

DECISION NUMBER: 17861

SUPPLY OF GOODS – Single supplies or separate supplies – disposable nappies sold in a promotion packaged in a plastic toy box – Whether single zero-rated supply of children's clothing – no – Whether separate zero-rated supply of children's clothing and standard-rated supply of toy box – yes – VATA 1994 Sch 8 Gp 16 Item No 1

SUPPLY FOR NO CONSIDERATION – Whether disposal of business assets for no consideration – if so, whether "small gifts" exception applied so that there is no deemed supply – no – Whether series or succession of gifts made to the same person – yes – Whether domestic legislation on "small gifts" beyond the scope of the European legislation – no – Article 5.6 EC Sixth Directive – VATA 1994 Sch 4 para. 5(1) and 5(2) – Appeals dismissed

LONDON TRIBUNAL CENTRE

KIMBERLY-CLARK LIMITED

Appellant

-and-

THE COMMISSIONERS OF CUSTOMS AND EXCISE

Respondents

R J Tribunal: MR A EDWARD SADLER (Chairman)
MRS R J MACKWORTH CBE

Sitting in public in London on 9 and 10 September 2002

Mr Paul Harris of Counsel, instructed by Deloitte & Touche for the Appellant

Mr Hugh McKay, instructed by the Solicitor for the Customs & Excise, for the Respondents

DECISION

The Appeal

1. Kimberly-Clark Limited ("KU) appeals against both a Notice of Assessment to pay VAT dated 22 February 1999 and also a decision of the Commissioners dated 12 November 2001 containing a ruling as to the treatment for VAT purposes of certain supplies made by KC. The Notice of Assessment relates to periods from 1 October 1996 to 31 December 1998 and the VAT assessed totals £321,439.00. Both the Notice of Assessment and the decision relate to identical facts and circumstances, and although the appeal against the Notice of Assessment was made out of time, no objection is made to that by the Commissioners. The two appeals are therefore taken together effectively as a single matter.
2. In summary the appeals relate to the VAT treatment of supplies made by KC which produces disposable nappies and sells them to retailers: was there a single (or "composite") supply or two distinct and separate supplies for VAT purposes? As a promotion designed to increase its market share, KC sold some of the nappies in a "free" plastic toy box. KC maintains that for VAT purposes there is a single, zero-rated, supply of nappies when it makes such sales and nothing else. The Commissioners argue that in these circumstances KC is making two distinct and separate supplies, namely a zero-rated supply of the nappies themselves, and also a standard-rated supply of a plastic toy box, and that KC is required to account for the VAT on that standard-rated supply.
3. Both parties rely upon the decision of the European Court of Justice in *Card Protection Plan Ltd v Customs & Excise Commissioners* (Case C-349/96) [1999] STC 270 ECJ in support of their respective positions. The detailed submissions of each party as to the application of this case are dealt with below, but it is sufficient to note here that the judgment in that case sets out the principles which are to be applied by the national court in deciding whether a transaction which has several component parts is to be regarded as a single supply for VAT purposes or as two or more distinct – and separately taxable – supplies.
4. KC also argues that, if it is wrong in its primary contention (so that there is in principle a separate standard-rated supply in respect of the plastic toy box), then it is a supply made for no consideration and that therefore there is no supply for VAT purposes. The Commissioners argue that even if it is a supply made for no, or *de minimis*, consideration, the applicable legislation has effect in this instance so as to deem KC to have made a supply of the plastic toy box and to have made that supply for a consideration equal to the cost to KC of the plastic toy box.

The legislation

5. There is no dispute between the parties as to the terms and application of the relevant legislation in respect of the primary issue in contention: Section 4 of The Value Added Tax Act 1994 ("VATA 94") charges VAT on any supply of goods made in the United Kingdom where the supply is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him. It is agreed that KC is a taxable person, that the supplies it makes of the disposable nappies in the plastic toy box are supplies of goods made in the United Kingdom, and that those supplies are made in the course of a business which it carries on.
6. Section 30 VATA 94 provides the legal framework for the zero-rating of certain supplies (so that supplies which are within the zero-rated categories are to be treated as taxable supplies, but no VAT is to be charged on such supplies), and goods are to be zero-rated if they are of a description for the time being specified in Schedule 8 to VATA 94. Item I of Group 16 of Schedule 8 VATA 94 specifies that supplies of the following goods are to be zero-rated:

Articles designed as clothing or footwear for young children and not suitable for older persons

It is agreed that, by virtue of these provisions, the supply of disposable nappies is a zero-rated supply.

7. It is also agreed that, if the supply of the plastic toy box is a separate and distinct supply from the supply of the disposable nappies, since plastic toy boxes are not goods specified in Schedule 8 VATA 94, supplies of such items are not zero-rated, (neither, it should be said for completeness, are they exempt supplies) and are therefore taxable supplies on which VAT at the standard rate is chargeable.
8. Since there was dispute between the parties as to the scope of the applicable legislation in relation to the secondary contention (that relating to whether, if there were a separate supply of the plastic toy box, it was nevertheless for no consideration and is therefore not to be treated as a supply), it is necessary to set out the relevant provisions in full. It is also necessary to refer to both the European Sixth Directive and the domestic legislation which gives effect to the relevant Sixth Directive provisions, since KC argues that, in a way which is material to its appeal on this point, the domestic legislation goes beyond the scope of the Sixth Directive, and to the extent it does so, the domestic provisions cannot be applied to KC in the present circumstances.
9. The EC Sixth Council Directive 77/388/EEC states as follows at Article 5.6:

The application by a taxable person of goods forming part of his business for his private use or that of his staff, or the disposal

thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration. However, applications for the giving of samples or the making of gifts of small value for the purposes of the taxable person's business shall not be so treated.

Thus, in summary, disposals of business goods by a taxable person for no consideration are nevertheless to be treated as supplies made for consideration, where the person is entitled to deduct the VAT chargeable on the corresponding input supplies in relation to those goods; but if the supplies of such goods comprise the making of gifts of small value, such supplies are not to be deemed as made for consideration (so that, in effect, no VAT is chargeable on such "small value gifts").

10. The domestic provisions are in paragraph 5, Schedule 4, VATA 94, and, so far as are material to this appeal, are as follows:

5-(1) Subject to sub paragraph (2) below, where goods forming part of the assets of a business are transferred or disposed of by or under the directions of the person carrying on a business so as no longer to form part of those assets, whether or not for a consideration, that is a supply by him of goods.

(2) Subparagraph (1) above does not apply where the transfer or disposal is –

(a) a gift of goods made in the course or furtherance of the business otherwise than as one forming part of a series or succession. of gifts made to the same person from time to time) where the cost to the donor of acquiring or, as the case may be, producing the goods was not more than f15;

(b) subject to subparagraph (3) below, a gift to any person of a sample of any goods.

The evidence and the findings of fact

11. There was no agreed statement of facts by the parties, but we had the benefit of the oral evidence of Mr Lloyd Allan Dunckley in addition to the evidence set out in a witness statement prepared by him and exchanged before the hearing. Mr Dunckley is Head of Business Analysis for KC, and at the time when the relevant supplies were made he was a Management Accountant for KC. His role at that time was to be involved in the costing of the plastic toy box and disposable nappies and in identifying retailers to target in this particular promotional campaign.
12. We find the following facts from the evidence of Mr Dunckley:

13. KC produces disposable nappies under the Huggies brand name, and it launched the Huggies range of nappies in 1996. At that time the leading brand in the disposable nappies market was Pampers, who had 70 – 80% of the market share.
14. In order to break into this market, and in particular to promote Huggies nappies to new mothers (who would not yet have developed a loyalty to any other brand), KC adopted a promotional campaign designed to attract consumers with a package that contained a product that was not immediately known and to tie the consumer into a month's supply of disposable nappies – the hope was that once the month had passed the product would have demonstrated its worth, and the vital brand loyalty would have been established.
15. Attracting the custom of new mothers is common in this particular business and market, and KC decided to use a toy box, containing a month's supply of nappies, as its distinctive campaign feature. The toy box provided attractive and distinctive "packaging" for the nappies, and it was promoted as a "free toy box". After purchase the toy box could be used for a variety of purposes – to store the initial purchase of nappies; to store subsequent purchases of nappies; as a toy storage box; or for whatever purpose took the fancy of the family who had made the purchase. The toy box was branded with the Huggies name, logo and other brand features, associating it with the original product even if it were eventually used for some quite different purpose.
16. The promotional campaign was primarily aimed at sales through the large supermarket retailers: it was not continuously undertaken by KC, and it could be, and was, directed at individual stores within a supermarket chain. The nappies sold in the toy box were identical to those sold outside the promotional campaign. Thus at the same time a retailer might sell in one store 124 nappies packaged in the plastic toy box whilst in another store the retailer would be selling a non-promotional "Quattro" pack of the same nappies (that is, 124 nappies in the conventional Huggies cardboard packaging), but the price would be the same. Since the sales of nappies in the plastic toy box were in substitution for sales in the normal "Quattro" pack, it was unlikely that the same store would be offering both types of promotion at the same time. The plastic toy box was marketed as "free", and this was so in that there was no price differential between 124 nappies sold in the toy box and 124 nappies sold in the normal "Quattro" package. Consistent with this, a customer who did not want the toy box when purchasing the 124 nappies would not be able to purchase the nappies at a reduced price by foregoing the toy box. Neither would a customer be able to acquire a toy box without paying for the nappies packed in it.
17. As to packaging, the 124 nappies destined for sale in the plastic toy box would be wrapped at the production mill in 4 packages of 31 nappies each, using a white plastic packaging to facilitate packing them in the

toy box and to reduce the risk of marketeers unpacking and re-selling the nappies. Where nappies were sold without the toy box, they were either wrapped in Huggies branded plastic or sold (in the case of the "Quattro" package) in a branded cardboard box.

18. KC is not in the business of supplying toy boxes other than in the context of this particular promotion. The plastic toy boxes used in the promotion were specially commissioned and produced for KC according to its specification. They were never intended to be supplied separately from the sale of the nappies packed in them, or to be viewed as an item for purchase in their own right. The cost of each toy box has varied over the period of the promotion between £2.75 and £3.47, and that cost is well above the usual cost of plastic boxes produced for general sale.
19. The specification of the toy boxes has developed over the lifetime of the campaign: thus the "Millenium" toy box shown to us at the hearing has improved safety features and improved design over its predecessor. It complies with national and international consumer safety standards applicable to toys (EN71, Lion Standard and BS665 Toy Safety), has rounded instead of sharp edges, a deflection element so that it absorbs a child's weight if it should fall onto the box, and ventilation holes. The box is finished in bright primary colours and a contrasting lid, consistent with the Huggies brand, and bears the Huggies name and logo and the legend "free toy box".
20. The plastic toy box provides an attractive form of packaging for the nappies – some form of packaging is essential for display, transport and storage, and in the normal "Quattro" pack that is provided by the branded cardboard box, and in the toy box promotional pack That is provided by the plastic toy box. Neither the general features of the plastic toy box itself nor its particular features (its rounded edges, deflection qualities, ventilation holes) have a function (over and above that provided by the normal cardboard pack) in enhancing the use or preservation of the nappies over and above providing packaging and storage – they are all features which principally pertain to its function as a toy or other storage box rather than as packaging for nappies at the point of retail.
21. In the promotion the plastic toy box was described and promoted as a toy box – it was not promoted as an elaborate form of packaging disposable nappies. However, the nappies in the plastic toy box would always be sold in the "baby products" aisle of the supermarket store.
22. As mentioned, the box was supplied "free" to consumers, and this was also the case in relation to the supply by KC to the retailers: KC sold to any particular retailer 124 nappies at the same price, whether in the normal "Quattro" packaging or in the plastic toy box. KC alone bore the additional cost of supplying the plastic toy box with the nappies under the promotion. In the illustrative figures which were part of Mr

Dunckley's evidence, in 1999 a pack of Huggies Midi disposable nappies in a toy box cost KC £14.25 to produce (including the cost of the toy box) and was sold to the retailer for £16.24. The retailer sold on the pack to the consumer for £19.99. The cost of the toy box was not separately identified in the price of the pack either in the sale by KC to the retailer or in the retailer's sale to the consumer. The selfsame figures appeared in the figures relating to the sale of the normal "Quattro" pack, except that the cost of the pack is less to KC since it does not have the cost of the toy box in this instance, but instead the lower cost of the normal cardboard packaging.

23. The toy box promotion has been successful for KC in increasing its overall market share in disposable nappies, so that currently it has between 10% and 35% of market share. However, the VAT treatment for which the Commissioners contend (that is, requiring KC to account for VAT on a separate supply for a consideration equal to the cost of the toy boxes) bears harshly on the overall financial return from the promotion, and KC also (by its agreement with the retailers) has to bear the additional cost of reimbursing the retailers for the cost to them of the corresponding VAT treatment on the retail supply. If this VAT treatment were upheld, the promotion would result in a loss were KC not able (as in fact it has been able to do) to absorb certain overhead costs as a result of the increased production flowing from the additional sales generated by the promotion.
24. When the Commissioners assessed the supply of the plastic toy box as a separate standard-rated supply for VAT they did so by reference to the cost to KC of the toy box (£2.75 to £3.47) plus a proportion of the fee of £0.05 paid by KC for repackaging the nappies in each toy box.

The contentions by KC on the "single supply" issue

25. Mr Harris for KC argued that the beginning and end of his case was that this was a sale of disposable nappies and nothing else: this was so whether the supply was viewed from the position of the ultimate consumer or from the position of KC as manufacturer. KC was concerned only to sell nappies, and it chose to do so by attracting custom by packaging the nappies in a particular way. It did not "sell" a plastic toy or storage box to the consumer any more than it "sold" the cardboard packaging when it sold the normal "Quattro" pack of nappies. It was a distortion and an over-analysis of the transaction to argue that KC was selling nappies and, separately, selling plastic toy boxes. There was, accordingly, a single zero-rated supply of disposable nappies.
26. He argued the further point, that even if the supply of the plastic toy box could be identified as something distinct, it was ancillary to the supply of the nappies and for that reason should be treated so as to be part of the single, or composite, zero-rated supply.

27. In relation to the argument that the plastic toy box was an ancillary supply, Mr Harris claimed support for his view in the principles set out in the decision of the European Court of Justice in *Card Protection Plan*, the definitive authority on the issue of whether something constitutes a single supply or a bundle of separate supplies. Since both Mr Harris for KC and Mr McKay for the Commissioners referred us to the relevant part of the decision, it is helpful to set out here the paragraphs concerned, which are found at p 293:

"26. By its first two questions, which should be taken together, the national court essentially asks, with reference to a plan such as that offered by CPP to its customers, what the appropriate criteria are for deciding, for VAT purposes, whether a transaction which comprises several elements is to be regarded as a single supply or as two or more distinct supplies to be assessed separately.

27. It must be borne in mind that the question of the extent of a transaction is of particular importance, for VAT purposes, both for identifying the place where the services are provided and for applying the rate of tax or, as in the present case, the exemption provisions in the Sixth Directive. In addition, having regard to the diversity of commercial operations, it is not possible to give exhaustive guidance on how to approach the problem correctly in all cases.

*28. However, as the court held in *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* (Case C-231/94) [1996] STC 774 at 783, [1996] ECR I-2395 at 2411-2412, paras 12 to 14, concerning the classification of restaurant transaction, where the transaction in question comprises a bundle of features and acts, regard must first be had to all the circumstances in which that transaction takes place.*

29. In this respect, taking into account, first, that it follows from art 2(1) of the Sixth Directive that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.

30. There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of

the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied (see Customs and Excise Comrs v Madgett and Baldwin (trading as Howden Court Hotel) (Joined cases C-308/96 and C-94/97) [1998] STC 1189 at 1206, para 24).

31. In those circumstances, the fact that a single price is charged is not decisive. Admittedly, if the service provided to customers consists of several elements for a single price, the single price may suggest that there is a single service. However, notwithstanding the single price, if circumstances such as those described in paras 7 to 10 above indicated that the customers intended to purchase two distinct services, namely an insurance supply and a card registration service, then it would be necessary to identify the part of the single price which related to the insurance supply, which would remain exempt in any event. The simplest possible method of calculation or assessment should be used for this (see, to that effect, Madgett and Baldwin (at 1208, paras 45 and 46)).

32. The answer to the first two questions must therefore be that it is for the national court to determine, in the light of the above criteria, whether a transaction such as those performed by CPP are to be regarded for VAT purposes as comprising two independent supplies, namely an exempt insurance supply and a taxable card registration service, or whether one of those two supplies is the principal supply to which the other is ancillary, so that it receives the same tax treatment as the principal supply."

28. Mr Harris also referred us to the decision of the House of Lords when the case came back before the national court, and in particular the remarks of Lord Slynn in *Card Protection Plan Ltd v Customs & Excise Commissioners* [2001] STC 174 at 183d:

"[22] It is clear from the Court of Justice's judgment that the national court's task is to have regard to the "essential features of the transaction" to see whether it is "several distinct principal services" or a single service and that what from an economic point of view is in reality a single service should not be "artificially split". It seems that an overall view should be taken and over-zealous dissecting and analysis of particular clauses should be avoided."

29. The *Card Protection Plan* Court of Justice decision requires us to ascertain "the essential features of the transaction", and Mr Harris argued that in this transaction the essential feature is the supply of disposable nappies – whether they are packaged in a cardboard box or in a plastic box is not material since the type of packaging must be

subsumed to the main supply of goods. He drew our attention to Article 11(2)(b) of the EC Sixth Directive, which although not in point for this appeal, nevertheless indicates that in the scheme of VAT packaging is to be treated as an expense which is incidental to the supply of the goods in question.

30. Even if the supply of the plastic toy box is distinct, it is an ancillary supply which should share the zero-rated tax treatment of the principal supply (the sale of the nappies) to which it is ancillary. The supply of the toy box must be regarded as ancillary *"if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied"*. The evidence of Mr Dunckley shows that the supply of the plastic toy boxes is not an aim in itself, it promotes and is an adjunct to the sale of nappies: packaging the nappies in this way erodes the profit margin on individual sales, although it has the longer term benefit of enhancing the overall level of sales. KC does not have the objective of selling plastic toy boxes except in the context of promoting the sale of the nappies packaged in those boxes.
31. Further, the supply of the toy boxes can correctly be described as *"a means of better enjoying the principal [goods] supplied"*: if this phrase is taken to mean "to facilitate the use of the principal goods, then this is an apt description of the function of the toy box which facilitates the sale of the nappies by keeping them together in one package and provides storage for them once the customer gets them home. The customer is either the parent who has made the purchase or the baby for whose use the nappies have been purchased, and since the box is a convenient way of storing the nappies it facilitates the enjoyment by the parent of the nappies.
32. Finally, in relation to the Court of Justice decision in *Card Protection Plan*, Mr Harris pointed out that there is a single price paid for the nappies sold in the toy box (both in respect of the sale by KC to the retailer, and then by the retailer to the customer); furthermore, the toy boxes are not supplied separately. Whilst a single price is not decisive, it is indicative of a single supply, and in the present case, taken together with all the other features of the transaction, it reflects the essential character of the transaction, namely that there is simply a supply of nappies. Adopting the words of Lord Slynn cited above, *"an overall view should be taken and over-zealous dissecting and analysis ... should be avoided"*: if the sale of the nappies in the plastic toy box is held to be two separate supplies, that would be the *"over-zealous dissecting and analysis"* which we are required to avoid.
33. We were also referred to *Customs & Excise Commissioners v United Biscuits (UK) Ltd (trading as Simmers)* [1992] STC 325. This is a decision which predates *Card Protection Plan*, but both Mr Harris and Mr McKay agreed that the decision could be regarded as consistent with the principles laid down by the Court of Justice in the later case. The

case concerned the supply of biscuits in a decorative tin where the tin could be used, after consumption of the biscuits, as a storage container. The cost of the tin to the supplier significantly exceeded the cost of the biscuits. It was held that the provision of the tin was incidental to the supply of the biscuits contained in the tin, since the essence of what was supplied were biscuits in a biscuit tin rather than a general purpose container with biscuits in it. Further, the tin was integral to the biscuits not merely in the sense that it was the packaging of the biscuits, but also in the further sense that it served as an effective means of identifying the restricted, duality market at which the biscuits were aimed, as well as prolonging the shelf-life of the biscuits and keeping them in better condition until they were consumed. Accordingly there was a single, zero-rated, supply.

34. Mr Harris argued that, in the language of *Card Protection Plan*, the supply of the tin was ancillary to the principal supply of the biscuits because it was a means of better enjoying the biscuits. In the present case the supply of the plastic toy box, although a promotional device (as was the biscuit tin), nevertheless was a means of better enjoying the nappies because of the packaging and storage function which it provided. It was not relevant that the toy box, after all the nappies had been used, had a subsequent use which might be unrelated to the nappies, just as it was not relevant that the biscuit tin could be used for storing things other than biscuits once all the biscuits had been consumed.

The contentions by the Commissioners on the "single supply" issue

35. Mr McKay for the Commissioners accepted that on the "single supply" issue there was a great deal of agreement between the parties as to the law. As Lord Hope said in *Customs & Excise Commissioners v British Telecommunications plc* [1999] STC 758 at 768. according to the guidance given by the Court of Justice in *Card Protection Plan*, "the question is one of fact and degree, taking account of all the circumstances". The tribunal must stand back to see what is really happening, the commercial reality.
36. From the Court of Justice decision in *Card Protection Plan* the Commissioners took the following additional points:
- (1) There is a presumption that every supply must nominally be regarded as distinct and independent (see paragraph 29): in the present case the presumption is that there is a supply of nappies and a distinct and independent supply of the plastic toy box. It is for KC to overcome this presumption.
 - (2) In determining whether a supply is to be regarded as ancillary to a principal supply, it is necessary to look at the position from the viewpoint of the recipient (i.e. the

customer), not from the position of the supplier (i.e. the manufacturer) (see paragraph 30): does the supply constitute *for customers* an aim in itself or a means of better enjoying the principal service supplied?

37. Taking this second point first, Mr McKay asked, how from the customer's viewpoint, was the plastic toy box a means of better enjoying the supply of the nappies, or, (since he was happy to adopt Mr Harris's re-statement), how does the toy box "facilitate the use of" the nappies? It is not sufficient that the toy box keeps the nappies together as a convenient and attractive form of packaging or that it serves as a means of storing the nappies until they are used: these are matters which are preparatory to the actual use of the nappies. The "enjoyment" of the nappies is their actual use as nappies, and the toy box has no part to play in that. The real purpose of the toy box is to entice the customer to buy the nappies.
38. Further, although the evidence of Mr Dunckley sought to emphasise the role which the toy box played in packaging the nappies, the toy box is a toy box, not packaging: it is called a "free toy box"; it has features which are relevant to a toy box and not to packaging; it conforms to the safety and other consumer standards applicable to plastic boxes used as toy boxes. It is special and qualitatively different from the normal cardboard box packaging used for disposable nappies. The customer, so Mr McKay contends, is offered an opportunity to get something which is an end or aim in itself, and which must therefore be a separate supply, and not a supply which is part of, or ancillary to, the supply of nappies.
39. As for the *United Biscuits* case, the factors which were there said to be determinative of the tin being a single supply with the biscuits are not present here in comparable form: there was a single supply of biscuits in a tin because the tin had a function which was directly the means by which the supply of biscuits was better enjoyed (prolonging their shelf-life, keeping the biscuits in better condition until they were all consumed).
40. Therefore, the presumption that every supply must normally be regarded as distinct and independent is not rebutted in the circumstances of this case by KC.

Our decision of the "single supply" issue

41. As mentioned, the parties are in agreement as to the principles which, in the light of *Card Protection Plan*, should be applied to decide whether a transaction comprising several elements should be treated as a single supply or as two or more separate supplies for VAT purposes. The task for us is to decide whether those principles, applied to the facts as we have found them, lead us to conclude that the supply of the plastic toy box containing the nappies is a single, zero-rated, supply of nappies or

two separate supplies, a zero-rated supply of nappies and a standard-rated supply of a plastic toy box.

42. Before turning to what we consider to be the key principle in this instance, we note that we must have regard to all the circumstances in which the transaction takes place, and that although, as Mr McKay expressed it, there is a presumption that every supply must be regarded as distinct and independent, a supply which comprises a single supply of goods from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system (or, in Lord Slynn's words, "... *an overall view should be taken and over-zealous dissecting and analysis of particular clauses should be avoided*"). Both parties invited us to stand back to see what is the nature of the supply made by KC, and we have endeavoured to do that so as to comply with these requirements.
43. Mr Harris first asks us to hold that there is, quite simply, a supply of disposable nappies only in this case, with the plastic toy box comprising simply the packaging in which the nappies are supplied – there is, on this basis as we understand his point, no separate element within the supply, so that the question of whether there is an ancillary supply and a principal supply does not arise. But this line of argument can be sustained only if the plastic toy box is indeed simply packaging, and whilst we have found that the toy box does carry out a function of packaging in the display, transport and storage of the nappies, neither the customer purchases, nor KC sells, the nappies in the plastic toy box on the basis that the toy box is simply, and only, packaging of the nappies. On any realistic basis the customer is purchasing, and KC is selling, something more than 124 nappies packaged in a particularly elaborate manner. The toy box is specifically promoted as a toy box, and the attraction to the customer in making the purchase is that he or she acquires something which has a use which is quite distinct from mere packaging and which should endure long after the nappies have been used and discarded. We therefore conclude that there is not a single element to the transaction and thereby a single supply: there are two component parts, namely the element which is the supply of the nappies and the element which is the supply of the plastic toy box.
44. Can it be said that, although there are two elements or component parts to the transaction, the supply of the plastic toy box is ancillary to the principal supply of the nappies and should share the VAT treatment of that principal supply? The key principle in applying this approach is that set out in paragraph 30 of the Court of Justice decision in *Card Protection Plan*: "*A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.*" Here we are dealing with supplies of goods, not services, but the key principle applies equally in that context.

45. Much of the argument we heard turned on the question of whether the toy box was, for the customers (be they the parent purchasing the nappies or the child using them), a means of "better enjoying" the nappies, or "facilitating the use" of the nappies. The arguments from both sides identified the "customer" as the ultimate consumer, but it is worth noting that (as we were reminded in the arguments on the secondary issue as to consideration) the supply under scrutiny is the supply made by KC to the retailer, so that, strictly, for KC the "customer" is the retailer. Nevertheless, it makes sense to apply the *Card Protection Plan* principles to the context of the ultimate consumer so as to understand the true nature of the supply (and to avoid any risk of a mis-match between the VAT treatment of the supply from manufacturer to retailer and the supply from retailer to consumer when in all material respects the supplies are identical in character). Indeed, since the retailer does not use the goods (other than in the sense of on-selling them at a profit), it is difficult to apply solely to the supply to the retailer the concepts of "better enjoyment" which are at the heart of the *Card Protection Plan* principles. We also note that the same approach was adopted in the *United Biscuits* case, where the use made of the tin by the consumer was clearly at the forefront, notwithstanding that the actual supply of the tin of biscuits was from the manufacturer to the retailer.
46. In our view it cannot be said that the plastic toy box is a means of better enjoying, or facilitating the use of, the nappies, whether the consumer is the parent or the child. Whilst the toy box does act as packaging (including acting as a container in which to keep the nappies until they are used), in that capacity it offers little more than is offered by the cardboard box in which the normal "Quattro" package is supplied. The nappies are not more conveniently usable as a result of the toy box; nor is there any suggestion that their absorption, strength, softness or other qualities are preserved, enhanced or prolonged as a result of the toy box or storage in that box. On this point it is telling that the promotion involving the plastic toy box makes no claims for the box in relation to the nappies themselves: the box is presented simply as a "free toy box". It is there to attract the customer to buy 124 Huggies nappies rather than nappies of a rival brand. For the parent customer, faced with the choice of purchasing 124 nappies in a plastic toy box or in the normal "Quattro" package, the aim of making the purchase of the nappies presented in the toy box is to acquire a free toy box in addition to the nappies.
47. These circumstances can be contrasted with those in the *United Biscuits* case. where the supply was held to be "biscuits in a biscuit tin", rather than "a general purpose container with biscuits in it". Here we have "a plastic toy box with nappies in it". In *United Biscuits* the tin was held to serve the supply of the biscuits by defining the target market, prolonging the shelf-life of the biscuits and keeping them in better condition once the packaging was opened. The plastic toy box had no function relative

to the use or condition of the nappies beyond that provided by any form of reasonable packaging.

48. We have noted that a single price is charged for the nappies in the plastic toy box, which may be indicative of a single supply notwithstanding the two elements. But the single price has as much to do with the nature of the promotion (the "free toy box") as with nature of the supply, and in any event is not a determinative factor if, as we consider is the present case, other more fundamental factors lead to the conclusion that there are separate supplies within the single transaction.
49. We therefore decide that there is a supply for VAT purposes of the plastic toy box which is a distinct and independent supply from that of the nappies. We do not consider this to be "an over-zealous dissecting and analysis" of the transaction: if the parent in the supermarket store were asked what he or she was purchasing, the reply would likely be, "I'm buying nappies and getting a free toy box", and that would be a fair statement of what was going on. To point up the contrast, ask the same question to the customer in the *United Biscuits* case, and the reply would likely be, "I'm buying a fancy tin of biscuits", and that too would be a fair statement of what was going on. The VAT treatment in each case is consistent with the transaction as it appears to the customer.

The "no consideration, no deemed supply" issue

50. KC's secondary grounds for appeal, which are only relevant if we find, as we do, that there is a separate supply for VAT purposes of the plastic toy box, relate to the question of consideration and deemed supply: in particular, that since the toy box is "free", no consideration is in fact given for the supply, and that this is a case where the normal deemed supply rules should not apply. In consequence, it is argued, the Commissioners have erred in charging VAT by reference to the cost to KC of the toy boxes, since there is no supply.
51. The relevant EC Directive and domestic provisions are set out above, and it helpful first to set out the case presented by each party by reference to the domestic legislation before turning to the wider point on the scope of that legislation which Mr Harris put forward for KC.
52. The scheme of the relevant provisions in paragraphs 5(1) and (2) of Schedule 4, VATA 94 is as follows: the general rule is that a disposal of goods which are assets of a business is to be treated as a supply of those goods for VAT purposes, even if there is no consideration for the disposal; but the general rule does not apply (so that there is no supply) in the case of a "small" gift of goods made in the course of the business; but the "small gifts" exception does not apply (so that the deemed supply rules are re-instated) if there is a succession or series of "small gifts" to the same person (i.e. if in reality the gifts are not "small"). For these purposes at the time relevant to these appeals, a gift is a "small" gift if the cost to the donor was not more than £15.

53. Elsewhere in the VAT legislation there are provisions which determine the consideration for which a deemed supply is treated as made: no issue in the present case turns on those provisions, so that if KC cannot escape the deemed supply provisions of paragraph 5, Schedule 4, VATA 94, it is not in dispute as to the amount of VAT which has been charged on the supply of the toy boxes.
54. The question may well be asked why, if a business person chooses to dispose of business assets for no consideration, he should be charged VAT on consideration he has not received: the answer is found within the provisions of Article 5.6 of the EC Sixth Directive, which places these rules in the context of the deduction of input tax in respect of the goods given away – to maintain equality of treatment between taxpayers, a business which has taken the benefit of a deduction of input tax when acquiring the goods which are subsequently disposed of must account for output tax on that disposal, whether or not the disposal is at full value.
55. Mr Harris argued first that on a proper analysis of the arrangements there was in fact no consideration given for the plastic toy box. He took us to the decision of the Court of Justice in *Kuwait Petroleum (GB) Ltd v Customs & Excise Commissioners* [1999] STC 488, and then to the decision of the High Court applying the Court of Justice decision: *Kuwait Petroleum (GB) Ltd v Customs & Excise Commissioners* [2001] STC 62. The facts are complex, relating to the question of whether consideration given on the purchase of petrol was in part consideration for gift redemption stamps given to the purchaser when purchasing the petrol, and/or in part consideration given for gifts eventually supplied on the redemption of stamps under the scheme. Mr Harris argued that since in the present appeal it was not possible to identify any price paid for the plastic toy box, it was properly a gift: as decided in the *Kuwait Petroleum* case, it must be shown that the parties to the transaction have agreed that part of the price is the value given in return for the particular supply. There is no evidence that the customer has agreed that part of the price paid for the nappies is given for the supply of the plastic toy box. There is no basis for any attribution of part of the total consideration to the toy box.
56. If then no consideration is given for the supply of the toy box, since each toy box is disposed of in the course of KC's business, and since each toy box has a cost to KC of less than £15, the supply comes within the "small gifts" exception to the general rule which deems there to be a supply when goods are disposed of for no consideration. Therefore, in the result, there is no supply of the toy boxes.
57. For the Commissioners, Mr McKay asked us to take account of the actual supply made by KC, which was a supply made to the retailer, and not to the customer. Each supply was made pursuant to a no doubt complex and carefully negotiated sale agreement under which the

parties agreed all relevant matters concerning the supply, including prices, discounts, volumes, promotional schemes and so forth. There was nothing in the evidence presented by KC which suggested that KC was giving anything away to the retailer or making supplies for no consideration. Different considerations might apply in relation to the supply to the ultimate customer, but they would be of no concern in looking at the only relevant supply, namely that between KC and each retailer. However, even if, in relation to that supply, it could be argued that there was a gift of the plastic toy box, the "small gifts" exception to the general rule would not apply, since the "gift" would be part of a series or succession of gifts to the same person: in the context of supplies to a major supermarket retailer, clearly the volume of supplies, taking each toy box as a separate supply, would be enormous and when aggregated, as required by the legislation, would far exceed the "small gifts" limit. Accordingly the general rule set out in paragraph 5(1), Schedule 4, VATA 94 applied to the supplies of toy boxes made by KC even if they were gifts: they were business assets which were disposed of by KC carrying on its business, and whether or not for a consideration they were supplies of goods for VAT purposes.

58. In reply, Mr Harris pointed out that the evidence of Mr Dunckley was that retailers purchased 124 packaged nappies at the same price from KC whether the package comprised the normal "Quattro" pack or the toy box promotional pack, so that the toy boxes were not charged for separately and as between the parties no part of the price was attributed to the toy boxes. It was therefore a reasonable inference that there was no consideration for the supply of the toy boxes. Furthermore, the rule relating to a "series or succession of gifts" was essentially an anti-avoidance rule designed to catch someone seeking to exploit the "small gifts" exception, and it was not appropriate to apply it in a genuine business and commercial context.
59. Mr Harris argued a further point: he referred to Article 5.6 of the EC Sixth Directive, which sets out the rule deeming gifts of business assets made by a taxable person to be supplies made for consideration. He pointed out that the terms of the Directive, setting out the exception to the general rule ("*... applications for... the making of gifts of small value for the purposes of the taxable person's business shall not be so treated*") has been qualified in the domestic legislation by the provision which aggregates a series or succession of "small gifts" made to the same person so as to take them outside the "small gifts" exception. That qualification goes beyond the scope of the Sixth Directive and cannot therefore be relied on by the Commissioners in their case against KC.
60. To this Mr McKay replied that Article 5.6 states the general proposition that "gifts of small value" are an exception to the general rule, but that it is for the domestic legislation to determine what comprises "gifts of small value". The UK legislature has decided that if a series of gifts to

the same person has an aggregate value exceeding the threshold "small gifts" amount, that is no longer a "small gift". In other words, the domestic legislation of paragraph 5(2), Schedule 4, VATA 94 is properly the means by which the "gifts of small value" requirement is brought into effect in the UK, in that the series of gifts provision is the means of determining what is or is not a "gift of small value" in accordance with Article 5.6.

Our decision on the "no consideration, no deemed supply" issue

61. On this issue also we accept the arguments of the Commissioners. The supply with which we are concerned is the supply by KC of the plastic toy box to the retailer. Even if we are prepared to accept that the toy box is supplied for no consideration to the retailer (and we do not necessarily accept that the fact that the two different packages of 124 nappies are sold at the same price means that in the case of the promotional toy box supply the toy box is sold for no consideration), we conclude that the supply does not fall within the "small gifts" exception to the general rule which deems there to be a supply even where business assets are disposed of for no consideration. The "series of gifts" provision has effect, and we do not consider that its terms are outside the scope of the European legislation on this subject. There should be no surprise in that outcome: the surprise would be if provisions which have a *de minimis* purpose were applicable to transactions between major businesses which in the aggregate have very substantial value.
62. Our decision is therefore that even if no consideration is given for the plastic toy boxes, there is a supply by KC of the plastic toy boxes within paragraph 5, Schedule 4, VATA 94, and that such supply is a separate supply from the supply of disposable nappies.
63. The appeals are therefore dismissed.