VAT : Budget 2012 changes to loopholes and anomalies

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In Budget 2012 the Government proposed the removal of a number of 'loopholes and anomalies' in the coverage of VAT from October 2012: these changes would affect the VAT liability of self-storage facilities, approved alterations to listed buildings, catering & hot takeaway food, sports drinks, holiday caravans and the rental of hairdressers' chairs.[1] Initially it was intended to make these changes by secondary legislation, though the *Finance Bill* published after the Budget included legislation to prevent 'forestalling' – attempts to retain VAT relief after 1 October by drawing up contractural arrangements for their provision beforehand.[2] Details were set out in a consultation document alongside the Budget.[3]

These changes proved controversial, and the department received nearly 1,500 responses by the close of the consultation period on 18 May 2012. Further to this, the Exchequer Secretary wrote to the Treasury Committee on 28 May explaining that the Government had decided to change its approach to amending the VAT treatment of two of this list of supplies: hot takeaway food and holiday caravans. In his letter the Minister underlined that a full response to the consultation, with revised draft legislation, would be published "with a view to debate and legislation later in the summer."[4]

On 28 June HM Revenue & Customs (HMRC) published this response document, confirming these changes along with a number of minor amendments.[5] Rather than enacting these changes to the VAT rules through a series of statutory instruments, the Government put down a new schedule to the *Finance Bill*, which was debated and approved at the Bill's report stage on 3 July 2012.[6] These provisions now form s196 & schedule 26 of *FA2012*.

This note examines these changes and the debate there has been about them.

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1 HC Deb 21 March 2012 c801; HC 1853 March 2012 para 2.179

2 HC Deb 21 March 2012 c57WS

3 HMRC, *VAT: Addressing borderline anomalies*, March 2012

4 *Letter from the Exchequer Secretary to the Treasury, David Gauke MP to the Chairman of the Treasury Select Committee, Andrew Tyrie MP*, 28 May 2012

5 HMRC, *VAT: Addressing borderline anomalies – summary of responses*, 28 June 2012; HC Deb 28 June 2012 c21WS.

6 HC Deb 3 July 2012 cc769-834. Guidance on these changes is given in a series of VAT Information Sheets (HMRC, *VAT InfoSheets 9/12-15/12*, August 2012).

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1 VAT – an introduction

VAT is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt. VAT is charged on the additional value of each transaction, and is collected at each stage of production and distribution. A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax, settling up with HM Revenue & Customs for the difference between the two. In the end the cost of the tax is borne by the final consumer. All businesses must register for VAT if their turnover of taxable goods and/or services is above a given threshold – which is £79,000 at present.[7]

Most VAT law is consolidated in the *Value Added Tax Act (VATA) 1994*. VAT is charged either at the standard rate, which is now 20%, or the zero rate, though there is limited use of a reduced rate of 5%. Zero-rated supplies include: food; construction of new dwellings; domestic and international passenger transport; books, newspapers and magazines; children's clothing and footwear; water and sewerage services; drugs and medicines on prescription; and certain supplies to charities.[8] Supplies liable to VAT at the 5% reduced rate include: the supply of domestic fuel and power, the installation of energy saving materials, women's sanitary products, children's car seats and certain types of construction work.[9] Further details on the rates of VAT applied to different goods and services are collated on the department's site.[10]

The exemption of goods and services from VAT should be distinguished from their being charged a zero rate. In the latter case these supplies are technically taxable and though no actual tax is paid on them, they still count as part of a business' taxable turnover. VAT charged on inputs relating to zero-rated activities can be reclaimed, unlike the VAT incurred by a business in the course of an exempt activity; in effect, a business making exempt supplies has to absorb the VAT charged to it by its suppliers. Categories of exempt supplies include land, insurance, finance, education, health and welfare.[11]

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[7] *Budget 2013* HC 1033 March 2013 para 2.179. The threshold was increased in line with inflation for the 2013/143 year with effect from 1 April 2013, by Order (SI 2013/660).

[8] Zero-rated supplies are set out in schedule 8 to *VATA 1994*.

[9] Reduced-rate supplies are set out in schedule 7A to *VATA 1994*.

[10] http://www.hmrc.gov.uk/vat/forms-rates/rates/goods-services.htm

[11] Exempt supplies are set out in schedule 9 to *VATA 1994*.

There is a considerable body of EU VAT law which underpins VAT law across all Member States – which determines the tax base, and limits the discretion of any Member State to set VAT rates on individual goods and services. Although the UK is entitled to maintain its existing zero rates, Member States may only introduce reduced rates – as low as 5% - on specific list of supplies and there is no provision for any State to introduce new zero rates.[12]

VAT was introduced in the UK on 1 April 1973 at two rates: a standard rate of 10%, and a zero rate on selected goods and services (such as food, books, children's clothing, and certain supplies for charities).

The main changes to the VAT structure since the introduction of the tax are:

- The standard rate was cut to 8% on 29 July 1974.
- A higher rate on selected goods and services was introduced on 18 November 1974, set at 25%. Initially this was applied to petrol only; it was extended to a list of other supplies from 1 May 1975. The higher rate was cut to 12.5% from 12 April 1976.
- The standard rate was increased to 15% on 18 June 1979; at this time, the higher rate of VAT was abolished.
- The standard rate was increased to 17.5% from 1 April 1991.
- Domestic supplies of fuel and power were charged VAT at a reduced rate of 8% from 1 December 1993. This was cut to 5% from 1 September 1997.
- The standard rate was cut temporarily to 15% from 1 December 2008 to 31 December 2009. It reverted back to 17.5% on 1 January 2010.
- The standard rate was increased to 20% from 4 January 2011.

Over the last 25 years there have been a number of changes to the coverage of the zero rate, affecting individual supplies. In addition, since its introduction in September 1997, the coverage of the 5% reduced rate has been extended to a small number of other supplies, including the installation of energy saving materials.

The approximate proportions of consumers' (household) expenditure that fall into the different VAT categories are:[13]

	Approximate proportion of consumers' expenditure
Subject to VAT at standard rate	52 per cent
Subject to VAT at reduced rate (5%)	4 per cent
Subject to VAT at zero rate	12 per cent
Exempt or out of scope	32 per cent

[12] For further details see, *VAT : European law on VAT rates*, SN2683, 28 August 2013

[13] Date for the year 2008. Percentages have been rounded individually. (HM Treasury, *Tax Benefit Reference Manual* 2009/10 ed. (Commons paper 2009-1987) p89)

Details of the costs of the most significant zero and reduced VAT rates are published by the department:[14]

Estimated costs of the principal tax expenditure and structural reliefs

£m

Tax Expenditures

	2011-12	2012-13
Value added tax [13]		
Zero-rating of:		
Food	14950	15450
Construction of new dwellings (includes refunds to DIY builders)*	5800	6500
Domestic passenger transport	3400	3500
International passenger transport (UK portion)*	250	300
Books, newspapers and magazines	1700	1750
Children's clothing	1750	1800
Water and sewerage services	1900	2000
Drugs and supplies on prescription	2900	3000
Supplies to charities [14]*	250	300
Certain ships and aircraft	700	750
Vehicles and other supplies to disabled people [14]	600	600
Reduced rate for: [15]		
Domestic fuel and power	5050	5200
Certain residential conversions and renovations	200	200

* These figures are particularly tentative and subject to a wide margin of error.

[13]Some of these tax expenditures and reliefs are mandatory or permitted under the EC 6th VAT Directive and some are derogations from the Directive. All the cost estimates relating to VAT are based on the actual standard rate of VAT that applied in the relevant periods

[14]Costs exclude the zero-rating of items appearing elsewhere in the list.

[15]The figures for all reduced-rate items are estimates of the cost of the difference between the standard rate of VAT and the reduced rate of 5 per cent.

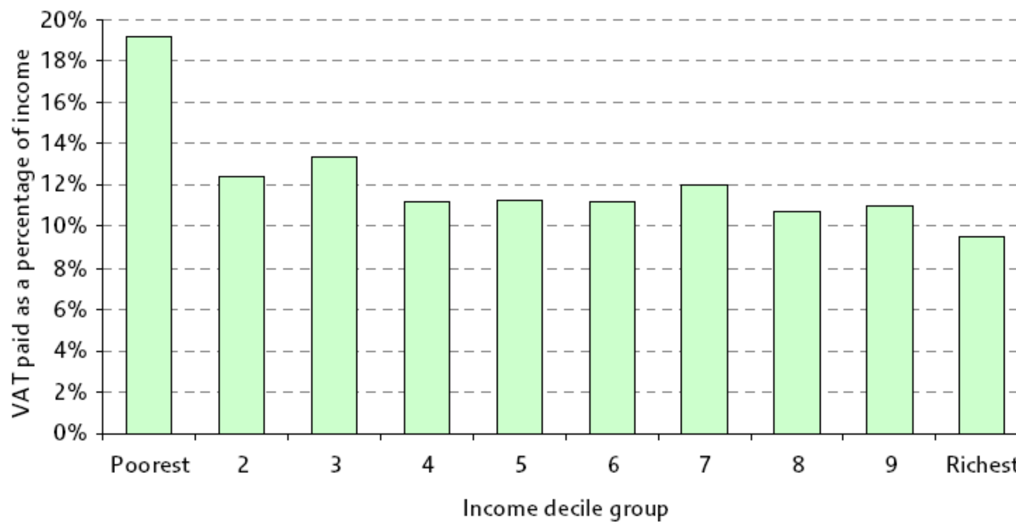
As VAT is imposed at a fixed rate on the price of goods and services, it is commonly accepted that the tax is regressive, that the burden of the tax lies more heavily on those with lower incomes, as the amount of tax paid by someone is not based in any way on that person's ability to pay. Arguably this is an over-simplification in two respects: that a person's expenditure *is*, in fact, a measure of their ability to pay and that in this country, the tax base is such that VAT is not levied on a relatively large part of poorer households' budgets (for example, the zero-rating of food). Finally looking at the impact of VAT alone may be misleading, without considering the alternatives for raising Exchequer revenues, or the variety of instruments governments may use to shape the overall progressivity of the tax and benefit system. Even so, there is robust statistical evidence that the poorest households do, in fact, pay a higher share of their income in VAT than other households.

In some analysis published in their 2009 *Green Budget* report, the Institute for Fiscal Studies suggested the issue was not entirely clear cut, as there was a good argument for measuring the tax burden by considering the share of VAT of household expenditure, rather than income.

The first point the authors made was that the bottom 10% of households did, indeed, pay proportionately more VAT, than others:

[14] HMRC, *Official Statistics: Table 1.5 – Main tax expenditures and structural reliefs*, December 2012

Figure 10.1. VAT paid as a percentage of net household income



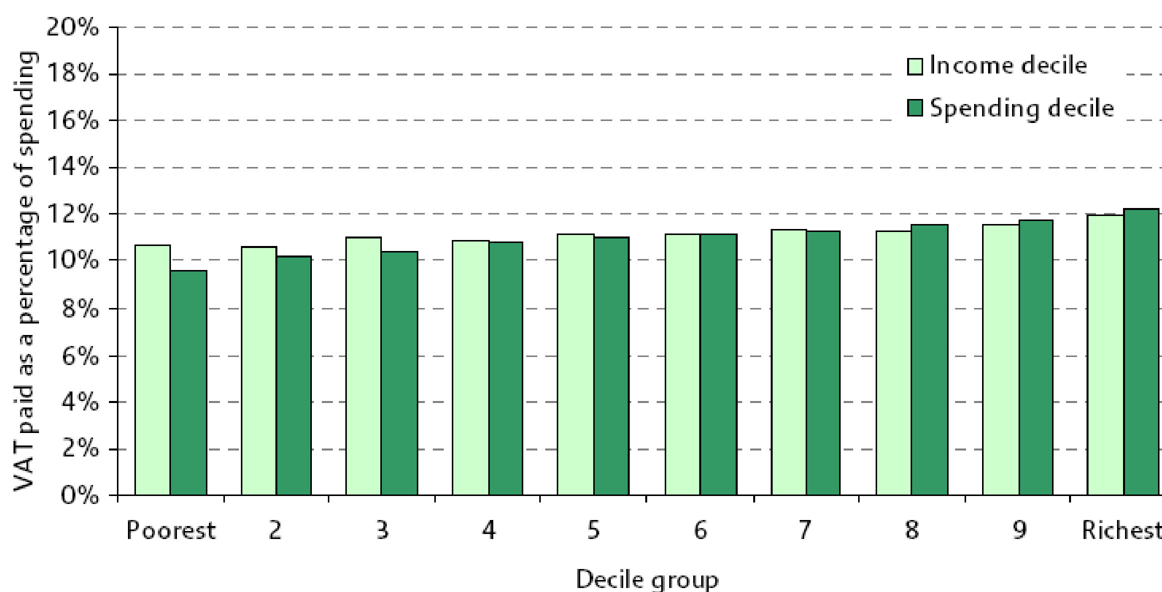
Notes: Income deciles based on equivalised household net income using McClements equivalence scales. Net income is defined as private income minus income tax, NI and council tax plus benefits and tax credits. The Family Expenditure Survey significantly under-records expenditure on VATable goods and hence all VAT amounts have been increased by a factor of 1.410 so that estimated VAT revenue matches government revenue estimates. Incomes data are from the Family Resources Survey 2006–07.

Sources: Family Expenditure Survey 2005–06; Family Resources Survey 2006–07; HM Treasury, *Pre-Budget Report 2008*, November 2008 … and authors' calculations.

The authors went on to suggest that looking at incomes in this way, rather than expenditure, ignored the fact that households will use savings over time to maintain a level of expenditure, while their income falls and rises:

> However, looking at a snapshot of the patterns of spending, VAT paid and income in the population at any given moment is misleading, because incomes are volatile and spending can be smoothed through borrowing and saving. Consider a student or a retiree: their current income is likely to be quite low but their lifetime earnings could be relatively high. The student may borrow to fund spending, whilst the retiree may be running down savings.
>
> Similarly, many people in the lowest income decile will be temporarily not in paid work and able to maintain relatively high spending in the short period they are out of the labour market. Because their spending is higher than their current income, these people will be paying a high fraction of their current income in VAT. Similarly, those with high current incomes tend to have high saving, and so appear to escape the tax, but they will face it when they come to spend the accumulated savings. Because of this 'consumption smoothing', expenditure is probably a better measure of living standards (and households' perceptions of the level of spending they can sustain).

Figure 10.2. VAT paid as a percentage of household expenditure



Notes: Income deciles based on equivalised household net income using McClements equivalence scales. Net income is defined as private income minus income tax, NI and council tax plus benefits and tax credits and is derived from the Family Resources Survey 2006–07. Expenditure deciles based on equivalised household non-housing expenditure using McClements equivalence scales.

The Family Expenditure Survey significantly under-records expenditure on all goods and hence expenditure has been increased by a factor of 1.37 so that it matches National Accounts data. Expenditure on VATable goods is particularly underestimated and hence all VAT amounts have been increased by a factor of 1.410 so that estimated VAT revenue matches government revenue estimates.

Sources: Family Expenditure Survey 2005–06; Family Resources Survey 2006–07; HM Treasury, Pre-Budget Report 2008, November 2008 …; National Accounts; and authors' calculations.

Figure 10.2 shows average amount of VAT paid as a percentage of average household expenditure – the light [shading] by current income decile (as in Figure 10.1) and the dark [shading] by current expenditure decile. It shows that, particularly when considering deciles based on household expenditure, poorer households pay a smaller proportion of their spending in VAT than do richer households.

This makes sense: those goods that are zero and reduced-rated, such as food and domestic fuel and power, are a higher proportion of the spending of poorer households than of rich households. Indeed, reduced- and zero-rating is often justified in terms of redistribution, although … this is not particularly well targeted at helping poorer households.[15]

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[15] *The IFS Green Budget*, January 2009 pp197-8. For a more detail examination of the operation of VAT and the argument for substantially extending the VAT base see, "Chapter 7: Implementation of VAT" & "Chapter 9: Broadening the VAT base", in *Tax By Design : The Mirrlees Review of the UK tax system*, Institute for Fiscal Studies 2011.

2 Budget 2012 – changes to coverage of VAT

In his Budget speech on 21 March 2012 the Chancellor George Osborne announced proposals to address a number of "loopholes and anomalies" in VAT:

> We will also address some of the loopholes and anomalies in our VAT system. For example, at present soft drinks and sports drinks are charged VAT, but sports nutrition drinks are not. Hot takeaway food on the high streets has been charged VAT for more than 20 years, but some new hot takeaway products in supermarkets are not. Some companies are using the VAT rules that exempt the rental of land to avoid the tax that their competitors are paying. We are publishing our plans today to remove loopholes and anomalies, but we will keep the broad exemptions on food, children's clothes, printed books and newspapers.[16]

Further details were given in the Budget report:

> The Government will address anomalous VAT borderlines by applying VAT to the provision of self storage facilities and to approved alterations to listed buildings. VAT will also apply, to the extent that it does not already do so, to the sale of hot food, cold food consumed on the supplier's premises, sports drinks and holiday caravans, and to the rental of hairdressers' chairs. This will have effect from 1 October 2012. HMRC are publishing a draft Statutory Instrument for consultation on 21 March 2012. Anti-forestalling provisions will be introduced in Finance Bill 2012 with effect from 21 March 2012. The Department for Culture, Media and Sport will extend its 'listed places of worship' grant scheme in light of the changes to VAT on alterations to listed buildings.[17]

Details of the anti-forestalling provisions mentioned in the Budget report were given in a written statement given on Budget day:

> **The Exchequer Secretary to the Treasury (Mr David Gauke):** The Chancellor of the Exchequer announced today as part of the Budget the removal of the VAT exemption for grants of facilities for the self storage of goods and the removal of the VAT zero rate for supplies of services and materials in connection with approved alterations of protected buildings. This will have effect from 1 October 2012. For approved alterations that are already contracted for or under way, transitional relief will be provided for supplies made before 21 March 2013.
>
> The Government have taken this step to address inconsistencies in the treatment of these supplies and to prevent VAT avoidance that exploits the VAT exemption for supplies of self storage. To protect the public finances from artificial avoidance of the change in VAT liability, the Finance Bill 2012 will contain anti-forestalling legislation to ensure that the VAT liability changes are fully effective.
>
> Anti-forestalling legislation will apply to these types of supplies made on or after 21 March 2012. This will ensure that the new VAT liability will apply to these supplies if they are performed (or, in the case of supplies of materials, incorporated in the building) on or after 1 October 2012, even if the supply is treated as being made earlier than this because of an advance payment or delivery of materials. The new VAT liability will also apply to grants of rights or options made on or after 21 March 2012 to receive supplies of self storage to be provided on or after 1 October 2012.

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[16] HC Deb 21 March 2012 c801

[17] HC 1853 March 2012 para 2.179

> Whilst the attached anti-forestalling legislation will apply for supplies treated as taking place on or after 21 March 2012, any VAT arising from its operation will not become due until 1 October 2012. Until then, suppliers should continue to apply the current rules. Further information on the anti-forestalling legislation is available at: www.hmrc.gov.uk.[18]

Taken together it was estimated these changes to VAT liability would raise £270m by 2013/14. By way of comparison details of the revenue impact of the changes announced in the Budget to personal taxation are reproduced below:[19]

Table 2.1: Budget 2012 policy decisions[1]

	Head	£ million				
		2012–13	2013–14	2014–15	2015–16	2016–17
Personal and Property tax						
1 Personal allowance: increase by £1,100 in 2013-14, with a proportion passed to higher rate tax payers	Tax	0	–3,320	–3,450	–3,510	–3,580
2 Child Benefit: threshold at £50,000 and taper to £60,000	Spend	–185	–690	–630	–	–
3 Income tax: reduce additional rate to 45p in 2013-14	Tax	0	–50	–100	–100	–110
4 Income tax: cap on unlimited tax reliefs[2]	Tax	0	*	+490	+240	+300
5 Stamp Duty Land Tax: avoidance on residential property and associated CGT changes	Tax	*	+65	+65	+65	+75
6 Stamp Duty Land Tax: 7% on residential properties over £2million	Tax	+150	+180	+225	+260	+300
Simplification						
26 Age-related allowances: freeze amount and restrict to existing recipients from 6 April 2013	Tax	0	+360	+670	+1,010	+1,250
27 VAT: correcting anomalies	Tax	+50	+115	+125	+145	+160
28 VAT: closing loopholes	Tax	+75	+155	+165	+170	+190

The department's *Overview of Tax Legislation & Rates* set out how VAT would be charged on these supplies:

> The changes address some anomalies by:
>
> - applying VAT to approved alterations to listed buildings to bring them into line with the VAT treatment of alterations to non-listed buildings, and repairs and maintenance for all buildings; and
> - providing consistency of treatment between self-storage and other forms of storage.
>
> They also close a number of loopholes by:
>
> - applying VAT, in the minority of cases where it does not already apply, to hot food and to sports drinks;
> - putting beyond doubt the fact that VAT applies to the rental of hairdressers' chairs and the sale of cold food for consumption on the supplier's premises (even if those premises are shared with other suppliers); and

18 HC Deb 21 March 2012 c57WS
19 HC 1853 March 2012 p50

- ensuring that the purchase of holiday caravans is taxed consistently at the standard rate.[20]

The department also published details of the size of each of these affected sectors and the degree to which behavioural responses were anticipated to undercut the revenue raised from removing VAT relief:[21]

The tax base

The tax base is consumer expenditure on the affected products. The value for each tax base is estimated using data from a range of sources.

- For self storage, data is taken from commercial reports. The tax base affected in the first full year of the measure is estimated to be about £200 million;
- For hairdressers' chairs, data is taken from HM Revenue and Customs and trade association reports. The tax base affected is estimated to be about £70 million;
- For alterations to listed buildings, data is taken from the Department for Communities and Local Government and local authority planning applications. The tax base affected is estimated to be about £600 million, of which about one fifth is estimated to become subject to the 5 per cent reduced rate of VAT for residential conversions;
- For caravans, data is taken from commercial and trade association reports. The tax base affected is estimated to be about £300 million;
- For sport drinks, data is taken from commercial reports, and the tax base affected is estimated to be about £70 million; and,
- For hot take-away food, data is taken from the Department for the Environment, Food and Rural Affairs, the Office for National Statistics and commercial reports. The tax base affected is estimated to about £700 million.

Each tax base has been grown in line with appropriate OBR economic determinants, and the total tax base affected in the first full year of the measure, in 2013-14, is estimated at approximately £1.9 billion.

Static costing

The static costing for this measure is calculated by in most cases applying the 20 per cent standard rate of VAT to the tax bases described above, and is adjusted where applicable to take account of any additional input tax businesses will be able to reclaim. The 5 per cent reduced rate of VAT is applied to about one fifth of the tax base for alterations to listed buildings.

Static Exchequer impact (£m)

	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer impact	+160	+355	+385	+410	+440

Post-behavioural costing

A behavioural response is included to take into account the fall in demand for goods in response to the increase in price. Elasticities of demand were applied to the products affected of -0.5 for self storage, -1.0 for hairdressers' chairs, -0.4 for alterations to listed buildings, -1.5 for static caravans and -0.8 for sports drinks and hot take-away food. The costing is also adjusted to allow for some non-compliance in these markets

[20] HMT/HMRC, *Overview of Tax Legislation & Rates*, 21 March 2012 p9. The document includes all the 'tax information and impact notes' listed below.

[21] HM Treasury, *Budget 2012 policy costings*, March 2012 pp37-8

once the goods become subject to the standard rate of VAT; a reduction of 10 per cent is applied, consistent with the expected level of the total VAT tax gap in the VAT receipts forecast.

Post-behavioural Exchequer impact (£m)

	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer impact	+125	+270	+290	+315	+350

More details, including estimates of how much of the total VAT yield was anticipated to come from each change, were given in a series of 'tax information and impact notes' as follows:

- *VAT: approved alterations to listed buildings*, TIIN4806 March 2012
- *VAT: self storage*, TIIN4801, March 2012
- *VAT: hot food and premises*, TIIN4803, March 2012
- *VAT: sports nutrition drinks*, TIIN4825, March 2012
- *VAT: hairdressers' chair rental*, TIIN4802, March 2012
- *VAT: taxing holiday caravans*, TIIN 4807, March 2012

Insofar as the initial reactions to the Budget mentioned these changes, commentators focused on the fact that VAT would be charged on all types of hot food, with the exception of freshly baked bread – a change dubbed variously as the 'samosa tax', the 'hot chicken tax', and the 'pasty tax',[22] culminating in a campaign by the *Sun* newspaper snappily entitled *Who VAT all the pies?*[23] Further to this, there were campaigns over the impact of these proposals on the caravan sector and the upkeep of listed churches.

By contrast there was relatively little comment on these changes as a whole, though in the *Tax Journal*, Robert Maas at the Institute of Indirect Taxation, suggested that 'correcting anomalies and closing loopholes' would be more accurately designated as "reversing all of the things that were decided against us [ie, HMRC] in the Tribunals and the courts in the last couple of years":

> The interesting question this raises is will it give HMRC a quiet life or will it turn into a string of European Commission v UK cases before the CJEU?
>
> It is hard to argue against the fact that the zero-rating of some foodstuffs is a mess. But the Chancellor has shied away from a full review of this area and has homed in instead on hot food and sports nutrition drinks. Ironically the first is an area where the law seemed to be developing coherently, apart from the dilemma of what is the premises. But 'areas adjacent to' a retailer is so vague that it is unlikely to help many people decide. Zero-rating is, of course, a transitional derogation so it is unclear to what extent EU law can be called an aid by taxpayers. But defining the nature of a product by how it is marketed, as the Chancellor has done with sports nutrition drinks, could well be a step too far.
>
> So could seeking to categorise land-based supplies such as hairdressing chair rental, caravans and storage, as a service rather than an interest in land irrespective of the

[22] "Hot pies face price rise over move to extend VAT", *Financial Times*, 22 March 2012; "VAT anomalies – hot snacks and hair salons hit", *Guardian*, 22 March 2012; "Hard to swallow: the supermarket sausage loses out", *Times*, 22 March 2012; "'Pasty lover' David Cameron defends VAT hike", *BBC News online*, 28 March 2012

[23] "Let them eat cold pasty: Osborne tells skint Brits to shun hot food", *The Sun*, 28 March 2012

facts. Any court is likely to take a dim view of the State labelling something as what it is clearly not. And when does chair rental merge into cost sharing?[24]

Writing in the same journal another practitioner, Marc Welby, commented that "perhaps unsurprisingly, none of the changes are expected to result in less VAT being collected"; acknowledging the projected £270m yield was "not a huge amount", Mr Welby went on to note that this was something the department would welcome if "the changes help to reduce the costs of administration which, in some areas, should be the case. We also should not lose sight of the fact that some businesses will both welcome and benefit from those changes which re-level the playing field."[25]

The Government had initially intended for these changes to the VAT rules to be implemented by secondary legislation – though they were the subject of debate by the Committee of the Whole House on 18 April. On this occasion the Exchequer Secretary, David Gauke, announced an extension in the deadline for responses to the department's consultation document – from 4 to 18 May.[26]

3 The Government's response to the consultation exercise

Prior to the publication of its formal response to the consultation, on 29 May the Government announced changes in its approach to applying VAT consistently to holiday caravans, and to hot takeaway food – two elements to this reform package that proved most contentious. These two issues are discussed in detail below – though in general it appears that this decision was broadly welcomed.[27]

The changes were the subject of a short debate in the House on 11 June, when the Exchequer Secretary, David Gauke, also confirmed a change to proposals regarding unlimited income tax reliefs:

> The Budget contained 282 measures. Having said that we would consult on some of its measures, we have made changes to three. On VAT for hot food, it is right to end anomalies and ensure that VAT is applied fairly between businesses. Where fish and chip shops had to charge VAT, supermarkets selling the same products did not. Having consulted, we have revised the relevant tests to ensure that, for example, bakers cooking hot savoury food that is left to cool are not caught in the changes.
>
> On VAT for static holiday caravans, we have listened to hon. Members, who argued that static caravans should be treated more akin to second homes and not like touring caravans. Given that static holiday vans fall in a grey area between residential properties and temporary holiday accommodation, and given the relevant tax regimes that apply to them, a 5% rate of VAT is a fair compromise.
>
> On tax reliefs, we continue to think that the system we inherited—which allows the wealthiest to pay the least tax, meaning that cleaners can pay a higher rate than their bosses—is unfair. We will therefore move to cap reliefs to ensure that this is addressed. However, having engaged with the sector, we will exclude reliefs relating to

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[24] "Budget comment: changes to VAT", *Tax Journal*, 30 March 2012

[25] "Budget analysis: VAT", *Tax Journal*, 30 March 2012

[26] HC Deb 18 April 2012 c441

[27] See, for example, "Osborne blows hot and cold on 'pasty' tax", *Times*, 29 May 2012 & "Humble pie for Osborne as his 'pasty tax' proves too hot to handle", *Financial Times*, 29 May 2012

> charitable giving from the cap … The amounts concerned are tiny compared with the total tax changes announced in the Budget—in monetary terms, less than 2% of the Budget changes … In the last year of the forecast period, the Budget measures that we announced in March would have resulted in an additional £1.14 billion for the Exchequer. As a consequence of these changes, that figure will now be £1 billion. These are relatively small items, but we have listened to the specific cases that have been made on the three elements.[28]

On this occasion several Members welcomed these changes, though speaking for the Opposition, Rachel Reeves, argued that "failing to do the necessary work on a policy before announcing it and then sneaking out a reversal … is not consultation – it is total incompetence."[29]

On 28 June the Exchequer Secretary announced the publication of the department's response to the consultation, and that provision would be made in the *Finance Bill* to implement these changes to the VAT rules:

> **The Exchequer Secretary to the Treasury (Mr David Gauke):** HM Revenue and Customs (HMRC) is today publishing its summary of responses to the consultation "VAT: Addressing Borderline Anomalies". The consultation, launched on 21 March 2012, closed on 18 May 2012 and nearly 1,500 responses were received. The Government have set out some amendments to the initial proposals and further details are contained within the response document.
>
> The changes to the VAT rules will be enacted through a new schedule to be introduced at the Report stage of the Finance Bill.
>
> The summary of responses document is available on HMRC's website and copies have been placed in the Libraries of both Houses.[30]

The department's document discussed the views it had received on these VAT changes and how, in each area, the Government would proceed. Notably most of the 1,493 responses received were on individual changes, and came from those businesses, individuals and charities that would be affected:

> The consultation was a technical consultation on the draft legislation and analysis published within the consultation document, and not a consultation on whether to proceed with the measures. However although the consultation document tried to steer responses by asking specific questions about the draft legislation, very few respondents provided specific answers to these questions. Most instead focussed on the impacts and whether they supported the measures or not.[31]

No other major changes to the original proposals were put forward, though some minor amendments were proposed. The document included updated impact notes which, in

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[28] HC Deb 11 June 2012 c23, c25. The background to the third of these issues is discussed in, *Income tax – cap on unlimited reliefs*, Library standard note SN6303, 16 July 2013.

[29] HC Deb 11 June 2012 c24

[30] HC Deb 28 June 2012 c21WS

[31] *VAT: Addressing borderline anomalies – summary of responses*, 28 June 2012 para 1.10

several cases, incorporated new costings of the amounts of money to be raised. It was now estimated that taken together these changes would raise around £210m by 2013/14.[32]

Rather than enacting these changes to the VAT rules through a series of statutory instruments, the Government put down a new schedule to the *Finance Bill*, which was debated and approved at the Bill's report stage of 3 July.[33] On this occasion the Exchequer Secretary argued that the new schedule "shows that the Government are willing to listen to practical concerns and to amend the proposal accordingly, without undermining the rationale for the measures." Speaking for the Opposition Catherine McKinnell MP argued that there should not be any changes to "VAT exemptions until [the Government] have … worked out exactly what the impact of any change would be on jobs, living standards and business," though the Government refused to undertake any further formal research on the issue.[34]

These changes to the VAT rules took effect from 1 October 2012 as initially announced, though the new 5% rate for static holiday caravans took effect from 6 April 2013.[35] Further guidance was given in a series of VAT Information Sheets all published in August 2012:[36]

- *VAT Info Sheet 15/12 : Sports nutrition drinks*
- *VAT Info Sheet 14/12 : Self storage*
- *VAT Info Sheet 13/12 : Hairdressers' chair rental*
- *VAT Info Sheet 12/12 : Hot food and premises*
- *VAT Info Sheet 11/12 : Taxing holiday caravans*
- *VAT Info Sheet 10/12 : Approved alterations to listed buildings*
- *VAT Info Sheet 09/12 : Anti-forestalling for approved alterations to listed buildings*

Since then these changes do not appear to have been debated at length in the House, or been discussed in the press. The following sections of this note look in more detail at the three elements to the package of measures that generated most controversy: holiday caravans, hot takeaway food, and, sports nutrition drinks.

4 Holiday caravans

Caravans are liable to VAT at the standard rate, though, since the introduction of VAT in 1973 static caravans have been zero-rated: the legislation has excepted those caravans whose size is such that they cannot be towed on the roads.[37] In brief caravans have been zero-rated if "exceeding the limits of size for the time being permitted for the use on roads of a trailer drawn by a motor vehicle having an unladen weight of less than 2,030

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[32] Initially the Government had anticipated these changes raising about £270m by 2013/14 (*Budget 2012* HC 1853 March 2012: Table 2.1 – items 27&28). The Autumn Statement revised this estimate slightly, to £205m by 2013/14 (Cm 8480, December 2012 p57: Table 2.1 – item 35).

[33] Notice of Amendments, *Finance Bill, as amended*, 28 June 2012 (New Schedule 1 pp171-5)

[34] HC Deb 3 July 2012 c784, c785. The new schedule was approved by 311 votes to 230 (HC Deb c830).

[35] *VAT … summary of responses*, 28 June 2012 para 3.1

[36] HMRC Business Brief 27/12, 3 September 2012

[37] Initially this exception was made under group 11 to schedule 4 of the VAT Act 1994.

kilogrammes."[38] HM Revenue & Customs publish guidance on the VAT treatment of caravans which gives some details on terminology, and how the zero-rate is applied:

> **2.1 What is a caravan?**
> The term 'caravan' is not defined in the VAT legislation.
> In practice we base our interpretation on the definitions in the Caravan Sites and Control of Development Act 1960 and the Caravans Sites Act 1968.
> A caravan is a structure that:
> - is designed or adapted for human habitation
> - when assembled, is physically capable of being moved from one place to another (whether by being towed or by being transported on a motor vehicle so designed or adapted), and
> - is no more than:
>   - 20 metres long (exclusive of any drawbar)
>   - 6.8 metres wide, or
>   - 3.05 metres high (measured internally from the floor at the lowest level to the ceiling at the highest level).
>
> A 'twin unit' caravan can fall within this definition if composed of no more than two sections designed to be assembled on site by means of bolts, clamps and other devices, as long as, once assembled, it is physically capable of being moved from one place to another.
>
> For a caravan to be regarded as designed for human habitation it must have the attributes of a dwelling, that is, it must consist of self-contained living accommodation. It would need to have washing facilities and the means to prepare food (such as kitchens and bathrooms). We see the term caravan as including mobile homes (often known as residential park homes), static caravans (often called caravan holiday homes or lodges), but not motor caravans (often called motor homes) … The VAT liability of a caravan depends upon its size (see paragraph 2.2).
>
> **2.2 What is the liability of the supply of a caravan?**
> For anyone making supplies of caravans it is necessary to establish whether or not VAT is chargeable.
>
> The supply will be **standard-rated** unless the caravan is **either**:
> - more than 7.0 metres long, **or**
> - more than 2.55 metres wide,
>
> in which case it is zero-rated.
>
> Note that these measurements exclude towing bars and any similar apparatus used solely for the purpose of attaching the caravan to a vehicle.[39]

It is worth adding that a static caravan is often sold with fixtures and removable features – such as tables, fridges and washing machines – that would be charged VAT at the standard rate. If the caravan in question is zero-rated, then goods that are supplied with it such as sinks and WCs that would ordinarily be part of a new house or flat would *also* be zero-rated.[40]

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[38] Under item 1 of group 9 to schedule 8 of the *VAT Act (VATA) 1994*. Caravans *under* this size limit were subject to the higher rate of VAT which covered certain 'luxury goods' from 1975 to 1979 (under item 1 to group 4 of schedule 7 to the *Finance (No.2) Act 1975*).

[39] VAT notice 701/20 – Caravans & houseboats, April 2012 pp4-5

[40] *op.cit.* para 3.1

In its consultation document HMRC explained that although the size test was intended to restrict the zero-rate to residential caravans, purchasers of holiday caravans have also been benefiting from tax relief:

> The VAT zero rate was only intended to apply to the sale of residential caravans and not to holiday caravans. The legislation only taxes as holiday caravans the sale of caravans that can legally be towed by a family car (commonly known as "tourer" caravans). However, over the years an increasing number of other caravans that are used for holiday purposes are benefitting from the zero rate but the sale of other types of holiday accommodation (in smaller caravans or in new holiday homes that cannot be occupied all year round) is taxable.[41]

The department went on to propose an amended test for zero-rating:

> The size test will be replaced by a new test that restricts the zero-rate to the sale of caravans that conform to British Standard BS 3632 (or equivalent) which indicates that the caravan is designed and manufactured for continuous all year round occupation, and is therefore suitable for residential accommodation. This change will help to ensure that all holiday caravans are taxed consistently at the standard rate.
>
> **Examples of products affected by the change include:** caravans and that do not meet the required British Standard.
>
> **Examples of products not affected by the change include:** residential park homes which do meet the required British Standard.[42]

As noted above, the House debated the Government's proposals in the context of the debates on the Finance Bill by the Committee of the Whole House (CWH) on 18 April. During the debate many Members raised concerns about this particular change. For example, Peter Aldous MP argued "today's static caravan has more in common with a holiday home that a mobile caravan. [They] … are more like are more like second homes in terms of their facilities and the nature of the accommodation, the investment that their owners have made in them, and the way in which they are used—not just for once-a year holidays, but for regular visits throughout the year."[43] Karl Turner MP suggested "a static caravan is often a second home, but if I accept that there is an anomaly, surely there should be time for a proper consultation and an opportunity for people to think about the impact on their businesses and jobs."[44]

Alan Johnson MP noted that the department's assessment showed extending VAT "will lead to a 30% reduction in demand, although the National Caravan Council says that the real figure will be more like 75% or 80%."[45] (Mr Johnson is referring to the department's costing of this change, and its estimate that the price elasticity of the market for static caravans is -1.5: all other things being equal, a 20 percentage point increase in price would see a 30 percentage point fall in sales. It is worth noting that elasticity is also a measure of constraints placed on suppliers in passing through price rises – and the Treasury assessment suggested

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41 *VAT: Addressing borderline anomalies*, March 2012 p20

42 *op.cit.* p21

43 HC Deb 18 April 2012 c420

44 *op.cit.* c426. In addition, 83 Members have signed an EDM critical of this change (EDM 31 of 2012-13, 9 May 2012).

45 *op.cit.* c422

the "measure might lead to a ***small increase*** in the price of static caravans which would lead to a fall in demand."[46])

In responding to these concerns from these and other Members, the Exchequer Secretary, David Gauke, said the following:

> Taxing static holiday caravans and larger touring caravans will bring their treatment into line with that of other holiday accommodation. VAT is already paid on mobile caravans, camper vans, canal narrow boats and camping equipment. We therefore propose to replace the current definition of a zero-rated caravan, which is based on size, with a new definition based on whether the caravan is designed for residential use. We are considering applying British Standard 3632, and are also considering an additional test. However, I have received representations from, among others, my hon. Friend the Member for Boston and Skegness (Mark Simmonds) arguing against that, and we will examine those arguments closely.[47]

The Minister also summarised the Government's case in Treasury Questions a few days after this debate; an extract from his comments is given below:

> The Government have proposed a new definition of a zero-rated caravan, based on whether it has been designed and constructed for residential purposes. To achieve that, we have proposed a test, based on British Standard 3632, indicating that the caravan has been designed for continuous, all-year-round occupation. We are consulting on whether additional criteria should be added to ensure that the zero rate applies only to caravans intended for residential use … VAT is chargeable on mobile caravans, camper vans, narrowboats, beach huts and tents, and we are seeking greater consistency in the area.[48]

Nonetheless at the conclusion of the CWH debate a good many Coalition Members voted against the Government on a series of new clauses opposing any change to these VAT proposals, with the vote on caravans being particularly close.[49]

On 28 May 2012 the Minister wrote to the Chairman of the Treasury Select Committee, confirming that the Government had decided to take a different approach to applying VAT in this area; an extract from his letter is given below:

> On static holiday caravans, the VAT zero rate was only ever intended to apply to the sale of residential caravans. However, over the years an increasing number of static holiday caravans have come to benefit from the zero rate. Having consulted on a standard test for residential caravan accommodation we are satisfied that the boundary between residential and non residential caravans is not clear cut. We will therefore take a stepped approach that takes account of this. At present, in the vast majority of cases, Council Tax is not paid on static holiday caravans (as happens with permanent residences) but nor are they subject to any VAT. We will therefore charge VAT at a permanent intermediate rate of 5% on static holiday caravans to reflect their position between permanent residences that are not liable for VAT and other caravans that are

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[46] *VAT: Addressing borderline anomalies*, March 2012 p41 – ***emphasis added***

[47] HC Deb 18 April 2012 c441

[48] HC Deb 24 April 2012 c802

[49] New clause 6 proposed that zero-rating for holiday caravans should not be amended, and was negatived by only 287 votes to 262 (*op.cit.* c451). See also, "Coalition MPs bloody Osborne's nose on Budget", *Financial Times*, 19 April 2012

> liable for standard rate VAT. This will apply from 6 April 2013, rather than 1 October 2012, to give the industry more time to adjust.[50]

The Government's change of approach was strongly welcomed by the industry,[51] and in its response document the department confirmed that they would proceed with this approach. The test for distinguishing between park homes and holiday caravans would rely on the British Standard BS 3632 as originally proposed:

> On balance, we have decided that the best way of achieving the policy objective without imposing significant additional burdens is to continue with the option in the consultation document basing the distinction between holiday and residential static caravans on the single test of whether they meet BS 3632 or not. This has the clear advantage of simplicity as any static caravan that meets BS 3632 will benefit from zero rating throughout the supply chain.
>
> Although some static caravans that meet BS 3632 may be used for holiday purposes it will still broadly meet the policy objective, particularly as the consultation has confirmed that it will not be financially advantageous to upgrade most static caravans used for holiday purposes to meet BS 3632.This is especially so now that static holiday caravans will be subject to 5% rather than 20% VAT. It will also mean that the VAT distinction is based on an objective criterion. Static caravans meeting BS 3632 meet key health and safety requirements that make them suitable as residential accommodation.[52]

At the report stage of the Finance Bill the Exchequer Secretary was asked about the potential impact of the new 5% rate; on this occasion Mr Gauke said the following:

> We assessed what the impact would be if VAT was at 20%, and obviously 5% is a quarter of that, so one can draw correlations ... The impact that we originally set out in the tax information and impact note at the time of the Budget will be significantly lessened by the change to the 5% rate, particularly bearing in mind that there is already a full 20% rate on a fair proportion of static caravans because of the durable goods contained within them.[53]

5 Catering & hot takeaway food

To date the supply of food for human consumption has been charged VAT at the zero rate, but the supply of food *in the course of catering* is specifically excluded from zero-rating.[54] This covers the supply of hot takeaway food – that is, the supply of hot food for consumption off the premises on which it is supplied. In this context, "hot food" is defined as food "which, or any part of which, (i) has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature; and, (ii) is above that temperature at the time it is provided to the customer."[55]

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[50] *Letter from the Exchequer Secretary to the Treasury, David Gauke MP to the Chairman of the Treasury Select Committee, Andrew Tyrie MP*, 28 May 2012

[51] National Caravan Council press notice, *VAT on holiday caravans to be levied at 5%*, 29 May 2012

[52] *VAT … summary of responses*, 28 June 2012 para 2.5.11

[53] HC Deb 3 July 2012 c777

[54] Under items1-4 of group 1 to schedule 8 of the *VAT Act (VATA) 1994*

[55] Under Note 3(b) to group 1, schedule 8 of *VATA 1994*

HM Revenue & Customs publish guidance on the VAT treatment of these supplies, including discussion of whether food is "hot" or not for the purposes of VAT – which illustrates the difficulties inherent in these distinctions:

> **4.3 What does 'hot' mean?**
> Hot in this context means above the surrounding air temperature.
>
> Examples of standard-rated sales when sold hot are:
> - fish and chips, chicken and chips
> - chips
> - Chinese, Indian, Greek, Italian and any similar take-away meals and dishes
> - baked potatoes with a hot or cold filling
> - hot dogs and hamburgers
> - pies, rolls, sausage rolls, pasties and similar items (if sold 'freshly cooked' see paragraph 4.4)
> - toasted sandwiches
> - cups of tea, coffee, chocolate and other hot drinks
> - cups of soup
> - roasted chestnuts
>
> **4.4 What about freshly cooked products?**
> If you sell freshly cooked products for consumption while they are still hot they are standard-rated, see paragraph 4.5. Some of these products are, however, not sold with such an intention They may only be hot/warm as they are in the process of cooling down. Examples include pies, pasties, sausage rolls and similar savoury products, cooked chickens or joints of meat, bread products and croissants. The liability will depend, therefore, on how you prepare and sell them.
>
> **If they are sold** specifically for consumption whilst still hot (as a result of being freshly prepared, baked, cooked, reheated or kept warm) **they will be standard-rated.** See also paragraph 4.5
>
> **If they are sold** warm simply because they happen to be freshly baked, are in the process of cooling down and are not intended to be eaten while hot; or cold or chilled at the time of purchase **they can be zero-rated**
>
> **4.5 What do we mean by 'specifically sold for consumption whilst still hot'?**
> You sell food specifically for consumption whilst still hot if you either:
> - have an established hot take-away trade and are selling the food as a part of that trade
> - advertise it as either hot take-away food or in any other way which indicates that it is meant to be eaten while still hot
> - sell it accompanied by napkins, forks, etc to enable it to be eaten before it cools
>
> It does not matter where you sell the food - if it is for consumption while still hot, it will be standard-rated. This means that hot take-away food sold in supermarkets, kiosks at airports or stalls at train stations, etc, are all subject to the same rules.[56]

When VAT was introduced in this country in 1973, a distinction was drawn between the supply of food (which was charged a zero rate), and the supply of catering (which was charged the standard rate). Initially the scope of the zero rate included hot takeaway food,

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[56] *Catering and take-away food - HMRC VAT Notice 709/1*, November 2011 paras 4.3-5

but in his Budget speech in March 1984 the then Conservative Chancellor Nigel Lawson Government stated that as “takeaway food clearly competes with other forms of catering”, it should also be standard-rated.[57] In 2005 the Labour Government made a small change in the law, to ensure consistent treatment for all hot takeaway food.[58] Some traders had made the argument that the precise wording of the law meant that hot takeaway food might be zero-rated if the customer paid for the food some time after it had been supplied. The then Paymaster General, Dawn Primarolo, set out the purpose of this change at some length, when the legislation was debated in the House:

> The effect of the present law on hot food is that a supply of food is excluded from the zero rate if, first, it has been heated for the purpose of enabling it to be consumed at a temperature above the ambient air temperature and, secondly, it is above that temperature at the time of supply. That means that VAT is not charged on the sale of all hot food but only on that food that has been heated or kept warm before sale in the expectation that it will be consumed before it has cooled to air temperature. Food such as freshly baked bread may be hot when sold, but is clearly not takeaway food, and will remain VAT-free.
>
> The present law therefore provides a VAT borderline between, on the one hand, most groceries, which are VAT-free, and, on the other hand, supplies of catering, including hot takeaway meals, on which VAT is chargeable. The present VAT position also ensures fair VAT treatment for the takeaway sector, by ensuring that all supplies of hot takeaway meals are taxed in the same way. The purpose of the order is to clarify and protect that position.
>
> We have become aware of the view, which we do not believe is widely held in the takeaway sector, that a certain construction might be put on the wording of existing VAT legislation. According to that interpretation, the reference to "time of supply" in the legislation means that the VAT treatment of food might depend on the point in the cooking process at which payment from the consumer is made and, in particular, whether the food is hot when payment is received by the supplier.
>
> Clearly, that interpretation would lead to an absurd outcome in which the method of payment for the food received and the point at which that payment was made would determine whether VAT was chargeable, rather than what was being supplied. Not only would such an outcome pose a risk to tax revenues, it would undermine the fair and equal VAT treatment of all takeaway outlets and penalise those, including many small takeaways, that are not in a position to arrange their affairs so as to take payment in advance of cooking the food that they sell.
>
> The Government do not accept that that construction of the law has any merit. However, to provide the takeaway sector with the benefit of legal certainty and an assurance of fair and equal VAT treatment, we believe that it is right to act so as to put the existing position beyond legal doubt. Therefore, the order makes clear that it is the temperature of the food when the customer receives it, rather than the temperature of the food when payment is received by the supplier, that determines whether VAT is chargeable.
>
> The order does no more than reflect the way in which the law has generally been understood and applied by Customs and Excise and takeaway businesses since 1984.

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[57] HC Deb 13 March 1984 c303. Provision to this effect was made by section 10 & part I to schedule 6 of the *Finance Act 1984*, with effect from 1 May 1984.

[58] under the *Value Added Tax (Food) Order* SI 2004/3343, which amended Note 3(b) to group 1, schedule 8 of *VATA 1994*, accordingly

> It will provide certainty and discourage attempts to undermine the VAT borderline between zero-rated groceries and standard-rated catering supplies. It will also protect VAT revenues and ensure the continuing equal VAT treatment of all takeaway outlets, while maintaining the present zero rate for food in its entirety.[59]

The change in the law did not prevent boundary disputes where businesses argued that they were supplying was zero-rated food while HMRC considered it to be standard-rated catering. A standard guide to the law cites some case law on this issue.[60] In a leading case the Court of Appeal was asked to consider the situation where a bakery shop cooked pies and pasties on the premises, then kept them on unheated wooden racks for sale. The Court held that these items could only be taxed as hot takeaway food *if* the predominant subjective purpose of the seller in heating the food was to enable it to be consumed while still hot. Zero-rating would apply, as in this case, where the aim of doing this was to assure customers that the goods in question were freshly-baked, even if some customers had bought and eaten items that were still warm from the oven.[61] A second case involved the tribunal rejecting an argument that filled croissants were heated to keep them fresh and to prevent them from hardening. On the evidence, it found that the company's predominant purpose in cooking the savoury croissants and presenting them for sale hot was so that they could be consumed at a temperature above the ambient air temperature.[62]

There have also been tribunal cases involving appeals by businesses operating Subway franchise stores selling toasted sandwiches;[63] indeed one tribunal case decided in 2010 noted that at that time there were about 250 appeals by Subway franchises. In this case, the tribunal required a long, detailed analysis of the way 'Subs' are prepared, to determine that this type of sandwich meets the criteria for standard-rating, as it is toasted in a speed oven so that the customer can eat the sandwich while it is still hot.[64] The issue was raised in a PQ last year; in response the Minister stated that the department had not changed its policy, but that in 2005 it changed its assessment in an individual case, having reviewed the facts:

> **Mr Chope**: To ask the Chancellor of the Exchequer (1) what his policy is in relation to the liability of fast food outlets to pay value added tax on toasted sandwiches; [40812]
> (2) for what reasons HM Revenue and Customs rescinded its decision that toasted sandwiches should be treated in the same way as other sandwiches and not subject to value added tax in December 2005. [40813]
>
> **Mr Gauke:** VAT is payable on a supply of hot food that has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature and it is above that temperature at the time it is provided to the customer. This applies to food sold by any business. Food served in restaurants and cafes has always been taxable at the standard rate as a supply of catering. In 1984 this was extended to include hot take-away food (including toasted sandwiches) in order to bring it into line with that of restaurant meals. HMRC has a responsibility to administer VAT law correctly. In 2005, a decision that had been made to an individual taxpayer

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[59] Fourth Standing Committee on Delegated Legislation, 19 January 2005 cc3-4

[60] *Tolley's VAT 2013/14* para 11.5.

[61] *John Pimblett & Sons v C&E Commrs* [1988] STC 358, CA – see also, "Ask an expert – VAT on hot food", *Tax Journal*, 20 April 2012

[62] *Pret A Manger (Europe) Ltd v Her Majesty's Revenue & Customs (VTD 16246)*

[63] *European Independent Purchasing Company Limited (1) Sub Retail Unit (2) v Her Majesty's Revenue & Customs (VTD 20697)*, 2 June 2008; *Sub One Limited (t/a Subway) v Her Majesty's Revenue & Customs* (TC 00747), 14 October 2010.

[64] The judgement is available at: http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j5116/TC00747.doc

> was withdrawn following a review of all the relevant facts. HMRCs policy on toasted sandwiches has remained unchanged since 1984.[65]

Turning to Budget 2012, HMRC set out its case for revising the law in its consultation document; an extract is given below:

> **Why do the current rules need changing?**
> The borderline between hot takeaway food (standard-rated) and cold takeaway food (zero-rated) has for a number of years been the subject of litigation with some retailers arguing that the purpose of heating their food products is to improve their appearance or to comply with health and safety regulations, rather than to enable them to be consumed hot. This litigation has been decided on the facts of each individual case. As a result, the VAT rules in this area have become unclear and increasingly prone to legal challenge, leading to similar products receiving different tax treatment. So, although many retailers and take away outlets charge VAT on the sale of hot chicken products, hot pies and toasted sandwiches, some retailers and bakery chains sell similar products zero-rated.
>
> **Scope of change**
> The changes will apply VAT at the standard rate to all food which is at a temperature above the ambient air temperature at the time that it is provided to the customer, with the exception of freshly baked bread. This will clarify the rules in this area and ensure that all hot takeaway food is taxed consistently. Freshly baked bread that is cooling down in racks will remain zero-rated. 'Bread' will be defined in guidance but will include loaves, rolls, baguettes etc.
>
> **Examples of products affected by the change include:** rotisserie chicken products, pies, pasties, toasted sandwiches etc. when above the ambient air temperature at the time they are provided to the customer.
>
> **Examples of products not affected by the change include:** Freshly baked bread; and pies, pasties, sandwiches etc. when at or below ambient air temperature at the time they are provided to the customer.
>
> *Proposed new legislation*
> *Hot food will be defined in a new note 3B as follows: "For the purposes of paragraph (b) of Note 3, "hot food" means food which, or any part of which, is above the ambient air temperature at the time it is provided to the customer, other than freshly baked bread"[66].*

As noted the Government wished to ensure that freshly baked bread remains zero-rated, and the consultation document asks if this can be done effectively: "freshly baked bread which is cooling down will remain zero-rated. Bread will be defined in guidance. What types of bread are most likely to be baked on a retailer's premises and are therefore above ambient air temperature at the time they are provided to customers?[67]

HMRC also proposed a change in the statutory definition of 'premises' – as where food is consumed 'on-premises' this is treated as catering, whereas cold food eaten 'off premises' may be zero-rated.[68] A second extract is reproduced below:

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[65] HC Deb 14 February 2011 cc556-7W

[66] *VAT: Addressing borderline anomalies*, March 2012 pp6-7

[67] *VAT: Addressing borderline anomalies*, March 2012 p7. For some criticism of this approach – and, in particular, the retention of this test using ambient temperature, see "Half-baked idea", *Taxation*, 11 April 2012.

[68] The legislation states that "catering" specifically includes any for consumption "on the premises in which it is supplied" and "hot food for consumption off those premises" (Note 3(a) to group 1, schedule 8 of *VATA 1994*).

A supply of food "in the course of catering" is standard-rated. This includes a supply of food for consumption on the premises on which it is supplied. "Premises" includes the unit from which a retailer makes its sales along with any other areas set aside for the consumption of food … The borderline between on-premises consumption of food (standard-rated) and off-premises consumption of cold food (zero-rated) has been the subject of litigation over the years. More recently disputes have arisen as to whether food courts in shopping centres (which can also be shared with other retailers) and tables and chairs outside a cafe form part of a retailer's premises …

What is the scope of the change?
This change will confirm that "premises" includes all areas that are set aside for the consumption of food even if those areas are shared with other retailers.

Examples of areas affected by this change include: tables and chairs on the pavement outside a café, food courts in shopping centres, other similar shared eating premises such as in motorway service stations, airports, railway stations etc.
Examples of areas not affected by this change include: benches in a shopping centre for resting, airport departure seating etc.

Proposed new legislation
The reference to "premises" in note 3(a) will be clarified in a separate note 3A as follows: "(3A) For the purposes of note (3), in the case of any supplier, the premises on which food is supplied include any area set aside for the consumption of food by that supplier's customers, whether or not the area may also be used by the customers of other suppliers".[69]

Given the sums of money involved, it is perhaps surprising that these proposals have generated the amount of comment that they have. Nevertheless, the issue arose when the Chancellor appeared before the Treasury Committee after the Budget:

Q316 John Mann: … As you are putting up the price of hot pasties in Greggs, if I buy a pasty from Greggs that is cooked hot, but by the time it gets in the paper bag and I take it away it is cold, will it be vatable or not?

Mr Osborne: If it is cold when you buy it, it will not be.

Q317 John Mann: So if they do a hot pasty that gets cold, that will not be vatable.

Mr Osborne: The intention was very clear … In 1984 Parliament decided that hot takeaway food should have VAT on it. Now, in the years-

John Mann: We are asking about your Budget.

Chair: John, let the Chancellor explain the position on hot and cold pasties, because this is a matter of burning significance in the west country.

Mr Osborne: Burning is partly the issue. In 1984, 30 years ago, there was an intention to make sure that hot takeaway food was vatable. Since then, under all Governments, there has been a load of legal action to try and get around that. Lots of reasons have been given for why some hot products are not designed to be hot when they are eaten. I am seeking to-of course, this was voted on last night by Parliament-just stick with the position that hot takeaway food has VAT on it. If you buy your pasty in a fish and chip shop, it almost certainly has VAT on it. If the pasty is heated up in a

[69] *VAT: Addressing borderline anomalies*, March 2012 pp8-9

microwave in the shop, it has a VAT on it. What we are trying to do is make sure that hot takeaway food has VAT on it. That was a decision made in 1984, 28 years ago.[70]

There were also been two Early Day Motions critical of the proposed change.[71]

For its part in its report on the Budget the Treasury Committee simply noted that this particular measure had "attracted significant attention from the public and the media", while going on to recommend that "where changes to complex areas of taxation are proposed, the greatest possible supporting material be published to allow for greater scrutiny of the possibility of unintended consequences."[72]

Speaking for the Opposition at the second reading of the Finance Bill, Rachel Reeves argued that extending VAT in this way would have a significant impact on business:

> VAT has been increased on the regular purchases of millions of ordinary families and is a heavy blow to many small businesses, manufacturers, retail employers and churches caught out by these changes … [With regard to VAT on hot snacks] many businesses are worried, about both the additional tax they will have to pay and the additional bureaucracy of form-filling. As hon. Members said, it is not at all clear at which point VAT will stop being charged. What temperature does the food have to be, or by how much must it have cooled down before the tax rate goes to 0% from 20%?[73]

In response the Exchequer Secretary, David Gauke, made the following comments:

> We have taken decisions to remove anomalies in the VAT system, but VAT is a broad-based tax and it is neither fair nor economically justifiable for similar or identical products to be treated in different ways on the basis of arbitrary distinctions. The same approach should apply to mobile caravans as to static, non-residential caravans, and to a hot pie served in a fish and shop and one served in a bakery.
>
> Labour Members argue that removing those anomalies will hit living standards, but may I put those measures in context? Next year, basic rate taxpayers will get a £170 income tax cut. That will be sufficient to pay VAT on 1,300 Greggs hot sausage rolls. I confess that those consuming more than 1,300 Greggs hot sausage rolls—that is 26 a week—will lose under the Budget, but I suspect that that is the least of their worries.[74]

Several Members raised this issue two days later, when all of the proposed VAT changes were discussed by the Committee of the Whole House. Stephen Gilbert MP moved a new clause to block any change in the scope of zero-rating, arguing that it would be "unfair and unworkable … and bad for the economy of Cornwall." George Henderson MP suggested that the proposed new statutory test would create more anomalies – as shops without air-conditioning – and higher 'ambient temperatures' – would be able to sell more zero-rated items, and shops would be entitled "to serve hotter pies without charging VAT in the summer than in the winter, when the ambient temperature if much lower."[75] The Exchequer Secretary, David Gauke, addressed these concerns in some detail when responding to the debate – an extract from his speech is given below:

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[70] Treasury Committee, *Thirtieth report – Budget 2012*, 18 April 2012 HC 1910-ii 2010-12 Ev 44. see also, "George Osborne chokes on pasty question", *Guardian*, 27 March 2012; "Cameron bits back at critics as 'pasty tax' troubles Tories", *Financial Times*, 29 March 2012

[71] EDM 2917 of 2010-12, 26 March 2012 & EDM 2952 of 2010-12, 16 April 2012; these motions were signed by 20 & 34 Members respectively.

[72] HC 1910 2012-12 para 116

[73] HC Deb 16 April 2012 cc48-9

[74] HC Deb 16 April 2012 c130-1

[75] HC Deb 18 April 2012 c427, c433

> The current rules on the VATability of such food have been made complex and unfair by a patchwork of different legal decisions taken over the decades. The definition of hot takeaway food has been in place since 1984, and it applies to food that "has been heated for the purposes of enabling it to be consumed at a temperature above ambient air temperature" and that is "above that temperature at the time it is provided to the customer".
>
> There have been repeated efforts since the 1980s, however, to chip away at this boundary. A number of businesses have argued in litigation that although the food they may provide to their customers is hot and is taken away, it should not be taxed as hot takeaway food, but should instead be zero-rated. Some have argued successfully that their intention was not to provide their customers with food to be eaten hot, but that they heated their food for other reasons instead—for hygiene reasons, or to finish the cooking process, or to provide evidence of freshness, or to create an aroma or to improve appearance, crispiness or texture ...
>
> Those arguments have not always been successful, but they have resulted in some businesses being able to secure VAT-free treatment for a range of hot products, such as hot rotisserie chickens, meat pies, pasties and panini. Other businesses, however, have continued to apply VAT to the similar hot-food products that they sell. They have accepted or the courts have ruled that their intention is to heat their food products so that their customers can eat them hot. Under the current rules, a small independent fish and chip shop will have to charge VAT on its hot chicken, but a major supermarket will argue that its rotisserie chickens are zero-rated. One baker who keeps his sausage rolls in a hot cabinet to provide his customers with a hot snack will charge tax, but the baker next door who keeps them hot and argues that the purpose is to maintain an appealing aroma will claim that they are zero-rated. The current rules mean that many customers simply do not know whether they are being charged VAT on their hot food because the treatment depends on the particular supplier's purpose in heating the food. The new rules will ensure a level playing field, and we are removing the subjective element …
>
> Let me make a point about the arguments surrounding ambient temperature. This test has been in place since 1984. We do not expect staff to take detailed temperature readings every time they sell a pasty. HMRC will take a pragmatic approach, and provide businesses with guidance, taking into account the responses of businesses on how to implement the change. I have to point out that existing simplification schemes are already available to allow businesses to calculate their VAT liability by reference to a fixed percentage of their turnover without requiring staff to consider the temperature of every product sold. This is a pragmatic approach, already in existence.[76]

Despite the Minister's comments, several Coalition Members voted against any change in the VAT liability of hot takeaway food, and the new clause moved to this effect was negatived by only 295 votes to 260.[77]

Writing on the problems to distinguishing between takeaway pizzas and hot pasties in the *Financial Times* John Kay suggested that "fine, but arbitrary distinctions, are endemic in tax law", but that "the fewer arbitrary distinctions we need … the better":

> Officials translate the incompletely formulated thoughts of policy makers into enforceable laws and regulations. But this is rarely an easy or trivial task. To tax income you must distinguish income from capital, and that distinction remains elusive even after thousands of pages of accounting principles. The common sense that says "I know the difference between a Cornish pasty and a ham sandwich when I see it" is

76 HC Deb 18 April 2012 cc439-440
77 *op.cit.* c447

appealing, but we would rightly find it unacceptable that the decisions of a tax inspector should be based on the principle that he knows what to tax when he sees it. And that is before you encounter the problem of tax advisers whose profession it is to make a Cornish pasty resemble a ham sandwich (or the reverse).

But to say that modern tax systems are inescapably complex does not mean that tax systems need be as complex as they are. Some distinctions are easier to make than others. Consumption is relatively simple – although not altogether simple – to define and monitor, which is why VAT has proved so successful. The difference between income and capital gains is more difficult, and the problems of implementing that distinction work to the advantage of the better off, whose finances are complex and who can afford good advice. Wealth taxes are everywhere hopeless, not because it is wrong to tax wealth, but because the practical problems of defining and identifying wealth in a modern society are so great.

The fewer arbitrary distinctions we need to make in our tax structure, the better. Every measure that uses tax or regulation for social or economic engineering requires us to differentiate between what is good and bad by reference to objective criteria based on the wording of a document or the physical characteristics of the taxed object. That is why we need legislation to distinguish a pasty from a sandwich. Whenever we find ourselves in that position, we should ask the question: is there a better way of achieving the underlying objective?[78]

In a slightly sardonic Q&A piece in the same paper the economist Tim Harford noted that the amounts anticipated to be raised from this change - £50m in 2012/13, rising to £105m by 2013/14 – were very small – but that should not prevent the controversy encouraging a much more substantive re-examination of the way VAT works:

Government tax revenue is £575bn. Her Majesty's Revenue & Customs reckons the pasty tax will raise £50m this year. You did such a good job on the last maths problem, can you tell me what percentage of the total tax base £50m is?

Not a very big one.

Quite so – about 0.01 per cent, although HMRC reckons it will rise to closer to 0.02 per cent over time. To put it another way, every British citizen pays an average of almost £10,000 in tax and the pasty tax will raise one pound a head … the budget already cut income tax for low- to middle-income families by over a hundred pounds a year, which will buy a lot of pasties. And if you care about poor families, note the cut in the welfare budget by £10bn a year, or 200 times the sum at stake with the pasty tax.

And it creates absurd anomalies – for instance, a warmish sausage roll will be subject to VAT, or not, depending on whether it's a cold day or a hot day.

I agree, but VAT is already subject to absurd anomalies, such as whether Jaffa Cakes are cakes or biscuits, and thereby exempt from or subject to VAT … The courts [ruled they were cakes] so Jaffa Cakes enjoy a tax break relative to chocolate digestives. But serious tax-watchers reckon that the UK's VAT system makes very little sense, and the pasty tax is a perfect example of it.

How so?

When you wait for a pasty to cool down in order to consume it free from tax, everybody loses: the taxman doesn't get his tax and you don't get your hot fresh pasty. That distortion leads to what we economists call "deadweight loss". The UK system is full of such distortions because so many items are VAT exempt.

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[78] "Fewer ingredients will best serve the VAT on food", *Financial Times* , 25 April 2012

So what should be done?

The Mirrlees Review is an attempt to figure out what the UK tax system would look like in an ideal world, and I looked it up. The authors reckon that you could levy a uniform rate of VAT on almost everything, raise benefits, pensions and tax credits, increase the income tax threshold by £1,000, cut the basic rate of tax to 18 per cent and the higher rate to 38.5 per cent, and leave pretty much everyone better off – the government would have more revenue and citizens would be more likely to buy what they really wanted rather than what the tax system nudged them to buy.

So you're arguing that VAT shouldn't just be introduced for sausage rolls, but for everything?

Yes. Fancy a sandwich?[79]

As noted above, on 28 May 2012 the Exchequer Secretary confirmed that the Government would take a different approach to applying VAT to hot takeaway food; details were given in a letter to the Treasury Committee, from which the following is taken:

Our proposed changes to VAT on hot take-away food were designed to ensure consistency and a level playing field in how VAT is applied and deal with the ambiguity in the system that has built up over time. The consultation has shown that there are anomalies in the current treatment to be addressed, but the proposed pragmatic approach to the treatment of food cooling down would involve a number of burdens for the businesses involved.

We have therefore decided, as a result of the responses we have received over the course of the consultation, that VAT should be consistently applied to food that is kept hot or marketed as hot, but not to food left to cool naturally. This is a more practical way of achieving our original intention - fair competition and consistency whilst addressing the practical points for business, particularly small bakers.[80]

Bakery retailers and industry groups welcomed the changes,[81] though writing in the *Tax Journal*, one tax practitioner noted that even this new test would create some uncertainties:

The change for hot food will cause many supplies which are currently zero-rated to be standard rated, such as food cooked and then kept heated for hygiene reasons.

But the crucial amendment is that freshly baked products (presumably ones that require cooking rather than heating), which are taken from the oven and allowed to cool naturally towards room temperature, will remain zero-rated even if sold while warm. This will create a new 'borderline', namely how to interpret 'cooling naturally'. We will then need to consider circumstances where that cooling process is arrested. Would a cabinet that allows minimal airflow, is made of heat-inert material, and perhaps features hot lighting, cause problems? The broad intention is for this to apply to batch baking, to avoid it applying to products that are cooked to order and which might be less palatable cold. The devil will be in the detail, and it will be interesting to see the new draft legislation.

One thing is clear – the original proposal was unworkable. The suggestion that a retailer might be able to determine if a product had reached 'ambient temperature' (thus zero-rated) or still hovered above it (standard-rated) was pie in the sky.[82]

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[79] "VAT reform would keep out pasties hot", *Financial Times*, 30 March 2012. As mentioned in section 1 of this note, details of the Mirrlees Review of the UK tax system are given on the Institute for Fiscal Studies' site.

[80] *Letter from the Exchequer Secretary to the Treasury, David Gauke MP to the Chairman of the Treasury Select Committee, Andrew Tyrie MP*, 28 May 2012

[81] For example, the Greggs' bakery chain and the Cornish Pasty Association; see also, "George Osborne forced into pasty tax U-turn", *Guardian*, 28 May 2012.

[82] "VAT reprieve for camping and pie industries", *Tax Journal*, 7 June 2012

Details of how the new test for hot food would work were set out in the department's response document:

> Under the revised proposal we will retain the existing test, which taxes food which is provided hot for the purposes of allowing it to be consumed above the ambient air temperature. But we will add to it a number of new objective tests to prevent the anomalies that have arisen as a result of case law over the years.
>
> Therefore, VAT will be applied at the standard rate to hot food which is:
> - provided hot for the purposes of allowing it to be eaten hot (the existing criterion), or
> - cooked, heated or reheated to order – for example toasted sandwiches; or
> - kept hot, or where the natural cooling process is delayed – this would include instances where businesses kept food hot in hot cabinets, hot plates, heat lamps, etc. or where heat is applied in order to slow the cooling process (Cornish pasties and sausage rolls would therefore be zero-rated where they are cooling naturally in the racks, but not when they are stored in heated cabinets); or
> - provided in heat retaining packaging or other packaging specifically designed for hot food – where the use of such packaging is a clear indicator that food is being kept hot (for example foil-lined takeaway packaging); or
> - advertised, marketed or promoted in any way that indicates that it is supplied as hot.[83]

On the linked question of a definition of premises, the department has taken the position that "the best approach is to continue with the proposed changes but to limit the scope for disagreement by providing detailed guidance for business and HMRC staff on how the new rules should be applied."[84]

When this change was debated at the report stage of the Finance Bill the Exchequer Secretary was asked about how the new tests for standard-rated hot food would work in practice; in response Mr Gauke said the following:

> We believe that we have reached the right position after much consultation and discussion with the industry and with hon. Members, many of whom have been very engaged in the matter ... The additional criteria will ensure that hot food will generally be taxed at the standard rate of VAT, but if food that would be zero-rated when cold is bought when it happens to be cooling down, but is not yet cold, it will still be zero-rated provided that it does not meet any of the criteria that I set out. These changes will add further tests to make the relief less open to abuse and provide a level playing field for all businesses supplying their customers with hot food.[85]

Although there has been little recent discussion of the Budget 2012 changes to VAT, in March 2013 John Leech MP submitted a petition for an extension of zero-rating to all types of toasted sandwich. The Chancellor published a response to this a few weeks later, reproduced below:

> The Chancellor announced in Budget 2012 a number of budget measures designed to clarify or to address anomalies and loopholes in the VAT system. The clarifying

[83] *VAT … summary of responses*, 28 June 2012 para 2.1.8-9. One advantage to the approach is that it would not need any separate definition of bread, to ensure that this remained zero-rated.

[84] *VAT … summary of responses*, 28 June 2012 para 2.1.16

[85] HC Deb 3 July 2012 c775

measures included an amendment to ensure that all hot takeaway food is subject to VAT.

The new legislation was debated and approved by Parliament last year and included in the 2012 Finance Act. It came into effect from 1 October 2012. The legislation does not distinguish between different hot takeaway food products. Any food product that is heated to order for a customer, kept hot or marketed as hot, is liable to VAT at the standard rate. If it is left to cool naturally, it is not. Toasted sandwiches have been liable to VAT at the standard rate since 1984, and there is nothing in the new legislation that changes this.

This petition proposes removing or reducing VAT from hot takeaway food "across the board". When the UK joined the European Community in 1973 we signed up to the general agreements that covered the application of VAT throughout the EC. Under these and successive agreements, we are allowed to keep our existing zero rates, but we may not extend the scope of our existing zero rate reliefs. Having excluded hot takeaway food from the scope of the zero rate in 1984, the UK cannot legally reinstate it.

Some EU Member States apply a reduced rate of VAT to restaurant and catering services, which is provided for in EU law. However, such a relief would necessarily go far wider than simply the treatment of toasted sandwiches, and would therefore come at a significant cost, which would have to be met either through increasing other types of tax or from increased public borrowing. Increasing borrowing would risk raising interest rates and undermining international confidence, which would damage the recovery and have an adverse impact on individuals, families and small businesses, including those in the hot takeaway food sector.

This Government do not plan to make any further changes to the legislation on hot takeaway food.[86]

6 Sports nutrition drinks

The relevant provisions for the zero-rating of food are set out in group 1 to schedule 8 of the *VAT Act 1994*. Under item 1 "food of a kind used for human consumption" is zero-rated, but alcoholic beverages and "other beverages (including fruit juices and bottled waters) and syrups, concentrates, essences, powders, crystals, or other products for the preparation of beverages" are standard-rated (items 3 & 4 of a list of excepted items to group 1). Unlike most beverages, specific provision is made to zero-rate "milk and preparations and extracts thereof" (item 6 to a list of exceptions). Food and beverages have been treated this way for VAT purposes since the introduction of the tax in 1973.[87]

The practical implications of these distinctions for the variety of drinks, beverages, foods and food supplements sold to help sporting performance is set out in HMRC's guidance:

4.6 Sports products
There are a wide variety of these products available including drinks, tablets, and bars. The VAT liability of these is as follows:

4.6.1 Sports/energy drinks

[86] HC Deb 25 March 2013 cc1437-8; HC Deb 24 April 2013 c6P

[87] Schedule 4 to the *Finance Act 1972* established the scope of zero-rating; group 1 dealt with food. The wording of these provisions is unchanged since then.

Drinks that are preparations of milk, meat, yeast or egg are zero-rated in their own right …Sports energy drinks are normally standard-rated beverages … but a product that is not a beverage and meets all the conditions below is zero-rated:

Condition	Description
1	It is aimed at supplying energy to enhance performance and/or accelerate recovery after exercise and both the packaging and advertising of the product reflect this.
2	It is not primarily marketed for consumption as a soft drink.
3	Its primary purpose is • the provision of energy; or • the provision of creatine; or • to build bulk; but • **not** rehydration
4	It is in the form of powder, syrup, concentrate, essence, crystal or gel or is the equivalent of these with water added.
5	It has as its main ingredient(s), other than water: • carbohydrate the majority of which is not sugar, or • creatine, or • protein, or • a mixture of each.

4.6.2 Tablets
These are standard-rated, with the exception of glucose, dextrose and Horlicks® tablets, which are zero-rated.

4.6.3 Cereal/fruit bars
Standard-rated items include compressed fruit bars, consisting mainly of fruit and nuts, and also sweet tasting cereal bars, whether or not coated with chocolate, with the exception of bars which qualify as cakes … Standard-rating applies to any product falling within the general definition of confectionery even when that product is intended to meet the special nutritional needs of athletes.

4.6.4 Creatine
With the exception of sports/energy drinks (see above), items made up wholly or mainly of creatine are standard-rated. Where it is clear that the main benefit of the product is not the creatine but carbohydrate, protein or fat, then it is treated as a food, and will be zero-rated unless it falls within one of the exceptions.[88]

The Government's consultation paper noted that the courts have ruled that some sports nutrition drinks can be considered to be zero-rated food rather than standard-rated beverages:

Why do the current rules need changing?
21. Despite their similarity to other standard-rated beverages, the courts have found some sports drinks not to be beverages because of their nutritional content and therefore zero-rated. This change ensures that all sports drinks are taxed in a similar way, ensuring that there is consistent treatment of sports drinks whether consumed for rehydration or nutritional purposes.

It went on to propose that specific provision should be made in the legislation to ensure that these products are all standard-rated:

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[88] HMRC, *VAT Notice 701/14 : Food*, October 2011 pp17-18. See also, HMRC, *VAT Manual : Food*, para 2700.

What is the scope of the change?
22. The change will only affect "sports nutrition" drinks that are currently treated as zero-rated and ensures that all sports drinks receive the same tax treatment ("sports energy drinks" for example are already standard–rated as beverages). The products affected exist pre-mixed in liquid form and also in powder form to be made up into a liquid by the consumer. They are often marketed as supplying energy to enhance performance, accelerating recovery after exercise, providing energy, or building bulk and often contain creatine.

Examples of products affected by the change include: sports nutrition drinks such as carbohydrate drinks, protein drinks, creatine drinks, work-out recovery products, whether or not in powder form.

Examples of products not affected by the change include: meal replacement drinks for slimmers and invalids.

Proposed New Legislation
A new excepted item 4A will be introduced that taxes
"Sports drinks that are marketed as products designed to enhance physical performance, accelerate recovery after exercise or build bulk, and other similar drinks including (in either case) syrups, concentrates, essences, powders, crystals or other products for the preparation of such drinks."[89]

The case law in this area was surveyed in a Tribunal case in late 2011 where it was ruled that 'Lucozade Sport' was a standard-rated beverage.[90] The tribunal considered the question of what constituted a standard-rated beverage; an extract from this is given below – enough, perhaps, to suggest why the department would be keen to have a clear statutory boundary:

Summary of decided cases relevant to the issues
8. The term "beverage" as found in Schedule 1 Group 1 is used in its ordinary English sense. The application of Group 1 is not, as Toulson observed in *HMRC v Procter & Gamble UK* [2009] STC 1990, paragraph 63, "a scientific question". And, as Warren J pointed out in paragraph 35 of the judgment in *Kalron Foods v HMRC* [2007] STC 1100 at 1108, the question whether a product is a beverage is a question of fact with the consequence that where (as has been the case here) HMRC have determined that the product is a beverage, the onus is on the taxpayer both to establish the primary facts on which it relies so as to displace that conclusion as well as to establish that its product is not a beverage. In paragraph 58 of the *Kalron* judgment, Warren J advises that caution should be "exercised in placing major reliance on any supposed distinction between drinks and beverages".

9. The Tribunal decisions on beverages have followed the approach taken in *Bioconcepts Ltd v Customs and Excise Commissioners* (1993) VAT Dec 11287 in which the Tribunal were referred to the Oxford English Dictionary definition of a "beverage" as – "Drink, liquor for drinking, especially a liquor which constitutes a common article of consumption".

Dealing with the former wording of Item 4, which referred to manufactured beverages, the Tribunal in *Bioconcepts* directed themselves that they had "to decide whether as a matter of ordinary usage the words "manufactured beverage" and "beverage" covered or applied to "Bio-Light". The Tribunal went on to reason that the meaning of "beverage" in ordinary usage – "… covers drinks or "liquors" that are commonly consumed. This is the primary meaning in the Oxford English Dictionary. Liquids that are commonly consumed are those that are characteristically taken to increase bodily liquid levels, to slake the thirst, to fortify and to give pleasure."

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[89] HMRC, *VAT: Addressing borderline anomalies*, March 2012 pp10-11
[90] Cited in, *Tolley's VAT 2013/14* para 24.11(e)

10. In *Unilever Bestfoods UK Ltd v Revenue and Customs Commissioners* (2007) VAT Dec 20016 the Tribunal described the *Bioconcepts"* approach as "workable and producing an intelligible set of results" (paragraph 31). They further explained at paragraph 28 that:

"The purpose of the Tribunal in *Bioconcepts* of including "to fortify" as an example of a liquid characteristically consumed as a drink (and consequently a beverage) was to recognise as beverages liquid products taken to enhance energy."

We should add that the Tribunal in *Bioconcepts* was not (as Warren J inferred in *Kalron*, at paragraph 61) attempting to lay down an exhaustive definition of what a beverage is.

11. Further Tribunal cases show examples of products that are not commonly consumed or do not have the characteristics of liquids that are commonly consumed. The Bio-Light fluid in *Bioconcepts* was one. The "creatine" products in the *Science in Sport Ltd* [2000] V&DR 195 decision were rejected from the scope of beverages because they were barely palatable and were best taken in conjunction when mixed with food. As regards the Science in Sport "("SIS") product based on carbohydrate", the Tribunal accepted that something consumed only by athletes and sports people for nutritional purposes was nonetheless "commonly consumed"; the Tribunal decided that the product, a powder, was excluded from being a beverage because it was not "for the preparation of beverages" but for the preparation of food supplements and it was "incidental" that they were consumed in liquid form. The Soya milk products were excluded by the Tribunal from the scope of beverages in *Alpro Ltd v Revenue and Customs Commissioners* (2006) VAT Dec 19911 because they did not have the characteristic of liquids commonly consumed: they neither slaked the thirst nor increased bodily fluids and gave no distinct pleasure to the consumer. The "Knorr Vie Shots" manufactured by Unilever, in *Unilever Bestfoods UK Ltd v Revenue and Customs Commissioners* (2007) VAT Dec 20016, were found to be drinkable food; they were too concentrated to slake the thirst or replace bodily fluids and were not characteristically consumed to fortify.[91]

Respondents to this part of the consultation document raised concerns over the proposed test for standard-rating, based as it was on the way in which sports drinks are marketed. They were also concerns that many drinks of this type were chemically similar to milk, while recent marketing campaigns for milk had seen this product consumed by athletes. The Government took the view that the proposed test would be robust, and was fair:

Many different foodstuffs are taxed in different ways despite having similar ingredients. Milk in particular has its own zero-rating provision which is not affected. Milk will remain zero-rated even if promoted as benefitting consumers taking part in sports activity. Although products such as meal replacements for dieters may be a similar product to a protein supplement used by athletes, they are aimed at different markets. The majority of products are clearly aimed and promoted at particular markets and so the VAT treatment will follow from this.

Although we considered alternative suggestions based around a list of ingredients we have concluded that manufacturers might be able to reformulate products to avoid this definition and that this definition would be more difficult to target. Overall, we still think that the consultation option is the best way of achieving the policy objective of taxing sports nutrition drinks.[92]

The issue was also raised at the report stage of the Finance Bill when the Minister was asked by Nigel Mills MP if there was a risk that milk might be standard-rated, because it was often marketed as improving physical performance; Mr Gauke said the following:

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[91] GlaxoSmithKline Services Unlimited, [2010] UKFTT 418 (TC)

[92] *VAT … summary of responses*, 28 June 2012 para 2.2.6-7

I confirm that … milk will not be standard rated for these purposes … The broad point is that sports drinks—such as Lucozade and others—are standard rated and have been for some time, and that sports nutrition drinks marketed as such will now become standard rated. We believe that that is fair. These products can be distinguished from a pint of milk or a milk drink not designed or marketed for sports nutrition purposes. Nothing in the consultation responses calls us to query the rationale for the measures or to amend the draft legislation other than through a minor amendment to tidy up the wording.[93]

[93] HC Deb 3 July 2012 c782-3