

Overstated profits and reduced penalties

(Lecture B1116 – 28.17 minutes)

Summary – The taxpayer's uninvoiced work was cancelled by bad debts and so the appeal was allowed in part; by contrast the appeal against the deduction for home office costs and capital allowances was dismissed but with penalties charged at lower rates.

Sandra Carter submitted her 2013/14 self-assessment tax return on 18 December 2014 consisting of the following:

- Self-employment pages for a child minding business: turnover of £21,154, allowable expenses of £20,579 and capital allowances of £5,834;
- Self-employment pages for a business giving tax advice and filing tax returns: turnover of £45,219, expenses of £39,673 and capital allowances of £1,200; business closed on 12 February 2014 as HMRC told her that they would no longer allow her to act as an authorised agent; her existing clients were subsequently transferred to another firm, called Candid Accountants.
- Property pages: income from rents of £15,900 and net profits of £1,173.

Following an enquiry into her 2013/14, during which time Sandra Carter co-operated fully, HMRC increased her assessment to reflect the following:

- Just over £36,000 of uninvoiced work resulting in an increase in profit of £22,915.17, after having allowed for VAT and certain expenses;
- Adjustment of £7,851.17 to disallow 4/5 of her deduction for home as office costs;
- Adjustment of £336 to correct her car capital allowance claim.

In addition, HMRC raised penalty assessments on the basis of a prompted disclosure where behaviour had been deliberate but not concealed. These were charged at rate of 45.5%, so below the maximum of 70% but above the minimum of 30%.

Sandra Carter appealed. She asked the Tribunal to reverse HMRC's amendments and allow a deduction for the £380,554.98. She claimed that the additional deduction was for costs that she was now seeking to claim that related to the £36,000 of uninvoiced client work.

Decision

The First Tier Tribunal dismissed the claim for the additional expense deduction saying that if Mrs Carter had genuinely incurred these costs in the 2013/14 tax year, she would have included them in the detailed schedules provided to HMRC; no credible evidence was supplied.

The Tribunal concluded that HMRC were correct:

- to increase turnover by £36,000 but should have made an identical adjustment countering this amount to reflect the fact that this amount would never be collected and so was deductible as a bad debt;
- that Sandra Carter's claim for "home as office" was too high; they agreed with HMRC and allowed a claim for expenses relating to one room in her house rather than the five rooms that she had claimed;
- that she also over-claimed her car capital allowances as she had calculated these on a straight line basis rather than using the rules prescribed in legislation.

HMRC were instructed to recalculate the penalties, based on the adjusted lower starting point but also using a lower percentage.

The maximum penalty for a prompted disclosure where the behaviour is deliberate but not concealed is 70% of the "potential lost revenue". HMRC mitigated this maximum penalty to 45.5%, having taken into account "quality of the disclosure". In assessing the "quality of the disclosure" HMRC said that Mrs Carter had "failed to admit the error" in her turnover figure and "failed to produce the original invoices or evidence of the bad debt."

The Tribunal instructed HMRC to recalculate the penalties using lower percentages. HMRC made no reference Sandra Carter acting "deliberately" in relation to the home as office claim or the car claim, but nevertheless calculated the penalty on the basis of the total figure by which Mrs Carter's assessment was increased. The Tribunal concluded that the penalties should be reduced and calculated as follows:

- Home as office: Mrs Carter must have known that she did not use five of her eight rooms entirely for her "assisting and consulting" business. Her actions were deliberate but she co-operated fully with HMRC and so this penalty should be charged at 35%
- Car capital allowances: The Tribunal said that It was clear from the correspondence that Mrs Carter did not understand the rules. She was not acting deliberately; she simply got the calculation wrong. However, as someone giving tax advice she should have checked the calculations. She was careless. Prompted disclosure with full cooperation resulted in a penalty of 15%, rather than the maximum that could have been charged of 30%.

A carelessness penalty can be suspended if compliance with a condition of suspension would help the person to avoid becoming liable to further penalties under for careless inaccuracies. The Tribunal concluded that it was clear from the correspondence that Mrs Carter considered herself capable of running her own tax affairs and that it was very unlikely that she would comply with a suspension condition. As a result, the penalty was not suspended. However, the Tribunal left it for HMRC to decide whether the carelessness penalty should be disregarded as below their assessing tolerance, stating that they did not have the discretionary power to make that decision.

Sandra Annette Carter v HMRC (TC06862)

Contractor engaged in construction contract

Summary – Thornton Heath LLP was not a contractor engaged in a construction contract and so was not required to file monthly CIS returns.

On 27th July 2007, Thornton Heath LLP acquired property in West Norwood, London that was let to two tenants:

- Iceland Foods (ground floor convenience store); and
- Norwood Leisure Ltd (first and second floors as a snooker club).

Following the expiry of the lease to Norwood Leisure on 8th August 2014, these floors were re-developed into nine residential apartments. Thornton Heath LLP signed a contract with ARJ Construction Ltd on 9 February 2015 to carry out the work. Practical completion of the scheme occurred on April 2016. Thornton Heath LLP retained the freehold interest in the property and continued to operate as an investment vehicle with the residential units having been sold under long leases and the tenants paying ground rent to Thornton Heath LLP, as landlord.

Thornton Heath LLP did not consider it necessary to register the partnership for CIS as it did not consider itself to be ‘a developer’; its primary activity being property investment. The partnership said that it held no other property and that this was the only development it had undertaken.

On 26th April 2016 HMRC advised Thornton Heath LLP to register itself for the CIS as a contractor and operate within the CIS legislation because it was considered that:

“The Conversion from office space to residential units is not considered to be a minor refurbishment to bring the properties up to a suitable standard to be able to let them. It is a substantial development required to change the building to its new use. ...we would regard your property investment business as having taken on the mantle of a mainstream contractor as its business activity is now that of construction operations”.

Thornton Heath LLP appealed arguing that it acquired the Property as an investment and it continued to be an investment. The nine residential units were a one- off development and no further developments were intended. Thornton Heath LLP was not a ‘contractor’ within the meaning of s 59 FA 2004. ARJ Construction Ltd was the contractor. Thornton Heath LLP was the principal. ARJ Construction Ltd was contracted to undertake the Property alterations with Thornton Heath LLP continuing to a property investment business. It is not a property developer and did not engage in ‘construction operations’ within the meaning of s57 FA 2004.

The issue to be decided was whether Thornton Heath LLP was a ‘contractor’ and carrying on a ‘business which includes construction operations’. If so, the second issue was whether HMRC had correctly raised the CIS penalties and whether those penalties had been correctly calculated.

Decision

The First Tier Tribunal said that Thornton Heath LLP was carrying on an investment business prior to conversion of the Property and that this was not in dispute. The issue was whether it's usual business changed when it undertook the conversion of the Property so that it was a contractor carrying on a business which includes construction operations.

The First Tier Tribunal concluded that Thornton Heath LLP was, as owner of the Property, acting as a principal and appointed ARJ Construction Ltd, as the main contractor. Thornton Heath LLP did not itself act as a contractor. ARJ probably engaged subcontractors. The contract between Thornton Heath LLP and ARJ Construction Ltd was therefore not a 'construction contract'. Consequently, Thornton Heath LLP was not obliged make monthly returns under the CIS for the period March 2015 to April 2016 inclusive. The appeal was allowed and the penalties are discharged.

Thornton Heath LLP v HMRC (TC06831)

Subcontractor's expenses claim

Summary - No deduction was allowed in respect of management services, translation fees or the substantial claim for home office expenses. A small deduction for accountancy fees was allowed.

Mr Rohac was Romanian/Moldovan and spoke very little English when he arrived in the UK. He was employed from 2010 in the construction industry.

In March 2014 he decided to become self-employed and registered as a 'subcontractor' within the Construction Industry Scheme on 9 April 2014. He received a notice to file a self-assessment return for 2014/15 that he filed on 23 May 2015. The return showed a claim for the deduction of £45,704 expenses.

On 8 June 2015 HMRC notified Mr Rohac that they intended to check his 2014/15 tax return and opened an enquiry. On 19 January 2016 HMRC closed the enquiry and issued a closure notice. HMRC disallowed £39,294 of expenses of the total of £45,704 expenses claimed.

HMRC allowed the deduction for £5,760 car expenses and £660 phone expenses. However, a number of expenses were disallowed, including:

- £25,000 for management services to Positive Response. According to the engagement letter this included, among other things, negotiating with contractors, searching for new clients and all administration and record keeping.
- £9,400 for translation services; Mr Rohac required translation services in order to allow Positive Response to advise him on technical issues and regulations given his limited English.
- £4,006 home office expenses. The claim was made on the basis that Mr Rohac used one of the three bedrooms in his house for the purposes of his business for an average of 36 hours per week, usually 3 hours per day. The total of his rent, council tax, water and power expense for the year was £13,291, and he claimed one third business use figure.

- £288 for accountancy services.

It was these expenses that were appealed. He claimed that he had paid the management expenses by transferring amounts of between £100 to £1,000 to a separate bank account and then paid this over as larger cash amounts to settle the expenses due. It was claimed that the translation services were paid in a similar way from Mr Rohac's personal bank account.

Mr Rohac died on 16 March 2017 and so the appeal was made by his personal representative on behalf of his estate.

Decision

The First Tribunal found that, while a schedule had been prepared showing bank transfers, the Tribunal was not convinced that Mr Rohac had proved, on the balance of probabilities that cash payments were made for the management services. The cash arrangements explained did not appear to be consistent with an engagement with a professional services provider. There is no record of the cash payments being made to or received by Positive Response and the payments were not made to Positive Response's bank account as required by the engagement letter. These expenses were disallowed.

The invoice relating to the translation services was drafted as an invoice for future services stating it was for "Assistance provided, and to be provided, to you during the period April 2014 to end March 2015". There was no record of the payments being made and the Tribunal concluded that it was not credible that nearly all of the cash withdrawals made from Mr Rohac's personal account over the tax year were cash payments for these services. These expenses were disallowed.

Despite claiming that his house was used mainly by "other people/labour", there was no evidence as to who these people were as he employed no staff and he was onsite labouring. The Tribunal were not satisfied that there was evidence of any exclusive business use of part of Mr Rohac's family home. The Tribunal considered that HMRC's amount of a £120 allowance for more limited home office use was reasonable in the circumstances.

The £288 for accountancy services was allowed.

PRs of Veaceslav Rohac v HMRC (TC06869)

Reasonable grounds for zero rating

Summary – The First Tier Tribunal had failed to give adequate reasons for its finding that the intended use of a clubhouse was use by a charity "as a village hall or..." and they had erred in concluding that GFC was not carrying out a business. However, they had correctly concluded that GFC had a reasonable excuse for believing that the works should be zero-rated.

The appeal to the First Tier Tribunal related to the liability of Greenisland Football Club (GFC) to pay VAT on the cost of the construction of a new clubhouse at Greenisland. The project was commenced in 2010 by GFC who hoped to construct a multipurpose facility for use by its members and the local community. The facilities at the clubhouse were available for booking on a first come first served basis and open to anyone in the local community. At the time of the original hearing there were five other bodies who had

keys to the clubhouse. There were at least 15 other groups that used the facilities including 12 charities. The First Tier Tribunal recorded that GFC did not have any priority over any other body when it came to reserving facilities nor could it block book a particular facility for, by way of example, the whole of the football season, at the start of that season.

GFC had successfully appealed to the First Tier Tribunal against the penalty issued by HMRC under s62(1) VATA 1994 for £53,101 arising out of the construction works where GFC had issued a zero rated certificate under Item 2 Group 5 Schedule 8 VATA 1994 which provides for zero-rating to apply if:

“The supply in the course of the construction of—

(a) a building ... intended for use solely for a ... relevant charitable purpose.”

Note 6 to Group 5 (“Note 6”) explains what is meant by a “relevant charitable purpose”:

“Use for a relevant charitable purpose means use by a charity in either or both the following ways, namely—

(a) otherwise than in the course or furtherance of a business;

(b) as a village hall or similarly in providing social or recreational facilities for a local community.”

HMRC obtained leave to appeal on three different grounds arguing that the First Tier Tribunal:

1. Failed to give adequate reasons for its finding that the intended use of the clubhouse was use by a charity “as a village hall or similarly ...”.
2. Erred in concluding that GFC was not carrying out a business;
3. Had incorrectly concluded that GFC had a reasonable excuse for believing that the works should be zero rated.

Decision

The Upper Tribunal concluded that there was no satisfactory explanation either in the decision or in the trial bundles as to why the First Tier Tribunal was able to conclude that the use of the clubhouse was a qualifying use within Note 6(b). There had been no attempt to analyse either the intended or actual use of the clubhouse and whether its intended use or actual use was similar to that of a village hall. Although the First Tier Tribunal recorded that both the local community and GFC used the clubhouse, it made no attempt to try and quantify or analyse the nature of their respective uses.

The Upper Tribunal noted that nowhere in the decision does the First Tier Tribunal explain why it has seen fit to ignore the deeming provision of Section 94(2) VATA 1994:

“(2) Without prejudice the generality of anything else in this Act, the following are deemed to be the carrying on of business –

(a) the provision by a club, association or organisation (for a subscription or other consideration) the facilities or advantages available to its members.”

However, there was no dispute that that the club provided facilities for a subscription from members or for a consideration to junior, associate or affiliated members. They questioned why the judgment contained no detailed discussion of:

- The substantial income in respect of dues from junior members for use of the clubhouse and for defraying other expenses;
- The After School's Club which generates £10,000 per annum, that is approximately £200 per week and presumably represents a rent or licence fee;
- A tuck shop selling goods which realise an income of £4,000 per annum.

The Upper Tribunal were satisfied that the First Tier Tribunal had erred in law in concluding that GFC was not operating a business at the clubhouse or did not intend to operate a business at the clubhouse.

Despite the appeal being over turned on points 1 and 2, HMRC failed on point 3. GFC had told the First Tier Tribunal that they had relied upon HMRC's guidance set out at VAT Notice 708 that explains when building work/materials can be zero/reduced rated. They had checked the position with their professional advisers and so confirmed their view. HMRC argued that a reasonable taxpayer should have checked the position with HMRC by way of a non-statutory clearance before issuing a zero rated certificate. The Upper Tribunal noted that there was no mention in HMRC's VAT Notice 708 advising a taxpayer to seek advice direct from HMRC. As GFC had provided the First Tier Tribunal with a reasonable excuse for having given a zero rated certificate, there were no grounds for the Upper Tribunal to interfere with that decision.

HMRC v Greenisland Football Club (UT/2018/0043)

Charitable building zero rating certificate

Summary – As a sub-contractor, their supplies could not be zero-rated. Failing to issue a standard rated invoice to the main contractor in time resulted in them suffering a loss of revenue.

J & B Hopkins Ltd (subcontractor) entered into a construction contract with Rok Building Limited (main contractor) to install equipment for a charity.

The charity provided Rok Building Limited with a certificate under VATA 1994, Sch 8 group 5 note (12)(b) stating the building was for charitable use only and that the work was zero rated. Note (12)(a) provides that the supplies by the main contractor can be zero rated.

However, Rok Building Limited gave the certificate to J & B Hopkins Ltd who in turn issued invoices to Rok Building Limited incorrectly treating the supplies as zero rated. Rok Building Limited paid these but in November 2012 went into liquidation

HMRC assessed J & B Hopkins Ltd at the standard rate on the supplies. This should not have caused a problem since Rok Building Limited's supplies to the charity were zero rated, it should have been able to recover any VAT charged to it by J & B Hopkins Ltd. Due to the liquidation, J & B Hopkins Ltd had not raised a revised invoice using standard rate. J & B Hopkins Ltd said that the HMRC assessments were contrary to EU law because HMRC would be unjustly enriched by the VAT since Rok Building Limited could no longer recover this VAT.

The First-tier Tribunal dismissed the taxpayer's appeal.

Decision

The Upper Tribunal agreed with the First Tier Tribunal that, to the extent that HMRC would be enriched, this would not be at J & B Hopkins Ltd's expense, but rather Rok Building Limited.

The only sense in which J & B Hopkins Ltd's was out of pocket was because Rok Building Limited had not paid the full price as J & B Hopkins Ltd had not invoiced at standard rate and that was their mistake. J & B Hopkins Ltd made an error which it did not discover until it was too late to pursue a contractual remedy against Rok Building Limited for the balance of the price.'

The J & B Hopkins Ltd 's appeal was dismissed.

*J & B Hopkins Ltd v HMRC [2018] UKUT 0382 (TCC)
Adapted from case summary in Taxation (10 January 2019)*

Refund under DIY builders scheme

Summary – The taxpayer was allowed to recover all of the VAT suffered when they demolished an interconnecting Annexe and replaced it with a new dwelling.

Roy Tabb and his wife owned a Barn that was converted into their original house and associated out buildings. One of those out buildings was a single storey cowshed that shared a short common wall with the Barn.

Initially the couple converted the cowshed into a games room that had no direct access to the barn, but later the Games Room was converted into a self-contained Annexe for his mother-in-law. The annexe had an external access but also internal access to the Tabb's Barn at the common wall.

In 2009 following the mother-in-law's death, the couple decided that they would demolish the Annexe, build a new house on its footprint ("the New House") and sell the Barn. The construction works involved the complete demolition of the Annexe including the replacement of the foundations so that there was no trace of any of the pre-existing walls.

The New House is free standing in that no part of it joins the Barn but instead abuts it at the location of what was previously the common wall. The internal access to the Barn has been blocked up, although the shape of the previous internal door is visible from inside the New House in that the internal rendering where the door was is inset against the profile of the rest of the internal wall around it.

Mr and Mrs Tabb moved into the New House in January 2017 and sold the Barn in 2018. On 11 April 2017 Roy Tabb made an application under the DIY Builders Scheme for the refund of £31,381.46 of VAT incurred in constructing the New House. On 21 April 2017 HMRC rejected the claim that was upheld on review. Roy Tabb appealed that decision on 26 June 2017.

The sole issue in this appeal was whether the works carried out to build the New House consisted of "the construction of a building designed as a dwelling" within s.35(1A) VATA 1994. Roy Tabb has two arguments based on the application of Notes 16 and 18 to Group 5 of Schedule 8 for the purposes of construing Section 35.

Argument 1: 'Existing buildings' only qualify under s35 if they satisfy Note 18. Roy Tabb argued that the New House is a new building under Note 18 as it ceased to be an 'existing building' when the Annexe was demolished to below ground level, the New House was then separately constructed. HMRC argued that under Note 18 the 'existing building' was the Barn and Annexe, and that only the Annexe had been demolished to below ground level, not the Barn.

Argument 2: Even if Note 18 did not apply, Roy Tabb argued that Note 16(b) allows 'existing buildings' to be included under s35 if they are reconstructed, enlarged or extended to create an additional dwelling or dwellings which was the case here. HMRC said that the New House was not wholly, but rather substantially within the area of the Annexe (being part of the existing building) and so Note 16(b) does not apply.

A supplemental point raised by HMRC in the context of this second argument was whether if Note 16(b) applied, the legislation requires an apportionment of the VAT recovery between that incurred on the existing building and on the new building.

Decision

The First Tier Tribunal took the view that the test in Note 18 as to whether the building has been demolished should be determined by reference to the building before and after the works had been carried out. Accordingly, while the New House is a new dwelling, it has been built from an existing building constituting the Barn and the Annexe that were physically connected and had an internal connection. The existing building had not been demolished completely to ground level as required by Note 18.

The Tribunal concluded that Note 16(b) requires two elements to be present, an “enlargement or extension” and that the enlargement or extension “creates an additional dwelling or dwellings”.

They concluded that both elements were present as:

1. the New House was an extension or enlargement of the prior building in that an additional floor was added to make a two storey building and the footprint was extended by the lean-to kitchen;
2. the extension or enlargement created a new dwelling, the old Annexe previously being interconnected to and forming a single dwelling with the Barn and the New House now being a new dwelling with no internal access to the Barn.

As for the need to apportion input VAT recovery, the Tribunal held that there was no need. The Tribunal found that the works carried out in this appeal were entirely focused on and attributable to constructing the New House. Even if an apportionment were required under Note 16(b), it was not relevant here.

Roy Tabb v HMRC (TC06870)

Buying essays online

Summary – The taxpayer should have accounted for output tax on the full value received from their clients as they were acting as principal who subcontracted out the production of the coursework that was being supplied.

All Answers Ltd’s supplied students with essays, coursework and dissertations produced by academic experts with the buyer specifying the grade they wished to achieve in their coursework.

All Answers Ltd argued that output tax was only payable on the commission that they retained as it was acting as an agent in bringing together the coursework writer and the student.

HMRC argued that All Answers Ltd acted as principal to the students by supplying them with essays with output tax due on the full payment received from the students. All Answers Ltd then subcontracted the production of the essays to the writers who worked for them.

Decision

The First-tier Tribunal concluded that the commercial reality indicated there was a single, contractual arrangement between the student and All Answers Ltd for the supply of a written document, for which the student paid a single price to All Answers Ltd.

The agency idea was wholly artificial and was intended to disguise the reality that the company engaged subcontractors to produce each piece of writing that it has contracted to supply.

The Tribunal listed several factors that showed that All Answers Ltd was acting as a principal:

- the student and author did not know each other's identity;
- customer perception from the company website was that the students thought they were dealing with the company, not the author;
- the author invoiced the company and was paid from the company's bank account;
- it was supplying to the student a completed essay which it acquired from an expert it had hired as a subcontractor.

The taxpayer's appeal was dismissed.

All Answers Ltd v HMRC (TC06845)

Meals replaced by juices Lecture

Summary - Products sold as part of a 'juice cleanse programme' were food rather than beverages and so fell within the zero-rated food provisions in Sch 8 Group 1 VATA 1994.

The Core is a health café in Swindon's old town supplying a range of juice and food plans. Juice Cleansing Plans are programmes that enable individuals to super charge nutrient intake and supply their body with raw, nutrient-rich juices and smoothies in place of meals, four times a day over a period of days.

The issue was whether the Juice Cleansing Plans were zero rated as food or standard rated beverages as excepted item 4 of Sch 8 Group 1.

Decision

The First Tier Tribunal found that buyers were using the Juice Cleansing Plans as meal replacements. They were not bought as beverages and they drink water in addition to consuming the juices. The products are not unpleasant to drink, but they are not consumed for pleasure.

Applying the test in Bioconcepts (1993) Decision no. 11287, which decides whether a drinkable liquid is a beverage, the Tribunal noted that the juices and smoothies sold by The Core were not bought to increase bodily fluid, to quench thirst, to fortify or to give pleasure.

In addition, the product would not be offered as a drink to a visitor as we might tea, coffee or a cold drink such as a fruit juice. They were therefore not beverages.

The Core (Swindon) Ltd v HRC TC06874)

Raw choc brownies Lecture

Summary – All four variants of the “Raw Choc Brownies” were correctly classified as cakes which made them zero rated and so the claims to overpaid VAT were repayable

This case concerned the classification for VAT purposes of “Raw Choc Brownies” produced in four flavours.

Pulsin’ Ltd sought to claim repayment of output tax for its brownie sales, originally treated as standard rated but subsequently considered to be properly taxed as zero rated cakes. HMRC considered that the Products were not eligible to be zero rated on the basis, in summary, that they did not display enough characteristics of a cake to so qualify.

The Raw Choc Brownies are individually wrapped bars produced by cold compression of predominantly: dates, cashews, cacao, various syrups, concentrated grape juice and brown rice bran. All ingredients used are intended to be as natural, unprocessed, hypoallergenic and as nutritionally beneficial as possible. Cacao is the predominant flavour of all four variants. They are all very dark brown and of a dense texture.

The Tribunal was shown a number of other products some of which were more closely examined than others.

- Closely examined products: Morrisons bakery brownies, Mr Kipling brownies, Mr Kipling gluten free brownies, Pret brownie bar, Morrisons own gluten and dairy free brownies, Kent & Fraser double chocolate vegan brownie.
- Other products available to the Tribunal: Mr Kipling French Fancies, whole Victoria sponge cake, Tunnock Tea Cakes, Mr Kipling Battenberg Bars.

The relevant legislation is contained in Schedule 8, Group 1 but is complicated.

- Item 1 provides for the zero rating of “Food of the kind used for human consumption”;
- Excepted item 2 excludes from zero rating “Confectionary, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some products similar in taste or appearance”;
- Note 5 provides “for the purposes of item 2 of the excepted items ‘confectionary’ includes chocolates, sweets and biscuits; drained glaze or crystallised fruits; and any item of sweetened prepared food which is normally eaten with the fingers”.

Both parties referred to the case of *Lees of Scotland Ltd & Thomas Tunnock Ltd v HMRC* [2014] UKFTT 630. This case considered whether a snowball was a cake and looked at whether it displayed “enough of the characteristics of a cake that it should be classified as such”.

The Tribunal said that the test is the view of the ordinary person, informed as to:

- Ingredients;
- Process of manufacture;
- Unpackaged appearance (including size);
- Taste and texture;
- Time, place and manner of consumption);
- Packaging;
- Marketing.

Decision

In the Tribunal's view, the brownies fell under the definition of confectionary (standard rated) subject to the statutory exception for cakes (zero rated). However, the Tribunal concluded that the current state of the law on the taxation of food items is not fit for purpose and will necessarily present apparently anomalous results as tastes and attitudes to eating change. They highlighted the VAT treatment of zero-rated flapjacks as cakes versus standard rated cereal bars, the main distinction being that the former only contained oats while the latter contained several cereals. They concluded that the 'test' for whether the brownies were to be classified as cakes was a matter of informed impression.

The Tribunal referred to HMRC's internal guidance on cakes which says that cakes includes sponge cakes, fruit cakes, pastries, eclairs, meringues and jaffa cakes, normally marketed as cakes, displayed with cakes rather than the confectionary section and packaged with a number of individual portions cellophane wrapped so contents are revealed. Examples included Flapjacks, Caramel shortcake and Marshmallow teacakes. The Tribunal pointed out at there was no similarity between the ingredients, manufacturing process, size, appearance, taste or texture of the products.

The First Tier Tribunal said that they needed to decide whether the brownies were cakes and their classification should be "a practical question calling for a practical answer" and not an "over-elaborate, almost mind-numbing, legal analysis" (*Proctor & Gamble UK v HMRC* [2009] EWCA Civ 407).

The Tribunal considered the factors identified in the Lees case outlined above as well as the products name and description and shelf life. On balance the Tribunal formed the view that the brownies did show enough characteristics of cakes to be zero rated. Put alongside a slice of traditional Victoria sponge, a French Fancie and a vanilla slice or chocolate éclair the products may look out of place. However, brownies are generally considered to be cakes. Put alongside a plate of brownies, or, for instance, at a cricket or sporting tea where it is more likely that bought and individually wrapped cakes will be served on a plate the products would absolutely not stand out as unusual

The appeal was allowed and the output VAT being reclaimed was repayable.

Pulsin' Ltd v HMRC (TC06909)