

Shipping & Transport - Cyprus

Cyprus's new shipping tax regime

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Background

The Cyprus registered fleet is among the largest in the European Union and the 10th largest worldwide. Cyprus has also developed into the largest third-party ship management centre in the European Union.

The Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (the Tonnage Tax Law) was enacted on April 29 2010 and has retroactive effect from January 1 2010. The new law marks a significant triumph for the Cyprus shipping authorities, which have secured EU approval on state aid for an updated tonnage tax regime that will secure Cyprus's continued competitiveness in shipping until 2019.

Since Cyprus's accession to the European Union in 2004, Cyprus resident shipping and ship management companies had enjoyed the most benevolent shipping taxation regime in Europe, with significant exemptions and the option for ship management companies to elect between a preferential corporate income tax rate of 4.25% or a tonnage tax regime.

The new law abolishes the old preferential corporate income tax rate, but significantly extends the availability of the tonnage tax basis for Cyprus resident shipping and ship management companies, simplifying and reducing the tax burden. It makes the benefits of the tonnage tax regime and exemptions from income tax currently enjoyed by owners, operators and managers of Cyprus flag ships available to owners and charterers of non-Cyprus flag vessels and widens the range of exempt gains to include profits on the disposal of vessels, interest earned on funds and dividends paid directly or indirectly from shipping-related profits, in addition to profits from shipping operations.

Qualifying persons, activities and vessels

In order to be eligible for the tonnage tax regime, a qualifying person must be carrying out qualifying activities in relation to qualifying vessels.

'Qualifying persons' are tax-resident owners or charterers (eg, bareboat, demise, time and voyage) of Cyprus ships, EU ships or fleets of ships comprising EU and non-EU ships, and ship managers providing technical or crewing services or both. Ship managers are required to maintain a functioning office in Cyprus staffed by a sufficient number of appropriately qualified personnel. At least 51% of onshore personnel must be citizens of the European Economic Area (EEA) (comprising the European Union, together with Iceland, Liechtenstein and Norway), and at least two-thirds of the total tonnage under management must be managed within the EEA.

For owners or charterers of Cyprus ships, the tonnage tax scheme is mandatory. Other owners or charterers and ship managers may opt for taxation based on profits or tonnage tax, but, upon opting for the tonnage tax scheme, they must remain within it for 10 years unless the vessel is sold or a charter or management agreement is terminated. For a fleet to qualify for the scheme, at least 60% of its tonnage must comprise EU ships. If this requirement is not met, the non-EU vessels may still qualify if certain criteria are met, but surcharges may be payable.

For owners and charterers, 'qualifying activities' are the maritime transport of goods or people between Cyprus ports and foreign ports or offshore installations, or between foreign ports or offshore installations, including towage, dredging and cable laying. For ship managers, 'qualifying activities' are the provision of

services under a written agreement to a ship owner or bareboat charterer in relation to crew management, technical management or both. A 'qualifying vessel' is a sea-going vessel that has been certified in accordance with international principles and legislation of the flag country, and that is registered in the register of a member country of the International Maritime Organization and the International Labour Organization. Vessels which transport humanitarian aid are included in the definition, but the following vessels are excluded:

- fishing and fish factory vessels;
- vessels used primarily for sport or recreation;
- vessels constructed exclusively for inland waterway navigation;
- harbour, estuary and river ferries and tug boats;
- fixed offshore installations which are not used for maritime transport;
- non-self-propelled floating cranes;
- non-ocean-going tug boats;
- stationary vessels employed for hotel and/or catering operations (floating hotels or restaurants); and
- vessels employed mainly as casinos or gambling facilities.

Tax exemption

The Tonnage Tax Law replaces taxes based on profits with a tax calculated on the net tonnage of the vessels concerned.

For owners and charterers, the tax exemption covers profits from the use of a qualifying vessel, dividends paid out of those profits at all levels of distribution and interest income relating to the financing, maintenance or use of a qualifying vessel and the related working capital, excluding interest on capital used for investments. Profits from the disposal of a qualifying vessel or any share or interest in it and profits from the disposal of shares in a ship owning company are also exempt from tax. In order to qualify for the exemption, at least 25% of the net tonnage of vessels subject to tonnage tax must be owned or bareboat chartered. The percentage can be reduced, but for no more than three consecutive years. The qualifying percentage is reduced to 10% if all the vessels of the charterer are registered or managed in the EEA.

Ship managers may elect to pay tonnage tax at one-quarter of the rates applicable to shipowners and charterers, in which case profits earned from the provision of technical and crewing services are exempt from tax in respect of qualifying vessels, together with dividends paid out of those profits at all levels of distribution.

Profits from commercial management are not covered by the tonnage tax scheme and remain taxable under corporation tax.

Section 46 of the Tonnage Tax Law contains an 'all or nothing' provision. Qualifying owners, charterers and ship managers opting to enter the tonnage tax system must include all qualifying ships. If a company which is part of a Cyprus tax resident group of companies enters the tonnage tax scheme, then all other qualifying members of the group must simultaneously enter the scheme.

Tonnage tax rates

Tonnage tax is charged on a sliding scale according to net tonnage. The initial rates charged to owners and charterers are outlined below:

Tonnage	Rate per tonne
First 1,000 tonnes	€0.3650
Next 9,000 tonnes	€0.3103
Next 15,000 tonnes	€0.2008
Next 15,000 tonnes	€0.1278
Each tonne above 40,000	€0.0730

For example, the annual tonnage tax on a ship of 50,000 tonnes would be €8,816.70. Cyprus flag ships are also subject to an annual registry maintenance fee of €300. For ship managers, the rates are one-quarter of those set out in the table above.

Other provisions

The Tonnage Tax Law contains 'ring-fencing' provisions to prevent exemption being gained in respect of ineligible activities. Separate accounts must be maintained in respect of qualifying and non-qualifying

activities, and transactions with related parties that are not in the tonnage tax system must be made at arm's length.

The tonnage tax system is administered by the Department of Merchant Shipping and taxpayers within its scope will receive an annual certificate, a copy of which will be sent to the income tax authorities.

The Department of Merchant Shipping will maintain records of all Cyprus flag vessels and their owners which are not deemed to carry out a qualifying activity, and of all ship managers, shipowners or charterers of foreign flag vessels that do not carry out a qualifying activity or have not opted for the tonnage tax system.

Following enactment of the Tonnage Tax Law, Section 19 of the Income Tax Laws of 2002 to 2010 (Law 118(I)/2002, as amended), which gave ship managers the option on a year-by-year basis of paying corporate income tax at a reduced rate of 4.25% on net earnings instead of tonnage tax, has been repealed by the Income Tax (Amendment) Law of 2010 (Law 41(I)/2010).

Comment

Enactment of the Tonnage Tax Law gives Cyprus the unique advantage of being the only country with an EU-approved tonnage tax regime for shipping activities which confers total exemption from income tax and tax on distributions at all levels and allows for both qualifying and non-qualifying activities. The new tonnage tax regime will further increase Cyprus's attractiveness as a maritime centre, providing incentives for the employment of EU crew members and the registration of vessels in Cyprus, and enhancing the competitiveness of shipowners, charterers and ship managers.

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