

12 April 2004

**INCOME FROM INTERNATIONAL TRANSPORT:  
UPDATING OF THE COMMENTARY TO THE OECD MODEL TAX CONVENTION**

In consultation with representatives of the airline and shipping industries, Working Party No. 1<sup>1</sup> of the OECD Committee on Fiscal Affairs has revised the Commentary on Article 8 of the Model Tax Convention (which deals with income from the operation of ships and aircraft in international traffic) in order to take account of the evolution in international transport activities.

This note includes the changes to the Commentary on Article 8 (as well as a minor drafting correction to the Commentary on the definition of “international traffic” that appears in Article 3 of the Model Tax Convention) that the Working Party approved at its February 2004 meeting, subject to any change or correction that could result from public comments.

Comments on the note should be sent **before 30 June 2004** to:

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1. Working Party No. 1 on Tax Conventions and Related Questions is the sub-group of the OECD Committee on Fiscal Affairs that deals with tax treaty issues.

**INCOME FROM INTERNATIONAL TRANSPORT:  
CHANGES TO THE COMMENTARY TO THE OECD MODEL TAX CONVENTION**

[Changes to the existing text of the Commentary appear in **bold italics** for additions and ~~strikethrough~~ for deletions]

**Proposed amendments to the Commentary on Article 3**

1. *Replace paragraph 6.3 of the Commentary on Article 3 by the following:*

"6.3 The definition of "international traffic" does not apply to ~~any~~ transport ***by an enterprise which has its place of effective management in one Contracting State*** when the ship ***or aircraft*** is operated between two places in the ~~same Contracting~~ ***other*** State, even if part of the transport takes place outside that State. Thus, for example, a cruise beginning and ending in ~~the same Contracting~~ ***that other*** State without a stop in a foreign port does not constitute a transport of passengers in international traffic. Contracting States wishing to expressly clarify that point in their conventions may agree bilaterally to amend the definition accordingly."

**Proposed amendments to the Commentary on Article 8**

2. *Replace the Commentary on Article 8 by the following:*

**COMMENTARY ON ARTICLE 8  
CONCERNING THE TAXATION OF PROFITS  
FROM SHIPPING, INLAND WATERWAYS TRANSPORT  
AND AIR TRANSPORT**

*Paragraph 1*

1. The object of paragraph 1 concerning profits from the operation of ships or aircraft in international traffic is to secure that such profits will be taxed in one State alone. The provision is based on the principle that the taxing right shall be left to the Contracting State in which the place of effective management of the enterprise is situated. The term "international traffic" is defined in subparagraph *d*) of paragraph 1 of Article 3.

2. In certain circumstances the Contracting State in which the place of effective management is situated may not be the State of which an enterprise operating ships or aircraft is a resident, and some States therefore prefer to confer the exclusive taxing right on the State of residence. Such States 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 in international traffic shall be taxable only in that State."

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.~~ *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.*

*4.3 In light of these principles, the following paragraphs discuss the extent to which paragraph 1 applies with respect to some particular types of activities that may be carried on by an enterprise engaged in the operation of ships or aircraft in international traffic.*

5. ~~Profits obtained by leasing a ship or aircraft on charter fully equipped, manned 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 7, 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 an enterprise engaged in the international operation of ships or aircraft.~~ *Profits obtained by leasing a ship or aircraft on charter fully*

*equipped, 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 7, and not Article 8, applies to profits from leasing a ship or aircraft on a bare boat charter basis except when it is an 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.~~

~~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.~~

~~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.~~

~~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.~~

*6. 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 slot-chartering 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. 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. 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. 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 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. — Recently, "containerisation" has come to play an increasing role in the field of 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.~~

~~10.1 — Another case would be that of a transport enterprise that would be required to have assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic and that would 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 staff, cargo handlers, catering staff and customer services personnel. Since the income so derived would not be related to the operation of ships or aircraft by the enterprise itself, that income would normally not fall within the scope of Article 8. Where, however, the enterprise provides goods to, or performs services for, another person that are supplementary or incidental to its operation of ships or aircraft in international traffic, the profits from the provision of such goods or services will fall under Article 8. Although the same considerations apply to a pool, joint business or international operating agency for the purposes of paragraph 4, what is required in that case is to examine how closely the activity is connected with the international transport activities of the pool, joint business or international operating agency as opposed to the activities of the individual enterprises participating in such arrangements.~~

*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 instance, where an airline enterprise that wants to reduce the costs of maintaining facilities for the operation of its aircraft in other countries agrees, under the 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. — 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 a shipbuilding yard operated in one country by a shipping enterprise having its place of effective management in another country. *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 vessels engaged in fishing, dredging or hauling activities on the high seas be treated as income falling under this Article. *[this paragraph becomes 17.1]*

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 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. Thus, the Article 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; it 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. *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."*

*Paragraph 2*

15. The rules with respect to the taxing right of the State of residence as set forth in paragraphs 2 and 3 above apply also to this paragraph of the Article.

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.

***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.

***17.1 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 or air transport**

18. It follows from the wording of paragraphs 1 and 2 that enterprises not exclusively engaged in shipping, inland waterways transport or air transport nevertheless come within the provisions of these paragraphs 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 paragraphs 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 attributed to the permanent establishment. 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, the permanent establishment's expenditure in respect of the operation of the ships, boats or aircraft should be attributed not to the permanent establishment but to the enterprise itself, since none of the profit obtained through the carrying benefits the permanent establishment.

21. Where ships or aircraft are operated in international traffic, the application of the 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 (for example, ships or aircraft put into service by the permanent establishment or figuring on the balance sheet of the permanent establishment).

*Paragraph 3*

22. This paragraph deals with the particular case where the place of effective management of the enterprise is aboard a ship or a boat. 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*

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."

25. [Renumbered as paragraph 34]

*Observations on the Commentary*

26. [Deleted/renumbered as paragraph 42]

27. ~~Portugal and Turkey~~ reserves the right, in the course of negotiations for concluding conventions with other Member countries, to propose that the part of inland transport (cf. paragraph 9 above) carried out by means other than that employed for international transport be excluded from the scope of the Article, whether or not the means of transport belong to the transporting enterprise.

28. ~~Portugal and Turkey~~ also reserves the right, in the course of such negotiations, to propose that the leasing of containers (cf. paragraph 10 above) even if supplementary or incidental be regarded as an activity separate from international shipping or aircraft operations, and consequently be excluded from the scope of the Article.

***28.1 Portugal reserves its position as to the application of this Article to income from ancillary activities (cf. paragraphs 4 to 10.1).***

29. Germany reserves its position as to the application of the Article to income from inland transportation ***of passengers or cargo and from*** ~~and~~ container services (cf. paragraphs ***4, 6, 7 and 9*** ~~and 10~~ above).

30. Greece will apply Article 12 to payments from leasing a ship or aircraft on a bareboat charter basis.

~~30.1 Australia does not agree with the interpretations given in paragraphs 8 d) and 9. Australia takes the view that international operation of ships and aircraft does not include inland transportation.~~

#### *Reservations on the Article*

31. *Canada, Hungary, Mexico, New Zealand and Poland* reserve the right to tax as profits from internal traffic profits from the carriage of passengers or cargo taken on board at one place in a respective country for discharge at another place in the same country. New Zealand also reserves the right to tax as profits from internal traffic profits from other coastal and continental shelf activities.

32. *Canada, Turkey, the United Kingdom and the United States* reserve the right not to extend the scope of the Article to cover inland transportation in bilateral conventions (paragraph 2 of the Article).

33. *Denmark, Norway and Sweden* reserve the right to insert special provisions regarding profits derived by the air transport consortium Scandinavian Airlines System (SAS).

34. The *United Kingdom* reserves the right to include in paragraph 1 of the Article profits from the leasing of ships or aircraft on a bare boat basis (~~cf. paragraph 5 above~~) and from the leasing of containers (~~cf. paragraph 10 above~~).

35. In view of its particular situation in relation to shipping, *Greece* will retain its freedom of action with regard to the provisions in the Convention relating to profits from the operation of ships in international traffic.

36. *Mexico* reserves the right to tax at source profits derived from the provision of accommodation.

37. *Poland* reserves the right to broaden the scope of the Article to cover transport by road vehicles and to make a corresponding change to the definition of "international traffic" in Article 3.

38. *Australia* reserves the right to tax profits from the carriage of passengers or cargo taken on board at one place in Australia for discharge in Australia. Australia also reserves the right to tax profits from other coastal and continental shelf activities.

39. The *United States* reserves the right to include within the scope of paragraph 1, income from the rental of ships and aircraft on a full basis, and on a bareboat basis if either the ships or aircraft are operated in international traffic by the lessee, or if the rental income is incidental to profits from the operation of ships or aircraft in international traffic. The United States also reserves the right to include within the scope of the paragraph, income from the use, maintenance or rental of containers used in international traffic.

40. The *Slovak Republic* reserves the right to tax under Article 12 profits from the leasing of ships, aircraft and containers.

41. *Ireland* reserves the right to include within the scope of the Article income from the rental of ships or aircraft on a bareboat basis if either the ships or aircraft are operated in international traffic by the lessee or if the rental income is incidental to profits from the operation of ships or aircraft in international traffic.

42. *Turkey* reserves the right in exceptional cases to apply the permanent establishment rule in taxation of profit from international transport. Turkey also reserves the right to broaden the scope of the Article to cover transport by road vehicle and to make a corresponding change to the definition of "international traffic" in Article 3.