

entity under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section. Under the terms of the partnership agreement, each partner contributes all of the ships in its fleet to P in exchange for interests in the partnership and shares in the P profits from the international carriage of cargo. The partners share in the overall management of P, but each partner, acting in its capacity as partner, continues to crew and manage all ships previously in its fleet.

(ii) *Analysis.* P owns the ships contributed by the partners and uses these ships to carry cargo for hire. Therefore, if P were a foreign corporation, it would be considered engaged in the operation of ships within the meaning of paragraph (e)(1) of this section. Accordingly, because P is a fiscally transparent entity under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section, X, Y, and Z are each considered engaged in the operation of ships through P, within the meaning of paragraph (e)(2)(i) of this section, with respect to their distributive share of income from P's international carriage of cargo.

*Example 3. Joint venture with chartered in ships—(i) Facts.* Foreign corporation A owns a number of foreign subsidiaries involved in various aspects of the shipping business, including S1, S2, S3, and S4. S4 is a foreign corporation that provides cruises but does not own any ships. S1, S2, and S3 are foreign corporations that own cruise ships. S1, S2, S3, and S4 form joint venture JV, in which they are all interest holders, to conduct cruises. JV is a fiscally transparent entity under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section. Under the terms of the joint venture, S1, S2, and S3 each enter into time charter agreements with JV, pursuant to which S1, S2, and S3 retain control of the navigation and management of the individual ships, and JV will use the ships to carry passengers for hire. The overall management of the cruise line will be provided by S4.

(ii) *Analysis.* S1, S2, and S3 each owns ships and time charters those ships to JV, which uses the ships to carry passengers for hire. Accordingly, S1, S2, and S3 are each considered engaged in the operation of ships under paragraph (e)(1) of this section. JV leases in entire ships by means of the time charters, and JV uses those ships to carry passengers on cruises. Thus, JV would be engaged in the operation of ships within the meaning of paragraph (e)(1) of this section if it were a foreign corporation. Therefore, although S4 does not directly own or lease in a ship, S4 also is engaged in the operation of ships, within the meaning of paragraph (e)(2)(i) of this section, with respect to its participation in JV.

*Example 4. Tiered partnerships—(i) Facts.* Foreign corporations A, B, and C enter into a partnership, P1. P1 is one of several shareholders of Poolco, a foreign limited liability company that makes an election pursuant to § 301.7701-3 of this chapter to be treated as a partnership for U.S. tax purposes. P1 acquires several ships and time charters them out to Poolco. Poolco slot or voyage charters such ships out to third parties for use in the carriage of cargo for hire. P1 and

Poolco are fiscally transparent entities under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section.

(ii) *Analysis.* A, B, and C are considered engaged in the operation of ships under paragraph (e)(2)(i) of this section with respect to their direct interest in P1 and with respect to their indirect interest in Poolco because both P1 and Poolco are fiscally transparent entities under the income tax laws of the United States and would be considered engaged in the operation of ships under paragraph (e)(1) of this section if they were foreign corporations. The result would be the same if Poolco were a single-member disregarded entity owned solely by P1.

(5) *Definitions—(i) Bareboat charter.* A bareboat charter is a contract for the use of a ship or aircraft whereby the lessee is in complete possession, control, and command of the ship or aircraft. For example, in a bareboat charter, the lessee is responsible for the navigation and management of the ship or aircraft, the crew, supplies, repairs and maintenance, fees, insurance, charges, commissions and other expenses connected with the use of the ship or aircraft. The lessor of the ship bears none of the expense or responsibility of operation of the ship or aircraft.

(ii) *Code-sharing arrangement.* A code-sharing arrangement is an arrangement in which one air carrier puts its identification code on the flight of another carrier. This arrangement allows the first carrier to hold itself out as providing service in markets where it does not otherwise operate or where it operates infrequently. Code-sharing arrangements can range from a very limited agreement between two carriers involving only one market to agreements involving multiple markets and alliances between or among international carriers which also include joint marketing, baggage handling, one-stop check-in service, sharing of frequent flyer awards, and other services. For rules involving the sale of code-sharing tickets, see paragraph (g)(1)(vi) of this section.

(iii) *Dry lease.* A dry lease is the bareboat charter of a aircraft.

(iv) *Entity.* For purposes of this paragraph (e), an entity is any person that is treated by the United States as other than an individual for U.S. Federal income tax purposes. The term includes disregarded entities.

(v) *Fiscally transparent entity under the income tax laws of the United States.* For purposes of this paragraph (e), an entity is fiscally transparent under the income tax laws of the United States if the entity would be considered fiscally transparent under the income tax laws of the United States under the principles of § 1.894-1(d)(3).

(vi) *Full charter.* Full charter (or full rental) means a time charter or a voyage charter of a ship or a wet lease of an aircraft but during which the full crew and management are provided by the lessor.

(vii) *Nonvessel operating common carrier.* A nonvessel operating common carrier is an entity that does not exercise control over any part of a vessel, but holds itself out to the public as providing transportation for hire, issues bills of lading, assumes responsibility or is liable by law as a common carrier for safe transportation of shipments, and arranges in its own name with other common carriers, including those engaged in the operation of ships, for the performance of such transportation.

(viii) *Space or slot charter.* A space or slot charter is a contract for use of a certain amount of space (but less than all of the space) on a ship or aircraft, and may be on a time or voyage basis. When used in connection with passenger aircraft this sort of charter may be referred to as the sale of block seats.

(ix) *Time charter.* A time charter is a contract for the use of a ship or aircraft for a specific period of time, during which the lessor of the ship or aircraft retains control of the navigation and management of the ship or aircraft (*i.e.*, the lessor continues to be responsible for the crew, supplies, repairs and maintenance, fees and insurance, charges, commissions and other expenses connected with the use of the ship or aircraft).

(x) *Voyage charter.* A voyage charter is a contract similar to a time charter except that the ship or aircraft is chartered for a specific voyage or flight rather than for a specific period of time.

(xi) *Wet lease.* A wet lease is the time or voyage charter of an aircraft.

(f) *International operation of ships or aircraft—(1) General rule.* The term *international operation of ships or aircraft* means the operation of ships or aircraft, as defined in paragraph (e) of this section, with respect to the carriage of passengers or cargo on voyages or flights that begin or end in the United States, as determined under paragraph (f)(2) of this section. The term does not include 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. Operation of ships or aircraft beyond the territorial limits of the United States does not constitute in itself