supports ship operating needs to be created, as operators are the basic seed of innovation which further leads to ship owning and creation of related value chain. Ship operating develops skill sets based on keen understanding of shipping markets, valuation, trade routes, technical parameters, etc., which can be scaled up to enable ship finance, management, ship-building and other related high-end activities. It is proposed to provide exemption from WHT on payment of charter hire from India-IFSC to foreign ship-owners. In addition, there is a need to enable financing for ship operators, where advances against freight receivables for contracts with approved clients is available.

4.5. Ship-building

- **Global Scenario**

According to the latest IHS Markit Maritime & Trade newbuilding data, Chinese shipbuilders picked up the lion's share of **shipbuilding** contracts amounting to about 68% of gross tonnage (GT) of all new orders in China in Q3-2021. Fuelled by rising demand, the bulk of these new orders are for container-ships and also amount to 50% of global new orders.

Driven by an exceptional container shipping market which is driving record margins for liner operators, and a requirement for more efficient and less polluting vessels, China and South Korea have been the main beneficiaries of liner shipping order boom. Chinese shipbuilders are also understood to be offering particularly attractive payment terms and financial packages supported by state-owned banks.

In Japan, Nihon Shipbuilding (a joint venture of Imabari Shipbuilding and JMU) picked up orders for a handful of 12,000 teu and 14,000 teu vessels for operations with Ocean Network Express during Q1-2021. However, since then no new box-ship orders have been recorded in Japan. Moreover, having run down a significant amount of shipbuilding capacity in the past decade due to Government policy, Japan's ability to attract major orders now appears limited. The only other significant builder of containerships is currently CSBC Corp of Chinese Taipei which has 4 x 3,000 teu ships on order building for its own account or for resale.

Figure 26: New Ship Orders and Demand for Containerships



Figure 27: China is the world leader in ship-building



China has strengthened its position as the leading shipbuilding nation. It currently has a 43.3% share of the global orderbook, having held the number one spot continuously since 2017. In 2020, China produced 41% of the world's ships by GT with this figure expected to rise to 45% for 2021.

Containerships now make up about 33% of the current orderbook, followed by dry cargo (bulk carrier and general cargo) sector at 22%, tankers at 16.8%, and gas sector (LNG and LPG) at 12.3%. Whilst the cruise and ferry sector presently make up 6.3% of the orderbook this is likely to *reduce* as cancellations of cruise vessels work their way through the system. Meanwhile, the offshore sector comprises 4.6%, ro-ro cargo and PCTC 1.7%, with all other sectors making up 2.7% of the orderbook.

Figure 28: Ship-building Orderbook by Shipping Sectors

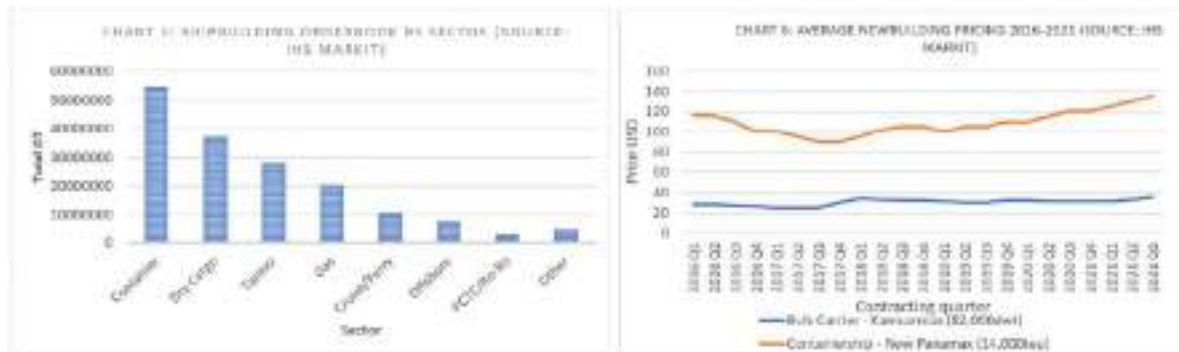


Figure 29: Ship-Deliveries in China, South Korea and Japan and Facilities in ROW

Deliveries (million dwt)	2009	2013	2014	2015	2016	2017	2018	2019	2020
China	36.5	43.1	36.0	36.4	36.0	38.7	34.8	36.3	35.1
South Korea	42.9	33.4	24.5	29.2	35.9	30.8	19.0	32.4	24.8
Japan	20.2	25.0	22.4	21.1	21.6	20.2	20.1	24.6	22.5



Source: BRS Review of Shipbuilding 2021

Increasing demand for containerships are allowing shipyards to increase their contract prices and at least provide an improvement in margins which have been historically low since the fallout from the global financial crisis. Nevertheless, contract prices are still only slightly above those seen during the previous bull market of 2006-08. In addition, recent increases in

steel plate prices, equipment and skilled shipbuilding labour shortages are likely to put further pressure on the global shipbuilding industry.

• Indian Scenario

Indian shipbuilding industry suffers from lack of infrastructure and capacity. Within the three shipyards in the public sector, the dry-dock at Cochin Shipyard currently possesses maximum ship-building capacity of approximately 1,10,000 DWT. This will be enhanced to approximately 2,00,000 DWT when the new dry-dock at CSL is commissioned (likely by December 2022). Another four public yards are under Department of Defence Production, all mostly dependent on orders from the Indian Navy, Coastguard and the government.

Figure 30: Ship-building Capacity in India, Company-wise, DWT in thousand MT.

S. No.	Name of The Company	2016-17	2017-18	2018-19	2019-20
(1)	(2)	(3)	(4)	(5)	(6)
A. PUBLIC SECTOR					
1	Alcock Ashdown (Gujarat) Ltd. @	15.00	15.00	15.00	
2	Cochin Shipyard Ltd.	110.00	110.00	110.00	110.00
3	Garden Reach Shipbuilders & Engineers Ltd.	0.22	-	-	-
4	Coa Shipyard Ltd.	4.50	4.50	4.50	4.50
5	Hindustan Shipyard Ltd.	80.00	80.00	80.00	80.00
6	Hooghly Dock & Port Engineers Ltd.	3.00	3.00	3.00	3.00
7	Mazgaon Dock Shipbuilders Ltd.	**	40.00	40.00	40.00
8	Shalimar Works Ltd.	0.05	0.50	0.50	1.20
B. PRIVATE SECTOR					
9	ABG Shipyard Ltd. @	120.00	120.00		
10	A.C.Rey & Co. Ltd.	1.50	1.50	1.50	1.50
11	A.S. Molobhoy Pvt. Ltd. @	-	-	-	
12	Bharat Defence & Infrastructure Ltd. @	70.00	70.00		
13	Bristol Boats Pvt. Ltd.	0.05	0.05	0.05	0.05
14	Chidambaram Shipcare Pvt. Ltd.	N.A	N.A	N.A	N.A
15	Chowgule & Co. Pvt. Ltd.	8.00	8.00	8.00	12.00
16	Dempe Shipbuilding and Engineering Pvt. Ltd.	5.50	4.50	4.50	4.50
17	Ferromar Shipping Pvt. Ltd.	2.00	2.00	2.50	2.50
18	Hema Engineering Works	N.A	N.A	N.A	N.A
19	JITF Shipyard Ltd	N.A	N.A	N.A	N.A
20	L&T Shipbuilding Ltd.	-	-	-	-
21	Mandovi Dry Dock		4.50	5.10	5.10
22	Marine Care 'N' Associates				-
23	Marine Frontiers Pvt. Ltd.			0.12	0.12
24	Modest Infrastructure Pvt. Ltd.	3.50	3.50	3.50	3.50
25	N N Shipbuilders And Engineers Pvt Ltd ***	N.A	N.A	N.A	N.A
26	Reliance Naval and Engineering Ltd. @	400.00	400.00	400.00	
27	San Marine				8.22
28	Sea Blue Shipyard Ltd.				0.34
29	Sembmarine Kakinada Ltd.***	50.00	50.00	50.00	50.00
30	Shoft Shipyard Pvt. Ltd.		2.35	2.35	2.35
31	Telma Shipyards Ltd.	12.00	12.00	5.00	5.00
32	Timble Drydocks Pvt. Ltd.		7.50	7.50	5.40
33	Titagarh Wagons Ltd.			8.00	8.00
34	Vijai Marine Shipyards		2.90	2.90	2.90
35	West Coast Shipyard Ltd.***			2.20	2.20

Source: Statistics of India's Ship-building & Ship Repair industry 2019-20, Ministry of Ports, Shipping & Waterways, Transport Research Wing

Private sector shipyards can build vessels up to cape size vessels comparable to some of the leading shipyards in the world. Reliance Naval Engineering Ltd. can build vessels up to

400,000 DWT and L&T Shipbuilding, Kattupalli up to 300,000 DWT, which includes large LNG Carriers. Smaller size LNG Carriers, Dredgers and other specialized vessels can be built by other shipyards also in the private sector, such as Shoft Shipyard, Chowgule & Co., Vijai Marine Shipyard, Mandovi Dry Docks, A.C. Roy & Co., Dempo Shipbuilding, etc.

At about 30,000 mt. dwt, the tonnage delivered by these yards in 2019-20 is quite insignificant. The yard orderbook is also low at 118,000 mt. dwt. While adverse market conditions are certainly to be partly blamed for the low performance, it is accepted generally that worker productivity in Indian yards is lower than global standards. There are also issues around import of ship parts and delays in clearances. Till complete ‘shipyard clusters’ are created, import of ship parts for construction needs to be fast tracked to match timelines for accelerated and upscaled shipbuilding in India.

Government has incentivized shipbuilding in India with several supporting policies, notably:

- Support for Indian shipyards for contracts signed during a ten-year period, viz. 2016-2026 under the Shipbuilding Financial Assistance Policy, 2016.
- Settlement of subsidy claims for executed shipbuilding contracts under the old shipbuilding subsidy scheme, 2002-2007, by extending the timeline and budgetary support beyond 31.03.2014 for release of committed liability of shipbuilding subsidy in financial years 2019-20, 2020-21 and 2021-22.
- All Government departments or agencies including CPSUs have to provide ROFR to Indian shipyards while procuring or repairing vessels meant for Governmental or own use till 2025, after which all such vessels will be procured only from Indian shipyards.
- Notified an updated Harmonized Master List of Infrastructure Sub-Sectors to include a new sub-sector “shipyards” under “Transport”, defined to cover floating or land-based facility having requisite facilities for carrying on shipbuilding/ repair/ breaking activities. Infrastructure status would enable Indian shipyards to avail cheaper long-term source of capital and reduce cost disadvantage and invest in capacity expansion.
- Notification No.1 of August 2018 of Make-in-India spells out minimum local content in shipbuilding with the aim of supporting local manufacturers of shipbuilding parts.
- A dedicated ‘shipbuilding policy’ has also been announced by Government of Gujarat¹⁹ to encourage creation of shipbuilding clusters in the state.

These initiatives are likely to bring dividends to the Indian ship-building industry in the near future, and can be dovetailed well with ship lease financing activities from India IFSC.

There is currently a shortage of skilled labour in the shipbuilding industry. Yards in Japan are being priced out due to high labour costs and Japanese yards have now started investing in countries like Vietnam to keep costs down. There is a good opportunity to capture this large capital investment from Japanese yards and also learn global best practices, especially for manpower management, once they set up in India.

Perhaps the weakest link in the entire chain is the market connect of Indian yards. Aggressive marketing and network development with industry end-users would help generate long-term trust and business prospects. Japanese, Korean and Chinese yards have long-term relationships with their clients, which are carefully nurtured by them. Each yard has a strong

marketing team and use a large network of project brokers and intermediaries to keep abreast of opportunities. Project brokers have the necessary expertise to guide the yards and structure transactions. It is important for Indian yards to establish themselves in the world markets and develop close relationships with potential clients and intermediaries. A case in point is the recent order won by Chowgule Shipyard of Goa.

Figure 31: Ships Deliveries and Orderbook by Type of Vessel

Table No. 4: Size and Number of Ships Delivered					Table-3: Current Order Book By Types of Vessels as on 31 st March, 2020 (*000 DWT)							
Name of Companies	Ships Delivered				Type Yards	Vessel No.	Tankers	Dry Cargo	Bulk Cargo	Passengers	Others	Total
	2018-19		2019-20									
	No.	DWT(*000)	No.	DWT(*000)								
(1)	(2)	(3)	(4)	(5)	Public Sector	3	6	4	6	115	128	
A. PUBLIC SECTOR (Total)	17	1.31	27	1.54	DWT	0.86	6	32.00	11.18	15.25	69.29	
B. PRIVATE SECTOR (Total)	Ships Delivered				Private Sector	5	4	2	6	104	121	
	2018-19		2019-20		DWT	5.51	16.88	11.42	0.33	14.87	49.01	
	No.	DWT(*000)	No.	DWT(*000)	Total	8	4	6	12	219	240	
	21	21.46	51	28.72	DWT	6.37	16.88	43.42	11.51	40.12	118.30	

Source: Statistics of India's Ship-building & Ship Repair industry 2019-20, Ministry of Ports, Shipping & Waterways, Transport Research Wing

To summarize, Indian-built and Indian-flagged vessels are being incentivised and given preference over foreign-flagged and/or foreign-built vessels. This in turn is intended to have the effect of promoting Indian-built as well as Indian-flagged vessels by giving them a relatively high priority for the grant of ROFR as compared to foreign vessels. This would be especially beneficial when it comes to long-term charters with PSUs, viz. IOC, BPL and HPCL, who largely operate through tender mechanism for chartering of vessels for their projects. This move is also in furtherance of the Make-in-India initiative in order to promote ship-building in India. Cochin Shipyard Limited has recently built an 8,000 mt. cargo vessel for JSW Shipping & Logistics (JSW), and managed to launch five vessels at one go including three Floating Border Outpost Vessels for Border Security Force.

It is expected that the triumvirate of regulatory ease and lower tax burden in leasing ships from India-IFSC, facilities and ease of doing business by units set up in SEZ GIFT-City, and the marine ecosystem of Gujarat Maritime Cluster will help connect the shipyards with project brokers, while also providing a range of financing options to the shipyard.

India-IFSC can also enable sale and leasing structures along the lines of JOLCOs and Chinese leasing structures, using a combination of Indian and overseas capital to fund the acquisition of the vessel by the lessor. This can be extended to ship buildings also for those opportunities in India or overseas where the ship operator / lessee requires new ships. The sale and leaseback structure can be created at India-IFSC and involve Indian shipyards for eventual use by India-IFSC controlled operators / lessors.

4.6. Ship Recycling and Repairs, Ship Breaking

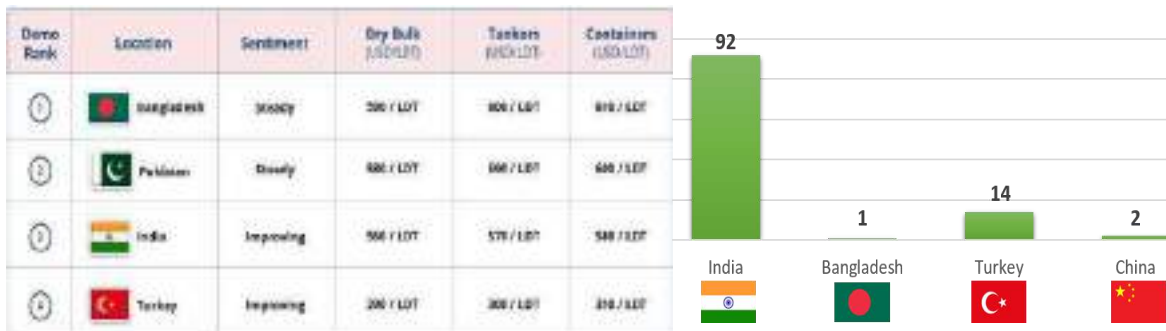
When a ship or floating/offshore asset reaches the end of its economic or functioning life (generally 20 years and older), the unit is sold for recycling at one of the 5 major destinations in the world: India, Bangladesh, Pakistan, China, or Turkey. Bangladesh has the largest global

a certificate from the flag State authorities showing that the ship has been deleted from their register and that there is no outstanding mortgage.

The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships, 2009, is aimed at ensuring that ships, when being recycled after reaching the end of their operational lives, do not pose any unnecessary risks to human health, safety, and environment. It addresses many issues around ship recycling, including that ships sold for scrapping may contain environmentally hazardous substances such as asbestos, heavy metals, hydrocarbons, ozone-depleting substances and others. It also addresses concerns raised about the working and environmental conditions at many of the world's ship recycling locations.

In 2015, ship recycling facilities based in India voluntarily came forward to develop the infrastructure by heavily investing in recycling ships the Convention’s guidelines. Class NK was the first classification society that developed guidelines to issue Statement of Compliance (SOC) to recycling facilities. After persistent efforts, four recycling facilities in Alang, India, were issued SOC for the first time in November 2015. Classification societies like Lloyd’s Register, RINA (Italy), Indian Register of Shipping, and Bureau Veritas, came forward and developed guidelines for recycling yards to recycle ships in compliance with the Convention.

Figure 33: Ship Recycling and Number of HK Convention Compliant Yards



Source: GMS newsletter update, Week 42 of 2021.

Due to continued demand of steel and growth of countries where recycling yards are located, ship recycling prices are expected to be stable in spite of high freight market levels. Large tonnage ordered in the credit boom period, and built in 2011 to 2014, is expected to soon come up for demolition, especially with new environmental regulations likely to be enforced by 2030.

In India, in 2018-19, a total of 706 ships were repaired out of which 341 ships were repaired by private sector shipyards and 365 ships by public sector shipyards, as compared to 528 ships repaired in 2017-18. However, the COVID-19 pandemic has disrupted almost every area of the shipping industry, after a promising 2019, with yard closures, logistical challenges and delay in surveys. It is also true that due to the structure of ship recycling industry and involvement of cash buyers, the commercial aspect of ship recycling industry did not fully develop in India. While Alang has now become one of the largest ship recycling yards in the world, the recycling companies in India are tied up with only a few cash buyers, predominantly in Dubai and Singapore. Two of the worlds’ largest cash buyers, controlled by persons of Indian origin are based in Dubai and Singapore respectively.

India-IFSC can play an important role in bringing the cash buyer industry to India. As FEMA is not applicable and with specific tax holidays for IFSC entities, cash buyers will find it easier to be closer to assets and breaking yards. India-IFSC would also need to ensure that IBUs of banks in GIFT City are geared up to serve this opportunity and aggressively market with cash buyers to transit their business from overseas hubs to GIFT-City. As many cash buyers are now actively owning vessels for longer duration of time before scrapping, the comprehensive eco system at IFSC-GIFT City which includes ship owning, will be a major factor in their decision to have a presence.

4.7. Ship management – Crewing/Technical & Indian Crewing

China, the Philippines, Indonesia, the Russian Federation and Ukraine are estimated to be the five largest supply countries for all seafarers (officers and ratings). The Philippines is the biggest supplier of ratings, followed by China, Indonesia, the Russian Federation and Ukraine. China is the biggest supplier of officers, followed by the Philippines, India, Indonesia and the Russian Federation. The inadequacy of private traders and user-industry in the shipping value chain has had a major impact on skilling of Indian manpower. Skillset, like time-chartering, vessel operating, etc. hardly developed in India. It was not till 1995, when Indian trading companies moved out of India, that Indian industry ventured into leasing.

The new *Seafarer Workforce Report* from BIMCO and International Chamber of Shipping cautions that the industry must significantly increase training and recruitment levels if it is to avoid a serious shortage in the total supply of officers by 2026. Given growing demand for Standards of Training Certification and Watchkeeping (STCW)-certified officers, the Report finds that 1.89m seafarers currently serve the world merchant fleet, operating over 74,000 vessels around the globe, but that there will be a need for an additional 89,510 officers by 2026 to operate the world's merchant fleet.

Although there has been a 10.8% increase in the supply of officers since 2015, the current 2021 shortfall of 26,240 STCW certified officers could be due to a reported increase in officers needed on board vessels, with an average of 1.4 officers required per berth. In addition, some officer categories are in especially short supply, notably, officers with technical experience especially at Management Level, and of Management Level Deck Officers in the tanker and offshore sectors. It has also been reported that in the past five years the industry has made progress in reducing officer turnover rates from 8% to 6%, retaining qualified seafarers and increasing the number of years that they serve at sea.

Globally, technical Manager and crewing agencies can be classified in three distinct categories: (a) global technical managers and crewing managers, are large companies with global presence which offer their clients a range of crewing options, and have training academies in the country from where they source crew. They are instrumental in promoting crewing from a particular nation and have long-term relationships with their clients who are shipowners with crewing requirements; (b) regional technical managers, have presence in more than one territory, but without the reach and scale of global technical managers, and (c) local technical managers and crewing agencies, typically have presence only in a single nation, and service a very few exclusive clients.

In India, the crewing agencies are registered by DG Shipping and are issued a Registration and Placement Service License (RPSL), which is issued by an approved classification society.

India-IFSC can provide an ideal platform for global and regional technical managers to establish their offices for technical management, crew recruitment and training. During stakeholder interactions, the issue of enabling a ‘client escrow’ was raised. Funds are received from clients for disbursement of ships’ expenses at regular intervals by managing companies. The accounts are prepared periodically and reconciled with what has been paid by the client. However, there are some issues with tax treatment of arrangement and most companies use offshore accounts to disburse funds received from clients. India-IFSC can enable the ready management of such funds and ensure quick disbursement and efficient banking services for the companies. It has also been proposed that leasing of training aids should be enabled.

4.8. Marine Insurance / P & I Club – IRDAI

Marine insurance is broadly divided into Hull and Machine (H&M) and Protection and Indemnity (P&I) insurance. While H&M is market-driven, P&I has its origins as an insurance undertaken by a group of ship-owners in order to cover third party liability and other risks not underwritten by H&M underwriters. There are also independent insurance companies which offer ‘fixed premium’ and ‘non-mutual’ P&I cover.

Given the relatively small size of Indian fleet and restrictions on movement of funds, none of the global insurance companies transact directly into India. Indian insurance companies place H&M insurance and re-insure with global companies. P&I insurance is undertaken by Indian companies after annual clearance from the regulatory authority, IRDAI, which has an annual approval mechanism for all insurances placed with foreign entities.

Insurance operations from IFSC started in year 2017 and at present there are IFSC Insurance Offices, namely General Insurance Corporation of India (GIC Re), The New India Assurance Company Ltd, and ICICI Lombard, besides the Export Credit Guarantee Corporation of India (ECGC). There are fourteen leading Insurance Brokers operating from IFSC. The Gross Written Premium by IFSC Insurance Offices was around USD 17mn. in 2020.

IFSC insurance entities can undertake dollar-denominated business from within the IFSC, all other special economic zones in India, from foreign countries (which covers foreign to foreign, IFSC to foreign and foreign to IFSC), and domestic insurance and reinsurance business subject to compliance with extant regulatory provisions. Up to 90% retrocession of re-insurance business is permissible.

Given that in absolute terms, substantial H&M and P&I business is underwritten for Indian markets, India-IFSC has the potential to be the regional hub for marine insurance. With the infrastructure and incentives offered in IFSC-GIFT City, insurance companies can set up regional offices and service various countries. It can further be used for re-insurance and investment of funds.

4.9. Inland Waterways

Despite having an extensive network of inland waterways in the form of rivers, canals, backwaters and creeks, freight and passenger transportation by waterways is highly under-utilized in India. Waterways currently contribute around 6% to India's transportation modal mix, which is significantly less than that in developed economies and some of the developing economies as well. India's hinterland connectivity is mainly based on road and rail with

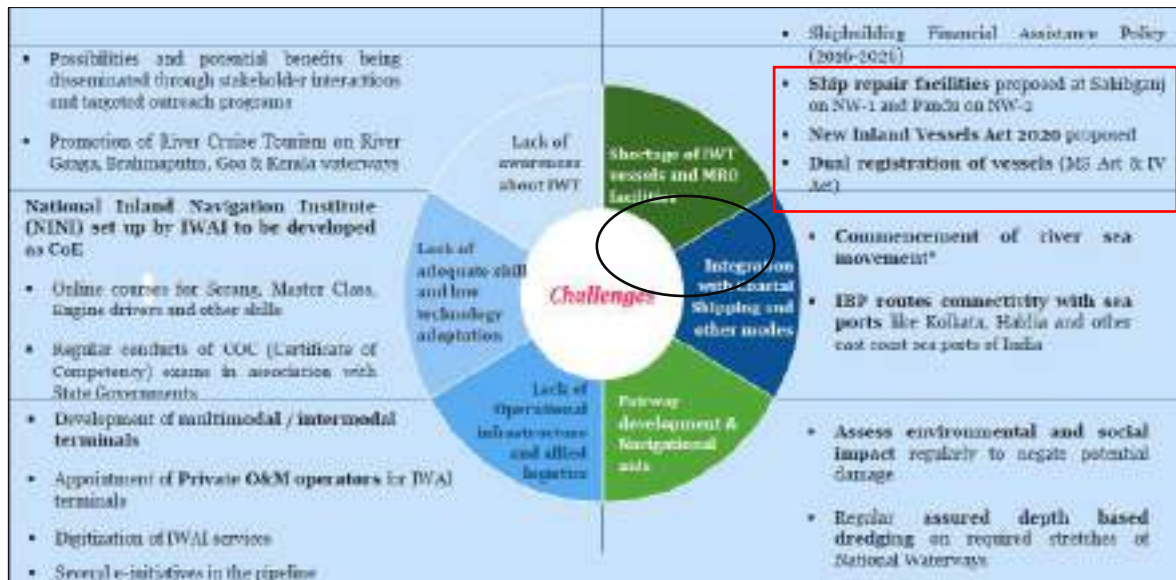
domestic waterways— both coastal shipping and inland waterways—playing a limited role. Waterways are found to be cost effective as well as an environmentally friendly means of transporting freight. In addition to cargo movement, Inland Water Transport (IWT) sector also provide a convenient function in related activities such as carriage of vehicles (on Roll-on-Roll-off mode of cross ferry) and tourism.

The National Waterways Act, 2016 has declared 111 IWs with a total length of 20,275 kms spread across 24 States as ‘National Waterways’ (NWs) to promote shipping and navigation on them. Inland Waterways Authority of India (IWAI) is an autonomous organization constituted on 27 October 1986 under the Inland Waterways Authority of India Act, 1985 which has the primarily responsibility of development, maintenance and regulation of NWs.

Figure 34: Snapshot of Inland Water Transport Sector in India (May 2021)



Figure 35: Challenges and Strategies adopted by IWAI



Source: Inland Waterways Authority of India, 18 May 2021

Requirements of IW tonnage provide a valuable opportunity for Indian shipyards to construct IW vessels. Various structures permissible in IFSC-GIFT City like sale and leaseback can also be used by lenders and other capital providers to fund Indian yards. The tonnage can be purchased by operators, end users, traders and other players, with support from IWAI.

4.10. Brand Maritime India

All maritime nations maintain a distinct brand identity in global markets. This includes activities ranging from ‘Maritime Weeks’ (like London Maritime Week, Singapore Maritime Week etc.), marketing global institutions of repute (like the Baltic Exchange, Erasmus Business School, Singapore Maritime Authority, Dubai Maritime Cluster etc.) and technical prowess (global P&I Clubs, Classification Society, Flag etc.).

Brand Maritime India, in the context of IFSC-GIFT City, can be enhanced in many ways. Maritime India has already made its mark in terms of crewing, ship recycling, and technical management of ships. It can be enhanced in the context of flag/registry and the leasing and financing platform at India-IFSC.

- **Flag State / Registry – Regulatory Performance and Ratings**

India’s regulatory performance, which is gauged at two levels, requires concerted initiatives and efforts to improve and upgrade.

First, Port State Control MOU is a harmonized system of common, documented standards and procedures for the ship inspection and also a common database for the inspected ships of its constituent Port States. There are nine such MOUs, besides the regime of USA. After the Paris MOU on Port State Control (of 1982), between 27 participating Maritime Authorities and over 18,000 annual inspections, IMO has supported the establishment of eight other regional port State control regimes, achieving a global maritime network comprising of: (i) Paris MOU: the areas of its responsibility cover the waters of European coastal States and North Atlantic basin from North America to parts of Europe and north Atlantic, (ii) Asia–Pacific Region MOU: Asia and part of the Pacific Ocean, (iii) Latin American MOU, (iv) Caribbean MOU, (v) West and Central Africa MOU, (vi) Black Sea MOU, (vii) Mediterranean MOU: Southern part of Mediterranean Sea, (viii) Indian Ocean MOU, (ix) Riyadh MOU: Persian Gulf; and the US Coast Guard maintains a tenth port State control regime.

Figure 36: ‘Grey List’ under the Paris MOU for 2018-2020

RANK	FLAG	INSPECTIONS 2018-2020	DETENTIONS 2018-2020	BLACK TO GREY LIMIT	GREY TO WHITE LIMIT	EXCESS FACTOR
GREY LIST						
40	Estonia	71	1	9	1	0.01
41	Saudi Arabia	54	1	7	0	0.11
42	Korea, Republic of	68	2	9	1	0.15
43	India	44	1	6	0	0.18
44	Philippines	133	6	15	4	0.19
45	Kazakhstan	34	1	5	0	0.27

Thus, Indian-flag ships entering the waters under regulatory control, for instance, of the Paris MOU are inspected and, if required detained. Based on a methodology specific to this MOU, the Flag State is ranked for ensuring compliances. Indian-flag vessels are currently positioned at rank 43 in the ‘Grey List’ of the Paris MoU. On WGB Lists for 2020, a total number of 70 flags are listed: 39 (White List), 22 (Grey List) and 9 (Black List). The Paris MOU is a definitive one for gauging the ranking or reputation of the Registry / Class. Its ‘White, Grey and Black (WGB) Lists’ present the full spectrum, from quality flags with a consistently low

detention record (White List) to flags with a average performance that are considered high risk (Grey List) or those with poor performance and a very high risk (Black List). It is based on the total number of inspections and detentions during a 3-year rolling period for flags with at least 30 inspections in the period. Flags shown on ‘Grey List’ would be incentivised to improve and move to the ‘White List’. Flags at the lower end of the ‘Grey List’ should be careful not to neglect control over their ships and risk ending up on the ‘Black List’ in the subsequent year(s).

Second, the inspection and survey of ships shall be carried out by officers of the Flag Administration under various IMO instruments. Flag Administration may, however, entrust inspections and surveys either to surveyors nominated for the purpose or to organizations recognized by it. IMO has gathered all applicable requirements for Recognized Organizations in a single IMO mandatory instrument, namely, the Code for Recognized Organizations (RO Code) which entered into force on 1 January 2015, under MARPOL annexes I and II, SOLAS 1974 and the 1988 Load Line Protocol. This Code serves to assist in achieving harmonized and consistent global implementation of requirements established by IMO instruments for the assessment and authorization of ROs. It provides the criteria against which ROs are assessed and recognized, and gives guidance for monitoring of ROs by Administrations.

Figure 37: Recognised Organisation Performance for 2018-2020

Recognized Organization	RO abbrev	Inspections	Detentions	Low/medium limit	Medium /high limit	Excess Factor	Performance level
American Bureau of Shipping	ABS	5,753	3	133	97	-1.92	High
DNVGLAS	DNVGL	17,859	14	388	326	-1.91	
Lloyd's Register	LR	11,313	11	251	201	-1.88	
Nippon Kaiji Kyokai	NKK	7,811	13	177	135	-1.79	
Bureau Veritas	BV	10,577	22	236	187	-1.75	
Russian Maritime Register of Shipping	RMRS	2,434	4	61	37	-1.72	
RINA Services S.p.A.	RINA	4,756	11	112	79	-1.68	
Korean Register	KRS	1,336	2	36	18	-1.66	
China Classification Society	CCS	815	1	23	9	-1.57	
Turkish Lloyd	TL	370	0	12	2	-1.09	
Polski Rejestr Statkow (Polish Register of Shipping)	PRS	542	1	17	5	-1.07	
Phoenix Register of Shipping	PHRS	591	5	18	6	-0.17	
Croatian Register of Shipping	CRS	142	0	6	0	0.06	
Panama Maritime Documentation Services	PMDS	130	0	6	0	0.08	
National Shipping Adjuster Inc.	NASHA	212	2	8	0	0.21	
Intermaritime Certification Services, ICS Class	ICS	177	2	7	0	0.28	
Indian Register of Shipping	IRS	197	4	8	0	0.51	
Overseas Marine Certification Services	OMCS	134	3	6	0	0.55	
Dromon Bureau of Shipping	DBS	606	13	18	6	0.57	
Panama Shipping Registrar Inc.	PSR	80	2	4	0	0.58	
Macosnar Corporation	MC	117	3	5	0	0.61	
Bulgarian Register of Shipping	BRS	240	6	9	1	0.65	
United Registration and Classification of Services	URACOS	89	3	4	0	0.73	
International Naval Surveys Bureau	INSB	544	14	17	5	0.77	
Maritime Lloyd - Georgia	ML	141	5	6	0	0.84	
Isthmus Bureau of Shipping, S.A.	IBS	138	5	6	0	0.85	

As may be seen, the Indian Register of Shipping (IRS), under such latest assessment, has been rated to have a 'Medium' performance level among the Recognised Organisations.

Apart from several initiatives of DG Shipping, in order to improve and secure top ratings and the high brand value for the Indian Flag and Registry, so that these become the choice that is exercised by shipping industry in India and globally, IFSC-Gift City can also take several measures to improve the reputation and performance of the flag / registry. This can include high performance standards of surveyors/ inspectors and their regular upskilling; greater participation in international standards setting bodies; holding more consultative discussions with reputed technical experts, closer interaction with companies with India-IFSC flag; and putting in place a reward system for companies that fare well in terms of Port State Control inspections and surveys.

- **Commercial Reputation**

It is imperative that a maritime hub ensures that its constituent companies are perceived as professional and solvent. A hub which gets the reputation of promoting all types of companies, including those without requisite professionals and worse, those with short term intentions of defrauding the markets, will not be able to prosper. London has the self-regulated market in the form of the 'The Baltic Exchange', while Singapore, Hong Kong and Dubai have various methods of ensuring the commercial reputation of the maritime hub.

In IFSC-GIFT City, the authorities would need to maintain a clear connect with markets. Those in the global markets who may have reason to complain about the conduct of a member company in execution of any obligation should have a forum to communicate such issues. IFSCA would need to maintain ultimate control in terms of disciplining companies, should it be required after investigation by them. Conversely, the authorities can maintain a confidential record of global companies defaulting worldwide (in line with the Baltic Exchange / BIMCO practices) in order to give such feedback to member companies.

- **Brand Promotion**

The maritime hub at IFSC-GIFT City would need to be at the forefront of global commercial, technical and financial maritime thought. Together with Indian Maritime University, Gujarat Maritime University and other institutions, like IIM Ahmedabad, IIT Gandhinagar, National Physical Laboratory, National Institute of Design, and Pandit Deendayal Energy University, the hub has the potential to emerge as a front runner in new thoughts and ideas across the spectrum of maritime activities. This has to be nurtured/ promoted by the authorities and hub.

Holding regular global events, presentations, and meetings at the hub, and attending such events at others are important for brand promotion. Overseas Indian Missions, Invest India and such other organizations could be properly briefed, for suitably marketing the opportunity worldwide.

5. FINANCIAL MODELS – COST COMPARISON OF INDIA WITH MAJOR HUBS

The Committee has identified systemic inefficiencies, and options to make ship-acquisition, financing and leasing attractive in IFSC, based on which financial viability was found.

Comparison of transacting out of India-IFSC and Major Global Jurisdictions:

Ship Operating in GIFT IFSC - Financial Model	
Key Assumptions:	
Ship Owner (Owner from a single jurisdiction for all scenarios to compare operating model)	Outside India (Eg: Singapore)
Charterer	India
Ship Operator	Dubai, Singapore, Hong-Kong, IFSC and India
Fixed Trip Route-	Xingang - Gladstone - Singapore - Vizag
Fueling	Singapore in all scenarios
Cargo vessel carrying capacity in MT	79,000
Voyage trip	37.93 (Sea and Port days)
Freight charges - USD per metric tonne	29.65
Hire charges - USD per day	35,000

FINANCIAL MODELS FOR COST COMPARISON

(Amounts in USD)

Particulars	Dubai	Singapore	Hong-Kong	IFSC - Pre	India DTA	IFSC - Post
Revenue						
Freight charges from Indian charterer (a)	23,42,350	23,42,350	23,42,350	23,42,350	23,42,350	23,42,350
GST - for information purpose only	1,17,118	1,17,118	1,17,118	1,17,118	1,17,118	1,17,118
TDS on freight charges	-	-	-	49,189	49,189	-
	(DTAA applicable)					
Less: Hire charges						
Hire Charges (b)	13,27,550	13,27,550	13,27,550	13,27,550	13,27,550	13,27,550
TDS on hire charges	-	-	-	1,47,506	1,47,506	-
Gross up hire charges	13,27,550	13,27,550	13,27,550	14,75,056	14,75,056	13,27,550
Add: GST	-	-	-	-	66,378	-
Less Operating cost:						
Bunker cost						
Consumption of Intermediate Fuel Oil	5,77,344	5,77,344	5,77,344	5,77,344	5,77,344	5,77,344
Consumption of Marine Diesel Oil and Gas Oil	21,353	21,353	21,353	21,353	21,353	21,353
GST on 10% of outstanding IFO,MDO and Gas Oil at Vizag Port	-	-	-	2,993	2,993	-
Total bunker cost (c)	5,98,697	5,98,697	5,98,697	6,01,691	6,01,691	5,98,697
Port Cost						
Cost at Gladstone port	1,00,000	1,00,000	1,00,000	1,00,000	1,00,000	1,00,000
Cost at Vizag port	35,000	35,000	35,000	35,000	35,000	35,000
Total Port cost (d)	1,35,000	1,35,000	1,35,000	1,35,000	1,35,000	1,35,000
Total Other cost (e)	44,279	44,279	44,279	44,279	44,279	44,279
Total Cost (f) = (b) + (c) + (d) + (e)	21,05,527	21,05,527	21,05,527	22,56,026	22,56,026	21,05,527
Total profit per voyage trip (g) = (a) –(f)	2,36,823	2,36,823	2,36,823	86,324	86,324	2,36,823
Less: Corporate tax (h)	-	-	-	-	21,726	-
Profit post tax per voyage trip (i) = (g) – (h)	2,36,823	2,36,823	2,36,823	86,324	64,598	2,36,823
Corporate tax (j)	-	-	-	-	21,726	-
TDS outflow (k)	-	-	-	-49,189	-49,189	-
Tax payable/ (refundable) (l) = (j) - (k)	-	-	-	-49,189	-27,463	-

FINANCIAL MODELS FOR COST COMPARISON

Ship Owning in GIFT IFSC - Financial Model
5-year-old Ultramax - Bulk carrier
Dead Weight – 60,000 MT
Scenario - Lease of 15 years and asset is sold

(Amount in USD)

Particulars	Dubai	HongKong	Singapore	Greece	India - Foreign Flag	India - Indian Flag	IFSC - Foreign Flag Post	IFSC - Indian Flag Post
Estimated Purchase Price of the Vessel (inclusive of GST and stamp duty)	2,50,00,000	2,50,00,000	2,50,00,000	2,50,00,000	2,58,75,000	2,62,50,000	2,50,00,000	2,62,50,000
Interest	23,90,625	23,90,625	23,90,625	13,28,125	49,48,594	50,20,313	37,18,750	39,04,688
Operating Expenses	3,35,07,000	3,35,07,000	3,35,07,000	3,35,07,000	2,34,54,900	3,00,79,650	2,34,54,900	2,34,54,900
Profit before depreciation over a 15-year period	5,59,74,375	5,59,74,375	5,59,74,375	5,70,36,875	6,20,76,506	5,53,80,038	6,33,06,350	6,31,20,413
Profit after taxes on income	3,18,53,984	3,18,53,984	3,18,53,984	3,28,20,232	2,79,07,412	3,07,10,610	3,91,85,959	3,77,94,002
Tax costs								
Income tax costs*	-	-	-	96,252	86,29,350	53,128	-	-
Dividend tax in the hands of resident in a tax free jurisdiction (say, a Dubai resident)	-	-	-	8,91,012	25,81,482	14,96,061	-	-
Capital Gains on sale of Ships	-	-	-	-	4,95,908	4,95,908	-	-
Tax Cost on Indian Crew	-	-	-	-	-	77,745	-	-
GST – Input Credit lost						29,45,169		
Total tax and duties	-	-	-	9,87,264	1,17,06,920	50,68,011	-	-
TDS deducted on charter hire income (cash flow trapped)	-	-	-	-	9,23,265	9,23,265	-	-
Income in hands of the shareholder	3,18,53,984	3,18,53,984	3,18,53,984	3,19,29,221	2,53,25,930	2,92,14,549	3,91,85,959	3,77,94,002

Note: * India owner with Indian flag shall qualify for tonnage tax scheme

FINANCIAL MODELS FOR COST COMPARISON

Tender Contract Model				
Vessel – Star of Emirates				
(Amounts in USD)				
Particulars - Ship Operator	Unit	IFSC – GIFT City	Singapore	India DTA
Total Cargo (A)	MT	79,000	79,000	79,000
Current Freight rate (B)	USD Per MT	29.65	29.65	29.65
Total Voyage Time - Sea and Port days (C)	Days	37.93	37.93	37.93
Total Operator income/day (D) = (A)*(B)/(C)	USD Per day	61,754.55	61,754.55	61,754.55
Less: Commission (E)	USD Per day	772	772	772
Less: Other Operating expenses (F)	USD Per day	21,321	21,321	21,321
Current Revenue per day - Time Charter Equivalent (G) = (D)- (E) - (F)		39,662	39,662	39,662
Less: Hire Charges - Based on sample tender (H)	USD Per day	35,000	35,000	35,000
Net Profit/Loss Per Day (I) = (G)-(H)		4,662	4,662	4,662
<i>Addition/(Saving) in cost of borrowings and tax in the hands of owner vis-à-vis IFSC</i>				
Add/(Less): Interest Cost (Note-1)	USD Per day	291	-	576
Add/(Less): Tax cost	USD Per day	-	-	1,011
Add/(Less): Crew Cost		-	-	1
Add/(Less) : Establishment Cost		(95)	-	(66)
Add/(Less): Other Capital Cost and market considerations - including license fee, registration fee etc.		-	-	1,270
Total Additional cost (J)	USD Per day	196	-	2,793
Revised Hire Charges (K) = (H) + (J)	USD Per day	35,196	35,000	37,793
Revised Net Profit/Loss Per Day		4,465	4,662	1,869
Increase/decrease in freight rate to achieve profit/loss vis-à-vis IFSC (L) = ((J)/(A))* (C)		0.09	-	1.34
Revised Freight rate (M) = (B) + (L)	USD Per MT	29.74	29.65	30.99
Percentage Difference (%) in comparison with Singapore		0.32		4.52
Order Preference		L2	L1	L3
		ROFR-2		ROFR-1

Note-1: For the purpose of this calculation, we have considered the interest cost in IFSC/Singapore/India for 60,000 MT vessel and increased it by a factor of 1.2 to arrive at interest cost for 79000 MT vessel as in this model. That interest cost was for the full life of the asset. We divided that by the number of years and then by the number of days to arrive at per day interest.

Above Model is based on the following recommendations:

- *If DTA India flagged vessel is L1 in bidding, then the tender is to be awarded to it and no ROFR is given for IFSC vessels.*
- *If IFSC India flagged or foreign flagged vessel is L1 in bidding, then the tender is to be awarded to IFSC vessel, waiving the requirement of ROFR for India DTA vessels.*
- *If a Foreign flag vessel is L1, tender is to be awarded as per the existing ROFR & price preference. IFSC India flagged vessels to participate in the ROFR; however, if DTA Vessel matches the L1, then the tender is to be awarded to the DTA Vessel, else tender awarded to IFSC flagged vessel. IFSC Vessels do not get right to price preference.*
- *IFSC unit could contract DTA India flagged vessels for participating in tenders.*
- *If IFSC Unit is participating in the tender, then it's overseas parent if any cannot participate in the tender. Related parties cannot participate simultaneously in the tender.*

6. CHALLENGES AND BARRIERS TO SHIP LEASE IN INDIA

6.1. Regulatory challenges

The current legal and regulatory framework relating to ship leasing and financing activities in India and IFSC is less favourable than jurisdictions such as Panama, Dubai and Singapore, which are currently the preferred jurisdictions for ship leasing and financing activities. The legal and regulatory impediments may be broadly categorised as follows:

- (i) Amendments required under IFSC regime including operating and financial leases;
- (ii) Issues under the Merchant Shipping Act, 1958 (the “MSA”) relating to registration, licensing, and mortgage requirements, restrictions on cabotage, tonnage, and crew;
- (iii) Security enforcement challenges under the Admiralty (Jurisdiction and Settlement of Maritime Claims) Act, 2017 (the “Admiralty Act”);
- (iv) Role of market participants, including NBFCs, Banking Units/ Indian Banks/ Foreign Banks, AIFs, Insurance Offices, Mutual Funds, Pension Funds, Employees Provident Fund Organizations; and
- (v) Stamp duty.

• IFSC Regime – Relaxations Required

Ship Leasing

The term “ship leasing” has been defined as per the IFSCA (Finance Company) Regulation, 2021 as follows:

“operating and financial lease and any hybrid of operating and financial lease of ships/ ocean vessels/ engine of ships or ocean vessels or any part thereof”.

However, this is not an exhaustive definition and does not take into consideration bare-boat charter, time charter, voyage charter, slot charter, and/or any other form of charter or hire, including hybrids thereof, of ships/ vessels, which also involves payment of fees, rentals etc. Further, the definitions of the term “ships” and “vessels” as per various enactments is limited.

Financial Lease and Operating Lease

- (a) The term “financial lease” has been defined under Section 2(ma) of the SARFAESI Act, 2002 to mean:

“a lease under any lease agreement of tangible asset, other than negotiable instrument or negotiable document, for transfer of lessors right therein to the lessee for a certain time in consideration of payment of agreement amount periodically and where the lessee becomes the owner of such assets at the expiry of the term of the lease or on payment of the agreed residual amount, as the case may be.”

Further, India Accounting Standards (IndAS 17) recognize a financial lease as a lease which transfers “*substantially all the risks and rewards incidental to ownership of the asset*”.

- (b) Regulation 5(ii)(d) of the IFSCA (Finance Company) Regulations, 2021 recognises the financial leasing of ships as a core activity. However, its applicability only extends to finance companies registered under the Regulations. Therefore, other market players (banks, banking units and other entities set up within IFSC) cannot undertake the business of financial leasing of ships.
- (c) With respect to operating leases, Regulation 5(iii)(k) of the IFSCA (Finance Company) Regulations, 2021 recognises ship operating leases as a ‘*non-core activity*’. However, similar to the regulatory impediments in respect of financial leases. since ship leasing has not been notified as a financial product by the IFSCA no services in respect of the same can be undertaken and the restrictions in carrying out ship operating leases are similar to those set out in Para 6.1.1(b) above wherein presently, no other market player can undertake ship operating leases.

- **Law on shipping under the Merchant Shipping Act, 1958**

The MSA and the rules framed thereunder govern *inter alia* the registration, license, transfer, and mortgage of both Indian and foreign ships. Key factors ascertaining the advantages and disadvantages of operating Indian and foreign vessels within India (and IFSC) are as follows:

Registration of Indian vessels and Foreign vessels:

The registration of Indian and foreign vessels is governed by Part V of the MSA read with the Merchant Shipping (Registration of Indian Ships) Rules, 1996 (as amended from time to time) and various orders of the Director General of Shipping (“DG Shipping”) issued from time to time.

- (a) Registration of Indian vessels – Under Section 22 of the MSA, Indian ships (i.e., ships wholly owned by (a) a citizen; or (b) a company or body established under a central or state act which has principal place of business in India; or (c) a cooperative society registered or deemed to be registered in India) are required to be registered under the MSA. Stakeholders have indicated that the process of registration is time consuming and cumbersome.
- (b) Registration of foreign vessels acquired under the MSA – As per Section 40 read with Rule 12 of the Merchant Shipping (Registration of Indian Ships) Rules, 1960, any ship built or acquired out of India which becomes the property of a person qualified to own an Indian ship, the owner or master is entitled to apply to the Indian Consular Office at the nearest port for provisional registration. However, the ships would have to enter Indian ports within 6 months for completion of registration requirements. We note from our discussions with stakeholders that the requirement to ensure that such ship is brought to an Indian port as per the time period prescribed is an impediment to the ships’ economic activity and therefore registration in India appears to be a less attractive proposition.

Licensing Indian and foreign vessels engaged in coasting trade (including ROFR)

With respect to Indian and foreign vessels being chartered for the purposes of coasting trade, Section 406 and 407 of the MSA mandates that a license be obtained from the DG Shipping. Further, its scheme to encourage the growth of the Indian economy, the DG Shipping has vide DGS Circular No. 02 of 2021 (the “ROFR Circular”) introduced rules relating to the ROFR which are favouring *inter alia* Indian-built and owned ships. This ROFR Circular supersedes all prior circulars issued in this regard and has a material bearing on the licensing restrictions applicable to ships.

- (a) Licensing requirements for Indian vessels – as per ROFR Circular, for vessels being chartered through the tendering process, the right of first refusal will be applicable to bidders in the following priority (Para 21 read with Para 21.3.4 of the ROFR Circular):
- (i) Indian built, Indian flagged, Indian owned;
 - (ii) Foreign built, Indian flagged, Indian owned; and
 - (iii) Indian built, foreign flagged, foreign owned.

Further, the aforesaid ROFR will arise to those bidders whose rate, though not being the lowest, is within 20% of the price quoted by the lowest bidder, commonly referred to as the ‘Margin of Purchase Preference’ (Para 21.3.5 of the ROFR Circular). We understand from our discussion with stakeholders that the said ROFR Circular serves as an impediment to foreign market players to engage in chartering activities in India.

- (b) Licensing requirements for Foreign Vessels – the ROFR Circular is disadvantageous to foreign vessels undertaking Indian coasting trade considering that if Indian entities who have bid in the same category and within the Margin of Purchase Preference, the said foreign vessels will not be awarded the tender. However as per DGS Order 10 of 2014, for foreign vessels acquired/ owned by Indians under the MSA and forming part of the Indian controlled tonnage shall be given priority in the ROFR process and shall within the category of serial number (ii) above. Further, as per DGS Circular No. 5 of 2021 dated February 11, 2021, where a bidder offering a vessel not falling within the ROFR categories gives an undertaking to convert such vessel to the ROFR categories specified therein prior to commencement of operations but later than the price bid opening, such vessels can be considered only if the other bidders falling within such categories has failed to match the lowest price. From the above mechanism, we note that the only way for Indian coasting trade to be a level playing field for Indian and foreign vessels is for foreign vessels to either be owned by Indians or be converted to Indian vessels, both of which are not only stringent requirements but also unviable.

Relaxations imposed in respect of licensing requirements

Relaxations have been introduced for Indian and foreign vessels engaged in coasting trade, which deviate from the licensing requirements under Section 406 and Section 407 of the MSA, respectively. Some of the relaxations introduced vide notifications and orders of the DG Shipping are being summarised as follows:

- (a) Relaxations with respect of Indian vessels:

- (i) Notification dated May 21, 2018 - as per the said notification, Section 406 shall not apply to ships chartered by citizens of Indian or a cooperative society registered in India and which are *inter alia* engaged in – (a) the transportation of EXIM laden containers for transshipment; and (b) the transportation of empty containers from one port of India to another port, so long as – (i) the container is consigned through a Bill of Lading to or from a foreign port for transshipment at an Indian port; (ii) the container is loaded or unloaded for transshipment purposes; and (iii) the container has an adequate arrival or departure manifest.
 - (ii) Notification dated May 22, 2018 – as per the said notification, Section 406 shall not apply to coastal movement of agriculture, fishery, farm produce and horticulture commodities, subject to the aforesaid cargo contributing to at least 50% of the cargo onboard the ship.
- (b) Cabotage Policy applicable to foreign vessels - Relaxations have been introduced to enable foreign vessels undertaking coasting trade (defined hereinbelow) within ports in India, which deviates for the license requirements under Section 407 of the MSA. The Cabotage Policy is as follows:
- (i) General Order No 1 of 2018 dated May 21, 2018 – as per the said notification, Section 407(1) shall not apply to – (a) foreign flag ships engaged, in full or part, for transportation of EXIM laden containers for transshipment; and (b) empty containers are exempted from the application of Section 407(1) so long as – (i) the container is consigned through a Bill of lading to or from a foreign port for transshipment at an Indian port; (ii) the container is loaded or unloaded for transshipment purposes; and (iii) the container has an adequate arrival or departure manifest
 - (ii) General Order No. 2 of 2018 dated May 22, 2018 – as per the said order, exemptions have been provided to foreign vessels engaged in the movement of agriculture, horticulture, fisheries, animal husbandry commodities within India, subject to the restriction that such cargo must contribute to at least 50% of the total cargo.
 - (iii) General Order No. 3 of 2018 dated June 22, 2018 – as per the said order, exemptions have been provided for foreign vessels engaged in coastal movement of fertilisers, subject to the restriction that such cargo must contribute at least 50% of the total cargo. Further, General Order No. 4 of 2018 dated September 10, 2018, sets out an illustrative clarification in respect of fertilisers being transported under the said exemption.
 - (iv) Circular No. SW-17011/2/2016-CT dated August 08, 2016 – foreign flag vessels carrying passengers are exempt from Section 407(1) to the extent that they are allowed to call at more than one Indian port up to 05.02.2024.

For the Indian and foreign vessels not being chartered for the purposes specifically exempted as detailed above, licenses would have to be obtained under Section 406 and 407 of the MSA.

We note from our consultations with stakeholders that the said process is cumbersome and time consuming.

Indian controlled tonnage and crew restrictions on Indian and foreign ships:

- (i) For entities acquiring vessels flagged outside India, as per DGS Order 10 of 2014, the tonnage flagged outside India shall not exceed its tonnage owned under the Indian flag. Such tonnage will be measured in accordance with the Merchant Shipping (Tonnage Measurement of Ships) Rules, 1987. The advantages of the Indian controlled tonnage are as follows:
 - (a) As per the aforesaid circular, while chartering such ships under Section 406 of 407 (licenses for coasting trade), such ships shall be treated in the new category of Indian controlled ships and shall be eligible for a priority higher than non-Indian ships, thereby falling under the category of serial number (ii) under the ROFR circular.
 - (b) Secondly, as per SD Circular No. 5 of 2016 dated April 1, 2016 read with SD Circular No. 3 of 2015 dated August 28, 2015, the vessels under the Indian Controlled Tonnage are charged a discounted processing fees, licensing fees on a monthly basis.
- (ii) In so far as the crew restrictions are concerned, as per DGS Order 10 of 2014, for those entities flagging vessels outside India, 50% of crew (officers and ratings combined) engaged on the vessel, as per the Safe Manning Document or actual deployment whichever is higher, shall be Indian crew. Further, for those operating on the Indian coast or offshore fields, shall engage trainees, officers, cadets as per the Tonnage Tax Scheme whereby the training commitment shall be as per Tonnage Tax Scheme, if applicable. In the event that laws of another flag state mandate minimum crew requirements, such foreign crew may be engaged to the extent required.

We note from the above that Indian entities engaged in ship owning are required to comply with Indian controlled tonnage and crew restrictions imposed by DG Shipping. As a result, most Indian entities prefer setting up offshore vehicles to circumvent these restrictions while freely being allowed to acquire foreign vessels.

Drawbacks with mortgaging

A statutory mortgage on a ship or a share therein is governed by the MSA read with the Merchant Shipping (Registration of Ships) Rules, 1960 (as amended) and the orders/ circulars of DG Shipping. However, the enforcement of such mortgages is governed by the Admiralty Act whereby specific High Courts are empowered to arrest ships in respect of 'Maritime Claims' and 'Liens', including for enforcement of mortgages.

Under DGS Order 2 of 2002, the following guidelines have *inter alia* been laid down with respect to the mortgage of ships:

- (a) upon entering a mortgage in the registry in respect of a ship which is provisionally registered, the registrar shall issue a letter to the bank/ FI stating that the mortgage

has been recorded on the provisional registration of the ship, which will continue to remain in force even after the ship has been granted permanent registration.

- (b) any second or subsequent mortgage on a ship will be recorded in the register of ships only after a no-objection certificate has been issued from the first or existing mortgage.
- (c) registration, modification or discharge of the mortgage with the registrar of companies shall not be a pre-requisite to registering such mortgage.
- (d) specific drawbacks in respect of the aforementioned system are as follows:
 - Restrictions on Self Help Remedies - Under Section 51 of the MSA, where it is only one mortgagee, the ship may be sold by the mortgagor. However, for two or more registered mortgagees, the High Court will have to be approached. While a mortgagor can approach the High Court for obtaining an order of arrest, the actual possession of vessel will seldom be with lessor, thereby reducing the ambit of self-help remedies.
 - Under construction vessels - Mortgages in respect of ships which are under-construction is not recognised under the aforesaid Section 47 of the MSA. Therefore, lenders would have to seek alternative security pending completion of the construction of the vessel.
 - Priority of Mortgages - Under Section 49 of the MSA, priority of mortgages is solely determined by the date on which each mortgage is recorded in the ship register.

6.2. Tax challenges

Taxation and other fiscal incentives are considered an important factor for the competitiveness of shipping industry. Major shipping hubs enjoy the benefit of a tax-friendly regime where only a nominal tax is levied. Foreign ship operating companies are on much better footing as compared to Indian companies. Indian shipping companies cannot be expected to do well if the Indian tax regime is complex. To retain its competitive edge, India's shipping industry must be brought on par to what prevails in these major hubs.

• Key Direct Tax challenges:

- Lease rental payments made to overseas entities are generally subjected to WHT at the rate of 10%. Overseas ship owners pass on the WHT burden to Indian ship leasing companies which makes ship leasing from Indian shores unviable.
- Overseas remittances from India are cumbersome and are subject to the requirement to obtain Chartered Accountant certificate.
- Payments of freight charges by Indian Charterers are subject to WHT at 2%.
- Any income by way of dividend received from a unit set-up or established in an IFSC is taxable in the hands of non-resident shareholders. As per the erstwhile income-tax laws, the dividend declared, distributed or paid by an IFSC unit was not subject to DDT and also was exempt in the hands of shareholders. Effective 1 April 2020, the tax incidence was shifted from the payer to the recipient of dividend. However, no

specific carve out was made for the dividend income earned by shareholders of the company, being an IFSC unit.

- Gains arising on transfer/sale of vessels or transfer/sale of partnership interest/shares of SPV holding the vessels attracts capital gains tax.
- Tonnage Tax Scheme is an optional scheme for qualifying Indian shipping company for taxation of income derived from shipping activities. The eligibility conditions such as of maintaining a tonnage reserve, mandatory training requirement in respect of trainee officers, 10 years period of exclusion from the regime on non-qualification for availing tonnage tax regime, etc. makes the regime ineffective. It is suggested that a simplified tonnage tax regime should be introduced for IFSC controlled tonnage. The Indian company as well as its foreign subsidiary having its place of effective management in IFSC should be eligible for the simplified tonnage tax.

- **Key Indirect Tax challenges:**

- Indian companies providing import freight services to foreign consignor for transportation of goods from outside India to India is subject to 5% IGST on the freight charges. Such IGST is a cost in the overall value chain.
- There is a sunset clause on exemption for supply of services of transportation of goods in vessels for export of goods upto 30 September 2022 which is being extended every year. For ease of operations and providing benefit on export services, exemption on export freight services should be provided indefinitely.
- Ship owners who are located overseas and provide charter hire services to ship operators in India are not required to charge GST. It is discharged by the ship operator on RCM basis. However, if the ship owner is located in IFSC it would need to charge GST on forward charge basis resulting in cash flow issues for the operator.
- Supply of services of transportation of goods by vessel to Indian customers is subject to IGST at the rate of 5% even when the movement of goods is from one country outside India to another country outside India.
- There is no specific provision in GST law which states that registration in IFSC will suffice for all locations and entities are not required to take separate registration at every port to avail GST at zero rate on services. Ship operators are therefore required to take registration at every port to avail the benefit of GST at zero rate on services.
- IGST is applicable on import of vessels and also fuel imported with the vessel. It takes a long time to utilize the IGST credit impacting cash flow of Indian shipping companies. Also, bunker fuel being used (as inputs/goods) for ocean import freight supplies carries restriction on availment of input tax credit.

6.3. SEZ challenges

Though IFSC is subset of SEZ Act 2005 and Rules 2006, the nature and premise of SEZ and IFSC is quite different. SEZs are meant for bringing in more foreign exchange and investment into India. Whereas IFSC is meant to make India a full-fledged finance hub and cause a shift from availing such financial services from other financial centres to IFSC.

Most of the provisions in SEZ Act and Rules are drafted keeping in mind typical manufacturing and service organizations and not from the perspective of Financial Services Industry. Additionally, most of the Rules have not been amended for a long time and the law is mainly governed through Circulars, Clarifications, Instructions. Therefore, there is a need for a complete overhaul of the SEZ Act and Rules from an IFSC perspective.

In respect of ship leasing business to be carried out from IFSC, there are certain key challenges which are required to be addressed to make it more efficient:

- (a) Net Foreign Exchange (NFE) requirement under SEZ Rules states that every unit is required to achieve positive NFE earning over a period of 5 years cumulatively. However, ship leasing business is quite different and it cannot be a NFE earner as per the formulae and mechanism prescribed in SEZ Rules. Ship leasing companies from IFSC should be completely exempted from such requirements. Savings in foreign currency should be equally be regarded as foreign currency earning.
- (b) SEZ provisions mandate that goods procured by SEZ Units should be physically brought to SEZ premises and then customs officers posted in SEZ carries out inspection to check marks and numbers. This condition is impossible to meet as the port is not an SEZ area.
- (c) Separate office and lease deed is required for each unit. Ship leasing entities are likely to have multiple SPVs and requirement to have separate office for each SPV will lead to increase in cost of operations.
- (d) Format of applications and compliance reporting is required to be changed completely to align with ship leasing business as most of the sections of current forms and compliances are not relevant for it.

SEZ Act and Rules have many other provisions which make it less flexible.

6.4. Financial challenges

Maritime financing involves many parties across the financing value chain. Such parties include: Non-Banking Financial Companies (“NBFC”), Pension Funds, Insurance Companies, Mutual Funds, Employees Provident Fund Organization (EPFO), National Investment and Infrastructure Fund (NIIF), and authorised dealers operating under External Commercial Borrowings (ECBs) guidelines.

Whilst India has come a long way in improving its financing infrastructure, this report looks to tap into the existing forementioned framework and pools of liquidity to encourage growth for the ship financing and leasing platform in India.

- **Non-Banking Financial Companies (“NBFC”)**

Additional guidelines required. While NBFCs can set up a finance company under the IFSCA (Finance Company Regulations) 2021, the RBI has not issued guidelines for NBFCs being set up in the IFSC.

Exclusion of FPIs. An AIF is a privately pooled investment fund incorporated in the form of a trust or LLP or a company and registered as such with SEBI. Category I and II AIFs can be

used to fund entities undertaking ship financing / leasing. Using an AIF is the most efficient route for HNIs to participate in this space. However, Foreign Portfolio Investors (FPIs) are not permitted to invest in Category I and II AIFs.

Lack of clarity in existing guidelines. AIFs operating under IFSC can accept investments from a broader remit of investors. However, it is unclear on the specific types of institutional investors contemplated under the SEBI (IFSC) Guidelines, 2015.

A domestic AIF is permitted, subject to prior approval from SEBI, to invest up to 25% of its investible funds of each scheme in equity and equity linked instruments of offshore venture capital undertakings (i.e. overseas unlisted entities). This raises questions about whether an investment by a domestic AIF into a Leasing Company operating in IFSC is permissible.

- **Pension Funds**

The National Pension System (NPS) is a national contributory pension fund system available for subscription to all Indian citizens (including non-resident Indians) which is regulated by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. NPS is managed and operated by pension fund managers known as pension funds. The subscribers to NPS may choose from multiple pension funds and multiple schemes. The pension fund manages schemes notified by PFRDA in accordance with norms of management of corpus of pension fund, including investment guidelines as approved by the PFRDA from time to time. However, the issues in relation thereto are with respect to the restrictions prescribed by PFRDA on the investments made by such pension funds.

- **Insurance Companies**

Not permitted to invest in ship leasing companies. Under Section 27A(4) of the Insurance Act, insurance companies are not permitted to invest in private limited companies, which include ship leasing companies. This restriction is replicated under the Insurance Regulations.

This restriction also applies to branches of Insurance Companies. IIOs (i.e. branches) of insurance companies operating out of IFSC are not permitted to undertake any business other than those permitted by IRDAI. IRDAI will have to issue a separate notification for IIOs to participate in ship financing / leasing through an entity established for that purpose.

Overseas investments and its relevance to IFSC. Under Section 27E of the Insurance Act, insurance companies are not permitted to invest funds of policyholders outside India either directly or indirectly. Unclear from the wording whether it would apply to investment by an insurance company into ship leasing companies established in IFSC.

- **Mutual Funds**

Low ceiling for ship finance limits. Mutual funds are not allowed to invest more than 10%-12% of its NAV in rated debt instruments, 10%-25% of their NAV in unrated debt instruments and 5%-10% of their NAV in unlisted equities. This restriction makes it challenging for mutual funds to gain meaningful ship finance/leasing exposure.

Inability to invest overseas. Mutual Funds are not permitted to invest in overseas unlisted equity/equity linked instruments and foreign debt instruments. Ship financing / leasing is a global business and oftentimes involves foreign debt/equity instruments.

Lack of clarity in existing guidelines. The SEBI (IFSC) Guidelines do not clarify the categories of investors that would be permitted to invest in Mutual Funds, given that the term ‘institutional investors’ as referred to in Clause 22(1)(iii) is not defined. Eligible resident individuals are permitted to invest up to USD 250,000 per annum into an overseas mutual fund as per the Liberalised Remittance Scheme. These limits restrict the ability of mutual funds located in IFSC to raise funds from domestic HNIs, and consequently their participation in ship financing.

- **Employees Provident Fund Organization (EPFO)**

Restrictions on investment by Employees Provident Fund Organization (EPFO) to invest in companies engaged in ship financing and leasing.

- **External Commercial Borrowings (ECBs) guidelines**

Lack of flexibility in pricing and tenor. All-in cost for ECBs is capped at LIBOR (or equivalent benchmark rate) plus 450 bps spread. The ‘all-in cost ceiling’ caps the returns for the lender on ECB financing. However, for a cyclical and capital-intensive industry such as shipping, further flexibility on pricing is required, given the market volatility, vessel age, new technology risk, bespoke structures (leasing- finance and operating, non-recourse) so as to accommodate and provide required flexibility for long economic life assets.

Minimum Average Maturity Period is between 3-7 years depending on the purpose of the loan. Call and put options shall not be exercisable prior to completion of the minimum average maturity. The requirement of minimum average maturity is that the term of the facility should have a certain minimum maturity as a result of which lenders do not have flexibility to have shorter tenor loans. Ship financing requires flexibility.

Inability to refinance. Foreign branches/ subsidiaries of Indian banks cannot advance ECBs for the purpose of refinancing domestic debt. Offshore branches of Indian banks regularly provide ship finance offshore. However, given the restriction on offshore subsidiaries of Indian banks refinancing domestic debt, bank branches in IBU cannot refinance domestic debt of shipping companies.

Inability to obtain “Infrastructure” status. Despite having long useful lives of 15 – 25 years, vessels are not granted “infrastructure” status, which will allow access to longer-term funding at more competitive rates

- **National Investment and infrastructure Fund (NIIF)**

The NIIF is a sovereign wealth fund registered as an AIF for the purpose of providing long-term funding to infrastructure related projects. However, the NIIF and the funds it invests in do not address capital intensive industries such as ship leasing, aircraft leasing etc.

- **RBI approvals**

- (i) By virtue of Section 13(1) of the IFSCA Act, the powers exercised by RBI shall not have any application within IFSC. In this regard, all powers generally vested with RBI shall vest with IFSCA for entities registered therein. However, relying on the FEMA (IFSC) Regulation, 2015 and instructions and clarifications on circulars issued under the IFSC (Banking) Regulations, 2020 dated December 24, 2020, it has been clarified that all financial institutions and banking units (including subsidiaries of domestic and foreign banks) shall be treated as persons resident outside India. In respect thereof, the FEMA, 1999 (including regulations, directions etc. issued thereunder) shall be applicable. Further as per the said circular, while the RBI (Interest Rate on Advances) Directions, 2016 shall have no application, the Master Circular on Loans and Advances – Statutory and Other Restrictions dated July 01, 2015 (as amended) shall be applicable to Banking Units. By virtue of the applicability of RBI as stated above, vessels will not be able to avail long term funding at competitive rates since they are not granted ‘infrastructure status’ as per RBI Circular DBOB.BP.BC.No. 58/08.12.014/2012-13 dated November 20, 2012 (as amended) and the ‘Harmonised Master List of Infrastructure Sub-sectors dated April 26, 2021.
- (ii) As per the RBI Master Directions – ECB, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers (the “ECB Master Directions”), the following restrictions are imposed:
 - (a) All-in cost for ECBs is capped at LIBOR (or equivalent benchmark rate) plus 450 bps spread;
 - (b) Minimum Average Maturity Period (Para 2.1(V) of Part I) is between 3-7 years depending on the purpose of the loan. Call and put options shall not be exercisable prior to completion of the minimum average maturity.
 - (c) Further, foreign branches/ subsidiaries of Indian banks cannot advance ECBs for the purpose of refinancing domestic debt.

As for limb (a) above, the ‘all-in cost ceiling’ caps the returns for the lender on ECB financing. However, for a cyclical and capital-intensive industry such as shipping, further flexibility on pricing is required, given the market volatility, vessel age, new technology risk, bespoke structures (leasing- finance and operating, non-recourse) so as to accommodate and provide required flexibility for long economic life assets.

As for limb (b) above, the requirement of minimum average maturity requires the term of the facility to have a certain minimum maturity as a result of which lenders do not have flexibility to have shorter tenor loans. However, ship financing requires flexibility. For instance, if the underlying vessel for which the funding is availed, is sold, then lenders may be entitled to prepayment which should be enabled without requiring an RBI approval or meeting the MAMP requirements. Similarly, in an event of default, the lender should have the right to get the facility prepaid without an RBI approval and meeting the MAMP requirements. This is also relevant because shipping is a cyclical industry so ship owners should have the flexibility to prepay debt when times are good / they have adequate liquidity. This also helps vessel owners in managing finance on underlying assets.

As for limb (c) above, offshore branches of Indian banks regularly provide ship finance offshore. However, given the restriction on offshore subsidiaries of Indian banks refinancing domestic debt, bank branches in IBU cannot refinance domestic debt of shipping companies.

6.5. Other General challenges

• The Admiralty Act vis a vis security enforcement

SARFAESI Act, 2002 -

As per Section 31(d) of the SARFAESI Act, 2002, the provisions of the act and the remedies available to secured creditors will not be applicable to the creation of security interest in any vessel (as defined under Section 3(55) of the MSA). Further, the High Court of Bombay in ICICI limited v. MFV Shilpa and Others, AIR 2002 Bom 371, Para 12 held that the Debt Recovery Tribunal shall have no jurisdiction to entertain a claim against a vessel on the basis that a vessel is not a living person.

Admiralty Act and its implications on protection of secured creditors versus IBC – The IBC being a relatively new regime, the jurisprudence on the interplay between IBC and Admiralty jurisdiction is yet to be fully settled by the Hon’ble Supreme Court of India. However, the Hon’ble High Court of Bombay, in Board of Trustees of the Port of Mumbai v. Barge Madhwa and Ors, 2020 (4) ABR 161, has set out the scope for harmonious construction of the IBC and Admiralty Act as follows:

- a. *Scenario 1 i.e. when the Plaintiff has commenced admiralty proceedings and obtained an order of arrest prior to insolvency proceedings being file (Para 51) - if the security has been provided for release of such vessel, then the suit ceases to be an action in rem (Para 51.1). However, the suit will not proceed against the furnisher of security, being the corporate debtor in light of Section 14(1)(a) of the IBC. However, the plaintiff will be treated as a secured creditor, whereby the security will be exclusively for the Plaintiff’s claim (Para 51.1) If the CIRP is successful and the resolution plan is approved, then the claim of the plaintiff will be determined in accordance with the resolution plan (Para 51.2). If the CIRP is not successful and the company is ordered to be liquidated, the security provided by the corporate debtor will inure to the sole benefit of the plaintiff (Para 51.3).*
- b. *If no security is furnished at the time when moratorium is declared, the suit will not proceed any further (Para 51.4). To this end, the RP can make security be furnished for release of vessel and if no security is furnished, the vessel continues to be arrested until the end of the CIRP period where the plaintiff will be considered a secured creditor and the ‘maritime claim’ or ‘maritime lien’ will operate as a charge on the vessel (Para 51.4).*
- c. *If the company is liquidated, the Admiralty Act will govern the sale of vessels and all others seeking sale proceeds (as not governed by the admiralty act) can be unsecured creditors or operational creditors, as the case may be (under 51.7 and Para 51.10, respectively).*
- d. *Scenario 2 i.e. if a moratorium is declared before a suit for enforcement is filed (Para 52) - there will be no bar on filing the suit since the claim is in respect of the vessel*

and not the corporate debtor. To that extent, the filing of an admiralty suit shall not be hit by the moratorium provisions (Para 52.1). Upon the resolution professional entering appearance on behalf of the owner of the vessel/ corporate debtor, the suit will not proceed and the admiralty suit may be stayed till such time that CIRP is completed (Para 52.1). In such a scenario, the vessel may also be permitted to continue trading during the moratorium period, in the event that trading of the vessel is in the interest of the corporate debtor (Para 52.2).

- e. In furtherance thereof, the Plaintiff shall be considered a secured creditor and if the resolution plan and the process stated in scenario 1 above shall be applicable (Para 52.3). In the event that the RP chooses to furnish security for release of the vessel, he shall have an overriding obligation to protect the interests of the ships and all payments made in respect of crew wages etc (Para 52.3). Upon an application before the admiralty court, the said court can consider sale of vessel and retain the proceeds pending the outcome of the CIRP (Para 52.3).*
- f. Scenario 3 i.e. if the owner of the vessel is in liquidation at the time when admiralty proceedings is instituted by the Plaintiff in rem for the arrest of the vessel (Para 55) - If arrest of ship is ordered, the vessel can be sold by the Admiralty Court in order to realise the maximum value as such judicial sale shall result in the extinguishment of all maritime liens thereby giving the buyer clear title, unlike via liquidation, thereby appearing to be less attractive (Para 55.3). Further, the liquidator shall be entitled to defend the suit (Para 55.3). Alternatively, once the Plaintiff obtains an order of arrest, he would become a secured creditor and be entitled to apply for the sale of the ship and realise his claim in accordance with the provisions applicable to the security interest and the Plaintiff (Para 55.4).*

In view of the above, it may be noted that while the aforesaid case aims at harmoniously interpreting both the IBC and the Admiralty Act, an operational or financial creditor for the purposes of the IBC in respect of a vessel or its owner (being the corporate debtor) shall not strictly be entitled to the remedies available under the IBC.

Admiralty Act versus arbitral proceedings - Reliance is placed on the case of JV Ocean Liner LLC v. MV Golden Progress, MANU/MH/0026/2007, Para 64 wherein it was held that an arrest of a ship is a right in rem whereas Section 9 of the arbitration act is an action in personam and therefore cannot be exercised for arrest of ship as security irrespective of whether the arbitration is foreign seated.

Although the Admiralty Act vests the High Courts (as defined therein) with the exclusive jurisdiction to arrest ships and decide matters arising from maritime liens and claims, it may be noted from the discussions with the stakeholders that the present judicial system is time consuming and therefore proves to be prohibitive as compared to other jurisdictions. Further, agitating maritime claims and liens over a vessel is only effective if the time period between the arrest of a vessel and its sale is minimal.

- **Stamp duty**

While as per Section 3(3) the Indian Stamp Act, 1899 instruments executed by, or, on behalf of, or in favour of the developer or unit in connection with the carrying out of purposes an

SEZ, would be exempt from payment of stamp duty, Section 21 of the Gujarat SEZ Act, 2004 which specifically exempts the application of stamp duty and registration fees for instruments executed by a unit, establishment of industry (relating to transfer of land, loan agreements, credit deeds, mortgages etc.), does not *inter alia* include within its ambit an exemption in respect of instruments executed in connection with, on behalf of, or in favour of the unit.

7. SHORT FORM OF THE RECOMMENDATIONS

7.1. Regulatory Recommendations

PARTICULARS	BACKGROUND	PROPOSAL	AUTHORITY
FINANCIAL PRODUCTS			
SHIP LEASING			
Notification of vessel leasing as a financial product	<p>Section 12(1) of the International Financial Services Centres Authority Act, 2019 empowers the International Financial Services Centres Authority to “develop and regulate the financial products, financial services and financial institutions in the IFSC”.</p> <p>In exercise of their powers, the IFSCA has passed, <i>inter alia</i>, the IFSCA (Finance Company) Regulations, 2021 and the IFSCA (Banking) Regulations, 2020. Presently, the term ‘ship lease’ has been defined by the IFSCA Finance Company Regulations to mean financial leases, operating leases and any hybrids in respect thereof of ships or ocean vessels and engines of ships or ocean vessels or any other part thereof. However, ship lease is not notified as a ‘financial product’.</p>	<p>Vessel leasing should be notified as a ‘financial product’ by notification of Central Government under Section 3(d)(vi) of the IFSCA Act.</p> <p>Alternatively, ‘operating lease of any equipment’ may be notified as financial product. IFSCA may, at its discretion, enable industry-wise operating lease through an appropriate framework.</p> <p>Additionally, the framework for ship operating lease should be notified.</p> <p>Entities who own vessels and who intend to carry on the business of ‘vessel lease’ will be entitled to register as ‘financial institutions’ and will be able to undertake vessel leasing. There is no separate mention of ship owning or acquisition in the above as such transactions are inherent to all the above activities and therefore will be covered under ‘financial product’.</p>	IFSCA

SHORT FORM OF THE RECOMMENDATIONS

PARTICULARS	BACKGROUND	PROPOSAL	AUTHORITY
Inclusion of charters (time charters, voyage charter, bareboat charters etc.) in the term “ship lease”	The definition of ship leasing as defined under the IFSCA Finance Company Regulations is not exhaustive.	The term “vessel”, “ship” and “vessel lease(s)” in the IFSCA (Finance Company) Regulations, 2021 should be defined.	IFSCA
‘Framework for enabling ancillary services at IFSC’ dated February 10, 2021 to be amended to include certain ancillary services	Some of the ancillary services in relation to the shipping industry are not covered within the heads of permissible activities as set out in Paragraph 5 of the Framework.	The Framework should include other marine ancillary services including crewing and training, operation and maintenance and management activities, and also commercial, technical and financial marine support services.	IFSCA
SHIPPING REGULATIONS			
Registration of vessels	<p>Registration of vessels is governed by Part V of MSA read with relevant rules and orders. Registration of certain kinds of vessels for operating in inland waters is also governed by the Inland Vessels Act, 1917 and fishing vessels and harbour-craft operating in coastal waters is governed by the Coasting Vessels, Act 1838 (to the extent applicable).</p> <p>Only Indian ships are permitted to register under the MSA</p> <p>As regards registration and acquisition of foreign vessels, judicial precedents suggest that after a ship has obtained provisional registration, they are</p>	<p>The following steps be taken to make ship registration (including registration of companies/ entities for that purpose) efficient:</p> <ul style="list-style-type: none"> – DG Shipping in consultation with M/o Shipping may clarify by way of notification/ circular that all registrations and annual compliances for an entity in IFSC should be made online or through IFSC authorized agents/ operators (including Authorized Economic Operators defined elsewhere by other Indian regulators) which may be displayed on IFSCA website. – Time-bound Ship Registrations. – DG Shipping and M/o Shipping may enable an improvised Spice+ for IFSC which allows for a single window and time-bound approval system for 	DG Shipping