



TC06619

**Appeal number: TC/2016/04816
TC/2017/03150**

*VALUE ADDED TAX – zero rating – clothing for young children – sleeved
fleece – whether designed as clothing – appeal allowed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

CHARACTER WORLD LIMITED

Appellant

- and -

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

Respondents

TRIBUNAL: JUDGE JONATHAN CANNAN

Sitting in public in Manchester on 26 March 2018

Mr Philip Simpson QC instructed by Grant Thornton UK LLP for the Appellant

**Ms Laura Poots instructed by HM Revenue & Customs Solicitor's Office and
Legal Services for the Respondents**

DECISION

Background

- 5 1. The appellant has a numbers of licences to design, manufacture and sell products
incorporating images of characters from popular movie, TV show, gaming and music
brands. The product relevant to this appeal is described by the appellant as a “sleeved
fleece” available in a range of printed designs with different children’s characters. The
appeal is concerned with products marketed in two sizes. One is said to be suitable for
10 ages 3-10 and the other for ages 10-13. The basic product is a piece of fleece material
with sleeves. For present purposes and to adopt a neutral term I shall describe it as “the
Product”.
- 15 2. *Group 16 Schedule 8 Value Added Tax Act 1994* (“VATA 1994”) has the effect of
zero-rating a supply of goods which are articles designed as clothing for young children
and not suitable for older people. The respondents consider that the Product is not
“designed as clothing” and therefore any supply of the Product is standard rated for
VAT purposes. The appellant contends that the Product is designed as clothing and is
to be zero rated.
- 20 3. The decisions under appeal are assessments dated 21 July 2016 covering supplies
of the Product by the appellant in the VAT periods 08/13 to 03/16. The total VAT
assessed is £157,579.
- 25 4. On 17 March 2017 the respondents gave notice of penalty assessments covering the
same periods in the sum of £71,698. Shortly before the hearing of the appeal the
respondents withdrew the penalty assessments. The appeal against the penalties is
therefore allowed.

Statutory Framework

5. The relevant statutory provisions are short. Section 30(2) VATA 1994 provides
that:
- 30 “A supply of goods or services ... is zero-rated ... if the goods or services are of a
description for the time being specified in Schedule 8 ...”
6. Group 16 of Schedule 8 concerns clothing and footwear. Item 1 is:
- “Articles designed as clothing or footwear for young children and not suitable for older
persons.”

Emphasis added

Findings of Fact

7. I heard evidence from Mr Mark Schweiger, Ms Karen Creed and Mr Tim Kilby on behalf of the appellant. Mr Schweiger is a chartered accountant and a member of the founding family of the appellant's business. He has been a director of the appellant since January 2003. Ms Creed joined the appellant as Head of Business Development in February 2012 and prior to that worked as a senior retail account manager with The Walt Disney Company Ltd. Since January 2014 she has been the appellant's Creative and Product Director. Mr Kilby is the Brand Director of the appellant and oversees the relationships the appellant has with its licensors.

8. The Product is an established line offered by the appellant as part of its wholesale range. It is not clear when the Product was introduced but it was sometime shortly before 2012. The appellant has sold over 350,000 items of the Product since it was introduced. The idea for the Product came from an existing product being advertised on television by a wholesale competitor, John Mills Limited ("JML"). JML called their product a "slanket", presumably derived from a description of the Product as a sleeved blanket.

9. The appellant's creative team considered that the appellant could use its licensing rights to give the Product a unique selling point. In particular using characters on the Product popular with young children such as Disney characters, Peppa Pig and Hello Kitty. I was shown an example of the Product, said to be for children aged 3-10 which incorporated Dreamworks Trolls in the design. The Product for children aged 10-13 would more typically feature music brands such as One Direction.

10. The Product as designed is a rectangular piece of micro fibre with two sleeves and is intended to be used indoors. Arms are placed in the sleeves and the Product can be used with the open sides at the back or at the front. In the latter case it has the appearance of a dressing gown although there is no fastening. The oral evidence which I accept is that the Product with dimensions 120cm x 90cm is intended for children aged 3-10 years and the Product with dimensions 140cm x 90cm is intended for children aged 10-13 years

11. The appellant came to manufacture and market the Product as follows. Having identified a plain product being marketed by JML, consideration was given to the function of the Product. It was intended for use by children around the house. It would provide more warmth to a child when lying down than a traditional dressing gown. It would be more useful than a blanket because when using it children can perform simple activities more easily, such as reading, playing on a games console and playing with small toys. The Product was trialled by the appellant's employees with their own children.

12. The size of the Product was originally based on a children's towelling poncho manufactured and distributed by the appellant. The poncho was 120cm x 60cm, but the width of the Product was increased so that it would fit more loosely around the body and could be wrapped around the body to give more warmth. The appellant's ponchos feature a hole in the middle of a rectangular piece of towelling fabric with a hood. They

are intended to be used at bath time, at swimming pools or on the beach. HMRC accept that the towelling poncho is designed as clothing for young children.

13. The Product has no fastening, unlike a dressing gown. The appellant did consider the addition of a fastening such as Velcro or a toggle but decided that it was not
5 necessary or cost effective. The Product was designed with the intention of the child wrapping it around the body.

14. Within each age group the Product is “one size fits all”. It is clear that the Product as sold in the age group 3-10 is very large on smaller children. The sleeves are very
10 long and the fabric trails on the floor when a smaller child is standing up with the opening either at the front or the back, depending on how the Product is used. The gap between the sleeves means that the Product in this age range does not rest easily on the shoulders or chest of a younger child.

15. The Product can be altered to make it shorter either by putting a hem on it, or simply
15 by cutting it. The fabric does not fray when cut. Having said that the Product is sold with a hem, and if cut without hemming it the result would probably look scruffy. The packaging contains no instructions about alterations, or information to the effect that the fabric can be cut without fraying.

16. If the Product is not altered and is used with the opening at the back by a smaller
20 child, trying to walk in the Product would pose a tripping hazard. The Product is clearly not suitable for use in that way by a smaller child. However, the Product can be used for walking in with the opening at the front by all children in the age range. In those circumstances the material would trail behind the child and not pose a tripping hazard.

17. Mr Schweiger’s evidence was that gap between the sleeves was particularly
25 important in the design of the Product. The gap was designed to be large enough for the Product to be used with the opening either at the front or the rear. It was not entirely clear how the size of the gap between the sleeves affected the ability to wear the Product with the opening at the front or the rear. I understand from Mr Schweiger’s evidence that if the gap was too narrow then whilst the product could used with the opening at
30 the back, it could not be used with the opening at the front in the manner of a dressing gown. In other words, if the gap was large enough that it could be used with the opening at the front then it could also be used with the opening at the back, but not vice versa. I am satisfied that the Product was intended to be used in both ways and that it was designed as such.

18. The evidence before me included various samples – a version of the Product for
35 ages 3-10 with a Dreamworks Trolls design, an adult version and a poncho. The Product is packaged in a transparent plastic bag containing a card insert. The dimensions of the Product are given but no age range is identified. Photographs used on the card insert show the Product in use. The main photograph shows a child lying on a sofa with the opening behind her. A smaller photograph shows the same child stood up, again with
40 the opening behind her. Similarly, examples of photos used by retailers to market the Product on Amazon and photographs on the appellant’s Facebook page show children standing up using the Product with the opening on the back. I am satisfied that there is no real significance to the fact that all these photographs show the Product with the

opening at the back. This is not because the Product was not designed to be used with the opening at the front, but because images of the characters used in the design are more prominent when the Product is used with the opening at the back. It is the characters which are the unique selling point of the appellant and I accept that is why the marketing material illustrates the Product being used in that way.

19. The appellant also produces an adult version of the Product which is considered to be more of a novelty item. The present appeal is not concerned with that version.

20. The appellant maintains a “design bank” for each of its products, which in each case includes a suite of photographs. Selections of photographs from the design bank are used on the appellant’s packaging for the Product and the photographs are available to retailers to use in advertising and marketing the Product if they so choose. The suite of photographs included photographs of Mr Schweiger’s two children taken approximately 4 years ago - his son, aged 6 at the time and his daughter aged 9. Both are shown wearing the Product with the opening at the front. In the case of Mr Schweiger’s son the Product gives the appearance of being too large for him, in the sense that there is too much material to rest neatly on his shoulders, one of the sleeves has been folded back and the product trails on the floor. In the case of Mr Schweiger’s daughter the Product gives the appearance of a “good fit” in the sense that it rests neatly on her shoulders, the sleeves are the right length and the material just brushes the floor. It looks very much like a dressing gown, albeit without any fastening.

21. In addition to the suite of photographs the appellant provides retailers with descriptions of products, a barcode and a recommended retail price. Retailers are not required to use these and are free to choose how a product is described, categorised, photographed and marketed. For example, Amazon has its own product categories over which the appellant has no control. Documents in evidence show the product advertised by retailers on Amazon in a category of blankets.

22. The license agreements entered into by the appellant with its licensors cover various product categories. The agreements are in standard forms drafted by the licensors. Each agreement gives the appellant access to a “style guide” which contains all images of the characters referred to in the licensing agreement. Those images are available to the appellant when designing products falling within the product categories covered by the agreement.

23. The appellant’s licensing agreement with The Walt Disney Company Ltd gives the appellant the right to use Disney characters on products of a description “Fleece Blankets” in the product category “Blankets/Plaids”. An agreement with Entertainment One UK Ltd gives the appellant the right to use Peppa Pig characters on articles described as “fleece blanket containing arm holes so it can be worn by a child”. An agreement with Sanrio GmbH gives the appellant the right to use Hello Kitty on articles described as “Kids sleeved fleece”.

24. The appellant’s core products covered by these licensing agreements include bedding, blankets, rugs, towels, ponchos, cushions and curtains although the description given in each licensing agreement may be different. Product specifications

and samples of products under development must be sent to the licensor for approval. If a new product is not covered by the licensing agreement it is necessary for the appellant to renegotiate the agreement with the licensor.

5 25. Licensors have agreements with a large number of businesses similar to the appellant giving exclusivity in relation to certain categories of products. For example The Walt Disney Company Ltd has agreements with businesses which produce items of clothing. Certain items may not clearly fall within existing product categories. Where a new product is developed there will often be agreement with the licensor that it falls within an existing product category in the license agreement, even if that product
10 category does not give the most accurate description.

15 26. The Product was treated by the appellant and The Walt Disney Company Ltd as falling within the description of a “Fleece Blanket” in the relevant licensing agreement. Disney agreed that the Product could be categorised as a fleece blanket because they wanted to put it into an existing contractual description rather than amend the licensing agreement.

27. I am satisfied that the agreements referred to above between the appellant and the three licensors identified in each case cover at least part of the periods of assessment under appeal.

Reasons

20 28. Both parties accepted and adopted the approach of the FTT in *Snugglebundl Ltd v HM Revenue & Customs [2014] UKFTT 1121 (TC)*. In that case the tribunal (Judge Kevin Poole and Mr Terry Bayliss) construed the term “designed as clothing” by reference to the ordinary usage of the words, applying *Brutus v Cozens [1973] AC 854*. The tribunal considered the meaning of the term clothing as follows:

25 “ 38. In ordinary usage, it seems to us that “clothing” refers to items (generally made of fabric, but sometimes of some other largely flexible membrane) that are *worn* (see [40] below) with the purpose of covering (or assist in covering) some part or parts of the body, either for practical reasons (physical comfort in the face of cold, heat, rain, etc) or for other personal (including religious) reasons (such as the preservation of modesty by the
30 Muslim hijab, the “outward sign” of the Sikh’s turban or the wish to enhance attractiveness with the fashionable designer dress).

35 39. It is clear that clothing may also serve some other purpose (including some purpose more important than its “clothing” purpose) without thereby ceasing to be clothing – HMRC’s Notice 714 acknowledges this, by referring to items which are primarily safety aids (such as sailors’ lifejackets) as still being clothing – see [25] above. This is an important point when considering the phrase “designed as clothing” – see [43] below.

40 40. To be *worn*, it seems to us that the item in question must be appropriately shaped to fit the contours of the body and accommodate its flexibility, though the degree to which this is necessary (and, in particular, the degree to which such shaping needs to be inherent in the design and manufacture of the item itself) will depend upon the nature of the item in question and the way in which it is intended to be used. A shawl is just as much an item of clothing as a carefully tailored suit, though the one may be simply a triangle of

plain fabric wrapped around the shoulders and the other is tailored to fit the whole body closely from neck to ankle. By way of contrast, a sleeping person may be covered with a blanket to keep them warm, but they could not be said to be “wearing” the blanket and it does not thereby become an article of clothing.

5 41. But just because something is worn, that does not necessarily make it clothing. A brooch or a climbing harness are both worn, but clearly neither of them is clothing, as neither of them provides any significant element of coverage for the body.

42. Finally, it is fair to say that what constitutes “clothing” can depend on the context. In particular (in the present case) it is appropriate to bear in mind that what constitutes “clothing” for a baby is likely to be quite different from what constitutes “clothing” for an adult, in particular because babies have no need for their clothing to accommodate irrelevant activities such as walking, but instead have their own special requirements (for example, easy access for nappy changing).”

29. The tribunal also considered whether an article was “designed” as clothing. It held that this required consideration of the designer’s subjective intentions. At [36] the tribunal stated:

“36. In deciding whether an item is “designed” (or planned/intended) as clothing, an assessment is clearly therefore required of the designer’s intentions or purpose when conceiving and finalising its design. This may largely (or even entirely) be inferred from an examination of the item in question, but whatever the item’s objective characteristics, the strict requirement of the legislation is to decide what the designer intended it to be, not what it objectively is.”

30. The submissions of Mr Simpson QC on behalf of the appellant may be summarised as follows:

25 (1) As a matter of fact the Product is a fleece material with sleeves. The material is contoured to fit the body of the wearer. The design is such that it can be worn as a dressing gown or as a “quasi-blanket”.

30 (2) The term clothing is to be given its ordinary meaning, which is an item to be worn by a person to provide decency, warmth, or protection from the elements.

(3) The initial impression is that the Product is clothing, being a variation on a dressing gown or a poncho and fulfils the function of clothing.

35 (4) It is clear that the Product may be worn, and is designed to be worn. The objective characteristics of the Product indicate that it was designed to fit a child, rather than a bed, with two sleeves so that the top edge would be just above the shoulders.

(5) The primary use of the Product is as clothing to be worn around the house, whilst walking around or seated. It allows the wearer to keep warm and at the same time perform tasks.

31. Ms Poots on behalf of the respondents accepted that the Product can be described as being worn, certainly when standing up with the opening at the front. However, she submitted as follows:

- 5 (1) The Product was primarily designed and marketed to be used on the front of a child with the opening at the back whilst the child is lying down or sitting on a sofa.
- (2) The elements of design to fit the body are minimal. The Product is simply a rectangle of cloth with sleeves, which are added to give the Product additional functionality as a blanket.
- 10 (3) The fact that the Product is “one size fits all” for children across a large age range is consistent with it being designed as a blanket rather than as clothing. The length of the Product indicated that it was not designed to be used whilst standing up, but it was designed to be used whilst lying or sitting on a sofa. For a 3 year old it was clearly not designed as clothing.
- 15 (4) The Product is not designed to allow smaller children to move around easily. If worn with the opening at the back it is a tripping hazard and if worn with the opening at the front then significant amounts of material would trail on the floor.
- (5) The absence of a fastening suggests that it is not clothing.
- 20 (6) There was little design input from the appellant. The appellant simply took an existing product designed by JML. It is important to look at the objective characteristics of the Product. Objectively, it does not fulfil the function of clothing.
- 25 (7) Clothes for a baby do not need to be designed for walking in. Clothes for a child must be designed to permit walking.

32. It seems to me that it is first necessary to consider what is clothing, according to the ordinary and natural meaning of that word. It is then necessary to consider whether the Product was designed as clothing.

33. The FTT in *Snugglebundl* considered the meaning of the word clothing, and both parties in the present case were content to adopt what was said in that case. Having regard to that decision and the submissions of the parties I consider that the following propositions are not controversial:

- 35 (1) Clothing generally refers to items made of fabric or some other material which are worn to cover the body parts of the body in order protect the wearer from the elements, to preserve modesty and/or for the purposes of fashion. These are the functions of clothing.
- (2) All clothing may be said to be worn.
- (3) An item of clothing will be worn where it is appropriately shaped to accommodate the contours and movement of the body, having regard to the functions it is intended to fulfil.
- 40

(4) Not everything that is worn is clothing. Examples are given in Snugglebundl and include a brooch or a climbing harness which do not fulfil the functions of clothing.

5 (5) The extent to which an item may be said to accommodate the contours and movement of the wearer will depend on the context.

(6) An item may fulfil other functions as well as the functions of clothing. For example, it is accepted in HMRC's VAT Notice 714 that a cyclist's tabard and a sailor's lifejacket are items of clothing but primarily function as safety aids.

10 34. It seems to me that if something fulfils one or more of the functions of clothing and may naturally be said to be worn, then prima facie it is properly described as clothing. Notice 714 distinguishes articles which may be described as accessories, but the present appeal is not concerned with what might be described as an accessory.

15 35. The FTT in Snugglebundl referred at [40] to a person sleeping with a blanket to keep warm, but rightly expressed the view that a person could not be said to be wearing the blanket. A blanket in ordinary usage fulfils the functions of clothing in that it protects from the cold and may preserve modesty. However, it is not clothing because the person would not be described as wearing the blanket. The person would simply be described as being covered by a blanket. The reason a blanket is not described as being
20 worn is because it is not shaped in any way to accommodate the contours and movement of the body.

25 36. Having said that, the FTT in Snugglebundl rightly referred to a shawl as being an item of clothing. A shawl may be a simple piece of cloth in the shape of a rectangle or triangle. However, it fulfils one or more of the functions of clothing and may naturally be described as being worn. It is appropriately shaped to be worn over the shoulders. Nothing more tailored is needed in the context of an item to be worn over the shoulders.

30 37. Once an article is identified as fulfilling one or more of the functions of clothing, and as being an item which would naturally be described as being worn, then prima facie it satisfies the definition of clothing. For the purposes of zero-rating it is then necessary to consider whether the article was designed as clothing. It seems to me that something will be designed as clothing if it was designed to fulfil one or more of the functions of clothing and it was designed to be worn. There is no issue in the present case that if the Product was designed as clothing, then it was designed as clothing for young children.

35 38. It is not sufficient for the person who designed the item in question to simply say that the item was designed as clothing. The subjective intentions of the designer will be relevant where known, but it is important to test any evidence of those intentions against the inferences to be drawn from the objective characteristics of the item in question. Indeed inferences to be drawn from the objective characteristics of the item in question
40 may be sufficient to establish that the item was designed as clothing or as something else. Evidence as to actual use of the product may also be relevant in identifying intended use.

39. An item will be designed as clothing if in the design process the intended use of the item was as clothing. If the designer or those responsible for the design say that certain features were included with the intention that purchasers would wear the item and that the item would protect the wearer from the elements or preserve the wearer's modesty then that is relevant to whether the item was designed as clothing. Similarly, the objective characteristics of the item may lead to an inference that the item was intended to be worn and to fulfil one or more of the functions of clothing.

40. Where an item is designed solely for a function other than that of clothing, for example as a climbing harness, then it clearly will not be designed as clothing. There may be cases where an item is designed not simply as clothing but for another function not fulfilled by clothing. Snugglebundl was such a case. The product in that case was designed to enable a baby to be carried as well as to fulfil a function of clothing. In those circumstances the parties in the present appeal accept that such an item is still designed as clothing, even if the primary function is something other than clothing. HMRC's position is set out in their VAT internal manual and I do not understand Ms Poots to have argued the contrary. Under the hearing "VAT Clothing" it states:

“ To have a function as clothing, an article must to some extent provide cover for the body, either for decency or as protection from the elements (e.g. to keep the wearer warm). An article may be primarily decorative - but it will still have these same basic characteristics. Bear in mind that a garment could be designed primarily for another purpose, but could also fulfil a clothing function, and thus qualify for zero-rating.”

41. Turning now to the facts of the present appeal, I am satisfied that the Product fulfils the functions of clothing. It keeps the user warm and can preserve the user's modesty. Those are equally the functions of a blanket. However, unlike a blanket in my view it is natural to consider a child using the Product to be wearing it. It is appropriately shaped to fit the arms and can then be wrapped around the body, either with the opening at the front or the back.

42. The Product comes in two sizes for children. I note that the packaging in which the Product is sold simply indicates the dimensions of the Product. It does not indicate age ranges. In the ordinary course that might be considered to be consistent with a blanket rather than clothing and I take that factor into account. Similarly the fact that the Product does not have fastenings.

43. The evidence before me as to how the Product is actually used in practice indicates that children will use the Product with the opening at the front or the rear. The Product may be used whilst lying or sitting on a sofa, or whilst standing up and walking about. I accept that when it is used to stand up and walk about it is more likely to be used with the opening at the front in a fashion similar to a dressing gown. In those circumstances Ms Poots accepted that the child could be said to be wearing the Product. It does not seem to me that younger children would often use the Product with the opening at the rear to walk about because of the trip hazard and using it in that way would not be comfortable for walking.

44. In any event, I consider that a child using the Product whilst lying or sitting on a sofa with the opening at the back or the rear would also be described as wearing the

Product. The product is more than simply a blanket, but the context in which the Product is intended to be used does not require anything more than a basic tailored fit. It simply requires sleeves in which to place the arms. The Product fulfils the function of a blanket, but the functions of a blanket include keeping the user warm and preserving modesty, which are also the functions of clothing. It is the existence of sleeves which in my view indicate the nature of the Product as clothing and distinguish it from a blanket.

45. I accept that smaller children might be less likely to use the Product to stand up in or to walk about in, given the size of the Product. In my view that does not change the nature of the Product. The fact that it is likely to be used by older children whilst standing or walking about indicates the nature of the Product as clothing. The fact it is “too large” without alteration means a younger child is only likely to wear it whilst sitting or lying down, or whilst standing or walking with the opening at the front. However, the child will still naturally be described as wearing the Product.

46. It is not necessarily helpful to compare the treatment of different articles. However, HMRC considers a shawl and a towelling poncho to be clothing. Each is shaped only to a limited extent to fit the contours and movement of the body. In my view each may be described as being worn by the user. In the case of a shawl there is no real shaping to fit the body beyond being rectangular or triangular. In the case of a poncho it is shaped to be worn over the shoulders with a hood. In the case of the Product, rather than being worn over the head and shoulders it is worn over the arms and shoulders.

47. Overall, I am satisfied that the Product is properly described as clothing within the ordinary usage of that term. It is then necessary to consider whether it was designed as clothing.

48. Mr Simpson relied on the evidence of Mr Schweiger who said that the Product had been designed as a flexible item of clothing that performed multiple functions. I do not regard such evidence as determinative or indeed very helpful in considering whether the Product was in fact designed as clothing.

49. The appellant took a design used by a competitor. The extent to which alterations were made to the basic design used by JML is not clear from the evidence. I have found however that the appellant’s intention as part of their design process was to ensure that the Product could be worn over the shoulders with the opening at the front or the back. I am satisfied on the basis of the evidence before me that the Product was designed to be worn in that way. Further, I am satisfied that the reason it was designed to be worn with the opening to the front was so that a child wearing the Product in that way could walk about in it.

50. The crucial characteristic of the Product for present purposes is the sleeves. It is the sleeves which enable the Product to be worn and in my view therefore the Product was designed to be worn. As such, it was designed as clothing, rather than as a blanket or something else.

51. Mr Simpson submitted that the categorisation of the Product for licensing purposes was not significant. I agree with that submission. The position is illustrated by the fact that in relation to The Walt Disney Company Limited it was agreed that the Product fell within the description “fleece blanket” because there was no other appropriate description and there was no desire to amend the agreement to change the descriptions.

Conclusion

52. For the reasons given above I am satisfied that the appellant’s sleeved fleece was properly zero-rated because it was designed as clothing for young children. In the circumstances I allow the appeal.

53. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

TRIBUNAL JUDGE CANNAN

RELEASE DATE: 21 JUNE 2018