

**Bloomberg
BNA**

TAX PLANNING INTERNATIONAL EUROPEAN TAX SERVICE

International Information for International Business



VOLUME 16, NUMBER 9 >>> SEPTEMBER 2014

www.bnai.com

Cyprus's shipping tax regime

Philippos Aristotelous and Stavros Supashis
Andreas Neocleous & Co LLC, Cyprus

Cyprus is among the world's top shipping centres, with a government policy which actively attracts investment to the island. This article looks at the features and exemptions which make it so attractive to shipping businesses.

I. Background

Since it became independent in 1960 Cyprus has recognised the importance and potential of shipping, and government policy has succeeded in attracting shipping entrepreneurs and developing the island into a major international shipping centre combining both a sovereign flag and a resident shipping industry. The Cyprus registry currently ranks tenth among international fleets, with 1,857 ocean going vessels with an aggregate gross tonnage of more than 21 million tonnes, and Cyprus is among the world's top five ship management centres, accounting for approximately one-fifth of the global third-party ship management market.

II. Introduction

Cyprus's attractiveness as a shipping centre is based on operational and financial benefits, not least of which is an extremely attractive tax regime for qualifying international shipping activities. Since Cyprus joined the EU 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 reduced corporate income tax rate of 4.25 percent or a tonnage tax regime under section 19 of the Income Tax Law of 2002 (Law 118(I) of 2002) as amended (ITL).

The Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (Tonnage Tax Law), which took effect from January 1, 2010, introduced a tonnage tax regime complying with EU state aid and other taxation norms and offering an even lower tax burden. Following enactment of the Tonnage Tax Law, section 19 of the ITL was repealed by the Income Tax (Amendment) Law of 2010 (Law 41 (I) of 2010).

The Tonnage Tax Law extended the benefits of the tonnage tax regime and exemptions from income tax that were previously restricted to owners, operators and managers of Cyprus-flag ships to Cyprus-resident owners and charterers of non-Cyprus flag vessels, and widened the scope of tax exemptions 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.

III. 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 (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 percent of onshore personnel must be citizens of the European Economic Area (EEA) (comprising the EU 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 of Cyprus ships the tonnage tax scheme is mandatory. Other owners or charterers and ship managers may opt for taxation based on profits under the ITL or tonnage tax, but, having opted 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

Philippos Aristotelous is partner and Stavros Supashis is associate in the Corporate and Commercial Department of Andreas Neocleous & Co LLC, Cyprus

for the scheme, at least 60 percent of its tonnage should 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:

- 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 a member country and is registered in the register of a member country of the International Maritime Organisation and International Labour Organisation. 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.

IV. 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 qualifying ship-owning company are also exempt from tax. In order to qualify for the exemption at least 25 percent of the net tonnage of vessels subject to tonnage tax must be owned or bareboat chartered. The percentage can be reduced but not for more than 3 consecutive years. The qualifying percentage is reduced to 10 percent 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 owners 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.

As noted above, entry into the tonnage tax system is for a minimum period of 10 years. Early withdrawal other than as a result of the disposal or termination of the charter of the vessels concerned, results in tax liabilities being recalculated based on the provisions of the ITL as if the taxpayer had never entered the scheme.

V. Tonnage tax rates

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

Tonnage	Rate per tonne
First 1,000 tonnes	EUR0.3650
Next 9,000 tonnes	EUR0.3103
Next 15,000 tonnes	EUR0.2008
Next 15,000 tonnes	EUR0.1278
Each tonne above 40,000	EUR0.0730

By way of example, the annual tonnage tax on a ship of 50,000 tonnes would be EUR8,816.70.

Cyprus-flag ships are also subject to an annual registry maintenance fee of EUR300.

For shipmanagers the rates are one-quarter of those set out in the table above.

VI. “Ring fencing” provisions

The Tonnage Tax Law contains ring-fencing provisions, so as to ensure that only profits from qualifying activities are subject to tonnage tax and that profits from other activities are not sheltered within tonnage tax. Separate accounts must be maintained in respect of qualifying and non-qualifying activities, and transactions with related parties that are outside the tonnage tax system must be made at arm’s length.

Section 41 of the Tonnage Tax Law requires transactions between two parts of the same corporate structure (whether in Cyprus or abroad) to 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. Section 42 requires qualifying shipping activities of a person subject to tonnage tax to 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.

Section 43 of the Tonnage Tax Law requires taxpayers to whom the provisions of section 41 apply to notify any potentially affected person of the possible application of the provisions of section 33 of the

Income Tax Law in relation to transactions between them within 90 days of entry into the tonnage tax scheme. Failure to comply with this obligation may give rise to criminal liability under section 136 of the Criminal Code.

Taxpayers are required to maintain adequate records to demonstrate that transactions have taken place on an arm's length basis and to produce 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 (DMS), which administers the tonnage tax system, maintains records of all vessels within the scheme, as well as of Cyprus flag vessels and their owners which are not deemed to carry out a qualifying activity, and of all managers, owners or charterers of foreign flag vessels who do not carry out a qualifying activity or have not opted for the tonnage tax system. It issues an annual certificate to participants in the scheme, a copy of which is sent to the income tax authorities, to confirm their exemption from corporate income tax.

VI. Reduction of tonnage tax

If a ship is laid up or rendered inoperative for at least three months as a result of judicial arrest, act of piracy, armed robbery or force majeure the tonnage tax payable is reduced by 75 percent for the period of inactivity provided that the DMS is duly notified not later than 3 months from the commencement of the period of inactivity.

VII. Surcharge on non-EU ships listed by the Paris MOU on Port State Control

Qualifying non-EU ships flying a flag of a registry that appears in the Grey List or the Black List of the Paris MOU are subject to a surcharge of 30 percent or 60 percent respectively.

VIII. Other tax benefits

There are several other benefits available to Cyprus-resident shipping businesses. The wages of officers and crew are exempt from income tax, there is no capital gains tax on the sale or transfer of a Cyprus-registered vessel or the shares of a vessel owning company, and no stamp duty on ship mortgage deeds or other security documents.

IX. Conclusion

Cyprus enjoys 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.

Philippos Aristotelous is partner and Stavros Supashis is associate in the Corporate and Commercial Department of Andreas Neocleous & Co LLC, Cyprus and can be contacted by email at: aristotelous@neocleous.com and stavros.supashis@neocleous.com.