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### **VAT exemption not applicable to supply of offshore jackup drilling rigs**

On June 20th, 2019, the Court of Justice (hereafter: "CJEU") published its judgment in the case *Grup Servicii Petroliere SA (C-291/18)* which has consequences for the VAT treatment of the supply and provisioning of offshore jackup drilling rigs (hereafter: "jackup rigs"). The ECJ has ruled that the supply of an offshore jackup drilling rig does not qualify as a sea-going vessel. This means on the one hand that such drilling rigs cannot be (locally) supplied under the zero VAT rate and on the other hand that supplies of provisioning goods and services related to such drilling rigs also no longer qualify for the zero VAT rate. Given the considerable value of drilling rigs in general, the impact on cash-flow and working capital should not be underestimated.

Businesses operating in the offshore and oil field services industry are advised to review contracts, invoicing and ERP tax code set-up to ensure standard rated VAT is applied instead of the zero rate. A wider review of all stationary vessels currently treated as sea-going is also recommended as it may be expected that local tax authorities will apply a more restrictive view than just to jackup drilling rigs.

#### **Background**

The interested party in this case has sold three jackup rigs. These jackup rigs were operating in the Black Sea, in Romanian territorial waters. Jackup rigs are mobile platforms which can be transported (floated) to the drilling locations. After arrival at the respective location, legs of the platform are anchored ('jacked') into the seabed and the platform is elevated above the sea surface. The rigs are not self-propelled but transported from location to location by a tugboat. The interested party applied the VAT exemption for sea-going vessels on the supply of the jackup rigs. The Romanian tax administration was of the opinion that the rigs are actually operated / utilized in stationary position and not during navigation on the high seas. As a result, the VAT exemption is not applicable.

The referring Romanian judge considers that it is necessary firstly to clarify whether the VAT exemption applies to the supply of jackup rigs, i.e. whether such a platform falls within the scope of a 'vessel' as defined in that provision. If such is the case, the judge wishes to know whether the act of navigation must actually prevail over the drilling activities as the essential condition to apply the VAT exemption.

#### **CJEU judgment**

The CJEU rules that jackup rigs do not qualify as vessels used for navigation on the high seas and therefore do not fall within the scope of the respective VAT exemption for the supply of sea-going vessels. The CJEU takes the following three considerations into account:

1. the expression 'vessels used for navigation' necessarily implies that the jackup rigs must actually be used for navigation;
2. the objective of the VAT exemption for the supply of sea-going vessels is to facilitate the international transport of goods. In that context, such vessels must be intended to navigate on the high seas. Vessels should therefore be at least primarily or predominantly used for such navigation on high seas;
3. the context of the respective VAT exemption for the supply of sea-going vessels should be interpreted strictly.





Taking the characteristics of the jackup rigs into consideration, the CJEU observes (to be verified by the referring judge) that these jackup rigs are not predominantly used for navigation. On the contrary, the main purpose of these mobile platforms is to perform its activities in a predominantly stationary situation. As a result, the CJEU rules that the VAT exemption is not applicable to the supply of these jackup rigs.

### **Practical consequences**

In the past, the application of the zero VAT rate for the supply of sea-going vessels in the Netherlands depended on the condition whether the vessel was suitable for navigation on the high seas. In practice, it was not required for that vessel to actually navigate on the high seas. On the back of impending infringement proceedings by the European Commission, the relevant section of the VAT legislation was amended. As from January 1st, 2019, sea-going vessels are required to be used for at least 70% on the high seas. Furthermore, these vessels must be fully utilized for commercial activities in order to apply the respective zero VAT rate. Based on current Dutch policy vessels, whereby navigation is accessory to its main operating function, e.g. drilling rigs and dredgers, could also qualify as sea-going vessels that are used for the navigation on high seas. The CJEU judgment could affect the offshore industry in a broader sense, i.e. not solely regarding drilling rigs, but other vessels as well. Other vessels that are predominantly stationary on the high seas because of its activities, such as (sand) dredgers, pontoons, dry docks, ships that are used to lay underwater cables or pipelines and other floating structures, could also be affected by the outcome of this case. The current Dutch policy may be adjusted.

The respective zero VAT rate for sea-going vessels can in principle no longer be applied regarding the supply of these predominantly stationary vessels. In addition, suppliers of goods and services to these rigs will in principle have to apply the general VAT rate on their supplies. However, we note that the effect on businesses will largely be limited to cashflow disadvantages as most parties will have a full input VAT recovery right.