VAT focus

VAT on food and the case for simplification

Speed read

The tribunal decisions in *Pulsin' Ltd* and *The Core (Swindon) Ltd* are further examples of the complexity of VAT on food. The need for simplification is clear, not just from the legal questions addressed by the tribunal, but also from the impact that liability disputes can have on commercial relationships. Yet the route to simplification is hard. A first step may be to ensure that VAT rulings on food can be made publicly available in anonymised form.

David Walters
Deloitte
David Walters is an associate director at Deloitte. He is part of Deloitte's tax quality group, which looks after knowledge management for Deloitte's indirect tax practice. He has specialised in VAT since 1996. Email: dwalters@deloitte.co.uk; tel: 0113 292 1552.

The tribunal's decision in *Pulsin' Ltd v HMRC* [2018] UKFTT 775 has all the hallmarks of a classic VAT food liability case. It concerns a straightforward question about whether 'Raw Choc Brownies' were cakes or confectionery. It involved a tasting session in which tax lawyers sat down to sample the product, alongside similar products. It considered a large number of different factors (such as manufacturing methods, ingredients, taste and appearance, marketing and packaging), which ultimately boiled down to an 'informed impression' that the brownies were cakes, and therefore qualified for zero-rating. In short, it involved a largely subjective test where opinions are easy to form, but difficult to prove. The decision attracted widespread coverage in the national press.

Food liability decisions

The popularity of food liability decisions is nothing new. The tribunal's decision about Jaffa Cakes in *United Biscuits (UK) Ltd (No. 2)* [1991] LON/91/160 (VTD 6344) remains popular, and has recently been cited in debates in Parliament, at the Treasury Committee, and in the last report from the Office of Tax Simplification on VAT (see bit.ly/2hkiHRO). References to the decision are frequently used to illustrate the unnecessary complexity of VAT rules.

Despite the acknowledgment of this complexity, the cases continue to come. Just before Christmas, in *The Core (Swindon) v HMRC* [2018] UKFTT 741, the tribunal ruled on the liability of a juice cleansing programme sold by The Core café in Swindon. In that case, the legal question was whether the juices were 'beverages' and therefore subject to VAT. The tribunal ruled in the taxpayer's favour, but its decision illustrates the uncertainty faced by taxpayers in this area. (In its latest VAT appeals update, HMRC has indicated that it is appealing this decision.) Blitz some tomatoes with a little garlic and onion and sell it to someone to eat as gazpacho at home, and no VAT is chargeable. Put the same juice in a bottle for a customer to enjoy on the move, and it will probably be categorised as a beverage and subject to VAT.

The facts of cases such as these clearly suggest a need for simplification in this area. In *Pulsin'*, Judge Brown went so far as to state that the current state of law is 'not fit for purpose and will necessarily present apparently anomalous results as tastes and attitudes to eating change'. The rules on zero-rating food were introduced in 1972, and in part their roots lie in purchase tax, which preceded VAT. For example, part of the definition of 'confectionery' is derived from purchase tax (see *CCE v Popcorn House* [1968] 3 All ER 782). The rules have changed comparatively little since then. It is hardly surprising that the case for updating this area of VAT grows ever stronger.

The financial importance of simplification should not be underestimated: the zero-rating of food is worth £18.6bn annually – around 40% of all zero-rated supplies (see bit.ly/2XYZLZj). That is greater than the exemptions for financial services, education, and betting and gaming *combined*. It's more than the total VAT repaid to local authorities, NHS trusts and government under VATA 1994 ss 33 and 41. It's larger than the relief given for inheritance tax by the nil rate band; bigger than capital allowances. This is not an area where confusion should be tolerated.

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Furthermore, the administrative burden caused by the complexity of the rules is considerable. Businesses have to spend a significant amount of time and money establishing the correct liability of food, and given the huge choice available at supermarkets, it is inevitable that borderline cases will arise and errors will be made.

Supply chain issues

Such mistakes can have a negative effect on supply chain relationships. A retailer might seek to pass back part of the cost of a VAT assessment to its suppliers when a product has incorrectly been zero-rated. Even where a VAT claim arises for products on which VAT should not have been charged, the question of who is entitled to the repayment can cause conflict. VAT is ultimately only a burden on the consumer at the point of a retail sale, but in many cases pricing is set independently of this (for example, by reference to market conditions or competitor pricing). Therefore, the price agreed commercially at earlier stages in the supply chain may be based on the VAT treatment which turns out to be incorrect. The question as to which party in the chain has suffered the economic burden of VAT and may be entitled to any repayment can be problematic, and can be further complicated by any unjust enrichment defence raised by HMRC.

Moreover, the possibility of a dispute can arise at any point during the supply chain. A manufacturer might have formed the view that its product is zero-rated, which is followed by the wholesalers but challenged by the retailer (whose decision on where to place the product may affect its VAT treatment). If the retailer approaches HMRC for clarification, then it may receive a ruling which affects not just it, but also the manufacturer and any other parties involved with selling the product.

The main VAT treatment of supplies of food

Any food supplied in the course of catering, including hot takeaway food, is always liable to VAT. If the food is not supplied in the course of catering or as hot takeaway food, the following VAT treatment should apply.

Most food items are liable to VAT at the zero-rate. However, there are a number of items of food that are liable to VAT at the standard-rate.

Items which are not fit for human consumption or animal consumption will be liable to VAT at the standard-rate.

Overview

Liable to VAT at the zero-rate	Liable to VAT at the standard-rate
Frozen yoghurt (must be designed to be thawed before consumption)	Ice cream and similar products
Cakes and certain biscuits (see below)	Confectionery
Milk and milk drinks, tea, mate, herbal tea, coffee and cocoa	Alcoholic drinks and other beverages (see below). Home-brewing and wine kits.
Drained cherries and candied peel	Potato crisps and roasted or salted nuts

Basic foodstuffs

A business can zero-rate all supplies of unprocessed foodstuff, including: raw meat and fish; vegetables and fruit; cereals, pulses and nuts; and herbs used for culinary purposes.

Liable to VAT at the zero-rate	Exclusions liable to VAT at the standard-rate
Meat, poultry and fish (includes fish withdrawn under EU fisheries rules)	Animal products that are used for medicinal purposes or are not fit for human consumption
Exotic meat, such as horse, ostrich, crocodile, alligator, kangaroo, etc	
Live animals and fish that are commonly used for human food	Fish used as bait, ornamental fish and live horses
Culinary herbs and spices	–
Vegetables and fruits, including pulp	Juice and juice concentrates, and ornamental vegetables
Cereals	–
Nuts and pulses	Shelled nuts that have either been roasted and / or salted

Bakery products

Most bakery products are liable to VAT at the zero-rate. However, some items of confectionery are liable to VAT at the standard-rate.

Liable to VAT at the zero-rate	Exceptions liable to VAT at the standard-rate
Bread, bread rolls, baps, pitta bread, etc	Bread products supplied in the course of catering such as part of a hamburger or kebab, or eaten in a restaurant or similar
Cakes: sponges, fruit cakes, meringues, as well as wedding, birthday and similar occasion cakes	Cakes supplied in the course of catering
Slab gingerbread	Biscuits wholly or partly covered in chocolate or similar
Marshmallow teacakes These can have a crumb biscuit or cake base, topped with a dome of marshmallow which can be coated with either chocolate, sugar or coconut.	Snowballs
Flapjacks	Cereal, muesli and similar types of bars that have honey or another added sweetener
Cakes made with cornflakes or other breakfast cereal products coated in chocolate / carob and pressed into flat cakes that are brittle	Florentines
Millionaire's shortcake or caramel shortcake	Shortbread wholly or partly covered in chocolate
Lebkuchen	Coconut ice

Biscuits: If the biscuit is wholly or partly covered in chocolate (or similar product), it is liable to VAT at the standard-rate.

Hot bakery food: It is common for pies, pasties, sausage rolls and other savoury products to be baked on retail premises and can be sold whilst still hot. If the business only sells the product hot because they have been baked on the premises and they are not specifically held out to be eaten as hot, the supply can be zero-rated.

If the business specifically intends that the customer should eat the product whilst hot, the supply will be liable to VAT as it will be treated as a 'supply in the course of catering'. The difference between selling hot, freshly baked product and hot takeaway food is contentious and has been the subject of many court cases.

Confectionery: Confectionery that is liable to VAT includes chocolates, sweets/candies and other items of sweetened prepared food that is intended to be eaten with your fingers. The item must have been sweetened and is sweet to taste.

Tolley Guidance (see www.tolley.co.uk/products/tolley-guidance).

Challenges for simplification

The amount of tax potentially involved, administrative burden and wider commercial considerations all point to the need to overhaul the VAT rules on food.

However, simplification is not easy. In the UK, significant reform of the VAT rules on food could create losers as well as winners. One only has to remember the uproar generated by the proposed 'pasty tax' in 2012 to realise that wholesale reforms in this area will be difficult. That proposal focused only on the niche question of what was meant by 'hot' food, and a proper overhaul of the rules would have to deal with many different issues.

The distinctions between cakes and sweets, soup and drinks or hot and cold food are therefore unlikely to become clear any time soon. Is there a practical way of ensuring that the views of the 'ordinary person on the street', which are important but can be subjective, are applied consistently?

The solution, perhaps, lies not with the OTS's recommendation for a comprehensive review of the zero rate (which, whilst valid, remains a longer term goal), but in its suggestion that HMRC might publish anonymised rulings relating to product liability. Even though food liability cases frequently turn on their own facts, this would reduce the risk of different taxpayers treating similar products differently. Over time it would build a body of rulings which would improve the chances of taxpayers finding recent relevant examples for liability questions. It would also demand a consistent approach from HMRC, reducing the likelihood of similar products being taxed in different ways.

Establishing a broader set of examples for food liability could help to establish where the boundary between the standard and zero rates lies, and allow food liability questions to recede from public attention, to the relief of most of those involved in this entertaining but frustrating area of VAT law. ■