Seafarers' earnings deduction (SED)

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Generally everyone who is resident in this country will normally pay UK tax on all their earned income, wherever it arises. However, seafarers are entitled to a deduction of 100% with respect to their earnings aboard, if their work has kept them out of the UK for a certain minimum period of time.[1] This 'foreign earnings deduction' was introduced in the mid-1970s and extended to all UK residents working overseas. In 1998 it was restricted to seafarers only and was renamed the 'seafarers' earnings deduction'.[2] A supplementary test was introduced to prevent individuals working on offshore installations from being able to claim relief. In 2004 the term 'offshore installation' was redefined to ensure only "genuine seafarers" were eligible to make a claim.[3]

In December 2007 the Special Commissioners considered an appeal by five individuals working in the oil industry who wished to claim this relief.[4] The case turned on the question of whether the craft they worked on was an 'onshore installation' or not. HM Revenue & Customs took the view that the Commissioners' decision clarified the scope of the legislation, as regards certain types of vessel, and wrote to tax practitioners to advise them of this forthcoming change. In turn many Members were contacted by constituents about this issue, although the Government stated that "the great majority of seafarers who claim SED will not be affected by this decision."[5]

In December 2008 the department confirmed that it would issue revised guidance in light of the decision in the new year,[6] though a second legal case published in June 2009 has meant further changes to this material.[7]

This note examines the changes made in 1998 to restrict this tax relief to seafarers, before discussing the way in which the relief is denied to those working on offshore installations, and the recent concerns over the department's change in approach.

1 Guidance on this relief is given on the department's site at: http://www.hmrc.gov.uk/incometax/relief-ship.htm
2 Provision to this effect was made in section 63 of the *Finance Act 1998* with effect from 17 March 1998.
3 *Pre-Budget Report* Cm 6042 December 2003 para 5.89
4 *Keith Wyn Torr et al. v HMRC* Spc00679, 14 January 2008
5 HC Deb 21 October 2008 c340W
6 HM Revenue & Customs, *Seafarer's Earnings Deduction: Pride South America*, 16 December 2008
7 HM Revenue & Customs, *Employment income - seafarers' earnings deduction*, 1 September 2009

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1 Restricting the foreign earnings deduction to seafarers

An individual's liability to UK tax depends on their residence status – whether they are 'resident' and 'ordinarily resident' in this country – and on their domicile, a legal term for the country which is one's permanent home.[8] Normally someone must be physically present in the UK to be treated as resident, and if they are here 183 days or more in a given tax year, they will always be treated as such. 'Ordinarily resident' refers to whether someone is resident in the UK year after year - that the UK is their normal home. Individuals who are resident and ordinarily resident are taxed on all their earned income, wherever it arises.[9]

Leaving the country to work abroad will result in one's ceasing to be resident and ordinarily resident, if one's absence from the UK and one's employment last for at least a whole tax year. In addition any visits made to the UK during this time must total less than 183 days in any one tax year, and average less than 91 days per tax year. In these circumstances, someone's overseas income would not be liable to UK income tax, though in general earnings from duties carried out in this country would continue to be charged UK tax.

Prior to March 1998, individuals who were both resident and ordinarily resident in this country but working abroad were entitled to claim a 'foreign earnings deduction' (FED): in effect, any overseas earnings they enjoyed would be free of UK income tax.[10] The claimant had to be absent from the UK for a "qualifying period" of at least 365 days between any two dates, though they did not need to have been working for the whole of this time. Limited provision was made for visits to the UK during this period. No single visit could be longer than 62 days. In addition any period of days could not be counted toward the 365 ceiling if someone made a single visit to the UK during this time that was more than one sixth of the total period of days, both home and abroad.

For example, if someone made a visit home, lasting 10 days, after having worked abroad for 30 days, they would then need to work abroad for at least *another* 20 days, before making a second visit to the UK, however short. This is because the 10 day visit represented exactly one sixth of the time between the start of this period, and its potential end, 60 days later. Provided this was the case, the 60 days would be counted toward the 365 days necessary to

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8 Someone born in the UK of British parents would certainly have domicile in this country.

9 The position of individuals with domicile outside the UK is not discussed here. Full details of these rules is given in, HM Revenue & Customs, *Residence, domicile & the remittance basis HMRC6*, April 2009. This is available at: http://www.hmrc.gov.uk/cnr/hmrc6.pdf

10 Prior to being abolished, this provision was made under section 193(1) of the *Income and Corporation Taxes Act (ICTA) 1988.*

qualify for the foreign earnings deduction. For seafarers the limits on home visits were 183 days (not 62) and one half (not one sixth) respectively.[11]

In the 1998 Budget the Government announced that legislation would be introduced in that year's Finance Bill to withdraw the 'general' FED with immediate effect, though it would be retained for seafarers.[12]

The Government's reasons for this change were discussed in the *Notes on Clauses* accompanying the Finance Bill that year:

> The Finance Acts of 1974 and 1977 increased the tax on earnings from overseas employment. The same legislation introduced special tax relief for UK residents employed overseas for significant periods. The stated aim of this relief was to encourage those at the sharp end of exporting, creating jobs in the UK. A more generous provision was later introduced for seafarers on defence grounds. The main aim of the seafarers' provision was to provide support for a merchant shipping fleet that could be called upon in war time, by encouraging use of UK crew on UK-owned deep-sea vessels.
>
> More recently, many of the main beneficiaries of FED have been media and entertainment personalities with very high incomes. They have been able to use FED as the keystone of schemes to avoid paying tax anywhere in the world. Other high earners, such as international management consultants have also been able to structure their work patterns to exploit this relief.
>
> In general, while FED has done much to subsidise overseas employment of UK residents through immunity from tax, there is little evidence to suggest that it has succeeded in generating employment on any significant scale in the UK. Indeed, it has always been the case the FED is of as much value to a buyer travelling abroad as to a seller. As far as the special seafarers relief is concerned, the majority of recent claims have come from oil and gas rig workers.
>
> The Inland Revenue have clear evidence of systematic exploitation of FED. Various schemes are used to allow UK residents to roll up large amounts of income and then, every few years, to spend sufficient time abroad to qualify for FED, during which period the accumulated income is paid out with no tax being charged. FED was not designed to protect employees from the risk of a double charge on their income by the UK and the host country. Other measures such as double taxation agreements are designed to protect taxpayers from such risk. The UK has the largest network of double taxation treaties in the world, involving treaties with over a hundred other countries.[13]

At the time it was estimated that about 20,000 employees would be affected by this change, while 15,000 seafarers would continue to enjoy the relief.[14] The withdrawal of FED attracted some attention in the press in the light of the decision by the Rolling Stones to postpone the British leg of their world tour, so that the band and crew would not be liable to UK tax on their

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[11] The limits on home visits were made more generous for seafarers under section 45 of the *Finance Act 1991*, and took effect from 6 April 1991.

[12] Inland Revenue Budget press notice IR33, 17 March 1998. Provision to withdraw the general FED was made under section 63 of the *Finance Act 1998*. It was debated at some length during the Committee stage of the Bill though agreed to on division: SC Deb (E) 2 June 1998 cc 413-466.

[13] HM Treasury, *Explanatory Notes Finance (No.2) Bill 1998*, April 1998 (Clause 63)

[14] HC Deb 1 July 1998 c182W

tour earnings for that tax year.[15] The *Financial Times* suggested there might be wider ramifications: "Tax experts believe more ex-pats on short term contracts will choose to become non resident, and align their periods out of the country more closely with the UK tax year. Costs could rise for UK companies with overseas operations, which are likely to pick up the tab for the extra tax their employees have to pay."[16]

When this measure was debated at the Committee stage of the Finance Bill, the then Financial Secretary Dawn Primarolo set out the Government's position:

> The basic question is why should UK residents not pay UK income tax when everyone else must …. Double taxation treaties are in place to ensure that no income is taxed twice … the Inland Revenue will give treaty exemption or relief immediately on receiving a claim. No taxpayer should suffer double taxation as a result of clause 63. When no double taxation treaty exists between the UK and the mother state, the UK will give unilateral relief. Income will not be taxed twice … The responsibility for claiming double taxation treaty exemption or relief lies with individual employees. The relief or exemption may then be given in one of two ways. It may be claimed at the end of the tax year, or it may be given on a weekly or monthly basis by adjusting the PAYE code number. The majority do it that way. The Inland Revenue are currently briefing all its district offices to ensure that claims are deal with speedily and, when requested, relief is given as salary is paid …
>
> Clause 63 does not increase the burden on the employer. The employer will be given a PAYE code. Computer-based payroll systems will calculate the tax on the basis of the code number. An offshore employee is dealt with in the same way as a UK-based company. The system is simple to operate. The relief gave some individuals an immunity to tax. There is no way to decide how to phase out an immunity without providing an opportunity for the Exchequer to lose revenue. That is why the Government have acted in this way. The vast majority of those who claimed the foreign earnings deduction were on substantial salaries. If they were in the UK, they would pay tax. If people in the UK who earn less than them pay tax, so should they. Thirty thousand people claimed FED last year out of nearly 30 million taxpayers who have to make good the revenue that is lost. Some 20,000 will be affected by the measure.[17]

On this occasion Members focused on the potential loss of this relief by teachers and aid workers working abroad;[18] the question of why tax relief was to be retained by seafarers was not discussed at any length, though the Minister noted, "in leaving the exemption in place for seafarers, we are agreeing with the previous Government, who introduced the exemption about the strategic value and importance of supporting the Merchant fleet, particularly in terms of security."[19]

This change was marked by the relief being renamed the 'seafarers' earnings deduction'.[20] When assessing the amount of time someone has spent outside the UK, service on any voyage which begins *and* ends within the UK does not count as work abroad. As a consequence seafarers whose work is solely on coastal waters are not eligible for this

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15 "Stones cancel tour over £12m tax bill", *Times*, 8 June 1998
16 "Taking the taxman on holiday", *Financial Times*, 21 March 1998
17 SC Deb (E) 2 June 1998 cc 440-444
18 The Minister addressed these concerns at a later stage in the debate: SC Deb (E) 2 June 1998 cc 444-446.
19 SC Deb (E) 2 June 1998 c352
20 The legislation is now consolidated in ss 378-385 of the *Income Tax (Earnings & Pensions) Act 2003*.

deduction. Any duties served on any part of a voyage (or the whole voyage, if there is no intervening place of call) beginning or ending in the UK, and ending or beginning abroad, are treated as having been performed abroad. [21] To be regarded as absent from the UK on a given day, an individual must be absent at the end of it.[22]

2 SED and offshore installations: the 1998 test

A second change was made to the scope of the foreign earnings deduction in 1998, as explained in a Budget press notice, "a lack of clarity in the existing legislation has, in certain circumstances, allowed some of those employed on particular types of oil rights to be treated as seafarers. The definition of seafarers is to be clarified so that there is no longer any doubt and no opportunity for the rules to be exploited in this way."[23] Up to this point, the critical test in assessing whether someone worked as a seafarer had been *where* an individual carried out their duties rather than exactly what those duties consisted of. For these purposes "employment as a seafarer" was defined as "employment consisting of the performance of duties on a ship (or of such duties and of others incidental to them)."[24]

The Taxes Acts does not provide a definition of the term 'ship', and the Revenue had drawn on other legislation for guidance; namely, that a ship "includes description of vessel used in navigation not propelled by oars",[25] and that references to a ship "include references to any structure (whether completed or in course of completion) launched and intended for use in navigation as a ship or part of a ship."[26] The phrase 'used in navigation' was taken to mean the action or practice of passing on water, especially the sea. However, technological progress in the oil and gas sector made these distinctions legally contentious, with the development of hybrid craft, ocean going vessels in their own right that could be used to service oil wells: in particular, semi-submersible rigs (which float, have 'dynamic positioning thrusters' and are 'tethered to the sea bed by anchors'), and jack-up rigs (which are 'towed from location to location or can be carried piggy-back or towed for long distances' before jacking themselves 'up and down for drilling and movement').[27]

Divers working in the North Sea from these types of craft found they could claim FED, whereas colleagues working from fixed oil rig platforms could not. In July 2001 the Court of Appeal upheld a claim by three appellants who had worked on jack-up rigs; the claim related to a period *prior* to the change in the law made in 1998.[28] The Court of Appeal overturned a decision of the High Court (and thereby upheld a ruling of the General Commissioners) as to whether a jack-up drilling rig was a ship within the terms of the Merchant Shipping Acts. The High Court held that the question of whether a jack-up rig was a ship was a matter of law. Ferris J ruled, on that basis, that the preponderance of features of jack-up rigs (no independent means of propulsion or controlling navigation, limited manoeuvrability, not for

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21 For these purposes, areas designated under s1(7) of the *Continental Shelf Act 1964* are treated as part of the UK (under s382(3) of *ITEPA 2003*).

22 under s378(4) of *ITEPA 2003*

23 Inland Revenue Budget press notice IR33, 17 March 1998

24 Previously this test was set out in para 3(2A) to schedule 12 of *ICTA 1988*. The changes in the *Finance Act 1998* saw this test retained in s192A(2) of *ICTA 1988*. It is now enshrined in s384(1) of *ITEPA 2003*.

25 Under s742 of the *Merchant Shipping Act 1894*

26 Schedule 4, Part II para 12 of the *Merchant Shipping Act 1979*

27 "Foreign earnings deduction: I see no ships", *Taxation*, 29 March 2001

28 *Clark (Insp of Taxes) v Perks* [2001] EWCA Civ 1228 (*Simon's Weekly Tax Intelligence* 2 August 2001 1068)

the conveyance of persons or cargo) were not characteristic of ships and that the rigs should not be treated as ships for the purpose of this tax relief.[29]

On appeal, the Court of Appeal decided that the question of whether the rig was a ship was not one of law and that the High Court had not been entitled to substitute its views for those of the Commissioners. Restoring the Commissioners' decisions, the Court of Appeal said that it did not matter that navigation was incidental to more specialised functions performed by the rig, what mattered was that the rigs were capable of and were used for navigation. As a result of the judgement, the Revenue was forced to concede that these rigs could be treated as a ship for these purposes.[30]

To prevent future claims by individuals working on these types of craft, the *Finance Act 1998* introduced a supplementary test for what constitutes "the performance of duties on a ship", specifically *excluding* "offshore installations" from qualifying as a ship, including a vessel used "while standing or stationed in relevant waters … for the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well."[31] For these purposes, the term "offshore installation" was given by reference to legislation created for the purposes of Health and Safety.[32]

3 SED and offshore installations: changes in 2004

At the time of the Pre-Budget Report in December 2003, the Government stated that the earnings deduction for seafarers was "being exploited by some oil and gas workers on offshore installations around the world, to receive a tax relief that was never intended for them." New rules would be introduced to tackle this abuse with effect from the 2004-05 tax year.[33] The Government confirmed it was proceeding with this measure in the Budget the following spring:

> Foreign Earnings Deduction (FED) is a deduction from earnings from employment available to a seafarer working on a ship who has an eligible period of absence in the UK. Workers on offshore installations are specifically excluded from the relief. This measure will redefine 'offshore installation' to ensure that FED remains available only to the parts of the shipping sector only for whom it is intended … The current definition of 'offshore installation' is given by reference to legislation created for the purposes of Health and Safety, not for the Taxes Acts. Changes to the Health and Safety legislation can inadvertently cause changes to FED entitlement so a free-standing definition is the best way to provide certainty and clarity in this instance. We are also taking the same approach with other instances in the Taxes Acts where offshore installation is defined.[34]

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29 [2000] STC 428

30 "Schedule E - foreign earnings deduction (FED) for seafarers - meaning of ship", *Tax Bulletin*, issue no.57, February 2002 pp 913-5. At: http://www.inlandrevenue.gov.uk/bulletins/tb57.pdf. The implications of the case were also the subject of a series of written answers (HC Deb 24 July 2002 cc 1186-7W).

31 Under s63(2) of the *Finance Act 1998*

32 Specifically, under reg 3 of the *Offshore Installations and Pipeline Works (Management and Administration) Regulations* SI 1995/738, as amended by the *Offshore Safety (Miscellaneous Amendments) Regulations* SI 2002/2175

33 HM Treasury Pre-Budget Press Notice PN6, *Protecting revenues*, 10 December 2003

34 Inland Revenue Budget Notice REV BN 14, 17 March 2004

At the time it was estimated the change would raise £20 million in 2005-06.[35]

As mentioned above, only individuals performing duties "on a ship" are entitled to claim SED, and the test introduced in 1998 specifically excluding "offshore installations" – referring to the definition found in the *Mineral Workings (Offshore Installations) Act 1971*; for convenience, this definition is reproduced in full below:

> **Meaning of "offshore installation"**
>
> (1) Subject to the provisions of this regulation, in these Regulations the expression "offshore installation" means a structure which is, or is to be, or has been used, while standing or stationed in relevant waters, or on the foreshore or other land intermittently covered with water—
>
> (a) for the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well;
> (b) for the storage of gas in or under the shore or bed of relevant waters or the recovery of gas so stored;
> (c) for the conveyance of things by means of a pipe; or
> (d) mainly for the provision of accommodation for persons who work on or from a structure falling within any of the provisions of this paragraph,
>
> together with any supplementary unit which is ordinarily connected to it or any part of it (including those parts described in paragraph (3) below) and all of the connections.
>
> (2) Any reference in paragraph (1) to a structure or unit does not include—
>
> (a) a structure which is connected with dry land by a permanent structure providing access at all times and for all purposes;
> (b) a well;
> (c) a structure or device which does not project above the sea at any state of the tide;
> (d) a structure which has ceased to be used for any of the purposes specified in paragraph (1), and has since been used for a purpose not so specified;
> (e) a mobile structure which has been taken out of use and is not yet being moved with a view to its being used for any of the purposes specified in paragraph (1); and
> (f) any part of a pipeline.
>
> (3) For the purposes of these Regulations there shall be deemed to be part of an offshore installation—
>
> (a) any well for the time being connected to it by pipe or cable;
> (b) such part of any pipeline connected to it as is within 500 metres of any part of its main structure;
> (c) any apparatus or works which are situated—
> (i) on or affixed to its main structure; or
> (ii) wholly or partly within 500 metres of any part of its main structure and associated with a pipe or system of pipes connected to any part of that installation.
>
> Where two or more structures are, or are to be, connected permanently above the sea at high tide they shall for the purposes of these Regulations be deemed to comprise a single offshore installation.[36]

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[35] HC 301 March 2004 p 188

[36] under reg 3 of the *Offshore Installations and Pipeline Works (Management and Administration) Regulations* SI 1995/738, as amended by the *Offshore Safety (Miscellaneous Amendments) Regulations* SI 2002/2175

Provision was made in the *Finance Act 2004* to create a free-standing definition, based largely on the existing definition.[37] The explanatory notes to the Finance Bill that year gave further details:

> The definition of offshore installation is currently given by reference to legislation created for the purposes of Health and Safety, not for the Tax Acts. Changes to Health and Safety legislation have the potential to cause changes inadvertently to entitlements such as the deduction for seafarers intended to be available through the Tax Acts. In addition, some workers on offshore installations, mostly working abroad, are claiming the income tax deduction for seafarers despite the specific exclusion which removes them from entitlement. A free-standing definition is therefore being provided to give certainty and clarity. For this reason certain references to "oil rigs" will be replaced by "offshore installation" so that the same free-standing definition can be used.
>
> The same types of vessel will continue to be categorised as offshore installations as now. These include vessels and other structures engaged in oil and gas exploration and exploitation or which provide accommodation for workers on offshore installations. For example, they include fixed and floating production platforms, Floating Production Storage and Offloading vessels, Floating Storage Units, Mobile Offshore Drilling Units such as semi-submersible and jack up drilling rigs, drill ships and floating accommodation units.[38]

Detailed guidance is provided on what is, and is not, an offshore installation, within the department's online *Employment Income Manual*; an extract is reproduced below:

> Seafarers' Earnings Deduction (SED) is available to a "seafarer" who performs duties of employment on a "ship" if various conditions are satisfied … From 6 April 2007 Section 1001 of the *Income Tax Act (ITA) 2007* provides a free-standing definition of offshore installation for the purposes of the Taxes Acts including SED. Between 6 April 2004 and 5 April 2007, the equivalent rules were found in Section 837C of the I*ncome & Corporation Taxes Act (ICTA) 1988* …
>
> *Definition of offshore installation - Section 1001 ITA 2007*
> The definition of a ship excludes an offshore installation … An offshore installation is a structure (a term which includes a ship or other vessel) which is, is to be, or has been, put to a "relevant use" while standing or stationed in any waters. The definition will therefore include any floating structure that maintains its position while being used for a relevant use regardless of whether it anchors or keeps on station by dynamic positioning … The reference to "any waters" means that structures of this nature that are, are to be or have been used for a relevant use anywhere in the world, should not be accepted as ships for the purposes of the deduction.
>
> *Relevant use*
> A structure is an offshore installation if it is, is to be or has been put to a relevant use whilst in water. A relevant use is use for -
>
> - exploiting mineral resources by means of a well;
> - exploration with a view to exploiting mineral resources by means of a well;
> - storage of gas in or under the shore or the bed of any waters;
> - recovery of gas so stored;

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[37] under part 1 of schedule 27 of the *Finance Act 2004*. Initially this was consolidated in s837C of the *Income & Corporation Taxes Act (ICTA) 1988*; for income tax purposes, this has now been superseded by s1001 of the *Income Tax Act 2007* with effect from 6 April 2007.

[38] Explanatory notes to clause 136 (Meaning of 'offshore installation') of *Finance Bill 2004* [Bill 89-EN]

- conveyance of things by means of a pipe;
- mainly for the provision of accommodation for persons who work on or from a structure which is, is to be, or has been, put to a use specified above ...

Changes in use
Section 1001(2) provides that a structure is not an offshore installation if -

- it has ceased permanently to be put to a relevant use,
- it is not, and is not to be, put to any other relevant use, and
- since ceasing permanently to be put to a relevant use, it has been put to a use which is not relevant.

The effect of this provision is that a structure that satisfies the definition of offshore installation will remain within the definition unless it has permanently ceased to be used as an offshore installation with no prospect of resuming such use and it has been put to an entirely new use. Permanent cessation requires a cessation of use that is both lasting (i.e. not merely temporary) and is combined with the lack of a fixed intention to use the vessels in such a manner again. This should be a straightforward question of fact. The term does not require

- either that there is an intention for the vessel never to be used again in a particular manner, or
- that the vessel be rendered physically incapable of such use ever again as a result of a refit or refurbishment …

Example
The following example illustrates how the legislation works. On 6 April 2007, a mobile drilling rig in port in Rotterdam obtained a contract for work in the Dutch sector of the North Sea from 1 May. It left Rotterdam on 30 April and carried out exploration drilling for gas until 31 July. On completion of its contract, it returned to Rotterdam and remained idle until 31 December. On 1 January 2008, it obtained a new drilling contract in the Gulf of Mexico and left Rotterdam on 1 February arriving in Mexican waters on 28 February where it drilled for oil between 1 March and 5 April.

The rig was an offshore installation throughout 2007-08. At any one time, it was either in use, to be used or it had been used for "exploration with a view to exploiting mineral resources by means of a well". This includes all periods in transit between locations and the periods when the rig was not used. Therefore, earnings attributable to any duties performed on the rig in 2007-08 are not eligible for SED.

Definition of offshore installation before 6 April 2007 - Section 837C ICTA 1988
The definition of an offshore installation in section 837C ICTA 1988 which applied until 5 April 2007 had the same effect as section 1001 ITA 2007. The only significant difference in wording was the reference to a "specified" use in section 837C instead of a "relevant" use in section 1001.[39]

The Manual goes on to state that some vessels used in the oil and gas industry "may be accepted as ships for the purposes of the deduction" *provided* that their use satisfies the general conditions for this relief. These include anchor handling vessels, diving support vessels, heavy lifting vessels, pipe laying barges, platform support vessels, safety standby vessels, seismic survey vessels, shuttle tankers, and, well service vessels.[40]

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[39] HM Revenue & Customs, *Employment Income Manual* para EIM33103
This is available at: http://www.hmrc.gov.uk/manuals/eimanual/EIM33103.htm

[40] *Employment Income Manual* para EIM33104. While this list remains relevant, it must now be considered in conjunction with two legal cases from January 2008 & June 2009 – this is discussed below.

4 Recent concerns

The question of whether a particular craft was an 'offshore installation' or not was the subject of an appeal heard by the Special Commissioners in December 2007 (the Commissioner's decision was published in January 2008).[41] Briefly, the Commissioners considered the case of five men who had worked on a ship, the Pride South America, carrying out maintenance operations on oil fields in the Campos Basin, within Brazilian territorial waters, during the period 2002-2005. The ship in question – a 'self-propelled, dynamically positioned, semi-submersible vessel' – was never used for drilling, but would be employed to fix problems with existing wells – the flow of oil being temporarily cut off, or 'killed', for that well while the work was carried out.

All five wished to claim the seafarers' earnings deduction. The Revenue challenged this on the grounds that the Pride South America met the criteria for being treated as an offshore installation, because it was being used for "exploiting mineral resources by means of a well", and it was "stationed" when it carried out this work. The Commissioner agreed, taking the view that "exploitation" would "cover repair work when the field is in production notwithstanding the fact that the field has to be temporarily killed." He also took the view that the vessel had been "stationed" during this time, given that it was kept "substantially stationary" while the work was done, though not actually anchored or tethered to the sea bed. He also noted that although the legislation had been amended twice since 2002-03, there had not been any substantive change as applied to the case at hand.[42]

The Revenue took the view that the decision clarified the scope of the legislation, as regards certain types of vessel. After the Commissioner's decision the department wrote to tax practitioners to advise them of this. Many Members were contacted by constituents concerned about the implications of this decision, and in turn raised it in the House. The Government's position was set out in answer to a PQ in October 2008:

> **Mr. David Anderson:** To ask the Chancellor of the Exchequer (1) what estimate he has made of the average financial effect on seafarers if the seafarers' earnings deduction is removed; (2) if he will review the decision of HM Revenue and Customs to remove the seafarers' earnings deduction.
>
> **Mr. Timms:** HM Revenue and Customs (HMRC) is not removing seafarers' earnings deduction (SED). Rather HMRC will revise its guidance on SED to reflect a decision made by the Special Commissioners, an independent appellate body, in the case of Torr and Others v. CIR (SpC679) The great majority of seafarers who claim SED will not be affected by this decision.
>
> I am aware of the concerns raised by the Special Commissioners decision in this case, which centred on whether the vessel on which the appellants performed their duties was a ship or an 'offshore installation' within the meaning of the legislation. The Special Commissioners decided it had been operating as an offshore installation, and refused the appellants' claims to SED. Broadly speaking, an offshore installation is a vessel that is engaged in exploiting mineral resources and is not mobile while doing so.

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41 *Keith Wyn Torr et al. v HMRC* Spc00679, 14 January 2008. The decision is published at: http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j3869/Spc00679.doc

42 Spc00679, 14 January 2008 paras 48, 50-2

> HMRC has written to tax practitioners about this decision and will discuss implementation with interested stakeholders before the revised guidance is issued.[43]

The issue attracted some attention in the press,[44] and both Angus MacNeil and Katy Clark put down EDMs, critical of the department's new approach and raising concerns that it would be applied with effect from January 2008.[45] On 16 December 2008 the department has announced it would issue revised guidance in the new year:

> **Seafarers Earnings Deduction: Pride South America**
>
> Seafarers may be entitled to a 100% relief from income tax on their earnings under Seafarer's Earnings Deduction (SED). A seafarer is eligible for SED if they perform duties of their employment wholly or partly abroad on a ship, provided they are absent from the United Kingdom for an "eligible period" of at least 365 days or a combined period made up of days abroad and days inside the United Kingdom.
>
> The Special Commissioners, an independent body who determine tax appeals, considered appeals by five individuals who had been employed on the Pride South America and had claimed SED. The Special Commissioner decided that the Pride South America was not a ship for the purposes of SED and the five appellants were therefore not entitled to SED (Torr and Others v CIR (SpC679)).
>
> The Special Commissioner's decision will affect some of the types of vessel which are ships for the purposes of SED. HMRC is aware of the uncertainty that this decision has caused. However, given the technical nature of the ruling HMRC want to work with representatives' bodies including Nautilus and the National Union of Rail Maritime & Transport Workers before issuing revised guidance. HM Revenue and Custom's revised guidance will reflect discussions with stakeholders about the interpretation of the Pride South America decision to ensure that it is implemented in a clear and practical manner. HMRC will publish revised guidance in February 2009.
>
> SED is a deduction from earnings from employment as a seafarer. SED has never been available for people working on "offshore installations" rather than ships. It was this issue that was subject to review by the Special Commissioners. Broadly, the legislation provides that there are two conditions both of which must be met for a vessel to be an "offshore installation". The first condition requires the vessel to be involved in a "relevant use", for which there are six alternative definitions. The definition of relevant use that applies most often, and which applied in the Pride South America case, relates to a vessel involved in the exploitation of mineral resources. The second condition, is that the vessel is standing or stationed whilst doing so. Construction, construction support, well service and dive support vessels that do not meet either of these tests will continue to be ships for the purposes of SED.
>
> The filing return dates for 2007/08 tax returns are 31 October 2008 for paper returns and 31 January 2009 for online returns. HMRC expects that most people who claim SED will have already submitted their 2007/08 returns. However, some people may not have submitted their 2007/08 return. HMRC appreciates that they may wonder whether they must submit their 2007-08 tax returns before we publish our revised guidance. All

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43 HC Deb 21 October 2008 c340W

44 "North Sea workers face tax bills", *BBC News site*, 26 September 2008 http://news.bbc.co.uk/1/hi/scotland/north_east/7638490.stm

45 EDM 2197 of 2007-08, 8 October 2008 & EDM 2232 of 2007-08, *Seafarers' pay*, 13 October 2008. The Motions were signed by 50 & 74 Members respectively.

> tax 2007-08 returns must be filed within the relevant deadlines which fall before the relevant guidance is due to be published in February 2009.
>
> Anyone who decides that they want to see HMRC's revised guidance before deciding whether they are entitled to claim SED can submit their return without a claim to SED. They can then amend their 2007-08 tax return in the usual way to include a claim to SED. People have 12 months from 31 January after the end of the tax year to correct their tax return. For the 2007-08 return, people have until 31 January 2010 to make an amendment. HMRC recognises that this may disappoint some individuals, however we believe that it is important to get the revised guidance right. If someone wishes to consider making a claim to SED for 2007-08 before the guidance is revised they can refer to the legislation on which HMRC's guidance for SED is based.[46]

In an article critical of the department's approach to the issue, the editor of *Taxation*, Mike Truman, commented "It's a mess. The *Torr* case clearly outlaws many vessels from being ships which rightly should be, and it is not acceptable to 'correct' that by guidance":

> The implications of [*Torr*] … are perfectly clear – a vessel which carries out its duties while it is substantially stationary, and which is involved in any part of the process of exploiting oil from a well (including repairs carried out while the well is temporarily killed) cannot be a 'ship' for SED. So, for example, a diving support vessel which has to be stationary over the well in order for the divers to descend to it is clearly carrying out its duties while substantially stationary. That would be the case even if the divers were only underwater for a few hours. It is hard, therefore, to see how a diving support vessel can be a ship at all under this definition, but it is still listed in [HM Revenue & Customs' *Employment Income Manual* para EIM33104] as a vessel which can be accepted as a ship, even though Torr might have 'some implications' in categorisation…
>
> [The Manual's new section discussing the *Torr* case – para EIM33106] sets out the facts and the decision in Torr, notes that it has implications for vessels previously treated as ships, and now promises new guidance 'in or before March 2009' which will ensure that 'the implications are applied in a fair and practical manner'. We appear, yet again, to be heading for a situation where taxpayers will be overtaxed by statute and then relieved by guidance.[47]

From a wider perspective, clearly the Government could legislate to amend the scope of this relief. In this context, the closing remarks of the Commissioner, commenting on the law as it stood before 2004, are worth repeating:

> While the logic of applying health and safety legislation to persons employed on offshore structures in British waters or the Continental Shelf is clear, the logic of denying foreign earnings deduction to seafarers working on offshore structures in the South Atlantic is not apparent. However while I have considerable sympathy with the Appellants, my duty is to interpret the law as enacted. The appeals are dismissed.[48]

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[46] HM Revenue & Customs, *Seafarers Earnings Deduction: Pride South America*, 16 December 2008. This is available at: http://www.hmrc.gov.uk/news/sea-south-america.htm

[47] "Gales ahead", *Taxation*, 29 January 2009

[48] Spc00679, 14 January 2008 para 53

However, the *Torr* case did not represent the end of the story. In June 2009 the First-Tier Tribunal published a second case which turned on the definition of an offshore installation.[49] In this case the appellants had served on three semi-submersible vessels, owned by the Prosafe Group, refitted so as to provide maintenance and construction support. The Judge took issue with the department's argument that the type of work the vessels were engaged in could be considered 'exploitation of mineral resources'.

> [One issue of interpretation in this case] … relates to the phrase *for the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well* in **Regulation 3(1)(a) of the 1995 Regulations** and what is substantially the same expression in section 837C(2)(a) of the 1988 Act. Counsel for HMRC submitted that the phrase should be given a wide construction as the overall purpose is to promote the health and safety of workers. While that may be true of the 1995 Regulations it cannot be the purpose of section 837C(2)(a) …
>
> There are three aspects to the interpretation of this phrase, namely *use*, *exploitation* and *by means of a well*. The word *use* connotes a physical activity in which the structure is engaged. Sub paragraphs (b) and (c) also focus on physical use. The word *exploitation* seems to have in mind the productive working of the structure, that is to say use in a manner which it is hoped will be profitable. *By means of a well* emphasises the manner of exploitation of the mineral resource. It would extend to extraction, storage and processing of the oil or gas but not to conveying it away by means of a pipe which is dealt with in Regulation 3(1)(c) (the *conveyance of things by means of a pipe*). Nor does it extend to the activities of maintenance and repair. To include those activities would be to substitute *in connection with* for the word *for* i.e. the indirect for the direct (c.f. regulation 2 of the 1995 Regulations where that phrase is used in the definition of associated structure).[50]

Commenting on the differences between this case and *Torr*, he noted:

> The facts in *Torr* show that the activities of the Pride South America were closely associated in a physical sense with the production of the mineral resources. The Special Commissioner founded particularly on its activities when an oil well was killed. These included working down the well, pumping heavy liquid into the well, removal of X-mas trees and the construction of manifolds. None of these activities was carried out by any of the vessels under consideration in the instant appeals.[51]

On 1 September 2009 the department published updated guidance in its online *Employment Income Manual*, to take account of the decision in *Spowage*; as it explained, the case meant that the broad definition suggested by *Torr*, of the types of work that would meet this test, was incorrect:

> Unlike the Pride of South American, which carried out activities in close association with the well and/or subsea equipment that comprised the production process (e.g. working down the well, pumping liquid down the well, removal and replacement of Xmas trees and construction of manifolds), the construction and maintenance carried out by the Prosafe vessels was too remote from the production process to be regarded as performed "by means of a well". Therefore the duties carried out did not amount to a

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[49] From 1 April 2009 the Tax Chamber of the First-tier Tribunal assumed responsibility for hearing appeals against decisions by HMRC – replacing the functions of both the General & Special Commissioners.

[50] *Spowage and Others v CIR* TC00110, 18 June 2009 paras 29-30
This is available at: http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j4468/TC00110.doc

[51] *Spowage and Others v CIR* TC00110, 18 June 2009 para 38

relevant use. As the vessels did not perform a relevant use they were not offshore installations. It follows that they should be treated as ships for the purposes of SED.

The new guidance clarifies this narrower definition, and explains how it is to be applied in practice:

> *How does the decision in Spowage impact on the decision in Torr*
> The decision in Torr published in January 2008 supported a broad definition of the definition of "exploiting mineral resources by means of a well", which could arguably include all parts of the process that occur between exploration of a mineral resource until extraction of the resource is complete and/or the production process is closed down. The decision in Spowage takes a more restricted view of the same definition. Whilst activities that involve extraction, storage and processing of the mineral resource, including in circumstances such as those carried out by the PSA in Torr, will continue to form part of the process of exploiting mineral resources by means of a well, construction and maintenance activities that are carried out remotely from the production process (e.g. away from the well head and/or associated subsea plant and equipment) will not form part of the process of exploiting mineral resources by means of a well …
>
> *Applying Spowage for 2008/09 onwards*
> The decisions in Torr and Spowage are complementary. It would not be equitable to apply one without taking into account the other, particularly as the later decision (Spowage) has a direct impact in some circumstances on the scope of the application of the earlier decision (Torr). Consequently whilst HMRC has already issued guidance … in February 2009 in relation to the Torr decision, and in particular how it should be applied for 2008/09 onwards, that guidance has been revised to take account of the later decision in Spowage as well. The later decision in Spowage provides further clarity in relation to the earlier decision in Torr. As HMRC has stated already that the Torr decision will apply for claims to SED from 2008/09 onwards, the clarification in Spowage of certain aspects of the Torr decision will also apply for claims to SED for 2008/09 onwards.[52]

[52] *Employment Income Manual* para EIM33112