TC00681

Appeal number LON/2008/7112

Customs duty – classification of 3rd generation iPod Nano - whether principal function test applicable - yes

FIRST-TIER TRIBUNAL

TAX

RMS COMMUNICATIONS LTD

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE AND CUSTOMS

Respondents

TRIBUNAL: Paulene Gandhi
Richard Law

Sitting in public in London on 1 March 2010

Mr Laurent Sykes, Counsel instructed by RMS Communications Ltd

Mr Kieron Beal, Counsel instructed by HMRC

DECISION

1. The appeal is brought against a decision of The Commissioners for Her Majesty's Revenue and Customs ("HMRC") dated 11 March 2008 to classify the 3rd generation Apple iPod Nano ("the Nano") to heading 8521 90 00 90 'video recording or reproducing apparatus, whether or not incorporating a video tuner') of Annex 1 ("the Combined Nomenclature" or "CN") of Council Regulation (EEC) No. 2658/87 of 23 July 1987, as amended ("the Tariff Regulation"), rather than to heading 8519 81 95 90 ('sound recording or reproducing apparatus').

2. The question for us to determine is whether or not the Nano should be classified under CN heading 8519 (as contended for by RMS Communications Ltd) or CN heading 8521 (as contended for by HMRC). At the material time, RMS Communications Ltd's classification bore a duty at 2% while HMRC's classification attracted a duty rate of 13.9%.

3. It seems to us that the questions at the crux of this appeal and the correct classification of the Nano for the purposes of customs duties are:

   a) whether the Nano has a principal function;

   b) if so what is its principal function?

4. Both parties accept that the Nano is capable of both sound and video reproduction; thus in our view it is potentially classifiable in more than one place. However HMRC contends that the Nano does not have a principal function as it is equally capable of audio and video and therefore, following the General Rules for the interpretation of the Combined Nomenclature ("GIR" or "GIRs") and, in particular, GIR 3, it must be classified under CN heading 8521, whilst RMS Communications Ltd contends that it does have a principal function - its audio capability - and thus it must be classified under CN heading 8519.

5. In essence we are looking at the question of the applicability of Note 3 to Section XVI of the CN ("Note 3"). Under the test set out in Note 3, the Nano is to be classified as that device which performs its principal function. RMS Communications Ltd submits that the principal function of the Nano is that of an audio player. If the Nano's principal function is indeed that of an audio player and Note 3 is the decisive provision, both parties accept that the Nano falls to be classified under heading 8519, rather than heading 8521.

6. The main dispute seems to be in relation to how we determine whether or not the Nano has a principal function and what factors we should take into account in relation to this issue: i.e. what are the objective characteristics of the product that therefore must be taken into account and what are subjective characteristics that cannot be taken into account.

7. RMS Communications Ltd accepts that the "principal function" test will not yield a result if we, the tribunal, are of the view that there are two or more principal functions or there is no principal function at all.

8. In that case, both RMS Communications Ltd and HMRC agree that GIR 3(a) to (c) would need to be applied. The effect of this would be as follows:

(a) Both parties agree that GIR 3(a) is unlikely to yield a result.

(b) RMS Communications Ltd submits that the effect of GIR 3(b) is that the Nano, which is made up of different components, would be classified according to that component which gives it its essential character. In this case, they say that the relevant components are those relating to the Nano's function as an MP3 player. HMRC say that this rule does not provide for the possibility of classifying mixtures or composite goods according to the function which gives them their essential character.

(c) Both parties agree however that if GIR 3(b) did not yield a result, then under GIR 3(c) the Nano would be classified under heading 8521 as contended for by HMRC.

The undisputed facts

9. On 6 February 2008, RMS Communications Ltd applied for a 'binding tariff information' ("BTI") for the Nano. The description of the product was given as follows:

'MP3 audio player with photo and video display function, also capable of download/storage of audio, video, image and data from PC or Apple Mac'.

10. The commercial denomination of the product was Apple iPod Nano [4GB/8GB memory]. The suggested CN code was 8519 81 95 90. The application referred to an Irish BTI which was said to have been issued to that CN heading. The application attached a technical specification for the product. According to that specification, the product had the following objective characteristics:

- A 4GB or 8GB flash drive;
- It was capable of holding up to 1,000 or 2,000 songs in a certain format;
- It could hold up to 3,500 or 7,000 iPod viewable photographs;
- It could hold up to 4 hours or up to 8 hours of video. A detailed description of the video files that could be played was given;
- It had a two inch LCD display with blue-white LED backlight;
- Its pixel resolution was 320x240 at 204 pixels per inch;

11. In the light of this information, HMRC on 11 March 2008 issued a BTI for the Nano classifying it under CN heading 8521 90 00 90. The 'justification for the classification of the goods' was given in the following terms: 'The classification is determined in accordance with the provisions of GIRs 1 and 6 as well as the text of headings 85.21, 85.21 90 and 85219000 (video recording or reproducing apparatus, whether or not incorporating a video tuner, other, other)'.

12. By letter dated 20 April 2008, RMS Communications Ltd requested a formal departmental review of the decision to issue the BTI. They contended that classification under CN heading 8519 was appropriate based on the "principal function criterion". They stated that the screen was small, the picture resolution was relatively low, and that, while one could connect the product to car speakers or to a PC to listen to music, in addition to being able to listen through headphones, one could only watch video on the screen of the iPod itself, unless one used additional software and compatible hardware. In view of all these limitations, RMS Communications Ltd argued that the video function was merely an 'extra' (just as it was with a number of mobile phones) and the product's primary function was to play music. They invoked a BTI issued to Apple Computer International by the Irish authorities, classifying the same product to heading 85.19 and a recent decision of the Dutch courts to the same effect, in relation to what they asserted was a similar product (although its screen was smaller, and its resolution lower). They also stated that RMS Communications Ltd was at a competitive disadvantage to Apple which benefitted from the Irish BTI.

13. By letter dated 9 June 2008, HMRC's review officer upheld the decision to issue the BTI in the CN code given. She considered that two Commission Regulations applied, which classified to heading 85.21 what she regarded as similar products. She added that, in view of the fact that devices similar to the Nano, but without a video capability, were available, a purchaser would not buy the disputed product unless they wanted to watch videos.

14. On 2 July 2008, RMS Communications Ltd filed a Notice of Appeal against HMRC's decision on the formal departmental review. Their grounds are: 'the coding 8521900090 is incorrect given that several EC Member States have previously issued 8519519590. This coding discriminates against the ability of RMS Communications Ltd to compete with other traders using the 8519 coding.' The appeal argued that regarding video as the main or primary function is not supportable.

The law

15. Article 12 of the Common Customs Code (Council Regulation 2913/92/EEC) ("the Code") provides for the issue by the customs authorities of BTI giving their opinion of the proper classification of the relevant goods.

16. The proper classification of goods entering the European Community is determined by the Tariff Regulation and the CN. The CN is amended each year and takes effect from each 1st January. The CN provides a systematic classification of all goods in international trade and, with assistance from the GIRs, ensures that any product is only classified in one place and one place only.

17. The CN applicable at the material time of the BTI application by RMS Communications Ltd was set out in Commission Regulation (EC) No. 1214/2007 of 20 September 2007 amending Annex 1 to Council Regulation (EEC) No. 2658/87 on the tariff and statistical nomenclature and on the

Common Customs Tariff. This applied from 1 January 2008 to 31 December 2008.

18. CN headings 8519 and 8521 both fall within Section XVI of the Tariff. Note 3 to Section XVI states that:

"Unless the context otherwise requires, composite machines consisting of two or more machines fitted together to form a whole and other machines designed for the purpose of performing two or more complimentary or alternative functions are to be classified as if consisting only of that component or as being that machine which performs the principal function."

19. Heading 8519 of the CN concerns sound recording or reproducing apparatus and states:

"**8519 Sound recording or sound reproducing apparatus**:
8519 20 - apparatus operated by coins, banknotes, bank cards, tokens or by other means of payment:
8519 20 10 -- Coin- or disc operated record players
-- Other:
8519 20 91 --- With laser reading system
8519 20 99 --- Other

8519 30 00 - Turntables (record decks)

8519 50 00 - Telephone answering machines

-other apparatus:
8519 81 -- Using magnetic, optical or semi-conductor media:
--- Sound reproducing apparatus (including cassette players), not incorporating a sound recording device:
8519 81 11 ----Transcribing machines
----Other sound reproducing apparatus:
8519 81 15 ----- Pocket size cassette players
----- Other, cassette type:
8519 81 21 ------ With an analog and digital reading system
8519 81 25 ------ Other
----- Other:
------ With laser reading system:
8519 81 31 ------- of a kind used in motor vehicles, other type using discs of a diameter not exceeding 6,5 cm
8519 81 35 ------- Other
8519 81 45 ------ Other
--- Other apparatus:
8519 81 51 ----Dictating machines not capable of operating without an external source of power
----Other magnetic tape recorders incorporating sound reproducing apparatus:
----- Cassette type:
------ With built-in amplifier and one or more built-in loudspeakers:

8519 81 55 ------- Capable of operating without an external source of power
8519 81 61 ------- Other
8519 81 65 ------ Pocket sized recorders
8519 81 75 ------ Other
----- Other:
8519 81 81 ------ Using magnetic tapes on reels, allowing sound recording or reproduction either at a single speed of 19 cm per second or at several speeds if those comprise only 19 cm per second and lower speeds
8519 81 85 ------ Other
8519 81 95 ----Other

8519 89 -- Other:
---Sound reproducing apparatus, not incorporating a sound recording device:
8519 89 11 ----Record players, other than those of subheading 8519 20
8519 89 15 ----Transcribing machines
8519 89 19 ----Other
8519 89 90 --- Other"

20. Heading 8521 of the CN concerns video recording or reproducing apparatus, whether or not incorporating a video tuner and states:

"**8521 Video recording or reproducing apparatus, whether or not incorporating a video tuner**:
8521 10-Magnetic tape type:
8521 10 20 -- Using tape of a width not exceeding 1, 3 cm and allowing recording or reproduction at a tape speed not exceeding 50 mm per second
8521 10 95-- Other
8521 90 00-Other."

21. The GIRs set out guidelines for the interpretation of the Tariff Regulation. Rule 1 of the GIRs states that "classification shall be determined according to the terms of the headings and any relative section or chapter notes and, provided such headings or notes do not otherwise require, according to the following provisions."

22. GIR 3 provides as follows:

"When by application of rule 2(b) or for any other reason, goods are *prima facie* classifiable under two or more headings, classification shall be affected as follows:

(a) the heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods;

(b) mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to 3(a), shall be classified as if they consisted of the material or component which gives them their essential character in so far as this criterion is applicable;

(c) When goods cannot be classified by reference to 3(a) or (b), they should be classified under the heading which occurs last in numerical order among those which equally merit consideration."

23. GIR 6 states:

"For legal purposes, the classification of goods in the subheadings of a heading shall be determined according to the terms of those subheadings and any related subheadings notes and *mutatis mutandis* to the above rules, on the understanding that only subheadings at the same level are comparable. For the purposes of this rule the relative section and chapter notes also apply, unless the context otherwise requires."

General principles derived from case law

The following general principles do not appear to be in dispute:

24. In Case 185/73 *Hauptzollamt Bielefeld v Offene Handelsgesellschaft in Firma HC Konig* [1974] E.C.R. 607, at paragraph 18, the European Court of Justice ("ECJ") held that the decisive criteria for classification of products in the Common Customs Tariff are their characteristics and objective properties. In *Customs and Excise Commissioners v General Instrument (UK) Ltd* [2000] 1 C.M.L.R. 34, Ch. D. ("*General Instrument*") , Dyson J. held (following the established Community case law) that the characteristics and objective properties of the product were decisive criteria for classification, not its subjective purpose.

25. Where explanatory notes are attached to the Tariff itself, the ECJ in Case 54/79 *Firma Hako-Schuh Dietrich Bahner v Hauptzollamt Frankfurt Am Main-Ost* [1980] ECR 311, at paragraph 6, has held that such explanatory notes constitute an important factor in its interpretation, enabling the headings or subheadings to be defined or clarified. In contrast, in Case C-35/93 *Develop Dr Eisbein GmbH & Co v Hauptzollamt Stuttgart-West* [1994] ECR I-2655, at paragraph 21, the ECJ at paragraphs 47 to 48 held that the Harmonised System Explanatory Notes ("the HSENs") can be used for persuasive but non-legally binding guidance.

26. In Case C-495/03 *Intermodal Transport BV v Staatssecretaris van Financieen* [2005] ECR I-8151 ECJ ("*Intermodal Transport*"), the ECJ recognised at paragraph 48 that the Explanatory Notes to the Combined Nomenclature published by the Customs Code Committee ("the CNENs") and the HSENs were an important aid to the interpretation of the scope of the various tariff headings, albeit that they did not have legally binding force. The content of these notes will be ignored if it is incompatible with the provisions of the CN or it alters the meaning of these provisions. The ECJ in C-142/06 *Olicom A/S v*

Skatteministeriet [2007] ECR I-6675, ECJ ("*Olicom*") noted at paragraph 17 that the CNENs were an important means of ensuring the uniform application of the Tariff and as such would be regarded as useful aids to interpretation. In contrast, in those cases where CNENs or HSENs are not incompatible with the terms of the CN, the ECJ has indicated that a national court should follow them, or will follow them itself. See Case C-400/05 *BAS Trucks BV v Staatssecretaris van Financien* [2007] ECR I-311, ECJ at paragraph 40.

HMRC's Case

27. HMRC contends that the only product in issue in this appeal is the Nano and not any other generations of it. HMRC accepts that if we find a principal function, then the principal function test is determinative. They also contend that the HSENs and CNENs are persuasive but not binding on us. Consequently, we should consider the notes and if they do not cut across the headings in the tariff then they are persuasive.

28. It is common ground between the parties that the Nano is capable of both sound and video reproduction. HMRC also contends, in light of the wording of the HSENs and CNENs, that it is capable of both sound and video recording through its connection via a USB cable to a computer.

29. HMRC contends that neither of these functions pre-dominates. Note 3 cannot therefore give a determinative answer as to what the principal function of the Nano is. RMS Communications Ltd relies on the subjective use of the Nano but HMRC contends that the right approach is functionality. The Nano is capable of video and audio playback e.g. it is multifunctional equipment.

30. The Nano introduced the concept of video playback to the Nano series. It was marketed by Apple as "the small iPod with one very big idea: video. Now the world's most popular music player lets you enjoy TV shows, music videos, video pod casts and more." In short the product in question records from a computer and plays both music and video. Based solely on the objective characteristics of the product, HMRC contends that neither of these functions holds sway over the other one. They are both equal functions and provide equal uses for the product. All of RMS Communications Ltd's attempts to claim the principal purpose for the audio playback are based on subjective considerations.

31. The technical specification of the product shows that this is a piece of equipment which is audio and video with no indication that one predominates over the other.

32. Looking at the iPod manual there is a hefty section given over to the playing and recording of videos and the iPod is designed and intended to use both functions so one cannot say one function predominates. Amazon's product description markets the Nano as something equally capable of audio and video playback.

33. HMRC accepts that the principal function of the Nano is not video but contends that audio is not the principal function either as the Nano was marketed as having video introduced for the 1st time. They say that it is the function of the

equipment rather than its use which is relevant and that this must be judged at the time of import when it is not known how people will use the equipment. In other words, we are looking at functionality not use, so that principal use is not the correct test.

34. HMRC contends that we must consider the objective characteristics of the Nano; everyone may use it as an MP3 player but we must consider its function. They say that the principal function does not equate to actual use and that we must assess the objective criteria at the point of entry. They also say that the adequacy or otherwise of the video function is not in issue. RMS Communications Ltd has concentrated on the practical use of the video function.

35. HMRC says that the survey of 100 people in Colchester is not a relevant guide to the pan-European tariff classification of this product. That survey addressed the issue of the subjective purpose to which the Nano would be put, which they say is not a legally relevant consideration.

36. Case C-130/02 *Krings GmbH v Oberfinanzdirecktion Nuernberg* [2004] ECR I-2121, ECJ ("*Krings GmbH*") paragraphs 25 to 28 and paragraph 30 renders irrelevant consumer market research as people's views are not derived from the inherent characteristic and assessment needs made on clearing customs.

37. Tariff classification is an objective assessment and must lead to legal clarity. The subjective assessment that is the survey furthers neither of these.

38. HMRC contends that GIR 3(b) is inapplicable in this case: see the Court of First Instance judgment in Case T-243/01 *Sony Computer Entertainment Europe Ltd v Commission of the European Communities* [2003] ECR II-418, CFI ("*Sony")*. GIR 3(c) will fall to be used where, as here, two functions of the apparatus are equally important and neither predominates. The Nano has audio function and video playback/recording function. If we take out the subjective use of the product we cannot say at the important stage – the moment of Customs entry - that the principal function is audio. 'Function' is not the same as 'use'. This therefore leads to the use of rule 3(c) - the tie-breaker - if we think the equipment has two or more functions and one does not predominate.

39. HMRC argues that the Nano is properly classified to subheading 8521. Despite the comparatively low resolution, the picture quality is good (assisted perhaps by the MPEG4 video compression) and the small size of screen does not necessarily interfere with the viewer's enjoyment. The product is perfectly apt to be used for watching film or television programmes at length, on a regular basis, and in most situations. In view of that circumstance, in HMRC's view, the video function is at least equal to the audio function and therefore whether by virtue of Note 3 to Section XVI or by virtue of GIR 3(c), the product is properly classified to heading 8521.

40. HMRC also relies upon the following facts and matters in support of their classification:

(a) Commission Regulation (EC) No 1056/2006 which should be applied by analogy. This supports classification under CN 8521;

(b) The HSENs for CN heading 8521 state as follows:

"(A) Recording and Combined Recording and Reproducing Apparatus
The heading also includes apparatus which record, generally on a magnetic disc, digital code representing video images and sound, by transferring the digital code from an automatic data processing machine (e.g., digital video recorders).
...
(B) Reproducing apparatus
...
(1) Apparatus using discs in which the image and sound data are stored on the disc by various methods and picked up by laser optical reading system, capacitive sensor, pressure sensor or magnetic head. Subject to Note 3 to Section XVI, apparatus which are capable of reproducing both video and audio recordings are to be classified in this heading."

The Union has also adopted Explanatory Notes to the CN (pursuant to Article 9(1)(a) of Council Regulation 2658/87), known as "CNENs". The CNENs which were in force for CN heading 8520 (which became heading 8519) referred to "sound recording" as also including "recording by methods other than those making use of the effects of acoustic vibrations, e.g. by recording data sound files, downloaded from an internet page or a compact disc by an automated data processing machine, onto the internal memory (e.g. FLASH memory) of digital audio device (MP3 player)."

(c) The BTIs issued by the German, Czech, Spanish, and Danish Customs Authorities in respect of the products that are identical to Apple iPod products, as evidenced from the image of the product attached to the BTI. These all classify products akin to the Nano under CN 85 21. The BTIs relied upon by RMS Communications Ltd (with the exception of the Irish BTI issued following the decision of its domestic Tribunal) do not clearly relate to products identical to or sufficiently akin to the iPod range of products;

(d) The views expressed in the Customs Code Committee meeting which, while acknowledging the difficulties of customs classification arising from multi-media, multi-functional products, nonetheless favours classification under CN 85 21;

RMS Communications Ltd's Case

41. RMS Communications Ltd in summary submits the following:

(a) It is unlikely that a "principal" function cannot be identified such that recourse to GIR 3 is required. One function is likely to be more important than the others even if those other functions enhance the device as a whole.

(b) Most of the case law does not deal with Note 3 and the principal function test. The question is what function is the device really made for above all others. It is not an abstract question but of the functional use made by the marketplace. Function or intended use of the Nano is reflected in the physical characteristics of the small screen and small storage.

(c) The test is not whether the video function is adequate or inadequate, but which of the two functions is the principal one having regard to the Nano's objective characteristics. A function can still be adequate but nevertheless not the principal function. In the event, the video capabilities of the Nano cannot be described as suitable for prolonged use, in contrast to its audio capabilities.

42. The Nano falls to be classified by reference to its objective characteristics and properties. RMS Communications Ltd contends that the intended use of a product may constitute an objective criterion for classification if it is inherent to the product. However that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties. See Case C-309/98 *Holz Geenen GmbH v Oberfinanzdirektion Muenchen* [2000] ECR I-1975 at para 15.

43. There are two steps to the analysis:
(a) The first step is to identify which heading or subheadings the Nano falls within. This is to be done on the basis of the Nano's objective characteristics – see paragraph 13 of *General Instrument*.

(b) The second step is as follows. If the Nano falls within more than one heading of Section XVI, then Note 3 must be applied. A machine designed for the purpose of performing two or more complementary or alternative functions is to be classified as being that machine which performs the principal function.

44. It is accepted by RMS Communications Ltd that, in applying this second step, regard must again be had to the Nano's objective characteristics; i.e. the principal function which is inherent to the Nano's objective characteristics which is relevant.

45. "Principal function" means, RMS Communications Ltd submits, the principal use to which the device would be put (having regard to its objective characteristics). There is no other meaning which makes any sense in the context. Indeed this is reflected in paragraph 13 (ii) of *General Instrument* - "function" and "intended use" are used synonymously. (See also paragraph 7 of the ECJ's judgement in Case C-395/93 *Neckermann Versand AG v Hauptzollamt Frankfurt/Main Ost* [1994] E.C.R. I-4027*("Neckermann")*).

46. RMS Communications Ltd argues that Case -459/93 *Hauptzollampt Hamburg-St Annen v Thyssen Haniel Logistic GmbH* [1995] E.C.R. I-1381, ECJ ("*Thyssen*") is authority for the proposition that intended use of the product can be relevant (assuming it is reflected in the physical characteristics of the

product). See also paragraph 23 of Case C-467/03 *Ikegami V Oberfinanzdirektion Nuernberg,* ECR I-2389, ECJ ("*Ikegami*").

47. It is implicit that the principal function referred to as the principal function of the device is from the perspective of consumers or purchasers of the product.

48. Evidence of consumers' use of the Nano is therefore relevant. This is not a novel proposition:

    (a) As the Advocate General noted in *Neckermann* at paragraph 14, intended purpose can be gauged by considering the habits of the Community as a whole. The same is true of the principal function test.

    (b) Consumer perception was considered relevant by the ECJ in *Sony* (see paragraph 113 of the case).

    (c) A report showing that the particular use of the product considered in *Thyssen* was "extremely unlikely from an economic point of view" was a highly relevant factor (see paragraph 16 of the ECJ judgement and the Advocate General's opinion).

    (d) Market research was taken into account in a Dutch decision.

49. RMS Communications Ltd submits that it would be surprising if HMRC were correct in their assertions that audio is not the primary function of the Nano given that the vast majority of independent third parties questioned would describe the Nano primarily as an audio device:

    (a) RMS Communications Ltd rely on internet reviews of the Nano. In essence the reviews state that the Nano is the ultimate portable audio player. Having the video capability is a nice feature, but it is not something to be used on a daily basis. The screen is too small to enjoy watching video and even a number of mobile phones have a bigger screen. Other than as a short-term novelty, the unit's storage capacity is also insufficient to hold a sensible amount of video.

    (b) They also rely upon a survey which found that 93.7% of Nano users thought the primary function of the Nano was that of an audio player with just 4.2% considering it to be both that of an audio player and video player. 91.6% of Nano users were most likely to use the audio function, 2.1% were most likely to use the video function, and 4.2% were most likely to use both the audio and video functions in equal measure. 100% of Nano users thought the Nano had the function of an audio player whilst only 72.9% were aware of the video function.

50. RMS Communications Ltd says that the marketing of the Nano does not imply that the main function of the product has changed. Video is an accessory and has not changed the main function. It is not enough to say the Nano is apt for watching video and therefore the video function is equal to the audio function. The audio function is what makes the Nano the market leader. The video is not

apt for prolonged use. The screen is too small and the memory is too small and the Nano is awkward to hold. Even if it were accepted that the product was apt for video it does not follow that the principal function is not audio.

51. Marketing can be a good indication of how people use the product but marketing hype must be taken into account. Apple wanted people to buy the Nano as the next generation device so they included video and exaggerated its usefulness.

52. As to whether the primary intended use as a music player is reflected in the physical characteristics of the product, RMS Communications Ltd's evidence also demonstrates that this is so - namely the small screen, memory etc. (It would be odd if that intended use were not reflected in the physical characteristics of the product.)

53. Given that the Nano is an evolution of the first- and second-generation iPod Nanos (which RMS Communications Ltd understands were classified under classification 8519) and is marketed as such, the starting presumption must, logically, be that its principal function is that of an audio device, unless the introduction of a video capacity as part of the third generation radically altered the nature of the device. RMS Communications Ltd contends that it does not, albeit video is a 'nice to have' addition.

54. The correct classification of the Nano has been tested before the Irish and Dutch courts. The Irish courts thought that the classification contended for by RMS Communications Ltd was the correct one and two Dutch courts have also reached the same conclusion in relation to similar devices. As far as RMS Communications Ltd is aware, these are the only three occasions where the issues discussed in this case have been tested before an independent judiciary. What case law there is on the Nano or analogous devices therefore supports RMS Communications Ltd's case. The Irish case is moreover the only case where there has been impartial judicial consideration of the correct classification of the Nano (the Dutch decisions referred do not address the Nano but a similar product).

55. RMS Communications Ltd avers that, having regard to the objective characteristics of the Nano, its principal function is that of an audio player. That is also the principal use to which a Nano would be put as a result of its features:

(a) The screen size means the Nano is not apt to be used for watching film or television programmes at length, on a regular basis, and in most situations. The Nano is appropriate only for watching short amounts of video and doing so only occasionally (a function in particular of its very small screen size). However it is by contrast apt to be used as an audio device in a far greater range of circumstances, whether the user is in motion or sedentary. Indeed it is this function which accounts for the genesis of the Nano through its earlier versions.

(b) The limited memory is far more detrimental to the video function than it is to the Nano's audio function. The Nano's memory size compares unfavourably to other portable devices with video capability. An example is the product in Commission Regulation 1056/2006 which has a 30GB storage capacity and has

the ability to store 120 hours of digital video. In contrast, the Nano has a 4 or 8GB storage capacity and has the ability to store 4 or 8 hours of digital video.

(c) Whereas it is possible to transfer any CD into “iTunes" and then onto the Nano, it is not possible to do the same with DVDs, as stated by Apple. This makes it impossible therefore to watch DVDs on the Nano without converting the DVDs to a different format first, which will take time, and using third party software, which will come at a cost, to do so; further the Nano has limited compatibility with established video formats.

56. HMRC relies on an HSEN to the effect that the 8519 classification excludes "video recording or reproducing apparatus of heading 8521". RMS Communications Ltd submits:

(a) There is no indication that the HSEN has been updated to reflect the point at issue. Hence MP3 players are mentioned as being within 8519 at XVI-8519-1 and XVI-8519-2.

(b) The exclusion from 8519 for “video recording or reproducing apparatus of heading 85.21" does not mean all video recording or reproducing apparatus is to be classified as 8521. If one looks at note (B) to 8521 it is still clear that "video recording of reproducing apparatus" only includes those devices which have been classified as such following the application of Note 3 to Section XVI.

(c) If, which is not the case, this HSEN could be read as seeking to override the principal function test, and no weight should be attached to it - see paragraph 48 of *Intermodal Transport*.

(d) It is significant that in none of the Commission documentation sought to be adduced is this point mentioned at all.

57. RMS Communications Ltd also adduced oral evidence from the author of survey, Ms Mackman of The Mackman Group, and Mr Sale, the Office Manager, demonstrated the watching of a movie on the Nano.

Our conclusions

58. The ECJ gave definitive guidance on the BTIs in the course of its judgment in *Intermodal Transport*. It held that:

(a) The fact that a BTI has been issued to another unrelated trader by another national customs authority for similar goods does not confer any rights on a BTI applicant in another Member State. A BTI is only binding for its holder (paragraph 27).

(b) The fact that a conflicting BTI has been issued by another customs authority does not mean a national court is compelled to make an order of a reference to the ECJ on the issue. Any divergent application of the rules in certain Member States cannot influence the interpretation of the Common Customs

Code which is based on the wording of the tariff headings (paragraphs 34 to 36).

(c) There are mechanisms in place which would prevent the continued existence of BTIs from different Member States which classified similar goods under different headings without justification. Thus, under Article 9 and Article 12(5)(a)(iii) of the Code, a BTI may be revoked if one or more of the conditions laid down for its issue were not or are no longer fulfilled. Where the customs authorities took the view that their initial interpretation was wrong, as the result of an error of assessment or evolution in their thinking in relation to tariff classification, they were entitled to consider that one of the conditions laid down for the issue of a BTI is no longer fulfilled and to revoke that BTI with a view to amending the tariff classification of the goods concerned. In addition, the Commission might enact a classification Regulation which would have the effect of invalidating a non-conforming BTI. Finally, a person might bring proceedings against the Commission for a failure to act if it declined to do so in appropriate circumstances (paragraphs 42 to 43);

(d) Nonetheless, the fact that the customs authorities of another Member State have adopted a BTI which gives a different interpretation from that reached by a Court in a Member State should certainly give that Court pause for thought and cause it to reflect on whether a reference to the ECJ would be appropriate to resolve the conflict (paragraph 34).

59. A customs classification regulation issued by the Commission would only be legally binding in respect of the product identified in it and identical other products, albeit that the application of the same classification to similar products by analogy would be preferable, in that it facilitates a coherent interpretation of the CN and promotes the equal treatment of traders. See Case C-14/05 *Anagram International Ltd v Inspecteur van de Belastingdienst (Rotterdam)* [2006] ECR I-6763, ECJ at paragraphs 31 and 32; and *Krings GmbH* at paragraphs 33 and 35.

60. We were referred by both parties to extensive case law from Member States as well as their classification of the Nano and similar products. It is clear from the case law we have noted above (at paragraphs 58-59) that we should certainly look at the classification given by other Member States to the same or similar products; however we are not bound by these classifications. We note that neither Member States' case law nor their classifications takes a consistent approach to the classification of multi-functional products such as the Nano and, as such, although we have noted this evidence, we find it is not of particular assistance to us.

61 Our initial task is to identify what, if anything, is the principal function of the Nano. It is not disputed that in doing this we must look at its objective characteristics.

62. HMRC state it is the function of the equipment rather than its use which is relevant and that we must judge this at the time of import, as we do not know

how people will use the equipment. However it is clear from the case law we were referred to that the marketing or intended use of the product may be determinative if it is ascertainable from the objective characteristics of the product itself and is not dependent on subjective intention; see *Ikegami* at paragraphs 21 and 23. For the purposes of classification under the appropriate heading (and in accordance with the section or chapter notes to the tariff), the intended use of a product may constitute an objective criterion for classification if it is inherent to the product, and that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties: see *Olicom* at paragraphs 16 to 18.

63. Further, *General Instrument* states as follows:

- The characteristics and objective properties of the product are the decisive criteria for classification
- The function and intended use of the product can be an objective characteristic
- The intended use of the product is only relevant if that use is reflected in the physical characteristics of the product
- If the "very purpose" of the product is to perform the function described in a heading it should be classified there.

64. We make the following findings of fact on the objective characteristics of the Nano:

i) <u>The Nano's design and size</u>

a) The Nano is a smaller version of the iPod. Its dimensions are 2.75" x 2.06" x 0.26". Subject to the consequent impact of the reduced size on memory, a small size is a wholly good thing as far as audio capability is concerned. A small size allows the Nano to be carried easily when moving about (e.g. when walking or jogging).

b) The video function is, in part, a means of supporting the "CoverFlow" function. This allows the songs to be linked to pictures of the relevant album cover to enable easier scrolling through the user's music library. This aspect is ancillary to the audio function.

c) The Nano's screen size, general design, and video compatibility make the Nano far less suitable for watching video for any length of time. We note that the French authorities have stated that a user needs a 3.5 inch minimum diagonal screen size for watching video (in contrast to the 2 inch screen of the Nano).

d) For a device which is intended predominantly for audio, the general rule would appear to be, within limits (for example relating to memory size), the smaller the size the better. However, a small size impacts adversely on the

video capabilities of a device to the extent that it impacts on the screen size. The Nano's 2 inch screen size makes it unsuitable, realistically, for prolonged use as a video device.

e) The small size of the Nano allows it to be easily carried, which is ideal for an audio device. However, as a video player, there is no stand or other support which would hold the device at the correct angle so as to be conveniently viewed. Manually holding the Nano is not suitable for prolonged use.

f) The visual experience is not helped by the "menu" bars used by the Nano to control the video. These are activated by movement. Movement causes them to appear, reducing the already viewable screen size. Unless one sets the Nano down, one cannot control these menu bars, but the screen size and shape of the iPod make it difficult to set it down to be watched.

ii) <u>The Nano's memory</u>

a) The Nano's memory (4GB or 8GB) allows it to store either 1,000 or 2,000 songs. This amounts approximately to over 33 or 66 hours of music.

b) The Nano's memory (4GB or 8GB) allows it to store up to four hours or eight hours of video (on the assumption that the memory is not otherwise used e.g. for music).

c) The limited memory is far more detrimental to the video function than it is to the Nano's audio function. In many cases, it can be presumed that the Nano's memory will be sufficient for an entire music collection.

d) The Nano's memory size compares unfavourably to some other portable devices with video capability. An example is the product in Commission Regulation 1056/2006 which has a 30GB storage capacity and the ability to store 120 hours of digital video.

iii) <u>Compatibility</u>

a) Whereas it is possible to transfer any CD into "iTunes" and then onto the Nano, it is not possible to do the same with DVDs. This makes it impossible therefore to watch DVDs on the Nano without converting the DVDs to a different format first, which will take time, and using third party software, will come at an additional cost.

b) The Nano has moreover limited compatibility with established video formats. The Nano supports MJPEG and MPEG-4 movie files (that end in ".mov", ".m4v", or ".mp4"). By contrast the device included in Commission Regulation 1056/2006 supports MJPEG and MPEG1, MPEG2, MPEG4, DivX, XviD and WMV movie formats.

65. In determining whether the Nano has a principal function, and, if so, which function is its primary function, we accept Mr Sykes' submission that one

appropriate test is to consider which function would, if removed, most impact on the functional utility of the device. We accept Mr Sykes' submission that, applying this test, it is clearly the audio function which is the principal function. Removal of the audio function would render the Nano 'a flawed device' with a screen size, design, video compatibility, and memory inadequate for proper use. By contrast, removal of the video function would not have such a significant impact on the Nano (as is reflected in the fact that its first and second generation predecessors did not have a similar video capability).

66. In relying on this test (by analogy with the test under GIR 3 (b)) we rely on Case C-250-05 *Turbon International GmbH* v Oberfinanzdirektion Koblenz [2006] ECR I-10531 ("Turbon") at para 21 which states:

"Under the general rule, in carrying out the tariff classification of goods it is necessary to identify from among the materials of which they are composed, the one which gives them their essential character. This may be done by determining whether the goods would retain their characteristic properties if one or other of their constituents were removed from them". (See also *Sportex* [1988] ECJ 3351 paragraph 8, C-288/99 *VanDe Sport* [2001] ECR I-3683 paragraph 25, and *Turbon* paragraph 26).

67. We also consider the decision in *Sony* which states the following (starting at paragraph 110):

"110. Moreover, in a similar case where neither the Combined Nomenclature nor the HSENs or the CNENs gave a definition of the goods in question, the Court of Justice found that it was appropriate to look for the objective characteristic of those goods which tended to distinguish them from others in the use for which those goods were intended. That case involved pyjamas, and the Court found that, according to their objective characteristic, they were to be worn in bed and that, if that objective characteristic could be established at the time of customs clearance, the fact that it might also be possible to envisage another use for the garments did not preclude them from being classified for legal purposes as pyjamas. It found that not only sets of two knitted garments which, according to their outward appearance, were to be worn exclusively in bed but also sets used mainly for that purpose had to be considered to be `pyjamas' within the meaning of tariff heading 6108…

111. Such reasoning can also be applied to a case such as this one. Thus, in the absence of a definition of `video games' for the purposes of subheading 9504 10, it is appropriate to consider as video games any products which are intended to be used, exclusively or mainly, for playing video games, even though they might be used for other purposes.

112. It is, moreover, undeniable that, both by the manner in which the PlayStation®2 is imported, sold and presented to the public and by the way it is configured, it is intended to be used mainly for playing video games, even though, as is apparent from the contested regulation, it may also be used for other purposes, such as playing video DVDs and audio CDs, in addition to automatic data processing.

113. This finding is corroborated by numerous documents, in particular the brochures and other promotional information relating to the PlayStation®2 which the parties have produced in these proceedings. Those documents show clearly that the PlayStation®2 is marketed and sold to consumers mainly as a video game console, even though it may also be put to other uses. In addition, the various answers given by the applicant during the presentation of the PlayStation®2 to the Nomenclature Committee on 27 February 2001 show that consumers perceive the PlayStation®2 mainly as a game console. Also, the description of the product contained in column 1 of the table in the Annex to the contested regulation shows that the PlayStation®2 is packaged for retail sale as a video game console, since it is presented with a `controller module [with] several control buttons, which are mainly used for playing video games', as well as connector cables. On the other hand, the other units, such as standard keyboard, mouse and ADP monitor to which it can be connected are sold separately, a point confirmed by the applicant.

114. In addition, neither the wording of subheading 9504 10 nor the section and chapter notes pertaining thereto contain any indications, much less limitations, as to the operation and/or the composition of the products coming there under. It follows that, contrary to what the applicant maintains, the mere fact that the PlayStation®2 may operate as an automatic data-processing machine and that video games are only one type of file that it can process does not by itself preclude its being classified under subheading 9504 10, since it is quite clear that it is intended mainly to be used to run video games."

68. It is clear from *Sony* that we must look at the objectively determined intended use when considering the product's objective characteristics. Indeed, when considering its objective characteristics we don't really see what else could be considered other than its (objectively determined) intended use as the question of its primary function.

69. It is also clear from the *Sony* case that customer perception is relevant. The way people use and view the Nano is relevant provided it is reflected in the physical characteristics of the device. The consumer's view as contained in the survey and the numerous reviews to which we have been referred in the main (with a few exceptions) state that the screen and storage are too small for the product to be used routinely as a video device and the best use of the product is as an audio device. We do not accept that, because the survey was not carried out at point of entry, this would make any difference to the conclusions contained therein.

70. Having considered *Krings GmbH* we do not accept, as HMRC contends, that it renders irrelevant consumer market research. It simply states general principles such as that at paragraph 30: 'the intended use of a product may constitute an objective criterion for classification if it is inherent to the product and that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties'.

71. We accept that video is a function but we do not accept HMRC's contention that video and audio are equal functions. This is clear from the reviews and survey

to which we have been referred where the vast majority of users indicate audio is the function which predominates and the function or intended use is reflected in the physical characteristics of the Nano, in particular its small screen and small storage capacity viz a viz video.

72. HMRC state that, looking at the iPod manual, there is a hefty section given over to the playing and recording of videos and, as the iPod is designed and intended to use both functions, we cannot say one function predominates. Further they referred us to Amazon's product description which markets the Nano as something equally capable of audio and video playback. However we accept Mr Sykes' submission that although marketing is a good indication of how people use the product we must take into account marketing hype. We accept his submission that Apple wanted people to buy the Nano (rather than any of its audio-only predecessors) so they brought it out with video capabilities and exaggerated its usefulness as a video. We accept that the Nano is apt only for watching short amounts of video and doing so only occasionally (a function in particular of its very small screen size). However it is by contrast appropriate to be used as an audio device in a far greater range of circumstances, regardless of whether the user is in motion or sedentary.

73. We accept Mr Sykes' submission that the video is a 'useful add on' to have but nothing more, as evidenced by the objective characteristics of the Nano as referred to above.

74. HMRC also state that Commission Regulation (EC) No 1056/2006 should be applied by analogy to the Nano and that this supports classification under CN 8521. However we note that guidance as to the weight to be given to the Commission Regulation in applying Note 3 to Section XVI can be found in the Opinion of Advocate General Mischo in Case C-119/99 *Hewlett Packard BV v Directeur General des Douanes et Driots Indirects* [2001] E.C.R. I-3981, ECJ ("Hewlett Packard"). This case also concerned the application of Note 3. The following principles are noted:

a) First, the Commission Regulation in that case did not "establish a rule that multifunction machines combining a facsimile, a printer, a scanner and a photocopier, and fitting the description in the left-hand column of the Annex, necessarily have the facsimile function as their principal function" (which was the function viewed as the principal one in the Regulation); see paragraphs 18-19.

b) The Commission Regulation did not therefore in that case remove the need to consider the principal function of the item in question when applying Note 3. Nor could the Commission Regulation be read as purporting to do so, as reflected in the fact that the Regulation, which referred to the application of Note 3, would contain an internal contradiction where it was attempting to override that test; see paragraph 29).

76. We therefore accept Mr Sykes' submission that, by close analogy, it is not the case that, because the Nano shares both an audio and video capability with the device noted in Commission Regulation 1056/2006, its principal function must

be viewed as video. Secondly, we also accept that the approach adopted by a classification regulation for a particular product "cannot unhesitatingly and automatically be adopted in the case of a similar product". On the contrary, "where reasoning by analogy is employed great care is called for" (see paragraph 24 of the Advocate General's opinion in *Hewlett Packard*). Moreover, as *Hewlett-Packard* makes clear, a Commission Regulation, such as Commission Regulation 1056/2006, is not to be construed as even attempting to override the natural application of the CN.

77. We accept that limited assistance is to be derived from the classification at item 1 of Annex to Regulation 1056/2006 because the Nano as Mr Sykes' submits is very different to the device mentioned there:

- The dimensions of the device mentioned in the Commission Regulation are not stated (and therefore its general design cannot be assessed).
- The screen is moreover half an inch greater diagonally than that of the Nano i.e. 25% greater.
- The memory capability is 30GB rather than 4GB or 8GB.
- The range of video formats supported is significantly in excess of those supported by the Nano.

78. We also take account of the fact that, in issuing Commission Regulation 1056/2006, so clearly was the device considered by the Commission a video player, the reason given for the classification was not the application of GIR 3 (which would be apposite if there were two or more principal functions or no principal functions), but a simple application of Note 3 to Section XVI i.e. the principal function test. Classification under 8519 is not even mentioned in the reasoning.

79. Further HMRC rely on an HSEN to the effect that the 8519 classification excludes "video recording or reproducing apparatus of heading 85.21". We however accept Mr Sykes' submissions that:

(a) There is no indication that the HSEN has been updated to reflect the point at issue. Hence MP3 players are mentioned as being within 8519 at XVI-8519-1 and XVI-8519-2.

(b) The exclusion from 8519 for "video recording or reproducing apparatus of heading 85.21" does not mean all video recording or reproducing apparatus is to be classified as 85.21. If one looks at note (B) to 8521 it is still clear that "video recording of reproducing apparatus" only includes those devices which have been classified as such following the application of Note 3 to Section XVI.

(c) If, which is not the case, this HSEN could be read as seeking to override the principal function test, no weight should be attached to it - see paragraph 48 of *Intermodal Transport.*

(d) It is significant that in none of the Commission documentation sought to be adduced is this point mentioned at all.

80. Both parties agree that if we find a principal function then the principal function test is determinative. Thus the correct classification of the Nano in our view is 8519 under Note 3 to Section XVI and the appeal is thus allowed.

In relation to 4th and 5th generation iPod Nano

81. RMS Communications Ltd submit that rather than make a further BTI request in respect of the fourth generation iPod Nano (the "4G Nano"), which would take further time to be heard by the courts, RMS Communications Ltd would like to rely on the reasoning of the tribunal in relation to the Nano (i.e. the third-generation iPod Nano) in determining the treatment to be accorded to the 4G Nano, albeit the 4G Nano is not strictly the subject matter of the appeal.

82. The technical specifications of the 4G Nano are set out at various reviews. The tribunal was informed that:

(a) The screen size of both the Nano and 4G Nano is the same (namely 2 inches).

(b) The 4G Nano is lighter, taller and thinner than the Nano but nothing would appear to turn on this. In particular it is no more easy to position the device so as to be able to watch a video for a prolonged period of time.

(c) The video formats with which the Nano and 4G Nano are compatible are the same i.e. they are limited.

(d) The 4G Nano comes in either an 8GB or 16GB version. Therefore the 8GB version is the same as the 8GB version of the Nano. The 16 GB 4G Nano could hold up to 4,000 songs or 16 hours of video. This is half of the storage capacity of the device at Commission Regulation 1056/2006.

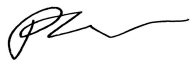
83. HMRC submits that the tribunal has no jurisdiction to engage in a roving classification of various of the Apple iPod products which are not the subject matter of any appeal. Consequently, RMS Communications Ltd's request that the tribunal should do so is inappropriate and should be rejected.

84. Although we have some sympathy for RMS Communications Ltd's wish to have the issue of the 4G Nano determined at the same time as the issue in relation to the Nano the matter under appeal is the third generation iPod Nano and nothing else. We have not heard full argument in relation to any of the other generations of iPod Nano and thus we are not prepared to reach a view on their classification. We also take into account Rule 20 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009.

Costs

85. In relation to the issue of costs both parties wished that question to be deferred pending the outcome of this appeal.

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

TRIBUNAL JUDGE 

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