

European Commission Challenges French VAT Exemption

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COUNTRY DIGEST

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The European Commission on September 29 referred France to the European Court of Justice over the French VAT treatment of commercial vessels operating in territorial waters. (For the referral, see *Doc 2011-20676* or *2011 WTD 190-18*.)

Article 148 of Council Directive 2006/112/EC of November 28, 2006,¹ (the VAT directive), titled “Exemptions related to International Transport,” provides that:

Member States shall exempt the following transactions:

(a) the supply of goods for the fueling and provisioning of vessels used for navigation on the high seas and carrying passengers for reward or used for the purpose of commercial, industrial, or fishing activities, or for rescue or assistance at sea, or for inshore fishing, with the exception, in the case of vessels used for inshore fishing, of ships’ provisions;

[. . .]

(c) the supply, modification, repair, maintenance, chartering, and hiring of the vessels referred to in point (a), and the supply, hiring, repair, and maintenance of equipment, including fishing equipment, incorporated or used therein.

(d) the supply of services other than those referred to in point (c), to meet the direct needs of the vessels referred to in point (a) or of their cargoes.

Therefore, in almost all EU jurisdictions, there is no exemption in law for yachts — even those used for commercial charters — because those vessels are not used only for navigation on the high seas (meaning sea areas outside the confines of the states’ territorial sea as designated under article 37 of the Montego Bay Convention on the Law of the Sea).

However, each EU member state is required to implement the VAT directive in its national legislation, and there are sometimes important discrepancies in various transposition measures from one member state to another. The issue in this case is whether commercial yachts fall within the “commercial vessels” category.

The ECJ seems to have answered negatively in *Etat du Grand Duché de Luxembourg v. Feltgen* (C-116/10) of December 22, 2010. The Court stated that article 15(5) of the Sixth VAT Directive should be interpreted as meaning that the VAT exemption in that provision does not apply to the service of making a vessel available, with a crew, for profit, to natural persons for the purpose of leisure travel on the high seas. (For the ECJ judgment in *Feltgen*, see *Doc 2010-27217* or *2010 WTD 247-18*.)

In France, the legislature in 2004 extended the above-mentioned exemption to all yachts used for commercial purposes.² Thus, any yacht in French waters can benefit from the exemption if it meets all of the following conditions:

- it holds a commercial registration certificate from any flag state;
- it has a permanent crew; and
- it is exclusively used for charter, meaning that each time it is used, it must be for commercial activities.

Should those conditions be met, all charter activities carried out in French waters are VAT exempt. Also, fueling and provisioning are tax-free.

However, the European Commission, in a reasoned opinion dated March 18, 2010, questioned France’s application of the VAT exemption, noting that article 262 II of the French Tax Code was not in compliance with the VAT directive because it did not provide that all vessels used for transporting passengers and commercial activities had to be navigating the high seas.

¹Previously article 15(5) of the Sixth VAT Directive 77/388/EEC of May 17, 1977.

²By way of article 262-II-2 of the French Tax Code.

Therefore, the French VAT exemption went beyond the exemption authorized by the VAT directive (which is limited to vessels engaged in navigation on the high seas), the European Commission said.

The reasoned opinion was the second stage of infringement proceedings against France, which was given two months to amend its legislation.

Because of that pressure from the European Commission and the ECJ, article 262-II-2 of the French Tax Code was slightly amended in December 2010 and now specifically includes the high seas criteria contained in article 148 of the VAT directive.

However, it appears that the previous exemption still applies in France for commercial yachts. This was con-

firmed in a February 22, 2011, ruling³ by the French tax authorities that maintained the VAT rules as they were previously applied.

Maintaining that France did not actually apply the condition of navigation of the high seas, the European Commission has therefore decided to refer France to the ECJ. ♦

♦ *Sophie Borenstein, partner, Reed Smith, Paris*

³RES No. 2011/2 (TCA).