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

INTRODUCTION

1. In 2012, the OECD Working Party 1 on Tax Conventions and Related Questions (which is the subgroup of the OECD Committee on Fiscal Affairs in charge of the OECD Model Tax Convention) undertook work in relation to Article 8 (Shipping, Inland Waterways Transport and Air Transport) and paragraph 3 of Article 15 (Income from Employment). That work was strictly limited to a modernisation of the wording of Article 8 and to addressing interpretation issues related to paragraph 3 of Article 15; it was not part of any comprehensive review of the treaty provisions applicable to international shipping and airline enterprises.

2. The changes that resulted from that work are aimed at reflecting the current treaty practices of the majority of OECD and non-OECD countries. A review of the preferences of the OECD and non-OECD countries that participated in the work of Working Party 1 revealed that:

> The vast majority of countries preferred the alternative provision included in paragraph 2 of the Commentary on Article 8 of the OECD Model, which provides for exclusive taxation in the State of the enterprise (State of residence), over paragraph 1 of Article 8, which provides for exclusive taxation in the State in which the place of effective management of the enterprise is situated. This is relevant for Article 8 (alternative A) and Article 8 (alternative B) of the UN Model as both alternatives refer to the State in which the place of effective management of the enterprise is situated.
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> Few countries, and very few outside Europe, wish to include in their treaties the provisions of paragraph 2 of Article 8 dealing with profits from the operation of boats engaged in inland waterways transport. This is relevant for Article 8 (alternative A) and Article 8 (alternative B) of the UN Model as both alternatives include a provision similar to that paragraph.

3. The changes to paragraph 3 of Article 15 are intended to address interpretation

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domestic law of many countries does not allow them to tax non-resident employees simply because the employer has its residence or place of effective management in these countries, which means that these countries cannot, in effect, exercise the taxing right provided for in paragraph 3 of Article 15. All these conclusions are relevant for Art. 15(3) of the UN Model.

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subparagraph 3 *e*) of Article 3, to paragraph 2 of Article 6 and to paragraph 3 of Articles 13 and 22 as a consequence of the changes to Article 8 and to paragraph 3 of Article 15. These changes would also be relevant for the equivalent provisions of the UN Model.

5. This note includes the changes to the OECD Model Tax Convention that resulted from the work of the Working Party on these issues. A first version of these changes was included in a discussion draft that was released by the OECD on 15 November 2013;[1] this note reflects the latest version of the changes, which the Working Party expects to finalise at its next meeting. Changes to the existing text of the OECD Model appear in ***bold italics*** for additions and strikethrough 4>5004F00031( )el7(xt -3(on)-(.)-9( )-1299)-5(or)0(a)-i3(oy)and 1299r

property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

13. Replace paragraph 3 of Article 15 by the following:

3. Notwithstanding the preceding provisions of this Article, remuneration derived ***by a resident of a Contracting State*** in respect of an employment***, as a member of the regular complement of a ship or aircraft, that is*** exercised aboard a ship or aircraft operated in international traffic, ***other than aboard a ship or aircraft operated solely within the other Contracting State,*** ~~, or aboard a boat engaged in inland waterways transport ,~~***shall be taxable only in the first-mentioned State*** ~~may be taxed in the Contracting State in which the place of effective management of the enterprise is situated~~***.***

14. Replace paragraph 3 of Article 22 by the following:

3. ~~Capital represented by ships and aircraft operated in international traffic and by boats engaged in inland waterways transport, and by movable property pertaining to~~

~~Contracting State,~~ except when such transport is solely between places in ~~the other~~***a*** Contracting State ***and the enterprise that operates the ship or aircraft is not an enterprise of that State***;

6.***4***~~3~~ ~~to a transport by an enterprise which has its place of effective management in one Contracting State~~ when ***a***~~the~~ ship or aircraft is operated between two places in ~~the other State~~***a Contracting State and the enterprise that operates the ship or aircraft is not an enterprise of that State***

3.1

~~16.1 Paragraphs 4 to 14 above provide guidance with respect to the profits that may be considered to be derived from the operation of ships or aircraft in international traffic. The principles and examples included in these paragraphs are applicable, with the necessary adaptations, for purposes of determining which profits may be considered to be derived from the operation of boats engaged in inland waterways transport.~~

~~17. The provision does not prevent specific tax problems which may arise in connection with inland waterways transport, in particular between adjacent countries, from being settled specially by bilateral agreement.~~

17. Whilst the above alternative provision uses the word "boat" with respect to inland waterways transport, this reflects a traditional distinction that should not be interpreted to restrict in any way the meaning of the word "ship" used throughout the Convention, which is intended to be given a wide meaning that covers any vessel used for water navigation.

1***8***~~7.1~~ It may also be agreed bilaterally that profits from the operation of vessels engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article.

Enterprises not exclusively engaged in shipping or air transport

18. It follows from the wording of paragraph~~s~~ 1 ~~and 2~~ that enterprises not exclusively engaged in shipping~~, inland waterways transport~~ or air transport nevertheless come within the provisions of th***is*** paragraph~~s~~ as regards profits arising to them from the operation of ships~~, boats~~ or aircraft belonging to them.

19. If such an enterprise has in a foreign country permanent establishments exclusively concerned with the operation of its ships or aircraft, there is no reason to treat such establishments differently from the permanent establishments of enterprises engaged exclusively in shipping~~, inland waterways transport~~ or air transport.

20. Nor does any difficulty arise in applying the provisions of paragraph~~s~~ 1 ~~and 2~~ if the enterprise has in another State a permanent establishment which is not exclusively engaged in shipping~~, inland waterways transport~~ or air transport. If its goods are carried in its own ships to a permanent establishment belonging to it in a foreign country, it is right to say that none of the profit obtained by the enterprise through acting as its own carrier can properly be taxed in the State where the permanent establishment is situated. The same must be true even if the permanent establishment maintains installations for operating the ships or aircraft (e.g. consignment wharves)

ods (e.g. staff costs). In this case, even though certain functions related to the operation of ships and aircraft in international traffic may be performed by the permanent establishment, the profits attributable to these functions are taxable exclusively in the State ~~where the~~

third State. As explained in paragraph 6.1 of the Commentary on Article 3, this last change allows the application of paragraph 3 of Article 15 to a resident of a Contracting State who derives remuneration from employment exercised aboard a ship or aircraft operated by an enterprise of a third State.

9.2 Where, however, the employment is exercised by a resident of a Contracting State aboard a ship or aircraft operated solely within the other State, it would clearly be inappropriate to grant an exclusive right to tax to the State of residence of the employee. The phrase "other than aboard a ship or aircraft operated solely within the other Contracting State" ensures that the paragraph does not apply to such an employee, which means that the taxation of the remuneration of that employee is covered by the provisions of paragraphs 1 and 2 of the Article.

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such remuneration may also be taxed in the first-mentioned State if it is derived by a resident of that State.

9.8 According to the alternative provision in paragraph 9.6 above, the Contracting State of the enterprise has the primary right to tax the remuneration of the employee. Where the employee is a resident of the other Contracting State, the remuneration may also be taxed in that other State, subject to the obligation of that State to provide relief of double taxation under the provisions of Article 23 A or 23 B.

9.9 Since that alternative provision allows taxation in the State of the enterprise that operates the ship or aircraft, it may help to address the situation of employees who work extensively aboard ships or aircraft operated in international traffic and who may find it advantageous to establish their residence in States that levy no or little tax on the employment income derived from such work performed outside their territory. The provision assumes, however, that the Contracting States have the possibility, under their domestic law, to tax the remuneration of employees working aboard ships or aircraft operated in international traffic solely because the enterprises that operate these ships or aircraft are enterprises of these States. Where this is not the case, the use of that provision in combination with the exemption method for the elimination of double taxation would create a risk of non-taxation. Assume, for instance, that the above provision has been included in a treaty between States R and S, that State R follows the exemption method and that an employee who is a resident of State R works on flights between State R and third States operated by an airline that is an enterprise of State S. In that case, if the domestic law of State S does not allow State S to tax the remuneration of employees of the airline who are not residents of, and do not work in, State S, State S will be unable to exercise the taxing right that has been allocated to it but State R will be required to exempt such remuneration because, under the provisions of the Convention, State S has the right to tax that remuneration.

9.10 *[the following is the last part of existing paragraph 9]* ***As explained in paragraph 3.1 of the Commentary on Article 8, it may be provided that the reference to the "place of effective management" in the alternative provision in*** paragraph ***2*** of ***that Commentary***