

SHIPPING UK TONNAGE TAX



The UK tonnage tax regime provides an alternative way of calculating taxable profits of companies operating qualifying ships that are strategically and commercially managed in the UK. This factsheet sets out the main points of the legislation.

CALCULATION OF TONNAGE TAX PROFITS

Taxable profits are calculated by reference to the net tonnage of the vessels a company operates.

Net tonnage of ship (rounded down to nearest 100)	Daily profit rate per 100 tons
0 – 1,000	£0.60
1,000 – 10,000	£0.45
10,000 – 25,000	£0.30
Above 25,000	£0.15

PROFITS AND ACTIVITIES COVERED

Relevant shipping profits

The following types of profits are covered by the tonnage tax regime:

- ▶ Income from tonnage tax activities, comprising core qualifying activities, qualifying secondary activities and qualifying incidental activities
- ▶ Qualifying dividends or other distributions from overseas shipping companies
- ▶ Certain financial income arising as part of the trading income from tonnage tax activities; and
- ▶ Capital gains on tonnage tax assets.

Core qualifying activities are:

- ▶ Activities in operating qualifying ships; and
- ▶ Other ship-related activities that are a necessary and integral part of the company's business of operating qualifying ships.

Qualifying incidental activities are shipping-related activities that are incidental to its core qualifying activities, and not qualifying secondary activities. The total turnover should not exceed 0.25% of the company's turnover from its core qualifying activities and qualifying secondary activities.

Dividends from overseas shipping companies

Dividends, or other distributions, received by a tonnage tax company from a company that is not UK tax resident are within the regime provided that a number of conditions are satisfied.

Incidental financial income

This refers to income from loan relationships, foreign exchange transactions and interest rate and currency contracts which arises as part of the company's shipping trade comprised in its tonnage tax activities. Strictly, this would not be income from tonnage tax activities but it is specifically included in the regime where it would be treated as part of the company's trading income under the relevant UK tax rules.

Qualifying ships

To qualify for inclusion in the regime, a ship must be seagoing and over 100 gross tons used for:

- ▶ The carriage by sea of passengers
- ▶ The carriage by sea of cargo
- ▶ Towage, salvage or other marine assistance carried out at sea; or
- ▶ Transport by sea in connection with other services of a kind necessarily provided at sea.

The appropriate authorities must have issued a certificate that allows the ship to lawfully operate at sea. There must be in force a valid International Tonnage Certificate (1969) or other valid certificate recording its tonnage as measured in accordance with the above regulations.

'Ship' means any vessel used in navigation, including a hovercraft. A ship does not qualify if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land.

FOR MORE INFORMATION:

BDO LONDON
+44 (0)20 7486 5888

JAMES BAILEY
james.bailey@bdo.co.uk

PHILIP PARR
philip.parr@bdo.co.uk

RICHARD GREINER
richard.greiner@bdo.co.uk

The following kinds of vessel are specifically excluded:

- ▶ Fishing vessels
- ▶ Factory ships (a vessel providing processing services for the fishing industry)
- ▶ Pleasure craft (a vessel of a kind whose primary use is for the purposes of sport or recreation)
- ▶ Harbour or river ferries (a vessel used for harbour, estuary or river crossings)
- ▶ Offshore installations (within the meaning of the Mineral Workings (Offshore Installations) Act 1971 but not limited to controlled waters)
- ▶ Tankers dedicated to a particular oil field (determined in accordance with section 2 of the Oil Taxation Act 1983 (dedicated mobile assets))
- ▶ Tugs and dredgers (unless subject to specific qualifying conditions).

QUALIFYING COMPANIES AND GROUPS

A company qualifies if it operates qualifying ships, and those ships are strategically and commercially managed in the UK. A group qualifies if it includes one or more qualifying companies.

Definitions

Operating a ship

A company is regarded as operating any ship owned by, or chartered to, the company, unless the ship is chartered out on bareboat charter terms other than to a member of the same group. A company is not, however, regarded as ceasing to operate a ship bareboat chartered out if it is temporarily surplus to the company's requirements and the term of the charter does not exceed three years.

Strategic and commercial management

Both tests must be satisfied. The strategic management test considers a high level of decision-making. The commercial management test considers the normal commercial operations and technical management. Both tests may also take into account additional factors such as the flag of the ships.

Bareboat charter terms

For the purposes of the regime, this means 'hiring of a ship for a stipulated period on terms which give the charterer possession and control of a ship including the right to appoint master and crew.'

Flagging requirements

- ▶ From 1 April 2022 all flagging requirements in respect of qualifying vessels were removed as a requirement under the regime. As such there are no restrictions on the flagging of a vessel
- ▶ A UK flag will be taken into consideration and may be an important factor when determining whether a company satisfies the strategic and commercial management requirement test.



TRAINING REQUIREMENT

Companies must commit to a minimum training obligation as a pre-condition of electing into the tonnage tax regime, as follows:

Officers

Companies must recruit and train one UK cadet per year for every 15 officer posts entered on the Safe Manning Certificates/Safe Manning Documents for all vessels in the regime. In addition, companies must continue to train recruits from the previous two years, so that once a company has been in tonnage tax for three years it will be training three UK cadets for every fifteen officer posts.

Ratings

Companies must review annually the feasibility of adopting each of the ratings' employment and development options agreed by the tripartite Ratings Task Force. It is recognised that training obligations applying to ratings need to be flexible.

A 'UK cadet' must be (i) a national of the UK, an EEA State, or a British citizen from the Channel Islands or Isle of Man, and (ii) ordinarily resident in the UK. Companies must produce an annual statement setting out their specific training obligations and how they are to be met. This is subject to approval by the Department for Transport (DfT). In exceptional circumstances where a company is unable to provide training it may be able to make payments in lieu of training (PILOT). There is a system of stepped surcharges in the event of significant failure to comply with training commitments.

The training commitment for all companies or groups will start on 1 October following their entry into tonnage tax. The annual plan will need to be submitted to the DfT so that they can consider it before the 1 October deadline. In order to make a valid tonnage tax election a company or group must have received approval of its training plans from the DfT.

75% LIMIT ON CHARTERED IN TONNAGE

Not more than 75% of the net tonnage of the qualifying ships operated can be chartered in other than on 'bareboat charter terms'. In the case of a group, the limit is applied to the aggregate tonnage of the qualifying ships operated by the group and does not apply to charters from members of the same UK group. A company could therefore, for example, have up to 75% of its net tonnage chartered in on time charters with the remaining 25% being chartered in on bareboat charters.

An election or renewal of an election to apply tonnage tax is invalid if the 75% limit is exceeded at the time. If the limit is exceeded on average over each of two or more consecutive accounting periods of a single company, HMRC may (but are not obliged to) exclude the company from the regime.

A group may be excluded if the limit on a group basis is exceeded over two or more consecutive accounting periods of a tonnage tax member of the group. Special rules apply to companies which have made a tonnage tax election recently.

ANTI-AVOIDANCE REQUIREMENT

It is a condition of remaining within the regime that a company is not a party to any transaction or arrangement that is an 'abuse' of the regime. This is aimed at deliberate cases of serious or repeated abuse.

ELECTION TO APPLY TONNAGE TAX

A qualifying company or group can elect to enter into the regime. If an election is made, all qualifying companies within the group must be party to the election. The notice must contain such information and be supported by such evidence as HMRC may require.

The definition of a 'group' is not one of the normal definitions of 'group' for tax purposes and, broadly, can include all companies under common control of an individual and/or his associates.

Time limits

When the tonnage tax legislation was originally introduced there was a 12 month 'window' during which an election could be made for companies or groups already carrying on qualifying activities. It is not clear whether there will be any further opportunity for groups already carrying on tonnage tax activities to make an election.

Where a single company or group first starts to be a qualifying company or group, there will be a 12 month window from the date that the single company or group first started to qualify. In the case of a group this will not apply if the group was, or is, substantially the same as a previously qualifying group. Specific advice should be obtained.

Where this initial 12 month election window has been missed, HMRC have the ability to accept late claims in certain limited circumstances.

When election takes effect

In the case of a newly qualifying company or group the election is effective from the time when the company concerned becomes a qualifying company.

In other cases, an election will take effect from the beginning of the accounting period in which the election is made. HMRC may agree that it takes effect from the beginning of an earlier accounting period, or from the beginning of the succeeding accounting period, or, exceptionally, from the next accounting period. This will depend on the circumstances.

Period for which in force

Elections made after 1 April 2022 will normally remain in force for 8 years but will cease to apply on the earlier of:

- ▶ The company or group ceasing to qualify
- ▶ The 75% limit on chartered tonnage being exceeded (at HMRC's discretion)
- ▶ Exclusion due to tax avoidance arrangements.

Renewal election

A renewal election may be made for the same company or group at any time while an existing election is in force, provided a non-compliance notice regarding the training requirement is not in force. The original election is then superseded and tonnage tax continues to apply for 8 years from the date of the renewal election.

Companies that fail to make a renewal election before the expiry of their current election can in certain circumstance make a "bridging" election.

CLEARANCES

A non-mandatory system of clearances is operated and preliminary applications can be made at any time.

FINANCE AND OPERATING LEASES

There are special capital allowances rules for a ship leased to a company within the regime.

There are restrictions on the amount of capital allowances available to the lessor. In certain circumstances, the lessor will not be entitled to capital allowances. Capital allowances may be available to lessors in respect of 'long funding leases' where the asset is a ship leased to a UK tonnage tax company.

These rules are complex and specific advice should be obtained.

RING-FENCING

As tonnage tax is a low-tax regime, activities falling within the regime are 'ring-fenced' from the rest of the corporation tax system. The transfer pricing rules apply to transactions between tonnage tax and non-tonnage tax activities. For example, if a non-tonnage tax company makes a loan to a tonnage tax company in the same group, the transfer pricing rules could apply to deem notional taxable interest income arising on the loan. Specific advice should be obtained.

ENTRY

Capital gains and losses

On the disposal of an asset that is or has been a tonnage tax asset, a capital gain or loss crystallises only for the period that the asset was not a tonnage tax asset, on a time apportionment basis. A company will not lose capital losses that crystallised before it entered the tonnage tax regime.

Tonnage tax assets are not regarded as 'new assets' for the purpose of rollover relief for replacement of business assets.

Where rollover relief for the replacement of business assets has already been claimed on a 'new asset' which later becomes a tonnage tax asset, then the 'rolled over' gain will crystallise on the disposal of the tonnage tax asset.

Capital allowances – ships and other plant and machinery

On entry all tax written down values and free allowances relating to tonnage tax activities are transferred to a single frozen 'tonnage tax pool'. This pool is not written down.

Where vessels held on entry are disposed of, the lower of original cost, sale proceeds or market value of the vessel on entry is deducted from the tonnage tax pool. If the sale proceeds exceed the amount of the tonnage tax pool then a balancing charge will arise. A company's tonnage tax pool can be surrendered to other group companies.

If a balancing charge arises, it is reduced depending on the number of whole years that the company has been subject to tonnage tax before the disposal:

Number of years	% reduction
1	15%
2	30%
3	45%
4	60%
5	75%
6	90%
7 or more	100%

Any remaining balancing charge may be deferred against the acquisition of a new qualifying ship by the company during the period from one year before to two years after the date of disposal provided certain conditions are satisfied.

EXIT

Detailed rules apply on exit from the regime and specific advice should be obtained.

Ten year disqualification from tonnage tax

A company or group cannot elect to enter the tonnage tax regime again until ten years after exit, unless the exit was due to the expiry of an election. This will also apply where a company leaves tonnage tax early for commercial reasons or makes a withdrawal notice.

OFFSHORE ACTIVITIES

Special rules apply to "offshore activities", which are activities in connection with the exploration or exploitation of the seabed or subsoil or their natural resources situated in the UK Continental Shelf. These rules apply to certain vessels such as diving support vessels, heavy lift crane barges, seismic survey ships and safety stand-by ships. These vessels are, very broadly, treated as being outside the tonnage tax regime whilst engaged in offshore activities. These rules are complex and specific advice should be obtained.