

Subcommittee on Article 8: International Transportation Issues

Recommendation of the Subcommittee on
possible changes to the Commentary on
Article 3 and 8

Subcommittee on international traffic

- The Subcommittee is mandated to report to the Committee, beginning at the Eleventh session, on possible updates to the Commentary on Article 8 of the UN Model Convention, in particular:
 - the issue of the application of Article 8 to cruise shipping (Article 3)
 - the coverage of the concept of “auxiliary activities” (Article 8).
- During the Twelfth session the Subcommittee presented possible changes to the Commentary on Article 3 and 8.
- Committee Members have been asked for comments and to make proposals for the minority views.

Proposed Change to Commentary on Article 3 (1) (d)

8. As also noted in the OECD Commentary, “[t]he definition of the term “international traffic” is broader than the term is normally understood [in order] to preserve for the State of the place of effective management the right to tax purely domestic traffic as well as international traffic between third states and to allow the other Contracting State to tax traffic solely within its borders”. **A ship or aircraft is operated solely between places in the other Contracting State in relation to a particular voyage if the place of departure and the place of arrival of the ship are both in that other Contracting State. Thus, for example, a cruise beginning and ending in that other Contracting State without a stop in a foreign port does not constitute a transport of passengers in international traffic. Conversely, a cruise beginning and ending in that other Contracting State with a stop in a foreign port constitutes a transport of passengers in international traffic. For this purpose, a “stop” has taken place if embarkation and disembarkation of passengers is enabled, even when passengers are permitted to go ashore temporarily.**

Commentary to Article 8

According to the updated OECD Commentary, Article 8 now refers to:

- profits “obtained by the enterprise from the carriage of passengers or cargo” in international traffic and
- profits from activities to permit, facilitate or support international traffic operations:
 - ✓ Directly connected with such operations,
 - ✓ Not directly connected but “**ancillary**” to such operations.

Commentary to Article 8, para 10

10. The Commentary on the OECD Model Convention notes that the place of effective management may be situated in a country different from the country of residence of an enterprise operating ships or aircraft and that “[...] some States therefore prefer to confer the exclusive taxing right on the State of residence”. The Commentary suggests that States may, in bilateral negotiations, substitute a rule on the following lines: “Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.” The Commentary continues:

3. Some other States, on the other hand, prefer to use a combination of the residence criterion and the place of effective management criterion by giving the primary right to tax to the State in which the place of effective management is situated while the State of residence eliminates double taxation in accordance with Article 23, so long as the former State is able to tax the total profits of the enterprise, and by giving the primary right to tax to the State of residence when the State of effective management is not able to tax total profits. States wishing to follow that principle are free to substitute a rule on the following lines:

Profits of an enterprise of a Contracting State from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the other Contracting State, shall be taxable only in the first-mentioned State. However, where the place of effective management of the enterprise is situated in the other State and that other State imposes tax on the whole of the profits of the enterprise from the operation of ships or aircraft, the profits from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the first-mentioned State, may be taxed in that other State.

~~4. — The profits covered consist in the first place of the profits obtained by the enterprise from the carriage of passengers or cargo. With this definition, however, the provision would be unduly restrictive, in view of the development of shipping and air transport, and for practical considerations also. The provision therefore covers other classes of profits as well, i.e. those which by reason of their nature or their close relationship with the profits directly obtained from transport may all be placed in a single category. Some of these classes of profits are mentioned in the following paragraphs [quoted paragraph 4 is taken from the Commentary on Article 8 as it read in the 2003 version of the OECD Model Convention].~~

Commentary to Article 8, new para 10.1

10.1 Referring to the meaning of the term “profits from the operation of ships or aircraft in international traffic”, the Commentary on the 2014 OECD Model Convention sets down two categories of profits which should fall within the scope of paragraph 1 of Article 8. The first relates to profits directly obtained by the enterprise from the carriage of passengers or cargo in international traffic, and the second to profits from activities to permit, facilitate or support international traffic operations. Within the second category the Commentary distinguishes two different types of activities: those directly connected with such operations and those not directly connected but “ancillary” to such operations. The Commentary notes as follows:

4. The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise’s ships or aircraft in international traffic as long as they are ancillary to such operation.

4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.

4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.

Commentary to Article 8, para 11

11. Applying the principles set out above, the Commentary on the ~~2003~~2014 OECD Model Convention deals with a number of activities in relation to the extent to which paragraph 1 will apply when those activities are carried on by an enterprise engaged in the operation of ships or aircraft in international traffic. The Commentary notes as follows:

5. Profits obtained by leasing a ship or aircraft on charter fully equipped, ~~manned~~crewed and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. However, Article [12], and not Article 8, applies to profits from leasing a ship or aircraft on a bare boat charter basis except when it is an ~~occasional source of income for~~ancillary activity of an enterprise engaged in the international operation of ships or aircraft.

~~6. — The principle that the taxing right should be left to one Contracting State alone makes it unnecessary to devise detailed rules, e.g. for defining the profits covered, this being rather a question of applying general principles of interpretation.~~

~~7. — Shipping and air transport enterprises — particularly the latter — often engage in additional activities more or less closely connected with the direct operation of ships and aircraft. Although it would be out of the question to list here all the auxiliary activities which could properly be brought under the provision, nevertheless a few examples may usefully be given.~~

~~8. — The provision applies, inter alia, to the following activities:~~

~~a) — the sale of passage tickets on behalf of other enterprises;~~

~~b) — the operation of a bus service connecting a town with its airport;~~

~~c) — advertising and commercial propaganda;~~

~~d) — transportation of goods by truck connecting a depot with a port or airport.~~

~~9. — If an enterprise engaged in international transport undertakes to see to it that, in connection with such transport, goods are delivered directly to the consignee in the other Contracting State, such inland transportation is considered to fall within the scope of the international operation of ships or aircraft and, therefore, is covered by the provisions of this Article.~~

~~10. — Recently, “containerisation” has come to play an increasing role in the field of international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers which is supplementary or incidental to its international operation of ships or aircraft fall within the scope of this Article.~~

Commentary to Article 8, para 11

6. Profits derived by an enterprise from the transportation of passengers or cargo otherwise than by ships or aircraft that it operates in international traffic are covered by the paragraph to the extent that such transportation is directly connected with the operation, by that enterprise, of ships or aircraft in international traffic or is an ancillary activity. One example would be that of an enterprise engaged in international transport that would have some of its passengers or cargo transported internationally by ships or aircraft operated by other enterprises, e.g. under code-sharing or slot chartering [Note to Subcommittee and Committee: secretariat has amended from “slotchartering”] arrangements or to take advantage of an earlier sailing. Another example would be that of an airline company that operates a bus service connecting a town with its airport primarily to provide access to and from that airport to the passengers of its international flights.

7. A further example would be that of an enterprise that transports passengers or cargo by ships or aircraft operated in international traffic which undertakes to have those passengers or that cargo picked up in the country where the transport originates or transported or delivered in the country of destination by any mode of inland transportation operated by other enterprises. In such a case, any profits derived by the first enterprise from arranging such transportation by other enterprises are covered by the paragraph even though the profits derived by the other enterprises that provide such inland transportation would not be.

8. An enterprise will frequently sell tickets on behalf of other transport enterprises at a location that it maintains primarily for purposes of selling tickets for transportation on ships or aircraft that it operates in international traffic. Such sales of tickets on behalf of other enterprises will either be directly connected with voyages aboard ships or aircraft that the enterprise operates (e.g. sale of a ticket issued by another enterprise for the domestic leg of an international voyage offered by the enterprise) or will be ancillary to its own sales. Profits derived by the first enterprise from selling such tickets are therefore covered by the paragraph.

8.1 Advertising that the enterprise may do for other enterprises in magazines offered aboard ships or aircraft that it operates or at its business locations (e.g. ticket offices) is ancillary to its operation of these ships or aircraft and profits generated by such advertising fall within the paragraph.

Commentary to Article 8, para 11

9. Containers are used extensively in international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers ~~which is supplementary or incidental to its international operation of ships or aircraft fall within the scope of this~~ **Article are usually either directly connected or ancillary to its operation of ships or aircraft in international traffic and in such cases fall within the scope of the paragraph. The same conclusion would apply with respect to profits derived by such an enterprise from the short-term storage of such containers (e.g. where the enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers.**

~~11. On the other hand, the provision does not cover a clearly separate activity such as the keeping of a hotel as a separate business; the profits from such an establishment are in any case easily determinable. In certain cases, however, circumstances are such that the provision must apply even to a hotel business e.g. the keeping of a hotel for no other purpose than to provide transit passengers with night accommodation, the cost of such a service being included in the price of the passage ticket. In such a case, the hotel can be regarded as a kind of waiting room.~~

~~12. There is another activity which is excluded from the field of application of the provision, namely~~

10. An enterprise that has assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic may derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground and equipment maintenance staff, cargo handlers, catering staff and customer services personnel. Where the enterprise provides such goods to, or performs services for, other enterprises and such activities are directly connected or ancillary to the enterprise's operation of ships or aircraft in international traffic, the profits from the provision of such goods or services to other enterprises will fall under the paragraph.

10.1 For example, enterprises engaged in international transport may enter into pooling arrangements for the purposes of reducing the costs of maintaining facilities needed for the operation of their ships or aircraft in other countries. For instance, where an airline enterprise agrees, under an International Airlines Technical Pool agreement, to provide spare parts or maintenance services to other airlines landing at a particular location (which allows it to benefit from these services at other locations), activities carried on pursuant to that agreement will be ancillary to the operation of aircraft in international traffic.

11. [Deleted]

Commentary to Article 8, para 11

12. The paragraph does not apply to a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country.

~~13. It may be agreed bilaterally that profits from the operation of a vessel engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article.~~

~~14. Investment income of shipping, inland waterways or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income [...].~~

13. [Renumbered]

14. Investment income of shipping or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income, except where the investment that generates the income is made as an integral part of the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State so that the investment may be considered to be directly connected with such operation. Thus, the paragraph would apply to interest income generated, for example, by the cash required in a Contracting State for the carrying on of that business or by bonds posted as security where this is required by law in order to carry on the business: in such cases, the investment is needed to allow the operation of the ships or aircraft at that location. The paragraph would not apply, however, to interest income derived in the course of the handling of cash-flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralisation of treasury and investment activities), nor would it apply to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.

14.1 Enterprises engaged in the operation of ships or aircraft in international traffic may be required to acquire and use emissions permits and credits for that purpose (the nature of these permits and credits is explained in paragraph 75.1 of the Commentary on Article 7). Paragraph 1 applies to income derived by such enterprises with respect to such permits and credits where such income is an integral part of carrying on the business of operating ships or aircraft in international traffic, e.g. where permits are acquired for the purpose of operating ships or aircraft or where permits acquired for that purpose are subsequently traded when it is realised that they will not be needed.

Commentary to Article 8, para 11.1

[11.1 Some members did not fully agree with the interpretation of “profits from the operation of ships or aircraft in international traffic” in the quoted OECD Model Convention Commentary as it applies to income from inland transportation of passengers or cargo. They considered that income from such transportation is not covered by Article 8 (alternatives A and B) even when such transport is directly connected with the operation of ships or aircraft in international traffic”. In order to avoid inconsistent interpretation of the term “profits from the operation of ships or aircraft in the international traffic” the Committee recommends to settle this issue by bilateral negotiations of the agreement on the avoidance of double taxation].

Commentary to Article 8, para 16

16. The rules set out in paragraphs 8 to ~~10~~11.1 above relating to taxing rights and profits covered apply equally to this paragraph.