

THE TONNAGE TAX SYSTEM

2015





“...the Cyprus VAT Authority has launched a scheme making Cyprus one of the most attractive EU jurisdictions for yacht registration”.



A. INTRODUCTION

Cyprus offers complete tax exemption of all profits and dividends at all levels of distribution arising from qualifying shipping operations. This tax relief was introduced in 1963 for 10 years and has been extended a number of times.

On 29 April 2010 the Cyprus Parliament enacted the long awaited new shipping legislation. The new Merchant Shipping Law, which applies from 1 January 2010, extended significantly the scope of the Tonnage Tax (“TT”) regime and enhanced the position of Cyprus as a maritime centre. The legislation, a major success for the Cyprus shipping industry, offers new opportunities. It introduced two new TT schemes applicable to ship owners of non-Cyprus flag vessels and charterers. It also extended the application of the TT regime (and exemption from profits tax) currently enjoyed by ship owners and ship managers.

The European Commission considered that the scheme is in line with the European Union’s Guidelines on state aid to maritime transport and authorised the scheme until 31 December 2019. It is aimed at supporting the shipping sector in Cyprus and other EU countries with a strong maritime sector, providing incentives for the employment of EU seamen and registration of vessels in the EU and enhancing the competitiveness of ship owners, charterers and ship managers operating in the EU. Under this legislation, qualifying shipping activities are fully exempt from corporation tax. Tonnage tax on the net tonnage of the vessels is imposed instead of corporation tax on the actual profits. Qualifying persons are also regulated completely by the Department of Merchant Shipping rather than the Tax Authorities.

B. THE TONNAGE TAX SYSTEM

The law provides full exemption to ship owners, charterers and ship managers from all profit taxes and imposes tonnage tax on the net tonnage of the vessels at the following rates. The conditions applicable to each of the three categories, as well as the taxation regime are analysed separately below.

NET TONNAGE				
0 - 1.000	1.001 - 10.000	10.001-25.000	25.001-40.000	> 40.000
€ 36,50 per 100 NT	€ 31,03 per 100 NT	€ 20,08 per 100 NT	€ 12,78 per 100 NT	€ 7,30 per 100 NT

NOTE: The rates applicable to ship managers are 25% of the above.

Sample calculation of the annual tonnage tax for a 19.538 net tonnage vessel:

1.000 NT	$1.000/100=10 \times 36,50=$	€ 365,00
9.000 NT	$9.000/100=90 \times 31,03=$	€ 2.792,70
9.500 NT	$9.500/100=95 \times 20,08=$	€ 1.907,60
38 NT	$38/100=0,38 \times 20,08=$	€ 7,63
ANNUAL TONNAGE TAX DUE	=	€ 5.072,93

The regime covers **qualifying persons** performing **qualifying activities** in relation to **qualifying vessels**.

- **Qualifying persons** are ship owners, charterers (bareboat, demise, time and voyage) and ship managers providing technical and/or crewing services.

- **Qualifying activity** for ship owners and charterers means maritime transport of goods or people between Cyprus ports and foreign ports / offshore installations, or between foreign ports or offshore installations and specifically includes towage, dredging and cable laying.

- **Qualifying activity** when applied to ship managers means services provided to a ship owner or bareboat charterer on the basis of written agreement in relation to crew and/or technical management.

- **Qualifying vessel** is a sea-going vessel that:

- has been certified in line with international principles and legislation of the flag country; and
- is registered in the register of a member country of the International Maritime Organisation ("IMO") and International Labour Organisation ("ILO").

The **definition** includes vessels that transport humanitarian aid but excludes the following vessels:

- fishing boats;
- boats that are primarily used for the athletic and entertaining purposes boats that have been constructed exclusively for domestic navigation;
- ferry and trailer boats that are used in ports, mouth of rivers and / or rivers;
- fixed offshore constructions that are not used for maritime transport;
- non self-propelled floating cranes;
- non sea-going trailers;
- floating hotels and restaurants; and
- floating or movable casinos.

C. SHIP OWNERS

The TT regime **applies to any owner** of qualifying vessels that carry out a qualifying activity:

- Cyprus flag vessels;
- EU/European Economic Area (“EEA”) flag vessels that exercised the option to be taxed under the TT regime; and
- Fleet of EU/EEA and non EU/EEA vessels that exercised the option to be taxed under the TT regime.

The new legislation introduces **the definition of a fleet**.

A fleet consists of two or more vessels that belong directly or indirectly to the same person(s) or companies of the same group. A group is defined as at least two companies that are directly or indirectly in a parent/subsidiary relationship or that are directly or indirectly subsidiaries of the same parent company.

The legislation allows non EU/EEA vessels to enter the TT regime provided the fleet is composed by at least 60% EU/EEA vessels. If this requirement is not met, the non EU/EEA vessels may still qualify if certain criteria are met.

The tax exemption covers:

- Profits from the use of a qualifying vessel;
- Profits from the disposal of a qualifying vessel and/or share and/or interest in it;
- Profits from the disposal of shares in a ship owning company;
- Dividends paid out of the above profits at all levels of distribution; and
- Interest income relating to the financing/maintenance/use of a qualifying vessel and the working capital, excluding interest on capital used for investments.

Where an option is exercised to enter the TT system, the ship owner must be a Cyprus tax resident and the option must remain in force for at least 10 years.



“A fleet consists of two or more vessels that belong directly or indirectly to the same person(s) or companies of the same group. A group is defined as at least two companies that are directly or indirectly in a parent/subsidiary relationship or that are directly or indirectly subsidiaries of the same parent company”.

D. CHARTERERS

As with ship owners, the TT regime applies to qualifying vessels that carry out a qualifying activity. An option exists for all vessels (Cyprus/EU/EEA/fleet) chartered under bareboat, demise, time, voyage charter, provided the charterer is a legal person tax resident in Cyprus. If the choice is not made, profits are taxable under 12.5% corporation tax.

The fleet qualifying criteria are the same as for ship owners and so is the minimum 10 year duration.



The tax exemption covers:

- Profits from the use of a qualifying vessel;
- Dividends paid out of such profits at all levels of distribution; and
- Interest income relating to the working capital / qualifying activity provided such interest is used to pay expenses arising from the charter, excluding interest on capital used for investments.

The law grants the exemption provided a composition requirement is met. That is, at least 25% of the net tonnage of vessels subject to tonnage tax are owned or are bareboat chartered. The percentage can be reduced but not for more than three consecutive years.

The percentage is reduced to 10% if all the vessels of the charterer:

- carry EU/EEA flags or
- are managed (crewing and technical) in the EU/EEA.

“Charterers: As with ship owners, the TT regime applies to qualifying vessels that carry out a qualifying activity. An option exists for all vessels (Cyprus/EU/EEA/fleet) chartered under bareboat, demise, time, voyage charter, provided the charterer is a legal person tax resident in Cyprus”.



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E. SHIP MANAGERS

A qualifying Ship manager is a legal person tax resident in Cyprus providing technical and/or crewing services in respect of qualifying vessels (Cyprus/EU/EEA/fleet).

An option exists to pay TT at 25% of the rates applicable to ship owners and charterers, for all vessels under management. If the choice is not made, profits are taxable under 12.5% corporation tax.

The fleet qualifying criteria are the same as the ship owners / charterers and so is the minimum 10 year duration.

Ship managers have to meet some additional requirements, namely:

- The ship manager is obliged to maintain a fully-fledged office in Cyprus with personnel sufficient in number and qualification;
- At least 51% of all onshore personnel must be EU/EEA citizens; and
- At least 2/3 of the total tonnage under management must be managed within the EU/EEA (any excess of 1/3 taxed under 12.5% corporation tax).

The tax exemption covers:

- Profits from technical and/or crew management;
- Dividends paid out of the above profits at all levels of distribution; and
- Interest income relating to the working capital / qualifying activity provided such interest is used to pay expenses relating to ship management, excluding interest on capital used for investments.

F. YACHT SCHEME

If the TT regime is a treat for commercial shipping enterprises, the yacht scheme is the icing on the cake. It is not covered by the Merchant Shipping Law, but it operates on the basis of the guidance issued by the Cyprus VAT authorities in cooperation with the tax authorities aiming at making Cyprus one of the most attractive jurisdictions for yacht registration within the EU.

THE ARRANGEMENT IN A SNAPSHOT

The lessor (the Cyprus Company being the owner of the yacht) contracts the use of the yacht to the lessee (the legal or natural person who leases the yacht) in return for a consideration. At the end of the lease period, the lessee may opt to purchase the yacht at a fraction of the original price.

Such final purchase is strictly an option which may be exercised by the lessee, at the end of the lease period, for a separate consideration.

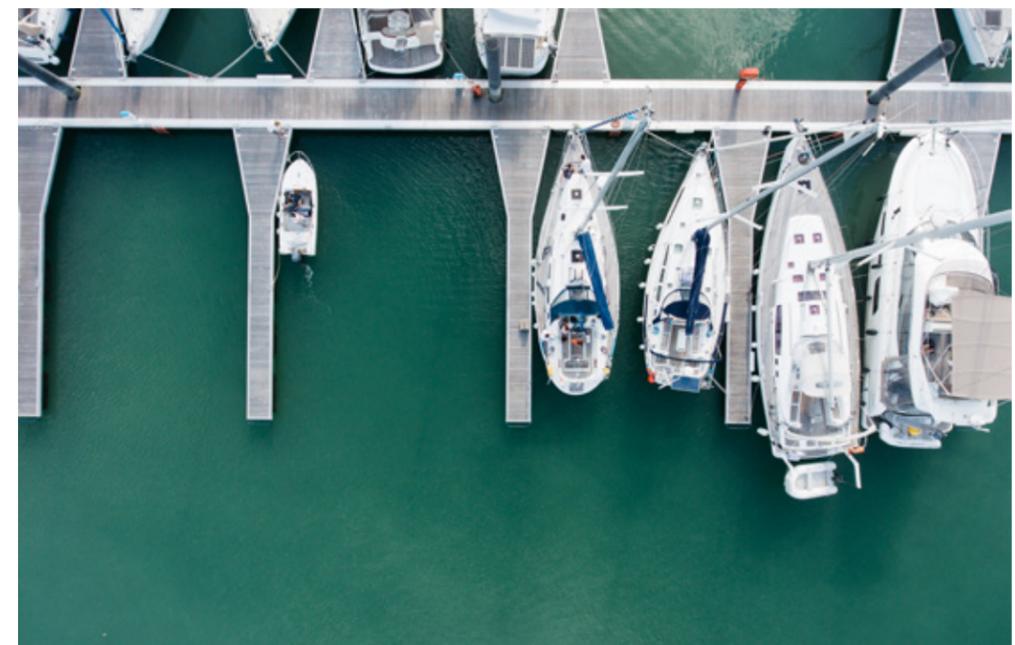
VAT TREATMENT

The leasing of the yacht is considered as a supply of services with the right of deduction of input VAT by the lessor. This supply of services by the lessor is taxable at the basic VAT rate of 19% but only to the extent that the leased yacht is used within the territorial waters of the EU. The guidance provides presumed percentage of the use of the yacht in the EU, which effectively may reduce the applicable VAT rate to as low as 4.94% on the registration of the yacht and up to 3.8% on the lease payments.

INCOME TAX TREATMENT

The total profit from the leasing agreement which amounts to 10% on the initial value of the yacht, will be subject to income tax at the rate of 12.5%.

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REALSUBSTANCE
FIDUCIARY SERVICES

25th March Ave & K. Matsi 18
2408 Nicosia, Cyprus

E. info@realsubstance.com.cy
T. +357 22 28 34 30