

French Tax Exemption for Commercial Vessels Illegal, ECJ Holds

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COUNTRY DIGEST

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The European Court of Justice on March 21 in *European Commission v. France* (C-197/12) held that French legislation providing a VAT exemption for some commercial vessels used for navigation on the high seas that carry passengers for remuneration or are used for commercial activities does not comply with Directive 2006/112/EC (the VAT directive), specifically with article 148(a), (c), and (d). The ECJ held that France failed to adequately apply the high seas condition. (The judgment has not been published in English.)

Background

In addition to the temporary importation exemption regime,¹ the VAT directive allows, under specified conditions, a tax exemption for the supply of goods for the fueling and provisioning of vessels used for navigation on the high seas, as well as the supply, modification, repairs, and locations of these vessels. However, in almost all EU jurisdictions — France being a notable exception — commercial yachts do not benefit from the VAT exemption.

In 2004, with an amendment to article 262-II-2° of the Tax Code, France extended the VAT exemption regime to all yachts used for commercial purposes. Under French law, any yacht, irrespective of its flag state or its VAT registration status, may benefit from a French VAT exemption if it is situated in French waters and fulfills all the following conditions:

- it holds a commercial registration certificate from any flag state;
- it has a permanent crew; and
- it is exclusively disposed to charter — that is, it must always be used for commercial activities.

¹Under this regime, yachts owned by non-EU residents registered outside the EU and sailed by a person not resident in the customs territory of the EU are entitled to tax-free importation into the EU for 18 months (the relief being invalidated if the yacht is hired, sold, or put at the disposal of an EU resident).

The European Commission's action began on March 8, 2010 (IP/10/296), when it officially called on France to amend its legislation within two months.

Further, the ECJ stated in *Etat du Grand Duché de Luxembourg v. Feltgen* (C-116/10, Dec. 22, 2010) that article 15(5) of the Sixth VAT Directive must be interpreted as meaning that the VAT exemption allowed by that provision does not apply to services consisting of making a vessel available for remuneration, with a crew, to natural persons for purposes of leisure travel on the high seas.

Because of pressure from the European Commission and the ECJ, France amended the above-mentioned Tax Code provision in December 2010 to include the high seas criteria contained in article 148 of the VAT directive.

But on April 26, 2012, the commission commenced an infringement proceeding against France for breach of the VAT directive, arguing that the French legislation and administrative doctrine unduly extended the scope of the VAT exemption by allowing it to be applied without requiring that vessels be used for navigating on the high seas — that is, in international waters. As evidence that the high seas condition was not applied, the commission cited an administrative interpretation published by France on February 22, 2011, which authorized that the rules previously applied be maintained, despite the legislative amendment. (ECJ reference.)

On November 21, 2012, the European Commission published Memo 12/876, covering the legal actions taken against member states for failing to comply with EU law and, particularly, the VAT directive. The commission stated in a reasoned opinion that the VAT exemption on chartering yachts in France did not comply with EU VAT rules. The notice required France to take steps to remove the exemption from its tax legislation within two months, failing which the commission would refer the matter to the ECJ. (Related coverage: *Tax Notes Int'l*, Dec. 3, 2012, p. 892.)

ECJ Decision

In its March 21 decision, the ECJ held that the French rules exempting from VAT those transactions

related to ships carrying passengers or exercising a commercial activity are not compatible with EU legislation and that France had failed to fulfill its obligations under the VAT directive by not explicitly making the VAT exemption conditional on the vessels' use for navigation on the high seas.

France argued that it was difficult to define the concept of use for navigation on the high seas because all vessels have to cross the territorial waters before reaching a port, but the ECJ found nothing to suggest that imposing the condition would make the practical application of the VAT directive provisions excessively difficult or uncertain.

The ECJ held that the VAT exemptions must be interpreted strictly because they constitute exceptions to

the general principle that any service rendered against payment by a taxable person for VAT purposes is subject to the tax.

The ECJ also noted that although it was not necessary in this case to rule on the specific criteria required for a ship to be considered as being used for navigation on the high seas, the fact remained that French legislation failed to provide sufficient guarantees to prevent the VAT exemption from being implemented in situations for which it is not prescribed. ◆

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