

REGULATORY IMPACT ASSESSMENT

TONNAGE TAX

What is tonnage tax?

Tonnage tax will be a new ring-fenced regime allowing companies to elect (on a group wide basis) to have their taxable profits from shipping activities determined at fixed rates by reference to the tonnage of their ships, rather than by reference to variable business results.

Elections into the regime are for 10 years at a time, renewable annually on a rolling basis.

Purpose and intended effect

The UK direct-owned fleet is in long-term decline and there has also been a heavy decline in the number of seafarers in recent years.

The Government is concerned at this decline and has sought to address the issue in a number of ways.

- In late 1997 it set up a Shipping Working Group, a body involving representatives from the industry, trades unions and Government departments. The Shipping Working Group reported in March 1998. It suggested that one of the key steps which Government could take to underpin a renaissance of the UK shipping industry would be to introduce a tonnage tax.
- In July 1998, it published a White Paper on the Future of Transport, which included a section on an integrated shipping policy.
- In December 1998, the UK Government published "British Shipping - Charting a New Course" - a paper which set out the Government's policy and objectives for the shipping industry.
- In March 1999, The Chancellor of the Exchequer commissioned from Lord Alexander of Weedon an independent enquiry into the case for and the design of a tonnage tax regime for shipping.

The conclusion was that a tonnage tax regime should be introduced in the UK as an essential element of UK maritime policy in order to create a positive fiscal environment for shipping in line with other major maritime countries.

The Deputy Prime Minister announced the intention to introduce a tonnage tax in the UK on 12 August 1999. The legislation for the regime will be introduced in the Year 2000 Finance Bill, to have effect so that companies may opt in for accounting periods starting on or after 1 January 2000.

Tonnage tax is a key ingredient in a package of measures worked up by Government in conjunction with the industry and trades unions. As a whole,

this package is designed to reverse the decline in the UK merchant fleet and allow the UK shipping industry achieve its full economic potential.

Options

Once it was decided to introduce a tonnage tax, legislation was the only option. Such a major change in the way shipping companies are taxed could not be delivered by extra-statutory concession or Statement of Practice.

Benefits of tonnage tax

- Tonnage tax offers a new, simple, fixed rate, low tax regime for shipping.
- Companies opting into the regime will be able to enjoy certainty as to the level of taxation to be imposed on their shipping activities.
- In the case of a singleton company or group of companies carrying out nothing other than shipping activities, it will greatly reduce the amount of effort required to complete annual tax returns and significant cost savings may be achieved.
- Publicly quoted companies will derive a significant advantage from the regime in that their deferred tax liability in respect of shipping will be phased out under the regime, thus increasing their reported earnings per share and strengthening the balance sheet.
- Entering into tonnage tax will see an end to tax-driven (rather than commercially motivated) ship investment.
- The tonnage tax training commitment will increase the availability of trained seafarers so ensuring the continuing economic success of shipping and maritime-related industries.

Compliance costs

Shipping companies

Tonnage tax is an optional scheme. It is thought that a large number of shipping companies may opt into the regime. Most of these are grouped and administered centrally. But, taking groups of companies as one business entity, it is thought that the number of businesses electing into tonnage tax will be relatively modest, although it may be boosted by some businesses which are currently based overseas.

The tonnage tax regime is designed to fit within the existing system of self-assessment for companies. Companies may elect, on a group wide basis, to calculate their profits from shipping activities by reference to low fixed rates dependent on the tonnage of the vessels that they operate. These profits will be subject to the normal prevailing rates of corporation tax. This will be reported as part of the company's self-assessment return, which means that the normal rules on enforcement and monitoring will apply.

As the regime will be ring-fenced to include only shipping activities, some larger groups of companies may choose to reorganise their operations to

isolate their shipping activities from any other activities to make the operation of the ring-fence principle easier. The costs of any such reorganisation will obviously vary depending on the circumstances of the group and will depend on how easy it would be to operate the ring-fence in the absence of any reorganisation. Singleton companies and small groups are less likely to need to undergo reorganisation than large groups which have complex business profiles spanning a range of activities in addition to shipping. Many companies will have no need to reorganise at all.

It may be necessary to make adjustments to a group or company's non-shipping profits because of transactions crossing the ring-fence. This may involve companies in some additional compliance burdens. However, the Inland Revenue is offering a non-mandatory clearance procedure for tonnage tax, under which methods of effecting ring-fence adjustments may be agreed in advance so that such issues will not need to be revisited every year. It will be up to companies to decide whether to concentrate some effort at the outset of the regime in submitting a clearance application in order to reduce any perennial costs arising later during the course of the election.

In the simplest case of a singleton company carrying on nothing other than shipping activities, tonnage tax will represent not only a reduction in tax payable, but a significant reduction in the compliance effort involved in producing tax computations as well as a high degree of certainty as to yearly tax payable. The same will be true of a small group of companies with no activities other than shipping.

One condition of electing into tonnage tax is a training commitment. Companies must submit a training plan to DETR demonstrating a commitment to provide officer training places (or make a payment in lieu of training in proportion to the crewing complement of the ships operated by the company). Like the rest of the tonnage tax regime, this proposal has been worked up in conjunction with the shipping industry. The envisaged system would allow flexibility in the way that a company may deliver its training obligation. The training requirement is a key ingredient in tonnage tax, ensuring replenishment of the numbers of trained seafarers for future use in the UK fleet and in related shore-based industries. The cost of providing officer training varies between companies, but a standard amount of £500 per head per month is proposed where payment is made in lieu of training. Many companies already have training policies in place and these may already meet the minimum training commitment for tonnage tax eligibility. The likely costs of drawing up and submitting the training plan are thought to be minimal.

Estimates of compliance costs

In researching the likely compliance costs to the industry, the Inland Revenue has looked at broadly four categories of shipping business, ranging from the largest players, through middle-sized businesses, both with complicated business profiles and the more straightforward, down to the smallest and simplest cases.

We have quantified savings in tax departments of these businesses arising from reduced work in compiling tax computations (largely on the capital allowances side), both for in house staff and external advisers. These savings are balanced against some one-off reorganisation costs, which may arise in some companies and groups, as well as the costs of delivering the minimum training requirement.

The one-off compliance costs are concentrated in the run-up to the start of tonnage tax, when the industry will incur both internal and external costs in planning for the change.

By comparison, the recurrent compliance costs are very modest. Some companies and groups will see overall savings. Across the whole industry we would expect there to be a small recurrent cost.

One-off costs

These are dependent on the complexity of the particular shipping business entering tonnage tax. It may be possible for some businesses to come into the regime with a minimum degree of change in their structures. If all businesses coming into tonnage tax fell into this category, we would expect the one-off compliance costs to be about £1 million across the industry.

On the other hand, in the more complex businesses it may be advantageous for companies to restructure their affairs before entry to the regime, incurring costs on both the actual reorganisation and the necessary advice. If all businesses coming into tonnage tax fell into this category, we would expect the one-off compliance costs to be about £3 million across the industry.

Assuming a mixture of types of business will elect into the regime, the one off costs are likely to fall somewhere between these two extremes.

Recurrent costs

Recurrent costs are strongly influenced by the costs of any additional training imposed by the minimum training obligation, which is a key feature of the scheme. Where a company's existing training level falls a long way short of that minimum obligation, recurrent costs will be much higher than for a company where there is a significant level of training already provided. On balance we estimate that if companies with a mixture of existing training profiles elect into the regime, the recurrent costs will be between £0.1 and £0.25 million per year.

Other costs

Lessors

As profits are not calculated on the usual basis in tonnage tax, shipping companies in the regime will not be able to claim capital allowances. The

regime also includes rules to limit the capital allowances that ships may generate if they are leased into the regime by companies outside it. Ship lessors are usually banks or other financial institutions. Ship lessors will have to prepare special capital allowances computations in respect of ships leased to tonnage tax companies. However, there are very few ships leased in any one year, so the additional costs of compliance for lessors will be minimal. An element in respect of lessors' compliance costs has been included in the estimates of one-off and recurrent costs given above: this element ranges from negligible to very small. Representatives of the leasing industry have been fully involved in the design of the special provisions for leasing.

Inland Revenue

As mentioned above, most of the shipping industry in the UK is concentrated in large groups of companies, currently handled in the Inland Revenue Large Business Offices. These groups already demand the attention of a significant number of Inspectors and it is thought that the work involved in administering tonnage tax after the initial period of clearance applications will simply replace work that was previously done checking the conventional computation of profits.

There will be some concentration of effort in dealing with clearance applications, but not to such a degree as would necessitate assignment of additional staff.

Consultation

The Inland Revenue worked together with the industry and with other Government Departments in providing evidence to Lord Alexander's independent enquiry. Since the publication of Lord Alexander's Report there has been continuous consultation with representatives of the shipping and leasing industries. All the parties concerned have worked together to produce a regime for tonnage tax that will be workable in practice and likely to achieve its stated objectives. Draft Clauses were published in December 1999 for consultation and the secondary legislation and Statement of Practice will also be published for consultation in due course.

Summary

The option for tonnage tax is being offered to the shipping industry in order to create a positive fiscal environment for shipping in line with other major maritime countries. This will play a key role in delivering the Government's wider objective of reversing the decline in the UK fleet.

In working up the proposals, the Inland Revenue has worked closely with representatives of the shipping industry, the leasing industry and the Department of the Environment, Transport and the Regions.

The simpler and smaller a group of companies opting into the regime, the less likely that it is to incur any additional compliance cost to set against the

considerable advantages of this new low-rate alternative taxation regime for shipping. Where there is a mix of activities there may be additional compliance effort involved in operating the ring-fence, but this will be mitigated by the opportunity to obtain advance clearance.

Tonnage tax will offer significant benefits for shipping companies in the UK:

- **simplicity**
- **certainty**
- **no deferred tax liability.**

We expect the one-off compliance costs to be between £1 million and £3 million across the industry. And we estimate the recurrent costs will be between £0.1 and £0.25 million per year. But many shipping companies have already indicated that the benefits far outweigh any additional costs involved and that they are likely to elect into the regime.

Enforcement, Sanctions and Review

Tonnage tax will be administered as part of the normal system of self-assessment for companies in the UK, as subject to the normal audit procedures built into that system. The regime will contain anti-avoidance provisions, so that companies abusing the regime may be expelled from it. We expect, in conjunction with DETR to make a preliminary evaluation of the success of the regime after it has been operating for two years.

**Tonnage Tax team
Room 211 Victory House
30-34 Kingsway
London
WC2B 6ES**

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