TREATMENT OF SHIPPING IN THE UN MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

Comments by the International Chamber of Shipping (ICS) and the World Shipping Council (WSC)

The International Chamber of Shipping (ICS) is the principal international trade association for merchant shipowners and operators, representing all sectors and trades (including *inter alia* tankers, dry bulk carriers, general cargo and specialised ships, as well as containerships) with the various intergovernmental bodies that impact on shipping. Its membership comprises national shipowners' associations in 36 countries representing over 80% of the world merchant fleet.

The World Shipping Council (WSC) is a membership organization representing the liner shipping industry on public policy issues of interest to its members before national, regional, and international governmental bodies. The Council has offices in Washington D.C. and Brussels. Taken together, the 29 World Shipping Council members provide approximately 90% of the world's containerized shipping capacity.

At the eighth session of the Committee of Experts on International Cooperation on Tax Matters, the shipping industry and other interested parties were invited to comment on the discussions about taxation of international transport. We appreciate this opportunity to provide the following remarks about the treatment of international shipping in the UN Model Double Taxation Convention.

About 90% of global trade is carried by sea. The efficiency of ship operations, and the global economy which they serve, is very much dependent upon the existence of a uniform and common understanding of how national rules apply to what is an international industry regulated by multilateral international treaties. If different national rules were to apply during different parts of a voyage then the result would be chaos and serious inefficiency in the movement of the world's energy, raw materials, food and manufactured products.

Shipping is an inherently globalised business with over 60,000 vessels engaged in international trade calling at numerous different countries during a year. This is true of most ships engaged in bulk and specialist trades, as well as those carrying containerized cargoes. In the case of container vessels, they nearly always carry cargo from a number of different countries during a specific journey voyage. It is therefore paramount that the present and long established principle of taxing international shipping in the 'home country' only (as may be defined by the authorities in that country) is maintained. For the same reason and in order to ensure that there remains a common understanding of the international principles for taxation of shipping, the UN and the OECD model treaties should as far as possible be aligned with respect to their treatment of international shipping. The OECD commentary was revised in 2005 after an extensive analysis of the functioning and operation of modern day international shipping activities. It is the opinion of the global shipping industry that the OECD model should serve as the inspiration for the discussions at the UN level.

General Principles

At the meeting of the Committee of Experts, the question of auxiliary/ancillary income was discussed. ICS commented on the development of the industry – in particular container shipping – where the containers can continue their journey after the vessel reaches port. ICS commented on the practical issues of allocating income between the primary and auxiliary activities, since they are often not separately invoiced. ICS also mentioned that the industry places great value in the importance of having an absolutely consistent interpretation of the scope of the Shipping Article in the UN Convention and its wish to avoid disputes in the large number of countries in which individual vessels call.

These views are fully supported by WSC.

ICS and WSC therefore welcome the efforts of the UN Committee to reach a consensus on the scope of Article 8. However, it is important to understand that any inconsistency with the OECD approach, or any new restriction on the scope of the current Shipping Article, would be extremely problematic for the industry since this could lead to different treatment by local authorities in the various ports of call on a voyage. Given the large number of ships and cargoes involved in international trade this would be chaotic, for tax authorities as well as shipping companies. This could seriously distort international trade which very much depends on common rules and an interpretation of such rules which allows market participants to offer cost-effective and efficient services.

At the UN meeting in October, ICS pointed out that inland transport is only included in the scope of taxable activity by the OECD commentary to the extent that the local leg is carried out by a domestic carrier, which would be taxed on its income. The international carrier providing through transportation is taxed for the revenue derived from that inland leg only in the "home country". Furthermore, ICS noted that it is not the practice of the industry to carry large volumes of containers on third party vessels outside a formal time charter, slot charter or vessel sharing arrangement. This latter point is relevant to the issue of prohibition of double taxation on the inland transportation leg of through international movements. It is also relevant to the point that the nature of the commercial arrangement under which an ocean carrier provides or obtains space on a ship should not affect that carrier's tax status.

Key Features of International Shipping

'Tramp' shipping (as opposed to liner shipping) is the maritime transportation of bulk materials (dry and wet) that does not adhere to published schedules and which often responds to instructions from a single charterer (customer) who in many cases takes effective control of the vessel, either for a single voyage or for several multiple voyages. The industry understands that tramp shipping has not developed from a tax point of view since the present UN texts were developed. However, some bulk trades, such as the shipping of oil and chemical products, exhibit similarities to containerised trades in that product tankers often carry cargoes in 'parcels' that belong to several different customers located in many different countries which the ship will visit during the course of a voyage.

For the purpose of this paper, however, ICS and WSC would like to focus on modern day liner shipping since it is this activity that is potentially most prone to give rise to double taxation issues.

An ocean carrier's service involves multiple ports of call and a plethora of international cargo origins and destinations on every single voyage. The maps below show the actual ports called by an ocean carrier on one of its many services. The upper map is the westbound service; the lower map is the eastbound service.

Port calls in a carrier's westbound service

Port calls in the same carrier's eastbound service

In the westbound service, for example, when the ship leaves Los Angeles, United States, it may have been loaded with cargo originating in Canada, the United States and various South American countries which will be unloaded from the ship at ports in Japan, Republic of Korea, Chinese Taipei, Hong Kong (China), Thailand, Sri Lanka, France, Netherlands, Germany, Belgium and the United Kingdom.

At each such port, some of the cargo will:

- be destined for that port and the ocean carrier's responsibilities will end at that port;
- be destined for inland points within the country of the port of call and the ocean carrier has the responsibility to deliver the cargo there;
- be destined for inland points within a country different from the country of the port of call and the ocean carrier has the responsibility to deliver the cargo there (e.g. cargo is discharged in Rotterdam, Netherlands and barged, railed or trucked to Germany); or
- be trans-shipped in this port onto different vessels used by the carrier to transport the cargo to other ports not on the first vessel's itinerary (e.g. cargo discharged in Colombo, Sri Lanka may be relayed to a different vessel that will call at Mumbai, India), which may then be further transported to the various destination possibilities outlined above.

Most ocean carriers have numerous vessel strings operating simultaneously, which are integrated into networks that enable the carrier to serve the needs of international exporters and importers by literally moving goods from virtually any point in the world to any other point in the world. These can be intricate and very complex networks.

The Entire End-To-End Movement – Including Inland Transportation – Must Be Exempt From Double Taxation as International Traffic

When a ship sails on an itinerary such as the one shown above, the ocean carrier will be required to take into account revenue for the entire promised through transportation that the shipper has negotiated and agreed to pay for, not for portions of the revenue broken into component parts. There will be literally thousands of possible origin and destination combinations across different national boundaries on every single voyage. In addition, payment for a shipment may be from the shipper or from the consignee, in the country of origin or destination or a third country, depending on the commercial factors involved in the sale of the goods.

According the Drewry Shipping Consultants, approximately 163 million TEU[1] of loaded shipping containers moved worldwide in 2011. It is an inherent and unavoidable aspect of the business that each vessel string used in a service, like the one described above, will have literally thousands of origins and destination pair combinations. To apply a varied, differing set of tax treatments to various portions of these thousands of cargo shipments

[1] Source: Drewry Container Market Review and Forecaster, Quarter 3, 2012. A "twenty foot equivalent unit" or "TEU" is a common unit of measure for containerships and containerized cargo. Many containers are 40 feet long. A forty foot container would represent 2 TEU.

would create immense difficulty. It would artificially sever the international transportation of cargo into components that neither the carrier nor its customer contracted for. If a shipper contracts with an ocean carrier to transport goods to a port and no further, the carrier's international transportation service stops there. But if a shipper contracts with an ocean carrier to transport a container of goods from say Frankfurt, Germany, to Chicago, United States, that is the international transportation service and the "international traffic".

Thus, while an "international journey of a ship" approach may have aptly covered the typical port-to-port movement before the advent of containerization, it does not reflect the reality of modern transportation for the international movement of cargo, where the sea-leg constitutes but one part, albeit an essential part. Thus, the shipping industry recommends that it be made very clear that the inland portion of international transportation of cargo is covered under the definition of "international traffic," which the existing UN and OECD Commentary to Article 8 clearly declares as the intention.

For the sake of clarity we would like to point out that an ocean carrier uses the services of third parties to offer inland transportation. Thereby the carrier neither competes with domestic companies nor profits from a beneficial tax treatment of such service.

Vessel Operating Ocean Carriers Should Qualify for Article 8 Regardless of the Commercial Arrangements Under Which They Provide or Obtain Vessel Capacity Used to Transport International Traffic

In addition to the inland transportation issue addressed above, there was also discussion at the most recent Committee of Experts meeting of the application of Article 8 to vessel space provided through vessel sharing arrangements. Specifically, there was a suggestion that Article 8 should not protect from double taxation revenues derived by an ocean carrier that transports a particular shipment using vessel space obtained from another carrier under a Vessel Sharing Agreement[2] or "VSA". The shipping industry believes that this suggestion is unworkable as a practical matter and could have serious implications for the level of service available to cargo interests if it were adopted.

Vessel sharing arrangements have become one of the most common features of the liner shipping industry, with over half of the containerized liner services offered worldwide being offered through such alliances. Because of the capital intensive nature of the shipping business, and because economies of scale have driven the industry towards the use of larger vessels in order to optimize fuel efficiency, it is cost-prohibitive for carriers to offer stand-alone services in many markets. By sharing vessel space, however, multiple carriers can maintain geographic coverage, vessel call frequency, and overall system capacity at levels beyond what they could provide individually, while at the same time those carriers continue to compete commercially for business. These arrangements provide more options, better service and thereby more competition for the carriers' shipper customers.

---

[2] We use the term "vessel sharing agreement" here in an inclusive sense, to encompass the full range of arrangements through which vessel operators share space. Such arrangements range from simple sales or exchanges of container slots on vessels to highly integrated operational alliances. The differences in the specifics of the various types of agreements are irrelevant for tax policy purposes.

Within a VSA each of the carriers typically participates in the joint service with a certain number of their own (or chartered) vessels. Each carrier has the right to use a specified amount of the container carrying capacity (TEU capacity / deadweight, whichever is reached first) on board of each of the vessels included in the joint service. The carriers share the capacity with each other on the basis of their share contribution (the ratio between each individual operator's capacity contribution and the joint service total capacity).

Take the example of three carriers cooperating to provide a service between 'Country A' and 'Country B', with each carrier supplying two of the six vessels necessary to provide a weekly service. Under that arrangement, each carrier has the right to use one third of the space on each vessel in the service, regardless of which VSA partner actually operates that particular vessel. Each individual carrier maintains its direct, independent relationship with its shipper customer, and the shipper looks to the carrier issuing the bill of lading to move the goods from origin to destination, regardless of who operates the ship on which the goods are transported. It is immaterial to the carrier and to the shipper – and it should be immaterial to the taxing authorities – which vessel is used for any given shipment. Each of the three VSA partners is a vessel operating ocean carrier providing international transportation under the arrangement described just as surely as it would be if it operated the service using only its own assets. The only difference between the two situations is that the assets are used more efficiently, and the shippers have more choices and better coverage and benefit from an optimised use of vessel resources.

If the application of Article 8 were dependent on whether the goods were moved on a vessel actually operated by the carrier issuing the bill of lading, then the operation of VSAs would be greatly complicated, and their use would be discouraged by tax policy. That, in turn, could have very negative implications for service quality and frequency, and therefore on the smooth flow of international trade. That would, in the view of the shipping industry, constitute a most unfortunate policy choice for everyone engaged – directly or indirectly – in international trade.

For these reasons, the shipping industry believes that any revised commentary should reaffirm the current understanding that any entity that is engaged in the international shipping business of transporting cargo for hire should qualify for exemption under Article 8 whether it is a shipowner, a vessel operator, a time or bareboat charterer, a space or slot charterer, or a lessor or a lessee for the voyage generating the revenue. These various arrangements merely characterize the financial and operational details of how the vessel comes to be made available for service; they have no significance to the policy considerations that underlie Article 8.

Auxiliary Services

At the meeting in October 2012 a discussion took place about the terms ancillary vs. auxiliary. As ship owners we are not concerned with the term as such but find that the latest elaboration from the OECD provides a pragmatic understanding of the activities that are clearly related to international transport without constituting a separate business for the shipping company. It is for example customary for shipping companies to charge shippers for late redelivery of containers, cargo storage etc. to ensure the smooth flow of cargo and equipment. Similarly, the income from the use, maintenance or rental of containers, including equipment for the transport of containers such as trailers and chassis, should be taxed only in the country of residence, provided that the containers are used for the international transport of cargo.

# # #

Current practice under the OECD Model Treaty and its commentary has generally resulted in a manageable system for the shipping industry that does not impose unreasonable administrative burdens or discourage service-enhancing arrangements such as vessel sharing agreements. Any proposed changes to that stable and workable regime should be considered with substantial caution. As mentioned, ICS and WSC greatly appreciate the opportunity to participate in the UN discussions of this important topic and would welcome any questions or comments from Committee members.

Contact:

John Butler
General Counsel
World Shipping Council
jbutler@worldshipping.org

Simon Bennett
Director External Relations
International Chamber of Shipping
Simon.Bennett@ics-shipping.org