

Harmonization of the EU “Zero Rate for Airlines”

In this article, the author highlights the problems for businesses operating in the aviation sector caused by lack of harmonized understanding of the zero rating of supplies of goods and services made to “airlines” within the meaning of article 148(e) of the EU VAT Directive, and recommends a possible solution.

1. Introduction

Article 148(e) to (g) of the VAT Directive¹ provides for the zero rating of, or, in the terminology of the Directive, an exemption from VAT for, a broad range of supplies of goods and services made to “aircraft used by airlines operating for reward chiefly on international routes ...”² As neither the Directive, nor the Implementing Regulation³ contains any further clarification, Member States have adopted in their national VAT legislation different policies on the scope of the zero rate, which has led to a situation of unequal treatment and practical difficulties for suppliers and recipients of goods and services in the aviation sector.

Since the territories of the Member States of the European Union are relatively small and intra-Community flights are still considered to be flights on “international routes,”⁴ the application of the zero rate seems to cause little problem for European air carriers⁵ carrying out exclusively or primarily the carriage of passengers or cargo for consideration – the so-called “scheduled airlines” or “cargo carriers”. Indeed, these operators normally take in fuel and receive services at passenger or cargo terminals in the European Union where the respective suppliers are experienced and

easily able to apply – and sustain on audit – the “zero rate for airlines”.

In this context, there seems to be little disagreement that corporate flight departments operating general aviation aircraft are not eligible for receiving zero-rated supplies because the “corporates” normally do not hold an air operator certificate (AOC) issued by the local aviation administration authorizing common carriage of passengers or cargo, or, in the case of US-based companies, an air carrier certificate (ACC).⁶

Between the scheduled carriers and the corporates lies a large segment of the general aviation industry for which the varying interpretations of “airlines operating for reward chiefly on international routes” create significant problems and dislocation.

In addition to aircraft management companies holding an AOC covering some or all of their managed fleets, this mid-ground is occupied by companies engaged in various types of aerial work for consideration – ferry flights, aircraft delivery, aerial mapping and photography – and others, such as fractional management companies, military contractors and air ambulance services. In addition to the difficulty in determining the eligible “airlines”, the phrase “operating chiefly on international routes” is highly problematic.

With limited guidance from the Directive, at least two competing approaches have emerged purporting to interpret the requirements laid down by article 148(e) as meaning that the zero rate applies:

- company-wide, i.e. the zero rate applies on a company-wide basis to all supplies of goods and services made to a (legal) entity holding common-carriage operating authority if the entity derives at least a majority of its revenues, or carries out a majority of its flights, for consideration, usually charter, taking off or landing outside the “test” country; or
- on a transactional basis – the zero rate applies to all supplies made to every charter or “for consideration” flight carried out by a (legal) entity holding common-carriage authority on any international itinerary.

Whereas the first approach appears to follow from the judgment of the Court of Justice of the European Union (ECJ) in *Cimber Air*,⁷ further review suggests that neither of these tests is sufficiently clear to prevent various distortions.

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1. Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006).
 2. Article 148 of the VAT Directive provides for the zero rating of:
 (e) the supply of goods for the fuelling and provisioning of;
 (f) the supply, modification, repair, maintenance, chartering and hiring of, and the supply, hiring, repair and maintenance of equipment incorporated or used in; and
 (g) the supply of other services to meet the direct needs or the cargoes of, aircraft used by airlines operating for reward chiefly on international routes. The latter phrase is laid down in article 148(e), and the subparagraphs (f) and (g) of article 148 refer to subparagraph (e).
 3. Council Implementing Regulation (EU) 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the Common System of Value Added Tax, OJ L77 of 23 March 2011. The “VAT Implementing Regulation” contains binding interpretations of the provisions of the VAT Directive.
 4. See section 3.4. of this article.
 5. Whether the major “flag” carriers based outside the European Union – especially those based in large home countries, such as North America – satisfy the conditions for application the zero rate is discussed in section 3.4.

6. See 14 CFR, Part 119, section 119.5. AOC and ACC are referred to collectively as “AOC”, which is the term in common usage globally.
 7. DK: ECJ, 16 Sep. 2004, Case C-382/02, *Cimber Air A/S v. Skatteministeriet*, ECJ Case Law IBFD, [2004] ECR I-9379.

The aviation industry and other stakeholders would benefit tremendously from the adoption by the European Council of implementing provisions defining the various terms used in article 148(e), as well as from consistent application of those terms in all EU Member States.

2. Business Problems

The lack of a commonly applied definition of the scope of the zero rates in article 148(e) to (g) of the VAT Directive causes significant problems and exposures for general aviation suppliers, various categories of aircraft operators and national tax authorities.

Firstly, even though the zero rate does not have a material effect for most EU operators, suppliers adhering to one of the two approaches can achieve a competitive advantage over suppliers adopting the other approach in some cases. For example, suppliers adopting the “company-wide” policy will be able to offer VAT-free goods and services⁸ throughout the European Union (or at least in Member States where the supplier maintains a VAT registration) for all flights carried out by a management company meeting the 50%-test, even for flights carried out on behalf of the managed owners that do not involve common carriage. Even though the recipients of goods and services can deduct or apply for a refund of the VAT that is due if the zero rate applies on a “transactional” basis, the suppliers are in a competitive disadvantage in respect of these non-common carriage flights.

Conversely, where the zero rate applies on a transactional basis, suppliers will be able to offer VAT-free fuel and services in every case of a charter flight, without having regard to the portion of the customer’s flights carried out for common carriage of passengers or cargo. So, even if the customer fails the 50%-test, “transactional” suppliers can still offer VAT-free goods and services in relation to the AOC operator’s international charter flights.

Secondly, by adopting either of these approaches, the VAT refund authorities⁹ can – and do – reject claims from

general aviation operators of all types on the basis that the VAT was “wrongly charged”, i.e. that the inputs should have been zero rated because the applicant holds an AOC or an ACC. If the supplier refuses to correct the mistake, the customer may eventually recover the VAT under the ECJ’s judgment in *Reemtsma*¹⁰ but the recovery procedure is rather burdensome. Of course, most suppliers are hesitant to issue credits in these cases due to uncertainty of the litigating position of their local VAT offices. Thus, with no guidance from the tax authorities, suppliers applying any definition of the scope of article 148(e) are highly exposed to adverse audit findings.

Thirdly, aircraft operators are not able to adequately plan their fuel purchases when they are unable to determine in advance what the VAT treatment might be. Since EU VAT rates now average over 20% of the base price plus any energy tax,¹¹ knowledge of the potential VAT charge can have a significant effect on determining when and where aircraft operators take in fuel, especially for operators adept at “tankering” calculations.

Finally, as illustrated by the ECJ’s judgment in *A Oy*,¹² lack of a commonly understood definition of the terms in article 148(e) can create substantial financial risks in the aircraft acquisition and financing sector. *A Oy* also illustrates, indeed provides a roadmap for, potential conversion of private, non-commercial activities into activities that satisfy the condition of article 148(e), a result not intended by the Directive but apparently possible given the lack of definitional guidance.

These are not insignificant problems.

3. Definitional Issues

Under article 148(e) to (g) of the VAT Directive, supplies of goods and services made to “aircraft used by airlines operating for reward chiefly on international routes ...” are zero rated. The same wording was used in the former Directive.¹³ There were and still are no implementing regula-

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8. Although, under the place-of-supply rules that came into effect on 1 January 2010, many services supplied to aircraft are deemed to be supplied at the place where the customer is established, to the effect that services supplied to customers established in another Member State are subject to VAT in the customers’ Member State and services supplied to customers established outside the European Union are not subject to any VAT at all, the (optional) application of the “effective-use-and-enjoyment” criterion varies from Member State to Member State and may have the effect that services incidental to operating aircraft, such as parking or overnight storage, are taxed at the place where non-EU customers effectively use and enjoy the services. Under those circumstances, the zero rating of services under article 148(e)-(g) of the VAT Directive becomes important for customers established outside the European Union. Although the upcoming amendments to the Implementing Regulation contain binding interpretations of “services connected with immovable property”, there is no uniformity in the scope of the national effective-use-and-enjoyment criteria for other services and, if that criterion applies, the place where the services are effectively used and enjoyed.
 9. Business established in a Member State of the European Union can apply for a refund of VAT incurred in another Member State under the provisions of Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State, OJ L44 (2008), whereas businesses established outside the European Union can apply

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- for a refund of VAT under the provisions of the Thirteenth Council Directive (86/560/EEC) of 17 November 1986 on the Harmonization of the Laws of the Member States relating to Turnover Taxes – Arrangements for the refund of value added tax to taxable persons not established in Community territory, OJ L326 (1986).
 10. IT: ECJ, 15 Mar. 2007, Case C-35/05, *Reemtsma Cigarettenfabriken GmbH v. Ministero delle Finanze*, ECJ Case Law IBFD, [2007] ECR I-2425. On that occasion, the ECJ declared that the principles of neutrality, effectiveness and non-discrimination do not preclude national legislation, according to which only the supplier may seek reimbursement of the sums unduly paid as VAT to the tax authorities and the recipient of the supply may bring a civil law action against that supplier for recovery of the sums paid but not due. However, where reimbursement of the VAT would become impossible or excessively difficult, the Member States must provide for the instruments necessary to enable that recipient to recover the unduly invoiced tax [from the tax authorities] in order to respect the principle of effectiveness.
 11. “Energy Tax” is the fuel excise tax imposed under the EU Energy Tax Directive, Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, OJ L283 of 31 October 2003. The current minimum energy tax rate is EUR 302 per kiloliter, but the tax rate can reach a high of EUR 654.50/kl, in Germany.
 12. FI: ECJ, 19 July 2012, Case C-33/11, *A Oy*, ECJ Case Law IBFD.
 13. Article 15(6), (7) and (9) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonization of the Laws of the Member States relating to

tions, and various government and litigating parties in the *Cimber Air* and *A Oy* cases offered no effective clarification outside the wording of the specific statutory provision.

There are at least several definitional difficulties with the following phrases in article 148(e).

3.1. “Used by”

One of the issues in *A Oy* was whether the zero rate could apply to an aircraft operated by an “airline”, such as pursuant to a management agreement, or whether the aircraft had to be “owned” by the airline. In its judgment, the ECJ noted that at least some national legislations have adopted the requirement of ownership. “Use” can presumably occur pursuant to some accepted type of legal authorization conferred by an owner, such as a financing or operational lease or under the terms of a management agreement granting operational control of the aircraft to the management company. On this issue, the ECJ concluded that legal or equitable ownership was not required by article 148(e); the legal right to operate the aircraft seems sufficient to satisfy the “used by” test.

3.2. “Airlines”

Determining whether a business organization qualifies as an “airline” is more difficult because the term is not defined in the VAT Directive and is used in so many different EU tax and customs settings with varying meanings. Most dictionary definitions are directed toward scheduled carriers. The “Open Skies” Agreement¹⁴ between the United States and the European Union refers in its definitional article¹⁵ to “air transportation” and then uses the term “airlines” in many contexts throughout the treaty without further definition.

In *A Oy*, the ECJ held, inter alia, that provision of passenger charter services, being in competition with scheduled providers, could be considered in making an article 148(e) determination, but it was not clear whether the ECJ was addressing the term “airline” or the phrase “for reward”.

The tax authorities in the United Kingdom, Her Majesty’s Revenue and Customs (HMRC), have recently issued their own guidance on the application of the zero rate under article 148(e), including the question of whether an aircraft management company qualifies as an “airline”. In their internal VAT transport manual, VTRANS 110640, HMRC note that “the terms and meaning [of the wording of article 148(e)] are quite vague.”

In VTRANS 110640, HMRC define an airline as “... an undertaking which provides services for the carriage by air of passengers or cargo.” After observing that multiple associated entities or VAT groups might be bound together as a single “airline”, the manual presents the confusing statement that corporate flight departments, operating from separate legal entities within the corporate group, may qualify

as an “airline”, notwithstanding the lack of common-carriage AOC authority, and notwithstanding the fact that the entity carries only associated employees rather than being held out to the general public. This form-over-substance inference was, however, also part of the facts in *A Oy*, as the only operating revenues derived by the “airline” in *A Oy* were generated from the corporate owner’s payment of the company’s charter invoices.

VTRANS 110650 then introduces the management company question by stating:

The activities of aircraft management companies vary quite widely and the correct treatment will depend on the contractual facts. However, this is an area that has been reported as causing the industry some difficulty and the following points try and assist in setting the perspective.

VTRANS 110650 focuses the “airline” question on the provision of transport services rather than the provision of that bundle of services inherent in the management and operation of an aircraft on behalf of its owner. There is, however, no explicit statement to the effect that only aircraft available for third-party passenger transport, by reason of listing on the operations specifications underlying the AOC, are to be taken into account in determining satisfaction of the condition “for reward chiefly on international routes” in article 148(e).

3.3. “Chiefly”

The ECJ discussed the term “chiefly” at some length in its judgment in *Cimber Air*.¹⁶ On that occasion, the ECJ had to answer two questions. The first question was whether the zero rate extended to supplies made to aircraft serving domestic routes that are operated by an airline operating chiefly internationally. The second question was what criteria are appropriate to determine whether or not an airline is operating “chiefly” on international routes.

The ECJ answered the first question by essentially reproducing the specific wording of the provision to apply at the company level rather than on a transactional basis.¹⁷ Thus, once an organization is an “airline operating for reward chiefly on international routes”, then all supplies to that organization, as described in article 148(e)-(g), are zero rated, not just those supplies involving its international activities.

However appealing this broad application may sound, it should be noted that *Cimber Air* only operated flights for consideration. All of its flights would require the authorization to operate as granted by its AOC, unlike management companies operating “owner” flights which would not require AOC authorization.

As to the term “chiefly”, the ECJ noted that several language versions of the Sixth Directive required that “essentially all” of the airline’s flights must be international flights,¹⁸ whereas several other language versions required only a

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Turnover Taxes – Common System of Value Added Tax: uniform basis of assessment, OJ L145 (1977).

14. US-EU Air Transport Agreement signed 30 April 2007.

15. Id., article 1.

16. *Supra* n. 7.

17. Id., at paragraphs 23-30.

18. For example, article 262(II)(4) of the French *Code Général des Impôts* (Tax Code) requires that 80% of the company’s traffic is carried out outside France.

majority of the airline's flight to be international. Unfortunately, instead of choosing one of these two options, the ECJ came up with its own interpretation – that:

... it is necessary to treat as airlines operating chiefly on international routes those whose operations on non-international routes are found to be considerably less extensive than their international activities.¹⁹

The ECJ also then left it to the national courts to decide what criteria are relevant – seat kilometres, as suggested by *Cimber Air*, or some other measure, such as domestic versus international passenger volume or number of flights carried out over some unspecified period. The ECJ concluded by suggesting that turnover derived from domestic versus international flights might be most relevant.²⁰

3.4. “International routes”

This phrase has apparently not been directly in dispute, although the ECJ mentioned the issue in the operative part of its judgment in *A Oy*. Speaking of the wording of article 15(6) of the former Sixth Directive, the ECJ said that international routes must mean:

... flights crossing over the airspace of several States, as well as, in some cases, over international airspace.²¹

It is not clear where the element of “airspace of several States” originated but a possible justification of the fact that, for the purposes of the concession laid down by article 148(e) to (g) of the VAT Directive, “international flights” are flights crossing over the airspace of several states may be found in the comprehensive international air treaty, known as the Chicago Convention of 1944.²² Although, at that time, VAT had not yet been introduced in the European Union, the Convention provides for a general exemption from duties for “aircraft stores” carried aboard international scheduled and non-scheduled aircraft. “International” is defined as meaning traffic “which passes through the airspace over the territory of more than one State.”²³

Even assuming that a flight crossing any international border could be considered “international”, it is not certain that some of the world's largest passenger carriers, such as the US “flag” carriers, would meet the test of operating “chiefly on international routes” because, depending on the measurement criteria, most of their revenues are derived from flights within the United States, even if a flight from, say, Miami in Florida to Houston in Texas were considered international for having crossed the Gulf of Mexico.²⁴

19. *Supra* n. 7, at paragraph 39.

20. In VTRANS 110640, HMRC recognize a plethora of possible determinants, indicating that “the important point is that the test and the result [are] fair and reasonable and are readily verifiable ... and that it [the test] relates to the flying operations.”

21. *Supra* n. 12, at paragraph 29.

22. *Convention on International Civil Aviation*, Ninth Edition, Doc 7300/9, ICAO (2006). Some 190 nations are now Contracting States to the Convention. The International Civil Aviation Organization (ICAO), which is now a body of the United Nations, was created under this agreement.

23. *Id.*, at article 96(b).

24. In the event that a foreign carrier failed the “chiefly on international routes” test due to a preponderance of its flights being in its home domestic market, tax relief would presumably be available under the various air services agreements, such as the Open Skies Agreement between the

In this context, it should be noted that a flight between two states of the United States is generally considered to be a “domestic” flight, whereas a flight between two Member States of the European Union is considered to be an “international” flight, at least for VAT purposes, even though, for VAT purposes, the internal borders between the EU Member States have been abolished twenty years ago. The broad interpretation of “international flights” within the European Union is in line with a statement in the minutes of the meeting of 16 December 1991 at which the Ecofin Council adopted Directive 91/680 on the VAT consequences of the abolition of the tax borders between the Member States.²⁵ On that occasion, the Council and the European Commission declared unanimously that, until the Council has adopted Community rules on the provisioning of vessels and aircraft, for the application of article 15(6) of the former Sixth Directive (article 148(e) of the current VAT Directive), *inter alia*, the words “international routes” also cover transport between Member States.²⁶ It is, however, less likely that “international routes” also include flights from a place of departure to a place of destination within the same Member State, where part of the journey takes place through the airspace over another Member State or in the airspace over a country outside the European Union.

In VTRANS 110640, HMRC take the view that “... any route that is not a wholly domestic route within the United Kingdom is an international route”. This approach would “save” the US flag carriers mentioned above, and indeed any other carrier based outside the United Kingdom, regardless of the portion of its flights crossing international borders.

4. EU Tax and Customs Treatment of Aviation

In addition to VAT, EU law applies other taxes, duties and customs rules to general and commercial aviation, and there have been a series of recent national and EU-wide proposals or new laws enacted imposing additional taxes on aviation.²⁷ Unfortunately, these other taxes have their own distinct rules based on differing concepts of “commercial” status, meaning that a general aviation operator can be treated as being “commercial” for one purpose, and as being “non-commercial” for another – all in relation to the same flight!

4.1. Importation of goods

Foreign aircraft entering into EU airspace have to comply with the rules and procedures laid down by the EU Customs Code governing the importation of goods. Unless an aircraft is in “free circulation”, i.e. was manufactured in, or has

European Union and the United States, OJ L134 (2007). A second phase of the agreement came into effect in 2010.

25. Council Directive 91/680/EEC of 16 December 1991 supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, OJ L376 (1991).

26. See FISC 123, which has been released on 18 December 1991.

27. For example, the EU Emissions Trading Scheme, the Italian “luxury” tax, and various enhanced passenger taxes, such as the UK and German “air passenger duties”.

previously been imported into, an EU Member State, the regime for "temporary importation" is normally available.²⁸

Articles 555 to 562 of the Customs Implementing Regulation,²⁹ which define the conditions for total relief from import duties for temporary importation of aircraft, provide, inter alia, that aircraft used for "commercial purposes" may remain within the European Union for the time necessary to carry out their transport; all aircraft used "privately" may remain there for a period of six months.

Article 555 of the Customs Implementing Regulation was amended in 2003 to limit "commercial use" to aircraft transporting passengers for remuneration or transporting cargo.³⁰ This provision appears to apply to both the scheduled carriers and charter flights carried out by aircraft management and other charter operators. Prior to the amendment, the definition of "commercial" in article 555 of the Customs Implementing Regulation included aircraft used for the transport of persons without remuneration "in the framework of the economic activity of an enterprise".³¹ Thus, for the temporary importation regime, business aircraft operated by corporate flight departments were considered "commercial" prior to 2004 but are categorized the same as aircraft operated for non-business, personal use since 2004.

Interestingly, the VAT Directive allows Member States to specifically correlate the suspension of VAT for temporarily imported goods to the period for which duty suspension under the Customs Code is applicable.³² Thus, here is an unusual case where, on the one hand, business activities and, on the other hand, personal, non-business activities are treated equally for VAT purposes.

4.2. EU energy tax

EU Member States may apply energy tax³³ to jet fuel used by general aviation. However, article 14 of the Energy Tax Directive provides for an exemption for fuel supplied to any aircraft operating in "air navigation other than private pleasure-flying". Most EU Member States apply the exemption from energy tax literally, allowing exemption at the time of supply of fuel to commercial and business jet operators. However, German law limits the exemption to flights for "commercial" purposes by air carriers, which has been recognized as permissible by the ECJ.³⁴

In order to ensure consistency with related provisions in the EU Customs Code, the Energy Tax Directive could have adopted the criteria that apply under the temporary importation rules laid down by the Customs Implementing Regulation for the purposes of delineating commercial use or use "for reward", business use and personal, non-business use.

4.3. ICAO and air transport agreements

The overall international aviation framework created by the Chicago Convention of 1944 is implemented through the International Civil Aviation Organization (ICAO), a body of the United Nations. The Convention established regulatory, safety and operational standards covering scheduled passenger, cargo and mail carriage, and government aircraft.

Regarding taxes, article 24 of the Chicago Convention contains a broad exemption from customs duties for equipment, stores and parts aboard aircraft operating on international flights. Although the Convention pre-dated the introduction of the EU VAT system (in 1968/1969), the exemption laid down by article 24 also applies to "similar national or local duties and charges". Unfortunately, there appears to be no further guidance or subsequent case law on the question of whether or not such "similar duties and charges" also include VAT.

Nor is it clear that such an exemption, even if applicable to VAT, can be applied to non-commercial general business aviation, which barely existed in 1944.

Article 96 ("Definitions") of the original Convention provided that:

- (a) "air services" means any scheduled air service performed by aircraft for the public transport of passengers, mail or cargo;
- (b) "international air services" means an air service which passes through the air space over the territory of more than one state; and
- (c) "airlines" means any air transport enterprise offering or operating an international air service.

Most of the Convention signatory nations have entered into further, more detailed, implementing agreements, generally known as "air transport agreements" or "air services agreements". Those agreements seem to provide more transparent definitions of the type of operations covered, often almost derived verbatim from the definitions in article 96 of the Convention.

For example, the "Open Skies Agreement" between the United States and the European Union that entered into effect in 2008³⁵ grants rights relating to the conduct of international air transportation by airlines. "Air transportation" is defined as meaning:

travel is not directly used for the supply, by that company, of air services for consideration.

- 35. Air Transport Agreement between the United States of America and the European Community, OJ L134 (2007).

28. Temporary importation of goods with relief from customs duties is authorized generally by articles 137 et seq. of Council Regulation (EEC) 2913/92 of 12 October 1992, establishing the Community Customs Code, OJ L302 (1992). Further details of the customs relief are laid down by articles 555 et seq. of the Customs Implementing Regulation (*infra* n. 29).

29. Commission Regulation (EEC) 2454/93 of 2 July 1993, OJ L253 (1993), as amended.

30. Article 1(14) of Commission Regulation (EC) 2286/2003 of 18 December 2003, OJ L343 (2003).

31. Article 555(1)(a) of the Customs Implementing Regulation, prior to amendment in 2003.

32. Article 161 of the VAT Directive.

33. See EU Energy Tax Directive, *supra* n. 11.

34. By its judgment of 1 December 2011 in *Systeme Helmholtz GmbH v. Hauptzollamt Nürnberg*, Case C-79/10, the ECJ declared that the tax exemption for air fuel used for the purpose of air navigation, provided for under article 14(1)(b) of Directive 2003/96, cannot apply in the case of a company, which, in order to develop its business, uses its own aircraft to transport members of its staff to clients or to trade fairs, in so far as that

the carriage by aircraft of passengers, baggage, cargo and mail, separately or in combination, held out to the public for remuneration or hire.³⁶

“International air transportation” is defined as meaning:

air transportation that passes through the airspace over the territory of more than one State³⁷

Unfortunately, the term “airlines” is not defined. The Treaty’s preambles do recite the purposes of the Treaty as promoting competition, meeting the needs of passengers and (cargo) shippers, and facilitating access of airlines to global capital markets. Such purposes would seem to confirm that the term “airlines” is best read to mean carriers of paying passengers or cargo. Yet, it remains unclear whether all or even a majority of a company’s traffic must be “air transportation” in order to qualify for benefits under the Treaty.

5. Harmonized Solution

As European VAT practitioners are well aware, lack of harmonized VAT definitions and working rules among the 28 Member States causes confusion, inefficiency and significant business costs in many business sectors.³⁸ For the purposes of the zero rate, the concepts of “airline” or “commercial” have not yet been fully harmonized. On the contrary, even though the harmonization is limited to the wording of article 148(e) of the VAT Directive, there are obvious instances of non-compliance with the wording of that provision. Examples of those unlawful deviations, which cause distortions in the market, include the United Kingdom’s view that jet fuel is being “exported” and Spain and Italy’s deficient policy of zero rating aircraft fuel.

“Export” of jet fuel

Under current UK law, supplies of jet fuel are zero rated on the basis of the statutory rules governing the exportation of goods.³⁹ This treatment was not “corrected” in the framework of the European Commission’s infringement proceedings against the United Kingdom in 2009⁴⁰ which focused on the Member State’s previous weight-

based concession applicable to most goods and services supplied to aircraft. In combination with the self-assessment of the energy tax and exemption for all business and commercial flights from the tax⁴¹ in the United Kingdom, the essentially tax-free supply of jet fuel in that Member State significantly influences purchasing decisions of many non-EU business operators.

Zero rating in Spain and Italy

In Spain and Italy, suppliers of aviation fuel do not have to charge VAT to their customers on supplies of fuel for transiting aircraft, but certain categories of fuel suppliers encounter considerable difficulty in reclaiming the VAT paid on their purchases of the fuel. The suppliers in question cannot easily satisfy the conditions for refund of the excess input VAT and the author is advised that fuel resellers’ have claims of millions of euros of VAT attributable to excess input VAT accumulated in Italy and Spain. Thus, suppliers are discouraged from entering these markets.

A logical first step to harmonize the application of the zero rate for the aviation sector would be for the European Commission to include the national implementation of article 148(e) of the VAT Directive within the Commission’s next review of potential matters to pursue under article 258 of the Treaty on the Functioning of the European Union (TFEU). To that end, the Commission may consider commissioning a third party to carry out an “expert study”⁴² to evaluate the extent and impact of the current divergences in practice and to propose solutions on the basis on the results of the industry surveys.

The VAT Committee may also wish to consider the matter at the request of the European Commission or any interested Member State, and adopt a (non-binding) guideline on the application of article 148(e) to (g) of the VAT Directive. Following the adoption of such a guideline, the European Commission may propose to the Council the adoption of the VAT Committee’s guideline in the form of a binding “implementing measure” to be included in the VAT Implementing Regulation.⁴³

Taking into account the rationale of the zero rate in article 148(e) to (g) of the VAT Directive, which is primarily aimed at preventing non-resident businesses involved in international aviation from having to apply for a refund of large amounts of VAT, and in view of other legal rules applicable to the general aviation sector, the current economic distortions and inefficiencies would probably be minimized if all holders of an AOC certificate that chiefly operate on international routes within the meaning of the ECJ’s judgment in *Cimber Air* are eligible for VAT-free purchases of fuel and other goods and services. In this context, “chiefly” should be based on turnover derived by an airline from “international” and “domestic” flights, and the antiquated

36. Id., article 1(2).

37. Id., article 1(5).

38. On a related subject – the VAT treatment of “buy-on-board” supplies to passengers on board various means of transport during an intra-Community passenger transport – PricewaterhouseCoopers recently issued a Final Report to the Commission describing the range of disharmony and distortion caused by the lack of harmonized VAT rules. See PwC’s Final Report of 8 February 2012 under Specific Contract No. 3, TAXUD/2010/DE/326, which the Commission published on 22 October 2012, COM(2012) 605. The report notes widely divergent national legislative provisions, exemption provisions, VAT rates and compliance burdens, and presents suggestions for short, medium and long-term harmonization strategies.

39. See section 30(6) and (7) of the UK VAT Act 1994, and HMRC’s VAT Notice 703, section 10.

40. See press release IP/09/1016 of 25 June 2009. On that occasion, the European Commission objected to the fact that, in the United Kingdom, the application of the zero rate did not depend of the status of the airline but on the weight and design of the aircraft. In respect of aircraft under 8,000 kg, the zero rate could not apply even if the aircraft was operated by a qualifying airline. Conversely, the zero rate did apply in relation to aircraft of a weight over 8,000 kg and not designed or adapted for private pleasure flying, even if the aircraft was not operated by an airline operating for reward chiefly on international routes.

41. See HMRC Notice 554 of February 2013, sections 10-16.

42. The European Commission frequently commissions third-party VAT specialists to carry out surveys in the field of VAT.

43. Article 397 of the VAT Directive authorizes the Commission to propose to the Council the adoption of implementing measures necessary to implement the VAT Directive.

concept of "international routes" should be interpreted, just like in the United Kingdom, as covering all activities of the airline outside the territory of the Member State in question.

Consequently, a shuttle between London and Paris should qualify as "international", whereas a shuttle between Berlin and Frankfurt would not, albeit that, in order to determine whether or not an airline chiefly operates on international routes for the purposes of the application of the zero rate in, for example, France, the shuttle between Berlin and Frankfurt would count as being "international". It should, however, be noted that this approach may be "politically sensitive" because, as regards VAT, the Member States of the European Union have abolished the internal borders between their territories.

Proper interpretation of the concept "international" would solve the problems of non-EU airlines that incidentally fuel up their aircraft in the European Union and chiefly operate on domestic routes outside the European Union.

General business aviation is growing within the European Union, as well as in the rest of the world. Within Europe, the European Business Aviation Association has begun promoting the importance of general business aviation. Employment in the aircraft manufacturing and servicing sectors, and other aviation-related services sectors, is definitely an important economic factor. Simplifying the EU VAT rules applicable to the aviation sector and making them more efficient, effective and uniform should be on the European Commission's agenda.

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