

August 19, 2022

**SHIPPING INDUSTRY RECOMMENDATIONS ON OECD PROGRESS REPORT ON
AMOUNT A OF PILLAR ONE**

This document provides recommendations of the World Shipping Council, the International Chamber of Shipping, the European Community Shipowners' Associations, and the Cruise Line International Association in respect of the OECD Public Consultation Document: *Progress Report on Amount A of Pillar One (11 July – 19 August 2022)* ("July 2022 OECD PCD"). In summary, as discussed below, we recommend that: (1) Special rules be adopted such that assets and employees of a shipping company that are employed in multiple jurisdictions, and primarily on the high seas, are fully taken into account for Pillar One profit over-allocation purposes (and similarly for Pillar Two substance-base income exclusion purposes); (2) The covered group definition apply the prior period and average tests to determine whether a group is in scope (a) every year and (b) in respect of revenues in addition to profitability; (3) 10 year net loss carryforwards be permitted from both pre- and post- Pillar One years; (4) Shipping companies not be subject to the 15% and 5% limitations on revenue from supplementary transactions; (5) The revenue allocation key for charter hire from unrelated persons should be the location of the customer; and (6) (a) The cargo non-air transport allocation key should make clear that empty shipping containers are not counted in doing allocations and (b) a company should have the option to do allocations based upon revenues rather than volume or weight.

1. Treatment of Mobile Assets -- (a) Marketing and Distribution Profits Safe Harbour Adjustment ("Over-Allocation Safe Harbor") and (b) Pillar Two Substance-Base Income Exclusion.

An international shipping company's business is predicated on the use of ships both in ports in multiple jurisdictions and, primarily, on the high seas, outside of the territorial waters of any jurisdiction. Special rules need to be developed in order to treat shipping companies fairly under both Pillar One and Pillar Two.

Article 6 of the July 2022 OECD PCD includes a formula for allocating residual profits to jurisdictions, including a downward adjustment to the profit allocation formula where a jurisdiction, without regard to Pillar One, already over-allocates profits to the jurisdiction. The Over-Allocation Safe Harbor, in paragraphs 3 and 5 of article 6, in conjunction with schedule J, provides for this downward adjustment. The mechanism of the downward adjustment is based upon certain returns on depreciation and payroll physically located in jurisdictions. These mechanisms simply do not work for an international shipping company whose assets and employees generally are used in multiple jurisdictions, and primarily on the high seas. The July 2022 OECD PCD acknowledges this in footnotes 21 and 22 on page 93, where it is stated that work is on-going in respect of the treatment of mobile assets and mobile employees.

The shipping industry believes that such mobile asset rules are *imperative* and must operate in a fashion such that assets and employees of a shipping company, in whatever jurisdiction employed, or if employed on the high seas, are fully eligible for the relevant relief. This is both a Pillar One and a Pillar Two issue.

The Pillar One issue relates to freight taxes. A number of countries, primarily in parts of Asia, Latin America, and Africa, subject shipping companies, in lieu of the regular corporate income tax, to gross income-based income taxes that are typically called freight taxes, but which may have other names (such as withholding tax, corporate income tax, or foreign contractor tax). These gross-basis in lieu of income taxes almost always presume an inherent profit margin on inbound or outbound freight (or both) that is substantially in excess of what a shipping company actually derives on the transportation of cargo to or from the jurisdiction. To allocate additional Pillar One residual profit to such jurisdictions would be inappropriate because profits allocated to such jurisdictions already are substantially exaggerated. The Over-Allocation Safe Harbor, or a similar mechanism, needs to prevent this unfair result by providing an appropriate downward adjustment.

While not the subject of this Pillar One public consultation, we note that the fair treatment of a business, such as a shipping business, using mobile property also is a very important Pillar Two issue. The Pillar Two international shipping income exclusion may not be available to some shipping companies (most likely where the “strategic or commercial management” requirement cannot be met). The Pillar Two Model Rules include a substance-base income exclusion which, as currently written, also look at assets and employees located in jurisdictions. These rules also do not work for a shipping company whose assets and employees are employed in multiple jurisdictions, and primarily on the high seas. The OECD also has recognized that special rules in this regard are needed for companies using mobile assets and employees. Please see the attached SHIPPING INDUSTRY PILLAR TWO IMPLEMENTATION FRAMEWORK RECOMMENDATIONS, dated April 11, 2022.

The shipping industry would be pleased to work with the OECD Secretariat to develop rules in respect of these two issues, both of which are very important to the industry.

2. Covered Group Definition.

Article 1 (2) of the July 2022 OECD PCD generally provides that a group is a “Covered Group” for a period where (a) the revenues for a period exceed EUR 20 billion and (b) the pre-tax profitability exceeds 10% (i) for the period and (ii) where the group was not a covered group for the two consecutive immediately preceding periods (a) in two of the four immediately preceding periods (“prior period test”) and (b) on average across the period and the immediately preceding four periods (“average test”). Thus, it would appear that the prior period and average tests do not apply once a group is a covered group for two consecutive years.

As indicated in our attached SHIPPING INDUSTRY RECOMMENDATIONS ON SCOPE OF PILLAR ONE – AMOUNT A, dated April 19, 2022, the shipping industry’s profitability and revenues are very volatile. In a ten year period, it is common for a shipping company to have net operating losses in more than half of the years.

Because of this high volatility, as recommended in our April 19, 2022, submission, we recommend that the prior period and average tests should be applied to determine whether a group is a covered group *every* period, not just if the group was not a covered group in the two consecutive immediately preceding periods.

In addition, as recommended in our April 19, 2022, submission, because high volatility also exists in respect of revenues (in addition to profitability), we again recommend that the prior period and average tests be applied in respect of revenues as well as profitability.

3. Net Loss Carryforwards.

Under articles 5 (1) and (3), profits are reduced by net losses carried forward from eligible prior periods. Under Title 7 (29)(a), the definition of eligible prior period seems unclear, but appears to permit carryforwards of (i) up to 10 years of post-Pillar One implementation losses and (ii) up to three years of pre-Pillar One implementation losses. As previously indicated, it is common for a shipping company to have net operating losses in more than half of the years in a ten year period. Because of such high volatility in the shipping industry's profitability, we recommend that the definition of eligible prior period should permit carryforwards of losses of 10 years FOR both pre- and post- Pillar One losses.

4. Revenue from Supplementary Transactions.

Under schedule E (Detailed Sourcing Rules), section 12 (39), Cargo Non-air Transport Service includes a service transaction that supplements cargo services. However, under schedule E, section 12 (25), Revenues from Supplementary Transactions do not include revenues that (a) exceed 15% of cargo services (plus supplementary transactions) or (b) exceed 5% of the Covered Group's revenues for the period. Determining whether these two limitations have been met would be administratively complex, particularly since, for Pillar Two purposes, shipping companies already will have to perform separate complex determinations; i.e., to determine whether, under paragraph 3.3.4 of the Pillar Two Model Rules, more than 50% of a group's Qualified Ancillary International Shipping Income exceeds 50% of the group's International Shipping Income. We recommend that the 15% and 5% limitations not apply in respect of revenues from supplementary transactions that constitute International Shipping Income or Qualified Ancillary International Shipping Income.

5. Charter Hire.

Time or bareboat charter hire received from unrelated persons can meet the definition of Cargo Non-air Transport Service (schedule E, section 12 (39)) and also Service Property Connected to Tangible Property (schedule E, section 12 (58)). Under schedule E, section 2 (6) (flush language), it appears in such a case that the prescribed allocation key for transport services must be used. However, a shipping company typically will not have information as to where the

charterer uses the vessel. Thus, we recommend that in such cases the revenue allocation key should be the location of the customer under schedule E, section 6 (A) (3).

6. Cargo Non-air Transport Allocation Key.

Under schedule E, section 12 (38), the Cargo Non-air Transportation Allocation Key, revenues are allocated based upon volume or weight (as the case may be) of cargo transported, split 50/50 (under schedule E, section 6, paragraph D (4)) between the place of origin and the place of destination. We have two recommendations in this regard. A. It should be made explicitly clear that, in the case of a container shipping line, these allocations do not take into account the volume of empty shipping containers. This was made explicitly clear in footnote 44 of the OECD Public Consultation Document, *Pillar One – Amount A: Draft Model Rules for Nexus and Revenue Sourcing (4 February 2022 – 18 February 2022)*. B. As recommended in footnote 2 of our attached ***Global Shipping Industry Recommendations on OECD Draft Rules for Pillar One Nexus and Revenue Sourcing***, dated February 17, 2022, if a company has the ability and desire to trace revenues to jurisdictions on the basis of revenues (as opposed to volume or weight), it should be given the option to do so.



If you have any questions, would like to discuss, or would like additional information, please contact Kenneth Klein at Mayer Brown LLP at kklein@mayerbrown.com or at +1 312 493 2342.

Attachments