

June 2010

## YACHTING VAT NOTE

## SWITCHEROO – ITALIAN STYLE

Two steps forward, two steps back. Italy has been shaking it all about so far this year. And after all that effort, by June 21<sup>st</sup> the Italian tax police were virtually back where they started the year.

The past three months have provided a perfect illustration of the *Guardia's* frantic footwork. They have been marked by a number of high-profile yacht arrests, the most dramatic of which has been of the 63-metre Force Blue, which for maximum effect the Guardia prosecuted with armed officers on gunboats and videoed. The yachts were supposedly arrested for reasons ranging from flag (non-EU) to smuggling to suspected tax evasion. But the announcement on June 21<sup>st</sup> of the conditional release from detention of the Cayman Islands flagged Force Blue to carry on with its charter trade as before, along the Mediterranean and Italian coasts, reflects continuing confusion about Italy's perspective on the VAT rules for commercial yachts.

On the practical side, the Italian authorities have since 2004 appeared to endorse the French approach which assimilates commercial yachts meeting specified criteria to the class of "merchant" ships and exempts them from VAT. This meant that a yacht holding a commercial registration certificate from any Flag State, having a permanent crew and operating in a *bona fide* commercial way was neither asked to have a VAT registration in Italy nor required to undergo any kind of customs import procedure. Like in France the VAT exemption appeared to apply to such yacht owners by default, both on the supplies they made with the yacht and the goods and services they received from others. They could perform charters in Italy, buy parts and equipment and receive services of repair and maintenance for their yachts, all free of Italian VAT. It all seemed so favourable and safe, so the sudden switch to militancy has shocked the industry somewhat.

But should it really? Speaking on Italian VAT practice on yachts at a conference some years ago, one Italian expert panellist pointed revealingly to the distinction between the formal way and "the Italian way". He was referring to the yawning gap between Italy's VAT legislation on yachts and its on-the-ground practice. Spanning the gap is a fairyland of high hopes and wishful thinking, upon which the legal obligations of the real world crash every so often. Witness for instance the constant dogfights between Italian leasing companies and the authorities over the scope of application of the reduced-rate VAT. Characteristically, the leasing activities rely heavily on tertiary practice and extra-statutory concessions, rather than primary law, allowing the authorities to shuffle capriciously at every step. The leasing companies often have different interpretations from what the authorities think. With the advent of the new EU cross-border place of supply rules from January 2010, nobody seems to be sure anymore as to how Italian leasing schemes should actually interact with the new rules.

Little wonder then why a negative undercurrent has

been washing away at this fragile picture of a VAT-free Italy for super yachts. Italy's legislation on the VAT treatment of yachts, unlike France's, has actually remained unchanged. The law maintains the typological distinction between classes of vessels. There is the class of 'qualifying ships' which is traditionally deemed to be eligible for VAT exemption under Article 148 of the VAT Directive. This class is interpreted to include only 'merchant' and 'cruise' ships that go on the high seas - their activities have 'export' connotations for VAT purposes. Also included are other utilitarian types like the submarine, hovercraft, dredger, fire float, light vessel and the mobile floating dock or crane. Then there is the class of 'pleasure craft' (so called because they are designed or adapted for use for recreation or pleasure), which is not exempt from VAT. Yachts, whatever their function and manner of operation, are classed as pleasure craft under this traditional view. Therefore unless a yacht is VAT paid, or deemed VAT paid, it is non-compliant and should not be used or chartered in the EU.

Tax suspension regimes, such as Temporary Importation and Inward Processing Relief, offer conditional easements for non-EU means of transport entering the EU. And there are other very restrictive provisions for commercially used means of transport operating in the EU only for 'the time required for carrying out the transport operations' under Article 562(b) of the Community Customs Code. But none of these exemptions or suspensions actually caters legally for the modern 'commercial' yacht that operates charters in the EU without a VAT paid status. France had realized this and amended its primary VAT and customs legislation in 2004 to reflect its true intentions. Italy has not changed its legislation, but its tacit approval over the years of yachts coming over from France has created an atmosphere fraught with ambiguity and misperception. We have tended to read Italy's forward and backward steps where Italy was just doing things its way. That way now includes a band of spirited local Prosecutors whose stark view of the law is un-nuanced by the unscripted culture and tolerances of the yachting industry.

**'It's the Flag, Stupid'**

Much has been made of the EU maritime cabotage rules and the fact that some of the yachts arrested in Italy fly non-EU flags. But there is no actual evidence that the Guardia is specifically targeting non-EU flags. Instead, they are targeting tax abuse, real or imagined, amidst a severe domestic financial crisis. In an industry where over 95% of the super yachts fly non-EU flags it is statistically obvious why non-EU yachts should fall victim in any sweep.

Of course flag matters, much like any image. A lot too remains unclear about the vague EU cabotage rules, despite the European Commission's assertion in 2003 that most activities of yachts fall outside the scope of these rules. But changing to an EU flag for any reason without structuring the ownership of the yacht to achieve essential EU tax compliance is like taking a placebo. Meanwhile, she may have been doing a two-minded hokey-cokey over the years, but it would be surprising if Italy were to pause now for breath.



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