VAT on farm food: navigating the zero rate

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Farmers diversifying into processed foods face complex VAT rules. Julie Butler FCA explains how perception can impact tax rates.

While most farm-produced food is zero-rated for VAT, as farm diversification increases, understanding VAT rules becomes crucial. Diversification can lead to products falling into different VAT rates. For example, while crops grown for human consumption are typically zero-rated, hay sold for pets, even horses, may need to be standard-rated.

This article explores recent legal cases that shed light on the complex world of VAT as it applies to food products, with a focus on implications for farmers and farm shops.

Understanding VAT on food

Generally, food for human consumption is zero-rated for VAT. The primary legislation governing this area is the Value Added Tax Act 1994 (VATA 1994), Schedule 8, Group 1. This provides for zero-rating of food but lists excepted items, which are subject to the standard rate of VAT.

One notable exception is Item 2, which covers ‘confectionery, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some product similar in taste and appearance’.

Note 5 to the legislation further defines ‘confectionary’ to include: chocolates, sweets and biscuits; drained, glacé or crystallised fruits; and any item of sweetened prepared food which is normally eaten with the fingers.

There have been a number of tax tribunals on the question of exactly what is confectionery and what is food – an area of legislation that many feel is unduly complex and even absurd.

Innovative Bites – Mega Marshmallows

Innovative Bites Ltd (IBL) sold American sweets and treats, including large marshmallows called ‘Mega Marshmallows’. IBL claimed these marshmallows were designed to be roasted and therefore qualified as a zero-rated cooking product for VAT purposes. HMRC, however, assessed IBL to VAT on the basis that the Mega

Marshmallows were standard-rated as an item of confectionery rather than zero-rated as a food product.

The First-tier Tribunal (FTT) ruled in favour of IBL, on the basis that the Mega Marshmallows were sold and purchased as a product specifically for roasting. The FTT considered the marketing, the packaging, the size of the product, the positioning in supermarkets and the seasonal fluctuation in sales when reaching its findings.

HMRC appealed the FTT's decision. HMRC claimed there was no case law to support the argument that simply heating a confectionery product and changing its texture and flavour caused it to lose its character as confectionery. The Upper Tribunal (UT) disagreed, stating that it could see 'no point of principle of legal proposition that suggests that the FTT could not take into account the fact that the product was intended to be subject to a cooking process before being eaten'. The UT went on to note that roasting a marshmallow is not 'simply heating' it.

HMRC also contended that the FTT had placed too much weight on the marketing of the product. However, again, the UT found no material error of law in the FTT's analysis. It emphasised that the primary question was whether the product was considered confectionery from the point of view of a typical consumer. The FTT's findings, which included evidence of the product's marketing and consumer user, supported that the Mega Marshmallows were not confectionery.

On whether the FTT had placed too much weight on the marketing of the marshmallows, the UT found it had not. There had been a 'basket of evidence' before the FTT from which it 'drew inferences as to how consumers used the product.' While its evaluation may not have been as 'detailed as perhaps it ought to have been,' the UT were of the view that the evidence supported the FTT's findings.

The UT therefore upheld the FTT's decision that the giant marshmallows were indeed food and therefore zero-rated for VAT. This is good news for farmers in that the UT upheld the FTT decision that Mega Marshmallows can be zero-rated because they do not fall within VATA 1994 Sch 8 Group 1 excepted item 2.

- FTT: Innovative Bites Ltd v HMRC [2022] UKFTT 00352
- UT: HMRC v Innovative Bitles Ltd [2024] UKUT 00095

Morrison food bars

In our next case, WM Morrison Supermarkets plc (Morrisons) appealed the decision of HMRC that wholefood bars manufactured by Organix and Nakd were standard-rated as confectionery rather than a zero-rated food item. HMRC had rejected a £1.1m rebate claim by Morrisons and, at a FTT hearing in spring 2021, the judge agreed with HMRC that the bars were subject to VAT at the standard rate.

Morrisons appealed that decision to the UT, which remitted the case back to a different FTT panel. The UT instructed the new panel to consider two specific issues:

1. the healthiness of the product; and

2. whether the bars were excluded from the definition of confectionery because they did not contain ingredients such as cane sugar, butter, and flour.

These two issues had not been considered by the original FTT when it reached its decision.

The panel in the second FTT hearing undertook a multifactorial assessment of the products and reached the same verdict, i.e. that the bars were confectionery. The judge said that whether an item qualifies as confectionery, or otherwise, is 'ultimately a matter of impression.' The tribunal found that the products had the 'appearance, texture, mouthfeel, density and taste of confectionery' and the 'ordinary person in the street' would reach the same conclusion.

The marketing of the product, which, again, was considered to be a key point, meant that potential buyers would see them as 'sweet snacks and treats' rather than a healthy food item.

The UT therefore upheld the FTT's conclusions that the wholefood bars were confectionery. This case illustrates the importance of understanding the factors that influence these decisions.

- FTT: WM Morrison Supermarkets plc v HMRC [2021] UKFTT 0106
- UT: WM Morrison Supermarkets plc v HMRC [2023] UKUT 00020
- Second FTT: WM Morrison Supermarkets plc v HMRC [2024] UKFTT 00181

Sports nutrition bars

Our final case concerns twin packs of sports nutrition bars made and sold by Duelfuel Nutrition Ltd (DNL). These bars consisted of a flapjack – to be eaten before physical exercise – and either a cake bar or brownie, which were to be eaten after exercise to assist the recovery process of the body.

HMRC's view was that the bars were standard-rated as confectionery, whereas DNL claimed the bars were zero-rated as nutritional food that qualified as a cake. The ordinary person in the street would, according to HMRC, not regard the products as a cake.

The FTT carried out a multifactorial assessment of the bars. It noted that the ingredients – such as protein powders – were different from those used in a cake. A cake was a treat, but the bars had tastes and textures that were quite unlike a treat; the products were targeted at people going to or from a gym for exercise, which was also not typical of a cake.

On the basis that the products did not qualify as a cake, the tribunal concluded they had to be classed as confectionery and therefore standard-rated by virtue of the exception to the zero rate for food at VATA 1994, Sch 8 Group 1 Note 5.

Furthermore, the judges noted the bars were sweetened prepared food, normally eaten with the fingers, so were deemed to be confectionery within excepted item 2 by virtue of Note 5 of Group 1. Despite noting that they 'do not find that the products

are confectionery on general principles', the FTT upheld HMRC's decision and the DNL appeal was dismissed.

The tribunal report in this case ran to 32 pages, yet again showing the complexity and absurdity of the legislation about VAT and food.

- FTT: Duelfuel Nutrition Ltd v HMRC [2024] UKFTT 00104

Diversifying farmers

The increasing trend of farmers diversifying into cereal bars, and farm shops offering cakes and biscuits, necessitates a clear understanding of VAT regulations. These are key cases for farmers to consider. Farmers and farm shops must carefully consider product strategy, including how items are marketed and their placement within the farm shop.

An understanding of these problems is important at all levels of farming but seeking specialist VAT advice when necessary can help navigate these complexities effectively.

*The views expressed are the author's and not ICAEW's

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