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VAT for Commercial Yachts: everithing is fine but we are not sure

“Zero VAT System” - A dream injudiciously sold over the years ?



with the authority of Italian Ship & Yacht Brokers Association



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“Zero VAT System” - A dream injudiciously sold over the years?

The turn of each year has a flavour. The current year, 2010, has a distinctive flavour too: it is a turn of apprehension, of uncertainties in various aspects of yachting business that have seemed strangely to reinforce one another.

One symptom of the mood is the muddle over **Value Added Tax (VAT)**. When the UK Revenue issued their “**Brief**” number 56/09 stating their view on the **VAT** treatment of yacht chartering or leasing activities in August 2009, it was turned into big news.

Yacht owners and operators, deeply unsettled because of the “**zero-VAT**” dream injudiciously sold to them over the years, suddenly began to ask questions of their legal and corporate service providers. Their “**everything-is-fine-but-we-are-not-sure**” messages only yielded more exaggerated depths of feeling.

Take the cross-border VAT changes being introduced from 1 January 2010. These changes seek to: modernise and simplify the current rules relating to crossborder supplies of services; make the recovery of VAT on purchases made in other EU countries more efficient; and help counter VAT fraud.

Crucially, for services of the **hiring of means of transport** (*including yachts*), the impact of the new rules depends on who receives the supply and how long the means of transport is hired for.

This is because in addition to the general rules distinguishing between B2B and B2C, there are also special place of supply rules for hire of means of transport which divide the service into “**short term**” and “**long term**”.

Short term hire of yachts is hiring for a continuous period not exceeding 90 days. Any hire beyond this period is a **long-term hire**.

B2B and **B2C short-term** hiring of means of transport are supplied where the means of transport is put at the disposal of the hiree - meaning the place where the customer takes physical control of the yacht.

In UK, “**HM Revenue & Customs**” states in January 2010 with Notice 741 A: “*Short-term hire of means of transport is hiring for a continuous period not exceeding 90 days if the means of transport is a vessel and not exceeding 30 days for any other means of transport. B2B and B2C short-term hiring of means of transport are supplied where the means of transport is put at the disposal of the hiree. The “place where the means of transport is put at the disposal of the customer” means the place where the customer takes actual physical control of the means of transport.*”

However to accurately interpret the rules and determine **where a “charter” is actually liable to VAT**, it is essential to

identify the exact nature of the services supplied by a “**Yacht in commercial use**” registered in UK or Isle of Man, and the nature of the Yacht (*mean of transport or qualifying ship, see HM&RC Notice 744C*).

a) The nature of “charter” is the hiring of a Yacht (*mean of transport*).

For “short-term hire of yacht” the “*place where the means of transport is put at the disposal of the customer*” means the place where the customer takes actual physical control of the means of transport. Hire of a means of transport includes the hire of ships under charter with or without a crew (*see HM&RC Notice 741A/2010*). What about services of short-term hire of means of transport that occur outside the UK?

If these occur in ...	then you may ...
.. other member states	<ul style="list-style-type: none"> • have to register for VAT in those member states and account for VAT at the relevant rate accordingly • if you do not have an establishment in those member states, you may need to appoint a local tax representative to account for the VAT there on your behalf.
.. countries out side the EU	<ul style="list-style-type: none"> • be liable to account for any tax in those countries that is applicable on these services
.. in international airspace or waters	<ul style="list-style-type: none"> • not have to account for any tax on that part of the supply in any country.

b) The nature of “charter” is a transport of passenger service (*qualifying ship*).

The place of supply of passenger transport services is determined according to where the transport physically takes place. What about transport services that occur outside the UK (*see “HM&RC Notice 744 A” for detailed guidance on the VAT treatment of passenger transport*)?

If these occur in ...	then you may ...
- other member states	<ul style="list-style-type: none"> - have to register for VAT in those member states and account for VAT at the relevant rate accordingly - if you do not have an establishment in those member states, you may need to appoint a local tax representative to account for the VAT there on your behalf.
- countries out side the EU	<ul style="list-style-type: none"> - be liable to account for any tax in those countries that is applicable on these services.
- in international airspace or waters	<ul style="list-style-type: none"> - not have to account for any tax on that part of the supply in any country.

For VAT purposes, a “**qualifying ship**” is legally defined as any ship: of a gross tonnage of not less than 15 tons; and which is neither designed nor adapted for use for recreation or pleasure (*see “HM&RC Notice 744 C”*). To be a “**qualifying ship**” it must be designed for commercial purposes. If a ship does not have any features that indicate a commercial design (*such*

as a cargo hold, commercial fishing equipment or the ability to convey large numbers of passengers) then it is not a qualifying ship. Motor cruisers, powerboats or yachts are designed or adapted for use for recreation or pleasure; they therefore **cannot** be considered as "**qualifying ships**" even if they are 15 gross tons or over, or supplied for business use.

How long will business models built on "zero VAT system" last?

The "charter" of a Yacht with foreign EC's flag in Italy - What about VAT

The "Charter" of Yachts in Italian waters that are registered as commercial vessels (*mean of transport or qualifying ship*) and are used exclusively in charter **can not legally be exempt from the VAT**.

- 1) If the nature of "charter" is the "short-term hiring of a Yacht" (*mean of transport*) registered in a EC's member State (*not in Italy*) and the place where the customer takes actual physical control of the Yacht is in Italy, then the Owners have to register for VAT in Italy (*or appoint a local tax representative*) and account at the relevant rate accordingly on the total "charter fees".
- 2) If the nature of the "charter" is the "transport of passenger services" performed with a "qualifying ship" registered in a EC's member State (*not in Italy*), the Owners have to register for VAT in Italy (*or appoint a local tax representative*) and account at the relevant rate accordingly only on the part of the journey inside Italian waters.

Additional contents ...

- 1) **HK - Notice 744 A** - Passenger Transport (December 2009)
- 2) **UK - Notice 744 C** - Ships, aircraft and associated services (September 2005)
- 3) **UK - Notice 741 A** - Place of supply of services (January 2010)
- 4) **UK - Brief 79/2009** - VAT schemes for luxury yachts (January 2010)
- 5) **UK - Brief 56/2009** - VAT treatment of yacht chartering or leasing activities (August 2009)
- 6) **FR - Memorandum** - Tax and customs rules applicable to commercial pleasure boating (17 May 2004)

Note n. 1

VAT in UK - HM Revenue & Customs "Notice 744 A": Passenger transport

To accurately interpret the rules and determine where a charter is actually liable to VAT, it is essential to identify the exact nature of the services supplied. Simply deducing liability to VAT on a generic "**hire of a yacht**" (*hiring of means of transport*) can be misleading, for example, where the actual supply includes the services of a pilot or crew (*pleasure cruises*) that would be treated as a **single supply of passenger transport**. And even when the nature of the hire is determined, additional rules relating to where the supply is used and enjoyed, and what special local rules apply (e.g. *the French commercial exemption*), have to be taken into account.

1. What does charter mean?

The term "**charter**" is sometimes used loosely. It can be used to describe:

- the hire of a ship or aircraft;
- freight transport services; or
- passenger transport services.

You need to look at the contractual information to determine what is being supplied. In each case, the VAT liability should be determined according to the particular nature of the service supplied and not on the basis of how it is described.

1. What do you mean by passenger transport services?

Passenger transport services are supplied when a vehicle, ship or aircraft is provided together with a driver or crew, for the carriage of passengers. This may also include any incidental services.

2. What do you mean by the hiring a vehicle?

If you **hire a vehicle**, ship or aircraft **without a driver or crew** or a ship or aircraft **under charter arrangements**, then you do not supply passenger transport services, but a **means of transport**.

3. VAT treatment of passenger transport services.

Passenger transport services supplied in the UK (*including its territorial waters*) can be either:

- zero-rated (*but you must keep evidence to substantiate zero-rating*), or
- standard-rated (17,5%).

You can zero-rate the transport of passengers:

- from a place within to a place outside the UK or vice versa to the extent those services are supplied in the UK;

- in any ship designed or adapted to carry not less than 10 passengers to the extent those services are supplied in the UK.

4. Place of supply of passenger transport

The place of supply of passenger transport services is determined according to where the transport physically takes place. If it takes place:

- inside the UK the supplies are all within the scope of UK VAT
- both inside and outside the UK, the element that takes place within the UK is within the scope of UK VAT, or
- outside the UK the supplies are outside the scope of UK VAT.

5. VAT liability of passenger transport that takes place both inside and outside the UK

Passenger transport that takes place both inside and outside the UK is zero-rated to the extent the transport takes place within the UK, irrespective of the carrying capacity of the vehicle, ship or aircraft. It applies to:

- single and return journeys, as long as the transport is scheduled to stop, put-in or land in another country, and
- journeys to or from oil rigs situated outside UK territorial waters.

6. How is the supply of a pleasure cruise treated?

If you provide a pleasure cruise, it may be treated as a single supply of passenger transport. If so, the element that takes place in the UK falls within the scope of UK VAT.

7. What about transport services that occur outside the UK?

<i>If these occur in ...</i>	<i>then you may ...</i>
.. other member states	<ul style="list-style-type: none"> • have to register for VAT in those member states and account for VAT at the relevant rate accordingly • if you do not have an establishment in those member states, you may need to appoint a local tax representative to account for the VAT there on your behalf.
.. countries out side the EU	<ul style="list-style-type: none"> • be liable to account for any tax in those countries that is applicable on these services
.. in international airspace or waters	<ul style="list-style-type: none"> • not have to account for any tax on that part of the supply in any country.

8. What if I provide passenger transport in the UK but I belong outside the UK?

If you belong outside the UK, you have two options:

<i>If you are ...</i>	<i>then ...</i>
not registered for VAT in the UK and your customer is registered for UK VAT	your customer can account for VAT on your supplies under the reverse charge procedure
not registered for VAT in the UK and your customer is not registered for	you are liable to account for the VAT in the UK and you must register for VAT in the

9. Does it make a difference whether I receive payment from an individual or a group of passengers?

No, the zero-rating applies whether you receive payment of a fare from an individual passenger or a bulk payment in respect of a group of passengers.

10. What if I supply vehicles, ships or aircraft with a carrying capacity of less than 10 passengers?

If the carrying capacity of the vehicle, ship or aircraft is less than 10 passengers, then the passenger transport is standard-rated.

11. When a ***cruise*** is a ***single supply of passenger transport***?

A ***cruise*** is a ***single supply of passenger transport*** when all the following conditions will have to be met:

- the essential nature of the supply is passenger transport, which is supported by the evidence provided;
- all elements of the cruise are integral and it would be neither practicable nor realistic to separate them, and
- the cruise is held out for sale at a single price with no specific charges or discounts for particular services taken or not taken up.

Note n. 2

VAT in UK - HM Revenue & Customs "Notice 744 C": Ships, aircraft and associated services

This notice explains the VAT liability for ships and aircraft and associated services, which are supplied in the UK.

1. "Ships" and "qualifying ships"

This section outlines what is meant by a "ship" and/or "qualifying ship" for VAT purposes. It should be read in conjunction with Section 4 which deals with the VAT liability of supplies of "ships" and "qualifying ships".

2. What is a "ship" ?

For the purposes of this notice, **ship** includes: submarines; hovercraft; light vessels; fire floats; dredgers; barges; lighters; mobile floating docks or cranes; and off-shore oil or gas installations, used in the underwater exploration or exploitation of oil and gas resources which are designed to be moved from place to place. But excludes: fixed oil and gas installations (*even though they might be transported to a site as a floating structure*); and vessels which are permanently moored (*for example as attractions*) and not readily capable of navigation.

3. What is a "qualifying ship"?

A "qualifying ship" is legally defined as any ship:

- of a gross tonnage of not less than 15 tons; and
- which is neither designed nor adapted for use for recreation or pleasure.

4. How do I determine whether my vessel has been designed for use for recreation or pleasure?

You need to consider the nature of the vessel's design. To be a qualifying ship it must be designed for commercial purposes. If your ship does not have any features that indicate a commercial design (such as a cargo hold, commercial fishing equipment or the ability to convey large numbers of passengers) then it is not a qualifying ship.

5. Can motor cruisers, powerboats or yachts be qualifying ships?

Motor cruisers, powerboats or yachts are designed or adapted for use for recreation or pleasure. They therefore cannot be considered as qualifying ships even if they are 15 gross tons or over, or supplied for business use.

6. How are cruise ships treated?

Cruise ships can be considered as qualifying ships provided they meet all the conditions below:

- they have a gross tonnage of not less than 15 tons;
- they are unsuitable for private use; and
- they are supplied for use in the business of providing recreation or pleasure cruises for fee-paying passengers.

Note n. 3

VAT in UK - Revenue & Customs "Notice 741 A": Services of the hiring of means of transport

This notice explains how to determine the place of supply of your services. 1 January 2010 saw the introduction of substantial changes to the place of supply of services rules. These changes include a new basic rule ("*the general rule*") for business to business (B2B) supplies and a reduction in the number of exceptions to the general rule.

1. What is "place of supply of services"?

For VAT purposes, the place of supply of services is the place where a service is treated as being supplied. This is the place where it is liable to VAT (*if any*). There are a number of place of supply rules for determining where services of different kinds are made:

- where the place of supply of services is in a Member State of the European Community (*EC*), that supply is subject to the VAT rules of that Member State and not those of any other country. If the Member State is not the UK, such supplies are said to be 'outside the scope' of UK VAT
- where the place of supply of services is outside the EC, that supply is made outside the EC and is therefore not liable to VAT in any Member State (*although local taxes may apply*). Such supplies are said to be "outside the scope" of both UK and EC VAT.

2. What is the place of supply of B2B and B2C services of short-term hire of means of transport?

Short-term hire of means of transport is hiring for a continuous period not exceeding 90 days if the means of transport is a vessel and not exceeding 30 days for any other means of transport. Any hire beyond this period is a long-term hire of means of transport. B2B and B2C short-term hiring of means of transport are supplied where the means of transport is put at the disposal of the hiree. The "*place where the means of transport is put at the disposal of the customer*" means the place where the customer takes actual physical control of the means of transport.

3. What about services of short-term hire of means of transport that occur outside the UK?

<i>If these occur in ...</i>	<i>then you may ...</i>
.. other member states	<ul style="list-style-type: none"> • have to register for VAT in those member states and account for VAT at the relevant rate accordingly • if you do not have an establishment in those member states, you may need to appoint a local tax representative to account for the VAT there on your behalf.
.. countries out side the EU	<ul style="list-style-type: none"> • be liable to account for any tax in those countries that is applicable on these services
.. in international airspace or waters	<ul style="list-style-type: none"> • not have to account for any tax on that part of the supply in any country.

Note n. 4

VAT in UK - Brief 79/09 - VAT schemes for luxury yachts

We are aware that various advisors are promoting VAT schemes through which private individuals incur little or no VAT on the purchase of pleasure craft (*both sailing and motor vessels*), particularly at the top end of the market.

The purpose of this Brief is to describe the key features of the schemes and to announce that we have serious concerns about the validity of the VAT treatment which is claimed for the schemes.

Under the schemes, the user acquires a new vessel which purportedly has 'VAT paid' status while, in reality, paying no VAT (*or a minimal amount of VAT*).

The schemes fall broadly into two categories - cross-border leasing and artificial chartering to the private funder. Both categories share the following common features:

They involve a contrived leasing or chartering arrangement of a vessel which is predominantly for the recreational use of an individual.

The individual provides the funds that are used to pay for the vessel either directly or indirectly (*maybe by lending money to an intermediary*).

Registered title to the vessel is held by a special purpose entity (*otherwise known as a special purpose vehicle or 'SPV'*) which is controlled (*directly or indirectly*) either by the individual or by the scheme provider. This SPV may be simply a shell company - also known as a '*brass plate*' company, bought off the shelf and with nominee directors standing in front of whoever really benefits.

The SPV purports to use the vessel in a chartering or leasing business. It does not incur VAT (*either through a zero-rated export if the SPV is outside the EU, or otherwise by recovering as input tax any VAT charged on the supply*).

The vessel is chartered or leased to the individual. No VAT (*or only a minimal amount of VAT*) is charged on the lease or charter payments.

Where there is evidence to suggest that a vessel has been supplied through one of these schemes we shall carry out a full investigation of the facts surrounding the supply and take any necessary action.

Note n. 5

VAT in UK - Brief 56/09 - Treatment of the hiring of a yacht or leasing activities

When the UK Revenue issued their "**Brief number 56/09**" stating their view on the VAT treatment of yacht chartering or leasing activities in August 2009, it was turned into big news. The existence of one or more of the following features might indicate an **abusive structure** (the list is not exhaustive - the indicators are illustrative of the points that we might take into account, together with others):

- The main user of a pleasure craft is the ultimate owner of the chartering or leasing entity.
- The main user of a pleasure craft funded the purchase of the vessel (*directly or indirectly*).
- The person who funded the purchase of a pleasure craft (*directly or indirectly*) uses the vessel for prolonged periods in the peak chartering season.
- The chartering of a pleasure craft to third parties would not, alone, be of sufficient continuity and substance to comprise an economic activity.
- The chartering or leasing entity shows significant ongoing losses in its financial statements.
- Charter fees or lease instalments due from the main user of a pleasure craft are paper transactions only (*for example being offset against loans*).
- Charter fees or lease instalments are below open market value.
- The terms of a lease differ significantly from normal commercial practice (*for example, the duration of the lease is unusually long*).

A person carrying out yacht chartering or leasing is therefore only entitled to VAT registration (*and the related entitlement to deduct input VAT*) where the chartering or leasing is carried out in the course of an economic activity. We may ask for evidence to show that an economic activity is being pursued, either before registration is allowed or during subsequent verification.

If an individual has legal ownership of the vessel in his own name and uses it wholly for his own private use then there is no economic activity and he is not entitled to register for VAT.

If an individual has legal ownership of the vessel in his own name and charters the vessel to others with sufficient continuity and substance to comprise an economic activity as well as using it himself then the vessel will be used partly for business and partly for private use.

Note n. 6

France - Tax and customs rules applicable to commercial pleasure boating

Customs and Indirect Taxation Directorate - Paris 17 may 2004 (Memorandum)

The purpose of this instruction is to inform the unit of the implementing terms of the tax and customs regulations applicable to certain types of ships used for pleasure boating purposes and used for profit off the French seashore.

This instruction was prepared in co-operation with the Ministry's units in charge of transportation, the tax legislation division and professionals and constitutes tax authorities' doctrine aimed at supplementing, in this area, existing provisions that do not contain any rules addressing the specific features of those ships, that are used, at the same time, for pleasure boating purposes and in connection with commercial operations.

This instruction shall apply immediately upon receipt and shall supersede any contrary earlier provision. Kindly send a copy hereof to the professionals concerned who are based in your district.

At present, the VAT-free status contained in Article 262-II-2° of the French Tax Code only applies to commercial ships, i.e. maritime ships used for commercial transactions for the transportation of goods or passengers, or for tourism trips.

It now seems possible to assimilate to commercial ships certain types of pleasure ships earmarked for commercial purposes. This doctrine leads to the application to these ships of the VAT-free status set forth by Article 262-II-2°, 3°, 6° and 7° and by Article 291-II- 5° of the French Tax Code.

The Instruction from the Tax Legislation Division published in the Official Tax Bulletin No. 168 of 22 October 2003 provides the following as regards the chartering of ships:

"Chartering agreements are agreements through which a charter operator agrees, against remuneration, to make a ship available to a charterer. Chartering operations are subject to the standard rate of VAT, subject to the exemption set forth under Article 262-II-2° of the French Tax Code. For the application of this Article, "maritime commercial ship" means any ship registered as a commercial ship in the official registries of any French or foreign administrative authority, provided that such ship has a permanent crew used for the purposes of commercial operations."

In order to qualify for this VAT-free status, the ships concerned must satisfy the above criteria in accordance with the terms and conditions below:

I – DISTINCTION CRITERIA

These criteria have been defined in order to avoid extending the tax benefits granted to commercial ships by Article 15 of the Sixth VAT Directive and Article 262 of the French Tax Code to persons who are operating their ships for profit only on an ad-hoc basis (*e.g. during the summer season*) and who reserve the right to use such ships for strictly personal purposes during the rest of the time. This is why the three conditions listed below must be satisfied simultaneously, when a pleasure ship is docked in or located in French territorial waters, so that such ship, regardless of its flag (*third country, other EU Member State or France*), may be, for tax and customs purposes, assimilated with

a commercial ship.

a) The ship must be registered for commercial purposes

Compliance with this requirement must be proved by the tendering of a registration certificate (*commercial category*) or any document deemed equivalent to a commercial registration in accordance with the laws of the country whose flag the ship is flying. This requirement shall be deemed not to be satisfied when the certificate does not expressly refer to the "commerce" category or to a commercial use. In the absence of such indication, no exemption from duties and taxes shall be granted under this instruction.

b) The ship must be used exclusively under rental (or chartering) agreements

In order to facilitate controls, users of the ship shall be asked to retain on board a copy of the agreement and to refer to such agreement in the logbook (*term, names of the lessee(s)*). The persons holding all or part of title to the ship may also, if they see fit, use such ship, subject to the express requirement that they do so as lessee, i.e. that they themselves pay a rent determined at arm's length. Subject to the sole exceptions set forth below, the ship is not to be used for private purposes.

Exceptions

These exceptions cover certain specific uses resulting from particular circumstances in connection with which the ship is not truly used for the principal purpose for which it has been designed: e.g. tests and demonstrations at sea, or even travel for the sole purpose of allowing for the boarding of new lessees. Also, in order to facilitate controls, the logbook must refer to such use. In addition, the persons on board may only include the navigating staff and professional or technical personnel. In case of tests or demonstrations with a view to a sale, the owner and the prospective buyer may also be present on board, subject to the obligation to give prior notice to the customs office.

c) The ship must be equipped with a permanent crew

Compliance with this requirement shall be checked through presentation of the crew's list or any document showing the assignment of a professional crew in accordance with the legislation of the country whose flag the ship is flying. When the ship shall be docked without being used, such condition shall be satisfied when at least one person included on the crew's list is assigned to serve the ship.

Under the foregoing, the tax and customs exemptions applicable to commercial ships are granted only to those ships that, whether docked or located in French territorial waters, meet the three above requirements. It is necessary to recall that this status leads to an exemption:

- from VAT, upon the import of the commercial ships. It is thus no longer necessary to maintain such pleasure ships under the temporary importation procedure;
- from the passport duty if any (*foreign ships whose owner or usual owner resides in France*);
- from VAT on the delivery of supplies and oil products and excise duties on oil (*regardless of the ship's flag*). The VAT-free status is granted only for ships engaging in maritime navigation, and therefore supplies on board that are granted the VAT-free status must, when these ships are docked, be restricted to the supplies used during the stay with respect to a mere call;
- VAT on supplies of goods intended for integration into the commercial ship, as well as maintenance and repair transactions (*regardless of the ship's flag*).

It is furthermore indicated that those of the relevant ships that are flying a foreign flag are not subject to the provisions of Article 257 of the French Tax Code in respect of reserved navigation insofar as they are used under rental agreements, instead of transportation agreements.

II – SPECIAL PROVISIONS

a) Francisation of pleasure boats intended for use for profit

In the cases where owners of these ships ask for an administrative decision authorising such ships to fly the French flag (*francisation*) for commercial purposes, it is necessary, upon submitting the application, to request from such owners a written certificate amounting to a commitment (*without any guarantee*) to use the ship in compliance with the requirements recalled under paragraph I, b) and c) above. If the other requirements for the grant of the francisation are satisfied, and in particular as regards safety (*tendering of a commercial ship inspection certificate with a view to its francisation, as prepared by the units of the transportation ministry*), a blue book shall then be issued to such owners subject of course to any subsequent checks that customs authorities reserve the right to carry out.

b) Flag inspection

Article 91 of the United Nations Convention on the Law of the Sea (*Montego Bay Convention*) sets forth that every State shall fix the conditions for the grant of its nationality to a ship and shall issue documents to that effect. Accordingly, the tax unit may not challenge the mode of preparation of the document that the flag State considers a nationality document. However, the tax unit must check the existence of such document, its validity (*affixing of the stamp of the relevant administrative authority*) and its applicability to the inspected ship (*indication of the name and home port*).