Indirect Tax Services
Newsletter

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On 23 December 2015, the "European Court of Justice delivered its Judgment in cases C-250/14 "Air France-KLM" and C-298/14 *"Hop!-Brit Air SAS,* which concerned whether Article 2(1) and 10(2) of the Sixth Directive and the amended Sixth Directive must be interpreted as meaning that the issue by an airline company of tickets for domestic flights is subject to VAT where those tickets have not been used by passengers and the latter are unable to receive a refund.

1. Summary of the Case

The ECJ decided that the consideration received by airline companies from passengers for domestic flights is subject to VAT irrespective of the fact that the passengers have not shown up and have not used the service.

The ECJ concluded that the price paid constitutes a supply of services for VAT purposes. The service being the right to benefit from the performance of obligation arising from the transport contract.

2. Facts of the Case and questions referred to the ECJ

Air France-KLM is a French air transport company. In France, domestic flights are subject to VAT at a reduced rate of 5, 5%. Air France-KLM did not charge French VAT on the sale of tickets not used by passengers. Air France – KLM did not refund the price paid for ticket to passengers who have not used the tickets.

In addition, a subsidiary of Air France – KLM, Hop Brit Air performed air transport services whereby Air France - KLM was responsible for the marketing and ticket management on the routes operated by Brit Air. Air France – KLM received the price of the tickets before paying on to Brit Air with respect to each passenger transport. In respect of tickets not used by passengers, Air France – KLM paid Brit Air an annual flat rate compensation calculated as 2% of the annual turnover. The latter, did not account for VAT on this amount. The French Authorities also assessed VAT on this amount.

The French TAX Authorities referred the following questions to the ECJ:

- The retention of a fare paid by a no-show passenger was compensation for the loss of revenue therefore, outside the scope of VAT or is it considered as a reciprocal performance of the airline contractual obligation and is thus, subject to VAT.
- Lump sum calculated as a percentage of the annual turnover received from routes operated as a franchise and paid by an airline company which issued on behalf of another company tickets which are no longer valid constitutes non-taxable compensation paid to the latter for the harm suffered as a result of the activation in vain by the latter of its means of transport, or a sum corresponding to the proceeds from tickets issued and expired which is subject to VAT.

3. Ruling of the ECJ

The ECJ ruled that VAT was due on airline unused transport tickets for local passenger transport. More specifically, the court stated that the consideration for the price of the tickets does not depend on the physical presence of the passenger at boarding but that it consists of the passenger's right to benefit from the performance of the transport service. Whether the passenger exercises that right or not is not relevant for VAT purposes. In other words, for VAT to be payable, it is sufficient that the airline company enables the passenger to benefit from the transport service.

With regards to the flat rate payment, the ECJ concluded that this is also subject to VAT.

4. Significance of the case and other considerations

Air France – KLM contended that in such circumstances, VAT was not due on the sale of the tickets. Following an earlier judgement of the ECJ which ruled that the retention of deposits by a hotel in the case of "no shows" was compensatory (Societe thermal d'Eugenie-les-Bains C-277/05) the airline argued that the income retained from the ticket sale for no show tickets should be treated as compensation and hence not be subject to VAT.

According to settled case law, the court considers that a supply of services is affected for consideration only if there is a legal relationship between the supplier and the customer which involves the reciprocal performance of contractual obligations. In this case, the performance of the airline obligations can only be performed if the passenger actually shows up at the airport at the agreed date and time – the passenger contractual rights being guaranteed by the airline until the time of boarding. The court held that the payment of the ticket price by the passenger constitutes full consideration for the passengers' right to benefit from the airline contractual obligation regardless of whether the passenger exercises the right. As such, the consideration is subject to VAT and is not compensatory in nature.

To conclude, the aforementioned ECJ case, blow for the airlines the well-known earlier hotel deposits case (Societe thermal d' Eugenie-les-Baines C-277/05) on the basis that a passenger pays the full price at the time of purchase and that there is a direct link between the service supplied and the consideration received (e.g. the sums paid constituting the actual consideration for an identifiable service supplied in the context of such a legal relationship).

Way forward: how PwC can help you

The dedicated team of VAT professionals at PwC is ready to assist you with potential obligations and VAT saving opportunities arising from the above case, including reviewing in detail the facts of each relevant case in order to assess the impact of this decision and examining whether and how any identified risks can be avoided and opportunities can be seized.

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