

FOLLOW-UP PILLAR TWO SHIPPING COMMENTS

This document urgently requests consideration of changes to the Pillar Two model rules *prior to their intended issuance by November 30*. The first of these is very important to the liner shipping sector. The second is very important to all shipping sectors.

First, as set forth in our 9 July 2021 memorandum (attached), and as discussed with the OECD Secretariat in a September 16 virtual meeting, slot charter hire should be treated as international shipping income (“ISI”), not as ancillary income. Treatment as ancillary income is based, we believe, on an incorrect interpretation of the article 8 OECD MTC Commentary. Slot charters arise every single day in the liner shipping industry under vessel sharing or other similar arrangements under which one carrier moves cargo for another carrier. This allows vessels to be used most efficiently, allowing earlier shipments and more transportation choices for the customers of shipping lines, and contributing substantially to the reduction of emissions into the atmosphere. Slot charters are very similar to voyage charters, except that only a portion of the ship is chartered (rather than the entire vessel). Because of the 50% (as a percentage of ISI) limitation on ancillary income that can be excluded, treatment as ISI, and not as ancillary income, is very important to the liner shipping industry. We believe that slot charter hire is NOT treated as ancillary income under the article 8 Commentary, as discussed in the next paragraph.

Paragraph 4 of the article 8 OECD MC Commentary provides that shipping profits are profits “directly obtained” from the transport of cargo. Slot charter hire is derived by a charter of part of the space (or “slots”) on a container ship and as such it is directly obtained from the transport of cargo. Under paragraph 4, shipping profits also can be derived from activities “directly connected” with shipping operations (defined in paragraph 4.1) and from activities not directly connected but “ancillary” to shipping operations (defined in paragraph 4.2). Paragraph 6 provides that the carrier who pays slot charter hire to another carrier to have the other carrier transport its cargo receives “directly connected” profits from its customers. In no paragraph is slot charter hire described as being ancillary. It is not ancillary. It is “directly obtained” from the transport of cargo and as such should be treated in the model rules as ISI, not as ancillary income. This interpretation of the treatment of slot hire is confirmed in the attached Maisto treatise (see paragraphs 5.1.2.1.3.1 and 5.1.2.2.4).

Second, we believe that it is imperative that a special rule be provided in the Pillar Two formulaic substance carve-out to consider the unique nature of tangible assets and services performed that are not exclusive to one jurisdiction. There will be many situations where shipping income will not qualify for the Pillar Two shipping income exclusion. From our very first meeting with the OECD Secretariat in September 2019, and in almost all our submissions, we have mentioned the importance of a substance carve-out, to the extent there is not a shipping income carve-out, because of the billions of dollars of investment in ships, other equipment, and crew made annually by the shipping industry.

In this regard, a rule that allocates assets and payroll to a jurisdiction based on the physical location of the assets or employees would result in the significant investments made by the shipping industry being allocated to “nowhere,” given that the assets and employees are used on the high seas and do not have a “location” in any jurisdiction for as much as 90% of the time. As a result, the substance carve-out might not apply to most shipping company assets and employees because it appears that the substance carve-out requires that the tangible assets and employees be located in a jurisdiction.

To avoid this inappropriate outcome, consistently with what we had understood, in our February 2020 discussions with the OECD Secretariat, was being contemplated, we believe that the model rules should either (a) simply provide that the substance carve-out apply to ships and other tangible property, and to employees, while on the high seas or (b) simply provide that substance carve-out amounts always be allocated to a jurisdiction in the same manner that income is allocated to a jurisdiction. In addition, to the extent that a substance carve-out would otherwise be allocable to a constituent entity to which the Pillar Two shipping exclusion applies, then the substance carve-out should be proportionately reduced. Thus, for example, assume that 60% of shipping income is excluded under the shipping income exclusion and that 40% is not excluded. In that case, only 40% of the investment in ships and only 40% of the employee expense should be taken into account under the substance carve-out.

Failure to make this adjustment may leave shipping as the only industry that cannot benefit from the substance carve-out for most of its tangible assets and employees.

We believe that both of these changes to the model rules can be drafted very quickly and easily.

We continue to believe that income from ancillary inland transportation activities should not be taken out of the shipping income exclusion. If it is not to be covered, we respectfully request clarification of the scope of what is not covered.

We also understand that the model rules will not include detailed definitions or guidance on the strategic and commercial management requirements. As stated in our attached September 15 memorandum, it is extremely important that detailed rules be provided in this regard, including addressing certain special situations. We understand that the commentary to the model rules, or other guidance, will be provided in this regard. We trust that this will happen, as it is crucial for shipping companies and taxing authorities to be able to know what needs to be done for them to comply with the requirements.

We were invited to provide detailed comments on the model rules after they are published. We expect to do so, but we would be very appreciative if the model rules would include the important changes discussed above.

Attachments