



[2016] UKUT 0142 (TCC)
Appeal number: FTC/07/2015

VAT – Flat rate scheme for farmers – whether Art 296.2 of the Principal VAT Directive (Council Directive 2006/112/EC) provides an exclusive regime as to when farmers can be excluded from the flat rate scheme – whether farmers who are found to be recovering substantially more as a member of the Flat Rate Scheme than they would if they were registered for VAT constitute a category for the purposes of Art 296.2 – reference to Court of Justice for preliminary rulings

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

SHIELDS & SONS PARTNERSHIP

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE & CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE NUGEE

Sitting in public at the Rolls Building, London EC4A 1NL on 1 and 2 February 2016

Michael Thomas, instructed by Croner Group Ltd, for the Appellant

Richard Chapman, instructed by the General Counsel and Solicitor for HM Revenue and Customs, for the Respondents

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DECISION

Mr Justice Nugee:

Introduction

1. This is an appeal by Shields & Sons Partnership (“**Shields**”) from a decision of the First-tier Tribunal (Judge Christopher Hacking and Celine Corrigan) (“**the FTT**”) dated 8 October 2014, in which the FTT dismissed Shields’ appeal against the decision of the Respondents, Her Majesty’s Revenue and Customs (“**HMRC**”) to cancel Shields’ certificate to use the UK’s Agricultural Flat Rate Scheme for VAT (“**the Flat Rate Scheme**” or “**the Scheme**”). The effect of the cancellation was to require Shields to account for VAT in the same way as other taxable businesses.
2. Shields’ appeal raises issues of EU law, in particular whether Council Directive 2006/112/EC (“**the Principal Directive**” or “**the Directive**”) permits a Member State, if it operates such a flat rate scheme, to provide for the exclusion of an individual business from the scheme on the basis that it was making a very substantial profit from it.
3. In essence Shields contends that such an exclusion is not consistent with the provisions of the Directive, whereas HMRC contend, and the FTT held, that there was nothing in the Directive preventing a Member State from including provisions designed to guard against the possibility of over recovery of flat rate tax when compared to the input tax that would otherwise be chargeable.
4. After hearing full argument from the parties on the substantive appeal, I have decided that I should seek clarification from the Court of Justice of the European Union (“**the Court of Justice**”) by way of a preliminary ruling on two questions, for the reasons explained below.

Legal context – EU law

5. Title XII of the Principal Directive makes provision for special schemes for VAT purposes. Chapter 2 of Title XII (Articles 295 to 305) makes provision for a common flat rate scheme for farmers.
6. The relevant provisions of Chapter 2 are as follows:

“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

...

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.

...

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.

Article 303

1. Where the taxable customer pays flat-rate compensation pursuant to Article 301(1), he shall be entitled, in accordance with the conditions laid down in Articles 167, 168 and 169 and Articles 173 to 177 and the procedures laid down by the Member States, to deduct the compensation amount from the VAT for which he is liable in the Member State in which his taxed transactions are carried out.

...”

7. References hereafter to Articles are, unless otherwise specified, references to these Articles of the Principal Directive.

National law

8. Article 296.1 enables a Member State to apply a flat-rate scheme to farmers. The UK has taken advantage of this option by establishing the Flat Rate Scheme. This was initially established in 1993 and is now provided for by s. 54 of the Value Added Tax Act 1994 (“**VATA 1994**”), which, so far as material, provides as follows:

“**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

...

- (3) The Commissioners may by regulations provide for an amount 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 section;

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

(c) to a taxable person,

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

- (4) The amount which, for the purposes of any provision made under subsection (3) above, may be included in the consideration for any supply shall be an amount equal to such percentage as the Treasury may by order specify of the sum which, with the addition of that amount, is equal to the consideration for the supply.

- (5) The Commissioners' power by regulations under section 39 to provide for the repayment to persons to whom that section applies of VAT which would be input tax of theirs if they were taxable persons in the United Kingdom includes power to provide for the payment to persons to whom that section applies of sums equal to the amounts which, if they were taxable persons in the United Kingdom, would be input tax of theirs by virtue of regulations under this section; and references in that section, or in any other enactment, to a repayment of VAT shall be construed accordingly.

- (6) Regulations under this section may provide—

...

(b) for the cases and manner in which the Commissioners may cancel a person's certification;

...

- (8) In this section “*designated activities*” means such activities, being activities carried on by a person who, by virtue of carrying them on, falls to be treated as a farmer for the purposes of Article 25 of the directive of the Council of the European Communities dated 17th May 1977 No.77/388/EEC (common flat-rate scheme for farmers), as the Treasury may by order designate.”

9. Regulations have been made under that section, namely Part XXIV (regulations 202 to 211) of the Value Added Tax Regulations 1995, SI 1995/2518 (“**the Regulations**”). The relevant provisions of the Regulations are as follows:

“203 Flat-rate scheme

- (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 (hereinafter in this Part referred to as "*the scheme*").

204 Admission to the scheme

The conditions mentioned in regulation 203 are that—

- (a) the person satisfies 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.

...

206 Cancellation of certificates

- (1) The Commissioners may cancel a person's certificate in any case where—
 - (a) a statement false in a material particular was made by him or on his behalf in relation to his application for certification,
 - (b) he has been convicted of an offence in connection with VAT or has made a payment to compound such proceedings under section 152 of the Customs and Excise Management Act 1979 as applied by section 72(12) of the Act,
 - (c) he has been assessed to a penalty under section 60 of the Act,
 - (d) he ceases to be involved in designated activities,
 - (e) he dies, becomes bankrupt or incapacitated,
 - (f) he is liable to be registered under Schedule 1, 1A or 3 to the Act,
 - (g) he makes an application in writing for cancellation,
 - (h) he makes an application in writing for registration under Schedule 1 or 3 to the Act, and such application shall be deemed to be an application for cancellation of his certificate,
 - (i) they consider it is necessary to do so for the protection of the revenue, or
 - (j) they are not satisfied that any of the grounds for cancellation of a certificate mentioned in sub-paragraphs (a) to (h) above do not apply.

- (2) Where the Commissioners cancel a person's certificate in accordance with paragraph (1) above, the effective date of the cancellation shall be for each of the cases mentioned respectively in that paragraph as follows—
 - (a) the date when the Commissioners discover that such a statement has been made,
 - (b) the date of his conviction or the date on which a sum is paid to compound proceedings,
 - (c) 30 days after the date when the assessment is notified,
 - (d) the date of the cessation of designated activities,
 - (e) the date on which he died, became bankrupt or incapacitated,
 - (f) the effective date of registration,
 - (g) not less than one year after the effective date of his certificate or such earlier date as the Commissioners may agree,
 - (h) not less than one year after the effective date of his certificate or such earlier date as the Commissioners may agree,
 - (i) the date on which the Commissioners consider a risk to the revenue arises, or
 - (j) the date mentioned in sub-paragraphs (a) to (h) above as appropriate.

...

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

- (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.”

10. As well as the Regulations there are two other relevant statutory instruments:

- (1) The Value Added Tax (Flat-rate Scheme for Farmers) (Designated Activities) Order 1992, SI 1992/3220.

This was made by HM Treasury under the power then contained in s. 37B(8) of the Value Added Tax Act 1983, the equivalent of s. 54(8) of VATA 1994. It designates the activities which qualify a person for the Flat Rate Scheme. This includes (by Part II para 1 of the schedule) “General stock farming”.

- (2) The Value Added Tax (Flat-rate Scheme for Farmers) (Percentage Addition) Order 1992, SI 1992/3221.

This was made by HM Treasury under the power then contained in s. 37B(4) of the Value Added Tax Act 1983, the equivalent of s. 54(4) of VATA 1994). It specifies the relevant

percentage for the Flat Rate Scheme at 4%. Although Article 297 permits Member States to fix varying percentages for different sub-divisions of agriculture, the UK has not taken advantage of this provision and has fixed a single uniform percentage.

11. HMRC publish Notices giving information about aspects of VAT to members of the public. VAT Notice 700/46 “Agricultural Flat Rate Scheme” gives information about the Flat Rate Scheme. I was shown a version dating from October 2012, although it is apparent that this replaced earlier versions. The Notice includes the following explanations of the Flat Rate Scheme:

- (1) Paragraph 1.4 explains that the Flat Rate Scheme is an alternative to VAT registration for farmers, and that “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” when selling goods to VAT registered customers. The flat rate addition “is not VAT but acts as compensation for losing input tax on purchases.”
- (2) Paragraphs 1.6 and 1.7 explain who can and cannot join the scheme; paragraph 1.8 explains that a person who qualifies for the scheme does not have to join it but can choose to remain registered for VAT (as provided for by Article 296.3).
- (3) Paragraph 4.6 is as follows:

“4.6 Can you refuse my application?”

We can refuse if...

- your non-farming activities are over the VAT threshold, or
- you would recover substantially more money through the flat rate scheme than the input tax you reclaim through VAT registration. This might happen because your input tax, when compared to your sales, is a much smaller percentage than the flat rate addition. But your application on these grounds will only be refused if the amount you stand to gain is more than £3,000 in the year following your application. This is calculated by comparing the flat rate addition that you would be able to charge, with the input tax you would normally be able to reclaim.”

- (4) Paragraph 7.2 is as follows:

“7.2 When must I leave the scheme?”

You must leave the scheme if you:

- become liable to be registered for VAT as a result of your non-farming supplies going over the threshold
- cease to produce agricultural goods qualifying for the flat rate scheme
- cease to qualify as a flat rate farmer because you sell your business or ownership of the business changes from sole proprietor to limited company, in which case you can apply for a new certificate
- become insolvent or otherwise incapacitated, or
- are found to be recovering substantially more as a flat rate farmer than you would if you were registered for VAT in the normal way.”

- (5) Paragraph 7.3 is as follows:

“7.3 When can Customs remove me compulsorily from the scheme?”

Some of the circumstances where we may cancel your certificate include where:

- it is discovered that you made a false statement on your application
- you have received a penalty for VAT evasion or been convicted of an offence in connection with VAT
- you cease to be involved in designated activities
- you die, or become bankrupt or incapacitated
- you become liable to be registered under the VAT Act 1994, Schedules 1, 1A or 3
- you make an application in writing for registration under Schedule 1, 1A or 3, which shall be seen as an application for cancellation of your certificate, or
- they consider it is necessary to do so for the protection of the revenue.”

The facts

12. The facts were found by the FTT and are not in dispute. They can be summarised as follows:

- (1) Shields is a family farming partnership which farms beef cattle on 600 acres in Castlewellan, Northern Ireland.
- (2) It deals only in beef livestock, buying cattle from between 6 months to 2 years old, fattening them and selling them on. The partnership holds livestock for between 60 to 120 days.
- (3) The fattened animals are then sold to a large local abattoir, Anglo Beef Processors in Newry (“ABP”). Since 2005 Shields has sold cattle almost exclusively to ABP.
- (4) ABP recommended the Flat Rate Scheme to Shields. Shields applied to join the Scheme in May 2004, with the assistance of its accountants, Malone Lynchehaun, and was accepted. A Flat Rate Farming Certificate was issued to Shields with an issue date of 14 May 2004 and an effective date of 1 May 2004.
- (5) Thereafter Shields issued invoices to ABP for the price of cattle sold and were paid a flat rate addition of 4% on such sales. In accordance with regulation 209 of the Regulations, ABP will have been able to treat the 4% as if it had been input tax for VAT, and claim repayment from HMRC, or a credit against output tax, accordingly.
- (6) That continued until 15 October 2012 when HMRC cancelled Shields’ certificate to use the Flat Rate Scheme with immediate effect, as set out below.

13. The FTT had before it certain financial information about Shields, which can be summarised as follows:

- (1) Shields makes up its accounts to the 30 June in each year.
- (2) In Shields’ application to join the Scheme it was estimated that its turnover would be £700,000 in the first year under the Scheme. This was in line with its livestock sales for the year ended 30 June 2003 (the last full year before joining the Scheme) which were £633,718, and its livestock sales for the year ended 30 June 2004, which were £692,751.
- (3) In fact in the year ended 30 June 2005 its livestock sales to ABP (which were the only sales on which it charged the flat rate addition of 4% – there were some other sales to local farmers but it did not claim the addition as these were short-term trading transactions) were £601,970.

Year ended	Input VAT estimated to be claimed £	4% Claimed under the Flat Rate Scheme £	Difference £
30.6.05	23,512.26	24,056.75	544.49
30.6.06	27,121.43	57,167.70	30,046.28
30.6.07	78,645.89	52,506.23	-26,139.66
30.6.08	138,861.49	91,607.08	-47,254.41
30.6.09	43,785.91	155,175.32	111,389.41
30.6.10	49,704.97	125,008.47	75,383.50
30.6.11	54,982.50	148,915.45	93,932.95
30.6.12	73,291.33	210,272.00	136,981.67

of 4% flat rate addition claimed in the year was £24,056.75, which was not significantly in excess of the input VAT which it is estimated Shields could otherwise have claimed of £23,512.26.

- (4) Thereafter however Shields decided that it was more profitable for the partnership to trade on an exclusive basis with ABP, and the turnover with ABP which qualified for the 4% addition increased significantly (in part due to increased prices for beef).
- (5) The FTT reproduced a table prepared by Mr Malone comparing the 4% flat rate addition in fact claimed by Shields, and the estimated input tax which it would have been able to claim had it been registered for VAT. This table was as follows:

It can be seen that in the years ended 30 June 2007 and 30 June 2008, Shields received less in flat rate additions than the input VAT that it incurred and would have been able to claim if registered. This is because Shields incurred significant capital expenditure in those years (of about £1,050,000). In the four subsequent years however, up to 30 June 2012, Shields received considerably more in flat rate additions than it would have been able to claim as input tax.

The cancellation of the certificate by HMRC

14. On 27 June 2012 an officer of HMRC, Mrs Siobhan Davidson, met Mr Malone of Malone Lynchehaun to obtain information regarding Shields' use of the Flat Rate Scheme. Having reviewed the information she wrote on 15 October 2012 to Shields informing them that HMRC had decided to

cancel Shields' certificate to use the Scheme with effect from that date.

15. The ground on which the decision was based was that the financial information provided by Mr Malone indicated that Shields had obtained a net benefit under the Scheme that was substantially greater than would be the case under a normal VAT registration. Accordingly HMRC had decided that it was necessary to cancel the certificate for the protection of the revenue under regulation 206(1)(i) of the Regulations, and that the cancellation should take effect with immediate effect under regulation 206(2)(i) of the Regulations.
16. Shields asked for a review of Mrs Davidson's decision. The review was carried out by another officer of HMRC, DJ O'Neil, whose decision, contained in a letter dated 21 December 2012, was to uphold the decision. The grounds for doing so were as follows:

"Paragraph 7.2 of the Notice [VAT Notice 700/46] covers circumstances when a business must leave the scheme and includes the situation where substantially more is being recovered under the AFRS than would be reclaimable from being VAT registered. Under paragraph 4.6 any benefit of more than £3,000 is seen as being significant and it would appear reasonable to apply the same value to define what is to be deemed as being "substantially more" when deciding if a business is required to leave the scheme under paragraph 7.2 of the Notice.

Under this definition it is clear that the Partnership has obtained a substantial benefit from using the scheme, even if the losses incurred in 2007 and 2008 are taken into account. This benefit is likely to continue in the future and I therefore agree with Mrs Davidson's decision to cancel the Partnership's certificate to use the scheme from 15 October 2012."

The appeal to the FTT

17. Shields appealed to the FTT against the decision of HMRC to cancel its certificate. By its decision dated 8 October 2014 the FTT dismissed the appeal. The essence of its reasoning can be found in the following parts of its decision:

"68 In this appeal the Appellant seeks to rely on the direct effect of the Directive in resisting the Respondents withdrawal of its flat-rate certificate.

69 However there is no specifically precise provision of any of Articles 295 to 300 which deals with the question of the cancellation of such a certificate. In fact nothing is said in the Directive at all about the termination of consent by a member state for farmers to use the agricultural flat-rate scheme. This is a matter for national law to deal with in the context of its development of a scheme which is compliant with and gives effect to the Directive.

70 What the Appellant contends is that Regulation 206(1)(i) , a provision of national law particularly having the object of ensuring compliance with Article 299 of the Treaty, is in some way incompatible with the Directive.

...

73 The Directive does not devolve to the particulars of a scheme but allows member states to design their own schemes compliant with the objectives and purpose of the Directive. The purpose of the Scheme is the simplification of VAT for hard pressed farmers for whom the administration of the normal VAT regime creates difficulties. A further objective is the matching, so far as possible, of the flat-rate with the input tax otherwise payable by farmers in their various enterprises so as to achieve fiscal neutrality.

74 Article 299 requires that the flat-rate percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input tax charged.

75 That a member state should not be competent to include provisions designed to guard

against abuse of the Scheme by reference to the possibility of over-recovery of flat-rate tax when compared to the input tax otherwise chargeable does seem to the tribunal to be an extraordinary proposition.

- 76 On behalf of the Respondents Mr Chapman contends that on a proper construction of Article 296(2) farmers for whom the flat-rate provides a benefit beyond the input tax chargeable represent a category of farmer to which regulation 206(1)(i) can properly be applied. The tribunal agrees.
- 77 Officer Davidson was asked whether HMRC had removed other farmers' certificates in similar situations. The tribunal was told that they had. In two other cases there had been an initial indication that the parties concerned would appeal but apparently they had not in fact persisted in this. HMRC is, we were told, looking more generally at those within the agricultural sector who may similarly be obtaining an advantage by operating under the scheme which was not intended by the directive. This tribunal sees no reason why it should not do this as this is entirely consistent with Article 299 of the Directive.
- 78 The conditions for applying for and admission to the flat-rate scheme include a requirement that the amount recovered under the scheme should not exceed by more than £3,000 the input tax which the applicant would otherwise be entitled to credit in the year following certification. Whilst this may not be expressed as a continuing condition it suggests that this does at least indicate the likely parameter of tolerance in respect of recovery of flat-rate tax which exceeds input tax otherwise chargeable.
- 79 Following the exercise conducted by HMRC into the accounts of the Appellant it was found that for the three preceding years a substantial benefit had accrued to the partnership much in excess of the £3,000 referred to in the provisions of Regulation 204 which address admission to the Scheme.
- 80 It is perfectly true that this may have been the result of increased beef prices. It is also true that a lower rate of flat-rate tax would provide a reduced benefit but these are not considerations which the Respondent can entertain. To do so would be in conflict with the clear objectives and purpose of the Directive and in particular would put at risk the princip[le] of fiscal neutrality.
- 81 As indicated above the tribunal is not persuaded either that the Appellant is entitled to invoke the direct effect of the Directive. There is no clear and precise provision in the Directive to which it can point dealing with the matter of the circumstances in which participation in the scheme might be terminated.
- 82 It must have been within the contemplation of those considering the scheme at the European level that there might come a time when a member of the scheme at a national level was recovering more in flat-rate tax than it would in respect of its input VAT. By wholly failing to address this issue other than in the broad terms of Article 299 the national legislatures were left to devise suitable rules which, so far as they were consistent with the Directive, would be expected to be upheld.
- 83 The arguments advanced by Mr Thomas on behalf of the Appellant are, in the view of the tribunal flawed for at least the reasons expressed above.
- 84 It was suggested by both parties that if the tribunal was to find against them, a course which was open to the tribunal would be to refer a question to the ECJ. That is not a course which this tribunal chooses to follow. The question, if it was to be referred as suggested, would presumably be in the nature of an enquiry as to whether a member state was entitled to include legislative provisions entitling it to withdraw a farmer's certificate in circumstances in which it was recovering significantly greater flat-rate tax than the input VAT it would otherwise have incurred. Having regard to Article 299 and to a proper construction of Article 296(2) the answer is, it is suggested, obvious. The Appellant is within a category of farmers whose continued participation in the scheme

is inappropriate by reason of its recovery of excess flat-rate tax in breach of the principle of fiscal neutrality.”

The issues

18. Mr Thomas’s submissions for Shields in effect raise two issues, which can be labelled the “exclusivity issue” and the “categories issue” respectively, namely:
- (1) The exclusivity issue is whether Article 296.2, which permits a Member State to exclude from the scheme “certain categories of farmers”, provides an exclusive regime as to when persons can be excluded from the common flat rate scheme.
 - (2) The categories issue is whether the exclusion of Shields from the scheme can be said to be, or result from, the exclusion of a category within the meaning of Article 296.2.

It is convenient to refer to these two issues separately.

The exclusivity issue – contentions of Shields

19. Mr Shields submitted that the Directive lays down a clear regime for the common flat rate scheme, and that although Article 296.1 gives Member States a discretion *whether* to adopt such a scheme, this does not mean that they have complete carte blanche as to *how* to implement the scheme if they do decide to adopt it: see by way of analogy *Zita Modes Sàrl v Administration de l’Enregistrement et des Domaines* (Case C-497/01). Here Article 5(8) of the Sixth Directive conferred on Member States an option to treat transfers of a business as giving rise to no supply, and provided that they could exclude certain transfers from the no-supply rule; the Court of Justice held (at [30]) that this provision:

“should be regarded as exhaustive in relation to the conditions under which a member state which makes use of the option laid down in the first sentence of this paragraph may limit the application of the no-supply rule.”

Similarly, he submitted, Article 296.2 should be regarded as exhaustive in relation to the conditions under which a Member State which makes use of the option laid down in Article 296.1 to adopt a flat rate scheme may exclude persons from the scheme.

20. He said that the regime laid down by the Directive contained a number of tools or levers which Member States could use. The first was in Article 298, which provides that the flat rate percentage should be calculated on the basis of the previous 3 years’ statistics for flat-rate farmers alone. In fact it appeared that the UK had used statistics relating to all farmers when the scheme was established in 1993; but since “flat-rate farmers” is defined by Article 295.1(3) as a farmer covered by the flat-rate scheme, it was probably inevitable that when the Scheme was first established, regard should be had to statistics for farmers as a whole. Mr Thomas however said that the obligation in Article 298 was an ongoing obligation, and enabled a Member State to re-set the percentage on the basis of statistics of flat-rate farmers alone. When read with Article 299 (see below), this meant that if flat-rate farmers as a whole were recovering more compensation under the scheme than the input tax they would otherwise have been able to claim, the percentage could be reduced. By this iterative process, a Member State could and should ensure that the scheme as a whole was kept fiscally neutral, so that although there would inevitably be “winners” and “losers” from the scheme, overall the two would balance out.
21. Article 299 provides that the compensation percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged. Mr Thomas said that this provision was intended to ensure that the scheme was fiscally neutral for flat-rate farmers *as a whole*, pointing to the French language version which refers to “*L’ensemble des agriculteurs*”, and the German language version which refers to “*ingesamt*”. He said that Article 299 was not concerned with any power to exclude farmers from the scheme, but was concerned with the setting of the rates of compensation percentage, to ensure that the scheme was and remained fiscally neutral overall.
22. The second tool was in Article 297 which enabled Member States to set different percentages for different sectors of agriculture. They could thereby take account of the fact that farmers in some sectors of agriculture might be able to make more money from the scheme than those in others. By

setting different percentages, a Member State could reduce such differences.

23. The third tool was in Article 296.2 which enabled a Member State to exclude certain categories of farmers from the scheme entirely. That enabled a Member State to look at a group of farmers, for example in a particular sector, or of a particular size, or both, and determine that they should not be eligible for the scheme; that would result in similar businesses being treated in the same way (this being the basis of the principle of fiscal neutrality).
24. The fourth tool was also in Article 296.2 and enabled a Member State to exclude those for whom application of the normal VAT arrangements would not be likely to cause them administrative difficulties.
25. Mr Thomas contended that with these four tools the Directive sets out a clear and comprehensive regime under which Member States can operate the flat rate scheme; the Directive does not however confer on Member States a general discretion as to how to operate the scheme once they have chosen to implement it. As a result, Mr Thomas contended, Article 296.2 contains an exhaustive statement of when a Member State can exclude farmers from the scheme.
26. It is common ground that the *Marleasing* principle (*Marleasing SA v La Comercial Internacional de Alimentacion SA* (Case C-106/89)) requires the UK's national legislation to be interpreted in conformity with the Directive, so if Mr Thomas is right that Article 296.2 is an exhaustive statement of the powers of Member States to exclude farmers from the scheme, it follows that regulation 206(1)(i) must be interpreted in such a way that HMRC's powers to cancel a farmer's certificate for the protection of the revenue can only be exercised in the way specified in Article 296.2, that is to exclude categories of farmers.

The exclusivity point – contentions of HMRC

27. Mr Chapman, who appeared for HMRC, said that the Directive does not prevent a Member State from putting in place mechanisms to achieve fiscal neutrality, and hence does not prevent the exclusion of farmers who make too much profit from the scheme. The Directive must be given a purposive (or teleological) interpretation. This requires identifying the purpose of the EU legislation. He said the purpose of the flat rate scheme was that identified by Advocate General Kokott in *Commission v Portugal* (C-524/10) at [45]:

“Flat-rate compensation does not achieve VAT neutrality on an individual basis like the entitlement to deduct, but the basic idea of the scheme is to ensure neutrality of VAT for the group of flat-rate farmers as a whole, and to be as close to it as possible on an individual basis.”

If the aim of the scheme is to be as close as possible to neutrality on an individual basis, then it is in accordance with the purpose of the legislation to exclude either a category of farmers, or individual farmers, where the effect of the scheme takes them too far away from this.

28. Fiscal neutrality means treating similar goods and supplies of services the same for VAT purposes (*Rank Group plc v HMRC* (C-259/10 and 260/10) at [32]). In the context of the flat rate scheme, it therefore involves comparing farmers who are on the scheme with those who are not, as from the point of view of the consumer their supplies are identical.
29. Mr Chapman said that it was artificial to separate out the concept of neutrality of the scheme for flat rate farmers as a whole, and neutrality for individual farmers. For example, the UK Scheme precluded anyone joining if the amount of benefit they stood to gain in the first year exceeded £3,000. That prevented a person joining the scheme where the individual benefit to him would be too great; but it also prevented the distortion of the whole group.
30. He accepted that Member States did not have carte blanche in introducing a scheme, and that they had to comply with the framework laid down by the Directive, but he submitted that the UK had not gone outside the framework in providing for the power to exclude individual businesses where they stood to profit very greatly from the scheme. Indeed to allow them to remain in the scheme would have a distortive effect because in order to achieve overall neutrality, it would in principle mean that other

farmers on the scheme would have to lose money from the scheme. To allow individual farmers to profit in this way would be contrary to the principle of neutrality reflected in Article 299.

The categories point – contentions of Shields

31. Mr Thomas's submissions on the categories point were as follows. A category is a class or division, or a group having similar features. (The German language text refers to "Gruppen", meaning groups or classes). But HMRC's decision in this case was not to exclude a category; it was to exclude Shields as an individual business on the basis that its receipts under the Scheme had substantially exceeded its input tax.
32. Second, the principle of legal certainty required that a category that was excluded should have objective characteristics, so that a farmer should be able to read what HMRC had published and know with reasonable predictability whether he fell into the category or not. A so-called category which included a large measure of discretion or too large an element of a value judgment did not qualify as a category for the purposes of Article 296.2.

The categories point – contentions of HMRC

33. Mr Chapman's submission was that the category which applied in Shields' case was as follows:

"Farmers who are found to be recovering substantially more as a member of the Flat Rate Scheme than they would if they were registered for VAT in the usual way."

In practice this was the same as farmers who make a substantial profit from the Scheme.

34. He accepted that the principle of legal certainty was that citizens of the EU should be able to know what law they were subject to, but said that this was satisfied here. He said that the real question was whether the criterion of making a "substantial profit" was precise enough, and that in practice the threshold of £3,000 in a year which applied when applying to join the scheme might be a good working definition of what was acceptable.

Reference to the Court of Justice

35. The principles governing a reference to the Court of Justice are well settled. They can be summarised as follows (which I have adapted, with gratitude, from the decision of the Upper Tribunal (Judge Roger Berner) in *Capernwray Missionary Fellowship of Torchbearers v HMRC* [2015] UKUT 0368 (TCC)):

- (1) The power to make a reference is derived from Article 267 of the Treaty on the Functioning of the European Union, which provides that the Court of Justice has jurisdiction to give preliminary rulings on interpretation of Directives, and that:

"Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon ..."

- (2) There is a distinction between the question whether a decision on EU law is critical to the decision of the court or tribunal, which is a jurisdictional criterion, and matters of discretion. So even where a tribunal considers it necessary to obtain a decision on a question of law to enable it to give judgment, it retains a limited discretion to decline to make a reference in certain cases: *HMRC v Bridport and West Dorset Golf Club Ltd* [2012] UKUT 272 (TCC) at [33] per Proudman J.

- (3) The principles have been encapsulated in the well-known passage from the judgment of Sir Thomas Bingham MR in *R v International Stock Exchange of the United Kingdom and the Republic of Ireland Ltd ex parte Else (1982) Ltd and another* [1993] QB 534, at 545:

"... I understand the correct approach in principle of a national court (other than a final court of appeal) to be quite clear: if the facts have been found and the Community law issue is critical to the court's final decision, the appropriate course

is ordinarily to refer the issue to the Court of Justice unless the national court can with complete confidence resolve the issue itself. In considering whether it can with complete confidence resolve the issue itself the national court must be fully mindful of the differences between national and Community legislation, of the pitfalls which face a national court venturing into what may be an unfamiliar field, of the need for uniform interpretation throughout the Community and of the great advantages enjoyed by the Court of Justice in construing Community instruments. If the national court has any real doubt, it should ordinarily refer.”

- (4) Sir Thomas Bingham referred, among other cases, to *CILFIT Srl v Ministro della Sanità* (C-283/81) where the Court of Justice recognised at [13ff] that no purpose might be served by the making of a reference where the question raised is materially identical to one that has already been the subject of a preliminary ruling in a similar case, or where previous decisions of the Court had already dealt with the point of law in question, even though the questions at issue are not strictly identical. The national court or tribunal may also take the view that the correct application of EU law is so obvious (*acte clair*) as to leave no scope for any reasonable doubt as to the manner in which the question is to be resolved; but in reaching such a view (and in so doing, refraining from submitting the question to the Court of Justice and taking upon itself the responsibility for resolving it) the national court or tribunal must have regard to the particular characteristics of EU law and the particular difficulties of its interpretation, which are summarised by Sir Thomas Bingham in *ex parte Else*. In particular, courts and tribunals should exercise great caution in relying on the doctrine of *acte clair* (*Bridport* at [33]), and in taking the view that the meaning of the English language version of an EU instrument is clear (*Henn and Darby v DPP* [1981] AC 850 at 906B per Lord Diplock).

- (5) In *The Littlewoods Organisation plc & others v Customs & Excise Commissioners* [2001] EWCA Civ 1542 the Court of Appeal said at [117] that

“a measure of self-restraint is required on the part of national courts, if the Court of Justice is not to become overwhelmed”

and drew attention to the remarks of Advocate General Jacobs in *Wiener SI GmbH v Hauptzollamt Emmerich* (C-338/95), where he urged self-restraint on national courts, in particular in cases where there was an established body of case law that might readily be transposed to the facts of the case, or where the question turned on a narrow point considered in the light of a very specific set of facts and the ruling was one that was unlikely to have any application beyond the particular case. It is worth noting however that the Court of Justice in *Wiener* did not follow the approach of the Advocate General (who had suggested that the Court should refer the case back to the referring court to determine the case itself), but proceeded to answer the question before it.

36. In applying these principles, I am satisfied that on each of the two issues which have been argued before me, the exclusivity issue and the categories issue, the answer depends on the interpretation of the Directive such that a decision on EU law is critical to the decision of this tribunal. The jurisdictional criterion is therefore satisfied.
37. And on neither issue do I consider that I can with complete confidence resolve the issue myself; nor do I consider that the answer is *acte clair*. Nor is this a case where there is an established body of case law that can easily be transposed to the facts of the case, or one where the question turns on a very narrow point dependent on a specific set of facts, where the ruling is unlikely to have any application beyond this case. On the contrary there appear to be no relevant decisions of the Court of Justice on the meaning and effect of Article 296.2; the answers to the issues are not (to my mind) obvious; and, taken together, they are likely to have a potentially significant impact on the compatibility of the UK’s Flat Rate Scheme, as currently designed and operated, with the provisions of the Directive.
38. I have therefore decided that it is appropriate to make a reference to the Court of Justice to seek preliminary rulings on both questions. The first question is whether Article 296.2 provides the exclusive basis on which a Member State may provide for the exclusion of farmers from the flat rate scheme. The second question, which only arises if the answer to the first question is Yes, is whether the decision by HMRC to exclude Shields can be justified on the basis of the exclusion of a category,

and whether the category suggested by HMRC (farmers who are found to be recovering substantially more as a member of the Flat Rate Scheme than they would if they were registered for VAT) is sufficiently precise to satisfy the principle of legal certainty and qualify as a category within Article 296.2.

Draft order for reference

39. I will invite the parties to agree a draft order and schedule specifying the precise questions to be asked of the Court of Justice, and otherwise satisfying the Court's requirements for a reference.
40. I will stay these proceedings for a period of 28 days from the date of the release of this decision to enable this to be done. If the parties are able to agree the terms of the draft order and schedule they should be lodged for the approval of the Tribunal. If they are unable to agree, the matter should be re-listed thereafter for further argument.



MR JUSTICE NUGEE

RELEASE DATE: 16 MARCH 2016