



## Shipping: tonnage tax

Standard Note: SN/BT/603  
Last updated: 22 February 2010  
Author: Louise Butcher  
Section: Business and Transport

---

The legislation for an optional ring-fenced regime for shipping companies, known as the tonnage tax, was contained in section 81 and Schedule 22 of the *Finance Act 2000*. This note describes how and why the tonnage tax was introduced and summarises its main features.

This Note is largely concerned with the transport aspects of the tax. For a more tax-centric explanation, please refer to the HMRC [Tonnage Tax Manual](#).

For information on UK and EU shipping policy more generally, please visit the relevant topical page of the [Parliament website](#).

### Contents

<b>1</b>	<b>Background</b>	<b>2</b>
1.1	Calls for a tonnage tax, 1997-1999	2
1.2	Inquiry and legislation, 1999-2000	4
1.3	International comparisons	5
<b>2</b>	<b>Key features of the tonnage tax</b>	<b>6</b>
2.1	General	6
2.2	Minimum training obligation	8
<b>3</b>	<b>Treasury review 2004</b>	<b>9</b>
<b>4</b>	<b>Transport Committee report, 2005</b>	<b>13</b>

This information is provided to Members of Parliament in support of their parliamentary duties and is not intended to address the specific circumstances of any particular individual. It should not be relied upon as being up to date; the law or policies may have changed since it was last updated; and it should not be relied upon as legal or professional advice or as a substitute for it. A suitably qualified professional should be consulted if specific advice or information is required.

This information is provided subject to [our general terms and conditions](#) which are available online or may be provided on request in hard copy. Authors are available to discuss the content of this briefing with Members and their staff, but not with the general public.

# 1 Background

## 1.1 Calls for a tonnage tax, 1997-1999

In its 1997 annual review, the Chamber of Shipping, called for a more competitive tax environment to be established in the UK. In particular, it suggested:

1. The introduction of a tonnage-based tax regime for British companies mirroring those in the Netherlands, Norway, Greece and soon in Germany;
2. Improvement to the current depreciation regime applicable to new investment in ships to match the value of the tonnage regime; and
3. Ensuring a genuine and permanent choice between the two systems - any company opting for the tonnage regime should do so for a minimum of ten years.<sup>1</sup>

The following year, the Shipping Working Group, set up by the Government to examine ways to promote British shipping, made the following recommendations about the fiscal regime:

Introduce the option of tonnage-based corporation tax for UK tax resident companies, or UK branches of non-resident companies, primarily involved in the operation of seagoing shipping services.

Introduce an enhancement to the rate of depreciation allowance within the orthodox corporation tax regime, for ship operating companies so that they can choose between this and the tonnage-based regime according to their particular circumstances.

Safeguard a generally attractive tax climate by, in addition to proposals 25 and 26, ensuring: (a) continuation of beneficial leasing arrangements; (b) the continuing attraction of the UK as a place to do business for both UK and foreign ship owners; (c) that cross-industry support does not have features that exclude shipping.<sup>2</sup>

In relation to the fiscal regime the Government undertook to “discuss fiscal options with the shipping industry in the context of the pre-Budget consultation and without any commitment on implementation”.<sup>3</sup>

In May 1999, the Transport sub-Committee of the Environment, Transport and Regional Affairs Select Committee published a report into the future of British Shipping. It too recommended the introduction of a tonnage tax with measures to boost training for British seafarers:

It is relatively easy for a ship-owner, operating in conditions where national boundaries are largely irrelevant, to "set up off-shore structures wherever you are in the world to operate your ships essentially in a low-tax or no-tax environment". As the daughter document says, "in this situation, national fiscal and regulatory regimes can be the main residual cause of cost differentials. Shipping investment tends to be drawn to low tax regimes". Those countries which place a higher tax burden on their shipping industries lose investment to other countries, and increasingly find that ship owners base themselves overseas. As a result 'flagging out' increases. To combat the problem several countries, such as the Netherlands, Norway, Germany, and Greece, have adopted tax measures for shipping which compare favourably to the lowest tax regimes to be found internationally.

---

<sup>1</sup> Chamber of Shipping, *Annual Review 1997*

<sup>2</sup> DETR, *British Shipping: Charting a new course*, December 1998, paras 25-27

<sup>3</sup> *ibid.*, para 125

The example most frequently quoted to us was that of the Netherlands, which introduced a tonnage tax in 1996. In that country shipping companies are subject to a nominal rate of corporation tax determined by the total tonnage of the ships in their fleet. Companies which base themselves in the Netherlands to take advantage of the lower tax rate must fulfil certain criteria in exchange, such as employing a certain number of Dutch seafarers. The tonnage tax enables the Netherlands "to compete on the same sort of basis as their major competitors". As a result it has attracting 120 ships to its register, with a "clear reduction in the number of Dutch-managed ships under foreign flags [and] a clear increase in the number of Dutch and other European Union seamen in the Dutch fleet".

The Shipping Working Group strongly recommended that a tonnage tax should be introduced in the United Kingdom, to provide a level playing field with countries both within and outside Europe. The tax would have benefits beyond giving incentives to ship owners to base themselves in the United Kingdom. For example, the Minister for Shipping told us that "the tonnage tax would carry with it a package of measures, the obvious one being a commitment to funding training, where it was analysed that that would increase the number of trainees, year on year, by 25 per cent". Furthermore, despite the fact that it was not proposed that the tonnage tax would be linked to the registration of vessels in this country, several of our witnesses believed that it would encourage growth of the UK register. The experience of the Netherlands appears to support that belief, and we note that Lord Sterling, of P&O, believes that with a 'sensible' tonnage tax his company would be able to bring up to 55 ships back to the register.

The tonnage tax is, however, of no benefit unless it is low enough to compete with other tax regimes. There will, therefore, be a cost to the Government of introducing such a scheme instead of corporation tax, because of reduced income from taxation. The Shipping Working Group estimated that the cost might be £40 million to £50 million per year. The Chamber of Shipping told us, however, that they thought that the cost would be lower, since the figure quoted by the Working Group had been based on the overall profits of shipping companies, many of which reinvest income in investment programmes which are already tax-free, and also since the shipping industry in the UK would be stimulated, and thus pay more tax. In all, the Chamber told us, the cost to the Treasury of introducing a tonnage tax would be "not more than £10 to £15 million maximum".

In view of the condition of the shipping industry, as we have described, and the fact that our witnesses were all in favour of the introduction of a tonnage tax, we were extremely disappointed by the wording of Action 23 of the daughter document, which simply said that "the Government will discuss fiscal options with the shipping industry in the context of the pre-Budget consultation and without commitment on implementation". We were further disappointed by the Budget, in which the Chancellor said that "the shipping industry has put to me the case for ... a lower rate ring-fenced tonnage tax. While I am attracted to these options, I have to be satisfied that lower tax rates will not become a vehicle for tax avoidance". It was announced that Lord Alexander would conduct a study of the "national and international issues involved".

We do not fully understand what "international issues" Lord Alexander must consider. The European Commission has told us that although the tonnage tax is a state aid, the Commission recognises that "it is a state aid that will not impede internal EU competition while promoting an EU fleet. This is why the tonnage tax is one of the measures within the guidelines that Member States can adopt if they want to help their fleet". The only other relevant international matter is its obvious success in other countries, which has been illustrated by the Shipping Working Group.

One "national issue" is concern about tax avoidance, since companies might seek to exploit the lower tax rate. Clearly such a situation would be unacceptable, but we do not believe that the Treasury would find any particular difficulty in framing such a tax, and we believe that the Treasury should have been ready at the time of the Budget to put forward proper proposals. It evidently was unable to do so: nor was it able to assist us in our inquiry. One of the reasons it was unprepared was the fact that neither the Treasury nor the Inland Revenue participated in the Shipping Working Group, which, given the subjects discussed in the Group, we find extraordinary. **We regard the fact that the Treasury and the Inland Revenue did not participate in the Shipping Working Group deplorable, and believe that their failure so to do has unnecessarily delayed the proper consideration of the tonnage tax. We also believe that the evidence given to us by the Treasury was ill-prepared and inadequate.**

An official from the Treasury told us that "if it is important to have a UK-owned merchant fleet and if it is possible to construct the right anti-avoidance regimes then I can see the advantage of a tonnage-based tax approach". We have amply demonstrated the importance of supporting the UK shipping industry. **The UK shipping industry is in a parlous condition, and radical measures are required to arrest and reverse its decline. We recommend that Lord Alexander's inquiry be brought to a close as soon as possible, and that a low rate tonnage tax, including measures to boost training of British seafarers, and to prevent tax avoidance, should be introduced without further delay, preferably as an amendment to the current Finance Bill.**<sup>4</sup>

In his evidence to the Committee, Lord Sterling, then Executive Chairman of P&O, said that if a tonnage tax were introduced "in a sensible fashion" he thought that P&O could more than double their tonnage on the UK Register.<sup>5</sup> At that time one third of P&O's ships were registered in the UK.

## 1.2 Inquiry and legislation, 1999-2000

The then Chancellor of the Exchequer, Gordon Brown, in his Budget speech in March 1999, announced that Lord Alexander of Weedon had been asked to conduct an independent study of the case for, and the design of, a lower, ring-fenced, tonnage-based tax that would include training incentives:

The shipping industry has put to me the case for enhanced training incentives and for a lower rate ring-fenced tonnage tax. While I am attracted to these options, I have to be satisfied that lower tax rates will not become a vehicle for tax avoidance and I am grateful to Lord Alexander for agreeing to conduct an independent study of the national and international issues involved.<sup>6</sup>

Lord Alexander's report was published in August 1999. In his report he compared a tonnage tax to the usual corporation tax:

A tonnage tax contrasts with the generic corporation tax system under which a company's tax liability is based on the commercial profits which the company has made in the year. It ignores actual profit and instead computes a notional profit on the basis of the number and size of ships operated and taxes this profit, rather than the commercial profit, at the normal corporation tax rate. The tonnage rate is generally set

---

<sup>4</sup> ETRA Committee, *The Future of the UK Shipping Industry* (twelfth report of session 1998-99), HC 172, 26 May 1999, paras 71-78 [emphasis in original]

<sup>5</sup> *ibid.*, Q264; the UK Register became the UK Ship Register in February 2007

<sup>6</sup> [HC Deb 9 March 1999, c177](#)

so that notional profits, and hence actual corporation tax paid, are minimal. The mechanism seems to be an ingenious device for obtaining virtual tax exemption compatible with international tax treaty obligations. It departs from normal corporation tax principles of taxing actual profits to introduce a notional basis which bears no relationship to actual profits earned.<sup>7</sup>

He concluded that:

If the shipping industry is to be revived, a package of measures is necessary, as is recognised in *Charting a new course*. It is obviously important to examine sympathetically the case for other potential measures which may improve the competitiveness of the UK shipping industry, such as extending the Foreign Earnings Deduction and expanding the Crew Relief Costs Scheme. But I believe that a form of tonnage tax is fundamental to this package.<sup>8</sup>

Lord Alexander advised that an effectively tax-exempt regime, along the lines described in paragraph 92 of his report, would be workable and necessary if the partnership (between Government, industry and trade unions) “is going to have the opportunity to implement the policy of reviving the industry to which the Government is committed”.<sup>9</sup>

When the report was published, the then DETR announced that legislation for the tax would be introduced as part of the following year’s Finance Bill.<sup>10</sup> The legislation is contained in section 81 and Schedule 22 of the *Finance Act 2000*. The detailed design of the tonnage tax is the one proposed by Lord Alexander in his report. It is defined in the *Tonnage Tax Manual* as follows:

[It is] an alternative method of calculating corporation tax profits by reference to the net tonnage of the ship operated. The tonnage tax profit replaces both the tax-adjusted commercial profit/loss on a shipping trade and the chargeable gains/losses made on tonnage tax assets. Other profits of a tonnage tax company are taxable in the normal way.

### 1.3 International comparisons

In response to a written question in July 2004, the then Transport Minister gave the tonnage tax figures for other EU countries:<sup>11</sup>

Taxable profit per ship per day per 100 net tons, in Euros	0 to 1,000 tons	1,001 to 10,000 tons	10,001 to 25,000 tons	25,001 tons and over
Denmark	0.94	0.67	0.40	0.27
Germany	0.92	0.69	0.46	0.23
Ireland	1.00	0.75	0.50	0.25
Netherlands	0.91	0.67	0.46	0.23

<sup>7</sup> Lord Alexander of Weedon QC, *Independent inquiry into tonnage tax*, August 1999, para 27

<sup>8</sup> *ibid.*, executive summary, para xiv

<sup>9</sup> *ibid.*, executive summary, para xv

<sup>10</sup> DETR press notice, “Prescott package will boost British shipping”, 12 August 1999

<sup>11</sup> HC Deb 14 July 2004, c1195W

Spain	0.90	0.70	0.40	0.20
UK	0.90	0.68	0.45	0.23
Belgium	1.00	0.60	0.40	0.20
France	0.93	0.71	0.47	0.25
Italy	0.90	0.70	0.40	0.20

In a debate in April 2006 the Transport Minister said:

I remind the House that there are many flags of convenience, and that there are also numerous variants on the tonnage tax now. We may have invented it, but other countries came along afterwards and thought, "That was a jolly good wheeze that the Brits came up with; we'll do the same thing." Shipowners have choices, and we have to find a way of navigating through those choices.<sup>12</sup>

In January 2009 the Minister confirmed that "We have currently no plans to increase the number of officers companies are required to train under the tonnage tax commitment. We are however looking into the practicalities of the joint proposals for increased support for training and employment received from our social partners".<sup>13</sup>

The RMT Union has [information on its website](#) about a campaign to link tonnage tax concessions to specifically UK seafarer employment.

## 2 Key features of the tonnage tax

### 2.1 General

The key features of the tax, as outlined in an Inland Revenue press notice of December 1999, are as follows:

#### Option to elect

Shipping companies will have the option to participate or to remain in the standard corporation tax regime, subject to all qualifying UK shipping activities within a group being taxed on the same basis.

#### Tax liability

A participating company's taxable profits will be derived by reference to the net tonnage of each of the qualifying ships it operates. It will pay corporation tax at the normal rate on the derived profit. The rates of profit per ton will be roughly equivalent to the rates charged in comparable regimes already in operation elsewhere (eg in the Netherlands).

Capital gains accruing during the currency of the election will not be chargeable to tax if they arise from assets used for the qualifying shipping activity. Balancing charges (arising on the disposal of assets for which capital allowances had previously been given) will be phased out using a sliding scale.

---

<sup>12</sup> [HC Deb 26 April 2006, c276WH](#)

<sup>13</sup> [HC Deb 12 January 2009, c407W](#)

## **Eligibility**

Qualifying ships must be seagoing, and of at least 100 tons gross tonnage.

Qualifying ships must be engaged in:

- The transportation of goods or passengers by sea
- The provision of marine assistance
- The provision of transport for services necessarily provided at sea (subject to qualification)

Companies must undertake the strategic and commercial management of ships within the tonnage tax regime from the UK (as required by the guidelines on Maritime State Aids).

The regime is not open to:

- fishing and factory support vessels
- pleasure craft
- harbour and river ferries
- fixed and floating oil rigs and platforms
- FPSOs/FSUs (floating production, storage and offtake vessels)
- existing dedicated shuttle tankers subject to the PRT regime
- any vessel whose main purpose is the provision of goods or services normally provided on land, such as floating supermarkets, restaurants etc.

## **Window of entry**

Elections to join the regime must be made within 12 months of Royal Assent, and companies will normally be expected to remain in the regime for at least 10 years.

## **Exiting the regime**

A company leaving the regime on expiry of the election will rejoin the normal corporation tax regime and be able to claim capital allowances on its assets on broadly the same basis as if it had remained in the normal corporation tax regime throughout. Companies will be discouraged from leaving the regime before their elections expire.

## **Ring-fencing**

Shipping profits will be ring fenced. There will be specific anti-avoidance provisions to prevent a company transferring profits from outside the regime into it or transferring losses outside the regime. There will also be a sweep up anti-avoidance provision aimed at moves to exploit the regime by complying with the form rather than the substance of the ring-fence rules.

## **Leasing**

Capital allowances available to lessors leasing to companies within the tonnage tax regime will be restricted with 25 per cent allowances available on only the first £40 million per vessel, 10 per cent allowances on the next £40 million expenditure on that

vessel and no allowances on any remaining expenditure. The values of these limits will be kept under review. No capital allowances would be available to lessors in the case of sale and lease-back or defeased or collateralised leasing (ie where the lessor does not carry the greater part of the risk as part of the leasing arrangement).

Lord Alexander's report suggested that these restrictions on leasing into tonnage tax companies should not apply to ship leases entered into before the date of announcement of the tonnage tax proposals (12 August 1999). In the attached draft Clauses, this relaxation has been extended so that the restrictions on leasing into the regime will not apply for ship leases entered into before today.

### **Foreign profits**

Foreign dividends from qualifying shipping subsidiaries will be within the tonnage tax regime (subject to certain conditions).

### **Clearances**

There will be a non-mandatory system of clearances (ie prior agreement between the Inland Revenue and a group or company as to its eligibility and about the way in which the regime will apply to it). The Inland Revenue will take steps to ensure a consistent approach.

### **Training link**

A company participating in the tonnage regime must meet a minimum training obligation. This aspect will be administered by the Department of the Environment, Transport and the Regions who will require companies to agree and stick to training plans in respect of ships benefiting from the new tax regime.<sup>14</sup>

The 'minimum training obligation', a feature possibly unique to the UK, is examined in more detail below.

As tonnage tax is optional, a company or group must elect into it. Where a group of companies is concerned, the whole group must elect to tonnage tax, it is not possible for selected companies within the group to opt to tonnage tax. Companies are able to make the election within the twelve months after the day on which they qualify. There is some flexibility as to when election will take effect. Normally it will be effective from the beginning of the accounting period in which election is made. As a general rule the election will last for ten years, although if the company ceases to be a qualifying one, the election will end then.

A written answer in April 2002 indicated that the introduction of the tonnage tax had contributed to a 61 per cent increase in tonnage of the UK registered fleet in the two years after its introduction.<sup>15</sup>

## **2.2 Minimum training obligation**

A condition of entering into the tonnage tax regime is that the company or group must enter into a 'minimum training obligation' with the Department for Transport. Broadly, this requires either the training of one trainee per year for each 15 officers, or a payment in lieu (PILOT) to the Maritime Training Trust (in addition, the trainees must be British or EEA nationals and

---

<sup>14</sup> Inland Revenue press notice, "Tonnage tax boost for UK shipping industry", 23 December 1999

<sup>15</sup> [HC Deb 22 April 2002, cc58-59W](#)



ordinarily resident in the UK).<sup>16</sup> The DfT's *Tonnage tax minimum training commitment* document gives an overview of how the scheme works:

The main elements of the system for administering the MTO are:

- The **Core Training Commitment (CTC)**, an annual plan produced by the company, and subject to DfT approval, setting out the company's training obligation and how it will be met;
- The **End of Period Adjustment (EPA)**, a retrospective update of the minimum training obligation, made three times a year in respect of the preceding 4-month period, to account for actual training performance against the CTC and any incremental training obligation arising as a result of a net increase in the number of vessels entered in the tonnage tax regime;
- **Payments In Lieu Of Training (PILOT)**, by the company to the Maritime Training Trust (MTT), if necessary to meet the minimum training obligation.<sup>17</sup>

It also explains how PILOT works within the scheme:

To implement the Minimum Training Obligation (MTO), companies will be asked to produce a Core Training Commitment (CTC) setting out their training obligation and how it will be met and End of Period Adjustments (EPA) after each period. This two-pronged approach recognises that training plans set out in the CTC may not be realised. It also accommodates any additional training obligation arising over and above the CTC.

[...]

Lord Alexander of Weedon's Report "Independent Enquiry into a Tonnage Tax" (HMT August 1999) made reference to the facility for companies to pay a cash contribution rather than train seafarers, but made it clear that this should apply only to those companies that are unable to meet the training commitment. Lord Alexander hoped that this "opting out" should be considered only in exceptional circumstances. The Government endorsed this view on the grounds that the policy objective of increasing and rejuvenating UK maritime employment was less likely to be achieved were companies to "opt out" of training.

It is recognised that situations may arise where some companies are unable to provide in-house training, although the option to contract-out seafarer training generally should be open. Where neither of these options is available to a company, subject to DfT agreement, the CTC shall be discharged through a **Payment In Lieu Of Training (PILOT)** to the MTT [the Maritime Training Trust]. In these circumstances, the company's CTC should explain the practical reasons why it needs to discharge its training obligation through PILOT.<sup>18</sup>

### 3 Treasury review 2004

The Treasury undertook a review of the tonnage tax in 2004.<sup>19</sup> The review covered the EU state aid guidelines, its impact on British shipping, the range of vessels covered, numerous technical points and the training link. The final report was published jointly by the Inland

---

<sup>16</sup> *Tonnage Tax (Training Requirement) Regulations 2000 (SI 2000/2129)*; the PILOT payment has subsequently been increased, the current figures are given in [SI 2009/2304](#)

<sup>17</sup> DfT, *The tonnage tax minimum training commitment*, 6 December 2005

<sup>18</sup> *ibid.*

<sup>19</sup> [HC Deb 17 May 2004, c747W](#)

Revenue and the Department for Transport in December 2004. The report concluded as follows:

The Government remains committed to the tonnage tax as one of the means to pursue the aims for shipping it has agreed with the industry and the trades unions. It will keep the rules within the 2004 revised guidelines.

The UK tonnage tax has:

- helped to reverse the decline in the UK merchant fleet;
- ensured that shipping companies have kept their bases in the UK with further spillover benefits for the economy;
- helped to promote the training of cadets and ratings;
- helped to protect the £1 billion a year contribution made to overseas earnings by the shore based maritime sector.

The Government remains committed to the aims of an integrated shipping policy set out in the White Paper on the Future of Transport published in 1998. These aims include the promotion of the employment and training of British seafarers in order to keep open a wide range of job opportunities for young people and to maintain a supply of skills and experience vital to the economy.

Ministers have agreed that consideration of proposals to improve the employment environment, including the possibility of including a mandatory employment link, should be taken forward by a sub-group of the Shipping Task Force and have agreed expanded Terms of Reference for the group to facilitate this. This will also include consideration of the proposals for a training commitment for ratings.

The Government will introduce legislation to require a link with a flag of a Member State in some circumstances.

With effect from the financial year starting on 1 April 2006, when a shipping operator within the tonnage tax adds a vessel to its fleet, that vessel must be flagged as a vessel of a Member State if all of the following conditions are met for tonnage tax benefits to be granted to that vessel:

The financial year must be specified as a period when the flagging requirements apply. The Government will specify a financial year if, in the preceding three calendar years, the proportion of vessels within the tonnage tax regime registered in any EU Member State has reduced.

Less than 60 per cent of the tonnage of the operator's fleet is already flagged under a Member State register.

The operator's fleet contains a lower proportion of EU Member State registered tonnage than during the first period when it entered tonnage tax.

The Inland Revenue and Department for Transport will be consulting further with the shipping industry about the most appropriate way in which the measurements of tonnage required by the 2004 revised guidelines should be made that will give an appropriate result without imposing unnecessary administrative costs. Matters yet to be determined include which vessels should be included in each part of the calculations, particularly in relation to vessels not owned by the ship operator, and the period over which any measurements are to be made.

With effect from 1 July 2005, a shipping operator within the tonnage tax must flag any qualifying tug or qualifying dredger as a vessel of a Member State.

If a shipping operator within the tonnage tax fails to flag a vessel as a vessel of a Member State when required, that vessel will not be able benefit from tonnage tax for as long as it remains in that operator's fleet.

The Government will consider introducing legislation requiring all tonnage tax companies or groups to provide regular reports showing that ships registered outside the EU are operated in ways that comply with international and Community standards relating to security, safety, environmental performance and on-board working conditions. Failure to adhere to these requirements could in future result in the exclusion of the company or group from tonnage tax.

An appropriate regulation making power is included in the draft legislation published with this report.

The Inland Revenue and Department for Transport will be consulting further with the shipping industry about the details of the scheme for monitoring standards.

The Government will introduce legislation to amend the extent to which towage can be a qualifying activity. With effect from 1 July 2005, the rules will be brought into line with the 2004 revised guidelines.

The Government recognises that there needs to be fair and appropriate arrangements for operators within tonnage tax that will be affected by the new rules for towage. In some cases these will mean that tug operators will no longer qualify for inclusion in the tonnage tax. Where that occurs, the Government will legislate to ensure that those parts of the existing rules imposing a tax penalty for early exits from tonnage tax (i.e. before the expiry of a tonnage tax election) do not apply. Changes to the exit rules are set out in further detail below.

The Government agrees that the operation of dredgers can be a maritime shipping activity of a kind that the tonnage tax is intended to benefit. It will legislate to extend the scope of qualifying activities to the transport of extracted materials at sea by self-propelled dredgers possessing their own cargo hold, with effect from 1 July 2005.

The Government is persuaded that there is a case for relaxing the current restrictions on ships that operate within the North Sea oil sector entering the tonnage tax regime. It intends, therefore, to legislate to allow emergency response and rescue vessels, and a number of multifunction vessels to enter the regime insofar as they carry out qualifying activities.

The Government intends to make it explicit in law that tonnage tax is only available to ships engaged in maritime transport activities by including a requirement that qualifying activities take place at sea. 56. At the present time the Government has no plans to extend the scope of tonnage tax beyond ship operating companies, for example to limited liability partnership investment vehicles, or ship management companies.

The Government does not consider that the separate charging where two or more group companies operate the same ship acts as a disincentive to normal commercial operations of tonnage tax groups, nor to groups that are contemplating coming to the UK. The present rules provide parity of treatment between transactions between related companies and those between unrelated parties in tonnage tax. Consequently there are no plans for change in this area.

The Government accepts that the case for companies being able to reassess whether they should elect into tonnage tax is a good one, and will use the powers available to it to create a further window of opportunity for new elections into the regime. It is anticipated that new elections into the regime will be possible between 1 July 2005 and 31 March 2006.

The Government will create a window of opportunity for companies currently within tonnage tax to withdraw from the regime by giving a withdrawal notice between the day on which the Finance Act 2005 is passed and 31 March 2006. Withdrawal will take effect from the beginning of the first accounting period beginning after 1 July 2005.

This will enable companies that are adversely affected by any changes to the regime, for example in respect of changes to the definitions of qualifying ships, to determine whether they are best served by remaining in the regime, or reverting to the normal corporation tax regime for all their ships.

In order to ensure that any company choosing to withdraw from tonnage can do so without incurring a tax penalty, the Government will also amend the rules relating to the calculation of capital allowance pools for plant and machinery assets after exit from the regime. At present these are designed to put a company in the same position that it would have been in if it had never been in tonnage tax. New rules will ensure that a company leaving tonnage tax, either on the expiry of its current election, or after giving a withdrawal notice, can do so on a basis that means it will not incur an immediate liability to deferred taxation on plant and machinery (including ships) used in its tonnage tax trade.

Lord Alexander discussed the case both for and against allowing leasing of vessels by participants in the tonnage tax regime. In the end he was swayed by the position of owners of small vessels for whom the tonnage tax would be only marginally beneficial, and so recommended a capped capital allowances regime that made economic sense for leasing of vessels that cost less than £80 million. For larger vessels he believed that the tonnage tax benefits were sufficient without the need to also access other tax benefits through finance leasing.

The Government reinforced the original leasing rules in the 2003 Finance Act when it brought certain long-term operating leases within the group of leases affected by the restrictions on capital allowances.

The Government did, however, undertake to keep the level of the lease cap under review. The main factors considered in this review have been:

- the costs of shipbuilding,
- the extent to which further encouragement to renew older ships is required through the availability of capital allowances to lessors, and
- the cost of the existing level of cap, together the relative costs of any change to the level.

The arguments in representations for raising the cap have been based not on any significant change in the costs of shipbuilding, but on a tendency for larger, more efficient ships to replace older ships.

Consequently the Government believes that the level of the lease cap should be maintained at present figures for the time being.

The Government has, however, accepted the case put forward for aligning the rules that permit sale and leaseback arrangements for new-build vessels with those that apply for a major ship conversion or refit. Draft legislation that would permit such arrangements is being published.

In response to representations received on the subject, the Government announced in the pre-budget report on 2 December 2004 that the proposals for leasing reform outlined in the Corporation Tax Reform Technical Note should not apply to leases on ships within tonnage tax.

The Government is not proposing any changes to the training requirement for cadets at this time. Proposals concerning the training of ratings are, as mentioned in paragraph 42, being considered by the Shipping Task Force.<sup>20</sup>

Following the publication of the report there was a consultation on draft legislation that would implement the report's conclusions.<sup>21</sup> The Regulations were finally published as the *Tonnage Tax (Training Requirement) (Amendment) Regulations 2005 (SI 2005/2295)*, and came into force on 1 October 2005.

#### **4 Transport Committee report, 2005**

The Transport Committee published a report on the tonnage tax in February 2005. The Committee concluded that the tonnage tax regime had led to an increase in the number of ships on the UK register and a small increase in the UK-owned fleet. It had also brought foreign shipping companies to the UK and persuaded UK companies to remain here who might have been tempted to leave. The training obligation for shipping companies, who opt into the tonnage tax regime, had resulted in an increase in the number of UK-based cadets being trained. The Committee was of the view that "to this extent it is an extremely welcome success". The Committee did, however, feel that:

...the Government could be more ambitious in exploring changes which might ensure the regime produced greater benefits for Britain, while still remaining attractive to industry. Tonnage tax has improved the situation of British shipping; it has not solved all its problems. The number of cadets being trained appears too low to increase the number of officers or produce the trained personnel needed to supply shore-based maritime industries. There is no system for monitoring what happens to cadets once they leave their initial training. There has been no increase in the employment of UK ratings.

The Government has asked the Shipping Task Force to look at employment and training. This is entirely appropriate, but ultimately, the Government is responsible for considering whether changes to the regime would be desirable and effective. Remitting difficult questions to the Shipping Task Force should not be used as a way to ensure they need never be answered. The task Force must be given a deadline for its work, and, once it has been completed, the Government must consider whether changes can be made to increase the effectiveness of the tonnage tax regime in supplying Britain with the trained personnel it needs and report back to the House.<sup>22</sup>

The Government replied to the report in October 2005. It highlighted provisions in the *Finance Act 2005* to permit the activities of North Sea multi function vessels and emergency

---

<sup>20</sup> Inland Revenue & DfT, *Post-Implementation Review of the Tonnage Tax*, December 2004, paras 39-69

<sup>21</sup> the draft legislation, notes and RIA were printed at the end of the 2004 report (ibid.)

<sup>22</sup> Transport Committee, *Tonnage Tax* (second report of session 2004-05), HC 299, 2 February 2005, paras 69-71

response and rescue vessels to come within tonnage tax. On the key issue of training, the response stated:

The Government agrees that this is an area that should be explored in more depth and has announced that improving maritime employment will be a key priority for its presidency of the EU. David Jamieson, the then shipping Minister, hosted an industry-wide seminar in London on 10 March 2005, specifically to consult the maritime community on how to improve employment prospects and secure future supply of maritime expertise. In taking this work forward, the Government will be working with other EU states to consider how maritime service industries can be more closely involved in sector-wide actions on recruitment and training and how "Maritime clusters" should be encouraged as a way to formalise cooperation between different branches of the maritime community.

The effect of tonnage tax on the number of trainees on UK registered vessels;

- What proportion of tonnage tax funded cadets really do fail to complete their training;
- The reasons why cadets fail to complete training;
- How the MTT fund can be used most effectively.

The Government shares the Committee's concerns about the level of unplanned payments in lieu of training. It is widely recognised that wastage rates among cadets are high. However, there are other causes of unplanned payments in lieu of training, amongst which the main one is temporary additions to the fleet which temporarily increase a company's training commitment for a limited period. The Department for Transport analyses the causes of non planned payments in lieu of training when End of Period Adjustment reports are submitted and reports to the Shipping Task Force. The Government agrees that the additional information highlighted by the Committee would be very helpful in identifying reasons behind wastage rates. The best way of obtaining this information is currently under consideration by the Department. One possible option is to include additional sections to the End of Period Adjustment reports.

The Government also believes that it is important to evaluate the effect of tonnage tax on the number of trainees on all vessels registered under the tonnage tax regime, not just those in registered in the UK (there is no requirement for ships in tonnage tax to be registered in the UK).

When the tonnage tax scheme was introduced, it was agreed that the Maritime Training Trust, which was established to provide a single vehicle for the receipt and administration of the wider industry's financial contributions to the cost of seafarer training, would receive and distribute the monies received from Payments in Lieu of Training. Members include representatives from RMT, the Chamber of Shipping and NUMAST. The Maritime Educational Foundation (MEF), set up by the Maritime Training Trust, is registered with the Charity Commission and was granted charitable status on 17 October 2003.

The Maritime Educational Foundation Objectives, amended by special resolution on 18 September 2003, are as follows: -

- The advancement of education and training in maritime skills for the benefit of the general public;

- The promotion of the mercantile marine for the benefit of the public, in particular by the education and training of seafarers and persons seeking to become seafarers in maritime skills;
- The relief of unemployment for the benefit of the public in particular by the provision of training and education to unemployed seafarers.

These were registered by the Charity Commission on 17 October 2003.

The Maritime Educational Foundation allocates the monies received to promote UK seafarer training for both cadets and ratings. DfT officials attend the meetings of both the Maritime Training Trust and the Maritime Educational Foundation, but, as agreed when the scheme was devised, the distribution of the funds is carried out independently from the Department.

The Government agrees with the Committee that it is important to establish how cadets are employed, once they have achieved their First Certificate of Competency. DfT are considering how best to access this information, possibly by adding an additional section to the End of Period Adjustment reports (...)

As part of the existing process to apply to DfT for approval of a training commitment, there is a requirement for companies in tonnage tax to review the recommendations of the Ratings Task Force (a body established in 1998 to consider training and employment opportunities for ratings) annually at board level and to submit a return to DfT stating which of the recommendations they plan to implement and how. These are

- To employ more British/EEA ratings
- To employ more highly -trained British/EEA ratings in some technical posts
- To recruit British/EEA ratings in a planned stream towards officer qualifications
- To assist existing British/EEA ratings to advance towards officer qualifications and posts

DfT officials do not accept or approve training commitments unless this form is submitted and at least one of the recommendations is being given active consideration.

These arrangements were put in place because the Chamber of Shipping and the maritime trades unions were unable to reach agreement on a formal training commitment for ratings in line with the 1:15 ratio for officer cadets when tonnage tax was first developed.<sup>23</sup>

---

<sup>23</sup> *Government Response to the Committee's Second Report of Session 2004-05* (sixth special report of session 2005-06), HC 6111, 1 November 2005