TC08004

VAT – Agricultural Flat Rate Scheme – Article 296(2) of the Principal VAT Directive – each Member State may exclude from the flat-rate scheme farmers for whom application of the normal VAT arrangements is not likely to give rise to administrative difficulties – interpretation by the CJEU in Shields and Sons v HMRC - Regulation 204(d) of the VAT Regulations 1995 – requires that in order to be certified to join the scheme, a business's total Flat Rate Addition of 4% of its anticipated total supplies to be made in the year following the date of certification cannot exceed by £3,000 or more the amount of input tax to which the business would otherwise be entitled to deduct under normal VAT arrangements – the Regulation is not ultra vires as regards the Directive but lawfully implements its aim of administrative simplification for small farming businesses – the Regulation and its application to the appellant do not offend principles of equality of treatment nor fiscal neutrality – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/02182 (V-TVP)

BETWEEN

MESSRS HARRISON **Appellant**

-and-

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

TRIBUNAL: JUDGE RUPERT JONES

The hearing took place on 26 November 2020. With the consent of the parties, the form of the hearing was V (video) through the Tribunal video platform (TVP). A face to face hearing was not held because of the ongoing pandemic and public health risks during the second national lockdown. It was in the interests of justice to proceed in this manner. A fair remote hearing was possible, the facts of the case were not in dispute and the issues were pure points of law. The documents to which I was referred were the parties' skeleton arguments, authorities bundle and the hearing bundle, all supplied in electronic format.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Mr Benson and Mr Hetherington of Marrs Benson accountants for the Appellant

James Puzey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

INTRODUCTION

1. This appeal concerns a decision by HMRC to refuse the Appellant's application to join the Agricultural Flat Rate Scheme ("AFRS"). The facts are agreed and the primary issue is whether the Appellant is entitled in law to be admitted to the AFRS. The Appellant maintains that as a matter of European Community Law (under Article 296(2) of the Principal VAT Directive) the grounds given by HMRC for refusing the application are unlawful notwithstanding they are in accordance with UK domestic law (Regulation 204(d) of the VAT Regulations 1995).

2. The Appellant's primary argument is that Regulation 204(d) is ultra vires as regards the Directive. HMRC's case is that UK law properly reflects Community law and Regulation 204(d) lawfully implements Article 296(2) of the Directive and is within its scope. Second, the Appellant submits that Regulation 204(d) and its application to its circumstances offended the principles of fiscal neutrality and equal treatment. HMRC submits that the Regulation and its application to the Appellant were consistent with those principles and therefore the grounds for refusing certification on the AFRS were lawful and should be upheld.

Factual Background

3. The facts were not in dispute and were agreed.

4. The Appellant partnership runs a beef and sheep farm in North Cumbria. It trades as a farming business from where it buys, rears and sells cattle and sheep. In short, it trades in cattle and sheep which are bought as immature animals (the "raw materials"). They are fed on farm to the point they are ready to be sold for slaughter to be processed for beef and sheep meat. Lambs are also reared from their own breeding flock of ewes.

5. The business primarily sells direct to businesses running abattoirs (the customer). This business model is replicated by many similar businesses in the agricultural industry.

6. The Appellant has been registered for VAT since 1973 and to date has always operated using the standard VAT system of filing returns and accounting for input tax and output tax.

7. By letter dated 24 December 2018 the Appellant's accountant, Marrs Benson, made an application to HMRC to join the Agricultural Flat Rate Scheme ('AFRS'). It sought HMRC's agreement that the Appellant could be certified under the AFRS.

Operation of the Agricultural Flat Rate Scheme ('AFRS')

8. Under VAT legislation, if they are eligible, farmers can elect to use the simplified process under the AFRS rather than account for VAT in the normal way. Farmers who elect to use this scheme are not required to submit a VAT return to HMRC or account for any VAT due on supplies made.

9. Farmers using the scheme charge and retain a flat rate of 4% on the sale of goods and services. They cannot recover input VAT incurred on costs associated with their business activities.

10. The AFRS is described in straightforward terms in VAT Notice 700/46:

1.4 Who the flat rate scheme is for

The flat rate scheme is an alternative to VAT registration for farmers.

If you register as a flat rate farmer you do not account for VAT or submit returns and so cannot reclaim input tax. But you can charge and keep a flat rate addition **(FRA)** when you sell goods or goods and services to VAT registered customers. You cannot join the scheme if the value of your non-farming activities is above the VAT registration threshold.

The flat rate addition is not VAT but acts as compensation for losing input tax on purchases. It is not intended as reimbursement for all the VAT incurred on purchases. The flat rate addition is 4%.

HMRC's Decision to refuse certification to join the AFRS

11. The Appellant's application to join the AFRS was refused by letter from HMRC dated 18 January 2019. The application was rejected on the basis that under Regulation 204(d) of the VAT Regulations 1995, as explained in VAT Notice 700/46, an applicant should not stand to gain more than £3,000 in the year following application. The Appellant was excluded from the AFRS because it was anticipated it would recover, through the 4% Flat Rate Addition on the total of all its sales, an excess of over £3,000 more than it would have been able to claim in input tax were it subject to normal VAT arrangements.

12. HMRC refused to admit the Appellant to the AFRS because the estimated value of its taxable supplies according to its application was £2,850,000, which would give rise to a Flat Rate Addition of £114,000 p/a (4% of the total sales of goods and services under the scheme). In contrast, in the year prior to its application the input tax recovered by the Appellant was £71,165. Based on the prior year's input tax and the anticipated taxable supplies, there would be an excess of over £42,000 (the difference between £114,000 and £71,165) if the Appellant operated under the AFRS rather than the normal VAT arrangements.

13. Therefore, under Regulation 204(d) of the Regulations the Appellant did not meet the conditions for certification under the scheme because it appeared to HMRC that the Appellant were to operate the AFRS it would have recovered in excess of £3,000 more than it would have been entitled to reclaim as input tax if it were operating on the usual terms of VAT registration. This is not in dispute as a matter of fact.

14. Further, there is no dispute that HMRC's decision to refuse certification and admission to the AFRS is in accordance with UK domestic law under the VAT Act 1994 and VAT Regulations 1995.

15. A review was sought on 22 January 2019 and the decision was upheld by HMRC on 11 March 2019. A Notice of Appeal was served on 4 April 2019.

The Law

16. Articles 295 to 305 of the Principal VAT Directive ("PVD") 2006/112/EC, provide the Community law vires for the AFRS. Articles 296 to 302 are of particular relevance to the present appeal and provide:

'Article 296

1. Where the application to farmers of the normal VAT arrangements, or the special scheme provided for in Chapter 1, is likely to give rise to difficulties, Member States may apply to farmers, in accordance with this Chapter, a flat-rate scheme designed to offset the VAT charged on purchases of goods and services made by the flat-rate farmers.

2. Each Member State may exclude from the flat-rate scheme certain categories of farmers, as well as farmers for whom application of the normal VAT arrangements, or of the simplified procedures provided for in Article 281, is not likely to give rise to administrative difficulties.

3. Every flat-rate farmer may opt, subject to the rules and conditions to be laid down by each Member State, for application of the normal VAT arrangements or, as the case may be, the simplified procedures provided for in Article 281.

Article 297

Member States shall, where necessary, fix the flat-rate compensation percentages. They may fix varying percentages for forestry, for the different sub-divisions of agriculture and for fisheries.
Member States shall notify the Commission of the flat-rate compensation percentages fixed in accordance with the first paragraph before applying them.

Article 298
The flat-rate compensation percentages shall be calculated on the basis of macro-economic statistics for flat-rate farmers alone for the preceding three years.
The percentages may be rounded up or down to the nearest half-point. Member States may also reduce such percentages to a nil rate.

Article 299
The flat-rate compensation percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged.

Article 300
The flat-rate compensation percentages shall be applied to the prices, exclusive of VAT, of the following goods and services:
(1) agricultural products supplied by flat-rate farmers to taxable persons other than those covered, in the Member State in which these products were supplied, by this flat-rate scheme;4
(2) …

Article 301
1. In the case of the supply of agricultural products or agricultural services specified in Article 300, Member States shall provide that the flat-rate compensation is to be paid either by the customer or by the public authorities.

2. In respect of any supply of agricultural products or agricultural services other than those specified in Article 300, the flat-rate compensation shall be deemed to be paid by the customer.

Article 302
If a flat-rate farmer is entitled to flat-rate compensation, he shall not be entitled to deduction of VAT in respect of activities covered by this flat-rate scheme.'

17. The United Kingdom has sought to give effect to Community law in primary legislation through s. 54 of the Value Added Tax Act 1994. Of particular relevance to this appeal are the following sub-sections:

'**54 Farmers etc**

(1) The Commissioners may, in accordance with such provision as may be contained in regulations made by them, certify for the purposes of this section any person who satisfies them –
(a) That he is carrying on a business involving one or more designated activities;
(b) That he is of such a description and has complied with such requirements as may be prescribed; and
(c) Where an earlier certification of that person has been cancelled, that more than the prescribed period has elapsed since the cancellation or that such other conditions as may be prescribed are satisfied.
…
(6) Regulations under this section may provide –
(a) For…and application for certification under this section, or for the cancellation of any such certification, to be made in the form and manner specified in the regulations or by the Commissioners in accordance with the regulations;
(b) For the cases and manner in which the Commissioners may cancel a person's certification;
…….'

18. 9Paragraph 1 of Pt II of the schedule to the Value Added Tax (Flat-rate Scheme for Farmers) (Designated Activities) Order 1992, SI 1992/3220, designates general stock farming among the activities which qualify a person for the flat-rate scheme.

19. The Value Added Tax (Flat-rate Scheme for Farmers) (Percentage Addition) Order 1992, SI 1992/3221, sets the flat-rate compensation percentage, applicable to all farmers within the scheme, at 4%.

20. The relevant Regulations for the purposes of section 54(1) and this appeal are contained in the VAT Regulations 1995 (SI 1995/2518) ("the Regulations"). The Regulations include Pt XXIV, which was adopted pursuant to s 54 of the 1994 Act and contains regulations 202 to 211, of which the following are most relevant:

'Flat Rate Scheme
203 (1) The Commissioners shall, if the conditions mentioned in regulation 204 are satisfied, certify that a person is a flat-rate farmer for the purposes of the flat-rate scheme ...

Admission to the Scheme
204 The conditions mentioned in regulation 203 are that –
(a) The person satisfied the Commissioners that he is carrying on a business involving one or more designated activities,
(b) He has not in the 3 years preceding the date of his application for certification –
(i) Been convicted of any offence in connection with VAT,
(ii) Made any payment to compound proceedings in respect of VAT under section 152 of the Customs and Excise Management Act 1979 as applied by section 72(12) of the
Act,
(iii) Been assessed to a penalty under section 60 of the Act,
(c) He makes an application for certification on the form [specified in a notice published by the Commissioners], and
(d) He satisfies the Commissioners that he is a person in respect of whom the total of the amounts as are mentioned in regulation 209 relating to supplies made in the year following the date of his certification will not exceed by £3,000 or more the amount of input tax to which he would otherwise be entitled to credit in that year."

Cancellation of certificates
206 (1) The Commissioners may cancel a person's certificate in any case where –
…
(i) They consider it is necessary to do so for the protection of the revenue, or
……..

Claims by taxable persons for amounts to be treated as credits for input tax

209 (1) The amount referred to in section 54(4) of the Act and included in the consideration for any taxable supply which is made—

(a)in the course or furtherance of the relevant part of his business by a person who is for the time being certified under this part,

(b)at a time when that person is not a taxable person, and

(c)to a taxable person,

shall be treated, for the purpose of determining the entitlement of the person supplied to credit under sections 25 and 26 of the Act, as VAT on a supply to that person.

……

(3) A taxable person shall not be entitled to credit as is mentioned in paragraph (1) above unless there has been issued an invoice containing the following particulars—

……

(g)the amount as is mentioned in paragraph (1) above which amount shall be entitled "Flat-rate Addition" or "FRA".'

Case law on whether the VAT Regulations properly implement Art. 296(2) of the Directive

21. The Appellant relies upon the judgment of the Court of Justice of the European Union ('CJEU') in *Shields & Sons Partnership v HMRC [STC] 2017 2205* ("*Shields & Sons*"). That case concerned a UK farmer who challenged a decision by HMRC to cancel its existing AFRS certification under Regulation 206(1)(i) of the VAT Regulations 1995 (as cited immediately above). This was because its FRA was substantially in excess of the input tax it would have otherwise been entitled to reclaim the input tax it would have otherwise been entitled to reclaim.

22. The CJEU stated as follows on the first of two questions it was referred by the Upper Tribunal:

'31. By its first question, the referring tribunal asks, in essence, whether art 296(2) of the VAT Directive must be interpreted as defining exhaustively all the cases in which a member state may exclude a farmer from the flat-rate scheme or whether art 299 of that directive, the principle of fiscal neutrality or other grounds may form the basis of such an exclusion.
32. First of all, it should be pointed out that, in the main proceedings, the Commissioners cancelled, on an individual basis, the certificate entitling the appellant in the main proceedings to use the flat-rate scheme on the ground that the earnings derived from application of the flat-rate compensation percentage substantially exceeded the input tax which it would have been able to deduct if it had been subject to the normal VAT arrangements.
33. It should be recalled that the flat-rate scheme is a scheme which derogates from and is an exception to the general scheme of the VAT Directive and which must therefore be applied only to the extent necessary to achieve its objective……
34. Among the two objectives of the flat-rate scheme is that relating to the need for administrative simplification for the farmers concerned, which must be reconciled with the objective of offsetting the input VAT borne by those farmers when acquiring goods used for the purposes of their activities….
35. The first question should be answered in the light of those factors.
36. Article 296(2) of the VAT Directive refers only to the possibility of excluding from the flat-rate scheme certain categories of farmers and farmers for whom application of the normal VAT arrangements, or of the simplified procedures provided for in art 281 of the directive, is not likely to give rise to administrative difficulties.
37. Neither the objectives of the flat-rate scheme nor the context of art 296(2) of the VAT Directive mean that the legislature is to be regarded as having intended to allow other grounds of exclusion.
38. It is true that one of the objectives pursued by the flat-rate scheme is to enable farmers who are subject to it to offset the VAT costs which they have borne on account of their activity. However, the risk of excessive offsetting in respect of VAT is taken into consideration by art 299 of the VAT Directive with regard to flat-rate farmers as a whole. To that end, art 299 prohibits the member states from setting flat-rate compensation percentages at levels which would have the effect of obtaining for flat-rate farmers as a whole refunds greater than the input VAT charged.
39. Furthermore, arts 297 to 299 of the VAT Directive provide that the flat-rate compensation percentages are set globally by each member state in the light of macroeconomic statistics for flat-rate farmers alone for the preceding three years. Therefore, art 299 of the directive cannot justify the adoption of a decision to exclude, on an individual basis, a farmer from the flat-rate scheme in the light of the refunds obtained by applying those percentages.
40. Finally, whilst the referring tribunal mentions the possibility of cancelling a certificate to use the flat-rate scheme on the ground that, in a situation such as that at issue in the main proceedings, its use

would undermine the principle of neutrality of VAT, it should be observed, as the Advocate General has noted in point 26 of his opinion, that the EU legislature intentionally based that scheme on a certain generalisation, derogating from that principle as it could legitimately do, since fiscal neutrality, within the meaning possessed by that concept in the main proceedings, is not an independent legal principle, but one of the objectives pursued by the VAT Directive, an objective that is in particular given concrete expression by art 167 et seq of the directive, which lay down the principle of a right to deduct input VAT.
41. Indeed, the court has already held that, as a matter of principle, the flat-rate scheme cannot ensure the complete neutrality of VAT, since the flat-rate scheme is intended precisely to reconcile that objective with the objective of simplification of the rules to which flat-rate farmers are subject (see, to that effect, judgment of 8 March 2012, Commission v Portugal, para 53).
42. Accordingly, it cannot be regarded as contrary to EU law for a farme**r** using that scheme to obtain, as in the present instance, compensation in respect of VAT that is greater than the amount of input VAT that he would have been able to deduct if he had been subject to VAT under the normal or simplified taxation arrangements.
43. Therefore, the principle of fiscal neutrality cannot justify a measure providing for exclusion from the flat-rate scheme, such as cancellation of a certificate to use that scheme.
44. It follows from all the foregoing considerations that the answer to the first question is that art 296(2) of the VAT Directive must be interpreted as laying down exhaustively all the cases in which a member state may exclude a farmer from the flat-rate scheme.'

19. On the second question, the CJEU held as follows:

'45. By its second question, the referring tribunal asks, in essence, whether art 296(2) of the VAT Directive must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements can constitute a category of farmers within the meaning of that provision.
46. Article 296(2) of the VAT Directive sets out the possibilities for excluding farmers from the flat-rate scheme, stating that such an exclusion may in particular concern categories of farmers, but it does not define the concept of 'categories of farmers'.
47. It is true that such a concept refers to the activity engaged in by the farmers concerned, who, in order to form a category, must share one or more characteristics.
48. Nevertheless, in the light of the principle of legal certainty, categories of farmers, as referred to in art 296(2) of the VAT Directive, must be laid down on the basis of objective, clear and precise criteria, by national legislation or, as the case may be, by the executive empowered in that regard by the national legislature. In addition, as the Advocate General has observed in point 36 of his opinion, those criteria must be laid down in advance, in the sense that the category subject to exclusion must be defined beforehand and in an abstract way, so that any farmer faced with a potential decision about entering the scheme is in a position to assess whether he belongs to the category that is subject to exclusion and whether he will still belong to that category in the future.
49. Thus, a farmer must be able to carry out in advance an individual analysis of his situation in order to determine whether, in the light of the objective criteria laid down by that legislation, he falls within a category of farmers that is excluded from the flat-rate scheme. Conversely, if the requirements of clarity and certainty in legal situations are not to be disregarded, a category of farmers, within the meaning of art 296(2) of the VAT Directive, cannot be defined by reference to a criterion which would not permit the persons concerned to conduct an individual analysis of that kind.
50. In the present instance, that is precisely the case with a criterion for excluding farmers from the flat-rate scheme which is founded on the concept of an amount that is 'substantially more' than another.
51. It follows from all the foregoing considerations that art 296(2) of the VAT Directive must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements cannot constitute a category of farmers within the meaning of that provision.'

Case law on equal treatment in VAT arrangements

23. In *Marks & Spencer plc v Customs and Excise Commissioners* (Case 0309/06). [2008] BVC 577 the European Court of Justice addressed the principle of equal treatment in relation to VAT as follows at [49]-[54]:

'49…… infringement of the general principle of equal treatment may be established, in matters relating to tax, by other kinds of discrimination which affect traders who are not necessarily in competition with each other but who are nevertheless in a similar situation in other respects.

50. The general principle of equal treatment thus applies in a situation where traders are all holders of VAT credits. seek to obtain repayment from the tax authorities and find that their claims for a refund are treated differently irrespective of the competitive relationships which may exist between them. It is thus necessary to examine whether that principle. in itself, precludes a legislative provision such as section 80 (Icch_uk/btllvata94-vat-s—80) of the VAT Act 1994.

51. In this connection, the general principle of equal treatment requires that similar situations are not treated differently unless differentiation is objectively justified (Joined Cases 201/85 and 202/85 *Klensch v Secrétaire d'Etat al'Agriculture et a la Viticulture [1986] ECR 3477. para. 9, and Idéal tourisme*, para. 35).

52. It is necessary to point out that, under national legislation such as that applicable in the main proceedings, the difference in the treatment of traders with regard to the notion of unjust enrichment on the basis of their initial position as creditors or debtors vis-a-vis the Treasury in respect of VAT is not objectively justified. The fact that a trader benefits from unjust enrichment is unrelated to the position of that trader vis-a-vis the tax authorities before repayment of the VAT, as the unjust enrichment stems, when it occurs, from the refund itself, and not from that trader's previous situation as a creditor or debtor vis-a-vis the tax authorities.

53. That analysis is borne out, if need be, by the amendment to the United Kingdom legislation following the letter of formal notice addressed by the Commission to that Member State in connection with the institution of proceedings for failure to fulfil obligations. Under section 3 of the Finance (No. 2) Act 2005, referred to in para. 8 of this judgment, a distinction is no longer made on the basis of the taxable person's situation vis-a-vis the Treasury.

54. The answer to the third question must therefore be that. although the principles of equal treatment and fiscal neutrality apply in principle to a case such as that in the main proceedings, an infringement of those principles is not constituted merely by the fact that a refusal to make repayment was based on the unjust enrichment of the taxable person concerned. By contrast, the principle of fiscal neutrality precludes the prohibition of unjust enrichment from being applied only to taxable persons such as 'payment traders' and not to p. 602 —» taxable persons such as 'repayment traders', in so far as those taxable persons have marketed similar goods. It will be for the national court to determine whether that is the position in the present case. Furthermore. the general principle of equal treatment, the infringement of which may be established, in matters relating to tax, by discrimination affecting traders who are not necessarily in competition with each other but are nevertheless in a similar situation in other respects, precludes discrimination between 'payment traders' and "repayment traders', which is not objectively justified.'

The Appellant's submissions

24. Mr Benson and Mr Hetherington, on behalf of the Appellant, rely upon both the CJEU's conclusions in *Shields & Sons* to argue that the HMRC's refusal to certify, register and admit it under the AFRS is unlawful.

25. First, they argue that the requirement imposed by Regulation 204(d) of the VAT Regulations is ultra vires as regards Article 296(2) of the Principal VAT Directive.

26. Second, the Appellant argues that it has been treated differently to other farmers in a comparable position leaving it at a competitive disadvantage. It is said that HMRC's decision is in breach of either the principal of fiscal neutrality or that of equal treatment because it is in the same position as the farmer in *Shields & Sons*.

The first ground of appeal – whether the Regulation is ultra vires the Directive

27. The Appellant's first and primary ground of appeal relies upon the judgment of the CJEU in *Shield and Sons*. Mr Benson and Mr Hetherington argued the following on behalf of the Appellant.

28. The UK's application of the AFRS follows UK legislation in the form of section 54 of the VAT Act 1994 which is supplemented by regulations 202-211 of the Value Added Tax Regulations 1995. The vires of these regulations comes from Articles 295-305 of Directive 2006/112. The UK's interpretation of its application was tested in the case of *Shields & Sons Partnership and The Commissioners for her Majesty's Revenue & Customs* which ultimately led to a judgment being given by the CJEU (Case 0262/16).

29. *Shield and Sons* concerned a UK farmer who challenged a decision by HMRC to cancel its existing certification under the AFRS because its FRA was substantially in excess of the input tax it would have otherwise been entitled to reclaim the input tax it would have otherwise been entitled to reclaim.

30. The Court held as follows on the first question it considered:

'31. By its first question, the referring tribunal asks, in essence, whether art 296(2) of the VAT Directive must be interpreted as defining exhaustively all the cases in which a member state may exclude a farmer from the flat-rate scheme or whether art 299 of that directive, the principle of fiscal neutrality or other grounds may form the basis of such an exclusion.

…

42. Accordingly, it cannot be regarded as contrary to EU law for a farmer using that scheme to obtain, as in the present instance, compensation in respect of VAT that is greater than the amount of input VAT that he would have been able to deduct if he had been subject to VAT under the normal or simplified taxation arrangements.

43. Therefore, the principle of fiscal neutrality cannot justify a measure providing for exclusion from the flat-rate scheme, such as cancellation of a certificate to use that scheme.

44. It follows from all the foregoing considerations that the answer to the first question is that art 296(2) of the VAT Directive must be interpreted as laying down exhaustively all the cases in which a member state may exclude a farmer from the flat-rate scheme.'

31. On the second question the Court held as follows:

'45. By its second question, the referring tribunal asks, in essence, whether art 296(2) of the VAT Directive must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements can constitute a category of farmers within the meaning of that provision.

…

51. It follows from all the foregoing considerations that art 296(2) of the VAT Directive must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements cannot constitute a category of farmers within the meaning of that provision.'

32. To summarise, the following questions were considered:

A. The CJEU considered whether article 296(2) defines exhaustively all the cases in which a member state may exclude a farmer from the Scheme or whether (1) article 299, (2) the principle of fiscal neutrality or (3) other grounds may form the basis of such an exclusion.
B. The CJEU considered whether article 296(2) means that farmers, who recover substantially more as Scheme members than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements, can constitute a category of farmers within the meaning of that provision.

33. Summarising the judgment, the CJEU held that:

— Article 299 prohibits the Member State from setting flat-rate compensation percentages at levels which would have the effect of obtaining for flat-rate farmers as a whole refunds greater than the input VAT charged.
— Articles 297 to 299 of the VAT Directive provide that the flat-rate compensation percentages are set globally by each Member State in the light of macroeconomic statistics for fiat-rate farmers alone for the preceding three years. Therefore, article 299 of the directive cannot justify the adoption of a decision to exclude, on an individual basis, a farmer from the flat—rate scheme in the light of the refunds obtained by applying those percentages.
- it cannot be regarded as contrary to EU law for a farmer using the AFRS to obtain compensation in respect of VAT that is greater than the amount of input VAT that he would have been able to deduct if he had been subject to VAT under the normal or simplified taxation arrangements.
- It follows that article 296(2) of the VAT Directive must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were subject to the normal VAT arrangements or the simplified VAT arrangements cannot constitute a category of farmers within the meaning of that provision.

34. The Appellant, in its primary ground of appeal, submits that HMRC's refusal of the Appellant's application to use the AFRS is based on UK legislation requiring an exclusion from the scheme of those farmers who stand to benefit £3,000 or more (Regulation 204(d)). However, this domestic test has no basis in Community Law and should not be applied for the reasons the CJEU explained in *Shields* at [52]:

'52. …….

On those grounds, the Court of Justice (Third Chamber) hereby rules:

1. Article 296(2) of Council Directive 2006/112/EC (on the common system of value added tax) must be interpreted as laying down exhaustively all the cases in which a member state may exclude a farmer from the common flat-rate scheme for farmers.

2. Article 296(2) of Directive 2006/112 must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the common flat-rate scheme for farmers than they would if they were subject to the normal value added tax arrangements or the simplified value added tax arrangements cannot constitute a category of farmers within the meaning of that provision.'

35. The £3,000 threshold within Regulation 204(d) forms no part of the superior framework of EU legislation under Article 296(2) of the Directive as is made clear at [52] of *Shields*, is inconsistent with Article 299 and is ultra vires.

36. In oral submissions Mr Hetherington expanded upon the point.

37. Accepting the analysis at [48]-[49] of *Shields*, a farmer must be able to establish rules of entry into the AFRS scheme at the time of the application. The criteria for entry to the

scheme must be clear, precise and objectively ascertainable. He accepted that Regulation 204(d) is sufficiently precisely defined. This is in contrast to the position in Shields where HMRC relied on Regulation 206(1)(i) to cancel registration for the protection of the protection of the revenue where a trader was recovering 'substantially more' by operation of the AFRS compared to normal VAT arrangements.

38. However, the criterion of an economic threshold for exclusion from the scheme has no substance in article 296(2) because (i) 296(2) exclusively defines the permitted exclusions from the scheme; and (ii) the limitation of economic benefits from operating the scheme is only governed by Article 299 and must be defined by broader macroeconomic tests rather than any criterion applied to an individual farmer – see *Shields* at [39].

39. The £3,000 threshold under Regulation 204(d) is not consistent with 'the no winners or losers' test to be considered on a macroeconomic basis for the purposes of Article 299. Article 299 requires that financial benefit from the AFRS has to be examined on a national level and should not be considered on an individual basis as Regulation 204(d) attempts to do.

40. Mr Hetherington submitted that a Member State cannot use an economic criterion for exclusion pursuant to [42] of *Shields:*

'42. Accordingly, it cannot be regarded as contrary to EU law for a farmer using that scheme to obtain, as in the present instance, compensation in respect of VAT that is greater than the amount of input VAT that he would have been able to deduct if he had been subject to VAT under the normal or simplified taxation arrangements.'

41. He submitted that Regulation 204(d) attempts to prevent compensation in respect of VAT that is greater than the amount of input VAT that a trader would have been able to deduct under the normal VAT arrangements in contravention of this conclusion. This is ultra vires.

42. Mr Hetherington submitted that the judgment in *Shields* cannot be distinguished on the basis it only applies to cancellation of AFRS registration under Regulation 206(1)(i). Article 296(2) applies to all exclusions from the AFRS whether that be a refusal to register for the scheme or cancellation of registration.

43. He submitted that UK legislation is entitled to define exclusion from the AFRS and define the categories. He submitted that *Shields* at [42] supports the submission that a category of farmer based on the extent of financial benefit from operation of the scheme could never be a lawful category for the reasons set out in *Shields* at [39]-[42]. Certain categories of farmer for the purpose of 'article 296(2) might mean arable or livestock farmers but not 'winners and losers' on a financial basis. The test of economic 'winners or losers' cannot be a lawful category under Article 29692). There would be nothing to prevent designation with the Regulation of a certain category of farmer to be excluded from the scheme for the purposes of Article 296(2) by reference to size of turnover, size of farm, administrative arrangements in place or number of employees. However, Regulation 204(d) does not do so.

44. Finally, Mr Hetherington submitted that if HMRC did not consider the decision in *Shields* accorded to their understanding of the Directive and how AFRS how the scheme should be defined, they should simply lay a fresh statutory instrument and amend the Regulations to specify the criteria. He submitted that Regulation 204(d) as currently drafted was ultra vires as regards the directive. If one ignored the criterion under Regulation 204(d), the Appellant fulfilled all the other conditions for registration under Regulation 204(a)-(c).

45. Mr Hetherington, in conclusion, submitted that the judgment in *Shields* confirms that in interpreting the first limb of article 296(2) on defining 'a certain category of farmer' does not permit Regulation 204(d) to implement this by way of a test of financial benefit to a farmer. This is not a permissible criterion for exclusion from the AFRS for the purpose of EU law, whether it be by reference to a financial benefit of £3,000 or by reference to recovery of substantially more - these are not permissible categories of farmer.

46. In relation to the second limb of Article 296(2), excluding those are likely not to suffer administrative difficulties in operating normal VAT arrangements, Regulation 204(d) does not specify or provide that a farmer suffering administrative difficulties is a ground for exclusion from the AFRS.

47. Therefore Regulation 204 does not implement the Directive and does not attempt to define or specify the primary purpose of the Directive – to exclude farmers who are likely to suffer administrative difficulties. The exclusion for administrative difficulties is not defined, the Regulation simply provides an economic 'winner or loser test'. Regulation 204(d) does not fall within the framework of wider EU legislation and is ultra vires as regards Article 296(2) of the Directive.

48. The individual circumstances of the Appellant are irrelevant to whether the Regulation is ultra vires. However, in passing, it was worth noting that the Appellant would not simply stand to benefit financially from certification on the AFRS, it would also reduce the administrative burden upon it from operating the normal VAT arrangements.

Second ground of appeal – equal treatment

49. The Appellant further submits that equal treatment is required under European Law, and confirmed in cases by the Court of Justice of the European Union. Where two businesses are comparable from the point of view of the average customer and meet the same needs of that customer, under the principle of equal treatment, they must be regarded as similar and receive the same treatment for VAT purposes.

50. In addition to *Shields* the Appellant was aware of businesses similar to itself being allowed to operate the AFRS scheme despite achieving benefits of more than £3,000 annually, a test that the Appellant contends is ultra vires for the reasons set out above.

51. The Appellant is in direct competition with these businesses when buying immature animals ie the raw material. The Appellant is at a distinct financial disadvantage and therefore unable to compete on a level playing field purely because of the gains being made competing businesses operating the AFRS who can pay more for the stock they buy. The Appellant submits that this is fundamentally unfair and breaches the European law concept of equal treatment.

52. The Appellant also made submissions on the financial impact of HMRC's decision upon it. The operation of the AFRS can give rise to financial benefits. In this case, HMRC have refused the Appellant's application to join the scheme on the basis that the financial gain is greater than the limits in Regulation 204(d) and VAT Notice 700/46.

53. Mr Hetherington made supplementary oral submissions on this ground. He submitted that HMRC's refusal to register the Appellant for AFRS is despite similar businesses with financial gains from the scheme currently being allowed to operate the scheme. As submitted above, the Appellant is competing against these businesses to buy zero rated supplies. There are businesses allowed to operate the scheme. The annual difference in VAT recovery purely because of the operation of the AFRS over normal VAT treatment, constitutes a significant

financial advantage for those businesses over the Appellant and this should be deemed unfair and unjustified unequal treatment.

54. Mr Hetherington relied upon *Marks and Spencer's v HMRC* (Case C-309/06) [2008] BVC 577. He submitted that the ECJ found that in that case the VAT charged should have been charged at zero rate over time. A number of taxpayers had the right to reclaim overpaid VAT. The Court held at [54]:

'54. The answer to the third question must therefore be that. although the principles of equal treatment and fiscal neutrality apply in principle to a case such as that in the main proceedings, an infringement of those principles is not constituted merely by the fact that a refusal to make repayment was based on the unjust enrichment of the taxable person concerned. By contrast, the principle of fiscal neutrality precludes the prohibition of unjust enrichment from being applied only to taxable persons such as 'payment traders' and not to p. 602 —» taxable persons such as 'repayment traders'. in so far as those taxable persons have marketed similar goods. It will be for the national court to determine whether that is the position in the present case. Furthermore. the general principle of equal treatment, the infringement of which may be established. in matters relating to tax, by discrimination affecting traders who are not necessarily in competition with each other but are nevertheless in a similar situation in other respects. precludes discrimination between 'payment traders' and "repayment traders'. which is not objectively justified.'

55. Mr Hetherington accepted that there will be differences between traders but that cannot be objectively justified when it is demonstrated that the economic benefit test under Regulation 204(d) is ultra vires as regards Article 296(2) – see [42] and [52.2] of Shields:

'52…….2. Article 296(2) of Directive 2006/112 must be interpreted as meaning that farmers who are found to be recovering substantially more as members of the common flat-rate scheme for farmers than they would if they were subject to the normal value added tax arrangements or the simplified value added tax arrangements cannot constitute a category of farmers within the meaning of that provision.'

56. In the same way HMRC cannot discriminate between taxpayers on the basis of the form of tax returns filed or whether a trader is a payment or repayment trader, different treatment by HMRC must be based on circumstances of the specific trade and taxpayer at the time of HMRC's action. He submitted that equal treatment has to be assessed by its effect on the taxpayer at the time of exclusion from the AFRS whether that is by virtue of being refused certification or cancellation of its certificate. All taxpayers are to be entitled to treated equally unless there is objective justification which there is not in this case.

HMRC's submissions

57. Mr Puzey, on behalf of HMRC, submitted that Regulation 204(d), conforms to Article 296(2) of the Directive and is not ultra vires. The application of the Regulation to the Appellant's case and HMRC's decision to refuse the Appellant certification under the AFRS was lawful. This is because the Regulation, and its application, is consistent with the purpose and effect of the Directive to exclude from the AFRS those farmers for whom operating the normal VAT scheme would not be likely to cause administrative difficulty.

58. He also submitted that there was no breach of fiscal neutrality nor equal treatment principles in refusing the Appellant's application to join the AFRS. Refusal to allow the Appellant to join the AFRS was consistent with those principles and lawful.

59. Mr Puzey made six points.

60. First, the decision to refuse certification of the Appellant for the AFRS is lawful under UK law.

61. Second, if the Appellant is correct in its interpretation then the purpose of the AFRS scheme would no longer be to simplify VAT arrangements for a farmer. The scheme would be open to all farmers regardless of size and sophistication. This is not the purpose of the AFRS as interpreted in *Shields.*

62. Third, there is a material distinction between a refusal to certify a farmer (the Appellant) from operating the AFRS and a decision to cancel registration of farmer already on the scheme (Shields). There are different statutory provisions in play. The difficulties that the CJEU found with the application of Regulation 206(1)(i) in *Shields* do not apply to Regulation 204(d).

63. Fourth, the provision in Regulation of 204(d) of a £3,000 differential or benefit threshold is an appropriate proxy to reflect administrative difficulties test set out in the Directive.

64. Mr Puzey submitted that the criterion under Regulation 204(d) implements the Directive's wording regarding excluding those unlikely to suffer administrative difficulties from operating normal VAT arrangements for the purposes of Article 296(2). Alternatively, the Regulation implements the wording of excluding 'a certain category of farmer' which is aligned to those unlikely to suffer administrative difficulties in operating the normal VAT scheme for the purpose of Article 296(2).

65. Fifth, there is no breach of fiscal neutrality – the rules of operating the normal VAT arrangements ensure fiscal neutrality more than those of AFRS.

66. Sixth, there is no breach of the equal treatment principle relied upon. Any other farmer in the Appellant's circumstances would be treated it in the same way and, even if there were any difference, this would be objectively justified.

Discussion and Decision

First ground of appeal – is Regulation 204(d) ultra vires Article 296(2) of the Directive?

67. I have not found this ground of appeal easy to decide. However, I largely agree with the submissions on behalf of HMRC for the reasons I now explain.

68. There is no dispute that HMRC's decision refusing the Appellant's application to join the AFRS is entirely lawful in domestic law under Regulation 204(d) of the VAT Regulations 1995. The question is whether the Regulation is ultra vires as regards the Principal VAT Directive.

Distinctions between Shields and the Appellant

69. The Appellant's first ground of appeal relies upon the judgment of the CJEU in *Shields & Sons*. However, the facts of *Shields* are not on all fours with the Appellant. The taxpayer in that case was already certified under the AFRS when it had its certification cancelled pursuant to Regulation 206(1)(i) of the VAT Regulations 1995 for protection of the revenue because the taxpayer was recovering 'substantially more' by way of the Flat Rate Addition ('FRA') under the AFRS scheme than it would have through operating normal VAT arrangements and deducting or recovering input tax.

70. The relevant distinction between the case of *Shields and Sons* and the present appeal is that in the former, the trader was already on the AFRS when its certificate was cancelled "for the protection of the revenue" because it was 'recovering substantially more' through the AFRS whereas in the present case the Appellant had been trading for many years under the normal VAT rules when it made the rejected application to join the AFRS scheme. The Appellant is therefore in a different position because it was not already a member of the

AFRS and HMRC's decision to refuse its application to join was made under a different regulation, namely Regulation 204(d).

71. For the purpose of considering 'certain categories of farmers' under Article 296(2), the CJEU in *Shields & Sons* noted at [48]-[49] that farmers must be able to know in advance whether by reference to objective criteria laid down by legislation that they fall within a category of farmers who are to be excluded from the Scheme. In that case the CJEU held that a farmer would not be able to know in advance whether they were to be excluded because the threshold for the decision was not sufficiently clear. The concept of farmers 'recovering substantially more' by virtue of the operation of the AFRS was not a certain category for exclusion from the scheme for the purposes of Article 296(2) as described in *Shields*. Therefore, cancellation of membership 'for protection of the revenue' on this basis was not lawful.

72. In the present appeal, however, Regulation 204(d) is framed by reference to a specific fixed amount, namely £3,000, rather than 'recovering substantially more' or the criterion under Regulation 206(1)(i), namely "for the protection of the revenue". The Appellant, like any farmer, would be well aware before it made its application to join the AFRS by how much the FRA on its total sales was likely to exceed its recovery of input tax under the usual VAT rules in the first year of operation. It would almost certainly know whether the difference would exceed the £3,000 threshold. The criterion was clearly identified and objectively foreseeable. There is no uncertainty of meaning created by the drafting of Regulation 204(d) nor its application. The Appellant accepts this much.

73. The Appellant has been registered for VAT since 1973. There is no suggestion that it was experiencing administrative difficulties in the application of the normal VAT rules. On the contrary, with a turnover of £2.85m it is apparent that the Appellant was primarily seeking a commercial benefit from joining the AFRS. The Appellant would benefit by over £42,000 a year or thereabouts simply by being admitted to the scheme. Even if it is said that membership of the AFRS would also reduce the Appellant's administrative burden of operating the normal VAT arrangements, this would be the same for any farmer and does not require it to have been experiencing difficulties in so doing.

74. The effect of finding Regulation 204(d) to be ultra vires as regards the Directive would also be to find that HMRC's refusal to certify the Appellant as a member of the AFRS was unlawful. It would allow the Appellant to join the AFRS. It would also mean that any farmer who applied to join the AFRS would have to be admitted (subject to the character and application requirements). This would be because Regulation 204(d) would have to be disapplied regardless of the applicant's turnover and the sophistication of their business operation. Nonetheless, and despite HMRC's submission as to the impact of such a ruling, this is not relevant to my determination.

75. I must decide the question of the vires of the Regulation by reference to principles of Community law. If Regulation 204(d) is ultra vires, a lawful test or mechanism can be introduced as a substitute under the Regulations. It is no answer for HMRC to rely on an argument that it would 'open the floodgates' if the Regulation were ruled to be ultra vires. The presumable consequence of such a ruling would be that Regulation 204(d) could be replaced with a criterion which properly implements the purpose of the directive.

The purpose and effect of Article 296 – reducing administrative difficulty in operating the VAT scheme and encouraging simplification

76. The issue is whether the meaning and application of Regulation 204(d) fulfils the purpose of the AFRS contained in Article 296, which is to achieve administrative

simplification or reduce administrative difficulties in the operation of VAT arrangements as explained by the CJEU in *Shields and Sons*.

77. The Court of Justice pointed out the following at [33] of the judgment in *Shields & Sons*:

'33. It should be recalled that the flat-rate scheme is a scheme which derogates from and is an exception to the general scheme of the VAT Directive and which must therefore be applied only to the extent necessary to achieve its objective (judgments of 15 July 2004, Finanzamt Rendsburg v Harbs (Case C-321/02) [2006] STC 340, [2004] ECR I-7101, para 27; of 8 March 2012, European Commission v Portugal (Case C-524/10) (unreported), para 49; and of 12 October 2016, Nigl v Finanzamt Waldviertel (Case C-340/15) (unreported), para 37).'

78. The CJEU makes clear, therefore, that the AFRS is an exception to the normal rules as to the application of VAT. In such circumstances its terms are to be narrowly construed and by extension the exceptions to its application are to be broadly construed; see *Stichting Uitvoering Financiele Acties v Staatssecretaris van Financien (348/87) [1989] ECR 1737* and *Commissioners of Revenue and Customs v Isle of Wight Council [2009] PTSR 875* at para 60. In *Case C – 434/05, Horizon College [2007] 3 CMLR 18 ('Horizon College)*, the CJEU said as follows at §§15-16:

'15. According to the case-law of the Court, the exemptions provided for in Article 13 of the Sixth Directive constitute independent concepts of Community law whose purpose is to avoid divergences in the application of the VAT system from one Member State to another (see Case C-349/96 CPP [1999] ECR I973, paragraph 15; Case C-240/99 Skandia [2001] ECR I1951, paragraph 23; and Ygeia, paragraph 15).

16. The terms used to specify those exemptions are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person (see Case C-287/00 Commission v Germany [2002] ECR I5811, paragraph 43, and Case C-8/01 Taksatorringen [2003] ECR I13711, paragraph 36). Nevertheless, the interpretation of those terms must be consistent with the objectives pursued by those exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT (see Case C-45/01 Dornier [2003] ECR I12911, paragraph 42; Case C-498/03 Kingscrest Associates and Montecello [2005] ECR I4427, paragraph 29; and Case C-106/05 L.u.P. [2006] ECR I5123, paragraph 24). Thus, the requirement of strict interpretation does not mean that the terms used to specify the exemptions referred to in Article 13 should be construed in such a way as to deprive the exemptions of their intended effect.'

79. An undisputed purpose of Articles 296(1) and (2) is to address the difficulties that the application, administration and operation of the normal VAT scheme causes to small farming businesses. The Appellant argues that Regulation 204(d), is in fact ultra vires pursuant to the Court of Justice's interpretation of Article 296(2) in *Shields and Sons*. HMRC submits that the Appellant seeks to undermine the stated purpose of that Article contrary to the principle stated in *Horizon College.*

80. As the CJEU observed in *Shields & Sons* at [34]:

'34. Among the two objectives of the flat-rate scheme is that relating to the need for administrative simplification for the farmers concerned, which must be reconciled with the objective of offsetting the input VAT borne by those farmers when acquiring goods used for the purposes of their activities (see, to that effect, judgments of 8 March 2012, Commission v Portugal, para 50, and of 12 October 2016, Nigl, para 38).'

81. I am satisfied that it is clear from the terms of Articles 296(1) and (2) that the scheme is not to be available for all farmers but only those for whom the application of normal VAT

Rules would create administrative difficulties, i.e. those farming on a small scale with limited resources. This was recognised at [23] of the Advocate General's Opinion:

'23. The second premise for exclusion concerns farmers for whom application of the normal arrangements or simplified procedures would not give rise to difficulties. Such an exclusion is usually linked to the size of the farm or the amount of turnover achieved by that farm and is based on the presumption that a farm of a specific size is in a position to manage the administrative obligations resulting from its status as an entity subject to VAT.'

82. The AFRS is itself an infringement of fiscal neutrality (see [40] and [41] of the judgment in *Shields &* Sons). That is to be balanced against the objective of administrative simplification. That balance is achieved by ensuring that not all farmers who apply are admitted to the Scheme but only those for whom the normal rules are likely to cause administrative difficulties.

83. Article 296(2) entitles 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 purpose of Articles 296(1) and (2) is to address the difficulties that the application, administration and operation of the normal VAT scheme causes to small farming businesses.

The terms of Regulation 204(d)

84. The issue is whether Regulation 204(d) is a lawful, reasonable and proportionate mechanism (or proxy) by which this aim or purpose of administrative simplification envisaged by Article 296 can be achieved.

85. I am satisfied that Regulation 204(d) provides for a clearly identifiable and objectively ascertainable, thus certain, category for exclusion from the AFRS as set out above. I am also satisfied that its purpose and effect is to implement administrative simplification and to reduce the administrative burden on small traders that operating the normal VAT arrangements would otherwise require for the reasons I now explain.

86. I repeat the Advocate General's opinion at [23] in *Shields* (as set out in full above), '*….based on the presumption that a farm of a specific size is in a position to manage the administrative obligations resulting from its status as an entity subject to VAT*.'

87. The larger the turnover of the business, the more likely that operation of the AFRS and charge of a 4% Flat Rate Addition is to exceed by more than £3,000 the input tax which it would recover or deduct under the normal VAT arrangements. Further, the higher the turnover, the larger the business and the more employees and administrative systems it is likely to employ. Therefore, it is less likely to experience difficulty in operating normal administrative arrangements in accounting for VAT. The smaller the business, the smaller the turnover and potential financial difference in operating the AFRS such that it is likely to qualify to operate the scheme under this sub-Regulation. Smaller businesses are likely to have fewer employees and systems in place and are more likely to experience administrative difficulty operating normal VAT arrangements.

88. Regulation 204(d) is consonant with the purpose of Article 296(1) and (2) and not ultra vires the Directive.

89. The provision contained in Regulation 204(d) which limits certification to those who would benefit by less than £3,000 in the first year of certification is, in effect, a proxy or mechanism for ensuring that only those farmers who are likely to have administrative difficulties by reason of the small scale of their businesses are admitted to the Scheme.

90. It is worth noting that Regulation 204(a),(b) & (c) do not provide any rules that equate to excluding farmers from the AFRS where there would be likely to be no administrative difficulty in operating the normal VAT arrangements. These criteria effectively address 'character' and administrative requirements for entering the scheme. It is not in dispute that the Appellant satisfied all these criteria.

91. The only sub-Regulation which addresses or is directed to likely administrative difficulties in operating the normal VAT arrangements is Regulation 204(d).

92. I accept there is some force in Appellant's argument that the Regulation might have achieved the same purpose of excluding farmers who are unlikely to suffer administrative difficulties by some other mechanism than the one employed in the drafting.

93. To lawfully address the unambiguous purpose of Article 296, the Regulation might have employed a test or mechanism to exclude farmers by reference to the size of their anticipated turnover, the number of employees, the size of their land or number of livestock, or extent of their administrative staff or systems. These types of categories may have been objectively identifiable and sufficiently precise or clear to act as exclusions from the AFRS for the purpose of administrative simplification as provided in Article 296(1) or (2). None of these tests would have been directed to nor had the effect of limiting the financial benefit of operating the AFRS, although they may have indirectly had the same effect of excluding larger and more sophisticated farms which are more likely to benefit financially from the operation of the AFRS.

94. The fact that there may have been other mechanisms specified in the VAT Regulations 1995 for achieving the same purpose does not, of itself, mean that the mechanism that they did employ in Regulation 204(d) was unlawful.

The lawfulness of Regulation 204(d) in excluding from AFRS a category of farmers who may benefit financially

95. The matter that gave me greatest cause to hesitate was the Appellant's argument, relying on [39]-[44] of *Shields* and Articles 297-299 of the Directive, that employing any financial benefit test under Regulation 204 was ultra vires as regards the Directive. This is argued to be the case because the fiscal impact of operating the scheme is to be assessed on a macroeconomic basis and not by reference to any individual farmer's benefit. It is argued that the fiscal impact, and the objective of fiscal neutrality, will all be taken into account when setting the appropriate Flat Rate Addition percentage for the scheme (it could, for instance, be lowered from 4% to 3% if the data for all farmers revealed this to be necessary). Therefore, it is said that Regulation 204(d) could not lawfully employ any financial benefit criterion.

96. In support of this argument, for instance, the Appellant relies on the CJEU's judgment at [39] & [42] in which the Court stated:

'39. Furthermore, arts 297 to 299 of the VAT Directive provide that the flat-rate compensation percentages are set globally by each member state in the light of macroeconomic statistics for flat-rate farmers alone for the preceding three years. Therefore, art 299 of the directive cannot justify the adoption of a decision to exclude, on an individual basis, a farmer from the flat-rate scheme in the light of the refunds obtained by applying those percentages.

…….

42. Accordingly, it cannot be regarded as contrary to EU law for a farmer using that scheme to obtain, as in the present instance, compensation in respect of VAT that is greater than the amount of input VAT that he would have been able to deduct if he had been subject to VAT under the normal or simplified taxation arrangements.'

97. I reject the Appellant's argument for three reasons.

98. The first is that a necessary purpose and effect of Regulation 204(d) is to act as a proxy or mechanism for excluding from the AFRS farmers who are not likely to suffer administrative difficulties in operating the normal VAT arrangements for the reasons set out above. Therefore, I am satisfied that an important purpose and effect of Regulation 204(d) is administrative simplification rather than only to prevent any individual farmer receiving compensation in respect of VAT that is greater than the amount of input VAT deducted under normal VAT arrangements.

99. The fact that Regulation 204(d) also has the effect of excluding from the scheme a certain category of farmers who might financially benefit from the scheme is not to say that this is its singular purpose or effect. The primary purpose and effect of Regulation 204(d) is reducing administrative difficulties, for the reasons I have set out above. The provision also happens to support the aim of preventing Article 299 being infringed, because it eliminates the risk of a category or class of farmer benefitting financially from the operation of the AFRS. Therefore, the effect of Regulation 204(d) does not contravene Article 299 whose purpose is that the scheme as a whole is not to have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged.

100. However, I accept that the additional or secondary effect, of Regulation 204(d), in excluding a certain category of farmers from enjoying financial benefit by operating the AFRS, cannot alone justify exclusion of farmers from the scheme for the reasons set out in [39]-[44] of the judgment in *Shields*. It might potentially be unlawful if this were its sole effect or purpose, particularly if the Regulation sought to exclude all farmers from enjoying a financial benefit from operating the AFRS rather than just a certain category.

101. This is because the percentage rate for the AFRS is set on a macroeconomic basis under Articles 297 to 299 which of itself reduces the need to employ any other mechanism to eliminate farmers from benefitting under the scheme. It is those Articles of the Directive which ensure fiscal neutrality as far as possible, when weighed against the competing purpose of reducing administrative complexity. The premise of the Court's ruling in *Shields* is that the same purpose of maximising fiscal neutrality through Article 299 is achieved across the whole class of farmers in the AFRS scheme by assessing the macroeconomic position of VAT payments for all farmers and in setting the percentage applicable for the FRA under the AFRS.

102. Second, the Regulation does allow for a certain category of farmers to join or remain within the AFRS and receive greater compensation than they would recover by deducting input tax under normal VAT arrangements but this is only to the specified extent (up to a threshold of £3,000). That is in accordance with EU law as interpreted at [42] of *Shields*. Regulation 204(d) does not prohibit a certain category of farmers receiving compensation in respect of VAT that is greater than the amount of input VAT that they would have been able to deduct if they had been subject to VAT under the normal or simplified taxation arrangements.

103. Third, the wording of the Regulation 204(d) does not require HMRC to make a decision to exclude a farmer for reason of financial benefit, *on an individual basis* as happened in *Shields*, but involves applying a class or category of exclusion as clearly defined on its face. The Appellant was excluded from the AFRS, as provided under the Regulation 204(d), because it would not have a difficulty operating the ordinary VAT arrangements and because it was one of a category of farmers who would otherwise financially benefit from the AFRS. This was not decided on the individual basis or analysis as relied upon in *Shields* but pursuant to a defined category under the Regulation.

104. This is consistent with the interpretation of the CJEU at [39] and [42] of *Shields and Sons*. Regulation 204(d), as applied to the Appellant, applies to all farmers in the same category. It does not mandate a decision to exclude a farmer from the flat-rate scheme *on an individual basis* in light of the refunds obtained by applying the flat rate percentage. Regulation 204(d) operates upon a class or category basis and does not subvert the macroeconomic assessment for participation in the scheme. It is to be remembered that in *Shields* the specific farmer's AFRS membership was cancelled under Regulation 206(1)(i) for the 'protection of the revenue' after a retrospective financial analysis of its trading. This required the farmer's position to be considered individually on a specific application of that Regulation. Regulation 204(d), in contrast, provides a general category basis for exclusion from the AFRS from the outset.

Conclusion on the first ground of appeal

105. In conclusion, I am satisfied that the scope of Regulation 204(d) lawfully implements Article 296(2) in purpose and effect by excluding from membership of the AFRS a certain category of farmers who are not likely to suffer administrative difficulties in operating normal VAT arrangements. The proxy mechanism employed by Regulation 204(d) for excluding farmers who are not likely to suffer administrative difficulties in operating normal VAT arrangements is within the scope of Article 296(2) in its purpose and effect. Therefore, the Regulation lawfully conforms to the Directive and is not ultra vires.

106. I am satisfied that Regulation 204(d) is a lawful mechanism to effect the objective of Article 296(1) and (2), that of administrative simplification of VAT arrangements for farmers. The Regulation's purpose and consequence is to exclude farmers from the AFRS who are likely to have no administrative difficulty in operating the normal VAT scheme. Member States are entitled pursuant to Article 296(3) to set rules and conditions for certification to the AFRS and to apply those rules and conditions. Regulation 204(d) of the VAT Regulations 1995 is in accordance with Article 296 and with Community law generally.

107. Therefore, HMRC's application of Regulation 204(d) to the Appellant's case and decision to refuse to certify it to operate under the AFRS was lawful in both domestic and Community law and in accordance with the underlying purpose of the AFRS.

108. That is sufficient to dispose of the first ground of appeal.

Further observations

109. I go on to make some further observations that were not the subject of argument and upon which there is no need to express a concluded view.

110. I am not required to decide how far the statement of principle at [42] of the judgment in *Shields* extends and whether it precludes Member States for setting any certain thresholds as to the extent of benefit from operating the scheme without regard to administrative simplification. The CJEU made its finding at [42] in the context of considering cancellation for the protection of the revenue under Regulation 206(1)(i) and its finding that a category of farmer who stood to benefit by 'recovering substantially more' VAT under the AFRS Scheme was not a certain category of farmer (see [51] of *Shields*).

111. If I were wrong in the conclusion that one purpose and effect of Regulation 204(d) is consonant with that Article 296(2) in terms of being a proxy for excluding from the AFRS those who would not experience administrative difficulties in operating normal VAT arrangements, that would not necessarily be the end of the matter. As I envisaged above, what would be the position if the sole purpose and effect of Regulation 204(d) were to exclude a certain category of farmer (rather than all farmers) from benefiting financially under the AFRS? Could Article 296(2) permit such a purpose?

112. At [44] of its judgment in *Shields and Sons*, the CJEU concluded that art 296(2) of the VAT Directive must be interpreted as laying down exhaustively all the cases in which a member state may exclude a farmer from the flat-rate scheme.

113. The cases are defined in article 296(2) as allowing 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.

114. The CJEU at [36] of its judgment does no more than repeat the wording of Article 296(2) (substituting '*and*' for '*as well as'*) which provides for the exclusion of certain categories of farmers and those for whom operating normal the VAT arrangements would be likely to cause administrative difficulties:

'36. Article 296(2) of the VAT Directive refers only to the possibility of excluding from the flat-rate scheme certain categories of farmers ***and*** farmers for whom application of the normal VAT arrangements, or of the simplified procedures provided for in art 281 of the directive, is not likely to give rise to administrative difficulties.'

115. One question is what is meant by 'certain categories'. I have addressed above potential other categories of farmer (by size of farm and turnover etc). which might be mechanisms or proxies for farmers who are unlikely to experience administrative difficulties in operating normal VAT arrangements.

116. At [45]-[51] in *Shields and Sons* the CJEU interpreted 'certain categories' in Article 296(2) to mean clear and identifiable categories of farmers which could be objectively predicted and ascertained. It provided no examples of such categories but these might include categories of farmers, such as:

- Arable: Crops;
- Pastoral: Animals;
- Mixed: Crops and animals;
- Subsistence: Grown just for the farmer and his family
- Commercial: Grown to sell;
- Intensive: High inputs of labour or capital usually small;
- Extensive: Low inputs of labour or capital;
- Sedentary: Permanently in in one place; and
- Nomadic: The farmers move around to find new areas to farm.

The CJEU's interpretation of the meaning 'certain categories of farmers' went beyond only meaning 'specific categories'.

117. The next question is whether to read the words 'as well as' in article 296(2) disjunctively (and/or) or conjunctively ('both and').

118. The argument of the parties in this appeal proceeded on the basis that 'as well as' in Article 296(2) must be read conjunctively and that it requires exclusion from the AFRS of certain categories of farmers who also are not likely to experience administrative difficulties in operating normal VAT arrangements. This reading is informed by Article 296(1) and the focus upon administrative difficulties therein.

119. If one reads Article 296(2) disjunctively ('as well as' meaning 'or'), as I consider may be permissible, all that Regulation 204(d) may need to do, in order to remain within the scope of the Directive, is exclude a certain category of farmer (subject to not offending any of the other Articles of the Directive, such as Article 297 to 299).

120. Therefore, it may be that the words 'as well as' in Article 296(2) could be read disjunctively and the excluded certain categories of farmers do not also have to be farmers not experiencing administrative difficulties. For example, by virtue of Regulation 204(a)-(c) HMRC may also exclude categories of farmers from the AFRS for non-administrative simplification reasons such as their character as defined in Regulation 204(b).

121. Regulation 204(d) provides a criterion for inclusion in the AFRS for farmers:

'……in respect of whom the total of the amounts as are mentioned in regulation 209 relating to supplies made in the year following the date of his certification will not exceed by £3,000 or more the amount of input tax to which he would otherwise be entitled to credit in that year.'

122. For the reasons set out above, the wording of Regulations 204(d) provides a clearly identifiable and certain category of farmer for the purposes of Article 296(2) irrespective of whether it addresses the issue of administrative difficulties.

123. Article 296(1), on Member States being permitted to provide an AFRS for those who are likely to experience administrative difficulties in operating normal VAT arrangements. Article 296.1 provides:

'Where the application to farmers of the normal VAT arrangements, or the special scheme provided for in Chapter 1, is likely to give rise to difficulties, Member States may apply to farmers, in accordance with this Chapter, a flat-rate scheme designed to offset the VAT charged on purchases of goods and services made by the flat-rate farmers.'

124. It is arguable that, while aimed at simplifying arrangements for the payment of VAT, Article 296(1) does not preclude a broader interpretation of Article 296(2) allowing exclusion of a certain category of farmers from the scheme for other purposes (so long as those purposes are not consistent with the other Articles of the Directive).

125. The purpose of Regulation 204(d) might remain lawfully consistent with the disjunctive reading of Article 296(2) even if it did not address administrative difficulties. Certain categories of farmers may be excluded from the regime for purpose other than reducing administrative difficulties. This is subject to the argument about the lawfulness of excluding a category of farmers who may financially benefit that I have addressed above.

126. I have set out above my reasons for deciding that Regulation 204(d) may have two effects and provided one effect is to reduce administrative difficulties, this is permissible so long any other purpose does not conflict with the other objective in Article 299 that, 'the scheme may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged'. It may also mean that the Regulation's sole purpose and effect might lawfully be to exclude a certain category of farmer, but not all farmers, who would benefit financially from the scheme.

127. It is unnecessary to come to any concluded view on this point given my earlier conclusion that reducing the financial benefit from operation of the AFRS is not the sole nor primary purpose and effect of Regulation 204(d). There may be a reading of the Directive that does not require only the exclusion of farmers for whom operation of the normal VAT arrangements would not be likely to cause administrative difficulties but permits a broader category of exclusion.

Second ground of appeal – fiscal neutrality and unequal treatment

128. The Appellant submits that the decision to exclude it from the AFRS contravenes the principle of fiscal neutrality. It is also argued that other farmers in a comparable position have been admitted to the AFRS such that it has suffered unequal treatment as explained by the CJEU in *Marks and Spencer v HMRC*.

129. In relation to fiscal neutrality, the Appellant is unable to explain how, if it is required to operate under the normal VAT rules, that is contrary to fiscal neutrality. Those rules operate so as to guarantee fiscal neutrality rather than the opposite. The Appellant accounts for output tax on its supplies and reclaims input tax on its purchases and sets one off against the other. There is nothing contrary to fiscal neutrality in so doing. In fact, as the CJEU has recognised the AFRS is itself a scheme that cannot fully ensure the concept of fiscal neutrality. On that basis fiscal neutrality is better supported by operating normal VAT arrangements than the AFRS.

130. In relation to unequal treatment, the Appellant relies upon the farmer in *Shields & Sons Partnership* as the comparator. It is relied upon as the example cited by the Appellant because it is said that the facts of that case were similar in an important respect. Shields was a farmer operating the AFRS in respect of whom the total of the amounts relating to supplies made in the year following the date of their certification exceeded by £3,000 or more the amount of input tax to which he would otherwise be entitled to credit in that year. The annual excess was over £40,000 just as it was for the Appellant. However, Shields was allowed to continue to operate the AFRS (the cancellation of its registration was overturned by the Upper Tribunal in light of the CJEU's judgment).

131. Nonetheless, for the reasons set out below, I am not satisfied that Shields is a proper comparator for the Appellant.

132. There is no indication *in Shields and Sons* that Shields did not qualify for registration and certification under the scheme under Regulation 204(d) at the time of admittance. Of particular relevance is [9] of the Advocate General's opinion:

'9. Shields and Sons has been covered by the common flat-rate scheme for farmers since the tax year 2004/2005. In that tax year, the reimbursement which Shields & Sons received by way of flat-rate compensation corresponded in principle to the amount of VAT which that undertaking would have been entitled to recover as a taxpayer operating under the normal arrangements. In subsequent years, however, those amounts began to vary significantly, such that the accumulated surplus in terms of compensation for the tax years from 2004/2005 to 2011/2012 amounted to 374,884.23 pounds sterling (GBP).'

133. In *Shields*, the Court relied on the above analysis. It was accepted that there was a financial benefit to the farmer in operating the AFRS from its admission to the scheme in 2004 onwards compared to an analysis of what it would have been entitled to recover by way of input tax under the normal VAT scheme. A retrospective analysis of its supplies had been conducted which indicated it benefited by over £374,000 for the years from 2004-2005 to 2011-2012 (averaging around £50,000 a year over the seven years from 2005-2006 onwards). However, [9] of the opinion is clear that during the first year of operation of the AFRS there was no financial benefit of Shields operating the AFRS.

134. It can reasonably be inferred that at the time of making its application to join the AFRS, Shields anticipated that its excess would be less than £3,000 such that it qualified under Regulation 204(d). That it is the relevant distinction to the Appellant who does not qualify for entry to the AFRS scheme from the outset because it cannot satisfy Regulation 204(d). Shields qualified for admission to the scheme from the outset unlike the Appellant.

135. Further, no evidence was provided of any other farmers being a member of the AFRS and receiving annual financial benefit exceeding £3,000. Likewise, there is no evidence of any other farmer being admitted to the scheme by HMRC despite not satisfying Regulation 204(d). I am satisfied that the lack of evidence of any unequal treatment is fatal to the Appellant's argument.

136. So far as it is said that the Appellant has, somehow, been "singled out" by HMRC such that it has been subjected to unequal treatment by the operation of the law, I do not accept this. The operation of Regulation 204(d) applies to all farmers who apply to join the AFRS. It provides a clear and certain criterion for admittance to the Scheme. It applies equally to all farmers at the time they apply for admittance to the scheme.

137. In the application of Regulation 204(d), there has been no unequal treatment at the relevant time by which it must be judged, the time at which the law was applied to the Appellant. The Advocate General's Opinion at [38] accepted that there may be change of circumstances post registration that later means that a farmer may be excluded from the scheme:

'38. It is of course possible that a farmer initially not belonging to a category subject to exclusion may subsequently come within the scope of such a category. This can occur for example as a result of an increase in the scale of his activities or a change in the nature of those activities. Those are situations which depend on the decisions of the person concerned, in which he is in a position to anticipate the impact of those decisions on his status as a flat-rate farmer. It does not, however, appear to me to be consistent with the logic of the flat-rate scheme that participation in that scheme may automatically give rise to exclusion from that scheme because of the advantageous financial results for a given farmer attributable to his participation in the scheme.'

138. Any potential difference from the Appellant might ariss by virtue of *Shields and Sons* later being excluded from the AFRS by cancellation of its certification under Regulation 206(1)(i) and that cancellation being overturned by the Court and Tribunal such that it remained in the scheme. That does not apply to the Appellant. The fact is that the Appellant does not qualify for the scheme by the application of the Regulation which is not in itself ultra vires.

139. The Advocate General stated the following at [17]-[19] & [38] of his opinion in *Shields*:

'17. The common flat-rate scheme for farmers serves two purposes. First, it is intended to provide administrative simplification for flat-rate farmers. The lack of obligation to pay VAT due to the state budget and the simultaneous lack of opportunity to deduct input tax enables flat-rate farmers to be exempt from a series of administrative obligations, such as the recording of goods and services purchased, the keeping of accounts, the issuing of invoices, and suchlike.

18. Secondly, that scheme is intended to enable flat-rate farmers to offset the costs of VAT charged for the purchase of goods or services used for the purposes of their activities. Were it not for such compensation, those farmers would bear the burden of that tax, which would be contrary to the principle of VAT neutrality for taxpayers, according to which the burden of that tax is to be borne by consumers. However, because the compensation percentage is calculated on an overall basis, in relation to all flat-rate farmers, tax neutrality is also maintained only on an overall basis. This means that in the case of one specific flat-rate farmer the compensation may in fact be higher or lower than the amount of VAT charged in a given tax year.

19. The common flat-rate scheme for farmers derogates from the general rules of Directive 2006/112 and must therefore be applied only to the extent necessary to achieve its objectives. Therefore, first, it must not be applied to farmers for whom application of the normal arrangements or, where appropriate, the special scheme for small enterprises6 would not give rise to administrative difficulties. Secondly, the application of the flat-rate scheme must not involve, in relation to all flat-rate farmers in a given member state, the recovery by way of flat-rate compensation of an amount greater than the amount of VAT which those farmers would be entitled to recover under the normal arrangements.'

137. Given that Article 299 provides for the fiscal neutrality of the AFRS to be judged on a macro-economic basis across all farmers, the Directive envisages that there will be individual differences on an individual level as to the benefit or loss a farmer may receive by operation

of the AFRS. However, it envisages that as a whole the total impact of all flat rate farmers' VAT arrangements should be fiscally neutral (or as close to this as possible when weighed up against the objective of administrative simplification). The same applies to any individual or category of farmer who is not entitled to be on the scheme.

138. The potentially unequal consequences of operation of the scheme can be anticipated at the time an applicant farmer applies to join the scheme. Given that the scheme is to be judged as a whole, then there is aimed to be equal treatment between the farmers on the scheme overall and any individual farmer outside the scheme.

139. Further, to the extent there is any difference in financial consequences between specific individual or categories of farmers, this is objectively justified by the Directive's objectives (as set out) to provide administrative simplification for flat-rate farmers and offset the costs of VAT charged. The Regulation, and its application by HMRC to the Appellant, is a lawful, reasonable and proportionate response to those objectives. It provides an objective justification for any difference in treatment.

Conclusion

140. I am extremely grateful to the parties for their very helpful submissions. For the reasons set out above, I have decided to dismiss the appeal. HMRC's decision to refuse the Appellant's application to be certified to operate the AFRS is confirmed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

141. 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.

RUPERT JONES
TRIBUNAL JUDGE

RELEASE DATE: 16 DECEMBER 2020