



DIRECT TAXATION OF AIR TRANSPORT ACTIVITIES UNDER DOMESTIC TAX LAW

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Structure

1. Key challenge
2. Categorization of the income
3. Taxation of the income
4. Cross border aspects
5. Conclusions



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Key challenge





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Categorization of income

General

- Primarily **trade or business income**
- Subordinately leases or royalties
- **Notable exception: Hong Kong**



Categorization of income

Hong Kong

- **“Aircraft income”** includes any sums derived from, attributable to or in respect of
 - Carriage of passengers or goods shipped in HK
 - Charter hire (international & within HK)
 - Charter party (outward of HK)
- Excluded: income from dealing in aircraft & agency business i.c.w. air transport



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Taxation of the income

General

- Computation of the income by accounting principles with modifications for tax purposes (depreciations, etc.)
 - **Exception: Hong Kong**
- Withholding tax on leases, royalties etc. common for non-residents



Taxation of the income

Hong Kong

- Computation by formula:

$$\textit{assessable profits} = \frac{\textit{"relevant sums"}}{\textit{total aircraft income}} \times \textit{total aircraft profits}$$

"relevant sums" = "Aircraft income"

total aircraft income: worldwide income from aircraft business

total aircraft profits: Profits derived from "total aircraft income"



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Cross border aspects

General - Resident enterprises

- Taxation of worldwide income predominant
- **Exception: Hong Kong**



Cross border aspects

Hong Kong

- **Territorial based** income tax regime
- Broad source rules established by case law
- **Special source rule** for aircraft income:
 - Business as owner of an aircraft
 - Controlled or managed in HK
 - or
 - Company incorporated in HK
- Income taxable in HK calculated pursuant to formula



Cross border aspects

Concept of residence

- Place of **Incorporation**
- Place of **Effective management**
- Place of **Controlling share power**
- **Seat** of the company
- **Notable: United Kingdom**



Cross border aspects

United Kingdom

- Incorporation in the UK (statutory rule)
- Central management and control exercised from the UK (case law)
- **Dually resident** companies (statutory rule):
 - If residence in other Contracting State per relevant tax treaty
 - **Non-resident** for all purposes of Corporate Tax Act



Cross border aspects

Domestic solution of double taxation of resident enterprises

- **Germany:** Tax credit or deduction of foreign tax as business expense
- **Italy:** Tax credit, foreign branch exemption
- **Liberia:** Tax credit
- **The Netherlands:** Tax exemption, tax credit, object exemption



Cross border aspects

Germany

- **Tax credit** for qualifying “foreign income”
 - Subject to foreign tax equivalent to German Income/Corporate Tax
 - Assessed, actually paid & no further discount
 - Per-country calculation & limitation
- Option for **deduction** of foreign tax as business expense
- If prerequisites of tax credit are not met, deduction also possible
- **Not applicable** if DTC sustains Germany’s right of taxation



Cross border aspects

Italy

- **Tax credit** for income from foreign PE
 - Only for direct foreign taxes
 - Per-country calculation
 - Excess may be carried back or forward up to 8 years
- Option for **foreign branch tax exemption**
 - Irrevocable & applies for all qualifying foreign PEs
 - **Not applicable** in cases of double exemption because of mismatch
- **Not applicable** if DTC sustains Italy's right of taxation



Cross border aspects

Liberia

- **Tax credit** for foreign income
 - Paid foreign income tax or tax imposed in lieu of income tax
 - Income not sourced in Liberia
 - Country-by-country determination
 - Limitation: maximum amount of tax credit in the amount of Liberian tax otherwise paid, determined by average tax rate



Cross border aspects

The Netherlands

- **Tax exemption** for dividends, capital gains, currency exchanges etc. from qualifying subsidiaries
- **Tax credit** for foreign withholding taxes on interest, dividends and royalty payments
 - Lowest of foreign withholding tax and Dutch tax
 - Unlimited carry forward of excess credits
- **Object exemption** for foreign income
 - Includes net profit from a foreign enterprise through PE or PR, from immovable property, from rights to a share of profits
 - Calculation on per-country basis
 - Particularity in the case of profits from air transport activities: profits have to be taxed in foreign country



Cross border aspects

General – non-resident enterprises

- Taxation of income sourced domestically:
 - Mostly by being attributable to domestic PE or dependent agent
 - Derived from domestic property
 - But also other source rules
- **Examples: Australia, Hong Kong, Germany**



Cross border aspects

Australia

- Calculation of Australian-sourced income by:
 - Maritime Formula
 - Calcutta Formula
 - **“gross Australian revenue”**
 - Point of uplift: place where the transport commences
 - Point of sale: place where the contracts are concluded
- Attribution to PE by Australian transfer pricing rules



Cross border aspects

Hong Kong

- **Nexus for taxation** of non-residents: Landing of aircraft on airport or aerodrome in HK
 - Exception: casual nature and improbable in the future
- Computation of income similar to residents
- **Alternative computation** available if ordinary computation is not satisfying
 - Fair percentage of “relevant sums”
 - Option for re-assessment using the ordinary method within 2 years



Cross border aspects

Germany

- Income attributable to domestic PE or dependent agent
- Income from purely domestic or transport from domestic airports to foreign airports
- Both set at a **lump sum of 5%** of the fare
 - **Not applicable** for pooling agreements
 - **Not applicable** if DTC sustains Germany's right of taxation



Cross border aspects

The relevance of permanent establishments

- Predominantly **main nexus** for right of taxation
- Often similar to art. 5 OECD-MC
 - Separate entity approach
 - Arm's length principle driven delimitation
 - **Notable: Italy**
 - **Exception: China**



Cross border aspects

Italy

- Almost similar wording to art. 5 OECD-MC
- But: shipbroker, ship's agents or air transport agents **do not constitute PE**
- "Base" of an air carrier **constitutes PE**

China

- Concept of "establishments"
- Much wider than OECD-MC concept
- However: already very extensive source rules



Cross border aspects

Reciprocal tax exemptions

- **Tax exemption** of profits from international transport by non-residents if **reciprocity** is ensured
 - Brazil
 - Germany
 - Canada
 - Hong Kong (part of Air Service Agreements)
 - Liberia
 - The Netherlands



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Conclusions

Taxation of residents

- Generally no special regimes regarding taxation of air transport activities
- No subsidies other than occasional special depreciation regimes

Taxation of non-residents

- PE main nexus for taxation
- Lump-sum determination for the sake of facilitation and administrability
- Reciprocal tax exemption on domestic level

Thank you for your
kind attention!

