Appeal number
FTC/27/2011

Value Added Tax – zero-rating – Value Added Tax Act 1994 Schedule 8 Part II Group 1 Note (3)(b)(i) – food – toasted sandwiches and meatball marinara – whether heated for the purposes of enabling it to be consumed at temperature above ambient air temperature – whether legislation and/or interpretation and/or application thereof infringed principle of fiscal neutrality – whether FTT findings irrational – application to adduce further evidence

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

SUB ONE LIMITED T/A SUBWAY **Appellant**

- and –

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

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 23-25 July 2012

Philippa Whipple QC, Andrew Young and Isabel McArdle, instructed by Dass Solicitors, for the Appellant

Melanie Hall QC, Owain Thomas and Ewan West, instructed by the Solicitor for HM Revenue & Customs, for the Respondents

MR JUSTICE ARNOLD:

Contents

Introduction

1. This is an appeal from a decision by the First-Tier Tribunal (Tax) (Tribunal Judge Michael Tildesley OBE, Marilyn Crompton and Susan Stott FCA) ("the Tribunal") dated 14 October 2010 [2010] UKFTT 487 (TC). By its decision the Tribunal dismissed the Appellant's appeal against HMRC's decision to treat supplies of toasted sandwiches known as toasted Subs and meatball marinara as falling within Schedule 8 Part II Group 1 Note (3)(b) of the Value Added Tax Act 1994, and hence as being standard-rated rather than zero-rated for the purposes of VAT. The Appellant, which is now in liquidation, formerly carried on business as a franchisee in the Subway chain. The appeal to the Tribunal was one of what I was told are now over 1200 appeals from Subway franchisees challenging the correct VAT treatment of such supplies. On 1 February 2010 the Tribunal directed that the Appellant's appeal be treated as the lead appeal in accordance with rule 18(1) of the Tribunal Procedure (First-Tier Tribunal)(Tax Chamber) Rules 2009.

2. The issues before the Tribunal were (1) whether the toasted Subs and meatball marinara were above ambient air temperature at the time of the supplies within Note (3)(b)(ii), and if so (2) whether they had been heated for the purposes of enabling them to be consumed at a temperature above ambient air temperature within Note (3)(b)(i). In a careful and detailed decision running to 194 paragraphs (not including two appendices) the Tribunal answered both questions in the affirmative. There was little or no dispute before the Tribunal as to the relevant law. In relation to issue (2), it was common ground that the test was a subjective one: see the Tribunal's decision at [4], [115], [126], [133], [138] and [179].

3. The Appellant does not challenge the Tribunal's conclusion on issue (1), but it does challenge its conclusion on issue (2). The Tribunal gave the Appellant permission to appeal on the sole ground that, although the Tribunal identified the correct legal test, it went on to ask itself the wrong question. On a further application to the Upper Tribunal, the Appellant was given permission by Sir Stephen Oliver QC to appeal on two further grounds. The first is that the Tribunal reached conclusions on the evidence which were irrational. The second is that the Tribunal's conclusions give rise to a result that is in breach of European Union law because (a) there is inequality of treatment as between the Appellant and other traders making objectively similar supplies and (b) the Appellant's supplies were not of services, but of goods. At the hearing of the appeal, the principal focus of counsel for the Appellant's argument was limb (a) of the second additional ground of appeal, although she maintained the other grounds.

4. It should be noted at the outset that, in response to the second additional ground of appeal, HMRC served a Respondents' Notice in which they went a considerable way towards conceding that the test applied by the Tribunal did not comply with European law. As I shall explain below, the result of the stance adopted by both parties is to require this Tribunal to consider for the first time the correct approach to Note (3)(b)(i) having regard to applicable European law notwithstanding the existence of a substantial body of domestic case law on Note (3)(b) going back to 1987.

European law

European legislation

5. Article 4(3) of the Treaty on European Union ("TEU") provides *inter alia*:

> "The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the Act of the institutions of the Union."

Essentially the same provision was previously to be found in Article 5 (later Article 10) of the European Community Treaty ("TEC"), and before that in Article 5 of the Treaty of Rome.

6. Article 113 of the Treaty on the Functioning of the European Union ("TFEU") (ex Article 93 TEC) provides:

> "The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition."

7. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ("the Principal VAT Directive") includes the following recitals:

> "(4) The attainment of the objective of establishing an internal market presupposes the application in Member States of legislation on turnover taxes that does not distort conditions of competition or hinder the free movement of goods and services. It is therefore necessary to achieve such harmonisation of legislation on turnover taxes by means of a system of value added tax (VAT), such as will eliminate, as far as possible, factors which may distort conditions of competition, whether at national or Community level.
>
> (5) A VAT system achieves the highest degree of simplicity and of neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution, as well as the supply of services. It is therefore in the interests of the internal market and of Member States to adopt a common system which also applies to the retail trade.
>
> (6) It is necessary to proceed by stages, since the harmonisation of turnover taxes leads in Member States to alterations in tax structure and appreciable consequences in the budgetary, economic and social fields.
>
> (7) The common system of VAT should, even if rates and exemptions are not fully harmonised, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain."

8. Articles 109 and 110 of the Principal VAT Directive provide:

> "***Special provisions applying until the adoption of definitive arrangements***
>
> *Article 109*

> Pending introduction of the definitive arrangements referred to in Article 402, the provisions laid down in this Chapter shall apply.
>
> *Article 110*
>
> Member States which, at 1 January 1991, were granting exemptions with deductibility of the VAT paid at the preceding stage or applying reduced rates lower than the minimum laid down in Article 99 may continue to grant those exemptions or apply those reduced rates.
>
> The exemptions and reduced rates referred to in the first paragraph must be in accordance with Community law and must have been adopted for clearly defined social reasons and for the benefit of the final consumer."

9. The predecessor to Article 110 was Article 28(2)(a) of the Sixth Council Directive of 17 May 1977 on the harmonisation of the law of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment ("the Sixth VAT Directive"). Article 28(2)(a) was amended by Council Directive 92/77/EC of 19 October 1992 supplementing the common system of value added tax and amending the Sixth Directive (approximation of VAT rates) so as to introduce the requirement that the exemptions and reduced rates "must be in accordance with Community law".

General principles of European law

10. A number of general principles of European law are relevant to this appeal.

11. *Fiscal neutrality*. The most important is the principle of fiscal neutrality, which is a "fundamental principle" of the common system of VAT (see e.g. Case C-255/02 *Halifax plc v Customs and Excise Commissioners* [2006] ECR I-1609 at [92]), and is now enshrined in recital (7) of the Principal VAT Directive. The principle of fiscal neutrality precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes: see Joined Cases C-259/10 and C-260/10 *Rank Group plc v Revenue and Customs Commissioners* [2011] ECR I-0000, [2012] STC 23 at [32] and the case law cited there. This is a reflection in the field of VAT law of the wider European principle of equal treatment: see e.g. Case C-106/05 *LuP GmbH v Finanzamt Bochum-Mitte* [2006] ECR I-5123 at [48].

12. As the Court of Justice of the European Union held in the *Rank* case at [36]:

> "… the principle of fiscal neutrality must be interpreted as meaning that a difference in treatment for the purposes of VAT of two supplies of services which are identical or similar from the point of view of the consumer and meet the same needs of the consumer is sufficient to establish an infringement of that principle. Such an infringement thus does not require in addition that the actual existence of competition between the

> services in question or distortion of competition because of such difference in treatment be established."

13. The Court also held:

> "43. In order to determine whether two supplies of services are similar within the meaning of the case-law cited in that paragraph, account must be taken of the point of view of a typical consumer (see, by analogy, Case C-349/96 *CPP* [1999] ECR I-973, paragraph 29), avoiding artificial distinctions based on insignificant differences (see, to that effect, *Commission* v *Germany*, paragraphs 22 and 23).
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> 44. Two supplies of services are therefore similar where they have similar characteristics and meet the same needs from the point of view of consumers, the test being whether their use is comparable, and where the differences between them do not have a significant influence on the decision of the average consumer to use one such service or the other (see, to that effect, Case C-481/98 *Commission* v *France*, paragraph 27, and, by analogy, Joined Cases C-367/93 to C-377/93 *Roders and Others* [1995] ECR I-2229, paragraph 27, and Case C-302/00 *Commission* v *France* [2002] ECR I-2055, paragraph 23)."

14. On this basis, the Court went on to hold at [51] that no account should be taken of the fact that two games of chance fell into different licensing categories and were subject to different legal regimes relating to control and regulation.

15. *Objective assessment*. In Case C-4/94 *BLP Group plc v Commissioners of Customs and Excise* [1995] ECR I-1001 at [24] the CJEU held that to impose an obligation on revenue authorities to carry out inquiries to determine the intention of the taxable person "would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question". It is common ground that this is a general principle in VAT cases.

16. *Primacy of European law*. Article 4(3) TFEU requires Member States, including their courts, to respect the primacy of European law. This means that national courts must refuse to apply domestic legislation which conflicts with European law: Case 106/77 *Amministratrazione delle Finanze dello Stato v Simmenthal SpA* [1978] ECR 629 at [24]. It also follows that lower courts and tribunals must depart from the case law of higher courts, even if it would be binding as a matter of domestic law, where this is necessary to apply European law correctly: see the Opinion of Advocate General Cruz Villalón in Case C-617/10 *Åklagaren v Åkerberg Fransson* (12 June 2012) at [112].

17. *Marleasing*. Domestic legislation, and in particular legislation specifically enacted or amended to implement a European directive, must be construed so far as is possible in conformity with, and to achieve the result intended by, the directive: Case C-106/89 *Marleasing SA v La Comercial Internacional de Alimentación SA* [1990] ECR I-4135 at [8]. This is a strong duty of interpretation. For a recent distillation of the relevant jurisprudence with regard to this duty, see *Vodafone 2 v Revenue and Customers Commissioners (No 2)* [2009] EWCA Civ 446, [2009] STC 1480 at [37]-[38].

18. *Procedural autonomy*. In the absence of specific applicable European rules, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from European law (the "principle of procedural autonomy"): see e.g. Case C-129/00 *Commission of the European Communities v Italian Republic* [2003] ECR I-14672 at [25] and Case C-432/05 *Unibet (London) Ltd v Justitiekanslern* [2007] ECR I-2271 at [39].

19. *Effectiveness*. The principle of procedural autonomy is subject to two conditions. The first is that the national rules must not render virtually impossible or excessively difficult the exercise of rights conferred by European law (the "principle of effectiveness"): see e.g. *Commission v Italy* at [25] and *Unibet v Justitiekanslern* at [43].

20. *Equivalence*. The second condition is that the national rules are not less favourable than those governing similar domestic actions (the "principle of equivalence"): see e.g. *Commission v Italy* at [25] and *Unibet v Justitiekanslern* at [43].

The CJEU's jurisprudence with regard to Article 110 and similar provisions

21. Two aspects of the CJEU's jurisprudence with regard to Article 110 of the Principal VAT Directive (or its predecessor Article 28(2)(a) of the Sixth VAT Directive) and similar provisions are relevant to this appeal. First, the Court's general approach to the extent to which Member States may legitimately zero-rate goods and services in reliance upon Article 110. Secondly, the Court's jurisprudence with regard to the interplay between Article 110 and similar provisions on the one hand and the principle of fiscal neutrality on the other hand.

22. *General*. In Case 416/85 *Commission of the European Communities v United Kingdom* [1988] ECR 3127 the Commission contended that the United Kingdom had contravened the Sixth VAT Directive by continuing to zero-rate various groups of goods and services on the grounds that this did not comply with the requirements of Article 28(2)(a) that exemptions could only be made "for clearly defined social reasons and for the benefit of the final consumer".

23. In relation to the concept of "clearly defined social reasons", the Court stated at [14]:

> "The identification of social reasons is in principle a matter of political choice for the Member States and can be the subject-matter 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."

24. In relation to the requirement of "benefit of the final consumer" the Court stated at [17]:

> "Under the general scheme of VAT the final consumer is the person who acquires goods or services for personal use, as opposed to an economic activity, and thus bears the tax. It follows that having regard to the social purpose of Article 17 the term 'final consumer' can be applied only to a person who does not use exempted goods or services in the course of an economic activity. The provision of goods or services at a stage higher in the production or distribution chain which is nevertheless sufficiently close to the consumer to be of advantage to him must also be considered to be for the benefit of the final consumer as so defined."

25. The Commission challenged the zero-rating of Group 1 (Food), General items 2, 3 and 4 as not being for the benefit of the final consumer. The Court rejected this contention for the reasons which it stated at [20]:

> "All the supplies at issue contribute to the production of substances intended for human consumption and are sufficiently close to the final consumer to be of advantage to him. Moreover, the negative effects of any taxation of those products on food prices, increases in which are particularly sensitive for the final consumer, who himself enjoys zero-rating, cannot be neglected."

26. In Case C-251/05 *Talacre Beach Caravan Sales Ltd v Customers and Excise Commissioners* [2006] ECR I-6269 the legislation provided that the supply of caravans was zero-rated while the standard rate applied to their contents. Talacre contended that the sale of a caravan and its contents was a single indivisible supply which should be zero-rated. The Court of Appeal referred the matter to the CJEU for a preliminary ruling.

27. The Court rejected Talacre's contention for the following reasons:

> "22. Clearly, such an interpretation of Article 28(2)(a) of the Sixth Directive would run counter to that provision's wording and purpose, according to which the scope of the derogation laid down by the provision is restricted to what was expressly covered by the national legislation on 1 January 1991. As the Advocate General observed in points 15 and 16 of her Opinion, Article 28(2)(a) of the Sixth Directive can be compared to a 'stand-still' clause, intended to prevent social hardship likely to

follow from the abolition of exemptions provided for by the national legislature but not included in the Sixth Directive. Having regard to that purpose, the content of the national legislation in force on 1 January 1991 is decisive in ascertaining the scope of the supplies in respect of which the Sixth Directive allows an exemption to be maintained during the transitional period.

23. Furthermore, as the Court has pointed out on a number of occasions, the provisions of the Sixth Directive laying down exceptions to the general principle that VAT is to be levied on all goods or services supplied for consideration by a taxable person are to be interpreted strictly (see, to that effect, Joined Cases C-308/96 and C-94/97 *Madgett and Baldwin* [1998] ECR I-6229, paragraph 34; Case C-384/01 *Commission* v *France* [2003] ECR I-4395, paragraph 28; Joined Cases C-394/04 and C-395/04 *Ygeia* [2005] ECR I-0000, paragraphs 15 and 16; and Case C-280/04 *Jyske Finans* [2005] ECR I-0000, paragraph 21). For that reason as well, the exemptions with refund of the tax paid referred to in Article 28(2)(a) of the Sixth Directive cannot cover items which were, as at 1 January 1991, excluded from such an exemption by the national legislature.

24. The fact that the supply of the caravan and of its contents may be characterised as a single supply does not affect that conclusion. The case-law on the taxation of single supplies, relied on by Talacre and referred to in paragraph 15 of this judgment, does not relate to the exemptions with refund of the tax paid with which Article 28 of the Sixth Directive is concerned. While it follows, admittedly, from that case-law that a single supply is, as a rule, subject to a single rate of VAT, the case-law does not preclude some elements of that supply from being taxed separately where only such taxation complies with the conditions imposed by Article 28(2)(a) of the Sixth Directive on the application of exemptions with refund of the tax paid.

25. In this connection, as the Advocate General rightly pointed out in points 38 to 40 of her Opinion, referring to paragraph 27 of *CCP*, there is no set rule for determining the scope of a supply from the VAT point of view and therefore all the circumstances, including the specific legal framework, must be taken into account. In the light of the wording and objective of Article 28(2)(a) of the Sixth Directive, recalled above, a national exemption authorised under that article can be applied only if it was in force on 1 January 1991 and was necessary, in the opinion of the Member State concerned, for social reasons and for the benefit of the final consumer. In the present case, the United Kingdom of Great Britain and Northern Ireland has

> determined that only the supply of the caravans themselves should be subject to the zero-rate. It did not consider that it was justified to apply that rate also to the supply of the contents of those caravans."

28. *Interplay with the principle of fiscal neutrality*. In Case C-36/99 *Idéal Tourisme SA v Belgian State* [2000] ECR I-6049 Idéal was a Belgian company which operated international passenger transport by coach. It contended that it should be entitled to zero-rate its supplies, rather than pay VAT at the rate of 6% prescribed by Belgian law, because international passenger transport by air was zero-rated under provisions which were enacted before the Sixth VAT Directive came into force. Idéal argued that this difference in taxation was contrary to the principle of equal treatment. The Tribunal de Première Instance de Liege referred two questions to the CJEU, the first of which the Court interpreted as asking essentially whether the principle of equal treatment precluded national legislation which exempted international passenger transport by air, but taxed international passenger transport by coach.

29. The Court began by observing:

> "32. It must be noted at the outset that Article 28(3)(b) of the Sixth Directive, read in conjunction with Annex F thereto, clearly and unambiguously authorises Member States to continue to apply, under the same conditions, certain exemptions which were provided for in their legislation before the entry into force of the Sixth Directive. While that article consequently does not permit Member States to introduce new exemptions or extend the scope of existing exemptions following the entry into force of that directive, it does not prevent a reduction of existing exemptions, especially as their abolition constitutes the objective pursued by Article 28(4) of the directive (see Case C-136/97 *Norbury Developments* v *Customs and Excise* [1999] ECR I-2941, paragraph 19).
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> 33. It follows that a Member State which, like the Kingdom of Belgium, imposes VAT on the international transport operations of coach passenger transport operators and continues to exempt international air passenger transport would not be authorised to extend to the former the exemption allowed to the latter, even if the difference in treatment infringed the Community principle of equal treatment. On the other hand, it could tax air transport as well, in order to remove such a difference in treatment.
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> 34. However, a Member State may continue on the one hand to exempt, under the conditions set out in Article 28(3)(b) of the Sixth Directive, international passenger transport by air, and on the other hand to tax international passenger transport by coach."

30. The Court went on to reject Idéal's argument for the following reasons:

> "35. The principle of equal treatment is indeed one of the fundamental principles of Community law. That principle requires that similar situations are not to be treated differently unless differentiation is objectively justified (Joined Cases 201/85 and 202/85 *Klensch and Others* v *Secrétaire d'État à l'Agriculture et à la Viticulture* [1986] ECR 3477, paragraph 9).
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> 36. As Idéal Tourisme rightly submits, it also follows from *Klensch*, paragraph 10, that when Member States transpose directives into their national law they must comply with the principle of equal treatment.
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> 37. However, the Community system of VAT is the result of a gradual harmonisation of national laws in the context of Articles 99 and 100 of the EC Treaty (now Articles 93 EC and 94 EC). As the Court has repeatedly stated, this harmonisation, as brought about by successive directives and in particular by the Sixth Directive, is still only partial (see Case C-165/88 *ORO Amsterdam Beheer and Concerto* v *Inspecteur der Omzetbelasting* [1989] ECR 4081, paragraph 21).
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> 38. As the Belgian State stated at the hearing, the harmonisation envisaged has not yet been achieved, in so far as the Sixth Directive, by virtue of Article 28(3)(b), unreservedly authorises the Member States to retain certain provisions of their national legislation predating the Sixth Directive which would, without that authorisation, be incompatible with that directive. Consequently, in so far as a Member State retains such provisions, it does not transpose the Sixth Directive and thus does not infringe either that directive or the general Community principles which Member States must, according to *Klensch*, comply with when implementing Community legislation.
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> 39. With respect to such a situation, it is for the Community legislature to establish the definitive Community system of exemptions from VAT and thereby to bring about the progressive harmonisation of national VAT laws (see, to that effect, Case C-305/97 *Royscot and Others* v *Customs and Excise* [1999] ECR I-0000, paragraph 31)."

31. Case C-481/98 *Commission of the European Communities v French Republic* [2001] ECR I-3369 concerned French legislation which provided for different rates of VAT for medicinal products depending on whether or not their cost was reimbursable under the social security system. If the products were

reimbursable the rate was 2.1%, whereas the rate for non-reimbursable products was 5.5%. The Commission contended that, while it was permissible to apply a rate lower than the minimum rate of 5% specified in Article 12(3)(a) of the Sixth VAT Directive to medicinal products by virtue of Article 28(2)(a), it was contrary to *inter alia* the principle of fiscal neutrality to treat non-reimbursable products differently to reimbursable products.

32. The CJEU began by stating the principles to be applied in the following terms:

> "21. According to Article 28(2)(a) of the Sixth Directive, the maintenance of reduced rates of VAT lower than the minimum rate laid down in Article 12(3)(a) of that directive must be consistent with Community legislation. It follows that the introduction and maintenance of a rate of 2.1% for reimbursable medicinal products, whereas the supply of non-reimbursable medicinal products is subject to a rate of 5.5%, are permissible only in so far as they are consistent with the principle of fiscal neutrality inherent in the common system of VAT and in compliance with which the Member States are required to transpose the Sixth Directive (see, to that effect, Case C-216/97 *Gregg* [1999] ECR I-4947, paragraph 19).
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> 22. That principle in particular precludes treating similar goods, which are thus in competition with each other, differently for VAT purposes (see, to this effect, the eighth recital in the preamble to the First Directive and paragraphs 21 and 27 of the judgment in Case C-283/95 *Fischer* [1998] ECR I-3369). It follows that those products must be subject to a uniform rate. The principle of fiscal neutrality for that reason also includes the other two principles invoked by the Commission, namely the principles of VAT uniformity and of elimination of distortion in competition."

33. The Court nevertheless went on to reject the Commission's contention on the grounds that reimbursable and non-reimbursable medicinal products were not similar products in competition with each other. On the contrary, reimbursable products had a decisive advantage from the point of view of the consumer from non-reimbursable products: see in particular [27].

34. Case C-309/06 *Marks & Spencer plc v Revenue and Customs Commissioners* [2008] ECR I-2283 ("*Marks & Spencer II*") was the second reference to the CJEU arising out of the fact that from April 1973 to October 1994 the Commissioners had, as they accepted, erroneously assessed Marks & Spencer's chocolate-coated teacakes as biscuits, and hence standard-rated, rather than cakes, which were zero-rated. In this reference the House of Lords referred a number of questions to the CJEU concerning the Commissioners' defence of unjust enrichment to Marks & Spencer's claim for repayment of the wrongly paid VAT.

35. The Court treated the first question as asking whether it was possible for a trader to derive directly from Community law the right to be taxed at a zero rate where that rate was the result of provisions of national law. In answering that question in the negative, the Court stated:

> "22. … it is important to bear in mind that, in authorising Member States to apply exemptions with refund of the tax paid, Article 28(2) of the Sixth Directive lays down a derogation to the rules which govern the standard rate of VAT (Case C-251/05 *Talacre Beach Caravan Sales* [2006] ECR I-6269, paragraph 17). It is therefore correct to state that it is by reason of Community law that those exemptions, known as 'zero-rating', are permitted.
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> 23. However, Community law does not require Member States to maintain such exemptions. It is apparent from the actual wording of the original version of Article 28(2) that the exemptions which were in force on 31 December 1975 'may be maintained', which means that it is for the Member State concerned alone to decide whether or not to retain a particular piece of legislation which satisfied, inter alia, the conditions set out in the final indent of Article 17 of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967, p. 16), now repealed, which provided that exemptions with refund of the tax paid could only be established for clearly-defined social reasons and for the benefit of the final consumer.
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> 24. Article 28(2)(a) of the Sixth Directive can therefore be compared to a 'stand-still' clause, intended to prevent social hardship likely to follow from the abolition of exemptions provided for by the national legislature but not included in the Sixth Directive (*Talacre Beach Caravan Sales*, paragraph 22). That optional maintenance of the previous status quo is therefore merely framed by the Sixth Directive. Consequently, it is pursuant to national legislation which does not constitute a measure for the implementation of the Sixth Directive (see, by analogy, Case C-36/99 *Idéal tourisme* [2000] ECR I-6049, paragraph 38), but the maintenance of an exemption which is permitted by that directive, regard being had to the social objectives pursued by the legislation of the United Kingdom in not making the final consumer pay VAT on everyday items of food, that Marks & Spencer may claim the exemption with refund of the tax paid at the preceding stage."

36. The Court treated the second question as asking whether a trader had a right, under the general principles of Community law, including the principle of fiscal neutrality, to claim a refund of the VAT which was wrongly levied, when the rate which should have been applied stemmed from national law. The Court answered this question as follows:

> "33. It must be noted at the outset that the actual wording of Article 28(2)(a) of the Sixth Directive, in the version resulting from Directive 92/77, states that the national legislation which may be maintained must be 'in accordance with Community law' and satisfy the conditions stated in the last indent of Article 17 of Directive 67/228. Although the addition relating to being 'in accordance with Community law' was made only in 1992, such a requirement, which forms an integral part of the proper functioning and the uniform interpretation of the common system of VAT, applies to the whole of the period of erroneous taxation at issue in the main proceedings. As the Court has had occasion to point out, the maintenance of exemptions or of reduced rates of VAT lower than the minimum rate laid down by the Sixth Directive is permissible only in so far as it complies with, inter alia, the principle of fiscal neutrality inherent in that system (see, to that effect, Case C-216/97 *Gregg* [1999] ECR I-4947, paragraph 19, and Case C-481/98 *Commission* v *France* [2001] ECR I-3369, paragraph 21).
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> 34. It thus follows that the principles governing the common system of VAT, including that of fiscal neutrality, apply even to the circumstances provided for in Article 28(2) of the Sixth Directive and may, if necessary, be relied on by a taxable person against a national provision, or the application thereof, which fails to have regard to those principles.
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> 35. As regards, more specifically, the right to a refund, as is apparent from the settled case-law of the Court, the right to obtain a refund of charges levied in a Member State in breach of rules of Community law is the consequence and the complement of the rights conferred directly on individuals by Community law (see in particular, to that effect, *Marks & Spencer*, paragraph 30 and the case-law cited). That principle also applies to charges levied in breach of national legislation permitted under Article 28(2) of the Sixth Directive.
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> 36. The answer to the second question must therefore be that where, under Article 28(2) of the Sixth Directive, both before and after the insertion of the amendments made to that provision by Directive 92/77, a Member State has maintained in its national legislation an exemption with refund of input tax in respect of certain specified supplies but has misinterpreted its national legislation, with the result that certain supplies which should have benefited from exemption with refund of

> input tax under its national legislation have been subject to tax at the standard rate, the general principles of Community law, including that of fiscal neutrality, apply so as to give a trader who has made such supplies a right to recover the sums mistakenly charged in respect of them."

37. Case C-288/07 *Revenue and Customs Commissioners v Isle of Wight Council* [2008] ECR I-7203 concerned the second subparagraph of Article 4(5) of the Sixth VAT Directive, but it is common ground that the following statement of principle by the Court at [44] is equally applicable to Article 110 of the Principal VAT Directive:

> "Whilst it is true that the Sixth Directive provides for certain derogations which may interfere to some extent with the application of the principle of fiscal neutrality, like the derogation under the second subparagraph of Article 4(5) of the Sixth Directive (see, to that effect, Case C-378/02 *Waterschap Zeeuws Vlaanderen* [2005] ECR I-4685, paragraph 43), since that provision permits the treatment of bodies governed by public law as non-taxable persons provided that such treatment would only distort competition insignificantly, the fact remains that that derogation must be interpreted in such a way that the least possible damage is done to that principle."

38. The *Rank* case cited above concerned Article 13B(f) of the Sixth VAT Directive, which exempted "betting, lotteries and other forms of gambling, subject to conditions and limitations laid down by each Member State", but it is common ground that provision gives rise to similar issues with regard to the principle of fiscal neutrality as Article 28(2)(a). Rank contended that its supplies of services provided by mechanised cash bingo ("MCB") and slot machines should be exempted. Under domestic legislation, MCB was only exempt if the stake was less than or equal to 50 pence and the prize was less than or equal to £25. It was common ground that there was no difference from the consumer's point of view between MCB fulfilling both of those conditions and MCB which did not fulfil either or both. Slot machines were taxed, but two other types of machines which it was common ground were similar from the consumer's point of view were not. In the case of one of the other types of machines, those machines were not exempt either, but in practice the Commissioners did not levy VAT on them during the years in issue. Rank argued that these differences in tax treatment breached the principle of fiscal neutrality. Questions were referred to the CJEU by the Court of Appeal (MCB) and this Tribunal (slot machine).

39. The CJEU treated the Upper Tribunal's second question as asking whether or not, in order to assess whether, in the light of the principle of fiscal neutrality, two types of slot machine were similar and required the same treatment for VAT purposes, account must be taken of permitted minimum and maximum stakes and prizes, the chances of winning, the available formats and the

possibility of interaction between the player and the slot machine. In answering this question in the affirmative, the Court held:

> "53. It must first be observed that, if Article 13B(f) of the Sixth Directive and the discretion which that provision grants to the Member States, mentioned in paragraph 40 of this judgment, are not to be deprived of all useful effect, the principle of fiscal neutrality cannot be interpreted as meaning that betting, lotteries and other games of chance must all be considered to be similar services within the meaning of that principle. A Member State may thus limit the VAT exemption to certain forms of game of chance (see, to that effect, *Leo-Libera*, paragraph 35).
>
> 54. It follows from that judgment that that principle is not breached where a Member State imposes VAT on services supplied by means of slot machines while exempting horse-race betting, fixed-odds bets, lotteries and draws from VAT (see, to that effect, *Leo-Libera*, paragraphs 9, 10 and 36).
>
> 55. However, in order not to deprive the principle of fiscal neutrality of meaning and so as not to distort the common system of VAT, a difference of treatment for VAT purposes cannot be based on differences in the details of the structure, the arrangements or the rules of the games concerned which all fall within a single category of game, such as slot machines.
>
> 56. It is apparent from paragraphs 43 and 44 of the present judgment that the determination whether games of chance which are taxed differently are similar, which it is for the national court to make in the light of the circumstances of the case (see, to that effect, Joined Cases C-443/04 and C-444/04 *Solleveld and van den Hout-van Eijnsbergen* [2006] ECR I-3617, paragraphs 42 and 45, and *Marks & Spencer*, paragraph 48), must be made from the point of view of the average consumer and take account of the relevant or significant evidence liable to have a considerable influence on his decision to play one game or the other.
>
> 57. In that regard, differences relating to the minimum and maximum stakes and prizes, the chances of winning, the formats available and the possibility of interaction between the player and the slot machine are liable to have a considerable influence on the decision of the average consumer, as the attraction of games of chance lies chiefly in the possibility of winning."

40. The CJEU treated the Court of Appeal's second question as asking whether the principle of fiscal neutrality must be interpreted as meaning that a taxable person could claim reimbursement of the VAT paid on certain services in

reliance on a breach of that principle, where the tax authorities of the Member State concerned had in practice treated similar services as exempt supplies, although they were not exempt from VAT under the relevant national legislation. The Court answered that question as follows:

> "61. In that regard, it must be recalled that the principle of fiscal neutrality was intended to reflect, in matters relating to VAT, the general principle of equal treatment (see, inter alia, Case C-174/08 [2009] ECR I-10567, paragraph 41, and Case C-262/08 *CopyGene* [2010] ECR I-0000, paragraph 64).
>
> 62. Although a public administration following a general practice may be bound by that practice (see, to that effect, Case 268/84 *Ferriera Valsabbia* v *Commission* [1987] ECR 353, paragraphs 14 and 15, and Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P and C-213/02 P *Dansk Rørindustri and Others* v *Commission* [2005] ECR I-5425, paragraph 211), the fact remains that the principle of equal treatment must be reconciled with the principle of legality, according to which a person may not rely, in support of his claim, on an unlawful act committed in favour of a third party (see, to that effect, Case 188/83 *Witte* v *Parliament* [1984] ECR 3465, paragraph 15; Case 134/84 *Williams* v *Court of Auditors* [1985] ECR 2225, paragraph 14, and Case C-51/10 P *Agencja Wydawnicza Technopol* v *OHIM* [2011] ECR I-0000, paragraphs 75 and 76).
>
> 63. It follows that a taxable person cannot demand that a certain supply be given the same tax treatment as another supply, where such treatment does not comply with the relevant national legislation.
>
> 64. Accordingly, the answer to the second question in Case C-259/10 is that the principle of fiscal neutrality must be interpreted as meaning that a taxable person cannot claim reimbursement of the VAT paid on certain supplies of services in reliance on a breach of that principle, where the tax authorities of the Member State concerned have, in practice, treated similar services as exempt supplies, although they were not exempt from VAT under the relevant national legislation."

Domestic legislation

41. Section 30 of the VAT Act 1994 provides, so far as relevant:

> "**Zero-rating**
>
> (1) Where a taxable person supplies goods or services and the supply is zero-rated, then, whether or not VAT would be chargeable on the supply apart from this section—

(a) no VAT shall be charged on the supply; but

(b) it shall in all other respects be treated as a taxable supply;

and accordingly the rate at which VAT is treated as charged on the supply shall be nil.

(2) A supply of goods or services is zero-rated by virtue of this subsection if the goods or services are of a description for the time being specified in Schedule 8 or the supply is of a description for the time being so specified."

42. Schedule 8 Part II provides, so far as relevant:

"**GROUP 1 - FOOD**

The supply of anything comprised in the general items set out below, except—

(a) a supply in the course of catering;

…

General items

Item No.	
1.	Food of a kind used for human consumption.

…

Notes:

…

(3) A supply of anything in the course of catering includes—

(a) any supply of it for consumption on the premises on which it is supplied; and

(b) any supply of hot food for consumption off those premises;

and for the purposes of paragraph (b) above 'hot food' means 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."

Initial comments on Note (3)(b)(i)

43. Approaching Note 3(b)(i) as if it were free from authority, I would make the following initial comments.

44. It can be seen that in general Group 1 item 1 zero-rates "food of a kind used for human consumption". The policy behind this is obvious, namely not to tax food since human beings have to eat to survive.

45. It can also be seen that the legislature has made a number of exceptions to this policy. One exception is for "a supply in the course of catering". This exception includes the two types of supply defined in Note (3). The first type is a supply "for consumption on the premises on which it is supplied". This differentiates between food for consumption on the premises and food for consumption off the premises. That is why VAT is charged on a sandwich for consumption on the premises, but not on a sandwich for consumption off the premises even if it is the same sandwich. This type of supply is excepted from zero-rating regardless of whether the food is cold or hot. Again the policy is clear, namely that human beings don't have to go out to restaurants, bars or cafés to eat. If they choose to do so, they will be taxed for the privilege.

46. The second type is a supply of "hot food for consumption off [the premises on which it is supplied]", or colloquially "hot takeway food". This type of supply is excepted from zero-rating only if the food is "hot". It is not hard to discern the policy behind this, namely that human beings don't have to buy hot takeaway food since they can cook food themselves. If they choose to buy hot takeaway food, they will be taxed for the privilege. It is obvious why the exception does not apply to cold food, since then it would catch all food purchased from shops.

47. It can be seen that the second exception applies regardless of how far "off" the premises the food it is to be eaten. Thus it applies whether the food is to be eaten in the street immediately outside the premises in question, in a nearby park or in the consumer's home.

48. Coming closer to the area of dispute, it is manifest that the draftsman of Note (3)(b) felt the need to provide a definition of "hot food". The definition he has supplied is in two parts. Taking the second part first, this requires that the food is above ambient air temperature at the time of supply. While the reference to "ambient air temperature" might be suggested to create uncertainty, in most circumstances this will refer to the temperature of the air in the premises from

which or to which the food is supplied i.e. room temperature. Thus in general the food will be "hot" if it is above room temperature. The draftsman clearly felt that this would cast the net too widely, however. Accordingly, he limited the definition by including the first part. This adds the requirement that the food "has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature".

49. In considering what this requirement means, I would suggest that two things are clear. First, the draftsman is distinguishing between food which is hot (i.e. above ambient temperature) at the time of supply because it has been heated for the purposes of enabling it to be consumed at such a temperature on the one hand, and food which is hot (i.e. above ambient temperature) at the time of supply because it has been heated for some other purpose on the other hand. The second is that the draftsman has chosen to differentiate by reference to "purposes" and not by reference to "intention".

50. The first observation invites the questions: why is food heated and why is food consumed hot? In general, food is heated in order to cook it. Cooking involves chemical reactions (such as the Maillard reaction which produces the characteristic browning of many types of food, including toasted bread) and other chemical or physical transformations (such as the denaturing of proteins) induced by heat which change the properties of the food in question in one or more ways. These changes make the food safer to eat and/or more digestible and/or more appetising. Food may also be re-heated after it has been cooked: an old example is soup, but the advent of "cook-chill" (also known as "blast chilling") food preparation technology has made it possible to treat a wide range of foods in this way. That takes me on to why food is consumed hot. In general, food is consumed hot not for the sake of the heat, although the warming effect of hot food may be very welcome to a person who is cold, but because hot food is more appetising than cold food. Heating releases flavours and aromas which appeal to the consumer of the food. This is so whether the food is hot because it has just been cooked or because it has been cooked previously and re-heated. (Some foods are unappetising if re-heated, however, because flavours and aromas have been irretrievably lost while the food was cooked and cooled down.)

51. The second observation immediately suggests that the draftsman must have intended an objective test. If he had intended that the test should depend on the subjective intention of the supplier, surely he would have said so.

Pimblett and its progeny

52. The interpretation of Note (3)(b)(i) was considered by the Court of Appeal in *John Pimblett and Sons Ltd v Customs and Excise Commissioners* [1988] STC 358. In that case the taxpayer operated a central bakery and eight retail shops. Among the products it made and sold were pies. The pies were centrally prepared in the bakery. In the bakery the filling of the pies was cooked, and the cooked fillings placed in pastry covers. The pies were then taken to the retail shops, where they were baked in ovens in order to cook the pastry covers. Only after this second baking were the pies properly cooked and in a

condition to be sold. In the process, the filling which had been previously cooked in the bakery was re-heated. When the pies came out of the oven, they were first stacked on trays for an initial period to enable them to be cooled sufficiently to be handled. Then they were stacked in wooden racks stacking from the top downwards, where they were left to cool naturally. The pies remained "pleasantly warm" for about an hour. When they were sold, they were sold also from the top downwards so that what the customer got, short of a particular request for something else, would always be the coolest of the pies which were in the stacked rack. There were two bakings in the shops. The first was around the time when the shop opened. The second baking was shortly before the lunch hour when demand was at its peak.

53. It was common ground that the major purpose of baking the pies in the shops was that it provided a pleasant smell and atmosphere, and made it plain to customers that what they were getting were freshly-baked pies. The taxpayer's evidence was it did not heat the pies with the intention of enabling them to be eaten hot. Nevertheless it was clear that, during the lunch hour, some pies were purchased by customers with the intention of consuming them off the premises relatively quickly, whilst they still had some heat in them.

54. Remarkably, at least to me, it was common ground before the VAT Tribunal and before Taylor J that the test under Note (3)(b)(i) was a subjective test of the purposes of the supplier i.e. a test of intention. The VAT Tribunal held that a proportion of the pies were standard-rated, while the rest were zero-rated. Taylor J allowed the taxpayer's appeal to the High Court. Only on the Commissioners' appeal to the Court Appeal did counsel for the Commissioners submit for the first time that the test was an objective test. In the alternative, he argued that, even if the test was subjective, it was satisfied because the taxpayer knew that some pies would be eaten at above ambient temperature.

55. Parker LJ, with whom Ralph Gibson LJ and Caulfield J agreed, began by explaining and commenting on the legislative history of Note (3)(b) as follows:

> "Schedule 5 of the Value Added Tax Act 1983 details those items which are subject to zero-rating. As originally enacted, Group 1 (so far as material) was in the following terms:
>
> > 'The supply of anything comprised in the general items set out below, except- (*a*) a supply in the course of catering.'
>
> General item no 1 was:
>
> > 'Food of a kind used for human consumption.'
>
> 'Notes' at the end of that group included note (3):

> 'A supply of anything in the course of catering includes- (*a*) any supply of it for consumption on the premises on which it is supplied …'

In 1984 it appears from the tribunal's finding in this case that the Chancellor of the Exchequer announced in his Budget Speech a decision to impose value added tax on hot take-away food and drink. The tribunal observes:

> 'This directly covered such business as fish and chip shops, Chinese take-aways and hamburger houses.'

That announcement having been made, the Finance Act 1984 amended note (3). The original provision '…any supply of it for consumption on the premises on which it is supplied' was numbered (*a*) and there was added (*b*)-

> 'any supply of hot food or consumption off those premises; and for the purpose of paragraph (*b*) above, "hot food" means food which, or any part of which,-
>
> (i) has been heated for the purpose of enabling it to be consumed at a temperature above the ambient air temperature; and
>
> (ii) is at the time of the supply above that temperature.'

Since value added tax is attracted on any individual supply, the application of that section strictly would involve measuring the ambient air temperature, whether inside or outside the shop or on any premises on which the food is ultimately consumed it is unnecessary to determine, and then, by means of some temperature probe, to find the temperature at which the food was at the moment of supply.

It is apparent that what happened was that the draftsman foresaw that there would be endless argument about what food was 'hot' food, and sought to put the matter beyond doubt. The test is a precise one. It involves the remarkable result that frozen food would be regarded as hot food if the ambient temperature was one degree lower than freezing. A praiseworthy attempt to produce precision does not, in this instance, appear to me to have advanced clarity one wit."

56. He went on to dismiss the appeal for reasons which he expressed as follows:

> "What has to be determined is what is intended by the words used in note (3); and the question which has to be asked is:

Were the pies, or any of them, heated for the purpose of enabling them to be consumed hot?

The evidence was that it was not part of the purpose of the taxpayers to enable the pies to be consumed hot, but it is said that they must have had, unconsciously or consciously, a direct or indirect purpose that, to some extent at any rate, the heat was applied for that purpose.

For my part, I am unable to accept that that is the position. These pies were pies which were not capable of being sold at all until they had received their second baking. Having received their second baking, they would then be sold and no doubt, during the course of the lunch-hour, some people would buy them for their own purpose, namely, consumption hot. But I am unable to accept that, because that was the position, it must be regarded as the taxpayer's purpose to enable the pies to be so consumed.

What is in effect being advanced is that the provisions of note (3) should have read into them additional words. Instead of reading 'has been heated for the purpose of enabling it to be consumed at a temperature above the ambient air temperature', there should be added these words also--

> 'or which, to the knowledge of the supplier, would or might be consumed at a temperature above the ambient air temperature'.

I can see no warrant for reading into a taxing statute words that are not there. It is a first principle of revenue law that the subject shall only be taxed by clear words, and it is impermissible to look at the substance or to imply or read in anything. The words used cannot be made to cover supplies in this case, in my view, save by implication or reading in. Furthermore, if one does look at the substance of the matter, it appears to me that what has happened in this case comes nowhere near any ordinary meaning of 'catering'. I accept that on the basis which has been held to be right by the judge, namely, what was the dominant purpose of the seller disregarding any inevitable results which might flow, there may be cases where there is unfairness as between trader and trader.

On the drafting of the provisions as they stand, I have however no doubt that whatever the meaning of the words is, there will inevitably be some degree of unfairness as between trader and trader and customer and customer. It may well be that the provision should be re-drafted so as to make it clearer what is covered and what is not covered. However, I have no doubt

> that the words do not cover the supply of pies by the taxpayers in this case.
>
> The tribunal were perfectly entitled, as I see it, to look at the facts for one purpose and for one purpose only, and that is for the purpose of considering the validity of the evidence given by the taxpayers as to their purpose. It might well be that the facts were such that a tribunal in one case might come to the conclusion that the asserted purpose could not be accepted-as, for example, while stoutly asserting that it was no part of their purpose in heating the pies to enable them to be consumed hot, evidence was given that there were extensive heating cabinets in the shop which kept the pies hot. Given such facts, I can well see that a tribunal might conclude that the assertion that it was no part of the sellers' purpose to enable them, or some of them, to be consumed hot was unacceptable. But that goes simply to the weight of the evidence and to nothing else.
>
> The evidence in this case is all one way. It is not suggested that it was in any way false, and what is relied on is, in my view, wholly insufficient to bring this supply within the terms of Sch 5 as amended. I would therefore dismiss this appeal."

57. In expressing himself in this way, Parker LJ did not explicitly reject the submission of counsel for the Commissioners, which he had recorded earlier in his judgment, that the test was an objective one. The case has generally been taken since then, however, as deciding that the test is subjective. Counsel for HMRC somewhat faintly submitted that, upon analysis of Parker LJ's reasoning, he had actually applied an objective test. I do not accept that. What he held was that objective factors could be used to test the taxpayer's evidence as to its subjective intention.

58. Leave to appeal to the House of Lords was refused by the Court of Appeal. It is not clear to me whether the Commissioners petitioned the House of Lords for leave. My assumption is that they did not.

59. It is important to note that there is no reference to European law anywhere in Parker LJ's judgment. Furthermore, the case was in any event decided before most of the decisions of the CJEU cited in this judgment. What I find surprising is that there appears to have been no proper attempt since *Pimblett* was decided in December 1987 to re-examine the correctness of Parker LJ's interpretation of Note (3)(b)(i) in the light of European law, although as I shall discuss below there have been two cases in which HMRC have made a challenge to it. What I do not find surprising is that, as I shall explain, history shows that tribunals have found the *Pimblett* test impossible to apply in a consistent manner.

60. According to counsel's researches, *Pimblett* has so far only been considered twice at this level. The first occasion was in *Malik v Customs and Excise*

Commissioners [1998] STC 537. In that case the taxpayer set up in business cooking food to order and delivering it to customers. The orders were placed over the telephone. The customer was told to allow at least one hour for cooking and delivery, because dishes were freshly cooked. As each dish was cooked, it was put into a tinfoil container with a lid, which in turn was put into a gas-heated "hot cupboard". This had been acquired by the taxpayer after advice from an environmental health officer, who had told her that she should keep the food above 63^{o}C when compiling orders after cooking. The tribunal found that the food stayed above that temperature for about an hour in the hot cupboard. When the order was ready for delivery and a driver available, the foil containers were put into polythene carrier bags which were put into an insulated box. The food was then delivered. Some customers re-heated the food, while others ate it without re-heating it. There was no dispute that the food was supplied at a temperature above ambient air temperature.

61. The VAT Tribunal dismissed the taxpayer's appeal against the Commissioners' assessment of the supplies as being standard-rated, and Keene J dismissed the taxpayer's appeal to the High Court. It was common ground before both the VAT Tribunal and Keene J that *Pimblett* had decided that (i) the question was what the dominant purpose of the heating was and (ii) the test was one of the taxpayer's subjective intention.

62. One of the taxpayer's arguments before Keene J was that the VAT Tribunal had been wrong to conclude that her dominant purpose in heating the food was to enable it to be consumed hot, since her dominant purpose was to cook the food to make it edible. Keene J rejected that argument for the following reasons:

> "I note that the tribunal found that the appellant sought to deliver the food to customers warm enough to enable it to be consumed above the ambient air temperature without reheating. Indeed, they added 'that much is clear'. Mr Ghosh seeks to challenge that finding of fact on the basis that there was no evidence for that. But I am bound to say that there was considerable evidence for that finding in the shape of the use of the hot cupboard, the use of the insulated boxes and the appellant's own evidence about giving customers 'a hot meal'. Once that finding has been reached, it was open to the tribunal to find that at least one of her purposes in cooking the food was to enable it to be consumed hot. The tribunal was entitled to look at all the circumstances to arrive at a conclusion as to her purpose or purposes, and those circumstances would include not only what she said about her purpose or purposes but also what she did after the food had been cooked and what she said about that stage of her activities. That was capable of throwing some light on the purpose she had when heating the food by way of cooking it, just as someone's intention may be discovered by having regard to actions and words both before and after the crucial moment when intention is important.

> It was therefore not irrelevant that the appellant sought to keep the food hot once it had been cooked. Keeping it hot may not have amounted to 'heating' as such, but it was none the less relevant to her purpose when heating the food in the first place. That may well be what Parker LJ had in mind in *Pimblett* in the example which he gave (see [1988] STC 358 at 361) and it accords with the tribunal's approach in *Stewart Supermarkets Ltd v Customs and Excise Comrs* (1995) VAT Decision 13338 (see p 6). Indeed, Mr Ghosh accepted in argument that the appellant's actions after the cooking process may properly throw light on her purpose when carrying out the cooking. At one point in the argument he also agreed that one of her purposes in cooking was to create a hot meal which could be eaten hot. But he submitted that that was not her dominant purpose. He later had some second thoughts about that concession. But the fact is that the evidence shows that the appellant did have two purposes when she heated this food by way of cooking; one was to render it edible and the other was to enable it to be eaten hot if the customer so chose.
>
> Once that point had been reached in the analysis, the tribunal had to decide which of those two purposes was the dominant one, if indeed, there was a dominant purpose. That decision inevitably required judgment to be exercised by the tribunal as the fact-finding body, weighing the evidence which it had heard. It is inherently very difficult for this court to conclude that there was no evidence on which the tribunal could have concluded that one of those purposes was the dominant one and which one it was. The evidence to which I have already referred, establishing that one of her purposes was to enable the food to be consumed hot, could also properly form the basis for a finding that that was her dominant purpose. The evidence did not suggest that that was a minor objective of cooking this food. As she is recorded as saying, her goal was to get the meals to arrive at the customer's home 'as hot as possible'. She took all the appropriate steps to achieve that. … I conclude that the tribunal's conclusion as to dominant purpose was one which was open to it."

63. The second case was *Deliverance Ltd v Revenue and Customs Commissioners* [2011] UKFTT 58 (TCC), [2011] STC 1049. The taxpayer was a catering company which delivered a wide range of freshly prepared food to customers. It supplied European, Italian, Japanese, Chinese, Thai and Indian dishes as well as other snacks, puddings, wine and beer. As its name suggested, it supplied food for delivery only. There was no dispute about most of the items it supplied. For example, burgers were standard-rated and salads were zero-rated. The dispute concerned crispy duck pancakes, spring rolls, samosas, falafels, sesame prawn toast, onion bhajis and breads of several kinds. It was common ground that these items were supplied to the customer at a

temperature above the ambient air temperature. The issue was to the taxpayer's purpose in heating the food. The First Tier Tribunal (Tax and Chancery Chamber) held that its purpose was to enable the food to be consumed hot. Proudman J allowed the taxpayer's appeal.

64. Again, it was common ground before both the First Tier Tribunal and Proudman J that *Pimblett* had decided that (i) the question was what the dominant purpose of the heating was and (ii) the test was one of the taxpayer's subjective intention. In addition, it appears not to have been disputed that *Pimblett* required a distinction to be drawn between the taxpayer's dominant purpose and any necessary consequence of that dominant purpose "even though this may result in different results as to rating as between traders conducting similar business": see Proudman J's decision at [6].

65. Proudman J quoted at [11] the following two key findings of fact by the First Tier Tribunal with her own emphases:

> "(6) All the cooked items are put into a cardboard box which is put on a shelf with heating above while the complete order is assembled. Cold items are put in bags. The hot items of the complete order are put in a heated cupboard for a maximum of 15 minutes pending dispatch. The complete order including the cold items is then put into a padded bag which goes into a lined box on the motorcycle for delivery. **The reason for treating the disputed items in the same way as other hot food in this respect is to save having a separate system for dealing with them and in order to comply with the Regulations below**.
>
> …
>
> (10) Mr Dye's evidence [Mr Dye was the appellant's witness] was that the Appellant's purpose in heating the food and keeping it hot pending and during delivery was so as to demonstrate that the food was freshly cooked. **We accept this and consider below the effect on the interpretation of Note (3).** We accept his evidence that all the disputed items could be eaten cold. We regard it as a matter of opinion whether they are better eaten hot or cold."

66. She analysed these findings at [18] as follows:

> "First, the purpose of heating the food was to demonstrate to the customer that the food was freshly cooked. Secondly, the purpose of keeping the food hot was to comply with food safety regulations (blast-chilling not being a financially acceptable option) and to avoid the expense of treating the items differently from other items which had been heated."

67. She went on to hold that the First Tier Tribunal had erred in inferring from these findings that the taxpayer's purpose was to enable the food to be consumed hot for the following reasons:

> "22. … it does seem to me that HMRC's argument disregards the clear distinction made in *Pimblett* and *Malik* between the subjective purpose of the supplier and the consequence of the heating. Bread is an obvious example. It is not good enough for the supplier's purposes to provide fresh-baked bread; he wants the bread to appear fresh-baked. It may well be the consequence of providing hot bread that the customer is enabled to eat it hot. However, that is separate from the question of whether his *purpose* is to enable the bread to be eaten while still hot.
>
> 23. I agree with [counsel for HMRC] that the facts of the present case are distinguishable from those in *Pimblett*. However the appellant's evidence as to its purpose in heating the items, and also the appellant's evidence as to the two reasons why the items were kept hot, was accepted by the Tribunal without qualification. The purpose of demonstrating that the food is freshly-baked and the purpose of enabling the food to be consumed hot are conceptually separate. One may be the consequence of the other (see *Pimblett* at 361) but I do not accept that the two formulations are different ways of describing the same subjective purpose of the supplier."

68. Neither in *Malik* nor in *Deliverance* was there any reference to European law. Nor did counsel for the Commissioners argue in either case that *Pimblett* should be reconsidered.

69. Counsel for the Appellant produced the following table of decisions since *Pimblett*:

Cases which have applied zero-rating to similar products to the Appellant's:	
Great American Bagel Factory VTD 17018	Toasted bagels
Tuscan Foods [2004] UK VAT V18716	Quizno's toasted baguettes
Warren [2006] UKVAT V19902	Grilled filled Paninis
Pure Atma Ltd VTD 18716	Toasted baguettes
Ainsley's of Leeds VTD 19694	Ciabatta melts
Waterfields [2008] UKVAT V20761	Ciabatta melts and Toastie Melts
Cases which have applied standard-rating to similar products:	
European Independent Purchasing Company and Sub-Retail Unit [2008] UKVAT V20697	Melt and Italian BMT sandwiches by Subway
Coffee Republic [2007] UKVAT V20150	Grilled filled Paninis
Pret a Manger (Europe) Ltd VTA 16246	Filled croissants
Other types of food zero-rated:	

Pimblett [1988] STC 358	Pies
Deliverance v RCC [2011] STC 1049	Falafels and crispy duck pancakes
Greenhalgh's Craft Bakery VTD 10955	Pies
Three Cooks Ltd VTD 13352	Pies
The Lewis' Group Ltd VTD 4931	Roast chickens sold in department store
Stewarts Supermarkets Ltd VTD 13338	Cooked chicken pieces from supermarket
A Leach (t/a Carlton Catering) VTD 17767	Cooked lunches supplied to schools
Lutron Ltd VTD 3686	Cornish pasties
W D Readhead VTD 3201	Waffles
Other types of food standard-rated:	
Malik t/a Hotline Foods [1998] STC 537	Takeaway curry
P & S Catering VTD 6382	School meals
P J Bridgewater VTD 10491	Meals on wheels
P A Marshall (t/a Harry Ramsbottoms) VTD 13766	Chip butties
Domino's Pizza Group Ltd No 1 VTD 18010	Dips to accompany pizza
Domino's Pizza Group Ltd No 2 VTD 18866	Pizza

70. Three points should be noted about the cases listed in this table. The first is that the first six decisions listed all concern supplies of toasted sandwiches and similar products by competitors of Subway and its franchisees such as the Appellant.

71. The second point is that only in two cases after *Pimblett* did counsel for the Commissioners submit that European law required an objective test to be applied. First, in *Stewarts Supermarkets Ltd v Commissioners of Customs and Excise* counsel for the Commissioners submitted that purpose should be judged by reference to "the standards and thinking of the ordinary businessman", relying on *Ian Flockton Developments Ltd v Commissioners of Customs and Excise* [1987] STC 395 and Case C-97/90 *Lennartz v Finanzamt München III* [1991] ECR I-3795. The VAT Tribunal did not accept that submission, holding at pages 4-5 of the decision that the test was a subjective one, although the taxpayer's evidence as to its purpose was to be measured against the standards and thinking of the ordinary businessman. Secondly, in *Three Cooks Ltd v Commissioners of Customs and Excise* counsel for the Commissioners submitted that "a more objective approach to purpose" should be adopted, relying upon *Lennartz* and *BLP*. The VAT Tribunal roundly rejected this submission, saying at page 9 of the decision, "In our judgment it would be quite wrong to treat those European cases as invalidating the interpretation given by the Court of Appeal to a domestic provision in an entirely different context".

72. The third point is that the Commissioners did not appeal against any of the decisions in which it was held that the supply should be zero-rated, and in

particular they did not appeal against any of the six decisions in which it was so held in relation to toasted sandwiches and similar products.

Can Note (3)(b)(i) be interpreted compliantly with European law?

73. Counsel for the Appellant submitted that it was impossible to construe Note (3)(b)(i) compliantly with European law, and in particular the principles of fiscal neutrality and objective assessment. Counsel for HMRC accepted that, to the extent that *Pimblett* decided that the test was a subjective one, it was contrary to European law, and in particular the principle of objective assessment. She submitted, however, that it was possible to construe Note (3)(b)(i) as imposing an objective test which did not infringe the principle of fiscal neutrality.

74. Thus it is common ground that European law requires Note (3)(b)(i) to be construed as imposing an objective test, and that, to the extent that *Pimblett* decides differently, it is wrong in law. It is also common ground that, by virtue of Article 4(3) TFEU and the *Marleasing* principle, this Tribunal is not merely free, but obliged, to depart from *Pimblett* to the extent that it is necessary to do so in order to interpret Note (3)(b)(i) in accordance with European law. It is worth emphasising that we have arrived at this position because the Appellant, not HMRC, decided to argue that *Pimblett* was contrary to European law.

75. What continues to divide the parties is whether it is possible to construe Note (3)(b)(i) in a manner which does not infringe the principle of fiscal neutrality. The Appellant contends that this is not possible, and thus Note (3)(b)(i) must be disapplied, with the consequence that the Appellant's supplies are to be treated as zero-rated. HMRC contend that it is possible, and that, so construed, it follows from the Tribunal's findings of fact that the Appellant's supplies are to be treated as standard-rated.

76. This issue depends upon two main two sub-issues. The first concerns the extent to which the principle of fiscal neutrality is engaged. In a nutshell, the Appellant contends that it is fully engaged, whereas HMRC contend that it is only engaged to a limited extent. The second concerns the proper construction of Note 3(b)(i) itself.

77. So far as the first sub-issue is concerned, as can be seen from *Pimblett*, the zero-rating provisions now contained in the VAT Act 1994 which are in issue in this case pre-date 1 January 1991 and thus are potentially permissible under Article 110 of the Principal VAT Directive provided that the conditions laid down there are fulfilled. As the CJEU held in *Commission v UK*, the decision as to which supplies should be zero-rated for social reasons is in principle a matter of political choice for the UK. Thus there is no dispute that it is open to the UK to decide to zero-rate some types of foods and not others, nor that the UK may decide to reduce the scope of zero-rating compared to that which existed on 1 January 1991, but not to enlarge it. It is also common ground that zero-rating food, including hot takeaway food, is for the benefit of the final consumer.

78. Counsel for the Appellant pointed out that it is a requirement of Article 110 that the exemption with deductibility "must be in accordance with Community law". She submitted that it followed that the zero rate must be in accordance with the applicable principles of European law, and in particular the principle of fiscal neutrality. She further submitted that this proposition was supported by the judgments of the CJEU in *Commission v France* at [21]-[22], *Marks & Spencer II* at [33]-[36] and *Rank* at [55]-[57]. Accordingly, she submitted that it was a breach of the principle of fiscal neutrality for some supplies to be zero-rated and others to be standard-rated when those supplies were identical or similar from the point of view of the consumer and met the same needs of the consumer.

79. Counsel for HMRC pointed out that zero-rated supplies falling within Article 110 were not harmonised. She submitted that it was for the UK to determine the boundary between zero-rated supplies and standard-rated supplies in accordance with its own social policy, and that the principle of fiscal neutrality could not be relied upon to challenge the UK's decision as to where to draw the line. She further submitted that this proposition was supported by the judgments of the CJEU in a series of cases, in particular *Idéal Tourisme* at [35]-[39], *Talacre* at [24]-[25], *Rank* at [53]-[54] and *Isle of Wight* at [44].

80. I accept counsel for HMRC's submission to the extent that the starting point is that it is for UK to determine the boundary between zero-rated supplies and standard-rated supplies. I also accept that the CJEU's judgments in *Rank* and *Isle of Wight* demonstrate that the principle of fiscal neutrality cannot be relied upon as depriving the UK as its discretion in this respect. It does not follow that the UK can draw the line in such a way as to discriminate between objectively similar supplies. On the contrary, Article 110 is explicit that exemptions must be in accordance with Community law. In my judgment *Commission v France* and *Marks & Spencer II* make it clear that the maintenance of the exemption is only permissible in so far as it complies with the principle of fiscal neutrality. As in *Idéal Tourisme* and *Commission v France*, the UK can distinguish between supplies with are different from the point of view of the consumer; but, as in *Rank*, it cannot distinguish between supplies which are the same from the point of the consumer.

81. Turning to the second sub-issue, counsel for HMRC submitted that it was possible, if necessary applying the *Marleasing* principle, to construe Note (3)(b)(i) in an objective manner which respected the principle of fiscal neutrality. She argued that *Pimblett* and its progeny had given to rise to three problems. The first and main problem was the test of subjective intention, which inevitably meant that decisions turned on the taxpayer's evidence as to its intention, and whether that evidence was accepted by the tribunal. This was bound to lead, and had led, to inconsistent decisions. The second and third problems were the propositions that it was necessary to distinguish between what the taxpayer intended, and the necessary consequence of what the taxpayer intended, and between the concept of ensuring that food was freshly-cooked and that of enabling the food to be consumed hot. These artificial distinctions compounded the difficulty faced by tribunals in applying Note (3)(b)(i) in a consistent manner. She further argued that, if Note (3)(b)(i) was

interpreted as imposing an objective test of purpose, then there would be no difficulty in applying it in a consistent manner so that similar supplies were treated equally.

82. Counsel for the Appellant submitted that, even if Note (3)(b)(i) was interpreted as imposing an objective test, it would still not comply with the principle of fiscal neutrality. She pointed out that, as discussed above, the principle prohibits a difference in treatment between supplies which are identical or similar from the point of view of the consumer. She argued that consumers did not care for what purpose food was heated. They might well care whether it was hot or cold, but that was a different matter. Accordingly, she submitted it was contrary to the principle of fiscal neutrality for Note (3)(b)(i) to differentiate between food that was hot because it had been heated for the purposes of enabling it to be consumed hot and food that was hot because it had been heated for some other purpose e.g. in order to cook it or to demonstrate that it was freshly-cooked or in order to comply with food safety requirements.

83. In my judgment, it is possible to construe Note (3)(b)(i) in a manner which does not infringe the principle of fiscal neutrality. First, Note (3)(b)(i) must be interpreted as imposing a wholly objective test, the subjective intention of the supplier being immaterial. That will ensure that supplies which are objectively the same are not treated differently merely because of a difference in the subjective intention of the supplier, still less because of a difference in the willingness of tribunals to disbelieve or discount the supplier's evidence as to its subjective intention. Secondly, the question to be addressed is whether, on an objective assessment, the food is hot (above ambient temperature) at the point of supply because it has been heated for the purposes of enabling it to be consumed hot or because it has been heated for some other purpose. Thirdly, in answering that question, account must be taken of the reasons why consumers prefer to eat food hot, as discussed above. Finally, the tribunal must use its common sense and avoid artificial distinctions: compare *Dr Beynon and Partners v Customs and Excise Commissioners* [2004] UKHL 53, [2005] STC 55 at [31] per Lord Hoffmann and *Procter & Gamble UK v Revenue and Customs Commissioners* [2009] EWCA Civ 207, [2009] STC 1990 at [14] per Jacob LJ.

84. If this approach is adopted, then I consider that it should be possible to treat objectively similar supplies in the same manner and objectively different supplies differently. For example, in *Pimblett*, the pies were baked for two reasons: (i) to complete the cooking and (ii) to fill the shops with the aroma of freshly-baked pies. They were not baked for the purposes of being consumed hot. On the contrary, the taxpayer's system involved selling the coldest pies first; the pies were perfectly appetising cold; and a majority of the pies were in fact consumed cold. It was immaterial that some consumers took advantage of the possibility of getting a hot pie, any more than it would matter in the case of bread that some consumers take advantage of the possibility of buying and eating bread hot from the oven. By contrast, in *Malik*, it is clear the purpose of cooking the food to order, keeping it in a hot cupboard prior to delivery and delivering it in containers inside insulated boxes was to ensure that the

customer received it warm. It was immaterial that a factor in the use of a hot cupboard was food safety or that some customers chose to re-heat the food.

Application to the present case

85. It follows from the foregoing analysis that, through no fault of its own, the Tribunal applied the wrong test in relation to Note (3)(b)(i). Counsel for the Appellant submitted that in those circumstances the matter should be remitted to the First Tier Tribunal. That would only be necessary if it was not possible for this tribunal to apply the correct test to the primary facts found by the Tribunal. In my judgment, however, the very full findings of fact made by the Tribunal provide an ample basis for the application of the correct test.

86. The Tribunal summarised the findings of fact upon which it placed weight in relation to toasted Subs at [177] as follows:

> "(1) The toasted Sub lost its distinctive characteristics and flavour if allowed to cool. Further the toasting process was intimately connected with the temperature at which the toasted sandwich was eaten (see paragraphs 144 and 145).
>
> (2) The temperatures of the toasted Sub as set out in paragraph 153, and in particular the temperature of the bread in all toasted Subs, and the temperature of the meat and or cheese filling in some Subs were significantly above ambient air temperature at the time they were provided to the customers. Also the finding that the speed oven heated not only the bread but also the meat and or cheese filling to temperatures significantly above ambient air temperature.
>
> (3) The Appellant's ethos of made to order sandwiches, freshly toasted, and giving the customer what he wanted (see paragraphs 157 and 172).
>
> (4) The manner in which the Appellant organised its business and managed its staff which was designed to ensure speed of delivery with the stated aim of getting customers in and out of the store as quickly as possible (see paragraph 157).
>
> (5) The Tribunal was satisfied that delays in service delivery were the exception and kept to a minimum (see paragraph 158).
>
> (6) [The Appellant's director] Mrs Mulligan's use of a powerful hot oven to heat the Subs and her detailed knowledge of its workings. The Tribunal was satisfied that Mrs Mulligan knew that the oven heated both the bread and filling throughout, significantly above ambient air temperature (see paragraph 159).

(7) The controls exercised by the Appellant to ensure adherence by members of staff to the established procedures (see paragraph 163).

(8) Mrs Mulligan's principal reason for adding salad to the Sub was to give the customer a choice of fresh vegetables not to reduce the temperature of the Sub (see paragraph 160).

(9) The significance of the toasted Sub being wrapped in paper which had no insulating qualities was much diminished when viewed in the context of the nature of the product (ready to be eaten from the hand), the speed of service delivery, and no evidence that the business relied on home delivery (see paragraph 161).

(10) The credibility of Mrs Mulligan's belief that a Sub was only hot if heated in a microwave was undermined by a combination of the franchisor's instructions on the use of the speed oven for making a hot Sub together with Mrs Mulligan's knowledge of the capability of the oven and her awareness of the Manual (see paragraphs 166 and 170).

(11) Although the adverts for toasted Subs did not use the word *hot*, the Tribunal found that the strap-line of *fresh toasted* and the images of browned bread and melted cheese were consistent with the application of heat (see paragraph 172).

(12) The Appellant's claims regarding the significance of Mrs Pancholi's [another Subway franchisee's] evidence arising from her status as a witness for HMRC should be treated with caution. The evidence of Mrs Pancholi's intentions for heating the Sub carried no weight when determining the Appellant's dominant purpose (see paragraphs 171 and 176).

(13) Mrs Mulligan's evidence on the non-existence of cold and hot ranges of Subs was irrelevant (see paragraph 173).

(14) The fact of when the Sub was actually consumed had no bearing upon the disputed issue which was concerned with *enabling* the toasted Sub to be consumed hot (see paragraph 162)."

87. The Appellant does not challenge the objective findings in this summary, only the subjective ones. As can be seen from the summary, the toasted Subs were made and toasted to order using a speed oven (namely, as described in more detail by the Tribunal at [36]-[44] and [159], a TurboChef oven which cooked food up to 12 times faster than conventional methods by a combination of microwave and forced air convection heating and which operated at 500^{o}C). The oven heated both the bread and the filling to significantly above ambient temperature. The toasted Subs were then finished by the addition of salad,

sauce and condiments, wrapped and supplied to the customers as soon as possible, and were at above ambient temperature when supplied. The toasted Subs lost their distinctive characteristics and flavour if allowed to cool. The toasted Subs were advertised as being "fresh toasted" using images of browned bread and melted cheese. The Appellant also sold ordinary Subs which were not toasted, and which were supplied to customers at or slightly below ambient temperature.

88. In my judgment, on an objective assessment, it is perfectly clear that the toasted Subs were heated for the purpose of enabling them to be consumed at above ambient temperature, and not for some other purpose. It does not matter whether that was Mrs Mulligan's subjective intention or not. Nor does it matter, as the Tribunal rightly held at [162], whether the toasted Subs were in fact consumed at above ambient temperature. That would inevitably depend on how quickly they were eaten, which in turn would depend on how far the consumer carried them before eating them. Nevertheless, it seems clear that the majority of customers wanted the toasted Subs warm, and thus appetising. They did not want cold pre-toasted Subs, which would be much less appetising.

89. The Tribunal summarised its findings of fact in relation to meatball marinara at [186] as follows:

> "(1) Mrs Mulligan heated a mixture of thawed meat balls and chilled marinara sauce in a microwave for three successive periods of eight minutes with the mixture being stirred at the end of each period. At the end of the microwaving the temperature of the mixture was in the range of 74 to 76 degrees centigrade.
>
> (2) Mrs Mulligan then transferred the meatball marinara to another container, known as a bain-marie, in the hot well section of the sandwich counter unit. In the hot well section the temperature of the meatball marinara was allowed to cool to a temperature between 63 and 68 degrees centigrade. The meatball marinara was then kept and sold at that temperature. The shelf life of meatball marinara once in the hot well was four hours.
>
> (3) The meatball marinara was sold either in a Sub or toasted Sub.
>
> (4) The temperature of the meatball marinara when put in the Sub would have been between 63 and 68 degrees centigrade, significantly above the ambient air temperature. The Appellant did not dispute that the temperature of the meatball marinara was above ambient air temperature when provided to the customer.
>
> (5) Mrs Mulligan accepted that the marination process was complete once the meatballs and the sauce had been micro-waved.

(6) Mrs Mulligan acknowledged that it was possible to cool down the meatball marinara without putting it in the bain-marie, and without compromising food and safety. This would be done by placing the product in a fridge and leaving it there for at least 24 hours.

(7) Mrs Mulligan agreed that meatball marinara which had cooled down after being heated would be unpalatable. The sauce would be thick and very glutinous. The meatball marinara in a cold state did not conform to Mrs Mulligan's aim of selling freshly prepared products.

(8) Mrs Mulligan sold freshly prepared products which could only be achieved if the meatball marinara was in a hot state.

(9) Mrs Mulligan deliberately kept the meatball marinara hot after completion of the cooking process.

(10) Mrs Mulligan sold the meatball marinara hot.

(11) Mrs Mulligan could not sell the meatball marinara in a hot state unless she complied with the food safety regulations regarding hot food."

90. In my judgment, in the light of these findings it is beyond dispute that the meatball marina was heated for the purposes of enabling it to be consumed at above ambient temperature.

91. It follows that I consider that the Tribunal was correct to conclude that both toasted Subs and meatball marinara should be subject to VAT at the standard rate even though it applied the wrong test.

What is the consequence of the inconsistent decisions?

92. The next issue concerns the impact of, and responsibility for, the case law in the 25 years since *Pimblett* was decided. The Appellant points out that, as the table reproduced above demonstrates, there has been a long series of inconsistent decisions, with the result that identical or very similar supplies are taxed differently. Thus the Appellant contends that, even if Note (3)(b)(i) was originally capable of being interpreted in a manner which was consistent with the principle of fiscal neutrality, subsequent history has made that impossible. In particular, the Appellant complains that the result of the Tribunal's decision is that its supplies of toasted sandwiches are standard-rated, whereas tribunals in six other decisions, such as the *Tuscan Foods* case concerning Quizno's toasted baguettes, have held that similar products supplied by a number of its competitors benefit from zero-rating, placing the Appellant at a competitive disadvantage.

93. The Appellant contends that the United Kingdom is responsible for this state of affairs in one or more of three ways: (i) failure legislatively to overrule

Pimblett despite the fact that Parker LJ stated in his judgment that he considered that "there will inevitably be some degree of unfairness as between trader and trader", (ii) failure on the part of HMRC as litigants to ensure correct application of European law, if necessary by appealing legally erroneous decisions, and (iii) failure on the part of HMRC to issue appropriate guidance.

94. The Appellant relies upon the recent amendment of Part II of Schedule 8 of the 1994 Act by paragraph 2 of Schedule 26 of the Finance Act 2012, and various pre-legislative materials relating to this amendment, as supporting these contentions, although the Appellant points out that this amendment only addresses the problem prospectively, not retrospectively.

95. HMRC contend that these points are outside the scope of the Appellant's permission to appeal. Without prejudice to that contention, HMRC do not dispute that there have been a number of inconsistent decisions over a considerable period of time, but do dispute that this amounts to an infringement of the principle of fiscal neutrality for which the United Kingdom can be held responsible. HMRC contend that the interpretation and application of Note (3)(b)(i) is a matter falling within the procedural autonomy of UK courts and tribunals, provided that there is no infringement of the principles of effectiveness and equivalence, and that there is no such infringement. If Note (3)(b)(i) is capable of being construed in a manner which complies with the principle of fiscal neutrality, as I have decided, then that is something which the courts and tribunals were always in a position to decide. That they did not do so is not HMRC's fault, since HMRC did at least make a couple of attempts at drawing the relevant principles of European law to the attention of competent tribunals. The blame must be shared by taxpayers who decided that it was in their interests to rely on *Pimblett*, rather than try and correct it. Thus HMRC contend that there was no need legislatively to overrule *Pimblett*. As for HMRC's published guidance, HMRC contend that this has been unobjectionable since it was consistent with European law.

96. Counsel for the Appellant relied on the judgments of the CJEU in *Commission v Italy* and Case C-62/00 *Marks & Spencer plc v Customs and Excise Commissioners* [2002] ECR I-6325 ("*Marks & Spencer I*"), and in particular *Commission v Italy*. In that case, Article 19 of Italy's Decree-Law No 688 of 30 September 1982 had provided that anyone who had paid taxes which were not due was entitled to repayment if he provided documentary evidence that the charge had not been passed on to other persons. The CJEU held in Case 199/82 *San Giorgio* [1983] ECR 3595 and Case 104/86 *Commission v Italy* [1988] ECR 1799 that Article 19 was contrary to Community law because it required the taxpayer to prove a negative and to do so only by means of documentary evidence. In response to the latter judgment, Italy enacted Article 29(2) of Law No 428/1990 which provided that taxes levied under national provisions which were incompatible with Community legislation should be repaid unless the amount had been passed on to others. In Case C-343/96 *Dilexport* [1999] ECR I-579 the national court held that the revenue authorities were entitled to rely on a presumption that such taxes were normally passed on to third parties, but the CJEU held that that was contrary

to Community law. The Commission then brought infraction proceedings against Italy on the basis *inter alia* that the case law of the Corte supreme di cassazione (Italian Supreme Court) established that there was a presumption that the taxes were passed on to third parties. The CJEU declared that Italy had failed to fulfil its obligations under the EC Treaty.

97. Counsel for the Appellant particularly relied on the following passage in the Court's judgment:

> "29. A Member State's failure to fulfil obligations may, in principle, be established under Article 226 EC whatever the agency of that State whose action or inaction is the cause of the failure to fulfil its obligations, even in the case of a constitutionally independent institution (Case 77/69 *Commission* v *Belgium* [1970] ECR 237, paragraph 15).
>
> 30. The scope of national laws, regulations or administrative provisions must be assessed in the light of the interpretation given to them by national courts (see, particularly, Case C-382/92 *Commission* v *United Kingdom* [1994] ECR I-2435, paragraph 36).
>
> 31. In this case what is at issue is Article 29(2) of Law No 428/1990 which provides that duties and charges levied under national provisions incompatible with Community legislation are to be repaid, unless the amount thereof has been passed on to others. Such a provision is in itself neutral in respect of Community law in relation both to the burden of proof that the charge has been passed on to other persons and to the evidence which is admissible to prove it. Its effect must be determined in the light of the construction which the national courts give it.
>
> 32. In that regard, isolated or numerically insignificant judicial decisions in the context of case-law taking a different direction, or still more a construction disowned by the national supreme court, cannot be taken into account. That is not true of a widely-held judicial construction which has not been disowned by the supreme court, but rather confirmed by it.
>
> 33. Where national legislation has been the subject of different relevant judicial constructions, some leading to the application of that legislation in compliance with Community law, others leading to the opposite application, it must be held that, at the very least, such legislation is not sufficiently clear to ensure its application in compliance with Community law."

98. Counsel for the Appellant argued that this reasoning was directly applicable to the present case: even if Note (3)(b)(i) was susceptible of being interpreted

consistently with European law, the *Pimblett* test was "a widely-held judicial construction which has not been disowned by the supreme court" and which was contrary to European law. At the very least, *Pimblett* and its progeny demonstrated that Note (3)(b)(i) was "not sufficiently clear to ensure its application in compliance with Community law".

99. On the other hand, counsel for HMRC pointed out that the Court went on as follows:

> "34. In the present case, the Italian Government does not dispute that a certain number of judgments of the Corte suprema di cassazione lead, by deductive reasoning, to the conclusion that, in the absence of evidence to the contrary, commercial undertakings trading normally pass on an indirect tax by subsequent sales, in particular if it is levied throughout the national territory for an appreciable period without objection. The Italian Government confines itself to explaining that numerous trial courts do not accept such reasoning as proof of such passing on and to providing examples of taxpayers who secured repayment of charges contrary to Community law, since the authorities did not succeed in those cases in proving to the relevant court that the taxpayers had passed on those charges.
>
> 35. The reasoning followed in the cited judgments of the Corte suprema di cassazione is itself based on a premiss which is a mere presumption, namely that indirect taxes are in principle passed on by subsequent sales by economic operators where they have the chance. The other factors, if any, taken into account, … permit the conclusion that an undertaking which has carried on its business in such a context has in fact passed on the charges in question only if one relies on the premiss that all economic operators act thus, save in special circumstances such as the absence of one or other of those factors. However, as the Court has already held (see *San Giorgio*, cited above, paragraphs 14 and 15; Joined Cases 331/85, 376/85 and 378/85 *Bianco and Girard* [1988] ECR I-1099, paragraph 17; *Commission* v *Italy*, cited above, paragraph 7, and *Comateb and Others*, paragraph 25), and for the economic reasons pointed out by the Advocate General in points 73 to 80 of his Opinion, such a premiss is unjustified in a certain number of situations and is merely a presumption which cannot be accepted in the context of the examination of claims for repayment of indirect taxes contrary to Community law.
>
> …
>
> 41. In the light of the foregoing considerations, it must be declared that, by failing to amend Article 29(2) of Law No 428/1990, which is construed and applied by the administrative

> authorities and a substantial proportion of the courts, including the Corte suprema di cassazione, in such a way that the exercise of the right to repayment of charges levied in breach of Community rules is made excessively difficult for the taxpayer, the Italian Republic has failed to fulfil its obligations under the EC Treaty."

100. Counsel for HMRC submitted that this reasoning amounted to saying that the Italian Supreme Court's consistent interpretation of the legislation contravened the principle of effectiveness. She argued that the present case was clearly distinguishable from *Commission v Italy*. *Pimblett* had not been confirmed by the UK Supreme Court. Although it had been widely applied by tribunals, its correctness had been challenged by HMRC and had never been properly re-considered by the higher courts. As discussed above, that was the fault of taxpayers as much as of HMRC. Now that the point had been raised by a taxpayer for the first time, HMRC had promptly conceded it in its Respondents' Notice. Although, as a result of applying (or at least trying to apply) *Pimblett*, a number of tribunals had made what counsel for HMRC asserted were clearly wrong decisions, she submitted that HMRC were under no duty to appeal such decisions. Nor could the Appellant claim parity with the taxpayers who benefited from those wrong decisions: see *Rank* at [61]-[64].

101. In my view these competing submissions highlight the unusual position of HMRC. HMRC are an emanation of the State who have a triple role of being responsible for (i) assessing and collecting tax revenue, (ii) prosecuting and defending cases against taxpayers before tribunals and courts and (iii) publishing guidance as to tax law and practice. The Appellant's argument raises the question of the extent to which HMRC as litigants have a duty to ensure that the law is correctly applied by courts and tribunals, including appealing adverse decisions.

102. In general, a private litigant is entitled to pick and choose which cases to fight and how far to take them and to apply a cost-benefit analysis in doing so. Thus, for example, a copyright owner whose copyright has been infringed by ten infringers is entitled to decide to sue just four of them; and if he loses all four cases because the courts have applied the wrong legal test, to decide to appeal only in one case. It is immaterial that, if the appeal succeeds, the respondent will be placed at a competitive disadvantage relative to the other nine infringers.

103. Do HMRC stand in the same position? It is implicit in the Appellant's case that they do not. Although counsel for the Appellant eschewed any submission that HMRC are subject to an enforceable public law duty to appeal against legally erroneous decisions, the burden of her argument is that the combined effect of HMRC's past failure to appeal the adverse decisions of the tribunals concerning toasted bagels, toasted baguettes and the like listed in the table and HMRC's support for the Tribunal's decision in the present case is to place the

United Kingdom in breach of the principle of fiscal neutrality because similar products have been taxed differently as a result.

104. It is important to note, however, that counsel for the Appellant accepted that the decisions which HMRC failed to appeal are only *res judicata* with regard to the tax years in question: see *Matalan Retail Ltd v Revenue and Customs Commissioners* [2009] EWHC 2046 (Ch), [2009] STC 2638 at [105]-[116]. In my view it follows that, subject to the applicable limitation period and any argument of abuse of process, it would be open to HMRC to argue that supplies of the same products in subsequent tax years should be standard-rated.

105. It is also important to appreciate that counsel for the Appellant did not go so far as to suggest that it had always been clear that *Pimblett* was contrary to European law. In my view it was at least arguable that *Pimblett* was contrary to the principle of objective assessment following the decision of the CJEU in *BLP* in 1995, and at least arguable that it was contrary to the principle of fiscal neutrality following the decision of the CJEU in *Commission v France* in 2001; but that does not mean that it was, or should have been, clear to all concerned that *Pimblett* could no longer stand as good law. That has only become clear as a result of the spotlight that has been shone on the matter in the present appeal.

106. In these circumstances, I am not persuaded that HMRC's failure to appeal the adverse decisions in question combined with its support for the Tribunal's decision in the present case has placed the United Kingdom in breach of the principles of fiscal neutrality or effectiveness. Once it became clear that *Pimblett* was contrary to European law, the correct interpretation of Note (3)(b)(i) was open to re-consideration. That has now happened, and without the need even for the issue to be considered by the Supreme Court, let alone referred to the CJEU. Accordingly, I do not consider that the UK's superior courts and tribunals can be said to have adopted an entrenched interpretation of the legislation in defiance of European law in the way that the Italian Supreme Court had in *Commission v Italy*. It follows that it was not incumbent on the UK legislatively to overrule *Pimblett*.

107. As for HMRC's published guidance, counsel for the Appellant focussed on three documents. Two of these (Notice 701/14 at paragraph 3.4.3 and Notice 709/1 at paragraph 4.4) use the word "intention", but nevertheless read as a whole I consider them to be consistent with an objective interpretation of Note (3)(b)(i). The third (VOFOOD4340) does expressly refer to a subjective test, but in the context of explaining HMRC's approach in the light of the tribunal decisions in the *Lewis Group* and *Stewarts Supermarkets* cases. Thus I do not regard these documents as showing that HMRC positively promoted a subjective interpretation of Note 3(b)(i), as opposed to acquiescing in certain tribunal decisions. In any event, counsel for the Appellant was unable to demonstrate that the publication of such guidance had caused any contravention of the principles of fiscal neutrality or effectiveness. For example, it does not appear that HMRC's published guidance was a factor in any of the six tribunal decisions favouring the Appellant's competitors.

108. It follows that it is unnecessary for me to rule on HMRC's argument regarding the scope of the Appellant's permission to appeal.

Goods or services?

109. The Appellant contends that its supplies of toasted Subs and meatball marinara are not of services, but of goods. In support of this contention, counsel for the Appellant relied upon two authorities. The first is Case C-231/94 *Faaborg-Gelting Linien A/S v Finanzmat Flensburg* [1996] ECR I-2395, where the CJEU held:

> "11. By its first question, the national court asks essentially whether restaurant transactions constitute supplies of goods within the meaning of Article 5 of the Sixth Directive, which, under Article 8(1)(b), are deemed to be carried out at the place where the goods are when the supply takes place, or whether they are supplies of services within the meaning of Article 6(1), which, under Article 9(1) of the directive, are deemed to be carried out at the place where the supplier has established his business.
>
> 12. In order to determine whether such transactions constitute supplies of goods or supplies of services, regard must be had to all the circumstances in which the transaction in question takes place in order to identify its characteristic features.
>
> 13. The supply of prepared food and drink for immediate consumption is the outcome of a series of services ranging from the cooking of the food to its physical service in a recipient, whilst at the same time an infrastructure is placed at the customer's disposal, including a dining room with appurtenances (cloak rooms, etc.), furniture and crockery. People, whose occupation consists in carrying out restaurant transactions, will have to perform such tasks as laying the table, advising the customer and explaining the food and drink on the menu to him, serving at table and clearing the table after the food has been eaten.
>
> 14. Consequently, restaurant transactions are characterized by a cluster of features and acts, of which the provision of food is only one component and in which services largely predominate. They must therefore be regarded as supplies of services within the meaning of Article 6(1) of the Sixth Directive. The situation is different, however, where the transaction relates to 'take-away' food and is not coupled with services designed to enhance consumption on the spot in an appropriate setting."

110. The second authority is Joined Cases C-497/09, C-499/09, C-501/99 and C-502/09 *Finanzamt Burgdorf v Bog* [2011] ECR I-0000 where the CJEU held:

> "66. In the present cases, according to the information provided by the referring court, the activities at issue in the main proceedings in Cases C-497/09 and C-501/09 concern sales from mobile snack bars or snack stalls of sausages, chips and other hot food for immediate consumption.
>
> 67. The supply of such products presupposes that they are cooked or reheated, which constitutes a service that must be taken into account in the overall assessment of the transaction for the purpose of classifying it as a supply of goods or a supply of services.
>
> 68. However, since the preparation of the hot end product is limited essentially to basic standard actions, which for the most part are done not in response to an order from a particular customer but in continuous or regular fashion according to the demand generally foreseeable, it does not constitute the predominant element of the transaction in question, and cannot in itself characterise that transaction as a supply of services.
>
> 69. Moreover, with respect to the elements of supply of services that are characteristic of restaurant transactions, as described in the case-law summarised in paragraphs 63 to 65 above, it is clear that, in the activities at issue in the main proceedings in Cases C-497/09 and C-501/09, there are no waiters, no real advice to customers, no service properly speaking consisting in particular in transmitting orders to the kitchen and then presenting and serving dishes to customers at tables, no enclosed spaces at an appropriate temperature dedicated to the consumption of the food served, no cloakrooms or lavatories, and essentially no crockery, furniture or place settings.
>
> 70. The elements of supply of services mentioned by the referring court consist solely in the presence of rudimentary facilities such as counters to eat at, with no possibility of sitting down, enabling a limited number of customers to eat on the spot, in the open air. Such rudimentary facilities require only negligible human intervention. In those circumstances, those elements are only minimal ancillary services, and cannot alter the predominant character of the principal supply, namely that of a supply of goods."

111. Counsel for the Appellant submitted that this reasoning was applicable to the Appellant's supplies of toasted Subs and meatball marinara. In my judgment it does not matter whether or not the Appellant is right on this point. Counsel for the Appellant submitted that the reason it mattered was that the Appellant's supplies could only amount to supplies within the relevant exception to zero-

rating if they were supplies of services. As counsel for HMRC pointed out, however, in general it does not matter for VAT purposes whether what is supplied is goods or services. Nor does it matter in determining whether or not a particular supply falls within exception (a) to Group 1 in Schedule 8 Part II. The exception is not of "catering services" of, but of supplies "in the course of catering". Classification of the supplies as being supplies of goods rather than of services is perfectly consistent with the supplies falling within Note (3)(b).

Irrationality

112. The Appellant's challenge to the Tribunal's findings on the ground of irrationality is limited to the Tribunal's rejection of Mrs Mulligan's evidence as to her subjective intention in heating the toasted Subs and meatball marinara, and in particular the Tribunal's categorisation of her evidence at [182] as "not credible". Since I have concluded that Mrs Mulligan's subjective intention is legally irrelevant, I shall deal with this point briefly. I have reviewed the correct approach to findings of fact made by the First Tier Tribunal in a number of decisions: see e.g. *Smith v Revenue and Customs Commissioners* [2011] UKUT 270 (TCC), [2011] STC 1724 at [46]-[50]. The Tribunal had the advantage of seeing and hearing Mrs Mulligan give her evidence. The Tribunal explained in considerable detail why it did not feel able to accept that evidence having regard to the objective circumstances. In my judgment there was nothing irrational in the Tribunal's assessment, and it was entitled to reach the conclusions that it did.

Application to adduce further evidence

113. On 27 June 2012 the Appellant applied to adduce further evidence in support of its appeal. The evidence consists of two witness statements, one from Hitesh Patel, a Subway Development Agent, dated 9 May 2012 and one from Gagen Sharma, the liquidator of the Appellant, dated 27 June 2012. HMRC resisted the admission of this further evidence. I decline to admit this evidence for the following reasons.

114. Hitesh Patel's statement concerns the availability of zero-rated toasted sandwiches from Subway's competitors such as Quizno's. There is no good reason why this evidence was not adduced before the Tribunal. Indeed, it appears to be essentially confirmatory of evidence which was adduced by the Appellant before the Tribunal (namely paragraph 59 of Mrs Mulligan's first witness statement). Furthermore, I do not consider that it would materially assist the Appellant's case on the appeal if it were admitted.

115. Gagen Sharma's statement contains opinion evidence to the effect that the Appellant failed as a business in very large part because it was required to account for VAT and at the standard rate on its toasted sandwiches whereas competitors were not. I accept that this evidence was not available to the Appellant at the time of the hearing, but I do not consider that it would materially assist the Appellant's case on the appeal if it were admitted.

Conclusion

116. The appeal is dismissed.

Mr Justice Arnold

Release date: 3 October 2012