



L. 1785/11
SF 3.860

15/07/2011

Dear Ms. Lejeune,

Article 37.3 Review – ECC submission

Introduction

The European Cruise Council (ECC) welcomes the opportunity to assist with the review of Article 37(3) of the VAT Directive by the European Commission – Directorate General Taxation and Customs Union.

The ECC is a not for profit trade association comprised of 30 cruise companies operating vessels in international transportation in the European Union or marketing and selling their cruise product in Europe. The members include many cruise lines that are established within the Member States of the EU together with cruise lines headquartered elsewhere but that operate vessels to or from EU ports.

The ECC has as its mission the:-

Promotion of the interests of cruise operators with the EU institutions in all matters of shipping policy and ship operations; and

Promotion of cruising to the European public and to encourage expansion of the European cruise market.

It is in under these broad objectives that we submit the following observations.

General Comments

The ECC commends DG-TAXUD for seeking to conduct a comprehensive analysis of the issues and impact of VAT on the international transportation sector with a view to understanding the manner in which this business is conducted and the unique challenges our members face. For any proposal for change to be successful, the policy and its administration must avoid impinging on the laws of other Member States and countries outside the EU, not distort competition and the burden of compliance should be such that both EU and non-EU vessel operators and Member States administrations can reasonably comply with the requirements.

On this latter point we are mindful that the European Commission recently issued a Green Paper consultation document entitled “On the future of VAT: Towards a simpler, more robust and efficient VAT system” in which the burden of compliance on business generally was prominently featured. We therefore suggest that whatever the result of the review of Article 37(3) may be, the manner in which the result is implemented should take into consideration the conclusions derived from the Green Paper consultation.

Initially, ECC comments were requested in your letter of 21 February 2011 wherein you requested broad input with respect to three matters:

What are the practical VAT issues your business is confronted with?

What should be changed in order to make the VAT system easier?

What is the economic impact on your business of the current VAT treatment of the supply of goods or services for consumption on board means of transport?

To this end, individual ECC members responded to the initial questionnaire provided with this request. Meetings between the ECC and PWC were then held on 2 March 2011 and 28 April 2011. Since the inception of this project, a number of telephone conference calls have been held between yourselves and the Chairman and members of the ECC Tax committee, the most recent of which was on 23 June 2011.

The ECC is now in a position to provide our more specific thoughts to the “policy options” first distributed 27 April 2011. However, ECC members have not completed the matrix as originally requested for several reasons. For example, they do not believe that there is a statistically supportable method of converting subjective observations into an objective standard from which decisions can reasonably be made. The specific concerns we have in relation to the use of Key Performance Indicators are developed further in Appendix 2 attached to this paper.

In addition, the large number of possible variations that our members found were produced when trying to apply their itineraries to the options, rendered the task both onerous to do and seemed to produce results that were meaningless and often contradictory. We were also unable to obtain a guarantee that the explanatory comments they felt would be necessary to insert into the final columns would be given full weight and attention when compiling the results of the Key Performance Indicator scores.

Consequently, we agreed that the ECC should furnish its views in written form.

However, the matrix has been most useful in focusing our attention on the issues raised by each of the options and has provided a framework for our response. We are therefore extremely grateful for the detailed work and effort that has gone into the preparation of the matrices that have brought these many issues to our attention.

Summary Conclusions

The full and exhaustive examination of all of the policy options presented to the industry leads the ECC and its members to conclude that none of them can be operated without significant problems. This is set out fully in Appendix 1 but we note the policy options fail to satisfy the following aspects:-

(a) Multiple Registration and Reporting

The rule that is ultimately adopted must address the administrative burden placed on a vessel operator, both on the vessel systems and with respect to the burden placed on its financial organization for compliance. Member States administrations also need to be able to audit compliance easily.

(b) Proportionality

Any taxing reference point, which exposes an industry such as cruises to multiple VAT rates and different compliance obligations in the course of a single voyage, or which may subject transactions to tax by one Member State when they physically occur in another, must comply with the proportionality principle.

(c) Territoriality/Treaty issues

Any taxing reference point must avoid potential conflict with the taxing jurisdictions of third countries for supplies made on non-EU flagged ships during transit of the high seas between EU ports.

(d) Inconsistent application of Customs/Excise/VAT rules

Customs duties, Excise taxes and VAT are so interrelated that coordination in their application and administration is necessary – for both the cruise industry and the Member States themselves. Some of the current rules may be ultra vires of EU legislation.

(e) Competition

Any changes to the present arrangements must not give rise to competitive distortions between Member States or between an EU and non-EU operator.

Summary

The ECC considers that, within the existing legislative framework, the only approach that may provide a partial benefit would be the introduction of a single country of departure reference point for taxing restaurant and catering services supplied on board ships, trains and aircraft which is subject to the corrective measures provided for in Article 59a of the principle VAT Directive and is interpreted in a uniform manner which is proportional to the objectives sought.

However, the ECC believes that the ultimate solution requires the development of a specially tailored system that recognizes the unique trading environment of travel retail.

The major element of such a system would be the introduction of a comprehensive one-stop-shop mechanism which embraces both a single VAT rate and VAT compliance obligations.

Detailed analysis

General

Cruise vessels are, by their very nature, highly itinerant and will frequently be deployed in different cruising regions throughout their working life. For instance, the North American brands that promote European cruising to American tourists may only operate two or three cruises a year in this region. Similarly, many European cruise brands will deploy their vessels in the Caribbean during the winter season. Moreover, and perhaps uniquely, cruise vessels transport passengers to several different taxing jurisdictions during the course of a single voyage for the purpose of enabling those passengers to visit and tour a number of cities and countries within a limited time and as economically as possible.

A cruise vessel may therefore call at four or five EU Member States ports during the course of a typical cruise itinerary. Moreover, it will frequently enter and leave the territorial seas of a Member State on more than one occasion during its approach and exit from those ports of call. Successive voyages may begin and end and call in different ports each voyage.

As a consequence, these vessels and their operators may be subject to compliance requirements with a number of VAT regimes, registration in a number of Member States and subject to a variety of differing invoicing, accounting and registration requirements concurrently. Despite modern day technological advances, the onboard electronic point of sale systems on these vessels are unable to cope with a taxing rule which imposes as many as ten or twelve different VAT rate changes during the course of a two week voyage.

Examination of Policy Options

In this section we will set out the overarching views of the ECC members on the various policy options that appear on the matrix. As stated above, the in-depth analysis appears at Appendix 1.

(a) Multiple Registrations and Reporting

If a supply is subject to the VAT system of a Member State the supplying enterprise must register for VAT in that country and file periodic VAT returns. Only Policy Option 3 (place of establishment) requires one registration. Policy Option 4 (point of departure) requires more than one registration if an operator has several points of departure in different countries under the definition of point of departure pursuant to the existing rule in the VAT Directive.

Compliance with VAT registrations in different countries multiplies the compliance costs which are often disproportionate to the VAT to be declared. Under a one-stop-shop system however, although the operator must calculate the VAT owed to individual Member States, the enterprise is registered only in one country and has to

file VAT returns only to one tax office. Together with the one stop shop, we would suggest that harmonized VAT rates and application rules of the country of registration be applied.

In the absence of a single rate and unified rules, compliance with different VAT rules and rates in different states requires considerable effort by the supplying enterprise in developing a deep knowledge of the VAT rules of all Member States involved. Your own survey of the rules of the 27 Member States of the EU admirably demonstrates what a challenge this presents.

In addition there will be the need to make considerable adaptations to the IT systems on board to comply with differing and inconsistent invoicing, accounting and other administrative rules, which will take some time to achieve. The one-stop-shop should be combined with harmonization of application regulations to make compliance at reasonable costs possible for enterprises. A “One-Stop-Shop” without the harmonization of application rules is unlikely to provide any significant benefit to operators. It will not reduce the compliance costs, because the IT systems on board must implement not only different VAT rates but, in addition, must be aware of the different VAT rules of different Member States.

(b) Proportionality

The Court of Justice of the European Union has considered the issue of proportionality in a number of cases and the key three tests to emerge are that a Community measure or decision must:

- constitute an effective means to realise the aims pursued by the measure or decision in question, (test of effectiveness),
- be necessary to achieve the relevant aims, which means in particular that no alternative and less intrusive measures are available, (test of necessity and subsidiarity), and
- not give rise to disadvantages which are disproportionate to the aims pursued, (test of proportionality *stricto sensu*).

If therefore, following the review, any change to the current arrangements is proposed, whatever rule is ultimately adopted must address the administrative burden placed on a vessel operator – both on the vessel systems and with respect to the burden placed on its financial organization for compliance. Member States administrations also need to be able to audit compliance easily.

(c) Territoriality/Treaty issues

Related to and influencing the notion of proportionality are the concepts of international law, including the exclusive jurisdiction in international waters over a vessel belonging to its flag state pursuant to Article 92 of the United Nations Convention on the Law of the Sea. We also note that Article 26 of the same Convention precludes charges to foreign ships passing through a country's territorial sea other than which may be levied for specific services rendered to the ship.

The itinerant nature of vessels and the control by the flag state can create serious challenges with respect to the actual or potential infringement of the taxing rights of other Member States and foreign countries.

Itineraries of transport over sea mostly include passing through international waters – the high seas. The present VAT Directive determines that VAT shall be applied in the territory of the Member State. Although not specific with regard to VAT, the notion that a vessel may be subject to the laws of multiple jurisdictions is well established. Primary jurisdiction over a vessel belongs to its country of registration or “flag state”¹. Concurrent jurisdiction may be exercised over a vessel by a coastal or port state while the vessel is in its territorial waters².

According to decisions made by the European Court of Justice (*Berkholz v Hamburg-Mitte-Altstadt* (Case 168/84)) a Member State may extend VAT beyond its territory as long as this does not encroach the sovereignty right of another state. In European or international itineraries of cruise vessels, taxation on the high seas may create distortion of competition (in different ways depending on the place of supply rule chosen) because it may determine taxation in a place different from the place of actual consumption (for example taxation may occur during a three months round the world cruise departing from a Member State on goods and services sold when the vessel is outside the territory of the Member State).

All options have a problem caused by the need to define the beginning and end of the taxable VAT area. The crossing from and to the high seas, the crossing from a non-taxable VAT area into a taxable VAT area, the crossing between EU VAT area states and between non EU VAT area states as well as the crossing of a border line of Member State territory can create significant application problems.

The limit of the territorial sea over which a Member State has jurisdiction follows the coast line seaward for 12 miles³. Based solely on the contour of the coast, a vessel travelling in a straight line may cross the border of one or more countries several times. Depending on weather and conditions, the points at which a vessel enters or leaves the territorial waters cannot be precisely predicted or controlled. It is for this reason that the concept of “innocent passage in the territorial sea” has developed providing generally the conditions where a coastal state cannot impede the movement of a vessel through its waters.

Consequently the points at which a vessel enters and departs the jurisdiction of a Member State are not appropriate for use as the start and end points for VAT. The ECC believes that the only applicable and controllable points are the mooring and casting off of the ship in the port as those points are used for Customs and Excise procedures already. Those points are also logical because after casting off and before mooring no person on the ship has the possibility to go ashore⁴.

¹ United Nations Convention on the Law of the Sea (« UNCLOS ») Art. 92

² E.g. UNCLOS arts. 24 and 25.

³ This is stated as the general rule. There are, however, exceptions for reefs, archipelagic states and other situations.

⁴ The same may be said for the sale of excise and duty free goods in airports once a passenger has entered the secure area with a boarding pass to a destination outside the EU.

Different rules for legs not crossing over high seas or crossing only the border line between two states – perhaps several times during the entrance to or departure from a port – would be very difficult to determine and to apply. Therefore the same “port rule” should be applied for all sea connections no matter if domestic or between different states. Services supplied and consumed in a free zone of a port would be taxable under the port rule. Goods delivered in a free zone of a port would be taxed, if the goods are cleared for free use in the EU VAT area and not taxed otherwise but subject to Customs control at entering the VAT area of the port’s country.

(d) Inconsistent application of Customs/Excise/VAT rules

Turning to another matter of concern, although not specifically covered by the terms of the review, we believe that Customs duties, Excise taxes and VAT are so interrelated that coordination in their application and administration is necessary – for both the cruise industry and the Member States themselves – and do need to be considered in the context of your deliberations.

This is because the present EU rules for retailing tax and duty-paid products during intra-EU travel journeys are completely unworkable for operators of multilateral voyages such as cruises.

Put briefly, these rules require operators of intra-EU multilateral voyages to purchase their stocks at the Excise rate of the Member State from which they set sail and then to change the fiscal state of the goods each time they enter the territory of another Member State on the itinerary.

This can only be accomplished by making an inventory of the stock on hand at the point of departure, making another at the point of entry into each new territory, making a declaration to the new Member State and then paying the duty required to put them into their fiscal regime. Operators can then apply for a reimbursement of the duty paid on unsold stocks but only when the vessel has left the territory of each Member State.

These totally impracticable procedures are further complicated by the fact that 23 Member States use tax stamps to evidence payment of excise duty on products released for consumption in their territory.

In a number of these countries the VAT element is also included in the amount of the stamp and is paid when the banderols are purchased by the manufacturer with no further payment/credit as the goods pass through the supply chain until they reach the final consumer. They also fix the maximum price that can be charged for the product.

However, all of these Member States rely on Article 39 of Directive 2008/118/EC which requires removal and annulment of these stamps before any claim for duty reimbursement will be entertained, and doing so means the packet is ruined and thus unfit for sale.

As a result, cruise operators are unable to retail tax and duty-paid excise products for passenger landing during an intra-EU cruise other than by carrying different duty paid stocks for each country visited on the itinerary.

It is our considered view that these markings act as a barrier to the free movement of goods sold onboard ships undertaking multilateral intra-EU journeys and thus are contrary to Articles 34 to 36 of the Treaty of Functioning of the EU and Article 39.3 of Directive 2008/118/EC.

(e) Competition

The place of establishment and place of departure reference points can cause distortion of competition if no corrective measures are applied. This is because the mere establishment of a supplier outside the EU or on a vessel departing a non-EU port will determine that no VAT will be charged on the same transactions that would be taxable if provided by an EU established supplier or a supplier on a vessel departing a non-EU port.

Although the corrective measures prescribed by Article 59a of the principle VAT Directive can be applied to supplies of services, they cannot be applied to supplies of goods. Thus, a supplier established in a non-EU Member State or a supplier on board a vessel departing a non-EU port could have a competitive advantage over a supplier established in a Member State or on a vessel departing an EU port.

(f) Rules for all kinds of Services and Supply of Goods

Policy Options 1 to 4 propose VAT regulations for the supply on board of goods for consumption and for take away, restaurant and catering services and other services. As under all suggested policy options the VAT can change - at least from taxability to non taxability (on high seas) - there needs to be a better definition for when the supply takes place than the current definition in Article 37 of the VAT Implementing Regulation.

The supply of goods for take away covers all deliveries on board of goods which are not usually consumed or used on board, eg, clothes, pictures, souvenirs, cameras, jewellery etc. Those goods may not be only subject to VAT at point of sale but may also be subject to import VAT and (possible) import duties at the destination. The VAT regulations should correspond with the Customs procedures and Excise rules to avoid any contradictions such as double or non taxation when the goods are consumed within the EU (unless exemption thresholds are applicable). Under the non taxability of the high seas rule such deliveries on the high seas will be not taxable, but may be subject to customs procedures on passengers leaving the ship in port.

(g) Goods for consumption

Supplies of goods for onboard consumption are currently exempt under article 37.3 of the Directive and the importance of this relief has long been recognized by the Commission. Assuming that such relief will not be withdrawn the definition of “goods for consumption on board” must be given in a harmonized application rule to avoid different interpretations in different Member States. For example, it may relate only to food and beverages or may extend to other goods like tobacco products, media products, health and beauty products etc. To abolish the exemption option does not remove the customs controls for take away goods, because the goods could have been bought on high seas or in a country outside the EU.

In any event (i.e. if the exemption relief is kept or not) the difference between the definition of supply of goods and of restaurant and catering services is important. Furthermore, a common understanding of the Council Regulation definition will need to be achieved to avoid distortions.

(h) Change of VAT directive and Requirement for an Impact Assessment. (IA).

Policy options 1 to 4 contain the following changes to the VAT directive, which would require an impact assessment:

- i. The abolition of the option to exempt the supply of goods for consumption on board (sub option in Policy options 1 to 4) by ending of the stand still option of Art. 37 (3) VAT Directive
- ii. The replacement of the European Court of Justice's establishment/fixed establishment rule for the place of supply of other services on board or place of supply changes from the place where the supplying enterprise is registered or its place or fixed establishment to the place of supply as defined by the new different rule.
- iii. The abolition of Art 57 (Supply of restaurant and catering services on board).

Conclusions and possible way forward

As has been demonstrated in the foregoing paragraphs all of the options proposed present some form of practical difficulty for a highly itinerant transport operator such as cruises although some clearly present more than others.

We believe that the ultimate solution may be the development of a system which recognises the unique trading environment of the maritime passenger transport industry.

The major element of such a system would be the introduction of a comprehensive one-stop-shop mechanism.

However, a one-stop-shop system that merely seeks to reduce the number of VAT returns that need to be made and does not address the underlying problem is not a major simplification. It seems to us that in order for a one-stop-shop system to work efficiently, the tax authorities of Member States need to adopt a much more pragmatic approach, bearing in mind that a business that is VAT compliant in its own country will not necessarily be willing to invest in the necessary resources in order to ensure it is VAT compliant in other countries.

The ECC therefore believes that what is needed is not just a single VAT return, but a single return which is based on a single VAT system.

This arrangement would require businesses that make B2C supplies, which are subject to VAT in a number of EU countries, to submit a single VAT return to the tax

authority of the Member State in which the business is established. Such VAT would be calculated in accordance with the VAT laws of the country of establishment or based on common principles and rates applicable to maritime passenger transport throughout the EU.

Ideally, a business would be able to account for VAT on all of its EU supplies at the rate applying in its home country and also deduct VAT incurred in another Member State in calculating its net VAT liability.

This simplification could be facilitated by requiring the business concerned to submit an accompanying supplementary statement showing the breakdown of its taxable purchases and supplies in each of the Member States concerned. It would then be for the tax authorities of the Member States concerned to ensure that the VAT actually paid was apportioned in a fair manner to the countries in which the supplies had taken place.

Not only would this arrangement provide a major administrative simplification for B2C suppliers throughout the EU but we see no reason why it could not be further adapted to make it easier for non-EU businesses that make occasional B2C supplies to EU consumers to comply with their EU VAT obligations.

However, this is likely to be a long term solution which may be more appropriately addressed in the recent Commission Green Paper initiative on the Future of VAT.

Within the existing legislative framework therefore, an alternative approach might be to introduce a single point of departure reference point for taxing all restaurant and catering services supplied onboard cruise vessels that depart an EU port, provided that, to the greatest extent possible, it also observes the principle of taxing at the place of consumption. For instance, it would totally undermine the place of consumption principle if restaurant and catering services supplied onboard a three month world cruise departing/returning the UK were subject to taxation when the vessel is in the middle of the Pacific or Indian oceans.

The benefit in this approach is that not only would it provide a single rate structure but it would also mirror the existing rule for intra-EU voyages which seems to work reasonably well for administrative purposes. A further benefit is that it would also avoid potential conflict with the taxing jurisdictions of Third Countries for supplies made on non-EU flagged ships during transit of the high seas between two EU ports.

The amended proposal for the place of supply of services Directive presented by the Commission on 20 July 2005, [COM(2005)334], included a provision to tax these services at the place of departure of the transport service, but with an option to override this rule for supplies used and enjoyed outside the territory of the EU or on the high seas. [see proposed Article 9f(d).2 and proposed Article 9j].

The ECC believes that inclusion of these transactions in the use and enjoyment provisions can be justified in order to address distortions of competition with cruises that depart non-EU ports. Moreover, it will also meet the criteria of taxing supplies which take place within the territory of the EU but without imposing disproportionate administrative burdens on cruise lines and Member States administrations.

Since the Commission clearly supported such an approach at the time of their amended proposal, we believe that further consideration should be given to what appears to be a sensible and pragmatic solution to the administrative difficulties which operators of international cruise operators will face in having to comply with the domestic taxing/invoicing rules of five or more Member States during the course of a single voyage under the 'where physically carried out' and 'use and enjoyment' reference points.

Finally, the present arrangements, including the treatment of restaurant and catering services as VAT exempt consumables, have worked efficiently and without problems for the past eighteen years.

Thus, if taxation is to be introduced under any of the policy options identified, the ECC believes this would be tantamount to a substantive change which has a clear and identifiable economic, social and environmental impact and as such should therefore be subject to a full Impact Assessment before implementation.

We hope that the comments above and the attached documents will enable you to be fully mindful of the views of the ECC and its members but we are always available to assist further if/as required and we look forward to the meeting you agreed to hold before you deliver your final papers to the EU Commission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'David Dingle', followed by a horizontal line.

David Dingle CBE
Chairman
ECC Taxation Sub-Committee

Ms. Ine Lejeune
PricewaterhouseCoopers
Tax Consultants
Wilsonplein 5 G
B-9000 Gent

Cc: Mr Donato Raponi