

Active Yacht Ownership for Less

An informal guide to the pros and cons of owning a charter yacht

A program that will allow your catamaran to be utilized for charter will allow you to own a boat at the lowest possible cost. This is achieved by purchasing a boat with the intention of putting it into service as a charter boat, allowing you to not only potentially generate profit, but also gain the ability to re-direct many of the taxes you are already paying for your primary source of income. This informal guide will help you with setting up a catamaran as a charter vessel, covering a range of topics from tax planning to exit strategy.

This plan has been gaining traction in the yachting world for some time now, as the advantages of acquiring tax breaks for other businesses (while at the same time building equity), are profound and can make a noticeable impact. The ability to buy a boat, have it generate profit and/or provide tax incentives, and then being able to own it after 3-8 years for anywhere from 75% to 0% of the initial purchase price is something not many potential boat owners know they have the option of doing. The amount of tax deduction you can carry out can be applied to your aggregate taxable income from any active business enterprises. This is not limited to just your own income or wages; if one has a joint account with their spouse, any taxable income may be deducted from their wages as well.



The key to getting all these tax breaks is presenting the purchasing and chartering of your yacht as a business in which you are actively, not just passively, involved in. Passive participation usually covers those who enter their boats into a mass charter company. Active participation constitutes being involved with finding potential charter clients, bringing the boat to boat shows, or inspecting the boat after it has been sailed by clients. The bottom line is that you need to be able to log more than 100 hours per year of being actively involved in trying to make your business profitable for your participation to be considered “active”. The specifics of which activities are considered active participation will be discussed further in later chapters.



Overview

This section is going to give a general outline of the process from initial contact to exit strategy. Keep in mind that this is not set process, but rather viewed as a reference to facilitate the procedure.

The first step to anything is planning, so it will help you and us if you read through this guide beforehand, and then seek the assistance of maritime attorneys and a CPA for further clarification. It can help to consider the following before making the decision to start this

program such as: desired amount of personal use per year, where your charter will be located, and what will happen to your yacht towards the end of its chartering lifetime. It is also important to have a specific boat with option packages in mind as soon as possible.

If you wish to finance the yacht a financing application is important, which our loan specialists will review for a pre-approval. After going through these initial steps, we will work together to create a plan for your unique requirements. Letting your own tax advisor know what you are planning to do is advisable at this point of the process. Having a plan lined up certainly ameliorates this step. After contemplating the details of your plan, it is advisable to place a deposit on the yacht of your preference, as pricing and delivery can change over time and this is the surest way of avoiding unnecessary price increases.



Active Involvement

In this section we will further explore what active involvement is, how to qualify as being actively involved in your charter business, and what benefits come as a result of active involvement. It is crucial to understand what constitutes active involvement, as many of the tax breaks only come into effect if one is actively involved in your business:

There are some concrete requirements that need to be met before one can be considered actively involved. These are as following:

1. You must be the one responsible for any expenses construed while chartering, as well as the initial purchase price of the yacht.
2. You should have made a 5-year plan with an alternative means of generating profit. This business plan can be created with our help, in coordination with your tax advisor.



3. The operation cannot be construed as a lease. Formal long term management commitments should be avoided, as well as programs what are based on fixed/guaranteed income. The correct way of doing this is having seasonal management agreement (aka Service agreement). This underscores the notion that you remain control of your own boat and business. Your business should be set up as a limited liability company.
4. You need to spend at least 100 hours in the activity, and this number of hours needs to be more than what any other single individual spends. Participation is better if it is continuous, so making possible referrals for clients during the year is a great way of showing year-round participation in your business.

The last point is usually the one that makes people the most hesitant when it comes to trying to achieve active involvement classification. What exactly can I log as active participation and what can't I? The following points should be seen as a good foundation for active involvement, but by no means is active involvement limited by these activities.

1. *Checking on the boat.* This means that after or before your yacht is used by charter clients, time spent checking on the condition of the boat and noting any possible damages is something that should definitely be logged.
2. *Promotional trips.* This covers anything from going on test sails with clients at a boat show, to taking friends out (who are curious about possibly chartering) on an evening sail. The hours that you are onboard and awake can be logged as active participation.
3. *Advertising.* If this sounds broad, it's because it is. Advertising could be your most recent trip to a secluded anchorage, if you take pictures and give a quick write-up about the trip to be posted online on your blog or our website.

These three points are some of the most overlooked (and easy) ways to qualify for active involvement. As stated previously, these are certainly not your only options; virtually any activity you partake in relation to your business can be seen as an active activity, such as repairs, sailing courses, bookkeeping, delivery trips, etc. Something important to consider is that personal use will cut into time that the boat is being used as a business, and therefore proportionally cut into your potential tax deductions. For example, using and logging the boat 25% of the year for personal use will result in you only being able to claim 75% business deductions.

Our "Affiliate Dealer" program sets you up to meet all these requirements easily. This program is designed to make you an active partner in the charter business. Having this title not only lets you log almost all time spent on the boat as business, it also opens up yet another source of potential income. By partnering up with us, time spent at boat shows and the opportunity to make commission for finding and referring new clients is also an added benefit. Keep in mind that doing any of these things are definitely loggable active participation hours. Active involvement might not be for everyone – but it is important to know that this constitutes a viable option for tax savings.



Tax

As mentioned in the *Introduction* of this guide, owning a boat as a charter tool gives you the opportunity to take away huge amounts of taxes you are already paying. Though we are not licensed tax advisors, the following suggestions have worked for many others and there is no reason they shouldn't work for you too. An often overlooked challenge is making your CPA understand what you are doing. Since this business model is relatively new, many tax advisors simply aren't familiar with some of the issues that come up in a boat business. If this is the case we are always happy to refer you to our marine attorney who has years of experience and valuable insight in this field. In an effort to make this process more straightforward for both you and your tax advisor, we have listed a few things you should present to your tax advisor.

1. A complete and thorough *Plan*. This will be created with our help, so we will make sure all the necessary inputs are covered.
2. *Tax Returns*. This may go without saying, but especially if you wish to finance your boat, it is crucial for your tax advisor to have your complete returns for at least 2 years.

3. *Boat equipment options.* Your tax advisor is looking for the most accurate number regarding costs, and an accurate number is near impossible to come by if you are still undecided on option packages and the like.
4. *Approved Financing.* If you are financing the boat, this should be arranged through our finance partners who are familiar with the finer details of marine financing. This loan is a simple interest loan with no prepayment penalty.
5. *Details.* There are many small things your tax advisor may want to see, including details on how the boat is managed, Coast Guard requirements, Jones act info, etc. These are all things the marine attorney will be happy to provide.

Location

Figuring out where you will keep your yacht is important, as this should be a direct response to what your preferences and requirements are. No single location is best for everybody, so a few points which are good to consider will be listed to help you make the right decision.



Where do you want to sail? Even though this program can make a lot of sense from a financial perspective, the true beauty of it is that the cost of ownership for a yacht (available for personal use) is lowered by a huge amount. Taking the time to think about where you want use the yacht is meaningful and should not be overlooked.

Another point to consider when contemplating location is where your charter potential can be maximized. Ideally you want to keep the yacht in a location where there is a constant demand for charters, so that chartering your yacht out is always an option which you can choose to use or not. The charter capital of the world has always been the Caribbean for a few different reasons. The weather makes the chartering season stretch out much longer than it would in an area with a less favorable climate. The tropical location and close proximity of sailing destinations also helps foster an environment ideal for charters. Because of its remoteness, when people go to visit the Islands they tend to stay for longer periods of time, meaning charters of 7-10 days instead of 3-7. Having your boat stationed at an island accessible by plane is also something which would increase demand, which is why many profitable charters are moored at islands like Saint Martin or the BVI's

If you live in America and ultimately make the decision to keep your boat in the Caribbean, remember that you still have the option getting the boat sailed to your home for the summer. However, taking the yacht out of the "charter capital" will shorten the charter weeks and reduce revenue. The boat will also accumulate more wear and tear on extended delivery trips, which all should be taken into account.



Exit Strategy

We advise our clients to have an exit strategy in mind before placing a deposit on a yacht. This is also something your tax advisor will want to see. There are typically 3 options:

- A. *Purchase* the yacht privately after it is no longer being used as a charter boat
- B. *Sell* the yacht
- C. *Trade* in the yacht for another and continue with your business
- D. *Continue* chartering the boat for a lower-tier chartering program

Each of these options have their pros and cons from a tax perspective. This will be discussed below.

A. *Keep* the yacht

This is a popular option, as many see the opportunity to own a yacht now for less and use it in the future, when they have the time to enjoy it in its entirety. If you keep the boat after chartering the boat for 5 years or less, the major issue at hand becomes possible tax recapture. This procedure is carried out by the IRS to collect income tax on a gain realized by a taxpayer when the taxpayer disposes of an asset that had previously provided an offset to ordinary income for the taxpayer through depreciation. To avoid this, you should take a max total depreciation of around 70%. Because the boat is not going up for sale and no concrete resale value is established, this is a reasonable estimate from the perspective of an auditor that this is the current value of the boat. Carrying out this procedure is not something that only we recommend; it is considered somewhat of an industry standard throughout the chartering world.

B. *Sell* the yacht

If you decide to sell the yacht after using it for around 5 years, it will have accumulated depreciation equal to about half of its purchase price. If you financed the yacht, this selling price will be approximately the same amount as the balance of your mortgage (assuming 20% down payment and that the boat has been in charter for about 20-30 weeks per year). This means you can walk away after 5 years with the only potential expense being the initial down payment for the mortgage, and even this expense can be cut down or eliminated by aggressive bareboat chartering (25-35 weeks per year). When selling the boat, its value is established and the standard income tax applies if the yacht sells for a price higher than the depreciated market value.

C. *Trade* in the yacht for another and continue with your business

If you wish to continue to retain the tax incentives and having your catamaran available for personal use after the yacht has outlived its useful charter lifetime, it is recommended that you “trade in” the yacht. This is comparable to like-kind exchange in real estate; the used yacht would be traded in for the new one, and a new basis for tax assessment and depreciation would be established based on the difference between the trade-in value of the old and purchase price of the new.

D. *Continue* chartering the boat for a lower-tier chartering program

Keeping the boat in a charter is also an alternative. The option to hand your boat over to a larger charter company is always there. The consequence of doing this will be the following; your boat will continue to accumulate wear and tear while constantly earning less revenue, as the longer a boat is kept in a charter service, the less desirable it becomes. This will make the asking price of a charter week congruent with the boats desirability. You may also lose tax advantages if you decide to stop being actively involved in the management and finding new clients. However, this is up to you, as staying actively involved in your business is still possible depending on which charter company you partner with.



Conclusion

A boat charter business is a program that makes financial sense, and will allow you to own a yacht for less. By following the suggestions laid out by this guide, owning the yacht earlier than you anticipated might be feasible financially. Because most people have busy schedules, this program justifies ownership of a yacht that does much more for you than just sit idle when unused. A boat charter business is not for everyone and also has its downsides. Having your boat chartered out and sailed on by strangers is not always the most pleasant idea. It will almost definitely take more wear than a sparsely used private vessel. However, the benefits of doing this are so numerous, they are impossible to overlook. Your boat will be generating revenue. You will be saving money on your taxes. Your boat will constantly be maintained and checked. You enjoy a carefree ownership, knowing that the boat is being looked after and insured by professionals, while still retaining control and the ability to use it whenever you like. You won't have a bad conscience about buying what some would consider a toy, as you have taken advantage of the charter opportunities and are using your asset as a legitimate way to generate revenue and saving money.

A charter ownership program is a well proven option for boat owners to own a boat for less. However, it is not for everyone due to each individual's circumstantial needs or wants. The purpose of this guide is to give a general overview of what this program does, and help you make an informed decision about buying a yacht and placing it into charter.