

Tax, Budget & Accounting

Tax Exclusions

Attorneys for Foreign Shipping Firms Differ in Reactions to Ship, Aircraft Rules

Practitioners who represent ocean carriers affected by recent Internal Revenue Service guidance (T.D. 9087) on the tax exclusion for income from international operations expressed varied reactions to BNA regarding the regulations.

Marc Fink of Sher & Blackwell in Washington, D.C., who represents carriers providing regularly scheduled services for container ships, told BNA Sept. 4 he was "reasonably happy" with the final rules.

But Kenneth Klein of Mayer, Brown, Rowe & Maw in Washington, D.C., who represents a substantial element of the world's commercial shipping industry, both U.S. and foreign-owned, told BNA Sept. 8 "the [final] regulations made some improvements over the proposed regulations, but could have reasonably gone significantly farther than they did."

Bill Goldstein of Drinker, Biddle & Reath in Philadelphia, told BNA Aug. 28 "the larger concepts in the regulations are done very well."

Stephen Flott of Flott & Co, P.C., in Arlington, Va., whose clients are principally "tramp" operators of bulk cargo vessels, told BNA Sept. 8 he was disappointed with the final regulations, which failed to include any of the proposals affecting tramp operators.

In some cases, IRS made the right call when it issued new proposed regulations in 2002, the practitioners said.

Rules Address International Operations

The final regulations (165 G-1, L-10, 8/26/03) interpret tax code Section 883, which exempts income from the international operation of ships and aircraft owned by a foreign corporation if the corporation is organized in a country that provides a similar income exclusion for U.S. corporations.

The final regulations adopted regulations (REG-136311-01) IRS had repropoed in July 2002 (148 DTR G-12, L-7, 8/1/02), after it withdrew regulations (REG-208280-86) proposed in 2000 (26 DTR G-2, L-28, 2/8/00).

The international operation of ships and aircraft refers to a voyage or flight that begins or ends in the United States, but does not include a trip that both begins and ends in the United States.

The regulations, for example, would address the treatment of income for a shipment of goods from New York to Hamburg, Germany, on a German ocean carrier, Fink explained. These rules exempt the shipping company's income from U.S. tax, provided the ship operates under the flag of a country that does not tax similar operations of U.S. companies.

Issues of Liner Carriers Addressed

Fink represents containerized carriers, which are also known as liner carriers, he said.

"Most of the issues we're concerned about have generally been [addressed]," Fink said, although he was not "thrilled" with the final regulations.

"Incidental income was an important issue," Fink said. These rules address whether income can be excluded because it is earned from an activity incidental to a ship's international operations.

"The rules reflect considerable dialogue with IRS on whether inland transportation [of cargo] is incidental, which was not the case with the 2000 rules," Fink said. "The final rules generally treat inland transportation as incidental. We might have wanted some different wording, but the final rules are [satisfactory]," he said.

Provision of Containers Considered 'Incidental'

When a carrier provides containers for a customer's use in connection with transportation to allow the customer to load or unload cargo, the issue is whether any income should be imputed when a container is provided for a period of time," Fink said. The final regulations are generally helpful, although the wording is not the best, he said.

The incidental activity rules for intermodal containers were modified in the final regulations to establish a presumption that containers used for five days or less are part of the international shipping activity.

Fink was satisfied that IRS reserved the rules for other ground services at terminals. "This really needs to be considered in an international context, with other countries and the [Organization for Economic Cooperation and Development], for example," he said. Reserving the issue allows further discussions, Fink said.

The ownership rules are not a particular concern for the liner community, Fink said.

Rules Improved for Publicly Traded Companies

Goldstein, a former deputy assistant secretary for tax policy, filed comments on behalf of a major international cruise line company.

"A major issue was determining the eligibility of publicly traded companies, and the repropounded regulations got it right," he told BNA. "The standards are fair and consistent with the policy of the statute," he said.

Section 883 requires that more than 50 percent of the ship or aircraft be owned by individuals of a country that provides a similar tax exclusion for U.S. corporations. The proposed rules would have disqualified a class of stock from the publicly traded test if, at any time during the year, one or more 5 percent shareholders owned 50 percent or more of the stock. The final rules require the disqualifying 50 percent stock ownership for more than half of the corporation's taxable year.

The final regulations declined to treat day trips on shore as incidental to a cruise ship operation. Goldstein said he had "quibbles" with some of the final rules, such as this one. He views shore excursions as an integral part of cruise. By taking a contrary view in the final regulations, IRS "drives up cost of compliance very high for a very small gain in revenue."

Section 883 was amended by the Tax Reform Act of 1986. "Taking 15 to 17 years to resolve this area is not real good, but apparently the regulation wasn't on the front burner," Goldstein said.

Compliance Termed Low for Tramp Operators

Flott said his clients operate bulk cargo vessels from port to port on an as-needed basis, as opposed to the liner services that operate on a regularly scheduled basis. For example, a client's tanker may carry grain from the United States to Europe, and then pick up a bulk cargo of cement to take to East Asia, much like a taxi cab, he said.

Many of his clients are in compliance with U.S. tax rules, Flott said, but the overall level of compliance with the reporting rules under Section 883 is minimal. Flott discussed the problems of low compliance in his comments on the proposed regulations (227 DTR G-13, TaxCore, 11/25/02)


The final rules "dramatically alter the amount of disclosure required, but will not increase compliance," Flott said. The rules require a great deal more bookkeeping, documentation, and disclosure--more paperwork, he said. The result will be that "the level of compliance will go down, and the new requirements will drive operators underground," he said.


Flott also said his clients consider requirements to put ownership information on a tax return and disclose it to IRS intrusive. Many carriers are family-owned or held by closely owned groups, Flott said, unlike liner companies, which are public companies and do not have the same concerns.

Flott had suggested an alternative procedure to IRS, rather than requiring disclosure up front. He proposed that the operator collect ownership information and deposit it in the United States with a U.S. practitioner subject to Circular 230, who would make the information available if requested during an audit. IRS declined to adopt this proposal.

By Brant Goldwyn

Copyright © 2003 by The Bureau of National Affairs, Inc., Washington D.C.

 **Previous Doc**

 **Next Doc**

 **Search**

 **Contents**

[=+9/9/2003+OR+FIELD+IssueDate+>=+9/9/2003\)](#)

[&SearchOrder=1&SearchMax=0&SearchWV=TRUE>](#)

 **Back to Search Results**