August 22, 2014

Mr. Michael Lennard
Chief, International Tax Cooperation Section
Financing for Development Office
U.N. Dept. Of Economic and Social Affairs
2 U.N. Plaza
Room DC2-2148
New York, New York 100017

Dear Mr. Lennard:

Further to our conversation, we wish to offer our comments to the United Nations Committee of Experts on International Cooperation in Tax Matters for its consideration as it discusses changes to Article 8 of the United Nations Model Double Taxation Convention between Developed and Developing Countries. Our comments are limited to the application of the Convention to the passenger cruise industry with ptr TD .06Tion to the 1(mry with4 Tw [(2 U.N. Plaza)-6.9( )]th

passenger transport by sea has existed. Possibly the first recorded round trip sightseeing voyage was the circumnavigation of Africa by the Phoenicians at the request of Pharoah Necho II.[5]

In the “modern” era, regularly scheduled transatlantic passenger service began with the Black Ball Line in 1817 and various sources date the first international round trip cruise to approximately 1833. Amenities were added to cruise ships when a cow was boarded on Cunard’s Brittania to supply fresh milk to passengers. Cruising as transportation between locations for the purpose of sightseeing was greatly popularized in the book “Notes on a Journey from Cornhill to Grand Cairo” originally published in 1846 recounting the 1844 journey of W.M. Thackeray on P&O vessels.[6] From that point, cruise ships operated globally as the transportation choices were very limited – over land or by sea.

Commercial aviation ultimately became passenger shipping’s competitor when KLM began operations in 1919, Lufthansa (then Deutsche Luft Hansa) inaugurated scheduled service in 1926 and Pan American Airlines established scheduled mail and passenger service between Key West and Havana in 1927. As the cost of air transportation decreased and the speed of transportation increased, aviation surpassed cruising in passengers carried. Concurrently, with different classes of service certain ships and airlines were considered luxurious and others not.[7]

Whatever the perceived quality of transportation by both air and sea, then and now, each transports passengers from place to place, both domestically and internationally.

Against this background, development of conventions and statutes governing the taxation of international transportation of passengers can be appreciated. Historically, the primary means by which shipping has been taxed was (and is) upon the import anpe.4((and i.8(ed lu)-4.4(xurin2(ip)-4.2(ping <.4(

Mexico convention in 1943, the shipping article was modified to encompass the "operation of ships or aircraft" and the London model convention added "engaged in international transport" to the requirement for exemption from source country taxation.[23] This same provision was assumed by the OECD in its original 1963 draft convention.[24]

These same words, substantially unchanged since the 1943 League of Nations draft, define those operations to which Article 8 applies and the scope of the exemption afforded by the article in both the U.N. and O.E.C.D. model conventions today.

United Nations Article 8[25]	OECD Article 8[26]
SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT (Alternative A) 1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. 2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. 3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or a boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.	SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT 1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. 2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. 3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the

[23] [illegible]

[24] [illegible]

[25] [illegible]

[26] [illegible]

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

(Alternative B)

1. Profits from the operation of aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of ships in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated unless the shipping activities arising from such operation in the other Contracting State are more than casual. If such activities are more than casual, such profits may be taxed in that other State. The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by ___ per cent. (The percentage is to be established through bilateral negotiations.)

3. Profits from the operation of boats

At the time Alternative B was added to the UN Model Convention (1980), it was recognized that Alternative A was an incorporation of the existing provision of the OECD Model Convention.[28] Thus, the UN Model incorporates the language and interpretations of the 1977 OECD Model Convention.

<u>Application of the UN Convention to Passenger Shipping</u>

Before the original League of Nations model convention, there was only passenger and freight shipping. In no documented discussion of the development of this model is its application to passenger shipping questioned.

Thus, drawing on the history of the development of the exemption for shipping income it is apparent that income tax exemption has applied to both the carriage of passengers and freight between countries – even in the absence of a treaty. With the advent of commercial air travel, the concept of reciprocal exemption was extended to international air transportation.

The commonly accepted definition of a ship or vessel includes "every description of watercraft or other artificial contrivance, except aircraft, used or capable of being used as a means of transportation on water, whether or not it is actually afloat."[29] For United States federal regulatory purposes, a "passenger ship" is a ship that carries or is licensed to carry more than twelve passengers.[30] Other definitions include vessels of any type not permanently attached to the sea-bed, including submersibles. Klaus Vogel adequately summarized the definitions as "all means of transport moving or moved on or under water."[31] It would be challenging to exclude commercial passenger vessels of any type from the definition of a "ship."[32]

International traffic is defined in Article 3 of the UN and OECD Models as any transport by ship or aircraft, except when the ship or aircraft is operated solely between places in the other Contracting State.[33] The OECD commentary specifically addresses cruises that are included within the definition of "international traffic."[34] Elaborating on this paragraph, a recent ruling issued by the Australian Tax Office provides a thorough analysis of the application of this provision to passenger cruise ships.[35]

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31 [illegible]
32 [illegible]
33 [illegible]
34 [illegible]
35 [illegible]

Incorporation of the OECD view by the UN is evidenced by extensive quotation of the OECD commentary in the original iteration of modern UN Model Convention. Further, reservations to the OECD Model lodged by Australia and Canada to tax as internal traffic profits from the

5. The United States, in regulations, addresses passenger transport by ship extensively – stating that the international operation of ships includes the carriage of passengers or cargo on a voyage or flight.[41]

The only distinctions between freight and passenger vessels involve their technical operation and design. That is, except where the nature and construction of the vessel differs, each type of ship is treated the same for many purposes.[42] How the OECD Model Convention and Commentary characterize passenger shipping for income tax purposes is unquestionable. One of the stated objectives of the UN is to provide interpretive consistency between the UN and OECD model wherever possible – unless there is a particular national reason that they should diverge.[43]

<u>Ancillary Income</u>

Article 8 of both the UN and OECD Models applies to income from the “operation” of ships and aircraft. As is commonly understood, income from the operation of a ship or aircraft is considerably broader than merely income from the transportation of goods or passengers.[44]

We believe that the change in the OECD Commentary to the term “ancillary” to refer to other activities sufficiently closely connected to the operation of ships and aircraft was appropriate to avoid confusion with “preparatory or auxiliary” under Article 5 and encourage the United Nations to do the same.

The manner passengers are charged for services associated with their transportation has changed over time. There is variation as to the components charged between various shipping lines and various airlines regarding the manner in which this is accomplished. For example, is there a fundamental difference between transportation that includes meals and transportation where meals are charged separately and transportation priced inclusively? A discussion of the changes in the airline industry concerning charges for meals, baggage and others and a history of the changes was the subject of a recent news report.[45]

We also believe that the manner in which various shipping companies and airlines will operate in the future will continue to evolve with changes in regulation, technology and consumer preferences. Flexibility needs to be incorporated into any definition of the goods and services

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