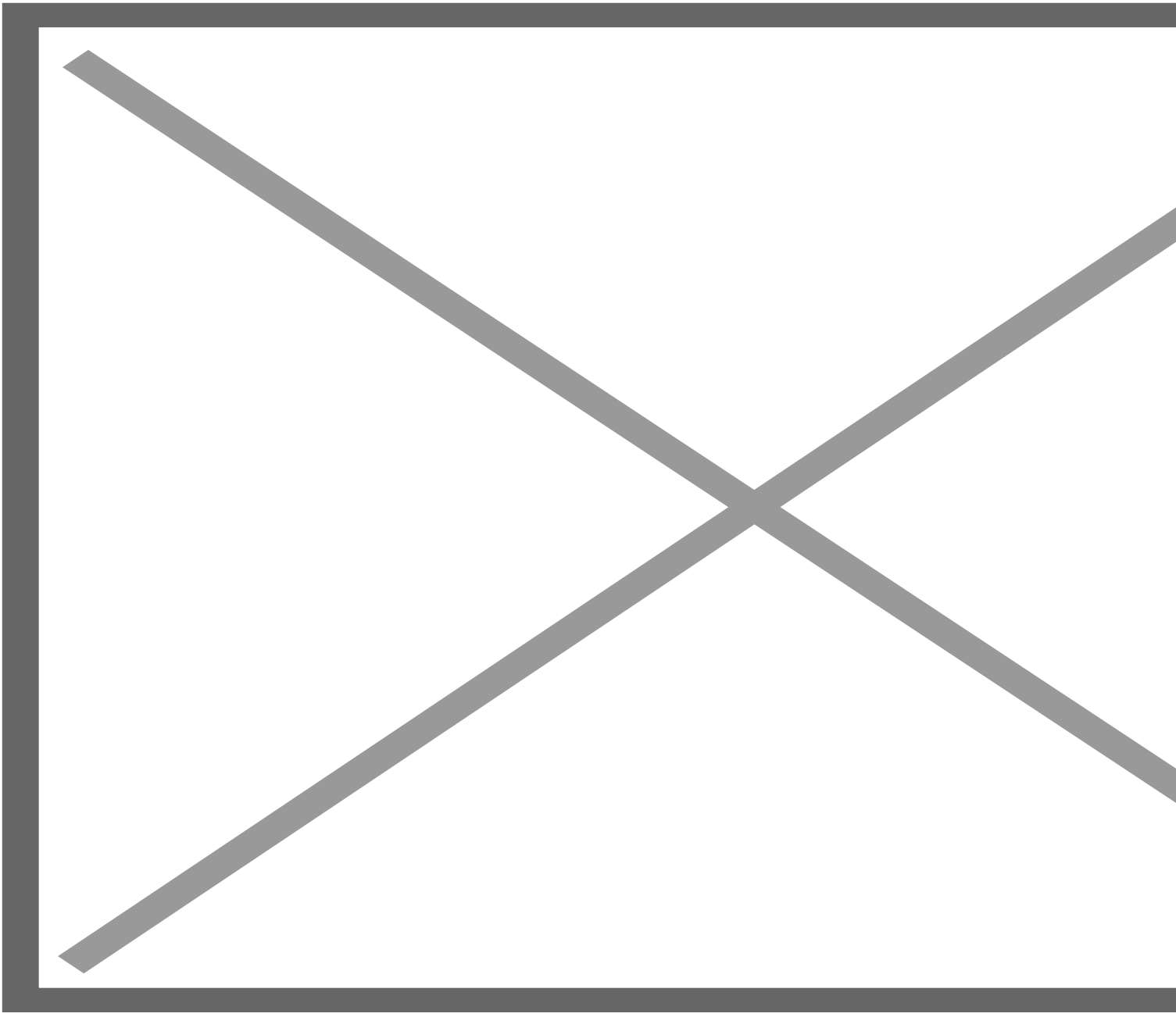
Down on the farm

Indirect Tax



01 March 2018

Keith Gordon considers a recent case on farmers' flat-rate VAT which required adjudication by the Court of Justice of the EU

Key Points

What is the issue?

In a recent case (*Shields & Sons Partnership v HMRC*), HMRC sought to remove a taxpayer unilaterally from the farmers' flat-rate scheme.

What does it mean to me?

The CJEU has now ruled that HMRC's criterion for exclusion is not in accordance with European law and may not be maintained. One hopes that HMRC will revise its guidance shortly so as not to mislead taxpayers or even their own officers.

What can I take away?

Advisers with farming clients should double-check the position. Of course, there is a risk that HMRC will revise their criteria and will continue to exclude farmers who are likely to benefit from the scheme.

For many tax advisers, references to VAT and flat-rates remind one of the rules which permit many VAT traders to operate a simplified VAT regime, paying over to HMRC a flat rate of tax and not recovering most (or any) of their input tax. The rate of tax to be paid depends on the industry in which the trader operates.

However, there is in fact a wholly different and older flat-rate scheme which is specifically available to farmers. It is designed to achieve a similar purpose (being that of simplification but revenue-neutral) but operates in a very different fashion.

This article considers a recent case (*Shields & Sons Partnership v HMRC*) where HMRC sought to remove a taxpayer unilaterally from the farmers' flat-rate scheme.

Facts of the case

The Shields & Sons Partnership operates in Northern Ireland where it rears cattle which it fattens before selling the animals to an abattoir. Since 1 May 2004, it has been a member of the flat-rate scheme available to farmers, meaning that it is entitled to increase its sales price by a flat rate of 4% (which is recoverable as input tax by its VAT-registered customers) but it is then precluded from recovering any input tax it incurs. When the Partnership applied to join the flat-rate scheme, it estimated its annual turnover would be in the region of £700,000: its actual turnover came in at about 10% less.

In June 2012, HMRC officers met the Partnership's accountants to determine whether the Partnership could remain within the scheme. It was established that, in the first eight years, the Partnership had derived a financial advantage of over £370,000 from its use of the scheme (i.e. comparing the actual financial position with that which would have been shown had the Partnership been subject to the regular VAT rules). Consequently, in October 2012, HMRC cancelled the Partnership's membership of the scheme on the ground that 'the earnings derived from the application of the flat-rate compensation percentage substantially exceeded the input tax which [the Partnership] would have been able to deduct if it had been subject to the normal VAT arrangements'.

That decision by HMRC was the subject of a review which upheld it. The Partnership appealed to the First-tier which dismissed its appeal. The Partnership then appealed to the Upper Tribunal.

On 8 October 2014, the Upper Tribunal decided to refer the case to the Court of Justice of the European Union (CJEU), formerly known as the European Court of Justice. The CJEU does not act as a final decision-maker but instead provides answers to questions of European law posed by the referring court or tribunal.

The reference to the CJEU was made because (as with VAT generally), the farmers' scheme is governed by the Principal VAT Directive (Dir 2006/112) (PVD) and it is necessary to ensure that interpretation of the Directive is uniform across the Union. In particular, Article 296(2) of the PVD permits member states to exclude from the flat-rate scheme 'certain categories of farmers, as well as farmers for whom application of the normal VAT arrangements … is not likely to give rise to administrative difficulties'. The Upper Tribunal needed to know whether HMRC's decision was in accordance with the Directive.

The questions asked by the Upper Tribunal were (in summary):

1. Does Article 296(2) provide an exhaustive list of the types of farmer who can be excluded from the scheme?
2. What is meant by 'certain categories of farmers'?
3. Does this entitle HMRC to exclude farmers who are recovering substantially more as members of the flat-rate scheme than they would if they were VAT registered?

The Court's decision

The CJEU gave its decision on 12 October 2017 (Case C-262/16).

The Court recognised that the operation of the scheme is meant to be revenue-neutral and, indeed, Article 299 ensures that the flat rate is not meant to exceed the input VAT charged. However, that relates to a decision taken at Government level and not on a farmer-by-farmer basis. Furthermore, the Court observed that it is going to be impossible to ensure a wholly tax-neutral scheme as the scheme is also meant to provide an element of simplification. Consequently, the fact that a particular farmer is advantaged under the arrangements cannot itself be contrary to EU law.

Although the judgment (as is often the case with those from the CJEU) then makes what looks like a non-sequitur, the Court concluded that Article 296(2) must be interpreted as laying down an exhaustive regime for all the cases that can be excluded from the flat-rate scheme.

The Court then considered the remaining two questions which it dealt with together. In particular, it determined that the exclusions within Article 296(2) require the criteria to be 'objective, clear and precise' and capable of being determined in advance. The Court considered that the criterion chosen by HMRC, being based on the concept of 'an amount that is substantially more than another', is incapable of such prior determination and therefore not in accordance with the Article.

Consequently, the reason given to the Partnership by HMRC is incompatible with European law.

Sending the case back to the Upper Tribunal

In the light of the CJEU's ruling, the case was remitted to the Upper Tribunal which formally allowed the Partnership's appeal ([2017] UKUT 504 (TCC)). Indeed, given the clear ruling from the CJEU, HMRC consented to the appeal being allowed.

Commentary

It should be noted, however, that HMRC's position, to exclude from farmers' flat-rate scheme taxpayers who would do substantially better under the scheme, was in accordance with HMRC's own published notices although HMRC acknowledged that the notices did not have the force of law. The CJEU has now ruled that HMRC's criterion for exclusion is not in accordance with European law and may not be maintained. One hopes that HMRC will revise its guidance shortly so as not to mislead taxpayers or even their own officers.

However, I wonder whether the victory enjoyed by Shields & Sons will have a long-lasting effect. First, it is noteworthy that any taxpayer which is going to make a 'substantial' tax saving (which HMRC define as £3,000 *per annum*) by participating in the scheme is not likely to encounter disproportionate administrative difficulties by accounting for VAT in the normal way (or at least ones that are not endured by other taxpayers). For this reason, HMRC might be capable of getting around the CJEU's judgment by modifying slightly their published criteria for entry into the scheme (but with similar effect). It will remain a question for another day as to how the phrase 'administrative difficulties' is properly defined.

Secondly, depending on the outcome of the Brexit discussions, the UK is likely to be free to set its own terms for VAT (or any replacement tax). Consequently, even if VAT is retained broadly in its current form, the UK will not necessarily be restricted by the terms of the PVD.

What to do next

In the meantime, other taxpayers who have been refused entry into the farmers' scheme (or who have been removed from it) should urgently consider whether they can reapply. I would like to think that, the CJEU's decision on 12 October 2017 would have been reflected in any formal decisions given after that date and, for any disputes which existed on that date, HMRC would respect the CJEU's decision without dissent. Nevertheless, advisers with farming clients should double-check the position. Of course, there is a risk that HMRC will revise their criteria as suggested above and will continue to exclude farmers who are likely to benefit from the scheme.