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## Onshore from Off - and Vice Versa

A fine lawyer has sorted out the inter-company contracts expertly. The yachting group has deftly restructured its affairs so that ownership of the yachts is transferred offshore to subsidiary companies. Because the offshore location is outside the VAT territory of the European Union (EU), there seemed to be no longer a need to be registered or to account for VAT on charters of the yachts within the EU. On the other hand, given the significant VAT costs being incurred on onshore expenditure, VAT refund is correctly sought through the mechanism provided for non-EU established persons under the EC 13<sup>th</sup> Directive. All fair sailing then in the clear waters of VAT "mitigation". So what could possibly knock such group restructuring off its wave?



The answer is quite a lot, judging by current trends in both individual Member State case law and the general EU VAT reform agenda. One topical case is *RAL (Channel Islands) Limited* (RAL), a case about a Guernsey company in the entertainment sector that began in a UK VAT Tribunal but ended up before the European Court of Justice (ECJ). The ECJ finding against RAL demonstrates how poorly thought-out VAT planning within a group of companies can go spectacularly wrong. When seen against the general move at EU level to make VAT chargeable at the place of consumption or exploitation of an asset (irrespective of place of establishment of owner), the ECJ judgment is an implied warning to all offshore companies who are implementing similar group restructuring.

The main technical basis for striking down VAT arrangements which take taxpayers offshore and out of the scope of EU VAT altogether are twofold. First is the Place of Supply (POS) rule, the rule that determines the place where VAT is charged. The POS rule is often invoked in circumstances where to decide otherwise would either lead to non-taxation or distortion of competition. Thus non-EU established companies who own yachts that operate charters in onshore locations within the EU are potentially liable to register and account for EU VAT. They can be compelled to register in the country of supply of the charters, because not doing so would disadvantage local suppliers against whom they compete.

The alternative technical basis is the Business Establishment (BEST) rule. The BEST rule often connects the owner, operator or even user of an asset with a country where the asset is based, whether temporarily or permanently. Customs would found their case about a yacht, for example, by arguing that in consequence of its contractual arrangements with onshore group companies or independent parties (such as brokers), the offshore owner of the yacht has establishments in the country from which it makes supplies of charters to the public. To appreciate how potent this argument can be the question is often asked as to whether, without the human and technical resources available through the contractual relationships, the offshore owner would be in a position to provide the charters in that country. More often than not the answer is no, so the taxman would demand the VAT.

Should Customs fail on both the POS and the BEST analysis, they can still draw on smaller, but no less potent, ammunition to defeat restructuring arrangements that are driven purely by residence or avoidance considerations. Amongst these are the "No Supply" and "Abuse of Rights" principles. Essentially, Customs would contend either that the offshore party has received no supply in the onshore Member State where it has, for example, made a 13<sup>th</sup> Directive VAT repayment claim; or, conversely, that the restructuring amounts to an artificial attempt to create the conditions for obtaining an advantage, against the spirit of the VAT legislation. The logic of either of these analyses would mean that the normal working of the VAT system is dis-applied to the offshore VAT claimant, on the grounds that they have attempted to pervert the system. This would trigger Customs rulings, as happened in RAL, to make the offshore claimant register for and collect the EU State's VAT on its onshore activities.

The lessons from the RAL case are therefore that taxpayers can no longer rely on restructuring arrangements that take them completely outside the scope of EU VAT. They can still become liable for VAT by forming contracts within the EU, even without "fixed establishments" or EU staff. VAT structuring or restructuring arrangements must be driven by wider considerations which go beyond residence and simple avoidance. And, whether onshore or off, there is safety in planning within, rather than outside, the EU VAT system.

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