Appeal numbers: FTC/13/2010
[2011] UKUT 193 (TCC)

EXEMPTION – Transactions treated as exports – Supplies within UK to other NATO states – Ship dismantling services by UK yard to US department managing Reserve Fleet of obsolete vessels – Whether for the armed forces of another NATO state – Whether exempt under Art 151(1)(c) of Principal VAT Directive – Matter referred to ECJ

IN THE UPPER TRIBUNAL (TAX AND CHANCERY)
ON APPEAL FROM THE FIRST-TIER TRIBUNAL
(TAX) FIRST-TIER TRIBUNAL REF: MAN/08/1497

BETWEEN

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Appellant**

- and -

ABLE UK LIMITED **Respondents**

SIR STEPHEN OLIVER) Judges of the
JUDITH POWELL) Upper Tribunal

Sitting in London on 8 December 2010

Nigel Gibbon, Omnis VAT Consultancy, for the Appellant

Raymond Hill, counsel, instructed by Solicitor for HMRC, for the Respondents

DECISION

1. This is an appeal by the Commissioners ("HMRC") to the Upper Tribunal against the decision of 24 November 2009 of Judge Tildesley OBE ("the Judge") sitting in the First-tier Tribunal.

2. The Respondent, Able UK Limited ("Able"), secured a contract with the United States Department of Transportation Maritime Administration ("MARAD") to dismantle thirteen vessels which were in the service of the US Navy, but had latterly been consigned to the US Navy's Reserve Fleet and moored in the James River in Virginia. The contract was in two distinct parts; firstly the ships had to be prepared and then towed from the US to the UK. Secondly, once they were secured at Able's facility on Teesside, they were to be dismantled. US Government inspectors were to have a presence on the site throughout the duration of the contract.

3. Able sought a ruling from the Commissioners as to the VAT liability of the dismantling service which it provided in a letter dated 27 August 2008. Able argued that the supply was exempt pursuant to the third indent of Article 15(10) of the Sixth VAT Directive.

4. Article 15(10) had in fact by then been replaced by Article 151(1)(c) of the Principal VAT Directive (Directive 2006/112/EC), which exempts:

> "the supply of goods or services within a Member State which is a party to the North Atlantic Treaty, intended either for the armed forces of other States party to that Treaty for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens when such forces take part in the common defence effort."

5. The Commissioners gave a ruling on 15 October 2008 that Able's dismantling services were standard rated. Able sought a reconsideration of that decision on 21 October 2008. The Commissioners then confirmed their ruling on 18 November 2008. In that letter, they accepted that MARAD formed part of NATO, but pointed out that "MARAD does not form part of the NATO Visiting Forces based in the UK" and therefore the supply could not be exempted under Article 151(1)(c), but had to be standard rated.

6. Able then appealed to the First-tier Tribunal against that decision on the basis that "Article 151(1)(c) does not restrict exemption from VAT to visiting NATO forces".

7. It was agreed between the parties that the sole issue for the First-tier Tribunal was:

> "… whether Article 151(1)(c) of the Principal VAT Directive provides exemption for supplies of services, even if those services are not

intended for the use of a *visiting* NATO armed force (i.e. a NATO force *when stationed or operating outside its home State and within an EU Member State*)."

8. The Judge allowed Able's appeal and held that its supplies of dismantling ships were exempt (paragraph 38 of the decision). In particular, he held that the words "armed forces" in Article 151(1)(c) were not restricted to visiting armed forces of other NATO members stationed within the relevant EU Member State. On his interpretation it was sufficient to obtain exemption that the relevant services were 9a) provided within the United Kingdom, which is an EU Member State which is also a State party to the North Atlantic Treaty and (b) the services were intended for the armed forces of the United States for the use of those forces (paragraph 36 of the decision).

9. His reasons were:

(a) He accepted HMRC's premise that where possible a purposive construction should be placed on Article 151(1)(c – but stated that "whatever purposive construction is placed on the Article, it should be derived from a firm evidential foundation" (paragraph 25 of the decision);

(b) He accepted HMRC's submission that the purpose of Article 151(1)(c was that "Member States should not receive a fiscal advantage from their NATO obligations", but went on to hold that "Such a purpose was consistent with [Able's] wider construction of Article 151(1)(c)" (paragraph 30 of the decision) and that "the Tribunal found on the evidence no policy reasons for limiting the exemption under Article 151(1)(c) to visiting forces stationed in the Member State". The Judge concluded that "evidence on the policy reasons for Article 151(1)(c) was not there in the public domain, and that a purposive analysis of the wording of Article 151 produced an indecisive outcome" (paragraph 31 of the decision). The Judge therefore appears to have agreed with Able that it was necessary to turn to an analysis of "the ordinary and natural meaning of Article 151(1)(c)" (paragraph 31 of the decision);

(c) The Judge then stated that if the EU legislators had intended Article 151(1)(c) to apply solely to visiting armed forces,, the legislation would have said so expressly (paragraph 33 of the decision);

(d) he noted that Article 151(1)(c) was worded differently from Article 151(1)(e), which exempted "the supply of goods or services to the armed forces of the United Kingdom stationed in the island of Cyprus pursuant to the Treaty of Establishment concerning the Republic of Cyprus, dated 16 August 1960, which are for the use of

those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens." The learned Judge concluded that Article 151(1)(c) would also have used the words "stationed in" had it been intended to restrict the exemption to visiting NATO armed forces stationed in the host Member State (paragraph 33 of the decision);

(e) The words "of the civilian staff accompanying them" in Article 151(1)(c) did not constrain the ordinary meaning of the words "armed forces" in the previous phrase of that Article. In particular, they did not give rise to an inference that the "armed forces" referred to must be visiting armed forces. The word "accompanying" simply meant "being with them" and did not imply that the civilian staff were "travelling with" the armed forces in question (paragraph 34(1) of the decision);

(f) Furthermore, "HMRC's analysis altered the structure of Article 151(1)(c) from three distinct exceptions to a hybrid structure comprising a merged exception and a separate exception. The effect of the hybrid structure was to corrupt a consistent use of *or* between the exceptions in the Article. Thus the *or* between *those forces* and *of the civilian staff* had a conjunctive meaning, whilst the *or* between *accompanying them* and *for supplying their messes* remained disjunctive. HMRC's analysis would have carried greater force if all the relevant *ors* could be read conjunctively" (paragraph 34(2) of the decision).

(g) The Tribunal concluded in paragraph 35 of the decision that it preferred Able's construction of Article 151(1)(c) "consisting of three separate exceptions which was reinforced by the use of *either* as well as *or* in the Article. Further the exception *of the civilian staff accompanying them* stood alone and did not constrain the ordinary meaning of *armed forces* in the previous exception".

Summary of the Commissioners' arguments

10. In summary, HMRC's case is that the Judge was wrong to come to those conclusions and that he should have held that the ship dismantling services supplied by Able to MARAD were subject to the standard rate of United Kingdom VAT;

(a) He should not have relied on a textual analysis of the English version of Article 151(1)(c). Rather, he should have ascertained its purpose by interpreting Article 151(1)(c) in its context and having regard to its schematic relationship with the other part of Article 151(1) in such a way that Article 151(1)(c) was given a reasonable and effective meaning;

(b) If he had done so, he would have concluded that Article 151(1)(c) applies only to the armed forces of a NATO country visiting

another EU and NATO Member State and only where those forces take part in an activity directly related to the common defence effort;

(c) To the extent that the Upper Tribunal held any remaining uncertainty as to the correct interpretation of Article 151(1)(c), the Commissioners submit hat it should refer the appeal to the Court of Justice in Luxembourg.

The text of Article 151 of the Principal VAT Directive

11. Article 151

1. Member States shall exempt the following transactions:

(a) the supply of goods or services under diplomatic and consular arrangements;

(b) the supply of goods or services to international bodies recognised as such by the public authorities of the host Member State, and to members of such bodies, within the limits and under the conditions laid down by the international conventions establishing the bodies or by headquarters agreements;

(c) the supply of goods or services within a Member State which is a party to the North Atlantic Treaty, intended either for the armed forces of other States party to that Treaty for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens when such forces take part in the common defence effort;

(d) the supply of goods or services to another Member State, intended for the armed forces of any State which is a party to the North Atlantic Treaty, other than the member State of destination itself, for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens when such forces take part in the common defence effort;

(e) the supply of goods or services to the armed forces of the United Kingdom stationed in the island of Cyprus pursuant to the Treaty of Establishment concerning the Republic of Cyprus, dated 16 August 1960, which are for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens. Pending the adoption of common tax rules, the exemptions provided for in the first subparagraph shall be subject to the limitations laid down by the host Member State.

2. In cases where the goods are not dispatched or transported out of the member State to which the supply takes place, and in the case of services, the exemption may be printed by means of a refund of the VAT.

Conclusions

12. The exemption given by Article 151(1)(c) is dependent upon three expressed conditions or requirements. These relate to the place of supply, the object of the supply and, in the English language and certain other translations, the period within which the supply must take place.

13. The first test is that the place of supply must be within the Member State which is a party to NATO. Here the supply is the dismantling of searching obsolete vessels that had once been in the service of the US Navy and had since been consigned to the US Navy's Reserve Fleet and moored in the James River in Virginia. The contract was with MARAD. It involved two parts. The first was the preparation of the particular vessel and its towage to the UK. The second was the dismantling. This took place once the vessel had been secured at Able's yard on Teesside. The place of the second part of the supply will have been in the UK.

14. The second requirement is that the object of the supply is "for the armed forces of other States party to" NATO. Those words operate as a general qualification. The specific requirement is expressed under two alternative heads:

> (a) The supply must be intended for the use of either or both of the armed forces of the other NATO state or states and the civilian staff accompanying those armed forces ("Object A").
> (b) The supply must be of goods or services "for supplying [the] messes or canteens" of those armed forces or their accompanying civilian staff ("Object B").

15. The third requirement is that the relevant supply must take place when such armed forces are taking part in the common defence effort.

16. A preliminary question of construction is whether the third requirement applies only to Object B supplies or whether it applies to both Objects A and B supplies. This is because MARAD (the actual recipient of Able's supplies) is accepted by HMRC in their letter of 18 November 2008 as having "formed part of NATO at the relevant time but did not form part of the NATO Visiting Forces based in the UK" (see para 5 above). If it be a necessary requirement that the recipient of the supply, such as MARAD in the present case, be part of the armed forces that are, at the time, taking part in the common defence effort, then Able's supply to MARAD will fail the requirement for exemption. But if there be no such requirement applicable to Object A, then Object A will be satisfied because Able's supply will have been intended for a party to NATO (it being accepted by HMRC, in HMRC's letter of 18 November 2008, that MARAD, the organisation responsible for the US' Reserve Fleet, " formed part of NATO" at the relevant time).

17. The UK translation of Article 151(1)(c) reads as if the third test, expressed with reference to the time of supply, is attached only to Object B. Supplies to messes and canteens are only to be exempt when their users are participating in the common

defence effort. By contrast, and adopting that reading, supplies within Object A are constrained only by the requirement that they be for the use of the armed forces of the State that is a party to NATO; (and, as we have just observed, the supplies in the present case could arguably satisfy the requirements of Object A).

18. Translations of Article 151(1)(c) for some other Member States appear to read as if the third test applies to supplies within both Objects A and B. Moreover, as far as we are aware, the texts of the third test in other translations do not contain the word "when" and consequently it does not read as referring to the time of supply.

19. The case for HMRC is that Article 151(1)(c) should be construed as applying only to the armed forces of a NATO country visiting another EU and NATO Member State and only where (to use their words) those forces take part in an activity directly related to the common defence effort. That argument is stronger if the third test relates to the time of supply and applies to Object A. Able's case is stronger if the contrary construction is employed. Both constructions are possible. For reasons that will appear, there are obstacles to understanding paragraph (1)(c) whichever interpretation is adopted. To resolve the issues guidance is needed from the Court of Justice as to the proper construction of that paragraph.

20. Developing the point about the differences in the texts, we note that the English language version follows the French language version in omitting a comma immediately before the third requirement, namely – "when such forces take part in the common defence effort". By contrast, neither the Spanish nor the German language texts place a common at that point. However, the presence or absence of a common at that point should not, we think, amount to a persuasive indication as to the proper construction of the provision as a whole. Our function, to use the words of the Court in Case C-473/08, *Eulitz*, to interpret the provision "on the basis of both the real intention of its author and the aim the latter seeks to achieve, in the light, in particular, of the versions in all languages."

21. What was the "real intention" of the author of Article 151(1)(c)? HMRC offered an explanation that was, within limits, accepted by the Tribunal. In paragraph 31 of the Decision Notice the Tribunal stated that it had found no evidence for limiting the exemption in Article 151(1)(c) to visiting forces stationed in the Member State of supply. In argument before us, Able drew our attention to Minutes of the 83rd Meeting of the European Committee held on 28 and 29 February 2008. At that Meeting the UK representative had suggested that it might not be a requirement for exemption under that provision that NATO forces be involved in the common defence effort; the chairman concluded the Meeting with the remark that the Commission might wish to return to that issue and that there might be a need to develop a guideline. (The matter has not apparently been revisited.) Earlier in the same Minutes is the statement attributed to the Commission that the fact that the forces of a NATO country were present in the country of a Member State (which was a NATO member) was "not itself sufficient for a VAT exemption to apply". Moreover the Commission advocated a narrow interpretation of Article 151(1)(c) and (d) which would reflect that the exemption only applied if the forces of a NATO member

country were stationed in another Member State which was also a NATO member and those forces took part in the common defence effort.

22. HMRC say that the wording of Article 151(1)(c) should be construed as representing the purpose of the exemption being to provide relief from VAT in respect of supplies made to NATO forces so as to ensure that the country of supply does not receive a fiscal advantage from the presence of those forces by taxing their expenditure on supplies to them when incurred during their visit. The provision prescribes that the destination of the supply made in the Member State in question be to the NATO country. The inference urged for HMRC is that the armed forces in question are those that are stationed here and it is only supplies to those of them who are stationed here that are exempt. This, say HMRC, is reinforced by the words of the provision that allow as concurrent or alternative users "the civilian staff accompanying them" and, additionally, give exemption where the destination of the supply is to "canteens or messes". Both those are typical features of overseas forces stationed in a host country. This, say HMRC, indicates that the interpretation that confines relief to the occasions "when such forces take part in the common defence effort" should be read as applying to the references earlier in the same provision to "forces" and "armed forces".

23. We have not found it possible to discover an evident purpose in the wording of Article 151(1)(c). HMRC's construction depends on reading into the words, as a necessary inference, that the armed forces for whom the supplies are intended to be those that are stationed here and that exemption be limited to those parts of the relevant armed forces that are stationed here. That reading is not, we think, sufficiently clear.

Points arising on the Tribunal's Decision

24. In paragraph 30 of its Decision the Tribunal accepted a broader purpose than that suggested by HMRC. This was that EU Member States should not receive a fiscal advantage from their NATO membership or their NATO obligations, as distinct from receiving a fiscal advantage from hosting the visiting forces of other NATO countries. On that basis exemption would, as the Tribunal ruled in the present case, be allowed for any supply made within the UK to the armed forces of any NATO ally. However, if the purpose had been to exempt all defence-related goods and services within the UK, it would have been irrational not to have granted a general exemption, including to the UK's own armed forces. And what is the point of granting the wide exemption that follows from the Tribunal's construction only to be followed by a specifically conferred exemption on supplies for the use of forces of NATO countries? The correct approach to the construction of an exempting provision, such as Article 151(1), should be to prefer the reading that limits its scope: see Case 3488/87, *SUFA*, at paragraph 13.

25. We add that, in our view, the Tribunal's interpretation of Article 151(1)(c) is at odds with the clear purpose of Article 151(1)(d). This exempts supplies to another Member State intended for the armed forces of any State which is a party to NATO,

"other than the member State of destination itself" for the use of either or both of those forces and the civilian staff accompanying them, or for supplying their messes or canteens "when such forces take part in the common defence effort". If Article 151(1)(c) exempted all supplies made to NATO forces generally provided only that the place of supply was within the Member State in which the exemption was sought (jeer, the UK), it would be difficult to understand the purpose of the exception to the exemption I Article 151(1)(d) for the armed forces of the Member State of destination.

26. Turning now to the Tribunal's statement in paragraph 33 of the Decision Notice that if the EU legislators had intended Article 151(1)(c) to apply to visiting armed forces, the legislature would have said so expressly, we note that that provision has been worded differently from Article 151(1)(e). The latter provision has exempted "the supply of goods and services to the armed forces of the UK stationed in the Island of Cyprus pursuant to the Treaty of Establishment concerning the Republic of Cyprus, dated 16 August 1960, which are for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens". The Tribunal concluded that Article 151(1)(c) would also have used the words "stationed in" had it been intended to restrict the exemption to visiting NATO armed forces stationed in the host Member State. HMRC's answer to this was presented by way of explanation. The reason why Article 151(1)(e) made an express reference to UK armed forces "stationed in" the Island of Cyprus was to differentiate between two different groups of military personnel who were physically present in Cyprus, namely (i) those stationed there in the UK Sovereign Base Areas created by the 1960 Treaty and (ii) those visiting Cyprus as part of the UN Peacekeeping Force in Cyprus ("UNFICIP") serving on the Green Line between the southern part of the island controlled by the Government of the Republic of Cyprus and the Turkish-Cypriot administered area in the north of the island. The UK contribution to UNFICIP is not stationed in Cyprus "pursuant to" the 1960 Treaty. Hence it does not benefit from the exemption in Article 151(1)(e). the words "stationed in" Cyprus were therefore inserted, not to emphasise the need for physical presence of the relevant UK armed forces in Cyprus, but to distinguish between the two groups of armed forces physically present in the island but each there on a different legal basis.

27. Able's answer to that is to accept the explanation without criticism but to point out that the words "stationed in the island of Cyprus" were indeed used in Article 151(1)(e): however, the EU legislators, having specified their intention in that provision that the forces be stationed in Cyprus, would have been expected to have expressed a similar intention in Article 151(1)(c) had that been their intention. We do not find that persuasive. There was a special reason for using those words in Article 151(1)(e) and that has nothing to do with their presence, by necessary implication, in Article 151(1)(c).

Reference

28. For the reasons we have given with regard to the two competing constructions of Article 151(1)(c) we think that this is an issue that we cannot resolve with complete

confidence. The matter should therefore be referred to the European Court of Justice. The question to be referred could be as follows:

> "Is Article 151(1)(c) of the Principal VAT Directive to be interpreted as exempting a supply in the UK of services of dismantling obsolete US Navy ships for the US Department of Transportation Maritime Administration in circumstances either –
>
> (a) where that supply was not made to a part of the armed forces of a NATO member taking part in the common defence effort or to civilian staff accompanying them or
>
> (b) where that supply was not made to a part of the armed forces of a NATO member stationed in or visiting the United Kingdom or to civilian staff accompanying such forces?"

29. The question postulated above is for consideration of the parties. The parties have one month from the release of this Decision to make representations, in the light of any comments made in this Decision, as to whether they see that as the appropriate question.

SIR STEPHEN OLIVER QC

JUDITH POWELL
JUDGES OF THE UPPER TRIBUNAL

Release Date: 25 February 2011