national treasury

Department:
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REPUBLIC OF SOUTH AFRICA

DISCUSSION DOCUMENT ON THE SOUTH AFRICAN TONNAGE TAX PROPOSAL

REPUBLIC OF SOUTH AFRICA

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FOREWORD

South Africa is an open economy and its economic growth, prosperity and welfare depend on fully accessing global trade opportunities. Consequently, government is continuously seeking to improve the country's trade and investment environment. This is to be achieved through a host of interventions to reduce the cost of doing business and investing in South Africa. These measures include the introduction of an industrial policy framework, establishment of a robust and predictable tax system, customs administration and tariff reforms, and the stepping up of investments in road, rail and ports infrastructure.

In the 2005 Budget, government announced its intention to investigate the possible introduction of a tonnage tax regime in keeping with long-term trade facilitation initiatives. This notional or presumptive corporate income tax system would align South Africa's shipping tax regime with the fiscal systems of other major maritime nations. The tonnage tax will also form an integral part of Government's Maritime Transport Agenda: 2010 which, *inter alia*, seeks to arrest the decline of the domestic shipping register. By potentially bringing shipping companies' key strategic management decisions back to South Africa the scope of secondary support activities will broaden. This includes a growth in crewing opportunities for South African seafarers. It also has the potential of reducing the sizable transport service payments to the rest of the world, which in turn would have a positive impact on the current account.

This discussion paper is released to the public in order to stimulate public debate as to whether South Africa should introduce a tonnage tax regime to support the development of a domestic shipping industry, and if so, to determine what the best structure for such a tax regime would be. It is therefore my hope that all stakeholders will engage robustly with the discussion document with the view to working with Government in creating a domestic environment which will be attractive to the shipping industry. The deadline for comments is the 31st October 2008.

Finally, I wish to express my appreciation to the team which drafted this discussion document. In particular, I would like to recognize Martin Grote and Olaotse Matshane from the National Treasury for leading this project, and Ms Terri Rawson, an external tax consultant, for supporting them with an invaluable contribution to this project.

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Director-General: National Treasury
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Glossary

Bareboat chartering	The charterer hire or charter the ship for a long period, appoint the master and crew and pay all running expenses. During this hire period the charterers are to maintain the ship in dry-docking, painting, repairing and all expenses incidental thereto.
Bareboat charter-cum-demise	A bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered.
Berth	a) A place in which a vessel is moored or secured; b) allotted accommodation in a ship.
Breaking bulk cargo	General cargoes carried in a ship which is shown on separate Bills of Lading, so to distinguish the merchandise from the whole shipment.
CFC	Controlled Foreign Company legislation refers to complex anti-avoidance provisions in the income tax system and it is designed to arrest diversions by resident taxpayers of income to companies they control and which commonly are located in jurisdictions with comparatively low-rate or no income tax. In terms of standard CFC legislation, income of the controlled company is typically either deemed to be realized directly by the shareholders or deemed to be distributed to them by way of a dividend. Often only passive income such as dividends, interest and royalties are targeted by CFC legislation. Mostly, CFC regimes only pertain to corporate shareholders. CFC regimes commonly exempt active business income from such deeming provisions.
Charter	(a) To charter a ship/vessel for a certain period known as 'time charter'; or (b) for one or other voyages known as 'voyage charter'; or (c) for the management known as 'bareboat charter or demise charter'.
Consolidation of cargo	Quantities of individual sea freight transport consignments grouped into one consignment, transported by sea to a destination where every single part-consignment is delivered to its individual consignee.
Deadweight of a vessel	Deadweight measures the lifting capacity of a ship expressed in long tons, including cargo, crew and consumables such as fuel, lube oil, drinking water and

stores. It is the difference between the number of tons of water a vessel displaces without such items on board and the number of tons it displaces when fully loaded.

EEA

European Economic Area and European Union comprises of member states Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxemburg, the Netherlands, Norway, Portugal, Spain, Sweden and Switzerland.

Factory ship

Includes a vessel providing facilities or services in respect of fish processing.

Fishing vessel

Shall have the meaning assigned to it in clause (12) of section 3 of the Merchant Shipping Act, No. 44 of 1958 (Republic of South Africa).

Flag of convenience

The registration of ships in a jurisdiction whose tax on the profits of trading ships is low or whose requirements concerning manning or maintenance are not stringent. Sometimes also referred to as *Flags of Necessity*.

Gross registered ton/tonnage

(Also known as gross tonnage) — The total of all enclosed spaces within a ship expressed in tons each of which is equivalent to 100 cubic feet (i.e., volume of the vessels enclosed spaces). It is a measure for the capacity of the vessel. It is used when deciding whether a ship qualifies for tonnage tax. This is also the basis on which manning rules and safety regulations are applied and registration fees are reckoned.

Joint charter

Shared partnering of a ship for a period of time or for a voyage.

Joint ventures

A venture or business activity undertaken by two or more people or firms in a merger or partnership

Net tonnage

The total of all enclosed spaces within a ship available for cargo expressed in tons and is the net tonnage less deductions for space occupied by crew accommodation, machinery. It measures the useful capacity of a vessel. The terms is used in the actual calculation of tonnage tax profit.

Open registry shipping

This is identical to Flags of Convenience.

Operating a ship

A company is regarded as operating a ship which is owned by the company or chartered to the company.

Partnerships	The relationship which exists between persons carrying on a business with a view to profit.
Pleasure craft	Means a ship of a kind whose primary use is for the purpose of sport or recreation.
Slot charter	The chartering in of a ship by a fleet operator for a specific voyage when none of the ships in the fleet is available.
Space charter	The chartering of a certain limited cargo area on a vessel for a certain period or voyage.
Time chartering "in"	See above under charter.
Tonnage Tax Assets	Assets that qualify for the preferential tax treatment under a tonnage tax regime. It includes assets used directly in connection with the operation of ships.
UNCLOS	United Nations Convention on the law of the sea – it's a framework / umbrella convention and can only be implemented through the operative regulations in other international agreements. Its general principles are given effect in practical terms, through the agreements concluded under the auspices of UN specialized agencies such as the IMO and the ILO.
Shipping line	A company which operates a ship or ships between advertised ports on a regular basis and offers space for goods in return for freight based on a tariff or rates.
Voyage chartering	See chartering above.

Chapter 1

Key Objectives of the South African Shipping Policy

South Africa significantly depends on maritime trade for its international transport needs. Unfortunately, foreign registered vessels almost solely provide this service, as only one convention vessel remains on the South African Ships Register (down from fifty vessels in the 1970s). This represents an opportunity cost to South Africa as registered ships, which transport commodities and goods of that jurisdiction, create wealth for the jurisdiction in which the vessels and the ship-owning company are registered locally. There exist therefore sound economic arguments for reviving the declining domestic shipping industry, including considering possible supportive roles for government.

International evidence suggests that South Africa is not alone in its endeavours to revive its flagging / dwindling fortunes as a potentially important maritime nation. This fate is a shared one; e.g. the US merchant marine has undergone a marked reduction in numbers since the 2nd World War. Many major industrialised countries have also witnessed such declines and this trend can be principally ascribed to higher operating costs, excessive red tape/regulations and tax competition which has resulted in this highly capital intensive but mobile industry registering in Flag of Convenience jurisdictions. Norway was the first jurisdiction which took drastic measures a decade ago by allowing ship owners to elect into a notional income tax system—the so-called tonnage tax system. This tax would impose a low income tax on ship owners, even in years where they generate accounting / tax losses; however given the extreme cyclical nature of this industry, the tax would be attractively low and predictable in boom periods when super profits are the norm. The positive feedback by industry regarding these fiscal changes, has led to the adoption of similar tax models in other traditionally vibrant maritime nations such as—

- The Netherlands
- The United Kingdom
- Denmark
- Germany
- Belgium
- Ireland
- India, to name just a few.

Clearly, in the case of South Africa one method of achieving more sustainable growth for the domestic industry is to create an attractive fiscal environment for shipping companies—the Minister of Finance announced in the 2005 Budget Review the investigation of a possible introduction of a South African tonnage tax.

The tonnage tax initiative is part of a coordinated transport strategy, led by the Department of Transport, with the aim of reviving the maritime industry. Therefore the tonnage tax regime will be framed in such a way so that it contributes to the wider policy objectives as set out in the Maritime Transport Agenda: 2010. Outlined in this strategy document is Government's

objective to: develop a comprehensive maritime transport policy, revive the maritime industry, grow the South African register and develop and position South Africa as an International Maritime Centre. The factors, which are also in need of reform to advance the flagging maritime industry are: the Ship Registration Act of 1998, the Merchant Shipping Act, mortgage ranking claims and labour issues. Only once these factors are aligned with international practices of successful shipping nations, can South Africa realistically expect to successfully revive the industry.

South Africa accepts that free international trade and unhindered access to the shipping markets is necessary to develop such a market domestically. Generally, international shipping is characterized by free and fair competition, with only a few markets or countries being hampered by restrictions, which exclude foreign shipping companies from servicing their overseas trades.

International organizations such as the WTO and OECD promote the principle of free market access in the shipping sector. An internationally supported liberal shipping policy clearly offers benefits not only to the shipping industry, but also to trade in general. Freedom of the seas without artificially created protectionist measures is central to a South African shipping policy. Consequently, ship-owners as supporters of the WTO attempt to extend liberalisation measures on a worldwide scale, the intention being to clearly uphold and expand the fairly unrestricted access to international shipping markets that already exist.

Simultaneously, apart from eliminating restrictions between industrialized nations, the Maritime Transport Committee of the OECD has made significant advances in its maritime dialogue with countries in the Far East, including China, as well as Russia and countries in South America. Generally, agreement on a free and fair shipping policy has been reached with these important markets. It is hoped that these positive results will create a precedent for more comprehensive WTO attempts to maintain and enhance the high level of liberalisation that characterizes modern international shipping[1].

1.1 SA shipping industry

Due to its location, South Africa is significantly dependent on maritime trade to transport goods to and from overseas. This is illustrated when considering that maritime exports constitute 95% of total exports by volume, and 93-95% of total imports by value. Presently South Africa is dependent on foreign registered vessels to facilitate its international trade by sea. Only one vessel currently remains on the South African ship register, which is used for international trade. This is a far cry from the 52 vessels which were once registered dating back to the 1970's.

[1] The South African shipping policy does not pertain to carbotage and coastal trade. This specific matter is being considered in a separate policy. However, this constitutes another important policy development process since international experience suggests that irrespective of the favourable development in international deep-sea shipping, the opening of so far closed coastal trades has proved difficult in many countries. Generally, only Northern European waters are open to all merchant fleets regardless of flag, but in other countries, coastal trades are still subject to some degree of protectionism being reserved for national tonnage. Preventing competing fleets from operating in coastal trades is detrimental to an efficient transportation pattern and will eventually lead to higher shipping costs for the customer. Due to their generally limited size, the opening of coastal trades would not as such have a major impact on an international merchant fleet, but particularly for those liner operators with connecting feeder services, the relaxation of such restrictive practices in the internationally related trades would enable improved services to local customers.

Approximately 1220 deep-sea trading vessels, regularly call at South African ports per annum to carry internationally bound cargo. As all these vessels are foreign owned, and crewed by foreign seafarers they do not contribute in creating wealth for South Africa. Instead they create wealth through transporting South African produce in the jurisdictions where the vessel is registered (Safmarine, 2004: 3-32). This represents an opportunity cost for South Africa, because if those vessels were registered in the Republic, and carried its flag, they would contribute to wealth creation in the country. There is therefore scope to try and revive the declining shipping industry and turn it into one of the main competitors in the global maritime industry. This can mainly be achieved through creating an attractive environment to entice shipping companies to set up business in South Africa, and ultimately register their vessels here.

An important factor that contributed to the decline in the number of ships registered is the relatively unattractive business environment South Africa offers the shipping industry compared to other countries. A unique characteristic of shipping companies is that their assets are highly mobile. This allows shipping companies the flexibility to register their vessels and operate their company in an environment that best suits their needs. One of the main factors, which have been identified by the industry as being inhospitable towards attracting shipping companies and their vessels, is the current tax environment. Resident (as defined in the Income Tax, 1962) shipping companies domiciled in South Africa are liable for corporate tax at the prevailing rate (i.e. 28 per cent) on profits derived from shipping activities and a secondary tax on companies (STC) on any dividends / deemed dividends declared to both local or foreign shareholders, currently taxed at 10 per cent.

1.2 Fiscal policies

International experience suggests that fiscal policy especially taxation is regarded as the an important factor impacting on investment decisions and national registration done by shipping firms (OECD, 2001: 39). This is evident in the large number of ships leaving their traditional registers for *flags of convenience*, a trend which started in the late 1960's and is only recently beginning to be reversed. Such a mass exodus is mainly due to ship owners realising that the industry has a unique characteristic, in that their assets are highly mobile (floatable) and relocated their business to countries where tax regimes were less restrictive than their own. For these reasons, Panama, Liberia and the Bahamas have become very successful open registers. South Africa therefore has a need to address the current fiscal environment of the shipping industry with a view to reversing the sharp decline of registered vessels.

In an effort to preserve and expand their fleets by making them more competitive, many nations are developing aggressive maritime promotional policies. Prominent among them are several European and Asian nations that have enacted measures—including tax incentives, direct subsidies and ship financing schemes—aimed at benefiting ship-owners operating under national flags, thus enhancing the appeal of their ship registries against flags of convenience. These efforts have been intensified in recent years. Many countries are taking steps to enhance the international appeal of their ship registries. Countries have introduced tonnage tax in order to become more globally competitive, level the playing fields and turn around their declining shipping industries.

Regarding the decision to introduce a tonnage tax system for South Africa, the policy choice has been between a 'flag of convenience' (FOC) regime and a notional income tax system

that would encourage the repatriation of real economic substance related to shipping activities back to South Africa from jurisdictions with more attractive fiscal regimes. The South African choice was not to grow the ship register in the hope that there would be secondary spin-offs. Consequently, flag of convenience objectives did not inform Government's policy direction.

Finally, in designing a tonnage tax regime for South Africa, it is important at this point of the discussion document to re-emphasize the most important element of a tonnage tax system, i.e. that shipping line operators are not forced into this dispensation. In fact, they must elect to either continue being liable under the standard income tax dispensation or to be assessed in terms of the newly proposed tax dispensation which assesses tax on the basis of the size of the operated vessels and the number of days in a year that the ships are being operated. It is this notional income, which constitutes the tax base, which then attracts the standard corporate income tax rate. Furthermore, it is important to note that as a tonnage tax is an alternative for normal income tax and, hence, both the tax treatment of depreciation and capital gains is no longer applicable under the tonnage tax regime. Consequently, shipping firms on the brink of major asset acquisitions will be loath to commit to the tonnage tax regime as they may want to benefit initially from capital allowances and accelerated tax depreciation—they may thus elect to enter only later into the more preferential regime.

These are the standard design features of this preferential regime, but many jurisdictions have gone further by allowing secondary or incidental shipping activities by line operators to be equally exempt from the normal income tax. Making a choice as to how far to cast the net of the more attractive tonnage tax remains a key element in this internationally unfolding "race to the bottom".

The National Treasury does not support extending the notional income tax benefits to a wider range of business activities, as this would erode the current corporate tax base whereas the whole objective of the South African tonnage tax proposal was to create a new primary—but less revenue productive—tax base. It is important to note that the intended benefit of the tonnage tax proposal was to stimulate the natural growth of secondary activity tax bases. The latter issue constitutes the real price for the fiscal authorities.

1.3 Traditional Register vs. Flags of Convenience (FOCs)

Open or International Registers—which are termed by critics as Flags of Convenience—are usually considered to allow registration of ships under conditions which are considered more convenient and opportune compared to those of a Traditional Register. According to the International Transport Workers Federation (ITF[2]) an FOC ship is one that flies the flag of a country other than the country of ownership. Where beneficial ownership and control of a vessel is found to lie elsewhere than in the country of the flag the vessel is flying, the vessel is considered as sailing under a Flag of Convenience. Open Registries usually do not require the ship to have any economic nexus to the country. Often the ships registered in Flags of Convenience have never even paid a visit to the country where they are registered. The ITF believes that since FOC ships have no real nationality, they are beyond the reach of any single national seafarers' trade union.

[2] ITF is an international trade union federation of transport workers unions. It represents the interest of transport workers union bodies which take decisions affecting jobs, employment conditions, safety etc.

The ITF takes into account the following when declaring a register an FOC:

- The level of enforcement of international minimum social standards, including respect for basic human and trade union rights;
- Social record as determined by the degree of ratification and enforcement of ILO conventions[3];
- Safety and environmental record – IMO conventions[4]; and
- Emphasises a "genuine link" between real owner of a vessel and the flag the vessel flies in accordance with UNCLOS[5].

Generally, FOC countries are usually characterised by the following minimum barriers:

- Cheap registration fees;
- Low or no taxes;
- Employment of cheap labour (pay minimal—not minimum—wages);
- No "genuine link" between real owner of a vessel and the flag the vessel flies;
- Poor safety and training standards (ships could pose health, environmental and safety risks for jurisdictions with coast lines); and
- Poor living and working conditions for the crew.

Given these elements, South Africa is not in favour to compete on these terms, as this would constitute the most aggressive race to the bottom, with unacceptable risks to seafarers and the marine and coastal environments. The only sensible competition is therefore in the area of the notional imputation, or tonnage tax system. The ITF lists 28 countries as FOC havens. Well-known FOC registers are Cyprus, Republic of Panama, Liberia, Marshall Islands, Malta, Philippines, the Bahamas, and Vanuatu[6].

1.4 Flag Link (vessel registration) vs. Flagging blind

The right to establish and maintain a Register of Ships is a fundamental right of all nation states. Registration is generally used to mean attributing a national character to a flag and a link from the ship to an ownership and control structure in that nation state (the flag state), which is then duly recorded in the Register of Ships[7]. When a ship is registered it receives legally recognisable "state" nationality evidenced by the registration certificate. This has advantages at home and abroad as the ship will be accorded "state" protection on the high seas and in foreign ports. In addition, the proof of ownership that registration provides will be recognised internationally, while at home it facilitates the sale of the vessel or the arrangement of mortgages and other forms of finance. Such registers are generally termed "Traditional or Closed Registers".

An economic and legal link between the flag state and its ships is considered essential to ensure proper enforcement. Article 91 of UNCLOS[8] requires that a genuine link exist between the flag state and the ship. In the absence of a genuine link, it is difficult for the flag

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[3] Specifies international seafarers code (working conditions at sea etc.).
[4] Provides a range of international conventions & protocols – safety and environmental standards for the shipping industry.
[5] www.itfglobal.org.flags-convenience/index.cfm.
[6] www.itfglobal.org/flags-convenience/flags-convenien-186.cfm.
[7] www.mondaq.com/article.asp?articleid
[8] United Nations Convention on the Law of the Sea.

state to enforce violations of international standards (e.g., workers rights). While UNCLOS places an obligation on states to exercise effective jurisdiction and control over their ships, each individual state is free to determine the conditions under which this will occur. Although registration confers nationality to ships, there is no restriction upon states to only register vessels that are owned, operated and crewed by their own citizens.

Most of the countries that have adopted tonnage tax regimes do not emphasise shipping companies having to register their vessels in the country (flag link), but rather to create an economic link in order to qualify for the tonnage tax regime. This is done by ensuring that shipping companies which can prove ownership and strategic management of a vessel, reside in the country. The locality, where effective and strategic management decisions are made, will also establish the nexus for drawing into the income tax net such activities.

In addition, reference in this instance must be made to Article 8 of the OECD Model Tax Convention, which provides that the residence of a shipping company will be determined in the place in which the effective and strategic management of the company takes place. It was this alternative that attracted National Treasury to the tonnage tax system.

Some countries, which also flag blind, might require additional evidence for the fulfilment of management requirements, but in general the necessity for the bulk of physical management and operations is the most important qualifier for inclusion in all of the schemes. Through not having to register their vessel and still enjoy the benefits of the regime, ship owners can have the freedom to choose other beneficial regimes to crew and register their vessel, but have their shipping base in the country offering the tonnage tax regime. This creates flexibility for the ship owner, thereby making the regime more attractive. The country therefore benefits through increased shipping activity and related activities and the revenue generated from it, and not from an increase in the ships register *per se*.

Such an approach is mainly being used in the European Union countries, where the object is not so much to attract more ships to the register, but to address the problem of their failing shipping/maritime industries. Countries who have adopted such a method, have not only improved their industries through increased direct and indirect employment, but also have managed to increase the number of ships registered in their countries. Examples of such countries are Ireland, the Netherlands, Germany and the United Kingdom.

It is suggested that South Africa should adopt such a stance, where the more important issue is to improve the maritime industry as a whole through attracting shipping companies to create economic links or backward domestic linkages with South Africa. Once such links have been created and grown, more ships can be expected to register in South Africa, if all aspects of the industry and associated regulations are of an international standard.

Chapter 2

The Economic Importance of a Tonnage Tax Regime

Through competitively offering lower tax and labour wage rates, as well as less stringent registration requirements, Flags of Convenience in the last few decades have managed to have a large impact on the shipping industry as these measures reduced transaction costs for the industry and created commercially higher profits. This is slowly being reversed by the traditional shipping nations, who themselves are now offering more attractive fiscal and regulatory environments than they have in the past.

If looking at the top 35 maritime countries in the world, most of them have introduced some sort of tax incentive for their shipping industry (see Table 1). A number of those jurisdictions, mainly in the European Union, have recently introduced a tonnage tax regime or notional income tax system, taxing commercial profits at a reduced effective corporate tax rate.

2.1 Definition of a tonnage corporation tax

A tonnage corporation tax—or simply tonnage tax—is a special tax regime for shipping companies. Generally, under a tonnage tax a notional profit is computed based on the number and size of ships operated and the standard corporate income tax rate[9] is then applied to this profit. The tonnage rate (used for calculating the notional profit) is generally set so that the profit and, hence, the actual corporate tax paid, is at a minimum. Other corporate income tax rules (e.g., regarding tax depreciation rules, the deduction of interest, capital gains tax provisions) may be adjusted accordingly. In some tonnage tax jurisdictions, the system acts as an effective exemption from corporate income tax on normal commercial profits and in others it merely serves as a deferral mechanism. The intended advantage of this system over other Flag of Convenience types of shipping incentives is that the companies remain subject to a corporate income tax and are therefore entitled to tax treaty benefits.[10]

A tonnage tax taxes shipping activities at fixed rates according to the size of the ships instead of the company's business results. It therefore differs from an ordinary tax regime, where the effective tax rate is made up of the nominal tax rate, capital allowances and other special deductions that apply. It also differs from the taxes paid in Flags of Convenience registers, where a very low and flat rate is applied to the tonnage of the registered vessel. These "Flag of Convenience" charges are akin to annual business license fees, which disqualify these charges of being non-creditable taxes for purposes of double tax agreements.

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[9] Currently, South Africa taxes corporate profits at 28 per cent, as announced in the 2008 Budget.
[10] International Bureau of Fiscal Documentation: *International Tax Glossary*, 4th edition, p 359.

Table .1: Maritime nations' tax dispensation for shipping

Ranking	Country	Tax Regime	National flagged ships	Foreign flagged ships	Total number	% of foreign flag
1	Greece	Tonnage Tax	758	2345	3103	76%
2	Japan	*	747	2163	2910	74%
3	Norway	Tonnage Tax	872	819	1691	48%
4	China	*	1617	704	2321	30%
5	United States	Tonnage Tax	583	870	1453	60%
6	Germany	Tonnage Tax	377	1925	2302	84%
7	Hong Kong (China)	*	235	334	569	59%
8	Republic of Korea	Tonnage Tax (2005)	491	364	855	43%
9	Taiwan Province of China	*	133	395	528	75%
10	Singapore	Shipping activities exempt	457	257	714	36%
11	United Kingdom	Tonnage Tax	396	383	779	49%
12	Denmark	Tonnage Tax	349	333	682	49%
13	Russian Federation	*	2176	380	2556	15%
14	Italy	Tonnage Tax	519	119	638	19%
15	Saudi Arabia	*	52	69	121	57%
16	India	Tonnage Tax	344	41	385	11%
17	Turkey	*	436	137	573	24%
18	Netherlands	Tonnage Tax	576	208	784	27%
19	Iran	*	149	4	153	3%
20	Switzerland	*	12	225	237	95%
21	Sweden	Tonnage Tax	162	162	324	50%
22	Malaysia	*	254	52	306	17%
23	Brazil	Exempt from freight revenue Taxes	142	22	164	13%
24	Belgium	Tonnage Tax	25	128	153	84%
25	France	Tonnage Tax	168	101	269	38%
26	Canada	Exempt from tax on certain Conditions	217	110	327	34%
27	Philippines	Exempt from Income tax	305	31	336	9%
28	Indonesia	CIT based on estimated profits	519	91	610	15%
29	Spain	Tonnage Tax	67	263	330	80%
30	Kuwait	*	32	0	32	0%
31	Monaco	CIT burden is reduced	0	103	103	100%
32	Australia	General Tax	47	40	87	46%
33	Cyprus	Significant tax incentives including tonnage tax	30	38	68	56%
34	Croatia	*	64	39	103	38%
35	Chile	*	56	34	90	38%

Sources: UNCTAD, 2003: 33; Ernst and Young, 2004; and the Transport Institute, 2004.
*: Information unavailable

2.2 Jurisdictions with Tonnage Tax

Mainly European countries have introduced tonnage tax regimes so far. Greece was the first jurisdiction introducing it in 1975, followed by Norway and the Netherlands in 1996. Since then, Germany, the United Kingdom, Belgium, France, Spain, Denmark, Finland, Ireland and Italy have introduced tonnage tax regimes, with India and Ireland introducing their regimes in 2004. The United States also recently passed legislation introducing such a preferential tax dispensation.

In all these instances, countries have done so in order to reverse their declining shipping industries creating global competitiveness through levelling the playing field with Flags of Convenience and other shipping nations who have offered various types of tax incentives.

2.3 Benefits of a tonnage tax regime

The key objective of the tonnage tax regime is to create a business environment which will deliver a number of real advantages for all shipping companies entering the regime. The related domestic business activities, supporting a vibrant shipping industry effectively managed and operated from within the jurisdiction, will constitute further growth in tax base (employment and business income) along with the additional or new tonnage tax income. Key benefits include:

- *Simplicity* — Straightforward and clear-cut tax calculations are the hallmarks of the system. In case of pure shipping companies, it will minimise administrative and compliance effort regarding the computation of annual tax returns with accompanying cost savings;

- *Increased cash-flow for vessel operators* — Low effective tax rate will make shipping companies internationally more competitive;

- *Certainty* — The level of tax will be known, thereby decreasing the need for the company to make provisions in its accounts for deferred taxation;

- *Flexibility* — Companies will have more freedom to make decisions that are commercially driven and are not primarily informed by taxation considerations;

- *Clarity* — A company’s tax position will be more easily understood, making the company more attractive to investors and potential business partners;

- *Compatibility and competitiveness* — It levels the playing fields between domestic and international counterparts in cases where at least 15 other important maritime nations have introduced similar notional income tax systems;

- *Employment and training* — It creates opportunities for local cadets and seafarers;

- If jurisdictions impose some sort of *training requirement* — It will be accompanied by an increase in the availability of trained seafarers to the shipping industry; and

- *Economic activity not ownership* is rewarded — Ship management companies must qualify.

2.4 Drawbacks of a tonnage tax regime

Given the principle of taxing notional income, it is conceivable that a tonnage tax regime could have adverse economic consequences for operators if there would be a cyclical downturn in the international shipping industry — highly unlikely given current robust growth in world trade. Similarly, a start-up firm investing in new vessels may find the standard corporate tax system more attractive due to the available accelerated tax depreciation provisions. Key drawbacks of a tonnage tax are as follows:

- The *incidence of tax could be high* — In cases of an economic downturn in the shipping business with declining turnovers with subsequent declines of freight rates, high operating cost, especially if the operator owns a significant net registered tonnage;

- The notional income *tax is payable even if operators turn in a loss situation*;

- Once a company has opted for a tonnage tax election, most jurisdictions stipulate a *lock-in period of ten years*, as constant switching in and out of the preferential tax treatment is accompanied by complex transition rules which are difficult to administer. For example, in times of declining world trade companies may suffer in terms of the tonnage tax an excessive tax burden and would be forced to opt out of the tonnage tax dispensation. In such situation, the shipping firm will be in terms of the standard tonnage tax dispensation be debarred from re-entry for ten years[11]; and

- Since most jurisdictions regard a tonnage tax system as a *preferential taxation regime*, it commonly *comes with a host of other government conditions* such as the creation of reserves or training requirements for domestic cadet officers and crews.

Consequently, any shipping company before opting for the preferential tonnage tax system must judiciously assess its complete financial position before such election can be exercised.

[11] The Korean tonnage tax regime stipulates only a five-year lock-in period.

Chapter 3

Cross-country Description of Tonnage Tax Regimes

Tonnage tax is an optional regime based on a determination of notional shipping profits taxed at the prevailing corporate tax rate. It is important to emphasize at this stage that a tonnage tax is not mandatory as certain companies may find that they would pay more tax under a tonnage tax regime than they would under the standard corporate tax system. For example, a shipping group may have continuing losses (as a result of capital allowances etc) which it currently uses as relief against profitable, non-shipping activities, whereas under a tonnage tax dispensation there would be a ring-fencing of shipping losses unavailable for offsetting against non-shipping activities.

In contrast, Flag of Convenience jurisdictions apply a fixed rate of tax referred to as a "tonnage tax", more akin to a business license fee, as previously referred. The reference to the term "tonnage tax" in these regimes is anomalous and has no bearing on the tonnage tax reference in traditional maritime nations, as referred to above.

3.1 Most commonly accepted tonnage tax model

The most commonly used model is the one adopted by the Netherlands in 1996 — hereafter the "Dutch model". According to this model, its taxable income is calculated based on the net tonnage of ships operated. The ordinary corporate tax rate is then applied on the attributed income[12] .

The "Norwegian model" is still only used by Norway in its entirety. It is a flat rate tax applied on the net tonnage of ships included and taxation of dividends at the ordinary company tax rate at company level. It also includes very detailed provisions for how the ship-owning companies should be structured in order to avoid difficulties regarding tax administration in separating tonnage tax and non-tonnage tax activities within companies.

There are many variations applied by different countries as to restricting the various activities of a qualifying shipping company for purposes of the tonnage tax. Similarly, the treatment of deferred taxes is dealt with in many divergent ways. Some countries have included a training element into the requirement for being eligible to enter a tonnage tax system.

[12] European Shipping Policy 2004

Table 2: Key design features of countries' tonnage tax regimes in 2004/05

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
1	Belgium (introduced in 2002)	Computation on a lump-sum basis of profits derived from the operation of a sea-going vessel with reference to the vessel's tonnage. The lump - sum profit is computed per ship, per day and per tonnage: - Up to 1000 t @1.0 €/day and per 100 tons - 1001 to 10 000 @ 0.6€ - 10 001 to 20 000 @ 0.4€ - 20 001 to 40 000 @ 0.2€ >40 000 @ 0.05€	34% (austerity surcharge included)	After election a 10-year lock-in period applies with automatic renewal	Seagoing vessels engaged in transport of goods/ persons, including towing & sea-rescue operations. The tonnage taxation of lump-sum profits applies not only to ship owners, joint owners or hull charterers of ships managed mainly in Belgium but also taxpayers involved in ship management.	A vessel registered in Belgian full register cannot be registered in another jurisdiction; except in bareboat register of that country. Belgian tonnage tax regime only applies to vessels flying the EU/EEA flag	Deferral of CGT on realization of vessel with compulsory reinvestment within 5 years & recording of capital gains in blocked reserve account.
2	Denmark – introduced in 2002	Tonnage income will be calculated per 100 net ton per 24 hours regardless of operating status: < 1000NT @ DKK7 1000NT>10 000NT @ DKK5 10000NT>25000NT @ DKK3 >25 000NT @ DKK2. All expenses concerning tonnage tax as per universal tonnage tax design is non-deductible, and assets do not qualify for tax depreciation	28%	On election, the choice of the shipping co will be binding for 10 yrs. Alternatively, companies that seek to continue with ordinary corp. income tax must commit also to 10 yrs.	Tonnage tax regime can be used by limited shipping co's registered in Denmark or EU shipping co's with permanent establishments in Denmark & all co's where management is located in Denmark. All qualifying shipping co's within group will have to choose similar tax regime. Only income from shipping business & associated activities (operation of dockyards, passenger terminals, containers, ticket offices, etc) can be subject to tonnage tax & it relates to transport of goods & passengers. Leasing of ships is not considered shipping business. Time-chartered tonnage can be	In line with EU state aid rules	Capital gains related to sale of ships will be taxed according to standard corporate income tax rules but this only happens when ship is sold at higher price than acquisition cost

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
					included in ratio of 4:1.		
3	Finland – only vessels operated in international transport of goods/persons	- Up to 1000 t @ 0.4 €/day and per 100 tons - 1001 to 10 000 @ 0.3€ - 10 001 to 25 000 @ 0.2€ >25 000 @ 0.1€	26%	In case of election, company must commit for a 10 years of tonnage tax regime period	Vessels held & chartered out on bareboat or time charter basis qualify for regime	No possibility of parallel registration, ie bareboat charter	
4	France – since 2003	Up to 1000 t @ 0.93 €/day and per 100 tons - 1001 to 10 000 @ 0.71€ - 10 001 to 25 000 @ 0.47€ >25 000 @ 0.24€	33.3%	Election is valid for 10 years, and is renewable	Only shipping co's established in France or French Permanent Establishments of shipping companies with offices in other states may exercise election	There are strict ship registration rules: co that owns 100% of ship must have its head office in France or an EU member state, but place of effective management must be in France	Normal income losses will be frozen for period of tonnage tax election & No CGT on sale of vessel during period vessel in in tonnage tax regime
5	Germany – since 1999	Up to 1000 t @ 0.92 €/day and per 100 tons - 1001 to 10 000 @ 0.69€ - 10 001 to 25 000 @ 0.46€ >25 001 @ 0.23€ (compare this to France – 'race to the bottom competition!)	38.6% If the shipping company is a corporation, a 25% corp. tax rate applies plus the temporarty surcharge of 5.5%	Election comes with a lock-in period of 10 yrs	Co's & partnerships with income from merchant shipping in international waters may elect to join tonnage Tax regime but enterprises place of effective management must be in Germany & individual ships must be operated & managed from Germany	German ship owners only fly German flag if tax benefits additional costs, such as high manning costs which are now being subsidized by the state. To qualify for the regime, the vessel must be registered in FRG for most of the financial year. Bareboat charters are possible.	
6	Greece – there remains doubt whether it is truly a notional income tax?	<u>Gross registered tonnage:</u> 100 – 10 000t @ coeff. of 1.2 10 001-20000 t @ .coeff of 1.1 20001-40000 @ coeff of 1 40001-80000 @ coeff of0.9	35%, but applicable tax rate depends on age of vessel, young vessel lower rate than old ship.	?	?	?	?
7	India	Taxes shipping company income on a flat rate basis on the Net Registered Tonnage.	35%, Tonnage Tax reduces companies' tax liability to an effective 2% tax	Election comes with 10-year lock-in period	Company owning at least one qualifying ship may join. A qualifying ship must weigh at least 15 tons. Furthermore,	Tonnage tax applies to Indian shipping companies whose main business is the operation of qualifying ships,	In the event of sale of any of the ships by a shipping company before a period of eight years, then entire sale proceeds

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
					incidental activities may also benefit from preferential regime, provided these do not exceed 0.25% in value of the core-shipping transport-activity.	including charter ships not exceeding 49% of the net tonnage	would be added to the profits in the year of sale.
8	Ireland – since 2003	Notional profit taxed based on net tonnage of owned/chartered vessel. Relevant shipping income includes income from sea-going carriage of passengers, cargo, towage, salvage or other marine assistance except work undertaken in a port area, provision on board of goods or services ancillary to carriage of passengers or cargo, other ship-related activities that are integral part of the business of operating qualifying vessels, etc Qualifying vessels must be self-propelled & sea-going with a mass of 100 tons or more of gross tonnage – fishing vessels, harbour ferries & offshore installations or dredgers are excluded. Notional income is calculated as follows: Up to 1000 t @ 1.0 €/day and per 100 tons - 1001 to 10 000 @ 0.75€ - 10 001 to 25 000 @ 0.5€ >25 001 @ 0.25€	12.5%	Once an election is made into the tonnage tax regime, it remains in force for 10 years. If a company opts out of the tonnage tax regime before the expiry of the 10 year period, it cannot re-enter the tonnage tax regime for a period of 10 years.	Irish resident co's owning ships or bareboat charterers with non-investment type of shipping income may elect. A qualifying company operates qualifying ships & carries on strategic and commercial management of those ships in Ireland.	Revised Irish Ship Register legislation provides for the registration of Irish-owned ships on a foreign register, it allows for bareboat registration, facilities to register vessels for a provisional period and greater access for non-Irish residents to the Irish Register. Ships owned by a body corporate established under EU law with principal place of business in an EU member state may register to fly the Irish flag.	CGT relief available for disposal of assets used for continuous period of at least 1 year for the purpose of tonnage tax activities. Apportionments are allowed where the assets were not used throughout the entire period of ownership in the tonnage tax activity, or where they are partly used for a tonnage tax activity and partly for a non-tonnage tax activity.
9	Italy – tonnage tax effective from 2004	Tonnage tax depends on both the tonnage and age of the vessel and is determined as follows (daily notional/forfait income per ton: Up to 1000 t @ 0.009 €/day - 1001 to 10 000 @ 0.007€ - 10 001 to 25 000 @ 0.004€ >25 001 @ 0.0020€ Yearly forfait revenue is multiplied according to following age ratios (rewarding new ships):	37.3%	After election has been exercised, firm must stay in regime for 10 years	Shipping groups must apply the tonnage tax regime to every vessel owned by group companies & law applies only to Italian companies/ permanent establishments. Ships registered in foreign register and bareboat-chartered to an Italian/EU entity can be	Tonnage tax regime only available for vessels registered in Italian International Shipping Register.	Capital gains/losses on transactions on relevant vessels are included in above forfait / notional income.

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
		0-5 years – ratio of 0.9 6 to 10 yrs – ratio of 0.95 11 to 25 yrs – ratio of 1.05 > 26 years – ratio of 1.10			temporarily registered in Italian International Register.		
10	Netherlands – Dutch tonnage tax operative since 1996	Tonnage tax regime applies to Dutch-based shipping companies Up to 1000 t @ 9.08 €/day and per 100 tons - 1001 to 10 000 @ 6.81€ - 10 001 to 25 000 @ 4.54€ >25 000 @ 2.27€	29%	Election for tonnage tax regime is for period of 10 years, renewable for another 10 years or migration back to normal standard corporate income tax model.	Tonnage-based taxation can be elected if vessels are shipping cargo and people on international ocean-going vessels, the taxpayer must be the beneficial owner of the vessel, and bareboat chartering-in is permissible too. But ocean-going vessels chartered bare to a third party do not qualify.	Only vessels, which the taxpayer operates, qualify. Operation is understood to mean that the owner takes care of least 30% of the management of the vessel and management is split into strategic, nautical, commercial and technical management. The vessels must be used at sea for at least 50% of the time they are operated…also, the annual total of the net daily tonnage of other foreign chartered-in vessels may not exceed 3 times the annual total of net daily tonnage of own vessels. Hence, the flag under which the vessel sails is not relevant to the application of the tonnage-based option.	There is no Capitlal Gains Tax in the Netherlands.
11	Norway – tonnage tax was introduced in 1996 to preserve Norway's ranking as the 3rd most important merchant fleet (1718 vessels) after Greece	Tonnage tax flat rates for every 1000 net tons & days of operation: >first 1000 tons @ NOK0 1000 - 10 000 tons @ NOK18 >10 000 – 25 000 tons @ NOK12 >25 000 tons @ NOK6 The Norwegian tonnage tax regime presents a deferral benefit for income tax. In the case of profit distribution & other investment income the	28%		Attractive exemption prevails in that individuals & co's residing outside Norway will not be subject to tax in Norway on income which results from owning/operating vessels in international traffic, even though	Tonnage tax beneficiaries must increase or maintain the share of owned vessels with European Economic Area (EEA) flag. Hence, tonnage tax benefits can only apply to EEA flagged vessels. Yet, flag	

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
	and Japan	normal corporate tax rate of 28% applies. The tonnage tax is ring-fenced only to the leasing and operation of owned or leased vessels. A company leaving the tonnage tax regime is subject to corporate income tax on the total of deferred profits.			vessels are effectively managed from Norway (except where bilateral tax treaty specifically precludes this).	requirement does not apply to leased vessels. Tonnage tax only applies to vessels used in maritime transport, excluding all movable installations for use in oil & gas industries, towing vessels or dredgers.	
12	South Africa – proposed to take effect, retroactively from 1 January 2008	See proposed details in discussion document	Currently 29%, but reduced to 28% with effect of 1 April 2008	5 year lock-in period	See proposed details in discussion document	See proposed details in discussion document	See proposed details in discussion document
13	Spain	Under Spanish Corporate Income Tax provisions, shipping companies can elect the tonnage tax regime by reference to the net tonnage registered: - From 0 to 1000 t @ 0.9 €/day - 1001 to 10 000 @ 0.7€ - 10 001 to 25 000 @ 0.4€ >25 001 @ 0.20€. In making above-mentioned computation, only days where the vessel is available for navigation must be taken into account	35%	A lock-in period of 10 years prevails, renewable for an additional period of ten years.	Tonnage tax only applies to qualifying ships, i.e., ships that must be strategically and commercially managed from Spain or from other EU member states and they must be sea-going for exclusive use of carriage of goods, passengers, towage, salvage or other marine assistance in the high seas.	Tonnage tax is provided just for shipping co's registered with any of the Spanish Ship Registries (Act No. 27/1992, irrespective of whether they own or time-charter the vessels.	Both capital gains and losses arising from disposal of a vessel used in tonnage tax dispensation are in principle included in the tax basis of tonnage tax. Hence, capital gains are exempt.
14	United Kingdom – the regime was introduced in July 2000	The benefits of the British tonnage tax are dependent on fulfilling certain training requirements for domestic labour. The notional tonnage tax is calculated by reference to the qualifying daily net tonnage of each ship operated under the tonnage tax profit system according to the following schedule: - from 0 to 1000 tons @ £0.6 per 100 net tons - 1000 to 10000 tons @ £0.45 per 100 net tons	30% The notional profit can be derived from core qualifying shipping activities, qualifying secondary activities (range of related commercial activities inherently	An election has a currency of 10 years and can only be withdrawn in limited circumstances. With the view to obtaining certainty for a shipping operator the election can be renewed annually on a rolling basis so	A co must be ordinarily subject to corporate income tax and operate ships which are strategically & commercially managed in the UK. The operation of a qualifying ship means to own or charter the ship and it is the operator of a ship that is eligible for tonnage tax	Revised EU Commission Guidelines on State Aid to Maritime Transport require that the benefits of various European tonnage tax regimes should be linked to an obligation to carry the EU flag. Less than 60% on average over a prescribed period of the company's	The notional profit system also replaces capital gains made by a company while it is in the tonnage tax system. Actual capital gains will be free from tax to the extent that the gains was realized by the taxpayer while the company was within the tonnage tax period, provided the asset

	Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
		- 10000 to 25000 tons @ £0.30 per 100 net tons - above 25000 tons @ £0.15 per 100 net tons Any non-shipping activity will be ring-fenced and taxed separately according to existing corporate tax rules. A qualifying ship must exceed 100 tons and must be sea-going. In addition, it must be employed in the carriage of passengers, cargo, towage, salvage or other marine assistance, and transport in respect of services necessarily provided at sea.	maritime in nature), qualifying incidental activities (that may not exceed 0.25% of the taxpayer's turnover from its core activities, dividends and interest receipts.	that any point in time there may be an election in place for the succeeding ten years.	treatment. A ship may be chartered out for maximum of 3 years as temporary surplus or to bareboat charter the ship to another member of the group. A co cannot time charter-in more than 75% of its net tonnage	registered aggregate net tonnage is EU flagged and all ships in the group will be taken into account as well as all ships operated by a subsidiary. A new ship must be registered on an EU flag within 3 months from the first date that all the EU flagging conditions are met. All qualifying tugs & dredgers will have to be registered on an EU flag.	in question was used for tonnage tax purposes. This rule applies to assets other than the ships and in this instance some apportionment rules apply.
15	United States – has introduced the notional profit tax in the format of a tonnage tax	No deductions and no credits are allowed against the notional tonnage tax. The notional shipping income for a tax year is the product of the daily notional profit from qualifying shipping operations times the number of days during the taxable year that the qualifying corporation operated such vessel in foreign trade, according to the following schedule: • from 0 to 25 000 net tons @ $0.40 for each 100 tons • exceeding 25 000 tons @ $0.20 for each 100 tons • United States 'foreign trade' means transportation of goods & passengers between a place in the US & a foreign place or between foreign places	Notional income in terms of the tonnage tax is taxable at the maximum corporate income tax rate of 39.3%	The lock-in period is for 5 years and the election is revocable, but if it is revoked, it cannot be made again for five years.	A qualifying vessel is defined as a self-propelled US flag vessel of not less than 10 000 deadweight tons that is exclusively used in US foreign trade. Deadweight measures the lifting capacity of a ship expressed in long tons, including cargo, crew and consumables such as fuel, lube oil, drinking water and stores. It is the difference between the number of tons of water a vessel displaces without such items on board and the number of tons it displaces when fully loaded. Core qualifying activities consist of operating qualifying vessels in US foreign trade. Gross income from 'secondary	In order to qualify for the election, at least 25% of the aggregate tonnage of qualifying vessels used by the corporation must be owned and operated by the corporation or bareboat chartered to the corporation.	Special deferral rules apply to realized gains on the sale of a qualifying vessel if such vessel is replaced during a limited replacement period; i.e., taxpayers may roll over tax-free the proceeds of the sale of a qualifying vessel into another qualifying vessel within 3 years.

Country	Tonnage notional profit rate = Total net tonnage – as calculated @ income /day per 100 tons	Corporate tax rate	Lock-in period	Qualifying operations	Economic or flag link	Capital gains rollover relief
				activities' is excluded from normally taxable gross corporate income calculations, only to the extent that the gross income from such activities does not exceed 20% of the taxpayer's gross income from its core qualifying activities. Hence, only *de minimis* income from incidental activities may be included into the tonnage tax regime.		

Sources: Ernst & Young – *Shipping Industry Almanac 2004*
European Commission, Press Release of 17 May 2006 – *New Report on Taxation in the EU from 1995 to 2004,* STAT/06/62.

3.2 Recommending Dutch tonnage tax model for South Africa

The South African tonnage tax regime will be based on the 'Dutch model', due to its proven design and administrative simplicity. It is important to note that because of these design advantages it has been adopted by other highly reputable ship registers, such as the Irish, German, United Kingdom and Belgian systems.

Chapter 4

Tonnage Tax Design and Computation

International experience suggests that companies should arrange or organize their affairs in such manner, whereby shipping activities are consolidated into a separate entity. Suggested approach will avoid lengthy arguments with the revenue authorities separating out those activities directly related to shipping activities from non-shipping commercial activities (e.g., income earned from land transport and other non-shipping activities and portfolio investment earnings such as interest and dividend income). Also, this arrangement simplifies the tax treatment of depreciable assets which experience a change of use as they migrate from one regime to another. In fact, the argument for splitting-off shipping from non-shipping activities by way of establishing two separate legal entities should be strongly advanced by the fiscal authorities. In this regard it is important to note that legislation should provide an enabling transitional fiscal arrangement (i.e., not deeming these transfers as realization events for capital gains tax purposes), so that companies should not be prejudiced by their "deemed transfer of business" with negative capital gains tax implications.

4.1 Definition of terms to be used in Income Tax Act of 1962

This chapter describes and defines the core principles, shipping business ratios and activities that would qualify carefully delineated shipping transport activities for the benefits of the preferential tonnage tax regime. Differently stated, these are the core elements of the proposed South African tonnage tax regime. When considering these key features of the domestic tonnage tax, it must be remembered that they were designed to be internationally competitive or attractive if compared to other existing tonnage tax systems. However, the biggest competitive hurdle for the South African tonnage tax proposal remains the current Irish regime which boasts a corporate rate of 12.5 per cent—as compared to the newly proposed 28 per cent in the case of South Africa[13].

Clearly, remaining key design options must then be focused on the other adaptable modalities of the tonnage tax regime, i.e., the determination of the notional profit, lock-in periods, transitional measures, rollover relief, the definition of qualifying shipping activities and vessels, etc. with the view to making the South African tonnage tax system truly internationally competitive in every respect.

It is important to note that the design of the domestic tonnage tax regime could therefore be labelled as a typical "*race to the bottom*" phenomenon since it seeks to roll out preferential tax rules. Nevertheless, it must be remembered that the South African fiscal authorities will not lose any currently collected tax revenues, as South Africa has at this stage no existing shipping transport tax base. Indeed, it has already lost for decades its direct and indirect shipping income tax bases to jurisdictions such as Belgium, the Netherlands, Denmark and

[13] Announced in the 2008 Budget, with an effective date of 1 April 2008.

the United Kingdom where in some instances the effective and strategic management of shipping companies reside, which traditionally served the South African market.

However, it is envisaged that the return of the inherent South African shipping industry to the South African home base will gradually materialize with the introduction of the South African tonnage tax regime. The suggested tax reforms would thereby fully recognise and capitalise on the existing benefits stemming from the domestic maritime infrastructure, local ports and the geographic locality advantages of South Africa vis-à-vis the African hinterland.

For purposes of drafting the South African tonnage tax regime—to be included in a separate schedule to the Income Tax Act of 1962—the internationally accepted meaning of the following terms should be adopted, and become key tax design features of the domestic tonnage tax:

(a) "**bareboat charter**" means the hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;

(b) "**bareboat charter-*cum*-demise**" also known as a "bareboat charter-out" means a bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered;

(c) **"factory ship"** includes a vessel providing processing services in respect of processing of the fishing produce;

(d) **"fishing vessel"** shall have the meaning assigned to it in clause (*12*) of section 3 of the South African Merchant Shipping Act, 1951 (Act No 57 of 1951);

(e) **"pleasure craft"** means a ship of a kind whose primary use is for the purposes of sport or recreation;

(f) **"operating"** a ship means, a company is regarded as operating a ship which is owned by the company or chartered to the company";

(g) **"qualifying company"** means a qualifying company if:-
   - It is an South African company liable to corporate tax;
   - The place of strategic and commercial management of the company is in South Africa;
   - It owns at least one qualifying ship; and
   - The main object of the company is to carry on the business of operating ships in the seagoing carriage of goods and passengers [or international trade – see US definition;

(h) **"qualifying ratio"** means—

- The requirement for remaining in tonnage tax in the case of a single company that not more than 80% of the net tonnage if the qualifying ships operated by it is chartered-in: This means owning one ship and chartering-in 4 other vessels;
- "chartered-in" means if it is chartered to a company otherwise, than on a bareboat charter terms, and, from a person who is not qualifying member of the same group.

(i) **"qualifying ship"** means—

- It must be sea-going—
  - Sea-going means that it must be certified for navigation at sea by a competent authority. The ship must be certificated and the certification must cover the normal commercial operation of the ship;
- It is 50 tons or more gross tonnage **and** it has an international tonnage certificate;
- It is used for—
  - carriage of passengers
  - carriage of cargo
  - towage, salvage or other marine assistance
  - transport in connection with other services of a kind provided at sea;
- It is not used for the provision of goods or services of a kind normally provided on land;
- It is not on the list of excluded vessels;
- Excluded vessels include—
  - Fishing vessels
  - Factory ships means a vessel providing processing services for the fishing industry
  - Pleasure craft means a vessel whose primary use is for purpose of recreation
  - Harbour or river ferries used for harbour, estuary or river crossings
  - Offshore installations
  - Tankers dedicated to a particular oil field
  - Dredgers;

(j) **"strategic and commercial management"** is based on three basic criteria:

- Strategic management is evidenced by the choice of location of headquarters and where senior management commonly operates; i.e., where decision-making of the company board of directors and decision-making of the operational board take place. Strategy-making also includes — decisions on significant capital expenditure / disposals; the award of major contracts; making agreements on strategic alliances with other firms or business partners; and the extent to which foreign offices work under the direction and supervision of South African-based personnel;

- Commercial Management is demonstrated by including, route planning of the shipping activities, taking bookings for cargo and passengers, managing the bunkers and stores, provisioning and victualing of the crew, personnel management, training, technical management and support facilities provided in and from South Africa; and

- The fact that a vessel may be flagged, classed, insured or financed in South Africa may add further weight to the identification of the geographic locality where both strategic and commercial management decisions are exercised;

(k) **"seagoing ship"** means a ship if it is certified as such by the competent authority of any country. It includes ships destined or used for short-distance international trade which would include coastal-water shipping;

(l) "**tonnage income**" means the income of a company, qualifying to elect for tonnage tax, computed in accordance with the tax base definition;

(m) "**tonnage tax activities**" means the activities consisting of:
- it's core qualifying activities
- it's qualifying secondary activities
- it's qualifying incidental activities, as described under the section – "qualifying activities";

(n) "**tonnage tax company**" means a qualifying company in relation to which tonnage tax election is in force; and

(o) "**tonnage tax regime**" means a regime for the computation of profits and gains of a company operating qualifying ships as discussed in this document. A tonnage tax company engaged in the business of operating qualifying ships shall compute the profits from such business under the tonnage tax scheme. Gross tonnage is used when deciding whether a ship qualifies for the tonnage tax, however net tonnage[14] is used in the actual calculation of tonnage tax profit.

4.2 Tax base delineation

In terms of a tonnage tax regime the taxable profit of a shipping company that has exercised the tonnage tax election is based on the net registered tonnage of its operated vessels. This results in a fixed rate profits tax for these taxpayers instead of taxation on their actual operating results. In this connection it is important to remember that only a taxpayer liable to corporate income tax can elect into the tonnage tax system in lieu of normal corporate income tax system.

This section addresses the business income elements that are proposed to form part of the tonnage tax base. Moreover, it is suggested that the tonnage tax regime ought to be tightly ring-fenced to ensure that:

[14] The total of all enclosed spaces within a ship which are available for cargo and passengers expressed in tons.

- Only income and expenses that belong to the *ship operation* trade are included within relevant shipping profits; and

- All other income earned and expenses incurred by the taxpayer are taxed under normal or standard corporate tax rules.

The design preference for a tight ring-fence around direct shipping profits is motivated by the need to allay the fears of the revenue service, which has zero tolerance for attempts to push or defuse the distinction between 'legitimate' and 'unacceptable or aggressive tax avoidance'. Generally, the tax design at the outset must seek to provide clarity with respect to definitions such as qualifying vessels, activities or operations with the view to sparing taxpayers and tax administration acrimonious and costly debates later.

The general ring-fence provisions must therefore cover details such as:

- The separation of relevant shipping profits from other 'secondary or auxiliary or incidental' profits generated by a company. Hence transitional and timing issues are key, as a company will begin a new accounting period when it enters or leaves the tonnage tax dispensation and a company's tonnage tax activities must therefore be deemed to be a separate trade distinct from its other activities.

- Controlled foreign companies (CFC's) may carry on shipping trades, which would be qualifying trades if the CFC were resident in South Africa. There are special rules dealing with the treatment of dividends received by, or amounts apportioned to, South African companies.

- The tonnage tax is designed to produce minimum level of tax, and there are special rules to prevent deductions being made from tonnage tax profits, or against the tax on those profits.

- The general transfer pricing rules are extended to cover transactions across the tonnage tax ring-fence.

- There are special rules to prevent a company or group charging a disproportionate amount of its finance costs outside the ring-fence.

4.3 Defining relevant shipping profits

Relevant shipping profits only has application for a company with tonnage tax profits, which it substitutes for its relevant ordinary shipping profits calculated in terms of the standard corporate income tax system. The law must therefore provide for the calculation of taxable profits of South African-resident shipping companies engaged in ocean-going shipping business on the basis of net-registered tonnage of their vessels. This results in a fixed rate profits tax (notional tax) for these companies in lieu of the taxation of their actual operating results.

This means that if a company does not operate any ships, it has no relevant shipping profits, even if it carries out ship-related activities on behalf of other members of the group. All its income will be outside the "ring-fence" (for example, ships agent earning commissions).

The income tax definition must provide that "**relevant shipping income**" consists of relevant shipping income and any chargeable gains normally subject to capital gains tax rules but excluded in terms of the specific provisions to the 8th Schedule to the Income Tax Act of 1962[15]. Furthermore, it is suggested that the proposed South African tonnage tax design will adopt mostly the UK legislative language which is again based on the Dutch model[16]. The South African tonnage tax must therefore include the following limitation descriptions regarding qualifying shipping income:

- **"Relevant shipping income"** consists of income from **tonnage tax activities**, including
  - certain distributions from qualifying overseas shipping companies; and
  - certain interest income, but subject to the general exclusion of investment income.

Thus, income from tonnage tax activities will form part of 'relevant shipping income'.

- **"Tonnage tax activities"** will consist of—
  - its core qualifying activities;
  - its qualifying secondary activities (to the extent they do not exceed permitted levels); and
  - its qualifying incidental activities (also, to the extent they do not exceed permitted levels).

In terms of the income tax' tax base definition, income from these activities will include all the income that is normally treated as trading income, including, for example, exchange gains. Furthermore, note that prior year adjustments are deemed to be relevant shipping income.

For example: A ship-operating company elects into the tonnage tax regime as from 1 January 2006. In the 31 December 2006 accounts, it makes a prior year tax adjustment written off in previous years resulting in a profit of R50 000. The R50 000 will form part of relevant shipping income.

4.4 Defining qualifying core shipping activities

In the case of South Africa, it is suggested that the policy design will provide that '**core qualifying activities**' must consist of—

- activities in operating qualifying ships; and
- other ship-related activities that are 'necessary' and an 'integral' part of the business of operating those qualifying ships.

International evidence from tonnage tax jurisdictions suggests that 'necessary and integral' is understood to include activities that are essential to enable the ship operation to take place. The definition must therefore include, ship management operations, such as purchasing fuel and hiring crew, and commercial management operations such as booking cargo.

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[15] Eighth Schedule inserted by s. 38 of Act No. 5 of 2001—"Determination of taxable capital gains and assessed capital losses".

[16] The National Treasury wishes to point out that there exists a huge advantage in simply taking over tonnage tax legislative language employed in other jurisdiction, since it first, has been tested as obtaining the desired policy outcome, but second, and most importantly, shipping operators have acquired confidence and familiarity with the relevant tax language in other jurisdictions. This reduces the overall compliance cost for taxpayers operating in the South African business environment.

In contrast, activities not included in the definition of ‘core qualifying activities’, will exclude activities which are merely customary or desirable activities, carried out on behalf of other companies in the same tonnage tax group.

Examples of ‘**core qualifying activities’** are as follows—

- Sale of tickets to passenger or booking of cargo
- Management of the company’s own ships, for example, route planning and fuel purchases
- Arrangement of time or voyage charters
- The transport element of profits from cable laying and diving support services
- Provision of food and drink for cruise passengers
- Maintenance and cargo, for example, provision of refrigerated storage facilities
- Day-to-day maintenance of ships
- Fulfilment of legal and insurance requirements in respect of the ship
- Staff administration of ship’s crew
- Activities involved in the acquisition or disposal of ships
- Towage, salvage or other marine assistance outside a port area
- Transport in respect of services necessarily provided at sea, etc…

4.5 Defining qualifying secondary shipping activities

Commonly, tonnage tax jurisdictions provide in their respective legislation that secondary activities include ship-related activities, customarily provided as part of the qualifying shipping activities, whether for the company or other group members. These activities must have a substantial connection with:

- The company’s core qualifying activities.

Adopted practices in tonnage tax regimes indicate that the VAT same supply rules are used to identify so-called ‘**activities, which qualify without restriction’**. Here it is suggested that the South African tonnage tax design makes reference to the principles and language of the “same supply” rule in the South African Value-Added Tax Act, No. 89 of 1991 under the provision of s. 11 (zero-rating), which means that the activity will qualify to the extent that the activity has been supplied by the same provider, and including—

- Carriage of passengers or cargo otherwise than on board a qualifying ship (transport services to take passengers to or from the ship), single nights accommodation for passengers in transit immediately prior to embarkation;
- Administrative and insurance services (customs, documentation handling, VAT and insurance in respect of voyages in question);
- Embarkation and disembarkation of passengers;
- The loading and unloading of cargo carried on a qualifying ship;
- Consolidation or breaking of cargo carried on a qualifying ship; and
- Rental or provision to customers of containers for goods to be carried on a qualifying ship operated by the company.

But as is customary in tax legislation, the legislator needs to drive maximum clarity and certainty with the view to eliminating ambiguity or opportunities for innovative/creative tax minimization or avoidance practices. Moreover, in the case of tax design for tax preferential

arrangements, the legislator must seek to limit the tax preference to the intended beneficiary—the shipping operators. It is for this reason that the South African legislation should provide for set, predetermined ratios for certain categories of activities which are also very much taking place on land, and if not carefully defined, may translate into significant base erosion of the corporate income tax system in South Africa. This must be avoided at all cost as the tonnage tax regime was intended to create new tax base and not to erode the existing corporate income tax base. Consequently, it is recommended that the preferential tonnage tax regime will not apply for the following problematic **'secondary activities,'** viz.—

i. Work carried out for third parties;

ii. Betting and gambling, only to the extent the turnover is negligible, i.e., 10 per cent of core qualifying activities. This issue is not academic, since some "floating casinos" could seek to be a qualifying ship! The intention in the South African milieu is that this may not qualify as it may be used to provide services normally offered on land; and

iii. Sale of luxury goods, including merchandise commonly sold in duty free shops.

This recommendation should be strongly supported by the revenue authorities, as it minimises the risk for intra-company transfer pricing and other tax avoidance schemes.

4.6 Defining qualifying incidental activities

Qualifying incidental activities constitute these activities that are not covered in the above two categories (qualifying core and secondary activities) and are—

- Incidental to its core qualifying activities; and
- Are not qualifying secondary activities.

The income from such activities may qualify if the turnover from them does not exceed 0.25% of the taxpayer's total turnover in the same accounting period from:

- It's core qualifying activities; and
- It's qualifying secondary activities to the extent that they do not exceed the permitted level.

In case where incidental activities exceed the 1 per cent level, then no part of those activities will qualify, and the whole of the income from them will fall outside the ring-fence.

Example:

If a company's income from activities is:

Core	R 500,000
Qualifying secondary	R100,000
Ship-related incidental, but consistently returned as non-shipping income outside tonnage tax	R 20,000
Other shipping-related incidental	R 5,000

Then the 1% limit will be:

(500,000 + 100,000) x 1% = 60,000.

The ‘other ship related income’ of R5,000 will therefore be qualifying incidental income, and will be included in the company’s ‘relevant shipping profits’. If the other incidental income had not been returned outside the tonnage tax ring fence, then the total of incidental income would have been R25 000 and all of it would have been assessed under the normal corporate tax rules.

4.7 Defining non-qualifying activities

Tonnage tax should be tightly ring-fenced. A ship must satisfy particular conditions (refer definition of qualifying ship). Even if a company operates nothing but qualifying ships, it is suggested that there are certain types of activities that will not qualify in terms of the benefits provided by the regime. These are—

- Activities that are not ship-related (e.g., running a conference and exhibition centre);
- Activities which, although related to shipping, are primarily land based activities; and
- International practice suggests that some ship-related activities, which are neither core nor secondary, may qualify as incidental.

Examples:

At a more incidental level, most activities, which may be in competition with companies ineligible for tonnage tax, are excluded from the regime. The following are non-qualifying shipping-related activities:

- Shipbuilding;
- The sale of ships as part of a ship-dealing trade;
- Onward transport of cargo, otherwise than on the ship operator’s ships;
- Sale on board of the ship goods or services not customarily provided to passengers for example, sale of cars, domestic appliance or livestock;
- The operation of a port or harbour. (In small ports which may have only one terminal the non-qualifying element should be determined on a just and reasonable basis);
- The processing of goods and materials whether on-board, on the quayside or elsewhere, other than consolidation and breaking of cargo in line with clearly drafted regulations, defining cargo consolidation practices. The protection and maintenance of cargo (such as refrigeration or the maintenance of any ripening fruit) will not be regarded as processing. It is important to note that in terms of an existing South African practice note regarding manufacturing, the refrigeration of perishables could be construed as a process of manufacture;
- The storage of cargo beyond what is immediately necessary whilst awaiting loading onto ships or onward transportation. For example, a warehousing or cold storage trade will not be within the tonnage tax regime;

- The hire of containers to customers for use otherwise than for cargoes booked by the tonnage tax company for transit by sea;

- The dealing or speculation in shipping futures or other shipping-related financial instruments such as bunkers, not wholly entered into to hedge the company's tonnage tax trade;

- A ship-based holiday accommodation site where the ship remains moored without any sea transportation element;

- The processing of sales where orders are taken on-board for goods to be subsequently delivered to an address provided by the customer or where the goods are not of a customary type for cruise or ferry passengers to purchase; and

- Operations that would tend to be treated as a separate trade under normal tax principles. For example, it is accepted that the buying and selling of ships is part of the normal operation of ships and is a core qualifying activity. However, where the buying and selling takes place to such an extent that the trade effectively becomes one of ship-dealing rather than ship operation, then it would fall outside tonnage tax.

4.8 Some international practices regarding qualifying activities

4.8.1 Denmark

Income subject to taxation in line with the tonnage tax regime would be:

(a) Income attributed to transport services supplied using qualifying vessel in connection with commercial activity involving the carriage of passengers or cargo aboard, including—

- A vessel which is <u>owned by a shipping company;</u>
- A vessel which is leased without a crew (i.e., bareboat charter and only in the event of temporary excess); or
- A vessel which is leased with a crew (i.e., time charter).

(b) The condition is however that the vessel exceeds 20 ton (in terms of gross registered tonnage, GRT) and, is operated <u>strategically and commercially from Denmark</u> (this allows for Denmark to have the taxing rights.); or

(c) Services, which have a close connection with the above.

Furthermore, income relating to the following activities will be attributed to the tonnage tax base if such activities are undertaken in close connection with the provision of transport services subject to the tonnage tax regime, namely:

- Use of containers;
- Operation of loading, unloading and maintenance facilities;
- Operation of ticket offices and passenger terminals;

- Operation of office facilities; and
- Sale of goods for use at sea.

According to Danish legislation, in the case where remuneration for total transport services includes transport (integral), as well as other auxiliary transport services, the combined remuneration will be taxed within the tonnage tax regime. But this only applies if the company, which is taxed on the tonnage tax basis, has entered into an agreement on the provision of those other transport services with another shipping company.

If the company, which is taxed in line with the tonnage regime, provides other transport services itself, that part of the income which relates to other services will be taxed in accordance with the standard corporate income tax rules.

This Danish provision can be further illustrated by considering the following situation:

- If a single transport service includes a land or air transport element as well as an element of transport by sea, payment for the transport service as a whole will be taxed in accordance with the tonnage tax scheme if the shipping company has entered into agreements with other carriers for the performance of the other elements in the overall transport service which is being provided;

- If, these other elements in the transport service are performed by the shipping company itself, it is the element of transport by sea alone which may be taxed in accordance with the tonnage tax scheme; and

- The remaining elements will be taxed in accordance with the standard corporate income tax rules.

The rationale for this is as follows:

In terms of normal income tax rules, other carriers will be taxed on the payments received for the land or air element of a combined transport service in accordance with the standard corporate tax rules if these elements in the shipment are performed by other companies as sub-contractors.

If, on the other hand, these elements of the shipment are performed using the shipping company's own trucks or aircraft, the shipping company will be taxed on this part of the payment in accordance with the standard corporate tax rules **to avoid any distortion in terms of fair competition** rules vis-à-vis other, non-related land or air transport firms. This consideration is also supported by two tax design principles, namely the horizontal equity and neutrality maxims of taxation**.**

According to Danish tonnage tax provisions, the following activities will not be regarded as qualifying commercial activities, involving the carriage of passengers or cargo:

- Feasibility studies, exploration or extraction of hydrocarbons and/or other natural resources;

- Fishing and processing;

- Construction and repair of harbours, piers, bridges, oil installations, offshore wind farms or other offshore installations, laying of pipelines on the seabed, dredging, trawling for mineral-bearing boulders on the seabed, suction dredging;

- Diving;

- Towing and pilotage etc, unless the vessel is engaged in foreign trade;

- Passenger services in and across the fairways;

- Training, social or educational activities;

- Museum activities and preservation of ships;

- Sport, excursions or leisure by boat or ship; and

- Use of a vessel lying permanently at anchor, regardless of the purpose.

4.8.2 United States of America

In terms of US tonnage tax legislation, a qualifying shipping activity means:

- Core qualifying activities;
- Secondary activities; and
- Qualifying incidental activities.

Core qualifying activities

This will include all activities in operating qualifying vessels engaged in the United States foreign trade.

Qualifying secondary activities

The term ‘qualifying secondary activities’ means secondary activities, provided the gross income derived there from does not exceed 20 per cent of the gross income derived by the company from it’s core qualifying activities. This US tax design feature provides a good example as to how the introduction of an objectively measurable ratio into tax legislation will create maximum certainty for the administration of the notional income tax. It is not left to an inquiry into taxpayer intent with the view to demarcating qualifying core and secondary shipping activities.

Secondary activities are defined in the US tonnage tax legislation as follows:

- Active management or operation of vessels other than qualifying vessels in United States foreign trade;

- Provision of vessel, barge, container, or cargo related facilities or services to any person (i.e., container depots etc); and

- Other activities of the tonnage tax qualifying company that are an integral part of it's business of operating qualifying vessels in United States foreign trade including:

    - Ownership or operation of barges, containers, chassis, and other equipment that are the complement of, or used in connection with a qualifying vessel in US foreign trade;

    - The inland haulage of cargo shipped, or to be shipped, on qualifying vessels in the US foreign trade;

    - The provision of terminal, maintenance, repair, logistical, or other vessel, barge, container, or cargo-related services that are an integral part of operating qualifying vessels in US foreign trade; and

    - Such other activities as may be prescribed pursuant to regulations.

It is important to note, that where a non-electing company is a member of an electing group of shipping companies, any core qualifying activities of the corporation shall be treated as qualifying secondary activities (and not as core qualifying activities).

Qualifying Incidental Activities

'Qualifying Incidental Activities' in the US tonnage tax scheme means shipping-related activities if:

- They are incidental to the company's core qualifying activities;

- They are not qualifying secondary activities; and

- The gross income derived by such company from such activities does not exceed 0.1% of the corporation's gross income from its core qualifying activities-electing group. Any core qualifying activities of the company shall be treated as qualifying secondary activities (and not as core qualifying activities).

Chapter 5

Notional Shipping Income Computation

In case of the proposed tonnage tax incentive scheme, the determination of the so-called fixed profit rates in Rand is the key international competition instrument in the hand of Government. This must be ascribed to the fact that the corporate tax rate or tax depreciation rules, which commonly would be used in driving international tax competition, are not available for this kind of tax preferential regime. The standard statutory corporate tax rate is a key fiscal policy instrument that is determined in line with overarching macroeconomic and fiscal balance policy considerations, as it determines a significant share of tax revenues for any government. Differently stated, instant tonnage tax policy initiative should not influence the overall corporate tax rate level or its marginal effective tax rate which is the result of the corporate tax rate and the allowable cost deductions in terms of the corporate tax calculation. Here it must be remembered that tax depreciation rules can significantly reduce the gross income of the firm for purposes of the taxable income calculations, resulting in significantly lower effective rates vis-à-vis the nominal or statutory rate. However, if Government would in the future decide to reduce the corporate tax rate further, say in line with emerging market economies' current average rate, the suggested tonnage tax regime would per definition become more competitive.

Consequently, the determination of the fixed profit rate for the South African tonnage tax scheme seeks to influence the international attractiveness thereof by manipulating the tax base definition against the background of other competing tonnage tax nations' announced fixed profit rates. For example, the low Irish corporate tax rate of 12.5 per cent vis-à-vis the current South African corporate rate of 28 per cent puts considerable competitive pressure on the daily profit rate determination for the South African tonnage tax proposal.

In terms of current proposal, the daily profit rate was therefore fixed at a level—that even with the current and internationally competitive corporate rate of 28 per cent—the South African tonnage tax regime will still achieve one of the most attractive annual tonnage tax bases. This pre-determined advantage will increase even more in South Africa's favour during times of domestic currency weakness vis-à-vis those of the country's main trading partners.

5.1 Tonnage Tax – Notional Income Calculation

Firstly, in calculating the notional income one begins by determining what the "fixed profit per day" is. This is done by referring to the calculations below, which shows at what amount of net tonnage of a vessel, a certain fixed profit per day rate applies.

Fixed Profit Rates: Proposed scale of charges based on vessels net tonnage in Euro	Fixed profit per day in R
▪ For each 100 tons up to 1 000 net tons	R4.00
▪ For each 100 tons between 1 000 and 10 000 net tons	R3.00
▪ For each 100 tons between 10 000 and 25 000 net tons	R2.00
▪ For each 100 tons above 25 000 tons	R1.00

Secondly, the graduated formula of fixed profit per day is then applied to the net registered tonnage (NRT) of the vessel, which takes into account only its carrying capacity, and not its gross registered tonnage (GRT). This calculation will result in a notional profit figure.

For example, a vessel with a net tonnage of 10,000 (this constitutes today the average net registered tonnage of new container ships), and assuming the ship was used for 365 days, the notional profit of a vessel will be calculated as follows:

Net tons	Calculation 1	Calculation 2	Equals to
0 – 1 000	1 000/100 = 10	10* R4.00*365 days	R14 600
1 000 – 10 000	9 000/100 = 90	90* R3*365 days	R10 950
10 000 – 25 000	15 000/100 = 150	0* R2*365 days	R00
t > 25 000	163 000/100 = 1,630	0* R1*365 days	R00
		Annual taxable tonnage profit	R25 550

Thirdly, in calculating the tax liability, the country's corporate tax rate is finally applied to the notional profit. The recent corporate tax rate reduction to a new level of 28% translates in instant example into a further tax relief to the amount of R255.50—or representing a 3.45 per cent decline of the tonnage tax liability vis-à-vis the 2007/08 rate structure.

Corporate tax rate = 29%: pre-1 April 2008	R25 550 * 29%	R7 409.50 = Tax bill
Corporate tax rate of 28%, post-1 April 2008	R25 550*28%	R7 154.00 = Tax bill

The annual tonnage tax paid by the shipping company operating a bulk carrier for 188 000 net tons will be R204 400 (at the new 28% corporate tax rate).

In this regard it is important to note that this amount constitutes a credible income tax liability for double tax agreements (DTA) purposes, which makes the tonnage tax preference a more beneficial fiscal measure than license fees offered by Flag of Convenience jurisdictions and which substitute in these jurisdictions for corporate taxes.

Net tons	Calculation 1	Calculation 2	Equals to
0 – 1,000	1,000/100 = 10	10* R4.00*365 days	R14 600
1,000 – 10,000	9,000/100 = 90	90* R3*365 days	R10 950
10,000 – 25, 000	15,000/100 = 150	150* R2*365 days	R109 500
t > 25, 000	163,000/100 = 1,630	1630* R1*365 days	R594 950
		Annual taxable tonnage profit	R730 000

This then results in the following tax liability:

Tax rate = 28%	R730 000 * 28%	R204 400 = Tax bill

It is important to understand that for some countries, due to having a low corporate tax rate, or setting the fixed profit rates high, the imposition of a tonnage tax regime would not significantly alter the level of tax paid by the shipping sector. The tax burden a country places on its shipping industry can therefore be purposefully manipulated to reflect the amount of tax the government wants ships on the register to pay.

5.2 Cross-country analyses

The reader is referred to table 2 in Chapter 3 for purposes of comparing the suggested South African tonnage tax scheme with the implemented tonnage tax regimes in fifteen other jurisdictions.

Chapter 6

Statutory Tax Incidence

This section seeks to clarify the statutory tax incidence — i.e., identify the corporate level which has to bear the tonnage tax.

6.1 Qualifying companies

In line with the UK tonnage tax legislation it is proposed to provide that—

- A qualifying company is one, which is within the charging regime of the corporation tax;
- Operates qualifying ships as defined; and
- Those qualifying ships are strategically and commercially managed in South Africa.

6.2 Strategic and commercial management

This is a completely different test to that of "effective management and control", which is largely based on the OECD Model Tax Convention interpretation. The strategic and commercial management test arises from the European Commission's guidelines on State Aid. In essence, this is a two-legged test; i.e., there must be an element of strategic and commercial management.

"*Strategic Management*" is evidenced by the choice of location of headquarters and where senior management commonly operates, i.e. where decision-making of the company board of directors, and decisions are taken by its operational board. For guidance, strategy-making decisions include, *inter alia*—

- Decisions on significant capital expenditure / disposals;
- The award of major contracts;
- Making agreements on strategic alliances with other firms or business partners; and
- The extent to which foreign offices work under the direction and supervision of South African-based personnel.

"*Commercial Management*" refers to decisions that include—

- Route planning for vessels;
- Taking bookings for cargo and passengers;
- Managing the bunkers and stores;
- Provisioning and victualling (supplying staff and passengers with food) of the crew;
- Personnel management, training, technical management; and
- Other support facilities provided in and from South Africa.

The fact that a vessel may be flagged, classed, insured or financed in South Africa may add further weight to the identification of the geographic locality where both strategic and commercial management decisions are exercised.

6.3 Qualifying ships

The reader is referred to the definitions of qualifying ship in Chapter 4. A **"qualifying ship"** means—

- It must be sea-going—
  - Sea going means that it must be certified for navigation at sea by a competent authority. The ship must be certificated and the certification must cover the normal commercial operation of the ship.

- It is 50 tons or more gross registered tonnage **and** it has an international tonnage certificate.

- It is used for—
  - carriage of passengers
  - carriage of cargo
  - towage, salvage or other marine assistance
  - transport in connection with other services of a kind provided at sea.

- It is not used for the provision of goods or services of a kind normally provided on land.

- It is not on the list of excluded vessels.

- Excluded vessels include—
  - Fishing vessels
  - Factory ships means a vessel providing processing services for the fishing industry
  - Pleasure craft means a vessel whose primary use is for purpose of recreation
  - Harbour or river ferries used for harbour, estuary or river crossings.
  - Offshore installations
  - Tankers dedicated to a particular oil field
  - Dredgers.

A **"seagoing ship"** means a ship if it is certified as such by the competent authority of any country. It includes ships destined or used for short distance international trade which would include coastal-water shipping.

However consideration must be given to important aspects in the operation of vessels which may impact on their tonnage tax qualifying status.

Change of Use

For example, in cases where vessels undergo a temporary "change of use" it may be disregarded. Temporary is understood to mean that one or more periods of non-qualifying use in a 12 month accounting period will be disregarded if the aggregate period of non-qualifying use is no more than 30 days. But, if the accounting period is less than 12 months or the ship is operated for only part of the accounting period then the 30 day period must be reduced proportionately.

When does a ship first become a qualifying ship?

A vessel is not a qualifying ship until it begins to be used. This should be taken to be when the vessel is handed over to its owner at the end of its sea trials or, if later, when first certificated for the use in question.

6.4 Operation of ship

A person is treated as operating any vessel during any accounting period if such vessel is:

- Owned by, or chartered (including time-charter) to, the person; and
- Is in use as a qualifying vessel during such period.

Special rules apply in the case of pass-through entities. Similarly, specific rules apply in an instance in which an electing entity temporarily ceases to operate a qualifying vessel. A specific exception will apply in situations where a person is treated as operating and using a vessel that is chartered-out on bareboat charter terms **only if**:

- The vessel is temporarily surplus to the person's requirements and the term of the charter does not exceed three years; or

- The vessel is bareboat chartered to a member of a controlled group which includes such person or to an unrelated person who sub-bare-boats or time-charters the vessel to such a member (including the owner of the vessel); and

- The vessel is used as a qualifying vessel by the person to whom it is ultimately chartered.

The effect of temporarily operating a qualifying vessel in the SA domestic trade:

An electing company will be treated as continuing to use a qualifying vessel in the South African foreign trade during any period of temporary use in the South African domestic trade if the electing corporation gives timely notice to the Commissioner stating that—

- (a) It temporarily operates or has operated in the South African domestic (within the commercial zone) trade a qualifying vessel which had been used previously in the South African foreign trade; and

- (b) It has the intention to resume operation of the vessel in the South African foreign trade (beyond the commercial zone).

Notice in this case shall be deemed timely if given not later than the due date (including extension) of the company tax return for the tax year in which the temporary cessation begins.

The temporary period disregarded, continues until the earlier date of which—

- The electing company abandons its intention to resume operations of the vessel in the South African foreign trade; or

- The electing company resumes operation of the vessel in the foreign trade.

The above however is disregarded for any qualifying vessel, which is operated in the South African domestic trade for longer than 30 days during the tax year.

Legislation must be drafted so that the following disruptive events trigger a clear termination of the vessel's tonnage tax qualification. It is important to note that a **ship will continue to qualify** as being 'operated', if it is—

- In ballast;
- Laid-up awaiting a charter;
- In dry-dock undergoing a refit; and
- Being repaired.

A ship **will not qualify as operated** in sea-going trade if it is:

- Lost at sea;
- Ceases to be certified for navigation at sea, i.e., it is no longer sea-going;
- It begins to be used for the provision of goods or services normally provided on land; or
- It becomes an excluded type of vessel.

These proposals were informed by US tonnage tax legislation, as discussed hereafter.

US example

In the case of the US, the tax effect of temporarily operating a qualifying vessel is dealt in the US tax legislation with reference to US <u>domestic</u> trade as follows:

- An electing company will be treated as continuing to use a qualifying vessel in the US foreign trade during any period of temporary use in the US domestic trade if the electing corporation gives timely notice to the Secretary of the Treasury by stating (through exercising administrative discretion)—

  - That is temporarily operates or has operated in the US domestic trade a qualifying vessel which had been used previously in the US foreign trade; and

- It still has the intention to resume operation of the vessel in the US foreign trade.

- Notice in this case is defined as – "*shall be deemed timely if given not later than the due date (including extension) of the company tax return for the tax year in which the temporary cessation begins*."

- The temporary period disregarded continues until the earlier date of which—

  - The electing company abandons its intention to resume operations of the vessel in the US foreign trade; or
  - The electing company resumes operation of the vessel in the foreign trade.

- The above however is disregarded for any qualifying vessel, which is operated in the US domestic trade for longer than 30 days during the tax year.

6.5 Qualifying ratio

The intention of the tonnage tax regime is to regain ship registrations or enhance material economic backward linkages for the jurisdiction that provides for such notional tax dispensation. Hence, with the view to growing these linkages with a high degree of permanence most tonnage tax jurisdictions seek to cap the quantum of time chartered-in vessels, as they constitute only a temporary benefit. Again, this constitutes a policy area where South Africa should seek to offer a slightly more attractive regime because most jurisdictions adhere to a 3 to 1 ratio (or not more than 75% of the net tonnage of the qualifying ships may be operated on the chartered-in basis).

It is therefore proposed that the South African legislation will provide for a requirement that a person will qualify for remaining in the tonnage tax system only in the case of—

- A single company – that, **not more than 80%** of the net tonnage of the qualifying ships operated by it is chartered-in (i.e., one ship is permanently owned and 4 vessels are chartered-in); and

- A group – that **not more than 80% of the aggregate net tonnage** of the qualifying ships operated by the members of the group that are qualifying companies is chartered-in. In practice this is applied by comparing:

  - The total tonnage of qualifying ships 'chartered-in' across the ring fence;
  - The total tonnage of the qualifying ships operated by the group; and
  - Where this test applies to an accounting period, the computation is made by reference to the average tonnage chartered-in/operated in that period.

Effect of exceeding the 80% limit

If the 80% limit is exceeded in two consecutive accounting periods after entry, the company or group may be excluded from the tonnage tax regime.

What is chartered-in?

As part of the tonnage tax proposal, care must be taken to carefully define situations where a vessel is chartered to a company—

- Otherwise, than on bareboat charter terms; and
- From a person who is not a qualifying member of the same group.

All bareboat charters and charters between tonnage tax companies in the same group are ignored when applying the 80% test. In situations where a ship, which is owned by one company and bare-boat chartered to and operated by another company in the same tonnage tax group, only the owning company's interest should be used in the computation of the tonnage operated by the group.

A ship that is time-chartered from another tonnage tax company in the same group is not 'chartered-in' by that company for purposes of applying the 80% test, but a ship that is time chartered-in from a <u>non-resident</u> member of that group will carry the label of ' chartered-in'. The non-resident company will not be a qualifying company, as it is not within the charge to South African corporate income tax.

Chartered-in: Charters to be taken into account

In calculating the qualifying ratio, charters otherwise than on bare-boat charter terms, i.e. time charters or voyage charters from a third party, must be added.

Charters-out: not to be taken into account

A charter on 'bareboat charter terms' is defined as meaning:

- 'a hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint her master and crew'; and

- Another name for such a charter is 'charter by demise'. A finance lease of a ship to an operator is another form of charter by demise.

A limit on such charters to 80% of the net tonnage should be fixed in order to allow into the tonnage tax regime only ship operators where there was a core activity of full ship-operation, yet one should allow for the flexibility of time and voyage charters.

How to calculate the 80% limit

- <u>All ships operated for the whole accounting period</u> - It is the average percentage of chartered-in ships over the whole accounting period that is needed. Hence, one needs to aggregate the net tonnage of all vessels employed over the accounting period and compute the percentage share of time and voyage charters.

- <u>Ships operated for varying periods during the accounting period:</u>

It is suggested to calculate the ratio, where there are varying periods of charter within the accounting period, as follows:

- Find for each qualifying ship the number of days operated and the vessel's net tonnage;
- Multiply the two figures to give the number of ton-days;
- Add the total ton-days for the company's/group's qualifying ships;
- Add the total ton-days of time and voyage charters-in; and
- Compute the percentage of time and voyage charters-in.

Chapter 7

Tax Treatment of Profit Distribution

The design of the tonnage tax regime becomes complicated in formulating an appropriate tax treatment for other income streams (such as dividend or interest income) generated by a qualifying tonnage tax company.

7.1 Selected international practices

Denmark

In the case of Denmark, dividend distributions received from domestic or foreign shareholdings are tax exempt subject to certain provisos.

The Netherlands

The Netherlands taxes domestic dividend distributions received under normal corporation tax rules and does not include these into the tonnage tax scheme (hence, no exemption from tax under the standard rule). Foreign distributions received are exempt from tax per the normal corporation tax rules. Distributions made to either a resident beneficial owner or EU member will not be subject to a dividend withholding tax. For shareholders outside of the EU, the tax treaties concluded reduce the withholding tax to 5%.

Norway

In Norway, dividend distributions are subject to normal dividend withholding tax; no special tonnage tax regime benefits arise.

Ireland

Similarly, Ireland subjects dividend payments to a withholding tax which in most cases is reduced to zero by virtue of the application of that country's concluded double tax treaties. The Irish domestic law provides for exemptions for dividends paid to most categories of inward investors.

The United Kingdom

The United Kingdom applies far more prescriptive provisions when including dividend distributions as "relevant shipping income". Distributions from qualifying overseas companies must meet the following conditions:

- The overseas company operates qualifying ships;

- More than 50% of the voting power in the overseas company is held by a company resident in an EU member state;

- The 75% ratio is not exceeded in relation to the overseas company in any accounting period in respect of which the distribution is paid. The test is applied to ships operated by the overseas company only, as if it were a single tonnage tax qualifying company;

- The income of the overseas company would be relevant shipping income if it were a UK tonnage tax company; and

- The profits of the overseas company are subject to a foreign tax on profits.

Example:

A tonnage tax company, Shipping Ltd, has an overseas, subsidiary, Overseas Shipping SA, with an accounting date of 31 December. Shipping Ltd elected into the tonnage tax scheme with effect from 1 January 2001. Overseas shipping SA has mixed (tonnage tax and non-tonnage tax) activities until July 2002, when it sells its non-tonnage tax activities to General trader SA, another overseas subsidiary of Shipping Ltd. During 2003 and 2004 the dividend / profit conditions are satisfied.

In May 2005 Overseas Shipping acquires a freight forwarding business from a third party, and the conditions cease to be satisfied from this date. In February 2006 Overseas Shipping acquires a freight forwarding business to General Trader SA, and the conditions are again satisfied from that date. Overseas shipping pays up various dividends to Shipping Limited:

- On 1 June 2003 it pays a dividend out of the profits that arose in 1999 and 2000. *<u>Answer:</u>* This dividend is not relevant shipping income as it is paid out of profits arising in a period when the recipient was not a tonnage tax company.

- On 1 June 2004 it pays a dividend out of the profits arising in 2001 and 2002. *<u>Answer:</u>* This dividend is not relevant shipping income as it was paid out of profits arising in a period when the conditions were not satisfied.

- On 1 December 2004 it pays a dividend out of the profits arising in 2003. *<u>Answer:</u>* This dividend is relevant shipping income, as it was paid at a time when the conditions were satisfied out of profits that arose in a period when the conditions were satisfied.

- On 1 June 2007 it pays a dividend out of the profits arising in 2004. *<u>Answer:</u>* This dividend is relevant shipping income, as it was paid at a time when the conditions were satisfied, out of profits that arose in a period when the conditions were satisfied.

Where dividends are received indirectly through a chain of overseas companies, each of those companies must itself satisfy the conditions referred to above.

7.2 Pre-tonnage tax profit distribution

Based on international practice, it is suggested that a distribution paid out of profits, which arose in a period before the beneficial recipient became a tonnage tax company should not satisfy the conditions. Hence, such dividend streams will be assessed outside the tonnage tax ring fence.

Distributions from qualifying overseas shipping companies: Disposal of overseas business

Profits arising on disposal of all, or part, of an overseas shipping business may be paid out as dividends under the aforementioned rules, provided that the overseas company has qualified to pay such dividends for the five years prior to the disposal. It must be remembered though, that profits on the disposal of shares in an overseas shipping company are not relevant shipping profits. Such a profit will fall outside the tonnage tax ring fence.

7.3 Policy proposal for South Africa

Prior to the 2007 Budget Tax Proposals, the existing application of the Income Tax Act (the Act hereafter), provides that, dividends distributed to both resident and non-resident shareholders will be subject to secondary tax on companies (STC) at a rate of 12.5% (reduced to 10% in the 2007 Budget). In limited circumstances, s64B(5)(f) of the Act provides that such dividends may elect to defer the 12.5%, now 10%, STC. This provision applies to resident companies only. No withholding tax is charged on the distribution of profits to non-resident shareholders.

Current restructuring of the STC system into a final dividend withholding tax

In the 2007 and 2008 Budgets the Minister of Finance announced fundamental structural reforms of the STC regime, the main purpose of which is to substitute the STC at company-level with a final withholding tax on dividends at individual shareholder-level. This will align the South African dividend tax with common international practice, making the South African dividend tax more familiar to international investors and reducing the combined effective of total corporate taxes on profits. The proposed new final dividend withholding tax rate is 10 per cent and no dividend withholding tax will be applied to dividends declared to income tax-exempt entities. As announced, the actual introduction date depends on the renegotiation and ratification of some of South Africa's tax treaties with Australia, Cyprus, Ireland, Kuwait, the Netherlands, Oman, Seychelles, Sweden and the United Kingdom as treaties with these jurisdictions limit currently South Africa's right to withhold tax on dividend repatriations to zero, with an unacceptable revenue loss.

Generally, distributions by companies will be treated as dividends unless evidence indicates that it is a capital distribution. The tax will be a final withholding tax, meaning that no deductions may be offset against the dividends received and South African dividends will not be included in the shareholder's taxable income, taxed at his or her marginal rate. However, South African resident companies will be the collecting agent by having to withhold the dividend withholding tax and transfer it to SARS. The tax will be payable by companies declaring dividends by the end of the month following the month during which a dividend becomes payable.

It is important to note in the context of the tonnage tax proposal that the new dividend withholding tax regime should only apply to dividends distributed to individual and non-domestic company shareholders. Consequently, an exemption will apply to all South African tax resident companies, South African retirement funds and public benefit organisations approved by SARS, all spheres of government of South Africa, and any other institution, board or body that is fully exempt from income tax. Companies, distributing dividends, will have to determine if a dividend qualifies for an exemption. In terms of existing bilateral tax treaties, dividends repatriated to non-resident shareholders may be taxed at rates lower than the 10%-rate, as stipulated in the tax treaty with the relevant treaty partner / country of which the shareholder is a resident. Again, the onus is on the company paying dividends to determine what the applicable and/or reduced withholding rate per non-resident shareholder would be. Consultations are ongoing as to the administrative procedures regarding nominee shareholders.

Existing so-called "STC credits", being excess dividends received which have not been deducted from dividends declared under the STC system, will be forfeited on the effective implementation date of the final dividend withholding tax.

Proposed tax treatment of dividends received by a tonnage tax company

In terms of 2007/08 income tax legislation, dividends received by a resident company from another SA resident company will not be subject to tax by virtue of the Act's exemption provision of s10(1)(k). Also, certain foreign dividends received by a resident company will be exempt in terms of S 10(1)(k)(ii).

Given, that the current dividend tax dispensation in South Africa is under review, it is advisable to reserve this particular aspect of the tonnage tax dispensation for the current dividend tax reform process. Obviously, one policy alternative could be to propose that the receipt of local dividends to a qualifying tonnage tax company continue to remain exempt regardless of whether the company distributing the profit is a tonnage tax company or not. This is in line with any other company in South Africa which receives a dividend, the receipt of such dividend which will be exempt in terms of s10(1)(k) of the Income Tax Act of 1962.

Foreign dividends received by the South African tonnage tax company, however, should only be exempted (will fall within the ring-fence of relevant shipping profits) if the profits distributed are received from a qualifying overseas shipping company. Guidance may be taken from the UK legislation which provides for this exemption's effective anti-avoidance provisions[17].

In other words, a foreign dividend received by a South African tonnage tax company will only be exempt from normal tax to the extent that the profits received are from a qualifying overseas company which:

- Operates qualifying ships;
- More than 50% of the voting power in the overseas company is held by a company resident in South Africa;

[17] See Annex on UK tonnage tax legislation.

- The 70%-ratio[18] is not exceeded in relation to the overseas company in any accounting period in respect of which the distribution is paid. The test is applied to ships operated by the overseas company only, as if it were a singleton qualifying company;

- The income of the overseas company would be relevant shipping income if it were a South African tonnage tax company; and

- The profits of the overseas company are subject to a foreign tax on profits.

The test to determine whether the profits from which the dividends are paid must be subject to tax will be satisfied even if there is no actual liability to tax on those profits, for example, the application of loss relief. It suffices to provide proof that the profits in question are "subject to tax on profits" in terms of foreign tax legislation.

Hence, local dividends received will fall to be exempt in terms of the existing provision of the Act's s10(1)(k) and foreign dividends will only fall within 'relevant shipping profits' if the conditions referred to above have been met.

[18] This controlling ratio is stipulated in the Act's definition (*vide* section 1) of "group of companies", meaning two or more companies in which one company (hereinafter referred to as the 'controlling group company') directly or indirectly holds shares in at least one other company (hereinafter referred to as the 'controlled group company'), to the extent that—

(a) at least 70% of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and

(b) the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.

Chapter 8

Tax Treatment of Capital Gains

When considering the tax treatment of capital gains for South African companies qualifying for the tonnage tax regime it is useful to consider the treatment of such gains in other jurisdictions.

8.1 Introduction

At the outset, it is important to note that the definition of a tonnage tax asset takes the same meaning when determining a capital allowance. That is, a tonnage tax asset is defined as, an asset used wholly and exclusively for the purposes of the tonnage tax activities of a tonnage tax company. In order to simplify the application of the rules, it is suggested that the assets forming part of the qualifying shipping activity are separated from “other assets”.

8.2 Selected international practices

The United Kingdom, Netherlands, Ireland and Norway treat capital gains similarly with one or two slight variations. The underlying principle however, is that under the standard rules of income taxation, a company is subject to tax on realized capital gains by commonly adding these to other taxable income. A tonnage tax company however will account for the gain or loss derived from the disposal of a tonnage tax asset as part of relevant shipping income to the extent the asset was used wholly and exclusively for qualifying activities carried out by the tonnage tax company.

Where an asset is used partly for non-tonnage tax activities, it will not be recognized as a tonnage tax asset and therefore it will not qualify to be included in relevant shipping profits. Within these jurisdictions, conditions are imposed to avoid abuse.

Norway

In the case of Norway, a so-called rollover rule pertains. It stipulates that where the company has sold its tonnage tax assets and no longer qualifies per the definition of a “qualifying company”, the company has one (1) year in which to acquire replacement assets for an equivalent value, failing which, the realized gains of the asset disposal will attract the normal income/capital gains tax liability.

Ireland

Ireland provides that gains derived from the disposal of assets during the tonnage tax period which were used prior to entering tonnage tax and subsequently sold whilst in tonnage tax,

the gain or loss will be apportioned between the standard / normal income tax system and tonnage tax rules, according to the time spent/recorded in the tonnage tax regime.

The United Kingdom

The United Kingdom similarly provides that a gain or loss derived from an asset realisation, which is or was a tonnage tax asset, will only be chargeable or allowable to the extent that it relates to periods when the asset was not a tonnage tax asset. A time apportionment formula is applied by reference to the time that the asset was used outside of the tonnage tax regime as a proportion of the total time that the asset was owned by the company. Unique to the UK is that the time apportionment applies, even if at the time of the eventual disposal the asset is no longer owned by a tonnage tax company.

In some instances rollover relief is given for pre-entry gains rolled over against the cost of an asset which became a tonnage tax asset at the time of entry into tonnage tax or a post-entry gain rolled over against the cost of an asset, which at the time was used for purposes of a company's non-tonnage tax activities. In the afore-mentioned the amount of the gain rolled over will be deducted from the base cost of the new asset. It is important to note, that the gain therefore effectively crystallizes when the new asset itself is disposed of. The UK however limits the rollover relief to a new asset which is not a tonnage tax asset.

Denmark and the United States

Denmark and the United States treat capital gains derived from the disposal of vessels which were subject to the tonnage tax scheme as taxable income and not relevant shipping profits. Rollover relief is however given where the vessel is replaced within a certain period of time.

8.3 Proposals for South African tonnage tax

Rollover relief

It is proposed that, for the South African tonnage tax system, capital gains or losses derived from the disposal of tonnage tax assets will fall within the normal corporate tax charging regime. Although the Danish or US rollover regime sound from a tax equity perspective realistic, the administrative compliance burden of maintaining two parallel but separate accounting systems remains a significant hurdle. Informed by the imperative of simplicity and minimal compliance burden the suggested approach will eliminate the argument of when the asset was used wholly and exclusively for qualifying shipping operations. The simplification arises from the fact that the assessment of tax liability will avoid complex time apportionment calculations.

Still cognisant of the competitive argument, Government may still consider granting relief provisions whereby no gain or loss will be recognized if any qualifying replacement asset is acquired during a specified period. Such specified period shall be:

- Beginning one year prior to the disposal of the qualifying asset and ending two years after the close of the first tax year in which the gain is realised; or
- Subject to the discretion of the Commissioner, such later date as directed by the Commissioner.

The amount of the gain rolled over / deferred will be deducted from the base cost of the replacement asset. By imposing the rule that the asset must be replaced within two (2) years, an opportunity will be eliminated whereby the vessel operators may sell all assets prior to exiting the regime and achieve maximum saving on the avoidance of capital gains tax.

Clogging of capital losses

Capital losses derived from the disposal of tonnage tax assets should be ring-fenced or clogged to be set off against any capital gains derived from tonnage tax assets. Should the company exit the tonnage tax regime with capital loss balances, these losses will be carried forward indefinitely to be set off against qualifying tonnage tax assets purchased in the future.

Chapter 9

Tax Treatment of Capital Allowances

9.1 Introduction

Again, this discussion and subsequent policy proposals will be informed by the need to keep the South African tonnage tax regime from an administrative and compliance burden perspective manageable and cost efficient.

9.2 Selected international practices

In jurisdictions that have implemented a tonnage tax regime, all have disallowed the allowance of wear and tear when determining the tonnage tax companies' shipping profits, In doing so, most European countries have implemented complex arrangements whereby apportioning the wear and tear allowances according to the time spent in the tonnage tax scheme vs., time spent outside of tonnage tax.

It may be that the wear and tear allowances exceed the depreciation resulting in deferred tax liabilities, prior to entering the tonnage tax regime. These balances are treated differently from jurisdiction to jurisdiction.

The United Kingdom

The United Kingdom has adopted a complex system, consisting of tonnage tax pools, balancing charges which are kept separately as long as the shipping assets remain in the tonnage tax system. This will provide the taxpayer with tax depreciation records in case when a company ultimately leaves the tonnage tax system. The taxpayer is therefore put in the same capital allowance position as if he/she had been operating within the normal income tax system throughout.

Denmark

Denmark treats vessels that were depreciated in terms of the normal tax rules prior to the conversion to tonnage tax as being liable to tax on any recovered depreciation (recoupment). Deferred tax on transition however is frozen and crystallises only if a major part of the fleet is sold. Special interim and equalisation balances are used to track these allowances.

9.3 Proposals for South African tonnage tax

It is proposed, that for South Africa, the policy is designed in a clear and simple manner. No capital allowances will be deducted when determining relevant shipping profits. It is proposed further, that on entry into the tonnage tax system, the depreciation allowances schedule continues per normal calculations, however, the wear and tear is added back in the tax

calculation. However, on sale of the vessel, during or after entry into the tonnage tax system, the recoupment of any tax allowances may be deferred, per the existing s8(4)(a) provision of the Income Tax Act. If the vessel is replaced with another qualifying vessel within a limited period of time (say 24 to 36 months), the recoupment will be deducted from the cost of the new vessel.

In other words, the company will not receive the benefit of the allowances whilst in the tonnage tax regime and the tax value of the vessel on exit from the tonnage tax regime will be as if the allowances had been received by the company throughout.

This proposed treatment will eliminate further debate on the treatment of assets that have a "change of use" during the tonnage tax regime or after exiting the regime. As and when an asset changes its use to one of outside that of qualifying activity, the wear and tear of such asset will be taken into account in the determination of the taxpayer's "other" profits.

For purposes of this tax treatment, a 'tonnage tax asset' means an asset used wholly and exclusively for the purposes of the tonnage tax activities of a tonnage tax company. For ease of application, it is suggested that the assets forming part of the qualifying shipping activity is clearly separated from "other assets".

Example:

Table 3: Treatment of capital allowances in the proposed tonnage tax system

CAPITAL ALLOWANCES

	Pre Tonnage Tax			Entry into Tonnage Tax		Exit TT	
	Yr 1 - 2003	Yr 2- 2004	Yr 3 - 2005	Yr 4 - 2006	Yr 5 - 2007	Yr 6 - 2008	Yr 7 - 2009
Cost B/Fwd	-	8,000,000	28,000,000	38,000,000	38,000,000	30,000,000	30,000,000
Additions	8,000,000 (1 Vsl) (A)	20,000,000 (2 Vsl) (B;C)	10,000,000 (1 Vsl) (D)	-	-	-	-
Disposals	-	-	-	-	8,000,000	-	-
Cost C/Fwd	8,000,000	28,000,000	38,000,000	38,000,000	30,000,000	30,000,000	30,000,000
Acc W&T of B/Fwd		1,600,000	7,200,000	14,800,000	22,400,000	22,000,000	28,000,000
Wear & Tear	1,600,000	5,600,000	7,600,000	7,600,000	6,000,000	6,000,000	2,000,000
Rev & Disposal	-	-	-	-	-6,400,000	-	-
Acc W&T of C/Fwd	1,600,000	7,200,000	14,800,000	22,400,000	22,000,000	28,000,000	30,000,000
Net Tax Value	6,400,000	20,800,000	23,200,000	15,600,000	8,000,000	2,000,000	0
Disposals at cost					8,000,000		

Acc W&T	6,400,000
NTV on Sale	1,600,000
Proceeds on Sale	10,000,000
Recoupment	6,400,000
Capital Profit	2,000,000
Scrap Allowance	0

NOTES:

Vessel A purchased	2003	8,000,000	Disposed	10,000,000
Vessel B purchased	2004	10,000,000		
Vessel C purchased	2004	10,000,000		
Vessel D purchased	2005	10,000,000		

On entry into the tonnage tax regime, the depreciation allowances schedule continues per normal calculations, however, the wear and tear is added back in the tax calculation.
On sale of the vessel after entry into the tonnage tax regime, the recoupment of tax allowances may be deferred – see s8(4)(a) of ITA, if the vessel is replaced with another vessel, the recoupment is then deducted from the cost of the new vessel

The capital profit of 2,000,000 is taken to the tax calculation and taxed accordingly, unless the vessel is replaced within the prescribed time limit..

Company exits tonnage tax in yr 7- 2009
The company is now entitled to wear and tear of 2,000,000.
The base cost of the vessel for capital gains tax purposes remains that of original cost as the vessel was acquired post 2002
If the vessel was acquired pre - October 2001 – the market value as determined will be the base cost.

The lock in period of 5 years ties in with the S12C wear and tear allowance which applies for 5 years.
Once the company has elected out, the company must stay out for 5 years.

Chapter 10

Making Elections into Tonnage Tax Regime

10.1 Election-in and election-out processes

Internationally, a tonnage tax system is designed to be an optional regime. Hence, a company must actively elect into it. It is therefore proposed that a qualifying company, intending to elect into the regime, must make an application to SARS in the form and manner as may be prescribed in the legislation.

The election will normally take effect from the start of the accounting period in which it is made, but it would be advisable to give existing shipping businesses some flexibility to back-date or defer their entry into the regime.

10.2 Lock-in period

Countries that have adopted the tonnage tax system (with the exception of Greece and Norway[19]), impose a 10-year lock in period for shipping companies that have elected into the regime. This condition serves to stop companies from cherry-picking their time in the tonnage system, i.e. they cannot move in and out of the regime as it suits them depending on their profit or loss status. For example, a company that were to acquire a number of ships would find it more beneficial to remain in the standard corporate income tax system for purposes of deducting acquisition cost by fully utilising the provided tax depreciation provisions. If after 10 years, the company wants to continue within the regime, they may elect to do so, and the company will be locked-in for a further period of 10 years.

A window period for election is provided to restrict opportunity for companies to defer tax whereby e.g., a company might reap its capital allowances before entering the regime. Ideally, companies should have a relatively short period of a few months in which to decide from the date of the tonnage tax inception, whether they would elect into the regime.

The reason for putting pressure on the shipping companies to exercise the election is informed by Government's desire to rapidly increase the South African tonnage register and to bring back strategic and effective management decision-making processes by shipping firms, so that the country will gradually reduce its huge transport service payments to the outside world. It is generally accepted that a trading nation or open economy should seek to own its shipping fleet (compare Table 1) to transport its export and import trade with accompanying huge foreign exchange savings on its balance of payments. South Africa's commodity and merchandise transport service payments to the rest of the world constitute a sizable 'leakage' on the country's service payments balance, as evidenced by information below. It is imperative that South Africa follows over time a targeted strategy to reducing these transfer payments, thereby narrowing the current account deficit.

[19] Companies opt for the regime one year at a time.

Table 4: SA transportation service payments to rest of the world, R billions

	1998	1999	2000	2001	2002	2003	2004	2005
Transportation	12.660	14.543	16.915	18.551	24.531	25.497	30.287	36.343
Passenger fares	3.271	4.208	4.133	4.106	4.586	5.767	6.963	9.168
Other	9.389	10.335	12.782	14.445	19.945	19.730	23.324	27.175
Travel	10.640	12.392	14.478	15.996	19.011	21.531	20.312	21.463
Business	3.317	3.872	4.957	5.669	7.256	8.493	8.043	8.506
Other	7.323	8.520	9.521	10.327	11.755	13.038	12.269	12.957
Other services	7.967	8.248	8.953	10.145	12.986	14.554	15.925	17.548
Total services	31.267	35.183	40.346	44.692	56.528	61.582	66.524	75.354

Source: South African Reserve Bank: *Quarterly Bulletin*, September 2006.

For example, in 2005 transportation payments to offshore service providers amounted to R27.2 billion or 36.1% of total service payments by South Africa to the rest of the world.

Proposal for South Africa

With the view to making South Africa an attractive tonnage tax jurisdiction, it is proposed that South Africa, in lieu of the standard ten (10) years lock-in period, will legislate for only a five (5) years lock-in period. However, as Government wants to expedite the growth of the domestic ship register and establishment of backward economic linkages, it is proposed to allow a company only a period of 6 months, in which it must make the election to joining the regime.

10.3 Exiting the tonnage tax regime

A tonnage tax company may exit the regime for the following reasons:

a. A qualifying company ceases to be a qualifying company;

b. In the event of a merger or similar change in the company's group structure;

c. A company is expelled from the regime where the fiscal authorities suspect there is an abuse of the scheme;

d. A company is excluded from the scheme if the charter-in limit is breached in any 36 months period or more consecutive accounting periods;

e. Where a company is expelled, the tonnage election ceases to have effect from the beginning of the accounting period in which the abuse started; and

f. If the preconditions for applying the tonnage tax scheme cease to be fulfilled in the course of the 5-year tonnage tax period, the company is expelled from that scheme. In such a case, past profits over the remainder of the tonnage tax period will be subject to standard corporation tax.

10.4 Amalgamation and demergers of shipping companies

Amalgamation/merger

Where there has been a merger between two companies, the provisions relating to the tonnage tax scheme shall apply to the merged company if it is a qualifying company. Where the merged company is not a tonnage tax company, it shall exercise the option for the tonnage tax scheme within 6 months from date of approval of the scheme.

Where the merged companies are tonnage tax companies, the tonnage tax provisions shall apply to the merged company for such period as the option for tonnage tax scheme that has the longest unexpired period continues to be in force.

Where one of the merging companies is a qualifying company as on the last day of the 6 months elective period and which has not exercised the option for tonnage tax within the "initial period", tonnage tax provisions shall not apply to the merged company. In this case the income of the merged company from the business of operating qualifying ships shall be computed in accordance with other standard corporate tax provisions.

Demerger

It is proposed that in cases where the demerged company transfers its business to the resulting new company before the expiry option for the tonnage tax scheme, then subject to the other provisions, the tonnage tax scheme shall still apply to the resulting company for the unexpired period if it is a qualifying company.

Chapter 11

Tonnage Tax and Tax Avoidance

11.1 Tax avoidance

In terms of the proposed legislation, it is a condition of remaining within the tonnage tax scheme that a company is not party to any transaction or arrangement that could lead to the abuse of the tonnage tax system. In this regard a transaction or arrangement will be regarded as an abuse if, in consequence of its being, or having been, entered into, the tonnage tax legislation falls to be applied in a way that results in:

- A tax advantage being obtained for a company other than a tonnage tax company; or
- A tonnage tax company seeks to get tonnage tax treatment in respect of it's non-tonnage tax activities; or
- The amount of the notional tonnage tax profits being calculated by a tonnage tax company being artificially understated.

11.2 Losses – No deduction from tonnage tax profits

Denmark

Denmark provides for tax losses incurred before 2002, to be carried forward for a period of five (5) years, whereas losses incurred after 2001 may be carried forward indefinitely.

Norway

Norway allows for a loss carry-forward of up to ten (10) years.

The Netherlands

Similarly, The Netherlands allows for losses to be carried forward indefinitely, in addition to a loss carry-back of three (3) years.

Ireland

Ireland allows for trading losses of a company to be set off against "trading income" of the company in the same accounting period. Alternatively, trading losses may be carried forward indefinitely against income from the same trade in future accounting periods. In addition to the afore-mentioned, trading losses may be converted into tax credits, used to reduce the corporate tax payable on other passive income and chargeable gains.

The United Kingdom

The United Kingdom provides no relief, deduction or set-off of losses incurred against a company's tonnage tax profits. Hence, no deduction for losses arising from the shipping trade before entry into the tonnage tax scheme may be carried forward. The tonnage tax company will only be entitled to carry the losses forward to the extent that they arise from activities that do not form part of its tonnage tax trade, once within tonnage tax.

Any trading losses directly or indirectly derived from activities that become part of the tonnage tax trade will be extinguished when the company enters into the tonnage tax system. Furthermore, trade losses are not re-instated when a company leaves the tonnage tax regime.

11.3 Proposals for South African tonnage tax

It is proposed that the treatment of loss carry-forwards follows the same principles as adopted by The United Kingdom for reasons of ease of administration. No loss carry-forward will be allowed to the extent the loss is derived from shipping activities. Losses incurred on "other" trading income may be set off against future "other" income.

Additionally, it is proposed that any losses incurred as a result of tonnage tax activities, will not be available for any set-off against "other" trading income. The existing provisions of s11(a) read with s20(1) could incorporate the above proposal or alternatively, be separately provided for in the 11th schedule to the Income Tax Act, 1962.

11.4 Finance Costs

In general, finance costs are not allowed as a deduction against relevant shipping income, as defined in almost all of the jurisdictions considered. But this is subject to certain exclusions.

In some instances, jurisdictions have allowed the deduction of interest expenditure directly related to the shipping income, for example finance costs on balances held on account for the defray of daily expenditure utilised for the operation of the vessels. Finance costs incurred for the purpose of acquiring fixed assets or investment expenditure is disallowed.

The United States disallows the interest expense in the ratio that the fair market value of such company's qualifying vessels bears to the fair market value of such company's total assets.

Examples – When investment income may qualify:

- Interest arising from the proceeds of ships held on deposit while replacement ships are sought;

  Answer: This will not satisfy the conditions, and such interest will be assessable outside the tonnage tax ring fence.

- Shipping is an international trade and trading contracts are often denominated in currencies other than the currency of the tonnage tax jurisdiction.

Answer: Exchange gains or losses on such contracts will normally fall to be included in relevant shipping income.

- An exchange gain on a currency futures contract entered into in order to hedge the exchange risks inherent in a contract for the acquisition of a new ship to be used in the tonnage tax trade.

  Answer: This will qualify and will be included in relevant shipping income.

- A gain from a futures' contract transaction is purely speculative in nature.

  Answer: This would fall outside the tonnage tax ring-fence.

11.5 Thick capitalisation rules

A company could arrange for all of its debt to be carried in the non-tonnage tax trade, obtaining a tax deduction for all the costs of debt finance. This arrangement would enable the firm to fund its tonnage tax trade with subsequently issued share capital. It is for this reason that tonnage tax jurisdictions have designed thick capitalisation rules with the view to preventing over-capitalisation of shipping companies, operating within the tonnage tax regime. The basic rule is that if the finance costs charged outside the tonnage tax ring-fence exceed a reasonable proportion of the total costs, then the excess is brought into account outside the ring fence.

In Denmark, a minimum ratio of 2:1 is set between own capital and external capital in tonnage tax companies. Nothing will prevent a shipping company from having own capital, which is greater in proportion to its external capital than the ratio of own capital to external capital for companies which are liable for "normal tax".

This is achieved by deducting the interest adjustment when the net investment income or net investment expenditure is assessed, as these will be divided between the part of the company which is taxed on tonnage tax and the part which is liable for "normal standard corporate tax". The afore-mentioned avoidance provisions may be considered for the South African tonnage tax regime.

Example:

A shipping company is engaged in both tonnage tax activity and other business. The company as a whole satisfies the requirement for the 2:1 ratio between own capital and external capital, and own capital of 100 currency units is contributed.

The company therefore becomes overcapitalized, and an interest adjustment must be calculated. The interest adjustment will only affect that part of the company which is engaged in the business taxed on tonnage, since no requirement for a fixed ceiling for the ratio of own capital to external capital pertain for companies which are liable for standard corporate income tax.

This is achieved by deducting the interest adjustment when the net investment income or net investment expenditure is assessed, since these must be divided between the part of the company which is taxed on tonnage and the part which is liable for standard tax.

The whole of the interest adjustment will be taxed in the company, but deducting the sum on assessment and dividing the net investment income or expenditure ensures that the interest adjustment only includes the part of the company, which is taxed in terms of the tonnage tax scheme.

11.6 Intra-group and inter-company loans

Interest on an intra-group loan will not normally be regarded as relevant shipping income. Interest on such loans will therefore be assessable outside the tonnage tax ring-fence.

If an intra-group loan is made to a tonnage tax company where the interest payable would be allowed as a deduction in computing the relevant shipping profits of the borrower, the normal transfer pricing rules will apply.

11.7 Investment income

Commonly and evidenced in most tonnage tax jurisdictions, making investments and deriving investment income, does not qualify as a tonnage tax activity. Income from investments will not form part of relevant shipping income, and to the extent that an activity gives rise to 'income from investments' it is not regarded as part of a company's tonnage tax activities.

An exception to the rule as discussed in Chapter 7 will be:

- Dividends from overseas shipping companies, if certain conditions are satisfied; and
- Certain interest, which should be treated as trading income under the normal corporation income tax rules.

11.8 Transfer pricing rules

Transfer pricing rules are necessary to prevent connected parties from manipulating the process to achieve maximum income within the tonnage tax ring fence and minimize the taxable profits outside the ring fence.

As described and proposed in Chapter 5, the taxable profits within the tonnage tax ring fence are fixed by reference to the tonnage of the ships operated. Hence, any reduction in the taxable profits outside the ring fence would not be matched by an increase in the taxable profits within the ring fence.

Goods and services provided to a tonnage tax company by an associated non-tonnage tax company are to be provided on an arm's length basis and vice versa. With the inclusion of tonnage tax legislation by way of the proposed Schedule 11 to the Income Tax Act, 1962, the

existing provisions of s31 (arm's length price determination in the transfer pricing rule) of the Income Tax Act will apply.

11.9 Thin capitalisation rules

It has been noted that many shipping groups use intra-group, interest free loans from one resident company to another, as a more flexible alternative to an equity investment. Under the transfer pricing rules, interest is not imputed on loans which cross the ring fence if they are properly regarded as performing an equity function.

11.10 CFC legislation

An important consideration for foreign shipping companies locating themselves in South Africa, will be the stipulations of the current Controlled Foreign Companies (hereinafter CFC) legislation. Most jurisdiction have CFC legislation, the effect of which is to tax the parent company in the home country on certain undistributed income of overseas affiliates that are under its control. In most jurisdictions the "control test" means more than a 50% of beneficial ownership interest.

Current CFC provisions are found in s9D of the Income Tax Act. These provisions largely represent the same principles as those established in the European jurisdictions studied for purposes of the tonnage tax design. The consequence of a foreign-related company being treated as a CFC, is that certain undistributed income of the CFC is treated as having been notionally distributed to the holding company by way of a dividend. This distribution is then taxed in the hands of the holding company in the home country.

The types of income that are within the CFC provisions, are as follows:

- Passive income;
- Income of a sales-and-distribution company[20] that sells goods to affiliated/related companies; and
- Income of a service company that performs services for affiliated/related companies.

There are however important exemptions contained in s9D(9), which will have a bearing on a foreign group that might consider South Africa as a location for part of its global shipping operations.

Typically, profits derived by an overseas affiliate from activities performed for third parties will not fall within the CFC provisions. In addition, profits derived by an overseas affiliate from activities carried out for related companies can fall outside the scope of the CFC rules, if certain conditions are met. These conditions are found in s9D(9) with reference to the business establishment test.

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[20] Term used in an international context to refer to a centralised unit (in a regional or geographic context) for selling or distributing products by a multinational group. Besides the sales and distribution function, this business unit may offer other related or subsidiary services such as managing warranties and promotional activities. Many jurisdictions incentivise the relocation of such centres to their shores through tax relief or tax expenditures, pertaining to such business activities.

Hence, one of the first issues to consider will be the level of substance required to satisfy the ‘business establishment test’ in either South Africa or the foreign territory. In this regard, the tests that are applied under the South African tonnage tax regime in determining whether strategic and commercial management are located in South Africa, are particularly relevant. It is likely that if SARS were satisfied that the strategic and commercial management of a company was in South Africa, then it should pass the business establishment test in South Africa and in those countries which have implemented similar CFC provisions. Secondly, multinational groups, subject to domestic CFC rules with subsidiaries in South Africa could take additional steps to avoid CFC notional distributions by ensuring that the relevant income, from related party transactions, are kept below 50% of their total income streams.

Cross Country Analysis:

Neither Greece nor The Netherlands have CFC legislation, as these are deemed to be too complex and compliance-intrusive. Denmark applies CFC rules similar to those of South Africa. Germany has stringent CFC rules which make if difficult for German shipping groups to establish overseas operations without a charge to German tax on overseas profits. Norway have CFC provisions which do not apply to a subsidiary located in a country with which Norway has entered into a Double Tax Treaty Agreement, provided the subsidiary is not regarded as a passive company. The United Kingdom applies CFC legislation. However, CFC rules do not apply if the overseas subsidiary satisfies the ‘exempt activities test’, typically similar or same as that of the exemptions found in s9D of the Income Tax Act of 1962.

It is proposed that no change is made to current treatment of deemed distributions to South African holding companies under the provisions of s9D. In the event the SA parent company is unable to satisfy the exemptions under the present provisions, the notional distribution should fall within the normal charge to tax.

Under the present South African CFC rules, foreign companies from the afore-mentioned jurisdictions would not be prejudiced.

Chapter 12

Tonnage Tax and More Special Incentives

12.1 Incentivising the attainment of a modern and safe fleet

One of the widely recognised factors contributing towards ships sinking or leaking dangerous toxins into the sea, thereby causing serious environmental risk, is that some ships are being used in excess of their useful age. Experience suggests that incentives for ship owners using new ships can be incorporated in tonnage tax regimes. For example, India requires from companies under their tonnage tax regime to reserve 20 per cent of their book profits in order to acquire new ships within eight years. Belgium offers a 50 per cent tax deduction for vessels younger than five (5) years, and 25 per cent for vessels between five (5) and ten (10) years. Greece also uses an age-related scale under her regime, whereby younger ships pay less tonnage tax than older ships.

With regards to the large number of ships on order up to 2008 to be built in shipyards around the world, the inclusion of an additional incentive in the tonnage tax regime for young ships could be a major motivating factor for owners of those companies to register their new vessels in South Africa. Due to the 5-year lock-in rule discussed above, the number of potential ships, which can be attracted to South Africa, is limited to new ships being built and ships moving from flags of convenience to other regimes. Based on current evidence, it therefore appears that a “new ship” provision would increase South Africa’s chances of attracting newer vessels.

12.2 Promoting sound environmental, health and safety standards

A tonnage tax regime can also be used as an indirect means to monitor compliance with a number of international and community standards relating to security, safety, environmental performance and on-board working conditions. South Africa has a large coastline and maritime zone which the South African Maritime Safety Authority (SAMSA) have the responsibility of monitoring. It is suggested that a tonnage tax regime would help SAMSA regulate this important area, through ensuring that ship owners and companies within the regimes report regularly on their compliance with safety standards. Failure to adhere to these requirements would result in the withdrawal of tonnage tax benefits, as the UK has successfully stipulated within her respective tonnage tax legislation.

However, inclusion of non-fiscal regulatory matters will make tax administration more cumbersome. It therefore remains for SARS to decide whether there is the capacity and the willingness within the revenue authority to absorb additional non-tax related functions, which in principle should be the responsibilities of the Departments of Transport and Environmental Affairs and Tourism, as well as SAMSA.

Chapter 13

Non-Tax Issues impacting on Successful Implementation of Tonnage Tax Regime

There are a number of peripheral regulatory issues that may have a significant influence on the overall attractiveness of the proposed South African Tonnage Tax regime. These regulatory matters all tend to increase the cost of maintaining and managing international shipping activities, operated from South Africa. Amongst the more prominent regulatory interventions are direct charges or fees and levies in support of maritime safety, security, environmental legislative requirements (which will be based on a user cost principle) and non-tax matters such as health and crewing requirements, mortgage ranking claims etc.

In this connection, it is important to point out that the design of the tonnage tax regime is but one of eight major government policy interventions across departments (National Treasury, Departments of Transport, Labour, Justice, Home Affairs and perhaps even Trade and Industry) to support the growth of the domestic maritime industry.

13.1 The Ship Registration Act, No. 58 of 1998

The South African Maritime Safety Authority (SAMSA), administers the South African Ships Register. It is required, in terms of official transport policy instructions, to ensure that the costs of administration are competitive by international standards. Similarly, the agency is tasked to ensure that the quality of administration remains at an internationally competitive and high standard. In both respects, SAMSA is to undertake benchmarking exercises from time to time to ensure that this goal will be attained. It is National Treasury's understanding that this ongoing benchmarking exercise is at an fairly advanced stage. The National Department of Transport has also advised that there are proposed amendments to the Ship Registration Act, which will soon be promulgated into legislation.

13.2 Exchange control regulations

It will require further interaction with the prospective shipping owners whether the fairly liberalised exchange control environment still impose any impediments to transferring some of the international shipping business activities back to South Africa.

13.3 Ranking of claims on judicial sale

It has long been claimed that a South African ship owner would not easily be able to obtain finance on the strength of a ship mortgage if the ranking of the mortgagee was as low as is currently the case in South Africa. Consequently, the Department of Justice, National Department of Transport and SAMSA have drafted amendments to section 11 of the Admiralty Jurisdiction Regulation Act, No. 105 of 1983 to, *inter alia*, provide the mortgagee with as high a ranking as is recognised internationally. Again, it is National Treasury's

understanding that the required amendments have been with the Department of Justice since 2005 and that the Department of Justice is coordinating the matter in close cooperation with the National Department of Transport.

13.4 Crewing and other labour regulation issues

Firstly, the Department of Labour indicated that it is re-examining Chapter V of the Merchant Shipping Act, No. 57 of 1951 to bring relevant provisions in line with international crewing standards. It does not, however, intend to go further than implementing international norms for purposes of protecting the rights of seamen. Indeed, the Department of Labour seems sensitive to not being out of step with international standards and seems prepared to consider reasonable proposals from ship operators with the view to making South Africa more attractive. In this respect it has been involved in discussions with stakeholders to consider entertaining lower wage rates than ITF rates for that purpose but had not taken that initiative further only because it felt that such negotiations should be conducted at an industry rather than an individual company level.

Secondly, a matter raised as an issue under crewing, is that of HIV/AIDS testing. It is understood that section 7(2) of the Employment Equity Act provides sufficient room for relief for industry and the National Department of Transport for such testing. For example, it provides—

> *"(2) Testing of an employee to determine that employee's HIV status is prohibited unless such testing is determined justifiable by the Labour Court in terms of section 50 (4) of this Act."*

Section 50(4) provides—

> *"If the Labour Court declares that the medical testing of an employee as contemplated in section 7 is justifiable, the court may make any order that it considers appropriate in the circumstances, including imposing conditions relating to-*
>
> *(a) the provision of counselling;*
> *(b) the maintenance of confidentiality;*
> *(c) the period during which the authorisation for any testing applies; and*
> *(d) the category or categories of jobs or employees in respect of which the authorisation for testing applies."*

However, the National Department of Transport, SAMSA and the Department of Labour would prefer a situation whereby the exemption to allow medical screening of crews before their placement on vessels is obtained, not through court action but consensus arising from engagement with labour.

It is important to note that the South African Government is considering an accession to an International Convention dealing with seafarers which, if acceded to, would address the issue of crews pre-placement on vessels. The National Department of Transport is presently reviewing practices of ship owners in this respect.

The third issue concerning crewing is the ease with which work permits can be obtained for foreign crews to work on South African managed vessels. Reportedly, some domestic marine operators had difficulties in obtaining work permits reasonably quickly and the

Department of Transport and SAMSA are engaged with the Department of Home Affairs in resolving such regulatory bottlenecks.

13.5 Technical maritime legislation

On the question whether the South African technical maritime legislation is in accordance with international standards, SAMSA has advised that it has commenced updating of local technical legislation to keep abreast of amendments to International Maritime Conventions.

13.6 National maritime policy development

Feedback received from foreign ship owners indicated that they would feel more comfortable if South Africa were to a have an officially gazetted national maritime policy, in line with internationally recognized principles. The National Department of Transport has developed a draft policy in this regard but it is still under consideration.

13.7 Training requirements

South Africa presents itself as an exciting source of seafarers. It has a very good marine educational system that produces competent seafarers. The cadets produced by these institutions are of a high standard and are put through stringent tests. One of the objectives of the tonnage tax regime is to increase and promote training opportunities and ultimately employment for local seafarers, and to maintain a supply of skills and experience vital for the maritime industry. The introduction of the tonnage tax in South Africa will provide a good opportunity for the industry to avail itself of the opportunity to employ young motivated officers and ratings (including ordinary and able seamen, wipers and oilers).

13.8 Tonnage tax minimum training obligation

In some jurisdictions it is a condition of entering into the tonnage tax regime or when making a renewal tonnage tax election that the company meets minimum training obligations in respect to seafaring ratings and officers. The training requirement is an important feature as it is key element in reducing the unemployment problem in South Africa by increasing the pool of South African trained and placed seafarers. It is therefore proposed that all tonnage tax companies must commit themselves to minimum training obligations.

It must be recognized that currently a key impediment to qualified cadet training is the availability of training berths (allotted accommodation in a ship). Therefore, the tonnage tax minimum training obligation must compel shipping companies to make available berths on board of their vessels to provide training for ratings and seafarers.

UK requirement

In a number of jurisdictions, including the UK, tonnage tax legislation requires that a company should train one officer trainee for each fifteen (15) officer posts in existence on the vessels that it operates.

Proposal for South Africa

Consideration should be given to discuss with industry a proposal whereby the shipping industry will be obliged to meet the following training targets:

- A company should train and provide berthing for at least 10 per cent of the number of ratings on board of the ship/vessel (or a minimum of 1); and
- At least 10 per cent of the number of officers on boards the ship/vessel (or a minimum 1).

13.9 Provision for cash payment in lieu of training obligation

Alternatively, consideration could be given to include in legislation a provision whereby companies would be required to make a cash contribution under exceptional circumstances where a tonnage tax applicant is unable to meet the training commitment. In this regard it is proposed that the cash contribution must be equivalent to the cost of remuneration plus providing berth on the ship for the trainee for a year. An option to contract-out seafarer training could first be considered.

Given the critical shortage of maritime skills resulting from the lack of training berths on vessels for the trainees to acquire their experiential training, the obligation should be compulsory for all companies.

13.10 Funding for minimum training obligation via SAMSA

It is recommended that together with on-board training obligations, companies will contribute funds into a maritime training fund. The fund shall be administered by SAMSA.

These minimum training obligations should be administered by SAMSA in accordance with a contract with the ship operator that elected into the tonnage tax regime. SAMSA should fulfill an executive role in ensuring that the training scheme is efficiently operated in accordance with the contract. In addition, SAMSA should be responsible for disbursing training support funds to accredited training providers in accordance with the existing legislation and regulations governing training providers. Accredited Training Providers (ATPs) should be responsible for ensuring that priority is given to sea training undertaken on those ships that are included under the tonnage tax regime in South Africa.

Each trainee is required to be:

(i) Sponsored by an accredited training provider;

(ii) A South African national; and

(iii) An ordinary resident of South Africa – foreigners who are subject to employment restrictions and/or a time limit on their stay are not eligible for grants.

Training support funds should however be disbursed to ATPs who must be able to provide and monitor the training opportunities necessary for trainees to meet the requirement of the

approved training programmes, leading to the relevant South African qualification or certificate of competency.

In order to meet their minimum training requirements, it is proposed that the shipping companies should provide a core training commitment setting out their specific training obligation and how it is to be met. This then needs to be submitted periodically to SAMSA. The core training commitment should run for a calendar year, from January to December and it should be tabled at or before election into the tonnage tax regime. Thereafter it should be reviewed on an annual basis and is subject to SAMSA's approval. SAMSA will calculate the training commitment and certify to SARS that a shipping company, electing into the tonnage tax regime, meets the minimum training obligation.

The core training commitment should relate to all vessels expected to be entered in the tonnage tax regime (owned / leased / chartered-in) at the date the training commitment is to come into force. It represents the minimum level of training to be provided during the year.

13.11 Penalty for non-compliance with the training requirement

Furthermore, it is suggested that in case the minimum training requirement is not complied with for a period not longer than two years, the option of the company to remain within the tonnage tax scheme shall cease to have effect. Legislation should provide for an end of the period adjustment in the event that a company significantly changes the number of vessels entered in the tonnage tax regime during the course of a year (e.g., as a result of an acquisition or of a permanent withdrawal from a market sector). It is also proposed that it may apply jointly to the Commissioner of SARS, the Department of Transport and SAMSA to agree on a revised core training commitment for the balance of the year.

Appendixes

Indian tonnage tax legislation:

'CHAPTER XII-G

SPECIAL PROVISIONS RELATING TO INCOME OF SHIPPING COMPANIES

A.—Meaning of certain expressions

115V. *Definitions.*—In this Chapter, unless the context otherwise requires,—

(*a*) "bareboat charter" means hiring of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;

(*b*) "bareboat charter-*cum*-demise" means a bareboat charter where the ownership of the ship is intended to be transferred after a specified period to the company to whom it has been chartered;

(*c*) "Director-General of Shipping" means the Director-General of Shipping appointed by the Central Government under sub-section (1) of section 7 of the Merchant Shipping Act, 1958 (44 of 1958);

(*d*) "factory ship" includes a vessel providing processing services in respect of processing of the fishing produce;

(*e*) "fishing vessel" shall have the meaning assigned to it in clause (*12*) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);

(*f*) "pleasure craft" means a ship of a kind whose primary use is for the purposes of sport or recreation;

(*g*) "qualifying company" means a company referred to in section 115VC;

(*h*) "qualifying ship" means a ship referred to in section 115VD;

(*i*) "seagoing ship" means a ship if it is certified as such by the competent authority of any country;

(*j*) "tonnage income" means the income of a tonnage tax company computed in accordance with the provisions of this Chapter;

(*k*) "tonnage tax activities" means the activities referred to in sub-section (1) of section 115V-I;

(*l*) "tonnage tax company" means a qualifying company in relation to which tonnage tax option is in force;

(*m*) "tonnage tax scheme" means a scheme for computation of profits and gains of business of operating qualifying ships under the provisions of this Chapter.

B.—Computation of tonnage income from business of operating qualifying ships

115VA. *Computation of profits and gains from the business of operating qualifying ships.*—Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of a company, the income from the business of operating qualifying ships, may, at its option, be computed in accordance with the provisions of this Chapter and such income shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

115VB. *Operating ships.*—For the purposes of this Chapter, a company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it and includes a case where even a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter :

Provided that a company shall not be regarded as the operator of a ship which has been chartered out by it on bareboat charter-*cum*-demise terms or on bareboat charter terms for a period exceeding three years.

115VC. *Qualifying company.*—For the purposes of this Chapter, a company is a qualifying company if—

(*a*) it is an Indian company;

(*b*) the place of effective management of the company is in India;

(*c*) it owns at least one qualifying ship; and

(*d*) the main object of the company is to carry on the business of operating ships.

Explanation.—For the purposes of this section, "place of effective management of the company" means—

(*A*) the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or

(*B*) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

115VD. *Qualifying ship.*— For the purposes of this Chapter, a ship is a qualifying ship if—

(*a*) it is a sea going ship or vessel of fifteen net tonnage or more;

(*b*) it is a ship registered under the Merchant Shipping Act, 1958, (44 of 1958) or a ship registered outside India in respect of which a licence has been issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958; (44 of 1958) and

(*c*) a valid certificate in respect of such ship indicating its net tonnage is in force,

but does not include—

(*i*) a seagoing ship or vessel if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land;

(*ii*) fishing vessels;

(*iii*) factory ships;

(*iv*) pleasure crafts;

(*v*) harbour and river ferries;

(*vi*) offshore installations;

(*vii*) dredgers;

(viii) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

115VE. *Manner of computation of income under tonnage tax scheme.*—(1) A tonnage tax company engaged in the business of operating qualifying ships shall compute the profits from such business under the tonnage tax scheme.

(2) The business of operating qualifying ships giving rise to income referred to in sub-section (1) of section 115V-I shall be considered as a separate business (hereafter in this Chapter referred to as the tonnage tax business) distinct from all other activities or business carried on by the company.

(3) The profits referred to in sub-section (1) shall be computed separately from the profits and gains from any other business.

(4) The tonnage tax scheme shall apply only if an option to that effect is made in accordance with the provisions of section 115VP.

(5) Where a company engaged in the business of operating qualifying ships is not covered under the tonnage tax scheme or, has not made an option to that effect, as the case may be, the profits and gains of such company from such business shall be computed in accordance with the other provisions of this Act.

115VF. *Tonnage income.*—Subject to the other provisions of this Chapter, the tonnage income shall be computed in accordance with section 115VG and the income so computed shall be deemed to be the profits chargeable under the head "Profits and gains of business or profession" and the relevant shipping income referred to in sub-section (1) of section 115V-I shall not be chargeable to tax.

115VG. *Computation of tonnage income.*—(1) The tonnage income of a tonnage tax company for a previous year shall be the aggregate of the tonnage income of each qualifying ship computed in accordance with the provisions of sub-sections (2) and (3).

(2) For the purposes of sub-section (1), the tonnage income of each qualifying ship shall be the daily tonnage income of each such ship multiplied by—

(*a*) the number of days in the previous year; or

(*b*) the number of days in part of the previous year in case the ship is operated by the company as a qualifying ship for only part of the previous year,

as the case may be.

(3) For the purposes of sub-section (2), the daily tonnage income of a qualifying ship having tonnage referred to in column (1) of the Table below shall be the amount specified in the corresponding entry in column (2) of the Table:

TABLE

Qualifying ship having net tonnage	*Amount of daily tonnage income*
(1)	*(2)*
Up to 1,000	Rs. 46 for each 100 tons
exceeding 1,000 but not more than 10,000	Rs. 460 *plus* Rs. 35 for each 100 tons exceeding 1,000 tons
exceeding 10,000 but not more than 25,000	Rs. 3,610 *plus* Rs. 28 for each 100 tons exceeding 10,000 tons
exceeding 25,000	Rs. 7,810 *plus* Rs. 19 for each 100 tons exceeding 25,000 tons.

(4) For the purposes of this Chapter, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner.

Explanation.—For the purposes of this sub-section, "deemed tonnage" shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

(5) The tonnage shall be rounded off to the nearest multiple of hundred tons and for this purpose any tonnage consisting of kilograms shall be ignored and thereafter if such tonnage is not a multiple of hundred, then, if the last figure in that amount is fifty tons or more, the tonnage shall be increased to the next higher tonnage which is a multiple of hundred and if the last figure is less than fifty tons, the tonnage shall be reduced to the next lower tonnage which is a multiple of hundred; and the tonnage so rounded off shall be the tonnage of the ship for the purposes of this section.

(6) Notwithstanding anything contained in any other provision of this Act, no deduction or set off shall be allowed in computing the tonnage income under this Chapter.

115VH. *Calculation in case of joint operation, etc.*—(1) Where a qualifying ship is operated by two or more companies by way of joint interest in the ship or by way of an agreement for the use of the ship and their

respective shares are definite and ascertainable, the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of that interest.

(2) Subject to the provisions of sub-section (1), where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator.

115V-I. *Relevant shipping income.*—(1) For the purposes of this Chapter, the relevant shipping income of a tonnage tax company means—

(*i*) its profits from core activities referred to in sub-section (2);

(*ii*) its profits from incidental activities referred to in sub-section (5):

Provided that where the aggregate of all such incomes specified in clause (*ii*) exceeds one-fourth per cent of the turnover from core activities referred to in sub-section (2), such excess shall not form part of the relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.

(2) The core activities of a tonnage tax company shall be—

(*i*) its activities from operating qualifying ships; and

(*ii*) other ship-related activities mentioned as under:—

(*A*) shipping contracts in respect of—

(*i*) earning from pooling arrangements;

(*ii*) contracts of affreightment.

Explanation.—For the purposes of this sub-clause,—

(*a*) "pooling arrangement" means an agreement between two or more persons for providing services through a pool or operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms;

(*b*) "contract of affreightment" means a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period;

(*B*) specific shipping trades, being,—

(*i*) on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;

(*ii*) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

(3) The Central Government, if it considers necessary or expedient so to do, may, by notification in the Official Gazette, exclude any activity referred to in clause (*ii*) of sub-section (2) or prescribe the limit up to which such activities shall be included in the core activities for the purposes of this section.

(4) Every notification issued under this Chapter shall be laid, as soon as may be after it is issued, before each House of Parliament, while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification, or both Houses agree that the notification should not be issued, the notification shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification.

(5) The incidental activities shall be the activities which are incidental to the core activities and which may be prescribed for the purpose.

(6) Where a tonnage tax company operates any ship, which is not a qualifying ship, the income attributable to operating such non-qualifying ship shall be computed in accordance with the other provisions of this Act.

(7) Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer, then, the relevant shipping income under this section shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date:

Provided that where, in the opinion of the Assessing Officer, the computa-tion of the relevant shipping income in the manner hereinbefore specified presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.

Explanation.—For the purposes of this sub-section, "market value", in relation to any goods or services, means the price that such goods or services would ordinarily fetch on sale in the open market.

(8) Where it appears to the Assessing Officer that, owing to the close connection between the tonnage tax company and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the tonnage tax company more than the ordinary profits which might be expected to arise in the tonnage tax business, the Assessing Officer shall, in computing the relevant shipping income of the tonnage tax company for the purposes of this Chapter, take the amount of income as may be reasonably deemed to have been derived therefrom.

Explanation.—For the purposes of this Chapter, in case the relevant shipping income of a tonnage tax company is a loss, then, such loss shall be ignored for the purposes of computing tonnage income.

115VJ. *Treatment of common costs.*—(1) Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, common costs attributable to the tonnage tax business shall be determined on a reasonable basis.

(2) Where any asset, other than a qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset shall be allocated between its tonnage tax business and other business on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

115VK. *Depreciation.*—(1) For the purposes of computing depreciation under clause (*iv*) of section 115VL, the depreciation for the first previous year of the tonnage tax scheme (hereafter in this section referred to as the first previous year) shall be computed on the written down value of the qualifying ships as specified under sub-section (2).

(2) The written down value of the block of assets, being ships, as on the first day of the first previous year, shall be divided in the ratio of the book written down value of the qualifying ships (hereafter in this section referred to as the qualifying assets) and the book written down value of the non-qualifying ships (hereafter in this section referred to as the other assets).

(3) The block of qualifying assets as determined under sub-section (2) shall constitute a separate block of assets for the purposes of this Chapter.

(4) For the purposes of sub-section (2), the book written down value of the block of qualifying assets and the block of other assets shall be computed in the following manner, namely:—

(*a*) the book written down value of each qualifying asset and each other asset as on the first day of the previous year and which form part of the block of assets to be divided shall be determined by taking the book written down value of each asset appearing in the books of account as on the last day of the preceding previous year:

Provided that any change in the value of the assets consequent to their revaluation after the date on which the Finance (No. 2) Bill, 2004 receives the assent of the President shall be ignored;

(*b*) the book written down value of all the qualifying assets and other assets shall be aggregated; and

(*c*) the ratio of the aggregate book written down value of the qualifying assets to the aggregate book written down value of the other assets shall be determined.

(5) Where an asset forming part of a block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down value allocable to such asset shall be reduced from the written down value of that block and shall be added to the block of other assets.

Explanation.—For the purposes of this sub-section, appropriate portion of the written down value allocable to the asset, which begins to be used for purposes other than the tonnage tax business, shall be an amount which bears the same proportion to the written down value of the block of qualifying assets as on the first day of the previous year as the book written down value of the asset beginning to be used for purposes other than tonnage tax business bears to the book written down value of all the assets forming the block of qualifying asset.

(6) Where an asset forming part of a block of other assets begins to be used for tonnage tax business, an appropriate portion of the written down value allocable to such asset shall be reduced from the written down value of the block of other assets and shall be added to the block of qualifying asset.

Explanation.—For the purposes of this sub-section, appropriate portion of written down value allocable to the asset which begins to be used for the tonnage tax business shall be an amount which bears the same proportion to the written down value of the block of other assets as on the first day of the previous year as the book written down value of the asset beginning to be used for tonnage tax business bears to the total book written down value of all the assets forming the block of other assets.

(7) For the purposes of computing depreciation under clause (*iv*) of section 115VL in respect of an asset mentioned in sub-sections (5) and (6), depreciation computed for the previous year shall be allocated in the ratio of the number of days for which the asset was used for the tonnage tax business and for purposes other than tonnage tax business.

Explanation 1.—For the removal of doubts, it is hereby declared that for the purposes of this Act, depreciation on the block of qualifying assets and block of other assets so created shall be allowed as if such written down value referred to in sub-section (2) had been brought forward from the preceding previous year.

Explanation 2.—For the purposes of this section, "book written down value" means the written down value as appearing in the books of account.

115VL. *General exclusion of deduction and set off, etc.*—(1) Notwithstanding anything contained in any other provision of this Act, in computing the tonnage income of a tonnage tax company for any previous year (hereafter in this section referred to as the "relevant previous year") in which it is chargeable to tax in accordance with this Chapter—

(*i*) sections 30 to 43B shall apply as if every loss, allowance or deduction referred to therein and relating to or allowable for any of the relevant previous years, had been given full effect to for that previous year itself;

(*ii*) no loss referred to in sub-sections (1) and (3) of section 70 or sub-sections (1) and (2) of section 71 or sub-section (1) of section 72 or sub-section (1) of section 72A, insofar as such loss relates to the business of operating qualifying ships of the company, shall be carried forward or set off where such loss relates to any of the previous years when the company is under the tonnage tax scheme;

(*iii*) no deduction shall be allowed under Chapter VI-A in relation to the profits and gains from the business of operating qualifying ships; and

(*iv*) in computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business shall be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous years.

115VM. *Exclusion of loss.*—(1) Section 72 shall apply in respect of any losses that have accrued to a company before its option for tonnage tax scheme and which are attributable to its tonnage tax business, as if such losses had been set off against the relevant shipping income in any of the previous years when the company is under the tonnage tax scheme.

(2) The losses referred to in sub-section (1) shall not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the company exercises its option under section 115VP.

(3) Any apportionment necessary to determine the losses referred to in sub-section (1) shall be made on a reasonable basis.

115VN. *Chargeable gains from transfer of tonnage tax assets.*—Any profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets shall be chargeable to income-tax in accordance with the provisions of section 45, read with section 50, and the capital gains so arising shall be computed in accordance with the provisions of sections 45 to 51:

Provided that for the purpose of computing such profits or gains, the provisions of section 50 shall have effect as if for the words "written down value of the block of assets", the words "written down value of the block of qualifying assets" had been substituted.

Explanation.—For the purposes of this Chapter, "written down value of the block of qualifying assets" means the written down value computed in accordance with the provisions of sub-section (2) of section 115VK.

115V-O. *Exclusion from section 115JB.*—The book profit or loss derived from the activities of a tonnage tax company, referred to in sub-section (1) of section 115V-I, shall be excluded from the book profit of the company for the purposes of section 115JB.

C.—Procedure for option of tonnage tax scheme

115VP. *Method and time of opting for tonnage tax scheme.*—(1) A qualifying company may opt for the tonnage tax scheme by making an application to the Joint Commissioner having jurisdiction over the company in the form and manner as may be prescribed, for such scheme.

(2) The application under sub-section (1) may be made by any existing qualifying company at any time after the 30th day of September, 2004 but before the 1st day of January, 2005 (hereafter referred to as the "initial period"):

Provided that—

(*i*) a company incorporated after the initial period; or

(*ii*) a qualifying company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period,

may make an application within three months of the date of its incorporation or the date on which it became a qualifying company, as the case may be.

(3) On receipt of an application for option for tonnage tax scheme under sub-section (1), the Joint Commissioner may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company and after satisfying himself about such eligibility of the company to make such option for tonnage tax scheme, he—

(*i*) shall pass an order in writing approving the option for tonnage tax scheme; or

(*ii*) shall, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme,

and a copy of such order shall be sent to the applicant:

Provided that no order under clause (*ii*) shall be passed unless the applicant has been given a reasonable opportunity of being heard.

(4) Every order granting or refusing the approval of the option for tonnage tax scheme under clause (*i*) or clause (*ii*), as the case may be, of sub-section (3) shall be passed before the expiry of one month, from the end of the month in which the application was received under sub-section (1).

(5) Where an order granting approval is passed under sub-section (3), the provisions of this Chapter shall apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

115VQ. *Period for which tonnage tax option to remain in force.*—(1) An option for tonnage tax scheme, after it has been approved under sub-section (3) of section 115VP, shall remain in force for a period of ten years from the date on which such option has been exercised and shall be taken into account from the assessment year relevant to the previous year in which such option is exercised.

(2) An option for tonnage tax scheme shall cease to have effect from the assessment year relevant to the previous year in which—

(*a*) the qualifying company ceases to be a qualifying company;

(*b*) a default is made in complying with the provisions contained in section 115VT or section 115VU or section 115VV;

(*c*) the tonnage tax company is excluded from the tonnage tax scheme under section 115VZC;

(*d*) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it, and the profits and gains of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of this Act.

115VR. *Renewal of tonnage tax scheme.*—(1) An option for tonnage tax scheme approved under sub-section (3) of section 115VP may be renewed within one year from the end of the previous year in which the option ceases to have effect.

(2) The provisions of sections 115VP and 115VQ shall apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

115VS. *Prohibition to opt for tonnage tax scheme in certain cases.*—A qualifying company, which, on its own, opts out of the tonnage tax scheme or makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or whose option has been excluded from tonnage tax scheme in pursuance of an order made under sub-section (1) of section 115VZC, shall not be eligible to opt for tonnage tax scheme for a period of ten years from the date of opting out or default or order, as the case may be.

D.—Conditions for applicability of tonnage tax scheme

115VT. *Transfer of profits to Tonnage Tax Reserve Account.*—(1) A tonnage tax company shall, subject to and in accordance with the provisions of this section, be required to credit to a reserve account (hereafter in this section referred to as the Tonnage Tax Reserve Account) an amount not less than twenty per cent of the book profit derived from the activities referred to in clauses (*i*) and (*ii*) of sub-section (1) of section 115V-I in each previous year to be utilised in the manner laid down in sub-section (3):

Provided that a tonnage tax company may transfer a sum in excess of twenty per cent of the book profit and such excess sum transferred shall also be utilised in the manner laid down in sub-section (3).

Explanation.—For the purposes of this section, "book profit" shall have the same meaning as in the *Explanation* to sub-section (2) of section 115JB so far as it relates to the income derived from the activities referred to in clauses (*i*) and (*ii*) of sub-section (1) of section 115V-I.

(2) Where the company has book profit from the business of operating qualifying ships and book loss from any other sources, and consequently, the company is not in a position to create the full or any part of the reserves under sub-section (1), the company shall create the reserves to the extent possible in that previous year and the shortfall, if any, shall be added to the amount of the reserves required to be created for the following previous year and such shortfall shall be deemed to be part of the reserve requirement of that following previous year :

Provided that to the extent the shortfall in creation of reserves during a particular previous year is carried forward to the following previous year under this sub-section, the company shall be considered as having created sufficient reserves for the first mentioned previous year:

Provided further that nothing contained in the first proviso shall apply in respect of the second year in case the shortfall in creation of reserves continues for two consecutive previous years.

(3) The amount credited to the Tonnage Tax Reserve Account under sub-section (1) shall be utilised by the company before the expiry of a period of eight years next following the previous year in which the amount was credited—

(*a*) for acquiring a new ship for the purposes of the business of the company; and

(*b*) until the acquisition of a new ship, for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

(4) Where any amount credited to the Tonnage Tax Reserve Account under sub-section (1),—

(*a*) has been utilised for any purpose other than that referred to in clause (*a*) or clause (*b*) of sub-section (3); or

(*b*) has not been utilised for the purpose specified in clause (*a*) of sub-section (3); or

(*c*) has been utilised for the purpose of acquiring a new ship as specified in clause (*a*) of sub-section (3), but such ship is sold or otherwise transferred, other than in any scheme of demerger by the company to any person at any time before the expiry of three years from the end of the previous year in which it was acquired,

an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilised or not utilised bears to the total reserve created during that year under sub-section (1) shall be taxable under the other provisions of this Act—

(*i*) in a case referred to in clause (*a*), in the year in which the amount was so utilised; or

(*ii*) in a case referred to in clause (*b*), in the year immediately following the period of eight years specified in sub-section (3); or

(*iii*) in a case referred to in clause (*c*), in the year in which the sale or transfer took place:

Provided that the income so taxable under the other provisions of this Act shall be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

(5) Notwithstanding anything contained in any other provision of this Chapter, where the amount credited to the Tonnage Tax Reserve Account in accordance with sub-section (1) is less than the minimum amount required to be credited under sub-section (1), an amount which bears the same proportion to the total relevant shipping income, as the shortfall in credit to the reserves bears to the minimum reserve required to

be credited under sub-section (1) shall not be taxable under the tonnage tax scheme and shall be taxable under the other provisions of this Act.

(6) If the reserve required to be created under sub-section (1) is not created for any two consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve under sub-section (1) had occurred.

Explanation.—For the purposes of this section, "new ship" includes a qualifying ship which, before the date of acquisition by the qualifying company was used by any other person, if it was not at any time previous to the date of such acquisition owned by any person resident in India.

115VU. *Minimum training requirement for tonnage tax company.*—(1) A tonnage tax company, after its option has been approved under sub-section (3) of section 115VP, shall comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government.

(2) The tonnage tax company shall be required to furnish a copy of the certificate issued by the Director-General of Shipping along with the return of income under section 139 to the effect that such company has complied with the minimum training requirement in accordance with the guidelines referred to in sub-section (1) for the previous year.

(3) If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the fifth consecutive previous year in which the failure to comply with the minimum training requirement under sub-section (1) had occurred.

115VV. *Limit for charter in of tonnage.*—(1) In the case of every company which has opted for tonnage tax scheme, not more than forty-nine per cent of the net tonnage of the qualifying ships operated by it during any previous year shall be chartered in.

(2) The proportion of net tonnage referred to in sub-section (1) in respect of a previous year shall be calculated based on the average of net tonnage during that previous year.

(3) For the purposes of sub-section (2), the average of net tonnage shall be computed in such manner as may be prescribed in consultation with the Director-General of Shipping.

(4) Where the net tonnage of ships chartered in exceeds the limit under sub-section (1) during any previous year, the total income of such company in relation to that previous year shall be computed as if the option for tonnage tax scheme does not have effect for that previous year.

(5) Where the limit under sub-section (1) is exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

Explanation.—For the purposes of this section, the term "chartered in" shall exclude a ship chartered in by the company on bareboat charter-*cum*-demise terms.

115VW. *Maintenance and audit of accounts.*—An option for tonnage tax scheme by a tonnage tax company shall not have effect in relation to a previous year unless such company—

(*i*) maintains separate books of account in respect of the business of operating qualifying ships; and

(*ii*) furnishes, along with the return of income for that previous year, the report of an accountant, in the prescribed form duly signed and verified by such accountant.

Explanation.—For the purposes of this section, "accountant" shall have the same meaning as in the *Explanation* below sub-section (2) of section 288.

115VX. *Determination of tonnage.*—(1) For the purposes of this Chapter,—

(*a*) the tonnage of a ship shall be determined in accordance with the valid certificate indicating its tonnage;

(*b*) "valid certificate" means,—

(*i*) in case of ships registered in India—

(*a*) having a length of less than twenty-four metres, a certificate issued under the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958 (44 of 1958);

(*b*) having a length of twenty-four metres or more, an international tonnage certificate issued under the provisions of the Convention on Tonnage Measurement of Ships, 1969 as specified in the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958 (44 of 1958);

(*ii*) in case of ships registered outside India, a licence issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 (44 of 1958) specifying the net tonnage on the basis of Tonnage Certificate issued by the Flag State Administration where the ship is registered or any other evidence acceptable to the Director-General of Shipping produced by the ship owner while seeking permission for chartering in the ship.

E.—Amalgamation and demerger of shipping companies

115VY. *Amalgamation.*—Where there has been an amalgamation of a company with another company or companies, then, subject to the other provisions of this section, the provisions relating to the tonnage tax scheme shall, as far as may be, apply to the amalgamated company if it is a qualifying company:

Provided that where the amalgamated company is not a tonnage tax company, it shall exercise an option for tonnage tax scheme under sub-section (1) of section 115VP within three months from the date of the approval of the scheme of amalgamation:

Provided further that where the amalgamating companies are tonnage tax companies, the provisions of this Chapter shall, as far as may be, apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force:

Provided also that where one of the amalgamating companies is a qualifying company as on the 1st day of October, 2004 and which has not exercised the option for tonnage tax scheme within the initial period, the provisions of this Chapter shall not apply to the amalgamated company and the income of the amalgamated company from the business of operating qualifying ships shall be computed in accordance with the other provisions of this Act.

115VZ. *Demerger.*—Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then, subject to the other provisions of this Chapter, the tonnage tax scheme shall, as far as may be, apply to the resulting company for the unexpired period if it is a qualifying company:

Provided that the option for tonnage tax scheme in respect of the demerged company shall remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

F.—Miscellaneous

115VZA. *Effect of temporarily ceasing to operate qualifying ships.*—(1) A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company shall not be considered as a cessation of operating of such qualifying ship and the company shall be deemed to be operating such qualifying ship for the purposes of this Chapter.

(2) Where a qualifying company continues to operate a ship, which temporarily ceases to be a qualifying ship, such ship shall not be considered as a qualifying ship for the purposes of this Chapter.

G.—Provisions of this Chapter not to apply in certain cases

115VZB. *Avoidance of tax.*—(1) Subject to the provisions of this Chapter, the tonnage tax scheme shall not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.

(2) For the purposes of sub-section (1), a transaction or arrangement shall be considered an abuse if the entering into or the application of such transaction or arrangement results, or would but for this section have resulted, in a tax advantage being obtained for—

(*i*) a person other than a tonnage tax company; or

(*ii*) a tonnage tax company in respect of its non-tonnage tax activities.

Explanation.—For the purposes of this section, "tax advantage" includes,—

(*i*) the determination of the allowance for any expense or interest, or the determination of any cost or expense allocated or apportioned, or, as the case may be, which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax, computed on the basis of entries made in the books of account in respect of the previous year in which the transaction was entered into; or

(*ii*) a transaction or arrangement which produces to the tonnage tax company more than ordinary profits which might be expected to arise from tonnage tax activities.

115VZC. *Exclusion from tonnage tax scheme.*—(1) Where a tonnage tax company is a party to any transaction or arrangement referred to in sub-section (1) of section 115VZB, the Assessing Officer shall, by an order in writing, exclude such company from the tonnage tax scheme:

Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon such company to show cause, on a date and time to be specified in the notice, why it should not be excluded from the tonnage tax scheme:

Provided further that no order under this sub-section shall be passed without the previous approval of the Chief Commissioner.

(2) The provisions of this section shall not apply where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a *bona fide* commercial transaction and had not been entered into for the purpose of obtaining tax advantage under this Chapter.

(3) Where an order has been passed under sub-section (1) by the Assessing Officer excluding the tonnage tax company from the tonnage tax scheme, the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.'

Irish tonnage tax legislation:

CHAPTER 4

Corporation Tax

Tonnage tax.

53. —(1) The Principal Act is amended by inserting the following after Part 24:

"PART 24A

SHIPPING: TONNAGE TAX

Interpretation(Part 24A).

697A.—(1) In this Part and in Schedule 18B—

'bareboat charter terms', in relation to the charter of a ship, means the letting on charter of a ship for a stipulated period on terms which give the charterer possession and control of the ship, including the right to appoint the master and crew;

'chartered in' means—

(*a*) in relation to a single company, the letting on charter of a ship to the company otherwise than on bareboat charter terms, and

(*b*) in relation to a group of companies, the letting on charter of a ship otherwise than on bareboat charter terms to a qualifying company that is a member of the group by a person who is not a qualifying company that is a member of the group;

'company election' and 'group election' have the meanings respectively assigned to them by section 697D(1);

'commencement date' means the day appointed by the Minister for Finance by order as the day *section 53* of the *Finance Act, 2002*, comes into operation;

'control' shall be construed in accordance with subsections (2) to (6) of section 432;

'initial period' has the meaning assigned to it by paragraph 2 of Schedule 18B;

'group of companies' means—

(*a*) all the companies of which an individual has control, or

(*b*) where a company that is not controlled by another person controls one or more other companies, that company and all the companies of which that company has control,

and references to membership of a group and group shall be construed accordingly;

'Member State' means a Member State of the European Communities;

'qualifying company' means a company—

(*a*) within the charge to corporation tax,

(*b*) that operates qualifying ships, and

(*c*) which carries on the strategic and commercial management of those ships in the State;

'qualifying group' means a group of companies of which one or more members are qualifying companies;

'qualifying ship' means, subject to subsection (2), a self-propelled seagoing vessel (including a hovercraft) of 100 tons or more gross tonnage which is certificated for navigation at sea by the competent authority of any country or territory, but does not include a vessel (in this Part and in Schedule 18B referred to as a 'vessel of an excluded kind') which is—

(*a*) a fishing vessel or a vessel used for subjecting fish to a manufacturing or other process on board the vessel,

(*b*) a vessel of a kind whose primary use is for the purposes of sport or recreation,

(*c*) a harbour, estuary or river ferry,

(*d*) an offshore installation, including a mobile or fixed rig, a platform or other installation of any kind at sea,

(*e*) a tanker used for petroleum extraction activities (within the meaning of Chapter 2 of Part 24),

(*f*) a dredger, including a vessel used primarily as a floating platform for working machinery or as a diving platform,

(*g*) a tug in respect of which a certificate has not been given by the Minister for the Marine and Natural Resources certifying that in the opinion of the Minister the tug is capable of operating in seas outside the portion of the seas which are, for the purposes of the Maritime Jurisdiction Act, 1959 , the territorial seas of the State;

'tonnage tax' has the meaning assigned to it in section 697B;

'tonnage tax activities', in relation to a tonnage tax company, means activities carried on by the company in the course of a trade which consists of one or more than one of the activities described in paragraphs (*a*) to (*j*) and paragraph (*m*) of the definition of

‘relevant shipping income’;

‘tonnage tax asset’ means an asset used wholly and exclusively for the purposes of the tonnage tax activities of a tonnage tax company;

‘tonnage tax company’ and ‘tonnage tax group’ mean, respectively, a company or group in relation to which a tonnage tax election has effect;

‘tonnage tax election’ has the meaning assigned to it in section 697D(1);

‘tonnage tax profits’, in relation to a tonnage tax company, means the company's profits for an accounting period calculated in accordance with section 697C;

‘tonnage tax trade’, in relation to a tonnage tax company, means a trade carried on by the company the income from which is within the charge to corporation tax and which consists solely of the carrying on of tonnage tax activities or, in the case of a trade consisting partly of the carrying on of such activities and partly of other activities, that part of the trade consisting solely of the carrying on of tonnage tax activities and which is treated under section 697L as a separate trade carried on by the company;

‘relevant shipping income’, in relation to a tonnage tax company, means the company's income from—

(*a*) the carriage of passengers by sea in a qualifying ship operated by the company, including income in respect of which the conditions set out in section 697I are met,

(*b*) the carriage of cargo by sea in a qualifying ship operated by the company, including income in respect of which the conditions set out in section 697I are met,

(*c*) towage, salvage or other marine assistance by a qualifying ship operated by the company,

(*d*) transport in connection with other services of a kind necessarily provided at sea by a qualifying ship operated by the company,

(*e*) the provision on board a qualifying ship operated by the company of services ancillary to the carriage of passengers or cargo,

(*f*) the granting of rights by virtue of which another person provides or will provide such ancillary services on board a qualifying ship operated by the company,

(*g*) other ship-related activities that are a necessary and integral part of the business of operating the company's qualifying ships,

(*h*) the provision at sea of marine research facilities on board a qualifying ship operated by the company,

(*i*) the letting on charter of a qualifying ship for use for the carriage by sea of passengers and cargo where the operation of the ship and the crew of

the ship remain under the direction and control of the company,

(*j*) the provision of ship management services for qualifying ships operated by the company,

(*k*) a dividend or other distribution of a company not resident in the State (in this Part referred to as the 'overseas company') in respect of which the conditions set out in section 697H(1) are met,

(*l*) gains treated as income by virtue of section 697J,

(*m*) activities which are incidental to the activities described in paragraphs (*a*) to (*j*) (in this paragraph referred to as the 'core activities') where the turnover in an accounting period of the company from all such incidental activities does not exceed 0.25 per cent of the company's turnover from its core activities,

'relevant shipping profits', in relation to a tonnage tax company, means—

(*a*) the company's relevant shipping income, and

(*b*) so much of the company's chargeable gains as are excluded from the charge to tax by section 697N;

'renewal election' has the meaning assigned to it in paragraph 6 of Schedule 18B;

'75 per cent limit' has the meaning assigned to it by section 697E.

(2) A vessel is not a qualifying ship for the purposes of this Part if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land.

(3) (*a*) References in this Part and in Schedule 18B to a company or group entering or leaving tonnage tax are references to its becoming or ceasing to be a tonnage tax company or group.

(*b*) References in this Part and in Schedule 18B to a company or group of companies being subject to tonnage tax are references to the company or group being entitled to calculate its profits in accordance with the provisions of this Part and that Schedule.

(4) Schedule 18B shall apply for the purposes of this Part.

Application.

697B.—Notwithstanding any other provision of the Tax Acts or the Capital Gains Tax Acts, this Part and Schedule 18B shall apply to provide an alternative method (in this Part referred to as 'tonnage tax') for computing the profits of a qualifying company for the purposes of corporation tax.

Calculation of profits of tonnage tax company.

697C.—(1) The tonnage tax profits of a tonnage tax company shall be charged to corporation tax in place of the company's relevant shipping profits.

(2) Where the profits of a tonnage tax company would be relevant shipping income,

any loss accruing to the company in respect of its tonnage tax activities or any loss which would, but for this subsection, be taken into account by virtue of section 79 in computing the trading income of the company shall not be brought into account for the purposes of corporation tax.

(3) A company's tonnage tax profits for an accounting period in respect of each qualifying ship operated by the company shall be calculated in accordance with this section by reference to the net tonnage of each qualifying ship operated by the company and, for this purpose, the net tonnage of a ship shall be rounded down (if necessary) to the nearest multiple of 100 tons.

(4) The daily profit to be attributed to each qualifying ship operated by the company shall be determined by reference to the net tonnage of the ship as follows:

(*a*) for each 100 tons up to 1,000 tons, €1.00,

(*b*) for each 100 tons between 1,000 and 10,000 tons, €0.75,

(*c*) for each 100 tons between 10,000 and 25,000 tons, €0.50, and

(*d*) for each 100 tons above 25,000 tons, €0.25.

(5) The profit to be attributed to each qualifying ship for the accounting period shall be determined by multiplying the daily profit as determined under subsection (4) by—

(*a*) the number of days in the accounting period, or

(*b*) if the ship was operated by the company as a qualifying ship for only part of the period, by the number of days in that part of the accounting period.

(6) The amount of the company's tonnage tax profits for the accounting period shall be the aggregate of the profit determined in respect of each qualifying ship operated by the company in accordance with subsection (5).

(7) If 2 or more companies are to be regarded as operators of a ship by virtue of a joint interest in the ship, or in an agreement for the use of the ship, the tonnage tax profits of each company shall be calculated as if each were entitled to a share of the profits proportionate to its share of that interest.

(8) If 2 or more companies are to be treated as the operator of a ship otherwise than as mentioned in subsection (7), the tonnage tax profits of each shall be computed as if each were the only operator.

Election for tonnage tax.

697D.—(1) Tonnage tax shall apply only if an election (in this Part and Schedule 18B referred to as a 'tonnage tax election') under this Part to that effect is made by a qualifying single company (in this Part and in Schedule 18B referred to as a 'company election') or by a qualifying group of companies (in this Part and in Schedule 18B referred to as a 'group election').

(2) (*a*) Tonnage tax shall only apply to a company which is a member of a group of companies if the company joins in a group election which shall be made jointly by all the qualifying companies in the group.

(*b*) A group election shall have effect in relation to all qualifying companies in the group.

(3) A tonnage tax election shall be made only if the requirements of section 697E and 697F are met.

(4) Part 1 of Schedule 18B shall apply for the purposes of making and giving effect to an election under this Part.

Requirement that not more than 75 per cent of fleet tonnage is chartered in.

697E.—(1) It shall be a requirement (in this Part and Schedule 18B referred to as the '75 per cent limit') of entering or remaining within tonnage tax—

(*a*) in the case of a single company, that not more than 75 per cent of the net tonnage of the qualifying ships operated by it is chartered in,

(*b*) in the case of a group of companies, that not more than 75 per cent of the aggregate net tonnage of the qualifying ships operated by the members of the group that are qualifying companies is chartered in.

(2) A ship shall not be counted more than once in determining for the purposes of subsection (1)(*b*) the aggregate net tonnage of the qualifying ships operated by the members of a group that are qualifying companies.

(3) Where a tonnage tax election (not being a renewal election) is made before the end of the initial period and the 75 per cent limit is exceeded in the first relevant accounting period, the election shall be treated as never having been of any effect.

(4) Where a tonnage tax election (not being a renewal election) is made after the end of the initial period, then—

(*a*) if the 75 per cent limit is exceeded in the first relevant accounting period, the election shall not have effect in relation to that period,

(*b*) if the 75 per cent limit is exceeded in the first and second relevant accounting periods, the election shall not have effect in relation to either of those periods, and

(*c*) if the 75 per cent limit is exceeded in the first, second and third relevant accounting periods, the election shall be treated as never having been of any effect.

(5) For the purposes of subsection (3) and (4) the first, second or third relevant accounting period means—

(*a*) in relation to a single company, the accounting period that, if the election had been effective, would have been the first, second or third accounting period of the company after its entry into tonnage tax, and

(*b*) in relation to a group of companies, the accounting period that, if the election had been effective, would have been the first, second or third accounting period of a member of the group that would have been a

tonnage tax company.

(6) Reference in this section to the 75 per cent limit being exceeded in an accounting period are to the limit being exceeded on average over the accounting period in question.

(7) (*a*) If the 75 per cent limit is exceeded in 2 or more consecutive accounting periods of a tonnage tax company (in this subsection referred to as the 'relevant company') the Revenue Commissioners may give notice excluding the relevant company or the group of companies of which the relevant company is a member from tonnage tax.

(*b*) The effect of any such notice is that the relevant company's tonnage tax election or the tonnage tax election of the group of which the relevant company is a member shall cease to be in force from such date as may be specified in the notice.

(*c*) The specified date shall not be earlier than the beginning of the accounting period of the relevant company that follows the second consecutive accounting period of that company in which the limit is exceeded.

(*d*) Subject to any arrangement under paragraph 22 of Schedule 18B, a notice under this subsection need only be given to the relevant company.

Requirement not to enter into tax avoidance arrangements.

697F.—(1) It shall be a condition of remaining within tonnage tax that a company is not a party to any transaction or arrangement that is an abuse of the tonnage tax regime.

(2) A transaction or arrangement shall be such an abuse as is referred to in subsection (1) if in consequence of its being, or having been, entered into the provisions of this Part and Schedule 18B may be applied in a way that results (or would but for this subsection result) in—

(*a*) a tax advantage (within the meaning of section 811) being obtained for—

(i) a company other than a tonnage tax company, or

(ii) a tonnage tax company in respect of its non-tonnage tax activities, or

(*b*) the amount of the tonnage tax profits of a tonnage tax company being artificially reduced.

(3) If a tonnage tax company is a party to any such transaction or arrangement as is referred to in subsection (1), the Revenue Commissioners may—

(*a*) if it is single company, give notice excluding it from tonnage tax;

(*b*) if it is a member of a group, subject to paragraph 22 of Schedule 18B, give notice to the tonnage tax company excluding the group from tonnage

tax.

(4) The effect of such a notice as is referred to in subsection (3)—

(*a*) in the case of a single company, is that the company's tonnage tax election shall cease to be in force from the beginning of the accounting period in which the transaction or arrangement was entered into, and

(*b*) in the case of a group, is that the group's tonnage tax election shall cease to be in force from such date as may be specified in the notice, but the date so specified shall not be earlier than the beginning of the earliest accounting period in which any member of the group entered into the transaction or arrangement in question.

(5) The provisions of sections 697P apply where a company ceases to be a tonnage tax company by virtue of this section.

Appeals.

697G.—Any person aggrieved by the giving of such a notice as is referred to in section 697E or 697F may by notice in writing to that effect made to the Revenue Commissioners within 30 days from the date of the giving of the first-mentioned notice appeal to the Appeal Commissioners. In the case of a notice given to a tonnage tax company which is a member of a group of companies only one appeal may be brought, but it may be brought jointly by 2 or more members of the group concerned.

Relevant shipping income: distributions of overseas shipping companies.

697H.—(1) The conditions referred to in paragraph (*k*) of the definition of 'relevant shipping income' in section 697A are—

(*a*) that the overseas company operates qualifying ships;

(*b*) that more than 50 per cent of the voting power in the overseas company is held by a company resident in a Member State, or that 2 or more companies each of which is resident in a Member State hold in aggregate more than 50 per cent of that voting power;

(*c*) that the 75 per cent limit is not exceeded in relation to the overseas company in any accounting period in respect of which the distribution is paid;

(*d*) that all the income of the overseas company is such that, if it were a tonnage tax company, it would be relevant shipping income;

(*e*) that the distribution is paid entirely out of profits arising at a time when—

(i) the conditions in paragraphs (*a*) to (*d*) were met, and

(ii) the tonnage tax company was subject to tonnage tax;

and

(*f*) the profits of the overseas company out of which the distribution is paid are subject to a tax on profits (in the country of residence of the company or elsewhere, or partly in that country and partly elsewhere).

(2) A dividend or other distribution of an overseas company which is made out of profits which are referable to a dividend or other distribution in relation to which the conditions of subsection (1) are met shall be deemed for the purposes of this Part to be a dividend or other distribution in respect of which the conditions in subsection (1) are met.

(3) Section 440 shall not apply to dividends and other distributions of an overseas company which is relevant shipping income of a tonnage tax company.

Relevant shipping income: cargo and passengers.

697I.—The conditions referred to in paragraphs (*a*) and (*b*) of the definition of 'relevant shipping income' in section 697A are—

(*a*) that the income arises from the transport of passengers or cargo,

(*b*) that there is a single contract between the tonnage tax company and a customer for the transport of cargo or passengers which includes carriage by sea in a qualifying ship operated by the company, and

(*c*) that the transport for the remainder of the journey is purchased or obtained by the tonnage tax company by way of a bargain made at arm's length such as would be made between persons who are not connected.

Relevant shipping income: foreign currency gains.

697J.—(1) This section shall apply to—

(*a*) any gain, whether realised or unrealised, attributable to a relevant monetary item (within the meaning of section 79) which would but for this Part be taken into account in computing the trading income of a company's tonnage tax trade in accordance with section 79, and

(*b*) any gain, whether realised or unrealised, attributable to a relevant contract (within the meaning of section 79) which would but for this Part be taken into account in computing the trading income of a company's tonnage tax trade in accordance with section 79.

(2) Where this section applies to any gain, the gain shall be treated as income for the purposes of the definition of 'relevant shipping income' in section 697A.

General exclusion of investment income.

697K.—(1) Income from investments shall not be relevant shipping income, and for this purpose 'income from investments' includes any income chargeable to tax under Case III, IV or V of Schedule D or under Schedule F.

(2) To the extent that an activity gives rise to income from investments it shall not be regarded as part of a company's tonnage tax activities.

(3) Subsection (1) shall not apply to income that is relevant shipping income under sections 697H and 697I or to income that is relevant shipping income by virtue of paragraph (*m*) of the definition of 'relevant shipping income'.

Tonnage tax trade.

697L.—(1) Subject to section 697M, where in an accounting period a tonnage tax company carries on as part of a trade tonnage tax activities, those activities shall be treated for the purposes of the Corporation Tax Acts (other than any provision of those Acts relating to the commencement or cessation of a trade) as a separate trade distinct from all other activities carried on by the company as part of the trade.

(2) An accounting period of a company shall end (if it would not otherwise do so) when the company enters or leaves tonnage tax.

Exclusion of reliefs, deductions and set-offs.

697M.—(1) No relief, deduction or set-off of any description is allowed against the amount of a company's tonnage tax profits.

(2) (*a*) When a company enters tonnage tax, any losses that have accrued to it before entry and are attributable—

(i) to activities that under tonnage tax become part of the company's tonnage tax trade, or

(ii) to a source of income that under tonnage tax becomes relevant shipping income,

shall not be available for loss relief in any accounting period beginning on or after the company's entry into tonnage tax.

(*b*) Any apportionment necessary to determine the losses so attributable shall be made on a just and reasonable basis.

(*c*) In paragraph (*a*) 'loss relief' includes any means by which a loss might be used to reduce the amount in respect of which that company, or any other company, is chargeable to tax.

(3) (*a*) Any relief or set-off against a company's tax liability for an accounting period shall not apply in relation to so much of that tax liability as is attributable to the company's tonnage tax profits.

(*b*) Relief to which this subsection applies includes, but is not limited to, any relief or set-off under section 826, 828 or Part 2 of Schedule 24.

(*c*) This subsection shall not apply to any set-off under section 24(2) or 25(3).

Chargeable gains.

697N.—(1) Where for one or more continuous periods of at least 12 months part of an asset has been used wholly and exclusively for the purposes of the tonnage tax activities of a tonnage tax company and part has not, this section shall apply as if the part so used were a separate asset.

(2) Where subsection (1) applies, any necessary apportionment of the gain or loss on the disposal of the whole asset shall be made on a just and reasonable basis.

(3) (*a*) When an asset is disposed of that is or has been a tonnage tax asset—

(i) any gain or loss on the disposal, which but for this paragraph would have been the amount of the chargeable gain or the allowable loss, shall be a chargeable gain or allowable loss only to the extent (if any) to which it is referable to periods during which the asset was not a tonnage tax asset, and

(ii) any such chargeable gain or allowable loss on a disposal by a

tonnage tax company shall be treated as arising otherwise than in the course of the company's tonnage tax trade.

(*b*) For the purposes of paragraph (*a*), the proportion of the gain or loss referable to periods during which the asset was not a tonnage tax asset shall be determined by the formula:

$$\frac{(P - T)}{P}$$

where

P is the total length of the period since the asset was created or, if later, the last third-party disposal, and

T is the length of the period (or the aggregate length of the periods) since—

(I) the asset was created, or

(II) if later, the last third-party disposal,

during which the asset was a tonnage tax asset.

(*c*) In paragraph (*b*) a 'third-party disposal' means a disposal (or deemed disposal) that is not treated as one on which neither a gain nor a loss accrues to the person making the disposal.

(4) A tonnage tax election shall not affect the deduction under section 31 as applied by section 78(2) of relevant allowable losses (within the meaning of section 78) that accrued to a company before it became a tonnage tax company.

Capital allowances: general.

697O.—(1) A company's tonnage tax trade shall not be treated as a trade for the purposes of determining the company's entitlement to capital allowances under Part 9 or under any other provision which is to be construed as one with that Part, but nothing in this subsection shall be taken as preventing the making of a balancing charge under those provisions as applied by Schedule 18B.

(2) Notwithstanding any other provision of the Tax Acts, Part 9 insofar as it relates to machinery or plant shall not apply to machinery or plant provided for leasing by a lessor (within the meaning of section 403) who is an individual to a lessee (within the meaning of section 403) for use in a tonnage tax trade carried on or to be carried on by the lessee.

(3) Part 3 of Schedule 18B shall apply for the purposes of applying the provisions of Part 9 or any other provision which is to be construed as one with that Part for the purposes of a tonnage tax trade of a tonnage tax company.

Withdrawal of relief etc. on company leaving tonnage tax.

697P.—(1) This section shall apply where a company ceases to be a tonnage tax company—

(*a*) on ceasing to be a qualifying company for reasons relating wholly or mainly to tax, or

(*b*) under section 697F.

(2) Where this section applies, section 697N shall apply in relation to chargeable gains (within the meaning of the Capital Gains Tax Acts), but not losses, on all relevant disposals as if the company had never been a tonnage tax company and for this purpose a 'relevant disposal' means a disposal—

(*a*) on or after the day on which the company ceases to be a tonnage tax company, or

(*b*) at any time during the period of 6 years immediately preceding that day when the company was a tonnage tax company.

(3) Where subsection (2) operates to increase the amount of the chargeable gain on a disposal made at a time within the period mentioned in subparagraph (2)(*b*), the gain is treated to the extent of the increase—

(*a*) as arising immediately before the company ceased to be a tonnage tax company, and

(*b*) as not being relevant shipping profits of the company.

(4) No relief, deduction or set-off of any description shall be allowed against the amount of that increase or the corporation tax charged on that amount.

(5) Where this section applies and in a relevant accounting period during which the company was a tonnage tax company the company was liable to a balancing charge in relation to which paragraph 16 or 17, as appropriate, of Schedule 18B applied to reduce the amount of the charge, then the company shall be treated as having received an additional amount of profits chargeable to corporation tax equal to the aggregate of the amounts by which those balancing charges were reduced.

(6) For the purposes of subsection (5) a 'relevant accounting period' means an accounting period ending not more than 6 years before the day on which the company ceased to be a tonnage tax company.

(7) The additional profits referred to in subsection (5) shall be treated—

(*a*) as arising immediately before the company ceased to be a tonnage tax company, and

(*b*) as not being relevant shipping profits of the company.

(8) No relief, deduction or set-off of any description shall be allowed against those profits or against the corporation tax charged on them.

Ten year disqualification from

697Q.—(1) This section shall apply in every case where a company ceases to be a tonnage tax company otherwise than on the expiry of a tonnage tax election.

re-entry into tonnage tax.

(2) Where this section applies—

(*a*) a company election made by a former tonnage tax company shall be ineffective if made before the end of the period of 10 years beginning with the date on which the company ceased to be a tonnage tax company, and

(*b*) a group election that—

(i) is made in respect of a group whose members include a former tonnage tax company, and

(ii) would result in that company becoming a tonnage tax company,

shall be ineffective if made before the end of the period of 10 years beginning with the date on which that company ceased to be a tonnage tax company.

(3) This section shall not prevent a company becoming a tonnage tax company under and in accordance with the rules in Part 4 of Schedule 18B.

(4) In this section 'former tonnage tax company' means a company that is not a tonnage tax company but has previously been a tonnage tax company.".

(2) The Principal Act is amended by inserting the following after Schedule 18A:

"SCHEDULE 18B

TONNAGE TAX

Part 1

Matters relating to election for tonnage tax

Method of making election

1. (1) A tonnage tax election shall be made by notice to the Revenue Commissioners.

(2) The notice shall contain such particulars and be supported by such evidence as the Revenue Commissioners may require.

When election may be made

2. (1) A tonnage tax election may be made at any time before the end of the period (in this Schedule referred to as the 'initial period') of 36 months beginning on the commencement date.

(2) After the end of the initial period a tonnage tax election may only be made in the circumstances specified in subparagraphs (3) and (4).

(3) (*a*) An election may be made after the end of the initial period in respect of a single company that becomes a qualifying company and has not previously been a qualifying company at any time on or after the commencement date.

(*b*) Any election under this subparagraph shall be made before the end of the period of 36 months beginning with the day on which the company became a qualifying company.

(4) (*a*) An election may be made after the end of the initial period in respect of a group of companies that becomes a qualifying group of companies by virtue of a member of the group becoming a qualifying company, not previously having been a qualifying company, at any time on or after the commencement date.

(*b*) This subparagraph shall not apply if the group of companies-

(i) was previously a qualifying group at any time on or after the commencement date, or

(ii) is substantially the same as a group that was previously a qualifying group of companies at any such time.

(*c*) An election under this subparagraph shall be made before the end of the period of 36 months beginning with the day on which the group of companies became a qualifying group of companies.

(5) This paragraph shall not prevent an election being made under Part 4.

(6) The Minister for Finance may by order provide for further periods within which a tonnage tax election may be made, and any such order may provide for this Part of this Schedule to apply, with any necessary modifications, as appears to the Minister to be appropriate in relation to such further periods as it applies in relation to the initial period.

When election takes effect

3. (1) Subject to this paragraph, a tonnage tax election shall have effect from the beginning of the accounting period in which it is made.

(2) A tonnage tax election shall not have effect in relation to an accounting period beginning before 1 January 2002, but where a tonnage tax election would have effect under subparagraph (1) for an accounting period beginning before 1 January 2002 the election shall have effect from the beginning of the accounting period following that in which it is made.

(3) The Revenue Commissioners may allow a tonnage tax election made before the end of the initial period to have effect from the beginning of an accounting period earlier than that in which it is made (but not one beginning before 1 January 2002).

(4) The Revenue Commissioners may allow a tonnage tax election made before the end of the initial period to have effect from the beginning of the accounting period following that in which it is made or, where the Revenue Commissioners determine that due to exceptional circumstances, unrelated to the avoidance or reduction of tax, it is commercially impracticable for the election to take effect, the beginning of the next following accounting period.

(5) In the case of a group election made in respect of a group of companies where the members have different accounting periods, subparagraph (1) or, if appropriate, subparagraph (3) or (4) shall apply in relation to each qualifying company by reference to that company's accounting periods.

(6) Subject to section 697E(4), a tonnage tax election under paragraph 2(3) or (4) shall have effect from the time at which the company in question became a qualifying company.

Period for which election is in force

4. (1) Subject to subparagraphs (2) and (3) and paragraph 6(3), a tonnage tax election shall remain in force until it expires at the end of the period of 10 years beginning—

(*a*) in the case of a company election, with the first day on which the election has effect in relation to the company, and

(*b*) in the case of a group election, with the first day on which the election has effect in relation to any member of the group.

(2) A tonnage tax election shall cease to be in force—

(*a*) in the case of a company election, if the company ceases to be a qualifying company, and

(*b*) in the case of a group election, if the group of companies ceases to be a qualifying group.

(3) A tonnage tax election may also cease to be in force under Part 4.

Effect of election ceasing to be in force

5. A tonnage tax election that ceases to be in force shall cease to have effect in relation to any company.

Renewal election

6. (1) At any time when a tonnage tax election is in force in respect of a single company or group of companies a further tonnage tax election (in Part 24A and this Schedule referred to as a 'renewal election') may be made in respect of that company or group.

(2) Section 697D and paragraphs 1, 4 and 5 shall apply in relation to a renewal election as they apply in relation to an original tonnage tax election.

(3) A renewal election supersedes the existing tonnage tax election.

Part 2

Matters relating to qualifying ships

Company temporarily ceasing to operate qualifying ships

7. (1) This paragraph shall apply where a company temporarily ceases to operate any qualifying

ships.

(2) This paragraph shall not apply where a company continues to operate a ship that temporarily ceases to be a qualifying ship.

(3) If a company which temporarily ceases to operate any qualifying ships gives notice to the Revenue Commissioners stating—

(*a*) its intention to resume operating qualifying ships, and

(*b*) its wish to remain within tonnage tax,

the company shall be treated for the purposes of Part 24A and this Schedule as if it had continued to operate the qualifying ship or ships it operated immediately before the temporary cessation.

(4) The notice must be given on or before the specified return date for the chargeable period (within the meaning of Part 41) of the company in which the temporary cessation begins.

(5) This paragraph shall cease to apply if and when the company—

(*a*) abandons its intention to resume operating qualifying ships, or

(*b*) again in fact operates a qualifying ship.

Meaning of operating a ship

8. (1) Subject to this paragraph, a company is regarded for the purposes of Part 24A and this Schedule as operating any ship owned by, or chartered to, the company.

(2) (*a*) A company shall not be regarded as the operator of a ship where part only of the ship has been chartered to it.

(*b*) For the purpose of subparagraph (*a*), a company shall not be taken as having part only of a ship chartered to it by reason only of the ship being chartered to it jointly with one or more other persons.

(3) Except as provided by subparagraphs (4) and (5), a company shall not be regarded as the operator of a ship that has been chartered out by it on bareboat charter terms.

(4) (*a*) A company shall be regarded as operating a ship that has been chartered out by it on bareboat charter terms if the person to whom it is chartered is not a third party.

(*b*) For the purpose of subparagraph (*a*), a 'third party' means—

(i) in the case of a single company, any other person,

(ii) in the case of a member of a group of companies—

(I) any member of the group that is not a tonnage tax company (and does not

become a tonnage tax company by virtue of the ship being chartered to it), or

(II) any person who is not a member of the group.

(5) A company shall not be regarded as ceasing to operate a ship that has been chartered out by it on bareboat charter terms if—

(*a*) the ship is chartered out because of short-term over-capacity, and

(*b*) the term of the charter does not exceed 3 years.

(6) A company shall be regarded as operating a qualifying ship for the purposes of the activity described in paragraph (*j*) of the definition of 'relevant shipping income' in section 697A if that company has entered contractual arrangements in relation to the provision of ship management services for the qualifying ship for a stipulated period and the terms of those arrangements give the company—

(*a*) possession and control of the ship,

(*b*) control over the day to day management of the ship, including the right to appoint the master and crew and route planning,

(*c*) control over the technical management of the ship, including decisions on its repair and maintenance,

(*d*) control over the safety management of the ship, including ensuring that all necessary safety and survey certificates are current,

(*e*) control over the training of the officers and crew of the ship, and

(*f*) the management of the bunkering, victualling and provisioning of the ship,

and those terms are actually implemented for the period in which the company provides ship management services in respect of that ship.

Qualifying ship used as vessel of an excluded kind

9. (1) A qualifying ship that begins to be used as a vessel of an excluded kind ceases to be a qualifying ship when it begins to be so used, but if—

(*a*) a company operates a ship throughout an accounting period of the company, and

(*b*) in that period the ship is used as a vessel of an excluded kind on not more than 30 days, that use shall be disregarded in determining whether the ship is a qualifying ship at any time during that period.

(2) In the case of an accounting period shorter than a year, the figure of 30 days in subparagraph (1) shall be proportionately reduced.

(3) If a company operates a ship during part only of an accounting period of the company, subparagraph (1) shall apply as if for 30 days, or the number of days substituted by subparagraph (2),

there were substituted the number of days that bear to the length of that part of the accounting period the same proportion that 30 days bears to a year.

Part 3

Capital Allowances, Balancing Charges and Related Matters

Plant and machinery used wholly for tonnage tax trade

10. (1) (*a*) This subparagraph shall apply where, on a company's entry to tonnage tax, machinery or plant, in respect of which capital expenditure was incurred by the company before its entry into tonnage tax, is to be used wholly and exclusively for the purposes of the company's tonnage tax trade.

(*b*) Where this subparagraph applies—

(i) no balancing charge or balancing allowance shall be made under section 288 as a result of the machinery or plant concerned being used for the purposes of the company's tonnage tax trade,

(ii) any allowance attributable to the machinery or plant referred to in subparagraph (*a*) which, but for this clause, would have been made to the company under Part 9 or under any provision that is construed as one with that Part for any accounting period in which the company is a tonnage tax company shall not be made, and

(iii) section 287 shall not apply as respects any accounting period during which the machinery or plant has been used wholly and exclusively for the purposes of a company's tonnage tax trade.

(2) (*a*) This subparagraph shall apply where the machinery or plant referred to in subparagraph (1)(*a*) begins to be used wholly or partly for purposes other than those of the company's tonnage tax trade.

(*b*) Where this subparagraph applies and the asset begins to be wholly used for purposes other than the company's tonnage tax trade—

(i) no balancing allowance shall be made on the company under section 288(2) for any period in which the company is subject to tonnage tax,

(ii) for the purposes of making a balancing charge under section 288 on the happening of any of the events referred to in subsection (1) of that section—

(I) section 296 shall not apply as respects any accounting period of a company in which the company is subject to tonnage tax,

(II) where the event occurs at a time when the company is subject to tonnage tax, the amount of the capital expenditure of the company still unallowed at the time of the event shall, notwithstanding section 296, be the amount of the capital expenditure of the company on the provision of the machinery or plant which was still unallowed at the time the company's

election into tonnage tax had effect, and

(III) where the event occurs at a time when the company is subject to tonnage tax, the references in section 288 to sale, insurance, salvage or compensation moneys and the reference in section 289(3)(*b*) to the open-market price of the machinery or plant shall be taken to be references to the least of—

(A) the actual cost to the company of the machinery or plant for the purpose of the trade carried on by the company,

(B) the price the machinery or plant would have fetched if sold in the open market at the time the company's election into tonnage tax had effect, and

(C) the sale, insurance, salvage or compensation moneys (within the meaning of Part 9) arising from the event or, where paragraph (*b*) of section 289(3) applies, the open-market price of the machinery or plant (within the meaning of that section) at the time of the event.

(*c*) Where this subparagraph applies and the asset begins to be partly used for purposes other than the company's tonnage tax trade—

(i) the machinery or plant shall be treated as 2 separate assets one in use wholly and exclusively for the purposes of the tonnage tax trade and the other in use wholly and exclusively for purposes other than the company's tonnage tax trade,

(ii) subparagraph (2)(*b*) shall apply in relation to the part of the asset treated by virtue of this subparagraph as in use wholly and exclusively for the purposes of the tonnage tax trade as it applies in relation to machinery or plant which begins to be used wholly for purposes other than the company's tonnage tax trade,

(iii) in determining the amount of any capital allowance or balancing charge, if any, to be made under Part 9 or under any other provision to be construed as one with that Part in relation to the part of the asset treated by virtue of this subparagraph as in use wholly and exclusively for purposes other than the company's tonnage tax trade regard shall be had to all relevant circumstances and, in particular, to the extent of the use, if any, of the machinery or plant for the purposes of a trade, and there shall be made to or on the company, in respect of that trade, an allowance of such an amount or a balancing charge of such an amount, as may be just and reasonable.

Plant and machinery used partly for purposes of tonnage tax trade

11. (1) This paragraph shall apply where, on a company's entry into tonnage tax, machinery or plant, in respect of which capital expenditure was incurred by the company before its entry into tonnage tax, is to be used partly for the purposes of the company's tonnage tax trade and partly for purposes other than the company's tonnage tax trade.

(2) Where this paragraph applies—

(*a*) the machinery or plant referred to in subparagraph (1) shall be treated as 2 separate assets one in use wholly and exclusively for the purposes of the tonnage tax trade and the other in use wholly and exclusively for the purposes of the other trade of the company,

(*b*) subject to clause (*c*), in determining the amount of—

(i) any capital allowance or balancing charge to be made in respect of that part of the asset treated as in use wholly and exclusively for purposes other than the company's tonnage tax trade under Part 9 or under any provision which is to be construed as one with that Part, or

(ii) the amount of any balancing charge to be made for the purpose of the tonnage tax trade under Part 9, or under any provision which is to be construed as one with that Part, as applied by this Schedule,

regard shall be had to all relevant circumstances and, in particular, to the extent of the use of the machinery or plant for the purposes of a trade other than the tonnage tax trade, and there shall be made to or on the company, in respect of that trade, an allowance of such an amount, or, in respect of both the tonnage tax trade and the other trade, a balancing charge of such an amount, as may be just and reasonable, and

(*c*) paragraph 10(1)(*b*) and paragraph 10(2)(*b*) shall apply in relation to the part of the asset treated by virtue of this paragraph as in use wholly and exclusively for the purposes of the tonnage tax trade as they apply in relation to the machinery or plant referred to in paragraph 10(1)(*a*).

Plant and machinery: new expenditure partly for tonnage tax purposes

12. (1) This paragraph shall apply where a company subject to tonnage tax incurs capital expenditure on the provision of machinery or plant partly for the purposes of its tonnage tax trade and partly for the purposes of another trade carried on by the company.

(2) Where this paragraph applies the machinery or plant shall be treated as 2 separate assets one in use wholly and exclusively for the purposes of the tonnage tax trade and the other in use wholly and exclusively for the purposes of the other trade of the company and, in determining the amount of any capital allowance, or the amount of any charge to be made, under Part 9 or under any provision which is to be construed as one with that Part in the case of that part of the asset treated as a separate asset for the purposes of the other trade of the company, regard shall be had to all relevant circumstances and, in particular, to the extent of the use of the machinery or plant for the purposes of the other trade, and there shall be made to or on the company, in respect of the other trade, an allowance of such an amount, or a charge of such an amount, as may be just and reasonable.

Plant and machinery: change of use of tonnage tax asset

13. (1) This paragraph shall apply where, at a time when a company is subject to tonnage tax, machinery or plant acquired after the company became so subject and which is used wholly and exclusively for the purposes of the company's tonnage tax trade begins to be used wholly or partly for purposes of another trade.

(2) Where this paragraph applies—

(*a*) if the asset begins to be used wholly for purposes of another trade the provisions of Part 9 shall apply as if capital expenditure had been incurred by the person carrying on the other trade on the provision of the plant or machinery for the purposes of that trade in that person's chargeable period (within the meaning of Part 9) in which the plant or machinery is brought into use for those purposes, and the amount of that expenditure shall be taken as the lesser of—

(i) the amount of the capital expenditure actually incurred by the person, and

(ii) the price which the machinery or plant would have fetched if sold on the open market on the date on which it was so brought into use, and

(*b*) if the asset begins to be used partly for purposes of another trade of the company and partly for the purposes of the tonnage tax trade—

(i) the machinery or plant shall be treated as 2 separate assets one in use wholly and exclusively for the purposes of the tonnage tax trade and the other in use wholly and exclusively for the purposes of the other trade of the company,

(ii) Part 9 shall apply as if the company had incurred capital expenditure on the provision of that part of the asset treated as in use wholly and exclusively for the other trade of the company in the accounting period of the company in which that part of the asset is brought into use for those purposes, and

(iii) in determining the amount of any capital expenditure incurred on the provision of that part of the asset treated as in use as a separate asset for the purposes of the other trade of the company regard shall be had to all relevant circumstances as is just and reasonable.

Plant and machinery: change of use of non-tonnage tax asset

14. (1) This paragraph shall apply where, at a time when a company is subject to tonnage tax, plant or machinery wholly and exclusively used for the purposes of another trade carried on by the company not being a tonnage tax trade begins to be used wholly or partly for the purposes of the company's tonnage tax trade.

(2) Where this paragraph applies and the asset begins to be wholly used for the purposes of the company's tonnage tax trade—

(*a*) no balancing allowance or balancing charge shall be made as a consequence of the change in use, and

(*b*) for the purposes of making a balancing charge under section 288 on the happening subsequent to the change in use of any of the events referred to in subsection (1) of that section—

(i) section 296 shall not apply as respects any accounting period of the company in which the asset is used wholly and exclusively for the purposes of the company's tonnage tax trade,

(ii) where the event occurs at a time when the asset is so used, the amount of the capital expenditure of the company still unallowed at the time of the event shall, notwithstanding section 296, be the amount of the capital expenditure of the company on the provision of the machinery or plant which was still unallowed at the time the asset began to be so used, and

(iii) where the event occurs at a time when the asset is so used, the references in section 288 to sale, insurance, salvage or compensation moneys and the reference in section 289(3)(*b*) to the open-market value of the machinery or plant shall be taken to be references to the least of—

(I) the actual cost to the company of the machinery or plant for the purpose of the trade carried on by the company,

(II) the price the machinery or plant would have fetched if sold in the open market at the time the asset began to be so used, and

(III) the sale, insurance, salvage or compensation moneys (within the meaning of Part 9) arising on the event or, where paragraph (*b*) of section 289(3) applies, the open-market price of the machinery or plant (within the meaning of that section) at the time of the event.

(3) Where this paragraph applies and the asset begins to be partly used for the purposes of the company's tonnage tax trade—

(*a*) the machinery or plant referred to in subparagraph (1) shall be treated as 2 separate assets one in use wholly and exclusively for the purposes of the other trade of the company and the other in use wholly and exclusively for the purposes of the tonnage tax trade of the company,

(*b*) no balancing charge or balancing allowance shall be made in respect of the part treated as in use wholly and exclusively for the purposes of the tonnage tax trade as a consequence of the change in use,

(*c*) subparagraph (2)(*b*) shall apply in relation to the part of the asset treated by virtue of this subparagraph as in use wholly and exclusively for the purposes of the tonnage tax trade as it applies in relation to the machinery or plant wholly used for the purposes of the company's tonnage tax trade.

Plant and machinery: provisions relating to balancing charges

15. (1) A balancing charge arising under Part 9 as applied by this Schedule or under this Schedule shall—

(*a*) be treated as arising in connection with a trade carried on by the company other than the company's tonnage tax trade, and

(*b*) be made in taxing that trade.

(2) Subject to paragraph 16 or 17, the charge shall be given effect in the accounting period in which it arises.

(3) On the first occasion of the happening of an event which gives rise to a balancing charge (including such an event arising in respect of more than one asset on the same date) under Part 9 as applied by this Schedule, or under this Schedule, on a tonnage tax company, the tonnage tax company shall by notice in writing to the Revenue Commissioners elect for relief against that charge under either paragraph 16 or, if applicable, paragraph 17 but not for relief under both, and any such election shall be irrevocable and be included in the company's return under section 951 for the accounting period in which the charge arises.

(4) Where a balancing charge arises on a tonnage tax company under Part 9 as applied by this Schedule or under this Schedule subsequent to any charge on the company such as is referred to in subparagraph (3), relief against that charge shall only be available under the paragraph for which the company elected for relief in accordance with that subparagraph.

(5) Relief under paragraph 16 or 17 shall not be available to a company unless the company has made an election under subparagraph (3).

Reduction in balancing charge by reference to time in tonnage tax

16. The amount of any balancing charge under Part 9 as applied by this Schedule or under this Schedule shall be reduced by 20 per cent of the amount of the charge for each whole year in which the company on which the charge is to be made has been subject to tonnage tax calculated by reference to the time of the event giving rise to the charge.

Set-off of accrued losses against balancing charge

17. Where a balancing charge under Part 9 as applied by this Schedule or under this Schedule arises in connection with the disposal of a qualifying ship, then the company may set off against any balancing charge so arising any losses (including any losses referable to capital allowances treated by virtue of section 307 or 308 as trading expenses of the company) which accrued to the company before its entry to tonnage tax and which are attributable to—

(*a*) activities which under tonnage tax became part of the company's tonnage tax trade, or

(*b*) a source of income which under tonnage tax becomes relevant shipping income.

Deferment of balancing charge on re-investment

18. (1) Where—

(*a*) a balancing charge under Part 9 as applied by this Schedule arises in connection with the disposal of a qualifying ship, and

(*b*) within the period beginning on the date the company's election for tonnage tax takes effect and ending 5 years after the date of the event giving rise to the balancing charge, the company or another qualifying company which is a member of the same tonnage tax group as the company incurs capital expenditure on the provision of one or more other qualifying ships (in this paragraph referred to as the 'new asset'),

Then

(i) if the amount on which the charge would have been made, as reduced under paragraph 16 or

17, if applicable, is greater than the capital expenditure on providing the new asset, the balancing charge shall be made only on an amount equal to the difference, and

(ii) if the capital expenditure on providing the new asset is equal to or greater than the amount on which the charge would have been made, as reduced under paragraph 16 or 17, if applicable, the balancing charge shall not be made.

(2) Where an event referred to in section 288(1) occurs in relation to the new asset in the period in which the company which incurs the expenditure on the new asset is subject to tonnage tax then a balancing charge shall be made under this paragraph on that company.

(3) Subject to any reduction under paragraph 16 or 17 and to any further application of this paragraph, the amount of the charge referred to in subparagraph (2) shall be—

(*a*) where subparagraph (1)(i) applies, the difference between the balancing charge which, but for subparagraph (1), would have been made on the disposal referred to in subparagraph (1) and the actual charge made,

(*b*) where subparagraph (1)(ii) applies, the amount of the charge which, but for subparagraph (1), would have been made on the disposal referred to in that subparagraph.

(4) Section 290 shall not apply in relation to balancing charges to which this paragraph applies.

(5) For the purposes of subparagraph (1), where machinery or plant is let to a tonnage tax company on the terms of that company being bound to maintain the machinery or plant and deliver it over in good condition at the end of the lease, and if the burden of the wear and tear on the machinery or plant will in fact fall directly on the company, then the capital expenditure on the provision of the machinery and plant shall be deemed to have been incurred by that company and the machinery and plant shall be deemed to belong to that company.

Exit: plant and machinery

19. (1) Where a company leaves tonnage tax the amount of capital expenditure incurred on the provision of machinery or plant in respect of each asset used by the company for the purposes of its tonnage tax trade which asset was acquired at a time the company was subject to tonnage tax and held by the company at the time it leaves tonnage tax shall be deemed to be the lesser of—

(*a*) the capital expenditure actually incurred by the company on the provision of that machinery or plant for the purposes of the company's tonnage tax trade, and

(*b*) the price the machinery or plant would have fetched if sold in the open market at the date the company leaves tonnage tax.

(2) For the purposes of the making of allowances and charges under Part 9 or any provision construed as one with that Part, the capital expenditure on the provision of the machinery or plant as determined in accordance with subparagraph (1) shall be deemed to have been incurred on the day immediately following the date the company leaves tonnage tax.

(3) (*a*) This subparagraph applies where a company—

(i) leaves tonnage tax having incurred expenditure on the provision of machinery or plant

for the purposes of a trade carried on by the company before entry into tonnage tax,

(ii) has used that machinery or plant for the purposes of its tonnage tax trade,

(iii) has been denied allowances in respect of that machinery or plant by virtue of section 697O and the provisions of paragraph 10(1)(*b*)(ii) or paragraph 11(2)(*c*), and

(iv) on leaving tonnage tax starts, recommences or continues to use that machinery or plant for the purposes of a trade carried on by it.

(*b*) Subject to clauses (*c*) and (*d*), where this subparagraph applies any allowance which, but for section 697O and paragraph 10(1)(*b*) or 11(2)(*c*), would have been made under Part 9 or any provision construed as one with that Part to the company for any accounting period in which it was subject to tonnage tax shall, subject to compliance with that Part, be made instead for such accounting periods immediately after the company leaves tonnage tax as will ensure, subject to that Part, that all such allowances are made to the company in those accounting periods as would have been made to the company in respect of that machinery or plant if the company had never been subject to tonnage tax.

(*c*) No wear and tear allowance shall be made by virtue of this subparagraph in respect of any machinery or plant for any accounting period of a company if such allowance when added to the allowances in respect of that machinery or plant made to that company for any previous accounting period will make the aggregate amount of the allowances exceed the actual cost to that company of the machinery or plant, including in that actual cost any expenditure in the nature of capital expenditure on the machinery or plant by means of renewal, improvement or reinstatement.

(*d*) A wear and tear allowance in respect of any machinery or plant made by virtue of this subparagraph for any accounting period shall not exceed the amount appropriate to that machinery or plant as set out in section 284(2).

Industrial buildings

20. (1) Where any identifiable part of a building or structure is used for the purposes of a company's tonnage tax trade, that part is treated for the purposes of Chapter 1 of Part 9 as used otherwise than as an industrial building or structure.

(2) (*a*) This subparagraph applies where, in an accounting period during which a company is subject to tonnage tax, an event giving rise to a balancing charge occurs in relation to an industrial building or structure in respect of which capital expenditure was incurred by the company before its entry into tonnage tax.

(*b*) Where this subparagraph applies—

(i) the sale, insurance, salvage or compensation moneys to be brought into account in respect of any industrial building or structure shall be limited to the market value of the relevant interest when the company entered tonnage tax, and

(ii) the amount of any balancing charge under that Part shall, subject to subparagraphs (3) to (5) of paragraph 15, be reduced in accordance with paragraph 16 or 17, as

appropriate.

(3) Where a company subject to tonnage tax disposes of the relevant interest in an industrial building or structure, section 277 shall apply to determine the residue of expenditure in the hands of the person who acquires the relevant interest, as if—

(*a*) the company had not been subject to tonnage tax, and

(*b*) all writing-down allowances, and balancing allowances and charges, had been made as could have been made if the company had not been subject to tonnage tax.

(4) Where a company leaves tonnage tax the amount of capital expenditure qualifying for relief under Chapter 1 of Part 9 shall be determined as if—

(*a*) the company had never been subject to tonnage tax, and

(*b*) all such allowances and charges under that Part had been made as could have been made.

Part 4

Groups, Mergers and Related Matters

Company not to be treated as member of more than one group

21. (1) Where a company is a member of both a tonnage tax group and a non-tonnage tax group which if a group election had been made would have been a tonnage tax group (in this paragraph referred to as a qualifying non-tonnage tax group), the company shall be treated as a member of the tonnage tax group and not of the qualifying non-tonnage tax group.

(2) Where a company is a member of 2 tonnage tax groups, the company shall be treated as a member of the group whose tonnage tax election was made first and not of the other tonnage tax group. In the case of group elections made at the same time, the company shall choose which election it joins in and for the purposes of Part 24A and this Schedule the company shall be treated as a member of the group in respect of which that election is made and not of any other tonnage tax group.

Arrangements for dealing with group matters

22. (1) The Revenue Commissioners may enter into arrangements with the qualifying companies in a group for one of those companies to deal on behalf of the group in relation to matters arising under Part 24A and this Schedule that may conveniently be dealt with on a group basis.

(2) Any such arrangements—

(*a*) may make provision in relation to cases where companies become or cease to be members of a group;

(*b*) may make provision for or in connection with the termination of the arrangements; and

(*c*) may make such supplementary, incidental, consequential or transitional provision as is

necessary or expedient for the purposes of the arrangements.

(3) Any such arrangements shall not affect—

(*a*) any requirement under Part 24A and this Schedule that an election be made jointly by all the qualifying companies in the group; or

(*b*) any liability under Part 24A, this Schedule or any other provision of the Tax Acts of a company to which the arrangements relate.

Meaning of 'merger' and 'demerger'

23. (1) In this Schedule—

'merger' means a transaction by which one or more companies become members of a group, and

'demerger' means a transaction by which one or more companies cease to be members of a group.

(2) References to a merger to which a group is a party include any merger affecting a member of the group.

Merger: between tonnage tax groups or companies

24. (1) This paragraph shall apply where there is a merger—

(*a*) between 2 or more tonnage tax groups,

(*b*) between one or more tonnage tax groups and one or more tonnage tax companies, or

(*c*) between two or more tonnage tax companies.

(2) Where this paragraph applies the group resulting from the merger is a tonnage tax group as if a group election had been made.

(3) The deemed election referred to in subparagraph (2) continues in force, subject to the provisions of this Part, until whichever of the existing tonnage tax elections had the longest period left to run would have expired.

Merger: tonnage tax group/ company and qualifying non-tonnage tax group/ company

25. (1) This paragraph shall apply where there is a merger between a tonnage tax group or company and a qualifying non-tonnage tax group or company.

(2) Where this paragraph applies the group resulting from the merger may elect that—

(*a*) it be treated as if a group election had been made which deemed election shall continue in force until the original election made by the tonnage tax group or company would have expired, or

(*b*) the tonnage tax election of the group or company ceases to be in force as from the date of the merger.

(3) Any election under subparagraph (2) shall be made jointly by all the qualifying companies in the group resulting from the merger and by way of notice in writing to the Revenue Commissioners within 12 months of the merger.

Merger: tonnage tax group or company and non-qualifying group or company

26. (1) This paragraph shall apply where there is a merger between a tonnage tax group or company and a non-qualifying group or company.

(2) Where this subsection applies the group resulting from the merger is a tonnage tax group by virtue of the election of the tonnage tax group or company.

Merger: non-qualifying group or company and qualifying non-tonnage tax group or company

27. (1) This paragraph shall apply where there is a merger between a non-qualifying group or company and a qualifying non-tonnage tax group or company.

(2) Where this paragraph applies, the group resulting from the merger may make a tonnage tax election having effect as from the date of the merger.

(3) Any such election shall be made jointly by all the qualifying companies in the group resulting from the merger, by notice in writing to the Revenue Commissioners, within 12 months of the merger.

Demerger: single company

28. (1) This paragraph shall apply where a tonnage tax company ceases to be a member of a tonnage tax group and does not become a member of another group.

(2) Where this paragraph applies—

(*a*) the company in question remains a tonnage tax company as if a single company election had been made, and

(*b*) that deemed election continues in force, subject to the provisions of this Schedule, until the group election would have expired.

(3) If 2 or more members of the previous group remain, and any of them is a qualifying company, the group consisting of those companies shall be a tonnage tax group by virtue of the previous group election.

Demerger: group

29. (1) This paragraph shall apply where a tonnage tax group splits into two or more groups.

(2) Where this paragraph applies each new group that contains a qualifying company that was a tonnage tax company before the demerger shall be a tonnage tax group as if a group election had been

made.

(3) That deemed election continues in force, subject to the provisions of this Schedule, until the group election would have expired.

Duty to notify Revenue Commissioners of group changes

30. (1) A tonnage tax company that becomes or ceases to be a member of a group, or of a particular group, shall give notice in writing to the Revenue Commissioners of that fact.

(2) The notice shall be given within the period of 12 months beginning with the date on which the company became or ceased to be a member of the group.

Part 5

Miscellaneous and supplemental

Measurement of tonnage of ship

31. (1) References in Part 24A and in this Schedule to the gross or net tonnage of a ship are to that tonnage as determined—

(*a*) in the case of a vessel of 24 metres in length or over, in accordance with the IMO International Convention on Tonnage Measurement of Ships 1969;

(*b*) in the case of a vessel under 24 metres in length, in accordance with tonnage regulations.

(2) A ship shall not be treated as a qualifying ship for the purposes of this Part and this Schedule unless there is in force—

(*a*) a valid International Tonnage Certificate (1969), or

(*b*) a valid certificate recording its tonnage as measured in accordance with tonnage regulations.

(3) In this paragraph 'tonnage regulations' means regulations under section 91 of the Mercantile Marine Act, 1955 or the provisions of the law of a country or territory outside the State corresponding to those regulations.

Second or subsequent application of sections 697P and 697Q

32. Where sections 697P and 697Q apply on a second or subsequent occasion on which a company ceases to be a tonnage tax company (whether or not those sections applied on any of the previous occasions)—

(*a*) the references to the company ceasing to be a tonnage tax company shall be read as references to the last occasion on which it did so, and

(*b*) the references to the period during which the company was a tonnage tax company do not include any period before its most recent entry into tonnage tax.

Appeals

33. Where in Part 24A and in this Schedule there is provision for the determination of any matter on a just and reasonable basis and it is not possible for the company concerned and the appropriate inspector (within the meaning of section 950) to agree on what is just and reasonable in the circumstances then there shall be the right of appeal to the Appeal Commissioners in the like manner as an appeal would lie against an assessment to corporation tax and the provisions of the Tax Acts relating to appeals shall apply accordingly.

Delegation of powers and functions

34. The Revenue Commissioners may nominate any of their officers to perform any acts and discharge any functions authorised by Part 24A or this Schedule to be performed or discharged by the Revenue Commissioners.".

(3) The Principal Act is amended in subsection (1A) of section 21 by inserting the following after paragraph (*b*):

"(*c*) Notwithstanding subsection (1), for the financial year 2002, in relation to a tonnage tax company (within the meaning of Part 24A), tonnage tax profits shall be charged to corporation tax at the rate of 12½ per cent.".

(4) Schedule 29 of the Principal Act is amended by inserting "Schedule 18B, paragraph 30" after "Schedule 18, paragraph 1(2)" in column 2.

(5) This section shall come into operation on such day as the Minister for Finance may by order appoint.

Relief for certain losses on a value basis.

54. —(1) The Principal Act is amended—

(*a*) in Part 8 by inserting the following after section 243A:

"Relief for certain charges on income on a value basis.

243B.—(1) In this section—

'charges on income paid for the purposes of the sale of goods' has the same meaning as in section 454;

'relevant corporation tax', in relation to an accounting period of a company, means the corporation tax which, apart from this section and sections 239, 241, 396B, 420B, 440 and 441, would be chargeable on the company for the accounting period;

'relevant trading charges on income' has the same meaning as in section 243A.

(2) Where a company pays relevant trading charges on income in an accounting period and the amount so paid exceeds an amount equal to the aggregate of the amounts allowed as deductions against—

(*a*) the income of the company in accordance with section 243A, and

(*b*) the income from the sale of goods in accordance with section 454,

of the company for the accounting period, the company may claim relief under this section for the accounting period in respect of the excess.

(3) Where for any accounting period a company claims relief under this section in respect of the excess, the relevant corporation tax of the company for the accounting period shall be reduced—

(*a*) in so far as the excess consists of charges on income paid for the purpose of the sale of goods (within the meaning of section 454), by an amount equal to 10 per cent of those charges on income paid for the purpose of the sale of goods, and

(*b*) in so far as the excess consists of charges on income (in this section referred to as 'other relevant trading charges on income') which are not charges on income paid for the purposes of the sale of goods (within the meaning of section 454), by an amount determined by the formula—

$$C \times \frac{R}{100}$$

where—

C is the amount of the other relevant trading charges on income, and

R is the rate per cent of corporation tax which, by virtue of section 21, applies in relation to the accounting period.

(4) (*a*) Where a company makes a claim for relief under this section in respect of any relevant trading charges on income paid in an accounting period, an amount (which shall not exceed the amount of the excess in respect of which a claim under this section may be made), determined in accordance with paragraph (*b*), shall be treated for the purposes of the Tax Acts as relieved under this section.

(*b*) Subject to paragraph (*c*), the amount determined in accordance with this paragraph in relation to an accounting period is an amount equal to the aggregate of the following amounts:

(i) where relief is given under paragraph (*a*) of subsection (3) for the accounting period, an amount equal to 10 times the amount by which the relevant corporation tax for the accounting period is reduced by virtue of that paragraph, and

(ii) where relief is given under paragraph (*b*) of subsection (3) for the accounting period, an amount determined by the formula—

$$T \times \frac{100}{R}$$

where—

T is the amount by which the relevant corporation tax for the accounting period is reduced by virtue of that paragraph, and

R is the rate per cent of corporation tax which, by virtue of section 21, applies in relation to the accounting period.”,

(*b*) in Part 12—

(i) in section 396—

(I) in subsection (1), by substituting “subsection (2) or section 396A(3), 396B(2) or 455(3)” for “subsection (2) or section 455(3)”, and

(II) in subsection (7), by inserting “net of any part of those charges relieved under section 243B” after “a company”,

(ii) by inserting the following after section 396A:

“Relief for certain trading losses on a value basis.

396B.—(1) In this section—

‘relevant corporation tax’, in relation to an accounting period of a company, means the corporation tax which, apart from this section and sections 239, 241, 420B, 440 and 441, would be chargeable on the company for the accounting period;

‘relevant trading loss’ has the same meaning as in section 396A but does not include any amount which is the relevant amount of the loss for the purposes of section 403(4).

(2) Where in any accounting period a company carrying on a trade incurs a relevant trading loss and the amount of the loss exceeds an amount equal to the aggregate of the amounts set off in respect of that loss for the purposes of corporation tax against—

(*a*) income of the company of that accounting period and any preceding accounting period in accordance with section 396A(3), and

(*b*) income of the company from the sale of goods of that accounting period and any preceding accounting period in accordance

with section 455(3),

the company may claim relief under this section in respect of the excess.

(3) Where for any accounting period a company claims relief under this section in respect of the excess, the relevant corporation tax of the company for that accounting period and, if the company was then carrying on the trade and the claim so requires, for preceding accounting periods ending within the time specified in subsection (4), shall be reduced—

(*a*) in so far as the excess consists of a loss from the sale of goods (within the meaning of section 455), by an amount equal to 10 per cent of the loss from the sale of goods, and

(*b*) in so far as the excess consists of a loss (in this section referred to as the 'remainder of the relevant trading loss') which is not a loss from the sale of goods (within the meaning of section 455), by an amount determined by the formula—

$$L \times \frac{R}{100}$$

where—

L is the amount of the remainder of the relevant trading loss, and

R is the rate per cent of corporation tax which, by virtue of section 21, applies in relation to the accounting period.

(4) For the purposes of subsection (3), the time referred to in that subsection shall be the time immediately preceding the accounting period first mentioned in subsection (3) equal in length to that accounting period; but the amount of the reduction which may be made under subsection (3) in the relevant corporation tax for an accounting period falling partly before that time shall not exceed such part of that relevant corporation tax as bears to the whole of that relevant corporation tax the same proportion as the part of the accounting period falling within that time bears to the whole of that accounting period.

(5) (*a*) Where a company makes a claim for relief for any accounting period under this section in respect of any relevant trading loss incurred in a trade in an accounting period, an amount (which shall not exceed the amount of the excess in respect of which a claim under this section may be made), determined in accordance with paragraph (*b*), shall be treated for the purposes of the Tax Acts as an amount of loss relieved against profits of that accounting period.

(*b*) Subject to paragraph (*c*), the amount determined in accordance with this paragraph in relation to an accounting period is an amount equal to the aggregate of the following amounts:

(i) where relief is given under paragraph (*a*) of subsection (3) for the accounting period, an amount equal to 10 times the amount by which the relevant corporation tax payable for the accounting period is reduced by virtue of that paragraph, and

(ii) where relief is given under paragraph (*b*) of subsection (3) for the accounting period, an amount determined by the formula—

$$T \times \frac{100}{R}$$

where—

T is the amount by which the relevant corporation tax payable is reduced by virtue of subsection (3)(*b*), and

R is the rate per cent of corporation tax which, by virtue of section 21, applies in relation to the accounting period.

(*c*) (i) In this paragraph 'relevant amount' means an amount (not being an amount incurred by a company for the purposes of a trade carried on by it) of charges on income, expenses of management or other amount (not being an allowance to which effect is given under section 308(4)) which is deductible from, or may be treated as reducing, profits of more than one description.

(ii) For the purposes of paragraph (*b*), where as respects an accounting period of a company a relevant amount is deductible from, or may be treated as reducing, profits of more than one description, the amount by which corporation tax is reduced by virtue of subsection (3) shall be deemed to be the amount by which it would have been reduced if no relevant amount were so deductible or so treated.",

and

(iii) by inserting the following after section 420A:

"Group relief: Relief for certain losses on a value basis.

420B.—(1) In this section—

'relevant corporation tax', in relation to an accounting period of a company means the corporation tax which, apart from this section and sections 239, 241, 440 and 441, would be chargeable on the company for the accounting period;

'relevant trading charges on income' has the same meaning as in section 243A;

'relevant trading loss' has the same meaning as in section 396A but does not include any amount which is the relevant amount of the loss for the purposes of section 403(4).

(2) Where in any accounting period the surrendering company has incurred a relevant trading loss, computed as for the purposes of section 396(2), or an excess of relevant trading charges on income, in carrying on a trade in respect of which the company is within the charge to corporation tax, and the amount of the loss or excess is greater than an amount equal to

the aggregate of the amounts set off in respect of that loss or excess for the purposes of corporation tax against—

(*a*) the income of the company in accordance with section 243A, 396A or 420A, and

(*b*) the income from the sale of goods in accordance with section 455 or 456,

of the claimant company for its corresponding accounting period, the claimant company may claim relief under this section for that corresponding accounting period in respect of the amount (in this section referred to as the 'relievable loss') by which the loss or excess is greater than that aggregate.

(3) Where for any accounting period a company claims relief under this section in respect of a relievable loss, the relevant corporation tax of the company for the accounting period shall be reduced—

(*a*) in so far as the relievable loss consists of a loss from the sale of goods (within the meaning of section 455) or charges on income paid for the sale of goods (within the meaning of section 454), by an amount equal to 10 per cent of that loss from the sale of goods or those charges on income from the sale of goods, and

(*b*) in so far as the relievable loss consists of a loss or charges on income (in this section referred to as the 'remainder of the loss or charges') which is not a loss or charge on income of the type mentioned in paragraph (*a*), by an amount determined by the formula—

$$L \times \frac{R}{100}$$

where—

L is an amount equal to the remainder of the loss or charges, and

R is the rate per cent specified in section 21 in relation to the accounting period.

(4) (*a*) Where for any accounting period a company claims relief under this section in respect of any relevant trading loss or excess of relevant trading charges on income, the surrendering company shall be treated as having surrendered, and the claimant company shall be treated as having claimed relief for, trading losses and charges on income of an amount determined in accordance with paragraph (*b*).

(*b*) The amount determined in accordance with this paragraph is an amount equal to the aggregate of the following amounts:

(i) where relief is given under paragraph (*a*) of subsection (3) for the accounting period, an amount equal to 10 times the amount by which the relevant corporation tax payable for the accounting period is reduced by virtue of that paragraph, and

(ii) where relief is given under paragraph (*b*) of subsection (3) for the accounting period, an amount determined by the formula—

$$T \times \frac{100}{R}$$

where—

T is the amount by which the relevant corporation tax payable for the accounting period is reduced by virtue of subsection (3)(*b*), and

R is the rate per cent of corporation tax which, by virtue of section 21, applies in relation to the accounting period.”,

and

(*c*) in section 454(2) by inserting “(within the meaning of section 243A)” after “relevant trading income”.

(2) For the purposes of computing the amount of—

(*a*) charges on income paid for the purposes of the sale of goods (within the meaning of section 454 of the Principal Act),

(*b*) a loss from the sale of goods (within the meaning of section 455 of the Principal Act),

(*c*) relevant trading charges on income (within the meaning of section 243A of the Principal Act), and

(*d*) relevant trading losses (within the meaning of section 396A of the Principal Act),

in respect of which relief may be claimed by virtue of this section, where an accounting period of a company begins before 6 March 2001 and ends on or after that date, it shall be divided into 2 parts, one beginning on the date on which the accounting period begins and ending on 5 March 2001 and the other beginning on 6 March 2001 and ending on the date on which the accounting period ends, and both parts shall be treated as if they were separate accounting periods of the company.

(3) This section applies as respects an accounting period ending on or after 6 March 2001.

Amendment of section 90 (restriction of certain

55. — Section 90 of the Finance Act, 2001 shall apply, and be deemed always to have applied, as if the following were substituted for subsection (4):

losses and charges) of Finance Act, 2001.

"(4) (*a*) For the purposes of—

(i) computing the amount of—

(I) relevant trading charges on income within the meaning of section 243A of the Principal Act, and

(II) relevant trading losses within the meaning of section 396A of the Principal Act,

and

(ii) this section insofar as it applies to sections 454 and 456 of the Principal Act,

where an accounting period of a company begins before 6 March 2001 and ends on or after that date, it shall be divided into 2 parts, one beginning on the date on which the accounting period begins and ending on 5 March 2001 and the other beginning on 6 March 2001 and ending on the date on which the accounting period ends, and both parts shall be treated as if they were separate accounting periods of the company.

(*b*) For the purposes of computing the amount of—

(i) charges on income paid for the purposes of the sale of goods within the meaning of section 454 of the Principal Act, and

(ii) a loss from the sale of goods within the meaning of section 455 of the Principal Act,

where an accounting period of a company begins before 1 January 2003 and ends on or after that date, it shall be divided into two parts, one beginning on the date on which the accounting period begins and ending on 31 December 2002 and the other beginning on 1 January 2003 and ending on the date which the accounting period ends, and both parts shall be treated as if they were separate accounting periods of the company.".

Amendment of section 483 (relief for certain gifts) of Principal Act.

56. —(1) Section 483 of the Principal Act is amended by inserting the following after subsection (4):

"(5) The Tax Acts shall apply to a loss referred to in subsection (4) as they would apply if sections 396A and 420A had not been enacted.".

(2) This section applies from 6 March 2001.

Credit for certain withholding tax.

57. —Schedule 24 to the Principal Act (which is amended by *section 38*) is further amended—

(*a*) in paragraph 4(5)—

(i) in clause (*a*) by substituting "this paragraph, paragraph 9D" for "this paragraph", and

(ii) in clause (*b*)—

(I) in subclause (ii) by deleting "and",

(II) in subclause (iii) by inserting "and" after "that section,", and

(III) by inserting the following after subclause (iii):

"(iv) the amount of income of a company treated for the purposes of paragraph 9D as referable to an amount of relevant interest (within the meaning of that paragraph)",

(*b*) in paragraph 9A(5)(*b*) by substituting "section 449 or paragraph 9D" for "section 449", and

(*c*) by inserting the following after paragraph 9C:

"9D.—(1) (*a*) In this paragraph—

'relevant foreign tax', in relation to interest receivable by a company, means tax—

(i) which under the laws of any foreign territory has been deducted from the amount of the interest,

(ii) which corresponds to income tax or corporation tax,

(iii) which has not been repaid to the company,

(iv) for which credit is not allowable under arrangements, and

(v) which, apart from this paragraph, is not treated under this Schedule as reducing the amount of income;

'relevant interest' means interest receivable by a company which interest falls to be taken into account in computing the trading income of a trade carried on by the company.

(*b*) For the purposes of this paragraph—

(i) the amount of corporation tax which apart from this paragraph would be payable by a company for an accounting period and which is attributable to an amount of relevant interest shall be an amount

equal to—

(I) in so far as it is corporation tax charged on profits which under section 26(3) are apportioned to the financial year 2002, 16 per cent, and

(II) in so far as it is corporation tax charged on profits which under section 26(3) are apportioned to the financial year 2003 or any subsequent financial year, 12.5 per cent,

of the amount of the income of the company referable to the amount of the relevant interest, and

(ii) the amount of any income of a company referable to an amount of relevant interest in an accounting period shall, subject to paragraph 4(5), be taken to be such sum as bears to the total amount of the trading income of the company for the accounting period the same proportion as the amount of relevant interest in the accounting period bears to the total amount receivable by the company in the course of the trade in the accounting period.

(2) Where, as respects an accounting period of a company, the trading income of a trade carried on by the company includes an amount of relevant interest, the amount of corporation tax which, apart from this paragraph, would be payable by the company for the accounting period shall be reduced by so much of—

(*a*) in so far as it is corporation tax charged on profits which under section 26(3) are apportioned to the financial year 2002, 84 per cent, and

(*b*) in so far as it is corporation tax charged on profits which under section 26(3) are apportioned to the financial year 2003 or any subsequent financial year, 87.5 per cent,

of any relevant foreign tax borne by the company in respect of relevant interest in that period as does not exceed the corporation tax which would be so payable and which is attributable to the amount of the relevant interest.

(3) (*a*) This paragraph shall not apply as respects any accounting period of a company which is a relevant accounting period within the meaning of section 442.

(*b*) Subsection (2) of section 442 shall apply for the purposes of this paragraph as it applies for the purposes of Part 14.".

Amendment of section 958 (date for payment of tax) of Principal Act.

58. —Section 958 (as amended by the Finance Act, 2001) of the Principal Act is amended—

(*a*) by substituting the following for subsection (1):

"(1) (*a*) In this section—

'corresponding corporation tax for the preceding chargeable period', in relation to a chargeable period which is an accounting period of a company, means an amount determined by the formula—

$$T \times \frac{C}{P}$$

where—

T is the corporation tax payable by the chargeable person for the preceding chargeable period,

C is the number of months in the chargeable period, and

P is the number of months in the preceding chargeable period;

'pre-preceding chargeable period', in relation to a chargeable period, means the chargeable period next before the preceding chargeable period;

'relevant limit', in relation to a chargeable period which is an accounting period of a company, means €50,000; but where the length of a chargeable period is less than 12 months the relevant limit in relation to the chargeable period shall be proportionately reduced.

(*b*) For the purposes of this section, a chargeable person being a company shall be a small company in relation to a chargeable period if the corresponding corporation tax for the preceding chargeable period payable by the chargeable person does not exceed the relevant limit in relation to the accounting period.",

(*b*) by substituting the following for subsection (2):

"(2) Subject to subsection (10), preliminary tax appropriate to a chargeable period which is a year of assessment for income tax shall be due and payable on or before 31 October in the year of assessment and, accordingly, references in this Part to the due date for the payment of an amount of preliminary tax shall, in the case where that tax is due for a chargeable period which is a year of assessment, be construed as a reference to 31 October in the year of assessment.

(2A) (*a*) Preliminary tax appropriate to a chargeable period which is an accounting period of a company ending in the period from 1 January 2002 to 31 December 2005 shall be due and payable in 2 instalments.

(*b*) The first of the 2 instalments referred to in paragraph (*a*) (in this section referred to as the 'first instalment') shall be due and payable not later

than the day which is 31 days before the day on which the accounting period ends; but where that day is later than day 28 of the month in which the first-mentioned day occurs, the first instalment shall be due and payable not later than day 28 of that month or such earlier day in that month as may be specified by order made by the Minister for Finance.

(*c*) Notwithstanding paragraph (*b*), in the case where an accounting period of a company is less than one month and one day in length, the first instalment shall be due and payable not later than the last day of the accounting period; but where that day is later than day 28 of the month in which that day occurs, the first instalment shall be due and payable not later than day 28 of that month or such earlier day in that month as may be specified by order made by the Minister for Finance.

(*d*) Notwithstanding paragraphs (*b*) and (*c*), in the case of an accounting period of a company ending in the year 2002, the first instalment shall not be due and payable earlier than 28 June 2002.

(*e*) The second of the 2 instalments referred to in paragraph (*a*) (in this section referred to as the 'second instalment') shall be due and payable within the period of 6 months from the end of the accounting period, but in any event not later than day 28 of the month in which that period of 6 months ends, or such earlier day in that month as may be specified by order made by the Minister for Finance.

(2B) (*a*) Preliminary tax appropriate to a chargeable period which is an accounting period of a company ending on or after 1 January 2006 shall be due and payable not later than the day which is 31 days before the day on which the accounting period ends; but where that day is later than day 28 of the month in which the first-mentioned day occurs, that tax shall be due and payable not later than day 28 of that month or such earlier day in that month as may be specified by order made by the Minister for Finance.

(*b*) Notwithstanding paragraph (*a*), in the case where an accounting period of a company ending on or after 1 January 2006 is less than one month and one day in length, preliminary tax shall be due and payable not later than the last day of the accounting period; but where that day is later than day 28 of the month in which that day occurs, preliminary tax shall be due and payable not later than day 28 of that month or such earlier day in that month as may be specified by order made by the Minister for Finance.

(2C) (*a*) References in this Part to the due date for the payment of the first instalment, or the second instalment, of preliminary tax shall be construed in accordance with subsection (2A).

(*b*) References in this Part to the due date for the payment of an amount of preliminary tax shall, in the case where that tax is due for a chargeable period which is an accounting period of a company ending on or after 1 January 2006, be construed in accordance with subsection (2B).",

(*c*) in subsection (3), by substituting “subsections (3A), (4), (4B), (4C), (4D) and (4E)” for “subsections (3A) and (4)”,

(*d*) in subsection (4), by inserting “which is a year of assessment” after “chargeable period” where it first occurs, and

(*e*) by inserting the following after subsection (4A):

“(4B) (*a*) Subject to subsection (4D), where but for this subsection tax payable by a chargeable person for a chargeable period which is an accounting period of a company ending in the period from 1 January 2002 to 31 December 2005 would be due and payable in accordance with subsection (3), and—

(i) the chargeable person has defaulted in the payment of the first instalment or the second instalment of preliminary tax for the chargeable period,

(ii) where the chargeable person is a small company in relation to the accounting period, the first instalment of the preliminary tax paid by the chargeable person for the chargeable period is less than, or less than the lower of—

(I) where the chargeable period is an accounting period of the company ending in the year 2002, 18 per cent of the tax payable by the chargeable person for the chargeable period or 20 per cent of the corresponding corporation tax for the preceding chargeable period,

(II) where the chargeable period is an accounting period of the company ending in the year 2003, 36 per cent of the tax payable by the chargeable person for the chargeable period or 40 per cent of the corresponding corporation tax for the preceding chargeable period,

(III) where the chargeable period is an accounting period of the company ending in the year 2004, 54 per cent of the tax payable by the chargeable person for the chargeable period or 60 per cent of the corresponding corporation tax for the preceding chargeable period, or

(IV) where the chargeable period is an accounting period of the company ending in the year 2005, 72 per cent of the tax payable by the chargeable person for the chargeable period or 80 per cent of the corresponding corporation tax for the preceding chargeable period,

(iii) where the chargeable person is not a small company in relation to the accounting period, the first instalment of the preliminary tax paid by the chargeable person for the chargeable period is less than—

(I) where the chargeable period is an accounting period of the company ending in the year 2002, 18 per cent,

(II) where the chargeable period is an accounting period of the company ending in the year 2003, 36 per cent,

(III) where the chargeable period is an accounting period of the company ending in the year 2004, 54 per cent, or

(IV) where the chargeable period is an accounting period of the company ending in the year 2005, 72 per cent,

of the tax payable by the chargeable person for the chargeable period,

(iv) the aggregate of the first instalment and the second instalment of the preliminary tax paid by the chargeable person for the chargeable period is less than 90 per cent of the tax payable by the chargeable person for the chargeable period, or

(v) the first instalment or the second instalment of the preliminary tax payable by the chargeable person for the chargeable period was not paid by the date on which it was due and payable,

then the tax payable by the chargeable person for the chargeable period shall be deemed to have been due and payable in accordance with paragraph (*b*).

(*b*) (i) Tax due and payable in accordance with this paragraph by a chargeable person for a chargeable period which is an accounting period of a company shall be due and payable in 2 instalments.

(ii) The first of the 2 instalments referred to in subparagraph (i) (in this paragraph and in paragraphs (*c*) and (*d*) referred to as the 'first relevant instalment') shall be due and payable not later than the day on which the first instalment of preliminary tax is due and payable in accordance with subsection (2A).

(iii) The second of the 2 instalments referred to in subparagraph (i) (in this paragraph and in paragraphs (*c*) and (*d*) referred to as the 'second relevant instalment') shall be due and payable not later than the day on which the second instalment of preliminary tax is due and payable in accordance with subsection (2A).

(*c*) The amount of the first relevant instalment shall be—

(i) where the chargeable period is an accounting period of the company ending in the year 2002, 20 per cent,

(ii) where the chargeable period is an accounting period of the company ending in the year 2003, 40 per cent,

(iii) where the chargeable period is an accounting period of the company ending in the year 2004, 60 per cent, and

(iv) where the chargeable period is an accounting period of the company ending in the year 2005, 80 per cent,

of the tax payable by the chargeable person for the chargeable period.

(*d*) The amount of the second relevant instalment shall be an amount equal to the excess of the tax payable by the chargeable person for the chargeable period over the amount of the first relevant instalment.

(4C) Subject to subsection (4E), where but for this subsection tax payable by a chargeable person for a chargeable period which is an accounting period of a company ending on or after 1 January 2006 would be due and payable in accordance with subsection (3), and—

(*a*) the chargeable person has defaulted in the payment of preliminary tax for the chargeable period,

(*b*) the preliminary tax paid by the chargeable person for the chargeable period is—

(i) where the chargeable person is a small company in relation to the accounting period, less than, or less than the lower of—

(I) 90 per cent of the tax payable by the chargeable person for the chargeable period, or

(II) the corresponding corporation tax for the preceding chargeable period,

And

(ii) where the chargeable person is not a small company in relation to the accounting period, less than 90 per cent of the tax payable by the chargeable person for the chargeable period,

Or

(*c*) the preliminary tax payable by the chargeable person for the chargeable period was not paid by the date on which it was due and payable,

then the tax payable by the chargeable person for the chargeable period shall be deemed to have been due and payable on the due date for the payment of an amount of preliminary tax for the chargeable period.

(4D) Where as respects a chargeable period which is an accounting period of a company ending in the period 1 January 2002 to 31 December 2005—

(*a*) the first instalment of preliminary tax paid by the chargeable person for the chargeable period in accordance with subsection (2A) is less than—

(i) where the chargeable period is an accounting period ending in 2002, 18 per cent,

(ii) where the chargeable period is an accounting period ending in 2003, 36 per cent,

(iii) where the chargeable period is an accounting period ending in 2004, 54 per cent, or

(iv) where the chargeable period is an accounting period ending in 2005, 72 per cent,

of the tax payable by the chargeable person for the chargeable period,

(*b*) the preliminary tax so paid by the chargeable person for the chargeable period is not less than—

(i) where the chargeable period is an accounting period ending in 2002, 18 per cent,

(ii) where the chargeable period is an accounting period ending in 2003, 36 per cent,

(iii) where the chargeable period is an accounting period ending in 2004, 54 per cent, or

(iv) where the chargeable period is an accounting period ending in 2005, 72 per cent,

of the amount which would be payable by the chargeable person for the chargeable period if no amount were included in the chargeable person's profits for the chargeable period in respect of chargeable gains on the disposal by the person of assets in the part of the chargeable period which is after the date by which the first instalment for the chargeable period is payable in accordance with subsection (2A),

(*c*) the chargeable person makes a further payment of preliminary tax for the chargeable period within one month after the end of the chargeable period and the aggregate of that payment and the first instalment paid by the chargeable person for the chargeable period in accordance with subsection (2A) is not less than the percentage specified in paragraph (*a*) in relation to the chargeable period of the tax payable by the chargeable person for the chargeable period, and

(*d*) the aggregate of those payments and the second instalment paid by the chargeable person for the chargeable period in accordance with subsection (2) is not less than 90 per cent of the tax payable by the chargeable person for the chargeable period,

then the preliminary tax paid by the chargeable person for the chargeable period shall be treated for the purposes of subsection (4B) as having been paid by the date by which it is due and payable.

(4E) Where as respects a chargeable period which is an accounting period of a company ending on or after 1 January 2006—

(*a*) the preliminary tax paid by the chargeable person for the chargeable period in accordance with subsection (2B) is less than 90 per cent of the tax payable by the chargeable person for the chargeable period,

(*b*) the preliminary tax so paid by the chargeable person for the chargeable period is not less than 90 per cent of the amount which would be payable by the chargeable person for the chargeable period if no amount were included in the chargeable person's profits for the chargeable period in respect of chargeable gains on the disposal by the person of assets in the part of the chargeable period which is after the date by which preliminary tax for the chargeable period is payable in accordance with subsection (2B), and

(*c*) the chargeable person makes a further payment of preliminary tax for the chargeable period within one month after the end of the chargeable period and the aggregate of that payment and the preliminary tax paid by the chargeable person for the chargeable period in accordance with subsection (2B) is not less than 90 per cent of the tax payable by the chargeable person for the chargeable period.

then the preliminary tax paid by the chargeable person for the chargeable period shall be treated for the purposes of subsection (4C) as having been paid by the date by which it is due and payable.”.

UK tonnage tax legislation

The UK tonnage tax legislation is summarized by the Law Firm Watson, Farley and Williams and can be perused by accessing the following link:

http://www.wfw.com/pubs/Summary%20of%20UK%20Tonnage%20Tax%20Legislation.pdf

SCHEDULE 7

TONNAGE TAX

PART 1

AMENDMENTS OF SCHEDULE 22 TO FA 2000

Introduction

Schedule 22 to FA 2000 shall be amended as follows.

Period for which election is in force

(1) Paragraph 13 is amended as follows.

(2) After sub-paragraph (2) insert-

"(2A) A tonnage tax election ceases to be in force-

(a) in the case of a company election, if a withdrawal notice in respect of the company takes effect under paragraph 15A;

(b) in the case of a group election, if a withdrawal notice in respect of the group takes effect under that paragraph.".

Withdrawal notices

After paragraph 15 (and before Part 3) insert-

"*Withdrawal notices*

15A (1) A withdrawal notice (see paragraph 13(2A)) may be given-

(a) in respect of a single company, or

(b) in respect of a group,

but only if the following conditions are met.

(2) Condition 1 is that the notice is given during the period-

(a) beginning with the day on which the Finance Act 2005 is passed, and

(b) ending with 31st March 2006.

(3) Condition 2 is that, for the whole of the period of three years ending with the day on which the Finance Act 2005 is passed, a tonnage tax election or a renewal election has been in force in respect of the company or group in respect of which the withdrawal notice is to be given.

(4) A withdrawal notice must be given to the Inland Revenue-

(a) in the case of a withdrawal notice in respect of a single company, by that company;

(b) in the case of a withdrawal notice in respect of a group, jointly by all the qualifying companies in the group.

(5) A withdrawal notice given in accordance with this paragraph takes effect at the end of the accounting period that precedes the first accounting period of the company to begin after 1st July 2005.

(6) In the case of a withdrawal notice given in respect of a group, sub-paragraph (5) has effect in relation to each qualifying company in the group by reference to that company's accounting periods.

Power to provide further opportunities for withdrawal

15B (1) The Treasury may by order provide for further periods during which withdrawal notices under paragraph 15A may be given.

(2) Any such order may provide for that paragraph to apply, with such consequential adaptations as appear to the Treasury to be appropriate, in relation to any such further period as it applies in relation to the period specified in sub-paragraph (2) of that paragraph.

(3) The consequential adaptations that may be made include adaptations of the reference in sub-paragraph (3) of that paragraph to the period of three years ending with the day on which the Finance Act 2005 is passed.".

Qualifying ships

(1) Paragraph 19 is amended as follows.

(2) In sub-paragraph (1) (meaning of "qualifying ship")-

(a) in paragraph (a), after "carriage" insert "by sea";

(b) in paragraph (b), after "carriage" insert "by sea";

(c) in paragraph (c), after "assistance" insert "carried out at sea";

(d) in paragraph (d), after "transport" insert "by sea".

(3) In sub-paragraph (3) (other provisions to which sub-paragraph (1) is subject)-

(a) after "subject to" insert-

"(a) ";

(b) at the end insert-

"(b) paragraph 20A (qualifying dredgers and tugs);

(c) paragraphs 22A to 22F (flagging).".

(4) After sub-paragraph (4) insert-

"(5) For the purposes of sub-paragraph (1) "sea" does not include-

(a) a port or harbour;

(b) an estuary, a tidal or other river or an inland waterway.".

Vessels excluded from being qualifying ships

(1) Paragraph 20 is amended as follows.

(2) In sub-paragraph (1) (list of excluded vessels) for paragraph (f) (dredgers) substitute-

"(f) dredgers other than qualifying dredgers.".

(3) After sub-paragraph (6) insert-

"(7) In this Schedule "qualifying dredger" means a dredger which-

(a) is self-propelled, and

(b) is constructed or adapted for the carriage of cargo;

(but see further paragraph 20A).".

Qualifying dredgers and tugs

After paragraph 20 insert-

"Qualifying dredgers and tugs

20A (1) This paragraph applies where a company operates a ship in an accounting period and the ship-

(a) is a qualifying dredger or a tug, and

(b) would, apart from this paragraph, be a qualifying ship.

(2) The ship shall not be regarded as a qualifying ship operated by the company in that accounting period unless it is used for one or more of the activities mentioned in paragraph 19(1)(a) to (d) for more than 50% of its operational time.

(3) In this paragraph "operational time", in relation to a ship operated by a company in an accounting period, means the time during that accounting period during which the ship is-

(a) operated by the company, and

(b) used for any activity.

(4) For the purposes of sub-paragraph (2) assisting a self-propelled vessel into or out of a port or harbour is not to be regarded as use for an activity mentioned in paragraph 19(1)(c).

(5) For the purposes of sub-paragraph (3) any waiting time spent by a tug for the purposes of a particular activity is to be treated as time during which the tug is used for that activity.".

Effect of change of use

(1) Paragraph 22 is amended as follows.

(2) In sub-paragraph (1) (qualifying ship beginning to be used as vessel of excluded kind ceases to be such ship when it begins to be so used) for "as a vessel of an excluded kind" substitute "for non-qualifying purposes".

(3) In sub-paragraph (2)(b) (use as vessel of excluded kind for up to 30 days in accounting period to be disregarded) for "as a vessel of an excluded kind" substitute "for non-qualifying purposes".

(4) In sub-paragraph (5) (meaning of references to use as vessel of excluded kind) for "as a vessel of an excluded kind are to" substitute"for non-qualifying purposes are to-

(a) use for an activity other than any of the activities mentioned in paragraph 19(1)(a) to (d), or

(b) - ".

(5) After that sub-paragraph insert-

"(6) This paragraph does not apply for the purposes of sub-paragraphs (2) to (5) of paragraph 20A (qualifying dredgers and tugs).".

Flagging: rule for ships other than dredgers and tugs

After paragraph 22 insert-

"Flagging: rule for ships other than dredgers and tugs

22A (1) This paragraph applies if the following conditions are satisfied in the case of a ship which-

(a) is neither a qualifying dredger nor a tug, and

(b) would, apart from this paragraph, be a qualifying ship.

(2) Condition 1 is that, at a time after the later of the reference date (see paragraph 22B(1)) and 30th June 2005,-

(a) in the case of a tonnage tax company which is a single company, the company begins, in a financial year which is not excepted (see paragraph 22B(2)), to operate the ship for the first time, or

(b) in the case of a tonnage tax company which is a member of a tonnage tax group, the company begins, in a financial year which is not excepted, to operate the ship for the first time, the ship not having previously been operated by any other member of the group.

(3) Condition 2 is that less than 60% of the company's total tonnage is Community-flagged (see paragraph 22B(3)) on average over the period-

(a) beginning with the first day of the financial year mentioned in condition 1, and

(b) ending with the day on which the company so begins to operate the ship.

(4) Condition 3 is that-

(a) the percentage of the company's total tonnage which is Community-flagged on average over

the period mentioned in condition 2,

is less than

(b) the percentage of the company's total tonnage which was Community-flagged on the reference date.

(5) Condition 4 is that, on the date on which the company so begins to operate the ship, the ship is not registered in one of the Member States' registers (see paragraph 22B(7)).

(6) Where this paragraph applies in relation to the ship, the ship shall not, at any time on or after that date, be regarded as-

(a) a qualifying ship operated by the company, or

(b) if immediately before that date the company is a member of a tonnage tax group, a qualifying ship operated by any company that is or becomes a member of the group.

(7) But sub-paragraph (6) does not apply if-

(a) the ship has become registered in one of the Member States' registers by the end of the period of three months beginning with that date, or

(b) the conditions in sub-paragraph (8) are satisfied.

(8) Those conditions are that-

(a) a substitute ship which was not registered in one of the Member States' registers has, during the period mentioned in sub-paragraph (7)(a), become so registered, and

(b) no later than the end of that period-

(i) if the company is a single company, the company makes an election under this sub-paragraph in relation to the substitute ship, or

(ii) if the company is a member of a tonnage tax group, all the qualifying companies in the group jointly make such an election.

(9) In sub-paragraph (8) a "substitute ship" means a qualifying ship-

(a) the tonnage of which is no less than that of the ship mentioned in sub-paragraph (1), and

(b) which was first operated by the company or, if the company is a member of a tonnage tax group, by any other member of the group more than three months before that date;

and for this purpose the tonnage of a ship is to be determined on the same basis as it is under paragraph 22B(3).

(10) An election under sub-paragraph (8) is made by notice to the Inland Revenue.

Flagging: meaning of terms used in paragraph 22A

22B (1) In paragraph 22A "the reference date" means 17th January 2004 or, if later,-

(a) in the case of a single company, the date of the end of the accounting period in which the company became (or becomes) a tonnage tax company;

(b) in the case of a member of a group, the date of the end of the accounting period in which the group became (or becomes) a tonnage tax group;

but where the members of a group had (or have) different accounting periods at the time the group became (or becomes) a tonnage tax group, paragraph (b) has effect by reference to the first of those accounting periods.

(2) For the purposes of sub-paragraph (2) of paragraph 22A a financial year is excepted if it is designated by an order made by the Treasury as a financial year in relation to which that paragraph is not to have effect (see further paragraph 22C(1) to (3)).

(3) For the purposes of paragraph 22A the percentage of a company's total tonnage which is Community-flagged is-

$$\frac{CFT}{TT} \times 100$$

where-

CFT is the aggregate tonnage of such of the relevant ships as are registered in one of the Member States' registers, and

TT is the aggregate tonnage of all the relevant ships.

(4) For the purposes of sub-paragraph (3) the ships which are the relevant ships are-

(a) if the company is a single company, the ships operated by the company, or

(b) if the company is a member of a tonnage tax group, the ships operated by each member of the group which is a qualifying company.

(5) Sub-paragraphs (3) and (4) are subject to any regulations made under paragraph 22C(4).

(6) A ship shall not be counted more than once in determining for the purposes of sub-paragraph (3) the aggregate tonnage of relevant ships.

(7) In this Schedule "Member States' registers" has the meaning given by the Annex to Commission communication C(2004) 43 - Community guidelines on State aid to maritime transport (as from time to time amended or replaced).

Flagging: provisions supplementing paragraphs 22A and 22B

22C (1) An order under paragraph 22B(2) designating a financial year shall be made if-

(a) the Treasury are satisfied, on the basis of the information available to them, that the percentage of the tonnage tax fleet which is Community-flagged has not decreased on average over a prescribed three year period, and

(b) the order is made before the beginning of that financial year.

(2) The Treasury may make provision by regulations for or in connection with-

(a) specifying the meaning, for the purposes of sub-paragraph (1)(a), of the percentage of the tonnage tax fleet which is Community-flagged;

(b) specifying the way in which an average is to be calculated for those purposes;

(c) requiring any tonnage tax company or tonnage tax group to provide prescribed information for the purposes of enabling the Treasury to determine whether the condition in sub-paragraph (1)(a) is met;

(d) imposing penalties in respect of a failure to comply with a provision of the regulations made by

virtue of paragraph (c) (including, in prescribed cases or circumstances, the exclusion of a company or group from tonnage tax).

(3) Section 828(3) of the Taxes Act 1988 shall not apply in relation to an order under paragraph 22B(2).

(4) The Treasury may make provision by regulations as to the way in which the percentage of a company's total tonnage which is Community-flagged is to be calculated for the purposes of paragraph 22A.

(5) The provision that may be made by regulations under sub-paragraph (4) includes provision for or in connection with-

(a) determining the percentage of a company's total tonnage which is Community-flagged on average over a period;

(b) specifying the basis on which the tonnage of a ship is to be determined;

(c) treating ships which would, but for the regulations, be relevant ships for the purposes of paragraph 22B(3) as not being relevant ships for those purposes;

(d) including in the calculation set out in paragraph 22B(3) only such proportion of the tonnage of a relevant ship as may be prescribed.

(6) Regulations under this paragraph-

(a) may make different provision for different cases or circumstances, and

(b) may contain such supplementary, incidental, consequential and transitional provisions as appear to the Treasury to be necessary or expedient.

(7) In this paragraph "prescribed" means-

(a) specified in, or

(b) determined in accordance with,

regulations under this paragraph.".

Flagging: rules for dredgers and tugs

After paragraph 22C insert-

"Flagging: rule on first operation of qualifying dredger or tug

22D (1) This paragraph applies if-

(a) a company begins to operate a ship which-

(i) is a qualifying dredger or a tug,

(ii) would, apart from this paragraph, be a qualifying ship, and

(iii) has not previously been operated by the company or, if the company is a member of a group, by any member of the group, and

(b) on the date on which the company so begins to operate the ship, the ship is not registered in one of the Member States' registers.

(2) The ship shall not, at any time on or after that date, be regarded as-

(a) a qualifying ship operated by the company, or

(b) if immediately before that date the company is a member of a group, a qualifying ship operated by any company that is or becomes a member of the group.

(3) But sub-paragraph (2) does not apply if the ship has become registered in one of the Member States' registers by the end of the period of three months beginning with that date.

Flagging: rule on subsequent re-flagging of qualifying dredger or tug

22E (1) This paragraph applies if-

(a) a qualifying ship operated by a company ceases to be registered in any of the Member States' registers, and

(b) the ship is a qualifying dredger or a tug.

(2) The ship shall not, at any time on or after the date on which it ceases to be so registered, be regarded as-

(a) a qualifying ship operated by the company, or

(b) if immediately before that date the company is a member of a group, a qualifying ship operated by any company that is or becomes a member of the group.".

Flagging: restrictions where dredger or tug ceases to be qualifying ship under paragraph 22E

After paragraph 22E insert-

"Flagging: restrictions where ship ceases to be qualifying ship under paragraph 22E

22F (1) This paragraph applies where a qualifying ship operated by a tonnage tax company ceases to be a qualifying ship by virtue of paragraph 22E.

(2) No notice may be given under section 130 of the Capital Allowances Act 2001 for the postponement of all or part of a relevant allowance to which-

(a) the company, or

(b) if immediately before the date on which the ship so ceases to be a qualifying ship ("the cessation date") the company is a member of a tonnage tax group, any company that is or becomes a member of the group,

becomes entitled on or after the cessation date.

(3) In sub-paragraph (2) "relevant allowance" means an allowance in respect of-

(a) qualifying expenditure on the provision of the ship, or

(b) qualifying expenditure which-

(i) is incurred on the provision of the ship, and

(ii) is allocated to a single ship pool.

(4) No claim may be made under section 135 of that Act for deferment of all or part of a balancing charge-

(a) to which the company or, if immediately before the cessation date the company is a member of a tonnage tax group, any company that is or becomes a member of the group becomes liable, and

(b) which arises when there is a disposal event in respect of the ship on or after the cessation date.

(5) Relief in respect of a relevant loss shall not be given under section 393A(1) of the Taxes Act 1988 (losses: set off against profits of the same, or an earlier, accounting period).

(6) Group relief under Chapter 4 of Part 10 of that Act shall not be available in respect of a relevant loss.

(7) Accordingly, relief in respect of a relevant loss shall be given only under section 393(1) of that Act (losses other than terminal losses).

(8) In sub-paragraphs (5) to (7) "relevant loss" means a loss which is incurred in respect of the ship on or after the cessation date in the course of a trade carried on by-

(a) the company, or

(b) if immediately before the cessation date the company is a member of a tonnage tax group, any company that is or becomes a member of the group.".

Requirement to prove compliance with safety etc standards

After paragraph 43 insert-

"The requirement to prove compliance with safety etc standards

43A (1) The Secretary of State may make provision by regulations for or in connection with requiring qualifying companies or qualifying groups to provide evidence of compliance with prescribed standards relating to-

(a) health and safety in connection with qualifying ships which are not registered in any of the Member States' registers;

(b) environmental performance of such ships;

(c) working conditions on such ships.

(2) The provision that may be made by regulations under this paragraph includes provision for or in connection with-

(a) requiring returns to be made at prescribed intervals;

(b) authorising the Secretary of State to require persons to provide prescribed information in prescribed cases or circumstances;

(c) enabling audits to be carried out on behalf of the Secretary of State;

(d) authorising the Secretary of State to issue certificates of non-compliance in prescribed cases or circumstances;

(e) the effect of such a certificate (including preventing the making of a renewal election when such a certificate is in force);

(f) enabling persons to apply to the Secretary of State for the cancellation of such a certificate;

(g) requiring or enabling the Secretary of State to revoke a tonnage tax election after a prescribed period of non-compliance;

(h) the making of appeals;

(i) authorising the disclosure of information between the Secretary of State and the Inland Revenue.

(3) Regulations under this paragraph may create criminal offences in respect of failures to comply with requirements imposed by the regulations.

(4) Regulations under this paragraph shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of the House of Commons.

(5) Regulations under this paragraph-

(a) may make different provision for different cases, and

(b) may contain such supplementary, incidental and transitional provisions as appear to the Secretary of State to be necessary or expedient.

(6) In this paragraph "prescribed" means prescribed by regulations under this paragraph.".

The ring fence: capital allowances: general: introduction

(1) Paragraph 68 is amended as follows.

(2) In sub-paragraph (2) (description of general scheme of Part 9 of Schedule 22) for paragraph (c) substitute-

"(c) on leaving tonnage tax-

(i) a company is treated as having incurred qualifying expenditure on its tonnage tax plant and machinery assets of an amount equal to the lower of cost and market value, where it leaves tonnage tax on expiry of an election or on the taking effect of a withdrawal notice, but

(ii) otherwise, a company is put broadly in the position it would have been in if it had never been subject to tonnage tax.".

The ring fence: capital allowances: exit: plant and machinery

(1) Paragraph 85 is amended as follows.

(2) After sub-paragraph (1) insert-

"(1A) Sub-paragraph (1C) applies where the company leaves tonnage tax-

(a) on the expiry of a tonnage tax election, or

(b) on a tonnage tax election ceasing to be in force under paragraph 13(2A) (taking effect of withdrawal notice under paragraph 15A).

(1B) In any other case, sub-paragraph (2) applies.

(1C) Where this sub-paragraph applies, the amount of qualifying expenditure in respect of each asset used by the company for the purposes of its tonnage tax activities and held by the company when it leaves tonnage tax shall be taken to be-

(a) the market value of the asset at the time the company leaves tonnage tax, or

(b) if less, the amount of expenditure incurred on the provision of the asset that would have been qualifying expenditure if the company had not been subject to tonnage tax.".

(3) In sub-paragraph (2) (amount of qualifying expenditure to be determined by reference to tax written down value of assets) at the beginning insert "Where this sub-paragraph applies,".

The ring fence: capital allowances: ship leasing: sale and lease-back arrangements

(1) Paragraph 92 is amended as follows.

(2) In sub-paragraph (2) (meaning of "sale and lease-back arrangements") for "subject to sub-paragraph (3)" substitute "subject to sub-paragraphs (3) and (3A)".

(3) After sub-paragraph (3) insert-

"(3A) This paragraph does not apply if-

(a) expenditure is incurred on enhancing the ship or on converting it to another use,

(b) the amount of that expenditure-

(i) is greater than 33% of the market value of the ship immediately after completion of the enhancement or conversion, and

(ii) is equal to or greater than the market value of the interest in the ship which is the subject of the transaction mentioned in Step Two in sub-paragraph (2), and

(c) that transaction is effected not more than four months after the first occasion following completion of the enhancement or conversion on which the ship is brought into use by any person for any purpose.".

Meaning of "offshore activities"

(1) Paragraph 104 is amended as follows.

(2) After sub-paragraph (1) (meaning of "offshore activities") insert-

"(1A) But none of the following activities is to be regarded as an offshore activity-

(a) offshore supply services;

(b) towage, salvage or other marine assistance;

(c) anchor handling;

(d) carriage of liquids or gases;

(e) safety or rescue services;

(f) the carriage of cargo in connection with dredging.

(1B) The Treasury may make provision by order amending sub-paragraph (1A) by-

(a) adding, or

(b) varying,

any description of activity.".

Vessels to which the special rules for offshore activities do not apply

Omit paragraph 105.

Index of defined expressions

(1) Paragraph 147 is amended as follows.

(2) Insert each of the following at the appropriate place-

"qualifying dredger paragraph 20(7)"

;

PART 2

COMMENCEMENT AND TRANSITIONAL PROVISION

Commencement

(1) Subject to paragraphs 19 to 21, paragraphs 4 to 6, 8 to 10 and 15 to 17 (and paragraph 1 so far as relating to those paragraphs) shall come into force on 1st July 2005.

(2) This Part of this Schedule, and the other provisions of Part 1 of this Schedule, shall come into force on the day on which this Act is passed.

Transitional provision: qualifying activities

(1) If a withdrawal notice is given on or before 31st March 2006 under paragraph 15A of Schedule 22 to FA 2000 in respect of a single company or a group, the amendments made by-

(a) paragraph 4, and

(b) so far as relating to tugs, paragraph 6,

shall not have effect in relation to that company or group until the day on which the relevant accounting period begins.

(2) In sub-paragraph (1) "the relevant accounting period" means the first accounting period of the company to begin after 1st July 2005.

(3) In the case of a withdrawal notice given in respect of a group, this paragraph has effect in relation to each qualifying company in the group by reference to that company's accounting periods.

Transitional provision: flagging: order designating financial year 2005

In relation to the financial year 2005, Schedule 22 to FA 2000 shall have effect with the omission of paragraph 22C(1).

Transitional provision: flagging

Where a company (whether or not a member of a group) has operated a qualifying dredger or a tug at any time before 1st July 2005, the company is to be treated, for the purposes of paragraph 22D of Schedule 22 to FA 2000, as not having operated the qualifying dredger or tug before that date.

"Member States' registers paragraph 22B(7)"

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