

## YACHT FISCAL2007 — Finance, Legal & Tax Issues affecting Superyachts

Day 2 — 7th March 2007

### Leasing — Protecting Your Capital

- **Leasing structures, new schemes and new territories** — What can we expect in the next five years?
- **Leasing vs. Financing** — The pros and cons: can the two work together?
- **When to lease and how to lease** — The benefits and differences
- **What to consider when entering into a lease arrangement?**
- **What happens at the end of the lease? The exit process and the implications**

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Steve Malley  
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### Steve Malley

Good afternoon ladies and gentleman. Thanks for coming and to Martin for allowing us to talk on this fascinating subject. As you may or may not know, Fortis do yacht leasing in a big way but I'm not going to rabbit on about Fortis because they don't appear at no. 1 on the leasing list.

What I want to do quickly is to run through the decision making process that I go through with a client to decide whether he wants to lease or finance or not at all. It's relatively straightforward. One thing I'm just going to comment on is the heading of this session. "Leasing — protecting your capital". Actually if you're doing a leasing structure properly it's not your capital at all it's the bank's. Which is an interesting concept.

Decision making process for setting up a leasing structure. My first decision always goes back to the client and whether he's an EU or non EU resident. The reason I make that decision is if he's a non EU resident the likelihood is he's not going to be going for a VAT deferment or VAT mitigation structure because he doesn't need to. If he sets his structure up properly and uses the boat under temporary importation for private use, of course, he doesn't need a leasing structure that saves him the VAT. I think in the past I've seen a number of structures where leasing has been offered to non EU clients and to me that's just not worth the effort of doing because the temporary importation rules and regulations are so beneficial to non EU residents that it makes leasing senseless. They might as well do a financing exercise. We'll compare financing to leasing a bit later on. That's the first decision—is he an EU resident or not.

The second decision is he chartering or is he not. We know that a lot of structures are set up to create chartering, to create commerciality and so on, but to me does a client want to charter his boat to get income to make a profit, or, more likely, to

reduce his loss on the operation of the boat. So to me if it's a charter structure then we don't want a leasing structure because leasing is essentially for private boats.

The next decision is does he want finance or does he not. I would say that ten years ago 10% of clients needed finance or wanted finance. Now it's probably 50% to 60%—some still don't need it but they know they can leverage off the asset and they can use that money to generate income elsewhere. If you can borrow it at 1 or 2½ basis points that's pretty cheap money and you can probably make some money on the turn on that. Let's assume that they do want finance and they're an EU resident and that they're not chartering.

We then have to decide whether we're going for an operating lease or finance lease. It's worth outlining the differences between operating leases at the moment and finance leases. With a finance lease it's only called a finance lease if there's an option to purchase the boat at some time during the leasing period or at the end of the leasing period. But an operating lease is purely like car hire—the asset never becomes yours. Quite simple. At the moment, I can tell you that most of the principle leases that are offered throughout Europe are finance leases, so again we'll be talking about Italian, French, Maltese and Dutch leases and what else is coming on, in due course. Those are all finance leases.

The leases operated out of the Isle of Man by some of the people we know and love are what I would call an operating lease so at the end of the day the boat never becomes the property of the lessee unless he decides to buy the structure at the end. So it's not an overt finance lease. These structures are not what I would call VAT mitigation structures — they're more like VAT deferral structures and in the end the client eventually pays the whole of that and the VAT. The assets during the course of the lease are not VAT paid, unlike most of the financial leases where the boats can be sold at the end of the lease as a VAT paid boat. VAT paid to clarify means VAT paid and never recovered. That's a big difference.

Just out of interest I dug out some of the numbers for Italy. We talked yesterday about charter structures, leasing structures — it might be interesting for a couple of minutes to look at the numbers of boats being leased. I've picked the Italian market because it happens to be the one I have the information on. The figures are from the Italian Leasing Association for 2005—2006. They make quite interesting reading. This is a period from January—July 2005 and January—July 2006.

In 2005, €871million worth of boats were sold through Italian lease structures. That was 2,189 boats. I think that is a fascinating figure. Average boat around €400,000. For the same period in 2006, the figure increased to €1.22 billion. 2,654 yachts in a seven month period. The average yacht price went up to €462,000 but interestingly enough for one particular company who only sold 14 leases in that same period, the average boat was €2.8million. So we're talking about probably for the whole of the year 2006 over 4,000 yachts alone sold under the Italian lease. That to me is an incredible increase for a start off, but it just goes to show how much of the Italian industry relies on the Italian lease product. If we think about what we were talking about yesterday and the UK Customs saying they don't like these leasing products, do you think they're going to persuade the Italian government to pull out of the Italian lease? I don't think so. It's so naïve to even think that the UK Customs or HM Revenue + Customs can have any influence on an industry that is that large. It is something that is quite clearly increasing; the French lease —I haven't got the figures from them—is doing rather well, the Maltese lease is a starting product and then in due course in the next couple of years you'll probably see leases coming out of the Isle of Man, finance leases out of the Isle of Man, and as we at Fortis have got a

leasing group in 18 countries we are investigating whether it might be possible to set up a similar lease in Slovenia, Rumania, Poland etc. If the authorities there will allow us to a government sponsored lease which gives advantages and brings business into those countries then we'll go ahead and do it, despite what the UK thinks. This is all about generation of profits for the country, employment, and so forth. They're just going to have to live with it. I think those figures are quite fascinating—that there are 4,000 boats just in Italy alone being sold every year—and that's an increasing figure.

I'd like to pass to my 2 colleagues, after I've outlined how big this particular industry is—and as I say, this is an interactive session, so you just fire the questions at us. We've got an outline of what we want to talk about and I think hopefully I've outlined that this is clearly a situation where we have yachts under private usage with EU residents. Other non EU residents and chartered structures we've pretty well highlighted. This is a major volume market — we might be talking about 40metre or 50metre yachts in handfuls but with yachts of this size we're talking about thousands of them.

I don't know if my colleagues would like to come in at this stage and follow on?

### **Ayuk Ntuiabane**

My focus on leasing is on the VAT side because it tends to be the case that I pick up the pieces when the yacht has exited the structure and you have a beneficial owner who has a yacht, needs a structure, has problems with documentation or has questions as to how they can evidence the VAT that they're supposed to have paid. So I'll keep it fairly simple. I have some bullet points here.

Leasing is a very old concept and in many ways it is a very simple and popular concept. But there are surprisingly quite a few misunderstandings. The VAT man looks at leasing in very simplistic terms as well. The question always is do you own the yacht or not? That's the first question. If you do, if you own the yacht, you have received goods. If you don't, you have received services — and that distinction is very important. If you've received goods, then you pay full VAT on the value of the yacht, quite often paying that VAT up front. If you've received services and as Steve has said, you have all types of leases, operating, finance, contract hire etc, these are receipt of services and so if you've received services you pay VAT with each instalment so that the full VAT is paid over the term of the lease. There are some instances where VAT is not payable on a lease and the law is pretty clear about this. If the lessor —the person leasing the yacht to you — doesn't charge you VAT then quite possibly they may have bought the yacht from a non taxable person and a private individual where VAT was already paid. Or possibly the lessor did not deduct VAT on purchase of that yacht and they are operating that yacht probably in terms of the transaction is beneath the VAT threshold — the VAT registration threshold. So they are not registered for VAT. This is unlikely to be the case because many leasing companies do substantial volumes, as Steve mentioned. So the instances where VAT should not be charged are very few indeed.

Another issue is the place of taxation in the leasing arrangement. The law is also very clear—the place of taxation is where the provider of the leasing is established, where they have established their business. It is not where the yacht is used. There are many cases that emphatically —for some reason, because of its simplicity, leasing is hard. If you look at the cases that have been decided by the European Court of Justice leasing is a very popular theme, for some reason. But the position is very clear. The place of establishment of the provider of the lease is where VAT is chargeable. What I've mentioned so far is to do with leasing as such.

It's important to distinguish leasing from instalment credit finance, because it makes a difference between the supply of services and the supply of goods. Instalment credit finance takes at least 3 forms. You have hire purchase, which effectively is an agreement to hire with an option to purchase, so legal title will pass when the instalment is paid. You have conditional sale, which is basically the sale of a yacht or any goods, with a price payable in instalments. The yacht remains the property of the seller until the full price is paid. You have a credit sale where effectively the yacht will become the property of the buyer, of the customer, immediately but the price is payable in instalments. Now in all 3 cases, the VAT liability is, as I mentioned before, the full amount of the VAT is payable quite often with the first instalment. The taxable value is the price, the contract price, before the deposit or maybe a part exchange value is deducted. The credit charge element of that whole arrangement is quite often separated from the contract price, or the value of the goods themselves. If it's separated as such, and disclosed to the customer, no VAT is payable on the credit charge. That's exempt under VAT law. Quite often at the end of a lease the customer will have 3 options. Either they return the yacht to the lessor or they act as an agent to sell the yacht to a third party or they renew the contract or enter what's commonly known as a secondary period. VAT at the end of a lease — when you or your client has exited from the leasing arrangement it's extremely important that you retain the VAT evidence. This takes many forms — quite often because it's instalment, you've serviced the lease if you like, in instalments. That would be evidenced by several documents. Some lessors would actually provide a summary statement of all that's been paid in original form; that needs to be retained. It's important to retain that evidence because that's effectively your passport to the VAT man for purposes of using your yacht. It's also very common for clients to then transfer that yacht into a company or assign the yacht into a company either for the purpose of charters or personal use, or whatever. This is something that's commonly done and indeed there is nothing wrong with it at all under the law. The yacht can be operated as a business, and expenses can be deducted as long as the structure's registered for VAT and the expenses are tied to the business that is being carried on with the yacht. It's allowed. It is quite often the case that some people assume that because VAT has been paid in instalments during a lease when you put that yacht into a company and it becomes part of the business assets of the company and you sell that yacht through a company then no other VAT is chargeable on the sale. That's a common misunderstanding because under VAT law as a taxable person, in other words a VAT registered person, selling business assets as such you have to charge VAT. So it's very critical that in transferring the yacht — a VAT paid yacht — into a structure you allow for the possibility of withdrawing that yacht — which is perfectly allowed — from the structure and selling it privately when it comes to selling it. If you sell it through the company, as part of the business assets, then you have to charge VAT on the sale, under the normal rules. And for those who are interested in the whole relationship between an asset that's been VAT paid and the sale of that vessel, there's a very interesting case — the famous case tried in 2001 where the European Court of Justice decided — I can give you the reference if you're interested in looking that up — I think it's case no. C415/98. It basically says that where you have a VAT paid means of transport (in this case it happened to be a Mercedes truck that was used in the business) the VAT was paid on that effectively, it was used in the business and the question was whether during the disposal of that truck VAT had to be charged in the sale. The Court said well, if the truck was sold as part of the business assets of the company the fact that VAT was paid and not reclaimed at the time of the purchase, is irrelevant. So yes, you can transfer your yacht into a company, carry out trade and deduct the ongoing expenses that relate to the cost you suffer in carrying out that trade, but please remember that when it comes to the

disposal of that yacht you should allow yourself the option of withdrawing that yacht from the structure and selling it in a private capacity.

I think that's my contribution. I'm happy to take any questions because quite often VAT tends to be an issue because most people want to operate their yachts through companies and they don't think of the issues ahead of time. When you go into a lease with your eyes open, plan ahead as to what will happen at the end of that lease and what exactly you will want to do with that yacht.

### **Remco Immink**

I'd like to state that my experience of leasing is based on day to day practice. I am not a lawyer nor a fiscalist. I've been in yacht financing since 1995 so I've seen a lot of different things coming by and seen going off the market.

I think if you look at leasing there are important elements before you start talking to the client and that is — what is the client looking for, what is his risk appetite and what are the alternatives.

We quite often get a question from a client — oh what about an Italian lease, a Maltese lease, or Isle of Man structure or safe haven structures. Do they work? Yes, they do all work. Can you give me a guarantee? Is it 100% safe? No, we cannot. So that means if a client is looking for 100% guarantee on a structure which means that he has a very low risk profile then we can already advise just pay the VAT, sail around and have no worries. If you are open for alternatives then you easily can go to Richard or other providers and look for structures which are still working which have a relatively low cost profile where you can sail around in the South of France where you can be happy to welcome Customs on board — they will love to see your boat and paperwork and will leave your yacht and you can go on with your holiday and what you're doing at that moment. But there's another trend at the moment and that is that clients say OK, if you look at all these structures based on charter concepts so to say, there is a lot of regulations you have to fulfil after the implementation of that structure. Then they say well, I'm not always into that so I prefer to pay some VAT and I think if you prefer to pay some VAT instead of nearly no VAT then leasing is becoming an interesting option. Then there's another item which is important for leasing — that is what do you want. Do you want to be an owner of your yacht, which is normally the case when it's privately owned or owned through a special purpose company, where you are very strongly in control of your own yacht and what's going to happen, or are you depending on a lease company, where the yacht for sure is not owned by you as a lessee. Quite often people say no problem, at the end of the day it is my yacht, legally it's not. And that brings in some other consideration, if you should lease, yes or no. If you are owning your yacht through a special purpose company — you are quite flexible in what you want to do with your yacht. If you want to sell your yacht after 3 months or 1 year, well, you can easily do so, paperwork and things to be done is pretty straightforward. If the yacht is owned by a lease company then you are less flexible — most lease contracts have a minimum duration of 3 years and if you want to do something within the 3 years then it's not a problem if you want to do it, but be aware what needs to be done at that moment and what the consequences of that action could be. But if you are happy with all these items and if you need external finance, what is also the case with most leases except with the Maltese lease option, then you are happy and free to go for leasing. The Italian lease is good, the French lease is good, the Maltese lease is good — the advantage of the Maltese lease is that you can set up your own leasing company so that the disadvantage of not being an owner can be solved for a part but the other disadvantage of the Maltese lease if you're looking for finance is

that the lease period is only 3 years. So you see, each lease has its own advantages and disadvantages. But if you choose to lease it's important to say well, to what company do I go? Is it a small, relatively small company, is it a bank related company. Ask for the draft documentation and go through it so you can see what's in the documentation. What is good advice is ask for references. Most lease companies are happy to present references. That all contributes to the owner taking the right decision as to what lease he should take.

## **Steve**

I can confirm what I said before that these leases were set up specifically to attract business to each country. The French lease was the first one set up. Someone will have to tell me exactly what year it was, but as a result of the French lease being set up, effectively the VAT rate was 50% of the then French and still French rate of 19.6 so instead of paying 19.6% VAT on your boat you actually paid 9.8%. The rationale behind that, and again, this started with the French, was that boats of certain sizes and in the French case the 50% effectively applies to all boats —the bigger the boat the more time it spent outside the EU. As a result of that they felt justified in saying that VAT would only be applied to 50% of the value of the boat under the lease. This was accepted, became part of French law and as a result thousands of Italian owners brought their boats to France to register them here and pay the lower rate of VAT. Obviously the Italians realised that was a bad thing so they set up their own lease. Not identical, in fact better. For boats over 24M only 30% or VAT on 30% of the usage is paid, on the presumption that the bigger boats spend 70% of their time outside the EU. So this was a concept that was kind of set in European law and the concession of course was that no-one has to prove to the Italian or French authorities that you actually do spend that much time outside the EU. Now the UK — back to them again — their view of all this is that this is not cricket, old boy, and it shouldn't be allowed. But it has been allowed, it is government approved by both governments and written into their law. Now the Maltese, not wishing to be outdone by the French or the Italians, and again trying to bring business to Malta, quite clearly after they joined the EU in 2004, set up a similar lease based on the Italian sizes of boats so over 24M, 30% of the usage of the boat is applicable to VAT and because the Maltese VAT rate is 18% the effective VAT rate is actually less than the Italian, and that's been successful. But in addition to that they opened up their leasing scheme to more flexibility, and as Remco just said, it is possible for the lessee to own the leasing company that leases the boat to him. If you talk to the UK authorities they would say that that is much more aggressive than the Italian or French lease where the boat is owned by the leasing company itself. Now I'm not going to make any particular comment on that other than to say that it is government sponsored by the Maltese government and that if the UK authorities, or anyone else, don't like it, then they should take it up in Brussels. The fact is that these structures are in existence, they are government approved, they may well be aggressive to the British but to anyone who enters into these leases they're not going to complain about them because quite clearly there is a justifiable VAT saving. If you ask 100 clients if they want to pay VAT on their boat I think 98 would say no. It goes without saying that they're going to be attracted and they certainly are.

What might come in the future is other member states seeing the situation where boats are leaving — in particular Belgium was concerned that a lot of the boats were leaving the Belgian market and being registered under French or Italian leases and they said well, we'd like to have some VAT paid in Belgium so we were in discussions with the Belgian authorities as to creating a Belgian financial lease that was actually better than the Italian lease. I think in the end the Belgians got cold feet and as far as I know, Remco, nothing has happened on that so far, has it. But it's the

rationale and mentality of the countries involved saying that we want to promote our marine industry, we want to do as much as we can within the European VAT framework to do it. And so far, only 3 countries have gone out and done it and as a result of that — and you can see by the figures I mentioned earlier on — they're reaping the reward. It's as simple as that.

Just going back to the question of leasing versus financing, obviously as a bank, and Remco will know this as well, is that there are a number of issues that need to be taken account of in financing. For financing generally there would be an SPC or an SPV ownership structure, the client will have to give a personal guarantee and he'd have to in effect take his trousers down to the bank to prove that he has the wherewithal to service the loan. Then he's got to set up the SPC or SPV to run it and to certain clients, especially with smaller boats, all that is too much of an effort and the justification for it is not sufficient therefore leasing is to them very practical. It's very simple; one leasing agreement, the boat is owned by the bank, leased to them over 3, 5 or 7 years or whatever, at the end of the period they pay a small residual (in the case of French, Italian or Maltese I think it's 1%) and the boat's theirs. To me it's very simple. Now the Italian market — as you probably know, most Italians are very secretive about their income for some reason — and it is always easier to justify to the Fiscale that you've leased the boat over 7 years than that you had the money in the first place to buy it, because the inevitable question would be where did the money come from in the first place? Which might not be a question that everyone wants to answer. I'm not saying there is anything incorrect in that but if this is all to do with anonymity then quite clearly if you're sitting on a leased boat and it's in the name of Locat or Italease and you can justify the paperwork everybody's happy, and you don't have to answer this inevitable question of where did the money come from the buy that. You can service it out of standard taxable income. So that's very often why the decision to lease is made. Quite apart from the fact that there are substantial VAT savings to be achieved. Again, 98 out of 100 people say I don't want to pay VAT, or I want to pay as little as possible, so if a government is sponsoring it and it's costing you 175 basis points or 2 basis points to do it does it matter? You get full access to the boat, the boat is in your mind yours, not legally of course but that's the way people want to go. What I would say about the Maltese lease is that there is a little bit of danger that perhaps they make these leases too flexible so they lose the sense and of course by doing that they create aggression which perhaps other member states can exploit, so I wouldn't like to see any dilution of the compulsory lending policy that they have in the French and Italian leases, that you have to actually borrow the money whereas in the Maltese lease you don't actually have to do that. You could in theory fund your own SPV which buys the boat and leases to you. Using a circular route that the UK have tried, they're saying that might just be a structure that is set up the sole purpose of which is to avoid VAT. I'd rather not give that argument to the UK authorities or any authorities so I still prefer out of the three leases that are available now the Italian and the French leases, because there is some semblance that it is a proper lease in the sense of the word.

We haven't at this moment mentioned the Dutch lease which as I said yesterday is still legal, is still available, and if someone wanted to do it I'm pretty sure they could. The advantage of the Dutch lease is that in effect less VAT is paid than under the Italian, French or Maltese lease. But in doing so the less VAT you pay the more aggressive it is — it doesn't necessarily mean it's illegal, it just means it's aggressive. If it's aggressive people look at it more closely and that's the disadvantage of the Dutch lease. It's still available though and anyone can get it at the moment.

The other advantage of leasing of course is that the lender has the ultimate security. It's his boat. If at any stage of the course of the lease there's a default he has the

boat, he just has to go and get it and sell it to recover his exposure. Whereas with a lender with an SPC or an SPV I should say, there's always this slight doubt that the loan might be there. Take as much security as they can but there's nothing like the security of actually having the legal ownership of the asset, and I think you'll find that lenders would much prefer to have that particular situation.

### **Remco**

Can I add something to this? You are saying that it's an advantage that the ownership is by the bank? But that's an advantage from the Bank. Not an advantage for the user.

### **Steve**

No, that's an advantage for the lender yes. But what it might mean is that the lender then might be more flexible on his terms, the length of the lease and so on, that he might not already have been with doing financing. I'll give you a quick instance which relates to aircraft. The Belgian aircraft registry for some reason will not allow a mortgage on a plane so lenders are very worried about lending into Belgian structures because they feel they don't have the security of the mortgage like you would have on a normal marine registry. This is because the Belgian authorities have not got round to making this available, so lenders are very worried about lending into Belgian aircraft structures so aircraft through the Belgian registry tend to be leased rather than financed. But they're leased in this way because of the problem with the Belgian registry. That's one particular instance where leasing is favourable over financing. My view is, if you look at the leasing opportunities and the financing opportunities the lender will always be more flexible on a lease than they would on financing. I don't know if anyone can disagree with me on that ? but that's the point I'm making.

*[from the floor]*

*Steve you mentioned that, given what we heard yesterday completely echoed your thoughts on the Malta leasing structure if you've got a lessee who is the same party as the beneficial owner as the lessor and indeed has injected the capital that's entirely circular, but regarding your comments on the French and Italian leases where you have to have third party finance if you have a cash buyer who wants to enjoy the lower VAT rate to what extent do you have to take third party financing? Can you put any of your cash in?*

### **Steve**

Well, with all leasing structures there is inevitably a deposit. Most people tend to want to go for the highest loan to value they possibly can which is usually about 80% across the board. Inevitably you've got to put 20% in. That 20% is a deposit, it's clearly your own money so there is an element of circularity in any lease. There is a school of thought —not my school of thought — that there should be at least 30% lending in any lease structure to remove this issue of circularity, that the beneficial owner leases to himself and therefore has created the structure just to mitigate VAT. So we would always say to anybody even in a Maltese leasing structure, let's have an element of lending in there. There's nothing in the law that says the deposit can't be 20%, 30%, 50% or even 70%. It's not written down. All I'm saying is that the powers that be look at these things and say this is contrived. The less it looks contrived the more you can protect it and look after it. It would in theory be possible, under the Isle of Man lease, or a Maltese lease, for a lender to lend 80% to the SPC,

the leasing company, and then the leasing company take the 20% deposit from the client who's probably guaranteed the loan in the first place and then lease it to himself, so you have a combination of a loan and a lease, and in fact the Maltese lease and the Isle of Man lease are actually pretty good for that. If I were going to set up either of those I would make sure that the leasing company did take third party finance and as much as possible, just to remove that argument that it's contrived. But again, it's not written down anywhere in law, it's just a matter of opinion.

*[from the floor]*

*Thanks. That's quite clear. I've just got one more question. If you come across a buyer who's already several stage payments into a new build project and has paid cash thus far, are there opportunities at that point having already paid maybe 50 or 60% of the value to bring that into a leasing structure?*

**Steve**

Yes, as far as I'm concerned, at any stage you can do that. I know that some leasing companies are very reluctant to take boats into leases late on, where there have been substantial payments, but if the contract says that there is a right to assign or novate and an issue in your contract then it could be done at any stage. And this was a point that came out yesterday with James Lawson when James mentioned about banks getting involved in new build contracts late on. Well, it's quite normal as far as I'm concerned for a client to reconsider his financial position half way through the build of a boat. Once you've agreed the contract with the builder and then the bank comes in and says oh we don't like this, we want refund guarantees, we want this or that, if the guy wants or needs the finance then he's got to bend over backwards to help the bank support the loan. Whether you do that with a side letter and not amend the contract, or you try and persuade the yard to make it more flexible, it is a situation that comes up every time. As far as I'm concerned it's perfectly acceptable up to—not quite the last minute—to assign the contract.

*[from the floor]*

*Sure. So it would be an element of equity release.*

**Steve**

Yes, well what we would all prefer to do is the contract is assigned, the original deposit is returned and then reinvested if you want to say that, back into the project through the new entity or through the leasing company. That is acceptable as well. And quite common.

*[from the floor]*

*I've got a couple of quick questions.*

*Am I right in saying that with the pure lease the leasing company retains title of the boat, is the registered owner of the boat throughout that period and the lessee has no title on the vessel at all? Part of the same question is, over a 3 or 5 year period, particularly on the bigger boats, there'll be an enormous expense when it comes to maintenance and perhaps refit and stuff like that — are those costs down to the lessee or are they factored into the leasing payments?*

**Steve**

They're not. Generally in a standard financial lease the lessee has all the obligations of insurance, maintenance, crewing, you name it. And the lending element is purely the capital plus interest.

*[from the floor] He buys insurance in the leasing company's name?*

**Steve**

No, he buys insurance in his own name with the leasing company as an interested party. That's generally what's happened in my experience. As long as the insurance company knows exactly what's going on, these boats are being operated privately so there's no issue of in effect MCA qualifications or whatever, so that shouldn't be a problem. But the leasing company would always be noted as an interested party.

*[from the floor]*

*We've done a few of these Italian ones, not for a while now, but we've always had the beneficial owner, or the company that's owned the boat, as a named insured on the policy. But what you're saying is he's not the registered owner so therefore has almost no financial interest.*

**Steve**

Well, does it matter which way you do it? As long as you know that the boat is insured, does it matter who is the main interested party? Because if the leasing agreement says it is the lessee's responsibility to insure the boat, then in theory he goes out and insures the boat and makes the leasing company an interested party. Can I just add that some of the leasing companies in the past have insisted, like an Italian leasing company, that the boat is registered on the Italian registry so they can get to grips with it. Now they're a lot more flexible and allow anyone to register, so who registers the boat —is it in the name of the leasing company or in the name of the lessee? Well, in many cases it's the lessee which is perfectly acceptable but the genuine owner of course is the leasing company. For insurance purposes, as far as I'm concerned, and you're the broker of course, it doesn't make any difference to me whoever prefers to be number one.

*[from the floor]*

*My other question was, when the lease finishes, does each leasing company (this is just a general question) have a broker, let's say, that they give the boats to sell on their behalf at the end of it, because you can have a lot — you can talk about 4,000 boats — 3, 4, or 5 years down the line, you're going to have a lot of second-hand boats flooding into the market.*

**Steve**

Well, Ayuk quite correctly pointed out that there are ways of, when you get to the end of the lease, what do you do with it. Do you walk away from it? Well, I'm not so sure you would walk away if you've paid for the boat — that would be a crazy situation. You could walk away under an operational lease but that's a different thing altogether. At the end of the lease you pay your 1% residual value payment and the boat's yours. At that stage you then have a number of options. We all know, and we've heard the lawyers tell us, that it's not a good idea to hold a yacht in your own personal name. Bearing in mind a lot of these leased yachts are at the lower end of

the scale for value purposes, you would still probably not want to have the boat in your own name so you transfer it from your name into an SPC just to hold it as a VAT paid boat. Going back to Ayuk's point about whether you sell it on after that is another matter but a lot of our old lessees have put their VAT paid boats in SPCs and just used them privately ad infinitum. The boats are then in their own names. As such the leasing companies are not selling the boats to third parties, they're selling the boats to the lessees and the lessees then decide what they want to do. Very often what happens is the lessee will then sell the boat through a broker of his own choosing and go and get another boat from a leasing company, and that's how they do it in perpetuity. So in fact they only own the boat in their own name for a very short period of time before they move it on. And many will put it back into the same broker and buy another slightly bigger boat.

*[from the floor]*

*Two questions Steve. One is, you mentioned terms of 3 years for the Maltese lease. Could you just tell us what the terms are typically for the Italian and French, and are they built into law? Then I have a second question, if I may.*

**Steve**

Sure. Well, with the Italian and French lease the minimum period is 3 years, I'm pretty sure. And maximum — I don't think there is a maximum, but normally there's a 7 year period for the French and Italian lease. For the Maltese lease the minimum is 1 year, and maximum is 3 years. I don't wish to comment on whether a one year lease is contrived or not, but it's all to do with what does the industry generally do. I've heard this argument so many times in the past. The normal is 3 to 7 years so therefore the Maltese lease is not "normal". It's not me saying that, it's just that it could be construed as not normal. Normally it's 3 to 7 years.

*[from the floor]*

*Thanks Steve. The other question is, from the owner's perspective, what are the likely circumstances under which a challenge would arise? Which would be the challenging entity and the circumstances?*

**Steve**

When you say a challenge, you mean a tax challenge?

*[from the floor]*

*Yes, I'm on my boat, I have it under one of these leases and I turn up in a port, is it that I'm going to be stopped in the port and prevented from leaving and, if so, which is the port where I'm likely not to sail from?*

**Steve**

Well, I think — I keep harping on about the UK. The UK are in northern Europe and all the good stuff happens in southern Europe, but they always seem to stick their oar into all of these things, and they have done, as most of you know. If you have a boat under Italian leasing and you're in France and you're in Spain, the Spanish Customs or the French Douane — I've seen these things hundreds of times, they recognise the documents, they know this is a government approved lease, you provide all your documents, and everyone's usually going to be happy. There have been very few

problems. Going back 5 or 6 years, I can't think of more than 2 or 3 times when a lease boat has been boarded and there's been a question about the documentation. They all sail with the proper documents, they sail with the leasing documents and I've never heard of any particular problems, until very recently. The only problems that have appeared relate to the UK and their justification of what they see as avoidance. Unfortunately they don't like the Italian and French leases. But what can they do about it. So if you're in French waters, forget the UK, have nothing to do with it. Can I just make a point — I didn't make this yesterday — or maybe I did and I've forgotten. This business brief that Ayuk correctly pointed out — my view of these things is that a boat of any significant size is not going to be in British waters so if it's a UK client and the boat is in French waters then the UK Customs have no jurisdiction because the VAT should never be paid in the UK anyway. And if it's a non UK client and the boat's not in UK waters they can sod off, basically. They've got no jurisdiction. They might issue these letters and rattle their sabres but they're not the VAT police of Europe. So my first reaction when I saw the business brief was to put it straight in the bin. I can tell you that most of my clients — they did phone me up and say what do you think of this? I said it's in the bin. You're French, or Italian, or you're German—it's nothing to do with you. They're sabre rattling. I think Ayuk agrees with that.

## **Ayuk**

Just to add that specifically I can think of at least 3 circumstances in which there would be a challenge; the first one is if you're sailing your yacht around the EU you have to prove ownership of that yacht to the authorities. So you get to a port and the authorities will check and you need to have the necessary documentation for that. If you're carrying passengers of course they would also want to know how protected they are, for various reasons. So you have questions about the insurance. Two other circumstances —one would be purely in VAT terms, if no VAT has been paid then they will challenge that. If very little VAT has been paid they would possibly challenge that. Going back to the so called business brief, the UK one, just to add to what Steve said, specifically I would be very reluctant to dismiss it—to throw the brief in the bin. I wouldn't go that far. What I would say is that we should always bear in mind that VAT is the only and main tax that's operated EU wide. It is harmonised just by the difficulties—the differences in interpretations. Each member state can effectively assume the obligation of controlling or pointing out misdeeds, or what they see as misdeeds or non compliance to other member states. There is growing co operation between individual member states, or between the member states that form the VAT territory of the EU so the UK — and we gave some examples yesterday where there's a clampdown if you like across the EU involving more than one state or most of the states working together. Also, if you use the UK or an Isle of Man structure, bear in mind that ultimately the UK — or in the case of the Isle of Man there is a different administration that looks after the VAT or administers VAT in the Isle of Man — but bear in mind that the Isle of Man and the UK are one VAT territory under EU law and ultimately, and this is a matter of fact, notices that are issued in the UK cannot be ignored in the Isle of Man. The UK Customs would not send their representatives or officers to inspect Isle of Man companies; however they would put pressure on Isle of Man Customs if they find evidence of activity that they're not happy with. So we shouldn't dismiss that too easily. Steve is right in general in saying that if one territory is operating a particular structure ultimately if other member states are not happy they would go through the usual channels in challenging or making their views known. So we should always bear that in mind. Just a caveat. Thank you.

## **Steve**

That's fair enough Ayuk. The term in the bin is kind of, you know, euphemism for not totally ignoring it but recognising when and where the UK authorities can stick their nose in. It's an interesting point. My view of these things and I think a lot of people here know my background is 15 years in UK Customs, I'll do anything as long as it's legal. When you get to that line down the middle, illegal/legal, you can walk along the line as far as I'm concerned as long as there's a piece of legislation that allows you to do it. Very often VAT law is administered in each member state as an interpretation of European law, which is why we have the Italian, French and Maltese leases. My view to the UK authorities is, well, instead of moaning about it, if you want to break it, break it through Brussels, if you don't want to break it, or you can't break it, why not do it yourselves. Instead of losing all the VAT to these other countries, as Belgium used to moan about, why don't you set up a similar lease and keep the VAT in the UK and support your own marine industry. Why should Sunseeker Fairline Princess—all that VAT—go to France and Italy. Why shouldn't it stay in the UK? It can stay in the UK if they set up the proper structures but you try and persuade the UK authorities to do that and it's just impossible. There's no-one there that's looking after Great Britain Plc. And that's a shame. Quite clearly the French government and Italian look after their industry in a big way. The UK don't do the same thing. I'm not a UK resident, I live in the Isle of Man. But the point is there—why aren't they doing everything they can to support the industry. Not just in the marine industries, other industries as well. It's very sad. And in all my years I only met one guy in Customs who said we should do this for Great Britain Plc. We should do this to bring business into the UK. One person in 32 years. That's crazy.

*[from the floor] Why do you think that is?*

### **Steve**

Why do I think that is? How long have you got? My view of these things is that all the best guys left Customs during the 80s and early 90s and went out into the private sector. How do you get judged in the private sector? You get judged by how much tax and how much VAT you save for your client. Because that's how you get paid. So to turn from a gamekeeper into a poacher is one thing but when you see—and I must admit I was naïve in the beginning—what support the marine industry gets in Italy from the authorities and what the French do for their industry, it's incredible. They're using taxation as a method of generating business. Now we know everyone has to pay tax, we said that yesterday. But where you're so blinkered and effectively you drive all the business away from the UK into France so they pay their VAT in France and nothing gets paid in the UK what's the good of that? There is no taxation and you're destroying the business as well. It's sad. I just think there's no-one left in the UK Revenue & Customs that has foresight to see these things as they really are. Sadly, I was going to say I have myself to blame because I spent many years training new customs officers and at the end of the day Customs is an organisation to collect tax and stop smuggling and the training entrenches that into everybody and since Customs & Revenue merged—her Majesty's Revenue and Income Tax people were pretty meek and mild but now you've got the other bunch with them, encouraging them, it's just making things worse. I'm not saying we shouldn't counter fraud, of course we should, that's a different thing altogether but minimising peoples' taxation is something that's been going on for hundreds of years and will continue to. It's just a matter of degree. My view is that there are some cases where you shouldn't try and beat it, you should try and join it. My thought for the day.

*[from the floor]*

*Ayuk I have a small question. My understanding is that if you lease a VAT paid boat, as the leasing instalments are clearly a delivery of services VAT, although mitigated according to the Italian rather than the French scheme, is to be then again applied. Is this correct? Because I seem to understand that from your previous speech you said that in the case of a VAT paid boat that is then again leased, VAT is not due on those instalments? But this is not consistent with my experience. I just want to have a little clarification regarding this.*

## **Ayuk**

If I understand you correctly, you are saying that—are you talking about the second period of the lease?

*[from the floor] No no. I'm talking about David Prinzi is purchasing through a leasing scheme a VAT paid boat. A second hand boat which has already paid VAT possibly purchased by a private individual. So that boat has already accounted for VAT. The leasing instalments that I will be paying in my understanding are still to be subject to VAT although mitigated. Is this correct or is there a ground for the instalments not being subject to any VAT as the leased boat has already paid it?*

## **Ayuk**

Most businesses that are leasing out boats will charge you VAT, correctly so. The point I made, and I emphasise that was an exception, it is very unlikely that you would be leasing a boat from a leasing company and not paying VAT. And I gave some examples of circumstances — I speculated about circumstances where the leasing company might not charge you VAT and two of them — one is that they are operating under the VAT threshold, their turnover is not enough in the country in which they carry out their business, to oblige them to register for VAT, because you have to be registered for VAT in order to charge it. The other circumstance I mentioned is one where because they bought the boat in the first place from a private individual who had already paid VAT, they could actually operate the boat under their leasing arrangement and under a registration threshold without charging VAT. I was saying it was an exception. In 99% of the — because leasing structures are always high volume, big operations — cases they will charge you VAT. So we do have some clients who come to us who say I have this boat that I leased and have now decided to acquire it at the end of the lease and I wasn't charged VAT because I was not supposed to be charged VAT. The question I ask is why weren't you charged VAT? I would need to look at the whole arrangement to see why that was.

## **Steve**

Sorry David, I think I know what you're talking about. There is this principle from an old case — it doesn't involve yachts— but where VAT is paid on an asset and it becomes effectively VAT paid within Europe, then unless its circumstances change it remains VAT paid in perpetuity, which is why boats that are sold 5 or 6 times carry that VAT paid status onwards and upwards. I was a little confused about what Ayuk said — we operate boats that have been through leasing structures where VAT has been paid on them and never recovered so they are in effect VAT paid. They are in effect VAT paid. But we can still operate those boats as commercial boats and as Ayuk correctly says, if you're charging for chartering that boat, then you'd have to account for VAT unless you're under the French exemption, or whatever, so that status is not necessarily effective. But if that boat were then sold at the end of the period, so it's been a lease boat, it's VAT paid, it's come into a commercial structure, and then it's to be sold onwards, there used to be a principle in UK VAT law that if

you bought an asset and didn't recover the VAT on it, when you sold it you didn't have to account for the VAT. The difference between that is being charged VAT and not recovering it, in other words it's a separate item on the invoice you take in, or it's included in the price as a VAT paid boat as most of the lease boats are. I can see where the confusion might lie. But the question that Martin asked is, what's happening to the Monaco lease?

*[from the floor]*

*There's no specific Monaco lease. We typically use our— we are part of a large investment bank in Milan and we typically use our sister company for the Italian scheme, which as you correctly said, for private registration, and seems to be one of the most efficient at least, and in other cases the French scheme. That's for other situations that don't need to be disclosed now.*

*[from the floor]*

*You can have a French or Italian lease with a Monaco flag. And that's only come in the last year or so.*

### **Steve**

There was a reluctance on behalf of our company to have anything other than an Italian flag, but I think that was just purely down to the security aspects — they used to say well, if we have an Italian flag at least we can get hold of the thing, whereas now they understand the concept of the Red Ensign mortgage and so on and they're quite happy about that. It was nothing to do with anything other than the security of the asset, as far as I'm concerned, and again, a Monegasque flag is perfectly acceptable — you've just got to be a Monegasque resident, is that right?

*[from the floor]*

*That's correct, yes. But there's one other point, Steve. My experience of leasing is that under French leasing you cannot actually commence the lease until the product is completed. The banks will in certain circumstances provide you with finance during the period up to delivery when it's converted into a lease, but until the product is delivered it doesn't exist.*

*[from the floor]*

*A quick question, Steve. You talked about finance lease, which is like the Italian and Maltese, where you pay a 1% residual and therefore you pay effectively VAT on the 1%. You then talked about the Isle of Man operating lease, which is not a finance lease therefore you have no right to acquire the vessel at the end, but if you did acquire the vessel at the end, what would be the basis on which you paid VAT? The market value or a residual value?*

### **Steve**

Actually the person who is an exponent of this lease is not here today — you could have asked him. Could I just point out that there is a difference between the common law treatment of finance leases and the civil law treatment of finance leases. Under the Italian and French leases VAT is paid on the deposit as a kind of upfront payment but at 30% of the true rate for boats over 24M and then it's paid in instalments as

each instalment goes, whereas if you were to operate a finance lease in the UK or Holland, under the common law treatment of finance leases it's treated as a supply of goods and VAT is paid immediately. So to do up a finance lease through the Isle of Man or UK or Holland, unless you use the cross board principle which is a different thing altogether, VAT is paid upfront at the very beginning. So there's no advantage. The only advantage would be if you then took this concession which the French and Italians and Maltese are using on saying that the boat in its future life or during the life of the lease will be used outside the EU and therefore there is an element on which VAT is not charged. That's the only difference. There are other differences between the way finance leases are treated in different countries as well, and that's a bit too complicated for me to understand so I don't particularly want to go into it. But I take your point, that an operational lease from the Isle of Man or perhaps from the UK is because if it were a finance lease VAT would be paid upfront and therefore there would be no advantage. The advantage of the Isle of Man lease is that VAT is deferred over a 20 or 25 year period. So you end up paying it in the end if ever you were to keep the boat for 25 years, so the advantage is just spreading the VAT over a long period of time. The only way to do that is by doing it as an operating lease so that the boat remains in the ownership of the leasing company. Now where the leasing company got the money from, to buy the boat in the first place, is another issue. So we're back to this concept of circularity. If it came from a third party lender, absolutely no problem. If it came from the beneficial owner who then became the lessee, I don't know how the UK authorities would treat that and as I'm not involved in them I don't know. The person who sells this isn't here today and I can't comment,

*[from the floor]*

*The question was, if you take it out of the structure, what is the VAT position?*

*What is the exit process?*

**Steve**

Well, I assume that at any point in that 20 year lease period if the boat is sold VAT is applied to the boat at that stage. Mr Barker at the front here is nodding so that is correct.

*[from the floor]*

*So effectively you pay it on the values?*

**Steve**

You pay it on the values that the leasing company sells to a third party. Unless of course it's exported or put into another structure.

*[from the floor]*

*I was just going to say that the interesting thing about the French and Italian schemes that I see is that you don't have that right to pre pay. If you lock in for 3 or 5 or 7 years you can pre pay but you lose all the benefits of the VAT mitigation if you do that. I'm not sure of the logic behind that? Is it obvious why that should be?*

**Steve**

What tends to happen with the Italian and French and Maltese leases is that you can actually assign the lease during the period.

He pays the residual value and he comes out. So it's quite normal for boats to be sold within leasing structure with 4 or 5 unexpired years.

*[from the floor]*

*I'm sure that's possible. But I've had cases where clients just simply weren't interested in staying in the lease. They simply wanted to pay it out. They were quite happy to pay cash and pay out the lease and they were refused. I just couldn't see the logic in why you could not make that prepayment and get the discount.*

*[from the floor]*

*I think David will probably have a view on this but we're doing one at the moment where it's a 3 year lease, Italian, two thirds of the way through, year to go, the guy's trading up his boat and what is happening there is that the final year that is unpaid will be paid at the differential between the 6 and 20%. So you can get out, but you pay that differential. I don't know whether David's in agreement on that or not.*

## **David**

The thing is that if you preterminate a lease it's not a delivery of services any longer, it's a delivery of goods, thus it's subject to full VAT but only on the outstanding instalments. Which at year 5 out of 7 it means that on the first 5 years assuming that typically these leasing structures go for full depreciation you've actually enjoyed for the VAT mitigation on most of it and you're just paying the full VAT on the pretermination, because it becomes a delivery of goods.

## **Steve**

Interestingly enough, the Dutch lease was criticised and is still being criticised because exactly the same principle applies. If you have a 7 year Dutch lease and you come out after 2, to get out you have to accelerate 5 years' worth of VAT payments, sorry, lease payments, on which full VAT is payable. So the same thing applies with the Dutch lease which to me indicates that it's not as aggressive as everyone made out and are still making out. So the same principle applies, that when you exit the lease it's a supply of goods and you pay the VAT where the exit takes place, whether that be France, Italy, Spain or whatever. And the consequent unexpired lease amounts attract VAT.

*[from the floor]*

*Just to add quickly to that in addition to the VAT that may be payable on termination you need to check carefully the banking terms in terms of termination, because we've seen quite a wide variety of bank fees payable at termination. Some of them have been really quite punitive, and others have been quite reasonable. So it's certainly one thing to check.*

## **Steve**

Again, any lease agreement or any loan agreement generally has upfront what penalties attract for early termination, and the same goes for any lease structure as well.

*[from the floor]*

*I only have one thing to add to the last remark— lease is a good solution but be careful and watch all the small clauses regarding fees, flexibility and what you're confronted with if you want to get out at an early stage.*