

H. Activities Incidental to the International Operation of Ships or Aircraft

Section 1.883-1(g) of the proposed regulations provides that certain activities of an operator of a ship or aircraft are so closely related to the primary activity of the international operation of ships or aircraft that income from those incidental activities shall be considered income from the international operation of ships or aircraft, and thus eligible for exemption.

Intermodal Containers

Section 1.883-1(g)(1)(x) of the proposed regulations treats certain container rental activities in the United States as incidental to the international operation of ships or aircraft. The regulations limit incidental treatment to the rental of containers for use in the United States for a period not exceeding five days beyond the original delivery date to the consignee as stated on the bill of lading, and also impose other limitations on incidental treatment.

Commentators stated that ocean carriers provide containers to their customers as an integral part of international shipping, but do not "rent" containers or provide them for "temporary warehousing" of cargo. Commentators also noted that deliveries can be delayed beyond five days for many reasons that clearly do not involve warehousing, such as congestion at port facilities. Commentators said it would be difficult and unrealistic to allocate a portion of the shipping charges to the use of containers.

For these reasons, the reference to container rental as an incidental activity has been modified. The "five day" rule has been eliminated and replaced with a more flexible rule under which the provision of containers or other related equipment by the foreign corporation in connection with the international carriage of cargo for use by its customers, including short-term use within the United States immediately preceding or following the international carriage of cargo, is considered an incidental activity. The regulations presume that a container is used in connection with the international carriage of cargo if it is used for a period of five days or less immediately preceding or following the international carriage of cargo. Beyond this five-day period, whether a container is being used in connection with the international carriage of cargo, or for some other purpose such as warehousing of cargo, will depend on the facts and circumstances. The regulations make clear that the use of

containers for any such other purpose will be considered to give rise to income that is not incidental to the international operation of ships or aircraft.

Hotel Accommodations

Arranging for one night in a hotel within the United States before or after a cruise is considered incidental to the international operation of ships under § 1.883-1(g)(1)(vii) of the proposed regulations. Commentators suggested that the exception also should apply to one-night hotel accommodations arranged by airlines. Commentators said that airlines occasionally provide such accommodations to passengers on tour packages for the same reasons that cruise companies provide accommodations. The final regulations do not adopt this suggestion. The IRS and Treasury believe that different rules are appropriate in light of operational differences between the airline and cruise industries.

Inland Transportation of Cargo

Section 1.883-1(g)(1)(v) treats the inland transportation of cargo by a related or unrelated corporation as incidental. Commentators suggested that inland transportation of cargo by the foreign corporation itself (after the cargo has passed through Customs) also should be treated as incidental. The final regulations do not adopt this suggestion. The IRS and Treasury are concerned that an exemption would permit foreign corporations engaged in international transportation to compete unfairly with other corporations engaged in the inland transportation of cargo.

Under the proposed regulations, inland transportation by another corporation must be documented by a through bill of lading, airway bill, or similar document. Commentators asked whether the term *similar document* can include any document showing an inland leg to international transportation, such as a seaway bill or cargo receipt. The IRS and Treasury believe that *similar document* may be construed broadly to include any appropriate document.

Commentators stated that some unincorporated entities provide inland transportation, and asked that such entities be included in the regulations. Accordingly, the final regulations have been revised to permit any unrelated person (whether incorporated or not) to provide inland transportation of cargo. The final regulations also provide that the rules of section 267(b) shall apply for purposes of determining whether persons are related.

Inland Transportation of Passengers

Section 1.883-1(g)(1)(vi) treats the sale or issuance by a foreign corporation of interline or code-sharing tickets for the inland transportation of passengers by air as an incidental activity. Commentators suggested that the inland segment of an international journey also should be treated as incidental when provided by the foreign airline itself through the sale or issuance of an intraline ticket. The final regulations extend incidental treatment to the sale or issuance of intraline tickets. The final regulations also impose a maximum 12-hour scheduled interval between the international and inland segments of any flight involving intraline tickets.

Shore Excursions

Land tour packages are excluded from incidental activities under § 1.883-1(g)(2)(i). Commentators contend that single-day shore excursions are not the same as land tour packages and should qualify as an incidental activity. The final regulations do not adopt this suggestion because the two activities are similar in nature.

Short-term Use

Ships normally engaged in international cruises may occasionally be used for other purposes, such as cruises to nowhere. Commentators asked that such short-term use be treated as an incidental activity. The final regulations do not adopt this suggestion because domestic use of a vessel does not qualify as the international operation of ships or aircraft.

Airline Tickets

Section 1.883-1(g)(1) treats as incidental the sale of tickets by an airline for international transportation on another airline, and the sale of tickets by a ship operator on behalf of another ship operator. Section 1.883-1(g)(2)(iii), however, excludes from incidental income the sale of airline tickets by a cruise company. Commentators objected to this exclusion. This exclusion is retained in the final regulations. Cruise companies that sell airline tickets are acting in a capacity comparable to travel agents, and would have an unfair competitive advantage if their income from this activity were exempt.

Ground Services and Other Services

The proposed regulations, in § 1.883-1(g)(3), reserve on the treatment of ground services, maintenance and catering, as well as other services not mentioned as included among incidental activities. In the absence of a