Tonnage Tax

Part 24A-00-01

This manual should be read in conjunction with sections 697(A) to 697(Q) and Schedule 18B Taxes Consolidation Act 1997 (TCA 1997)

Document last reviewed October 2021

Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

Table of Contents

Introduction

This Tax Instruction explains what Tonnage Tax is, why it was introduced in Ireland and the essential requirements necessary for shipping companies to qualify under the regime.

1. What is Tonnage Tax?

Tonnage tax is a scheme whereby, as an alternative to charging corporation tax on certain profits of a qualifying shipping company, a tax charge is levied each year, instead, on the tonnage of the ships operated by the company.

The scheme was introduced as an encouragement to the EU maritime business and allows Irish-based companies to compete with EU competitors benefiting from tonnage tax regimes in their jurisdictions.

The scheme which was introduced under the Taxes Consolidation Act 1997 Part 24A, Sections 697(A) to 697(Q) and Schedule 18B came into operation with effect from 28 March 2003. The legislation was framed in such a way that it could apply to the shipping profits of companies electing into the regime where those profits arose on or after 1 January 2002.

The term “Tonnage Tax” while standard in the various countries that 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 for tax purposes the income and gains arising to a shipping company from certain very specific activities.

2. Advantages of Tonnage Tax

The main advantages of tonnage tax are:

- Certainty, since the level of tax is 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 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 is more readily understood. Consequently, a company may become more attractive to investors and potential business partners.

- Compatibility and competitiveness with the fiscal regimes of other countries. This is particularly important from the point of view of maintaining and developing Ireland's indigenous shipping industry.

3. How companies qualify for Tonnage Tax

The Tonnage Tax scheme is elective – to make an election under Section 697D of the TCA 1997 a company must complete form "Tonnage Tax 1" (available on the Revenue web site www.revenue.ie) and sign the Declaration that the company is a "qualifying company" for the purposes of section 697A TCA 1997 (see page 7 of the form).

It is important to note that all qualifying companies in a group must enter the scheme. A "qualifying company" means a company:

- Which is within the charge to corporation tax,
- Which operates qualifying ships, and
- Which carries on the strategic and commercial management of those ships in Ireland.

A **"qualifying ship"** is a self-propelled 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. It does not include a vessel of "an excluded kind". Some examples of vessels excluded from the definition include fishing and fish factory vessels, recreational vessels, oil tankers and dredgers [a full list is contained in Section 697A(1) TCA 1997].

3.1 Strategic and Commercial Management of qualifying ships in the State

The legislation does not define **"strategic and commercial management"**. The reason for this was to avoid being too prescriptive as a wide variety of activities can be encompassed in the term "strategic and commercial".

A company must satisfy both aspects of the 'strategic and commercial test' before it can be considered eligible for inclusion under the tonnage tax regime. A company must demonstrate that all elements of management activity relevant to the ships in question take place in Ireland.

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, 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 and 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.

Important: hard copy evidence (e.g. copies of emails, contracts, ship management agreements, extracts from minutes or reports of meetings of directors etc.) must be provided to the Revenue Commissioners to show that decisions are being made by the company in Ireland.

4. Elections

4.1 Accounting period from which a valid election for Tonnage Tax takes effect [Section 697D and Part 1 Schedule 18B TCA 1997]

A valid election for tonnage tax takes effect from the beginning of the accounting period in which it is made. The legislation gives Revenue the authority to allow, in exceptional circumstances (for example, the need to complete re-structuring to enable the legislation to actually apply to the business), an election to take effect from an earlier or later accounting period than the period in which the election is made. However, this discretion is subject to the overriding rule that no election can apply for any accounting period beginning before 1 January 2002 (this reflects the Minister’s original Budget announcement that tonnage tax would apply with effect from 1 January 2002).

4.2 Renewal Election – Ten-year commitment to remain within the tonnage tax regime [Para 6 Schedule 18B TCA 1997]

A company 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 by election (called a “renewal election”) at any time in which case the period of the election is extended for a further period of 10 years from the date of this renewal election.

5. Tonnage Tax Activities

“Tonnage tax activities” in relation to a tonnage tax company (as defined under Section 697A(1) TCA 1997) mean 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 the paragraphs which come under the definition of “relevant shipping income” in section 697A.

5.1 Relevant shipping income [Section 697A(1) TCA 1997]

The most important of the activities coming under the definition of "relevant shipping income", which are included in the tonnage tax regime, include:

- 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 the provision on board 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.
- Income from the provision of ship management services for qualifying ships.

(see section 697A (1) TCA 1997 for a full list of what constitutes "relevant shipping income")

6. Calculation of "Profits" under Tonnage Tax [Section 697C TCA 1997 sets out the rules for the calculation of the tonnage tax profits of a tonnage tax company]

- The tonnage tax "profits" of a qualifying company replace the company's accounting profits for the purposes of applying corporation tax to those profits. However, only the "relevant shipping profits" of the company are displaced for this purpose. The normal accounting profits of the company adjusted for taxation purposes from all other activities are subject to corporation tax in the normal way.
- The tonnage tax profit is calculated on the basis of a notional daily profit per ship based on a sliding tariff by reference to the net tonnage of the ship (see Table 1). This notional profit per ship is then multiplied by the number of days the ship was operated in the accounting period by the company. This gives the profit per ship for each accounting period. The profit per ship is aggregated to get the company's overall tonnage tax profits for the accounting period. The 12.5% corporation tax rate is then applied to this profit instead of being applied to the company's relevant shipping profits.
- To account for tonnage tax profits companies must complete a return (Form CT1 Supplement – Tonnage Tax Profits). This Return is part of the company's Corporation Tax return (Form CT1).

Table 1: Calculation of Tonnage Tax Profits

Band	Rate per 100 ton unit
For each unit of 100 tons up to 1,000 tons	€1
For each unit of 100 tons between 1,000 tons and 10,000 tons	€0.75
For each unit of 100 tons between 10,000 tons and 25,000 tons	€0.50
For each unit of 100 tons above 25,000 tons	€0.25

7. Treatment of Capital Allowances, Losses and Other Reliefs [Sections 697M, 697N, 697O and Part 3, Schedule 18B TCA 1997]

- 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 to 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 re-investment 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 to tonnage tax.
- A company cannot use losses carried forward from any period before entry into tonnage tax to reduce tonnage tax profits. Such losses are therefore effectively extinguished. In a similar manner, other corporation tax reliefs (for example, film relief) are not available. Also, tax credits (including foreign tax credits) are not available to reduce the corporation tax payable by a company to the extent that the corporation tax is referable to tonnage tax profits.

8. Ring-fencing Measures

The tonnage tax legislation includes extensive ring-fencing measures which are designed to ensure that the tonnage tax regime operates as intended. Relief for losses incurred on tonnage tax activities is not available against other sources of income and income from non-tonnage tax activities may not be included under the regime. Some additional measures include:

- A requirement that goods and services provided to a tonnage tax company by an associated non-tonnage tax company be provided on an arm's length basis and vice versa [Section 697LA TCA 1997]. This provision also applies where a tonnage tax company has a number of business units some of which are covered by the tonnage tax regime and others which are not.
- Anti-thin capitalisation measures are also included [a company is said to be "thinly capitalised" when its equity capital is small in comparison to its debt capital]. In general, most companies are financed by a mixture of equity finance and loan capital. Companies in the tonnage tax regime do not get a tax deduction for interest paid on borrowings. Therefore, there is scope for the artificial allocation of debt within a company or group so that the debt that is in reality referable to the tonnage tax business is transferred to its non-tonnage tax activities where a tax deduction for interest paid would be of most value. The legislation deals with such a case by re-allocating a portion of the interest charge to the tonnage tax side of the business on a just and reasonable basis [Section 697LB TCA 1997].
- Anti-avoidance measures are also included to prevent the regime from being used for tax avoidance activities and transactions [Section 697F TCA 1997].

9. Schedule 18B TCA 1997

This Schedule contains provisions which are supplemental to the principal tonnage tax provisions contained in Part 24A. The Schedule consists of five parts:

- Part 1 deals with matters relating to election for tonnage tax,
- Part 2 is concerned with matters relating to qualifying ships,
- Part 3 concerns capital allowances, balancing charges, and related matters,
- Part 4 deals with issues relating to groups, mergers and related matters and,
- Part 5 is concerned with miscellaneous and supplemental matters.

10. Finance Act 2006 - changes to Tonnage Tax

Four changes to the tonnage tax regime, recommended by the Department of Finance's internal review in 2005 of various tax schemes, were made in the Finance Act 2006:

Firstly, new forms prescribed by the Revenue Commissioners will be used for the application process.

Secondly, the Revenue Commissioners have been given the authority to seek further information from companies seeking entry to the regime to establish their bona fides.

Thirdly, the provision that excludes vessels primarily used for sport & recreation has been tightened up.

Lastly, section 67 permits the Minister for Finance to remove (by Commencement Order) the limit (currently 75%) imposed on the proportion of ships that a company may charter if it is to qualify for the tonnage tax regime. It should be noted that this Commencement Order has yet to be introduced.

All enquiries and applications for tonnage tax should be addressed to:

Business Taxes Policy & Legislation Division,

First Floor,

Stamping Building,

Dublin Castle,

Dublin 2,

D02 HW86.

Phone number: 01-8589883