

Advertising costs are a cost component of sales

[UKFTT 204 DFS](#)

Background

DFS is a well known supplier of sofas (the term sofas encompasses the variety of types of upholstered sitting furniture which DFS supplies). If a customer goes to a store and decides to buy a sofa then he may be offered, and he may agree to take one of two types of insurance. The first type is anti-stain insurance which is only offered to customers after they have made the decision to buy a fabric covered sofa. The second type of insurance is Payment Protection Insurance and is only offered to customers who bought a sofa on interest free credit terms. The case concerned whether advertising costs were residual or fully recoverable.

None of the advertisements made any reference to any form of insurance. All advertisements contained DFS's logo and generally the catch phrase "think sofas, think DFS". All advertisements displayed pictures of sofas. The Tribunal accepted that the success of the marketing campaigns was measured by comparing relative values of sales by type of sofa in periods before, during and after the campaign. If during a campaign the sales of a featured model did not go up, then that model would be dropped.

Held

The Tribunal found that the advertising costs had a direct and immediate link to the taxable sales of furniture but that no direct and immediate link was present in relation to the exempt insurance intermediation income.

In reaching its conclusions, the Tribunal gave a lot of consideration to whether the cost of advertising is a cost component of the sales of sofas or the provision of intermediation. If it is not a cost component of either of the two, then it will fall into the overheads pot. The Tribunal considered that the correct test for determining the cost component question is, by reference to the activity of making the sales rather than to what is sold. On this basis the Tribunal concluded that the costs of advertising are a cost component of the activity of supplying sofas. The following reasons were given for this conclusion:

- The adverts are directed at the sale of sofas. There is nothing in the nature of the business of the Appellant which suggests that this is not an object of the advertising.
- The very fact that the Appellant, a commercial enterprise selling sofas incurs very considerable expense in placing adverts which are directed at the sale of sofas indicates objectively that the adverts are directly linked to the selling, and the costs of the adverts are directly and immediately

**WE HOPE YOU FIND THIS NEWS ARTICLE HELPFUL. IF YOU WOULD LIKE TO REGISTER TO RECEIVE
FUTURE UPDATES BY EMAIL THEN PLEASE SEND A REQUEST TO**

info@4eyesltd.co.uk

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.

linked to the sales activity: no enterprise would incur such costs if they were not for the sales activity.

- The link between advertising and the sales activity is free from any intermediate steps and is directly rather than indirectly connected to and bound up with that activity.

The Tribunal having reached a conclusion on the cost component issue proceeded to consider separately the issue of direct and immediate link. The Tribunal's view was that there is a link between the advertising and the intermediation. The issue however, is whether that is a direct and immediate link. The existence of a direct and immediate link to the selling of the sofas does not in itself prevent there also being a direct and immediate link to the intermediation making the VAT residual.

The Tribunal distinguished the case of Dial-a-phone (DAP) and held that the intermediation provided by DFS took place after, and was less commercially important than, the primary sales activity. In DAP the advertisements mentioned free insurance. Thus the adverts could be seen to be clearly linked to the subsequent 'paid for' insurance and indeed DAP acted as insurance intermediary throughout in respect of both the free and paid for contracts. The Tribunal held that the approach that they have taken is not inconsistent with the approach of the courts in DAP in particular the fact that it regarded the effect of the advertisement as relevant to the objective determination of how the advertising costs are utilised. However, the Tribunal concluded that though there is a link between adverts and intermediation in DFS's case it is not as clear and as close as it was in DAP and "not sufficiently close to be a direct link". The sales process in DAP, led seemingly unavoidably in each customer's case to the question of insurance. In DFS's case there are contingencies in the process which interrupted the link: PPI is only relevant if credit is taken and anti stain insurance is only relevant to fabric covered sofas. Those contingencies result in a large proportion of sofa sales being made without any intermediation activity.

Importantly, the Tribunal rejected the Commissioners' argument that the effect of the adverts was to get people in the stores to buy insurance. (That is because the stores were plainly places where people were to be sold sofas). Going to a store was necessary to buy a sofa from DFS: it was merely a step in the process of buying a sofa. And going to a store enabled insurance to be sold only if a sofa was bought first.

Comment

This case is similar to the Skipton case ([click here](#)) whereby HMRC unsuccessfully tried to impose a restriction on the ability of an otherwise taxable business to recover costs by reference to incidental exempt supplies which may arise.

**WE HOPE YOU FIND THIS NEWS ARTICLE HELPFUL. IF YOU WOULD LIKE TO REGISTER TO RECEIVE
FUTURE UPDATES BY EMAIL THEN PLEASE SEND A REQUEST TO**

info@4eyesltd.co.uk

This VAT update is published for the general information of 4 Eyes Ltd personnel, clients and contacts. It provides only an overview of the rules and regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this e-mail will be accepted by the authors or the firm.