August 31, 2005

The Honorable Charles E. Grassley
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Max S. Baucus
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Re: S. 1447, the Tax Technical Corrections Act of 2005

Dear Chairman Grassley and Senator Baucus:

The undersigned U.S. flag ocean carriers and associations are writing to propose certain technical corrections to the tonnage tax provisions (Subchapter R) of the American Jobs Creation Act. We would like to express our sincere appreciation for your efforts and those of the Congress to revitalize the U.S. shipping industry and to bring the taxation of U.S. shipping into conformity with global practices regarding the taxation of shipping. We note that S. 1447 as introduced contains certain provisions relating to the tonnage tax and we endorse those provisions. We have one additional suggestion that we offer as follows.

The technical correction we propose would define the term "operating agreement" which was introduced in the tonnage tax provisions late in the legislative process. The amendment would define the term consistent with industry practices and provide that operating agreement revenues received by a corporation otherwise eligible for tonnage tax treatment would also be subject to the tonnage tax regime. Whether a corporation meets the "shipping activity" requirement of the Code would, however, be determined without regard to the corporation's operating agreement. We enclose a more detailed explanation of the proposed amendment and legislative language for your consideration.

The amendment meets the standards of a technical correction in that it defines terms not otherwise defined and clarifies the relation of such terms to the structure of the tonnage tax regime. We urge that these provisions be included in the Tax Technical Corrections Act.

Very truly yours,

American Ocean Enterprises, Inc

APL, Ltd

Central Gulf Lines, Inc.

Maersk Lines Limited

Waterman Steamship Corporation

American Maritime Congress

Maritime Institute for Research and Development

The Transportation Institute

Enclosures

August 31, 2005

Legislative Language of Proposed Amendment

(a) AMENDMENT RELATED TO THE AMERICAN JOBS CREATION ACT OF 2004.—

(1) AMENDMENT RELATED TO SECTION 248 OF THE ACT.— Paragraph (8) of Subsection (a) of section 1355 of the Internal Revenue Code of 1986 is amended by adding at the end the following: "An 'operating agreement' means an agreement to provide vessel operating services in respect of a qualifying vessel, such as crew, technical, commercial, or other vessel management services or the provision of related equipment, tools, provisions, and supplies by the person providing the operating services. A vessel in respect of which an operating agreement exists shall be treated as bareboat (or sub-bareboat) chartered to the person providing services under the operating agreement and time chartered back to the other party to the agreement. This paragraph shall apply only in the case of a corporation that meets (or is a member of a controlled group that meets) the shipping activity requirement in subsection (c) without regard to this paragraph."

August 31, 2005

General Explanation of Proposed Amendment

Congress believed operators of U.S. flag vessels in international trade generally were subject to higher taxes than their international competitors, who benefited from tonnage tax and other preferential income tax regimes. Congress believed that this tax differential caused a steady and substantial decline of the U.S. industry and its well-paying, unionized U.S. jobs.

Therefore, Section 248 of the American Jobs Creation Act of 2004 (the "Jobs Act") added a tonnage tax regime for the taxation of certain U.S. flag vessels. A provision stating that the term "charter" includes an "operating agreement" was added in the conference. No definition of the term "operating agreement" was provided or included in the legislative history, and neither this provision nor the legislative history clarified the consequences of treating an "operating agreement" as a charter to the parties to such an agreement.

The technical correction provides a definition of the term operating agreement that reflects customary practices in the industry, and provides that an operating agreement would be treated as a bareboat charter of the vessel to the operator and a time charter back to the person owning the vessel. This definition applies only to a corporation (or a member of a controlled group) that otherwise meets the statutory shipping activity requirement.

An operating agreement is defined to include an agreement to provide vessel operating services in respect of a qualifying vessel, such as crew, technical, commercial, or other vessel management services or the provision of related equipment, tools, provisions, and supplies by the person providing the operating services.

Under the amendment, both the owner and the person providing the operating services qualify for tonnage tax treatment with respect to earnings realized from the operation of the vessel in a qualified trade.

Because the proposed amendment would treat a vessel subject to an operating agreement as bareboat chartered to the person providing the operating services, the operator is permitted to count the vessel that is the subject of the operating agreement for purposes of meeting the "Shipping Activity Requirement" applicable to the operator as is the other party to the operating agreement.

In summary, this technical correction is needed to clarify application of the statute, reflect industry practices, and maintain the competitiveness of U.S. industry.

August 31, 2005

Technical Explanation of Proposed Amendment

In the Conference on H.R. 4520, the American Jobs Creation Act of 2004 (the "Jobs Act"), Paragraph (8) of Subsection (a) of new section 1355 of the Internal Revenue Code of 1986, as amended (the "Code") was added and provided that the term "charter" includes an "operating agreement." No definition of the term "operating agreement" was provided or included in the legislative history, and neither this provision nor the legislative history clarified the consequences of treating an "operating agreement" as a charter to the parties to such an agreement.

Section 1355 of the Code is part of the alternative tonnage tax regime (Subchapter R) enacted by the Jobs Act, under which a "qualifying vessel operator" may generally elect to be subject to the corporate income tax on certain notional shipping income in lieu of actual amounts of income from "qualifying shipping activities." A "qualifying vessel operator" is defined as any corporation who operates one or more qualifying vessels and who meets the shipping activity requirement of Subsection (c) of section 1355. For purposes of the first prong of the test, a person is generally considered to operate a qualifying vessel during any period that it either owns or charters (including time charters) the vessel (the "Operates Requirement"). Although a person is generally not considered to operate or use a vessel that it charters out on bareboat charter terms, exceptions apply where the vessel is bareboat chartered to another member of such person's controlled group, or where the vessel is bareboat chartered to either a controlled group member or an unrelated person who sub-bareboat charters or time charters the same vessel back to the owner or another member of the controlled group (who ultimately uses the vessel as a qualifying vessel). The second prong of the test, the "Shipping Activity Requirement," is met for any taxable year, if, on average during such year, at least 25 percent of the aggregate tonnage of qualifying vessels used by the corporation (or other members of the corporation's controlled group) were owned by such corporation or chartered to such corporation on bareboat charter terms.

The first sentence of the attached technical corrections amendment provides a definition of an "operating agreement" that would cover agreements typically used in the shipping industry for the provision of vessel operating services in respect of a qualifying vessel.

The second sentence of the proposed amendment clarifies how both parties to an operating agreement can qualify for the tonnage tax provisions in respect of a vessel subject to an operating agreement, assuming that the Shipping Activity Requirement and all of the other requirements of this Subchapter are met. Since the proposed amendment would treat such a vessel as bareboat chartered to the person providing the services under an "operating agreement," such person is treated as satisfying the Operates Requirement. Furthermore, since the proposed amendment treats the vessel in respect of which an operating agreement exists as bareboat (or sub-bareboat) chartered to the person providing the services under the operating agreement *and time chartered* back to the other party to the agreement, such other party is also treated as satisfying the Operates Requirement, regardless of whether the parties to the operating agreement are members of the same controlled group.

The third sentence of this proposed amendment limits applicability of this provision to corporations that meet (or are members of controlled groups that meet) the Shipping Activity Requirement without regard to the treatment of operating agreements as charters under this paragraph. Thus, a corporation will not meet the Shipping Activity Requirement and qualify for the tonnage tax provisions solely by reason of an operating agreement. However, if a corporation (or its controlled group) independently meets the Shipping Activity Requirement (by owning or bareboat chartering sufficient tonnage of other qualifying vessels), it will qualify for the tonnage tax provisions in respect of any qualifying vessel that it is treated as operating by reason of providing services under an operating agreement.