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ATTORNEYS

US TAXATION OF INTERNATIONAL SHIPPING

GLOBAL TAX FOR SHIPPING

DEXTER HOUSE, LONDON

7-8 November 2013

Agenda

- ❖ **History – Tax Reform Act of 1986**
 - ❖ **Overview – Structure of Tax**
 - ❖ **Scope – Transportation Income**
- ❖ **Exemptions – How They Work**
- ❖ **Section 883 Regulations**
- ❖ **Compliance – How You Comply**

The Tax Reform Act of 1986

- ❖ Added Section 887 – 4% Tax
- ❖ Changed “source” rules for income from “international transportation” of cargo/passengers
- ❖ 50% is deemed “US source gross transportation income” - USSGTI
- ❖ USSGTI includes T/C, V/C and B/B hire

The Tax Reform Act of 1986

- ❖ Tax is levied on a “gross basis” – no deductions are allowed
- ❖ Creates “multiple” taxation of USSGTI of owners, desponent owners & charterers

The Tax Reform Act of 1986

- ❖ **B/B & T/C income are calculated from time vessel begins cargo operations in the load port until vessel completes discharge at the destination port or ports**
- ❖ **V/C income is the gross freight plus demurrage and “dead freight” less “dispatch”**

The Tax Reform Act of 1986

- ❖ Provided for exemptions from the tax for all recipients of USSGTI based on
 - ❖ treaties between country of incorporation and US
 - ❖ exchanges of notes between country of incorporation and the US
 - ❖ domestic law of the country of incorporation

Treaty Exemptions

- ❖ **Company seeking to use treaty exemption must be incorporated in a US treaty partner**
- ❖ **It must be all of the conditions set out in the treaty, including the “limitation on benefits” article**

Section 883 Exemptions

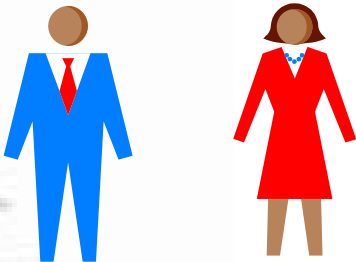
❖ Qualification for exemption starts with country of incorporation of vessel owning company, flag is generally not relevant

“Good” countries qualify based on either an exchange of notes with the US or the domestic law of the country of incorporation

“Look Through Rule”

- ❖ Ignores all intervening corporations or other entities between vessel owning corporation and ultimate beneficial owners**

More than 50% of the shares (by value) of the vessel corporation must be owned by persons who reside in “good” countries



Beneficial Owners

~~X Shipping Inc.~~

~~Y Shipping Inc.~~

~~Z Shipping Inc.~~

~~TRUST~~

Look Through Rule

Section §883 Regulations

- ❖ **Published on August 26, 2003**
- ❖ **Effective on September 25, 2003**
- ❖ **JOBS Act in October 2004 extended effective date to September 24, 2004**
- ❖ **Apply to tax years beginning on or after September 24, 2004, meaning they apply as of 1/1/2005 for most companies**

**Section §883 Regulations DO
NOT APPLY to corporations
that qualify for exemption
based on a tax treaty with the
US**

**Corporations that cannot use a
tax treaty exemption must
comply with the §883
Regulations to qualify for
exemption from the tax**

Section §883 Regulations

- ❖ **Qualified Foreign Corporation Rules**
- ❖ **Qualified Shareholder Rules**
- ❖ **Residency Requirements**
- ❖ **Documentation Requirements**
- ❖ **Disclosure Requirements**

Section §883 Regulations

❖ Qualified Foreign Corporation Rules?

To be a qualified foreign corporation, the corporation must satisfy the stock ownership test of §1.883-1(c)(2) AND satisfy the substantiation and reporting requirements described in §1.883-1(c)(3)

Stock Ownership Tests

- ❖ **Publicly-traded test of §1.883-2(a)**
 - Only consider definition
- ❖ **CFC (controlled foreign corporation) test of §1.883-3(a)**
 - Companies owned/controlled by US citizens
 - Regulation not considered at all
- ❖ **Qualified shareholder test of §1.883-4(a)**
 - Requirements considered in detail later

Stock Ownership Tests

❖ Publicly-traded test of §1.883-2(a)

A foreign corporation satisfies the stock ownership test if it is considered a publicly-traded corporation AND satisfies the substantiation and reporting requirements of §1.883-2(e) & (f)

Stock Ownership Tests

❖ Publicly-traded

To be considered a publicly-traded corporation, the stock of the foreign corporation must be primarily and regularly traded on one or more established securities markets in either the United States or any qualified country

Stock Ownership Tests

❖ Qualified Shareholder Stock Ownership

A foreign corporation satisfies the stock ownership test if more than 50% of the value of its outstanding shares is owned (or treated as owned by applying the attribution rules of §1.883-4(c)) for at least half of the corporation's tax year by one or more qualified shareholders as defined in §1.883-4(b)

Qualified Shareholder

❖ General Rule

A shareholder is a qualified shareholder **ONLY** if the shareholder

- resides (as defined in §1.883-4(b)(2)) in a qualified country
- does not own his/her/its interest in the foreign corporation through bearer shares either directly or by applying the attribution rules of §1.883-4(c)
- provides to the foreign corporation the documentation required by §1.883-4(d); **AND**
- meets the reporting requirements of §1.883-4(e)

Qualified Shareholder

❖ Residence of individual shareholders

A shareholder is a resident of a qualified country only if the shareholder is fully liable to tax as a resident of such country; remittance taxpayers are not treated as residents unless all residents of that country are treated on the same basis, *i.e.*, as remittance taxpayers AND

Qualified Shareholder

- ❖ **Residence of individual shareholders**
 - **The individual has a tax home in that qualified foreign country for 183 days or more of the tax year**
 - **An individual's tax home is considered to be where the individual's regular or principal place of business is located**
 - **If an individual has no regular or principal place of business or abode for 183 days or more, he has no tax home**

Qualified Shareholder

❖ Constructive ownership

- Stock owned by or for a corporation, partnership, trust, estate, or similar entity shall be treated as owned proportionately by its shareholders, partners, beneficiaries, grantors or other interest holders as provided in §1.883-4(c)(2)-(7)
- No attribution will apply to an interest held directly or indirectly through bearer shares

Compliance

- ❖ **US tax return (Form 1120F) must be filed EVERY YEAR if a vessel calls at a US port to load or discharge cargo**
- ❖ **By owner, disponent owner and all charterers who earn income from the movement of cargo to or from the US**
- ❖ **Even if the owner, disponent owner and all charterers are exempt**

Compliance

- ❖ **Treaty based returns must be filed on Form 1120F and must include a Treaty-based Return Disclosure Statement (Form 8833)**
- ❖ **Section 883 returns must be filed on Form 1120F and include specified disclosure information based on sworn ownership statements**

Compliance

- ❖ **Failure to file a Treaty-based return is subject to a \$10,000 penalty for each year that Form 8833 is not filed**
- ❖ **Failure to file a Section 883 return is subject to a \$10,000 penalty for failure to comply with Section 6038A**
- ❖ **There is NO statute of limitation for unfiled returns**

Section 883 Compliance

❖ Substantiation and reporting requirements

❖ To be a qualified foreign corporation, it must include the following information in its Form 1120-F:

- **Name and address**
- **US tax identification number (EIN)**
- **Name of country of incorporation**
- **Authority for foreign country's equivalent exemption (note or domestic law)**
- **Categories of qualified income**
- **A reasonable estimate of such income**
- **Information under §1.883-2(f), §1.883-3(d), or §1.883-4(e)**
- **Any other information requested on Form 1120-F**

Qualified Shareholder

❖ Substantiation of stock ownership

A foreign corporation that relies on §1.883-4 must establish that more than 50% of the value of its shares is owned (or treated as owned) by qualified shareholders; a foreign corporation cannot meet this test with respect to any stock issued in bearer form; a shareholder that holds shares directly or indirectly in bearer form cannot be a qualified shareholder

Qualified Shareholder

❖ Ownership Statements

A person can be treated as a qualified shareholder by a foreign corporation relying on §1.883-4 ONLY if that person provides an ownership statement AND the corporation obtains the statement required and maintains it on file

Qualified Shareholder

- ❖ **If the individual owns stock in a corporation that, in turn, directly or indirectly owns stock in the corporation that seeks exemption from the tax, that individual must provide the name of the intermediary corporation, the number and class of shares or amount and nature of the person's interest in such corporation and the period of time during the year that the individual held such interest**

Ownership Statements

- ❖ To be considered a qualified shareholder, one must complete an ownership statement described in §1.883-4(d)(4) or have a valid ownership statement in effect under §1.883-4(d)(2)(ii)
- ❖ Each intermediary in the chain of ownership between a qualified shareholder and the foreign corporation must complete an intermediary ownership statement described in §1.883-4(d)(v) or have a valid ownership statement in effect under §1.883-4(d)(2)(ii)

Ownership Statements

- ❖ **An ownership statement is valid for three years until either the last day of the third calendar year following the year in which the statement is signed or the day on which a change in circumstances occurs that makes the information on the statement incorrect**

Ownership Statements

❖ From Individuals

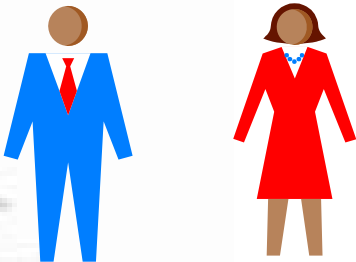
An ownership statement must be in writing, be dated and signed by the individual under penalty of perjury, and must contain the following information:

- ❖ **The individual's name, permanent address, and the identity of the country where the individual is fully liable to tax as a resident**
- ❖ **If not a resident of that country for the entire year, the name of each foreign country in which that person resided and the date(s) of such residence**
- ❖ **The name of the corporation in which the individual owns stock, the number of each class of stock owned by him/her/it and the period during the year that the individual owned such stock**

- ❖ **To the extent known by the individual, a description of the chain of ownership through which the individual owns stock in the corporation seeking qualified foreign corporation status, including the name and address of each intermediary standing between the intermediary corporation and the individual**



Ownership Statement



Beneficial Owners

~~X Shipping Inc.~~

~~Y Shipping Inc.~~

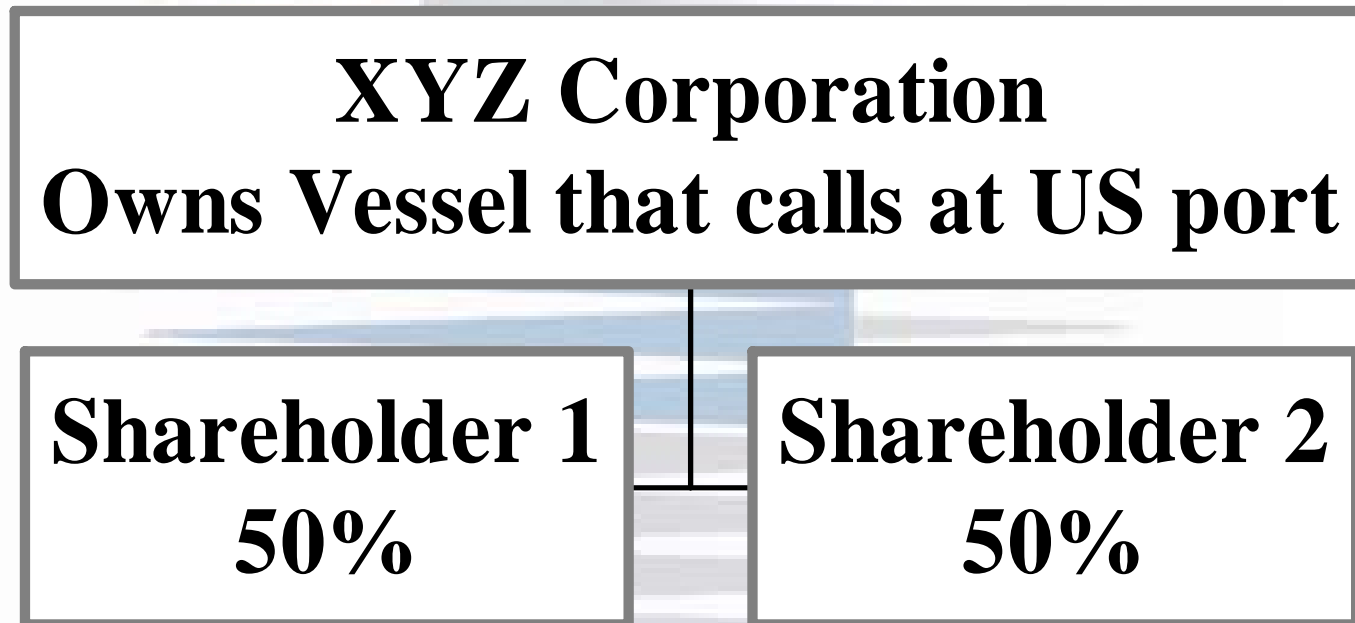
~~Z Shipping Inc.~~

~~TRUST~~

Statement must describe chain of ownership from individual to shipowning company

Ownership Statements–Example #1

Direct ownership of Vessel Corp.



Ownership Statements–Example #2

Indirect ownership of Vessel Corp.

XYZ Corporation
Owns Vessel that calls at US port

100%
ABC Corporation
Applies to all intermediaries
(Nominee shareholders, etc.)

Shareholder 1
50%

Shareholder 2
50%

Ownership Statements

❖ From Intermediaries

An intermediary ownership statement must be in writing, be dated and signed by the intermediary (if an individual or by the person who would be authorized to sign a tax return if a corporation) under penalty of perjury, and must contain the following information:

- ❖ **The name, address, country of residence, and principal place of business of the intermediary**
- ❖ **The same information required of an individual shareholder**
- ❖ **If the person is a nominee for a shareholder or another intermediary, the name and permanent residence of the shareholder, or the name and principal place of business of the intermediary**
- ❖ **If the intermediary is not a nominee, the name and country of residence and the interest in the intermediary of each shareholder of the intermediary**

Ownership Statements

❖ Retention and Availability

The ownership statements described in the preceding slides must be kept by the corporation for six years and must be made available for inspection when and where requested by the IRS

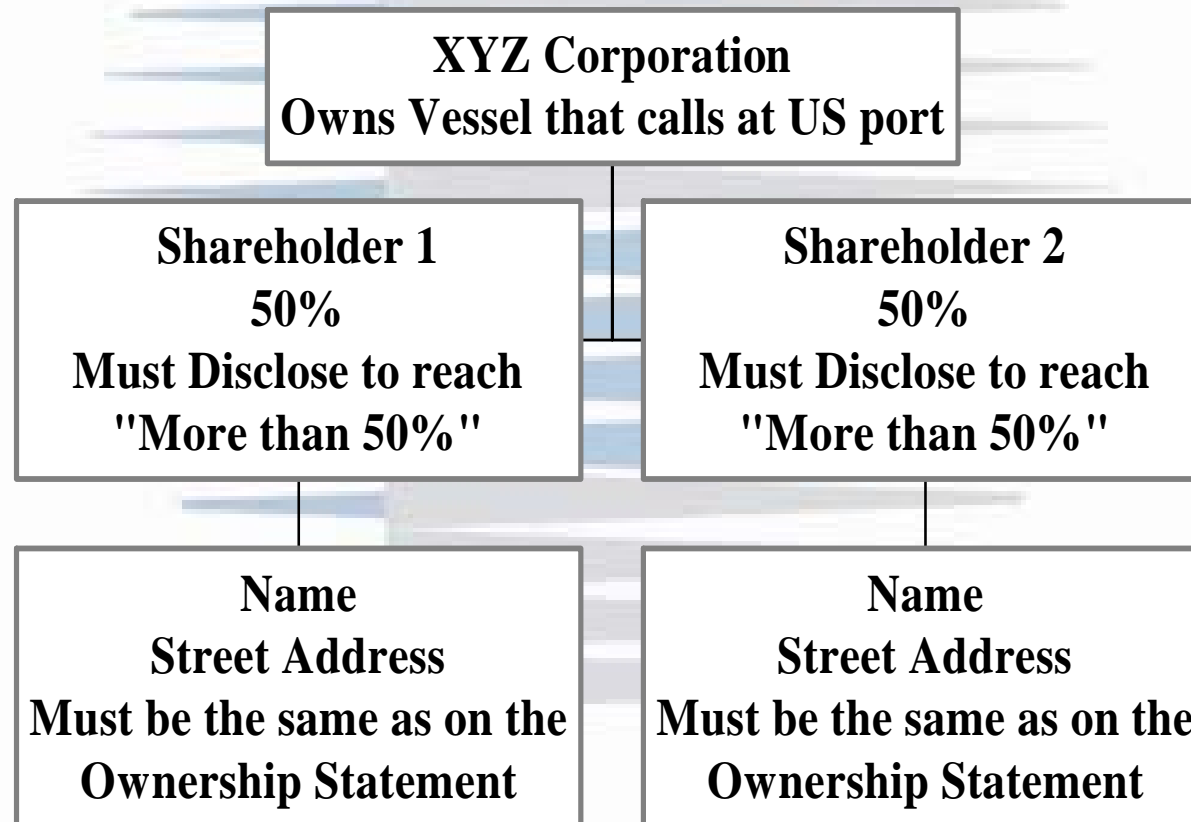
Qualified Shareholder

❖ Reporting Requirements

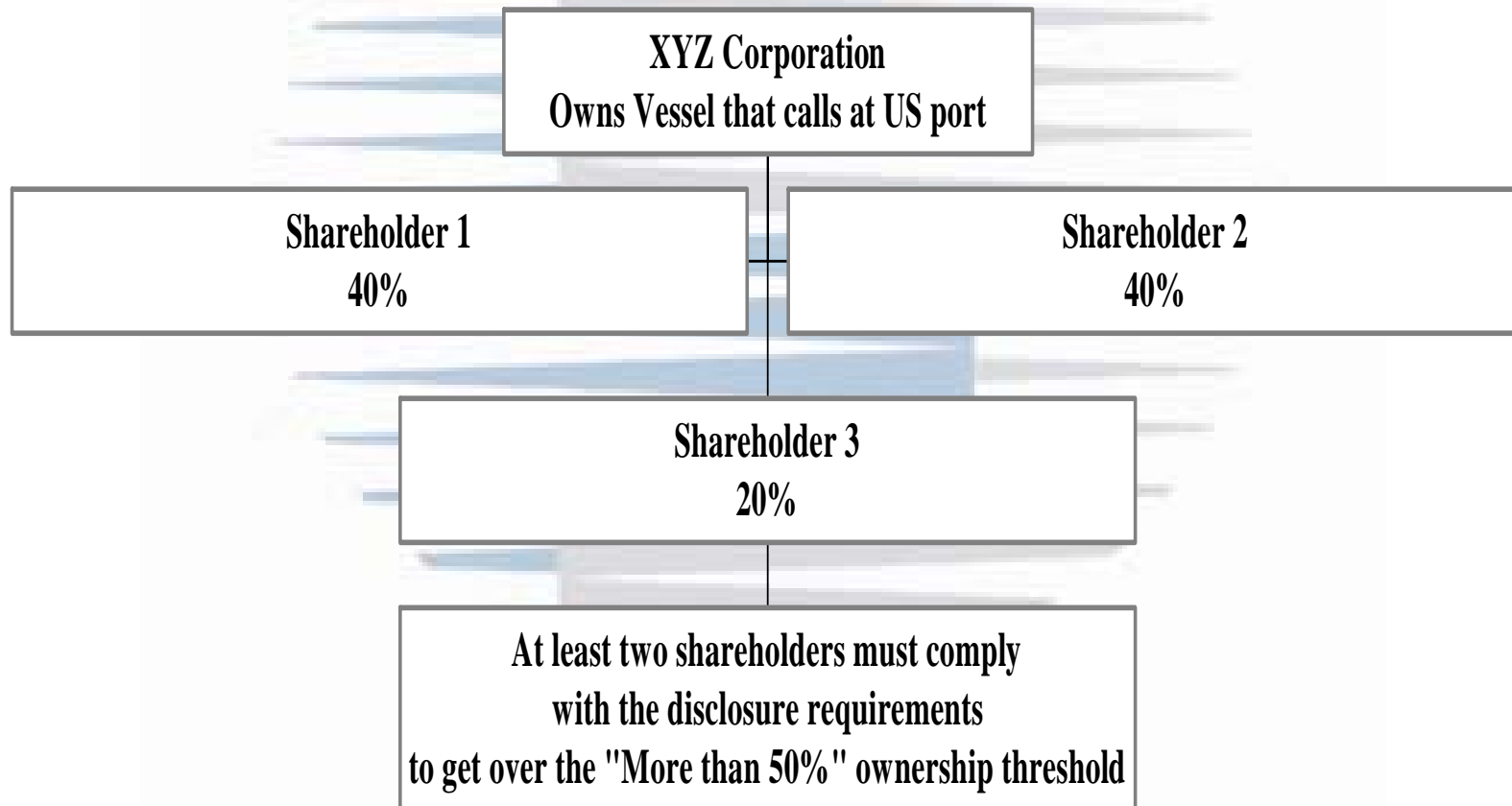
A foreign corporation relying on the qualified shareholder stock ownership test **MUST** provide the following information in its Form 1120-F and the information **MUST** be current as of the end of the corporation's tax year

- ❖ **A representation that more than 50% of the value of the outstanding shares of the corporation is owned by qualified shareholders**
- ❖ **The name, street address of each qualified shareholder owning 5% or more relied on to meet the “more than 50%” ownership test**
- ❖ **The name and address should be as it appears on the ownership statement**
- ❖ **The total percentage of the value of outstanding shares owned by qualified shareholders by country of residence**

Disclosure required on Form 1120-F Direct ownership of Vessel Corp.



Disclosure required on Form 1120-F Direct ownership of Vessel Corp.



Disclosure required on Form 1120-F Indirect ownership of Vessel Corp.

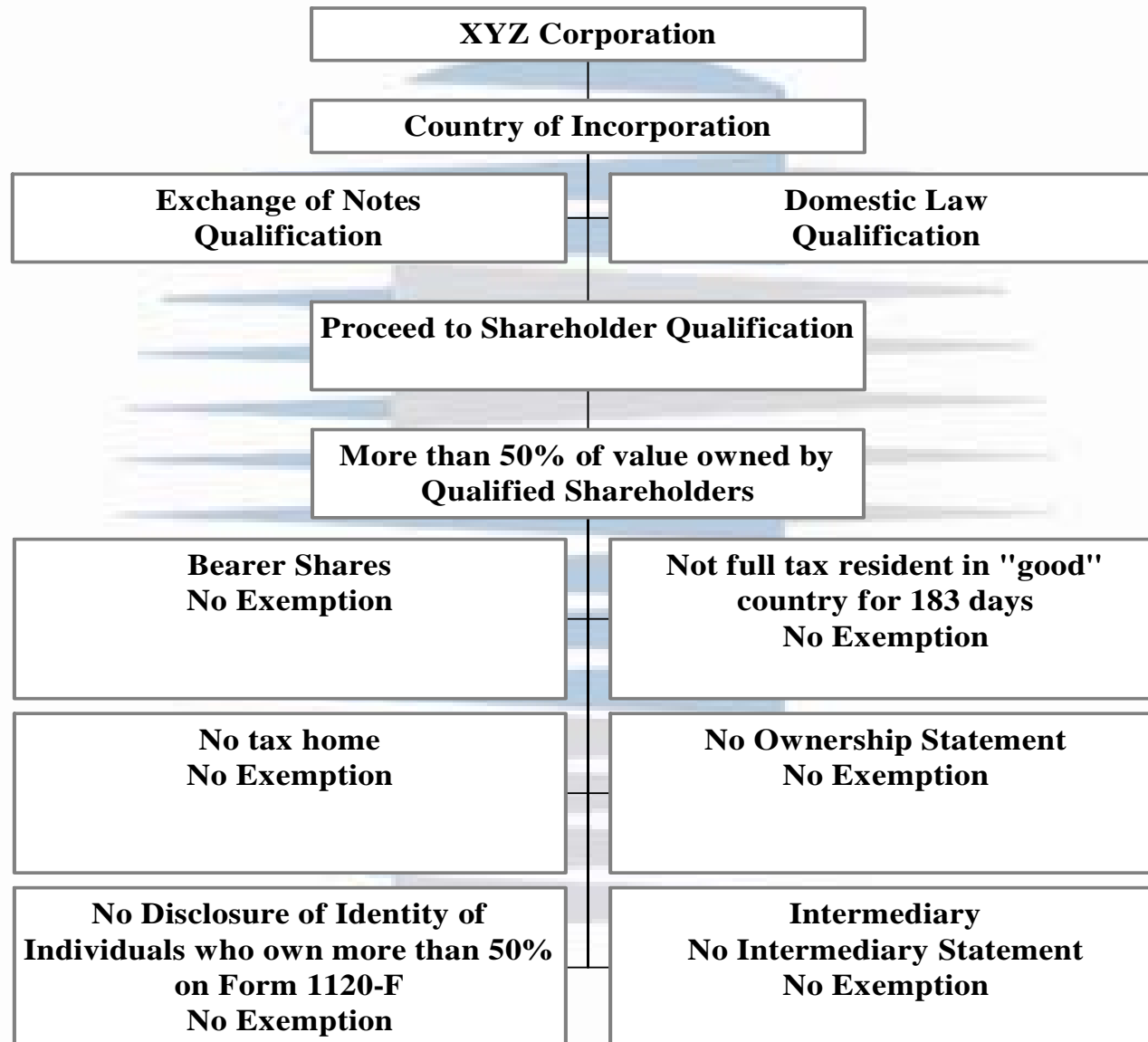
**XYZ Corporation
Owns Vessel that calls at US port**

**Intermediary Corporation owns 100%
of XYZ Corporation**

**Intermediary needs to complete
Ownership Intermediary Statement
Corporation needs to keep on file**

**Shareholder owns 100%
of Intermediary Corporation**

**Disclosure required in 1120-F
Name & Street Address
Must be the same as on the
Ownership Statement**



Paying the tax

- ❖ **Rev.Proc. 91-12 – USSGTI (§3.02)**
 - ❖ **Tax is 4% of US Source Gross Transportation Income (USSGTI)**
 - ❖ **USSGTI is 50% of income from transportation that begins or ends in the US**
 - ❖ **In effect, the tax equals 2% of the total hire earned on voyages to or from the US**

Paying the tax

❖ Rev.Proc. 91-12 – Determining the amount of USSGTI (§5.02)

Taxpayer must establish the actual amount of USSGTI, using any reasonable method AND disclose the method used to calculate USSGTI in the manner described in §7.01

Net income is explicitly excluded as a reasonable basis for calculation

Paying the tax

- ❖ **Rev.Proc. 91-12 – Information to be included in the Form 1120F (§7.01)**
 - **Name and Lloyd’s Register of the vessel(s)**
 - **Country of registration (flag state)**
 - **Name and address of each charterer, the term of same and number of days during the tax year the vessel was under charter**
 - **Description of method used to calculate USSGTI for each vessel**

Paying the tax

- ❖ **Rev.Proc. 91-12 – Information to be included in the Form 1120F (§7.01)**
 - **Total amount of charter hire income for the tax year**
 - **US Customs Service International Carrier's Bond Number, if one**

**Please contact us if you wish
further advice:**

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