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Proposed changes to the UN Tax Model Convention – 10 reasons why Article 8 must be kept unchanged for airlines

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The UN Tax Committee is currently considering revising the UN Model Double Taxation Convention between Developed and Developing Countries^[1], particularly Article 8 (Alternative B), which relates to International Shipping and Air Transport.

The proposal^[2], which was released earlier this year, suggests abandoning the current fiscal framework – i.e., international air traffic income being exclusively taxed in the airlines' home jurisdiction – and creates additional source-based taxing rights in all jurisdictions where airlines fly to/from (or where revenue is generated). In other words, some developing States believe they will gain additional tax revenues from this change.

In Paragraph 15 of the proposal, a question is raised as to whether the new proposal should be restricted to international shipping activities or should it also be extended to airlines. We urge States and decision-makers to keep the current wording under Article 8 of the UN Model Convention – and present 10 reasons why this proposal must not include international air transport.

1. The rationale behind the proposal is counterproductive

The proposal intends to give all States taxing rights over the airlines' economic activity related to their country. There is an implicit suggestion (Paragraph 4) that travelling by air is a developed country's endeavor. This argument is incorrect. We would like to state that airlines are headquartered both in developed and Least Developed Countries (LDCs). In fact, some LDCs have two or even three airlines headquartered in their territory. Moreover, we would like to mention that there is no concentration of airlines in specific countries due to potentially favorable tax regimes. These arguments are inadequate for aviation, and its mention demonstrates this proposal's lack of understanding of the aviation industry.

2. The proposal hits the Least Developed Countries more heavily

Although the proposal may seem like a tempting and meritorious alternative for States to increase their source of public revenues, in reality, it implies that many countries – including LDCs – may lose exclusive taxing rights over their State-registered carriers. Additionally, it impacts consumers since it may increase the ticket cost (including the residents of LDCs) and reduce the number of routes. Moreover, it brings additional functional and administrative burdens to LDCs' tax authorities, who must receive, process and audit tax submissions from all airlines flying to their

country and be prepared to be challenged and challenge any discrepancies, legal interpretations and juridical disputes. All the above elements, particularly for the LDCs, outweigh any potential revenue these authorities could expect.

3. Airlines already pay their taxes, as any other corporation

Airlines are subject to income, excise, and other types of taxes. Due to the difficulties in apportioning the exact revenue and costs to all the jurisdictions airlines fly to, from, or through, including airspace over the high seas (i.e., international airspace), it was internationally agreed that international air traffic would be subject to taxation in the airline's home jurisdiction, in equal terms to any other corporation. This is the status recognized in both Double Taxation Model Conventions of the United Nations, and the Organization for Economic Cooperation and Development (OECD), which serve as a basis for double taxation agreements worldwide. Suggestions that airlines do not pay taxes (Paragraph 8) are also incorrect. On the contrary, following all legal predicaments, airlines do pay taxes in their home countries.

4. Lack of consultation with the UN agency for aviation and the impacted stakeholders

The International Civil Aviation Organization (ICAO) is the United Nations aviation-specialized agency under the UN Economic and Social Council (ECOSOC). The ECOSOC's Tax Committee is analyzing this proposal (initiated by its Subcommittee on the UN Model Convention). The proposal, heavily impacting the current global fiscal policies, has not been brought to the attention of ICAO, which was not consulted. The UN Tax Committee did not involve the impacted stakeholders (airlines) or their representatives. Lack of appropriate consultation with key stakeholders goes against the principles that guide transparency and equality in policymaking.

5. Existing policies on Taxation in the Field of International Air Transport

One of the major flaws of this proposal is the inconsistency and incoherence with existing legal frameworks and global practices. On top of disregarding ICAO, the proposal by the Subcommittee on the UN Tax Model Convention neglects the existence of applicable international fiscal policy approved by ICAO and its 193 Member States. Indeed, although the ICAO Document 8632 (ICAO's Policies on Taxation in the Field of International Air Transport^[3]) was approved by the ICAO Assembly and is applicable in all ICAO Member States, the document is not mentioned in the proposal.

6. Financial statements and expense allocation

The reason for residence taxation is linked to the specificities of international air traffic. For its nature, this economic activity faces several complexities and challenges; one of the biggest is allocating expenses — such as aircraft lease rentals, crew, fuel, maintenance, engineering software, training, technical updates, spares' inventory, and financial interests — to the various jurisdictions where airlines do business or generate revenue. Due to such difficulties, no separate accounts or financial statements exist for each jurisdiction to which airlines operate outside their headquarters country. This makes it impossible for the airlines to comply with the proposed change in calculation of "*profits*".

7. Other complexities and challenges related to international air transportation

Besides the impracticality of accurate expense allocation, other particularities of the airline

industry make it impossible to comply with such a proposal: various distribution and sales channels; codeshares, interline, and joint venture agreements; and ancillary sales (additional bags, seat upgrades, lounge access, priority boarding, in-flight sales of food and beverages, duty-free goods, among others) — all of these done through different sale channels. Finally, the nonstandard definitions of “revenue” in the various national legislations regarding international air transportation bring increased calculation complexities for each jurisdiction, resulting in a data collection nightmare for airlines, a patchwork of tax treatments, and leads to different interpretations and legal disputes.

8. Airlines’ net profit per passenger in 2023 is estimated at US\$2.25

According to IATA’s analysis in June 2023^[4], the estimated net profit margin per ticket for 2023 in absolute terms is US\$2.25. Yes, that is two dollars and twenty-five cents per flown passenger. While most airlines are still in real economic loss, bringing additional financial and administrative burdens to airlines is an unbearable proposition which must be rejected. In other words, any proposal linked to taxation on the basis of gross receipts, in addition to being unworkable, could create financial issues for this industry.

9. The value of aviation

Besides supporting 88 million jobs and US\$3.5 trillion in GDP, aviation plays an enormous social and humanitarian role in the world. Safe, reliable, efficient and cost-effective air transport is an essential component of a broader mobility strategy to help achieve the United Nations 2030 Agenda for Sustainable Development. The aviation sector plays an active role in at least 15 of the 17 Sustainable Development Goals. Besides these aspects, aviation is the first link in the value chain to be mobilized and rapidly move relief supplies to disaster zones when calamity strikes. Air transport also provides vital links to communities in remote parts of the world, including all the Least Developed Countries. Regarding connectivity, 272 million people worldwide lived outside their country of birth in 2019, and aviation provides this and other forms of connectivity.

10. If things work well, don’t change them

Indeed, airlines pay their taxes exclusively in their home jurisdictions because there is no known better and fairer policy solution given the challenges of this industry. The airline industry has been both heavily scrutinized and fully transparent to ensure complete compliance with the current global fiscal policy.

The international community – including the United Nations and the OECD – has long agreed on the importance of a specific fiscal framework applicable to international air traffic, and has maintained Article 8 of the Model Conventions purpose fully stable, obliging airlines to comply with their taxing obligations in the jurisdiction where they are registered. This solution is transparent, fair and non-distortive.

The 2021 version of the UN Model Convention states that the exemption from tax in the source country is predicated largely on the premise that the income of these airline enterprises is earned on airspace “*over the high seas*”. Additionally, it recognizes that “*the exposure to the tax laws of numerous countries is likely to result in double taxation or, at best, in difficult allocation problems*”. Finally, there is a recognition that “*exemption in places other than the home country ensures that the enterprises will not be taxed in foreign countries if their overall operations turn out to be unprofitable*”.

These statements made remain valid in 2023 (and, undoubtedly, in the years to come). There are no foreseeable changes to this scenario capable of justifying the proposed change, and therefore policymakers should reject the proposal to include international air transport.

[1] The UN Model Double Taxation Convention between Developed and Developing Countries is available at https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf

[2] Proposal to change Article 8 (Alternative B) available on [https://financing.desa.un.org/sites/default/files/2023-04/CRP.14 UN Model Article 8 final.pdf](https://financing.desa.un.org/sites/default/files/2023-04/CRP.14%20UN%20Model%20Article%208%20final.pdf)

[3] The ICAO Document 8632, ICAO's Policies on Taxation in the Field of International Air Transport, is available at https://www.icao.int/publications/Documents/8632_cons_en.pdf

[4] See IATA Industry Statistics at <https://www.iata.org/en/pressroom/2023-releases/2023-06-05-01/>

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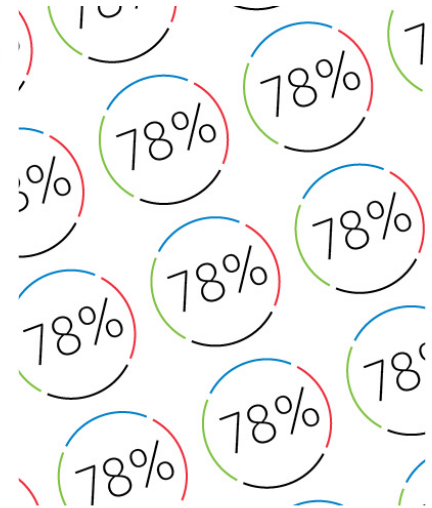
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