

Commentators said that a shipping company utilizing less than the entire space on several vessels also should be considered engaged in the operation of ships or aircraft. The final regulations do not adopt this suggestion. The IRS and Treasury believe that it is appropriate to consider a foreign corporation to be engaged in the operation of ships or aircraft for purposes of section 883 only when it is an owner or lessee of an entire ship or aircraft.

C. Pool, Partnership, Strategic Alliance, Joint Operating Agreement, Code-Sharing Arrangement or Other Joint Venture

Section 1.883-1(e)(2) generally treats a foreign corporation as engaged in the operation of ships or aircraft with respect to its participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture. Commentators asked that these rules be made applicable to single-member disregarded entities in addition to arrangements with multiple owners. Commentators also asked for clarification concerning whether these rules apply to tiered partnerships, such as in the case of a foreign corporation that is a partner in a partnership, whose sole activity is to be a partner in another partnership that is engaged in international shipping.

The rules have been revised to cover single-member disregarded entities, and to clarify that they apply to tiered entities in the case of both joint venture entities and joint ventures that are not entities. An example was added to illustrate these revisions.

D. Cruises to Nowhere

Section 1.883-1(f)(1) excludes from the international operation of ships or aircraft the carriage of passengers or cargo on a voyage or flight that begins and ends in the United States, even if the voyage or flight contains a segment extending beyond the territorial limits of the United States, unless the passenger disembarks or the cargo is unloaded outside the United States. Commentators renewed their objection to this exclusion of such "cruises to nowhere." The final regulations continue to exclude cruises to nowhere because such travel has beginning and ending points within the United States within the meaning of section 863(c)(1).

E. Determining Whether Income Is Derived From International Operation of Ships or Aircraft

Section 1.883-1(f)(2) of the proposed regulations provides that whether

income is derived from international operation of ships or aircraft is determined on a passenger by passenger basis and on an item-of-cargo by item-of-cargo basis. Commentators suggested that with respect to the carriage of passengers by ship, the determination should be made on a voyage by voyage basis. Commentators said the voyage should be treated as international if it cannot be completed because of weather or similar factors.

The final regulations do not adopt the suggestion that income be determined on a voyage by voyage basis. The regulations have been revised, however, to exempt income from the sale of a ticket for international carriage of a passenger when the passenger does not begin or complete an international journey because of unanticipated circumstances. For example, if a passenger does not leave on an international flight because of a change in plans, or is unable to complete an international voyage because of illness, any income derived from the sale of the ticket nonetheless will qualify for exemption.

F. International Carriage of Cargo

Under § 1.883-1(e)(1), a foreign corporation is considered engaged in the operation of ships or aircraft only if the ship or aircraft is used in the carriage of passengers or cargo for hire. Commentators pointed out that the regulations do not define the term *for hire*. They expressed concern that requiring the carriage of cargo for hire might be interpreted to exclude income derived by a vessel owner or operator who charters a vessel to a lessee, if the lessee uses it to transport the lessee's own cargo or repositions the vessel without cargo on board for its next voyage. Commentators suggested that the term *for hire* be defined to include carriage of proprietary goods and an empty backhaul voyage, or that it be deleted from the regulations.

Section 1.883-1(f)(2)(iv) of the final regulations provides that if a foreign corporation time, voyage, or bareboat charters out a ship or aircraft, and the lowest-tier lessee uses the ship or aircraft to carry passengers or cargo on a fee basis, the ship or aircraft is considered used to carry passengers or cargo for hire, regardless of whether the ship or aircraft may be empty during a portion of the charter period due to a backhaul voyage or flight or for purposes of repositioning. If a foreign corporation time, voyage, or bareboat charters out a ship or aircraft, and the lowest-tier lessee uses the ship or aircraft for the carriage of proprietary goods, including an empty backhaul

voyage or flight or repositioning related to such carriage of proprietary goods, the ship or aircraft similarly will be treated as used to carry cargo for hire.

G. Bareboat Charter of Ships or Dry Lease of Aircraft Used in International Operation of Ships or Aircraft

When a foreign corporation bareboat charters a ship or dry leases an aircraft to a lessee, § 1.883-1(f)(2)(iii) of the proposed regulations requires the corporation to adopt a reasonable method for determining the amount of charter income attributable to the international operation of ships or aircraft by the lowest tier lessee. The regulations contain two ratios that may provide a reasonable method for determining the amount of qualifying charter income.

Commentators asked for clarification that business records or log books are a reasonable method for determining the amount of charter income when those records show that the vessel has been used exclusively in international transportation. Commentators also asserted that the ratios are unnecessary and suggested that they be deleted.

The IRS and Treasury believe that business records or log books showing that a ship or aircraft has been used exclusively on voyages or flights that begin or end in the United States (but not both) may be sufficient to establish that the foreign corporation's entire gross income is income from the international operation of ships or aircraft. However, if the ship or aircraft also has been used on voyages or flights that begin and end outside the United States, the foreign corporation must determine the amount of the charter income that is attributable to voyages or flights that begin or end in the United States (but not both) to determine the amount of income potentially within the scope of section 883. The final regulations have been revised generally to require such a foreign corporation to determine the amount of such income based on the total number of days of uninterrupted travel on voyages or flights between the United States and the farthest point or points where cargo or passengers are loaded en route to, or discharged en route from, the United States. However, the final regulations permit the foreign corporation to adopt an alternative method for determining the amount of the charter income that is attributable to the international operation of ships or aircraft if it can establish that the alternative method more accurately reflects the amount of such income.