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Shipowners eye tax horizon

Barry Parker

Barry Parker reports on how tax concerns remain at the forefront for -shipowners as the industry faces a changing economic environment-

Every year in early February, the New York chapters of Greek and Norwegian trade associations hold their annual conference highlighting important developments in shipping finance.

In response to the impacts of external shocks on funding markets that are slowly emerging, a panel of bankers tried to provide colour to the changed landscape. One featured transport banker, Merrill Lynch's Mark Friedman, in talking about the more volatile financing landscape, told the audience that "2008 will be a more challenging year than 2007 - and it will feel like a different year. Risk premiums have gone up".

'Tougher loan-to-value ratios'

Hugh Baker, senior relationship manager for North America at HSH Nordbank, described the market as "returning to longer-term norms", in terms of "tougher loan-to-value [LTV] ratios, quicker amortisations and slightly lower advance rates". Baker's remarks paralleled those made the previous week by Nordea Bank Senior Vice-President Ronny Bjorndal, who heads the bank's global syndication department. Speaking at the Baltic Exchange in London, Bjorndal said: "Old-style financings are back in fashion with appropriate amortisation, covenants and so on. There -will be no more covenant-light, limited-amortisation transactions. Banks are more selective in respect to what they support."

The agenda for the New York conference was an eye opener. A financial panel described the burgeoning market in freight derivatives in which Greeks and Norwegians have been playing a leadership role. Georgios Voulgarakis, the Greek merchant marine minister, stressed the privatisation initiatives under way at Piraeus and Thessaloniki.

Tenders are out at both ports to potential concessionaires, said to include giants such as Maersk, Mediterranean Shipping and Cosco as well as extremely acquisitive Dubai Ports World. Putting Greek infrastructure into the private sector has been a -priority for Greek Prime Minister Costas Karamanlis. Voulgarakis also -noted the growth of Greek-owned shipping. Many Greek-controlled vessels are registered under offshore flags of convenience, low operating cost environments with mortgage and corporate law acceptable to the big ship-lending banks. The minister's remarks fit squarely with the conference theme of the "bulls and the bears".

Surprisingly, a major recent concern for Norwegian owners has been the shift in Norwegian tax policy although that change was not addressed in the conference programme. Perhaps the exclusion -reflects an implicit sense of resignation to changes now hitting company earnings. The Norwegian Storting (parliament) approved the new tax regime in December 2007. Yet, the continued strength of shipping markets around the world and the inexorable push to harmonise regulations within the EU and beyond has brought taxation issues to the forefront in Norway and elsewhere.

Tonnage taxes have been an effective tool for governments in high-cost jurisdictions to bring shipping into national flags, thus providing employment and keeping a strategic industry in the fold. These taxes are now being considered as far afield as Japan, which is now looking into such a regime. Tonnage taxes are essentially flat taxes on notional profits tied to a vessel's net tonnage. Tonnage taxes have filled the void as other tax incentives for ship investment have been phased out.

In the EU, tonnage tax schemes have flourished and partially filled the void left as tax leasing schemes - some of which have been labelled as providing unfair advantages - have come under greater scrutiny.

The availability of an attractive tonnage tax has generated business for Ireland's burgeoning maritime cluster. Maritime lawyer Helen Noble of Dublin-based Mason, Hayes & Curran, said: "The net effect is that when Ireland's low corporate tax rate is applied to the notional daily rate of profit per vessel, the Irish tonnage tax is -the lowest tonnage tax in the European Union."

Noble described the management services change at Italian tanker specialist D'Amico several years ago as a "boost for Irish shipping". D'Amico subsequently gained a share listing for its product tanker business in Milan and through a private placement in the US.

In Germany, many KG companies have elected to be taxed through the tonnage tax regime, following changes in late 2005 when the ability of individuals to deduct losses from KG investments was limited. Lawyers at Watson Farley & Williams, in describing the German tonnage tax environment, say: "The lump sum profit - a deemed profit related to the ship's tonnage instead of the actual operating results - is the tax basis for trade tax and income tax of all investors. -Effectively the lump sum allows a nearly tax-free income from shipping business for investors."

In Norway, shipowners fought a losing battle, as the government sought to equalise tax treatment with that of other EU nations. In 3Q07, the government proposed a new shipping taxation scheme that would subject owners to a near-zero taxation rate (0.6 per cent) - on par with tonnage tax regimes in EU countries. However, in a quid pro quo, the government asked shipowners to pay retroactively a substantial portion of taxes that had been exempt since 1996. The government sought to claw back a total of approximately NOK14 billion (USD2.6 billion), equating to about two-thirds of the taxes that had been deferred. Those taxes will be paid by shipowners over a 10-year period.

Could such tremors erupt elsewhere? The political nature of taxation - which has a profound influence on shipping investment and finance - is often troubling to those working in the sector. Norwegian shipowners have railed against rule changes, following a decision in the mid-1990s to remain in the jurisdiction. Although unmentioned by presenters on the dais at the New York conference, attendees spoke among themselves about the potential impact of a Democratic victory in the upcoming US presidential race. Some attendees suggested that political winds could reverse the beneficial tax treatment that US-listed companies have enjoyed since tax changes in late 2004.

Indeed, New York's maritime initial public offering (IPO) boom that began in 2005 has benefited greatly from the largesse of tax policy. A significant provision of the American Jobs Creation Act of late 2004 is removal of foreign base company shipping income from the US tax code. The provision, which has enabled companies based in the US to significantly defer taxes on international shipping operations run from the US, provided profits that are re-invested in the business. New rules - which allow for shareholder dividends - have buttressed the wave of US public equity listings. For US owners of ships trading internationally (not in coastwise trades), the 2004 legislation also established a tonnage tax for US shipowners.

US tonnage tax language

Horizon Lines, a listed US flag carrier, active in the US offshore trades - including Puerto Rico, Hawaii and Alaska - was instrumental in drafting US tonnage tax language. When Horizon elected to jettison normal corporate tax treatment in favour of the tonnage tax, the company estimated a tax saving of USD42.6 million in 2006 on qualifying vessels - not insignificant in comparison with 2006 EBITDA of USD163 million. Matson Lines, serving Hawaii and US possessions in the Pacific, also elected the tonnage tax.

Norway is not the only country where the tax rules are not carved in stone. Horizon Lines, experienced a great deal of angst when a November 2007 draft of legislation contained wording that cast doubt on the -applicability of the tonnage tax to Horizon's Puerto Rico trades. The worrisome language was subsequently removed by a tax-writing committee after a concerted lobbying effort by Horizon, organised labour and business interests on the US mainland and in Puerto Rico.

At the conference, the subtleties of tax policy and blurring of politics emerged in other ways. One panel participant offering a unique perspective on where assets are financed was Peter Shaerf, a partner at AMA Capital Partners, who also serves on the boards of General Maritime Corporation, Trailer Bridge and Seaspan Corporation. Shaerf has recently taken over as chairman of Nymar (New York Maritime), a collection of lawyers, bankers and others connected to shipping deals. Nymar is making a push to draw business to New York that might otherwise be done in London. Tax considerations are providing Nymar with fodder to counteract the disadvantages of having to comply with the US Sarbanes Oxley (Sox) Act. The more acerbic pundits have referred to Sox, a compliance regime seen to be overly onerous and expensive, as the Job Creation Act for Accountants.

UK tonnage taxes, established in 2000 and amended following 2006 changes to ship leasing rules, "aim to achieve a real and permanent reduction in the tax liability of participating businesses", according to a 2007 report from law firm Watson Farley & Williams. The report adds: "This is in contrast to the tonnage tax systems of some other countries, where there is simply a deferral of tax until a business leaves the system".

However, accounting firm Moore Stephens has expressed concern at draft provisions tabled by the UK Inland Revenue. Proposed rules are aimed at moving the UK further into harmonisation with the dictates of the EU. The impact, a tightening up of eligibility for qualifying assets, prompts Sue Bill, a tax partner at Moore Stephens, to remark on the disappointment of shipowners who have made a 10-year commitment to the UK flag. Bill adds: "The timing is unfortunate too, as shipowners are likely to still be feeling jittery following recent developments in Norway."

The UK policy on non-domiciled taxpayers or "non-doms", an attempt to tax wealthy foreigners living in Britain, could easily disgruntle foreign shipowners residing in the UK. A number of Greek companies have listed on London's Alternative Investment Market (AIM), with UK resident executives. Shaerf, a London native who moved to New York in the late 1970s, turns the Sarbanes Oxley legislation around, extolling the US regime for its transparency and corporate guidance.

The UK has gained some ships from at least one Scandinavian stalwart that has expressed frustration with the Norwegian system.

Wilh Wilhelmsen, with two dozen ships registered in the UK and technical management handled in Southampton, announced in February that the company would move an additional five vessels to the UK flag. Wilh Wilhelmsen, controlling nearly 160 vessels worldwide, indicated that 17 vessels are still under the Norwegian regime.

Impact of tax changes

With 2007 financial results emerging, the impact of tax changes is being recognised. In its 4Q07 results, Wilh Wilhelmsen reported a much lower operating profit compared with the previous year. However, the company took a USD208 million provision for deferred taxes related to changes in the Norwegian tax system. While taken against income for one quarter, the actual tax bill will be paid down over 10 years in what Wilh Wilhelmsen describes as a linear payment profile - provided the company remains in Norway. In Wilh Wilhelmsen's 4Q07 financials, the company's shipping business reported a loss of USD189.4 million due to a tax expense of USD215.2 million versus a gain in the comparable 2006 quarter of USD45.1 million. Wilh Wilhelmsen's overall 2007 profit after taxes was reported (unaudited) at USD6.9 million.

Wilh Wilhelmsen is far from sanguine about its Norwegian future, strongly signalling that the company might choose to leave the Norwegian tax venue - in which case back taxes would be due promptly. According to Nils Dyvik, the company's chief financial officer: "We are no longer a traditional shipping company" but a worldwide player in transport services.

Wilh Wilhelmsen is active in the logistics sector as well as ship services and the agency sector. Solid profits from these other businesses offset the detrimental impact of the tax change on shipping. Dyvik adds: "Wilh Wilhelmsen will take a final decision on the choice of tax regime when it submits its tax return, which is due at the end of May."

At precisely the same time as Wilh Wilhelmsen's mid-February release of 4Q07 earnings, the Norwegian Shipowners Association (NSA) announced that it was reversing a previous recommendation that Norwegian owners not register vessels in Liberia - a longtime flag of convenience registry - because of concerns about transparency. When Wilh Wilhelmsen's May decision time comes, it would be no surprise to see company vessels moving to the Liberian flag.