



INDUSTRY BRIEFING

THE 2019 MEDITERRANEAN YACHTING SEASON IS UNDERWAY

With the Mediterranean yachting season beginning, the HFW yacht team analyse some of the latest developments to affect the yachting industry.

Viva España

On 10 October 2018, at the request of the Spanish National Yachting Association (ANEN), the Department of Customs and Duties of the Spanish Tax Agency (AEAT) published a clarifying note on the entry and exit of yachts from the Customs Territory of the European Union (EU) and the temporary admissions relief from VAT (TA). The AEAT's note clarifies the Spanish view that a yacht entering or leaving Spanish territorial waters:

- and meeting the strict requirements of TA; or
- with VAT validly accounted for in the EU and seeking to rely on the returned goods relief which allows a yacht to operate for up to 3 years outside of the EU without having to account for VAT on their return to the Customs Territory,

need no longer lodge a declaration with Spanish Customs upon entry and/or exit and instead the crossing of the frontier (12 miles off the coast of the EU) is all that is required. For those yachts registered in the EU, there is no change and this merely clarifies a point of Spanish law. The important point to note is that those yachts registered outside of the EU and seeking to rely on the returned goods relief, which previously had to file a single administrative document (SAD) with Spanish Customs on their exit from the Customs Territory, need no longer do so.

The AEAT also made clear in their note that it is now possible for those yachts operating under TA relief to undertake charters in Spain as long as this is permitted by their flag state, though neither the charterer nor its guests should be resident in the EU. This paves the way for the operation of yachts as Yachts Engaged in Trade (known as YETs) in Spain. Spain thereby joins France and Monaco on the list of EU member states in which such a registration is formally recognised. However, no yacht operating on charter in Spain should embark or disembark guests at the beginning or end of a charter without having formal clearance from the Spanish authorities in the form of a charter licence.

The yachting industry in Spain, led by the ANEN, has for many years been campaigning for an end to the inconsistent approach of the Spanish

authorities when issuing charter licenses, particularly when dealing with non-Spanish yachts. An agreement between the relevant authorities to simplify and unify the licencing process across Spain was announced on 17 May 2019 which should make the operation of yachts on a commercial basis in Spain more straightforward.

As these changes demonstrate, Spain is increasingly embracing the economic opportunity presented by yachting and gradually relaxing its approach to the commercial operation of yachts within its territory. Undoubtedly, these changes will further encourage the growth of the industry in Spain and make registration as a YET more attractive to yacht owners. However, care must still be taken and any failure to comply with all applicable rules, which are likely to be strictly enforced, will leave a yacht open to the risk of the Spanish authorities assessing it for VAT on its hull value (if not VAT paid) as well as seeking to recover both VAT on charter hire and matriculation tax.

Environmental Regulations

With the coming into force on 1 January 2020 of the revised MARPOL Annex VI (commonly referred to as IMO 2020) a global cap of 0.5% on the sulphur content of all marine fuel will be put in place. There are fears of fuel shortages, contaminated fuel, operational complications and limitations in both the supply and use of the exhaust gas scrubbers available on the market.

Whilst we recognise that these changes will only impact the very largest yachts, the consequences for those yachts are real, so to is the spotlight that this issue is likely to shine on the subject of exhaust gas emissions and environmental regulations in the wider yachting industry.

On 1 August 2018 the Maritime Authorities of the Paris and Tokyo Memoranda of Understanding on Port State Control (MOUs) launched a joint Concentrated Inspection Campaign (known as a CIC) on MARPOL Annex VI. The aim is to encourage compliance with MARPOL and to raise awareness of the impact of sulphur and nitrogen oxide pollution. Sanctions for owners found in breach of the new regulations range from having the deficiency noted and recorded, to the detention of the vessel.

MARPOL have since continued to pursue improved environmental compliance and ahead of 1 January 2020 the MOUs are running a warning letter campaign to raise awareness of the issue. The warning letter is publicly available¹. The letter indicates the criteria for the cap and warns of the repercussions for a vessel that fails to comply. It goes on to explain that, from 1 January 2020 Port State Control officers will be putting emphasis on the requirement for compliant bunkers, checking the presence on-board of bunker delivery notes and written procedures covering oil changeover operations, and ensuring that the master and crew are familiar with fuel oil management procedures.

At a time when the yachting industry is also preparing for the implementation of the IMO's Nitrogen Oxide (NOx) Tier III Regulations which will apply to all yachts over 24 meters, even if under 500GT, from 1 January 2021, it is clear that compliance with environmental regulations will continue to be a pressing issue for all in the maritime environment, including the yachting industry.

The authorities' focus on environmental matters should encourage preparations for compliance. On a practical level, those affected should consider how they will source compliant fuel, and/or treat exhaust gasses. From a legal perspective, owners and charterers will need to consider the apportionment of liability in circumstances where the regulations are breached.

The Maltese Lease

Following the withdrawal by the Maltese authorities of their popular VAT leasing arrangements in the face of the EU Commission's infringement proceedings against them, the yachting industry has been waiting anxiously to see how, if at all, they will return to the market. Malta has now published new guidelines on the operation of leasing arrangements in their jurisdictions based on the implementation of Article 59A of the EU VAT Directive.

The new arrangements aim to calculate VAT on the basis of the yacht's actual use and enjoyment whilst in EU territorial waters rather than, as they used to, making an assessment of VAT based upon the amount of time a yacht of a certain type and size is deemed to spend in EU territorial waters.

¹ <https://www.parismou.org/sites/default/files/Letter%20of%20Warning%20Sulphur%20Content%20-%20Paris%20MoU%20on%20PSC.pdf>

Unlike the old Maltese lease, a yacht will not automatically exit its lease upon its expiry with a VAT paid status. However, assuming it is approved by the EU Commission, the new Maltese lease will enable yacht owners to defer the payment of the VAT due on their yacht's hull value until a later date, at which point they can either account for it by an alternative means, pay it on the depreciated hull value or sell the yacht and pass the responsibility for the VAT due on to the buyer.

There are, of course, costs involved in entering such an arrangement, not least of which will be the VAT paid on the lease instalments, which cannot be recovered. However, depending on how much time a yacht spends outside of EU territorial waters whilst in use by its beneficial owner, it is considered that the new Maltese lease will offer an economically viable alternative to the Monaco lease. Since the calculation of the VAT due will depend to a much greater extent on the actual use of the yacht, it may be sensible to obtain comparative proposals from both Malta and Monaco.

The onus will be on the master of the yacht to record the yacht's actual use and enjoyment, paying particular attention to any time spent outside of EU territorial waters. When entering the lease, a 'preliminary ratio' based on the planned use and enjoyment of the yacht will be issued and used to calculate VAT for the first year of the lease. Thereafter, the data on the use and enjoyment having been collected and reported, an 'actual ratio' will be issued and an adjustment made in the VAT return to account for the difference between the provisional and actual ratio.

The Maltese authorities have indicated that they will take a strong stance on enforcing compliance with the conditions of the lease. Further, it has been suggested that, unlike in the past, they will also be reviewing the data provided to ensure a realistic percentage of use and enjoyment of the yacht inside and outside EU waters is recorded.

The Insurance Landscape

Yachts remain a hot topic of conversation in the London insurance market. In addition to premium increases because of a series of recent losses, yacht specialist underwriters are

increasingly alive to the threat posed by natural catastrophes, causing more than a third of the market's losses in 2017. This is nowhere more apparent than in the United States following a succession of devastating hurricanes including Irma, Harvey and Michael.

However, whilst the US has always been at high risk of such events, insurers are now increasingly concerned about regions not previously considered to have been prone to natural catastrophes, such as the Cote d'Azur and Liguria, following November 2018 storms which caused substantial damage to the coastal infrastructure and yachts in their path.

Such events have accelerated the departure of a number of Lloyds syndicates from yacht insurance, whilst others have increased their premiums substantially. Given the sustained pressure on marine insurance in Lloyds, it is not unreasonable to expect a further rise in premiums and reduction in capacity, making it increasingly difficult to place full cover for larger yachts.

Whilst owners have, to date, largely accepted premium increases, it is foreseeable that some may be tempted to reduce their cover or otherwise place insurance in less well-founded insurance markets. Notwithstanding the premium increases and reduction in capacity, it remains essential that owners secure appropriate levels of cover from well capitalised and experienced underwriters using brokers who genuinely understand the insurance product on offer, the nuances of operating a large yacht (particularly when in commercial use) and the owner's risk appetite.

Owners should focus on having adequate protection against risks that are specific to the yachting industry. For instance, in 2017, P&I clubs reported that more than 70% of the claims in the yachting industry involved crew members. Achieving the right level of insurance for crew members can be a particularly challenging task for owners and the requirements for such cover depend on a variety of factors, for example, if a crew member is resident in the same member state as the remunerator and likely to bring a claim or otherwise have to account for social security. Cover should always include medical protection, disabilities, injuries and death. Failure to ensure

compliance with such requirements could result in the yacht being in breach of its flag requirements and at risk of detention by flag state and/or port state control.

Brexit and Yachting

Whether Brexit will happen (and what it may look like) still remains entirely uncertain. Whilst the consequences of Brexit on the yachting industry are a source of considerable discussion at an industry level, they have, perhaps understandably, not received much attention at governmental level. However, at a time when the UK Government has set a target of doubling the size of the UK fleet, Brexit, and particularly a no-deal Brexit, could result in a serious reduction in the number of yachts registered on the UK flag and, indeed, we are already seeing the departure of a significant number of commercial ships. Some sources have suggested that up to 25% of the yachts over 24 meters in length and currently registered on the UK flag might flag elsewhere.

In response to such concerns both the UK Ship Register and its parent agency, the Maritime & Coastguard Agency (MCA), have reaffirmed their commitment to growing the number of vessels registered in the UK. By way of assurance, the MCA has stated that its surveyors offer technical expertise recognised as being among the best in the world and that such support is available 24/7 to their customers.

Given the uncertainty, UK based yacht builders and ship repair facilities face challenges, but the weakened value of Sterling also presents an opportunity for international clients, particularly those funding a project in US Dollars.

There are potential difficulties ahead for those seafarers holding UK certificates of competency. The UK Government has admitted that such seafarers will lose the automatic right to work on EU flagged ships despite the fact that those with EU tickets will retain the right to work on UK ships. It remains to be seen how the Government proposes to overcome such disparity.

There may also be complications for UK flagged commercial yachts operating in the EU but in the event of the UK leaving the EU Customs Territory, it is conceivable that privately operated UK owned and registered yachts might qualify for temporary admission relief

on VAT. Although it is hard to foresee EU member states allowing this to happen, it would likely result in a boom in UK yacht ownership and registration if they did.

Intended Pleasure Vessel Code

The Code of Practice for Intended Pleasure Vessel in Temporary Commercial Use at Sea (IPV Code) came into force on 1 January 2019 by means of an addendum to the MCA's Small Commercial Vessel Code and Large Commercial Yacht Code. It allows pleasure vessels to be in temporary commercial use for specific purposes. The IPV Code's establishment follows market demands to improve the provision for occasions where vessels need to operate outside the narrow definition of a pleasure vessel and the MCA acknowledging that previously available options were burdensome and impractical. In developing the IPV Code, the MCA worked in partnership with British Marine, the Royal Yachting Association and the Yacht Brokers, Designers and Surveyors Association (YBDSA).

The IPV Code is made up of two parts, the first relating to certain business purposes and the second relating to race support activities. Each part contains requirements for owners and operators of vessels and they will each need to ensure that they comply with the IPV Code. The definition of "operator" varies between Part 1 and Part 2 but generally refers to the individual or body corporate who is responsible for the operation and safety onboard an Intended Pleasure Vessel (IPV) while at sea.

Part 1 allows for IPVs to be in temporary commercial use on a single-voyage basis for business purposes relating to sale, repair, post-production, post-repair or mid-survey sea trials, customer sea trials, or vessel delivery outside the definition of a Pleasure Vessel. It is applicable to IPVs of any size registered in the UK and to IPVs registered elsewhere whilst in UK waters and operating from UK ports.

Part 2 allows for IPVs to be in temporary commercial use at sea on a single-voyage basis for the purpose of race support activities for yacht or powerboat racing affiliated to

the national governing body of the applicable sport. It provides a standard for no more than 10 occasions per calendar year, never more than 3 miles from land in favourable weather and daylight, and applies to IPVs of no more than 15m Length.

The IPV Code places obligations on the operator of the vessel, although the responsibility for ensuring that the operator has complied with such requirements resides with the master and owner (who may also be the operator).

Under the Marine Guidance Note 564 amended to reflect the IPV Code, the master has an obligation under the IPV Code to report any accidents to the Marine Accident Investigation Branch (MAIB). The IPV Code is not an alternative to a "Yacht Engaged in Trade" registration as offered by the Cayman Islands and the Marshall Islands but it does pave the way for commercial activity, albeit on a limited basis.

HFW has over 600 lawyers working in offices across Australia, Asia, the Middle East, Europe and the Americas. We advise clients on legal issues in relation to all aspects of international commerce and we are regarded as one of the world's leading shipping law firms. The expertise, experience and reputation earned in commercial shipping are carried into our yacht practice.

COMPREHENSIVELY YACHTS

Our yacht team has over 25 years' experience of working in this intimate industry and our in-depth knowledge combined with our international reach ensures we are pre-eminent in the field. For more information on HFW's yacht team and the services we offer, please see www.hfwyachts.com