August 22, 2014

Mr. Michael Lennard
Chief, International Tax Cooperation Section
Financing for Development Office
U.N. Dept. Of Economic and Social Affairs
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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 particular attention to the inclusion of cruise ship operations as international transport and identifying those operations that are ancillary/auxiliary to the international transportation of passengers.

CLIA Background

The Cruise Lines International Association (CLIA) is the world's largest cruise industry trade association with representation in North and South America, the United Kingdom, Europe, Asia and Australasia. A list of CLIA's cruise line members is attached as **Appendix A**. CLIA is the cruise industry's representative at the International Maritime Organization (IMO), actively providing input on maritime policies and submitting policy proposals for consideration by the IMO's member states.

Passenger Transport by Sea

One of the challenges that impedes reasoned analysis of the cruise industry is nomenclature. Same ship, different destinations, different itineraries. What distinguishes a ship or voyage classified as a "cruise" from one which is not? Is there any relevance to the characterization?

For example, Cunard Line operates regularly scheduled service from Southampton to New York – as it has done almost continuously since Samuel Cunard was awarded the first British

transatlantic steamship mail contract in 1839. The vessels currently employed in this trade may, in the course of a year, also take passengers around the world, through the Mediterranean, to places in the South Pacific, or elsewhere.

Webster's Dictionary defines "cruising" as:

1. n. a journey on a boat or ship to a number of places as a vacation;
2. v. to call about touching at a series of ports

We believe it inappropriate to limit the definition to a "vacation" as cruise ships have business travelers also – seminars, continuing education and other similar reasons.[1] It is also unproductive to define a product based on the intent of the customer.[2] Thus, we believe that the better definition might be:

n. the transportation of passengers by boat or ship to a place or number of places

The challenge in using intent of the passenger is demonstrated by a vessel that, while carrying passengers on multi-night/destination voyages; may, at the same time, be carrying some passengers port to port.[3] Since all passengers are being transported, is there a rational reason that the income of passengers traveling to one port be treated differently from that derived from passengers traveling to several?

As discussed more fully below, the definition we propose is consistent with those used in most countries and includes most, if not all, the transportation variations, currently employed – implicitly or explicitly.[4]

History of Cruising

The movement of passengers and freight dates to the invention of boats in approximately 3,500 B.C. As long as individuals have had to cross bodies of water to hunt, fish, explore or trade,

[1] Possibly the most publicized recent business travel on cruise ships occurred in 2010 when transatlantic air travel was interrupted by the eruption of the Iceland volcano Eyjafjallökull.
[2] Is a football a different product when used as a business tool by professionals in the World Cup than it is if used by children for recreation – besides that a tax deduction is only available for the football used by professionals?
[3] One cruise line advertises "6, 7, 11, or 12-day Norwegian Coastal Voyages" and "[o]ver 1,000 short port to port variations to choose from on the Norwegian Coastal Voyage."
[4] Article 37 of the European Union Principal VAT Directive refers to "passenger transport operation" by ship, making no reference to the term "cruise" although other documents by the European Commission and the Court of Justice for the European Union have done so. E.g., Commission Explanatory Notes for Application of Council Implementing Regulation (EU) No. 1042/2013.

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 and export of goods or persons. From ancient times, portoria, to the present – port, customs, immigration and other charges, have been imposed. Some of these charges are loosely characterized as payments for service, others are plainly taxes.[8,9, 10]

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[5] History of Herodotus, Book IV, para. 42.
[6] William Makepeace Thackeray, Notes on a Journey from Cornhill to Grand Cairo by way of Lisbon, Athens, Constantinople, and Jerusalem: Performed in the Steamers of the Peninsular and Oriental Company. (Wiley & Putnam ed.) (1846). http://books.google.com/books?id=TD0PAAAAYAAJ&pg=PR3&source=gbs_selected_pages&cad=3#v=onepage&q&f=false
[7] Recall that Pan American's first intercontinental aircraft were called "Clippers" after the 19th century clipper ships.
[8] Black's Law Dictionary, 5th ed.
[9] Current charges imposed for delivery of passengers by ship range from less than US $1 to more than US $200 per passenger.
[10] "[C]ountries that expect to retain any sizeable presence in global shipping and/or ship-building must be generous in tax treatment for these activities. On the other hand, substantial tonnage and port-user fees can and should be charged on all imports coming into their coastal waters and harbors. These fees can be used to support port infrastructure, pilotage, safety, security measures,

Income taxes were generally of secondary importance to direct taxes, if they were a concern at all. Many countries, by practice or by law, exempted shipping operations not managed, or vessels not registered, in their jurisdictions from income taxes.

The earliest recorded discussions recognized that the equitable division of income earned from vessel operations was virtually impossible. The Netherlands enacted the first statutory reciprocal exemption for shipping in 1914. The United States enacted source-based taxation in 1916 which was met with diplomatic complaints and threats of retaliatory actions.[11] In 1920, double taxation of shipping operations was more a theoretical, than practical, concern.[12] In 1921, the United States enacted its reciprocal exemption provision which, but for the addition of air transport in 1948 and elimination of the registration requirement, remains substantially unchanged today.[13]

Application of the Model Conventions to Passenger Transport by Ship

In pre-treaty international law, by practice or statute, source states did not generally impose income taxes on vessels calling within their jurisdiction. The primary right to impose income tax was reserved to the country of registry or effective management. As a consequence, the model conventions codified an element of customary international law, satisfying both requirements.

a. State practice
b. Opinio juris sive necessitates or a belief that the practice is dictated by a legal obligation.[14]

The belief that source country taxation was impermissible was based on equitable grounds – the inability to apportion income in a manner that was fair and would avoid duplicate taxation. Much of what has developed as customary international law is based on equities and this is consistent with that development.[15]

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environmental supervision and the essential subsidies necessary to maintain a maritime presence in global trade." William R. Lovett, ed. U.S. Shipping Policies and the World Market (1996) p. 302.

[11] Guglielmo Maisto, *The History of Article 8 of the OECD Model Treaty on Taxation of Shipping and Air Transport*, 31 Intertax 232. See discussion pp. 232-233.

[12] See, Michael J. Graetz and Michael M. O'Hear, *The "Original Intent" of US International Taxation*, 46 Duke L.J. 1021, 1094-1095 citing materials prepared by the American Section of the International Chamber of Commerce Double Taxation Committee (May 23, 1922).

[13] Revenue Act of 1921, Pub. L. No. 67-98, §213(b)(8); S. Rep. No. 275, 67th Cong. 1st Sess. (1921) *reprinted in* 1939-1 (Part 2) C.B. 181, 191.

[14] North Sea Continental Shelf Cases (Federal Republic of German v. Netherlands) 1969 I.C.J. Reports 4, April 26, 1968.

[15] The North Sea Continental Shelf Cases are a prime example as the delineation of continental shelf boundaries is purely a matter of balancing equities which has now been incorporated into the United Nations Convention on the Law of the Sea, Art. 70. It appears from the proceedings by the League of

Against the background of little, if any, income tax and established practice ceding the right to tax to the country of a vessel's management or registry, the work of the International Chamber of Commerce and the League of Nations began. The first work on the avoidance of double taxation was contained in the 1923 International Chamber of Commerce Resolutions and was continued in the Experts' Report on Double Taxation for the League of Nations. Each addressed many facets of the avoidance of double taxation for income, including shipping, income. The experts, particularly Professor Seligman, gave the primary right to tax shipping income to the country of registry as "there was no particular country to which origin could be prescribed to if the vessels plied the high seas."[16] The report contemplated that vessels could traverse different countries and have several places of origin – exactly the situation present in the cruise industry today.[17] Income tax on shipping and air transportation has been recognized as virtually impossible to apportion equitably.[18]

Building on and memorializing this work, income taxation of shipping income was addressed in the first draft of the League of Nations model in 1927. The provision was incorporated into the Geneva Model of 1928. After adoption of the Geneva Model convention, 17 countries entered into treaties between 1930 and 1931 with shipping articles.[19, 20] Exemption for shipping was continued in the League of Nations' Mexico convention of 1943 and the London convention of 1946.[21] The work of the League of Nations was assumed by the OECD in its model conventions for the avoidance of double taxation on income and capital in 1963 and following. The United Nations' Model Double Taxation Convention between Developed and Developing Countries dates from 1980.

The identification and scope of the exemption afforded international maritime operations has shifted only slightly since the publication of the 1928 Geneva Model. The Geneva Model applied to "maritime shipping" with no requirement that it be international.[22] Beginning with the

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Nations that there was unanimity in the view that country of registry or management should have the primary right to tax income from shipping, unlike the discussion of the International Law Commission concerning the coastal boundaries at issue in the North Sea Continental Shelf Cases. Id. para. 49.

[16] Sunita Jogarajan, *Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation*, 5 W. Tax J. 368,390.

[17] Legislative History of United States Tax Conventions. Vol. 4, Section1: League of Nations, reprinted in U.S. Joint Committee on Internal Revenue Taxation (1962). See also n. 3, supra.

[18] A more modern analysis of Seligman's paradox of multiple origins is contained in Tony Kelly, *Reciprocal Exemption: A regime to Treasure,* 39 Bull. IBFD 267 (1985).

[19] Legislative History of United States Tax Conventions, supra. N. 14,. p. 4226.

[20] Early development of the shipping article of treaties is well summarized in John F. Avery Jones, et. al., *The Origins of Concepts and Expressions used in the OECD Model and their Adoption by States,* 51 Brit. T. Rev. 694, 740-742.

[21] D. Hund, *The Development of Double Taxation Conventions with Particular Reference to Taxation of International Air Transport,* 36 Bull. IBFD 111 (1982).

[22] International transportation was not a requirement until the advent of cabotage laws.

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] **SHIPPING, INLAND WATERWAYS TRANSPORT AND AIR TRANSPORT** **(Alternative A)**	**OECD Article 8** [26] **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.	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.	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.	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] Model Bilateral Convention for the Prevention of the Double Taxation of Income, Mexico Draft (1943) Art. V.; Model Bilateral Convention for the Prevention Of the Double Taxation of Income and Property, London Draft (1946), Art. V.
[24] OECD Draft Double Taxation Convention on Income and Capital (1963) Art. 8.
[25] United Nations Model Double Taxation Convention between Developed and Developing Countries (2011) (hereinafter, "UN Model").
[26] OECD Model Tax Convention on Income and Capital (2010) (hereinafter, "OECD Model").

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.	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.
(Alternative B)	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.
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 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. 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.	

Each model (and most, if not all, treaties in force) applies to all matters associated with the *operation* of a vessel moving something or someone internationally.

Parsing the first paragraph of each model – there are two requirements for its application: i) a ship (or aircraft), which is ii) operated in international traffic. There is no distinction between the transportation of passengers and freight – and rightly so based upon the purpose and proper interpretation of these provisions.

Article 8 is the only treaty provision that addresses a specific industry and uses terms of art. Consequently it is appropriate that other maritime laws and Conventions be considered when we define terms used in the conventions such as "ship" and "international traffic." The vast body of maritime law and treaties form part of the "relevant rules of international law" that are to be considered when we seek to interpret Article 8 of the Conventions.

We believe the application of the Conventions to cruise passenger vessels is well settled and substantial guidelines exist to assist in the definition of the revenue to be included with the "operation of a ship."

We also believe that the Alternative B to Article 8 of the UN Model represents a deviation from customary international law and note that its use has declined dramatically, representing a universal return to the international norm.[27] It is also interesting to note that Alternative B applies only to international shipping about which the customary international law was developed, and not to air transport.

[27] Wim Winjen and Ian de Goede, *The UN Model in Practice 1997-2013*, 68 Bull. Int'l Tax'n 118. Use of Alternative B by non-OECD countries declined by 60% between 1997 and 2013 while use of this alternative by OECD countries was eliminated entirely. Id. para 2.10.3.

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.

Application of the UN Convention to Passenger Shipping

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 caries 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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[28] UN Income and Capital Model Convention (Commentary)(1980) Art. 8 Sec. A.
[29] 47 U.S.C. §153(46)(A).
[30] 47 U.S.C. §153(46)(B).
[31] Klaus Vogel on Double Taxations Conventions, 3d ed. (1996) 484.
[32] We also note that recently a cruise was characterized as maritime transport services in the European Union. Alpina River Cruise GmbH v. Ministero delle infrastrutture e dei transporti – Capitaneria di Porto di Chioggia (C-17/13 (March 27, 2014).
[33] UN Model, Art. 3 1.(d). OECD Model, Art. 3 1.(e).
[34] OCED Model Tax Convention on Income and Capital Commentary (2010) (hereinafter, "OECD Commentary"), para. 6.3 (2010).
[35] TR 2014/2.

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 carriage of passengers between places within the same country clearly demonstrates that the parties understood the convention to apply to passenger transport.

Many treaties, particularly those using Alternative B, above, specifically include the movement of passengers from a port within the text of the treaty.[36] Other treaties refer to the movement of passengers by sea specifically within the relevant article.[37] Where the United States has issued a technical explanation to its treaties, many refer to "cruises to nowhere" as being excluded due to the absence of an international or foreign port of call – reinforcing that a cruise is otherwise international passenger transport.[38]

That a cruise is international passenger transport, has been documented in rulings and regulations throughout the world. For example:

1. Australia recently issued ruling TR 2014/2 clarifying which voyages, particularly for passengers, are considered international for purpose of applying the shipping and aircraft article of Australia's income tax treaties.
2. Belgian advance tax ruling decision number 2010.524 addressed the relationship between articles 7 and 8 of its tax conventions, the exemption afforded international maritime transport and the wage tax obligations irrespective of article 8.
3. The Court of Justice of the European Community (formerly the European Court of Justice) has determined that the call of a passenger vessel outside the European Community cannot be ignored as the transportation is international.[39] It has also determined that a cruise ship falls within Directive 1999/32 as a "passenger ship" serving "traffic between for the purpose of controlling sulphur dioxide emissions from the combustion of certain liquid fuels.[40]
4. In Consulta V0186-06 Spain has ruled concerning the scope of ancillary services related to passenger shipping under Article 8 of the Spain-Italy Convention for the Avoidance of Double Taxation.

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[36] E.g., Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, United States - Sri Lanka, Feb. 24, 2003.
[37] E.g., Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, Belgium – India, Apr. 26, 1993, Art. 8 2.(b).
[38] E.g., Technical Explanation to the 1996 Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, United States – Thailand, Nov. 26, 1996.
[39] Antje Köhler v. Finanzamt Düsseldorf-Nord (C-58/04) September 15, 2005.
[40] Compagnia Naviera Orchestr v. Genova (C-537/11) January 23, 2014.

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]

Ancillary Income

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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[41] 26 C.F.R. 1.883-1 et. seq.
[42] E.g., Convention on Facilitation of International Maritime Traffic, Opened for Signing May, 3, 1967;
[43] United Nations Model Double Taxation Convention between Developed and Developing Countries (2011) p. vi.
[44] See, United Nations Model Double Taxation Convention between developed and Developing Countries (Commentary) (2011) Art. 3, para. 8, quoting the OECD Commentary.
[45] British Broadcasting Company, Flying the unfriendly – and pricey – skies. August 5, 2014. http://www.bbc.com/capital/story/20140804-flying-the-unfriendly-skies.

that are included or related to the operation of a vessel or aircraft.[46] The OECD commentary contains a combination of general and specific guidance which, we believe on the whole, is reasonable.[47] We also believe that this is an area where consistency among the model conventions is critical for the efficient administration of a transportation enterprise.[48]

Conclusion

CLIA greatly appreciates the opportunity to provide its thoughts as the United Nations Committee of Experts on International Cooperation in Tax Matters discusses future changes to the model convention and we look forward to continuing this discussion at the October meeting.

Regards,

James R. Border
Chairman, Global Tax Committee

Cc: Mr. Enrico Martino

[46] Anne Jorritsma and Marlies Baijer, *Article 8 of the OECD Model lags behind international business,* Int'l Tax Rev. (September 1, 2013)
[47] OECD Commentary, Art. 8, para. 4 et. seq.
[48] Cf. Brian J. Arnold, *Some Thoughts on Convergence and Tax Treaty Interpretation*, 67 Bull. Int'l Tax'n 575.