INTERNATIONAL OIL POLLUTION COMPENSATION FUNDS

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Supplementary Fund Assembly	**SA11**	●

COMPENSATION FOR CLAIMS FOR VAT BY CENTRAL GOVERNMENTS

Note by the Secretariat

Summary: The document summarises the current policy of the IOPC Funds in respect of claims for compensation of VAT from central governments, and highlights that the issue has arisen again recently as a result of claims arising from the *Hebei Spirit* incident.

The document also provides a summary of the considerations of the 1992 Fund Administrative Council in October 2013, following the submission of documents by the Secretariat (document IOPC/OCT13/4/7/1) and the delegation of France (document IOPC/OCT13/4/7), which both commented on French civil law aspects regarding the payment of VAT.

The document further summarises the discussions arising following the submission of document IOPC/OCT14/4/5 by the Director in October 2014, as a result of the instruction from the Administrative Council to investigate further, the recoverability of VAT by central governments claiming from the IOPC Funds.

The document submitted by the Director in October 2014 contained at its Annex the legal opinions of lawyers from a wide cross-section of Member States. Following consideration of the legal opinions, the Director invited Member States to comment on the issue of compensation for VAT by central governments.

Following a debate on the issue, the 1992 Fund Assembly noted the views of the delegations and also noted that further time was required to discuss this difficult issue.

However, the question of how the 1992 Fund should handle claims for compensation of VAT from central governments is now under consideration as a result of two court decisions arising from the *Hebei Spirit* incident. The 1992 Fund has currently appealed the two decisions. The appeals are expected to be heard before the spring 2016 sessions of the governing bodies when the 1992 Fund will report the outcome of the litigation.

Action to be taken: 1992 Fund Assembly and Supplementary Fund Assembly

Information to be noted.

1 Background information

Current IOPC Funds' policy in respect of claims for compensation of VAT from central governments

1.1 The position taken by the IOPC Funds over the years in the matter of VAT is that VAT is compensated to all victims who have been required by national law to pay these sums in respect of the purchase of equipment or the procurement of services and cannot recover it as part of their normal business. This includes private individuals, companies or local and regional authorities as long as they are separate legal entities from the State.

1.2 In this regard, although a central government may be made up of several ministries or departments, all of them are branches of a single legal entity. Furthermore, normally any VAT paid by a government department would be paid to that government's Ministry of Finance and if the IOPC Funds were to pay VAT to the government as part of compensation of their department's claim, the central government would have, in effect, received the same VAT twice, which would be unjust enrichment.

1.3 The issue of VAT was debated at length during the *Haven* incident (Italy, 1991) when a decision was taken by the 1971 Fund Executive Committee not to accept the claim for VAT lodged by the Italian Government since any compensation for VAT to the central government would in effect be unjust enrichment.

1.4 However, when the 1971 Fund did compensate VAT to a government agency, as for instance in the case of the United Kingdom MCA in the *Sea Empress* incident, it was because it was an agency separate from the central government, with a separate budget, and it would therefore have indeed suffered an economic loss, were the VAT not to have been compensated.

2 Considerations by the 1992 Fund Administrative Council at its 11th session held in October 2013

2.1 In October 2013, the issue of compensation for claims for VAT by central governments was considered in documents IOPC/OCT13/4/7 submitted by France and IOPC/OCT13/4/7/1 submitted by the Secretariat.

DOCUMENT IOPC/OCT13/4/7 SUBMITTED BY FRANCE

2.2 In document IOPC/OCT13/4/7, the French Government noted that in the *Prestige* incident, the 1992 Fund had deducted the sum of €6.2 million from the French State's claim in respect of VAT paid by it for the supply of services and goods necessary for clean-up operations since in the view of the 1992 Fund, the payment of VAT was not eligible for compensation, since the State would recover the amount of VAT in the form of tax revenues.

2.3 It was noted that because of the 1992 Fund compensation limits, the French State would not receive any compensation from the 1992 Fund as a result of the *Prestige* incident, and therefore the question of the recoverability of VAT was not specific to the *Prestige* incident. It was also noted that France had requested that the governing bodies recognise that an affected State may obtain compensation for the VAT paid by it for the supply of goods and services necessary for clean-up and preventive measures.

Non-reimbursement of VAT would be an additional loss to the affected State

2.4 The document explained that in the opinion of France, the non-reimbursement of VAT paid to private contractors for the supply of services and goods necessary for clean-up operations was an undue burden which caused financial loss to the affected State, since if the State decided to leave it for the shipowner to carry out the clean up, that shipowner would engage private contractors which it would pay for the services provided, including VAT and then the VAT would be paid to the affected State in the form of tax revenues. However, if the State engaged the contractors directly and paid the VAT itself, it assumed an additional loss, if it did not obtain full reimbursement of the expenditures incurred, including VAT.

VAT was reimbursed by the IOPC Funds in previous oil spills

2.5 The document stated that in the case of past oil spills which had affected the French coast, the French State, in accordance with French law, had automatically included in the calculation of its loss the amount of VAT paid to private contractors which had supplied services or goods for oil spill response and that the French State had always been compensated for its loss by the IOPC Funds or by the shipowner's insurer, without the compensation for VAT being disputed.

2.6 The document also noted that in the case of the oil spill from the *Sea Empress* the IOPC Funds had also reimbursed the Maritime and Coastguard Agency (MCA) for VAT paid to private contractors involved in the response operations. The document further noted that the IOPC Funds considered that the reimbursement of VAT in relation to this incident was justified by the fact that it concerned an agency, independent of the State. However, in the view of the French delegation, as the financing of that agency came from public funds, no distinction could be made between reimbursement to a public agency and a State, for that would mean discrimination between States, depending on their administrative organisation.

In French law, compensation of the affected State for damage incurred by it includes VAT paid to contractors

2.7 The document stated that French courts recognised the right of the French State, as the victim of damage, to obtain reimbursement of VAT paid to private contractors. The document also stated that according to French jurisprudence, compensation was only paid net of tax when the victim enjoyed a tax regime which allowed it to deduct all or part of the VAT invoiced to it and that in that case, the VAT was not included in the compensation, since the victim passed it on to a third party. The document also stated that when the VAT paid by the victim could not be deducted, the loss must be compensated including VAT, so that the final tax charge was borne by the person causing the damage and not the victim.

2.8 The document stated that only persons subject to VAT who were required to invoice this tax to their customers enjoyed the right to deduct. However, legal persons under public law were not subject to VAT for their administrative service activities and that, to the extent that they were not subject to a legal regime allowing them to deduct all or part of the tax paid with respect to their own operations, public persons had the right, in the exercise of their administrative tasks, to reimbursement of VAT by the person responsible for the damage.

2.9 The document highlighted that in litigation relating to offences against the public domain, the Conseil d'État (highest administrative jurisdiction in France) had held ineffective the method suggested by the IOPC Funds since the fact that the State, which was responsible for collecting taxes and duties and is the beneficiary of the VAT revenue, "does not have the effect of making it subject, with respect to this tax, to a particular tax regime which allows it to deduct VAT on the costs of restoration measures to the public domain" and the VAT must therefore be included in the compensation granted to the State.

2.10 The document further highlighted that the French State, which was required to pay VAT to its service providers and suppliers, did not enjoy any right of deduction with regard to the operations carried out following a large oil spill and that for that reason, France believed that the compensation granted to the French State in reparation for its loss, must include the total amount of VAT paid.

DOCUMENT IOPC/OCT13/4/7/1 SUBMITTED BY THE SECRETARIAT

2.11 The document submitted by the Secretariat explained the current policy in respect of claims for compensation of VAT from central governments, whilst noting that in a number of cases VAT had been paid in respect of government claims due to diverse circumstances.

2.12 The document also provided a preliminary legal opinion on the French civil law aspects from Professor Alain Bénabent, a lawyer acting in the Conseil d'État and the Cour de Cassation, contained at the Annex of document IOPC/OCT13/4/7/1.

Legal opinion in respect of claims for compensation of VAT from French central Government

2.13 In the opinion, Professor Bénabent stated that the general rule was that compensation awarded would include VAT when the claimant could not recover it and, conversely, compensation would exclude VAT when the claimant was in a position to recover the VAT that he/she had had to pay. The rationale behind this general rule was to guarantee the principle of full compensation for the damage suffered, ie so that the claimant was put in the same position as he/she would have been had the damage not occurred.

2.14 Professor Bénabent further stated that if VAT was excluded from compensation because the claimant had the possibility to claim it back, and therefore his true loss was limited to the amount excluding VAT, to compensate him for the VAT that he had already recovered, or would recover, would be providing compensation over and above the loss. Professor Bénabent was therefore of the view that since the State was both the party paying and receiving the tax, the State had already received 'restitution' of the amount paid in VAT and thus had suffered no loss.

2.15 The Director recognised that the IOPC Funds had not always been consistent in the way they had dealt with the issue of whether VAT paid by governments as a result of an incident should be included in the compensation paid to them by the IOPC Funds. The Director also stated that this was a very complex issue and that he required more time to study the issue further. He therefore proposed that a decision should be postponed until October 2014 to give time for a careful consideration of the complicated issue of VAT.

Statement by France

2.16 The delegation of France made a statement, which noted that several oil spills had affected France since the creation of the international compensation regime, but there was no clear policy defined by the 1992 Fund Assembly on the question of compensation of a State for the VAT paid to private companies involved in the clean-up operations, and that in some incidents reimbursement of VAT had been granted to Member States.

2.17 The statement also highlighted that this situation gave rise to discrepancies in the compensation paid to the States affected which was not acceptable. The French delegation therefore wished for the 1992 Fund Assembly to adopt a clear and definitive position on compensation for VAT, in order to allow equal treatment of all States affected by pollution, but also recognised that the issue was complex and required an in-depth examination by Member States of the rules applicable in their national law.

Debate

2.18 Following a debate during which the risk of discriminating between different States depending on the administrative organisation of those States was highlighted, a number of delegations agreed with the opinion that central governments should not be reimbursed VAT for three reasons. Firstly, it would constitute unjust enrichment because although the State was paying VAT, the same State was also receiving that VAT. Secondly, compensating VAT could be an incentive for Member States to increase VAT for pollution related services. Thirdly, reimbursing VAT to a State would be to the detriment of other pollution victims.

2.19 Many delegations stressed that VAT should not be a means of unjust enrichment and that the application of the principle of full compensation meant that VAT paid by a State and later recovered by it, did not constitute a loss, and that a State should be only reimbursed for the VAT paid by it, if it had suffered a real loss. Concern was expressed that it would be difficult to identify whether an agency could be viewed as part of the State that received VAT.

2.20 Conversely, many delegations expressed the view that a State that used services of private contractors should be reimbursed for the VAT paid to those contractors since, as stated by the delegation of France, if a government decided not to intervene but to leave it for the shipowner to carry out the clean-up operations, VAT would be paid to the State. A number of delegations also supported the

view that there should be full compensation for the loss suffered by a State and agreed with the position submitted by the delegation of France.

2.21 Some delegations expressed concern that in certain countries with a complex administrative organisation the issue of whether one branch of the government should be compensated for VAT would not constitute a clear case. These delegations expressed the view that, since the administrative organisation would differ in each State, every case should be decided by taking into account the administrative peculiarities of that State.

2.22 Many delegations, however, expressed concern that the policy of the IOPC Funds should be clear and that there should not be different solutions depending on the State but that the same criteria should be applied to all States.

2.23 The United Kingdon delegation took the floor and explained that the fact that the MCA was an independent agency was not the reason why the MCA had been compensated for VAT paid in the *Sea Empress* incident. That delegation stated that the opinion of Customs and Excise was that not being reimbursed for VAT, would have constituted a loss for the MCA. That delegation also explained that over the years since the *Sea Empress* incident, the MCA had developed a policy whereby for each activity carried out, a ruling would be obtained from Customs and Excise, based on which, a decision on whether to include VAT in a claim would be made in each particular case.

2.24 The Chairman of the 1992 Fund Administrative Council summarised the discussion stating that the delegations which took the floor, had expressed gratitude to the delegation of France for bringing the subject to the attention of the Administrative Council, and noted that the problem of VAT was not limited to France and that since the IOPC Funds were international bodies it was important for this matter to be dealt with in a consistent manner.

2.25 The 1992 Fund Administrative Council decided that, given its complexity, the issue of whether VAT paid by governments in the response to an oil pollution incident should be reimbursed to them by the IOPC Funds should be studied further, and instructed the Director to study the matter and report back to the October 2014 session.

3 Considerations by the 1992 Fund Assembly at its 19th session held in October 2014

3.1 In accordance with the instructions, in October 2014, the Secretariat submitted document IOPC/OCT14/4/5 relating to the issue of compensation for claims for VAT by central governments.

3.2 The document contained an opinion by Professor Alain Bénabent, on the history of the case law as mentioned by the French Government in its document IOPC/OCT13/4/7, and also provided a legal opinion from a practising barrister, Mr Harry Wright of 7 King's Bench Walk Chambers, London, who had been requested to answer the primary question of whether, as a matter of English law, VAT paid by governments in response to an oil pollution incident should be reimbursed by the IOPC Funds. Mr Wright's legal opinion, in addition to the English law position, considered the position under Australian, Canadian, Indian, New Zealand, Singaporean and South African law.

3.3 The Director had also sought legal opinions from a wide geographical cross-section of Member States, including Argentina, Denmark, France, Germany, Greece, Islamic Republic of Iran, Italy, Japan, Mexico, Morocco, the Netherlands, Nigeria, Norway, Republic of Korea, Russian Federation, Spain and the United Arab Emirates.

Conclusions of the legal opinion of Professor Bénabent

3.4 Professor Bénabent's legal opinion stated that while the principles for the inclusion or otherwise of VAT in assessment of damages in general were well established in case law, their application to the State, which raised particular difficulties, had given rise to very little case law. Professor Bénabent stated that the general rule was that compensation awarded would include VAT when the claimant could not recover it and, conversely, compensation would exclude VAT when the claimant was in a position to recover the VAT that he/she has had to pay. The rationale behind this general rule was to

guarantee the principle of full compensation for the damage suffered, ie so that the claimant was put in the same position as he/she would have been had the damage not occurred.

3.5 In summary, Professor Bénabent was of the view that:

(a) Only three judgments of the Conseil d'État, (ie the Supreme Court in the order of jurisdictions of administrative law) rendered on 30 December 1996, 18 June 1997 and 6 March 2002 suggested that when the State called on private enterprises to remedy damage to its assets caused by a third party, it was entitled to claim compensation inclusive of VAT;

(b) These three decisions were eminently open to criticism because they ignored the meaning and scope of the principle of reparation in full which governed the French law of liability, and were not based on any persuasive argument;

(c) Consequently, it could reasonably be considered that if the civil courts were seized of the issue, they would be inclined towards a calculation of the compensation net of VAT, respecting the principle that required the victim to be compensated without loss or profit.

Conclusions of Mr Harry Wright's legal opinion

3.6 The document also provided a legal opinion from a practising barrister, Mr Harry Wright, who had been requested to answer the primary question of whether VAT paid by governments in the response to an oil pollution incident should be reimbursed to them by the IOPC Funds. Mr Wright's legal opinion covered the jurisdictions of England and Wales, Australia, Canada, India, New Zealand, Singapore and South Africa.

3.7 After proposing a modified test from which a policy for the IOPC Funds could be drawn for its question of whether a payment of VAT by a given body qualified as a loss, Mr Wright's legal opinion concluded as follows:

(a) The principles of the law of damages were applicable to the Fund's questions. Two fundamental rules of damages were (1) that a party may not recover damages where it had suffered no loss and (2) that a party may not enjoy a double recovery of damages. It appeared that these principles were applied in the jurisdictions of England and Wales, Australia, Canada, India, New Zealand, Singapore and South Africa in much the same way.

(b) If the State, or an organ of the State whose legal personality was the same as the State, claimed VAT from the IOPC Funds, it should not recover such VAT. This is because it had suffered no loss, and were it to recover VAT, it would amount to a double recovery.

(c) If an organ of the State whose legal personality was distinct from that of the State, were to claim VAT from the IOPC Funds, it should recover such VAT, since it would in fact have suffered a loss.

(d) In order to distinguish between the two distinct categories for the purpose of assessing whether VAT was recoverable, the IOPC Funds could look to the domestic law of Member States, or alternatively could adopt a modified test based on the European law test (the Foster Test) for what amounted to 'an emanation of the State'. There were potential advantages and disadvantages of both tests.

Summary of the legal opinions covering the jurisdictions of several Member States

3.8 The document also provided further legal opinions from lawyers from a wide geographical cross-section of Member States, including Argentina, Denmark, France, Germany, Greece, Islamic Republic of Iran, Italy, Japan, Mexico, Morocco, the Netherlands, Nigeria, Norway, Republic of Korea, Russian Federation, Spain and the United Arab Emirates.

3.9 The document explained that the lawyers instructed by the 1992 Fund had been requested to respond to a series of questions regarding the recoverability of VAT from the IOPC Funds under their respective domestic laws. The questions posed to the lawyers and a summary of the answers received were as follows:

Does your national law recognise the rule that a party should not be able to recover damages where it has suffered no loss?

3.10 An analysis of the responses received, revealed that all of the lawyers confirmed that under their respective domestic laws, parties were not permitted to recover damages where that party had not suffered a loss.

Does your national law recognise the rule against 'double recovery'?

3.11 The docuemnt also explained that all of the lawyers from whom legal opinions were sought, stated that their respective Member States recognised the rule against double recovery, or an equivalent rule, known as the rule against 'unjust enrichment', with just one proviso relating to government entities under Mexican law.

Does your national law impose VAT or equivalent?

3.12 With the exception of the United Arab Emirates, all of the Member States for which legal opinions were provided, imposed a form of VAT.

If so, does your national law permit a body or agency, which by virtue of provisions of national law has a legal personality which is the same as that of the State, to recover VAT which it has incurred acting in mitigation of a breach of contract or some other breach of civil law?

3.13 In response to this question, the document stated that a wide variety of responses were received. In some Member States, where the body or agency had the same legal personality as the State, no loss would be judged to have occurred, and thus the body or agency would not be entitled to recover VAT.

3.14 In other Member States, the answer was clearly opposite, as either the local laws made it mandatory for bodies or agencies to charge and collect VAT (the government agency would not otherwise be able to recover VAT) or the courts had declined to apply the double recovery principle.

3.15 The document noted that there was no uniformity on the answer due to a variety of complex legal issues.

Under your national law, if the State paid a contractor to prevent oil pollution and thereby incurred VAT on those costs, would the State be entitled to recover that VAT from the 1992 Fund?

3.16 The answers to this question generally mirrored the answers to the previous question, with a wide range of responses received.

Does your national law recognise that certain bodies or agencies which may be associated with the State are accorded the same legal status as the State?

3.17 In response to this specific question, there were also a wide variety of replies ranging from confirmation that certain bodies associated with the State were accorded the same legal status as the State, to recognition that some public bodies had separate legal personalities.

3.18 The analysis of the responses revealed that in some cases, special rules applied to the government agency or body so that they were not subject to the payment of VAT, due to their public nature, even if they collected fees contributions or other payments through transactions. In other cases, the matter had not been resolved and was before the courts awaiting an answer.

Director's recommendations

3.19 In summarising the legal opinions, the Director recognised that the recoverability of VAT for government claims had not always been treated consistently in previous incidents, and that although the policy followed by the IOPC Funds over the years had precluded the payment of compensation for VAT in respect of government claims, in a number of cases VAT had been paid in respect of government claims due to diverse circumstances.

3.20 In view of the foregoing and in order to provide some form of consistency in future incidents, given the wide range of responses provided in the legal opinions submitted to date, the Director recommended that delegations be given further opportunity to consider the legal opinions provided, and to consider whether to give further thought to adopting a test, such as the modified 'Foster Test' as proposed by Mr Harry Wright, in order to determine an answer to the question of whether a payment of VAT qualified as a loss for which the IOPC Funds should pay compensation.

3.21 By way of summary. the proposed modified 'Foster Test' reads as follows:

(1) A private individual or body which had incurred VAT in connection with the prevention of oil pollution may (subject to satisfying the criteria laid down by the 1992 Fund) recover that VAT from the 1992 Fund.

(2) A State, or any emanation of the State, which had incurred VAT in connection with the prevention of oil pollution should not recover VAT, but would be deemed by the 1992 Fund to have suffered no loss, since the State should recover such VAT in revenue.

(3) For the purposes of subsection (2) above, a party would qualify as an 'emanation of the State' if it was:

(a) Responsible for the provision of a public service pursuant to a measure adopted by the State; and

(b) Was controlled by the State; and

(c) Had been given special powers beyond those which resulted from the normal rules applicable in relations between individuals for the purpose of carrying out its role in subsection (a); and

(d) Was entitled to receive funding from the State for the purpose of carrying out its role in subsection (a).

Debate

3.22 One delegation stated that since it was a Federal Republic with 16 separate States, with separate taxes and income, it doubted that the modified 'Foster Test' took into account its position. Whilst it understood that there should be a common approach adopted by the 1992 Fund Assembly, in its view such an approach was difficult to apply to a Federal State. That delegation further stated that even if a common approach could be found amongst Member States, in its view, the Member States' courts would still apply their own domestic legislation, which might cause a problem if different to any common approach adopted by the 1992 Fund Assembly.

3.23 Another delegation stated that it agreed with the basic principles discussed in document IOPC/OCT14/4/5, namely that a claimant should be fully compensated and should not be unjustly enriched, although it was now verifying this matter including the examination of the legal opinion. This delegation also stated that due to the different accounting system of States' budget, it considered it inappropriate and unrealistic to consider a test or model which was too formulistic or simplistic.

3.24 The delegation of France made a statement, which noted the Director's intention to allow delegations further time to consider the question of whether VAT should be included or not, whilst at the same

time inviting Member States to adopt a decision on this question at the next sessions of the governing bodies of the IOPC Funds. The French delegation made further comments which confirmed that French Law, like other legal systems, did not allow for a person to obtain damages and interest if they had not suffered a loss. The French delegation did not therefore intend to challenge this principle, and confirmed that what it considered important was the principle of full compensation for the damage suffered.

3.25 With regard to the document, the French delegation posed a number of questions, as follows:

- Is it certain that the State recovers in full and under any circumstances the VAT that it has actually paid when it has suffered a loss?

- The legal opinion of Mr Harry Wright in Annex II provides the legal situation in Commonwealth countries, the different opinions in Annex III complete the picture for the civil law countries.

- The legal opinion of Professor Benabent in Annex I, as respectable as it may be, is it enough by itself to challenge French Law? As a reminder, French jurisprudence of the highest French administrative court, the Conseil d'Etat, clearly states that VAT should be included. This jurisprudence has never been questioned until now.

- Regarding Annex III, and the response to the questionnaire on French law in respect of VAT by the law firm *Villeneau, Rohart and Simon*, the French delegation noted that the firm only made reference to the opinion of Professor Benabent, and did not mention the jurisprudence of the Conseil d'Etat.

3.26 The French delegation, shared the view of the Director that further time should be given to delegations to study the various legal opinions provided and to further consider the question, which was complex and had received a variety of responses from the Member States. The French delegation indicated that it would produce a new document to explain its position.

3.27 In concluding its comments, the French delegation stated that, on the question of VAT, it was concerned about considering the principle of the matter. The position that France was defending was therefore not specific to the *Prestige* incident and would not have any financial impact on the IOPC Fund in that regard, given that the French State was standing last in the queue.

3.28 Another delegation stated that the document and legal opinions submitted in document IOPC/OCT14/4/5 demonstrated the complexity of the issue and that in its opinion, the issue of compensation for claims for VAT by central governments should be dealt with on a case-by-case basis, and that if a major incident were to occur in its territorial waters, it would seek to recover the VAT.

3.29 One delegation stated that although it was too early to adopt a final position, in its view consideration should be given to adopting a policy based on the modified 'Foster Test', although it also foresaw that a hybrid approach could be used, such that priority be given to the national legislation of the Member State affected by the incident, but that where a discrepancy existed, the modified 'Foster Test' could be used to resolve any ambiguity.

3.30 Another delegation stated that under its legislation, payments of compensation in principle should not include VAT, so no issue arose, but payments for legal services, which could form a significant percentage of losses claimed, would have to be reimbursed.

3.31 The 1992 Fund Assembly noted the delegations' views that obtaining a common approach might be difficult, and that further time was required to discuss this difficult issue.

4 Developments since October 2014

4.1 The issue of compensation for VAT by central governments was not discussed at the April 2015 sessions of the 1992 Fund governing bodies, so no opportunity has arisen for Member States to comment further on the issues at stake.

4.2 However, as detailed in the document submitted by the Secretariat on the *Hebei Spirit* incident (document IOPC/OCT15/3/6), the issue has recently arisen whilst dealing with claims arising from that incident, because a number of claims made by the Korean Government for costs incurred in clean-up operations following the incident, include the equivalent of VAT.

4.3 Presently, the Korean courts have rendered first instance judgements in respect of two of the claims made by the Korean Government which include VAT.

4.4 Judgments on two claims by the Republic of Korea

4.4.1 In May 2015, the Seosan Court issued two judgments on claims by the Korean Navy and the Korean Naval Operation Command relating to costs incurred during the response to the spill.

4.4.2 The 1992 Fund had assessed the claim by the Korean Navy at KRW 975 848 374 (£555 000) and the claim by the Naval Operation Command at KRW 298 291 200 (£170 000).

4.4.3 In its judgments, the Court accepted the 1992 Fund's assessment of both claims. However, in the same judgments, the Court also held that the VAT paid to external contractors in the amount of KRW 1 037 092 (£590) and KRW 1 350 511 (£770) respectively, was compensable. In its reasoning, the Court indicated that under Korean law, VAT is returnable (or deductible from output tax) only to entrepreneurs. However, although the Korean Government did not fall within that category, it argued that it had paid for the services of an enterpreneur, and on that basis, the Korean Government claimant was claiming compensation for the VAT.

4.4.4 In addition, the court also emphasized that the procedure for determining compensable amounts through objection proceedings, and the procedure for calculating VAT returns (or deductions), were separate, and therefore it would not be fair to change the amounts of damages awarded, purely on the basis that the claimant was the government.

4.4.5 The 1992 Fund objected to these judgments based on the advice of its Korean lawyers at that time because although the claimant's payment to the contractor's company included VAT, since the Korean Government claimant was also the party imposing VAT, the payment of such VAT could not constitute a loss to the claimant. Moreover, since the VAT would eventually be returned to the claimant (ie to the Republic of Korea), a payment of VAT to the government as part of compensation of their department's claim, would have to be considered a double payment.

4.4.6 However, subsequent to filing the appeals and contrary to their initial advice, the 1992 Fund's Korean lawyers advised that they were now of the view that the Korean Government would be able to recover the VAT, because the VAT paid to the external contractors, and the VAT paid by the external contractors to the Korean Government, arose from separate causes of action, and there was no direct link between the two causes.

4.4.7 Specifically, the 1992 Fund's lawyers are now of the view that the basis/cause of action of the payment of the VAT by the Korean Government to the external contractors, was the expenditure by the Korean Government for preventive measures against pollution (ie pilotage services as part of preventive measures), whereas the basis/cause of action of the payment of VAT by the contractors to the Korean Government was not the oil pollution, but the procurement of pilotage services carried out by the external contractors. The 1992 Fund's lawyers advise that as a matter of Korean law, it shall not be deemed a double compensation, if the basis/cause of action of the recovery are separate/not directly linked.

4.4.8 The 1992 Fund's lawyers also advised that if the Court held that the Korean Government forfeited its

right to recover the paid VAT, merely because the Korean Government was the party which procured services from external contractors, this would be unfair upon the Korean Government, since this would amount to an unfair impairment of the right of the Korean Government to impose tax on pilotage businesses.

4.5 The 1992 Fund has appealed both judgments.

5 Directors considerations

5.1 The Director notes that no decision was reached by Member States regarding this very difficult issue when the matter was discussed in October 2013 and October 2014.

5.2 However, the Director notes that this matter is now under consideration by the Korean courts as a result of two claims arising from the *Hebei Spirit* incident. The Director also notes that although the amounts under consideration are small, the issues arising are matters of principle, and the 1992 Fund would benefit from further clarification from the Korean courts of their position.

5.3 The 1992 Fund has provisionally appealed the two decisions. The appeals are expected to be heard before the spring 2016 sessions of the governing bodies when the 1992 Fund will report the outcome of the litigation.

6 Action to be taken

1992 Fund Assembly and Supplementary Fund Assembly

The governing bodies are invited to take note of the information contained in this document.