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Item 3(c) of the provisional agenda
Issues related to the United Nations Model Double Taxation Convention between Developed and Developing Countries

Co-Coordinators' Report: Proposal for a revision to Article 8 (Alternative B) of the United Nations Model Double Taxation Convention between Developed and Developing Countries

Summary

This note is provided to the Committee for ***discussion*** at its Twenty-seventh Session.

At its Twenty-sixth Session, the Committee considered E/C.18/2023/CRP.14, which set out the Subcommittee's proposed draft of a revision of Alternative B, which would provide limited source taxation. The Subcommittee had noted that it was still considering certain technical issues; this note provides updated drafting of the proposed provision to reflect the Committee's comments and technical discussions in the Subcommittee.

The Committee therefore is asked to consider and discuss:

i) whether Article 8 should continue to have an option providing for exclusive residence-based taxation as in Alternative A;

ii) if the answer to i) is yes, whether the order of the alternatives in Article 8 should be reversed, presenting the option that allows source-State taxation first;

iii) whether the redrafted present Alternative B is fine;

iv) whether Alt B, paragraph 2 should cover both shipping and international air transport (as in the draft in paragraph 16) or only shipping;

v) to what extent ancillary income should be covered under Article 8, and some examples of what members think is covered and what is not; and

vi) general suggestions on language of the proposed Commentary.

I. INTRODUCTION

1. The United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN Model) provides two alternatives for the treatment of income from shipping and air transport. Article 8 (Alternative A), like the OECD Model Tax Convention on Income and on Capital (the OECD Model) provides for exclusive residence-State taxation of income derived from the operation of ships and aircraft in international traffic. Article 8 (Alternative B) provides the same exclusive residence-State taxation rule for income from international air transport but allows for limited source State taxation of income from international shipping activities.

2. The 2017 version of the UN Model includes certain clarifications relating to the treatment of income from international traffic. Recently, some Committee Members and members of civil society have called for a fundamental reconsideration of Article 8. At its meeting in January 2022, the Subcommittee noted that, while a number of countries have negotiated bilateral tax treaties that allow for source State taxation of income from international shipping activities, very few (if any) of those treaties follow the approach of Article 8 (Alternative B) of the UN Model. The Subcommittee decided to consider whether a different formulation of Article 8 (Alternative B), more consistent with actual treaty practice, should be included in the UN Model, although a few participants in the Subcommittee expressed the view that the project should be a reconsideration of the entire article. To assist the Subcommittee, several participants provided information regarding their countries' domestic law and recent treaty provisions that provide for source State taxation of income from shipping.

3. The arguments of those calling for a fundamental reconsideration of Article 8 are set out in Section II of this note. Section III explains why the provision allowing for source State taxing rights, currently found in Alternative B, needs to be changed, whether or not there is a change in fundamental approach under Article 8 and sets out a possible draft of such a provision. Section V provides a draft Commentary for the possible new Alternative B.

II. REQUEST FOR A RECONSIDERATION OF THE POLICY OF ARTICLE 8

4. The main argument for a reconsideration of the policy behind Article 8 is that very few ships and aircraft used in international traffic are operated by enterprises of developing countries, so that the effect of a residence-only rule with respect to income from international traffic is to require developing countries to give up much more revenue from international traffic than developed countries give up under the provision. The need to take into account the differing economic circumstances of developed and developing countries was one of the primary reasons for the development of the UN Model. In fact, a 1965 report by the Fiscal Committee of the Organisation for Economic Cooperation and Development, focused on increasing private investment in developing countries, acknowledged that certain provisions would not be appropriate:

> Existing treaties between industrialized countries sometimes require the country of residence to give up revenue. More often, however, it is the country of source which gives up revenue. Such a pattern may not be equally appropriate in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue sacrifice would be one-sided.

5. When the UN Model was released in 1980, it provided for increased taxation at source, as compared to the OECD Model, of certain types of income, such as royalties. Since then, source State taxation in the UN Model has been expanded to cover fees for technical services and income from automated digital services, to address cases where substantial amounts of income can be generated by a non-resident without creating a permanent establishment in the source State. The logic underlying these expanded taxing rights

applies (at least) equally to income from international traffic – a residence-only rule would heavily favor developed countries, and income from international traffic is, by definition, highly mobile. For some developing countries, the "revenue sacrifice" from the exclusive residence State taxation of such income is substantial in view of their economic circumstances (whether or not the relevant amount would be viewed as substantial in developed countries).

6. Proponents of source State taxation of income from international traffic point out that the domestic laws of many countries provide for source taxation of such income, which would apply in the absence of a tax treaties or other agreements relating to the taxation of income from international transportation. The United States, for example, has a rule that provides for tax of 4% on U.S.-source transportation income,[1] defined as 50% of the revenue from any voyage to or from the United States. In India, 5% of airline revenue and 7.5% of shipping revenue sourced from India is considered as deemed income of a non-resident from airline and shipping and tax at applicable rate applies.[2]

7. They therefore question the administrative rationale for the rule, which is explained in the Commentary on Article 8 as follows:

> 2. With regard to the taxation of profits from the operation of ships in international traffic, many countries support the position taken in Article 8 (alternative A). In their view, shipping enterprises should not be exposed to the tax laws of the numerous countries to which their operations extend. They argued that if every country taxed a portion of the profits of a shipping line, computed according to its own rules, the sum of those portions might well exceed the total income of the enterprise. Consequently, that would constitute a serious problem, especially because taxes in developing countries could be excessively high, and the total profits of shipping enterprises were frequently quite modest.
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> 3. Other countries asserted that they were not in a position to forgo even the limited revenue to be derived from taxing foreign shipping enterprises as long as their own shipping industries were not more fully developed. They recognized, however, that considerable difficulties were involved in determining a taxable profit in such a situation and allocating the profit to the various countries concerned in the course of the operation of ships in international traffic.
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> 4. Since no consensus could be reached on a provision concerning the taxation of shipping profits, the use of two alternatives in the Model Convention is proposed and the question of such taxation should be left to bilateral negotiations.

They argue that the development of agreed source rules would go far towards eliminating the risk of multiple taxation described in paragraph 2 of the Commentary. Moreover, they argue, work on Pillar One in the Inclusive Framework on BEPS shows that it is possible to reach general agreement on principles for such source rules.

8. They also find the allocation of exclusive taxing rights to the residence State to be particularly troubling in the case of income from international traffic because residence States frequently do not tax that income. Many developed countries have adopted "tonnage tax" regimes that result in much lower levels of taxation, particularly in recent years when gross revenues from shipping activities have skyrocketed. Moreover, while the industry argues that profit margins are "frequently quite modest", one might question

[1] Internal Revenue Code of 1986, section 887.
[2] See, section 44B and section 44BBA of the Indian Income Tax Act, available at https://www.incometaxindia.gov.in/pages/indiacode/income-tax-act.aspx

whether that is true on a cash-flow basis that does not take into account the depreciation deductions attributable to a company's hard assets (ships or aircraft).

9. Finally, they point to the important role that the UN Model serves as the "holy grail" for many developing countries; they expect that the provisions included in the UN Model are those that will be most beneficial to developing countries. Because of that role, in their view, the UN Model has failed developing countries by not taking a stronger position on Article 8. The current situation, in which fewer than 10% of existing bilateral tax treaties provide for source State taxation under Article 8, is seen by them as the result of the UN Model taking a neutral stance as between source State and exclusive residence State taxation, and not providing a workable version of source State taxation (as described further below). In their view, if the UN Model included only one option – a workable provision allowing for source State taxation of income from international traffic – developing countries would be able more easily to negotiate treaties that allow for source-State taxation under Article 8. Moreover, in their view, if more countries successfully negotiated for, and implemented, source State taxation in their treaties, it would become easier for other countries to negotiate similar provisions. Finally, in their view, that makes the argument that it is "realistic" to maintain the alternative of exclusive residence State, simply because most treaties include that rule, a self-fulfilling prophecy.

10. Paragraph 28 of the draft report of the Twenty-sixth Session of the Committee notes that there were mixed views regarding retaining Alternative A, although the majority of those who spoke favored retaining it. If Alternative A is to be retained, it is suggested that the introductory paragraphs of the Commentary on Article 8 should be modified to reflect the arguments set out in this section. A possible re-draft of those paragraphs could read:

A. General considerations

> 1. Two alternative versions are given for Article 8 of the United Nations Model Tax Convention, namely Article 8 (Alternative A) and Article 8 (Alternative B). Article 8 (Alternative A) reproduces Article 8 of the OECD Model Tax Convention. Article 8 (Alternative B) introduces substantive changes to Article 8 (Alternative A), dealing separately with profits from the operation of aircraft and profits from the operation of ships in paragraphs 1 and 2, respectively. Paragraph 3 reproduces paragraph 2 of the 2017 OECD Model Tax Convention, with minor adjustment to reflect the additional paragraph added in Alternative B.
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> 2. ***When the former Ad Hoc Group of Experts considered this issue,*** ~~with regard to the taxation of profits from the operation of ships in international traffic~~ many ~~countries~~ ***members*** supported the position taken in Article 8 (Alternative A) ***with regard to the taxation of profits from the operation of ships in international traffic***. In their view, shipping enterprises should not be exposed to the tax laws of the numerous countries to which their operations extend. They argued that if every country taxed a portion of the profits of a shipping line, computed according to its own rules, the sum of those portions might well exceed the total income of the enterprise. Consequently, that would constitute a serious problem, especially because***, in their view,*** taxes in developing countries could be excessively high, and the total profits of shipping enterprises were frequently quite modest.
>
> 3. Other ~~countries~~ ***members of the Ad Hoc Group*** asserted that ~~they~~ ***developing countries*** were not in a position to forgo even the limited revenue to be derived from taxing foreign

shipping enterprises as long as their own shipping industries were not more fully developed. They recognized, however, that considerable difficulties were involved in determining a taxable profit in such a situation and allocating the profit to the various countries concerned in the course of the operation of ships in international traffic.

4. Since no consensus could be reached on a provision concerning the taxation of shipping profits, it was decided to use the two alternatives in the United Nations Model Tax Convention and to leave the question of such taxation to bilateral negotiations.

5. In connection with the [2025] revision of the UN Model, the Committee of Experts returned to the issue of whether exclusive residence taxation of income from international transport is justified. A [XX minority] would have eliminated Alternative A. They note that, since the original work of the Ad Hoc Group, source State taxation in the UN Model has been expanded to cover fees for technical services and income from automated digital services, to address cases where substantial amounts of income can be generated by a non-resident without creating a permanent establishment in the source State. In their view, the logic underlying these expanded taxing rights applies equally to income from international traffic – a residence-only rule heavily favors developed countries, and income from international traffic is, by definition, highly mobile. For some developing countries, the "revenue sacrifice" from the exclusive residence State taxation of such income is substantial in view of their economic circumstances (whether or not the relevant amount would be viewed as substantial in developed countries).

6. Proponents of source State taxation of income from international traffic also question the administrative rationale for the rule set out in paragraph 2. They point out that the domestic laws of many countries provide for source taxation of such income, which would apply in the absence of tax treaties or other agreements relating to the taxation of income from international transportation. They argue that the development of agreed source rules would help to reduce the risk of multiple taxation. They also find the allocation of exclusive taxing rights to the residence State to be troubling in the case of income from international shipping because residence States frequently do not tax that income. Many developed countries have adopted "tonnage tax" regimes that result in much lower levels of taxation than would apply under normal corporate income tax rules.

7. The Committee continued to support the inclusion of an exclusive residence-taxation alternative in the Model. As a result***, the current UN Model continues to include two alternatives for the taxation of income from international transport. However, the source State alternative has been substantially changed, as described below.***

[Renumber existing paragraphs 5 through 11.]

III. PROPOSAL FOR A SUBSTITUTE FOR THE EXISTING ALTERNATIVE B

11. The paragraphs in the Commentary quoted above suggest that Article 8 (alternative B) can be seen as an attempt to allow for source State taxation while addressing the risk of multiple taxation described in paragraph 3 of the Commentary on Article 8. It does so by adopting a formulary approach to the allocation of net profits. Under Article 8 (alternative B), the host State may tax a portion of the "overall net profits" derived by an enterprise from its shipping operation if shipping activities in the host State are "more than casual".[3] Once the amount of profits that may be taxed in the host State is determined, the tax that otherwise would be imposed is to be reduced by some percentage as determined through bilateral negotiations. By contrast, in other cases where there is to be shared taxation, such as articles 10, 11 and 12 of the UN Model, the article anticipates that an upper limit on source State taxation, expressed as a percentage of gross income, will be established through bilateral negotiations and set out in the treaty itself.

12. Paragraph 2 of Article 8 (alternative B) states that the source State's taxing rights are based on an "appropriate allocation" of the enterprise's "overall net profits" from shipping activities. Neither the treaty text nor the Commentary contains a formula for calculating either amount. Rather, paragraph 14 of the Commentary notes various aspects of the calculation that should be negotiated bilaterally. It states:

> The overall net profits should, in general, be determined by the authorities of the State of the enterprise (or the State in which the place of effective management of the enterprise is situated). The final conditions of the determination might be decided in bilateral negotiations. In the course of such negotiations, it might be specified, for example, whether the net profits are to be determined before the deduction of special allowances or incentives which could not be assimilated to depreciation allowances but could be considered rather as subsidies to the enterprise. It might also be specified in the course of the bilateral negotiations that direct subsidies paid to the enterprise by a Government should be included in net profits. The method for the recognition of any losses incurred during prior years, for the purpose of the determination of net profits, might also be worked out in the negotiations. In order to implement that approach, the country of residence would furnish a certificate indicating the net shipping profits of the enterprise and the amounts of any special items, including prior-year losses, which in accordance with the decisions reached in the negotiations were to be included in, or excluded from, the determination of the net profits to be apportioned or otherwise specially treated in that determination. The allocation of profits to be taxed might be based on some proportional factor specified in the bilateral negotiations, preferably the factor of outgoing freight receipts (determined on a uniform basis with or without the deduction of commissions). The percentage reduction in the tax computed on the basis of the allocated profits is intended to achieve a sharing of revenues that would reflect the managerial and capital inputs originating in the country of residence.

13. In order to implement Article 8 (alternative B) as suggested by the commentary above, the State of residence effectively would be required to audit each shipping company resident in its State each year to determine its net profits, as adjusted in accordance with the negotiated terms. While such an approach may

[3] Although there has been some suggestion that "more than casual" is not adequately defined, paragraph 13 of the Commentary on Article 8 states that the term "covers both regular or frequent shipping visits and irregular or isolated visits, provided the latter were planned and not merely fortuitous. The phrase 'more than casual' means a scheduled or planned visit of a ship to a particular country to pick up freight or passengers." Casual visits therefore are those that are unplanned, perhaps emergency stops to pick up supplies or to allow a sick or troublesome passenger to disembark.

function tolerably well in a multilateral context where the same "adjustments" to net profits are agreed, it is not terribly surprising that countries have been reluctant to agree to this obligation in bilateral negotiations. In addition, resolution of the issues set out in paragraph 12 in different ways in different bilateral treaties could result in the very types of over-taxation that formulary apportionment was meant to avoid.

14. Those countries that have included source State taxation of income from shipping activities in their treaties tend to adopt a simpler approach than Article 8 (alternative B), imposing tax at a low rate on payments made to ship goods to or from their ports. In some cases, an upper limit is set out in the treaty; however, in most, the upper limit is expressed as a certain percentage (usually 50%) of the tax that otherwise would have applied. In a few treaties, the limit is expressed as "the lower of" those two limits.

15. At the Twenty-sixth Session, the Subcommittee presented a possible provision based on several recent provisions relating to international shipping. The structure of the possible provision is more consistent with the other provisions of the UN Model that allow for source taxation than some of the referenced precedents. That is, the possible provision begins with the distributive rules, followed by a definition of the income covered, then a source rule. E/C.18/2023/CRP.14 noted that the Subcommittee would continue to discuss a number of technical issues.

16. The provision presented in the Twenty-sixth Session goes further than most current treaties as it would allow source State taxation of income from international air transport as well as international shipping. In the report on the Twenty-sixth Session, Ms. Smith noted that there was some support for so extending it; the possible provision and Commentary set out below are drafted on the basis that it would cover both, with an alternative set out in paragraph 16 of the draft Commentary that would allow for source State taxation only of international shipping income. If the Committee concludes that source State taxation should only apply with respect to income from international shipping and not international air transport, the version of the provision described in paragraph 16 of the draft Commentary, with necessary changes to the Commentary, would be presented to the Committee at its Twenty-eighth Session.

17. The Committee therefore is invited to discuss the following possible revision of Article 8 (Alternative B):

ARTICLE 8

INTERNATIONAL SHIPPING AND AIR TRANSPORT

ALTERNATIVE B

> 1. Income arising in a Contracting State from the operation of ships or aircraft in international traffic and paid to a resident of the other Contracting State may be taxed in that other State.
>
> 2. However, income from the operation of ships or aircraft in international traffic arising in a Contracting State may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of such income is a resident of the other Contracting State, the tax so charged in the State in which the income arises shall not exceed:
>
> > (a) 50 per cent of the tax otherwise imposed by the taxation law of that State on the net profits from such income, or

(b) __ per cent *[the percentage is to be established through bilateral negotiations]* of the gross amount of the payments underlying such income,

whichever is lower.

3. For the purposes of this Article, "income from the operation of ships or aircraft in international traffic" means the total gross amount received, less commissions paid to sales agents, arising from the carriage of passengers, mail, livestock or goods in international traffic. The term also shall include items of income directly connected to, or ancillary to, the operation by that enterprise of ships or aircraft in international traffic, except where such items of income are dealt with separately in other Articles of this Convention (other than Article 7).

4. For the purposes of this Article, income from the operation of ships or aircraft in international traffic shall be deemed to arise in a Contracting State if such income is received for the carriage of passengers, livestock, mail or goods:

(a) from a location in that Contracting State to a location outside that Contracting State; or

(b) from a location in a third state to that Contracting State.

5. The provisions of paragraphs 1 and 2 shall also apply to income from the participation in a pool, a joint business or an international operating agency engaged in the operation of ships.

IV. Proposed Commentary Changes to Reflect Revised Alternative B

18. The Subcommittee proposes the following changes to the Commentary on Article 8 (Alternative B) (for ease of reference, the paragraph numbering refers to the 2021 version of the UN Model and does not take into account the renumbering required by the changes in paragraph 10 of this note) to explain the possible new Alternative B:

Paragraph 1 of Article 8 (Alternative B)

15. This paragraph, which does not correspond to any provision in the OECD Model Tax Convention, provides that income arising in a Contracting State from the operation of ships or aircraft in international traffic and paid to a resident of the other Contracting State may be taxed in that other State. It does not, however, provide that such income may be taxed exclusively in that State and therefore leaves open the possibility of taxation by the State in which the income arises.

~~This paragraph reproduces paragraph 1 of Article 8 of the OECD Model Tax Convention, with the deletion of the words "ships or". Thus the paragraph does not apply to the taxation of profits from the operation of ships in international traffic but does apply to the taxation of profits from the operation of aircraft in international traffic. Hence the Commentary on paragraph 1 of Article 8 (Alternative A) is relevant insofar as the operation of aircraft is concerned.~~

16. Some countries prefer Article 8 (Alternative B) to apply only to income from shipping and not to international air transport. To achieve that result, the word "However" should

be deleted from the first sentence of paragraph 2, the words "or aircraft" should be deleted throughout the provision and paragraph 1 should be replaced by the following:

> ***Profits of an enterprise of a Contracting State from the operation of aircraft in international traffic shall be taxable only in that State.***

Paragraph 2 of Article 8 (Alternative B)

17**~~6~~*. This paragraph allows ~~profits~~income*** from the operation of ships ***or aircraft*** in international traffic to be taxed in the source country~~ if operations in that country are "more than casual"~~. It also provides an independent operative rule for ***income arising in a Contracting State from the operation of ships or aircraft in international traffic*** ~~the shipping business~~ and is not qualified by Articles 5 and 7 relating to business profits governed by the permanent establishment rule. It covers both regular or frequent ~~shipping~~ visits and irregular or isolated visits ***by ships or aircraft***~~, provided the latter were planned and not merely fortuitous~~. ~~The phrase "more than casual" means a scheduled or planned visit of a ship to a particular country to pick up freight or passengers.~~

18**~~7~~*. This paragraph lays down the principle that the Contracting State in which ***income from the operation of ships or aircraft in international traffic arises may tax the underlying payments in accordance with the provisions of its domestic law. However, if the beneficial owner of the income is a resident of the other Contracting State, the amount of tax imposed by the State in which such income arises is limited to the lower of two amounts. The first amount is 50 per cent of the tax that would have been imposed in that State in the absence of the convention. This amount usually will be determined on the basis of the net profits of the enterprise relating to the underlying payments. The second amount is determined by applying a negotiated rate to the gross amount of the payments underlying such income. Where there is an existing shipping or air services agreement between the Contracting States that provides for a different allocation rule, such as exclusive residence State taxation, States including paragraph 2 of Article 8 (Alternative B) should clarify how the two agreements interact, which may require modifying or terminating the tax provisions of such agreement in order to provide certainty.

19**~~8~~*. ***For purposes of the first limit, ~~The overall~~ net profits ~~should, in general,~~ ***would*** be determined by the authorities of the ***source*** State ~~of the enterprise (or the State in which the place of effective management of the enterprise is situated if the wording proposed in paragraph 10 above is used). The final conditions of the determination might be decided in bilateral negotiations. In the course of such negotiations, it might be specified, for example, whether the net profits are to be determined before the deduction of special allowances or incentives which could not be assimilated to depreciation allowances but could be considered rather as subsidies to the enterprise. It might also be specified in the course of the bilateral negotiations that direct subsidies paid to the enterprise by a Government should be included in net profits. The method for the recognition of any losses incurred during prior years, for the purpose of the determination of net profits, might also be worked out in the negotiations. In order to implement that approach, the country of residence would furnish a certificate indicating the net shipping profits of the enterprise and the amounts of any special items, including prior-year losses, which in accordance with the decisions reached in the negotiations were to be included in, or excluded from, the determination of the net profits to be apportioned or otherwise specially treated in that determination. The~~

~~allocation of profits to be taxed might be based on some proportional factor specified in the bilateral negotiations, preferably the factor of outgoing freight receipts (determined on a uniform basis with or without the deduction of commissions).~~ The ***50*** per cent~~age~~ reduction in the tax computed on the basis of the ~~allocated~~ profits ***so determined*** is intended to achieve a sharing of revenues that would ***generally*** reflect the ~~managerial and capital~~ inputs originating in the country of residence ***(such as management and capital)***.

20. Because the first limit, in subparagraph (a), depends entirely on the tax system in the source State, the second limit, in subparagraph (b), was included in order to provide certainty that source State taxation on income from the operation of ships or aircraft in international traffic would not exceed an amount envisioned by the two parties. Countries are free, in their bilateral negotiations, to provide for only one of the limits in subparagraph (a) or (b) rather than both.

21. The maximum rate of tax under subparagraph (b) is to be established through the bilateral negotiations between the Contracting States. It is recommended, however, that it be set at a modest value. In addition, the rate should take into account the risk of multiple taxation arising from the source rule of paragraph 4, discussed in paragraph 27 below.

Paragraph 3 of Article 8 (Alternative B)

22. Paragraph 3 defines "income from the operation of ships or aircraft in international traffic" as the income directly obtained by the enterprise from the transportation of passengers, mail, livestock or goods in international traffic, whether the relevant ships or aircraft are owned, leased or otherwise at the disposal of the enterprise. The Article also covers profits from activities directly connected with such operations as well as profits from activities that 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. However, the definition does not include income that is dealt with separately under another article of the convention (other than Article 7).

[Paragraphs 23 to 25 reserved]

Paragraph 4 of Article 8 (Alternative B)

26. Paragraph 4 lays down the principle that income from the operation of ships or aircraft in international traffic arises in a Contracting State if such income is received for the carriage of passengers, livestock, mail or goods from a location in a Contracting State to a location outside that Contracting State or from a location in a third state to that Contracting State. That is, a Contracting State will be allowed to tax fees received for carriage when the relevant ship or aircraft is embarking from within it, and when the carriage starts from a third state and ends in that State.

27. For example, assume ManuCo, a company resident in Country H, pays ShipCo, a company resident in Country S, to pick up goods manufactured by its subsidiary in Country F and deliver them to Country M, where ManuCo's distribution subsidiary will sell them to unrelated parties. If the Country S-Country F treaty and the Country S-Country M treaty each includes Article 8 (Alternative B), Country F would be able to tax the fees received by ShipCo under subparagraph 4(a), while Country M would be able

to tax the fees received by ShipCo under subparagraph 4(b). Because of the risk of multiple taxation of the same income, some countries choose to tax only when carriage begins in that country; if both countries agree, paragraph 4 can be modified accordingly by dropping subparagraph (b). Otherwise, countries may want to take account of the risk of multiple taxation when establishing the withholding rate under subparagraph 2(b).

28. Some countries that rely on withholding taxes may foresee difficulty collecting taxes under paragraph 4 when the payer of the fees is not a resident of their State and does not have a permanent establishment therein, as is the case of the payment from ManuCo to ShipCo in the example in paragraph 25. Some countries have solved this problem by requiring proof of payment of taxes before permission to embark is granted. In some cases, responsibility for administration of the tax is delegated to the port authorities. However, taxpayers must have the ability to file returns after the close of the year in order to determine whether subparagraph 2(a) or 2(b) results in a lower tax (for example, as a result of losses).

Paragraph 2 of Article 8 (Alternative A) and paragraph ~~3~~5 of Article 8 (Alternative B)

29~~22~~. Paragraph 2 of Article 8 (Alternative A) reproduces paragraph 2 of Article 8 of the OECD Model Tax Convention. Paragraph ~~3~~***5*** of Article 8 (Alternative B) also reproduces the latter paragraph, with one adjustment, namely, the replacement of the phrase "paragraph 1" by the words "paragraphs 1 and 2". The Committee considers that the following part of the Commentary on Article 8 of the 2017 OECD Model Tax Convention, which provides additional explanations with respect to paragraph 2 of that Article, is applicable to paragraph 2 of Article 8 (Alternative A) and to paragraph ~~3~~***5*** of Article 8 (Alternative B) of this Model:

V. Issues for the Committee

19. The Committee is asked to consider and discuss:

i) whether Article 8 should continue to have an option providing for exclusive residence-based taxation as in Alternative A;

ii) if the answer to i) is yes, whether the order of the alternatives in Article 8 should be reversed, presenting the option that allows source-State taxation first;

iii) whether the redrafted present Alternative B is fine;

iv) whether Alt B, paragraph 2 should cover only both shipping and international air transport (as in the draft in paragraph 16) or only shipping;

v) to what extent ancillary income should be covered under Article 8, and some examples of what members think is covered and what is not; and

vi) general suggestions on language of the proposed Commentary.