TUGS & BARGES 2010

FINDING THE MONEY -- IN TODAY'S CHALLENGING ECONOMY-- WITH MARAD's CCF

H. Clayton Cook, Jr.

Seward & Kissel LLP

MARAD’s CAPITAL CONSTRUCTION FUND “CCF” PROGRAM

The Merchant Marine Act of 1970 authorized a “Capital Construction Fund” tax deferral program that allows vessel owners to purchase vessels and retire vessel debt with pre-tax dollars.

MARAD's CAPITAL CONSTRUCTION FUND "CCF" PROGRAM

The CCF Program allows a taxpayer to shelter income from current taxation in exchange for the taxpayer's commitment to purchase or construct a new vessel or reconstruct an existing vessel.

It allows an owner to take "CCF Depreciation" before a vessel is placed in service (rather than only after) and it allows an owner's investment income to be compounded tax free for periods of up to 25 years.

MARAD's CAPITAL CONSTRUCTION FUND "CCF" PROGRAM

The CCF Program provides an interest free "loan" (of tax monies that would otherwise have been paid), which the taxpayer "repays" (through reduced depreciation deductions) when the taxpayer purchases a vessel.

MARAD's CAPITAL CONSTRUCTION FUND "CCF" PROGRAM

The CCF Program has been available since 1970 for the Great Lakes and Alaska, Hawaii and Puerto Rico and Off-Shore domestic trades – and since December 2007 for domestic Container and Roll On/Roll Off services nationwide.

The CCF Program provides benefits – for vessel owners and operators, and for shipyards, and for leasing company owner-lessors. Almost everyone here today is a potential beneficiary.

INTRODUCTION – FINDING THE MONEY

This morning we will deal with CCF Program use by only the first of these three classes of potential users – that of vessel owners and operators.

INTRODUCTION – FINDING THE MONEY

We'll examine two examples of Program use by a vessel owner-operator in funding equity for new vessel purchases.

INTRODUCTION – FINDING THE MONEY

Alpha Corp. an owner-operator of offshore service and supply vessels wishes to add as many as five new platform supply vessels (“PSVs”) to its existing fleet.

INTRODUCTION – FINDING THE MONEY

First, we'll see how Alpha finds the equity to purchase three PSVs by accumulating before-tax dollars from current service and supply vessel operating income.

INTRODUCTION -- FINDING THE MONEY

Second, we'll see how Alpha obtains the equity to purchase two additional PSVs by using before-tax dollars to pay down existing vessel debt.

FINDING THE MONEY -- TWO CCF APPLICATIONS

Alpha Corp wishes to contract for three to five PSV 2013 deliveries. Alpha believes that prices may be as much as $30 million for each PSV, for a total cost ranging from $90 million for three PSVs to $150 million for five PSVs.

Alpha expects debt financing from a Norwegian bank-led lender syndicate for 80 per cent of Alpha’s PSV costs. But Alpha will still need to provide $18 million to $30 million for PSV equity.

FINDING THE MONEY -- APPLICATION 1: SHELTERING CURRENT EARNINGS

Alpha's planning staff has calculated that Alpha can only afford to put aside $3 million per year in before-tax income from its current service vessel earnings to fund the equity for this expansion plan.

If Alpha attempts to accumulate its needed equity with only these $3 million set asides, Alpha will accumulate only $10.76 million over the next 5 years – enough equity for the purchase of only one PSV.

APPLICATION 1: SHELTERING CURRENT EARNINGS

Accumulating Capital without CCF: $10,755,573 – One PSV

Year	*Taxable Income[a]*	*Tax Payable[b]*	*Non-CCF Account Deposits (Jan 1)[c]*	*Income on Non-CCF Account Balance (Dec 31) [c][d]*	*Tax Payable on Non-CCF Account Income[b]*	*Non-CCF Account Balance (Dec 31)*
1	$3,000,000	$1,200,000	$1,800,000	$180,000	$72,000	$1,908,000
2	$3,000,000	$1,200,000	$1,800,000	$370,800	$148,320	$3,930,480
3	$3,000,000	$1,200,000	$1,800,000	$573,048	$229,219	$6,074,309
4	$3,000,000	$1,200,000	$1,800,000	$787,431	$314,972	$8,346,767
5	$3,000,000	$1,200,000	$1,800,000	$1,014,677	$405,871	$10,755,573

Equity funds available for fleet expansion: $10,755,573 – One PSV

---

a) Taxable income from prior tax year.
b) Assuming a federal tax at Alpha's highest marginal rate, and a combined federal and state tax rate of 40 percent.
c) Taxable income remains taxable in the absence of CCF account deposits.
d) Assuming a 10.0 percent rate of return on deposited funds.

APPLICATION 1: SHELTERING CURRENT EARNINGS

Alpha's tax counsel has suggested the use of MARAD's CCF Program as a means of accumulating the equity for the purchase of at least three of the five PSVs.

Alpha enters a CCF Program contract and deposits $3 million of available service vessel earnings in each of the next five years for use as PSV vessel equity.

APPLICATION 1: SHELTERING CURRENT EARNINGS

At the end of the five years, this $15 million, together with $5.15 million of investment income, will provide Alpha with $20.15 million for PSV vessel equity; sufficient equity for Alpha's purchase of three of the five PSVs.

APPLICATION 1: SHELTERING CURRENT EARNINGS

Accumulating Capital with CCF: $20,146,830 – Three PSVs

Year	*Taxable Income*[a]	*CCF Account Deposits (Jan 1)*	*Tax Payable*	*Income on CCF Account Balance (Dec 31)*[b]	*Tax Payable on CCF Account Income*	*CCF Account Balance (Dec 31)*
1	$3,000,000	$3,000,000	-0-	$300,000	-0-	$3,300,000
2	$3,000,000	$3,000,000	-0-	$630,000	-0-	$6,930,000
3	$3,000,000	$3,000,000	-0-	$993,000	-0-	$10,923,000
4	$3,000,000	$3,000,000	-0-	$1,392,300	-0-	$15,315,300
5	$3,000,000	$3,000,000	-0-	$1,831,530	-0-	$20,146,830

Equity funds available for fleet expansion: $20,146,830 – Three PSVs

---

a) Taxable income from prior tax year.
b) Assuming a 10.0 percent rate of return on deposited funds.

APPLICATION 1: SHELTERING CURRENT EARNINGS

Without CCF: $10,755,573 – One PSV

With CCF: $20,146,830 – Three PSVs

Finding the Money: $9,391.257

FINDING THE MONEY – APPLICATION 2: RETIRING EXISTING DEBT

Alpha's existing service and supply vessels have been financed, on a vessel by vessel basis, with long-term vessel-associated debt.

APPLICATION 2: RETIRING EXISTING DEBT

Rather than making its service and supply debt service payments from general funds, Alpha deposits sufficient vessel operating income in its CCF Program account to make these debt payments with funds taken from its Program account in qualified withdrawals.

APPLICATION 2: RETIRING EXISTING DEBT

In this fashion, Alpha's debt service can be made with before-tax dollars, the measure of funds otherwise required for debt service will be reduced, and the funds available for the PSV purchases will be increased.

APPLICATION 2: RETIRING EXISTING DEBT

Assume that Alpha has annual debt service (principal payment) obligations that total $3 million per year. In order to make these $3 million payments with after-tax income (Alpha's income is taxed at 40 percent) Alpha must earn $5 million before-tax.

Over a five-year period, Alpha will require $25 million in before-tax dollars to service its $15 million in debt payments.

APPLICATION 2: RETIRING EXISTING DEBT

Retiring Debt without CCF - Additional funds for PSV fleet expansion $ 0

Year	*Taxable Income[a]*	*CCF Account Deposits (Jan 1)[b]*	*Tax Payable[c]*	*Debt Payments (Jan 1)*	*CCF Account Balance (Jan 1)*	*Income on CCF Account Balance (Dec 31)*	*CCF Account Balance (Dec 31)*
1	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
2	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
3	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
4	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-
5	$5,000,000	-0-	$2,000,000	$3,000,000	-0-	-0-	-0-

Additional funds available for PSV fleet expansion: $ 0

---

a) Taxable income from prior tax year.
b) Taxable income remains taxable in the absence of CCF account deposits; thus, eliminating funds available for fleet expansion.
c) Assuming a federal tax at Alpha's highest marginal rate, and a combined federal and state tax rate of 40 percent.

APPLICATION 2: RETIRING EXISTING DEBT

Making use of the CCF Program, Alpha will need only $15 million in before-tax dollars to service its service and supply vessel debt during the same five-year period.

If this savings is deposited and invested in Alpha's CCF Program accounts, Alpha will have an additional $13.4 million for PSV fleet expansion at the end of five years.

APPLICATION 2: RETIRING EXISTING DEBT

Retiring Debt with CCF - Additional funds for PSV expansion $13,431,220

Year	***Taxable Income[a]***	***CCF Account Deposits (Jan 1)***	***Tax Payable***	***Debt Payments (Jan 1)***	***CCF Account Balance (Jan 1)***	***Income on CCF Account Balance (Dec 31)[b]***	***CCF Account Balance (Dec 31)***
1	$5,000,000	$5,000,000	-0-	$3,000,000	$2,000,000	$200,000	$2,200,000
2	$5,000,000	$5,000,000	-0-	$3,000,000	$4,200,000	$420,000	$4,620,000
3	$5,000,000	$5,000,000	-0-	$3,000,000	$6,620,000	$662,000	$7,282,000
4	$5,000,000	$5,000,000	-0-	$3,000,000	$9,282,000	$928,200	$10,210,200
5	$5,000,000	$5,000,000	-0-	$3,000,000	$12,210,200	$1,221,020	$13,431,220

Additional funds for PSV expansion: $13,431,220 – Two PSVs

---

a) Taxable income from prior tax year.
b) Assuming a 10.0 percent rate of return on deposited funds.

APPLICATIONS 1 & 2: FINDING THE MONEY

By using the CCF Program, Alpha will have “found” an extra $22.8 million for PSV vessel equity, for a total of $33.6 million.[(a)]

This will allow Alpha to fund the equity requirements for the entire five vessel addition to its PSV fleet.

---

a) $9.39 million of this “extra” money has been achieved by deferring tax on money set aside from current service vessel earnings, and $13.43 million by deferring tax on money used to pay existing service vessel debt, which when these two figures are combined with Alpha’s base case of $10.76 produces a total of $33.6 million.

APPLICATIONS 1 & 2: FINDING THE MONEY

Without CCF: One PSV

With CCF: Five PSVs

Finding the Money $22.82 million

FINDING THE MONEY WITH MARAD'S CCF

THANK YOU

ADDITIONAL INFORMATION: For background and follow-on reading you may wish to refer to my Marine Money article on the MARAD CCF Program: Cook, "Financing the US Market via MARAD's 'CCF' Program," Marine Money International, October 2007.

H. Clayton Cook, Jr., Seward & Kissel LLP
1200 G Street, N.W., Washington, D.C. 20005
Phone: 202 661 7185 Email: Cookhc@sewkis.com