

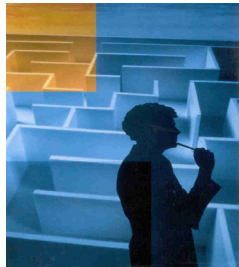
# YACHTING VAT NOTE

March 2008

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## Good Cop Time

The surprise mood element in the UK Revenue & Customs (HMRC) Brief number 11/07 of 6 February 2007 was the brimstone. Captioned "VAT schemes for luxury yachts", the Brief was unusual in that it seemed tailor-made to menace rather than enlighten.



The offending schemes about which HMRC had "serious concerns" were identified as "cross-border leasing and artificial chartering to the private funder". The validity of the Value Added Tax (VAT) treatment that some in the industry were claiming for the schemes were suspect, they charged, before raising the hatchet:

*"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."*

Since that announcement HMRC (with assistance from other EU tax administrations) have indeed launched investigations against some UK-resident yacht owners. On the UK VAT registration front, there was evidence of a decisive shift in their attitude towards 'intending' yachting businesses. Most applications for VAT registration were either dismissed out of hand as hobby pursuits just wanting to obtain recovery of input VAT; or else subjected to filibuster-type questioning on matters ranging from the yacht's inspection reports to food preparation certificates.

The exact impact of the measures taken so far remains to be seen. But it would seem that HMRC's examination of the yachting sector has already yielded them one benefit – a better insight into what is after all a 'cottage' industry. VAT abuse, they have discovered, is not as widespread in yachting as they first thought; and whatever mischief exists is fuelled more by casual practice than by a studied and concerted criminal attack on the EU VAT system.

The realisation is unlikely to cause a cessation of hostilities – only a pause to parley, you might say. But it has at least injected something sobering into the tactics. By the end of 2007, HMRC had performed a kind of converse alchemy, transforming their brimstone into cool graphite.

## Pencil Wielding

For evidence of this pencil-wielding approach look no further than their treatise on 'Lennartz Accounting' for yachts and other "mixed-use" assets, published on 14

November 2007. In it HMRC admit that they may not have been explicit in the past about how VAT on the private (read "beneficial owner") use of business yachts should be calculated. To dispel any further doubt, they affirm the 'Lennartz mechanism' as providing such clarity. 'Lennartz' is a reference to the 1991 European Court of Justice case in which the Court set out the key principles of VAT on private use based on the interpretation of Articles 6(2)(a) and 11A(1)(c) of the Sixth VAT Directive.

When applied to a yacht those key principles mean that where a business incurs VAT on a yacht that is intended for both business and private purposes, it may treat it as a wholly business asset and deduct the VAT in full. However, the business must then account for VAT in respect of any subsequent private use of the yacht. The business is a 'deemed supplier' of services to that private user, even if that private user is the business itself.

The value of the deemed supply is based on the full cost to the business of making the yacht available for private use. "Full cost" is determined by reference to the taxable VAT-bearing costs of the yacht. Once determined, the cost of purchasing the yacht is then spread over the 'economic life' of the yacht and charged proportionately to the private user each VAT period according to actual percentage of private use. The whole calculation is captured in the formula  $X=(A/B) \times (CxU)/100$ , where **X** is the value of the supply for the VAT return period, **A** is the number of months in the VAT return, **B** is the number of months of economic life of the yacht (set at 5 years maximum), **C** is the cost of the yacht and **U** is the actual private use which is expressed as a percentage of total use per VAT period.

The calculation is designed to ensure that non-business use of the yacht is not excessively taxed. In its essence, it is a VAT deferment calculation. It contrasts with the rather punitive "charter rate" approach of common wisdom. On expiration of the statutory period or on a proper sale, the yacht's 'economic life' ends. No further deemed supplies arise, so the charging of VAT to the private user ceases. A new economic life will start afresh with the new owner if he also applies the Lennartz mechanism.

The UK has thus explicitly set the Lennartz method to statute in the form of the *Lennartz Accounting Regulations 2007*, which came into force on 1 November 2007. The hope is that the legal certainty that this provides, combined with their clear narrative, will sensitise the yachting industry enough to put paid to dicey VAT schemes through which private individuals incur little or no VAT on their use of yachts on which they have deducted VAT. Open sesame, perhaps?

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