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## **New Merchant Shipping Legislation**

On 29 April 2010 the Cyprus Parliament enacted **The Merchant Shipping (Fees and Taxing Provisions) Law of 2010**. The new Merchant Shipping Law, which applies retroactively from 1 January 2010, extends significantly the scope of the Tonnage Tax (TT) regime and enhances the position of Cyprus as a maritime centre. The Cypriot maritime industry is one of the largest in the EU and the 10th largest worldwide. Moreover, Cyprus is the biggest third party ship management centre in the EU.

The European Commission considers 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 shipowners, charterers and shipmanagers operating in the EU.

Cyprus is the **only country in the EU** that has an **EU approved** shipping legislation that:

1. provides for the payment of TT on the net tonnage of the vessels, rather than corporation tax on their actual profits, regulated completely by the Department of Merchant Shipping rather than the Tax Authorities
2. grants *total* tax exemption of profits tax and distribution tax at *all* levels
3. allows *mixed* activities (shipping subject to TT and other subject to corporation tax) within a company/group
4. supports an *open* registry
5. allows *split* shipmanagement activities (crewing or technical)

The legislation introduces two new TT schemes applicable to shipowners of non-Cyprus flag vessels and charterers. It also extends the application of the TT regime (and exemption from profits tax) currently enjoyed by shipowners and shipmanagers.

The provisions of the new legislation are analysed below.

### **1. Definitions**

In a nutshell, the regime covers **qualifying persons** performing **qualifying activities** in relation to **qualifying vessels**.

#### **1.1 Qualifying persons**

Qualifying persons are shipowners, charterers (bareboat, demise, time and voyage) and shipmanagers providing technical and/or crewing services.

#### **1.2 Qualifying activity**

Qualifying activity for **shipowners 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 **shipmanagers** means services provided to a shipowner or bareboat charterer on the basis of written agreement in relation to crew and/or technical management.

### 1.3 Qualifying vessel

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

- a) has been certified in line with international principles and legislation of the flag country, and
- b) 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,
- floating or movable casinos.

## 2. Tax exemption

The law provides full exemption to shipowners, charterers and shipmanagers from **all** profit taxes and imposes tonnage tax on the **net** tonnage of the vessels.

The conditions applicable to each of the three categories, as well as the taxation regime is analysed separately below.

### 2.1 Shipowners

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 tonnage
- Fleet of EU/EEA and non EU/EEA vessels that exercised the option to be taxed under tonnage

The new legislation introduces the definition of a **fleet**. A fleet consists of 2 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 2 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 shipowning company
- Dividends paid out of the above profits at all levels of distribution
- 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 shipowner must be a Cyprus tax resident and the option must remain in force for at least 10 years.

## 2.2 Charterers

As with shipowners, 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 10% corporation tax.

The fleet qualifying criteria are the same as for shipowners 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
- 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 bare boat chartered. The percentage can be reduced but not for more than 3 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.

## 2.3 Shipmanagers

A qualifying shipmanager is a legal person tax resident in Cyprus providing technical and/or crewing services in respect of qualifying vessels (Cyprus/EU/EEA/fleet). Commercial management is taxable under corporation tax.

An option exists to pay TT at 25% of the rates applicable to shipowners and charterers, for **all** vessels under management. If the choice is not made, profits are taxable under 10% corporation tax.

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

Shipmanagers have to meet some additional requirements, namely:

- a. The shipmanager is obliged to maintain a fully fledged office in Cyprus with personnel sufficient in number and qualification
- b. At least 51% of all onshore personnel must be EU/EEA citizens.
- c. At least 2/3 of the total tonnage under management must be managed within the EU/EEA (any excess of 1/3 taxed under 10% 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,
- Interest income relating to the working capital / qualifying activity provided such interest is used to pay expenses relating to shipmanagement, excluding interest on capital used for investments.

## 3. Other provisions

- Separate books must be kept if mixed income earned (TT and corporation tax)
- Transactions with related parties who are not in the TT system should be made at arms length
- Persons in the TT system are granted annually with a certificate by the Department of Merchant Shipping (DMS), a copy of which is sent to the Tax Office.

- A list is kept by the DMS of all Cyprus flag vessels and their owners that are not considered to carry out a qualifying activity
- Similar lists are kept by the DMS of all shipowners / charterers / shipmanagers for foreign flag vessels that either do not carry out a qualifying activity or the choice was not made to enter the TT system
- Remuneration of crew aboard a Cyprus flag vessel is exempt from income tax
- Provisions relating to safety apply to shipowners and shipmanagers.

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