The UK tonnage tax regime provides an alternative way of calculating the taxable profits of companies operating qualifying ships that are strategically and commercially managed in the UK. In certain circumstances, ships which start to be operated within the UK tonnage tax will be excluded from the regime unless they are registered under an EU flag.

Where a tonnage tax company or group starts to operate a new vessel, the vessel must be flagged under an EU flag if the following conditions are satisfied:

- broadly, less than 60% of the tonnage tax company or group’s fleet is flagged under an EU flag;
- the tonnage tax company or group’s fleet contains a lower proportion of EU Member State registered tonnage than during the first period it entered tonnage tax; and
- the financial year in which the ship is first operated is one which has not been excepted from the rules by the UK government. The government will except a financial year if the percentage of the UK tonnage tax fleet which is EU flagged has not decreased on average over a previous three year period.

The government has so far announced that the following years will not be excepted from the rules: the years commencing 1 April 2008 to 1 April 2016 inclusive.

A company or group will start to “operate” a new vessel if the vessel is owned or chartered in.

**60% test**

The EU flag requirement will not apply if, on average, more than 60% of the company or group’s fleet is flagged under an EU flag considering the period from the start of the financial year (1 April 2016 in the case of the financial year 2016) to the date that the company first starts to operate the ship. The financial year 2016 is the year commencing 1 April 2016.

**Example**

On 1 April 2016, the total gross registered tonnage (g rt) of ships operated by a UK tonnage tax company and qualifying for tonnage tax is 400,000 g rt.

Of this, 150,000 g rt is registered in the EU, with the remaining 250,000 g rt being registered outside the EU.

On 1 September 2016, the company begins operating a new vessel of 20,000 g rt, which is not registered in the EU.

The relevant percentage to be used in the calculation is gross ton days and the period 1 April 2016 to 31 August 2016 is 153 days.

**Total gross ton days is:**

400,000 x 153 = 61,200,000

**Total gross EU ton days is:**

150,000 x 153 = 22,950,000

On 1 September 2016, the company begins operating the new non EU registered vessel and therefore:

**Total tonnage is now:**

420,000

**Total EU tonnage remains:**

150,000

To calculate the average you must add the gross registered tonnage of the vessels on 1 September 2016 to the total gross registered tonnage for the previous five months - i.e. the period from 1 April 2016.

**Total gross ton days:**

61,200,000 + 420,000 = 61,620,000

**Total gross EU ton days:**

22,950,000 + 150,000 = 23,100,000
The average total EU registered tonnage as a percentage of total ton days is:

\[
\frac{23,100,000}{61,620,000} = 37.49\%
\]

In this case, less than 60% of the company’s fleet is flagged under an EU flag. The remaining conditions must, therefore, be considered in order to decide whether the EU flagging requirement applies.

**The percentage of EU flagged vessels is maintained**
The flagging requirement will not apply if the percentage of the fleet flagged under an EU flag is equal to or greater than the percentage on the company or group’s “reference date”. The reference date is 17 January 2004, or, if later, the end of the first tax accounting period when the group or company entered tonnage tax.

The current percentage of the fleet flagged under an EU flag which is considered is again the average from the start of the financial year to the date that the company starts to operate the ship.

**Example**
Continuing the previous example, the company entered the tonnage tax regime in the year ended 31 December 2002 and therefore its reference date is 17 January 2004. On that date the company had a fleet with total gross registered tonnage of 300,000 of which 100,000 grt was registered in the EU, being 33.33% of their fleet. This is the percentage that the company must maintain as EU registered. In the previous example it was calculated that the company had an average EU registered percentage of 37.49% from 1 April 2016 to 1 September 2016 when it began operating the new vessel. This is greater than the 33.33% that was EU registered on the reference date and therefore this condition is not met.

The company is not required to register the new vessel in the EU as it has maintained its EU registered tonnage.

Interestingly, if the percentage of the fleet flagged under an EU flag on the reference date is 0%, then the company or group can maintain a zero percentage.

**Vessels operated**
In carrying out the above calculations, under current rules, all vessels operated must be considered, including vessels time and voyage chartered in, as well as owned and bareboat chartered in vessels. However, whether or not vessels which are outside tonnage tax are included is a difficult area and specialist advice should be obtained.

**Gross registered tonnage**
The HMRC guidelines use gross registered tonnage in their calculations. The correct tonnage to use is not completely clear from the legislation, so it might be sensible to carry out calculations by reference to net registered tonnage as well.

**EU flagging requirement**
If the EU flagging requirement applies, the vessel needs to be re-registered under an EU flag within three months of first starting to be operated by the company. Alternatively, the company or group can substitute another ship.

**Substitute ship**
Where the EU flagging rules apply, a company can elect to register a substitute qualifying vessel onto an EU register. The substitute vessel must:
- be a single vessel of at least the same tonnage as the new ship;
- currently be registered other than on the register of an EU Member State; and
- have been first operated by the company at least three months before the date on which the vessel it is substituting was first operated.

A formal election must be made within three months of the original vessel first being operated by the company. HMRC has provided details of information which needs to be included in the formal election.

**EU requirement**
These EU flagging rules are a requirement set out in EU guidelines which apply to all EU tonnage tax regimes. Therefore, other EU Member States will also need to implement them.

**Tugs and dredgers**
Tugs and dredgers must be flagged under an EU flag in order to be in the UK tonnage tax regime.

HMRC has confirmed that anchor handling tug supply (AHTS) vessels are not regarded as tugs for this purpose.

**EU flags**
For the purpose of the flagging rules, the term “Member State’s Register” has the same meaning as in the annex to the Commission’s Guidelines on State Aid for Maritime Transport.

These guidelines also apply to the three EEA EFTA states, Norway, Iceland and Liechtenstein.

“Member States’ registers” should be understood as meaning registers governed by the law of a Member State applying to their territories forming part of the European Community.
Shipping

All the first registers of Member States or the first registers of the three EEA EFTA states are Member States’ registers.

In addition, the following registers are Member States’ registers for the purpose of the flagging rules:

- Canary Island register;
- Danish International Register of Ships (DIS);
- German International Shipping Register (ISR);
- Gibraltar register;
- Italian International Shipping Register;
- Madeira International Ship Register (MAR); and
- Norwegian International Ship register (NIS).

The following registers are not considered to be Member States’ registers:

- Bermuda register;
- Cayman Islands register;
- Dutch Antilles’ register;
- Isle of Man register; and
- Kerguelen register.

UK flag

There is no specific UK flag requirement within the UK tonnage tax regime. However, whether or not vessels are flagged under a UK flag is still taken into account in considering the location of the strategic and commercial management of the ships.

EU flagging requirement is not complied with

If the EU flagging requirement applies and the vessel is not re-registered under an EU flag within the time period and no election is made to use a substitute ship, then the vessel will be outside the UK tonnage tax regime and the normal UK corporation tax rules will apply to that vessel.

Action required

It is important to ascertain the percentage of the fleet flagged under an EU flag at the company or group’s reference date in order to ascertain how these rules will apply.

If the rules do apply, and a company or group wishes to own or charter in a ship flagged under a non-EU flag, in tonnage tax, then specific advice should be obtained.

Brexit

It is not yet known to what extent these rules will change following Brexit.

If you would like any further information on any item in this factsheet, or information on our services to the shipping industry, please contact:

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