Platform for Taxation in Latin America and the Caribbean

8 February ‘24

PTLAC - South Centre Closed Technical Briefing

Reforming Taxation of International Shipping and Air Transport in the UN Model Tax Convention

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Key References

Dr. Muhammad Ashfaq Ahmed, UN MTC Article 8: Was the Source Rule Surrender on Article 8 a Blunder? The Case Study of Pakistan
INTERTAX, Volume 48, Issue 1 (2020)

Bob Michel and Tatiana Falcão, Taxing Profits from International Maritime Shipping in Africa: Past, Present and Future of UN Model Article 8 (Alternative B) Funded and Published by International Centre for Tax and Development (2021)

Bob Michel, Muhammad Ashfaq Ahmed, Tatiana Falcao, Abdul Muheet Chowdhary, *Source taxation of international shipping income: charting a new course for the LAC region countries*
Fedesarrollo (2023)

Proposal for a revision to Article 8 (Alternative B) of the United Nations Model Double Taxation Convention between Developed and Developing Countries
United Nations (2023)

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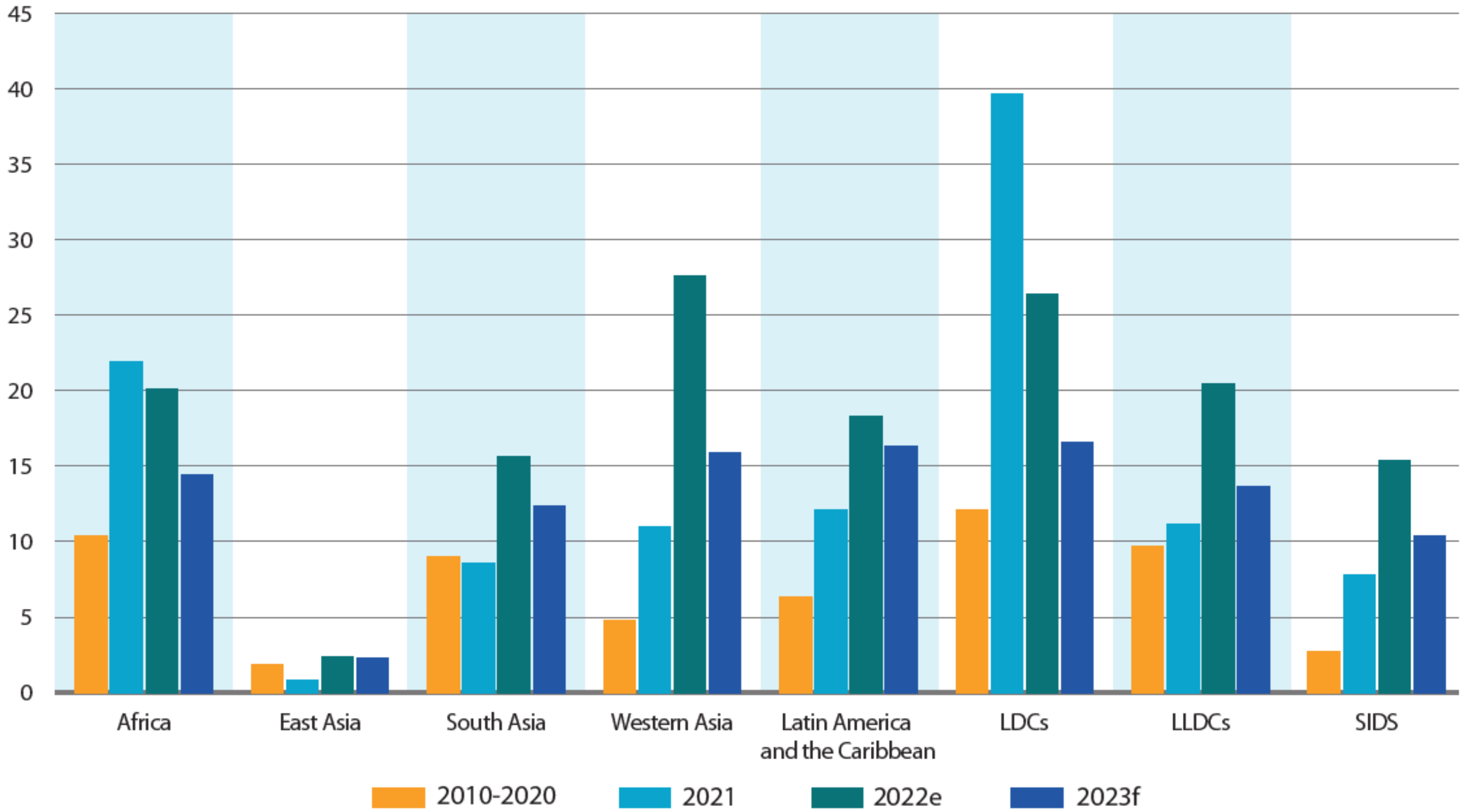
High Inflation for the Global South…..

Inflation in developing countries and selected country groupings

(Percentage)



Source: UN DESA, based on estimates and forecasts produced with the World Economic Forecasting Model.
Note: e = estimates, f = forecasts. Data for Latin America and the Caribbean excludes the data for Venezuela (Bolivarian Republic of) .

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….Contributes to Record Profits for the Shipping Industry

Container shipping profits

$400 billion

- Q2 2020

$300 Billion

in 2021-2022

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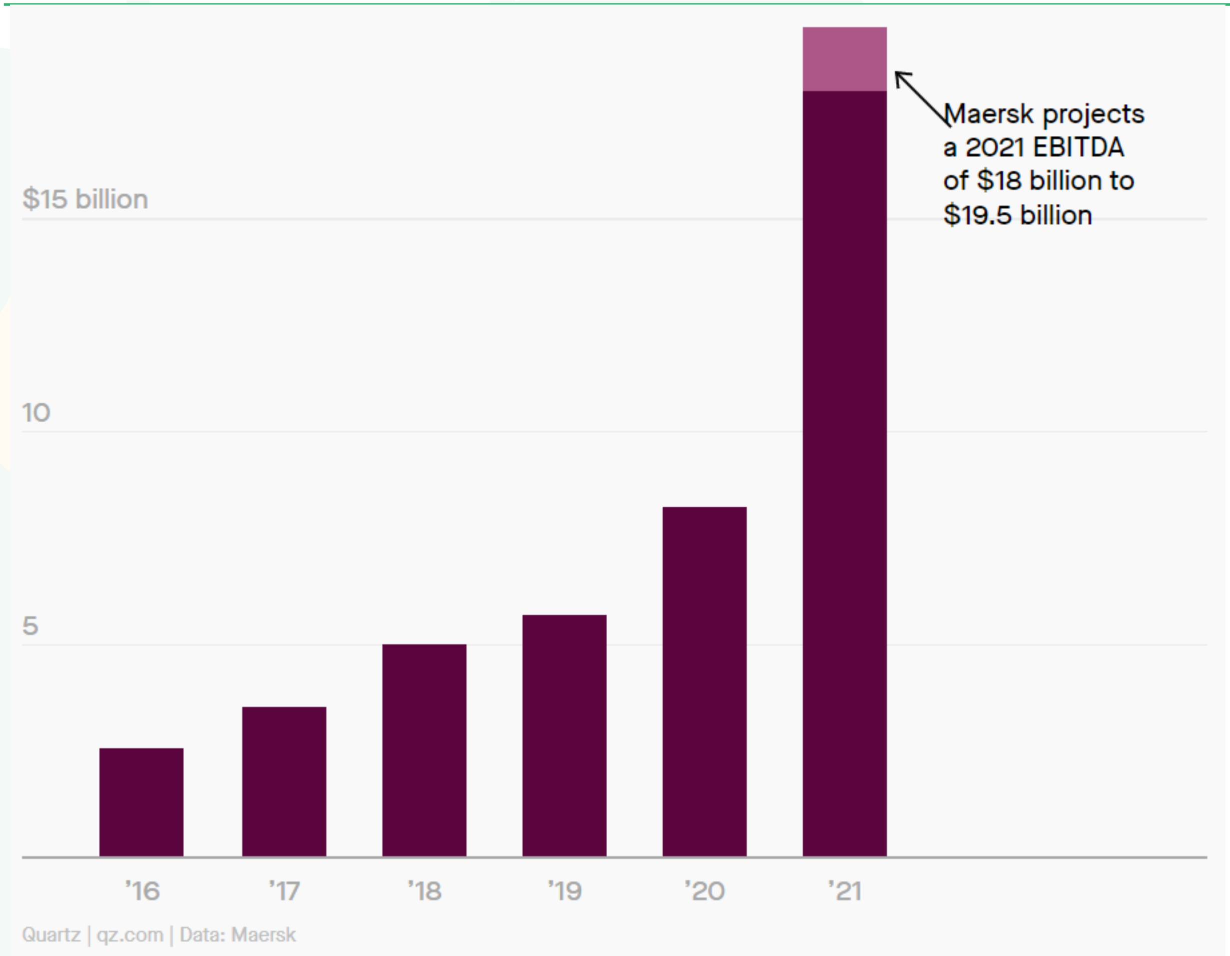
Company-level Samples
Maersk (World’s #1 Shipper)



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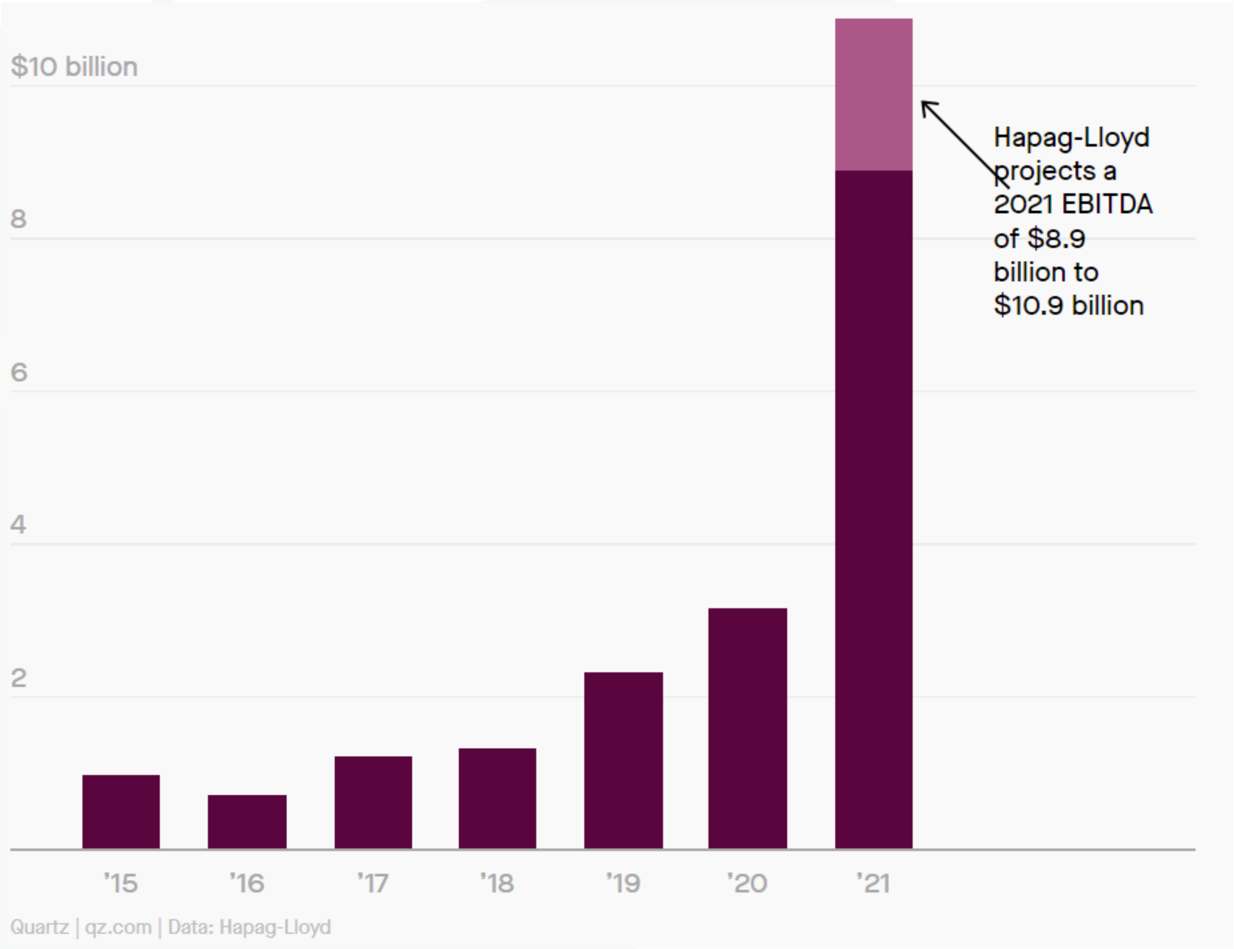
Company-level Samples

Hapag-Lloyd (World’s #5 Shipper)



Shipping Industry Pays Less Taxes Than You and Me
Effective Corporate Income Tax Rate

- 6% for bulk transport
- 3% for the tanker sector
- 0% for cruise shipping companies (!)
- 7% for the overall Shipping Sector
- Source: Wall Street Journal (2021), Merk (2020)

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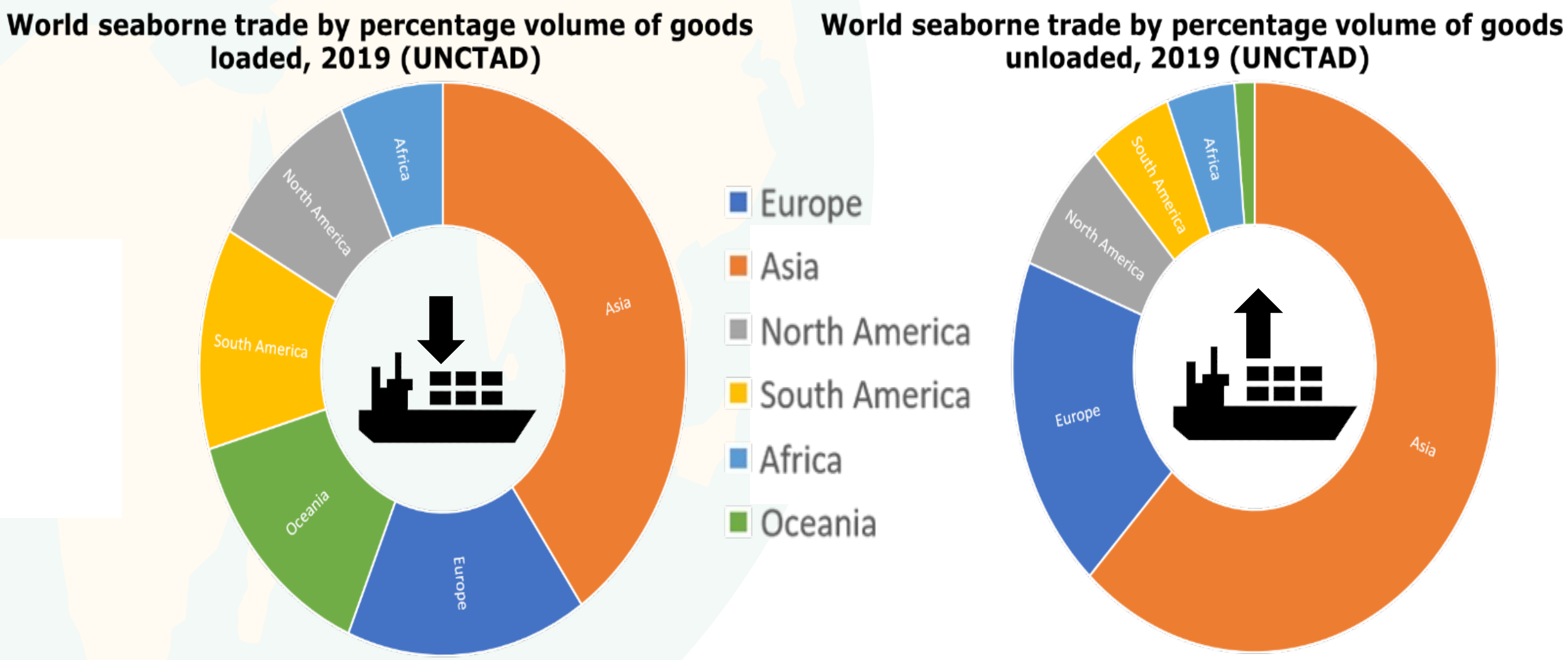
Case in Point: Switzerland

Major cruise line shipowner country

- Landlocked country in the middle of Europe
- No seas, no shipping activity
- Tax regime allows ETR to be around 0
- Shows absurdity of the current regime if seen from dimension of taxing profits where they are generated
- Cruise line shipping has huge environmental footprints in the source countries

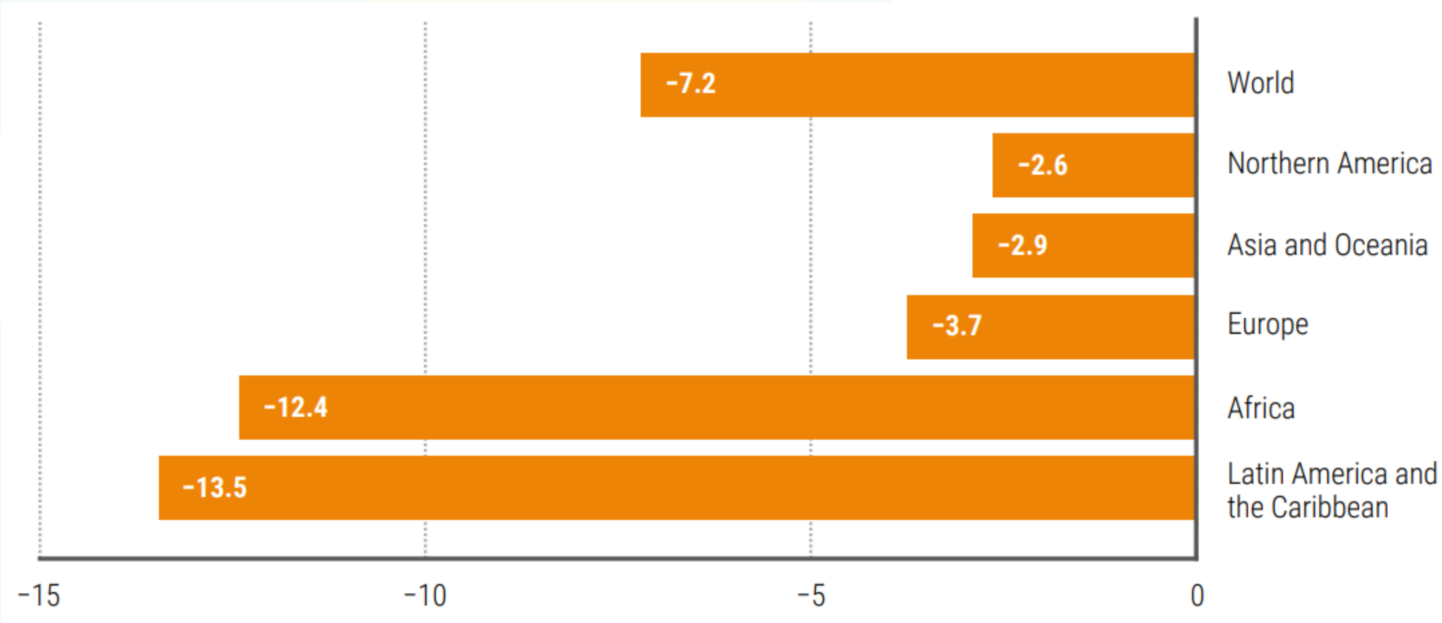
Global South accounts for significant volume of Shipping Activity

Goods loaded (exports) Goods unloaded (imports)



Africa and Latin America and the Caribbean especially reliant on shipping activity

Reduction in Port Calls during COVID pandemic



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Shipping Activity in the Global South growing at rapid rates

Increase in world container port throughput by region 2020-2021 (UNCTAD, 2022)

(millions of 20-foot equivalent units and annual percentage change)

	20-foot equivalent units		Annual percentage change 2020–2021
	2020	2021	
Asia	506	535	6%
Europe	136	143	5%
North America	67	77	14%
Latin America and the Caribean	49	55	11%
Africa	30	33	10%
Oceania	13	14	8%
World total	**802**	**857**	**7%**

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Why? How?

Weak International Tax Standards

OECD Model Tax Convention

- Article 8 allocates Taxing Right to Residence State
- Many Shipping and Aircraft Companies ‘residents’ of shipping tax havens or low-tax jurisdictions
- Resident countries typically tax shipping industry at a low rate

UN Model Tax Convention

- ‘Alternative A’ same as OECD Model
- ‘Alternative B’ provides very weak source taxation:
  - Profits taxable at source only if activities ‘more than casual’
  - Taxable Profits determined by ‘appropriate allocation of overall net profits’
  - These to be then reduced by ____% (typically between 40%-60% in practice)

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Developed Countries Dominate Fleet Ownership & Have Used OECD & UN Model To Minimize Source Taxation on their Shipping Companies

Top 10 shipowner countries per segment, 2019

Total vessel values in USD millions	GRAND TOTAL	CON-TAINER	BULKER	TANkER OIL	General: DRY	General: REEFER	TANKER: LNG	TANKER: LPG	OFFSHORE: OSV	OFFSHORE: OCV	OFFSHORE: MODU
GREECE	$105,227	$7,693	$37,430	$38,396	$2,33	$180	$18,404	$2,751	$50	$90	\
JAPAN	$94,721	$10,113	$40,780	$19,434	$3,534	$513	$15,264	$4,072	$34	$175	$802
CHINA	$90,873	$17,293	$33,332	$20,535	$3,465	$182	$5,754	$2,045	$1,520	$999	$5,748
SINGAPORE	$49,966	$10,154	$11,280	$16,452	$915	$23	$488	$3,995	$2,580	$1,939	$2,181
NORWAY	$48,854	$2,451	$6,091	$12,025	$648	$136	$4,466	$2,544	$3,179	$5,474	$11,842
USA	$44,519	$4,089	$6,916	$14,110	$237	$123	$1,648	$460	$5,084	$2,321	$9,530
GERMANY	$31,460	$16,417	$6,445	$3,218	$3,337	$176	$549	$1,163	$92	$53	\
SOUTH KOREA	$30,007	$5,659	$10,769	$8,789	$715	$183	$2,573	$1,218	$6	$95	\
UK	29,028	$5,268	$3,047	$3,277	$285	$119	$4,153	$1,827	$678	$1,739	$8,635
DENMARK	23,028	$8,988	$2,021	$4,929	$311	$0.5	$1,718	$756	$646	$578	$3,081

Source: Michel and Falcão, 2021

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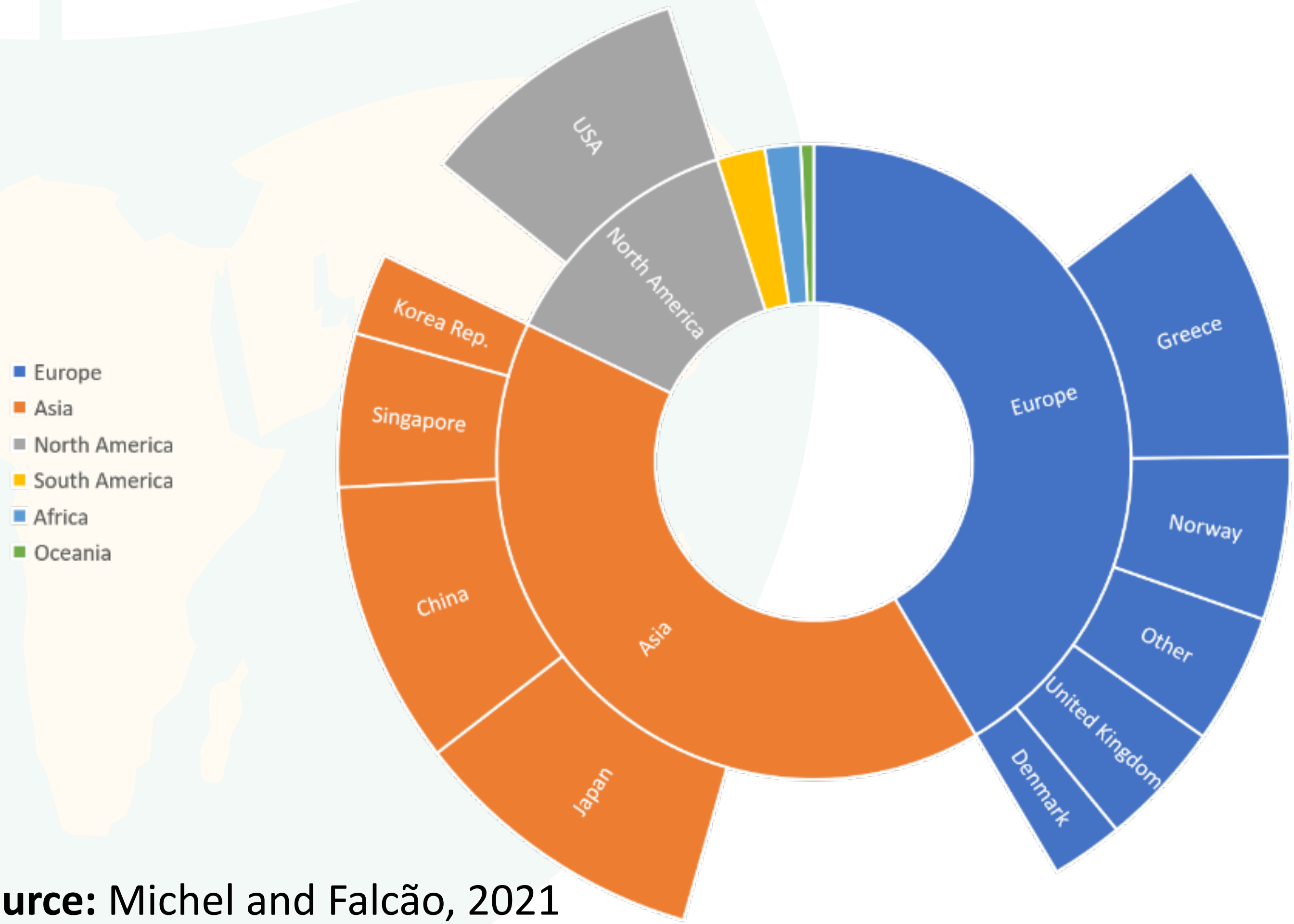
Developed Countries Dominate Fleet Ownership & Have Used OECD & UN Model To Minimize Source Taxation on their Shipping Companies

Share of the world merchant fleet value by country of beneficial ownership, 2020



Source: Michel and Falcão, 2021

Main Parts of Global South that tax Shipping Income at Source are South and Southeast Asia; Africa and Latin America losing out

Latin America and the Caribbean

- Number of Treaties in Latin America and Caribbean that include Article 8 alternative B: 3%
- Brazil, Chile, Mexico and Uruguay
- All with South and Southeast Asian countries and **not** with developed countries
- Exception of Dominican Republic (with Spain and Canada)

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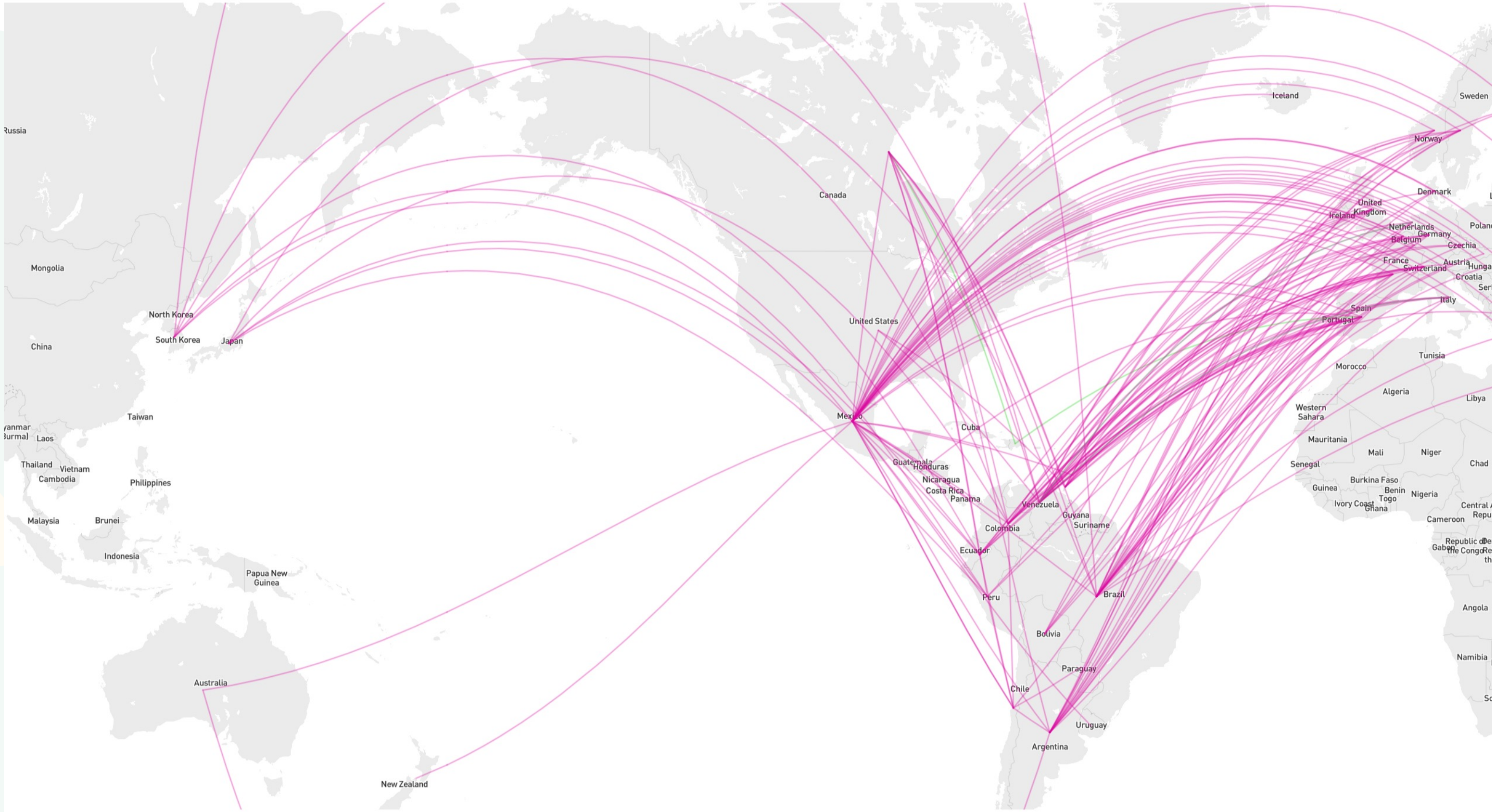
Vast Majority of Latin American and Caribbean Treaties with OECD countries Do Not Tax Shipping Income At Source

Map of treaties



treaties.tax - CC BY 4.0

Article 8B?
Pink: No
Green: Yes

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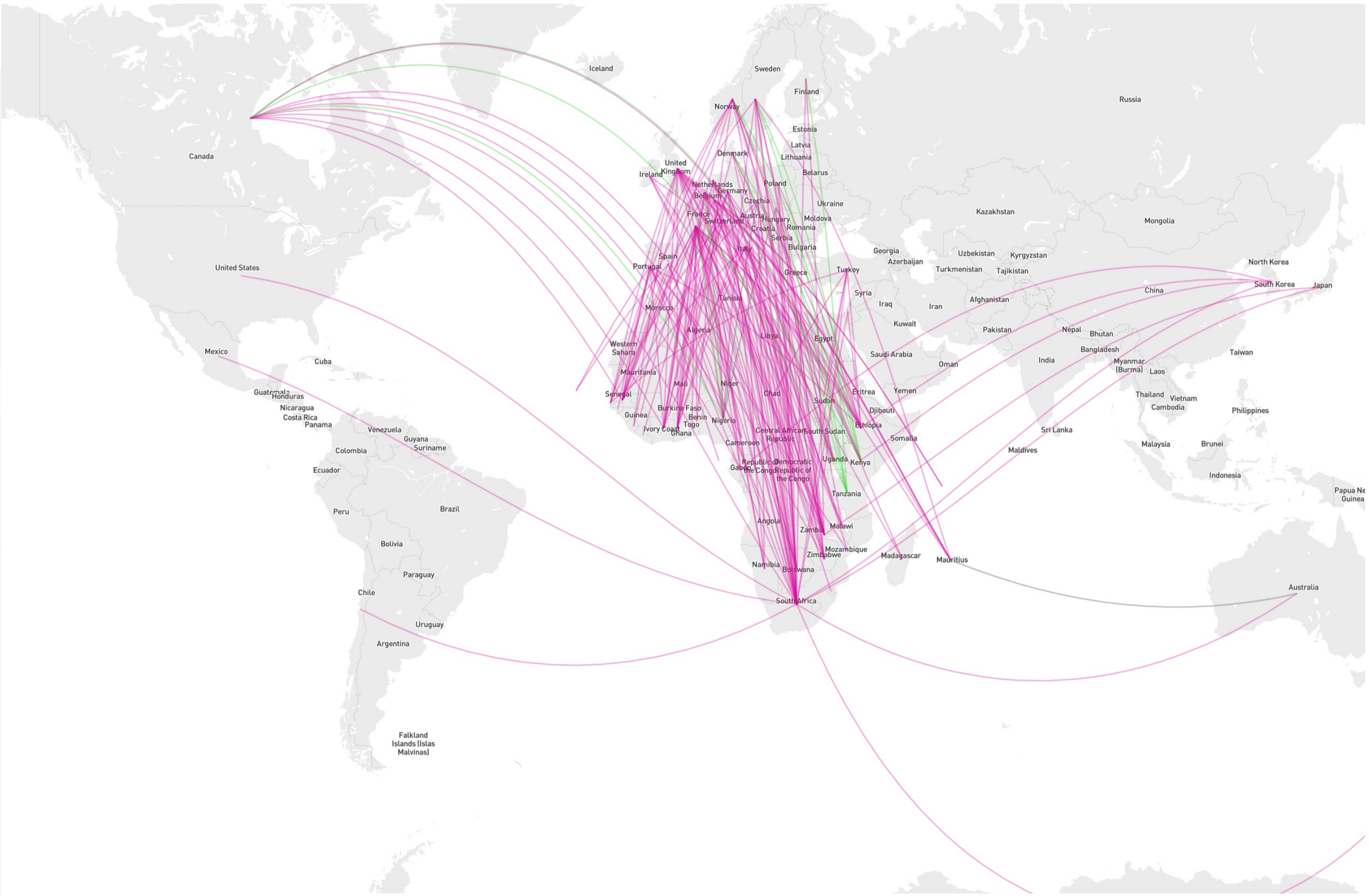
Vast Majority of African Treaties with OECD countries Do Not Tax Shipping Income At Source

Map of treaties



treaties.tax - CC BY 4.0

Article 8B?

Pink: No

Green: Yes

Implications of Surrendering Source Taxation
Revenue Loss: Shipping

- Developing Countries losing out on potentially huge source of revenue from shipping activities in their countries
- No data available so far on country-level estimates of revenue loss from not taxing shipping income
- Research required on this topic
- Developing countries encouraged to engage universities and think tanks in their countries to come up with this data
- **South Centre willing to partner with such institutions to come up with this data**
- **We can be contacted at taxcooperation@southcentre.int to carry out joint studies on this issue**

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Implications of Surrendering Source Taxation

Revenue Loss: Aircraft/ Evidence from Pakistan

Table 10 Pakistan & DTA-Partners: Reciprocally Exempted Revenue T/Y 2014–2018 (Rupees in Million)

	Bahrain		*Oman*		*S. Arabia*		*Turkey*		*Qatar*		*UAE*	
Year	*Given*	*Got*	*Given*	*Got*	*Given*	*Got*	*Given*	*Got*	*Given*	*Got*	*Given*	*Got*
2014	836	6	997	71	2,837	918	738	-	2,781	14	10,084	367
2015	923	8	946	84	3,037	850	1,022	-	3373	24	10,893	369
2016	1,169	30	795	83	3,776	1,324	1,672	0.16	4,742	41	15,570	741
2017	1,259	25	1469	139	4,842	1,610	1,725	0.16	5,268	39	16,114	733
2018	1,269	.31	1582	129	6,076	1,710	2,063	-	5,675	24	16,739	725
Total	5,456	69	5789	506	20,568	6,412	7,220	0.32	21,839	142	69,400	2,935

Source: Civil Aviation Authority vide letter No. HQCAA/1091//067/ATIR/XIV dated 19 October 2018.

Source: Ahmed, 2020

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Implications of Surrendering Source Taxation

Revenue Loss: Aircraft/ Evidence from Pakistan

- Average revenue exemption given 2014-2018: PKR 21,712 million
- Average revenue exemption got 2014-2018: PKR 1,677 million
- **Pakistan lost on average 12X the revenue it received through reciprocal exemption of aircraft income**
- This meant Pakistan's national airways suffered highly unequal competition

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Implications of Surrendering Source Taxation

Stunting of Domestic Shipping and Aircraft Industries/ Evidence from Pakistan

Table 6 Pakistan's DTA Partners (Flights & Revenue): T/Ys 2014 to 2018 (Rupees in Million)

	T/Y 2014		T/Y 2015		T/Y 2016		T/Y 2017		T/Y2018	
Country	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*
Bahrain	3,067	836	3,164	923	3,268	1,169	3,943	1,259	3,993	1,269
Bangladesh	680	44	377	36	24	27	25	28	21	25
China	840	220	930	240	1,079	388	1,354	507	1,613	674
H. Kong	3,119	372	3,156	243	1,808	149	1,483	128	1,297	118
Iran	52	32	60	30	89	40	70	36	53	30
Kuwait	2,037	371	2,400	442	2,737	513	3,623	599	4,373	703
Germany	770	69	503	44	420	33	529	41	540	43
Oman	5,274	995	5,589	946	6,705	795	7,843	1,469	7,640	1,582
Malaysia	-	-	-	-	75	33	335	163	275	141
Sri Lanka	1,257	217	1,193	244	798	269	719	262	621	294
S. Arabia	7,198	2,837	8,122	3,037	8,172	3,776	9,297	4,842	10,823	6,076
Turkey	6,643	738	8,065	1,022	10,138	1,672	10,653	1,725	10,755	2,063
Thailand	9,410	444	9,001	422	7,932	495	9,033	579	9,883	656
Qatar	17,943	2,781	19,450	3,373	20,657	4,742	21,784	5,268	26,762	5,675
UAE	48,749	10,084	57,332	10,893	60,373	15,570	62,497	16,114	60,546	16,739
Uzbekistan	1,806	101	1,691	70	1,549	74	1,471	76	1,630	119
Total	108,845	20,140	121,033	21,965	125,839	29,748	134,664	33,099	140,825	36,207

Source: Civil Aviation Authority vide letter No. HQCAA/1091//067/ATIR/XIV dated 19 October 2018.

Source: Ahmed, 2020

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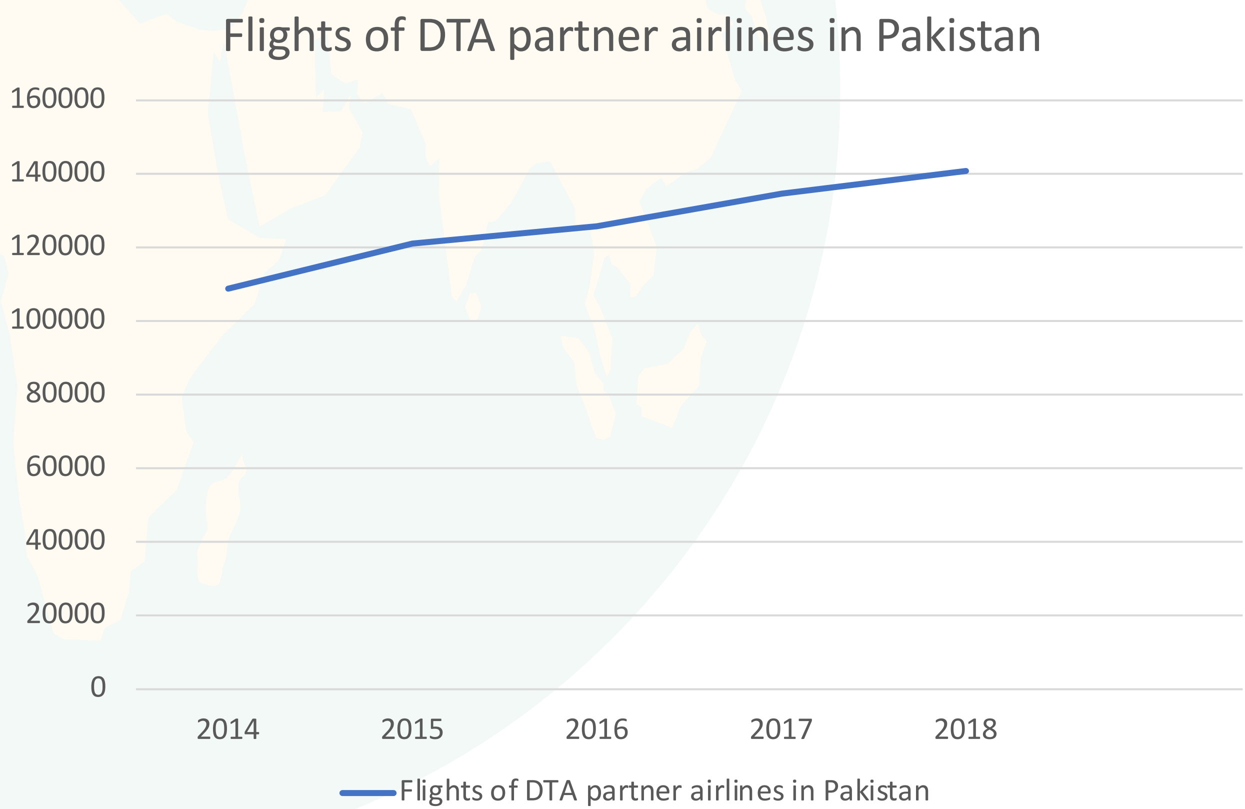
Implications of Surrendering Source Taxation

Stunting of Domestic Shipping and Aircraft Industries / Evidence from Pakistan

- Massive growth in flights of airways from treaty partners
- Increased from 108, 845 in 2014 to 140,825 in 2018
- **Loss of Pakistan's market share to foreign airline companies**



Implications of Surrendering Source Taxation

Stunting of Domestic Shipping and Aircraft Industries / Evidence from Pakistan

Table 9 Pakistan's Aviation in DTA Partners (Flights & Revenue): T/Ys 2014 to 2018 (Rupees in Million)

	T/Y 2014		T/Y 2015		T/Y 2016		T/Y 2017		T/Y 2018	
Country	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*	*Flights*	*Revenue*
Bahrain	21	6	26	8	85	30	77	25	1	0.318
Bangladesh	197	13	134	13	123	138	107	120	129	154
China	150	39	153	39	186	67	146	55	104	43
Iran	26	16	15	8	-	-	-	-	-	-
Kuwait	241	44	221	41	213	40	225	37	159	26
Germany	9	1	-	-	-	-	-	-	-	-
Oman	374	71	498	84	703	83	740	139	625	129
Malaysia	192	-	229	-	294	129	307	149	216	111
S. Arabia	2,330	918	2,273	850	2,866	1,324	3,092	1,610	3,046	1,710
Turkey	-	-	-	-	1	0.164	1	0.162	-	-
Qatar	88	14	137	24	178	41	162	39	112	24
UAE	1,774	367	1,940	369	2,874	741	2,842	733	2,624	725
Total	5,402	1,488	5,626	1,435	7,523	2,595	7,699	2,907	7,017	2,922

Source: Civil Aviation Authority vide letter No. HQCAA/1091//067/ATIR/XIV dated 19 October 2018.

Source: Ahmed, 2020

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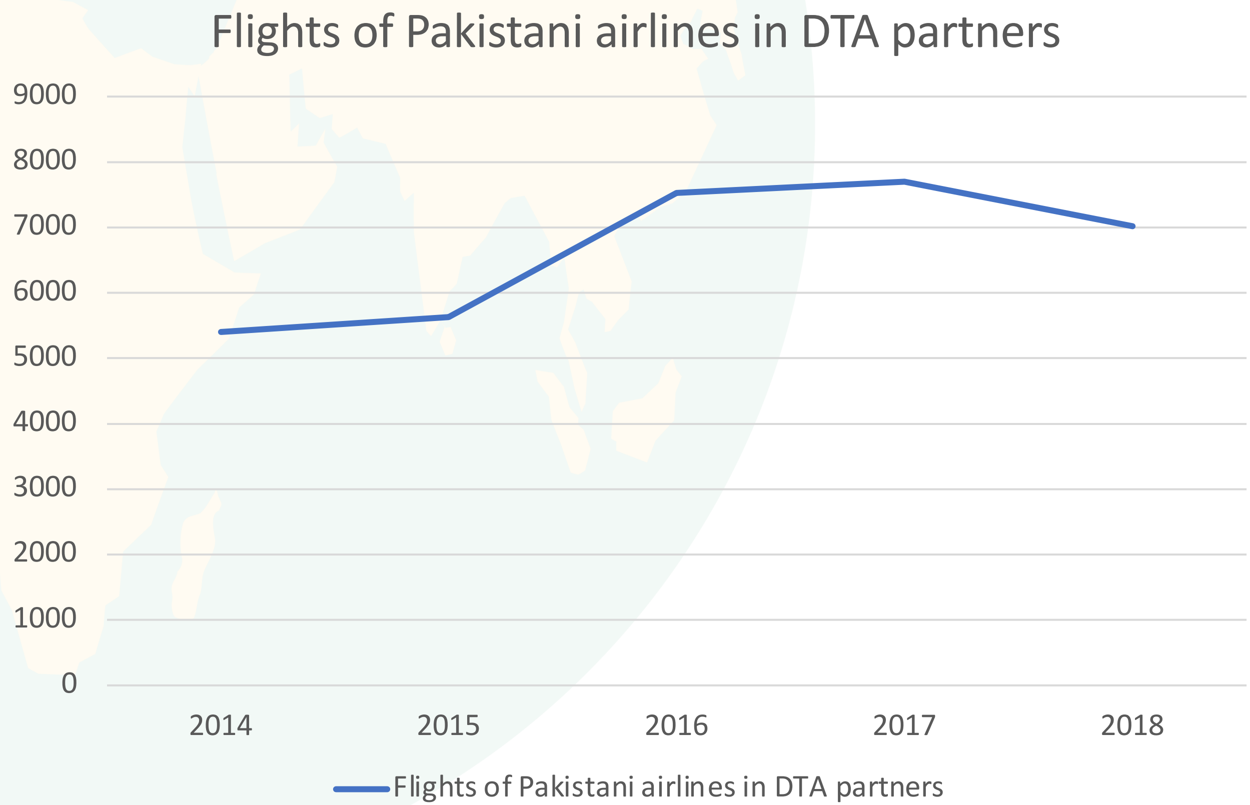
Implications of Surrendering Source Taxation

Stunting of Domestic Shipping and Aircraft Industries / Evidence from Pakistan

- Flights of Pakistani airways to treaty partners began to actually decline
- **Contributed to overall decline of Pakistan's aviation sector**



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Implications of Surrendering Source Taxation

Weakening of National Defence

- National Defence Requires Navy and Air Force
- Domestically manufacturing these requires strong shipping and aircraft industries
- Stunting of these industries through unequal tax-based competition also weakens national defence

Implications of Surrendering Source Taxation

Continuous Expansion of Income Under Article 8

Income Under Article 8 effectively taxed lower than Business Profits (Article 7)

Steady Expansion of what counts as ‘profits’ from international shipping & aircraft

Scope expanded from activities *directly* connected to include *ancillary*

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Implications of Surrendering Source Taxation

‘Ancillary’ Activities as per OECD Guidelines

- (1) leasing of ships or aircrafts on charter;
- (2) sale of tickets or booking of load on behalf of other enterprises
- (3) operation of a link passenger transport service;
- (4) marketing, advertising or commercial publicity
- (5) transportation of goods by trucks to and from a port or airport to a depot
- (6) containerization as well as ‘from detention charges for the late return of containers’
- (7) operation of boats and vessels ‘engaged in fishing, dredging or hauling activities on the high seas

Implications of Surrendering Source Taxation

Phenomenon Mirrored in Domestic Law

Residence countries expanding tonnage tax regime to not just cover shipping income, but also ancillary income of any kind

And to include core activities that are not transport

Eg - Netherlands

Tonnage tax regime modified to include all activities from offshore service vessels (dredging, pipelaying, exploration etc)

Activities will not be under article 8.

But given that these activities do not trigger the PE threshold under the treaties in source countries (and assuming there is no 12A in play)…

…end result is the same: exclusive residence taxation and very low rates due to tonnage tax regimes

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Implications of Surrendering Source Taxation

Capital Gains effectively Exempt Under UN Model Tax Convention

Capital Gains from selling ships or aircraft or movable property relating to it....

...is taxable in the resident State

Article 13(3) UN MTC 2021

Implications of Surrendering Source Taxation

Balance of Payments Crisis

- Foreign Exchange outflow
- Balance of Payments Crisis
- Going to IMF & countries for bailouts

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Advantages of Source Taxation of Shipping & Aircraft Income

Benefits for Developing Countries

- Many Developing countries coastal nations
- In their interest to tax shipping & aircraft income at source
- Increased Tax Revenues
- Increased Forex Reserves
- Strengthened Domestic Shipping & Airlines Industries
- Strengthened National Defences
- Geopolitical Independence (reduced debt & military dependency on foreign countries)
- National Pride as flag-bearing nations

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Stance of African countries towards source taxation of shipping and air transport income

Already, many ATAF countries are extremely in favour of source taxation of maritime shipping and air transport income, as evident from their stance in the taxation of shipping and air transport income under the ATAF Model Agreement for the elimination of double taxation with respect to taxes on income and the prevention of tax avoidance and evasion*:

- The countries reserving the right to tax maritime transport profits at source are: Benin, Gabon, Gambia, Ghana, Kenya, Nigeria, Senegal, Togo and Uganda.
- The countries reserving the right to tax air transport profits at source are: Benin, Chad, Gabon, Gambia, Ghana, Niger, Nigeria, Swaziland, Togo and Uganda.

* https://events.ataftax.org/media/events/6/documents/ATAF_Model_DTA_Revised_30_Nov.pdf

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UN Model Article 8 (Alternative B): Overview of South/South-East Asian tax treaty practice

	8B Treaties/ Total Tax Treaties	Treaty: Income covered (SEA/AIR)	Treaty: Residence state (RES/PoEM)	Treaty: Sourcing rule (most used)	Treaty: Taxation method source state	Domestic law: Income covered	Domestic law: sourcing rule/tax base	Domestic law: method of taxation
BANGLADESH	31/34 (91%)	SEA	RES	• Profits derived from the other state	• 50% reduction of tax (on gross or net income)	SEA/AIR	• Payments made in country to non-resident	• 7.5% WHT on gross (SEA) • 3% WHT on gross (AIR)
INDIA	17/103 (17%)	SEA	RES	• Profits from operation within the other state • Profits from transport between source state and third countries • Profits derived from the other state	• 40 to 66% reduction of tax (on gross or net income) • No limit in case of transport between source state and third countries	SEA/AIR	• Payments, made in India or outside, for outbound transport; and • Payments, made in India, for inbound transport	• 7.5% WHT on gross (SEA) • 5% WHT on gross (AIR)
INDONESIA	21/70 (19%)	SEA	RES	• Profits from sources in the other state	• 50% reduction of tax (on gross or net income)	SEA/AIR	• Gross turnover on outbound transport	• 2.40% on gross (based on 6% deemed net profits) (SEA and AIR) • 20% WHT if no PE/agent in source state
MYANMAR	8/8 (100%)	SEA	RES	• Profits derived from (sources in) the other state	• 50% reduction of tax (on gross or net income)	*(no information)*	*(no information)*	*(no information)*

Source: ICTD's Working Paper 133
Taxing Profits from International Maritime Shipping in Africa: Past, Present and Future of UN Model Article 8 (Alternative B), by Bob Michel and Tatiana Falcão, November 2021

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UN Model Article 8 (Alternative B): Overview of South/South-East Asian tax treaty practice cont….

	8B Treaties/ Total Tax Treaties	Treaty: Income covered (SEA/AIR)	Treaty: Residence state (RES/PoEM)	Treaty: Sourcing rule (most used)	Treaty: Taxation method source state	Domestic law: Income covered	Domestic law: sourcing rule/tax base	Domestic law: method of taxation
PAKISTAN	28/66 (43%)	SEA	RES	• Profits from sources in the other state	• 50% reduction of tax (on gross or net income)	SEA/AIR	• Gross payments, wherever received, for outbound transport; and • Gross payments in Pakistan for inbound transport	• 8% WHT on gross (SEA) • 3% WHT on gross (AIR)
PHILIPPINES	43/43 (100%)	SEA/AIR	RES	• Profits arising in the other state	• Max. 1.5% on gross revenue • MFN clause lowest rate in Philippine tax treaties	SEA/AIR	• 'gross Philippine billings' (*i.e.* gross revenue derived from outbound transport, wherever paid)	• 2.5% on gross receipts (SEA and AIR)
SRI LANKA	46/47 (95%)	SEA	RES	• Profits from the state where the operation is carried on • Profits derived in the other state	• 50% reduction of tax (on gross or net income)	SEA/AIR	• Payments for outbound transport are deemed to have source in country	• 2% on gross receipts (SEA and AIR) • If PE in Sri Lanka: net taxation at standard rate of 14%

Source: ICTD's Working Paper 133
Taxing Profits from International Maritime Shipping in Africa: Past, Present and Future of UN Model Article 8 (Alternative B), by Bob Michel and Tatiana Falcão, November 2021

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UN Model Article 8 (Alternative B): Overview of South/South East Asian tax treaty practice cont….

	8B Treaties/ Total Tax Treaties	Treaty: Income covered (SEA/AIR)	Treaty: Residence state (RES/PoEM)	Treaty: Sourcing rule (most used)	Treaty: Taxation method source state	Domestic law: Income covered	Domestic law: sourcing rule/tax base	Domestic law: method of taxation
THAILAND	58/61 (86%)	SEA	RES	• Profits from the operation in the other state • No sourcing rule • If PE in source state	• 50% reduction of tax (on gross or net income)	SEA/AIR	• Goods: Gross freight charges inbound and outbound transport • Passengers: gross ticketing revenue physically connected to Thailand with deduction of expenses	• Goods: 3% on gross receipts • Passengers: 3% on gross ticketing receipts after deduction of expenses

Source: ICTD's Working Paper 133
Taxing Profits from International Maritime Shipping in Africa: Past, Present and Future of UN Model Article 8 (Alternative B), by Bob Michel and Tatiana Falcão, November 2021

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Other notable facts in South/South-East Asia Tax Treaties

Country	Treaty related information in respect of shipping income			Whether tax treaties contain an activity threshold ('more than casual' as in Article 8 (Alternative B) of the UN Model)
	Total Treaties	Treaties with OECD countries	Source taxation with OECD countries	
Bangladesh	34	17	15 (86%)	No, which means the source country can tax any income that meets the source rule criteria as per its domestic law.
India	103	35	6 (17%)	-do-
Indonesia	70	27	5 (19%)	-do-
Myanmar	8	1	1 (100%)	-do-

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Other notable facts in South/South-East Asia Tax Treaties cont..

Country	Treaty related information in respect of shipping income			Whether tax treaties contain an activity threshold ('more than casual' as in Article 8 (Alternative B) of the UN Model)
	Total Treaties	Treaties with OECD countries	Source taxation with OECD countries	
Pakistan	66	23	10 (43%)	No, which means the source country can tax any income that meets the source rule criteria as per its domestic law.
Philippines	43	25	25 (100%)	-do-
Sri Lanka	47	20	19 (95%)	-do-
Thailand	61	29	25 (86%)	-do-

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Taxation of air transport

- The Philippines: developed a substantial practice of taxing air transport at source and its tax treaties with a number of countries has source-based taxation.

- Indonesia: In four tax treaties currently in force (for example with the Philippines, Qatar), source state taxing rights are also allocated for air transport.

- India: The tax treaty of India with the Philippines allocates source state taxing rights on profits from air transport.

- Thailand: Treaty with Philippines (2013) also applies source taxation to air transport.

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Conclusion

- Despite developing countries being an important shipping destination, since they are lacking in significant domestic shipping business, inclusion of Article 8 (Alternative B) of the UN Model provides scope for source state taxation of shipping profits.

- A significant number of African and South/South-East Asian countries already favour source-based taxation of profits arising from maritime shipping and air transport activities.

- As discussed above for South/South-East Asian countries:
  - have treaty and domestic law provisions to tax shipping income.
  - taxation of air transport profits are provided for in some treaties, whereas domestic law of all such countries contain provisions to tax air transport profits.
  - number of treaties with OECD countries already provide for source taxation.

  - **Weak international standards nevertheless make it challenging for developing countries to include source taxation in tax treaties**

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Reform Options

Strengthening International Tax Standards

UN Model Tax Convention

- Ongoing Efforts to Reform Article 8 of UN Model Tax Convention
- Reform options to be discussed in next session of UN Tax Committee

Discussion in 27th Session of the UN Tax Committee

i. whether Article 8 should continue to have an option providing for exclusive residence- based taxation as in Alternative A;

ii. if the answer to i) is yes, whether the order of the alternatives in Article 8 should be reversed, presenting the option that allows source-State taxation first;

iii. whether the redrafted present Alternative B is fine;

iv. whether Alternative B, paragraph 2 should cover both shipping and international air transport (as in the draft in paragraph 16) or only shipping;

v. to what extent ancillary income should be covered under Article 8, and some examples of what members think is covered and what is not; and

vi. general suggestions on language of the proposed Commentary.

SOUTH CENTRE

Refer CRP 44 of the October ’23 Session

Position of Developing Country Members of the UN Tax Committee

- **Alternative 8A, which provides for exclusive residence based taxation, should be removed from the Article.** If necessary, could be placed into the Commentary.

- Developing countries which are in favour of it can draw upon the version in the OECD Model instead in treaty negotiations.

- Sourcing rules, which will attribute profit to developing countries, very important and design requires careful attention. **Inputs required from Country Observers.**

- Commentary could give options to countries on whether tax should be on gross or net basis if they have domestic law provisions.

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Refer CRP 44 of the October ’23 Session

Way Forward

What can PTLAC and South Centre Member States do Individually?

Register for 28th Session of UN Tax Committee and Participate as Country Observers either online or in person

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Registration link: https://financing.desa.un.org/events/28th-session-committee-experts-international-cooperation-tax-matters

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Speak during the session and support reform position of developing country Members of UN Tax Committee

Way Forward

What can PTLAC and South Centre Member States do Individually?

Domestic Law

- Introduce laws to tax income from shipping and aircraft at source

Treaties

- Renegotiate/terminate treaties which lack source taxation of international transport

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