INCOME TAX - Schedule E - Claim to foreign earnings deduction - Taxpayer employed on a mobile offshore drilling unit - Whether taxpayer employed as a seafarer - Whether the mobile offshore drilling unit on which he was employed was a ship - Section 193 and Schedule 12 para 3(2A) Income and Corporation Taxes Act 1988

THE SPECIAL COMMISSIONERS SpC 00230

JOSEPH LAVERY Appellant

- and -

IAIN MACLEOD

(HM INSPECTOR OF TAXES) Respondent

Special Commissioners: DR A N BRICE

MR T H K EVERETT

Sitting in London on 8 and 9 December 1999

Mr Michael Davey of Counsel, instructed by Mr G Robertson of Diss Accounting and Taxation Services Ltd, for the Appellant

Mr Timothy Brennan of Counsel, instructed by the Solicitor of Inland Revenue, for the Respondents

DECISION

Joseph Lavery ("Mr Lavery") appeals against an assessment to income tax under Schedule E for the year 1995/96.

The point at issue between the parties is whether Mr Lavery is entitled to a foreign earnings deduction for the year in question. During that year he was employed in various capacities on a mobile offshore drilling unit, known as a "Jack-up Rig". In order to be entitled to the foreign earnings deduction claimed the taxpayer must show that he received emoluments from "employment as a seafarer" when working on the jack-up rig. Since "employment as a seafarer" means "employment consisting of performance of duties on a ship" the issue between the parties may be shortly stated as "is a jack-up rig a ship?"

The question for determination as agreed between the parties is whether the performance of the duties of the employment of Mr Lavery on the jack-up rig known as Glomar Adriatic IX during the period 6 April 1995 to 5 April 1996 was employment consisting of the performance of duties "on a ship" for the purposes of section 193(1) of, and paragraph 3(2A) of Schedule 12 of the Income and Corporation Taxes Act 1988 (as applicable to the year 1995/96).

The evidence before us consisted of two bundles of documents, one from each party. These were supplemented by two large colourful posters showing pictorially the various types of equipment used to seek and eventually obtain oil and gas from under sea fields.

Oral evidence was provided by Mr Lavery.

In addition, each party submitted an expert report. Professor Nigel Douglas Philip Barltrop, BSc, FRINA, FICE, FIESIS, MSNAME was called by the Respondent. Professor Barltrop is John Elder Chair and Head of the Naval Architecture and Ocean Engineering Department at Glasgow University.

Professor Chengi Kuo, BSc, PhD, CEng, FRINA, FRSA, FRSE of the University of Strathclyde was called by Mr Lavery.

Where the reports of Professor Barltrop and Professor Kuo conflict, we prefer the evidence of Professor Kuo, as Professor Barltrop’s experience related more to the production of oil and gas rather than to offshore drilling for exploration purposes.

The facts

From the evidence before us (which included a brief statement of agreed facts), we find the following facts.

1. Throughout the year 1995/96 Mr Lavery was employed by Global Marine International as a tool-pusher. His emoluments from employment were in the sum of £49,457.

2. During 1995/96 Mr Lavery performed the duties of his employment upon three types of offshore drilling unit. Two of those were a drillship and a semi-submersible unit in respect of which no issue arises, as those units are accepted by the Inland Revenue to be ships. The third unit was a self-elevating mobile offshore drilling unit (or "jack-up rig") known as "Glomar Adriatic IX".

3. Glomar Adriatic IX has a hull which measures 243ft x 200ft x 26ft. It is triangular in shape and possesses three jacks or legs which can be raised or

lowered hydraulically. When in transit the legs tower above the superstructure of the unit. When engaged in drilling operations the legs are lowered to the sea bed. The unit is capable of operating in water to a depth of 300ft and can drill to a depth of 20,000ft.

In addition to the hydraulic legs the unit possesses three cranes and when drilling utilises four 10,000lb anchors.

The unit has quarters for 80 persons. When in transit the number of persons on board is slightly less than when it is operating as a drilling rig.

The unit possesses a heliport.

The unit is not self-propelled and when in transit is towed by two tugs directed from the bridge of Glomar Adriatic IX by a Master Mariner. The unit is designed to withstand wind speeds of up to 75 knots when being towed.

Occasionally for very long journeys in transit the unit can be loaded onto a special type of ship designed for the purpose which can carry it. Such an operation is called "a dry lift", which was an operation never experienced by Mr Lavery.

4. In performing his duties for Global Marine International during 1995/96 Mr Lavery was absent from the United Kingdom as follows:

UK	Return to UK	Employed upon	Days absent from UK during 1995/96	Subsequent days in UK
5. 4.95	26. 4.95	Semi-submersible	20	2
28. 4.95	14. 5.95	Drill ship	16	3
17. 5.95	7. 6.95	Semi-submersible	21	13
28. 6.95	23. 7.95	Glomar Adriatic IX	33	23
15. 8.95	15. 9.95	Glomar Adriatic IX	31	7
22. 9.95	30. 9.95	Semi-submersible	8	9
9.10.95	11.11.95	Glomar Adriatic IX	33	24
5.12.95	6. 1.96	Glomar Adriatic IX	32	24
30. 1.96	2. 3.96	Glomar Adriatic IX	32	24
26. 3.96	21. 4.96	Glomar Adriatic IX	26	-

5. The following descriptions are taken from one of the posters viewed by us in the court room during the hearing:

(a) "Jack-up drilling rigs"

"These units are basically barges fitted out for offshore drilling, with legs which enable them to "stand" on the sea bed. Once the jack-up has been manoeuvred, usually by tugs, onto the precise drilling location, the legs, which are fitted with ratchet teeth are jacked down using electrical or hydraulic rack and pinion mechanisms. Jacking down proceeds through a pre-loading test period when the spud cans at the base of the legs penetrate the sea bed and take the full weight of the barge. After this, jacking continues and the barge starts to climb the legs until the hull is high enough above sea level to be clear of the highest waves expected at the location. The largest jack-ups are capable of drilling wells in 350ft of water to a depth in excess of 25,000ft, unhampered by the roll, pitch and heave motions of floating units."

(b) "Rig moves/jack-ups"

"A number of different techniques are employed for the "transiting" of rigs from one location to another. Jack-up units are usually transported, especially over longer ocean passages aboard special semi-submersible ships. These are often converted tankers or bulk carriers which are able to "ballast down" to allow the rig to be floated into position over the main deck and then de-ballasted lifting the rig clear of the water. This mode of transport for jack-ups has proved to be highly cost-effective."

(c) "Semi-submersible drilling rigs"

"The "semi-sub" was evolved in the late fifties to provide a stable platform for drilling in water depths that were beyond the reach of jack-up technology. The biggest problem once drilling rigs moved into open water was heave (i.e. the up and down motion as the vessel rides the waves) which was overcome by semi-subs in two ways. Firstly the design, as its name implies, allowed ballasting down to achieve considerable draft often in excess of 80ft, which isolated the unit against much surface wave action. Secondly, sophisticated motion compensation systems have been evolved to isolate the rigs fixed marine riser/drill sting from the heave motion created by long period ocean swells. Semi-submersibles are usually moored on location by an eight-point anchor system up to a practical working depth of 1,500ft. Beyond this depth anchoring often becomes impractical and semi-submersibles are fitted with [dynamic positioning systems] or drillships are deployed."

(d) "Rig moves/semi-submersibles"

"Semi-subs are also transported from one location to another on specialist vessels, especially when very long passages are involved. Their design, however, makes them more suitable for ocean tows in hostile conditions than jack-ups and indeed many of today’s sophisticated units are self-propelled giving them transit

speed capabilities of around 6 knots. In practice most semi-submersibles are moved with tug assistance for "pulling" and laying anchors and more importantly to increase transit speeds. In this mode the semi-subs' own thruster power is used to augment the power of the towing vessel and to assist in directional control."

(e) "Drillships"

"There are over 80 drillships working worldwide the largest of which has a dead weight of 36,000 tons. They are mainly used for drilling exploration wells in deep water, remote and hostile locations because they have a larger onboard capacity for fuel, water, drilling fluids and other consumables than semi-subs or jack-ups. They also mostly feature advanced dynamic positioning systems, which by use of computer controlled thruster propellors allow the vessel to maintain station over the well without the use of anchors. Most drillships do have anchors for mooring where water depths and the availability of anchor handling tugs make this possible because dynamic positioning is heavy on fuel consumption. Operating parameters for drillships are drilling to 25,000ft in water depths of up to 7,500ft and the ability to continue drilling in 24ft significant wave heights and wind speeds of up to 60 knots. Transit speeds of between 9 and 14 knots are the norm."

(f) "Towage"

"Ocean towage of jack-ups and semi-submersibles for their relocation from one drilling site to another is common place. However, such tows require considerable pre-planning to evaluate the likely sea and weather conditions, the acceptable duration for the tow, bearing in mind tow vessel charter rates, rig "down time" and not least the tows insurance implications."

6. Drillships have the appearance of conventional ships, but with a large derrick standing in the centre of the vessel. Semi-submersible drilling rigs are rectangular in shape and supported by six, or sometimes eight, pontoons which are able to maintain the deck of the unit at a suitable height above the surface of the water.

7. Glomar Adriatic IX possesses certain navigation equipment. Professor Kuo described in his report (at pages 5 and 6) typical navigation equipment for a jack-up rig as follows:

"Any sea-going ship must be carrying some form of navigation equipment. The actual units in any given case depend on the type and size of the ship. For a barge without self-propulsion capability [such as the Glomar Adriatic IX] navigation equipment includes:

Global Positioning System Establishes the position of the barge

(GPS) using signals from satellites circling the earth

Standard magnetic compass Indicates the magnetic north

Master gyroscope Indicates the current position of the barge

Master gyroscope repeater Devices at various locations on the ship repeating the information provided by the master gyroscope

Full radio installation For communication with base and other

traffic

One radar installation For identifying the presence of obstacles

or other ships

Fire detector control Controls the actual fire detector

One log To keep a record of all events

One echo sounder For determining immediate water depth

Navigation lights on the sides To provide other ships with visual

of the hull information about the presence and

position of this one

A typical jack-up will carry the same equipment with the possible exception of the magnetic compass, as a GPS is already part of the equipment on board. Adriatic IX would have this equipment installed. It is used during tows to provide continuous monitoring of the jack-up's position as the tugs tend to have less sophisticated facilities."

8. Professor Kuo also commented on the presence on board Glomar Adriatic IX of other essential ship equipment as follows: (at pages 6 and 7 of his report)

"The profile of Adriatic IX ... shows the presence of two essential items of equipment on board, which are present on all ships, and these are:

(i) Lifeboat Provision : there are two lifeboats on each side of the barge hull for the evacuation of personnel in the event of an emergency requiring the jack-up to be abandoned.

(ii) Conventional Mooring Arrangements : when the jack-up is not in drilling mode the barge hull would be moored in the seaways by the conventional ship mooring arrangement of an anchor and chain."

9. We accept Professor Kuo's report. He concludes at page 12 with his summary as follows:

"The report shows that the jack-up concept was developed by putting oil- drilling facilities as used on land onto a barge-hull. In order to hold the barge sufficiently still in seaways while drilling is taking place, movable legs were introduced that could be "jacked-down" or lowered to the seabed at the start of a drilling operation to provide a stable unit. When the jack-up has to be moved from one location to another as required by oil company contracts, the legs are jacked up to their highest position. Thus, the legs are entirely out of the water, apart from

their feet which are tucked below the hull. The vessel can then be towed to a new location by means of a tug in the same way as other types of barge are towed, e.g., off the west coast of Canada.

The operation of a jack-up requires the services of personnel with maritime training equivalent to that of ship's crew members. During towing operations the personnel on board the jack-up consist of a Captain (with a Ship's Master's Certificate), a Marine Engineer (with a Ship's Chief Engineer's Certificate) plus seamen and technicians."

10. Glomar Adriatic IX was subjected to a considerable number of moves during the relevant year, none of which was undertaken as a "dry lift" (where a drilling unit is carried aboard a ship). On each occasion the unit was moved by towing. Details of its moves are as follows (page 93 of the Respondent's bundle):

From To Date Duration

Equatorial Guinea Calabar 6-16 May 95 11 days

Calabar Warri 5-13 Aug 95 9 days

Warri Estravas 21-27 Sept 95 7 days

Estravas Calabar 26 Jan-2 Feb 96 7 days

Calabar Senegal 18 Apr-14 May 96 27 days

Senegal Calabar 29 May-22 June 96 25 days

Calabar Calabar 26 July-1 Aug 96 7 days

Calabar Calabar 25 Aug-1 Sept 96 8 days

Calabar Lagos 29 Sept-22 Oct 96 24 days

On the evidence of Mr Lavery, which we accept, the tow undertaken from Calabar to Senegal in April and May of 1996 which lasted 27 days covered a distance of 2,500 miles. Mr Lavery was on board for part of the journey.

11. Various certificates relating to Glomar Adriatic IX were put in evidence in support of Mr Lavery's claim : viz:

(a) A certificate of classification from the American Bureau of Shipping describing the unit as "Steel Barge Drilling Platform". (Divider 2 in Mr Lavery's bundle).

(b) A certificate from the Republic of Panama describing the unit as "a vessel". (Divider 3 in Mr Lavery's bundle).

(c) An International Tonnage Certificate issued by the American Bureau of Shipping describing the unit as "a ship". (Divider 5 in Mr Lavery's bundle).

(d) A certificate issued by the American Bureau of Shipping certifying that the unit (described as a "self-elevating drilling unit") had sufficient life saving appliances to accommodate 100 persons. (Divider 6 in Mr Lavery's bundle).

(e) A certificate issued by the American Bureau of Shipping supplementing an international oil pollution prevention certificate, which was not in evidence describing the unit as a "ship". (Divider 7 in Mr Lavery's bundle).

(f) A certificate from the American Bureau of Shipping issued pursuant to the International Convention on Load Lines 1966, wherein the unit is described as "a ship". (Divider 8 in Mr Lavery's bundle).

(g) A Rummage Certificate issued by the Nigerian Customs service describing the unit variously as "a vessel" and "a ship". (Divider 9 in Mr Lavery's bundle).

(h) A Deratting Exemption Certificate issued by the Federal Republic of Nigeria which states (inter alia) "this certificate should be kept on the ship". (Divider 10 of Mr Lavery's bundle).

The contentions of the parties

Mr Michael Davey, who appeared for Mr Lavery, relied upon the definition of ship contained in section 313 of the Merchant Shipping Act 1995 which states:

"In this Act, unless the context otherwise requires -

"ship" includes every description of vessel used in navigation."

He also relied upon some decisions of General Commissioners in similar cases and sought support from the following authorities Ex parte Ferguson and Hutchinson (1871) MLC 8; 24 Law Times Reports 96. The "Mac" (1882) 7 P 126; Wells v the Owners of the Gas Float "Whitton No.2" [1897] AC 337 (which decided that a gas float was not a ship); Merchants' Marine Insurance Co Ltd v North of England Protecting & Indemnity Association (1926) 25 Lloyds List Law Reports 446; Polpen v Commercial Union [1943] 1 KB 161 (which decided that a flying boat was not a ship or vessel); Steedman v Scofield [1992] 2 Lloyd's Rep. 163 (which held that a jet ski was not a ship); Cook v Dredging & Construction Co Ltd (1958) 1 Lloyd's Rep. 334; Robison v Offshore Co, a decision of the United States Court of Appeal's 5th Circuit delivered in 1959; Dependable Marine Co Ltd v Commissioners of Customs and Excise (1965) 1 Lloyd's Rep. 550 and Addison v Denholm Ship Management (UK) Ltd [1997] ICR 770.

Mr Davey submitted that a jack-up rig is plainly a "vessel" since it is a hollow floating structure which carries people and equipment by sea. It is also used in navigation since it proceeds in an ordered manner from one marine location to another. It therefore qualifies as a ship in the same way as other barges.

He contended that the fact that a jack-up rig does not have its own internal means of propulsion and carries out work other than navigating the seas does not mean that it is not a ship.

Mr Davey also submitted that Glomar Adriatic IX remained at all times capable of navigating and indeed was used in navigation during the relevant period and therefore fulfils all the requirements of a ship.

Mr Brennan, who appeared for the Respondent Inspector, contended that no educated and fluent speaker of modern English, using the word "ship" in its ordinary sense, would say that a jack-up is a ship. It is obviously not. It is a mobile offshore drilling unit, a sui generis large piece of equipment designed for and used in the offshore oil industry.

Mr Brennan also sought support from The Mac; Merchants Marine Insurance Co Ltd v North of England P&I Association; Polpen Shipping Co Ltd v Commercial Union Assurance; Wells v Gas Float Whitton No.2; and Steedman v Scofield. He also referred us to The Mudlark [1911] P.116 and The Harlow [1922] P.175.

He contended that Glomar Adriatic IX is plainly not a ship. Accordingly Mr Lavery was not therefore in receipt of emoluments from employment as a seafarer when he worked on it.

Conclusions

We believe it to be common ground in this case that Glomar Adriatic IX does not appear at first glance to be what a layman would describe as a ship. It does not have the appearance of a ship, it cannot propel itself through the water and it does not even possess a rudder. However, that is not the end of the matter. It is common ground in this appeal that for the purposes of Section 193 and paragraph 3 of Schedule 12 of the Taxes Act both a drillship and a semi-submersible rig are ships. Whilst a drillship looks very much like a ship to a layman (despite having a drill rig amidships) it is doubtful whether a layman would regard a semi-submersible as a ship.

We enquired of Mr Brennan during his address whether the Inland Revenue would regard a lightship as a ship and it appears that they would not. Now a light- ship looks very much like a ship and therefore we believe that we can disregard the questions of appearance and whether the structural unit in question would seem to a layman to be a ship.

There is no definition of ship in the Taxes Act and therefore we accept Mr Davey’s argument that reference to the definition contained in section 313 of the Merchant Shipping Act 1995 may be helpful.

We have gained little from the General Commissioners’ cases which have been placed before us as possible "authorities". General Commissioners are not required to give reasons for their decisions and accordingly we find that the contents of the stated cases placed before us by Mr Davey are of little assistance.

In considering the long list of authorities which have been placed before us it seems to us that each of them turns upon its own special facts. At one end of the scale we have Wells v Gas Float Whitton No.2 which decided that a gas float, shaped like a boat, but neither intended nor fitted to be navigated was not a ship or part of a ship. On the other hand, in the St John Pilot Commissioners v The Cumberland Railway & Coal Company [1910] AC 208 vessels built for the purpose of carrying coal and carrying sails so as to be able to run before the wind, but not so as to be safely navigated in the ordinary way as sailing vessels and which were towed by a steam tug in and out of the Port of St John were held to be ships.

Looking at the evidence placed before us it seems to us that on the facts of the present appeal and on the balance of probabilities the Glomar Adriatic IX falls on the ship side of the line rather than the non-ship for the purposes of this appeal

We are impressed by the movements which the unit undertook and particularly its voyage (for we hold it to be such) from Calabar to Senegal in April and May of 1996 lasting 27 days and covering 2,500 miles. During that time it was navigated by a

Master Mariner who controlled the movements of the unit by giving instructions to the tugs which were towing the unit. At the same time a radio operator was on duty on the unit and an engineer was ensuring that electric power was provided. Watch was being kept and it seems to us that in all respects the rig was operating as a ship whilst in transit with the sole exception of the fact that it did not provide its own motive power. Admittedly it lacked a rudder but it seems to us that a rudder was unnecessary when the unit was being towed by two tugs whose movements were under the control of a Master Mariner on the bridge of the jack-up.

The quotation from the poster put in evidence, and to which we have referred in paragraph 5(b) of our findings of fact, stated that "jack-up units are usually transported, especially over longer ocean passages aboard special semi-submersible ships". Glomar Adriatic IX would appear to be an exception to such a norm, in that it was seldom transported by means of a dry lift, and never in the experience of Mr Lavery.

We also find it somewhat difficult to distinguish between this jack-up unit and a semi-submersible unit. The latter is accepted by the Inland Revenue as a ship and having gone so far as to accept the semi-submersibles' status we believe that the Inland Revenue should take the extra step and concede the status of this particular jack-up rig.

In conclusion we must emphasise that our decision depends upon the peculiar facts presented to us in this appeal. The world of offshore drilling is developing fast and it is possible that other units may come into existence, or already exist, which may, or may not satisfy the courts as to their status as ships. Indeed, there may be other individual jack-up units which may fail to qualify as ships.

The appeal succeeds and we find on the facts that Mr Lavery's employment on Glomar Adriatic IX during the year 1995/96 consisted of the performance of duties on a ship. In that event he is entitled to a foreign earnings deduction from his employments of £49,457. That sum is equal to the amount of his emoluments for the year in question, leaving nil chargeable to tax.

DR A N BRICE

T H K EVERETT

SPECIAL COMMISSIONERS

SC 3013/98