[2014] UKUT 0097 (TCC)

Appeal number: FTC/59/2013

CUSTOMS DUTIES – duty suspension – shipwork end-use relief – imported goods used in manufacture of lobster creels subsequently supplied for equipping fishing vessels – refusal of renewal of authorisation – whether processing of imported goods in the course of manufacture of creels excluded the goods from end-use relief – Council Regulation 2658/87/EEC, Annex I, Part One, Section II.A.1

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

ON APPEAL FROM THE
FIRST-TIER TRIBUNAL (TAX CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

v

CAITHNESS CREELS LIMITED

Respondent

TRIBUNAL: LORD TYRE

Sitting in public at George House, 126 George Street, Edinburgh on 3 February 2014

Almira Delibegović-Broome, Advocate, instructed by the Office of the Advocate General for Scotland, for the Appellants (HMRC)

Philip Challen for the Respondent (Caithness Creels Limited)

DECISION

LORD TYRE

Introduction

1. The respondent carries on business at Wick manufacturing creels used by fishermen to catch lobster and other crustaceans. In the course of the manufacturing process, the respondent uses materials including steel rods, netting, twine and fastenings. Some of these materials are sourced within the European Union and some are imported from countries outside the EU. On 3 October 2011, the respondent applied to the appellants for renewal of its long-standing authorisation to place imported goods under the favourable regime commonly known as shipwork end-use relief for the purposes of customs duties. Authorisation was refused. The respondent appealed successfully against that refusal to the First-Tier Tribunal (FTT), whose decision was issued on 1 February 2013. The appellants now appeal, with the leave of this Tribunal, against the FTT's decision.

2. The issue raised by the appeal is whether the processing undergone by the imported goods in the course of manufacture of the creels excludes the goods from shipwork end-use relief.

The customs tariffs regime

3. The Community Customs Code (CCC) contained in Council Regulation No 2913/92/EEC recognises that importation of certain goods will attract favourable treatment for customs duties by reason of their intended end-use. The favourable treatment with which this appeal is concerned consists of suspension of import duty. Where goods released for free circulation at a reduced or zero-rate of duty on account of their end-use remain for the time being under customs supervision, a written authorisation for the purposes of end-use supervision is necessary: see Commission Regulation No 2454/93/EEC (the Implementing Regulation) at article 291.

4. Council Regulation 2658/87/EEC (the Tariff Regulation) makes provision for a common nomenclature (called the "combined nomenclature" or CN) to apply throughout what is now the EU in relation to the imposition of customs duties. Annex I to the Regulation contains a long and detailed list of the customs duties imposed on goods classified under headings according to the CN. Part One contains preliminary provisions which include both "general rules" in section I and "special provisions" in section II. Among the general rules one finds Section I.A.2(a) which states:

"Any reference in a heading to an article shall be taken to include a reference to that article incomplete or unfinished, provided that, as presented, the incomplete or unfinished article has the essential character of the complete or finished article. It shall also be taken to include a reference to that article complete or finished (or falling to be classified as complete or finished by virtue of this rule), presented unassembled or disassembled."

5. The key provision for the purposes of this appeal is Section II.A.1. It appears under the heading "Goods for certain categories of ships, boats and other vessels and for drilling or production platforms" and provides as follows:

"1. Customs duties shall be suspended in respect of goods intended for incorporation in the ships, boats or other vessels listed in the following schedule, for the purposes of their construction, repair, maintenance or conversion, and in respect of goods intended for fitting to or equipping such ships, boats or other vessels."

Among the vessels listed in the schedule are fishing vessels; it may be noted in passing that yachts and other vessels for pleasure or sports are also included. Sub-paragraph II.A.3 states that these suspensions shall be subject to conditions laid down in relevant Community provisions with a view to customs control of the use of the goods. Duty suspension under Section II.A.1 is referred to in official documentation as "shipwork end-use relief".

6. Parties were agreed that little published assistance was available with regard to interpretation of Section II.A.1. Article 10.1 of the Tariff Regulation states that the Commission shall be assisted by the Customs Code Committee set up under the CCC. Reference was made in the course of the hearing before me to a document issued by the Commission on 1 May 2009 for discussion at a forthcoming meeting of the Tariff and Statistical Nomenclature Section of the Customs Code Committee. The topic for discussion was Section II.A.1. The Commission noted that it occasionally received queries concerning this provision and that there were no rules for its interpretation. It noted further that the possibility of drawing up a schedule of qualifying goods had been discussed at two previous meetings, but the proposal had never been taken up due to the difficulty of drawing up an exhaustive list. The paper went on, however, to discuss the possible scope of what the Commission saw as the two categories of goods falling within Section II.A.1. As regards the first of these, i.e. goods intended for incorporation in a vessel for the purposes of its construction, repair, maintenance or conversion, the Commission observed that there was practically no limit on the products to be considered, provided they became an integral part of the vessel. As regards the second category, i.e. goods intended for fitting to or equipping a vessel, it was noted that there was no definition of "fitting to" or "equipping" in the CN. Reference was made to certain broad definitions appearing in other contexts in EC Directives and other publications. Examples given of goods meeting the description were accessories such as lifeboats, life-saving devices, furniture and ship's apparel. It was noted, however, that certain Member

States adopted a wider interpretation and included items such as tarpaulins, crockery, silverware, table and bed linen, kitchen utensils and radio equipment for the entertainment of the crew. Some also included videocassettes and other goods for entertainment as well as gymnastic apparatus and gear. The Commission paper is of interest but what, if anything, the committee made of it is unknown; I was given no indication that it ever received any form of official approval.

7. I was also referred to (non-binding) guidelines issued by the Commission (OJ C 207, 31.8.2002) on the provisions of the Implementing Regulation concerning end-use. In relation to article 300, which is concerned with completion of the end-use procedure, the guidelines state:

> "Normally goods remain under customs supervision and conditionally liable to import duties until they are first assigned to the prescribed end-use. With the assignment to the prescribed end-use the procedure is completed. From this moment no possibility exists that a customs debt on importation could be incurred. The holder of an authorisation is then able to do as one wants with the goods. E.g. the holder could sell and transfer the goods to an operator who does not have an end-use authorisation."

The guidelines go on to give examples of when goods could be regarded as "first assigned to the prescribed end-use". These include the following:

- goods intended for certain classes of vessel… for the purpose of construction, repair, maintenance, conversion, fitting or equipping – when the vessel… is transferred to a third party, or again made available to its owner following maintenance, repair or conversion;

- goods supplied directly on board a vessel for the purpose of equipping the vessel – at the time of supply.

8. I should mention at this stage that there exists a separate duty suspension procedure known as "Processing under customs control" (PCC). The significance of this procedure, which is detailed in articles 130-136 of the CCC, is that it allows suspension of duty on goods imported to undergo manufacturing or processing operations. Its purpose is described in Lyons, *EC Customs Law* (2nd ed, 2008) at page 384 as follows:

> "It permits non-Community goods to be used in the customs territory of the Community in operations which alter their nature, or state, without becoming subject to import duties or commercial policy measures. It also permits the products which result from such operations, so-called 'processed products', to be released for free circulation at the rate of import duty appropriate to them."

Authorisation is required for PCC; a series of conditions set out in article 133 must be satisfied. One of these conditions (the economic test) is that the procedure must help create or maintain a processing activity in the Community without adversely affecting the essential interests of Community producers of similar goods; this requires an overall

assessment of all relevant factors including the value of the investment and the permanence of the envisaged activity as well as the number of jobs created by the processing (see *Friesland Coberco Dairy Foods BV, t/a Friesland Supply Point Ede v Inspecteur van de Belastingdienst/Douane Noord/kantoor Groningen* [2006] ECR I-4285, para 59).

The FTT's findings of fact and decision

9. At the hearing before the FTT, the respondent did not appear and was not represented. The evidence consisted of a witness statement by Mr George Laing, a higher compliance officer with the appellant, and a letter from the respondent's managing director, Mr John Sinclair, enclosing some leaflets obtained from the website of the Sea Fish Industry Authority illustrating different types of fishing gear. Mr Laing visited the respondent's premises in December 2011. The process of making creels and the various commodities consumed in production were explained to him. According to the FTT's summary, Mr Laing noted

> "that steel rods are straightened or bent and cut to the appropriate length using specialised machinery, that the metal rods are spot welded to form the frame, that the frame is plastic coated using a specialist oven, that netting is attached to the creel, that there are at least six different types of netting and, not only that, the bait bag, may be of a different smaller mesh size.
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> Protection from the seabed is provided by rubber protection, ropes are attached to the creel and as an alternative to sewing on bait bags, bags may be attached by stainless steel clips known as 'hog rings'."

Mr Laing's statement contains further factual information, none of which I understand to be in dispute: all of the respondent's current customers are fishermen, mostly in the United Kingdom but with a small number in Ireland and the Channel Islands. The metal work and plastic for the creels is sourced from within the EU. The imported goods are the netting and twine, most of which comes from India, and the hog rings which are produced in the United States of America.

10. I need not set out set out in detail the argument presented to the FTT by the present appellants (HMRC) because it was substantially repeated before me. Briefly, it was submitted to the FTT that the imported items did not fall within either branch of Section II.A.1 so as to qualify for shipwork end-use relief and did not therefore meet the condition for authorisation in article 293(1)(a) of the Implementation Regulation. What was imported was not a finished item such as a creel intended for equipping a fishing vessel (which would qualify under the second branch of Section II.A.1) but rather materials such as netting and twine which were not themselves being used to fit out or equip a vessel and whose end use was the manufacture of creels. Previous authorisations

had been issued in error. The appropriate relief to meet the present respondent's circumstances was PCC.

11. The FTT allowed the appeal. Its reasoning is set out in paragraphs 54 to 56 of its decision as follows:

> "54. The Tribunal considered that a creel is simply a different configuration of the various parts or components making up a type of fishing net; that the imported goods although not in a finished state were the 'finished components for further assembly' albeit that they appeared to be assembled in a more intricate way.
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> 55. The Tribunal do not accept that the various components, net, twine and rope are manufactured into completely different products as creel pots. They are simply an assembly of those components to create a type of fishing net suitable for a particular type of creature that lives in the sea, a crustacean. Accordingly, they have the essential character of the complete or finished article; a creel, and are suitable for the prescribed end use of equipping fishing boats.
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> 56. The Tribunal note that within Council Regulation 2913/92 at Article 84(3) there is a definition of 'goods in an unaltered state' which means import goods which under inward processing procedures or other procedures for processing under customs control have undergone no form of processing. If the legislation so wished there was a precise definition which could be used which would not allow CC [i.e. the present respondent] to deal with the goods as they did but this was not used for shipwork EUR."

Submission on behalf of the appellants

12. On behalf of the appellants, Ms Delibegović-Broome submitted, firstly, that the FTT had erred in making findings in fact that were not supported by the evidence before it and, secondly, that the FTT had erred in law in its interpretation of Section II.A.1. A third ground of appeal concerning the nature of the FTT's jurisdiction was not insisted upon.

13. As regards the first ground, it was submitted that on the basis of the evidence before the FTT the process of making a creel could not reasonably be described as "simply an assembly" of imported components. It was clear from Mr Laing's description (above) that the manufacturing process went well beyond mere assembly. The FTT might have been misled by comparing the functions of creels and trawler nets rather than focusing, as it ought to have done, upon the production process.

14. So far as error of law was concerned, the FTT had failed to distinguish between goods which were themselves "intended for fitting to or equipping" vessels and raw materials used to manufacture a product that might – or might not – eventually be fitted to a vessel. If the FTT had taken Section I.A.2(a) (the general rule regarding unfinished or

unassembled articles) into account, it had not necessarily erred in law in so doing but had erred in categorising the process of making a creel as assembly rather than manufacture.

15. Ms Delibegović-Broome reiterated the position taken by the appellants in correspondence and before the FTT that the relief appropriate to the respondent's circumstances was PCC. It was the appellants' understanding that the respondent would not fall foul of the economic test. The respondent's description (see below) of the complexity of the PCC in operation, especially if used in conjunction with shipwork end-use relief was exaggerated; if an integrated application were made there would be no duplication of cost.

Submission on behalf of the respondent

16. On behalf of the respondent, Mr Challen submitted that the appeal should be refused, but he did not seek to support the reasoning of the FTT. On the evidence before it, the FTT had been entitled to find in fact that the making of creels consisted of the further assembly of finished components; however that finding was irrelevant if the legislation was correctly construed. The FTT had erred in analysing Section II.A.1 as containing a general exclusion from shipwork end-use relief of components used to manufacture goods intended for fitting to or equipping vessels, together with an exception thereto for finished components awaiting further assembly. Properly analysed, it contained neither.

17. Section II.A.1 required to be given a purposive construction. Its purpose was to suspend import duties on goods used in the construction, repair, maintenance, fitting or equipping of eligible vessels. It was wrong in law to divide the section into two parts. Processing of goods while under customs supervision was a normal and unremarkable activity and there was no rational basis for treating processed goods differently from other goods used in the construction or equipping of a vessel. Any attempted distinction between manufacturing and assembly, or between components and raw materials, or between finished and semi-finished products would be highly subjective. If such difficult distinctions fell to be made, one would have expected EU guidance to be published, yet this duty suspension had been operating since the 1970s without any apparent need for such guidance. Properly analysed, the matter was straightforward: the true end-use of the materials was the equipping of vessels and not the manufacture of creels. The benefit of the duty suspension was intended to be conferred on those engaged in commercial maritime activity generally and not merely on the shipbuilding industry. The only reason to exclude processed goods from end-use relief would be if, exceptionally, the administrative cost was wholly disproportionate to the benefit to the trader. That was not said to be the case here.

18. No guidance was afforded by the general rule in Section 1.A.2(a) because it applied only to goods classified under the CN headings; goods qualifying for duty suspension in the form of shipwork end-use relief did not require to be so classified. An example of the kind of item falling within this rule would be a wind turbine whose base, tower, nacelle

and blades would be separately transported prior to assembly on site. In any event the respondent was not suggesting that the imported netting and twine could be classified as an unassembled creel, which would be absurd. Nor could anything be taken from the Commission's 2009 discussion paper except that the absence of any concrete outcome illustrated the difficulty of distinguishing between processed and non-processed goods. The appellants' decision refusing renewal of authorisation and its submission to the FTT – and hence the FTT's decision – had proceeded upon the footing that there was a category of "finished components for further assembly" which met the conditions for shipwork end-use relief, but the Tariff Regulation afforded no support for the existence of such a categorisation.

19. On the other hand, the 2002 Commission guidelines as to when goods may be regarded as first assigned to the prescribed end-use were of assistance. They demonstrated that the Commission drew no distinction between goods supplied for equipping a vessel after processing and goods supplied without processing. In each case the end-use occurred when the goods were supplied, whether as part of the vessel or directly on board the vessel. It was implicit in the guidelines that processing while under customs control was regarded as the norm.

20. There were significant practical differences between the operation of shipwork end-use relief on the one hand and PCC on the other. Use of the latter by the respondent – which would be in addition to the former – would be more expensive and highly complex. Records would require to be kept of every step of the manufacturing process in order to keep track of goods under customs control. The complexity of operation of PCC – especially in combination with end-use relief –was demonstrated by the comparatively small number of UK traders using it. Accordingly, although it was accepted that PCC was theoretically available, it was qualitatively different from end-use relief and unattractive as an alternative.

Discussion

21. In my opinion Section II.A.1 requires to be interpreted as contended for by the appellants. I accept that it is appropriate to read the section as applying shipwork end-use relief to two categories of goods: one being goods intended for incorporation into the vessel itself and the other being goods intended for fitting to or equipping a vessel. In each case the focus of the provision is on the item imported. In the present case the goods imported were some of the components used to manufacture creels. I can find nothing in Section II.A.1 itself to support the respondent's contention that it is intended to encompass goods imported for the purpose of the manufacture of an item which is in turn intended for fitting to or equipping a vessel. Nor, in my opinion, does this contention obtain any support from the Commission guidelines on time of assignment to first use. The reference to "fitting or equipping" in the first of the two bullet points that I have quoted

above does no more than acknowledge that certain goods meeting the conditions for end-use relief will not leave customs control until the time when the vessel is made available to its owner, which may be later than the time of supply to the holder of the authorisation. This begs the question of whether the goods meet the conditions for end-use relief in the first place.

22. There is much in the respondent's submission with which I find myself in agreement. I accept that little assistance can be obtained from the 2009 Commission discussion paper. I also accept that the general rule in Section I.A.2(a) is concerned with the articles listed in the CN and is of no direct relevance to goods benefiting from duty suspension under the special provisions. There is, in my opinion, no sound basis for applying expressions which appear in Section I.A.2(a), such as "the essential character of the complete or finished article", to goods which qualify for relief regardless of their classification within the CN. Accordingly, having disagreed with Mr Challen's submission that Section II.A.1 contains no general exclusion from end-use relief of components used for processing, I agree with him that the provision contains no exception for finished components awaiting further assembly. Such an exception would, as Mr Challen submitted, require a highly subjective judgment of the distinction between, on the one hand, further assembly (which does not disqualify the goods from end-use relief) and other forms of processing (which does disqualify them).

23. This is a matter of some importance in the present appeal because the basis upon which the FTT found in favour of the respondent was that "…the imported goods although not in a finished state were the 'finished components for further assembly'". That phrase appears to derive from letters sent by the appellants refusing authorisation and upholding that refusal on review, and from the statement of case initially submitted to the FTT on behalf of HMRC. It does not, however, appear to have been founded upon in HMRC's skeleton argument for the hearing before the FTT. In my opinion the FTT erred in law by holding that the goods with which this appeal is concerned qualified for shipwork end-use relief because they were finished components for further assembly. I do not find it necessary to decide whether there was a sufficient evidential basis for such a finding in fact because there is, in my opinion, no justification in Section II.A.1 for allowing shipwork end-use relief on this basis. Accordingly, as Mr Challen contended, such a finding in fact would not be made to any useful purpose.

24. Mr Challen argued that there was no reason in principle why goods whose ultimate destination was the fitting or equipping of a qualifying vessel should be excluded from duty suspension merely because they had undergone a greater or lesser degree of processing after importation. If shipwork end-use relief stood alone, I might have regarded this argument as having some force. It does not, however, stand alone. As both parties appeared to accept, PCC is available to the respondent with regard to the goods that it imports for the purpose of manufacturing creels. It seems to me that the two reliefs are complementary and that a clear purpose can be identified in the CCC that, taken together, the two reliefs should allow duty suspension in appropriate circumstances

regardless of whether goods destined for the fitting or equipping of a vessel undergo a processing operation. Application of an economic test to PCC but not to end-use relief appears to me to be an entirely comprehensible policy decision. As regards the submission by Mr Challen that PCC constitutes an unacceptable alternative because of its complexity and additional cost, I am unable to make any finding to that effect on the basis of the material placed before me. However, even if it were the case that PCC is more complex and expensive for a trader to operate, I would regard that as much less important than the fact that such a relief, deriving from the same EU customs code, is available to cover precisely the circumstances in which the respondent claims to have been wrongfully refused shipwork end-use relief.

Decision

25. For these reasons the appeal is allowed. Parties were agreed that I should exercise the power to "re-make the decision" contained in section 12(2)(b)(ii) of the Tribunals, Courts and Enforcement Act 2007. The effect of my decision is that the respondent's appeal against the appellants' decision dated 8 February 2012 to refuse the respondent's application dated 3 October 2011 for renewal of shipwork end-use authorisation is refused.

Lord Tyre

Release Date: 5 March 2014