

Yacht finance - spotlight on Cyprus

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Introduction

This briefing paper builds on our Yacht Financing briefing paper and focuses, in particular, on Cyprus as a jurisdiction of registration. Whilst the Cypriot flag has long been a popular "flag of convenience", recent VAT reform is likely to increase this popularity among yacht owners.

We have set out below the basic aspects of registering a yacht in Cyprus. Please do not hesitate to contact us should you have any particular queries.

Transactional structure

Asset finance structures

Large assets such as yachts are typically financed through either a secured lending structure or a finance leasing structure. Which of these structures is the most appropriate will depend on the specific facts of a particular transaction, and will be determined by a range of factors, including:

- Where and how often the yacht is to be used
- Whether the financing is to be used to purchase a new build (by funding pre-delivery instalments payable to a shipyard under a construction contract), or whether the yacht is being purchased from an existing owner
- Whether the owner intends to charter the yacht
- The jurisdiction in which the yacht is being constructed or is presently registered
- The proposed jurisdiction of registration of the yacht

Probably the most common structure is that of secured lending, which operates by way of a loan and mortgage. In this structure, the bank will lend money to the borrower to enable it to purchase the yacht. The borrower will grant the bank a mortgage over the yacht and, usually under a deed of covenant, will also assign to the bank the insurances over the yacht, any earnings it may generate, and any requisition compensation which the borrower will be entitled to in the event of requisition of the yacht by a government in time of war.

However, in certain situations significant tax savings can be achieved by utilising a finance leasing structure. In this structure, a finance leasing agreement must be entered into by a lessor and a lessee, whereby the lessee is granted the option to purchase the yacht at the end of the lease. Whilst the lessee will pay the lessor rentals in exchange for its

lease of the asset, the rentals will be calculated so that, over the course of the lease, these effectively cover the lessor's costs of acquiring the yacht. In this structure, the lessee is said to have the "economic ownership" of the yacht, because the economic benefits and burdens will lie with that party.

In either structure, careful consideration needs to be given as to the entity that will eventually own the vessel (and which will be the counterparty under the financing arrangements). Typically, where yachts are being financed, the ultimate beneficial owner will be an individual, although for various tax (and other) reasons it is likely that a special purpose vehicle (an "SPV") will be set up to be the registered owner of the vessel (and the financing counterparty). In a finance leasing structure there is an added complication, which is the inclusion of a lessor in the structure.

Jurisdiction of registration

A number of factors will determine the choice of jurisdiction of registration of a yacht, including the factors set out below. These factors will need to be weighed up against each other – depending on the circumstances of a particular transaction, the combination of these factors will determine the final choice of jurisdiction.

Tax factors – Each jurisdiction will, of course, have its own distinct (and often complex) tax regime. Given the significant costs and asset values associated with yacht financing, this choice will frequently be driven by a wish to minimise the tax liabilities incurred in relation to the ownership and operation of the yacht. In some cases (such as Malta and Cyprus), jurisdictions have introduced tax regimes specifically designed to make their jurisdiction more palatable to the owners and operators of yachts.

Ease of registration – The registration procedures of some jurisdictions require applicants to deal with more 'red tape' than others. Owners of yachts will often opt for jurisdictions where the registration process is relatively straightforward.

Financier's interests – Registration in a particular jurisdiction will not only need to appeal to the borrower/lessee, but also to the financier, who will need to be certain that its interests will be protected by the laws of that jurisdiction. In particular, the financier will want to be able to rely on the rights and remedies available upon

the borrower's/lessee's default. For example, jurisdictions allowing the self-help remedies that do not require a lender first to obtain a court order prior to enforcing its security will be favourable to financiers.

Finance leasing in Cyprus

In this briefing paper, we have focused on the finance leasing structure through registration of a yacht in Cyprus. The Cypriot government has recently reformed its VAT regime, and the reformed regime is likely to lead to an increase in the popularity of such structures.

There are a number of advantages to registering a yacht under the Cypriot flag. The Cypriot Department of Merchant Shipping cites, among others, the following advantages:

- No tax on profits from the operation or management of a Cyprus-registered vessel or on dividends received from a vessel owning company
- No capital gains tax on the sale or transfer of a Cyprus-registered vessel or the shares of a vessel owning company
- No restrictions or taxation on the sale or the transfer of shares of a company owning Cypriot registered yachts
- No income tax on the wages of officers and crew
- No restrictions on the nationality of the master, officers and crew
- Favourable tonnage tax scheme based on vessel gross tonnage
- No stamp duty on vessel mortgage deeds or other security documents
- Double tax treaties with 43 countries
- No exchange control and freedom of movement of foreign currency
- Full protection for financiers and mortgagees
- Low set-up and operating costs for companies
- EU flag (which is associated with advanced safety and anti-pollution requirements)
- Reduced VAT

Registration

Which register?

Yachts to be registered under the Cypriot flag should be registered in the Register of Cypriot Ships. The Register of Small Vessels will in most cases not be appropriate as such vessels are permitted to sail only in the territorial waters of Cyprus.

Which type of vessel?

In most cases, private yachts will qualify for the "pleasure craft" type for the purposes of Cypriot ship registration, as pleasure craft are yachts or other types of vessels used exclusively for recreation and are not engaged in any commercial operations, irrespective of size. However, where a private yacht is to be chartered out during periods where its owner does not wish to use it exclusively for personal use, the vessel may need to be registered as a different type of vessel.

Vessels qualifying as pleasure craft that do not exceed 25 years of age may be registered without any additional conditions; those exceeding 25 years of age may be registered, provided they undergo an entry inspection which is completed with satisfactory results.

Which type of registration?

There are three types of ship registration in Cyprus:

Provisional registration – most ship owners opt for this as it gives them a six month period (which can be extended by a further three months) during which they will be able to complete the administrative formalities required for permanent registration

Permanent registration – usually following provisional registration

Parallel registration – two forms of internationally accepted bareboat registration exist, parallel-in and parallel-out, and these offer some very interesting opportunities for leaseback, hire purchase and finance arrangements

Details for each of these registration types are set out below.

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Conditions to registration

A ship may only be registered in the Register of Cyprus Ships if:

- More than 50% of the shares of the company owning the vessel are owned:
 - ◇ By Cypriot citizens
 - ◇ By citizens of other EU Member States who (if not permanent residents of Cyprus) will have appointed an authorised representative in Cyprus or
- 100% of the shares (of the company owning the vessel) are owned by one or more corporations, which, broadly speaking, have been established and operate in accordance with:
 - ◇ The laws of Cyprus
 - ◇ The laws of any other EU Member State (and either an authorised Cypriot representative or a Cypriot vessel management company has been appointed) or
 - ◇ The laws of any other country but where control of such entity or entities rests with Cypriot citizens or citizens of EU Member States (and either an authorised Cypriot representative or a Cypriot vessel management company has been appointed)

Provisional registration

In order to enable the Registrar of Cyprus Ships to initiate the procedure for the provisional registration of a vessel, information and documentation set out in Appendix A is required.

Permanent registration

The application for permanent registration must be made within 6 months from the commencement of the provisional registration (or 9 months if an additional 3 months extension has been obtained). The documents set out in Appendix B must be submitted to the Registrar of Cyprus in addition to those required for the provisional registration.

Parallel registration

Parallel-in registration enables a foreign-flag vessel on

bareboat charter to be registered in 'parallel' under the Cypriot flag. This is usually for a renewable period of two years.

Parallel-out registration allows the financing of a vessel and her mortgaging under the Cypriot flag and her registration in a foreign registry through a bareboat charter arrangement.

VAT issues

Cyprus's VAT scheme in respect of pleasure yachts

The Cypriot Customs and Excise Department and VAT Service recently published guidance on the VAT treatment of yacht leasing schemes applicable to pleasure yachts. The Cypriot scheme allows yacht owners to benefit from one of the most attractive VAT regimes within the EU during the term of the lease agreement. In addition, at the end of the leasing scheme and upon exercise of the lessee's option to acquire the yacht, the lessee will obtain an EU VAT paid certificate on the pleasure yacht.

The Cypriot VAT scheme is modelled closely on the Maltese scheme, although the Cypriot scheme includes some improvements on this. For instance, the Cypriot scheme allows for lower levels of VAT (as low as 3.4%, compared to Malta's 5.4%) and also allows for softer lease repayments over a maximum of four years (whereas the Maltese scheme allows for only three years).

The Cypriot scheme also extends various advantages to the lessor in a yacht leasing agreement so that, for example, lessors can ensure significant tax savings through the use of Cypriot non-resident companies (which are afforded tax exempt status).

The Yacht Leasing Agreement

To benefit from the Cypriot VAT scheme on pleasure yachts, the lessor and lessee must enter into a leasing agreement by which the lessee is granted an option to purchase the yacht at the end of the lease.

Notably, the leasing agreement will be null and void if the lessor is not (a) a Cyprus-registered entity and (b) the owner of the yacht in question. The yacht can be purchased directly from the owner or, if it is new, direct from the shipyard.

VAT rates

Until recently, yacht purchase and leasing agreements in Cyprus were subject to the full rate of VAT (17%). However, in response to the complaints this had raised in respect of yachts that were not actually used within the territorial waters of Cyprus or the EU, it has been decided that in such instances there should be a partial relief on VAT. Under the new regime, the effective rate of VAT for motor yachts will range from 3.4% to 17%, and from 3.4% to 10.2% for sailing yachts.

In their circular of 13 March 2012, the Cypriot Customs and Excise Department and VAT Service established the procedures and policies concerning yacht leasing and purchasing. Specifically, it has issued two tables (one for motor yachts and one for sailing yachts), in which it sets out (by reference to the length of the yacht and the percentage of use within Cypriot/EU territorial waters), the extent of the relief on VAT that is available. These tables have been set out in Appendix C.

Conditions for VAT relief

In order for this VAT relief to apply, the following conditions must be satisfied:

- The finance leasing agreement must be with a Cypriot company as lessor (there is no restriction on the nationality of the lessee) (i.e. a bank would make a loan to a Cypriot company as lessor which would then lease the asset to a lessee in return for lease rentals)
- The yacht must be in Cypriot territorial waters within the first month of the leasing agreement (though extensions to this period can be sought)
- An initial contribution amounting to at least 40% of the value of the yacht must have been paid by the lessee to the lessor
- Lease instalments must be payable monthly (with the applicable VAT rate being calculated by reference to the information reflected in the above tables)
- The term of the lease agreement must not exceed 48 months
- The lessor's income under the lease agreement must exceed the value of the yacht, and the lessor's expected profit must not be less than 10% of the value of the yacht
- The final payment at the end of the lease (at which point the yacht is effectively transferred in the ownership of the lessee) must not be less than 5% of the yacht's value

(and is subject to the full VAT rate)

- Prior approval must be sought in writing from the Commissioner of VAT (for which a valuation certificate in respect of the yacht, the leasing agreement and an application for approval must be submitted)
- If the lessee opts to purchase the yacht at the end of the lease and all VAT due has been paid, an EU VAT paid certificate will be issued to the lessee

Process for VAT registration

The process for the approval of the above VAT scheme is, broadly, as follows:

- The Cypriot company should seek prior approval from the Commissioner of VAT (by submission of relevant details of the yacht, including, *inter alia*, certification and survey of the vessel, bill of sale, and such other documentary evidence as may be requested), who will confirm the rate of VAT payable and the acceptability of the declared value of the yacht
- The Cypriot company should apply for VAT registration from the Cypriot Customs and Excise Department and VAT Service (this normally takes no more than two working days)
- Once the VAT number is obtained, the Cypriot company should enter a lease agreement with the lessee
- The Cypriot company should submit the following to the Cypriot Customs and Excise Department and VAT Service:
 - ◇ A copy of the lease agreement
 - ◇ Certification of the yacht to be leased
 - ◇ Specification List of the yacht to be leased
 - ◇ Surveyor's valuation of the yacht to be leased
 - ◇ Bill of sale for the yacht to be leased (if bought new)

Provided all requirements are satisfied, the Cypriot Customs and Excise Department and VAT Service issues a letter of approval, confirming the applicable rate of VAT.

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Appendix A

In order to enable the Registrar of Cyprus Ships to initiate the procedure for the provisional registration of a vessel, the following information is required:

- Name of the vessel and her flag at the time of the application
- Name of the person (legal or natural) applying for the registration of the vessel
- Name under which the vessel will be registered
- Particulars of the vessel (type, year of build, date keel of the vessel was laid, gross and net tonnage)
- Name of the classification society with which the vessel is entered. If the owners of the vessel contemplate a change of the classification society on acquiring the vessel this should also be stated
- Declaration of Particulars of the company for ISM Code (Form ISM 01/Revision 03)
- Intended trading area of the vessel
- Place where the vessel will be at the time of her provisional registration, if known. This must be communicated to the Registrar of Cyprus Ships prior to the provisional registration
- The consular office where the owner wishes to effect the provisional registration of the vessel
- Name and address of the shareholders and directors of the company in whose ownership the vessel will be registered

Further, the following supporting documents/information (duly executed, where applicable) must be forwarded to the Registrar of Cyprus Ships together with the application for the provisional registration of the vessel:

- Memorandum and Articles of Association of the Cypriot company (or, for non-Cypriot companies, a notary's certificate)
- Certificates of Incorporation, directors and secretary, shareholders and registered office of the Cypriot company (or, if owned by an individual, a passport or identity card)
- Resolutions of the directors of the company for the purchase of the vessel and its registration in the Register of Cyprus Ships
- Power of attorney authorising the person who will sign all the necessary documents on behalf and on account of the company
- Bill of sale / builder's certificate

- Certificate of deletion of the vessel / certificate of ownership and freedom of encumbrances from the previous registry
- Confirmation of Radio Traffic Accounting Authority
- Confirmation of vessel's Classification Society (where applicable)
- Continuous Synopsis Record (CSR)
- Declaration of ownership
- Appointment of Authorised Representative (M.S. 57)
- Registration of a Mobile Maritime Radio Station (M.S.34) and copy of Shore Based Maintenance Agreement
- Registration of SAR Particulars (M.S.45)
- ISM forms where this is required
- In the case of Parallel Registration in a foreign register, a Certificate of Parallel Registration from the foreign registry
- In the case of pleasure craft under 24 metres:
 - ◇ Declaration of Conformity
 - ◇ EC Type Examination Certificate from a Notifying Body
 - ◇ Owner's Manual

Appendix B

The following documents must be submitted to the Registrar of Cyprus in addition to those required for the provisional registration:

- Certificate of Survey and Tonnage Certificate from a recognized Classification Society
- Ship's Carving and Marking note
- International certificates from a recognised Classification Society in accordance with the relevant international maritime conventions in force
- Safety Management Certificate (where required)
- Confirmation of the Cypriot Customs and Excise Department and VAT Service on the payment of VAT for pleasure craft (where applicable)

Appendix C

Table A: motor yachts

Length of motor yacht	% of use within EU	Effective rate of VAT (Cyprus)
Over 24 metres	20%	20% of consideration x 17% = 3.4%
Between 14.01 to 24 metres	30%	30% of consideration x 17% = 5.1%
Between 8.01 to 14 metres	50%	50% of consideration x 17% = 8.5%
Up to 8 metres	60%	60% of consideration x 17% = 10.2%
Craft permitted to sail in Cypriot waters only	100%	100% of consideration x 17% = 17%

Table B: sailing yachts

Length of sailing yacht	% of use within EU	Effective rate of VAT (Cyprus)
Over 24 metres	20%	20% of consideration x 17% = 3.4%
Between 20.01 to 24 metres	30%	30% of consideration x 17% = 5.1%
Between 10.01 to 20 metres	50%	50% of consideration x 17% = 8.5%
Up to 10 metres	60%	60% of consideration x 17% = 10.2%

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This publication is not a substitute for detailed advice on specific transactions and should not be taken as providing legal advice on any of the topics discussed. In particular, please note that as yacht financing transactions are highly complex, specialist legal advice (including Cypriot tax law advice) should always be sought.

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