

Financing of ships through Tax Lease model

Treball Final de Grau



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Barcelona, 18/12/2018

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ACKNOWLEDGMENTS

First of I would like to thank the current lecturer on the university Miguel Pardo and also my tutor for this on going project that I embarked myself on. I assume that without his help I couldn't have made this project until to this date.

Actually he encouraged me to select this topic because it would be great to work on due to my late interests in economics regardless of the fact that I am going to hold a degree in engineering. He also facilitated me some useful information and many documents that are going to be seen along the work.

Finally give especial thanks to the close ones that bore with me through the whole degree including this last effort, also known as final degree assignment.

Hope you all enjoy



1.INTRODUCTION

Nowadays most of the assets that are acquired by people are going through the process of finance. Likewise it also happens in the naval industry but with a downside, that is actually a high downpayment that much likely nobody can afford. That is why exist several types of finance and that is where the common topic of this work comes in, the Tax Leasing (just a model of financing that leads to benefit taxation through several regulations and laws)

The main goal of this assignment is to really know deep down how this model of financing really works, how many firms/ entities do they really work with these type of “investments”, the basic concepts of economics that go with it and the story before all started to take off.

Once all of those goals stated above are achieved, the next step will be to discover whether it is a really good system or not and if there are another options that will bring further better results in every aspect such as in the environmental and juridic field.

It will also be discussed the future of this model of financing.

Finally will be the disposal of an actual model of a current project and if not a sample of it with the most important aspects to take into account.



2. AN APPROACH TO TO THE HISTORY & ECONOMIC TERMS

2.1 Leasing introduction & key factors

To put things into perspective , in this era where everything is set up to a high fast pace changing paradigm, things must be changing accordingly in order to keep up.

Nowadays it is all oriented towards a better use of fixed assets , financial resources or any kind of resources, therefore it has to be an arise of new methods that tackle these necessities.

The term lease, as all of the words known to this day, comes from Latin (*laxus*) and made it all the way until this day to its full meaning.

Similar words related to lease were used back into BC years, but it wasn't until 1800's when a Company called 'Bell' decided to lease its products instead of just selling them.

When it comes to defining lease as a term, it can be done from different approaches as the following ones:

- The lessee (user) has to pay the lessor (owner) regarding the use of an asset through an actual contractual arrangement
- Financial technique used by a financial company with a legal support regarding a contract that implies a lease of any kind of goods and its extended to a period of time explicit in the contract
- Financial companies or institutions that are specialized in operations that let other companies or manufacturers borrow funds to use or buy any given product or ítem



From the legal framework point of view, international leasing was not summoned until 28th May 1988, where it took place at the Convention on international financial leasing given by the Commission of the International Institute for Uniformity of Private Law at Ottawa.

In Europe, the leading representative is the European Federation of National Associations of Leasing Companies that was founded in 1973 with the goal in mind to discuss several issues regarding this new type of financing. However it ended up being an institution that promotes interests of the members that take participation in.

From a logical observation it can be deduced that a ship is an investment. Therefore, that implies a wise decision with a back up plan and a thorough research in order to identify the best outcome possible.

That is why it is so important to jot down a plan and follow a structure that will lead to a better result.

First off it should be taken into account what will be the reach of the investment project and how is it supposed to work out. In the second place, what are the financial traits that will run the entire project and what are the strategies that will be followed. Last but not least, what is going to be the ROI (Return of Investment) expected once this long-term project investment is done.

Of all the conditions or steps stated above, the second one is considered one of the most important ones, thus there is going to be an incision on the different financial flows that characterises this process. The three financial flows that are going to be reflected on are conducted on a study by Scientific Bulletin- Economic Sciences, Vol.9 (15) that includes an abstract from Senior lecturer Ph.D Adrian Simon.



1. The cost of the investment that includes the inicial expenses regarding intangible assets and the original value of current assets.

$CI = Vfa + Via + Vca + OC - Vifa$, where:

CI- Cost of investment

Vfa- Value of fixed assets invested

Via- Value of intangible assets invested

Vca- Initial value of current assets

OC- Other investment costs

Vifa- The liquidation value of fixed assets replaced. This liquidation value follows the next relationship

Selling Price – (selling Price- stock value)* tax rate on income

2. Financial flows proceeded along the whole investment project. A good KPI (key performance indicator) is the cash flow out of all the operations done. It can be considered two types of components:

-Net profit

-Depreciation and amortization

$PF = NP + D + AIA + I \pm \Delta WC - OF$, where:

PF- Annual positive flows generated by the investment

NP- Net profit

D- Annual depreciation of fixed assets

AIA- Annual amortization of intangible assets

I-Interest on loans and leasing used to finance the investment

ΔWC - The changes in the working capital

OF- Other financial flows



3. Financial flows related to the liquidation of the investment

LF= V_{lfa}+WC, where:

LF- Liquidation flow

V_{lfa}- Liquidation of fixed assets

WC- Working capital when the investment is liquidated

One of other steps that should be taken into consideration must be to check whether the project is profitable or not. That will be done through a complete process based on the updated net value (UNV) and it will be stated the ROI . Analysing pros and cons will determine an estimated efficiency of the investment in hand. Therefore, there are several variables that should be regarded:

- Inflation level
- Risk of project
- Opportunity cost
- Expectations of the return from capital providers

It is expected that if the ROI outcome turns out to be highly positive, the economic profitability of the project will be most likely to be great . Although it can also be that does not meet the requirements of ROI thus its under the criteria and it is still sufficient to be applied.

Last but not least, there is the final step when it all comes down to the further implementation and the lay out of the process. Regarding the project implementation there are some factors that may contribute to the final decision ⁽¹⁾:

- Considering an investment as a long-term goal puts the company into a waiving mild flow where its stability gets compromised and ultimately more vulnerable.
- The decision of committing to enroll in the process of performing a lasting investment is based on increased future cash flows so it is deduced that there has to be a proper planning of revenues.
- All investment decisions are performing as a whole management strategy.

(1) This factors are also based on Phd Adrian Simon as it has been stated in prior pages



2.2 Advantages of leasing

Over the years there have been thorough analysis which led to the conclusion leasing has loads of qualities that other methods of investment do not have.

When it comes down to choosing an acceptable method to do a savvy investment , the company should look for the credit interest rate and the commissions stated by the other company that leases its services, the tax benefits for that lease and the depreciation of the asset. Thus going for that lease may lead the company to a phase where they are able to be more flexible (despite of the vulnerability that comes with in), they can benefit from taxes (after purchasing the asset within the first years, property payment taxes are slightly reduced), and its financial availability turns out slightly ginormous.

Other upsides of choosing the leasing as a way to provide the Company with an asset , may be that the leasing company just takes over all the operations related to the asset that is being purchased, thus the company that is making this investment may avoid some capital restraints. It also gives a company the chance of holding accountable itself by being aware of the quantification of the costs throughout the whole operation. For some companies which do not have enough financial resources , can take a leap of faith through the lease and they end up with more possibilities of development.

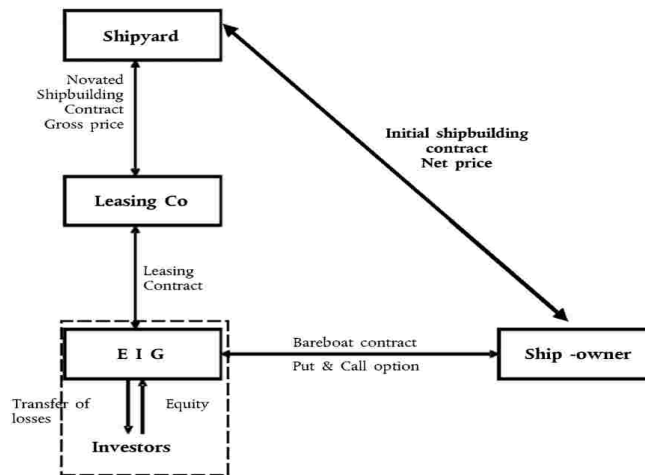


Figure 1. Simple outline of how leasing works in the naval industry

Source: europeanlawglog.eu

3. TYPES OF FINANCING SHIPS

As a broad general concept of “types” of financing, there are only a few of them. In fact, in the maritime industry it is likely to only find two of the most common methods: the *Operating Leasing* and the *Finance Leasing*. Besides those, depending on the market that is considered, the companies will slightly make up their own kind of lease models to suit the needs of it – the market they are currently operating.

For some companies like ICBC from China, they have considered the Sale & Leaseback, the aforementioned Operating Lease and Finance Lease, the Import Lease and others.

In this section the point is just to simply lay out the different types and introduce them in a simplistic way through tables and basic schemes (see below). Further information will be provided in the next chapters with deep concepts and digging in this intricate topic.

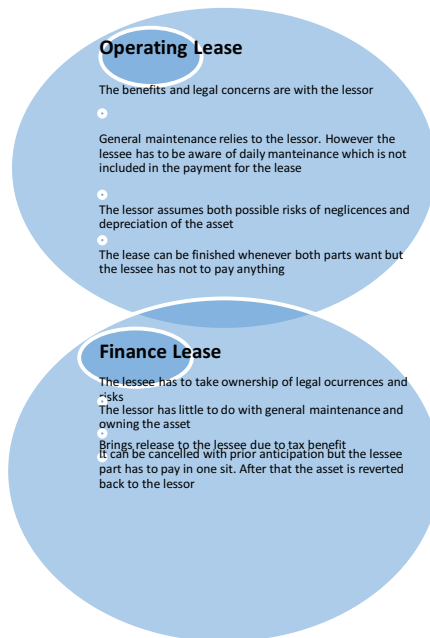


Figure 2. Brief representation of both models with pros and cons

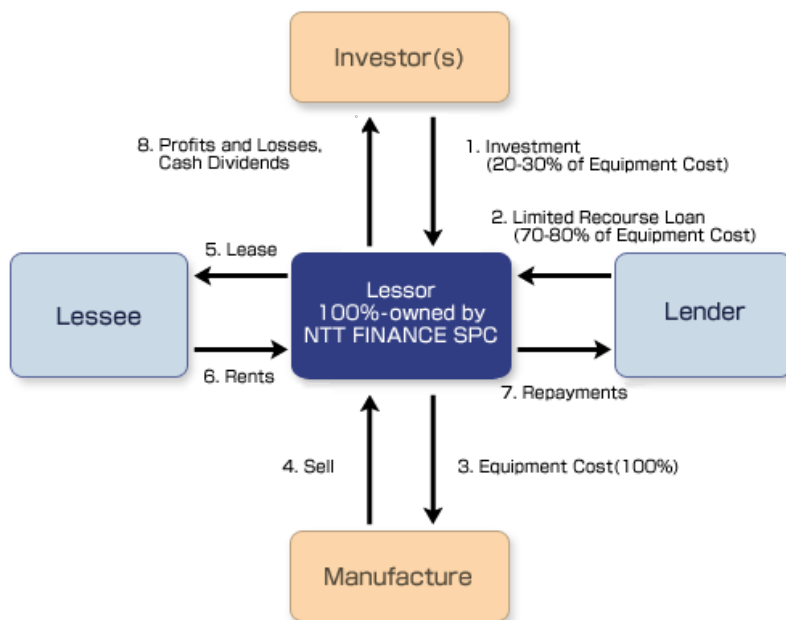


Figure 3. Operational Leasing scheme from a Japanese company

Source: ntt-finance.co.jp

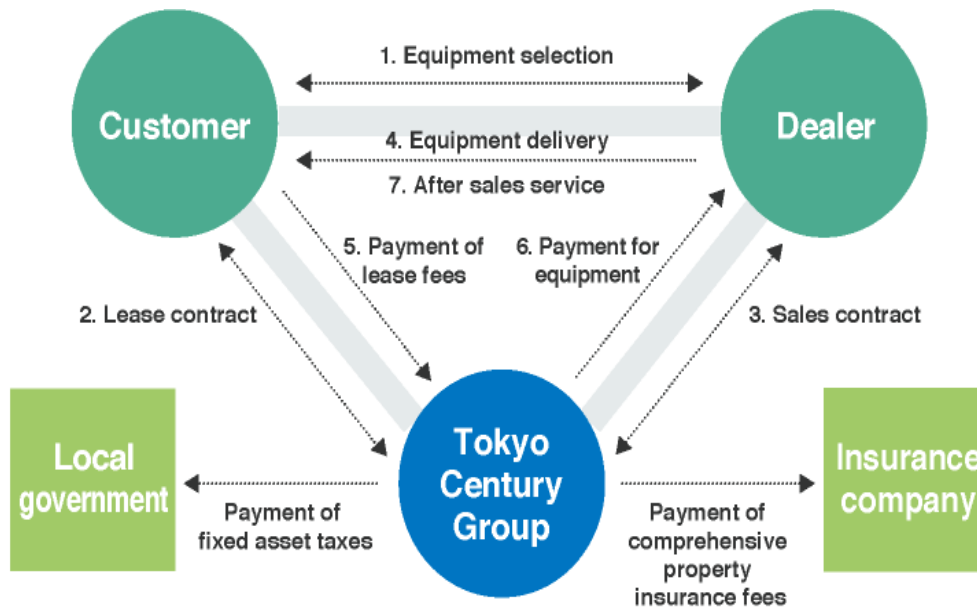


Figure 4. Finance Leasing from Tokyo Century Group

Source: tokyocentury.co.jp

3.1 History & overview

The business in the maritime sector or just considering shipping in its own, it is considered one of the very first ventures in the world. Prior to the logistics, technology and other traits of modern model, there was this practice of leasing ships back in B.C. years between the Sumerians and Akkadians who used to carry out several products and perform several trades.

However, if the focus is in today's methodologies, are far way more trickier than before, high-end sophistication due to the needs of commercial environment. The maritime industry is constantly taking a huge leap and it is overall a highly competitive market despite being recognized by both the public and private sectors.



A ship is known to be a movable asset but puts up with some traits of immovables. Nevertheless, shipping does not meet the requirements for the economical layout of practicality and full transparency with every operation that is being implemented.

First class financial entities, want to see a certain well-defined structure and predictable revenues that comes with every venture of the shipping business. Sadly to say, that is far from the truth due to the volatility of the business, dealing with high uncertainties such as the rise and fall of the value of the ship, prices of fuel, market variability, etc, that ends up with the unwanted outcome of gains or losses. Aside from risks that shipping entities may encounter throughout the periods of operational charters like possible sinks, storms or collides that might lead to huge losses that they will have to bear up with.

Notwithstanding all of the reasons stated above, shipowners still manage to get enough resources for the acquisition or operation of ships.

When it comes to finance a depreciate asset over time, future shipowners must decide which financial method does fit better regarding taxation, law, fiscal and finances (these are the one to be checked out first). Basically, ships can be financed through debt or equity. Choosing to use debt, the owner will obtain a loan from a financial institution whilst placing the ships as security check that holds accountable for any situation. Thus, the loaner with this condition aforementioned, still benefits from that and the interest that is being paid from the lessee (ship owner).

On the other hand, with equity financing it is the lessor who realizes the payment in order to acquire the vessel and operating with full availability. Out of this financial move, the lessor investor expects to have a highly structured ROI determined by the ups and downs of the market.



Finally , the leasing option it is also considered an alternative with its pros and cons that hand over prosperous results to both parts.

Until this point, it has been covered a bit of history and how the maritime business works. Though, the point is to show how leasing works – from every perspective-, its concepts and a bit of contextualization in the current framework (further information will also appeared in uncoming chapters).

3.2 Introduction to finance methodologies layout

Regularly the acquisition of assets require some type of financing due to its high cost. A ship is more keen to be financed than other assets; thus that is why is going through a debt or equity finance. The acquisition is a long harduous process that must be proceeded accordingly.

Nowadays the current and most popular method is that the ship is normally owned by an entity or company that act on behalf the holding of the asset despite not using it; therefore all legal and economic stuff lays on their responsibilities.

There may be several owners of the asset – the ship- that have shares in common, but as it is known the ship must be ruled by a national legislation of the flag state. Nevertheless that does not limit the participation of other companies , entities or partnerships that may be enrolled in the share of the whole asset.

Some sources of information and articles about shares of ships and their ownership, note or verify that most were owned solely by one person back then in the 1800's. Lately, with a prompt growth of companies and capitalisation, eventually the finance and debt were more prone to be used and still to this day are more well received.



Name and Address of Beneficial Owner (1)	Amount of Beneficial Ownership of Class A and Class B common shares	Approximate Percentage of Outstanding Common Shares
Michael S. Gross(2)(3)	10,752,754	19.54%
Howard Boyd(3)	70,362	0.13%
Angus R. Frew(3)	70,362	0.13%
Philippe Lemonnier(3)	0	0.0%
Guy Morel(3)	70,362	0.13%
Alain Wils(3)	10,500	0.02%
John J. van de Merwe(3)	11,500	0.02%
Ian J. Webber(4)	204,800	0.37%
Thomas Lister(5)	103,600	0.19%
Vivek Puri(6)	49,400	0.09%
All directors and executive officers as a group (10 individuals)	11,343,640	20.62%
CMA CGM S.A.(7)	24,412,700	44.37%

Figure 5. Example of ownership of the company Global Ship Lease company that owns a ship

Source: Global Ship Lease Annual Reports 2017 Form 20-F

3.3 Operating Lease

It is one of the most common types of lease used in several sectors and also in the maritime one. Normally it is widely used for products, services, equipment or anything that is durable and non-perishable. As stated in previous chapters, it sticks out the fact that the risk remains on the lessor whilst maintaining fully the ownership of the asset and the lessee utilizes the usufruct of it .

It is necessary to make clear that both parts (if stated in the contact) can cancel the contract anytime and the asset goes back to the lessor.



3.4 Types of Charters

Depending on whether it is a long or short-term lease, it may be encountered several types of operational leasing.

Short/Mid- Term Bareboat Charter: It is expected to last a short period of time (between 6-12 months or couple of years max). Once the contract is finished, the asset goes back to the lessor, the one who assumes whatever type of risks or setbacks that might happen along the whole lease.

To foster a better understanding of this affair, it can be imagined as a house. Holding this premise, normally a person can rent an apartment or a house for a certain period of time with or without the option to finally buy the house; well, with the ship happens the same but with the difference that the lessee only pays for the lease payments but does not contribute to the amortisation plus has no option to purchase the given asset.

Lately it has been promoted by entities and governments to fund this type of financing and provide the market with more ship units.

Time Charter: Remarkably a method used most all the times. It is an a type of lease where the lessor has to provide the fleet and the equipment in order to fully operate the vessel.

The same traits specified above, apply to this very type of lease. However the lessor does not really own the full tenancy.

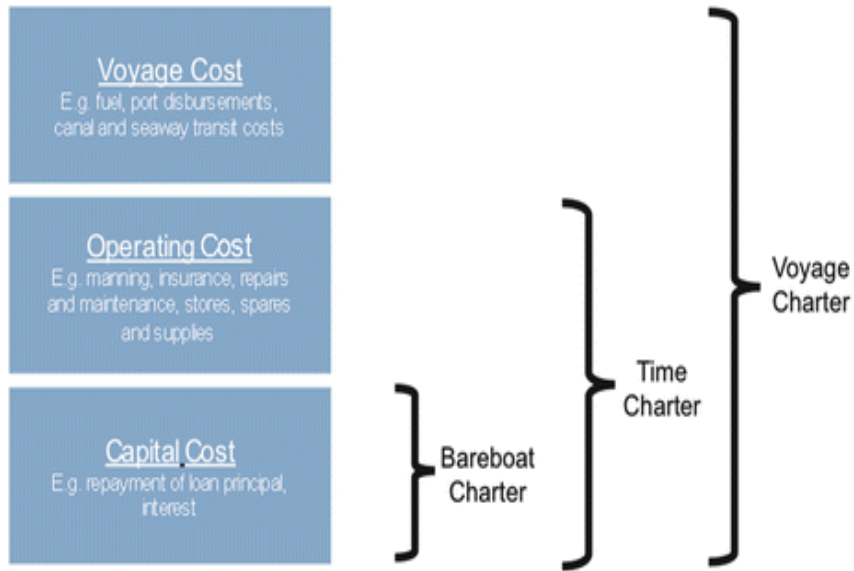


Figure 6. Costs hedge varying due to different types of charters

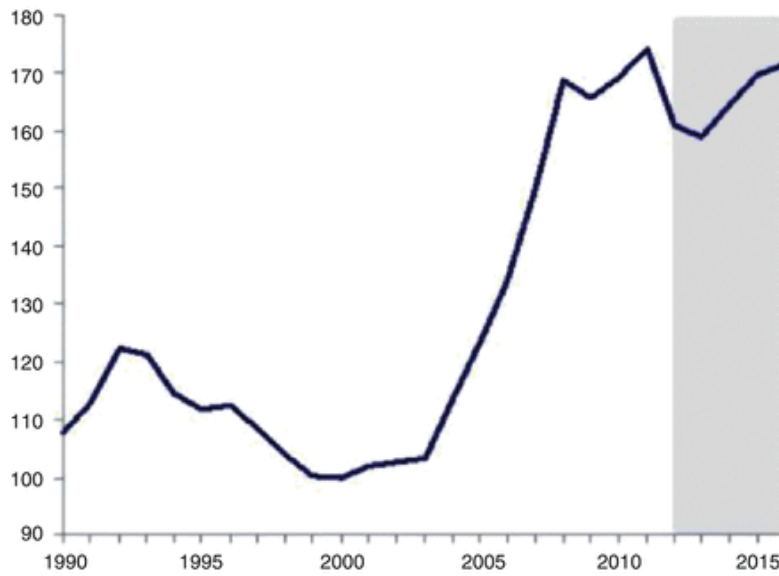


Figure 7. Running costs on time charter⁽²⁾

Source: It shows how the market fluctuates along the years

(2) Prices may vary and because of inflation total costs have to respond accordingly plus offer and demand

3.5 Finance Lease

Contrary to what has been jot down previously, a finance lease regards total accountability to the lessee that must take all risks and rewards of what an ownership of an asset complies, which that means that he also has to pay for full amortization and is not entitled to call off the contract.

Usually a finance lease is related to the above-mentioned bareboat charter . The latter implies a long term contract where the lessor gets paid out almost the whole quantity (80-90%) specified to cover the cost of the purchase of the ship plus another additional expenses. However, the lessee has to provide full responsibility and must tackle anything that may be presented regarding occurrences such as insurance, risks, fixing whatsoever. All of this can be seen in the table below Table 1.

TYPE OF LEASE	FORM	PERIOD	SPECIFICATION	MAINTENANCE	CALL OFF	PURCHASE OPTION	AMORTIZED	MAIN RISK
FINANCE	Bareboat Charter	Long	Lessee	Lessee	No	Yes	Yes	Lessee
OPERATING	Bareboat Charter	Short-Mid	Lessor	Lessee	Yes	No	No	Lessor
	Time Charter	Short-Mid	Lessor	Lessor	Yes	No	No	Lessor

Table 1. Basic features of the different types of lease



From an accounting perspective, it can be done from different approaches. The legal method considers the whole thing hiring an asset; in this case rewards and taxation runs by the lessor’s part and it is considered a fixed asset run by another person or entity and a depreciated or amortized asset. As a result the lessee has still to pay the operating expense that is equal to the rent split into a period of time.

On the other hand , the substance method has been gaining consistently traction over the years and it depicts a crystal clear differentiation between both operating and leasing methods⁽³⁾. The differences are laid out below in Table 2.

TYPE OF LEASE		ACCOUNTING OWNER	TAX OWNER	DEPRECIATION	CAPITALIZATION	OFF-BALANCE SHEET
FINANCE LEASE	Legal method	Lessor	Lessor	Lessor	Lessor	Yes
	Substance method	Lessee	Lessee	Lessor	Both	No
OPERATING LEASE		Lessor	Lessor	Lessor	Lessor	Yes

Table 2. Basic features of the different types of lease regarding accounting

(3) According to an article of Business Leasing Manual

3.5.1 General Scheme of financial lease & legal issues

Whether if the vessel is built from scratch or second hand purchased, the agreements and procedures involve the same structure.

The lessor which is normally a huge bank or a company that may be benefit from future taxation - coming from this venture- finances the whole purchase resting accountable for the ship's depreciation that can be outweighed by the possible profits generated thanks to the payments that the lessee has to give back.



Figure 8. Basic structure of financial lease

It can also be applied by a leveraged financial lease. The differentiation from the one above comes when there is a third part that takes place. Hence, there is the lessee, the lessor and the lender. Normally under this scenario the lessor pays about 15-20% of the total amount as a downpayment and then obtains the rest from a loan given by an institution 85-90%.

Under this circumstances the lessor expects an optimal return of the depreciation from the ship. Then, the lessee pays the rent over the period of leasing due to his entitlement of using the ship over that long-term agreement.

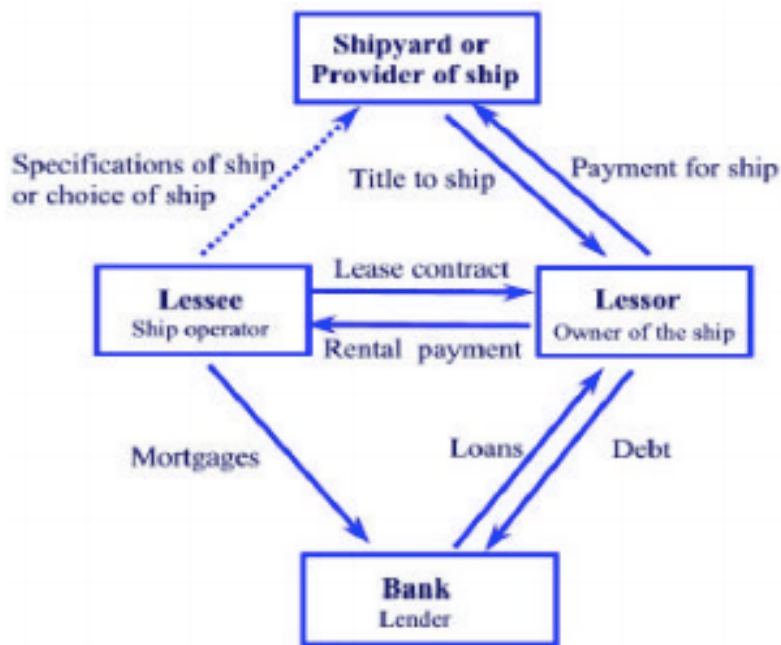


Figure 9. Basic structure of leveraged finance lease

So overall, we can deduce that the finance lease method is the most complex transaction but also the most rewarding for both parts in terms of benefits and taxation. Over the years this method has evolved and therefore discussed thoroughly what should be the relationship between lessee and lessor in terms of rights, obligations and duties. The figure of the lessor is not only to be the one who brings the financial flows in order to pay the ship but to also receive rental payments throughout the course and enables to recover from the investment



Regarding the legal background, the characteristics of this process usually revolves around the benefits and interests between both parts. However it is known that the contracts are very standarized and also particularized.

In the process of the acquisition of an asset there has to be some kind of security when achieving it. Depending on how is it going to be financed – through debt or equity- it will be stated in the contract how the lessor and the lessee are going to proceed .

The most important part has to be the mortgage of the ship; because of that there are some arrangements that have to be settled down due to the movable and immovable characteristics that the vessel holds.

The term mortgage can be described as a charge which the borrower of money creates a proprietary interest in favor of the lender of moneys. In some way shape or form it gives a certain security to the lender to recieve back whilst conferring some rights on the lender.

Whilst in the operating leasing, the mortgage still may occur but has no relevance in legal specifications . Despite being used for accounting purposes that also have ta implications, the goal is no less than procuring to finance the ship. However it does not matter which type of financing is being choosen, rather it inflicts more importance on the law side. Normally this process will be regulated by any authority and reviewed by the substance of it.

The main difference that is being held in this issue, is no more than whether there is a clause in the contract that states if the lessee can call off the contract or not; that will make such a big difference of how things will end up working, indeed.

Needless to say, the main focus of this thesis is the finance lease. As stated previously the finance lease involves three people; the lessor , the lessee and the supplier of the vessel.



Therefore it has to be differentiated two contracts between three parts, being the one amongst the lessor and lessee , and ultimately the lessor and the supplier known as the supply agreement.

The one of this triangle of agreements that has to watch for his/her benefits is the lessee, so it would be depicted in the layout that the lessee is who selects the ship and gives clear specifications.

Previously has been mentioned some finance and law traits regarding the lease financing. However it will be useful to summarize some of them to get all together at once. These points are deducted of all stated above

- The lessee chooses the supplier of the ship
- The lessor remains always as the owner of the sip
- The vessel is only used for commercial purpose
- The lessee chooses the ship accordingly in order to satisfy his/her needs
- The risks must be assumed by the lessee
- Any kind of rewards that the lessor may receive from the purchase of the ship, will be transferred to the lessee
- The lessee can decide whether he will or will not buy the ship at the end of the lease
- Until expiry , the arrangement will benefit both parts

Legal issues

The lessor as owner of the ship wants to have his interests protected , thus must register the vessel and hiself as the owner on the title. Nevertheless, the lessee also needs to be protected in terms of legal and benefits issues. Then , the lessee will obtain this protection throughout being registered as a bareboat charter in a bareboat charter registry. Within a friendly jurisdiction , the leseee will enjoy any kind of advantages in terms of taxes.



The standard form of bareboat charter known as BARECON does provide this practice, indeed. There has been an increase in the number of registries and has also been recognized by two international conventions; United Nations Convention on Conditions for Registration of ships and the International Convention on Maritime Liens and Mortgages.

In the law field there is always place for any type of claims. Some of them related to the maritime world, like pollution, evading taxes or any type of misleading practice will rest under the owner responsibility; thus is going to put the lessor in certain particular vulnerable positions that may compromise the contracts already going.

However some of these claims attached to the figure of the lessor, can be deviated towards the lessee responsibility through the introduction of a system that notifies that it actually exists a contract between the lessor and lessee, which will determine that ultimately the lessee is the one and only that must be responsible for arising setbacks or risks.

The register of the lessee stated above as bareboat charterer can also be known as the vessel's flag registration.

The security is also one of the key factors whilst financing these types of transactions. This ensures that the lessor or owner of the ship is under legal protection if he or she suffers any detriment by the lessee part. Therefore, between the lessor and the lessee there is not a direct loan relationship, rather than a contract that states some clauses and manifestates the law background and the interests that will be satisfied.



3.5.2 Advantages and disadvantages

There is no doubt about the fact that leasing is still in debate to whether it is a good method or not. From the taxation point of view, can be deducted that both lessor and lessee get some benefits stated in previous chapters. It also has to be taken into consideration the economical perspective that incorporates other key features that may help some companies.

Needless to say, it s quite a complex capital structure overall due to the constant menacing market changes. However, in the shipping industry is going to be considered as a perfect market where the worries should be focused on free defaulters related to leases, information and ratio of costs plus some risks added whatsoever. Leasing can be a good way to avoid constraints in the economical field , to uplift and promote a high sales growth and to outsource the financial management of the assets. The latter makes sense in markets where companies have practically the same marketing strategies as a differentiation feature and for them will be a path to dive with ease.

Within the current framework of the shipping industry, there have been several papers, researchs and articles that have been discussing the issue from the tax, law and economical perspective to figure out what would be the best option.

Therefore, the tax benefit has to be one of the strongest beneficial features that leasing has to offer to this trait. The most common one is the delay of tax liability on capital allowance. Normally the financial institutions get the most out of this situation where they get profits through activities that have to do with the whole issue of the lease. After all, the benefits also go to the lessee throughout deductions of rental payment, that is why the latter is always kind of in 'disguise' where the finance lease is intended to be perceived as an operating lease to derive the off-balance sheet benefit.



For a better understanding of what is exactly pictured in this scheme, let's take as an example the following one.

The key factors in these types of situations are : the schedule where all the payments are set out, highlighting the timing and tax repayments (however the goal is always to avoid taxes).

Lets consider the Lessor named "Company X" , the lessee "Company Y" and finally the finance insitution "Finances Corp". They split the whole partnership (0,5/0,5/99 respectively)and each part proportionates an exact amount of capital to contribute to the \$100M. Thereafter, they purchase 2 ships of \$50M each, and proceeds to include a lease. Finances Corp requires Company X & Y to buy the interests for about \$80 after 6 years .

Finances Corp recieves 99% of tax losses over 6 years of the lease which ends in \$60M, generating as well a tax relief of \$18M. Then, what we got is 5% repay of capital plus the tax relief. The \$81M (99-18) is likely to be a capital receipt within the scope of chargeable gains, but as the cost exceeds the proceeds no tax is due.

Company X& Y have already increased their investment in the partnership to \$84M plus they will have to ensure that the rental stream is not taxed. Nevertheless, if taxed the \$18M tax benefits would be recovered.

Normally this can be deduced as an arrangement of a standard finance lease (could even be considered as an operating lease) but is highly doubtful that will challenge the lease itself.

Since, companies need a budget to manage their resources and used them wisely, as then the lease will make possible to invest in new ventures, products or services that will impact positively in their revenue and the adaptation in the market they are operatng. As far as container lines are concerned -it is known by some sources of information-, that companies are taking risks in placing witty investments through leasing that make their fleet expand , buy bigger warehouses and improve their distribution.



The lessee does not have to have a clear capital outlay in order to acquire the ship . Whilst acquiring the latter what reflects in the contract of a standardized lease is the interest deducted from payable raised in the construction period. Therefore the first payment will not take place until the delivery of the ship.

On the other hand, it is also taken into consideration that the vessel as a financial vehicle , leasing can do little to solve the financial problems . What gives credit to the companies in the sector is their trustworthiness , endorsements and the outcomes they get from operating alongside other less relevant factors that have to do little within this framework. Unless the lessor is not sure whether the investment is secured and there will not be any kind of default from the lessee, the leasing will not take place in the end.

In the shipping industry, there is a tendency to see the finance lease as only an off-balance sheet in practice because it is right to be perceived as an operating lease in disguise from which benefits will be obtained.

Deeming the complex arrangements, the risks are also a factor that resides in both parts , the lessor and lessee. Normally the lessor calculates the ROI of the investment, proceeds to derive the rental variation and collects the monthly or yearly payments.

Then the lessee restricts its responsibilities to only run the vessel but also takes ownership to indemnify the lessor if any damage is done.

If we make an approach to a more complex lease -the leveraged lease-, if there are any defaults from the lessee, the lessor will no longer be able to receive compensations from the economical standpoint.



Until this point, there have been several advantages pinpointed. Nevertheless, it is not always everything done nicely and smoothly, there has to be at least one disadvantage. In the shipping industry this type of financing has been consistently gaining traction but there are few points that make a detriment when is the time for the companies to decide if enroll or not to enroll.

The fact that the lessee is able to cancel the contract at any time (if stated in the actual contract) will make the lessor sensible to detrimental features and therefore will lose the initial benefits.

Bearing with this premise in mind, the inflexibility of termination and the length of commitment are the most common disadvantages. Hence, the lease financing will be more appropriate for owners who wants a sense of security and will operate for relatively longer periods of time. Normally companies such as long-term charters, like containerships (like ICBC, Global Ship Leasing) or cruiseships (Trasmediterranea) are more keen to use this technique compared to dry bulk carriers or gas liquid carriers that would not fit properly.

Another setback that may arise a side from the high initial cost involved , may be the uncertainty regarding taxation and laws specific to every country and its legislation. Therefore, both lessor and lessee must be aware at any time to check the changes that could rise the rental obligations from the latter and likely will have to restructure the lease transaction if the amount is very high.

There is an issue that has not been mentioned before but it is likely to be kind of obvious, that is tax exportation is not allowed. That means taxes must be paid under the coverage of laws and taxation from the country of origin, thus there are restrictions when chartering out vessels is intended.

Financial institutions playing the role as the lessor, are actually aware of the potential liabilities to which they might be exposed in case of risks or damages related to pollution.

All information stated above is summarized in the following tables 3 and 4.

Advantages Assumed	Disadvantages Assumed
The lessee enjoys the benefits deducted from the lessor	Potential Liability
Preserve the capital and increase the cash flow	Modification of the arrangement due to taxation and legislation modifications
Long-term payments	No flexibility
Allocated risks	Complexity in the structure

Table 3. Lay out of the advantages and disadvantages stated in the whole chapter

Incongruences of the advantages assumed	Incongruences of the disadvantages assumed
No off-balance sheet transaction	Complex restraints due to taxes and legislation that make it hard to operate
No trustworthiness no deal	No restrictions in the asset
No more secure than a mortgage	No tax exportation but slightly different for different countries
Leveraged lease, the lessor has no security to receive money if there are defaults	

Table 4. Lay out of the incongruences related to advantages and disadvantages



4. FINANCE LEASE IN-DEPTH

In order to give more meaning to the current topic, there are several areas that have to be discussed and explained. It can be defined as a three step process that implies the whole macro situation of the Tax Finance Lease (model just applied in Spain) :

First of all, it can be considered the accelerated amortization, which basically is the action of paying off of debt with fixed payments accordingly scheduled regarding a tangible or non-tangible asset (a ship for example is a tangible asset) within a short timeline.

Second of all, the Tonnage Tax is a model used after the asset is already paid off so the owners of the latter can benefit even more (profits) through taxes and fiscal/legal voids (further information will be provided below with remarks).

Last but not least, there is also an important figure mentioned previously that plays a higher role compared to the other parts that take place in this affair- that is the EIG (Economic Interest Grouping).

4.1 Accelerated Amortization

Basically the Spanish Tax Lease involves transactions between a bank, a shipyard and a shipping company (financial entity/ EIG, seller/lessor, buyer/lessee) that are carried out by means of *ad hoc* and operates within the Spanish taxes field.

Therefore, in this situation the shipowner has the free will to have built a vessel with 20/30% rebate on the price. However, this is not possible if the shipping company does not obtain the ship through an economic interest grouping. The latter provides an environment where they get tax benefits and part of them go to the shipping company in the form of a rebate whilst EIG keeps the rest of these benefits.



Putting into better words, the EIG leases a vessel from a leasing company from the date it starts to be built. Then the EIG charters out the vessel to the shipping company and then it is up and running .

The aforementioned benefits that comes from the tax system implied, can be deducted into two stages where the EIG collects them.

First off, they operate within a normal corporate tax system where it comes to play the accelerated depreciation of the asset that leads to huge tax losses for the investors part. Moreover, within these considerations there will be increased tax payments due to the fact that the vessel can no longer be depreciated – so no declaration of taxes has to be performed- plus EIG's transparency heads to a shift paradigm where there will be profits for the investors

For a better understanding, let it be considered the income statement or P&L where it is shown the expenses and revenues that a company is experiencing . So if considered a plain and simple example of deduction from this case , it would be as follows:

P&L : REVENUES , EXPENSES , AMORTIZATION

If revenues are kept steadily growing or just maintaining its value , then expenses are also steadily and finally amortization is the factor that goes up and down, that is the one which affects taxes thus benefits.

If amortization goes down (the quantity that is being amortized) then the company will experiment somehow major benefits (adding revenues and subtracting expenses). Hence, the taxes will slightly be lower.

If considered the opposite framework, where amortization goes up –known as accelerated amortization- will lead to less benefits throughout a period of years .



But the big why explains itself. If you pay out the amortization of the asset faster than what normally would take (on a normal amortization), that will leave the equation with only two factors- revenues and expenses- and ultimately leads to benefits for the investors.

Once this stage 1 is finished, understood as the operation where the EIG will no longer own the vessel because of full depreciation has been done (thus no further need to own it)

Switching from stage 1 to stage 2 where the aim is to obtain benefits from Tonnage Tax (TT) which is a system of income taxation that evokes full exemption of the capital gains from selling the vessel. However switching to the TT system is not mandatory, and if not applied the parties would have to pay more taxes even so.

However there are several restraints where, considering that the lessor will include the portion of the payments as a tax-deductible expenditure, will absolutely not surpass a certain value (coefficient of maximum depreciation of the asset times the amount deducted from payments). Holding onto the premise formentioned, normally a standard depreciation takes or is spread over the course of 10 years where it is deducted a 10%, but no the accelerated depreciation which aims at a 20-30% per year resulting a 3-5 years process.

Concerning now the activity of EIG's, they have a separate legal background where an application for both methods of accelerated depreciation and gross tonnage can be filled up. If they get passed by the legal requirements under Spanish law, the rules provided by Articles 124-128 TRLIS will be applied. EIG's being considered as a financial entity or an investing personality translates ultimately to a tax transparency where the possible losses may be passed to the investors , who will outweigh them thus reduce the tax charge.

4.2 Tonnage Tax System

System that was implemented in the Spanish legislation since 2002 that gives an alternative for the calculation of tax deduction for shipping companies instead of giving their P&L's. It is necessary to highlight that the way of proceeding is subject to only certain transport activities for a maximum period of 10 years. The tax deduction calculations are laid out as it follows.

Net registered tonnage	Daily amount per 100 tonnes (EUR)
From 0 to 1 000	0,90
From 1 001 to 10 000	0,70
From 10 001 to 25 000	0,40
Over 25 001	0,20

Table 5. Tax Tonnage System

Source: Article CP137/06 Eur-Lex

When the transfer from normal taxation system to the Tonnage Tax system occurs, special rules shall be applied to the vessel (whether it is new or second-handed)

- Within the first year that TT is applied non-distributable reserves equal to the difference between normal market value and net accounting value must be set aside in the annual report.
- That positive reserve between tax and accounting depreciation has to be added to the TT taxable base don the Article 125.



4.3 Analysis of the situation

The European Commission acted accordingly and took a glimpse at the current situation back then of the TSL (Tax Lease System). They concluded several reasons why it shouldn't be operating under those conditions thus a slightly modification and regulation were necessarily to happen⁽⁴⁾ :

- The accelerated depreciation of leased assets (measure No 1) could constitute State aid, but would constitute existing aid in any case because it was implemented before accession. Consequently, the formal investigation procedure was not opened in respect of this measure.
- The early depreciation of leased assets (measure No 2) could constitute State aid as it provides a selective advantage in view of the vague conditions established by the Spanish legislation and the discretionary powers exercised by the Spanish tax administration in interpreting these conditions. This measure, which came into force in 2002⁽²⁷⁾, was regarded as unlawful and possibly incompatible State aid.
- The EIG status (measure No 3) was not identified as potential State aid. The formal investigation procedure was not opened in respect of this measure.
- The TT system (measure No 4) was authorised by the Commission as compatible State aid in 2002. The compatibility of the TT system as approved was not questioned in Decision C(2011) 4494 final. By virtue of the authorisation granted by the Commission, this measure should in any case be regarded as existing aid.
- The Commission questioned the possibility given to certain undertakings, such as the EIGs involved in STL operations, of benefiting from the TT system where their activities are limited to renting or leasing out vessels on a bareboat basis. The Commission considered that these undertakings were not active in the sector of maritime



transport of goods or passengers as defined in Council Regulation (EEC) No 4055/86 ⁽²⁸⁾ and in Council Regulation (EEC) No 3577/92 ⁽²⁹⁾, but rather in the sector of financial investment and the renting or leasing of goods. The Commission noted that their eligibility for the Spanish TT system was never notified to or authorised by the Commission.

- The tax exemption for capital gains (measure No 5) resulting from the implementing measures of the TT system (Article 50(3) RIS) and presented by the Spanish authorities as part of the authorised TT system was regarded as an additional measure falling outside the scope of the authorisation granted by the Commission in 2002. This measure was also regarded as unlawful and possibly incompatible aid.

Besides the complaints or the unequivocal reasons that the Commission gave, Spain did not wait and some parties raised against the resolution given by the first entity.

The least to say that Spanish State considered that the investigation had been initiated without permission with its government, thus would have been considered an infringement in the administrative procedure. Moreover, they considered that those who took place in this way of financing were absolutely free to choose the cheapest way to obtain an asset, hence Spanish State shouldn't be considering itself accountable for the advantages that come directly and acquire the taxpayers.

(4) Reasons given in the article found in Annex A Point 3



Last but not least, it is necessary to give explicit emphasis to the fact that this type of systems are created throughout the current framework due to competence from other countries that may have better characteristics that attract more investors and buyers. Bearing with that idea in mind, China is one of those countries which plays an important role due to its prices deduced from its lower costs of workforce, taxes, fares and other aspects.

However several countries from Europe are trying to fight back with witty strategies that will tackle the dominance from leading power

5 .FINANCE & SHIPPING ENTITIES IN THE SHIP INDUSTRY

The aim of this chapter is to make a full disclosure of which companies do make an impact in this industry of shipping. There will be mentioned several of them , acting as the renown lessor previously remarked.

There is also going to be a highlight of the company Global Ship Lease, where information will be shared directly from the public documents they already have in their website. Some of the traits that will be treated are: examples of taxation, global generic information about marketing differentiation, financing, off- balance sheets and so on.

The world's best 10 international container leasing for the 20 foot equivalent unit (TEU) – which is an unit inexact of cargo unit usually used to describe the capacity of container ships with a determined size that fluctuates between 1,30-2,90 and 2,59m of length and height respectively-.

- **Triton Container / TAL International**

4.550.00 Capacity and has a market share of 25,2%

- **Textainer Group**

Capacity and has a market share of 17,9%



- **HNA/ Bohai Group**
 - 2.177.500 and has a market share of 12,1%
- **Florens Container**
 - 1.895.000 Capacity and has a market share of 10,5%
- **SeaCube Container Leasing**
 - 1.237.500 Capacity and has a market share of 6,9%
- **CAI International**
 - 1.165.000 Capacity and has a market share of 6.5%
- **Dong Fang International**
 - 755.000 Capacity and has a market share of 4.2%
- **Beacon Intermodal Leasing**
 - 660.000 Capacity and has a market share of 3.7%
- **Touax Container Solutions**
 - 630.000 Capacity and has a market share of 3,7%

From now on, the attention is going to be focused around the company Global Ship Lease (GPS) that was mentioned priorly. GPS is a company that began shipping in the 1950's and its main purpose is to aim at the container market niche. Accordingly, this business is a containership lessor focused on providing time chartered vessels (charter market).

As stated above and in its website , leases are structured as time charters that manage to operate costs of the vessels , except running costs of the ship that goes to the lessee. Normally there are time charters that aim for a lower duration contract of 12 months or less or actually longer periods extended up to 5 years or more. In the figure provided below it can be seen the current customers they have. One of the guidelines that rule the company is to be aware



of keeping the good customers and focusin on normal and good flow of income rather than random.

Vessel Name	Size (TEU)	Year Built	Delivery to GSL
CMA CGM Matisse	2,262	1999	December 2007
CMA CGM Utrillo	2,262	1999	December 2007
Delmas Keta	2,207	2003	December 2007
GSL Julie	2,207	2002	December 2007
Kumasi	2,207	2002	December 2007
Marie Delmas	2,207	2002	December 2007
CMA CGM La Tour	2,272	2001	December 2007
CMA CGM Manet	2,272	2001	December 2007
CMA CGM Alcazar	5,089	2007	January 2008
CMA CGM Chateau d'If	5,089	2007	January 2008
CMA CGM Sambhar	4,045	2006	December 2008
CMA CGM Jamaica	4,298	2006	December 2008
CMA CGM America	4,045	2006	December 2008
CMA CGM Thalassa	11,040	2008	December 2008
CMA CGM Bertioz	6,621	2001	August 2009
GSL Tianjin	8,063	2005	October 2014
OOCL Qingdao	8,063	2004	March 2015
GSL Ningbo	8,063	2004	September 2015
GSL Valerie	2,824	2005	June 2018

Figure 10. Current fleet of the company Global Ship Lease

Source: Globalshiplease.com

Vessel Name	Capacity in TEUs (1)	Year Built	Charterer	Earliest Charter Expiry (2)	Daily Charter Rate \$
CMA CGM Matisse	2,262	1999	CMA CGM	September 21, 2019	15300
CMA CGM Utrillo	2,262	1999	CMA CGM	September 11, 2019	15300
Delmas Keta	2,207	2003	CMA CGM	August 6, 2018	7800
GSL Julie	2,207	2002	CMA CGM	January 20, 2019	7800
Kumasi	2,207	2002	CMA CGM	October 2, 2020	9800
Marie Delmas	2,207	2002	CMA CGM	October 2, 2020	9800
CMA CGM La Tour	2,272	2001	CMA CGM	September 20, 2019	15300
CMA CGM Manet	2,272	2001	CMA CGM	September 7, 2019	15300
CMA CGM Alcazar	5,089	2007	CMA CGM	October 18, 2020	33750
CMA CGM Chateau d'If	5,089	2007	CMA CGM	October 11, 2020	33750
CMA CGM Thalassa	11,040	2008	CMA CGM	October 1, 2025	47200
CMA CGM Jamaica	4,298	2006	CMA CGM	September 17, 2022	25350
CMA CGM Sambhar	4,045	2006	CMA CGM	September 16, 2022	25350
CMA CGM America	4,045	2006	CMA CGM	September 19, 2022	25350
CMA CGM Bertioz	6,621	2001	CMA CGM	May 28, 2021	34000
GSL Tianjin	8,063	2005	CMA CGM	September 26, 2018	11900
OOCL Qingdao	8,063	2004	OOCL	January 1, 2019	14000
GSL Ningbo	8,063	2004	Maersk	November 21, 2018	11500 ⁽³⁾
GSL Valerie	2,824	2005	CMA CGM	June 1, 2019	9000



Figure 11. Charters provided by the company Global Ship Lease

Source: Globalshiplease.com

It has to be mentioned the socking fact that in their guidelines is stated that they only aim for short period of times charters, despite having long contracts (see figure 12 earliest charter expiry).

Next up, is their current financial data:

	2017	2016	2015	2014	2013
Statement of Income					
Operating revenues:					
Time charter revenue	\$ 159.0	\$ 166.5	\$ 164.9	\$ 138.6	\$ 143.2
Operating expenses:					
Vessel expenses	(43.5)	(45.7)	(50.1)	(48.8)	(46.0)
Depreciation	(38.0)	(42.8)	(44.9)	(41.1)	(40.4)
General and administrative	(5.3)	(6.3)	(6.5)	(7.0)	(6.0)
Impairment charge (1)	(87.6)	(92.4)	(44.7)	—	—
Other operating income	0.1	0.2	0.5	0.5	0.4
Total operating expenses	(174.3)	(187.0)	(145.7)	(96.3)	(92.1)
Operating (loss) income	(15.3)	(20.5)	19.3	42.3	51.2
Non-operating income (expense)					
Interest income	0.5	0.2	0.1	0.1	—
Interest expense	(59.4)	(44.8)	(48.2)	(43.9)	(18.8)
Gain on redemption of Series A preferred shares	—	—	—	8.6	—
Realized (loss) on interest rate derivatives (2)	—	—	—	(2.8)	(14.0)
Unrealized gain on interest rate derivatives (2)	—	—	—	1.9	14.3
(Loss) income before income taxes	(74.2)	(65.1)	(28.8)	6.2	32.6
Taxes on income	0.0	0.0	0.0	(0.1)	(0.1)
Net (loss) income	(74.3)	(65.1)	(28.9)	6.1	32.5
Earnings allocated to Series B preferred shares	(3.1)	(3.1)	(3.1)	(1.1)	—
Net (loss) income available to common shareholders	(77.3)	(68.2)	(31.9)	\$ 5.0	\$ 32.5
Net (loss) income per Class A common share in \$					
Basic and diluted	(1.61)	(1.42)	(0.67)	0.10	0.68
Weighted average number of Class A common shares outstanding					
Basic in millions	48.0	47.9	47.8	47.7	47.6
Diluted in millions	48.0	47.9	47.8	47.8	47.8
Net income per Class B common share in \$					
Basic and diluted	Nil	Nil	Nil	Nil	Nil
Weighted average number of Class B common shares outstanding					
Basic and diluted in millions	7.4	7.4	7.4	7.4	7.4
Dividend per Class A common share in \$	—	—	0.20	—	—
Statement of cash flow					
Net cash from Operating Activities	\$ 57.8	\$ 71.2	\$ 62.3	\$ 60.9	\$ 74.3
Net cash (used in) Investing Activities	(4.9)	(6.9)	(101.2)	(80.1)	(16.6)
Net cash (used in) provided by Financing Activities	(33.9)	(63.6)	59.2	27.9	(59.3)
Balance sheet data (at period end)					
Total current assets	77.4	56.9	57.6	36.7	37.0
Total vessels	597.8	719.1	846.9	836.5	817.9
Total assets (2)	675.2	776.3	904.9	873.7	855.0
Debt (current and non-current portion) (2)	398.5	419.9	478.1	401.9	363.1
Preferred shares (3)	—	—	—	—	45.0
Class A and B common stock	0.6	0.6	0.5	0.5	0.5
Stockholders' equity (4)	251.6	328.9	395.8	438.1	399.5
Other data (time charter business)					
Number of vessels in operation at period end	18	18	18	18	17
Ownership days (5)	6,570	6,588	6,893	6,270	6,205
Utilization (6)	98.4%	98.4%	99.6%	98.0%	99.5%

Figure 12. Financial data from 2013 until 2017

Source: Global Ship Lease Annual Reports 2017 Form 20-F

In their current annual report they stated (E. Off-Balance Sheet Arrangements) that do not have any off-balance sheet arrangements going on nor is going to be that way and it is not going to cause any future effect on their financial conditions. From that, it can be deducted that they only operate through finance leasing. However, as stated many times in prior chapters they can be using the finance leasing method in disguise as an operating leasing for several reasons that may benefit them.

Another feature important to mention is the taxation applied in the shipping industry. In the annual report from the company in hand , they present all the information discussing this topic. Regarding the taxation of operating income is subject to U.S federal income taxation under one of the following tax regimes: the 4% gross basis tax or the net basis tax and branch profits tax.

The 4% gross basis tax

For foreign corporations not engaged in a U.S. trade or business, the United States imposes a 4% U.S. federal income tax (without allowance of any deductions) on the corporation's U.S. source gross transportation income. For this purpose, transportation income includes income from the use, hiring or leasing of a vessel, or the performance of services directly related to the use of a vessel (and thus includes time charter and bareboat charter income). The U.S. source portion of transportation income includes 50% of the income attributable to voyages that begin or end (but not both) in the United States. Generally, no amount of the income from voyages that begin and end outside the United States is treated as U.S. source, and consequently none of the transportation income attributable to such voyages is subject to this 4% tax. Although the entire amount of transportation income from voyages that begin and end in the United States would be U.S. source, we do not expect to have any transportation income from voyages that begin and end in the United States.

The net basis tax and branch profits tax

We do not expect to engage in any activities in the United States or otherwise have a fixed place of business in the United States. Nonetheless, if this situation were to change or were we to be treated as engaged in a U.S. trade or business, all or a portion of our taxable income, including gains from the sale of vessels, could be treated as effectively connected with the conduct of this U.S. trade or business, or effectively connected income. Any effectively connected income would be subject to U.S. federal corporate income tax (with the highest statutory rate being 21% from January 1, 2018, previously 35%). In addition, an additional 30% branch profits tax would be imposed on us at such time as our after-tax effectively connected income is viewed as having been repatriated to our offshore office. The 4% gross basis tax described above is inapplicable to income that is treated as effectively connected income.

The Section 883 exemption

Both the 4% gross basis tax and the net basis and branch profits taxes described above are inapplicable to U.S. source transportation income that qualifies for exemption under Section 883 of the Code. To qualify for the Section 883 exemption, a foreign corporation must, among other things:

- be organized in a jurisdiction outside the United States that grants an equivalent exemption from tax to corporations organized in the United States, which we call an Equivalent Exemption;
- satisfy one of the following three ownership tests (discussed in more detail below): (1) the more than 50% ownership test, or 50% Ownership Test, (2) the controlled foreign corporation test, or CFC Test or (3) the "Publicly Traded Test"; and
- meet certain substantiation, reporting and other requirements (that include the filing of U.S. income tax returns).

We are organized under the laws of the Marshall Islands. Each of the vessels in the fleet is owned by a separate wholly owned subsidiary organized either in the Marshall Islands, Cyprus or Hong Kong. The U.S. Treasury Department recognizes the Marshall Islands, Cyprus and Hong Kong as jurisdictions that grant an Equivalent Exemption; therefore, we should meet the first requirement for the Section 883 exemption. Additionally, we intend to comply with the substantiation, reporting and other requirements that are applicable under Section 883 of the Code. As a result, qualification for the Section 883 exemption will turn primarily on our ability to satisfy the second requirement enumerated above.



(1) The 50% Ownership Test

In order to satisfy the 50% Ownership Test, a non-U.S. corporation must be able to substantiate that more than 50% of the value of its stock is owned, directly or indirectly, by "qualified shareholders." For this purpose, qualified shareholders include: (1) individuals who are residents (as defined in the regulations promulgated under Section 883 of the Code, or Section 883 Regulations) of countries, other than the United States, that grant an Equivalent Exemption, (2) non-U.S. corporations that meet the Publicly Traded Test of the Section 883 Regulations and are organized in countries that grant an Equivalent Exemption, or (3) certain foreign governments, non-profit organizations, and certain beneficiaries of foreign pension funds. A corporation claiming the Section 883 exemption based on the 50% Ownership Test must obtain all the facts necessary to satisfy the IRS that the 50% Ownership Test has been satisfied (as detailed in the Section 883 Regulations). We believe that we satisfied the 50% Ownership Test, up to and including 2008, due to being a wholly owned subsidiary of CMA CGM until the Merger on August 14, 2008, but believe that we currently may not be able to satisfy the 50% Ownership Test due to our lack of knowledge of the direct and indirect owners of entities which own our Class A common shares.

Figure 13. Taxation policies of the Global Ship Lease I

Source: Global Ship Lease Annual Reports 2017 Form 20-F

(2) The CFC Test

The CFC Test requires that the non-U.S. corporation be treated as a controlled foreign corporation, or CFC, for U.S. federal income tax purposes. We believe that we are not a CFC but cannot predict whether we will become a CFC, and satisfaction of the CFC definitional test is outside of our control.

(3) The Publicly Traded Test

The Publicly Traded Test requires that one or more classes of equity representing more than 50% of the voting power and value in a non-U.S. corporation be "primarily and regularly traded" on an established securities market either in the United States or in a foreign country that grants an Equivalent Exemption.

The Section 883 Regulations provide, in pertinent part, that stock of a non-U.S. corporation will be considered to be "primarily traded" on an established securities market in a given country if the number of shares of each class of stock that are traded during any taxable year on all established securities markets in that country exceeds the number of shares in each such class that are traded during that year on established securities markets in any other single country. Our Class A common shares are listed on the NYSE and are not listed on any other securities exchange. Therefore, our Class A common shares should be treated as primarily traded on an established securities market in the United States. Moreover, the Class A common shares represent more than 50% of both the voting power and value of all classes of our shares.

The Section 883 Regulations also generally provide that stock will be considered to be "regularly traded" on an established securities market if one or more classes of stock in the corporation representing in the aggregate more than 50% of the total combined voting power and value of all classes of stock of the corporation are listed on an established securities market during the taxable year. However, even if a class of shares is so listed, it is not treated as regularly traded under the Section 883 Regulations unless (1) trades are made in the shares on the established securities market, other than in minimal quantities, on at least 60 days during the taxable year (or 1/6 of the days in a short taxable year); and (2) the aggregate number of shares traded on the established securities market during the taxable year is at least 10% of the average number of outstanding shares of that class during that year (as appropriately adjusted in the case of a short taxable year). Even if these trading frequency and trading volume tests are not satisfied with respect to the Class A common shares, however, the Section 883 Regulations provide that such tests will be deemed satisfied if the Class A common shares are regularly quoted by dealers making a market in such Class A common shares. While we anticipate that these trading frequency and trading volume tests will be satisfied each year, satisfaction of these requirements is outside of our control and, hence, no assurances can be provided that we will satisfy the Publicly Traded Test each year.

In addition, even if the "primarily and regularly traded" tests described above are satisfied, a class of stock will not be treated as primarily and regularly traded on an established securities market if, during more than half the number of days during the taxable year, one or more shareholders holding, directly or indirectly, at least 5% of the vote and value of that class of stock, or 5% Shareholders, own, in the aggregate, 50% or more of the vote and value of that class of stock. This is referred to as the 5% Override Rule. In performing the analysis, we are entitled to rely on current Schedule 13D and 13G filings with the SEC to identify our 5% Shareholders, without having to make any independent investigation to determine the identity of the 5% Shareholder. In the event the 5% Override Rule is triggered, the Section 883 Regulations provide that the 5% Override Rule will nevertheless not apply if the company can establish that among the closely-held group of 5% Shareholders, sufficient shares are owned by 5% Shareholders that are considered to be "qualified shareholders," as defined above, to preclude non-qualified 5% Shareholders in the closely-held group from owning 50% or more of the total value of the relevant class of stock held by 5% Shareholders for more than half the number of days during the taxable year.

Based on information that we have as to our shareholders and other matters, we believed that we qualified for the Section 883 exemption for 2009 through 2017 under the Publicly Traded Test, and expect to so qualify for 2018. However, it is possible that our ownership may change such that qualified shareholders will not own, in the aggregate, a sufficient amount of our stock for more than half the days during the taxable year to preclude the non-qualifying 5% Shareholders from owning 50% or more of the total value of our stock held by the 5% Shareholders group, causing the 5% Override Rule to apply. If the 5% Override Rule applies, we would fail the Publicly Traded Test, and may fail to qualify for the Section 883 exemption.

Such an ownership change, and certain other requirements for our stock to be treated as primarily and regularly traded on an established securities market, are outside of our control and, as a result, no assurances can be provided that our stock will be so treated for any year. Moreover, since the availability of the Section 883 exemption depends on other matters over which we have no control, we can give no assurances that we will, or will continue to, qualify for the Section 883 exemption.



If we were not to qualify for the Section 883 exemption in any year, the U.S. income taxes that become payable could have a negative effect on our business, and could result in decreased earnings available for distribution to our shareholders. However, under the charter agreements, CMA CGM has agreed to provide reimbursement for any such taxes.

United States taxation of gain on sale of vessels

If we qualify for the Section 883 exemption, then gain from the sale of any vessel may be exempt from tax under Section 883. Even if such gain is not exempt from tax under Section 883, we will not be subject to U.S. federal income taxation with respect to such gain, assuming that we are not, and have never been, engaged in a U.S. trade or business. Under certain circumstances, if we are so engaged, gain on sale of vessels could be subject to U.S. federal income tax.

Possibility of taxation as a U.S. corporation

Section 7874 of the Code provides that a foreign corporation that acquires substantially all the properties of a U.S. corporation is generally treated as though it were a U.S. corporation for U.S. federal income tax purposes if, after the acquisition, (1) at least 80% (by vote or value) of the stock of the foreign corporation is owned by former shareholders of the U.S. corporation by reason of owning stock in the U.S. corporation, and (2) the foreign corporation's expanded affiliate group does not have substantial business activities in the foreign corporation's jurisdiction of organization. Although we believe that this rule should not apply to us in the context of the Merger, there is no definitive legal authority applying the principles of Section 7874 of the Code and, therefore, there can be no assurance that the IRS would not seek to challenge such a position, or that such a challenge would not be successful.

If we were to be treated as a U.S. corporation, our net income would be subject to U.S. federal corporate income tax with the highest statutory rate being 21% from January 1, 2018, previously 35%. The imposition of this tax would likely have a negative effect on our business, financial condition and results of operations.

Figure 14. Taxation applied to the company Global Ship Lease
Source: Global Ship Lease Annual Reports 2017 Form 20-F



6. RESEARCH & JURIDIC BACKGROUND

6.1 Introduction

Current tax financing lease in the shipping business has been wobbling due to the review of the sentence officially declared by the European Commission back then in 2013. In 2002, the lax leasing system was introduced to Spain, a system which basically aims at the reduction of taxes that have to be paid.

The main problem arises when back then in early 2000's this new system that was implemented, was not notified to the EU Commission at the time.

Whilst not being notified accordingly, that regimen was set up as an illegal procedure that violated the 108.3 article. The whole thing were on and on without proper action from the President's perspective and the issue was not dealt properly. What happened those years was that the ships turned out between 20-30% less expensive, where the savvy investors gained a lot of profitability from those ventures.

Adding insult to injury, more businesses joined the adventure of this venue of "no taxation whatsoever" that made them gain piles of cash (firms that didn't have to do anything related to the maritime business such Banco Santander, Banco Popular, Ikea and Inditex).

As a result, the outcome was a sea of mayhem where the government ceased to recollect over (3.000 Millions of Euros) because those firms were not declaring their taxes.

Knowing that in order to have a full tax lease it is needed the lessor (financing entity), the lessee (charter that operates the vessel) and other bigger company or entity that will purchase the whole ship. The latter will receive a benefit of "tax avoidance" that will save about 10%.



Once this operation is up and running, there will be a contract where the EIG (Economic Interest Companies) rent the ship to the lessor whose payments will be on until the delivery of it. Fast forward a few years, it is 2011 and there are several lawsuits from the EU Commission to its new system of leasing. 95% of the transactions settled down within a 10 years window happened in Spain.

However, The European Court of Justice (ECJ) on 25th July of 2018 ruled that the Spanish tax lease system constitutes State aid in case C-128/16 P overturning a ruling of the EU General Court. After all, the issue with accelerated amortization - which is a key component of tax leasing that last 3-5 years instead of a normal amortization of 10) - was fixed and the EIG was no longer integrated by entities that had to do nothing with the maritime sector (more information can be found in Annex A with an abstract of the resolution of the Commission).

To sum up the tax leasing was just and still is a juridic and financial structure *ad hoc* organized by a bank and run by other entities that through signatures and complex processes get their benefits.

6.2 Future of Tax Lease

Bearing in mind with the law problems incurred from *bad praxis* of Spanish firms, adding up more laws that will restrict in the foreseeable future the practice of leasing in the shipping industry, a possible recession of the economy and many other factors is seemingly obvious that this market will face a great milestone in terms of figuring out how to adapt to the constant changing landscape.

The ECB (European Central Bank) has been carrying out an exhaustive analysis in-depth to discover possible defaults and possible mischiefs carried away by Spanish institutions.



Whilst European banks are having a hard time trying to manage their investments and giving loans to these companies in the industry, Chinese banks and leasing companies have been stepping their game up into many areas. China did enter the market due to its ferocious plan that also generated plenty of work for its shipyards . Because of that the industry has been changing a lot in the past decade and affecting other areas of the globe, resulting in the adaptation from European countries with the purpose of chasing the scope for traditional ship (small/medium markets).

There is also the factor that can not be under control of the fluctuation in oil prices that for sure makes an impact in the of transportation, thus the price of agreements (leases) should be modified accordingly if so. Needless to say that the market, despite being in a fluctuating state it is rather going downhill because of economy downfall.

Meanwhile the companies will adapt to which situation may pop up out of nowhere and will seek different sources of financing (equity, debt...).

Future owners of ships will have to face several crucial innovations which will lead to re-think their proposition and strategies, plus facing external constraints.

Bluntly, the task of mapping out a certain forecast of the lease in the shipping industry is far from achievable and not practical by any means. Even though, it is fair to say that the world needs the vessels to send all over the world the goods and necessities. Hence, it is imposible that the market could even experiment a huge bump in the predictable future.

However after the resolution that the European Comission gave, it can be inferred that regarding measures related to the Article 115 the activities in the internal market are incompatible except to the extent where financial entities and companies operate under Maritime Guidelines. Moreover, the Spanish government must have put to an end the unlawfully operational scheme related to tax evasion (meaning that had to be modified back then in 2013)



Now, the STL (Spanish Tax Lease) scheme , as it is clarified in its own name, it only implies the Spanish market. Further information and resolution to the issue in hands, has nothing to do within the reaches of the relator.

Therefore it can be concluded that is left to be studied and check future updates related to the topic.

7. ENVIRONMENTAL IMPACT

There is no cause such as threats or impacts known coming strictly and directly derived from the lease finance, thus it will be made an assumption based on sources and prior knowledge to this topic. However something important to notice is that newer ships tend to pollute less, so this type of financing could be seen as a helpful tool.

It can be understood as an indirect cause because of finance participation to the shipping industry as it states:

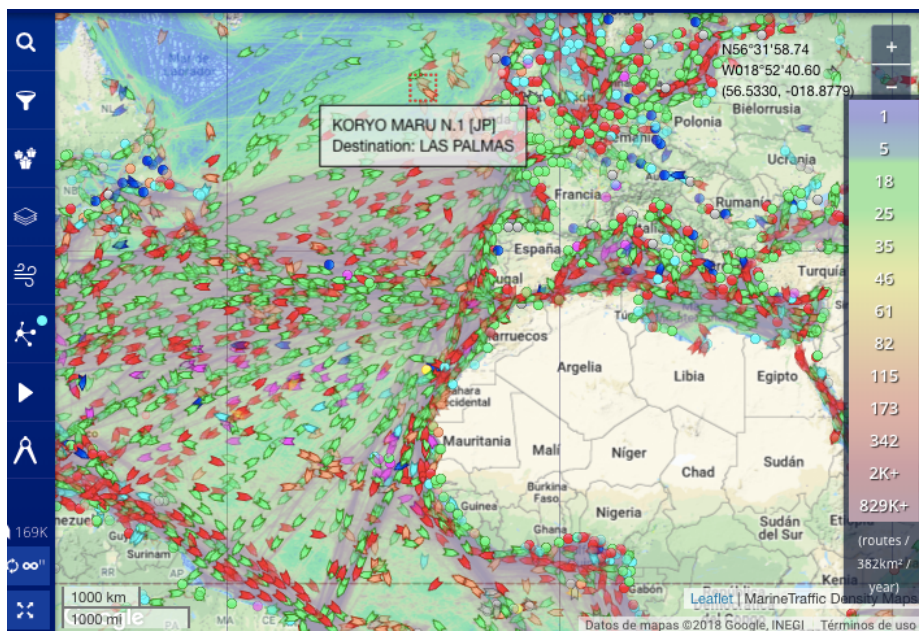
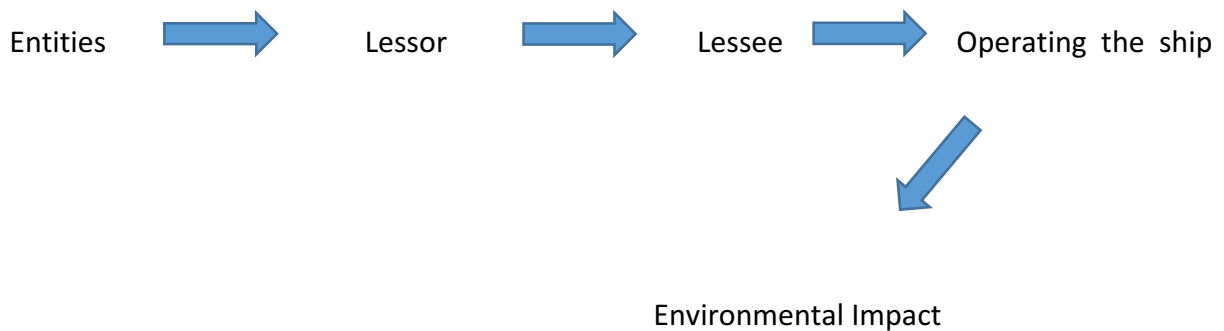


Figure 15. Current marine traffic (to the day it was searched)

Source: marinetraffic.com



The figure displayed previously is intended to foreground the unavoidable deed of the huge amount of trips that ships perform along the year. That means that as long the number of ships keeps increasing (through several methods of finance) , it will impact inevitably the environment and cause the detriment of our planet

The impact from shipping activities comes from greenhouse gas emissions, acoustic and oil pollution. Other negative impacts are the sound pollution, the collisions against the animals in /on the sea, and waters derived from the ships (sewage and cleaning).

One of several institutions that deal with these issues is the International Maritime Organization (IMO). An international meeting that took place in Oslo back in 2008, discussed the topics such as techniques to reduce CO2 emissions and the layout to follow.

The MARPOL 73/78 is one of the most important international marine environmental conventions. Actually was developed by the IMO which battle the most important threats to this day, which goal is to preserve the marine environment in an attempt to completely erase the pollution by oil and other substances.

It is composed by 6 Annexes according to several causes and deals with the regulations for each one of it

- Annex I: Prevention of Pollution by oil & oily water
- Annex II: Control of pollution by noxious liquid in bulk
- Annex III: Prevention of pollution by harmful substances carried by sea in packaged form
- Annex IV: Pollution by sewage from ships
- Annex V: Pollution by garbage from ships
- Annex VI: Prevention of air pollution from ships

However, despite being applied to the vast majority of the operating vessels, there are still some issues. When a ship is visiting a country different from its flag, the first one can conduct an examination to verify ship's compliance.



When occurs and incident and jurisdiction cannot be determined, then comes into pay the accordance with MARPOL.

The OPA (Oil Pollution Act of 1990) it also works as a law enforcement in order to keep up with oil spills and other criterias. It works “against” those vessels that incurred into a detrimental situation by forcing them to assing liabilities and pay for the cost of cleanup with specific procedures. Structure is given below

- Title I. Oil Pollution Liability and Compensation
- Title II. Conforming Amendments
- Title III. International Oil Pollution Prevention and Removal
- Title IV. Preventio and Removal
- Title V. Prince William Sound Provisions
- Title VI. Miscellaneous
- Title VII. Oil Pollution Research and Development Program
- Title VII. Trans-Alaska Pipeline System
- Title IX. Amdendments to Oil Spill Liability Trust Fund, etc

As regarding the topic of environment, there is obvisouly further information provided from different sources, but since has to do nothing with finance leasing, will not be trated as the whole main topic. Therefore there is only stated the essential with clarifications of the main threats. Further discussion will be in the Conclusions chapter.



8. CONCLUSIONS

The main point of this final thesis was to analyze, synthesize information and evaluate the current framework of operation of the finance leasing.

Given the fact that the concept of leasing comes from many years ago, implemented by some countries for its own benefits, still is a modern concept developing constantly.

Managing to acquire an asset in business requires all types of financing and the shipping industry is also included in this feature. Needless to say it is considered a tricky and complex system composed by several traits that constitutes a given structure belonging to this sector.

Out of all the methods discovered and explained throughout all the length of this thesis , it has been shown the characteristics and benefits from each one. There is no magical method that will give a situation of 100% of advantages. Deducting it can be stated that the tax finance leasing is still to this day one of the most used ones due to its practicality overall.

However , equity and debt methods are used more often than leasing, but secures its part in the industry , plus the leveraged finance leases take a small part due to its complexity regarding legal issues.

All parts that may take part in the venture of financing or running a ship (lessor, lessee, financing entity) should be aware of the regimes that exists in each country and the legal framework that will determine which method do they want to embark themselves on with its rights and rewards. Accordingly, from studies and sources on this topic have shown that finance leasing is beneficial in terms of taxes and financing for the lessee part.



The future of tax finance leasing is basically uncertain thus there can not be made assumptions based on the current information that has been laid out on previous chapters. It will only depend on whether the finance leases adapt to the new market landscape and both parts cooperate endlessly to seek better results from it.

From the environmental perspective, it can be reassured that there is no direct impact whatsoever coming straight from the tax leasing phenomena, thus there is no sense to make such a declaration in regarding this topic. However, the environmental impact is still a thing happening due to the operations performed by the ships yearly. It is seemingly alarming that if there is no awareness and no further intention of acting upon this issue, it can be confirmed that the environment will be threatened even more than what it is now.



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ANNEX A: Abstract from Article CP137/06

COMMISSION DECISION

of 17 July 2013

on the aid scheme SA.21233 C/11 (ex NN/11, ex CP 137/06) implemented by Spain Tax scheme applicable to certain finance lease agreements also known as the Spanish Tax Lease System

(notified under document C(2013) 4426)

(Only the Spanish text is authentic)

(Text with EEA relevance)

(2014/200/EU)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above ⁽¹⁾ and having regard to their comments,

Whereas:

1. PROCEDURE

(1)According to several complaints registered with the Commission since May 2006, the Spanish scheme applicable to shipping companies since 2002 (Spanish Tax Lease System) allowed maritime transport companies to buy ships in Spain at a 20-30 % rebate. In particular, two national federations of shipyards and one individual shipyard complained that this scheme resulted in the loss of shipbuilding contracts from their members to Spanish shipyards. On 13 July 2010, shipbuilding associations of seven European countries together signed a petition against the so-called Spanish Tax Lease system (hereinafter 'STL'). At least one shipping company supported these complaints. In August 2010, a Member of the European Parliament asked a question on the same topic ⁽²⁾.

(2)By letters of 15 September 2006, 30 January 2007, 6 November 2007 and 3 March 2008, the Commission sent Spain requests for information. Spain answered by letters of 16 October 2006, 23 and 27 February 2007, and 11 January and 27 March 2008. At a meeting held on 29 April 2008, the Commission requested additional information which Spain



provided by letter of 17 June 2008. The Commission requested further additional information by letter of 23 September 2008, which Spain provided by letter of 24 October 2008.

- (3) Following new information from complainants, the Commission requested further additional information by letters of 11 January and 25 May 2010. Spain answered by letters of 10 March and 26 July 2010. A meeting with the Spanish authorities took place on 24 January 2011.
- (4) By letter dated 29 June 2011, the Commission informed Spain that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union in respect of the aid.
- (5) By letter dated 2 August 2011, Spain commented on the decision to open formal proceedings.
- (6) The Commission decision to initiate the formal investigation procedure (hereinafter 'Decision C(2011) 4494 final') was published in the *Official Journal of the European Union* ⁽³⁾. The Commission invited interested parties to submit their comments on the measures.
- (7) The Commission received comments from several interested parties. By letters of 23 February, 7 March, 11 July and 29 October 2012, and 12 and 25 February and 22 April 2013, it forwarded them to Spain, which was given the opportunity to react. Its comments were received by letters dated 30 April, 24 May, 9 and 23 July and 14 November 2012, and 25 February, 12 March and 21 May 2013. Spain also submitted additional observations by letters of 3 and 9 October 2012. At their request, the Commission had meetings with Pequeños y Medianos Astilleros en Reconversión (PYMAR) ⁽⁴⁾ on 13 November 2012 and 4 February 2013, and with the Spanish authorities on 6 March 2013.

2. DESCRIPTION OF THE SPANISH TAX LEASE SYSTEM

- (8) The Spanish Tax Lease system is used in transactions involving the building by shipyards (sellers) and the acquisition by maritime shipping companies (buyers) of sea-going vessels and the financing of these transactions by means of an ad hoc legal and financial structure.
- (9) The STL system is based on:
 - an ad hoc legal and financial structure organised by a bank and interposed between the shipping company and the shipyard, respectively the buyer and the seller of a vessel,
 - a complex network of contracts between the different parties,
 - the application of several Spanish tax measures.
- (10) At the Commission's request, the Spanish authorities have confirmed that the STL was used in 273 shipbuilding and acquisition transactions between 1 January 2002 and 30 June 2010, for a total value of EUR 8 727 997 332. The scheme continued to apply until 29 June 2011, when the formal investigation procedure was initiated. Buyers are shipping

companies from all over Europe and beyond. All but one of the transactions (a contract for EUR 6 148 969) involved Spanish shipyards.

2.1. THE STL — LEGAL AND FINANCIAL STRUCTURE

- (11) As stated, an STL operation allows a shipowner to have a new vessel built with a 20-30 % rebate on the price charged by the shipyard. In order to obtain the discounted price (after deducting the rebate), a shipping company must agree not to buy the vessel directly from the shipyard but from an economic interest grouping (EIG) incorporated under Spanish law and set up by a bank.
- (12) The STL structure is a tax planning scheme generally organised by a bank in order to generate tax benefits for investors in a tax transparent EIG and transfer part of these tax benefits to the shipping company in the form of a rebate on the price of the vessel. The rest of the benefits are kept by the investors in the EIG as remuneration for their investment. In addition to the EIG, an STL operation also involves other intermediaries, such as a bank and a leasing company (see chart below).
- (13) In practice, the EIG leases the vessel from a leasing company from the date that it starts to be built. Once it has been built, the EIG charters out the vessel to the shipping company, on a bareboat basis, and the shipping company starts operating the vessel. In any case, the EIG undertakes to buy the vessel at the end of the leasing contract and the shipping company undertakes to buy the vessel at the end of the bareboat charter contract, by means of reciprocal buy and sell option contracts ⁽⁵⁾. The date of exercising the options established by the leasing contract is set a few weeks before the exercise date of the option set by the bareboat charter. Both options are exercised once the EIG comes under the tonnage tax system (for a more detailed description, see Section 2.2.4 Measure 4: Tonnage tax). A framework agreement is signed by the parties involved to make sure that they all agree on the organisation and functioning of the STL structure.
- (14) The transactions that take place between the different participants in the STL operation have been described in more detail in Decision C(2011) 4494 final (Section 2.2) ⁽⁶⁾ on the basis of the examples provided by Spain ⁽⁷⁾.

2.2. THE STL — TAX ASPECTS

- (15) The purpose of the STL scheme described in Section 2.1 above is first to generate the benefits of certain tax measures in favour of the EIG and the investors participating in it, which will then pass on part of those benefits to the shipping company that acquires a new vessel.
- (16) The EIG collects the tax benefits in two stages under two different sets of tax rules. In the first stage, early and accelerated depreciation of the leased vessel is applied within the 'normal' corporate income tax system. This generates heavy tax losses for the EIG. Because of the EIG's tax transparency, these tax losses are deductible from the investors' own revenues pro rata to their shares in the EIG.



- (17) In normal circumstances, the tax savings made by this early and accelerated depreciation of the cost of the vessel should be offset later on by increased tax payments either when the vessel is completely depreciated and no more depreciation costs can be deducted or when the vessel is sold and a capital gain results from the sale ⁽⁸⁾. Because of the EIG's tax transparency, its increased profits in later years would normally be added to the investors' own revenues and would be liable to tax.
- (18) However, in an STL operation, the EIGs do not keep the vessels after full depreciation is achieved. In the second stage, the tax savings resulting from the initial losses transferred to the investors are then safeguarded as a result of the EIG's switchover to the tonnage tax (TT) system of income taxation and the full exemption of the capital gains resulting from the sale of the vessel — shortly after switching to the new system — to the shipping company ⁽⁹⁾. For further details about these two stages, see Decision C(2011) 4494 final (Section 2.3.1).
- (19) According to information available to the Commission ⁽¹⁰⁾, the combined effect of the tax measures used in the STL enables the EIG and its investors to achieve a tax gain of approximately 30 % of the initial gross price of the vessel. Part of this tax gain — initially collected by the EIG/its investors — is kept by the investors (10-15 %) and part of it is passed on to the shipping company (85-90 %), which in the end becomes the owner of the vessel, with a 20 % to 30 % reduction in the initial gross price of the vessel.
- (20) As already stated, STL operations combine different individual — yet interrelated — tax measures in order to generate a tax benefit. The section below briefly describes these measures. For a more detailed description, see Decision C(2011) 4494 final (Section 2.4).

2.2.1. Measure 1 — Accelerated depreciation ⁽¹¹⁾ of leased assets

(Article 115(6) TRLIS)

- (21) In Spain, the tax treatment of a leasing transaction is different from its accounting treatment. Chapter XIII of Royal Legislative Decree 4/2004 of 5 March 2004 approving the consolidated version of the Law on Corporate Tax (TRLIS) ⁽¹²⁾ and Article 49 of Royal Decree 1777/2004 of 30 July 2004 approving the Regulation on Corporate Tax (RIS) ⁽¹³⁾, apply to finance leasing contracts with a minimum duration of two years if they relate to movable property and 10 years if they relate to immovable property or industrial establishments.
- (22) For tax purposes only, the portion of the payments that allows the lessor to recover the cost of the asset ⁽¹⁴⁾ is considered tax-deductible expenditure within certain limits, namely: the amount deducted may not exceed the amount obtained by multiplying the cost of the asset by twice or three times the official coefficient of maximum straight-line depreciation for the type of asset.
- (23) In the case of vessels, the normal straight-line depreciation is spread — for tax purposes — over 10 years (10 % per year). The maximum accelerated depreciation rate for leased assets ranges between 20 % and 30 % per year (from 40 to 60 months). Under Spanish

law, owners of vessels can also depreciate according to the declining balance method ⁽¹⁵⁾ or the sum-of-the-years-digit method (SYD) ⁽¹⁶⁾.

2.2.2. Measure 2: Discretionary application of early depreciation of leased assets

(Articles 115(11) and 48(4) TRLIS and Article 49 RIS)

(24) Under Article 115(6) TRLIS, the accelerated depreciation of the leased asset starts on the date on which the asset becomes operational, i.e. not before the asset is delivered to and starts being used by the lessee. However, pursuant to Article 115(11) TRLIS ⁽¹⁷⁾, the Ministry of Economic Affairs and Finance may, upon formal request by the lessee, determine an earlier starting date for depreciation. In principle, this provision applies, under certain conditions, to all leased assets covered by a leasing contract and eligible for accelerated depreciation.

(25) In fact, Article 115(11) TRLIS imposes two general conditions. First, the new starting date should be determined taking account of ‘the specific characteristics of the contracting or construction period for the asset and the specific nature of its economic use’. Pursuant to Article 49 RIS, the tax authorities only authorise early depreciation from the beginning of the construction period when this construction period is over 12 months, and the leasing contract provides for anticipated lease payments. Second, ‘determining this date (should) not affect the calculation of the taxable amount arising from the actual use of the asset or the payments resulting from the transfer of ownership, which must be determined in accordance with either the general tax regime or the special regime provided for in Chapter VIII of Title VII TRLIS’.

(26) According to Article 48(4) TRLIS ⁽¹⁸⁾, the assets covered by the early depreciation scheme described in Article 115(1) TRLIS will be leased to EIGs registered in Spain, which, in turn, will sublease them to third parties. Furthermore, Article 49 RIS establishes the procedure to be followed when filing an application for the early depreciation of leased assets.

2.2.3. Measure 3: Economic interest groupings (EIGs)

(27) As already stated, Spanish EIGs have a separate legal personality from that of their members. As a result, EIGs can file an application both for the early depreciation measure and for the alternative tonnage taxation scheme provided for by Articles 124-128 TRLIS (see Section 2.2.4.) if they meet the eligibility requirements under Spanish law, even if none of their members is a shipping company.

(28) However, from a tax perspective, EIGs are transparent with respect to their Spanish resident shareholders. In other words, for tax purposes, profits (or losses) made by EIGs are directly attributed to their Spanish resident members on a pro rata basis. Since the EIGs involved in STL operations are regarded as an investment vehicle by their members — rather than as a way of carrying out an activity jointly — this Decision refers to them as investors.

(29) EIGs' tax transparency means that the substantial losses incurred by the EIG through early and accelerated depreciation can be passed on directly to the investors, who can offset these losses against profits of their own and reduce the tax due.

2.2.4. Measure 4: Tonnage tax system (Articles 124 to 128 TRLIS)

(30) The Spanish TT legislation has applied since 2002. It provides for an alternative calculation of the taxable profits of shipping companies in respect of their eligible transport activities, based on tonnage operated rather than the difference between revenue and expenditure.

(31) The Commission authorised ⁽¹⁹⁾ the Spanish TT scheme as compatible State aid on the basis of the Community Guidelines on State aid to maritime transport ⁽²⁰⁾ (hereinafter 'the Maritime Guidelines'). The provisions governing the TT scheme are contained in Chapter XVII, Articles 124 to 128 TRLIS.

(32) Spain also adopted implementing measures contained in Title VI, Articles 50 to 52 of the RIS. The Commission notes that, contrary to the rules set out in Articles 124-128 TRLIS, which were notified to and approved by the Commission, these implementing measures — and in particular the exception contained in Article 50(3) RIS (see Section 2.2.5) — were not notified to or authorised by the Commission.

(33) As in other Member States, joining the Spanish TT scheme is optional and requires prior authorisation from the tax authorities, valid for 10 years. Revenues from non-shipping — or non-eligible — activities are subject to normal income tax rules.

(34) Under Spanish law, EIGs involved in the STL can be entered in one of the registers of shipping companies ⁽²¹⁾ because, according to the Spanish authorities, their activities include the operation of their own and chartered vessels. The concept of operating a vessel would therefore include making a vessel available to a third party under a bareboat charter.

(35) The tax base for eligible shipping activities is calculated according to gross tonnage:

Net registered tonnage	Daily amount per 100 tonnes (EUR)
From 0 to 1 000	0,90
From 1 001 to 10 000	0,70
From 10 001 to 25 000	0,40
Over 25 001	0,20

(36) Once the alternative tax base is calculated according to the gross tonnage operated by the shipping company, the normal corporate tax rate is applied to this base.

(37) Pursuant to the first indent of Article 125(2) TRLIS, the TT taxable base is deemed to include all revenues from (eligible) shipping activities on the high seas including, in particular, the capital gains realised when vessels — acquired new by an undertaking benefiting from the TT system — are subsequently sold while the undertaking remains under the TT system. Conversely, under normal corporate income tax rules, since the tax base is determined as the difference between revenue and expenditure, when vessels are acquired by an undertaking and subsequently sold with a capital gain, these exceptional capital gains constitute taxable revenue and will thus increase the taxable base on which corporate tax will be levied.

Tax treatment of exceptional capital gains in the context of the transfer of vessels to the TT system

(38) Special rules apply where a vessel — which is no longer new — and the taxation of its revenue are transferred from the normal corporate tax system to the TT system. In the case of vessels already owned by an undertaking when it joins the TT system, or of second-hand vessels (hereinafter ‘used’ vessels) purchased when an undertaking already benefits from the TT system, a special procedure provided for in Article 125(2) TRLIS ⁽²²⁾ applies. Under this procedure, the taxation of certain amounts takes place under normal corporate tax arrangements only when the vessel is subsequently sold:

— In the first financial year in which the TT system is applied, or in which the used vessels have been acquired, non-distributable reserves equal to the difference between the normal market value and the net accounting value of each of the ships concerned by this rule must be set aside, or this difference must be stated separately in the annual report for each vessel, for each financial year in which ownership of them is retained.

— The amount of the said positive reserve together with the positive difference, at the date of transfer of ownership, between the tax depreciation and the accounting depreciation for the vessel sold will be added to the TT taxable base referred to in Article 125(1) TRLIS once the sale of the vessel is completed.

(39) Thus, under normal application of the Spanish TT system, as approved by the Commission, potential capital gains are taxed on entry into the TT system and it is assumed that the taxation of capital gains, even though it is delayed, takes place later on when the vessel is sold or dismantled. As explained in Section 2.2.5, under the STL system, this taxation is not deferred but completely avoided because the vessels concerned are deemed to be new, not used. Hence, the special procedure does not apply.

2.2.5. Measure 5: Article 50(3) RIS

(40) In the case of the authorised STL transactions, the Commission observes that the EIGs can leave the normal corporate income taxation system to join the TT system without settling the hidden tax liability resulting from the early and accelerated depreciation either upon entry into the TT system or subsequently when the vessel is sold or dismantled.

(41) Indeed, by way of exception from the rule set out in Article 125(2) TRLIS, Article 50(3) RIS ⁽²³⁾ states that when vessels are acquired through a call option as part of a leasing

contract previously approved by the tax authorities, those vessels are deemed to be new ⁽²⁴⁾ — not used — without taking into consideration whether they have already been operated or depreciated — as of the date the leasing option is exercised, i.e. after the EIG's switch to the TT system. According to the information available to the Commission, this exception was only applied to specific leasing contracts approved by the tax authorities in the context of applications for early depreciation pursuant to Article 115(11) TRLIS (see Section 2.2.2 above, Measure 2: Discretionary application of early depreciation of leased assets) i.e. in relation to leased newly built sea-going vessels acquired through STL operations, and — with one exception — from Spanish shipyards.

(42) In such cases, the vessel is deemed to have been acquired new by the EIG on the date the leasing option was exercised, i.e. after the EIG's entry into the TT system. The first consequence of the exception provided for in Article 50(3) RIS is that the application of the rules set out in Article 125(2) TRLIS is avoided. The EIG does not need to establish a non-distributable reserve and neither the positive difference between the price paid by the shipping company and the accounting value of the vessel in the EIG's books ⁽²⁵⁾, nor the positive difference between the accounting value and the tax value of the vessel ⁽²⁶⁾ is taxed. The second consequence is that the revenue from the sale to the shipping company (the substantial bareboat charter option exercise price) is deemed to originate from a vessel bought and sold by an undertaking benefiting from the TT system and will be included in the TT taxable base pursuant to the first indent of Article 125(2) TRLIS.

3. REASONS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

(43) As a first step, the Commission took the view that the Spanish Tax Lease system, in spite of the application of different tax measures, should be analysed as one single system (global approach) because the different measures could only be used jointly — *de jure* or *de facto* — and concluded that it constituted State aid.

(44) As a second step, the individual measures were assessed separately (individual approach) and the Commission concluded at that stage as follows:

- The accelerated depreciation of leased assets (measure No 1) could constitute State aid, but would constitute existing aid in any case because it was implemented before accession. Consequently, the formal investigation procedure was not opened in respect of this measure.
- The early depreciation of leased assets (measure No 2) could constitute State aid as it provides a selective advantage in view of the vague conditions established by the Spanish legislation and the discretionary powers exercised by the Spanish tax administration in interpreting these conditions. This measure, which came into force in 2002 ⁽²⁷⁾, was regarded as unlawful and possibly incompatible State aid.
- The EIG status (measure No 3) was not identified as potential State aid. The formal investigation procedure was not opened in respect of this measure.
- The TT system (measure No 4) was authorised by the Commission as compatible State aid in 2002. The compatibility of the TT system as approved was not questioned in



Decision C(2011) 4494 final. By virtue of the authorisation granted by the Commission, this measure should in any case be regarded as existing aid.

However, the Commission questioned two aspects related to the TT system:

- The Commission questioned the possibility given to certain undertakings, such as the EIGs involved in STL operations, of benefiting from the TT system where their activities are limited to renting or leasing out vessels on a bareboat basis. The Commission considered that these undertakings were not active in the sector of maritime transport of goods or passengers as defined in Council Regulation (EEC) No 4055/86 ⁽²⁸⁾ and in Council Regulation (EEC) No 3577/92 ⁽²⁹⁾, but rather in the sector of financial investment and the renting or leasing of goods. The Commission noted that their eligibility for the Spanish TT system was never notified to or authorised by the Commission.
- The tax exemption for capital gains (measure No 5) resulting from the implementing measures of the TT system (Article 50(3) RIS) and presented by the Spanish authorities as part of the authorised TT system was regarded as an additional measure falling outside the scope of the authorisation granted by the Commission in 2002. This measure was also regarded as unlawful and possibly incompatible aid.

(45)The potential recipients of the aid were identified as:

- the EIGs as the primary recipients of the tax advantages,
- the members/investors in the EIGs which benefit from the tax advantages based on the EIGs' transparency,
- the shipping companies which receive part of the tax advantages in the form of a rebate on the price of the ship,
- possibly the shipyards, the banks involved, the leasing companies and other intermediaries.

(46)The Commission considered that the aid did not appear to be compatible with the internal market.

4. COMMENTS FROM SPAIN AND FROM INTERESTED PARTIES

(47)Comments were received from the Spanish authorities and from 41 third parties including public authorities, sectoral associations and individual undertakings either involved in STL operations or competitors of those involved, such as foreign shipyards or shipbuilding associations.

(48)The observations address the following aspects of the Commission's assessment made in Decision C(2011) 4494 final:

- procedural aspects,
- the general approach: assessment of the STL as a scheme as against assessment of the individual measures forming part of the STL,

- whether the individual measures amount to State aid (presence of an advantage, state resources, imputability to the State, effect on competition and trade) and whether some of them constitute existing aid,
- identification of the aid recipients,
- compatibility of possible State aid,
- obstacles to recovery of the aid (equal treatment, legitimate expectations, legal certainty).

4.1. PROCEDURE

(49) Spain considers that the Commission initiated the formal investigation procedure without duly checking its main conclusions with the Spanish authorities. As a consequence, the Spanish State's right of defence and the adversarial principle essential to any administrative procedure has been infringed.

(50) According to a number of third parties, the Commission should have used the existing aid procedure, because if they constitute aid, the two tax measures involved (depreciation rules for leased assets and the TT system) would be existing aid.

4.2. ASSESSMENT OF THE STL AS A SCHEME/ASSESSMENT OF INDIVIDUAL MEASURES

4.2.1. Complainants

(51) Holland Shipbuilding considers that the STL should be viewed as a single system because it is an organised system which deliberately exploits different tax measures to produce an economic advantage which is far greater than the total advantage that could be gained from applying the different measures separately and because the measures are interdependent. The use of the TT system allows EIGs to make the temporary tax advantage generated by early and accelerated depreciation permanent. The vague conditions imposed on the application of early depreciation and their interpretation by the Spanish authorities confer discretionary powers on the tax administration. This is borne out by the fact that, in practice, the authorisation is only granted if the switch is made from the normal corporate taxation system to the TT system.

(52) Danish Maritime and [...] ⁽³⁰⁾ ⁽³¹⁾ also regard the STL as a whole as a State aid scheme that — regardless of who the recipients are — clearly gives an economic advantage to certain undertakings.

4.2.2. Spain and the participants in tax lease transactions

(53) However, Spain and the undertakings identified by the Commission as potential recipients of aid (shipping companies, banks, investors in EIGs, shipyards involved in STL operations) challenge this global approach.

(54) They consider that the STL is not enshrined as such in the Spanish tax legislation, that STL operations are private agreements (leasing, bareboat charter, EIG) concluded by private



parties that are free to choose the cheapest way to finance an asset and use the contractual and tax arrangements available to them. They also maintain that Spain should not be held responsible for advantages acquired by taxpayers in a move to reduce their tax burden. Moreover, the tax legislation does not require the use of all the measures mentioned by the Commission in Decision C(2011) 4494 final.

(55) The Asociación Española de Banca (the Spanish Banking Association — AEB) considers that it is the first time that the Commission has identified State aid in a combination of legal transactions between private entities rather than in a legal provision.

(56) Rather than a system, the AEB considers that there are two different schemes (the depreciation scheme and the TT) which can clearly be split and treated separately, regardless of whether they are used separately or jointly.

(57) In addition, the AEB considers that the Commission failed to identify a general system of reference before identifying a selective advantage. According to the AEB, there are very many ways of financing the acquisition of an asset using different combinations of legal instruments and tax measures and the Commission should compare all these alternative situations. Concluding that the STL confers a selective advantage on certain companies would therefore be artificial, especially if the Commission uses as a reference the most costly way — from a tax point of view — to finance an investment thereby ignoring all the incentive measures available to investors.

(58) Consequently, the STL does not confer a selective advantage. This is borne out in particular by the fact that the Commission identifies several potential recipients which do not correspond to economic sectors. Referring to the Commission Notice on the application of the State aid rules to measures relating to direct business taxation ⁽³²⁾ (hereinafter ‘the Commission Notice on business taxation’) and to the Commission Decision concerning the Dutch *Groepsrentebox* ⁽³³⁾, the AEB considers that it cannot be concluded that the measure is selective because it is of more benefit to members of EIGs investing in sea-going vessels rather than in other assets.

(59) As the STL consists solely of private parties using general tax measures in the context of private agreements, there are no state resources involved.

(60) According to the AEB, there is no effect on competition and trade between Member States because the main recipients identified by the Commission are shipping companies and the measure is available to all shipping companies from Europe and elsewhere in the world.

(61) In their comments, these third parties describe the STL as a series of unrelated measures (individual approach) and make no further comments about the STL as a whole.

4.3. OBSERVATIONS RELATED TO THE ASSESSMENT OF THE INDIVIDUAL MEASURES

4.3.1. Accelerated depreciation (Article 115(6) TRLIS ⁽³⁴⁾) — Measure 1

(62) According to Spain and certain third parties, this measure is generally applicable to all types of assets and all sectors. The different tax and accounting treatment of leasing fees



does not entail any de facto selectivity, which is borne out by the diversity of the sectors applying this measure. In addition, the Spanish corporate tax system allows alternative arrangements for accelerated depreciation. The AEB states that straight-line depreciation cannot be regarded as the (sole) reference for establishing the existence of an advantage because other methods of depreciation are generally allowed. Article 11 TRLIS and Articles 1-5 RIS provide for the possibility of applying degressive methods such as the declining balance ⁽³⁵⁾ or the sum-of-the-year-digit (SYD) methods ⁽³⁶⁾ as well as the possibility of depreciating an asset according to a specific plan agreed with the tax administration ⁽³⁷⁾. The AEB cites as an example that the declining balance method would be applicable at a rate 2,5 times higher than the applicable straight-line depreciation rate, i.e. 25 %.

4.3.2. Discretionary application of early depreciation (Article 115(11) TRLIS, Article 48(4) TRLIS and Article 49 RIS) — Measure 2

- (63) It is argued that early depreciation is just a method of accelerated depreciation which establishes that accelerated depreciation can start, under certain conditions, before the date when the asset is delivered to and operated by the final user. If it were not possible to deduct the amounts paid during the construction of the asset, this would in fact imply an anticipation of taxation. Early depreciation only restores neutrality and the correspondence between the financial flow and the tax treatment.
- (64) The AEB insists that the possibility of anticipating the start of the depreciation period is a general measure that is also provided for in Article 11(1)(d) TRLIS and in Article 5 RIS, which define the general rules applicable to depreciation. These provisions allow the tax administration to approve a specific depreciation plan presented and justified by the taxable person, including for assets under construction.
- (65) The sole aim of prior authorisation of early depreciation and the procedure followed by the tax administration is to check that the operation is real and that the objective criteria laid down in the legislation are met. In particular, it must be ensured in advance that: there is a lease agreement whose start date is prior to the commissioning or delivery of the asset; when the request is made it is indicated that payments for the recovery of the cost of the asset are deductible; the contract is for the acquisition of an asset requiring a long contractual/construction period in line with the operating conditions of the asset; the asset construction contract is signed, and that an indication is given of the specific contractual conditions governing use of the asset.
- (66) Besides the general conditions set out in Article 49 RIS, an additional condition is imposed by Article 48(4) TRLIS when the applicant is an EIG. The authorisation does not depend on the application of other measures or the submission of additional documents. Finally, the absence of any discretion in the procedure is illustrated by the fact that no application filed with the tax administration has ever been rejected. In that respect, the AEB considers that the Commission should investigate more closely the reasons why financing operations are not carried out. If, as maintained by the Commission on the basis of informal information, some shipping companies were unable to find a bank to organise

the operation, this has more to do with the fact that the parties could not agree on certain elements of the operations, such as the price. The AEB formally denies that any of its members participated in any meeting or informal contact with the Spanish authorities. In fact, the situation is not the same as that described in the Commission Decision on the French *GIE fiscaux* ⁽³⁸⁾, where the condition that the operation should represent a significant economic and social interest was found to be imprecise and left to the discretion of the tax authorities. On the contrary, the AEB denies that any of the conditions specified by Article 49 RIS is imprecise and open to interpretation

(67)As a consequence, early depreciation — in the same way as accelerated depreciation — is generally applicable to all types of assets and all sectors. It is a general measure.

(68)As it is a method of applying accelerated depreciation, if it considered to be aid, it should be regarded as existing aid.

4.3.3. The tax transparency of economic interest groupings (Article 48 TRLIS) — Measure 3

(69)According to the AEB, the transparency of EIGs is consistent with the logic of the Spanish tax system. This transparency allows several investors to make a joint investment which none of them would undertake on its own and yet to apply — because of this transparency and in respect of their share in the investment — the tax treatment that would have applied had they invested on their own. Hence there is no advantage linked to the application of EIG status. Moreover, this status does not entail any sectoral limitations. Any Spanish taxpayer can be a member of an EIG. It is therefore not selective.

4.3.4. The TT system (Articles 124 to 128 TRLIS) — Measure 4

(70)As the Commission stated in Decision C(2011) 4494 final that it had authorised the Spanish TT system in 2002 as aid compatible with the Maritime Guidelines ⁽³⁹⁾, the Spanish authorities and the third parties focus their comments on the scope of the 2002 approval and on the specific issues of whether financial EIGs ⁽⁴⁰⁾ involved in STL operations should benefit from the TT scheme.

(71)As to the question whether financial EIGs ⁽⁴⁰⁾ involved in STL operations — which do not operate vessels but invest in them and charter them out as part of financial investments — should benefit from the TT system, Spain maintains that the companies operate vessels by chartering them out and have therefore been listed in Spanish shipping registers (as shipping companies) since the entry into force of Article 1 of Royal Decree 1027/1989 ⁽⁴¹⁾ of 28 July 1989, repeated in Article 9 of Law 27/1992 of 24 November 1992. As the Commission has authorised the application of the TT system to all companies listed in the Spanish shipping registers ⁽⁴²⁾, this authorisation includes companies that own vessels and rent or lease them out to third parties. If that measure is regarded as State aid, it should therefore be considered existing aid.

4.3.5. Article 50(3) RIS — Measure 5



(72)Spain, PYMAR and some banks argue that Article 50(3) RIS only contains implementing measures intended to provide legal certainty. They maintain that, in accordance with the principles of the Spanish legal system, substantive elements of a tax measure must always be governed by law and that this provision — which is contained in a Royal Decree — does not introduce anything new but only clarifies the scope of Article 125(2) TRLIS. It does not depart from the law or create additional benefits. The non-taxation of capital gains already formed part of the scheme authorised by the Commission and therefore, if it constitutes aid, it should be regarded as existing aid.

(73)Furthermore, Spain and the alleged recipients maintain that it is logical to consider the vessel to be ‘new’ since no one used it before the leaseholder, and the exercise of the option is agreed when the leasing contract is signed ⁽⁴³⁾. The AEB states that normally an asset is considered to be new when it is acquired via the option of a leasing contract.

4.4. OBSERVATIONS RELATED TO THE TRANSFER OF STATE RESOURCES AND THE IMPUTABILITY OF THE MEASURES TO THE STATE

(74)According to the complainants, a tax deduction implies a transfer of state resources in the form of a loss of tax revenue. The STL/tax measures are imputable to the State because all the measures are contained in Spanish law. Moreover, the STL relies on an authorisation that is granted by the tax authorities. Even if these authorisations relate to individual measures, it is clear that, in practice, the authorisations are granted to the overall STL transactions. This is borne out by the fact that the request for early depreciation filed with the tax administration describes in detail the construction and the distribution of the tax advantage between EIG or the investors and the shipping company as well as a notice from the shipyard setting out the expected social and economic benefits from the arrangement. There is no reason why these documents would systematically be provided if they were not in fact a precondition for approval.

(75)The shipping companies, on the other hand, argue that the discount given by the shipyard or the EIG on the initial price is not imputable to the State because it results from private contractual relationships between the EIG and the shipping company involved in the operation.

4.5. OBSERVATIONS RELATED TO THE DISTORTION OF COMPETITION AND THE EFFECTS ON TRADE

(76)[...] considers that the size of the advantages concerned (EUR 14 million in the example given in Decision C(2011) 4494 final) undoubtedly affects the recipients’ market position and therefore creates substantial distortions in markets characterised by a high level of competition. The scheme provides a great advantage to Spanish shipyards which can promote their ships at a price — lower than that of other European shipyards — which includes the benefits under the STL. [...] refers to statistics from the Spanish Ministry for Industry showing that over time the Spanish shipyards have served more and more shipowners from abroad.

- (77)As for the shipping companies, [...] considers that buying ships from Spanish shipyards at a much lower price enables them to save millions of euros on a substantial part of their fixed costs. As it is spread over the duration of the recovery of the cost of the ships, this advantage gives them a competitive edge over other shipping operators and therefore distorts competition for many years.
- (78)As already stated, shipowners argue that all shipping companies have access to the conditions offered by Spanish shipyards and can therefore benefit from any price rebates that Spanish shipyards might offer. They also argue that they have paid a fair market price and have not benefited from any economic advantage. Consequently, the acquisition of vessels from Spanish shipyards is unlikely to reduce their operating costs significantly or to strengthen their position in a durable manner, as stated by the Commission in Decision C(2011) 4494 final.

4.6. OBSERVATIONS RELATED TO THE IDENTIFICATION OF THE RECIPIENTS OF AID

- (79)According to the AEB, EIGs cannot be recipients of aid. Because of their tax transparency, it is the investors who have to pay the tax resulting from the EIGs' commercial activity. Hence EIGs cannot enjoy any economic advantage resulting from a tax reduction. In addition, any Spanish taxpayer can be an investor — a member — of an EIG.
- (80)On the other hand, a number of shipping companies consider that the EIGs are the only possible recipients of aid. Shipowners cannot be recipients of aid because they are not Spanish taxpayers. Moreover, they argue that the Commission wrongly assumed — without giving any explanation — that the tax benefits would be transferred from the EIG to the shipping company through a price rebate. In fact, the price is fixed as a result of a commercial decision taken by the private owner of an asset.
- (81)Shipowners argue that shipping companies from all over the world generally acquire vessels from shipyards from different countries, including, if they so wish, Spanish shipyards. All shipping companies can therefore benefit from any price rebates that Spanish shipyards are able to offer.
- (82)Several shipowners argue that if the STL constitutes State aid, they are not the recipients of this aid. Two reasons are given: first, the way the STL structure functions shows that there is coordination between the EIG and the shipyard, which constitutes a single centre of interest and fixes the sales price; second, companies operating tugboats and salvage vessels give examples of offers received from shipyards outside Spain to build similar tugs. Those offers are in the same price range or even cheaper than those of the Spanish shipyards eventually selected. They argue that consequently they have paid a fair market price and have not benefited from any economic advantage within the meaning of Article 107(1) TFEU. If the STL were to offer an economic advantage, the recipients would be the shipyards involved in STL operations and not the shipping companies.
- (83)Holland Shipbuilding considers that the recipients of aid are the EIGs and their investors, as well as the shipping companies, but also the Spanish shipyards because there is a substantial difference between the price paid by the



shipowner and the price received by the shipyard, which is above the market price. According to a national shipbuilding association, the scheme was designed to benefit the shipyards. It would be incorrect to conclude that STL is of benefit to the shipping companies. The reduction in the building price does not necessarily imply an advantage for the purchaser of the ship. Moreover, Spanish shipyards can only offer this advantage to buyers that use the STL. The STL constitutes unlawful aid to shipbuilding that is damaging to national shipbuilders that are in direct competition with Spanish ones.

(84)PYMAR considers that the Commission did not give sufficient grounds in Decision C(2011) 4494 final as to why it identifies shipyards as potential recipients of State aid. It also points out that in the decisions in the *GIE Fiscaux*, *Brittany Ferries*, *Air Caraïbes* or *Le Levant* ⁽⁴⁴⁾ cases concerning similar tax schemes, the Commission did not identify the producer of the asset as a recipient of State aid.