VAT treatment of confectionary: unnecessary complexity

Indirect Tax

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In a case that considers whether certain foods constitute confectionery, we ask if VAT treatment could come down to the view of a single judge.

Key Points

What is the issue?

Determining whether a particular item of food falls within the basic meaning of confectionery requires a multi-factorial evaluation of the various attributes of the food.

What does it mean for me?

The case *WM Morrison Supermarkets plc v HMRC* highlights what is, in my view, the wholly unnecessary complexity of the VAT rules when it comes to food.

What can I take away?

Many aspects of the tax code turn on an evaluative exercise. A First-tier Tribunal will have to weigh up the various relevant factors and, on any further appeal, that evaluative exercise will be hard to challenge unless an error of principle can be identified.

It is widely known that the VAT rules concerning food can be confusing in practice. The starting point is that ‘food of a kind used for human consumption’ is zero-rated and therefore incurs no VAT charge (whilst permitting full recovery of any input tax incurred) (Value Added Tax Act 1994 Sch 8 Group 1). However, that starting point is subject to a number of exceptions, including ‘Item 2’ – which is ‘confectionery’; these exceptions are standard rated for VAT.

However, matters do not stop there as some confectionery – ‘cakes or biscuits’ – is excluded from the exception (and therefore remains zero-rated). To further increase the complexity, some biscuits (but not cakes) are themselves excluded from the exclusion (i.e. from the exception) if they are ‘biscuits wholly or partly covered with chocolate or some product similar in taste and appearance’. Such biscuits are therefore standard rated.

Furthermore, within the terms of Group 1, Note 5 qualifies the definition of confectionery so as to include ‘chocolates, sweets and biscuits; drained, glacé or crystallised fruits; and any item of sweetened prepared food which is normally eaten with the fingers’.

Determining whether a particular item of food falls within the basic meaning of confectionery (i.e. without recourse to the deeming provision in Note 5) requires a multi-factorial evaluation of the various attributes of the food and taking a view as to whether the ordinary person on the street would regard it as confectionery.

The facts of the case

This case concerns an appeal by the supermarket owner, ‘Morrisons’, in *WM Morrison Supermarkets plc v HMRC* [2023] UKUT 20 (TCC). Morrisons had previously treated as standard rated Organix Bars and Nakd Bars but sought to recover the VAT paid in respect of those bars on the basis that it now considered the products to be zero-rated.

HMRC refused to allow the repayment on the basis that the original categorisation (as standard rated) was correct. The First-tier Tribunal upheld HMRC’s decision when Morrisons appealed. The company appealed against that decision to the Upper Tribunal.

The company did not object to the general approach taken by the First-tier Tribunal when considering whether the bars constituted confectionery. The First-tier Tribunal had recognised that it was to make an evaluative decision based on the relevant factors. However, the company challenged the tribunal’s decision on the basis that during the evaluative exercise it had failed to take into account two particular factors that Morrisons considered to be relevant. Those omitted factors were:

1. the actual or perceived healthiness of the products (and their being marketed as healthy products); and
2. the absence of cane sugar, flour and butter (as found in traditional confectionery) from the products’ ingredients.

In response, HMRC challenged Morrisons’ grounds of appeal. Furthermore, it argued that, irrespective of the outcome of Morrisons’ complaints, Note 5 would bring the bars within the scope of confectionery because of their sweetness levels, even though the products were naturally sweet rather than having had any sweetener added.

Morrisons’ grounds of appeal led to two further questions that the Upper Tribunal had to resolve. Multi-factorial evaluations require the First-tier Tribunal to decide how much weight to give to any particular factor, and such a decision is categorised as a question on fact (and not law). First, therefore, is the Upper Tribunal entitled to intervene in cases where the First-tier Tribunal has decided that a particular matter is irrelevant to the overall exercise? Secondly, even if a factor has been erroneously omitted by the First-tier Tribunal, when is such an omission material in the sense that the Upper Tribunal should then proceed to set aside the First-tier Tribunal’s decision?

The Upper Tribunal’s decision

The case came before Upper Tribunal Judges Swami Raghavan and Guy Brannan.

As to the preliminary questions, the Upper Tribunal emphasised that an appellate court or tribunal should show deference to a fact-finding court or tribunal (particularly when the tribunal is a specialist tribunal as in the present case). Nevertheless, it was clear that there is a difference between the evaluation exercise itself,

including deciding how much weight to give to each of the relevant factors (where the Upper Tribunal should intervene only if that was carried out perversely) and the prior stage of identifying the factors to include in (or to exclude from) the evaluation. In the latter scenario, the inclusion of an irrelevant factor and the exclusion of a relevant one would amount to an error of law, permitting the Upper Tribunal's intervention.

The Upper Tribunal also rejected HMRC's suggestion that an error of law was material only if it *would* have made a difference to the overall outcome. As the earlier case law made clear, an error would be material (and require the First-tier Tribunal's decision to be set aside) even if it merely *might* have made a difference to the evaluative exercise.

In respect of the company's first ground of appeal, the Upper Tribunal held that the First-tier Tribunal had wrongly excluded considerations as to the products' actual or perceived healthiness. Its error had arisen from a misreading of an earlier case (*Kalron Foods Ltd v HMRC* [2007] STC 1100). In *Kalron*, the High Court had considered that there was no obvious policy underlying Group 1 and therefore, when trying to interpret the Group as a whole, the question as to whether a product was or was not healthy (or perceived as such) was not a relevant factor. However, the Upper Tribunal agreed with Morrisons that the *Kalron* decision 'did not rule out considerations of healthiness when considering whether a product fell within the ordinary meaning of' any particular item within the Group; in this case, the meaning of confectionery.

HMRC had also argued that the concept of healthiness was too loose, meaning that it would be impossible to set clear standards by which the concept could be measured. This, in turn, would make any multi-factorial assessment unworkable. However, that argument was rejected by the Upper Tribunal, which noted that other factors which are considered to be relevant (including whether the product's packaging is brightly coloured) are similarly incapable of being defined to precise standards. In conclusion, the Upper Tribunal held that it saw no reason why healthiness was not in principle a factor to be weighed up as part of the overall evaluative exercise.

The Upper Tribunal went on to agree with Morrisons that the First-tier Tribunal had indeed failed to consider the healthiness of the products when it carried out its overall evaluations.

Morrisons' second ground of appeal was addressed more quickly. The First-tier Tribunal had expressly decided that the absence of certain key ingredients was irrelevant to the question as to whether the products constituted confectionery. It had done so on the basis of the High Court's decision in *Premier Foods (Holdings) Ltd v HMRC* [2008] STC 176. However, contrary to the First-tier Tribunal's reading of *Premier Foods*, that was not a case in which the High Court held fruit bars (containing no sugar, etc.) to be confectionery. Instead, the High Court merely commented that the absence of those ingredients was not fatal to a conclusion that the products would be confectionery. (The High Court then remitted the *Premier* case back to the VAT Tribunal for the status of those particular bars to be determined.) Accordingly, the Upper Tribunal then held that the First-tier Tribunal had also made the second error of law complained of by Morrisons.

As for HMRC's arguments that the products were sweetened and therefore fell within the definition of confectionery under Note 5, the Upper Tribunal dismissed that argument. Instead, it concluded that this part of Note 5 did not extend to products that were naturally sweet and was limited to products that had additional sweetness added.

Having agreed with Morrisons' arguments that the First-tier Tribunal made those errors of law and having disagreed with HMRC's arguments on Note 5 (which would have brought the products squarely within the meaning of confectionery), the Upper Tribunal then proceeded to consider whether the First-tier Tribunal's errors were material. Since the Upper Tribunal concluded that the omitted factors might have made a difference to the overall evaluative exercise, the Upper Tribunal concluded that it should set aside the decision.

Although the Upper Tribunal has the power to remake such decisions in such cases, it felt that there was a likelihood that new findings of fact would be necessary. As a result, it chose to remit the case to the First-tier Tribunal. Finally, without wishing to impugn the professionalism of the original judge in the First-tier Tribunal, the Upper Tribunal felt that this was a case where the case should be remitted to a different judge. However, so as to minimise the further time and costs to be expended on any fresh hearing, the Upper Tribunal set out directions which it hoped would make the remitted hearing proceed as efficiently as possible.

Commentary

For readers wishing to know the VAT treatment of the Organix and Nakd bars, it can be seen that this still remains to be decided. (It should also be remembered that there was no published final decision of the remitted *Premier* case, and so perhaps the final answer might never be known.)

The case also highlights (and not for the first time) what is, in my view, the wholly unnecessary complexity of the VAT rules when it comes to food. Nakd Bars are the latest members of the list of such cases headed by Jaffa Cakes, teacakes, Nesquik drinks, Pringles and the other recent joiner, large marshmallows. Indeed, as the *Morrisons* case itself makes clear, the VAT treatment of the Organix and Nakd Bars could come down to the view of a single judge.

Even if the case were then to proceed on further appeal all the way to the Supreme Court, it could transpire that each of the (typically) ten other judges who might end up hearing the case might actually disagree with the first judge's conclusion; however, given the deference given to the fact-finding tribunal, they would all be unable to reverse the decision in the absence of any error of approach. Furthermore, there would be nothing to stop the same (or different) parties taking another appeal to the tribunal (if the same parties, in respect of a different VAT period) and running the same arguments and reaching a different result. In other words, even expensive litigation will be incapable of producing a definitive answer.

Given the increasing evidence that the VAT efficiencies of zero rating (at least in respect of other types of product) are principally enjoyed by the manufacturers and the retailers (rather than the consumers who one would expect to be the intended beneficiaries of the tax relief), a case could probably be made out for scrapping the rules altogether. However, I suspect that no politician would want to be the one to impose a 20% tax on the basic essentials of life, even if the economics actually meant that no prices would rise.

What to do next

Finally, it is worth recalling that many of the principles arising in this case go far beyond the VAT world. There are many aspects of the tax code which turn on an evaluative exercise – ranging from 'just and reasonable apportionments' and considerations as to whether a taxpayer has a reasonable excuse or whether special circumstances exist so as to reduce a penalty, through to questions as to whether a person's connection with a property is sufficient to amount to residence there and whether a person is in employment or carrying out work in business on his or her own account. In all of these situations, a First-tier Tribunal will have to weigh up the various relevant factors and, on any further appeal, that evaluative exercise will be hard to challenge unless an error of principle can be identified.

However, in all such cases, if the First-tier Tribunal omits a relevant factor or takes into account an irrelevant consideration, then (as in this case) the decision risks being set aside.