

Distr.: General
4 December 2016

Original: English

**Committee of Experts on International
Cooperation in Tax Matters
Thirteenth Session**

New York, 5-8 December 2016

Agenda item 3 (a) (i) of the provisional agenda

**Article 8 (Shipping, inland waterways transport and air transport):
“profits from the operation of ships or aircraft in international traffic”**

Secretariat Note: Proposed Changes to the UN Model Double Taxation
Convention Commentary on Articles 3 and 8

Summary

This paper represents proposed changes to the Commentary on Articles 3 (Part A of the paper) and 8 (Part B of the paper) of the UN Model Double Taxation Convention as a result of discussions in the *Subcommittee on Article 8: International Transportation Issues*. The paper includes proposed changes presented at the twelfth session of the Committee in October 2016, and fresh proposals made to the thirteenth session.

While this paper is almost entirely the consensus work of that Subcommittee, there are some unconcluded discussions in the Subcommittee and this paper should therefore not be taken as necessarily reflecting consensus decisions in every respect. The paper is presented for the guidance and agreement of the Committee, with a view to including updated commentary to Articles 3 and 8 in the forthcoming update of the UN Model Tax Convention.

This paper addresses issues related to, but distinct from, the issues dealt with in agenda item 3 (a) (ii) – Presentation by OECD representative on OECD Model changes relating to international traffic and possible similar changes to the UN Model – and its accompanying paper ([E/C.18/2016/CRP.17](#))

Part B: Proposed Change to Commentary on Article 8 (with deletions in ~~strikeout~~ and additions highlighted in **bold text**. *Italicised bold text* represents text new to this session)

Article 8

SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT

A. General considerations

1. Two alternative versions are given for Article 8 of the United Nations Model Convention,

E/C.18/201

Artic0.58

~~covers other classes of profits as well, i.e. those which by reason of their nature or their close relationship with the profits directly obtained from transport may all be placed in a single category. Some of these classes of profits are mentioned in the following paragraphs [quoted paragraph 4 is taken from the Commentary on Article 8 as it read in the 2003 version of the OECD Model Convention].~~

[Note to Committee: removed to UN Commentary para 10.1 below in its updated form]

10.1 Referring to the meaning of the term “profits from the operation of ships or aircraft in international traffic”, the Commentary on the 2014 OECD Model Convention sets down two categories of profits which should fall within the scope of paragraph 1 of Article 8. The first relates to profits directly obtained by the enterprise from the carriage of passengers or cargo in international traffic, and the second to profits from activities to permit, facilitate or support international traffic operations. Within the second category the Commentary distinguishes two different types of activities: those directly connected with such operations and those not directly connected but “ancillary” to such operations. The Commentary notes as follows:

4. The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise’s ships or aircraft in international traffic as long as they are ancillary to such operation.

4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.

4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.

11. Applying the principles set out above, the Commentary on the 2003~~2014~~

will apply when those activities are carried on by an enterprise engaged in the operation of ships or aircraft in international traffic. The Commentary notes as follows:

5.

international traffic or is an ancillary activity. One example would be that of an enterprise engaged in international transport that would have some of its

enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers.

~~11. On the other hand, the provision does not cover a clearly separate activity such as the keeping of a hotel as a separate business; the profits from such an establishment are in any case easily determinable. In certain cases, however, circumstances are such that the provision must apply even to a hotel business e.g. the keeping of a hotel for no other purpose than to provide transit passengers with night accommodation, the cost of such a service being included in the price of the passage ticket. In such a case, the hotel can be regarded as a kind of waiting room.~~

~~12. There is another activity which is excluded from the field of application of the provision, namely~~

10. An enterprise that has assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic may derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground and equipment maintenance staff, cargo handlers, catering staff and customer services personnel. Where the enterprise provides such goods to, or performs services for, other enterprises and such activities are directly connected or ancillary to the enterprise's operation of ships or aircraft in international traffic, the profits from the provision of such goods or services to other enterprises will fall under the paragraph.

10.1 For example, enterprises engaged in international transport may enter into pooling arrangements for the purposes of reducing the costs of maintaining facilities needed for the operation of their ships or aircraft in other countries. For instance, where an airline enterprise agrees, under an International Airlines Technical Pool agreement, to provide spare parts or maintenance services to other airlines landing at a particular location (which allows it to benefit from these services at other locations), activities carried on pursuant to that agreement will be ancillary to the operation of aircraft in international traffic.

11. [Deleted]

12. The paragraph does not apply to a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country.

~~13. It may be agreed bilaterally that profits from the operation of a vessel engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article.~~

~~14. Investment income of shipping, inland waterways or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment~~

13. [Renumbered]

14. Investment income of shipping or air transport enterprises (e.g. income from stocks, bonds, shares or loans) is to be subjected to the treatment ordinarily applied to this class of income, except where the investment that generates the income is made as an integral part of the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State so that the investment may be considered to be directly connected with such operation. Thus, the paragraph would apply to interest income generated, for example, by the cash required in a Contracting State for the carrying on of that business or by bonds posted as security where this is required by law in order to carry on the business: in such cases, the investment is needed to allow the operation of the ships or aircraft at that location. The paragraph would not apply, however, to interest income derived in the course of the handling of cash-flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralisation of treasury and investment activities), nor would it apply to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.

14.1 Enterprises engaged in the operation of ships or aircraft in international traffic may be required to acquire and use emissions permits and credits for that purpose (the nature of these permits and credits is explained in paragraph 75.1 of the Commentary on Article 7). Paragraph 1 applies to income derived by such enterprises with respect to such permits and credits where such income is an integral part of

[Secretariat Suggestion to the Subcommittee and Committee: If this last sentence is retained, the more usual form for the Model would be something like: “

be based on some proportional factor specified in the bilateral negotiations, preferably the factor of outgoing freight receipts (determined on a uniform basis with or without the deduction of commissions). The percentage reduction in the tax computed on the basis of the allocated profits is intended to achieve a sharing of revenues that would reflect the managerial and capital inputs originating in the country of residence.

23. Various forms of international co-operation exist in shipping or air transport. In this field international co-operation is secured through pooling agreements or other conventions of a similar kind which lay down certain rules for apportioning the receipts (or profits) from the joint business.

24. In order to clarify the taxation position of the participant in a pool, joint business or in an international operating agency and to cope with any difficulties which may arise the Contracting States may bilaterally add the following, if they find it necessary:

to the participant in

proportion to its share in the joint operation.