The Taxation of Income Derived from the Leasing of Containers

(adopted by the OECD Council on 13 September 1983)

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I. INTRODUCTION

1. When adopting, on 11th April 1977, a Recommendation concerning the avoidance of double taxation, the Council recommended the Governments of member countries to conform to the 1977 OECD Model Convention for the avoidance of double taxation with respect to taxes on income and capital, and instructed the Committee on Fiscal Affairs "to proceed to periodic reviews of situations where double taxation may occur, in the light of experience gained by member countries, and to make appropriate proposals for its removal".

2. This report has been prepared by the Committee in that context, with a view to elucidating some of the issues related to the taxation of income derived from the leasing of containers[1] – whatever is the type of transportation of such containers – under the Model Convention or under bilateral treaties. The report also suggests lines for possible future action by member countries in this field.

II. ECONOMIC BACKGROUND

1. General

3. The leasing of containers became an important activity during the 1970s. This was dependent on the "containerisation" of important parts of the world transportation system which took place in the previous decade. While in the first phase of this development, containers were generally owned by a carrier or ship-owner, in the second phase more and more containers were owned by separate enterprises and operated on a leasing basis. Today, container leasing enterprises (CLE) appear to own more than 50 per cent of the world container population.[2]

4. This development took place because CLEs fulfil various functions in the complex environments of the world transportation system. Three functions can be clearly identified:

- *a)* CLEs provide carriers and other participants with containers, thereby providing an essential asset for the transportation business;
- *b)* CLEs perform a clearing function where containers are in surplus at one point and scarce at others; the enterprises thus perform an important service for the world transportation system;
- *c)* Leasing enterprises may participate in specific financial arrangements, *e.g.* in the case of fixed price buying options or full pay-out leases. They thus perform financial functions which are not necessarily essential to the world transportation system.

5. While all these functions are of relevance when considering a CLE, tax administrations are often concerned with some of these functions only, *e.g.* those performed by a specific establishment only having limited functions.

2. Business performances

6. The leasing of containers is a complex and world-wide activity. A single CLE normally handles tens of thousands of containers and may have to maintain more than 100 “depots” where its customers may pick up or re-deliver the containers.

7. The operation of such a vast “pool” of containers, their world-wide movements, the cash flows and other commercial operations involved is almost totally dependent upon electronic data processing. The computer systems – normally situated at the headquarters of the CLE – are therefore an essential element in operating, controlling and assessing its world-wide business.

8. Accordingly, the daily activities are for the most part highly centralised, though a vast network of “depots” exists. The contracts with customers are negotiated and concluded either by the leasing company or by a local agent or, in some cases, by the operator of the depot (the operator of such a depot may also conclude contracts with customers). A major problem confronting the industry is the unbalanced flow of containers which results in their accumulating in one place while there are shortages in others. Once more, this can only be solved by centralisation and computerisation.

9. For the purposes of analysis, three countries or groups of countries have to be distinguished:

- The container leasing enterprise’s *country of residence,* where this enterprise has the centre of its activities;
- *The countries of the various depots* between which containers move, being transported in an irregular way between different locations by a greater or lesser number of shipowners. The leasing enterprise may have specific installations in these countries, but it is more common for it to rely on wholly independent enterprises resident there;
- The *lessee’s country* where a specific lessee has his residence or its head office; the leasing enterprise may or may not have a permanent establishment in this country for the conclusion of contracts or for the handling of containers reaching that country or for both.

3. *Activities*

10. The leasing of containers may assume various forms. The following seems a fair description and uses a terminology generally accepted in the industry:

i) Trip leases for one or more trips, including:

- Single-trip leases: leases from one depot to another,
- Round-trip leases: leases from one depot for a round-trip back to the same depot or another depot in the same country,
- Possible "mixed" leases, *e.g.* single-trip leases with a round-trip option;

ii) Short-term leases, for terms of less than one year, including:

- Fixed minimum leasing time with open termination (*e.g.* minimum time 20 days, 3 months, 6 months, 9 months),
- Minimum leasing time with renewal option (*e.g.* for 6 months, 12 months, 2 years, 3 years, etc.),
- Fixed leasing time (*e.g.* 30 days, 3 months, 9 months);

iii) Long-term leases for leasing terms of one year or more, including contracts with:

- Minimum leasing time with open termination,
- Minimum leasing time with renewal option,
- Minimum leasing time with premature cancellation option after 4, 3, 2, 1 years,
- Fixed-price buying option or full pay-out leases (at the end of the leasing time the container automatically becomes the property of the leasing customer).

11. Leasing enterprises may also negotiate special agreements with their customers for leasing containers in certain operating areas, from and to certain depots, in certain quantities and at certain rates which are fixed for a specific period.

12. Generally speaking, rules of taxation are the same for all these activities. Problems may however arise where containers are leased in the context of specific financial arrangements or where special container equipment is being leased for exceptional purposes (*e.g.* atomic fuels transport). These cases are not dealt with in this report, but reference is made to the Committee's report on "The taxation of income derived from the leasing of industrial, commercial or scientific equipment".

III. RULES FOR THE TAXATION OF INCOME DERIVED FROM THE LEASING OF CONTAINERS UNDER THE OECD MODEL CONVENTION

1. *Effects of existing rules*

13. Income derived from the leasing of containers, being income from the leasing of industrial equipment, falls in the first instance under Article 12 (Royalties) and, where it is received by an enterprise, falls also within the scope of Articles 7 (Business profits), and 5 (Permanent establishment). Article 12 contains a specific rule which provides for no taxation in the State of source except where royalties are attributable to a permanent establishment in that State. As a consequence, enterprises leasing containers are, generally speaking, taxable in the State of residence. A number of countries have, however, entered a reservation on the exemption at source provided for under Article 12.

2. *Options for a future revision of the Model Convention*

14. The Committee has studied three different possibilities. A first possibility would be for the profits from the leasing of containers to be subjected to a limited tax at source where a bilateral treaty provides for such a tax on royalties in general. The Committee, in its large majority, found that this alternative would create major difficulties for the leasing of containers and for the international transportation system generally. It therefore rejected this solution. In connection with this, reference is made to the report on the leasing of industrial, commercial or scientific equipment, which recommends the general exclusion of income from leasing of these assets from the scope of Article 12 of the OECD Model Convention.

15. Another possibility would be for profits from the leasing of containers to be, in the future, only subject to Articles 7 and 5 of the OECD Model. In order to avoid certain difficulties which have arisen from the fact that some countries have entered reservations on Article 12 and levy taxes at source on royalties under bilateral conventions, (*cf*. Part V below), income from container leasing should be clearly excluded from the scope of Article 12. This would be in line with the OECD Model as such income is derived from a business activity. It seemed adequate to subject enterprises leasing containers to taxation in States where they have permanent establishments, and to avoid double taxation in the State of residence by using the methods set out in Articles 23 A and 23 B of the Model. Any practical difficulties or doubts for applying Articles 7 and 5 of the Model Convention might be sorted out by an adequate interpretation of these Articles and by having recourse to the mutual agreement procedure (Article 25). The principles developed in Part IV of this

report would in fact form the basis for this approach. Such a solution met with a large support in the Committee.

16. Finally, the profits from the leasing of containers might be treated on a similar basis as profits from the operation of ships in international traffic and be taxed in accordance with Article 8 of the OECD Model, *i.e.* only in the State in which the place of effective management of the enterprise is situated (*cf.* paragraph 10 of the Commentary on Article 8). Such a solution is premised on the view that, in the absence of such a rule, the requisite allocation of rental income among various source States is inherently subject to the application of inconsistent allocation rules in those States and to arbitrary approximations, which can lead to the imposition of a prohibitive multiple tax burden. Exemption at source ensures that a tax will be imposed only where the overall leasing operations of an enterprise are profitable. Granting the tax right to one State eliminates the need to develop complex rules for defining the profits to be taxed by each State, and the State in which the lessor is resident stands in the best position to account for the income and expense of a container leasing enterprise.

17. However, the Committee observed that, from the standpoint of principle, the problems raised by the taxation of income from container leasing differed little from the familiar problems that arose for implementing the principles of the OECD Model. A substantial majority of countries considered that container leasing was basically no different from the leasing of other industrial or scientific equipment, even if the containers were not used in the country of the first lessee. It would thus be unfortunate to create a precedent here that was contrary to the customary rules for taxation of this type of income. The Committee therefore does not recommend submitting container leasing income to the rules of Article 8, which might, however, be examined in the light of new experience when the OECD Model is fully revised. Pending this revision, countries which favour submitting income from container leasing to the rules of Article 8 are free to suggest this solution when entering into bilateral negotiations.

IV. APPLICATION OF THE OECD MODEL CONVENTION

1. General

18. While the OECD Model is in itself clear, it raises a number of practical problems.

a) A first problem relates to the question of whether the leasing enterprise has permanent establishments within the meaning of Article 5 of the OECD Model. This may be unclear, *e.g.* in States where depots are situated, when the activities of the enterprise are often so

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limited that it is difficult to establish whether or not these activities, taken in themselves, would qualify for exemption under paragraph 4 of Article 5 of the OECD Model. Likewise it may be doubtful whether there is or is not a permanent establishment in the State of a customer (*e.g.* carrier or other user of the containers) by the mere fact of the presence of containers there;

b) Determining which profits of an enterprise leasing containers are attributable to a permanent establishment qualifying as such under Article 5 of the OECD Model may be even more difficult.

2. *Guidelines for the application of Article 5 of the OECD Model (existence of a permanent establishment)*

19. The Committee decided to approach this problem by examining some basic cases often encountered in the operation of CLEs. The solutions proposed could constitute guidelines for policy-making and mutual agreement procedures regarding the application of bilateral treaties. This does not mean, of course, that the specific circumstances of each case should not be taken into account.

Case A: Simple depots

i) Case description

20. The leasing enterprise rents containers all over the world. The lessee may surrender his container to any one of more than 100 depots in 40 countries. Most depots are owned and operated by independent enterprises taking over the containers and delivering them to their new customers. The depot operator generally receives a lump sum plus a special fee depending on the actual use of the depot and the services actually performed. The operation of the depot will normally require the following activities:

- Being notified of the arrival of containers which will be put at the disposal of the leasing enterprise;
- Notification of demands for containers;
- Managing a deposit for containers which have to be kept at the port under the disposition of the leasing enterprise;
- Handling of containers, namely receiving them from shipping enterprises or delivering to them on demand;
- Control of containers returned to the enterprise or delivered by it;
- Technical inspection establishing whether there is damage, informing the CLE in case of damage and auxiliary services to provide for repair through third parties.

The depot is normally used by several enterprises including container leasers, auto transporters, ocean carriers.

ii) Guidelines

21. The Committee suggests that a simple depot, as described above, does not normally give rise to a permanent establishment if operated by an independent enterprise. In cases where the operator serves as a depot for only one enterprise it might, however, be necessary to examine whether an operating depot as described in Case D below does not in fact exist.

22. A simple depot might, however, be deemed a permanent establishment in the meaning of Article 5, paragraph 1 of the OECD Model if owned and operated by the CLE itself. A strong majority of the Committee holds, however, that in these circumstances the establishment should not generally be deemed to be a permanent establishment under Article 5, paragraph 4 of the OECD Model. This appears to be justified because:

- Many activities of such establishments come under the wording of subparagraphs *a)* and *b)* of Article 5, paragraph 4;
- The remaining activities are generally so limited as to be regarded as being of an auxiliary character within the meaning of subparagraph *e*) of paragraph 4;
- The activity of a depot constitutes only a small part of that of the enterprise as a whole and it would hardly be possible to individuate more than an insubstantial amount of profits attributable to it;
- Consequently, the overall activity resulting from the combination of activities falling under subparagraphs *a), b)* and *e)* is of an auxiliary character within the meaning of subparagraph *f)* of paragraph 4.

23. The Committee therefore recommends applying the rules for exceptions provided in Article 5, paragraph 4 of the OECD Model in the cases mentioned above.

Case B: Depot-Agence

i) Case description

24. The lessor maintains agencies which rent the containers to customers approaching them. The contracts are normally signed by the agent who will closely observe general guidelines, special instructions or specific orders of the lessor, as the case may be. The agent may be fully independent of the lessor and serve more than one enterprise leasing containers. There may, however, also be closer relationships with the lessor.

ii) Guidelines

25. Where a depot-agence is owned and operated by a third party having an independent status and acting in the ordinary course of its business, it is not to be deemed a permanent establishment under Article 5, paragraph 6 of the OECD Model. Otherwise, it should be deemed a permanent establishment under Article 5, paragraph 5 of the OECD Model.

26. After careful consideration the Committee, in its vast majority, recommends granting the status of an independent agent if the operator is dealing with more than one enterprise, since the criteria described in paragraph 35 of the Commentary are met in such circumstances. Other cases should be examined on a case by case basis in the light of paragraphs 36 and 37 of the Commentary on Article 5.

27. Where the depot-agence is owned and operated by the CLE itself, the Committee considers that a permanent establishment clearly exists.

Case C: Inspection and repair

i) Case description

28. Containers deposited in a depot are inspected and, in the event of unacceptable damage, repaired on request of the lessor. Normally, this will be done by independent inspectors and/or repair shops (normal technical inspection stating whether there is any damage at all will normally be carried out by the depot operator). In some cases the lessor may own a repair shop in ports of special importance.

ii) Guidelines

29. The Committee is of the opinion that inspection and repair through independent enterprises does not constitute a permanent establishment. Even in the special cases where this might be regarded as a fixed place of business, paragraph 4 *e)* and *f)* should lead to the conclusion that there is no permanent establishment.

Case D: Operational branches

i) Case description

30. The lessor maintains an office in a port to take care of all its operations in the region; this would include notification of arrival and demands, operating the depot for containers, handling them and carrying on inspection and repair. It would likewise include, under the supervision of the head office, the lessor's marketing and the acquisition of contracts. Such operational

branches appear to be set up principally in order to co-ordinate the CLE's activity on a regional basis.

ii) Guidelines

31. In these cases, the application of Article 5 of the OECD Model will usually lead to the existence of a permanent establishment.

Case E: Mere presence of containers

i) Case description

32. Containers of the lessor are used in the country by, or on behalf of, the lessee or a third person.

ii) Guidelines

33. It is clear that in such a case the mere presence of the containers does not constitute a permanent establishment as there is no fixed place of business nor any activity performed by the lessor.

3. Guidelines for the application of Article 7 of the OECD Model (profit allocation)

34. The guidelines for the application of Article 5 of the OECD Model as set out above will prevent the CLE's profits from being split up excessively. The Committee agreed therefore that relatively general guidelines would meet the situation from a practical point of view.

35. Only in exceptional cases would a simple depot and a depot-agence [Cases A and B] be regarded as permanent establishments. Allocation of profits should be based on the fact that the permanent establishment in these cases is not active in the business of leasing containers, but rather rendering limited services. Its profits, therefore, should be determined by:

a) The amount a distinct and separate enterprise would receive under similar conditions as a consideration for holding a depot (*e.g.* a lump-sum payment and/or a special fee dependent on the actual use of the depot);

b) Less: expenses incurred for the purposes of the depot;

c) Less: an appropriate share of the headquarters' expenses including executive and general administrative expenses (if not otherwise taken into account).

36. Problems may be different in the case of an operational establishment [Case D]. In calculating the profits attributable to it, functions between such a permanent establishment and the headquarters of the lessor should be

carefully weighted. Expenses including executive and general administrative expenses incurred at the headquarters should be deducted. This would cover, *inter alia,* expenditure for financing containers, depreciation and management.

37. In Cases A and B, the profits to be allocated to the permanent establishment would normally be small. This can only be ascertained at the headquarters. States taxing such profits might, under a mutual agreement procedure, rely on the amounts determined in the headquarters' books and the country in which the headquarters is located might, in such a case, undertake to examine these amounts when auditing the CLE and to advise the other State in the case of some serious deficiency being ascertained.

V. PROBLEMS REGARDING ARTICLES ON ROYALTIES IN BILATERAL CONVENTIONS

38. The application of articles on royalties in bilateral conventions does not give rise to difficulties as long as they provide for no taxation at source on payments (rents) for container leasing. This would be in line with Article 12 of the OECD Model which exempts royalties (including rents) for scientific, industrial or commercial equipment from taxation in the State of source.

39. There are, however, bilateral conventions which provide for a limited tax at source on royalties. Reference is made in this respect to the report on the report on the taxation of income derived from the leasing of industrial, commercial or scientific equipment, the conclusions of which also cover income from the leasing of containers. In that report, the Committee takes the view that income from leasing should not be subjected to taxation at source and, therefore, be excluded from the scope of provisions corresponding to Article 12. Furthermore, it recommends making appropriate amendments to that Article or the Commentary thereto in an eventual revision of the OECD Model.

40. The question may be asked whether it is cogent to apply the provision of bilateral conventions providing for a tax at source on royalties (including rents on industrial, commercial or scientific equipment) to rents from the leasing of containers. These bilateral conventions normally use the language of Article 12, paragraph 2 of the OECD Model in defining the term "royalties". No consensus on this question could be reached in the Committee.

- *a)* One line of argument was that the leasing of containers is presently, according to the strict wording of such treaties, always to be regarded as "leasing of ... industrial equipment". This might be supported by the fact that the Commentary on Article 12 of the OECD Model

appears to follow this line. As the wording of the Model is quite clear, only a change in the Model could alter the situation;

b) On the other hand, it has been argued that the economic reality of container leasing goes far beyond the simple lease of a tangible good. The advent of container leasing was not due to the wish of carriers to rent rather than own containers. The economic reason underlying this development was rather the wish to be able to pick up and leave a container wherever it is convenient for the carrier to do so. This is only made possible by the fact that the leasing enterprises have built up a world-wide network of installations and perform a kind of clearing function where there is a surplus of containers at one point and a scarcity at others. The enterprise thus performs a service in balancing supply and demand for containers on a world-wide scale; the lease is an instrument rather than an ultimate end in itself. As Article 12 of the OECD Model deals only with situations where the lease is the ultimate end, it is not applicable to container leasing.

41. While the majority of countries adhered to the first interpretation, a minority preferred the second alternative as a functional interpretative approach. The Committee as a whole stated that the problem was due to the fact that bilateral conventions deviate from Article 12 of the OECD Model and that a common solution could not be envisaged. However, it recommends that Contracting States make use of the mutual agreement procedure, where this is possible, in order to avoid double taxation or harmful effects caused by taxation at source on royalties.

42. In this context, difficulties in the application and in the interpretation of conventions which may arise where taxation at source may be imposed on payments for the leasing of containers have been considered by the Committee. Reference is made to paragraphs 16 to 20 of the above-mentioned report on the leasing of industrial, commercial and scientific equipment.

VI. CONCLUSIONS

43. The Committee has come to the conclusion that the approach adopted in the Model Convention does provide for satisfactory solutions and t hat there is no reason to depart from principles applicable to other enterprises. In order to facilitate the application of these principles to container leasing enterprises

and having due regard to what is said in Part V above, the Committee suggests that the Council may wish to:

a) Recommend member countries, when applying existing bilateral conventions to enterprises leasing containers:

i) To take account of the considerations set out in Parts IV and V of the present report for the interpretation of Articles 5, 7 and 12 of the OECD Model Convention,

ii) To resolve administrative difficulties of application of these Articles by way of mutual agreement,

iii) To grant relief where possible, either under Article 25 of the OECD Model Convention or under their domestic laws, in order to avoid double taxation or other harmful effects caused by the taxation at source of such income;

b) Recommend member countries, when concluding new conventions or revising existing ones, not to subject income from the leasing of containers to provisions under which such income may be subject to taxation at source.

44. The Committee suggests that the Council may wish to instruct it to take into account suggestions made in this report regarding the scope of Article 12 when the OECD Model Convention is next revised.

45. The Committee also suggests that the present report be published and given appropriate publicity by the OECD Secretariat.

VII. RESERVATIONS

46. *Australia* reserves the right to tax income derived from the leasing of containers as royalties under its double taxation agreements, where such income, under Australian law, has a source in Australia.

47. *Canada* reserves the right to retain a 10 per cent rate of tax at source on income derived from the leasing of containers. However, Canada would be prepared to agree to apply, on a reciprocal basis, the rules of Article 8 to income derived from the leasing of containers used in international traffic.

48. *Italy* reserves the right to continue to include income derived from the leasing of containers in the definition of royalty as provided for in paragraph 2 of Article 12 of the 1977 Model Convention.

49. *New Zealand, Portugal* and *Spain* reserve the right to tax at source income from the leasing of containers.

50. *Turkey* reserves the right to subject income from the leasing of containers to a withholding tax at source in all cases. In case of the application of the Articles 5 and 7 of the Model Convention to such income, Turkey would like to

apply the permanent establishment rule to the simple depot, depot-agence and operational branches cases.

Notes and References

1. Shipping, inland waterways, air freight, rail or road transportation, etc.
2. For the purpose of this report, container leasing enterprises do not include shipping companies exploiting containers as an activity of an auxiliary character, in the meaning of Article 5 (paragraph 4) of the 1977 Model Convention (*cf.* paragraph 10 of the Commentary on Article 8).

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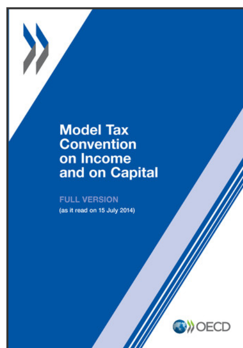

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