



29 July 2019

## PRESS SUMMARY

**Commissioners for Her Majesty’s Revenue and Customs (Appellant) v Frank A Smart & Son Ltd (Respondent) (Scotland)**

**[2019] UKSC 39**

*On appeal from [2017] CSIH 77*

**JUSTICES:** Lord Reed (Deputy President), Lord Wilson, Lord Hodge, Lord Briggs, Lady Arden

### **BACKGROUND TO THE APPEAL**

This appeal is concerned with the entitlement of a taxpayer to deduct input value added tax (“VAT”) and claim repayment of surplus input VAT. It concerns the interpretation of articles 167 and 168(1) of Council Directive (EC) 2006/112/EC of 28 November 2006 on the common system of value added tax (“the Principal VAT Directive”) and the case law of the Court of Justice of the European Union (“CJEU”) relating to those articles. In short, the question is whether a taxpayer can deduct as input tax the VAT which it has incurred in purchasing entitlements to an EU farm subsidy, the Single Farm Payment (“SFP”). The taxpayer has used those entitlements to annual subsidies over several years and intends to use money resulting from the receipt of those subsidies to fund its current and future business activities, which currently involve only taxable supplies.

Frank A Smart & Son Ltd (“FASL”) is a Scottish company which carries on a farming business in Aberdeenshire. FASL is wholly owned by Mr Frank Smart, who is its sole director. Mr Smart and his wife are the partners in a partnership which owns Tolmauds Farm, which it leases to FASL. FASL received SFPs from the Scottish Government. SFPs were agricultural subsidies which between 2005 and 2014 were paid to farmers who met certain requirements. When the scheme was initiated, farmers in the United Kingdom were allocated initial units of entitlement to single farm payments (“SFPEs”) for no consideration. The SFPEs were tradeable and a market in them developed. FASL took advantage of the market in SFPE units to accumulate a fund for the development of its business. It spent about £7.7m between 2007 and 2012 on purchasing 34,377 SFPE units in addition to its initial allocation of 194.98 units for Tolmauds Farm. In this period FASL paid VAT on the SFPE units which it purchased and it has sought to deduct or claim repayment of that VAT as input tax.

HMRC refused to allow FASL to deduct VAT of £1,054,852.28 in its returns between December 2008 and June 2012. FASL appealed to the First-tier Tribunal (“FTT”). The FTT allowed the appeal. The FTT found that, when it purchased the SFPE units, FASL intended to apply the income which it received from the SFPs to pay off its overdraft and to develop its business operations. FASL was also contemplating three principal developments of its business, including establishing a windfarm, constructing further farm buildings and purchasing neighbouring farms. Based on those findings, the FTT concluded that the funding opportunity afforded by the purchase of the SFPE units did not form a separate business activity of FASL but was “a wholly integrated feature of the farming enterprise”. HMRC appealed to the Upper Tribunal (Lord Tyre), which refused the appeal. HMRC appealed to the Inner House of the Court of Session. An Extra Division of the Inner House (Lord Menzies, Brodie and Drummond Young) dismissed the appeal. HMRC appealed to the Supreme Court.

### **JUDGMENT**

The Supreme Court unanimously dismisses the appeal. Lord Hodge gives the sole judgment with which the other Justices agree.

## REASONS FOR THE JUDGMENT

The Supreme Court considered the Principal VAT Directive [11-16], the Value Added Tax Act 1994 [17-19] and the relevant CJEU case law [25-64]. It derived the following propositions [65]:

- (1) As VAT is a tax on the value added by the taxable person, the VAT system relieves the taxable person of the burden of VAT payable or paid in the course of that person's economic activity and thus avoids double taxation.
- (2) There must be a direct and immediate link between the goods and services which the taxable person has acquired (in other words the particular input transaction) and the taxable supplies which that person makes (in other words its particular output transaction). This link gives rise to the right to deduct. The needed link exists if the acquired goods and services are part of the cost components of that person's taxable transactions which utilise those goods and services.
- (3) Alternatively, there must be a direct and immediate link between those acquired goods and services and the whole of the taxable person's economic activity because their cost forms part of that business's overheads and thus a component part of the price of its products.
- (4) Where the taxable person acquires professional services for an initial fund-raising transaction which is outside the scope of VAT, that use of the services does not prevent it from deducting the VAT payable on those services as input tax and retaining that deduction if its purpose in fund-raising, objectively ascertained, was to fund its economic activity and it later uses the funds raised to develop its business of providing taxable supplies. The same may apply if an analogous transaction involving the sale of shares is classified as an exempt transaction.
- (5) Where the cost of the acquired services, including services relating to fund-raising, are a cost component of downstream activities of the taxable person which are either exempt transactions or transactions outside the scope of VAT, the VAT paid on such services is not deductible as input tax. Where the taxable person carries on taxable transactions, exempt transactions and transactions outside the scope of VAT, the VAT paid on the services it has acquired has to be apportioned.
- (6) The right to deduct VAT as input tax arises immediately when the deductible tax becomes chargeable. As a result, there may be a time lapse between the deduction of the input tax and the use of the acquired goods or services in an output transaction. Further, if the taxable person acquired the goods and services for its economic activity but, as a result of circumstances beyond its control, it is unable to use them in the context of taxable transactions, the taxable person retains its entitlement to deduct.
- (7) The purpose of the taxable person in carrying out the fund-raising is a question of fact which the court determines by having regard to objective evidence. The existence of a link between the fund-raising transaction and the person's taxable activity is to be assessed in the light of the objective content of the transaction. The ultimate question is whether the taxable person is acting as such for the purposes of an economic activity. This is a question of fact which must be assessed in the light of all the circumstances of the case, including the nature of the asset concerned and the period between its acquisition and its use for the purposes of the taxable person's economic activity.

In light of the foregoing, the Court considers that FASL, when it incurred the costs of the SFPE units, was acting as a taxable person because it was acquiring assets in support of its current and planned economic activities, namely farming and the windfarm. On that basis, FASL was entitled to an immediate right of deduction of the VAT paid on the purchase of the SFPE units and is entitled to retain that deduction or repayment so long as it uses the SFPs which it received as cost components of its economic activities. Moreover, on the facts found, FASL does not carry out and does not propose to carry out downstream non-economic activities or exempt transactions. Therefore, no question of apportionment arises [68].

*References in square brackets are to paragraphs in the judgment.*

**NOTE:** This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at:

<http://supremecourt.uk/decided-cases/index.html>