



INTERNATIONAL CHAMBER OF SHIPPING

PRELIMINARY COMMENTS ON PROPOSED CHANGES TO THE OECD MODEL TAX CONVENTION DEALING WITH THE OPERATION OF SHIPS AND AIRCRAFT IN INTERNATIONAL TRAFFIC

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, containerships, general cargo and specialised ships, as well as passenger ships) with the various intergovernmental bodies that impact on shipping. ICS membership comprises national shipowners' associations in 35 countries representing over 80% of the world merchant fleet.

On 15 November 2013, OECD Working Party 1 on Tax Conventions and Related Questions published a 'public discussion draft' on proposed changes to Articles 8 and 15 of the OECD Model Tax Convention and its Commentary, and invited interested parties to comment.

Summary

In summary, the international shipping industry is broadly satisfied with the *status quo* with respect to the current text of the Convention, including Article 8. However, with respect to the current text of Article 15, opinions within the shipping industry appear to differ. ICS is cautious about commenting on proposed changes whose wider implications are difficult to fully understand, despite having been carefully studied by our members. ICS therefore suggests that the proposed changes to the OECD Model Convention need to be subjected to a far more comprehensive review.

General Comments

The existing OECD Model Tax Convention as it relates to the operation of ships (which is also, of course, the model upon which the similar United Nations Convention is based) has served the global shipping industry well, and helps to facilitate very cost-efficient transportation of the 90% of world trade that is carried by sea.

The current Convention has provided a framework for the taxation of this complex industry in a manner which is widely understood, both by the industry itself and – importantly – by the national authorities responsible for administering taxation.

This has helped to provide the industry with a degree of stability that is necessary in order to operate in shipping markets that are very cyclical and also subject to considerable short term freight rate volatility caused by continuous changes in demand for shipping services, both generally and with respect to specific trades.

The transportation of cargo and passengers by sea is an inherently global industry operating in a highly competitive environment. Profits from operating merchant ships typically represent a very small proportion of what is often a very large turnover, and are to a significant extent determined by the successful management of costs. Considered tax planning is also important. The jurisdiction under which a shipping company may choose to operate is thus one of the more important financial decisions that it has to make, especially as its competitors enjoy similar flexibility when taking such decisions about where they are located.

Because merchant ships are by definition movable assets, ship operators operate in an environment characterised by significant flexibility with respect to the national jurisdiction under which they elect to locate the effective management of their business.

Ships can trade under the flag of one nation, be owned by a company in another (which in turn may be a subsidiary of a group located elsewhere), be operationally managed by a company in another nation, and with the crew on board the ships being employed from several others.

It is important to understand that a ship can be re-registered with a different flag State (as defined by the United Nations Convention on the Law of the Sea) within a 24 hour period. Shipping companies also exercise significant flexibility with respect to where they wish to locate the management of the business. This is a decision which can be extremely sensitive to the financial and taxation regimes under which companies operate, given that the number of staff employed by shipping companies ashore may sometimes be small in comparison to the number of seafarers employed to work at sea.

ICS understands that the main justification given for the current review is the desire of Working Party 1 to reflect current treaty practices in order 'to modernise' the wording of Article 8 and to address 'interpretation issues' related to Article 15.

However, the primary concern of ICS is that insufficient information has been provided about the rationale for the specific changes proposed to the Articles, which could potentially in fact be changes of **substance** rather simply adding clarity to interpretation (which is the authors' stated intention).

ICS is therefore concerned that no detailed analysis has been provided of the potential implications in practice of the proposed changes, or the potential impact upon the manner in which shipping is currently taxed.

In view of the acute sensitivity of the industry to changes to the taxation regimes under which shipping companies operate, ICS is concerned that these implications could potentially be far reaching with respect to the structure of the industry and the decisions taken by shipping companies with regard to the flag States under which they choose to register their ships, the countries from which they employ crew, and the nations in which they decide to locate their shore-based operations.

ICS therefore suggests that the proposed changes to the OECD Model Convention need to be subjected to a far more comprehensive review. ICS suggests that this should involve a full and proper consultation with shipping, transport and trade ministries in order to achieve an in-depth understanding of the possible unintended consequences that might arise from making the changes proposed.

Such a review might adopt a holistic approach to consider the potential implications that changes to one Article in the Convention might have on the way in which other Articles are interpreted. For example, what will be the implications for Article 15 of changing the text of Article 8 from 'place of effective management where the enterprise is situated' to an 'enterprise of a Contracting State'?

ICS believes that the conduct of a detailed review of the implications of the proposed amendments, involving maritime experts from governments, will be vital in order to allow both OECD economies and the shipping industry to comment meaningfully on whether they can agree with what is proposed or how the text might be further refined.

Article 8

ICS wishes to emphasise the importance of avoiding any unintentional restrictions on the current scope of Article 8.

Shipping is a globalised business with over 60,000 vessels engaged in international trade calling at numerous different countries during a year (or indeed during the course of a single voyage). It is therefore paramount that the present and long established principle of taxing international shipping in the home country of the shipping company only is maintained (retaining the flexibility as to how the home country is defined as provided for by the existing OECD Commentary).

In particular, ICS believes that before any meaningful comment can be made by industry on the proposal to change Article 8, the practical implications of the proposed transfer of taxation rights from the State in which the **'place of effective management of the enterprise is situated'** to **'an enterprise of a Contracting State'** must be further explained. What does the new term mean? We presume it is not meant to be limited to state owned companies, but are unclear about the practical consequences arising from this change that the authors might have in mind.

The work of Working Party 1 is apparently ‘strictly limited’ to the modernisation of the wording of Article 8. However, unless a comprehensive review of the potential impact of the proposed textual amendments is carried out, it is not possible to know whether the new wording will have substantive implications for the way in which international shipping is taxed.

ICS also believes that further explanation is required of the reasons behind the proposed amendment.

Article 15

With regard to paragraph 3 of Article 15, ICS recognises that the proposal to give exclusive taxation rights over seafarers’ remuneration to the State of ‘residence’ may be consistent with the approach adopted by some OECD governments in their domestic law.

However, the practice of giving exclusive taxation rights over seafarer’s remuneration to the seafarer’s state of residence is not universal. In some countries the taxation authority over non-resident seafarer income continues to be exercised by the State in which the place of effective management is situated, consistent with the current text of the OECD Model, the related Commentary, and the possible existence of bilateral treaties. The fact that ‘domestic law in many countries’ may not permit them to tax non-residents is not a reason for suggesting that other States should not continue to maintain their current arrangements, as the proposed new wording for Article 15 seems to imply.

ICS therefore suggests that any proposed amendment to change the emphasis of Article 15(3) towards taxation in the seafarer’s state of residence must consider retaining a degree of flexibility in order to accommodate cases in which the ‘place of effective management’ approach is used. Regardless of the content of the Commentary, ICS believes that the flexibility of the current Article should not be reduced without proper justification or an understanding of the potential implications.

Employment costs, which are of course directly affected by taxation, represent one of the largest **variable** operating costs for shipping companies. Even minor changes to the way in which seafarers are taxed in certain countries could therefore have profound consequences for the nationalities of the seafarers employed by international shipping companies, as well as the company’s choice of flag State.

About two thirds of the seafarers employed on merchant ships currently reside in non-OECD nations, while the majority of seafarers are currently employed on board ships that fly the flag of a country that it is different to their country of residence. Most seafarers are also employed on relatively short term contracts. In addition to

considering the implications for the employment of seafarers resident in OECD nations but which may be employed by companies located in a different nation, it will also be important to bear in mind the potential implications of any changes to Article 15 for the employment of seafarers that reside in non-OECD nations, especially developing countries where seafarers' remittances are an important source of national income.

Article 3

ICS also notes the proposed changes to subparagraph 3(e) of Article 3 regarding the definition of "international traffic" for the purposes of the Convention, in particular the proposed addition of the following text: '**and the enterprise that operates the ship or aircraft is not an enterprise of that state**'. ICS would appreciate further clarification with respect to the implications of this change and the rationale for proposing it.

ICS hopes that these initial comments with respect to this complicated issue are helpful, and looks forward to contributing further comments as this important review progresses.