Summer 2008

MOORE STEPHENS
CHARTERED ACCOUNTANTS

The Bottom **Line**

Business advisers and auditors to the shipping industry

Inside

Shipping retains confidence levels - but at a higher price

Moore Stephens' latest Shipping Confidence Survey has revealed that overall confidence in the market for the next twelve months remains unaffected by the global credit crunch. But two-thirds of shipping interests expect finance costs to rise - a 10% cent increase on levels reported in the last survey, in March 2008 - while there has also been a fall in the number of owners who expect to make a major business investment in the next twelve months.

On a scale of 1 to 10, the overall confidence shown in the market by those who responded to the survey was unchanged at 6.8, with owners and managers expressing the highest levels of confidence at 7.0 (marginally down on the previous survey) against the 6.3 recorded by charterers.

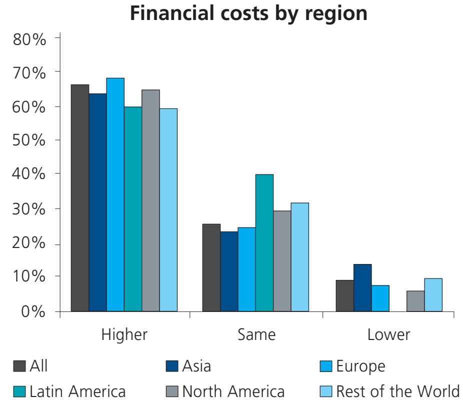
Some respondents acknowledged that the current financial crisis could affect world trade. But this was balanced by the expectation that continuing high demand from Asia and the Far East, in particular, would ensure that shipping would ride out the financial slump. Meanwhile, a shortage of suitably qualified crew and the escalating cost of fuel were recurring themes among respondents.

Demand trends and competition emerged as the factors deemed most likely to influence performance over the next twelve months. Operating costs, which were cited as the most significant factor in this category in the last survey, came in fourth, behind the cost of finance. Comments included doubts about the industry's ability to build sufficient numbers of new ships to meet demand, and the inability of freight rates to keep pace with the rocketing price of oil.

Owners remained the most likely to make a major investment or significant development during the next twelve months, but their rating of 6.5 out of 10 (against an average overall score of 5.9) was half a point down on the previous survey. Ship managers returned a score of 6.0 in this category, an increase of 0.3 points.

There was a strong message from the survey that finance costs were likely to rise, with 66% of respondents expecting costs to be higher in twelve months time than they are at present, as against 56% in the previous survey. There was a sharp increase - from 47% to 71% - in the number of brokers anticipating a higher cost of borrowing, while

Financial costs by region



70% of managers, and 59% of owners, shared the same expectation. Europe - the largest group overall - was the most pessimistic in this regard, with over 68% of respondents from that region anticipating an increase in finance costs.

Opinions about the direction in which freight rates in the tanker market were likely to move over the next twelve months showed some sharp variations, with 64% of charterers expecting rates to increase, and only 31% of owners sharing that view. Regionally, Latin America and Asia, with 60% and 56% respectively, led the way in expecting an increase in tanker rates, while in Europe the figure was much lower, at 37%.

In the dry bulk sector there was a 4% increase, to 32%, in the number of respondents who expected rates to be higher in twelve months time, and a corresponding fall, from 40 to 35%, in those who were predicting lower rates.

Finally, charterers (50%) continued to lead the way in expecting higher rates in the container ship trades over the next twelve months.

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Non-doms need to plan

The changes to the taxation of non-domiciled individuals came into effect from 6 April 2008. However, the proposed legislation in the Finance Bill 2008 is still a work in progress.

Despite this period of uncertainty, non-doms need to plan, starting with a review of their financial position, and quite possibly that of their family as a whole. There are planning opportunities. It is possible, for example, to opt in and out of the remittance basis for different tax years, and financial affairs may be able to be rearranged to prevent both a husband and wife paying the £30,000 levy.

The current tax year is the first under the new rules. Non-doms should be reviewing their position now rather than waiting until 5 April 2009.

Moore Stephens has produced a briefing paper on the new regime for offshore trusts and non-UK domiciliaries. For a copy of the paper or advice, please get in touch with your usual Moore Stephens contact or go to www.moorestephens.co.uk.

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Banking covenants and GAAP

Not much more than a year ago the financial press included articles dealing with the growth of covenant-lite financing arrangements. There aren't a lot of those around at the moment. We are back to the situation where all loan agreements are likely to contain a wide range of covenants. Some are likely to relate directly to the amounts shown in accounts.

David Chopping

If accounting rules never changed, such covenants would continue to achieve whatever it was they were originally intended to achieve. And 2008 is one of those rare years where accounting changes will be minimal, at least for companies reporting under IFRS. In 2009, normal service is resumed and new accounting rules will apply.

The problem with changes in accounting requirements is that covenants based on accounts may have unintended effects. A company may have a breach which arises solely due to the accounting changes, without any real change in their business. This problem can be solved by fixing the accounting rules in the covenant; the test is then the rules in force at a specified date. But this is not without cost. As accounting changes accumulate over time, dealing with the differences between the current rules and those used for applying the covenant becomes more and more complex. As a result, this route is not that common.

In the more usual situation, where covenants are based on current accounting rules and therefore change over time, management should consider the impact accounting changes may have on compliance with covenants. When management realises an accounting change may lead to a breach they should be talking to lenders at that stage, not waiting until the breach has occurred.

Even apart from the obvious commercial benefits of early negotiations this will often have beneficial accounting consequences. One common effect of a breach is to allow the lender to recall amounts on demand. If a breach has occurred, but not been remedied by the balance sheet date, this means that balances will usually have to be shown as current liabilities. This would make many companies look at least highly illiquid and possibly insolvent. This treatment applies even if a recall is not made or where the breach is remedied after the balance sheet date. Sorting out the potential problem before the balance sheet date avoids this problem.

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Think before you sign

About to buy a large yacht or a private jet? Think before you act, says Ayuk Ntuiabane, Director of VAT Services at Moore Stephens Consulting, Isle of Man.

"If you want your yacht or aircraft to circulate freely in the EU without incurring a large VAT bill it is essential to get good advice before you begin the transaction. It is important to get the ownership structure correct and the newbuilding or purchase transaction properly thought through. If you do that then VAT can be minimised or eliminated. But once you have begun a transaction it is very hard to go back and unpick, and you can end up with a large and unnecessary VAT bill the first time you move the boat or plane across a border."

Demand for mega yachts and private aircraft is booming. Most high net worth individuals who buy these assets want to own them through companies and to be free to operate them anywhere in the EU. There is pressure to do deals quickly and order yachts to capture delivery slots. But it is important to get the VAT right, wherever you are resident and wherever the yacht will be built or is being bought from. If not, then once it enters the EU there will be complications.

"There are a number of places you can structure a company to own the asset, and of course the Isle of Man is a good place for that," explains Ayuk. "It also has a very high quality Commercial Yacht Register and an aircraft register. But there are other places which may be better for individuals. The main thing is to get the purchase contract right before anything is signed."

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Independent stakeholder avoids anti-trust issues

The competition authorities in the EU and the USA are increasingly focussing on shipping. And that is creating demand in shipping for trusted independent intermediaries where data has to be compared or compiled to avoid any suggestion of collusion, however unintentional.

Mike Simms

As a dispersed and global industry shipping has formed a number of international trade bodies to facilitate international co-operation and further best practices. However, there is an increasing danger that such bodies, especially those which set standards of entry, may be seen as anti-competitive. The International Association of Classification Societies (IACS) and its EU-based members were recently raided by investigators from the EU Competition Directorate, and an ongoing investigation is underway. Legal professionals have warned that pools and other shipping structures must also revise their structures to ensure they do not breach competition legislation. Indeed, the EU has formally adopted new guidelines on the application of competition rules to maritime transport services.

Moore Stephens has recently been able to help two groups to compare data and benchmark performance without any party actually exchanging data with another. In one case, Moore Stephens is acting as the trusted intermediary to an international trade body. This body collects data from its members every year to enable it to publish comprehensive trade statistics. As of this year, Moore Stephens will hold the data, preventing any suggestion that one or more member companies could inadvertently or otherwise share commercial data.

In another case, Moore Stephens helped a number of leading shipping businesses to benchmark their performance in different areas by collating and comparing input data from the companies, without any data being shared directly.

In both examples above it was leading law firms who advised their clients to use Moore Stephens as an independent intermediary, effectively putting a firewall between companies to avoid anti-competitive data sharing. The message is clear, law firms are watching the actions of the competition authorities and wise organisations and companies are turning to intermediaries to avoid problems.

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Industry maintains tonnage tax flagging pressure

The shipping industry is maintaining pressure on the UK government to exclude chartered-in vessels from tonnage tax flagging requirements.

Sue Bill

The inclusion of such vessels in the calculations owners must make, when deciding how many vessels must be flagged in the EU, could have serious repercussions for owners of existing tonnage tax fleets and could also deter new entrants. Both the UK Chamber of Shipping and Moore Stephens have made representations to HMRC to this effect.

EU requirements for tonnage tax mean that owners must have a certain proportion of their fleet under an EU flag to qualify. The exact proportion depends on a number of factors, but, as of 1 April 2008, owners have to count both time and voyage chartered vessels as part of their fleets when deciding how many owned ships must be EU flagged. It is impractical for owners to have to consider reflagging time and voyage chartered ships, and it is unfair to place new flagging obligations on owners who are already in the tonnage tax regime and who met the obligations in place when they entered. Some major users of the UK tonnage tax regime have publicly stated that they will scale back UK operations if the current uncertainty over flagging rules is not resolved.

Watch this space to see if HMRC uses the latitude the government has to vary the EU reforms and exclude chartered-in ships.

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Crew training - beware the charter trap

Shipowners using the UK tonnage tax regime need to be aware that the Crew Training Commitment applies to chartered-in ships as well as owned vessels. And the Department for Transport and HMRC are now liaising closely to ensure that CTC returns are accurate.

Some Moore Stephens tonnage tax clients have recently fallen foul of the CTC requirements, and could have faced penalty charges if mitigating circumstances had not been successfully negotiated. Under the tonnage tax regime companies must submit a CTC form before 31 August every year detailing the ships in the fleet and the British/EEA nationals resident in the UK being trained in order to comply with the minimum training obligations. Every four months the company has to submit updated forms relating to the trainees and any fleet composition changes, either by chartering in or out tonnage.

The exact training obligation is not always simple to calculate or maintain, and although payments may be made in lieu of training, these are subject to interest and penalty surcharges if not timely and correct.

Some owners leave the CTC compliance to their ship managers and may overlook both time and voyage chartered-in vessels. In the present climate, it is wiser to seek advice and to ensure the documentation is correctly submitted on time to avoid penalties.

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Profile: Ayuk Ntuiabane

Ayuk Ntuiabane has a complicated name and an unusual CV. But he has a straightforward take on life. "I fell in love, I moved to a beautiful place to bring up my children and I have a job solving problems for people," he says. "I wouldn't want to change much about that."

Ayuk lives on the Isle of Man, where he is Director of VAT, Shipping and Aviation Services for Moore Stephens Consulting. "Most of our clients are very wealthy people. They want to own a yacht or a plane and need help with managing their EU VAT liabilities, which can be complex and costly. We might have a German owner, resident in Cyprus, ordering a new yacht to be built in Italy. Where, when and how should he own the yacht? These sound simple questions but the liabilities across the EU can be a nightmare of complexity, which is why I love this job. Every day I get the chance to solve a problem for someone, and the result is a happy client and a real sense of achievement."

Originally an English language lecturer in French-speaking Cameroon, Ayuk came to the UK to study Applied Linguistics at Reading University. There he fell in love with a veterinary surgeon from the Isle of Man. "Once we were married and about to have the first of our two sons we decided to move to the Isle of Man," says Ayuk. "It is a beautiful place, ideal for bringing up children, with good schools and lovely countryside." Ayuk by that time was working in exports, where he was constantly in touch with VAT officials. "I built up an interest and a practical knowledge of VAT internationally, which formal training has since strengthened," he explains. "Then I joined Moore Stephens in 1999. As the market for mega yachts and private aircraft has boomed, so has the demand for good VAT advice. Although many of our clients don't use Isle of Man structures to register or own their assets, they or their lawyers come to us to get their VAT structures right wherever they will own them. I'm always building up the team and we've just been joined by an ex-Customs official with a lot of VAT experience. We want to complement the London team's shipping expertise with a yacht and plane VAT centre of excellence here in Douglas to support the whole global Moore Stephens network."

VAT seems a long way from linguistics, but Ayuk insists that he uses linguistics every day. "A big part of my job is the ability to communicate globally with clients from many different countries," he explains. "Linguistics helps me understand their needs and communicate my advice. It helps a lot to deal with a complicated subject if you can really hear what people say and they can understand you easily."

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Expert witness appointments

Moore Stephens' forensic accounting team has been busy with shipping-related assignments.

Julian Wilkinson

One recent appointment was to give an expert opinion on the quantum of a loss arising from the early termination of a joint service for containerised cargo. Another was to report on the quantum of a loss arising from the failure of owners to supply a series of vessels under a trip time charter to owners for a non-containerised cargo service. A more glamourous job was to assess the operating costs of a superyacht currently under arrest, the ownership of which is disputed. And finally, an expert report was delivered to a port authority on the losses arising from an uncompleted dredging contract.

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Quote

"This loan shows that even under difficult credit conditions good projects can still get financed. It may be true that last year this facility could have been put together in a quicker time and with fewer banks willing to underwrite a bigger amount. However, the solid, committed shipping banks are still active and still have funds if owners know who to deal with."

Anthony Zolotas, managing director of Eurofin, commenting on arranging a $440m loan to Kiran Holdings, the largest ever loan made to Turkish shipping.

Who to contact

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