[2018] UKUT 0029 (TCC)

Appeal number: UT/2016/120

VAT - zero rating of food - Group 1 Sch 8 VATA - banana and strawberry flavoured Nesquik - whether within Excepted Item 4 as powder for the preparation of beverages - held: standard rated.

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

NESTLÉ UK LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: MR JUSTICE SNOWDEN
JUDGE CHARLES HELLIER

Sitting in public at The Rolls Building on 22 June and 12 July 2017

Roderick Cordara QC instructed by PricewaterhouseCoopers LLP for the Appellant

Eleni Mitrophanous, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the rate of VAT chargeable on supplies of strawberry and banana Nesquik.

2. There is no issue as to the factual background. Nesquik is a powder designed and marketed to flavour milk. It is available in strawberry, banana and chocolate flavours. The powder contains strawberry or banana flavouring or cocoa together in each case with some sugar, vitamins and minerals. It contains no milk or milk extract.

3. To make a Nesquik flavoured drink, three or four teaspoonfuls of the powder are normally mixed to a paste with a little milk, and then further milk is added. The addition of the powder makes little discernable difference to the milk other than to change its taste and colour.

4. HMRC accept that chocolate Nesquik should be zero rated but refused a repayment claim made by Nestlé, the makers of Nesquik, on the basis that strawberry and banana Nesquik were standard rated for VAT. Nestlé appealed against that decision to the FTT. The FTT (Judge Harriet Morgan and Jill Hunter) held that banana and strawberry Nesquik were standard rated. Nestlé now appeals against that decision.

The legislation

5. By virtue of Article 110 of the Principal VAT Directive 2006/112/EEC the UK is permitted to zero rate certain items for clearly defined social reasons. In section 30 Value Added Tax Act 1994, ("VATA") the UK has taken advantage of this provision by zero rating the supply of those goods or services which fall within Schedule 8 VATA.

6. Group 1 Schedule 8 VATA relates to food. The provisions of Group 1 relevant to the arguments in this appeal are the following,

> "**Group 1**
>
> The supply of anything comprised in the general items set out below, except-
>
> (a) a supply in the course of catering,
>
> (b) a supply of anything comprised in any of the excepted items set out below, unless it is also comprised in any of the items overriding the exceptions set out below which relates to that excepted item.
>
> *General Items*
>
> Item No
>
> **1** Food of a kind used for human consumption.

2 Animal feeding stuffs.

3 Seeds or other means of propagation of plants comprised in item 1 or 2.

4 Live animals of a kind generally used as, or yielding or producing, food for human consumption.

Excepted items

1 Ice cream, ice lollies, frozen yoghurt, water ices and similar frozen products, and prepared mixes and powders for making such products.

2 Confectionery, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some product similar in taste and appearance.

3 Beverages chargeable with any duty of excise specifically charged on spirits, beer, wine or made-wine and preparations thereof.

4 Other beverages (including fruit juices and bottled waters) and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages.

4A Sports drinks that are advertised or 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.

5 Any of the following when packaged for human consumption without further preparation, namely, potato crisps, potato sticks, potato puffs, and similar products made from the potato, or from potato flour, or from potato starch, and savoury food products obtained by the swelling of cereals or cereal products; and salted or roasted nuts other than nuts in shell.

6 Pet foods, canned packaged or prepared; packaged foods (not being pet foods) for birds other than poultry or game; and biscuits and meal for cats and dogs…

Items overriding the exceptions

1 Yoghurt unsuitable for immediate consumption when frozen.

2 Drained cherries.

3 Candied peels.

4 Tea, maté, herbal teas and similar products, and preparations and extracts thereof.

5 Cocoa, coffee and chicory and other roasted coffee substitutes, and preparations and extracts thereof.

6 Milk and preparations and extracts thereof.

7 Preparations and extracts of meat, yeast or egg."

We shall refer to the relevant classes as the General Items, the Excepted Items and the Overriding Items.

7. By section 96 VATA, Schedule 8 is to be interpreted in accordance with the Notes to the schedule. The relevant Notes include the following,

"NOTES

(1) "Food" includes drink.

(2) …..

(4) Item 1 of the items overriding the exceptions relates to item 1 of the excepted items.

(5) Items 2 and 3 of the items overriding the exceptions relate to item 2 of the excepted items; and for the purposes of item 2 of the excepted items "confectionery" includes chocolates, sweets and biscuits; drained, glacé or crystallised fruits; and any item of sweetened prepared food which is normally eaten with the fingers.

(6) Items 4 to 6 of the items overriding the exceptions relate to item 4 of the excepted items."

The FTT's decision

8. Before the FTT, the Appellant argued that banana and strawberry Nesquik fell within General Item 1 but did not fall within Excepted Item 4 on two alternative bases:

(1) Route 1: that as a matter of purposive construction, "beverages" in each place where it occurs in Excepted Item 4 does not include milk and preparations of milk; so that Nesquik is not a powder for the preparation of a "beverage"; or

(2) Route 2: that if, (contrary to (1)), milk and preparations of milk are a "beverage" for the purposes of Excepted Item 4, nonetheless Nesquik is not a powder "for the preparation of" a beverage, because that expression requires the creation of a new beverage. Adding Nesquik to milk merely adds flavour and colour, but does not result in a new beverage.

9. The FTT rejected both arguments. In relation to the first argument, it held that on the plain meaning of the words in the provision "beverage" was not so limited [127] and that the structure and words of Excepted Item 4 did not indicate that Parliament intended to zero rate a powder for adding to milk which did not itself contain milk [129]. In relation to the second argument, the FTT held that for a powder to be "for the preparation of beverages" it must have "as its sole use the

playing of some part in the action or process of the making of "beverages"" [134-135], and that such was the sole use of Nesquik [140(1)]. The FTT considered that it did not matter whether the addition of Nesquik to milk did or did not create a new beverage [140(4)].

10. Having so held, the FTT considered whether the social policy objectives of zero rating required a different conclusion, and found that they did not [154].

11. The FTT also considered whether fiscal neutrality required a different result, and applying the principles in *Rank Group plc v Revenue & Customs Commissioners* C-259/10 [2012] STC 23, it found that from the perspective of the typical customer banana and strawberry flavoured Nesquik were not sufficiently similar to milk drinks or to chocolate Nesquik as to require the same zero rating [200-208]. The Appellant did not challenge the factual findings of the FTT on this issue and did not, therefore, pursue an argument that fiscal neutrality required zero rating.

The history of the domestic legislation

12. Before turning to the detail of the Appellant's arguments, in particular on legislative purpose, it is necessary to understand some of the history of the domestic legislation and the EU context.

13. The relevant wording of Group 1 of Schedule 8 VATA can be traced back to Schedule 1 of the Purchase Tax Act 1963 ("PTA"). This specified 36 groups of items on which purchase tax was levied. Groups 28 (ice cream etc), 34, (confectionery) 35 (beverages), 36 (crisps etc) and 37 (pet foods) brought into the charge the types of items of food now in Excepted Items 1, 2, 4, 5 and 6. Other groups brought into tax products such as adults' clothes, paper doyleys, wallpaper, furniture (other than babies' and invalids' furniture), domestic appliances, clocks, furs and jewellery.

14. So far as beverages were concerned, Group 35 Schedule 1 PTA described the goods taxed thus:

> "(a) Manufactured beverages, including fruit juices and bottled waters, and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages but not including beverages or products in the list set out at the end of this group……22%
>
> (b) Containers of gas for the preparation of carbonated beverages … 22%
>
> *Goods not comprised in paragraph (a)*
>
> 1. Beverages chargeable with any duty of customs and excise specifically charged on spirits, beer, wine or British wine, and preparations thereof.
>
> 2. Tea, maté, herbal teas and similar products, and preparations and extracts thereof.
>
> 3. Cocoa, coffee, and chicory and other roasted coffee substitutes, and preparations and extracts thereof.
>
> 4. Preparations and extracts of meat, yeast, egg or milk.

15. On the coming into force of the Finance Act 1972, purchase tax was abolished and VAT introduced. The structure of the new tax was the reverse of purchase tax in that every supply was taxable unless zero rated or exempted. The general approach under the new regime was that food would be zero rated for VAT unless it had been subject to purchase tax.

16. Schedule 4 of the 1972 Act contained the description of zero rated supplies and Group 1 of that Schedule adopted the same structure of specifying general items, excepted items and overriding items which now appears in Schedule 8 VATA. Excepted Items 1, 3 and 4 were as follows,

> "**1** Ice cream, ice lollies, frozen yoghurt, water ices and similar frozen products, and prepared mixes and powders for making such products.
>
> **3** Beverages chargeable with any duty of customs or excise specifically charged on spirits, beer, wine or British wine and preparations thereof.
>
> **4** Other manufactured beverages, including fruit juices and bottled waters, and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages."

17. There was no Overriding Item relating to Excepted Item 1, but Overriding Item 6 related to Excepted Item 4, and was as follows,

> "6 Preparations and extracts of meat, yeast, egg or milk."

18. In 1973, Excepted Items 1 and 4 in Group 1 of Schedule 4 to the Finance Act 1972 were repealed, but that momentary freedom from VAT was reversed in 1974. Accordingly, on 31 December 1975 (an important date for EU law purposes) the description of taxable beverages was virtually the same as it had been under the PTA.

19. The list of 17 groups of zero rated items in the Finance Act 1972 was then replicated almost entirely in Schedule 5 to the Value Added Tax Act 1983, and the drafting of Group 1 of that schedule remained the same.

20. The formulation in Group 1 remained unchanged until 1993 when steps were taken to amend Excepted Item 4 so as to reverse the decision of the VAT tribunal in *Tropicana UK Ltd v CCE* Lon 92/2342. In *Tropicana* the tribunal had found that pasteurised fruit juice was not a "manufactured" beverage. The word "manufactured" was therefore deleted from the start of Excepted Item 4, which henceforth simply referred to "Other beverages". However, the tribunal had also said that it considered that milk was a beverage, albeit not a manufactured one. On that basis, the deletion of "manufactured" in Excepted Item 4 would have meant that milk became taxable. To prevent that, "milk" was deleted from the words of what is now Overriding Item 7, and what is now Overriding Item 6 ("milk and preparations and extracts thereof") was inserted. The net effect was that milk and preparations and extracts thereof remained zero rated.

21. In 1994, Schedule 5 to the Value Added Tax Act 1983 (as amended) was re-enacted as Schedule 8 VATA.

22. Between 2000 and 2011 there were a number of appeals dealing with sports nutritional drinks in which tribunals reached differing views as to whether the particular drinks they were dealing with fell within Excepted Item 4. Following those decisions, with effect from 1 October 2012, Excepted Item 4A was added to remove all sports drinks and powders etc for their preparation from zero rating. The view of HMRC was that this meant that such drinks and powders were standard rated, even if those drinks were milk-based, because the Notes were not amended and hence Overriding Item 6 did not relate to Excepted Item 4A.

The EU law background.

23. Article 28 of the Sixth VAT Directive provided that only zero rating provisions which were in force on 31 December 1975, and which satisfied the conditions in Article 17 of the Second Directive might be maintained. Article 17 of the second Directive provided that Member States might provide for reduced rates or zero rating, but that

> "such measures may only be taken for clearly defined social reasons and for the benefit of the final consumer."

Thus there was a freeze on the enactment of zero rating provisions and a new constraint on those which were permitted to remain in force.

24. In *Commission v UK* C-416/85 [1990] 2 QB 130, the Commission took issue with the width of some of the UK's zero rating provisions. The Advocate General was of the opinion that zero rating was not legitimate if it did not relate to the satisfaction of the fundamental needs, whether individual or collective, of the population of the Member State [13]. However, the Court, in discussing the concept of "clearly defined social reasons" in Article 17 said:

> "14. The identification of social reasons is a matter of political choice for the Member States and can be the subject of supervision at the Community Level only in so far as, by distorting that concept, it leads to measures which because of their effects and their true objectives lie outside its scope."

25. The following was said about the nature of the social reasons for zero rating of General Items 2, 3 and 4 (animal feeds, seeds etc):

> "19. The United Kingdom argues that the application of a positive rate of VAT to these products would entail an increase in food prices and thus jeopardise the achievement of the social objectives which it is pursuing."

26. Finding that the social reasons condition was satisfied for these items, the Court said [20] that the negative effect of taxation on food prices, "increases in which are particularly sensitive for the final consumers", could not be neglected.

The Appellant's arguments

27. Before us, the Appellant essentially relied upon the same "Route 1" and "Route 2" arguments as it had advanced to the FTT.

Route 1: the argument that "beverage" in Excepted Item 4 does not include milk.

28. The meaning of "beverage" in the context of the VAT legislation has been considered in a number of cases. In *Kalron Food Limited v Revenue and Customs Commissioners* [2007] STC 1100 at [68], Warren J held that it is a word that should be given its ordinary meaning.

29. In *Kalron*, Warren J also ventured the view (obiter) that milk might not ordinarily be regarded as a beverage. A variety of tribunals have reached differing views on the same subject: see e.g. *Tropicana, Alpro v HMRC* (Decision 19911) and *R Twining and Co. v HMRC*, 5 July 2007.

30. Mr. Cordara accepted that, at least as a matter of ordinary language, milk and a flavoured milk drink are both "beverages" and that Nesquik is "a powder for the preparation of a beverage". However, Mr. Cordara said that such an approach to the interpretation of the words in Excepted Item 4 would be wrong. He contended that statutes should be interpreted purposively, and that purposively interpreted together with Overriding Item 6, "beverage" in Excepted Item 4 does not include milk or flavoured milk drinks, and Excepted Item 4 does not include powders for the preparation of such flavoured milk drinks.

31. In seeking to reconcile these observations with the wording of Group 1, Mr. Cordara contended that the group should not be read step-by-step (i.e. it should not be read by asking sequentially whether the item is a General Item, and if so whether it is an Excepted Item, and if so whether it is an Overriding Item). Instead he contended that the provisions of the Group should be read as a whole, so that the meaning of "other beverages" in Excepted Item 4 also had to take into account Overriding Item 6, whose object and effect (he submitted) was to remove milk and preparations of milk from the concept of a beverage. Mr. Cordara therefore contended that Excepted Item 4 should be read as follows,

> "Other beverages (including fruit juices and bottled waters) (excluding milk and preparations and extracts thereof) and syrups, concentrates, essences, powders, crystals or other products for the preparation of beverages (excluding milk and preparations and extracts thereof)."

32. Mr. Cordara based his contention as to the purposes of the statute on the fact that milk is zero rated and he asserted that the "clearly defined social reason" required by EU law for such rating is to encourage or facilitate the consumption of milk. He contended that it is clear that this pro-milk policy extends to things to be added to milk to make it attractive, in particular, to children. He recalled the comment of the FTT in *R Twinings* that there was once a government policy of distributing milk which at its height provided "free cows milk daily to every child in the land" [52]; and

he noted the FTT's findings in this appeal at [128] that Nesquik is marketed to encourage children to drink milk.

33. Mr. Cordara also submitted that the legislative history illustrates that Parliament never intended to tax milk or preparations of milk. He pointed out that the Purchase Tax legislation taxed "manufactured" beverages but expressly excluded preparations of milk; and the VAT legislation adopted the same words. He also relied upon the fact that when the word "manufactured" was removed from the equivalent of Excepted Item 4 after the *Tropicana* case, an express override for milk and preparations of milk was added, which he submitted reflected a pro-milk policy.

34. Mr. Cordara reinforced his submissions as to legislative purpose by pointing to what he contended would be a number of irrationalities if Nesquik were not to be zero rated. In particular, Mr. Cordara pointed out that it is clear that milk is zero rated and that the supply of a ready-mixed milk drink flavoured with Nesquik would also be zero rated because it would be a preparation of milk. He contended that Parliament cannot sensibly have intended that an ingredient to be added to a zero rated drink (milk) to create a drink that if sold in pre-prepared form would be zero rated, should be taxable; and he added that no rational legislature would have encouraged milk drinking but sought to tax additives used to encourage milk drinking by children.

35. Lastly, Mr. Cordara pointed to the anomaly that chocolate Nesquik powder (which contains cocoa) is zero rated as a result of the effect of Overriding Item 5 as a preparation of cocoa, whereas if the FTT is correct, banana and strawberry Nesquik would not be. As indicated above, Mr. Cordara did not go so far as to argue that this result would infringe the doctrine of fiscal neutrality, but he claimed that avoiding such an anomalous result was a further pointer in favour of his arguments on purposive interpretation.

Discussion

The statutory history

36. As indicated above, the effect of Article 28 of the Sixth Directive was to freeze at 31 December 1975 the classes of supplies which Member States were permitted to zero rate, and, in addition, Article 17 of the Second Directive further limited the permissible zero rating by the requirement of clearly defined social reasons for the benefit of consumers. This strongly suggests that whilst social circumstances could change after 31 December 1975 so as to reduce or eliminate the reasons for a zero rate, it is most unlikely that an entirely new purpose or policy justifying a zero rate could now exist that did not exist prior to that date. This invites an analysis of the position under the PTA which then formed the basis for the new VAT regime which was introduced in 1972.

37. An examination of the items in Schedule 1 PTA suggest that the broad general policy of the Act may have been to charge purchase tax on certain items which would, in the 1960s and early 1970s, have been regarded as luxury items e.g. furs, home appliances and jewellery, and to leave out of the tax necessities such as toilet paper,

safety products and most food. There are items whose treatment is difficult to reconcile with such a policy at this distance in time, but nevertheless that is the only indication of any general policy which we can glean from that legislation.

38. As regards milk, it is clear that purchase tax was not charged on milk, because it was not a “manufactured beverage” within Group 35 of Schedule 1 PTA. Likewise flavoured milk was exempt from purchase tax, either because it was not a “manufactured beverage”, or because it was a “preparation of milk”. But that apart, we do not see anything in the drafting of Group 35 which permits a conclusion that one of its purposes was to exclude from purchase tax all things which might be associated with or added to milk to encourage people to drink milk.

39. Specifically, the only reference in Group 35 to milk was the limited provision in paragraph 4 of the list, that preparations and extracts of milk were not to be comprised in paragraph (a). We cannot discern from that reference a wider policy of exempting from the tax anything that might be associated with milk or added to milk or which might have encouraged the drinking of milk.

40. Similarly, there is no indication that powders for the preparation of flavoured milk drinks were exempt from purchase tax. Paragraph (a) in Group 35 simply imposed a tax on “powders ... for the preparation of *beverages*”. The imposition of tax was not limited to "powders for the preparation of *manufactured* beverages" or "powders for the preparation of *such* beverages". Purchase tax was therefore levied on powders for the preparation of *all* beverages (subject only to the exceptions for tea, coffee and cocoa etc).

41. After the replacement of purchase tax with VAT, it is clear that following the *Tropicana* case the amendments made to Excepted Item 4 (to exclude "manufactured", etc) displayed a Parliamentary intention that milk and preparations and extracts thereof should remain zero rated. But there is nothing in the changes which suggested either that the overall policy of zero rating most everyday food had changed, or that there was a new intention to zero rate things which were added to milk. The changes merely illustrated that milk and preparations of milk which had previously been zero rated were intended to remain zero rated.

42. We also note that at least from 1972, Item 1 in Group 1 has excepted from zero rating ice cream and frozen yoghurts, even though they are plainly preparations of milk. That provides no support for the proposition that there is a general policy that items associated with milk should be zero rated.

43. We also note the change introduced by the addition of Excepted Item 4A, namely to remove all sports drinks and powders etc for their preparation from zero rating. One of the most obvious examples of a product which is standard rated as a result is a flavoured protein powder designed to be added to milk to provide a post-exercise high-protein drink for body-builders and athletes seeking to build muscle. Though such products are obviously not aimed at children, their subjection to standard rating gives no support to the suggestion that the legislature had any general desire to zero rate products designed to be used with milk.

The case-law

44. The policy reasons for some of the UK's zero rated exemptions from VAT have also been considered in a number of cases. We do not, however, think that they take matters much further as regards the issues that we have to decide.

45. In *Commission v UK* in 1988, the issue concerned the application of zero rates to animal foodstuffs, seeds and live animals used as food for human consumption. The Advocate-General and the ECJ both accepted the UK's argument that all the supplies in issue contributed to the production of food for human consumption and that the negative effect on food prices for the ultimate consumer of applying VAT to these products was sufficient to justify the zero rating. There is nothing in the report to suggest that the UK had any specific or wider purpose in zero rating milk.

46. In *Marks & Spencer Ltd v Revenue and Customs Commissioners* [2008] STC 1408, the first issue was whether a right to have transactions taxed at a zero rate derived from Community law or national law. The answer was that although it was Community law that permitted zero rating exemptions, it was for national law to decide whether to maintain, and if so, to justify such exemptions. In giving its analysis of the position, at [24], the CJEU described the social objective of the UK in relation to its exemptions as "not making the final consumer pay VAT on everyday items of food". That is consistent with our assumption as to the general policy of the purchase tax legislation and its transformation into Group 1 (see above): everyday items are intended to be zero rated, so generally things which might have been considered luxuries remain standard rated. That apart, the *Marks & Spencer* case casts no real light on the issues which we have to determine.

47. Other tribunals have sought to divine the policy behind Excepted Item 4 and its related Overriding Items. In *Alpro*, the tribunal considered that one theme was that "commonly consumed drinks" were not to be taxed, although it regarded cocoa "which might be seen as something of a luxury" as a paradoxical item. The tribunal also suggested that there would be a political fury if milk had been taxed at a time when it enjoyed "near iconic status in the national diet". That last statement, however, carries no indication of any wider policy to encourage the use of additives to flavour milk.

48. In *Tropicana*, at the end of its decision, the tribunal contrasted milk with the "unhealthy or frivolous products under 'exempted items'", but in *Kalron* at [9-11] Warren J said it was difficult to detect any policy behind these detailed exemptions and overriders. He rejected an argument that there was a policy to exclude junk food because there were plenty of junk foods which did not fall within the exceptions, and many healthy foods which did.

49. In *Innocent Ltd* v. *Revenue and Customs Commissioners* [2010] UKFTT 516 (TC), the tribunal was also unable to identify any consistent policy behind the exception of certain beverages from food zero rating. It also found that it was not possible to identify a policy bias in favour of healthy or nutritious foods.

50. Taking all this together we conclude that there is nothing in the history of these provisions or the case law that indicates a legislative purpose to zero rate all preparations of milk, still less to zero rate anything that might be added to milk - whether to make it a more appealing drink or otherwise. So far as we can discern, the legislation was exempting everyday items from tax, and preserving the tax on items of food which, broadly speaking, had previously been regarded as luxury; rather than promoting a particular drink or things to add to that drink.

The interpretation of Group 1

51. We therefore turn to consider the wording of Group 1.

52. Mr. Cordara submitted that Group 1 is not to be read as if Parliament had first identified one category of items as zero rated, and then decided to carve out certain exceptions by the Excepted Items, and then decided to qualify those exceptions by the Overriding Items. Instead, he submitted, Group 1 should be read as a whole, so that an Excepted Item should be construed as one with an Overriding Item which relates to it.

53. We do not agree that this is the correct way to read Group 1. In our judgment the natural sense of the opening words of Group 1 is that a step-by-step approach is required. The relevant opening words are,

> "The supply of anything comprised in the general items set out below, except-
>
> (a) …,
>
> (b) a supply of anything comprised in any of the excepted items set out below, unless it is also comprised in any of the items overriding the exceptions set out below which relates to that excepted item."

54. The natural sense of these words requires the reader to take the "thing" in question ("anything" in line 1), and to ask first whether it is comprised in the General Items; then, as a result of (b), to ask whether that "thing" is comprised in the Excepted Items; and then to ask whether the "thing" is also comprised in a relevant Overriding Item. What is mandated by the opening words is not a process of interpretation of one legislative provision by reference to another, but a step-by-step examination of the "thing" in question against each separate category.

55. We also consider that the word "relates" in the last line of (b) is an aid to navigation through the structure of Group 1, rather than a requirement as to how the provisions should be construed. It limits the consideration of whether the "thing" is comprised within an Overriding Item, to those Overriding Items which are specified in relation to the relevant class of Excepted Items.

56. Accordingly, like the FTT, we see no indication in the words of Group 1 that "beverage" when referred to in Excepted Item 4 should not include milk beverages or that powders for the preparation of beverages should not include powders for the preparation of milk beverages. Whilst there is clearly an intention to zero rate milk

itself and preparations of milk, we see no indication of any wider purpose or intent to zero rate the separate supply of powders etc that might be added to milk.

Anomalies

57. As a repost to Mr. Cordara's arguments on the anomalies that were created by the FTT's decision and which could not (he submitted) have been intended by the legislature, Ms Mitrophanous pointed out that, to a modern mind at least, there are many apparent anomalies in Group 1, e.g.,

(1) fruit salad is zero rated; smoothies made from fruit are standard rated (*Innocent Ltd*);

(2) oranges are zero rated; fruit juices are standard rated;

(3) turnip crisps are zero rated; potato crisps are standard rated (see *Proctor & Gamble v. Revenue and Customs Commissioners* [2008] STC 2650 (Ch) at [30] (affd, [2009] STC 1990);

(4) chocolate cake is zero rated; chocolate biscuits are standard rated;

(5) frozen yoghurt desert is standard rated; yoghurt which is frozen but is to be eaten above freezing point is zero rated.

58. The existence of such anomalies and the recognition that Group 1 does not represent a perfectly logical and consistent regime, significantly dilutes the force of Mr. Cordara's argument. It does not seem to us that the anomalies which Mr. Cordara says arise on the basis of the FTT decision require any answer other than that Parliament has chosen to zero rate certain foods, generally because they were everyday foods, tax on which would be "particularly sensitive" for much of the population, and has chosen not to zero rate others. We are not persuaded that the anomalies that Mr. Cordara identified are sufficient to require a different reading of the legislation.

59. Nor do we think that an appeal to the spirit of fiscal neutrality can avail Mr. Cordara who renounces reliance on the principle in its full glory because of the factual findings of the FTT. Once the edifice of fiscal neutrality has been removed from the scene it no longer casts a shadow: there is no halfway house in which the principle should bend our thoughts but have no absolute effect. That argument is therefore in effect a repetition of the appeal to anomalies.

Route 1 - Conclusion

60. We find no legislative purpose or other reason for construing "beverages" where that word appears in Excepted Item 4 as excluding milk or preparations of milk.

Route 2

61. Mr. Cordara submitted that (assuming for this purpose that "beverages" in Excepted Item 4 includes milk and preparations of milk) unless the use of a substance of the type described (syrups, concentrates, essences, powders, crystals etc) creates a

new or different beverage, that substance could not be “for the preparation of beverages” within the meaning of Excepted Item 4. Mr. Cordara suggested that this followed from the natural meaning of the language: he suggested that one does not “prepare” a beverage by simply adding something to an existing beverage without changing its essential character.

62. By way of illustration, Mr. Cordara suggested that adding sugar to coffee, or Worcester sauce to tomato juice does not create a new beverage, and hence that neither sugar nor Worcester sauce would be regarded as being “for the preparation of beverages”. As a contrast, he accepted that a fruit cordial or concentrate designed to be diluted with plain water to make a fruit squash would be within Excepted Item 4.

63. On this basis, Mr. Cordara pointed to the FTT’s finding that the addition of Nesquik to milk makes little discernible difference to the consumer apart from adding flavouring and colour. He relied upon that finding to argue that the beverage which results from adding Nesquik to milk is still essentially milk and is not some new or different beverage. Hence, he submitted, Nesquik is not a powder “for the preparation of beverages”.

64. It seems to us that there is a short answer to this argument. The relevant words of Excepted Item 4 do not expressly provide that they only apply to substances that are for the preparation of beverages that are new or different from anything that existed before the act of preparation. Nor can we see how the language of Excepted Item 4 invites examination of the (difficult) question of whether (and if so, how) a resulting beverage might be classified as a different beverage from its constituent parts. Such an approach would raise fine and subjective distinctions that cannot have been intended by the legislature. The simple question in this respect is whether what results from the use of the product in question is a beverage or not.

65. As we see it, the more significant focus of the relevant words in Excepted Item 4 is on the purpose for which the product in question is used: is it “*for* the preparation of beverages”? In answer to that question, the FTT determined at [134] that it was only a substance whose sole use was for the preparation of beverages and which had no other use which was caught by Excepted Item 4. On appeal neither side sought to persuade us to adopt that approach, which we accept might be too narrow. Ms Mitrophanous suggested that a “used predominantly for” might suffice.

66. We do not need to decide what test might be adopted, since on any view the FTT found as a fact that the only use to which Nesquik is intended to be put is in the manner which we have described, namely in the preparation of flavoured and coloured milk drinks. We concur in that assessment and Mr. Cordara did not seek to persuade us of any other practical use for Nesquik. That is sufficient to conclude, as a matter of ordinary language, that Nesquik is "for" such preparation and that it falls within Excepted Item 4.

67. In passing we would observe that sugar and Worcester sauce are plainly different: they have many other uses outside the preparation of drinks - sufficient other uses that it cannot be said that they are "for" the preparation of beverages.

Route 2 - Conclusion

68. For these reasons, which are essentially those given by the FTT, we reject the argument under Route 2.

Conclusion

69. We consider that the FTT reached the correct answer, and we dismiss the appeal.

MR JUSTICE SNOWDEN
JUDGE CHARLES HELLIER

JUDGES OF THE UPPER TRIBUNAL
RELEASE DATE: 14 February 2018