

Shipping & Transport - Cyprus

New circular clarifies ring fencing provisions of Tonnage Tax Law

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The Department of Merchant Shipping recently issued Circular 21/2011 drawing attention to the ring fencing provisions of the Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (44(I)/2010) (Tonnage Tax Law).

These provisions forbid the transfer of income or expenses between affiliated persons engaged in activities subject to tonnage tax and income tax, to ensure that only profits from qualifying activities are subject to tonnage tax and that profits from other activities are not sheltered within the tonnage tax scheme.

Section 41 of the law requires that transactions between two parts of the same corporate structure (whether in Cyprus or abroad) take place on arm's-length terms and prices, as if the two parties involved were independent from each other and not part of the same corporate group. Similarly, under Section 42 of the law, qualifying shipping activities of a person subject to tonnage tax must be segregated from non-qualifying activities carried out by the same person and accounted for on an arm's-length basis. Where transactions subject to Section 41 or 42 have taken place other than on arm's-length terms, the tax authorities may make an appropriate adjustment to the taxable profits under Section 33(1)(b) of the Income Tax Law of 2002.

Section 43 of the Tonnage Tax Law requires taxpayers to which Section 41 applies to notify any potentially affected person of the possible application of Section 33 of the Income Tax Law in relation to transactions between them. Failure to comply with this obligation may give rise to criminal liability under Section 136 of the Cyprus Criminal Code. According to Section 43, notification must take place within 90 days of entry into the tonnage tax scheme. However, the retrospective application of the scheme makes this timescale impossible - the following arrangements therefore apply instead.

For qualifying owners of Cyprus ships, notification must take place no later than September 1 2011 in respect of ships that are currently registered in the Register of Cyprus Ships, and no later than 90 days from the date of registration of each additional vessel. For other persons or companies subject to tonnage tax (owners or charterers of foreign ships or ship managers), the period of 90 days will run from July 15 2011, the cut-off date for the Department of Merchant Shipping to decide on eligibility for the tonnage tax scheme. Accordingly, notification must take place by October 15 2011.

Taxpayers are required to maintain adequate records to demonstrate that transactions have taken place on an arm's-length basis and to provide them to the authorities on request. If the terms differ from normal market terms, adequate reasoning must also be given.

The Department of Merchant Shipping aims to publish a formal notification in the *Official Gazette* shortly, giving details regarding implementation of the arm's-length principles and the sanctions for non-compliance.

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