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Changes to the UN Model Double Taxation Convention Dealing with the Operation of Ships and Aircraft in International Traffic

CHANGES TO THE UN MODEL DOUBLE TAXATION CONVENTION DEALING WITH THE OPERATION OF SHIPS AND AIRCRAFT IN INTERNATIONAL TRAFFIC

INTRODUCTION

1. The Committee of Experts on International Cooperation in Tax Matters, during its 10th Session held in Geneva in 2014, decided to establish the Subcommittee on Article 8: International Transportation Issues. The Subcommittee was mandated to report to the Committee, beginning at the eleventh session, in 2015, on possible updates to the Commentary on Article 8 of the UN Model Convention, in particular the coverage of the concept of "auxiliary activities" and the issue of the application of article 8 to cruise shipping.

2. At its 13th Session held in New York in December 2016, the Committee discussed and finally approved proposed amendments to the UN Commentary concerning application of Article 8 of the UN Model Convention to the above-mentioned issues, in particular:

- the amendment to the Commentary on Article 3 paragraph 1(d) – especially concerning the understanding of the term "stop in a foreign port" ,

- the amendment to the Commentary on Article 8 on the term "profits from the operation of ships and aircraft in the international traffic", and

- the text of the minority view on the scope of the term "ancillary activities".

3. Additionally the issues of whether other OECD changes to the Model and Commentary may be relevant to the UN Model Convention were outlined in an OECD Paper for the thirteenth session (E/C.18/2016/CRP.17). The Committee had an initial discussion of some aspects of that paper and decided to return to that at the fourteenth session.

CHANGES TO THE UN MODEL DOUBLE TAXATION CONVENTION

4. This note includes the following changes to the UN Model Convention and the Commentary:

- amendments to the Commentary on paragraph 8 of Article 3 concerning cruise shipping, paragraphs 10 and 11 of Article 8 on the term “profits from the operation of ships and aircraft in the international traffic“ and addition of paragraph 11.1 concerning the minority view on the scope of the term “ancillary activities”, which have been already approved by the Committee; and

- proposals for the amendments on paragraph 1(d) of Article 3, paragraph 2 of Article 6, Article 8 (alternative A and B), paragraph 3 of Article 13, paragraph 3 of Article 15, paragraph 3 of Article 22 of the UN Model Convention and the relevant changes to the Commentary on Articles 3, 8 and 15, for the discussion and decision by the Committee.

5. The above-mentioned proposals reflect OECD work on the new changes to the OECD Model Tax Convention, in particular:

- change of the definition of the international traffic,

- the taxation of the profits from the operation of ships and aircraft in international traffic in the state of the enterprise (departure from the taxation in the state of effective management) and the application of the same rule respectively to capital gains and capital taxes,

- exclusion of the inland waterways transport from Article 8, and

- taxation of the remuneration of crews of ships and aircraft operated in international traffic only in the state of residence of the employee.

6. Changes to the existing text of the UN Model Convention appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions. Whilst a number of purely consequential changes will also be made to the Introduction and the Commentary when these changes are adopted

(e.g. to remove the references to boats engaged in inland waterways transport and to replace phrases such as “the State in which the place of effective management of the enterprise” is situated), these consequential changes do not appear below.

Changes to the Articles

7. Replace paragraph 1 (d) of Article 3 by the following:

> (d) The term “international traffic” means any transport by a ship or aircraft ~~operated by an enterprise that has its place of effective management in a Contracting State~~, except when the ship or aircraft is operated 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***;

8. Replace paragraph 2 of Article 6 by the following:

> 2. The term “immovable property” shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, ~~boats~~ and aircraft shall not be regarded as immovable property.

9. Replace Article 8 by the following:

Article 8

INTERNATIONAL SHIPPING~~, INLAND WATERWAYS TRANSPORT~~ AND AIR TRANSPORT

Article 8 *(alternative A)*

1. Profits ***of an enterprise of a Contracting State*** from the operation of ships or aircraft in international traffic shall be taxable only in ~~the Contracting~~***that*** 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.~~

2~~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.

Article 8 *(alternative B)*

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

2. Profits ***of an enterprise of a Contracting State*** from the operation of ships in international traffic shall be taxable only in ~~the Contracting~~ ***that*** 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 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.~~

~~4. 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 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.~~

3~~5~~. The provisions of paragraphs 1 and 2 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

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

3. ~~Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.~~ ***Gains that an enterprise of a Contracting State that operates ships or aircraft in international traffic derives from the alienation of such ships or aircraft, or from movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.***

11. 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~~***.***

12. 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 the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.~~ ***Capital of an enterprise of a Contracting State that operates ships or aircraft in international traffic represented by such ships or aircraft, and by movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.***

Changes to the Commentary

13. Replace paragraphs 7 and 8 of the Commentary on Article 3 by the following:

> 7. The definition of the "international traffic" is based on the principle that the right to tax profits ***of an enterprise of a Contracting State*** arising from the operation of ships or aircraft in international traffic resides only in ~~the Contracting~~ ***that*** State ~~in which the place of effective management is situated~~. This principle is set forth in Article 8 (alternative A), paragraph 1 (corresponding to Article 8, paragraph 1, of the OECD Model Convention), and in Article 8 (alternative B), paragraph 1, and the first sentence of paragraph 2 (provided in the latter case that the shipping activities concerned are not more than casual). However, the Contracting States may agree on a bilateral basis to substitute a reference to ~~residence~~ ***the State in which the place of effective management of the enterprise is situated*** in subparagraph (d) if appropriate to conform to the general tenor of the other articles relating to international traffic. In such cases, as noted in the Commentary on the OECD Model Convention, ~~"the words 'an enterprise that has its place of effective management in a Contracting State' should be replaced by 'an enterprise of a Contracting State' or 'a resident of a Contracting State'"~~ ***the definition should read: "the term 'international traffic' means any transport by a ship or aircraft except when the ship or aircraft is operated solely between places in a Contracting State in which the enterprise that operates the ship or aircraft does not have its place of effective management."***
>
> 8. As also noted in the OECD Commentary, "[t]he definition of the term 'international traffic' is broader than the term is normally understood [in order] to

preserve for the State of the ***enterprise*** ~~place of effective management~~ the right to tax purely domestic traffic as well as international traffic between third States, and to allow the other Contracting State to tax traffic solely within its borders". ***A ship or aircraft is operated solely between places in the other Contracting State in relation to a particular voyage if the place of departure and the place of arrival of the ship are both in that other Contracting State. Thus, for example, a cruise beginning and ending in that other Contracting State without a stop in a foreign port does not constitute a transport of passengers in international traffic. Conversely, a cruise beginning and ending in that other Contracting State with a stop in a foreign port constitutes a transport of passengers in international traffic and for this purpose a "stop" has taken place if passengers are permitted to go ashore, even temporarily, but only at a scheduled intermediate destination.***

8.1 The OECD Commentary also explains that "[t]he definition was amended in 2017 to ensure that it also applied to a transport by a ship or aircraft operated by an enterprise of a third State. Whilst this change does not affect the application of Article 8, which only deals with profits of an enterprise of a Contracting State, it 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."

14. Replace paragraphs 2, 5 to 11 and 14 to 19 of the Commentary on Article 8, and the headings above these paragraphs, by the following:

2. With regard to the taxation of profits from the operation of ships in international traffic, many countries support the position taken in Article 8 (alternative A). In their view, shipping enterprises should not be exposed to the tax laws of the numerous countries to which their operations extend~~; taxation at the place of effective management was also preferable from the viewpoint of the various tax administrations~~. They argued that if every country taxed a portion of the profits of a shipping line, computed according to its own rules, the sum of those portions might well exceed the total income of the enterprise. Consequently, that would constitute a serious problem, especially because taxes in developing countries could be excessively high, and the total profits of shipping enterprises were frequently quite modest.

5. ***Until 2017***, ~~Although~~ the texts of Article 8 (alternatives A and B) both refer***red*** to the "place of effective management of the enterprise". ***Taking into account the***

practice of most countries, the Committee of Experts then decided to follow the wording of other Articles and to refer instead to an "entreprise of a Contracting State" and the Article (alternatives A and B) was changed accordingly. S~~s~~ome countries may, ***however***, ***prefer to continue to use the previous formulation and*** ~~wish~~ to refer ~~instead~~ to the "State of ~~residence of the enterprise~~ ***in which the place of effective management of the enterprise is situated***".

6. Although there was a consensus to recommend Articles 8 (alternatives A and B) as alternatives, some countries who could not agree to Article 8 (alternative A) also could not agree to Article 8 (alternative B) because of the phrase "more than casual". They argued that some countries might wish to tax either all shipping profits or all airline profits, and acceptance of Article 8 (alternative B) might thus lead to a revenue loss, considering the limited number of shipping companies or airlines ***that are enterprises of those States*** ~~whose effective management was situated in those countries~~. Again, in such cases taxation should be left to bilateral negotiations.

7. Depending on the frequency or volume of cross-border traffic, countries may, during bilateral negotiations, wish to extend the provisions of Article 8 to cover rail or road transport. ***As explained in paragraph 15 below, they may also want to cover inland waterways transport.***

8. [EXISTING PARAGRAPH 8 HAS BEEN MOVED TO PARAGRAPH 15.1]

Paragraph 1 of Article 8 (alternative A)

9. This paragraph, which reproduces Article 8, paragraph 1, of the ***2017*** OECD Model Convention, has the objective of ensuring that profits from the operation of ships or aircraft in international traffic will be taxed in one State alone. The paragraph's effect is that these profits are wholly exempt from tax at source and are taxed exclusively in the ***Contracting*** State ~~in which the place of effective management~~ of the enterprise engaged in international traffic ~~is situated~~. It provides an independent operative rule for these activities and is not qualified by Articles 5 and 7 relating to business profits governed by the permanent establishment rule. The exemption from tax in the source country is predicated largely on the premise that the income of ***shipping*** enterprises is earned on the high seas, that exposure to the tax laws of numerous countries is likely to result in double taxation or at best in difficult allocation problems, and that exemption in places other than the home country ensures that the enterprises will not be taxed in foreign countries if their overall operations turn out to be unprofitable. Considerations relating to international air traffic are similar. Since a number of countries with water boundaries do not have

resident shipping companies but do have ports used to a significant extent by ships from other countries, they have traditionally disagreed with the principle of such an exemption of shipping profits and would argue in favour of alternative B.

10. The Commentary on the OECD Model Convention notes that ~~the place of effective management may be situated in a country different from the country of residence of an enterprise operating ships or aircraft and that "[…] some States therefore prefer to confer the exclusive taxing right on the State of residence". The Commentary suggests that States may, in bilateral negotiations, substitute a rule on the following lines: "Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State." The Commentary continues~~ ***while paragraph 1 is based on the principle that the taxing right shall be left to the Contracting State the enterprise, . some countries may wish to refer instead to the place of effective management of the enterprise and draft the paragraph along the following lines:***

> ***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.***

> ~~3. Some other States, on the other hand, prefer to use a combination of the residence criterion and the place of effective management criterion by giving the primary right to tax to the State in which the place of effective management is situated while the State of residence eliminates double taxation in accordance with Article 23, so long as the former State is able to tax the total profits of the enterprise, and by giving the primary right to tax to the State of residence when the State of effective management is not able to tax total profits. States wishing to follow that principle are free to substitute a rule on the following lines:~~

> > ~~Profits of an enterprise of a Contracting State from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the other Contracting State, shall be taxable only in the first-mentioned State. However, where the place of effective management of the enterprise is situated in the other State and that other State imposes tax on the whole of the profits of the enterprise from the operation of ships or aircraft, the profits from the operation of ships or aircraft, other than those from transport by ships or aircraft operated solely between places in the first-mentioned State, may be taxed in that other State.~~

~~4. The profits covered consist in the first place of the profits obtained by the enterprise from the carriage of passengers or cargo. With this definition, however, the provision would be unduly restrictive, in view of the development of shipping and air transport, and for practical considerations also. The provision therefore 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].~~

10.1 Countries wishing to refer to the "place of effective management of the enterprise" in paragraph 1 may also want to deal with the particular case where the place of effective management of the enterprise is aboard a ship, which could be done by adding the following provision:

> ***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 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*** [EXISTING PARAGRAPH 3 OF ARTICLE 8 (ALTERNATIVE A) AND PARAGRAPH 4 OF ARTICLE 8 (ALTERNATIVE B)].

10.2 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*** OECD Model Convention deals with a number of activities in relation to the extent to which paragraph 1 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. Profits obtained by leasing a ship or aircraft on charter fully equipped, ~~manned~~***crewed*** and supplied must be treated like the profits from the carriage of passengers or cargo. Otherwise, a great deal of business of shipping or air transport would not come within the scope of the provision. However, Article [12], and not Article 8, applies to profits from leasing a ship or aircraft on a bare boat charter basis except when it is an ~~occasional source of income for~~***ancillary activity of*** an enterprise engaged in the international operation of ships or aircraft.

6. ~~The principle that the taxing right should be left to one Contracting State alone makes it unnecessary to devise detailed rules, e.g. for defining the profits covered, this being rather a question of applying general principles of interpretation.~~ ***Profits derived by an enterprise from the transportation of passengers or cargo otherwise than by ships or aircraft that it operates in international traffic are covered by the paragraph to the extent that such transportation is directly connected with the operation, by that enterprise, of***

ships or aircraft in 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 passengers or cargo transported internationally by ships or aircraft operated by other enterprises, e.g. under code-sharing or slotchartering arrangements or to take advantage of an earlier sailing. Another example would be that of an airline company that operates a bus service connecting a town with its airport primarily to provide access to and from that airport to the passengers of its international flights.

7. ~~Shipping and air transport enterprises – particularly the latter – often engage in additional activities more or less closely connected with the direct operation of ships and aircraft. Although it would be out of the question to list here all the auxiliary activities which could properly be brought under the provision, nevertheless a few examples may usefully be given.~~ ***A further example would be that of an enterprise that transports passengers or cargo by ships or aircraft operated in international traffic which undertakes to have those passengers or that cargo picked up in the country where the transport originates or transported or delivered in the country of destination by any mode of inland transportation operated by other enterprises. In such a case, any profits derived by the first enterprise from arranging such transportation by other enterprises are covered by the paragraph even though the profits derived by the other enterprises that provide such inland transportation would not be.***

8. ~~The provision applies, inter alia, to the following activities:~~
~~a) the sale of passage tickets on behalf of other enterprises;~~
~~b) the operation of a bus service connecting a town with its airport;~~
~~c) advertising and commercial propaganda;~~
~~d) transportation of goods by truck connecting a depot with a port or airport.~~

8. An enterprise will frequently sell tickets on behalf of other transport enterprises at a location that it maintains primarily for purposes of selling tickets for transportation on ships or aircraft that it operates in international traffic. Such sales of tickets on behalf of other enterprises will either be directly connected with voyages aboard ships or aircraft that the enterprise operates (e.g. sale of a ticket issued by another enterprise for the domestic leg of an international voyage offered by the enterprise) or will be ancillary to its own sales. Profits derived by the first enterprise from selling such tickets are therefore covered by the paragraph.

8.1 Advertising that the enterprise may do for other enterprises in magazines offered aboard ships or aircraft that it operates or at its business locations (e.g. ticket offices) is ancillary to its operation of these ships or aircraft and profits generated by such advertising fall within the paragraph.

~~9. If an enterprise engaged in international transport undertakes to see to it that, in connection with such transport, goods are delivered directly to the consignee in the other Contracting State, such inland transportation is considered to fall within the scope of the international operation of ships or aircraft and, therefore, is covered by the provisions of this Article.~~

~~9~~10. ~~Recently, "containerisation" has come to play an increasing role in the field of~~ ***Containers are used extensively in*** international transport. Such containers frequently are also used in inland transport. Profits derived by an enterprise engaged in international transport from the lease of containers which ~~is supplementary or incidental to its international operation of ships or aircraft fall within the scope of this Article~~ ***are usually either directly connected or ancillary to its operation of ships or aircraft in international traffic and in such cases fall within the scope of the paragraph. The same conclusion would apply with respect to profits derived by such an enterprise from the short-term storage of such containers (e.g. where the enterprise charges a customer for keeping a loaded container in a warehouse pending delivery) or from detention charges for the late return of containers.***

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]*** ~~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~~ ***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.***[Renumbered]*** ~~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 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 carrying on the business of operating ships or aircraft in international traffic, e.g. where permits are acquired for the purpose of operating ships or aircraft or where permits acquired for that purpose are subsequently traded when it is realised that they will not be needed.

11.1 Some members do not fully agree with the interpretation of "profits from the operation of ships or aircraft in international traffic" in paragraphs 10.~~1~~2 and 11 of this Commentary. Some of those members consider that activities of an ancillary nature are not covered by the text of Article 8 as such activities are not mentioned in the text of that article of the United Nations Model Convention. Others consider that only some of the examples given in the OECD Commentary quoted above will not fall within the definition of "profits from the operation of ships or aircraft in international traffic". Conflicting interpretations that may arise in such cases should be addressed bilaterally.

Paragraph 2 of Article 8 (Alternative B)

14. The overall net profits should, in general, be determined by the authorities of the ***State*** ~~country in which the place of effective management~~ of the enterprise ~~is situated~~ (or country ***in which the place of effective management of the enterprise is situated*** ~~of residence~~). The final conditions of the determination might be decided in bilateral negotiations. In the course of such negotiations, it might be specified, for example, whether the net profits are to be determined before the deduction of special allowances or incentives which could not be assimilated to depreciation allowances but could be considered rather as subsidies to the enterprise. It might also be specified in the course of the bilateral negotiations that direct subsidies paid to the enterprise by a Government should be included in net profits. The method for the recognition of

any losses incurred during prior years, for the purpose of the determination of net profits, might also be worked out in the negotiations. In order to implement that approach, the country of residence would furnish a certificate indicating the net shipping profits of the enterprise and the amounts of any special items, including prior-year losses, which in accordance with the decisions reached in the negotiations were to be included in, or excluded from, the determination of the net profits to be apportioned or otherwise specially treated in that determination. The allocation of profits to be taxed might 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.

~~Paragraph 2 of Article 8 (alternative A) and paragraph 3 of Article 8 (alternative B)~~

Operation of boats engaged in inland waterways transport

15. ~~Each of these paragraphs reproduces Article 8, paragraph 2, of the OECD Model Convention. The paragraphs apply not only to inland waterways transport between two or more countries but also to inland waterways transport effected by an enterprise of one country between two points in another country. Countries are free to settle any specific tax problem which may occur with regard to inland waterways transport, particularly between adjacent countries, through bilateral negotiations.~~ ***Countries wishing to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic can do so by including the following provision in their bilateral treaties:***

> ***Profits of an enterprise of a Contracting State from the operation of boats engaged in inland waterways transport shall be taxable only in that State.***

15.1 [THE FOLLOWING REPRODUCES PARAGRAPH 8] Some countries***, however,*** consider that the activity of transport carried out in inland waters, by definition, cannot be considered international transport and, by virtue of that, the fiscal or tax power should be attributed exclusively to the source country in which the activities are carried out. Since ~~Article 8~~***the above alternative provision*** deals with ~~"Shipping,~~ inland waterways transport ~~and air transport"~~, obviously all three modes of transport dealt with in ~~this~~ Article ***8*** involve problems of double taxation. Income

derived from inland waterways transport is also subject to double taxation if a river or lake used for commercial transportation flows from more than one country with the headquarters of the establishment in one country and traffic originating in more than one country. Hence, it is possible that inland waterways transport would give rise to problems of double taxation.

16. The rules set out in paragraphs ***9***~~8~~ to ~~10~~***11.1*** above relating to taxing rights and profits covered apply equally to ~~this paragraph~~ ***the alternative provision set forth in paragraph 15 above***. ***The 2017 Commentary on the OECD Model Convention also notes as follows***:

> 16. ~~The object of this paragraph is to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic. The provision applies not only to inland waterways transport between two or more countries, but also to inland waterways transport carried on by an enterprise of one country between two points in another country.~~***The above provision would apply not only to inland waterways transport between two or more countries (in which case it would overlap with paragraph 1), but also to inland waterways transport carried on by an enterprise of one State between two points in another State. The alternative formulation set forth in paragraph 2 above according to which the taxing right would be granted to the State in which the place of effective management of the enterprise is situated also applies to the above provision. If this alternative provision is used, it would be appropriate to add a reference to "boats engaged in inland waterways transport" in paragraph 3 of Articles 13 and 22 in order to ensure that such boats are treated in the same way as ships and aircraft operated in international traffic (see also paragraph 9.3 of the Commentary on Article 15). Also, the principles and examples included in paragraphs 4 and 14 above would be 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. Specific tax problems which may arise in connection with inland waterways transport, in particular between adjacent countries, could also be settled specially by bilateral agreement.***
>
> ~~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~~, inland waterways transport and~~ or air transport.

17. With regard to enterprises not exclusively engaged in shipping~~, inland waterways transport~~ or air transport, the Commentary on Article 8~~, paragraph 2,~~of the ***2017*** OECD Model Convention observes:

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 ~~these~~ ***this*** 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) or incurs other costs in connection with the carriage of the enterprise's goods (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 place of effective management of~~ ***to which*** the enterprise ***belongs*** ~~is situated~~. Any expenses, or part thereof, incurred in performing such functions must be deducted in computing that part of the profit that is not taxable in the State where the permanent establishment is located and will not, therefore, reduce the part of the profits attributable to the permanent establishment which may be taxed in that State pursuant to Article 7.

21. Where ships or aircraft are operated in international traffic, ***the application of the alternative formulation in paragraph [10]*** above ~~Article~~ to the profits arising from such operation will not be affected by the fact that the ships or aircraft are operated by a permanent establishment which is not the place of effective management of the whole enterprise; thus, even if such profits could be attributed to the permanent establishment under Article 7, they will only be taxable in the State in which the place of effective management of the enterprise is situated […].

~~Paragraph 3 of Article 8 (alternative A) and paragraph 4 of Article 8 (alternative B)~~

~~18.~~ ***[Deleted]*** ~~Each of these paragraphs, which reproduce Article 8, paragraph 3, of the OECD Model Convention, refers to the case in which the place of effective management of the enterprise concerned is aboard a ship or a boat. As noted in the Commentary on the OECD Model Convention:~~

> ~~22. […] In this case tax will only be charged by the State where the home harbour of the ship or boat is situated. It is provided that if the home harbour cannot be determined, tax will be charged only in the Contracting State of which the operator of the ship or boat is a resident.~~

Paragraph ~~4~~ 2 of Article 8 (alternative A) and paragraph ~~5~~ 3 of Article 8 (alternative B)

19. Paragraph ~~4~~ ***2*** of Article 8 (alternative A) reproduces Article 8, paragraph ~~4~~ ***2***, of the OECD Model Convention. Paragraph ~~5~~ ***3*** of Article 8 (alternative B) also reproduces the latter paragraph, with one adjustment, namely, the replacement of the phrase "paragraph 1" by the words "paragraphs 1 and 2". As the Commentary on the OECD Model Convention observes:

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:

> … but only to so much of the profits so derived as is attributable to the participant in proportion to its share in the joint operation.

15. In paragraph 1 of the Commentary on Article 15 replace "Commentary on Article 15 of the OECD Model Tax Convention" with "Commentary on Article 15 of the OECD 2017 Model Tax Convention" and replace paragraph 9 of the OECD Commentary on Article 15 of the 2017 OECD Model by the following:

> 9. Paragraph 3 applies to the remuneration of crews of ships or aircraft operated in international traffic, ~~or of boats engaged in inland waterways transport, a rule which follows up to a certain extent the rule applied to the income from shipping, inland waterways transport and air transport, that is, to tax them in the Contracting State in which the place of effective management of the enterprise concerned is situated~~ ***and provides that such remuneration shall be taxable only in the State of residence of the employee. The principle of exclusive taxation in the State of residence of the employee was incorporated in the paragraph through a change made in [2017]. The purpose of that amendment was to provide a clearer and administratively simpler rule concerning the taxation of the remuneration of these crews.*** [REST OF

EXISTING PARAGRAPH 9 HAS BEEN MOVED TO PARAGRAPHS 9.3 AND 9.4]

9.1 At the same time, the definition of international traffic was modified to ensure that it also applied to a transport by a ship or aircraft operated by an enterprise of a third State. As explained in paragraph 6.1 [paragraph 8.1 of the UN Commentary] ***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.

9.3 As indicated in paragraph 9 above, paragraph 3 applies to the crews of ships or aircraft. This is made clear by the reference to employment exercised "as a member of the regular complement of a ship or aircraft". These words are broad enough to cover any employment activities performed in the course of the usual~~that are related to the~~ operation of ~~a~~ the ship or aircraft, including, for example, the activities of employees of restaurants aboard a cruise ship or the activities of a flight attendant who would only work on a single flight before leaving his employment; they would not cover, however, employment activities that may be performed aboard a ship or aircraft but are unrelated to its operation (e.g. an employee of an insurance company that sells home and auto insurance to the passengers of a cruise ship).

9.4 As explained in paragraph 15 of the Commentary on Article 8, States wishing to apply the same treatment to transport on rivers, canals and lakes as to shipping and air transport in international traffic may extend the scope of Article 8 to cover profits from the operation of boats engaged in inland waterways transport. These States could then wish to apply paragraph 3 of Article 15 to the remuneration of employees working on these boats. In the case of the remuneration derived by an employee working aboard a boat

engaged in inland waterways transport, however, paragraph 3 should only apply to the extent that the boat is operated by an enterprise of the State of residence of the employee. It would indeed be inappropriate for one Contracting State to be required to exempt remuneration derived by an employee who is a resident of the other State but is employed by an enterprise of the first-mentioned State (or of a third State with which the first-mentioned State did not agree to exempt profits derived from the operation of boats engaged in inland waterways transport) where that remuneration relates to activities exercised solely in that first-mentioned State. Contracting States wishing to address this issue could do so by including in their bilateral treaty a separate provision dealing with crews of boats engaged in inland waterways transport that would be drafted as follows:

> ***Notwithstanding the preceding provisions of this Article and of Article 1, remuneration derived by an individual, whether a resident of a Contracting State or not, in respect of an employment, as a member of the regular complement of a boat ~~ship or aircraft~~, that is exercised aboard a boat engaged in inland waterways transport in a Contracting State and operated by an enterprise of the other State shall be taxable only in that other State. However, such remuneration may also be taxed in the first-mentioned State if it is derived by a resident of that State.***

9.5 [THE FOLLOWING DELETED PART IS CURRENTLY IN EXISTING PARAGRAPH 9] ~~In the Commentary on Article 8, it is indicated that Contracting States may agree to confer the right to tax such income on the State of the enterprise operating the ships, boats or aircraft. The reasons for introducing that possibility in the case of profits income from shipping, inland waterways and air transport operations are valid also in respect of remuneration of the crew. Accordingly Contracting States are left free to agree on a provision which gives the right to tax such remuneration to the State of the enterprise. Such a provision, as well as that of paragraph 3 of Article 15, assumes that the domestic laws of the State on which the right to tax is conferred allows it to tax the remuneration of a person in the service of the enterprise concerned, irrespective of his residence.~~ ***As indicated in paragraph 2*** [paragraph 10 of the UN Commentary] ***of the Commentary on Article 8, some States may prefer to attribute the exclusive right to tax profits from shipping and air transport to the State in which the place of effective management of the enterprise is situated rather than the State of residence. Where the Contracting States follow that approach, a similar change should be made to the alternative***

provisions included in paragraphs 9.4 above and 9.6 below if these provisions are used.

9.6 Some States prefer to allow taxation of the remuneration of an employee who works aboard a ship or aircraft operated in international traffic both by the State of the enterprise that operates such ship or aircraft and the State of residence of the employee. States wishing to do so may draft paragraph 3 along the following lines:

> ***3. Notwithstanding the preceding provisions of this Article and Article 1, remuneration derived by an individual, whether a resident of a Contracting State or not, 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 by an enterprise of a Contracting State shall be taxable only in that Contracting State. Where, however, such remuneration is derived by a resident of the other Contracting State, it may also be taxed in that other State.***

9.7 Some States wishing to apply that approach may also wish to restrict the application of paragraph 3 to employees who are residents of one of the Contracting States, which could be done by using the following wording:

> ***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 shall be taxable only in that State. Where, however, the ship or aircraft is operated by an enterprise of the other Contracting State, such remuneration may also be taxed in the other 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*** [paragraph 10.1 of the UN Commentary] ***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*** [10] of that Commentary is applicable if the place of effective management of a shipping enterprise ~~or of an inland waterways transport enterprise~~ is aboard a ship or a boat. According to the domestic laws of some ~~member~~ countries, tax is levied on remuneration received by non-resident members of the crew in respect of employment aboard ships only if the ship has the nationality of such a State. For that reason conventions concluded between these States provide that the right to tax such remuneration is given to the State of the nationality of the ship. On the other hand many States cannot make use of such a taxation right and the provision could in such cases lead to ***a*** non-taxation ***situation similar to the one described in the preceding paragraph***. However, States having that taxation principle in their domestic laws may agree bilaterally to confer the right to tax remuneration in respect of employment aboard ships on the State of the nationality of the ship.