New York: Tax Advantages as a Maritime Jurisdiction

by James C. Cofer, Seward & Kissel LLP

NEW YORK IS WORLD-RENOWNED FOR many things—a center of finance, a cultural mecca and the best pizza in the world (sorry, Chicago). New York is also world-renowned for high taxes. But you might be surprised to learn that for international shipping companies, there is no better place to do business than New York.

An international shipping company may be able to operate in New York completely tax-free with proper structuring. Combined with New York's other advantages as a financial and cultural center, this presents a unique business opportunity for shipping companies.

Let's look at some of the advantages:

• FEDERAL TAX EXEMPTION

The federal government provides a statutory exemption from U.S. federal income tax for certain foreign corporations engaged in the international operation of ships.

The international operation of ships generally includes carriage of cargo or passengers for hire, chartering of ships (whether on a time, voyage or bareboat basis) to other persons engaged in the carriage of cargo or passengers, participation in a pool or a joint venture engaged in the international operation of ships and certain activities incidental to the international operation of ships. In addition, gain from the sale of a vessel by a foreign corporation may also be exempt from U.S. federal income tax.

Although the international operation of ships generally does not include ship management activities performed for third parties, it does include activities related to the management of one's own vessels.

In order to qualify for the exemption, a foreign corporation must satisfy a "country of organization" test and any one of three ownership tests.

In order to satisfy the "country of organization test," a foreign corporation must be organized in a jurisdiction which provides a reciprocal exemption from tax on shipping income to U.S. corporations (including the Marshall Islands, Liberia and Panama) (a "qualified foreign country").

There are three ownership tests that can be satisfied to qualify for the exemption: (1) the "publicly-traded test," (2) the "50% ownership test" and (3) the "CFC test."

A foreign corporation will qualify for the publicly-traded test if it has one or more classes of stock representing the majority of the vote and value of all of its classes of stock that are "primarily traded" and "regularly traded" on an "established securities market" in the United States or a non-U.S. jurisdiction that provides a reciprocal exemptions. Special rules apply certain closely-held corporations.

A foreign corporation will qualify for the 50% ownership test if more than 50% of the value of its stock is owned by one or more tax residents of a qualified foreign country.

Finally, a foreign corporation will qualify for the "CFC Test" if it is treated as a "controlled foreign corporation" for U.S. federal income tax purposes (meaning that more than 50% of the vote or value of its stock is owned by one or more 10% U.S. voting shareholders) and more than 50% of the value of its stock is owned by U.S. individual taxpayers, U.S. corporations or certain U.S. trusts.

In addition, a foreign corporation which is resident in a jurisdiction that has an income tax treaty with the United States may also qualify for an exemption under that treaty.

The U.S. federal "check-the-box" tax regime allows additional flexibility and potential cost-savings to ship managers located in New York. Under this regime, a shipping company can elect to disregard its ship-owning subsidiaries formed in certain non-U.S. jurisdictions for

U.S. federal income tax purposes. This can allow for the filing of a single U.S. tax return for all shipping operations.

In addition, a shipping company can employ personnel in New York and gain significant liability protection by using a separate limited liability company to employ those personnel. Under U.S. federal income tax laws, this separate LLC can operate on a tax-free basis as a "branch" of the parent company but still serve as a liability shield for corporate law purposes.

In summary, the U.S. federal income tax exemption allows a shipping company to operate vessels around the world from New York without any U.S. federal income tax.

• NEW YORK TAX EXEMPTIONS

New York State law completely exempts enterprises engaged in international (and interstate) shipping from all New York income taxes, including taxes imposed by New York City.

When this exemption is combined with the federal tax exemption, an international shipping business can operate in New York virtually tax-free.

• NEW JERSEY AND CONNECTICUT TAX EXEMPTIONS

If you prefer to be outside of New York, the other states in the tri-state area also have a favorable tax climate for shipping. Both New Jersey and Connecticut provide a tax exemption similar to the federal exemption discussed above for foreign corporations engaged in the international operation of ships.

• EXPERTISE

The New York metropolitan area is home to the best advisors to the shipping industry for finance, legal and accounting in the world. In addition, New York is the center of the world's capital markets with the New York Stock Exchange and NASDAQ both competing for new listings of companies.

To summarize, an international shipping company can be located in the New York metropolitan area and operate completely free of income taxation. Combined with New York's other advantages, this makes New York the best choice for locating your shipping company.

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Jim represents private investment funds (including hedge funds, funds of funds, and private equity funds) and mutual funds on a variety of tax issues, including initial structuring, investments by tax-exempt entities, investments in underlying funds, transactional matters, financial instruments, seed capital arrangements, and deferred compensation structures (including Section 409A of the Internal Revenue Code).

In addition to his investment funds practice, Jim represents international and domestic shipping companies on all aspects of their operations. Jim advises shipping companies on Section 883 of the Internal Revenue Code, joint ventures, cross-border transactions, the controlled foreign corporation and passive foreign investment company rules, internal restructurings, and the U.S. tonnage tax regime. Jim has also represented numerous shipping companies (including MLPs) in their public offerings of equity and debt securities, as well as the underwriters of such offerings.

He received a B.A. (with high honors) from Rutgers University, a J.D. from New York University School of Law, and an LL.M. (in Taxation) from New York University School of Law.