

**DESCRIPTION OF REVENUE PROVISIONS
RELATING TO SHIPPING INCOME**

**To Be Offered in the Amendment in the
Nature of a Substitute to H.R. 2754,
the "Shipbuilding Trade Agreement Act,"
Scheduled for Markup by the
Committee on Ways and Means
on March 21, 1996**

Present Law

The United States imposes a 4-percent tax on the U.S. source gross transportation income of nonresident alien individuals and foreign corporations (sec. 887). This tax does not apply to income that is effectively connected with the foreign person's conduct of a U.S. trade or business. Nonresident alien individuals and foreign corporations are subject to U.S. tax at regular graduated rates on net income that is effectively connected with a U.S. trade or business (secs. 871(b) and 882). The U.S. taxation of a nonresident alien or foreign corporation may be altered by the provisions of an applicable tax treaty.

Transportation income is any income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel or aircraft (or a container used in connection therewith) or the performance of services directly related to such use (sec. 863(c)(3)). Transportation income attributable to transportation that begins and ends in the United States is treated as derived from sources in the United States (sec. 863(c)(1)). In the case of transportation income attributable to transportation that begins in, and ends outside, the United States or that begins outside, and ends in, the United States, generally 50 percent is treated as U.S. source and 50 percent is treated as foreign source (sec. 863(c)(2)). United States source transportation income is treated as effectively connected with a foreign person's conduct of a U.S. trade or business only if the foreign person has a fixed place of business in the U.S. that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation (sec. 887(b)(4)).

An exemption from U.S. tax is provided for gross income derived by a nonresident alien individual from the international operation of a ship, provided that the foreign country in which such individual is resident grants an equivalent exemption to individual residents of the United States (sec. 872(b)(1)). A similar exemption from U.S. tax is provided for gross income derived

by a foreign corporation from the international operation of a ship, provided that the foreign country in which the corporation is organized grants an equivalent exemption to corporations organized in the United States (sec. 883(a)(1)).

Pursuant to guidance published by the Internal Revenue Service, a nonresident alien individual or foreign corporation that is entitled to an exemption from U.S. tax for its income from the international operation of a ship must file a U.S. income tax return and must attach to such return a statement claiming the exemption (Rev. Proc. 91-12, 1991-1 C.B. 473). If the foreign person is claiming an exemption based on an applicable income tax treaty, the foreign person must disclose that fact as required by the Secretary of the Treasury (sec. 6114). The penalty for failure to make disclosure of a treaty-based position as required under section 6114 is \$1,000 for an individual and \$10,000 for a corporation (sec. 6712).

Descriptions of Proposals

1. Penalty for failure to file disclosure of exemption for shipping income

Under the proposal, a nonresident alien individual or foreign corporation that claims exemption from U.S. tax for income from the international operation of ships but does not satisfy the filing requirement for claiming such exemption would be subject to the penalty of the denial of such exemption and any deductions or credits otherwise allowable in determining the U.S. tax liability with respect to such income. In addition, under the proposal, the U.S. Customs Service would be directed to provide to the Secretary of the Treasury information necessary to enable the Secretary to identify foreign-flag ships engaged in shipping to or from the United States. The proposal would not apply to the extent the application would be contrary to any treaty obligation of the United States.

2. Additional penalty for such failure applicable to foreign source shipping income attributable to a fixed place of business in the United States

Under the proposal, if a nonresident alien individual or foreign corporation that has a fixed place of business in the United States fails to satisfy the filing requirements for claiming an exemption from U.S. tax for its income from the international operation of ships, such person would be subject to the additional penalty that any foreign source income from the international operation of ships that is attributable to such fixed place of business would be treated as effectively connected with the conduct of a U.S. trade or business. Income that is so treated as effectively connected with a U.S. business would be subject to U.S. tax at the regular graduated rates. The proposal would not apply to the extent the application would be contrary to any treaty obligation of the United States.

Effective Date

The proposal would be effective for taxable years beginning after the later of the date the Shipbuilding Agreement takes effect or December 31, 1996.