

HILL DICKINSON

**THE CONSTRUCTION,
PURCHASE AND REGISTRATION
OF LUXURY YACHTS**



Shipping 'at a glance' guide 6

HILL DICKINSON

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Introduction

Any yacht purchase and its subsequent ownership and operation, whether the yacht is a newbuilding or has been previously owned, will give rise to a number of legal issues and contractual relationships.

Where the yacht concerned is from the growing market for larger or luxury yachts these issues may take on an importance commensurate with the substantial purchase prices that will be paid and the intricacies of the underlying asset involved.

Accordingly, even where the yacht will not be used for commercial purposes, it is often sensible to seek advice on certain aspects of the transactions being entered into and how the position and potential obligations of a buyer or seller can be protected and/or improved.

As a law firm we have a wealth of experience in advising clients on such matters and, accordingly, have produced this Guide to highlight some of the main issues which need to be considered in connection with the construction, purchase, finance and registration of a luxury yacht.

1. Construction

The yacht broker's rule of thumb is that an individual should not invest more than 10% of their net worth in buying a yacht and should expect to spend at least 1% of their net worth each year on running costs.

If there is any comparable legal rule of thumb it is that given the competing interests of a buyer and its chosen builder, unless the yacht is to be of a standard design the respective rights and obligations of the parties should be set out in a properly negotiated and documented contract (rather than on the builder's standard terms and conditions). Without such a bespoke contract, disputes and expensive legal proceedings are often the result. With it, the likelihood of such disputes can usually be minimised and a more harmonious building process achieved.

We have set out below some of the various issues that such a contract would need to deal with.

Specification and Plans

The agreement of a detailed specification for the yacht is of particular relevance if the yacht is of a non-standard design with specific requirements in terms of design, quality and performance and its interior fittings and layout (as is normally the case).

Often, the buyer may select a specific designer to advise him in relation to the design, required performance and interior layout. This may necessitate a separate design contract between the buyer and the chosen designer although sometimes these terms may be incorporated into the construction agreement. Unless the designer is suitably qualified it may also be necessary to appoint a naval architect or technical supervisor to negotiate and agree the detailed specification with the builder and to oversee the construction on behalf of the buyer. This will necessitate a separate agreement.

The ultimate objective is for a detailed specification to be agreed and to form part of the contract (usually by way of a schedule thereto) although in the event of any inconsistencies between the agreed specification and the contract the latter will normally prevail. The production and agreement of plans for the yacht will also be necessary and these should also become an integral part of the contract.

Contract Price

The overall purchase price and amount of and stages of construction at which the instalments of the purchase price will be paid.

In most cases the price agreed will be fixed and the builder will bear the risk of any increased costs of construction. Nevertheless, it is possible that in volatile conditions a builder may seek provision for the price to be varied in certain circumstances eg to take account of variation in the cost of core construction materials (such as the price of steel) or to take account of variations to exchange rates.

It would also be normal for the contract to deal with any price adjustments that may result from a change in specification or requirements from the buyer. Such changes (and the resulting price adjustments) are a common cause of dispute and one reason why it is advisable to agree a detailed specification from the outset in order to minimise any requirement for changes to the same.

Payments

In most cases the first instalment of the purchase price will be payable as a down payment before construction starts. Subsequent instalments will then become due following completion of particular stages of construction with a final instalment due on delivery. Completion of a stage of construction (i.e. keel laying, hull completion and launching) would normally be confirmed by a classification society surveyor and the society's certificate of completion would trigger payment. One alternative to this is to provide for pre-delivery instalments to be paid on particular dates regardless of the stage of construction reached.

Sub-Contracting/Suppliers

The right to sub-contract certain of the works is likely to be sought by a builder. This will be required for certain technical aspects of the construction where appropriate expertise may not be possessed by the builder (e.g. for engines and navigation systems). Alternatively, sub-contracting may be necessary to meet production deadlines. However, where sub-contractors are to be used the buyer should ensure that it will be able to approve the major sub-contractors and that the builder will continue to be liable to it in relation to any works that a sub-contractor may carry out. Where possible the buyer would also seek to ensure that the sub-contractors do not have retention of title rights in relation to equipment supplied. To ensure the quality and performance required the buyer will also wish to have the right to approve and agree the major suppliers of materials and equipment to the yacht.

Failure to Meet Performance Criteria

Most contracts will include a liquidated damages provision setting out the agreed damages payable to the buyer as a result of any delay in delivery of the yacht or as a result of its failure to comply with certain aspects of the specification (ie noise, vibration, speed, range). There is normally a right to cancel or terminate the contract and the obligation to purchase the yacht for any excessive delay or failure to achieve the performance criteria despite attempts by the builder to rectify the same. However, where the delay or failure is within an agreed range the liquidated damages would be applicable. Such clauses have advantages for both parties because:

- ◆ the buyer will not be required to prove its loss through court or arbitration proceedings in order to claim the liquidated damages referred to; and
- ◆ the builder will not be liable for unlimited losses which it will not be able to quantify or insure against.

However, these clauses are normally the subject of extensive negotiations. A buyer may need to get its technical advisers involved in these negotiations and will be seeking to ensure that there are suitable incentives for the builder to comply with the specification and meet the required delivery date. In contrast the builder will be seeking to minimise its liability for liquidated damages as much as possible.

Risk

The contract should also require the builder to maintain insurance against any loss or damage to the yacht during the course of its construction. The buyer will also want a right to approve the terms of such insurance and the amount of cover to be obtained. The contract should also specify that in the event of a total loss of the yacht prior to delivery the buyer shall have the option either:

- ◆ to cancel the contract and receive a refund of all pre-delivery instalments; or
- ◆ to require the builder to recommence construction of the yacht and to apply the insurance proceeds towards the cost thereof.

In most cases builders will be keen to maintain the building in these circumstances subject to new delivery schedules and any variation to the price being agreed.

It will also be important for a buyer to ensure that its representatives supervising the building works are adequately insured.

Security

Given that the buyer will be making pre-delivery instalments, which in certain circumstances will become repayable by the builder (e.g. following a total loss or cancellation), it will be important for the buyer to obtain some security for the builder's repayment obligations. This will often be provided in the form of a refund guarantee pursuant to which a bank (acceptable to the buyer) will guarantee the repayment by the builder of any money that becomes due up to a specified period. Accordingly, agreeing the identity of this bank and the terms and extent of any refund guarantees as well as the amount of the pre-delivery instalments will be an important part of the negotiation process. Additional or alternative security may be available to the buyer by having title (but not risk) to the yacht transferred to it as it is being constructed. However, whilst this may give the buyer additional leverage in the event of a dispute there may be practical limitations on the buyer asserting ownership before the yacht is delivered.

The buyer may, in turn, be required to provide security for its payment obligations under the contract (often also in the form of a guarantee from its parent or beneficial owner).

Trials

The contract (or specification) should specify the trials and tests to be carried during construction and the buyer should be entitled to have a representative present who can comment thereon. The contract (or specification) also sets out the sea trials to be carried out following construction and the conditions in which such sea trials are to be effected in order to ascertain whether or not the yacht as constructed complies with the specification. A representative of the relevant classification society will be present during the sea trials and it may be agreed that in the event of any dispute their determination of the yacht's performance at sea trials and its compliance with the contract will be conclusive. It is also important for a representative of the buyer to attend such sea trials.

Documentation and Delivery

The contract will need to specify both the time and procedure for delivery of the yacht and the documentation that will be provided by the builder upon delivery in exchange for the final instalment of the purchase price. This should include documents of title to the yacht such as a builder's certificate or a bill of sale and such other documents as the buyer may require for the purposes of registration (see Section 4 (Registration)). In addition a buyer will want to receive the plans and manuals required for the ongoing maintenance and operation of the yacht.

The place of delivery must also be agreed. Normally, this will be at the builder's yard although the buyer may be able to negotiate delivery at a location which is more convenient (e.g. in terms of crewing and the yacht's intended mooring location) or which is required as part of any scheme to avoid Value Added Tax (see Section 5).

Warranty Period

It is standard for the builder to guarantee the materials and workmanship used in the construction of the yacht for a period after delivery. Depending on negotiations between the parties this can be for a period of between 6 and 18 months with a period of 12 months being most commonly agreed. Although this period may appear relatively short in respect of an asset which should have a useful life of 20-30 years, after the warranty period the buyer should have recourse to its insurers in respect of many defects depending on its insurance coverage. In some cases extended warranties may be available in respect of particular components or where the same are available from the suppliers.

Whether any security is required in respect of the builder's obligations under the warranty provision will also need to be considered. This may take the form of a bank guarantee issued by the builder's bank (a warranty guarantee). Alternatively, in some instances the buyer may be able to negotiate the retention of an equivalent amount of the purchase price for the duration of the warranty period.

Default

The effect of any failure by either party to comply with the terms of the contract will also need to be specified.

For the buyer this will normally be a case of non-payment which could result in a cancellation. Other defaults for which a buyer may commonly be liable are delays in approving plans and drawings for incorporation into the yacht. The normal consequence of such a default is that there will be a permitted delay to the date of delivery for which the builder will not be responsible.

Default by the builder will be dealt with to a large extent in the liquidated damages provision (referred to above). Any liquidated damages due will normally be recovered by a reduction to the instalment of the purchase price payable on delivery. However, the buyer may also have a right to cancel the contract in the event of a protracted delay or a major non-compliance with specifications. In these circumstances the buyer would normally become entitled to a full refund of the pre-delivery instalments that it has made (together with interest thereon since the date of payment) and would be making an immediate claim under any refund guarantees given.

One alternative remedy that the buyer may seek is a right to take possession of the unfinished yacht and to remove the same from the builder's yard for completion elsewhere. However, in practice and depending on where the yacht is being built exercising such a right is often fraught with difficulty.

Dispute Resolution

The contract should also contain detailed provision setting out an agreed procedure for the resolution of any disputes that do arise. Commonly, this will involve some or all of the following:

- ◆ Provision for a reference to be made to a classification society surveyor or other technical expert to determine disputes in relation to technical issues.
- ◆ In relation to other disputes arbitration or the issue of legal proceedings through the courts.

Arbitration remains the favoured procedure in contracts of this type and an arbitration provision will therefore be agreed in most circumstances.

Choice of Law

English law remains a common choice of law for many shipbuilding contracts and is usually acceptable to both buyer and builder. Clearly, the choice of law should be independent of the law and jurisdiction applicable to the builder.

2. Sale and Purchase

Type of Yacht

Yachts will either be brought and sold as newbuildings or second hand. Where a newbuilding is concerned the terms of the sale and purchase (and the documentation to be provided) will be covered by the contract as referred to in Section 1 (Construction) above.

Where a second hand yacht is being sold, the main commercial terms will, typically, be agreed through a yacht broker. A Memorandum of Agreement (“MOA”) will then usually be signed by the parties reflecting these agreed terms. The MOA is a legally binding agreement by the parties to buy and sell the yacht. Accordingly, it is recommended that the parties seek legal advice before entering into the MOA.

Several standard forms of MOA are available. The most commonly used for yachts being the The Mediterranean Yacht Brokers and the Royal Yachting Association form. For larger yachts an amended version of the Norwegian Sale Form (typically used for commercial vessels) could also be used.

However, what is most appropriate in any case and whether any amendments to the standard form are required will depend on the type and size of yacht concerned and any other issues arising from the sale that need to be dealt with. These may include whether the yacht is to be used for any commercial purpose (e.g. chartering) or solely for pleasure.

The MOA

The MOA will normally provide for a deposit of 10% of the purchase price to be paid by the buyers at the time the MOA is executed (or shortly thereafter) with the balance to be paid at the time of delivery of the yacht.

In exchange for payment of the purchase price, the seller will make physical delivery of the yacht at a specified location and within a specified timescale. The seller will also provide documents of title enabling the buyer to register its ownership of the yacht in its chosen jurisdiction. The delivery documents required will depend to some extent upon the jurisdiction in which it is intended to register the yacht. It is therefore important for the buyer to confirm these requirements and to ensure that the seller is required to provide all such registration documents under the terms of the MOA. Two documents that will always be required are:

- ◆ a bill of sale transferring title to the yacht from the buyer to the seller; and
- ◆ a protocol of Delivery and Acceptance recording the date and time at which the transfer of title is to be effective.

The terms of the MOA will normally be negotiated following a detailed inspection and survey of the yacht and an acceptance of its condition. As the yacht will remain in the possession of the seller up to the date of delivery the MOA should also contain assurances that the condition of the yacht will be the same as at the time the yacht was inspected or surveyed. Sometimes the MOA will also require the seller to complete certain surveys or remedial works prior to delivery as a condition of the sale.

A yacht MOA should include as inventory of all items which are to be included in the sale. Any inventory of items should be as detailed as possible specifying all items from navigation equipment, furniture, bed linen, crockery and cutlery together with any artwork, antiques, tenders, jet skis or diving equipment which are to be sold along with the yacht. For clarification, it is also often necessary to specifically identify any items which are to be excluded from the sale. In addition to an inventory of belongings, the treatment of consumable stores such as fuel and lubricating oils should be specified. It is usual for an additional payment to be made for these and this could be substantial depending on the quantities on board.

An important term of the MOA is the warranty that the yacht will be delivered free of debts or encumbrances of any kind. Although it should be possible to ascertain whether there are any registered encumbrances, such as a mortgage, by checking the yacht's registration details, some other liens may attach to the yacht automatically and without any requirement for registration. Therefore, where possible this warranty should also be matched by an indemnity in respect of any claims or liabilities against the yacht arising prior to delivery to the buyer. Yacht ownership structures are usually arranged through offshore companies with no assets other than the yacht itself. As a result, the value of an indemnity from the seller of the yacht is likely to be limited. If there is any particular cause for concern, it will be necessary to seek a guarantee from an entity of more substance (such as the beneficial owner of the yacht).

Confirming whether Value Added Tax (or its equivalent) is payable and/or has been paid in respect of the yacht will also be important if the yacht is to remain in EU waters for any significant length of time since if tax is due but has not been paid the yacht would be liable to arrest and detention by the relevant customs authorities. This issue is dealt with in more detail in Section 5 (Value Added Tax) of this Guide.

Other terms commonly included provide for a mechanism for the resolution of disputes (often initially arbitration and then in the Courts), events which will be considered force majeure events terminating the MoA without liability for either party and a clause specifying the consequences of either party defaulting. Normally, if the buyer is in default they will risk losing their deposit. A party in default would also face a claim for damages.

Insurance

Buyers will need to arrange for the yacht to be appropriately insured from the time at which ownership of the yacht passes to the buyer. During construction the buyer will also need to be satisfied that the yacht is covered by appropriate Builder's Risks Insurance.

There are various standard marine insurance policy wordings specifically for yachts. Two sets of standard wordings in current use in the London market are the Institute Yacht Clauses 1/11/85 (CL328) and the American Yacht Clauses May 1947 (CLA231), but both have exclusions and warranties that may limit cover. However, extensions are available covering further and ancillary risks which may need to be covered and might otherwise be excluded - for example in the English forms extensions for the following risks can be obtained:

- ◆ War and strikes
- ◆ Additional machinery damage
- ◆ Racing risks

- ◆ Personal effects
- ◆ Transit
- ◆ Speedboats

Amongst the American standard additional wordings there are yacht protection and indemnity insurance and medical payments clauses.

Alternatively, there are tailored sets of insurance clauses, providing a package of insurance, offered by certain specific yacht insurers.

Amongst other things, it will be important for buyers to ensure that all crew, guests and ancillary items of value (such as art works, jet skis, speed boats, tenders, helicopters etc) are fully and adequately covered by insurance.

In some cases insurance for the yacht itself and for liabilities will be placed on one policy with yacht insurers. In other cases it may be appropriate to place certain categories of risk on separate policies, for example with a Protection and Indemnity Association (P&I Club). If the yacht is of a substantial size obtaining cover for oil pollution will also be a consideration.

It may also be possible for the yacht to be covered as part of an existing fleet package for commercial vessels but care needs to be taken to ensure that the correct cover and values are available within that fleet package. Care should be used when using standard wordings and the advice and guidance of brokers specialising in this area is always to be recommended.

Crew and Charters

A buyer may often wish to re-employ the seller's crew for the sake of convenience. If it wishes to do this it will normally wish to see copies of the crew's existing employment contracts so that these can be repeated with the buyer. In such a case it may also be appropriate to make the sale of the yacht conditional upon new employment contracts being signed. Otherwise, if the existing crew is not being taken over arrangements will need to be made for the new crew to be available to take physical delivery of the yacht when title passes. Yachts which have been used for commercial purposes will often also be sold subject to and with the benefit of any pre-arranged charters. In these circumstances it will be important for the buyer to approve the terms of any relevant charters and for any necessary amendments to be made thereto (e.g. to the payment terms to ensure that the buyers receive the charter hire). Accordingly, the MoA will need to provide for copies of the charters to be provided prior to delivery (with the originals being handed over on delivery).

Management

Buyers will commonly employ managers to take care of such matters as the crewing and chartering of the yacht (where the same is to be used for commercial purposes) as well as ongoing maintenance and survey requirements. Many specialist yacht managers offer these type of services and different levels of management will be available depending on exactly what is required. In each case a management agreement should be signed specifying what services are to be provided and what management fees will be payable. Since this agreement is also likely to contain certain indemnities in favour of the manager and limitations of its liabilities legal advice on the terms of the agreement is advisable.

3. Finance

Historically most luxury yachts will have been sold to cash buyers so that the need for finance would not arise. In addition banks and other financiers were in the past reluctant to fund yacht purchases because of the non-commercial purposes for which the yacht would normally be used. However, this position has now changed and many banks are now willing to finance luxury yacht acquisitions (whether newbuildings or otherwise) provided appropriate security is available. Some banks also have special teams dedicated to this area.

The loan terms available will obviously be dependent upon various factors such as the creditworthiness of the owner, the age and value of the yacht and any other collateral security that is available.

However, typically the terms offered are likely to be as follows:

- ◆ A loan of between 50-65% of the yacht's value with a security maintenance covenant requiring the owner to prepay a part of the loan or provide additional security if at any time the outstanding amount of the loan exceeds the percentage specified. Accordingly, even where finance is being obtained it is likely that the owner will need to provide between 30-45% of the purchase Price from their own resources.
- ◆ A repayment period of between 5-7 years.
- ◆ Semi-annual repayments of interest and principal although it may be possible for the owner to defer a significant proportion of the principal as a balloon payment that would become due upon maturity of the loan (which would be paid either from the proceeds of sale of the yacht or through a re-financing at that time).

- ◆ An interest margin dependant upon the security available and other evidence the owner is able to provide regarding their net worth. The owner may also be required to covenant that their net worth will never be less than a specified multiple of the amount of the loan.

The particular terms of any loan are then likely to be set out in a detailed loan agreement including the various conditions required to be satisfied prior to any drawdown and the ongoing covenants with which the owners would be required to comply until the loan is repaid (e.g. concerning the use, condition and operation of the yacht). In addition the following security is likely to be required:

- ◆ A first priority mortgage over the yacht. In the event of any non-payment the bank would be entitled to enforce the mortgage by repossessing and selling the yacht and using the proceeds of sale to recover what is owed to it. Given that this is its main security a bank will also want a right to approve the jurisdiction in which the yacht is to be registered since the system for registration of mortgages in some of the less well known jurisdictions may not be acceptable to it.
- ◆ A Deed of Covenants (either contained within or collateral to the mortgage) setting out the ongoing covenants regarding the required use, insurance, maintenance and operation of the yacht. These covenants are intended to prevent anything which may put the yacht at undue risk or reduce its value thereby affecting the security available to the bank.
- ◆ A survey and independent valuation of the yacht (repeated annually).
- ◆ An assignment of insurances. This would be intended to provide the bank with first recourse to any insurance proceeds over the yacht (e.g. in the event that it is a total loss or there is a major casualty) so that any outstanding part of the loan could be paid from such insurance proceeds. The financing bank will want to have its interest noted on the relevant policies and is also likely to require the buyer to pay for the cost of mortgagee's interest insurance which would cover the bank in the event of the buyer's insurances being for any reason invalid.
- ◆ An assignment of charter hire. This may depend on the extent to which the yacht is to be put to commercial use in the charter market. Related to this may be a requirement for any charter hire that is earned to be paid into accounts with the financing bank.
- ◆ In the case of a newbuilding, an assignment of the builder's and manufacturer's warranties.
- ◆ Third party guarantees. This may include a requirement for a guarantee from the beneficial owner or some other form of cash collateral.
- ◆ Covenants regarding the yacht's habitual location.

The above is just a brief indication of the relevant terms and what is involved in raising finance. Should you wish us to receive further information please let us know.

4. Registration

With an ever increasing number of jurisdictions available, the choice of where to register a yacht is becoming more and more difficult for owners. In each case the registration process involved is likely to be similar and, accordingly, the choice for any owner will depend upon a number of other factors including the intended use of the yacht (i.e. whether it is to be used for commercial or non-commercial purposes), the likely geographical scope of operation, the owner's domicile as well as various factors relating to the yacht itself.

The following matters are likely to be of particular importance:

- ◆ Eligibility for registration (this will normally depend on the yacht's age and how it is owned)
- ◆ Cost (e.g. initial and on-going registration fees)
- ◆ Survey requirements
- ◆ Political considerations
- ◆ Acceptability to financiers

The political stability and reputation associated with the British Red Ensign jurisdictions (which include Bermuda, British Virgin Islands, The Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey and Turks and Caicos) makes these a popular choice. As well as having reputations for efficient management and administration, these jurisdictions also benefit from British Consular support which may be useful in connection with crewing matters. However there are differences between the Red Ensign flags e.g. as to registration fees and with some imposing more onerous manning constrictions than others, or requiring vessels to be within a certain age range to be eligible for registration. The relative merits of the flags would therefore need to be compared in each case.

All the Red Ensign countries also require compliance with the Maritime and Coastguard Agency's Code of Practice for Safety of Large Commercial Sailing and Motor Yachts (the "Code"). The Code applies to any existing or new yachts which are:

- ◆ Over 24m in length
- ◆ Over 150 gross tons if built prior to 21st July 1968
- ◆ Are in commercial use for pleasure or sport
- ◆ Do not carry more than 12 passengers (where more than 12 passengers are carried more onerous passenger ship regulations are likely to apply)
- ◆ Do not carry cargo

This Code has effectively set the international safety standards for large yachts, addressing such matters as construction, equipment and manning requirements and as a result has been adopted by countries outside of the Red Ensign (such as the Bahamas). Accordingly, compliance with the Code should satisfy the requirements of port authorities worldwide (at least in any IMO convention state). In addition apart from direct improvement in terms of safety, compliance will enhance the image of the yacht in the charter and brokerage markets. Even yachts not engaged in commercial activity are also likely to benefit from compliance and may increase their resale value. Further, insurance premiums may also be reduced where the yacht complies with the Code.

Outside the Red Ensign, the Marshall Islands is a popular choice reflecting the Marshall Islands' benefits as an offshore jurisdiction and the fact that it has adopted a Safety Code of Practice for Large Yachts. The Marshall Islands is also a relatively cost efficient jurisdiction through which to own and register a yacht and has liaised closely with the United States Coast Guard to ensure that Marshall Islands registered yachts have automatic rights to a cruising permit for sailing in US territorial waters.

The Bahamas is also becoming popular but the array of possible jurisdictions are large.

Providing more detailed information on specific jurisdictions is beyond the scope of this Guide but such information can be provided on request.

5. Value Added Tax

It used to be said that Value Added Tax (VAT) did not affect anything which “touched with the sea”. This has not been the case for some years and for yachts in use after 1 January 1985, which were moored in the EU on 31 December 1992¹, VAT is now payable at the relevant local rate in the EU country where the pleasure craft is permanently moored. As a result, purchasing a new yacht in an EU country or importing a yacht into the EU for the first time VAT will normally be payable. However, whilst the principle remains the same throughout the EU, each Member State interprets and implements the legislation differently and the rates of VAT and exceptions to the rules may vary from Member State to Member State. Accordingly, there is some scope for “forum shopping” to make VAT savings. In certain circumstances the VAT cost can also be neutralised.

¹ These dates are 1 January 1987 and 31 December 1994 in respect of Austria, Finland and Sweden as later entrants to the EU.

UK Summary

We have summarised the position in the UK below to provide some guidance as to whether or not VAT will be payable in any particular case.

EU Resident / EU Vessel

Should an EU resident purchase a yacht from within the EU with the intention that the yacht remains in the EU, the yacht will be subject to VAT. Normally in such instances VAT is payable where the yacht is first imported within the EU or where it was built in the EU. However, when EU-residents purchase EU vessels with the intention of taking them to another Member State (in a contrast to normal VAT rules) VAT will not be payable to the seller on the consideration (so its supply can be zero rated) but instead will be payable by the buyer in the Member State of destination, provided that the yacht is a “new means of transport”.

EU Resident / Non-EU Vessel

Any EU resident purchasing or bringing in a non-EU yacht into the EU will in general be liable for VAT upon arrival of the yacht at its first EU port of call, regardless of the yacht’s age or previous tax history. If an EU resident purchases a yacht in the UK where VAT has been paid and then exports it from the EU for a period of over three years he may have to pay VAT again if it is re-imported into the EU.

Non-EU Resident / EU Vessel

Should a yacht be purchased in the EU but then immediately exported under its own power to a destination outside the EU VAT territory, it can be zero rated for VAT purpose. However, if an EU registered yacht is bought/kept in the EU, the yacht will be liable to VAT even if it has an owner that is not resident in the EU.

Non-EU Resident / Non EU Vessel

If it is intended that a non-EU yacht owned by a non-EU resident be re-exported, it may be brought into and used privately in the EU temporarily without incurring VAT. To do so, the yacht must fall within the Temporary Importation procedure and can only remain in the EU for a limited period (currently 18 months in any 24 months) before either leaving the EU territory or becoming liable to VAT.

Should a non-EU resident be contemplating a move to the EU, new legislation provides for a Transfer of Residence (“TOR”) relief, which may reduce the financial burden of bringing their goods (including yachts) into the EU. However, such relief is discretionary and will depend on various conditions being met and care should be taken to ensure that once given, other Member States visited will recognise the TOR relief granted.

Isle of Man Schemes

If the yacht is to be used for commercial purposes it may be possible to neutralise any VAT cost for the buyer by the establishment and VAT registration of the buyer in the Isle of Man. This is achievable because the Isle of Man is within the VAT territory of the EU and is therefore a Member State for the purposes of importation or of obtaining zero rated supplies. At the same time if the buyer is an Isle of Man non-resident company which will be paying 0% corporation tax it can carry on commercial purposes and avoid paying VAT in the Isle of Man without any adverse tax consequences. Currently, it is also not necessary for the yacht to sail to the Isle of Man at the time of acquisition in order for VAT to be dealt with in this way. However, proper advice on any such scheme will be necessary.

Commentary

No matter what the status of the yacht, it will be important for owners to keep documented records of VAT-payments and also proof of visits into and out of EU territories as well as other pertinent records in order to prove that VAT has been paid or that the yacht is exempt (e.g. under the Temporary Importation rules). Upon a purchase of a yacht the buyer should ensure he receives all the necessary papers including the original VAT invoice.

The most common scenario, however, is where owners want to sail their non-EU vessels in EU waters. In this situation, much depends on the residency status of the owner. If resident in the EU, the yacht will be liable to VAT. However, charges can be minimised by choosing a jurisdiction where the VAT rates are lowest as the yacht's first port of call. Moreover, it may also be possible to arrange for the newly built vessel to arrive in the EU second-hand. In such circumstances, the owner would be importing a yacht which is of substantially lower value than when newly built meaning that VAT will be levied on a lesser amount.

As a result of this, owners are advised to plan their yacht's entry in the EU carefully and to consider the importation and relief options available in conjunction with their own needs and take advice where necessary in order to achieve an optimum VAT position.

Notes

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