September 20, 2021

Pillar One and International Shipping

There should be an international shipping income carve-out from Pillar One for (1) policy reasons, (2) sourcing reasons, and (3) revenue allocation reasons that are **unique** to the international shipping industry.

Policy Reasons

The January 2020 OECD/G20 international shipping carve-out should be reinstated for two policy reasons which, when combined, apply uniquely to the international shipping industry. First, application of Pillar One would reverse the 100-year policy, as reflected in the OECD model tax convention and 3,500+ income tax treaties, that international shipping income should be taxed only in the country of residence to reflect the fact the most shipping income is earned on the high seas and to prevent compliance and administrative burdens to taxpayers and tax authorities resulting from the allocation of shipping income to dozens or hundreds of countries.[1] Second, application of Pillar One to international shipping would undermine the policies behind OECD and EU approved special shipping tax regimes (e.g., tonnage tax regimes) that have been enacted by many countries for, as stated by the OECD, "significant non-tax considerations"[2] to bolster their maritime sectors or for national security. Undermining those policies, as the OECD has said, could lead to competitive distortions and unstable outcomes.[3] Again, the international shipping industry is described as "unique."[4] International shipping is carved out from Pillar Two. For the same policy reasons, we believe it also should be carved out from Pillar One.

Sourcing Reasons

The July 1, 2021, OECD/G20 *Statement on a Two-Pillar Solution* states that "revenues will be sourced to the end market jurisdictions where goods or services are used or consumed." Consistently, paragraphs 281-282 of the *October 2020 Pillar One Blueprint* state that services are sourced in the jurisdiction of the use of the service; i.e., where the service is performed. Similarly, the OECD in July

[1] See October 2020 *OECD Pillar One Blueprint* ¶¶ 156-164. *Id*. Paragraph 159 correctly describes this policy as "unique." While this policy reason also applies to airlines, the second policy reason does not.
[2] 2015 *OECD Harmful Tax Practice Report* ¶ 84.
[3] See October 2020 *OECD Pillar Two Blueprint* ¶¶ 110-113. While this statement was made in respect of Pillar Two, we believe it applies equally to Pillar One.
[4] *Id*. at ¶ 110. The shipping industry is unique in other respects, as well. It is subject to hundreds of special port-related and other taxes in multiple countries, gross basis freight taxes in many countries, especially in Asia and Latin America, and tonnage taxes. A Pillar One tax would not be creditable against any of these taxes. Further, shipping costs are almost always passed down the supply chain, such that any shipping profit or loss ultimately gets reflected in taxable profit or loss in the jurisdictions where goods are consumed.

2021 said that Pillar One carve-outs for extractives and regulated financial institutions were based upon those industry's "profit[s] … [being] tied to the place where … [they] are earned."[5] International shipping, once again, is *unique* in this regard. On a time or mileage basis, substantially all international shipping takes place on the high seas, not in any jurisdiction. The principles of the sourcing provisions would suggest that substantially all of international shipping revenues *should not be sourced to any country.*[6] For that reason alone, international shipping should be carved out from Pillar One because substantially all international shipping income does not relate to services performed in any jurisdiction, but rather on the high seas.

Revenue Allocation Issues

For Pillar One to apply to international shipping income, the policy reasons and sourcing reasons described above would have to be ignored and a special and a complex revenue allocation key would have to be developed that would be relevant *only* to international shipping. We submit that business operating models in the shipping industry, and the placement of shipping in the supply chain, would make any type of a revenue allocation among countries almost arbitrary. No very large shipping company within the scope of Pillar One, nor any taxing authority auditing such a company, will have access to sufficient facts to be able to allocate shipping income to countries in any reasonable, meaningful, equitable, efficient, or transparent fashion. Allocation based on the location of the customer will not work. Allocation based up on the destination or origin of goods shipped will not work. Allocation based upon loading or unloading ports would be distortive. Set forth below are some examples that illustrate the difficulties that would be faced in devising a reasonable Pillar One allocation key for international shipping.

1. Many different parties pay for transportation; sometimes the shipper (the party who contracts with the carrier for transportation shipped), sometimes the consignee, and sometimes a third party.
2. Often, different parties pay for different parts of the transportation (e.g., ocean freight versus terminal charges).
3. Shipping companies very often do not know the ultimate destination (or origin) of the cargo they transport, just the ports of loading or unloading, as illustrated further below.
4. Cargo loaded at a port is often consolidated and can originate in multiple countries unknown to the shipping company.
5. Cargo unloaded at a port can be destined to multiple countries unknown to the shipping company.
6. Even in the case of so-called "through bills of lading," where the shipping company knows where cargo is headed from the port by truck or train, the consignee is often a distributor or consolidator who may deliver the goods to multiple countries.

[5] OECD July 2021 *Highlights Brochure* at 16.
[6] In a recent OECD Podcast, a senior OECD official said, in justifying the Pillar Two international shipping carve-out, that "ships are in the middle of the ocean." That is how international shipping income should be sourced for Pillar One purposes.

7. The person who orders the transportation may be in Country 1, the person who pays for the transportation may be in Country 2, and the cargo may be transported between Country 3 and Country 4.
8. With large customers, the individual contracting with the carrier may be in Country 1 and the contract may cover multiple voyages between many countries over long periods of time. In one actual example, the customer's contracting individual was in Country 1 and the contract covered transportation involving 30 countries, none of which was Country 1.
9. In the liner shipping industry, one ship can carry up to 21,000 twenty-foot shipping containers filled with goods going to multiple ports in multiple countries and then beyond to multiple countries unknown to the shipping company. In one actual example, over a three-month period, a particular vessel makes 27 stops in eight European ports and eight Asian ports.
10. In the liner shipping industry, the shipper is often a consolidator or a so-called non-vessel operating common carrier who orders the shipment and then, after the goods are unloaded from the shipping container, causes the goods to be transported to multiple customers of the shipper, who are unknown to the shipping company, wherever they may be. In Europe, on average, approximately 65-70% of shipments are in this category.
11. In the liner and tanker shipping industries, there are numerous transshipment ports around the world where cargo originating in multiple countries is transferred from larger vessels to smaller vessels or from smaller vessels to larger vessels for further shipment to multiple other countries.
12. It is common for a shipping company A to time charter vessels to a shipping company B, which enters into contracts of affreightment to move cargo for third party customers. Shipping company A typically will have no knowledge in respect of company B's third party customers.
13. In an actual continuous cruise example for a single ship, passengers were from over 20 countries, embarking or disembarking in any of ten different ports, visiting over 40 countries, less than 8% of miles were spent in the territorial seas of such countries, and less than 2% of the miles were spent within the countries where passengers embarked and disembarked.
14. Allocating shipping income solely to port countries would be arbitrary and very distortive because the goods very often are ultimately shipped from the port countries to numerous other countries (or the goods very often originate in multiple countries). For example, goods unloaded in Rotterdam or Antwerp could be destined for delivery in a dozen or more European countries. Only in a relatively few (usually large) countries (e.g., the United States) would one think that the country of the port of unloading is usually also the country of the likely destination of the goods, although even in those cases there will be cases of onward movements to other countries (e.g., from a US port to consignees in Canada or Mexico). Thus, allocation solely to port countries would be distortive in that countries without ports would receive no allocation even though the goods could originate in, or be destined for, countries without ports.

We would submit that devising a revenue allocation key for international shipping would be a very complex task. Allocation based upon the location of the customer or the destination of the goods have too many unknowns. Allocation based upon the ports of loading or unloading would lead to distortive results. There are just too many unknowns such that any revenue key that we can think of that might be devised would be futile, because a shipping company and a tax authority would not be able to obtain the needed information in a very large percentages of cases, and thus the revenue key likely would produce arbitrary or distortive results.