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## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics*



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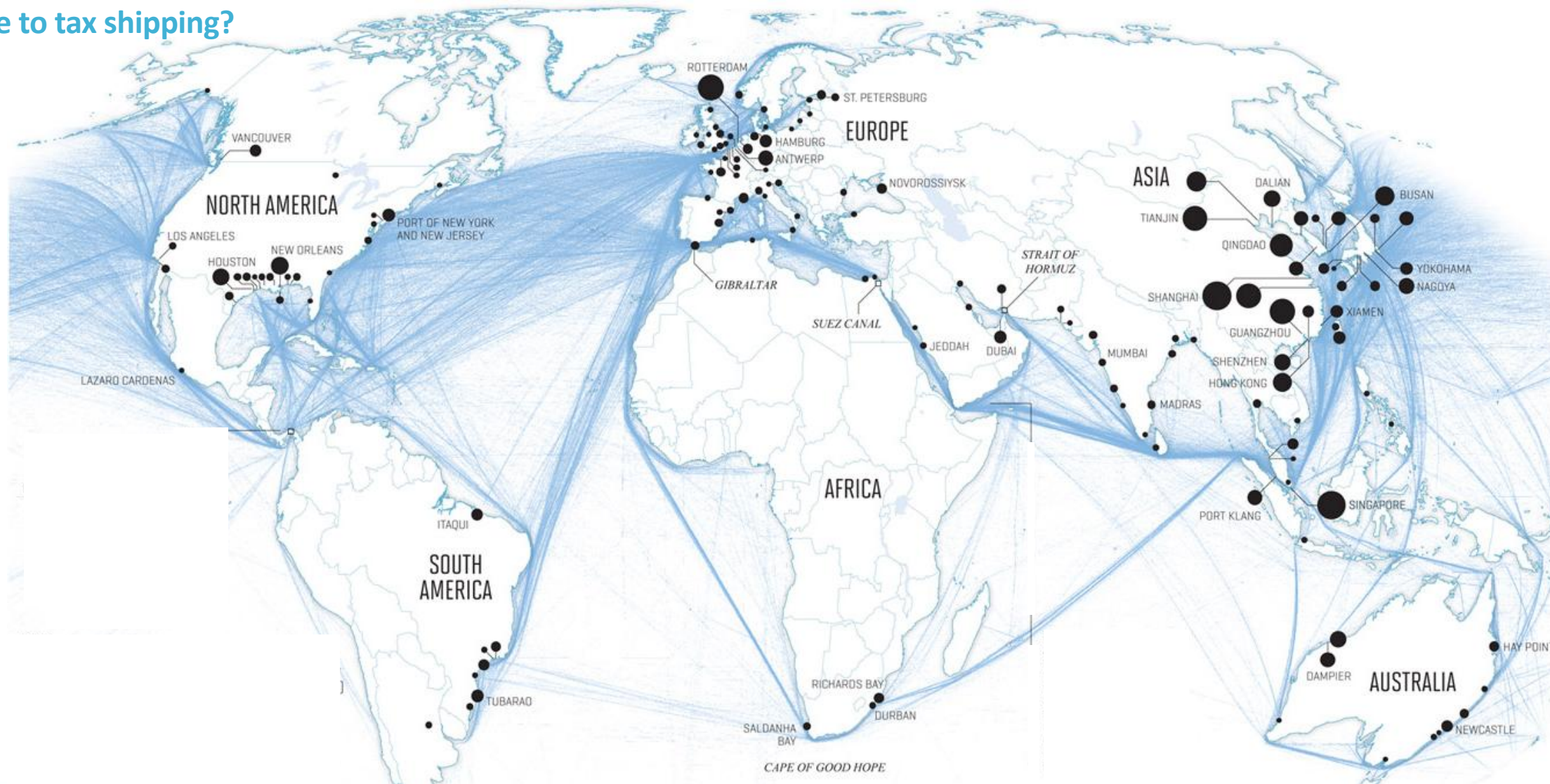
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## Where to tax shipping?





# U.S. Taxation of Domestic Corporations

- The U.S. taxation of international transportation income reflects the historic tension between residence-based taxation versus sourced based taxation.
- A U.S. corporation is subject to worldwide taxation on its income, including with respect to the income of CFCs
  - Pre-TCJA corporations were taxed currently on passive income and on active income only when repatriated.
  - Post TCJA/OBBBA all income is taxable to a U.S. corporate parent currently albeit at reduced rates for active income.
- Income from international shipping/transportation was not offered exceptional treatment until introduction of the elective tonnage tax regime in 2004.



# U.S. International Transportation Tax Regime

- “Transportation Income” is a defined term relevant to international shipping and air transport activities. It includes:
  - Income from using or leasing vessels used to transport property or passengers.
  - Income from the performance of services directly related to the use of these vessels.
  - Vessels include containers used in connection with a vessel.
  - Sales of vessels or containers are not a “use.”



# U.S. Taxation of Domestic Corporations

- Residence based worldwide taxation historically subjected U.S. corporations stubbornly high U.S. corporate tax rates (including with respect to income earned by CFCs).
- It also subjected U.S. corporations to risks of double taxation, although mitigated by our U.S. foreign tax credit regime.
- To preserve the US tax base and having to provide tax credits for substantial non-U.S. taxes, the US has used carrots and sticks to discourage non- U.S. jurisdictions from taxing a US corporation's transportation income in international voyages.
  - Taxes are imposed on non-U.S. owned ships and exemptions are offered where a reciprocal exemption is available to the U.S. shipper under domestic law or under an income tax treaty.
- Because of global tax competition, residency-based income taxation was an impediment for U.S. corporate carriers engaged in international voyages. This drove the introduction of the Tonnage Tax.



# U.S. Income Taxation of Non-U.S. Corporations

- Non-U.S. corporations are taxable under domestic law on income “effectively connected” with the conduct of a U.S. trade or business.
  - Transportation income only can be effectively connected if it is “U.S. source.”
  - Under U.S. sourcing rules for international transportation income, 50 percent of the income is treated as U.S. source and the other 50 percent is treated as non-U.S. source.
    - International Transportation Income means “Transportation Income” arising from voyages with one leg originating (or ending) at a U.S. port and the other leg ending (or beginning) at a non-U.S. port.
    - U.S. sourcing rules, like rules globally, grapple with how to allocate taxing rights where performance is largely extraterritorial and the value of the service performed benefits parties in two jurisdictions.



# U.S. Income Taxation of Non-U.S. Corporations

- Significantly, special rules apply for testing whether U.S. source income is “effectively connected” and as a result eligible for taxation on a net income basis. A non-U.S. corporate taxpayer must:
  - Have a U.S permanent establishment through which the transportation income is earned.
  - And “substantially all” (90% in this case percent) of the foreign corporation’s U.S. source transportation income must be attributable to regularly scheduled transportation. (Section 887(b)(4))
  - To qualify income must be earned from vessels that follow “a published schedule with repeated sailings...at regular intervals between the same point for voyages” (Rev. Proc. 91-21).
- Congress was concerned that non-U.S. carriers did not report net income (because of low margins and expense allocations) or were eligible for a reciprocal exemption (under section 883) that at the time applied to ships flagged in no-tax jurisdictions and therefore fiscally advantaged.



# U.S. Income Taxation of Non-U.S. Corporations

- For shipping not meeting the net income tax treatment standard, the U.S. source transportation income is taxable on a gross basis at a 4% rate. (See section 887).
  - This regime is viewed as significantly more administrable and was thought to provide a greater incentive for other jurisdictions to afford an exemption to U.S. shippers.
  - A tax treaty as well as an applicable reciprocal exemption applicable to U.S. taxpayers (under section 883) eliminates the 4% gross income tax on U.S. source transportation income.
    - Entitlement to treaty benefits for private companies contain stringent anti-treaty shopping measures that impact corporations owned by non-treaty jurisdiction residents. These provisions are echoed in the reciprocal exemption.



# U.S. Elective Tonnage Tax

- For U.S. corporations a tonnage tax regime is available on an elective basis as an alternative to the income tax regime.
- The tax is based on the size of the ship and amount of time in the US. (\$.40 per 100 tons for the first 25,000 net tons and the \$.20 on the excess).
- The regime requires the operation of U.S. flagged vessels, but not something that is seen in international shipping in the wild.
- The regime does not apply to domestic shipping (between U.S. ports, activities covered under the Jones Act).



# Shipping Between U.S. Ports

- Under the Jones Act, no foreign-flagged vessel (absent a waiver) may transport merchandise between U.S. ports.
- This law applies even if there is an intermediate non-U.S. port.
- All income between U.S. legs is domestic source income and subject to a corporate level tax.
  - Non-U.S shippers, who obtain a waiver from the Jones Act, are not eligible for the special rules under section 883, non-U.S. persons are generally subject to 30 percent withholding tax.
  - Jones Act waivers had been offered in extenuating circumstances (post-Hurricane Katerina to permit petroleum transportation, permitting 883 treatment).
  - That relief was withdrawn, but a treaty can still provide an exemption under business profits if no PE, but not for the incidental services performed in the U.S. (which may be performed by a U.S. corporate affiliate).



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### **1. Introduction and background to taxation of international shipping income / activities**

Brazil is a major commodity exporter but has NO tonnage tax, a LIMITED treaty network, and is simultaneously implementing a brand-new transfer pricing regime, introducing Pillar 2 rules and undergoing a consumption Tax Reform (VAT inspired).

### **2. Overview of taxation of shipping income**

Shipping income earned by foreign shipowners is subject to withholding tax at the source — typically 15%, or 25% if the beneficiary is in a listed tax haven jurisdiction.

There is a **ZERO-RATE WHT regime** for remittances abroad for freight, charter, lease of foreign vessels — but only if: (a) the charter/lease is approved by ANTAQ (the Brazilian maritime regulatory agency); and (b) the beneficiary is NOT resident in a jurisdiction classified as having favorable taxation (the “black list” issued by Brazilian IRS).



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### 2. Overview of taxation of shipping income

Inflated charter rates to related parties offshore in the oil & gas industry has been challenged by Brazilian IRS and has resulted in legislative changes. New TP rules also address this issue.

Brazil has a **limited treaty network** (~39 treaties in force). Many key shipping jurisdictions — Greece, Panama, Liberia, Marshall Islands — are NOT covered. This means WHT at source with no treaty relief.

The concept of “*place of effective management*” is becoming more complex. Brazil’s new treaties follow the OECD Model (Art. 8), taxing shipping profits only in the state of effective management — but with so few treaties, this is often irrelevant for Brazil.

Brazil’s **AFRMM** (Adicional ao Frete para Renovação da Marinha Mercante) is a levy on freight that funds the Brazilian merchant marine development. It adds to the overall tax cost of shipping operations touching Brazil. The interaction between Brazil’s domestic WHT rules, its limited treaty network, and the new TP regime creates a uniquely complex environment for multinational shipping and logistics groups.



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - China Practice*

1. Introduction and background to taxation of international shipping income / activities
2. Overview of taxation of shipping income

**Mainland China Practice** - taxation in resident state, exemption in source state, most of 114 tax treaties

**Hong Kong Practice** - territorial system, double taxation relief or reciprocal tax exemption, 36 treaties



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Certainty of taxation is more important than rules and rates.



The specifics of shipping is often not considered in new legislation. Requires advocacy.

Pillar 2 carve out





## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### 3. Pillar 2 Issues

Brazil implemented Pillar 2 through the creation of the "Additional to Social Contribution on Net Profits" — designed as a Qualified Domestic Minimum Top-up Tax (QDMTT).

Brazilian QDMTT applies when a constituent entity in Brazil that is part of a multinational group (revenue > **€750M**) has an effective tax rate below 15%, after applying the Substance-Based Income Exclusion (SBIE).

For **SHIPPING specifically**, the "strategic and commercial management" concept is critical because it determines WHERE the top-up tax is collected. If a shipping group has SPVs in Marshall Islands (zero tax), a management company in Greece (tonnage tax = 2% ETR), and a subsidiary in Brazil (34% nominal rate), the question is: which jurisdiction collects the top-up?

Brazil's position: the QDMTT captures under-taxed income of constituent entities LOCATED IN BRAZIL. For shipping groups, the Brazilian entity (freight forwarder, agent, charterer) will almost always have an ETR above 15% due to the combined 34% IRPJ/CSLL rate. The exposure arises in the low-tax jurisdictions (Marshall Islands SPVs, tonnage tax entities).



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### 3. Pillar 2 Issues

The practical Brazilian concern is **DEFENSIVE**: if Brazil did not adopt the QDMTT, income earned in Brazil that is subtaxed (e.g., due to incentive regimes) could be top-up taxed abroad.

The SBIE is particularly problematic for asset-light logistics businesses and for shipping structures that rely on tonnage tax — both may have minimal tangible assets and payroll in the relevant jurisdiction.

**The IRONY from Brazil's perspective:** Brazilian entities in shipping/logistics groups will typically NOT trigger top-up tax (their ETR is well above 15%). But the group's low-tax entities (tonnage tax, SPVs) may face significant top-up, which changes the economics of the entire structure — and may redirect investment or restructure intercompany arrangements in ways that INCREASE the Brazilian entity's functional profile (and, under the new TP regime, its share of profit).



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - China Practice*

### **3. Pillar 2 Issues**

In Mainland China, domestic laws not yet modified to incorporate Pillar 2 rules

Implemented in Hong Kong



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## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - China Practice*

### **4. Transfer Pricing Considerations**

#### **Mainland China practice**

- Income tax: some incentives, limitations, not nationally
- VAT/GST: 0% for int'l shipping income; exempt freight forwarder's agency service income

#### **Hong Kong Practice**

- Income tax: "exempt sums", "relevant sums", "substantial activities", "ship operators"
- NO VAT/GST, no withholding tax on dividends, interest, service fee



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### **4. Transfer Pricing Considerations**

The old Brazilian TP system used **FIXED MARGINS** (e.g., 15% cost-plus for exports, 20–40% for imports). Shipping groups could operate within these margins without detailed functional analysis. This era is OVER.

**Law 14,596/2023** (effective January 1, 2024) introduced the arm's length principle, requiring: functional analysis (functions, assets, risks), comparability analysis, most appropriate method selection, and contemporaneous documentation (Global File + Local File).

Brazilian IRS monitors approximately 8,596 large taxpayers through specialized sectoral teams. Priority sectors include oil & gas (highly relevant for offshore shipping/charter), financial institutions, and others. While "shipping" is not a standalone category, it intersects with oil & gas, agriculture-commodities (export logistics), and chemicals.



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - Brazil*

### **4. Transfer Pricing Considerations**

#### **APAS:**

Brazil introduced APAs for the first time under the new TP regime — a major development that shipping groups should consider, especially for complex charter and logistics arrangements.

Brazilian IRS is still building its APA practice. Early movers may benefit from setting precedents in a cooperative (rather than adversarial) environment.

#### ***Key audit risk areas for shipping/logistics:***

Intragroup charter rates (bareboat and time charter) — are they arm's length?

Management fees from offshore entities — do they reflect genuine services?

Commission structures for local agents — does cost+5% reflect actual functions/risks?

Freight forwarding margins — is the Brazilian entity truly a limited-risk agent, or has it evolved into a local principal?

Classification of payments (charter vs. service vs. royalty) — affects both TP and WHT



## *Global Currents: Navigating the Troubled Tax Waters in International Shipping, Trade and Logistics - China Practice*

### **5. Tariffs**

Brazil, as a major commodity origin, is both affected by and a potential beneficiary of trade diversion — but the tax implications of rerouted supply chains (new intercompany service flows, revised freight allocations, changed risk profiles) are often overlooked.

From Brazil's perspective, increased commodity exports to China (replacing US-origin goods) and the growth of Brazil as a transshipment alternative both generate incremental WHT, AFRMM, and TP exposure. Groups should model the tax cost of tariff-driven rerouting — not just the customs duty savings — when restructuring supply chains.

### **5. Tariffs**

Chinese multinationals diversify its manufacturing sits worldwide, e.g., EV manufacturers