



REPUBLIC OF CYPRUS
MINISTRY OF
COMMUNICATIONS AND WORKS



DEPARTMENT
OF MERCHANT SHIPPING
LEMESOS

Circular No. 21/2011

TEN 12.3.01.36

TEN 5.13.09

1 June 2011

- All Owners of Cyprus Ships,
Owners of Ships under Foreign Flag,
Charterers and Ship Managers
operating in the Republic of Cyprus.
- All Members of the Cyprus Shipping Chamber c/o CSC
- All Members of the Cyprus Union of Shipowners c/o CUS

Subject: Cyprus Tonnage Tax System (Law 44(I)/2010) – Ring-Fencing
Provisions: Arm´s length principles

1. I refer to the above subject and further to my Circulars No. 14/2010, No. 28/2010, No. 31/2010, No. 32/2010, No.39/2010, No.42/2010, No.1/2011, No.3/2011, No.4/2011, No.6/2011, No.8/2011, No.11/2011 and No.13/2011 respectively there is an urgent need to remind all qualifying owners, qualifying charterers or qualifying ship managers, as the case may be, who are subject to tonnage tax, of their obligation to comply with the relevant provisions contained in sections 41-43 of the *Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (Law 44(I)/2010)* (hereinafter referred to as “the Law”).

2. Sections 41-43 of the Law contain the appropriate ring fencing mechanisms, known as **transactions not at arm´s length**. These mechanisms ensure that **profits from other activities are not sheltered within tonnage tax**. They prevent the “transfer” of income or expenses between affiliated persons engaged in activities subject to tonnage tax and income tax.

In other words, the Law contains provisions which ensure that the **arm's length principle** is applied to transactions between:

- persons qualifying for tonnage tax and non-qualifying persons either within Cyprus or between Cyprus and abroad, and,
- activities qualifying for tonnage tax of a qualifying person and non-qualifying activities of the same person.

The ‘**arm's length' principle** means that transactions must take place for business purposes at ‘**arm's length' prices**, i.e. as if the transactions would have been made between independent persons (**equivalent to market prices**).



3. Section 41 of the Law covers the case of transactions made between a person subject to tonnage tax and any other person, which must be made on the basis of the arm's length principle. In such case, where the commercial transaction is made between a person subject to tonnage tax (qualifying owner of a Cyprus or foreign ship, qualifying charterer or qualifying ship manager, as the case may be) and another person belonging to the same corporate structure (either in Cyprus or abroad), the transaction must take place at **arm's length prices**, i.e. as if the two persons involved were independent from each other and not part of the same corporate group.

In other words, section 41 of the Law deals with taxable persons who are associated and there is a risk that they establish or impose, as a result of this association in their commercial or financial relations, conditions different from those which independent business entities would agree amongst themselves.

4. Similarly under section 42 of the Law, the **arm's length principle** is also extended to commercial transactions between a qualifying shipping activity of a person subject to tonnage tax and another non-qualifying shipping activity carried out by the same person.

5. In the case of transactions covered under sections 41 and 42 of the Law, where no income is subsequently declared or is declared as being lower than would be expected had these associations not existed, then the income of the said business entity and the tax for which it is liable shall be calculated without taking into account the circumstances arising from the association. This rule is enshrined in **section 33(1)(b)** of the **Cyprus Income Tax Law of 2002**. This is the reason why both sections 41 and 42 of the Law make an express reference to said section 33 (see attached ANNEX for an unofficial English translation).

6. Section 43 of the Law contains the duty of persons subject to tonnage tax to whom the provisions of section 41 apply, to give notice within 90 days to any person whose tax liability may be affected by the said provision.

Non-compliance with the obligation to give notice under section 43 may constitute a **criminal offence** punishable under the provisions of section 136 (*disobedience to statutory duty*)¹ of the *Cyprus Criminal Code (Cap. 154 as amended)* or under the provisions of Regulations 20 and 21 of *P.I. 395/2000*.²

¹ Section 136 of the Criminal Code provides : “ *Every person who wilfully disobeys any Law by doing any act which it forbids, or by omitting to do any act which it requires to be done , and which concerns the public or any part of the public, is guilty of a misdemeanour and is liable unless it appears from the Law that it was the intention of the Legislature to provide for some other penalty for such disobedience , to imprisonment for a term not exceeding two years or to a fine not exceeding 2562 euros or to both. ”*

² Regulations 20 and 21 of *The Merchant Shipping (Taxation of Shipmanagement Services) Regulations of 2000*, saved and still applicable by virtue of paragraph 14 of *The Tonnage Tax (Special Provisions on the Levy and Collection) Notification of 2010 (P.I. 417/2010)*.

Under the present circumstances, for the fiscal year 2010 the obligation to give notice within 90 days has to be *de facto* accommodated with special arrangements-timeframes:

(i) For qualifying **owners of Cyprus ships**, the following arrangements are herewith announced:

a) For “*existing Cyprus ships*” , i.e. ships that on the date of issuing of this Circular are already registered in the Register of Cyprus Ships (RCS) : the notice under section 43 of the Law has to be given within 90 days from the date of issuing of this Circular (namely until 1 September 2011);

b) For “*new Cyprus ships*” i.e. ships registered in the RCS after the date of issuing of this Circular, the notice under section 43 of the Law has to be given within 90 days as from the date of registration of the vessel in the RCS.

(ii) For qualifying **owners of foreign ships, Charterers and Ship Managers** the following arrangements are herewith announced:

The period of 90 days will count as from 15 July 2011 which, for the fiscal year 2010, is the cutting date on which the DMS Director has to decide if a company who has opted for the tonnage tax is finally eligible or not, to enter the Tonnage Tax system.³ Therefore, the relevant companies must give notice under section 43 of the Law, the latest by **15 October 2011**.

7. The implementation of the *Arm’s Length principles* must therefore be exercised in the following cases:

i) transactions between companies qualifying for tonnage tax and non-qualifying Cypriot companies (in the case of related companies);

ii) transactions between companies qualifying for tonnage tax and non-qualifying non- Cypriot companies (in the case of related companies);

iii) transactions between activities qualifying for tonnage tax and non-qualifying activities of the same qualifying company.

All persons subject to tonnage tax (qualifying owners of Cyprus or foreign ships , qualifying charterers or qualifying ship managers, as the case may be) who are involved in any of the transactions mentioned above, are therefore under a duty to present, upon request, any relevant documentation as to how prices and conditions in the said transactions have been established in order to prove that the transactions in question do not differ from transactions that would have involved independent persons. If the transactions deviate from the normal market transactions-prices, adequate reasoning must also be given.

Refusal to produce the relevant documentation as to how prices and conditions in the said transactions have been established may constitute a **criminal offence** punishable under the provisions of section 136 (*disobedience to statutory duty*) of the Cyprus Criminal Code, or under the provisions of Regulations 20 and 21 of P.I. 395/2000.

³ As a result of the combined reading of paragraph 6(1) of P.I. 417/2010 and DMS Circular No. 4/2011.

Further details as to the effective implementation of the ***Arm's length principles*** and the effect of non-compliance with the relevant provisions, will be given in a *Notification* which will be issued and published in the Official Gazette of the Republic in the coming weeks.



Serghios S. Serghiou
Director
Department of Merchant Shipping

- Cc:** - Permanent Secretary, Ministry of Communications and Works
- Permanent Secretary, Ministry of Finance
- Permanent Secretary, Ministry of Foreign Affairs
- Maritime Offices of the Department of Merchant Shipping abroad
- Diplomatic Missions and Honorary Consular Officers of the Republic
- Commissioner for State Aid Control
- Director, Department of Inland Revenue
- Director General, Cyprus Investment Promotion Agency (CIPA)
- Cyprus Bar Association
- Institute of Certified Public Accountants of Cyprus

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ANNEX

Unofficial translation of section 33 of the Cyprus Income Tax Law of 2002

Arm's length principles .

- 33. - (1) Where –**
- (a) a business (enterprise) in the Republic participates directly or indirectly in the management, control or capital of a business of another person ; or
 - (b) the same persons participate directly or indirectly in the management, control or capital of two or more businesses and in either case conditions are made or imposed between the two businesses in their commercial or financial relations which differ from those which would be made between independent businesses , then any profits which would, but for those conditions, have accrued to one of the businesses , but, by reason of those conditions, have not so accrued, may be included in the profits of that business and taxed accordingly.
- (2) The provisions of sub-section (1) apply also in connection with any transactions between connected persons.
- (3) For the purposes of this section :
- (a) An individual is connected with another individual if the first individual is the spouse or relative of the second individual , or the spouse of a relative of the second individual, or relative of the husband or wife of the second individual ;
 - (b) a person is connected with any person with whom he is in partnership, and with the husband or wife or relative of any individual with whom he is in partnership ;
 - (c) a company is connected with another company –
 - (i) if the same person has control of both companies , or a person has control of the one company and persons connected with him , or he and persons connected with him, have control of the other company ; or
 - (ii) if a group of two or more persons has control of each company , and the groups either consist of the same persons or could be regarded as consisting of the same person by treating (in one or more cases) a member of either group as replaced by a person with whom he is connected ;
 - (d) a company is connected with another person if that person has control of the company or if that person and persons connected with him together have control of the company ;
 - (e) any two or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company .
- (4) In this section -
- (a) “control” in relation to a company , means the power of a person to secure –
 - (i) by means of the holding of shares or the possession of voting power in or with relation to that company or in relation to any other company , or
 - (ii) by virtue of any powers conferred by the articles of association or other document relating to the operation of that company or

any other company ,

that the affairs of the first -mentioned company are conducted in accordance with the wishes of that person , and,

(b) “control” in relation to a partnership , means the right to a share of more than one-half of the assets , or of more than one half of the income of the partnership ;

(c) “relative” means spouse and individual up to the third degree of kindred whether unmarried or married.
