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New scheme covering lease of pleasure boats in Cyprus

Cyprus VAT and Tax implications

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A special scheme covering lease of pleasure boats/yachts was recently adopted in Cyprus.

This publication aims to briefly outline the required conditions and the procedure that must be followed in order to admit a pleasure boat/yacht to the scheme.

Please note that the entire procedure required for the admission to the special scheme will be processed, for the time being, only at the Head Offices of the Cyprus VAT Authorities.

GENERAL GUIDELINES REGARDING THE VAT TREATMENT OF PLEASURE BOATS LEASING

Interpretation of ‘lease agreement’ regarding a pleasure boat/yacht

For the purposes of the present scheme, an agreement for lease of a pleasure boat/yacht (hereinafter PB/Y) is an agreement according to which the lessor (the owner of the PB/Y) enters into a contract with the lessee (the person who leases the PB/Y) for the use of the PB/Y for a consideration. Additionally, such an agreement may at the end of the lease term give the lessee an option to purchase the PB/Y at a price being a percentage of the initial value of the PB/Y. The final purchase is strictly an option, which may be executed at the end of the PB/Y’s lease period for a separate consideration.

VAT treatment of a lease agreement involving a pleasure boat

For VAT purposes, the leasing of a PB/Y constitutes a supply of services with a right to input VAT deduction, where the said right is applicable. The supply of the leasing services constitutes a taxable transaction subject to the standard VAT rate (currently 17%) to the extent the leased PB/Y is used within EU waters. An essential precondition is the lessor’s place of origin (establishment), which must be a company registered under the Cyprus’ Companies Law, whilst the lessee may be either a legal or physical person regardless of the place of establishment or residence.

Calculation of specific rate of use of a pleasure boat within EU waters

For the purpose of calculating the PB/Y’s specific rate of use within EU waters, there is no requirement to maintain any documentary evidence, including the PB/Y’s log book of the places the PB/Y travels. It is generally accepted that there are practical difficulties in calculating the exact time the PB/Y sails within EU territorial waters and the time that it sails outside EU waters. For this purpose, specific rates of use (percentages) have been predetermined. These percentages are set in accordance to the length of the PB/Y and the way it sails (i.e. motorboat or sailing boat).

Tables designating the percentages of use within the EU

Table A: Motor boats

| Boat length | Percentage use within EU | VAT Calculations |
|---|--------------------------|-----------------------------|
| Length greater than 24 meters | 20 | 20% of consideration x 17% |
| Length between 14,01 and 24 meters | 30 | 30% of consideration x 17% |
| Length between 8,01 and 14 meters | 50 | 50% of consideration x 17% |
| Length up to 8 meters | 60 | 60% of consideration x 17% |
| Boat with permissible navigation only within protected waters | 100 | 100% of consideration x 17% |

Table B: Sailing boats

| Boat length | Percentage use within EU | VAT Calculations |
|------------------------------------|--------------------------|----------------------------|
| Length greater than 24 meters | 20 | 20% of consideration x 17% |
| Length between 20,01 and 24 meters | 30 | 30% of consideration x 17% |
| Length between 10,01 and 20 meters | 50 | 50% of consideration x 17% |
| Length less than 10 meters | 60 | 60% of consideration x 17% |

Examples

1. A sailing boat which length is greater than 24 meters is considered as being used 20% of the time within EU waters and 80% of the time outside EU waters.

Consequently, the lessor is liable to account for VAT in Cyprus only on 20% of the lease payments. No VAT is to be accounted for on the remaining 80% of the lease payments, on the grounds that they are considered as relating to the time the PB/Y is used outside EU waters.

2. A motor boat which length is 7 meters is considered as being used 60% of the time within EU waters. Consequently the lessor is liable to charge the lessee VAT on 60% of the lease payments, whilst there will be no VAT charge on the remaining 40%.

Conditions for application of the specific VAT rates

For the VAT rates shown on the tables above to be applied, all of the following conditions must be satisfied:

- a. The PB/Y lease agreement must be between a Cyprus established company and any physical or legal person irrespective of origin. If the lessee is a legal person, then it has to be established within the Republic as well
- b. The PB/Y must sail to Cyprus within one month of signing of the lease agreement. An extension with regards to the one month period may be given only by the VAT Commissioner. However, it is understood that the extension under no circumstances could be over the time at which the right of purchase of the PB/Y is exercised by the lessee
- c. An initial lump sum payment of at least 40% of the PB/Y's value must be paid by the lessee to the lessor
- d. The lease payments must be payable on a monthly basis and the term of the lease agreement cannot exceed the period of 48 months
- e. The lessor is expected to attain a profit margin from the lease agreement of not less than 10% of the total value of the PB/Y. At the time of the lease agreement commencement, the total amount of the lease installments, on which VAT is calculated, is increased by half of the profit margin, i.e. 5%
- f. The final payment at the end of the finance lease term, as a result of which the legal ownership essentially is transferred to the lessee, cannot be less than 5% of the value of the PB/Y, which represents part of the agreement's total profit. The last payment is subject to the prevailing standard rate of VAT
- g. The written approval of the VAT Commissioner is required to be obtained in advance, confirming the value of the PB/Y and the applicable amounts on which VAT will be levied according to the extent of its use within EU waters. The application must also include a certificate of the value of the PB/Y, as well as the lease agreement entered into by the parties.

It is understood that the VAT Commissioner may reject any application filed or request from the lessor additional details regarding the use of the PB/Y.

VAT Certificate

If the lessee elects to purchase the PB/Y at the end of the term of the finance lease, a certificate certifying the payment of VAT will be issued to the lessee provided that all payable VAT has been settled.

What if the lessee is not another Cyprus Company?

Where the lessee is either an individual or a legal person established outside Cyprus, the following rules will apply:

Where the lessee is an individual (EU or non EU)

- a. The place of supply of the lease payments is where the lessor is established, subject to the use and enjoyment rules
- b. The lease payments will be subject to Cyprus VAT as per the tables above
- c. The lessor is liable to pay corporate tax on 10% of the certified and approved value of the yacht
- d. No additional tax is payable by the individual.

Where the lessee is a legal entity established in the EU

- a. The place of supply of the leasing services is where the lessee is established, subject to the use and enjoyment rules. Where the lessee is VAT registered in another EU country, the place of supply is the EU country where the lessee is established. However, even if the lessee is registered for VAT purposes, it must confirm that the yacht is used for business purposes and not for private purposes
- b. If the yacht is leased to a non registered company or is used for private purposes, the lease payments will be subject to Cyprus VAT as per the tables above
- c. The lessor is liable to pay corporate tax on 10% of the certified and approved value of the yacht.

Where the lessee is a legal entity established outside the EU

- a. The place of supply of the lease payments is where the lessee is established, subject to the use and enjoyment rules
- b. The lease payments will be subject to Cyprus VAT as per the tables above
- c. The lessor is liable to pay corporate tax on 10% of the certified and approved value of the yacht

- d. No additional tax is payable by the non-Cyprus established lessee on the running and maintenance costs.

Income Tax implications

Persons employing the scheme, in addition to the above described VAT implications, must also be aware of the following corporate tax implications that will result from the acquisition, leasing and usage of a pleasure boat under the scheme.

- a. The lessor company is subject to 10% Corporation tax on 10% of the value of the vessel (section 33 of Income Tax Act), provided the shareholders of the company are foreigners
- b. The lessor company is subject to 10% Corporation tax on 10% of the value of the vessel plus special contribution on defence on the deemed distribution of dividends where the ultimate shareholders are Cyprus tax residents
- c. No capital allowance is allowed to the lessor.

Stamp duty implications

Cyprus stamp duty is levied on 'documents' (i.e. written agreements/contracts) relating to assets located in Cyprus and/or matters or things taking place in Cyprus. Stamp duty is calculated on the value of the agreement at 0.15% for the first €170.860 and at 0.2% thereafter. As of 2007 onwards, stamp duty due on agreements effected is capped to a maximum of €17.086 per stampable agreement. The person legally liable to pay such stamp duty (unless otherwise stated on the agreement) is the purchaser. The due date for such stamp duty payment is within 30 days from the day of the 'signing' of a document which is considered to be subject to stamp duty.

Example

An individual, resident of an EU or a non-EU country, contemplates purchasing a new yacht and wants to be informed as to whether or not there are any tax and VAT advantages of registering the yacht in Cyprus.

The following information is made available to a Cyprus professional in order to calculate the expected benefits from registering the new yacht in Cyprus.

- a. Value of the yacht: €50m
- b. Principal descriptions
- Length overall (inc. pulpit): 131ft 9in (40.16m)
 - Beam: 26ft 4in (8.05m)
 - Draft: 7ft 6in (2.28m) Half Load
 - Displacement: 180.0 tonnes (Light Disp.)
 - Fuel capacity: 6,455 gallons (29,345 litres)
 - Water capacity (inc. calorifier): 880 gal (4,000 litres)

General requirements as far as the owner lessor is concerned

- a. A main requirement for obtaining any VAT and tax advantages is to register a Cyprus Company and to purchase the yacht
- b. The yacht should sail to Cyprus within one month from the date the lease agreement is put into effect. Alternatively, the owner may apply for an extension but such an extension, if granted by the Commissioner, cannot exceed the term of the lease
- c. An approval must be obtained from the VAT Commissioner agreeing the value of the yacht, as shown on a valuation certificate, which must be included together with the approval application
- d. If the yacht comes from a third country, then an import declaration should be submitted to the Customs Authorities together with a proof that the VAT due has been paid. However, before submitting the import declaration, the lease company should obtain a Cyprus VAT registration number through the regular registration procedure
- e. The expected profit of the owner/lessor cannot be less than 10% on the value of the yacht, i.e. the profit must be at least €5m (10% of €50m)
- f. At the time of commencement of the lease agreement, the total amount of lease payments on which the VAT liability is calculated is increased by half of the amount of the profit, i.e. 5%
- g. The residual value cannot be less than 5% of the value of the yacht, i.e. €2.5m (50m x 5%).

VAT and Tax liability

- a. Based on the fact that the yacht is motorized and its length is 40.16m, the percentage of its assumed use within EU waters is 20% (see table A)
- b. The effective VAT rate is therefore 20% of 17% (current standard VAT rate,) i.e. 3.4%
- c. Lease payments:
 - The VAT on the balloon payment of 40% of the value of the yacht of €680.000 (€50m x 40% x 3.4% = €680.000)
 - 48 installments of €677.083,33 calculated as follows:

| Monthly installments | |
|--|--|
| Total value of yacht | 50.000.000,00 |
| 5% of required profit | 2.500.000,00 |
| Total value plus 5% of expected profit | 52.500.000,00 |
| Less balloon payment | 20.000.000,00 |
| Total lease instalments | 32.500.000,00 (677.083,33 x 48 installments) |
| Residual value 5% of total value | 2.500.000,00 |
| Total cash outflow | 55.000.000,00 |

- VAT on the lease instalments of €23.021 (€677.083.33 x 3.4%)
- Schedule calculating the VAT and tax liability over the term of the lease

| VAT and tax liability over the term of the lease | | | | | | | |
|---|------------|----------------------------------|-------------------------|-----------------------|-----------------------|-----------------------|-------------------------|
| | | VAT or Corporate tax rate | Year 1 | Year 2 | Year 3 | Year 4 | Total |
| VAT implications | | | | | | | |
| Balloon payment | 20.000.000 | 3,40% | 680.000 | - | - | - | 680.000 |
| Monthly lease payments | 677.083 | 3,40% | 276.250 | 276.250 | 276.250 | 276.250 | 1.105.000 |
| Residual value | 2.500.000 | 17% | - | - | - | 425.000 | 425.000 |
| Total VAT per year | | | 956.250 | 276.250 | 276.250 | 701.250 | 2.210.000 |
| Tax implications | | | | | | | |
| Expected profit per year | 5.000.000 | | 1.250.000 | 1.250.000 | 1.250.000 | 1.250.000 | 5.000.000 |
| Corporation tax per year | | 10% | 125.000 | 125.000 | 125.000 | 125.000 | 500.000 |
| Total VAT and Tax payments | | | <u>1.081.250</u> | <u>401.250</u> | <u>401.250</u> | <u>826.250</u> | <u>2.710.000</u> |

From the above table it is concluded that the effective rate of tax for the particular yacht is 5.42% (€2.710/€50.000).

How we can assist

KPMG Cyprus may assist interested parties to

- Set up the required legal entities to hold the pleasure boat/yacht
- Draft the required lease agreement
- File all necessary documents for participating in the scheme
- Comply with all subsequent requirements after joining the scheme

Any additional information or clarifications concerning the scheme may be addressed to KPMG's Indirect Tax Board Member Harry Charalambous on + 357 22 209 260/300 or at hcharalambous@kpmg.com.

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