Notes for Guidance - Taxes Consolidation Act 1997

Finance Act 2021 edition

Part 24A

Shipping: Tonnage Tax

December 2021

The information in this document is provided as a guide only and is not professional advice, including legal advice. It should not be assumed that the guidance is comprehensive or that it provides a definitive answer in every case.

Notes for Guidance - Taxes Consolidation Act 1997
Finance Act 2021 edition

Part 24A Shipping: Tonnage Tax

697A Interpretation (*Part 24A*)

697B Application

697C Calculation of profits of tonnage tax company

697D Election for tonnage tax

697E Requirement that not more than 75 per cent of fleet tonnage is chartered in

697F Requirement not to enter into tax avoidance arrangements

697G Appeals

697H Relevant shipping income: distributions of overseas shipping companies

697I Relevant shipping income: cargo and passengers

697J Relevant shipping income: foreign currency gains

697K General exclusion of investment income

697L Tonnage tax trade

697LA Transactions between associated persons and between tonnage tax trade and other activities of same company

697LB Treatment of finance costs

697M Exclusion of reliefs, deductions and set-offs

697N Chargeable gains

697O Capital allowances: general

697P Withdrawal of relief etc. on company leaving tonnage tax

697Q Ten year disqualification from re-entry into tonnage tax

PART 24A
SHIPPING: TONNAGE TAX

Overview

This Part provides an alternative method (called "tonnage tax") for calculating the shipping related profits of a company for corporation tax purposes.

The term "tonnage tax" while standard in the various countries which have introduced similar measures is something of a misnomer. Tonnage tax is not itself a tax, rather it is an alternative method by which shipping companies may calculate their shipping related profits for corporation tax purposes. The shipping related profits once calculated using the tonnage tax method are subject to the 12.5 per cent rate of corporation tax. The profits are calculated by reference to the tonnage of the ships used in a company's shipping trade and hence the title. Essentially, the "tonnage" profits replace the accounting profits of the shipping company for tax purposes.

The purpose of Tonnage Tax is not specifically to provide a tax break for shipping. The intention behind tonnage tax is to provide a number of real advantages for all shipping companies which enter the regime. These include:

- ***Certainty***, since the level of tax will be known and minimal. This reduces the need for a company to make provision in its accounts for deferred taxation, thereby increasing earnings per share.
- ***Flexibility***, since companies will have more freedom to choose when to buy ships and how to finance them. These decisions will now largely be determined by commercial rather than tax considerations.
- ***Clarity***, a company's tax position will now be more readily understood, consequently the company may become more attractive to investors and potential business partners.
- Finally, ***compatibility*** and ***competitiveness*** with the fiscal regimes of other countries. This is particularly important from the point of view of maintaining and developing our indigenous shipping industry.

The tonnage tax scheme is elective, companies may choose whether to stay in the normal corporation tax system or move their shipping activities into tonnage tax. If a company enters tonnage tax it must stay in it for a minimum of 10 years. The commitment to stay in for 10 years can be renewed at any time.

The scheme came into operation with effect from 28 March 2003.

All qualifying companies in a group must enter the scheme. Cherry picking is not an option.

A qualifying company must meet 3 tests:

- It must be within the charge to Irish corporation tax,
- It must operate qualifying ships, and
- It must carry on both the strategic and commercial management of these ships in the State.

The most important income sources which qualifies for shelter under the tonnage tax are:

- Income from activities which are related to the actual operation of a qualifying ship (for example, profits from the carriage of cargo or passengers at sea).
- Income from activities carried out on board qualifying ships which are ancillary to these activities such as the operation of cinemas, bars, shops, restaurants, etc. where

the goods and services provided are consumed on board a qualifying ship.

- Income from activities which are undertaken in order for these shipping operations to be undertaken (such as embarkation/disembarkation services, tickets sales, hire of containers, etc).
- Income from the provision of ship management services for qualifying ships.

Capital allowances, balancing charges and capital gains are not a part of the tonnage tax scheme once a company is established in tonnage tax. However, these matters do come into play in relation to certain transitional arrangements which may leave companies open to some balancing charges and some capital gains charges in relation to assets acquired before entry into tonnage tax. These charges, however, will not arise until a ship is sold and even then reliefs are available which will defer any balancing charge if there is reinvestment in a new ship or reduce or eliminate any such charge by reference to either the time the company has been in tonnage tax or to unrelieved losses incurred before entry into tonnage tax.

There are extensive ring-fencing measures which are designed to ensure that advantage is not taken of the tonnage tax regime to include income from non-tonnage tax activities or to get tax relief for losses incurred on tonnage tax activities against other sources of income. These include arm's length pricing (***section 697LA***) and anti-thick capitalisation measures (***section 697LB***). Anti-avoidance measures are also included to prevent the regime from being used for tax avoidance activities and transactions.

Enquiries concerning tonnage tax and election to tonnage tax should be addressed to:

Corporation Tax Unit 1,
Corporate Business and International Division,
Revenue Commissioners,
Dublin Castle,
Dublin 2.
Telephone: 01-7024102;
Fax: 01-6795814.

697A Interpretation (*Part 24A*)

Summary

This is the interpretation and construction section for both ***Part 24A*** and ***Schedule 18B***.

Details

Definitions

"bareboat charter terms" is defined for the purposes of ***paragraph 8*** of ***Schedule 18B***. This paragraph provides for the interpretation of the term "operating a ship". This is relevant for the purposes of ***paragraphs (e)*** to ***(g)*** and ***paragraphs (i)*** and ***(j)*** of the definition of "relevant shipping income" (see below). Income from shipping activities will not be relevant shipping income and therefore subject to the tonnage tax shelter unless it is income derived from the operation of qualifying ships. ***(1)***

A "bareboat charter" means that the person chartering the ship can crew, provision and direct the ship. The owner has no responsibilities for these matters.

"chartered in" is defined for the purposes of ***section 697E*** which places a limit on the number of ships a shipping company may charter in if it is to qualify as a "qualifying company" for the purposes of tonnage tax. For this purpose ships "chartered in" means

ships chartered in on terms other than bareboat charter terms. Therefore, the limit in ***section 697E*** does not apply to ships chartered in on bareboat charter terms.

"commencement date" is the date the scheme comes into operation and is 28 March 2003.

"control" is defined for the purposes of the definition of "group of companies" by reference to ***subsections (2)*** to ***(6)*** of ***section 432***. Under those provisions a person controls a company if the person is able to control or to acquire control, either directly or indirectly of the company's affairs. Under ***section 432(2)*** a person is regarded as having control of a company if the person has or is entitled to acquire —

- the majority of the issued share capital or voting power,
- such part of the capital as would entitle the person on a total distribution of income to more than 50 per cent of such distribution, or
- such rights as would entitle the person on a winding up or otherwise to more than 50 per cent of the distributable assets. ***Subsections (4), (5)*** and ***(6)*** of ***section 432*** provide for supplementary matters.

"group of companies" is defined as all the companies controlled by an individual or, in a case where a company is not controlled by any other person, that company and all other companies which that company controls. This definition goes further than the normal definition of group for corporation tax purposes. Provision is also included for construction of various types of references to "group of companies". "Group of companies" is one of the more important concepts in "tonnage tax". All qualifying companies which are members of a group must elect for tonnage tax as a group by way of a group election. It is not possible for one group company which qualifies for tonnage tax to stay out and for another group company which qualifies to elect into tonnage tax. For this reason extensive provision is made in ***Part 1*** (matters relating to election for tonnage tax) and ***Part 4*** (matters relating to groups and the merging and de-merging of companies and groups) of ***Schedule 18B*** in relation to groups of companies.

"Member State" is defined for the purposes of ***section 697H*** (relevant shipping income: distributions of overseas shipping companies).

"qualifying company" has to be a company which is chargeable to Irish corporation tax on any profits which accrue to it. It must also operate qualifying ships (ownership is not a requirement). Finally, and most importantly, the company must carry on the strategic and commercial management of these ships in Ireland. Strategic and commercial management is left undefined as any such definition may prove too restrictive and inflexible. Indeed, it can mean different things depending on the context. For example, strategic and commercial management of ships in the context of providing ship management services will differ from the meaning of the term in the context of a company which actually owns the ships it is operating. All elements of management activity relevant to the ships in question will be taken into account in determining whether strategic and commercial management is carried out in the State. Basically what is envisaged is that a company will, in the case of strategic management, take decisions in Ireland on significant capital expenditure and disposals (although in the case of ship management services this factor will have no relevance), the award of major contracts, agreement on strategic alliances, etc. In assessing these matters the extent to which foreign based personnel work under the direction of, and report to, personnel based in Ireland would be important. Also important in assessing whether the strategic function is carried out in Ireland would be location of headquarters, including senior managers; location of decision making of board of directors; location of decision making of operational board. In the case of commercial management, matters relating to route planning, taking bookings for passengers or cargo, managing the bunkers, provisioning and victualling requirements of ships, personnel management, training, technical management of ships including the taking of decisions on the repair and

maintenance of vessels should take place in Ireland. Also relevant might be the maintenance of support facilities such as training centres, terminals, etc. in Ireland and the extent to which foreign offices/branches work under the direction of personnel based in Ireland. The fact that a ship is flagged, classed, insured or financed in Ireland may add further weight to the indicators set out above. Both aspects of the test (i.e. both strategic and commercial management in Ireland) must be complied with.

"qualifying group" is a group of companies where at least one member of the group is a qualifying company.

"qualifying ship" is a seagoing vessel of an adequate size to engage in reasonable commercial operations and which complies with all the requirements for navigation at sea imposed by the competent authorities of any country or territory. Acceptance of a ship as seagoing will normally require the ship to be certificated as such under the International Load Line or the SOLAS (Safety of Life at Sea) Convention. Excluded from the definition are vessels which are:

- Fishing and fish factory vessels.
- Vessels used primarily for sport or recreation (other than vessels operated for commercial purposes with an overnight passenger capacity of 50 or more, excluding crew).
- Harbour, estuary and river ferries.
- Various types of offshore installations which are not for the purposes of transporting cargo or passengers by sea.
- An oil tanker used for the purposes of delivering oil from an offshore oil field to an on-shore storage facility. This is excluded as the profits attributable to such activities are already subject to a special tax regime under ***Part 24***.
- Dredgers, working platforms such as seagoing cranes and cable laying vessels.
- Non-ocean going tugs.

Regardless of the activities which a vessel of an excluded kind is engaged in, income from such ships cannot be "relevant shipping income" and therefore cannot be sheltered within tonnage tax. ***Paragraph 9*** of ***Part 2*** of ***Schedule 18B*** makes provision for a case where a qualifying vessel is used as a vessel of an excluded kind.

"tonnage tax" is the description given to the method provided for by ***section 697C*** of calculating the profits of a tonnage tax company (i.e. a qualifying company which has elected for the tonnage tax method of calculating its profits). It is also used in ***section 697D*** in requiring companies to elect for the application of tonnage tax.

"tonnage tax activities" are such trading activities of a tonnage tax company as are described in ***paragraphs (a)*** to ***(g)*** and ***paragraphs (i)*** and ***(j)*** of the definition of "relevant shipping income". This term is defined for the purposes of the definition of tonnage tax trade. In this context, the term is particularly of importance in relation to the ring-fence on losses incurred in relation to tonnage tax activities provided for in ***section 697C(2)*** and the separate trade provisions in ***section 697L***. It is also used in ***section 697K*** where income sources (other than those specified) which gives rise to investment income are specifically excluded from being part of a company's tonnage tax activity and in ***section 697N*** (chargeable gains) where an asset must be used for tonnage tax activities in order to avail of the capital gains exemption (such an asset is referred to as a "tonnage tax asset").

"tonnage tax asset" is an asset used for the purposes of the tonnage tax activities of a tonnage tax company. The definition is used in ***section 697N*** to identify those assets which will benefit from the tonnage tax shelter in respect of any chargeable gains which may arise on disposal.

"tonnage tax company" and "tonnage tax group" are used throughout this Part and ***Schedule 18B*** to refer to qualifying companies or qualifying group of companies which have elected for tonnage tax.

"tonnage tax profits" are the profits of a tonnage tax company calculated according to the tonnage tax method set out in ***section 697C***. These profits displace the normal profits of the company for the purposes of corporation tax.

"tonnage tax trade" defines the trade of a tonnage tax company by reference to the tonnage tax activities carried on by the company. These activities are treated as a separate trade carried on by the company by virtue of ***section 697L*** if more than just these activities constitutes the activities carried on by the company.

"relevant shipping income" lists the sources of a tonnage tax company's income which are to be sheltered from taxation by the tonnage tax profits of that company.

The sources of income covered are —

- income from the transport by sea of cargo and passengers in a qualifying ship operated by the company. Any income referable to the transport of such cargo or passengers by land or referable to any other purpose (for example, the provision of holiday accommodation) is excluded from this definition;
- income from towage, salvage and marine assistance services provided by a qualifying ship operated by the company but does not include income from such work which is undertaken in a port or port area. It is to be noted that profits from the sale of salvaged goods would not be relevant shipping income;
- income from transport services provided by a qualifying ship operated by the company in connection with other activities carried out at sea. The type of activities envisaged are diving support, cable laying, construction work in the marine environment. It will be necessary to apportion the profits or losses from the operation of such vessels between that attributable to transport and that attributable to the other activities. In practice, it is envisaged that any method of apportionment which produces a result which is just and reasonable will be acceptable;
- income from the provision by the company operating the qualifying ship of services such as the operation of cinemas, bars and restaurants, shops, etc, which are ancillary to the transport of cargo and passengers where the goods and services concerned are consumed on board the qualifying ship. Where these activities are not ancillary to the transport of cargo or passengers the provisions of ***subsection (2)*** may serve to disqualify the ship from being a qualifying ship and any income arising from these activities would accordingly not be relevant shipping income;
- income from the contracting out or franchising to specialist operators of the on-board services just described;
- income from ship related activities which are a necessary and integral part of the business of operating the company's qualifying ships. By "necessary and integral" is meant activities which are both required for the business of operating the company's qualifying ships and which enable the company to carry on its business of operating those ships. These activities include —
    - ship management operations such as purchasing fuel and hiring crew,
    - commercial management operations such as booking cargo or passengers,
    - administrative and insurance services related to the transport of people or cargo,
    - transport on another ship if there is a single contract which includes transport on a qualifying ship operated by the company,

- provision of excursions for passengers on qualifying ships operated by the company,
- the sale of a holiday under a single contract which includes transport on a qualifying ship operated by the company,
- embarkation and disembarkation of passengers from a qualifying ship operated by the company,
- loading and unloading of cargo on a qualifying ship operated by the company, including the moving of containers within a port area immediately before or after the voyage,
- consolidation or breaking of cargo carried on on a qualifying ship operated by the company immediately before or after the voyage,
- rental or provision to customers of containers for goods to be carried on a qualifying ship operated by the company.

  It may be necessary for Revenue to look at the facts in relation to a particular company in order to decide in any one case whether or not particular activities are necessary and integral to the company's core business. It may be necessary for Revenue to specify limits in relation to particular activities. If the limit were to be breached the whole of the income from that activity may fall outside of relevant shipping income.

- income from the leasing of a qualifying ship where the company retains control over the operation and crewing of the ship;
- income from ship management services provided in respect of qualifying ships operated by the company. The meaning of "ship management services" in the context of operating a ship is provided for by ***paragraph 8(6)*** of ***Part 2*** of ***Schedule 18B***;
- distributions from overseas companies which are referable to income which if it had arisen to the company would have been relevant shipping income and certain gains arising from foreign exchange transactions are also included.

"relevant shipping profits" covers the company's relevant shipping income plus so much of the company's chargeable gains as are to be excluded from taxation by ***section 697N***. The company's "relevant shipping profits" is the amount which would normally be brought within the charge to corporation tax in respect of the income from the activities sheltered by tonnage tax and the gains on assets used for the purposes of these activities disposed of by the company.

Construction

A ship which is used to provide "goods or services" of a kind normally provided on land is prohibited from being a qualifying ship. This would include businesses such as retailing, restaurants, hotels, radio stations, casinos, financial services. This is not an exhaustive list. ***(2)***

The construction of references to a company or group entering or leaving tonnage tax and to a company or group being subject to tonnage tax is set out. ***(3)***

Schedule 18B is applied for the purposes of ***Part 24A***. ***(4)***

697B Application

By virtue of this section the provisions of this Part and of ***Schedule 18B*** are applied to provide an alternative means of calculating the profits of a qualifying company for corporation tax purposes.

697C Calculation of profits of tonnage tax company

Summary

This section gives the rules for the calculation of tonnage tax.

Details

Replacement of accounting profit by tonnage profits

The tonnage tax profits of a tonnage tax company (i.e. a company which is a qualifying company and which has elected for tonnage tax) as calculated under this section are brought into charge to corporation tax in place of the company's relevant shipping profits (i.e. its relevant shipping income and its chargeable gains referable to disposal of tonnage tax assets). ***(1)***

Treatment of losses

Where a tonnage tax company incurs a loss on any of its tonnage tax activities or a foreign exchange loss which would otherwise be taken into account in calculating the company's trading income, the loss cannot be used to obtain relief for the purposes of corporation tax. ***(2)***

Tonnage tax profit calculation

The actual tonnage tax profit calculation is best described by way of an example. ***(3) to (6)***

Example

The tonnage tax computation is straightforward. This example concerns a shipping company which operates two qualifying ships of 25,000 tons each.

STEP 1 – calculate profit per day per ship:

This calculation is made by reference to an amount of profit for each 100 tons as follows:

Each 100 tons up to 1,000 tons @ €1 =	€10
Each 100 tons between 1,000 and 10,000 tons @ €0.75 = 90 x 0.75 =	€67.50
Each 100 tons between 10,000 and 25,000 tons @ €0.50 = 150 x 0.50 =	€75
THIS GIVES A PROFIT PER DAY PER SHIP OF	€152.50

STEP 2 – calculate profit per ship for the accounting period:

If it is assumed that it is a normal accounting period of a year, one gets a profit per ship for the accounting period of €152.50 x 365 = €55,663.

STEP 3 – calculate company's tonnage tax profits:

The profit for each ship is aggregated. In this case, the profit for each ship is the same as they are both 25,000 tons. This means that the total profit for the accounting period is (€55,663 x 2 = €111,326).

STEP 4 – calculate corporation tax:

Applying the 12.5% rate of corporation tax to the company's profits, we get tax of €13,916 for the company (€111,326 x 12.5%).

Ships operated by more than one person

Where a ship is operated jointly, the tonnage tax calculation is to be made by reference to each company's proportionate share of the interest in the ship. If, in the case of a ship operated jointly, it is not possible to determine each company's proportionate share, the tonnage tax profits of each company with an interest in the ship is to be calculated as if each were the only operator of that ship. ***(7) & (8)***

697D Election for tonnage tax

The tonnage tax method of calculating profits for corporation tax purposes can only be used by a qualifying company which has elected (either by way of a company election or a group election) for tonnage tax. ***(1)***

If a group election is to be made all qualifying companies in the group must join in the election by way of a joint election. Such a joint election has effect for all qualifying companies in the group. ***(2)***

The election only has effect if the provisions of ***section 697E*** in relation to the 75% limit and ***section 697F*** in relation to not engaging in tax avoidance are complied with. ***(3)***

The provisions of ***Part 1*** of ***Schedule 18B*** are specifically applied for the purposes of making and giving effect to an election to tonnage tax. ***(4)***

697E Requirement that not more than 75 per cent of fleet tonnage is chartered in

Summary

This section imposes a limit on the net tonnage of qualifying ships which can be chartered in and operated by a tonnage tax company. For this purpose "chartered in" means chartered on terms other than "bareboat charter terms". The limit only applies where the company charters in ships without having the right to provide for such things as the master and crew, the direction of the ship and bunkering and provisioning, etc. The limit does not apply where the company charters in ships on the basis of bareboat charters or where the company provides ship management services. In the case of a group, the limit only applies to the aggregate net tonnage of qualifying ships chartered in.

NOTE: Removal of the 75% limit is under consideration in line with the liberalisation of EU State Aid rules. Provisions have been made allowing for the deletion of ***section 697E*** and certain consequential amendments. However this is subject to a Commencement Order which has not been made to date. Accordingly ***section 697E*** remains in place pending the making of this Order.

Details

The rule

It is a requirement of entering and remaining within tonnage tax that a company must not have chartered in more than 75 per cent of the net tonnage of the qualifying ships operated by it. In the case of a group, the limit is 75 per cent of the aggregate net tonnage of all the qualifying ships operated by group members which are qualifying companies. ***(1)***

Counting of ships in group context

A chartered in ship is not to be counted more than once in a group context. This ensures that chartered in ships which are re-chartered within the group are not double counted. ***(2)***

Limit breached where election made in initial period

If the 75 per cent limit is breached in respect of the first accounting period the company is within tonnage tax, the election will be treated as never having had effect. This only applies where the election is made within the initial period (i.e. the period of 36 months beginning after the commencement date – ***paragraph 2*** of ***Part 1*** of ***Schedule 18B*** refers). The consequence of this is that normal corporation tax computational rules would continue to apply for all periods after the election. This provision does not apply to a renewals election – see note below. ***(3)***

Limit breached where election made after initial period

Rules are provided for the consequences where the 75 per cent limit is exceeded in the first, second and third accounting period for which an initial election has effect. These rules apply where the election is made after the expiry of the initial period. They do not apply in relation to a renewal election – see note below. Where the 75% limit is exceeded in each of the first 3 accounting periods the election will be treated as never having had effect and the normal corporation tax computation rules continue to apply. Where the 75% limit is exceeded only in the first accounting period or only in the first and second accounting periods, the election does not have effect for the one and /or two "exceeded" accounting periods. Effectively entry to tonnage tax is deferred until the first period that the limit is satisfied. ***(4)***

Definitions

A meaning for the first, second and third relevant accounting periods is provided for the purposes of the application of the two rules set out above. ***(5)***

Also provided for is a means for determining when the 75 per cent limit is exceeded. ***(6)***

Limit breached in other circumstances

A company is excluded from tonnage tax where the 75 per cent limit is breached in any two or more consecutive accounting periods. The power to exclude is a permissive one. If there are mitigating circumstances (e.g. the loss at sea of a vessel and its temporary replacement by a chartered in vessel) the company need not be excluded. Conversely, if there is evidence of an attempt to engineer an early exit from tonnage tax, then Revenue may decide not to exercise the power of exclusion. ***(7)***

697F Requirement not to enter into tax avoidance arrangements

Summary

This section makes it a condition of remaining within tonnage tax that the company not be a party to anything which would be an abuse of the regime. This provision is aimed at deliberate cases of serious or repeated abuse. It will not be used to attack minor computational errors or genuine misunderstandings. Also, it would not be deployed to attack legitimate pre-election restructuring such as that needed to allow a group elect for the regime (e.g. division of activities into shipping activities and non-shipping activities).

Details

The section applies if a tax advantage (within the meaning of the general anti-avoidance section, namely, ***section 811***) is obtained through the application of tonnage tax, by either the tonnage tax company for its non-tonnage tax activities or by any other company. ***(1) & (2)***

A company is expelled from tonnage tax where there is an abuse of the scheme as determined under this section. Again, the power of expulsion is permissive. Circumstances ***(3)***

may arise where expulsion may not be appropriate.

Where a single company is expelled, the tonnage tax election ceases to have effect from the beginning of the accounting period in which the abuse started. In the case of a group, the group election ceases to have effect from whatever date Revenue specifies. But the date cannot be earlier than the start of the accounting period in which a group member entered into the transaction or arrangement concerned. ***(4)***

Exit charges as provided for in ***section 697P*** apply to a company expelled from tonnage tax. ***(5)***

697G Appeals

Appeals are permitted against the application of the 75 per cent test (***section 697E***) or the anti-avoidance provision (***section 697F***).

697H Relevant shipping income: distributions of overseas shipping companies

Summary

Rules are set out which are to apply if distributions of an overseas company are to be treated as relevant shipping income.

Details

The only distributions which qualify are distributions which are made in respect of profits arising to the overseas company at a time when the company concerned complies with all the rules and the company receiving the distributions is at that same time a tonnage tax company. Accordingly, distributions made in respect of profits arising at a time when the rules were not complied with by the overseas company or which arose in respect of a time when the company receiving the distributions was not a tonnage tax company do not qualify. ***(1)***

These distributions are to qualify even where they are received through a chain of companies, provided the distribution can be traced back to income which would have been qualifying shipping income if the overseas company which earned the income were a tonnage tax company. ***(2)***

The surcharge on the undistributed investment profits of a close company provided for by ***section 440*** does not apply to these distributions. ***(3)***

697I Relevant shipping income: cargo and passengers

This section was deleted by section 62(1)(b) of the Finance Act 2003 as on and from 28 March 2003.

697J Relevant shipping income: foreign currency gains

Foreign exchange gains which are referable to the company's trading activities are included in the definition of "relevant shipping income".

697K General exclusion of investment income

This section excludes investment income from being "relevant shipping income". However, the exclusion does not apply to income which is income of the kind described in ***section 697H*** (i.e. distributions of overseas shipping companies).

697L Tonnage tax trade

The tonnage tax activities of a tonnage tax company are to be treated as a separate trade of the company distinct from all other activities of the company. This effectively establishes a ring fence around the tonnage tax activities of the company for tax purposes. The separate trade created by this provision is subject to special provisions for the purposes of the tonnage tax regime. The ring fence ensures that the benefits of the regime only apply to qualifying activities and ensures that the normal corporation tax rules apply to activities outside the ring fence even if carried on by the same company. ***(1) & (2)***

As respects any activities treated as a separate trade of a company, the company is required to comply with all relevant requirements as to the computation of tax and the keeping of records in relation to these activities separate from any other activities carried on by the company. ***(3)***

697LA Transactions between associated persons and between tonnage tax trade and other activities of same company

Summary

This section ensures that arm's length pricing applies to transaction between associated companies and transactions between a tonnage tax trade and other activities of the same company.

Details

Definitions

References to "control" take their meaning from ***section 11***. The aspect relevant here is the meaning of control in relation to a company and it is the ability of a person to direct that the affairs of the company are conducted in accordance with the wishes of that person. ***(1)***

"losses" includes management expenses and group relief.

"transaction" is intended to include as wide a variety of transaction as is possible.

Transactions between associated companies

This provision is concerned with transactions between a tonnage tax company and another company where one company controls the other or both companies are under the control of a third party. Tonnage tax as an extremely low tax environment may provide an incentive for associated companies to transfer as much profit as possible into the tonnage tax company by undercharging the tonnage tax company for goods or services provided. Conversely, there may be an incentive for a tonnage tax company to overcharge for its services so as to maximise its profits and provide the other company with larger than normal tax deductions which could be used to shelter other profits. ***(2)***

The provision applies where —

- a transaction (or a series of transactions) takes place between two persons,
- one of the persons is within the tonnage tax scheme,
- one of the persons controls the other or both are under common control,
- the terms of the transaction(s) differs from arm's length terms such that the income of the tonnage tax company is greater than it would have been if the parties to the transaction were independent parties dealing at arm's length.

In these circumstances, the profits and losses of each of the companies must be recomputed by reference to arm's length prices.

Supplies of goods and services between a tonnage tax trade and non-tonnage tax trade of a company

The rule as respects supplies of goods and services between associated companies is adapted for a case where a company carries on a tonnage tax trade and other activities so as to apply where goods or services are supplied to or by the tonnage tax trade by or to the other business units in the company. *(3)*

Record keeping

A requirement is imposed on a company to keep sufficient records for a period of 6 years available to establish how pricing and terms are determined. *(4)*

Revenue are authorised to access records and seek information to verify compliance with this section. *(5)*

A penalty is provided for where there is a failure to keep records for the purposes of the section. *(6)*

Revenue have power to audit a company to ensure compliance with the section. *(7)*

Adjustments as a result of this section

Any adjustments made as a result of the application of this section does not affect the tonnage tax computation of the company. That is, the computation of the tax charge by reference to the tonnage of the ships operated by the company. *(8)*

697LB Treatment of finance costs

Summary

This section deals with the tax treatment of a tonnage tax company's or a tonnage tax group's financing costs. This section is designed to prevent a company or group arranging for tonnage tax activities to be financed by non-tax deductible equity capital while its non-tonnage tax activities are financed by tax deductible debt.

The rules operate on the basis that debt finance is "fungible". In other words, borrowings serve to finance the activities of the company or group as a whole, even if they are earmarked initially for a particular project. The section requires companies to consider their activities as a whole and to ensure that only a just and reasonable proportion of any finance costs incurred are treated as tax deductible in companies or activities outside of tonnage tax. Where a company or group has more that a just and reasonable proportion of its finance costs claimed as deductions against profits outside tonnage tax, then an appropriate amount is added to its taxable profits from activities outside tonnage tax.

Details

Definitions and interpretation

"finance costs" is all of the costs to a company arising from debt financing. It is intended that this provision be interpreted very broadly. It includes the obvious costs such as interest on a loan but also includes less straightforward costs such as exchange gains and losses arising from the translation of foreign currency loans. It could include off-balance sheet methods of financing. *(1)*

"deductible finance costs outside the tonnage tax trade" in the case of single company, refers to the total of the amounts which the company may deduct for financing reasons in calculating its corporation tax other than any amount which is referable to the financing of its tonnage tax activities. In the case of a group of company's, this amount is the amounts

which group companies may deduct from their profits other than any amount which is referable to the group's profits from its tonnage tax activities.

"finance lease" is basically a lease under which all the risks and benefits associated with ownership of plant and machinery other than actual legal title is borne by the lessee and that this is recognised as such by the accounting treatment afforded the lease.

Where companies accounting periods do not correspond then for the purposes of this section the periods are to be matched on whatever basis is just and reasonable in the circumstances.

Determination of excessive finance deductions outside tonnage tax

Where a company's deductions which are referable to financing costs exceed a fair proportion of the company's total finance costs, then the adjustment to the company's profits for tax purposes provided for in ***subsection (3)*** is to be made. ***(2) to (8)***

The adjustment is to be made on whatever basis is just and reasonable in the circumstances. The just and reasonable calculation should take into account the fact that finance requirements differ from activity to activity. Shipping is generally a capital intensive activity due to the high costs of assets and would usually be expected to absorb a large part of any finance raised. To the extent that a company has more than a just and reasonable proportion of its finance costs claimed as deductions against profits from activities outside the tonnage tax trade, then an addition is to be made to its taxable profits outside the tonnage tax trade.

Similar provision is made in relation to a group of companies.

This section will not apply where the amount of costs and losses incurred is exceeded by the amount of profits or gains arising in the calculation of the company's or group's deductible finance costs outside the tonnage tax trade.

697M Exclusion of reliefs, deductions and set-offs

Relief which would generally be available for set-off against the profits of a company is not to be available for set-off etc. against a company's tonnage tax profits. ***(1)***

A company is prevented from using losses accrued from any period before entry into tonnage tax to reduce tonnage tax profits. These losses are, therefore, effectively extinguished. However, they may under ***paragraph 17*** of ***Schedule 18B*** be utilised against a balancing charge made on the company. ***(2)***

A prohibition is imposed on setting reliefs which are available as a credit against a company's tax liabilities being set against that part of a company's tax liability as is attributable to the company's tonnage tax profits. Specifically mentioned is double tax relief, but this provision could apply on a wider basis where necessary. The provision does not apply where income tax is deducted from a payment made to the company. Such deductions are still to be allowed against the company's corporation tax liability. ***(3)***

697N Chargeable gains

Summary

This section makes provision for relief in relation to chargeable gains which arise on the disposal of assets which were used for a company's tonnage tax trade.

Details

Assets used for a company's tonnage tax trade but which are also used for other purposes ***(1)***

are treated as separate assets.

An apportionment is to be made on a just and reasonable basis of any gain/loss arising on a disposal of an asset treated in accordance with this section as separate assets. ***(2)***

An exemption from tax is provided for any gain arising on an asset for the period for which the asset was used for the purposes of the company's tonnage tax trade. Apportionment of the gain/loss between time in tonnage and time outside of tonnage tax is to be made on a time basis. ***(3)***

Capital losses referable to periods outside of tonnage tax are available for set off against any capital gains arising on a tonnage tax asset which is referable to periods spent outside of tonnage tax. ***(4)***

697O Capital allowances: general

A company's tonnage tax trade is not to be treated as a trade for the purposes of entitlement to capital allowances. The effect of this is that a company is not entitled to capital allowances in respect of capital expenditure on assets which are used in the company's tonnage tax trade for the duration of their use in that trade. The provision makes it clear that a balancing charge may still be made on a tonnage tax company where appropriate. ***(1)***

Individual lessors are prohibited from obtaining the capital allowances which would otherwise be available in respect of capital expenditure on plant or machinery used in a company's tonnage tax trade. ***(2)***

Part 3 of ***Schedule 18B*** is specifically applied for the purposes of giving effect to the capital allowances provisions in relation to a tonnage tax trade. Extensive adaptations of those provisions are contained in that Part of ***Schedule 18B***. ***(3)***

697P Withdrawal of relief etc. on company leaving tonnage tax

This section sets out the consequences of a company ceasing to be a tonnage tax company. ***(1)***

Any exemption given in respect of chargeable gains on the disposal of tonnage tax assets under ***section 697N*** is clawed back in the event of a company ceasing to be a tonnage tax company. ***(2)***

Any balancing charge arising in the period in which the company was subject to tonnage tax in respect of which relief under ***paragraph 16*** or ***17*** of ***Schedule 18B*** was taken is also clawed back in the event of a company ceasing to be a tonnage tax company. ***(5) & (6)***

Provision is made for taxing the increased chargeable gain and the relief in respect of balancing charges which is clawed back. ***(3) & (7)***

No relief is available for the gain brought back into charge to tax by, or for any tax charged as a result of, this section. ***(4) & (8)***

697Q Ten year disqualification from re-entry into tonnage tax

This section provides for disqualification from tonnage tax where a company leaves tonnage tax other than on the expiry of its election. A 10 year exclusion period will apply. Currently, this provision is of little practical application as there is no provision for entry into tonnage tax except by way of election in the initial period or election within 36 months of becoming a qualifying company – see ***paragraph 2*** of ***Schedule 18B***. Also there is currently no mechanism for re-entry to tonnage tax should a company exit after the expiry of the 10 year election period without making a renewals election. However, under ***paragraph 2(6)*** of ***Schedule 18B***, the Minister for Finance can provide for additional periods in which a company may elect for tonnage tax. Any company excluded from

tonnage tax under this section would not be able to re-enter the regime under any other election procedure which may be provided until the expiry of a 10 year period.