TC04657

Appeal number: TC/2013/03851

Corporation tax – taxability of VAT repayment and associated simple interest – whether Shop Direct Group v HMRC decision correct in the light of EU law – whether VAT repayment and interest payment could be characterised, by virtue of EU law, as falling due under the English law of restitution – whether application of principles of restitution should prevent HMRC from recovering corporation tax referable to VAT repayment and interest – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

COIN-A-DRINK LIMITED **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
RUTH WATTS DAVIES

Sitting in public in the Royal Courts of Justice, Strand, London on 17-18 November 2014

David Southern QC instructed by BDO LLP for the Appellant

Rupert Baldry QC, Elizabeth Wilson and Nicholas Saunders instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns the ability of HMRC to impose a corporation tax liability on sums paid to the appellant by way of refund of overpaid VAT in the sum of £411,230 ("the VAT Repayment") and associated interest in the sum of £949,452.14 ("the Interest Payment").

2. The Interest Payment was calculated and paid as simple interest by HMRC purportedly pursuant to section 78 Value Added Tax Act 1994 ("VATA"). The appellant is claiming further interest on a compound basis of up to £7.1 million. That claim is currently stayed pending the final outcome of what is commonly called the *Littlewoods* litigation and therefore this appeal does not formally determine the liability of any such further interest to corporation tax.

3. It might be thought that these issues had been definitively resolved by the case of *Shop Direct Group and others v HMRC* [2014] EWCA Civ 255 (in relation to which the decision of the Court of Appeal is now final, save in respect of one issue that does not arise in this appeal). However, this appeal has been pursued entirely on the basis of EU law arguments that were not put forward to (nor, therefore, considered by) any of the First-tier Tribunal, the Upper Tribunal or the Court of Appeal in *Shop Direct*. Thus, it appears, these words of Henderson J in *Littlewoods Retail Limited and others v Revenue & Customs Commissioners* [2014] STC 1761 ("*Littlewoods 2*") at [65] were uttered prematurely when referring to the *Shop Direct* litigation:

> "The litigation has thus determined in HMRC's favour all of the points of principle relating to the taxability of the sums of principal and interest already paid."

The facts

4. The relevant facts were agreed, and the bulk of the hearing was devoted to legal argument on the basis of those facts. We heard no live evidence, and the bundle of documents before us mainly comprised the correspondence between the parties and the appellant's accounts and tax computations for the relevant years. A statement of agreed facts was submitted to us, which read as follows:

> "1. At all material times (including the period 1973-1984) Coin-a-Drink Limited ("CAD") carried on a trade of operating full service automatic food beverage and snack vending machines.
>
> 2. By letter dated 26 March 2009 CAD made a voluntary disclosure claim under section 80 Value Added Tax Act 1994 ("VATA 1994") for repayment of amounts overpaid by way of output tax on supplies of hot drinks up to 1 May 1984. The claim related to *Compass Contract Services UK Ltd* [2006] EWCA Civ 730.

3. On or about 22 September 2009 CAD received confirmation from HMRC that its claim for repayment of amounts overpaid by way of VAT of £411,230 had been accepted, and that statutory interest arising under s 78 VATA 1994 had been calculated in the sum of £949,452.14 (making a total sum payable of £1,360,682).

4. CAD recognised the repayments in respect of amounts overpaid by way of VAT in its profit and loss account for the period ended 31 July 2010 in accordance with GAAP, disclosed separately as other income and shown below operating profit.

5. CAD recognised the interest payable under s 78 in its profit and loss account for the period ended 31 July 2010 in accordance with GAAP, disclosed separately as other income and shown below operating profit.

6. Note 2 to CAD's financial statements reads:- "2 Exceptional Items On 29 September 2009 the company received £1,360,682 net of expenses of £204,102 (2009 - £90,965) from HMRC in respect of a VAT reclaim relating to sales of hot drinks in the period 1973-1984 This income has been treated as non taxable."

7. The amounts overpaid by way of VAT were excluded from CAD's profit and loss account for the periods in respect of which the overpayments were made (i.e., 1973-1984).

8. The overpayments were made in the course of CAD's trading activities during 1973 to 1984.

9. CAD has made a claim against HMRC for compound interest in respect of a total VAT repayment of £411,229.89 (Claim No 1BM30048). The claim was issued on 28 January 2011 in the High Court of Justice (Birmingham District Registry). Paragraph 13 of the Particulars of Claim records that the Appellant "was prepared as an interim measure to accept a payment of statutory interest calculated in accordance with section 78… in partial satisfaction of their entitlement on a compound basis". The Claim includes the amounts at issue in this appeal.

10. CAD's tax return and computation for this period were filed with HMRC on 2 February 2011. HMRC opened an enquiry into this period on 20 May 2011. HMRC closed this enquiry on 22 January 2013. The company formally appealed against this closure notice on 1 February 2013 and a statutory review of HMRC's decision was undertaken by HMRC's appeals and reviews team. This review was completed on 3 May 2013. The company appealed to the First-tier Tribunal on 28 May 2013."

5. By way of supplement to paragraph 1 of the above statement, a little more background to the business of the appellant was included in an "appellant's statement of case" that was submitted in November 2013 to particularise the very broad grounds of appeal that had been set out in its original notice of appeal. The extra information

set out there does not affect the crucial facts, but will assist the reader in understanding the background:

> "The Company is a well-established business which has been operating in the same trade since 1966. The principal activities of the Company comprise the operation of full service automatic food, beverage and snack vending machines ('UPOS'). The Company's accounting reference date is 31 July.
>
> For many years all sales made through vending machines, whether of hot or cold food, or of tea or coffee, were treated as liable to VAT at the standard rate. This was because the supplies in question were thought to be made in the course of catering. In *Compass Contract Services UK Limited* [2006] STC 1999 it was held that supplies of cold prepared food from retail outlets were not made in the course of catering, but were simply zero-rated supplies of food. The Commissioners' response to this decision was set out in Business Brief 12/06 [2006] STI 2126.
>
> Tea and coffee supplies were standard rated from 1 May 1984. All the Company's sales cold food sales *[sic]* from vending machines should accordingly have been zero-rated rather than standard rated, as should tea and coffee sales up to 1 May 1984. Accordingly the Appellant had a right to recover overpaid VAT in respect of:
>
> (1) cold food from 1973 to 4 December 1999;
>
> (2) tea and coffee from 1973 to 30 April 1984."

6. We also note that in the appellant's original letter of claim dated 26 March 2009 (submitted on its behalf by its accountants), the appellant's claim was stated to take the form of a "voluntary disclosure claim for a repayment of output VAT… which has been overpaid", together with a claim for compound interest, in respect of which any payment of interest "calculated in accordance with section 78 VATA 1994" would be accepted "in part satisfaction".

The issues

7. The parties were agreed that if considered solely in the light of UK law, the appeal must fail (following the various decisions in *Shop Direct*). The dispute centred on the impact, if any, of the application of EU law principles to the facts of the case.

8. The essential argument of the appellant was described by Mr Southern to be "in summary" as follows:

> "The payments which the Company has received, and whose taxability is in issue in this appeal, are made under a statutory scheme. That statutory scheme is made to implement a mistake-based restitutionary principle established by EU law. It is a basic of the law of restitution that the party unjustly enriched should disgorge all the benefits which he has received. Where the enrichee is the State, the State cannot give back 100 and then recover 25 through taxation. This is to confuse

> damages and restitution. You cannot give with one hand and take back with the other. You cannot approbate and reprobate. That is fundamental to the law of restitution, and is expressive of a wider legal principle… Insofar as UK law produces a different result, it must be disapplied."

Submissions of the parties

Introduction

9. The appellant's skeleton argument ran to 53 pages, the respondents' comprising a more moderate 17 pages. Much of the appellant's skeleton argument was unnecessary, in that it covered ground which was not disputed and which could have been omitted or dealt with far more briefly had the appellant made greater efforts to particularise its grounds of appeal in the first place, thus allowing the dispute between the parties to be narrowed down. The original notice of appeal set out the purported grounds of appeal in broad and general terms in just 67 words, and whilst HMRC did their best to address the perceived grounds of appeal in their statement of case, they also (quite properly) requested a more detailed particularisation of the appellant's case. When the appellant then delivered its own statement of case, it only did so on what was still, in effect, an indicative basis. The detailed areas of dispute between the parties therefore only became clear at the hearing.

Submissions of the parties

10. In his skeleton argument on behalf of the appellant, Mr Southern identified six issues in this appeal:

(1) Is EU law engaged?

(2) What is the EU law remedy for sums paid in error as tax?

(3) What remedy does UK law provide for tax paid in error?

(4) What is the relationship between EU law, the statutory scheme and common law remedies?

(5) Would the imposition of the charge to corporation tax on these payments involve a breach of EU law?

(6) Do different considerations apply to the interest element?

11. We consider the respective submissions of each party in turn under these six headings.

Issue 1 – Is EU law engaged?

12. Mr Southern argued at some length that EU law was engaged in the present case, but as Mr Baldry did not disagree on the point, we consider his submissions no

further. As previously mentioned, this was a line of argument that was not raised at all in *Shop Direct*.

13. The real dispute was not whether EU law was engaged, but as to the effect of such engagement; we examine below the differences between the parties on the specifics.

Issue 2 - What is the EU law remedy for sums paid in error as tax?

14. Mr Southern referred to the leading ECJ case of *Amministrazione delle Finanze dello Stato v SpA San Giorgio* (Case 199/82) [1983] ECR 3595, in which it was pointed out (at paragraph [12] of the Court's decision) that:

> "… entitlement to the repayment of charges levied by a Member State contrary to the rules of Community law is a consequence of, and an adjunct to, the rights conferred on individuals by the Community provisions prohibiting charges having an effect equivalent to [the relevant duties] or, as the case may be, the discriminatory application of internal taxes."

15. He went on to submit, with reference to the Supreme Court decision in *Test Claimants in the FII Group Litigation v HMRC* [2012] STC p1362 ("*FII SC*") (at [26]) that the taxpayer's right was "a restitutionary right":

> "It is now clear that, apart from any possible claim for damages, the claims to be met by … HMRC … are restitutionary in nature.."

16. As was identified by the Advocate General in the following passage from the ECJ case of *Metallgesellschaft Ltd and others v IRC* [2001] STC 452 (at [45]) there is, he submitted, a principle which underlies the requirement for states to repay charges levied in breach of EU law:

> "The notion underlying this principle is that a member state must not profit – and an individual who has been required to pay the unlawful charge must not suffer loss – as a result of the imposition of the charge."

17. The precise extent of the taxpayer's rights under this principle has not been the subject of detailed definition by the ECJ, which in general limits itself to broad statements of principle on the point. The position however has, he submitted, been succinctly summarised by Chadwick LJ in *Sempra Metals Limited v Commissioners of Inland Revenue* [2005] STC 687 at [25]:

> "First, the national court is required to give a remedy, whether by way of restitution or as compensation, in respect of the breach of Community law. It is not open to the national court to deny restitution or compensation on the ground that no remedy would lie under domestic law. If necessary, Community law demands an autonomous remedy in respect of the breach of Community law which has occurred. Second, *the remedy to be given by the national court must be a "full"*

> *remedy; in the sense that it must be such as will restore the equality of treatment guaranteed by article 52 (now article 43) of the EC Treaty. Nothing less will do*. A full remedy for the loss of the use of money over a specified period may be measured by reference to the interest "accrued" on the amount of the tax paid prematurely. But it is important to keep in mind that there is no true analogy with the award of interest on a domestic judgment. The task of the national court is to ascertain the amount which the member state must pay to the claimant in order to restore the claimant to the position that it would have been in if it had not been required to pay an amount of corporation tax prematurely." *[Emphasis added]*

18. Mr Southern acknowledged that it was a matter of domestic UK law as to how the EU law right was delivered, subject only to the two EU law principles of "equivalence" and "effectiveness". The meaning of these two principles was summarised by Lord Sumption in *FII SC* at [146] as follows:

> "… national legal systems should provide a minimum standard of protection for EU law rights. In the case law of the Court of Justice, the standard of protection required is embodied in two principles which are restated in almost every decision on the point. First, the substantive and procedural provisions of national law must be effective to protect EU law rights (the 'principle of effectiveness'). Their enforcement in national law must not be subject to onerous collateral conditions or disproportionate procedural requirements. They must not render 'virtually impossible or excessively difficult' the exercise of rights conferred by EU law. Secondly, the relevant provisions of national law must not discriminate between the rules and procedures applying to the enforcement of EU law rights, and those applying to the enforcement of comparable national law rights ('the principle of equivalence')."

19. We would observe that it is perhaps misleading to talk in terms of EU law "remedies". Taxpayers undoubtedly have EU law rights, and those rights can only be given effect to by means of remedies. But the remedies themselves are provided by domestic law.

20. Beyond observing that neither *San Giorgio* nor any of the other ECJ cases said anything to suggest that a *San Giorgio* repayment should be exempt from tax, Mr Baldry did not appear to disagree significantly with Mr Southern's analysis on the second issue.

Issue 3 – What remedy does UK law provide for tax paid in error?

21. Mr Southern submitted that domestic law provided three potential remedies in the present case by virtue of (a) the statutory provisions in VATA, (b) a common law claim for restitution on what is commonly called the "*Woolwich* basis" (referring to the House of Lords decision in *Woolwich Equitable Building Society v IRC* [1993] AC 70) and/or (c) a common law claim for what is commonly known as "mistake-based restitution" (following the House of Lords decision in *Deutsche Morgan Grenfell Group plc v IRC and the Attorney General* [2006] UKHL 49, [2007] STC 1

("*DMG*")). Under domestic law the appellant would, he submitted, be entitled to elect which remedy it wished to pursue.

22. Mr Baldry did not substantially dispute this as a general statement of the potentially available remedies in respect of overpaid tax (and indeed, he would have added to the list a possible claim for damages under the principle established by the ECJ in *Andrea Frankovich and another v The Republic (Italy)* (cases C-6/90 & 9/90) [1993] 2 CMLR 66, though the parties were agreed such a claim would not be available in this case) but submitted that as a matter of fact, the tax repayment and interest payment relevant to this appeal were both made pursuant to the statutory provisions. In particular, section 80 VATA provided a complete, exhaustive and EU law compliant remedy to recover the overpaid VAT and whatever the position might be in relation to the appellant's compound interest claim, the Interest Payment at issue in this case had been specifically made pursuant to section 78 VATA.

Issue 4 – The relationship between EU law, the statutory scheme and the other UK remedies

23. Mr Southern described this relationship as "conglomerate". It is clear that the domestic law must comply with EU law, and he referred us to a number of cases in which elements of the UK statutory code had been disapplied in order to provide an EU law compliant remedy. As issue 5 effectively turns to consider the practical consequences in the light of the general principles which he argued emerged from those cases, it is more appropriate to consider the effect of both parties' submissions under the two issues together, which we do below.

Issue 5 – Would the imposition of corporation tax on these payments breach EU law?

24. Mr Southern submitted that, as a matter of general principle, a taxpayer in the appellant's position had three potential domestic law remedies available to it to recover the overpaid tax and interest and, as a matter of both EU and domestic law, it could choose whichever of those remedies suited it best (see issue 3 above).

25. In the present case, the appellant wished to rely on its "mistake-based" restitution claim, both in relation to the VAT Repayment itself and in relation to the Interest Payment.

26. Under domestic law, section 80(7) VATA 94 would prevent it from doing so in relation to the VAT Repayment, by excluding any claim for repayment outside the statutory code contained in section 80.

27. However, a number of cases had made it clear that section 80(7) was, by virtue of the operation of EU law, to be disapplied in situations such as this. He referred in particular to *Investment Trust Companies (in liquidation) v HMRC* [2012] EWHC 458 (Ch), [2012] STC 1150 (at [146]) and *Littlewoods 2* at [341].

28. It was also clear that, once section 80(7) was disapplied, EU law required the full range of domestic law remedies to be available to a taxpayer in the appellant's position; by reason of the principle of equivalence, it was not permissible for domestic

law to limit the taxpayer to less than the full range of remedies that would be open to it in respect of a purely domestic claim. Here he referred to *FII SC* and the associated ECJ case of *Test Claimants in the FII Group Litigation v Revenue & Customs Commissioners* [2014] STC 638 (Case C-362/12).

29. It followed that the appellant was entitled, as a matter of EU law, to recover under the domestic general law of restitution (in this case, for mistake-based restitution following *DMG*); and it was a central principle of that law that the unjustly enriched party must disgorge all benefits it had obtained in consequence of the unjust enrichment. In the present case, HMRC would not be disgorging all the benefit they had obtained if they then sought to impose a corporation tax liability on either the VAT Repayment or the Interest Payment. Further, if HMRC took back corporation tax on the payments made by them, that would amount to a breach of the EU law principle of effectiveness, as the appellant would end up with less than the "adequate indemnity" required under EU law. Whilst he acknowledged this might be seen as something of a windfall for the appellant, that was simply the result of the way EU law interacted with domestic law in this case.

30. Mr Baldry argued that the VAT Repayment and the Interest Payment which were the subject of this appeal arose from simple statutory claims. It was not open to the appellant to "dress them up" as claims in restitution in order to invest them with any extra advantages that such claims might carry. He accepted that the appellant's compound interest claim was restitutionary at common law, but he maintained that did not affect the statutory nature of the VAT Repayment and the Interest Payment. The various systems were not capable of merging and it was necessary to respect the actual category into which any particular claim fell.

31. There was, he submitted, no EU law requirement in this case to disapply sections 78 and 80 VATA. As to the repayment of the overpaid VAT, section 80 VATA provided exactly what EU law required. As to the payment of interest, it was apparent (subject to the final outcome of the *Littlewoods* litigation) that the effect of the EU law requirement for an "adequate indemnity" would mean that the statutory interest payment under section 78 VATA may be found to be inadequate. This would mean the appellant would have further rights in restitution but this did not affect the fact that the interest payment which was the subject of this appeal was, in his submission, as a matter of fact a payment of statutory interest pursuant to section 78 VATA.

32. It followed that the various submissions that Mr Southern had made about the effect of the law of restitution were entirely irrelevant.

33. He went on to submit, however, that even if it were accepted that the VAT Repayment and both parts of the interest claim resulted (or could be characterised as resulting) from claims under the English law of restitution, the position would still be the same. Essentially this was because if the VAT had never been overpaid, the amount of the appellant's taxable profits at the time would have increased by the amount of the overpayment, and that increase would indisputably have been subject to normal corporation tax. Effectively, therefore, the imposition of corporation tax now

did not represent a retention of part of the benefit HMRC had wrongfully obtained, rather it simply represented a somewhat delayed working through of the normal rules. *Shop Direct* had established that the corporation tax liability arose as a matter of domestic law, and there was nothing in any of the EU law principles which required the domestic law to be overridden. A similar argument would apply in relation to the taxation of interest – because the appellant had lost interest as a result of the overpayment, it should receive interest to compensate for that loss; and since the "lost" interest would have been taxable in the hands of the appellant, there would be no retention of benefit by HMRC in taxing the interest actually paid.

Issue 6 – Do different considerations apply to the interest element?

34. As the parties both ultimately agreed that the same considerations should apply to the taxability of the profit arising from the VAT Repayment itself and of the associated interest, it is not necessary to summarise the arguments under this heading.

Discussion and decision

The issues

35. We are being asked to decide whether EU law principles affect the clear rulings which have been given in *Shop Direct* as to the UK corporation tax liability arising from repayments of VAT and associated interest.

36. It is agreed that EU law arguments were not advanced before the tribunals or the Court of Appeal in that case and in reaching our decision we are therefore not bound by the decisions of the Upper Tribunal and the Court of Appeal.

37. Essentially, we are being asked to determine two issues:

(1) The first is as to the true legal character, under domestic law (as applied in accordance with EU law) of the VAT Repayment and Interest Payment, i.e. whether they should be regarded as having been made (a) pursuant to rights conferred by statute or (b) pursuant to rights in mistake-based restitution (any *Woolwich* restitution claim having become long since time-barred).

(2) The second is whether, if we find any part of them to have been the latter, HMRC should consequently be precluded from recovering corporation tax on (a) the additional profit arising from the VAT Repayment or (b) the Interest Payment.

38. We address these two issues in turn. Whilst we are not directly concerned with the taxability of any further interest the appellant might receive pursuant to its compound interest claim, that claim forms an important part of the background to the present appeal. We therefore consider it important that any decision in this appeal should be consistent with our view on the taxability of anything received pursuant to that claim.

Were the payments statutory or restitutionary?

Preliminary observations

39. It is clear that EU law does not lay down any requirements in this area. As the ECJ said in *Metallgesellschaft* at [81]:

> "it is not for the court to assign a legal classification to the actions brought by the plaintiff before the national court"

40. The use of the word "restitutionary" by Lord Walker in *FII* (see [15] above) should not be allowed to confuse matters; it must be remembered that in *FII*, there were no statutory provisions for the taxpayers to rely on and therefore their claims had to be framed in restitution. That does not mean that all claims for tax and/or interest are restitutionary.

41. This is an illustration of the confusion that can arise, when seeking to derive the correct principles from the reported cases, as a result of the different underlying subject matter of those cases. In some cases, the claim has been for repayment of tax overpaid or paid prematurely (generally, together with interest); in others, where the fact of overpayment has been agreed, the claim has simply been for interest. It is a truism to observe that the decision of the court must in each case be set in its proper context, but there has been a tendency (which must be resisted) to generalise the conclusions to be reached from points decided in particular contexts.

42. With those preliminary comments in mind, we consider it appropriate to consider separately in this decision the analysis applying to the VAT Repayment and that applying to the Interest Payment.

The VAT Repayment

43. As has been made clear by the courts on a number of occasions (most recently by the Court of Appeal in *Littlewoods Limited and others v The Commissioners for Her Majesty's Revenue & Customs* [2015] EWCA Civ 515 ("*Littlewoods CA*"), decided after the hearing of this appeal), as a matter of pure domestic law, section 80 VATA provides (by reason of section 80(7)[1]) an exhaustive and exclusive code governing the repayment of overpaid VAT. As was said in *Littlewoods CA* at [31]:

> "There can be no doubt that section 80 provides an exclusive statutory scheme which deals specifically with the case where a taxpayer claims repayment of tax which is not due…. The liability to repay imposed on HMRC by section 80(1) is to the exclusion of any other liability 'to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them': section 80(7). The net effect of these provisions is that the only cause of action available to the taxpayer

[1] Section 80(7) provides: "Except as provided by this section, the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them."

> for the repayment of the principal sums is that afforded by section 80(1)."

44. It has been made equally clear, however, that in certain circumstances this apparent exclusiveness is overridden (and section 80(7) is consequently disapplied) as a result of the requirements of EU law.

45. Most recently, this has occurred in *Littlewoods CA*, where the Court of Appeal was considering the taxpayer's claim for compound interest (there being no dispute about the repayment of overpaid VAT, which had already been made). After holding that sections 78 and 80 VATA 94 "have to be construed as a consistent code", the Court held (at [118]) that:

> "The accommodation of Littlewoods' EU claims has therefore to be advanced through the disapplication of sections 78(1) and 80(7) VATA 1994."

46. It is important to remember, however, that any such disapplication is specific to the situation in which it is effected. In *Littlewoods* the claim being considered was purely in respect of interest, nonetheless the Court of Appeal considered that because of the interaction between the scope of that claim (as required under EU law) and the structure of the available remedies under domestic law, the only way to accommodate it was by disapplying both section 78(1) and section 80(7) VATA 94. We agree with Mr Baldry however that no such disapplication is required in order to provide a taxpayer such as the appellant with a simple right to repayment of overpaid VAT which is compliant with EU law requirements as set out in *San Giorgio* and subsequent cases. We therefore consider that no right exists, taking account of the requirements of EU law, to characterise the VAT Repayment as having been made to satisfy a liability for mistake-based restitution, whether or not the existence of such a liability would carry the wider benefits argued for by Mr Southern. We therefore hold that the VAT Repayment was made solely pursuant to the statutory provisions of section 80 VATA and the appellant's repayment claim cannot be characterised as a claim in mistake-based restitution.

The Interest Payment

47. It is clear a "full" remedy for overpayment of tax includes not only the repayment of the tax itself but also compensation for the loss of use of the overpaid tax while it was incorrectly held by the state. The various stages of the *Littlewoods* litigation (most recently the judgment of the Court of Appeal in *Littlewoods CA*), have explored the implications of this requirement at some length, and have also given birth to the phrase "adequate indemnity" as a description of what the ECJ considers to be required "for the loss occasioned through the undue payment of VAT" (at [29] of the ECJ decision in *Littlewoods Retail Limited and others v Revenue & Customs Commissioners* [2012] STC 1714, Case C-591/10 ("*Littlewoods ECJ*")).

48. We recognise that the full scope of the *San Giorgio* remedy (as the ECJ itself said in *Littlewoods ECJ* at [26]) is to "repay with interest amounts of tax levied in breach of EU law". As Henderson J observed in *Littlewoods 2* (at [287] and [291]),

the right to interest representing an "adequate indemnity" is "derived from, and protected by, EU law" and "ranks equally with the right to repayment of the unlawful tax itself".

49. In *Littlewoods ECJ* at [34] the ECJ said there is no general EU law rule that more than simple interest is required to satisfy a taxpayer's rights:

> "It is for national law to determine, in compliance with the principles of effectiveness and equivalence, whether the principal sum must bear 'simple interest', 'compound interest' or another type of interest."

50. Following the ECJ's decision, however, Henderson J in *Littlewoods 2* at [302] interpreted the ECJ's ruling as requiring:

> "payment of an amount of interest which is broadly commensurate with the loss suffered by the taxpayer of the use value of the tax which he has overpaid, running from the date of payment until the date of repayment."

51. On assessing the level of loss actually suffered by the taxpayer in that case, in order to determine whether the simple interest which had actually been paid met this requirement, Henderson J accepted the taxpayer's calculations of its loss (which were based on the government's, rather than the taxpayer's, cost of borrowing – a basis which he appears to have agreed was not "conceptually the correct one", but which was the basis claimed by the taxpayer and clearly resulted in a lower figure). Even after taking account of the extra corporation tax which the taxpayer would have paid if it had not overpaid the VAT, it was clear that the total cost of borrowing saved by the government as a result of the overpayment was at least some £430 million more than the simple interest paid (of some £268 million). Accordingly, he held, "the simple interest paid could not, on any view, have provided the claimants with an adequate indemnity for their loss, and I would hold accordingly".

52. The Court of Appeal in *Littlewoods CA*, in upholding Henderson J, appear to have accepted (at [107]) his view that "the compensation must be broadly commensurate with the loss of the use value of the overpaid tax"; as HMRC had not sought to argue that simple interest satisfied this requirement, it followed that Henderson J had been correct. The Court was however anxious to emphasise that each case had to be examined individually, applying the ECJ's test and that "the conclusions we have reached are those which apply in the circumstances of this case".

53. The difficulty to be faced in the present case is that it has not yet been decided whether the simple interest comprised in the Interest Payment represents an "adequate indemnity" as that phrase has been interpreted by the courts in *Littlewoods 2* and *Littlewoods CA*. It is true that the appellant's claim for compound interest (as appears from the claim form included in our bundle) amounts to some £8 million (applying annually compounded interest at 3% over bank base rate, said to represent the appellant's cost of borrowing over the relevant period) or some £4.5 million (applying annually compounded interest at 1% over bank base rate, said to represent the government's cost of borrowing over the same period) and at first sight the

comparison of either sum with the £950,000 of simple interest actually paid to date would appear to suggest that simple interest would not represent an "adequate indemnity" in the present case, any more than it did in *Littlewoods* (where the simple interest paid was some £268 million and the compound interest claimed was at least an additional £430 million); but that point has not yet been decided, indeed it is not a matter over which this Tribunal even has jurisdiction, nor has the Court of Appeal given any general guidance on how it is to be decided in any particular case.

54. Why should this matter? Our concern is that:

(1) if the Interest Payment already made is found to represent an "adequate indemnity", then there is no warrant for regarding section 78 VATA as being disapplied in relation to the appellant's overall claim for interest. In that case, the decision of the Court of Appeal in *Littlewoods CA* makes it clear that the (simple) interest paid could only be regarded as having been paid pursuant to the exclusive statutory scheme set out in section 78 VATA, thereby negating any suggestion that it should be invested with the further benefits of a mistake-based restitutionary claim as argued by Mr Southern; whereas

(2) if the Interest Payment already made is <u>not</u> found to represent an "adequate indemnity", then the Court of Appeal decision in *Littlewoods CA* (at [118]) makes it clear that the accommodation of the appellant's "EU law claims" (remembering that the claim in that case was for interest only, the overpaid VAT having already been repaid) would have to entail the disapplication of sections 78(1) and 80(7) VATA, thus allowing those claims to be characterised as mistake-based restitution claims. In such a situation, we do not see how it would be possible to treat the "simple interest" element of the claims (which are the subject of this appeal) differently from the compound interest element; as we read it, the decision of the Court of Appeal must mean that the whole of the interest claim is <u>either</u> satisfied by a payment of simple interest (in which case the whole interest payment can only be regarded as exclusively statutory in nature – see (1) above) <u>or</u> it can only be satisfied by a payment of something more (in which case the whole claim, including any simple interest paid "on account" and purportedly pursuant to section 78 VATA, must be characterised as having the legal status of a mistake-based restitution claim).

55. In passing, we also note that in *Littlewoods CA* the Court was quite clear that it was possible to characterise a VAT repayment claim as purely and exclusively statutory in nature, whilst also characterising an associated interest claim (including compound interest) as restitutionary – see [42] and [43] in *Littlewoods CA*.

56. We consider it is likely, on the current state of the law, that the simple interest already paid (the corporation tax treatment of which is a subject of this appeal) would be found <u>not</u> to represent an "adequate indemnity" and accordingly (as set out at [54(2)] above) it could be regarded as having the legal status of a mistake-based restitution claim. But that is not an issue which this Tribunal has jurisdiction to decide. We must therefore address both possibilities.

Classification of the claims - summary

The VAT Repayment

57. We have held (see [46] above) that the VAT Repayment was made entirely pursuant to statute and is not capable of being characterised as the payment of a "mistake-based" restitution claim. It therefore follows that it cannot have the advantages of such a claim which are argued for by Mr Southern. The appellant's entitlement in respect of it is exclusively governed by statute and it has no right to the disgorgement of any other benefit accruing to HMRC by reason of it. In particular, to the extent that payment of corporation tax by reference to the VAT Repayment might be regarded as a benefit to HMRC, they are under no obligation to disgorge that benefit. In other words, the decision in *Shop Direct* remains unaffected by the application of EU law.

58. In case we are wrong in that conclusion, however, we go on to consider below the implications of a finding that any part of the appellant's claim can properly be classified as a "mistake-based" restitution claim (see [62] *et seq*).

The Interest Payment

59. We have held (see [56] above) that we are unable to say definitively whether the Interest Payment can be characterised as a payment in respect of a "mistake-based" restitution claim. It is fair to say that, on the current state of the authorities, it would appear more likely than not that it can be so characterised, but for the reasons set out above it is not possible to be definitive on the point unless and until it has been formally decided whether or not the Interest Payment represents an "adequate indemnity" for the losses constituted by the unavailability to the appellant of the VAT it had overpaid.

60. Clearly, if it is in fact decided that the Interest Payment did provide the appellant with an "adequate indemnity", then there would be no warrant in EU law for characterising what the Court of Appeal has found in *Littlewoods CA* to be (as a matter of domestic law) an exclusively statutory claim to interest as a claim in mistake-based restitution. It would therefore follow that it could not have the advantages of such a claim which are argued for by Mr Southern (see [54(1)]) and the appeal would accordingly fail insofar as it concerns the Interest Payment.

61. If, on the other hand (as appears more likely), it is decided that the Interest Payment did not provide the appellant with an "adequate indemnity", then we consider that EU law would, following the Court of Appeal's decision in *Littlewoods CA*, permit the appellant's interest claim as a whole (and not just a part of it) to be characterised as a claim in mistake-based restitution (see [54(2)]).

Consequences of categorising claims as being in mistake-based restitution

62. If any part of the VAT Repayment or the Interest Payment were properly characterised as arising from a mistake-based restitution claim, the question then arises: would HMRC thereby be prevented from recovering corporation tax on that

part by operation of the general principles of the domestic law of restitution (or indeed of the EU law principle of effectiveness)?

The VAT Repayment

63. Whilst we do not consider the point to be relevant in relation to the VAT Repayment (see [46] above), we address it in case we are wrong in that view. In spite of this it is more logical to consider the VAT Repayment before turning to the Interest Payment.

64. As regards the VAT Repayment, it is clear that if the VAT had not been overpaid in the first place, the amount which was in fact overpaid would have formed part of the appellant's taxable profit and would accordingly have been subject to corporation tax. When HMRC refunded the overpayment with a VAT Repayment which itself was subject to corporation tax in the same way, we agree with Mr Baldry that the state does not unjustly enrich itself at the expense of the appellant when that corporation tax liability falls due. Far from obtaining some further benefit which ought to be disgorged, it has finally obtained the corporation tax which would in any event have been accounted for at an earlier time if the original overpayment had never been made.

65. It might be considered relevant to know precisely what amounts of corporation tax would have been chargeable on the extra trading profits if the overpayments had never been made, in order to establish whether the corporation tax actually charged in respect of the VAT Repayment in 2009-10 was greater or less than would have fallen due in respect of the earlier years if the overpayments had never been made; if the corporation tax imposed on the 2009-10 repayment were higher than the tax that would have accrued on the extra profit in the earlier years, one might have expected there to be an argument that at least the excess represented a benefit which HMRC ought to disgorge. Neither party invited us to explore that avenue and we heard no evidence about the actual amounts of corporation tax which would have fallen due on the relevant taxable income over the period 1973 to 1984 if the overpayments had never been made; indeed (as can be seen from the similar exercise that was undertaken in *Littlewoods 2*) it may be difficult or even impossible to reach a clear answer on that point. The most we can say about it is that given the historic downward trend in corporation tax rates (from 52% in 1973 to 45% in 1984 and 28% in 2010), it would appear unlikely that the deferral of the charge would have prejudiced the appellant or benefited HMRC by increasing the effective rate of tax on the relevant amounts. In the absence of any argument or evidence to the contrary, therefore, we consider this point no further.

66. Thus the domestic law of restitution would not, in our judgment, entitle the appellant to relief from the corporation tax charge on the VAT Repayment.

67. Nor do we consider the EU law principle of effectiveness would assist it. We agree with Mr Baldry that the replacement of what would have been taxable trading income by a taxable repayment of VAT fully satisfies the requirements of that principle.

The Interest Payment

68. Both parties were agreed that if the Interest Payment (and, therefore, any further payment pursuant to the appellant's compound interest claim) was characterised as a claim in mistake-based restitution, then precisely the same arguments applied to its taxability under EU law as applied to the taxability of the VAT Repayment under that law.

69. In particular, if the function of the interest actually paid is to compensate for the loss of use of the overpaid VAT over the period of overpayment, then in considering the issue of unjust enrichment (i.e. whether the state would be unjustly enriched by subjecting the interest to corporation tax), both parties accepted that the interest actually paid effectively replaces the interest which would have been earned on the overpayments if they had been retained by the appellant and not wrongly paid over. If that interest had in fact been earned, it would indisputably have been taxable. We accept Mr Baldry's argument that the imposition of corporation tax in 2009-10 on interest which compensates for interest lost in earlier years (when it would have been taxable) cannot be regarded as a benefit which HMRC can be required to disgorge under the common law of restitution.

70. So far as the principle of effectiveness is concerned, we also agree with his submission that "the principle of effectiveness… requires that, because the taxpayer has lost interest, he should receive an award of interest to make up for that loss. Since the 'lost' interest would have been taxable in the hands of the taxpayer, an award of interest which is likewise taxable must satisfy the principle of effectiveness".

71. Thus we reach the same conclusion in relation to the Interest Payment as we would in relation to the VAT Repayment (if it were characterised as being made pursuant to a claim in restitution).

Summary and conclusion

The VAT Repayment

72. We have found that the VAT Repayment was made exclusively pursuant to section 80 VATA and cannot be characterised as payment in respect of a mistake-based restitution claim (see [46] above). Section 80 VATA provides a complete and EU law-compliant remedy to recover the overpayment of VAT.

73. Accordingly, no question can arise of the corporation tax liability on the VAT Repayment being removed by operation of the domestic law of restitution or of the EU law principle of effectiveness. The decision in *Shop Direct* therefore applies, notwithstanding the application of EU law principles.

74. If we are wrong in this and the VAT Repayment can be characterised as a payment in respect of a mistake-based restitution claim, then the result is, in our view, the same, for the reasons summarised under "Restitution and disgorgement" at [80] *et seq* below.

The Interest Payment

75. If the Interest Payment represents an "adequate indemnity" (and the appellant therefore has no entitlement to any further interest in respect of the overpaid VAT), then we have found that it was made exclusively pursuant to section 78 VATA and cannot be characterised as payment in respect of a mistake-based restitution claim (see [54(1)] above). Section 78 VATA would, in that case, be found to provide a complete and EU-law compliant remedy to compensate the appellant for the losses constituted by the unavailability of the overpaid VAT.

76. In that case, no question could arise of the corporation tax liability on the Interest Payment being removed by operation of the domestic law of restitution or of the EU law principle of effectiveness. The decision in *Shop Direct* would therefore apply, notwithstanding the application of EU law principles.

77. This Tribunal does not have jurisdiction to determine whether the Interest Payment represents an "adequate indemnity" as referred to at [53] above. That question will, if not agreed between the parties, be decided in the appellant's "compound interest" claim through the Courts.

78. We consider it likely, however, that the Interest Payment will be found not to represent an "adequate indemnity" as referred to above. In that case, we consider that the Interest Payment can properly be characterised (along with any further interest awarded in the compound interest claim) as arising from a mistake-based restitution claim (see [56] above).

79. As such, the general principles of the law of restitution would apply, requiring HMRC to disgorge all benefits accruing to them as a result of the overpayment.

Restitution and disgorgement

80. On a proper analysis of the requirement to disgorge benefits, however, we do not consider that it would extend to include the cancellation or disapplication of the corporation tax liability which would otherwise arise in connection with the VAT Repayment or the Interest Payment (or, indeed, in connection with any further interest paid pursuant to the appellant's compound interest claim). The same applies to the operation of the EU law principle of effectiveness. See [66], [67] and [71] above.

81. It follows that there is no basis for the corporation tax liability referable to either the VAT Repayment or the Interest Payment (or indeed any further interest paid pursuant to the appellant's compound interest claim, even though such payments fall outside the scope of this appeal) to be disapplied.

82. The appeal is therefore DISMISSED.

83. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 06 OCTOBER 2015