Littlewoods v HMRC

[2015] EWCA Civ 515

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The Court of Appeal has upheld Littlewoods' claim for adequate indemnity by way of compound interest. HMRC however succeeded on Littlewoods' appeal against Vos J's earlier decision[1] that restitution claims are excluded by sections 78 and 80 Value Added Tax Act 1994 ("VATA"). This may be relevant to other claims for compound interest where High Court proceedings have not been issued.

Lady Justice Arden DBE, who gave judgment for their lordships dealt with a series of issue. The following is a summary of each of the issues and the Court's conclusion on each.

Issue 1: Are Littlewoods' restitution claims excluded by sections 78 and 80 of VATA 1994 as a matter of English law and without reference to EU Law?

Yes.

Issue 1 arose out of what was called the 'section 78(1) reservation'. That provides that interest is payable under s78 *"if and to the extent that [the Commissioners] would not be liable to do so apart from this section".*

Littlewoods sought to argue that its claim for compound interest by way of restitution was preserved by the section 78(1) reservation, without which section 78 would have set out an exclusive statutory regime for the payment of interest. The Court held that the section 78(1) reservation only preserves a 'liability to pay interest'. That would cover interest due under s84 VATA and s35A Senior Courts Act. The Court accepted that any claim for interest must be founded on the claimant's right to return of the principal sum, which arose exclusively under section 80 because of section 80(7) [36]. However, although *"all claims for repayment of wrongly paid VAT are claims under section 80(1), and will normally carry with them a restitutionary claim for interest, including compound interest"*, the related claim for interest falls within section 78 [43]. The restitutionary claim itself does not create a liability to pay interest. The interest reverses the *"benefit gained by unjust enrichment, which may be calculated by reference to interest rates. But it is strained use of language to describe this as a liability to pay interest"* [45] Effectively, the court is saying that, although in economic terms the reversal of the benefit may be akin to interest,

1. *Littlewoods Retail Ltd and others v Revenue and Customs Commissioners* [2010] EWHC 1071 (Ch); [2010] STC 2072

as it is not actually interest, strictly, it was clear that Parliament did not intend to include the restitutionary claim within the section 78(1) reservation. That may appear to be inconsistent with the Court's decision on 'objective use value'. However, *"if the section 78(1) reservation includes restitutionary claims for interest, section 78 would never apply"* [43].

A simpler way of putting the Court of Appeal's point is that section 78(1) was intended to ensure that all taxpayers had the same minimum entitlement to interest. Hence, it applies where the taxpayer's right or claim does not otherwise carry with it a right to interest. As restitutionary VAT claims are covered exclusively by section 80 (which does not provide for the award of interest), it follows that section 78 applies. That conclusion could not be avoided by elevating Littlewoods' claim into a distinct claim for the time value of the overpaid VAT.

Issue 2: If Littlewoods' restitution claims are excluded by sections 78 and 80 VATA 1994, is that exclusion contrary to EU law? Specifically, notwithstanding the right to interest under section 78 VATA 1994, does that exclusion violate the principle of effectiveness by depriving Littlewoods of an adequate indemnity for the loss occasioned through the undue payment of VAT?

The Court essentially answered both questions affirmatively so far as Littlewoods was concerned.

The wider application of this decision was qualified. Firstly, the 'adequate indemnity' the CJEU ruled had to be given was, the Court said *"not a rigid straitjacket and certainly does not go so far as to require compound interest in every case"* [108]. Secondly, *"whether s78 affords an adequate remedy for the losses occasioned to an individual taxpayer was not obvious and will, as the court [the CJEU] says at [30], depends on a consideration of "all the circumstances of the case""* [96].

Like Henderson J in the High Court, the Court of Appeal analysed developments in the CJEU in *Littlewoods* and later cases. The Court defined, by reference to authorities, the content of the EU law right to reimbursement. Firstly, it is a personal or private right [85]. Secondly, at [94] it said *"that it is now tolerably clear that EU law requires national law to reimburse the losses occasioned by the unavailability of money as a result of tax being levied unlawfully."* The Court added *"the use of the word "reimbursement" in [25] is, in our judgement, of great importance."* Thirdly, EU law does not merely require *"the provision of a remedy which meets the description "interest""* [95]. Fourthly, "the taxpayer is *"entitled to reimbursement... of amounts paid to the state or retained by it."* Fifthly, the principle of effectiveness is not complied with *"provided the resulting payment is not deprived of substance."* The national rules must not deprive the

taxpayer of an “adequate indemnity”. Sixthly, as stated above, what amounts to adequate indemnity will depend on all the circumstances of the case [96].

HMRC placed great reliance on paragraph [27] in the CJEU’s judgment, namely that ‘it is for the internal legal order of each Member State to lay down conditions in which such interest must be paid, particularly the rate of that interest and its method of calculation (simple or ‘compound’ interest)’ subject to the principles of equivalence and effectiveness. That, HMRC argued, gave national law ‘a wide margin of discretion or autonomy as to substance or procedure’. HMRCs’ argument went on to say that EU law requires the remedy of compensation for the unavailability of money. Simple interest provided that remedy. HMRC also placed reliance on the opinion of Advocate General Trstenjak and observations of the CJEU that the simple interest awarded to Littlewoods exceeded the principal amount repaid. At [99], the Court stated that HMRC misunderstood Littlewoods’ case. As Henderson J had stated, Littlewoods’ case was not that EU law always requires the payment of compound interest but “rather that interest reflecting the use value of the money received”. The principle of effectiveness required the court to establish the entitlement in principle, but left the national court “to apply it in varying factual circumstances of each case. At [100] Arden LJ said:

> *“[27] of the court’s judgment is therefore doing no more than pointing out that it is for the national court to decide on a way of working out the award – the method of calculation. Simple interest at an appropriate rate may well be a satisfactory way of arriving at an adequate indemnity in many cases, with higher rates being necessary for longer periods. The difference between simple and compound interest, moreover, only starts to emerge once several years are involved, particularly where rates are low. It is for the national court to do the arithmetic.”*

At [102] Arden LJ added

> *“Once one appreciates from [25] that the content of the right is reimbursement of the losses sustained by the unavailability of money, a formulation which is echoed in [29], the argument that [27] is concerned in any way with modifying the content of the right falls away. HMRC’s argument therefore places weight on [27] which it cannot properly bear.”*

The Court would only go so far as to say that “adequate indemnity” did not have the meaning contended for by HMRC [107]. The court also emphasised that its conclusions only apply to circumstances of Littlewoods’ case.

The Court helpfully defines the content of the EU right to reimbursement. However, the wider application of that right will turn on the facts of each case.

Issue 3: If issues 1 and 2 are answered in the affirmative:

> ***(A) Can sections 78 and 80 of VATA 1994 be construed so as to conform with EU law (and if so how), or must they be disapplied?***
>
> ***(B) If section 78 and 80 VATA 1994 must be disapplied, must they be disapplied so as to allow only Woolwich-type restitution claims, or (b) both Woolwich-type restitution claims and mistake based restitution claims?***

The Court concluded that sections 78 and 80 VATA could not be construed to conform to EU law, so they had to be disapplied. Once disapplied that permitted both *Woolwich* and mistake based restitution claims to be made.

By issue 1, the Court had held that claims for restitution were excluded by sections78 and 80. Issue 2 confirms that a taxpayer has an EU law right to an adequate remedy. Issue 3 is effectively concerned with how the EU law right is given effect in national law.

In order to invoke their EU law rights, taxpayers need a cause of action. That cause of action may lie in statute or common law. The arguments for a conforming construction sought to place the cause of action in s78. In other words, they sought to invoke the EU law right through s78. The court rejected that contention, saying:

> *"... the statutory bar in VATA 1994 to common law claims for compound interest stems from section 80(7) whether one adopts the first or the second approaches to construction we have set out in relation to issue 1. Even if section 80(7) does not have the effect of removing Littlewoods' cause of action in restitution for interest, it does have an obvious impact on the construction of section 78(1) in terms of whether it should be treated as an exhaustive remedy. The two sections have to be construed as a consistent code. Looked at in this way, it is difficult to treat the exclusion of the common law claims for interest as anything but a cardinal feature of the legislation and, in our view, the conforming construction suggested by Mr Elliott does go against the grain. The accommodation of Littlewoods' EU claims has therefore to be advanced through the disapplication of sections 78(1) and 80(7) VATA 1994."* [118]

The court started on issue 3B by stating that *"under domestic law a claimant is entitled to pursue at his own election whatever causes of action are available to him in order to obtain the relief he seeks"* [119]. Accordingly, once it was concluded that sections 78(1) and 80(7) were to be disapplied, Littlewoods had a choice as to how to invoke its EU law right. It had done so through

its restitutionary common law claims made in the High Court. There was no dispute that both *Woolwich* and mistake based claims were capable of providing "an appropriate measure of recovery to vindicate the taxpayer's *San Giorgio* rights" [120].

HMRC argued that the Court was not required to disapply sections 78(1) and 80(7) beyond the point of allowing Littlewoods to pursue their *Woolwich* claims. They relied on provisional support from Vos J's decision in *Littlewoods* (No. 1)[2]. However, following *FII (SC)* and *FII (ECJ) III*[3] the Court found that the law had developed such that once exclusionary provisions such as those in s78(1) and 80(7) had been disapplied, all applicable causes of action became available to taxpayers, which in this case were both *Woolwich* and mistake-based claims. The national court could not choose which of the two remedies should be provided [136, 142].

It is noteworthy that Littlewoods succeeded by reliance on the principle of effectiveness rather than the principle of equivalence. Although, on behalf of Littlewoods, it was argued that the principle of equivalence was engaged, that argument failed essentially because Littlewoods was not able to demonstrate discriminatory treatment. It was accepted that sections 78(1) and 80(7) apply indiscriminately to both domestic and EU law claims for repayment of overpaid tax [133], so the principle of equivalence did not assist Littlewoods. The principle of effectiveness required the *"court to disapply some rule of national law in order to give effect to the claimant's EU law rights"*[137]. The Court held that this engaged section 2(1) of the European Communities Act 1972 which

> *"...imposes on the court an obligation and gives it the power to enforce the relevant rights under EU law in priority to and notwithstanding any contrary provisions of domestic law. It therefore allows Littlewoods' San Giorgio rights to override sections 78(1) and 80(7) VATA 1994 but it does not prescribe how the courts applying domestic law are to give content to those rights. That is done by applying (so far as necessary) the principles of equivalence and effectiveness which qualify the long-standing EU principle of procedural autonomy to the extent that the remedies available under national law may be inadequate."* [138]

This led to the conclusion at [141]

> *"...that the process of disapplying any domestic rule of law in favour of EU law leaves the national court with procedural autonomy in relation*

2. *Littlewoods Retail Ltd and others v Revenue and Customs Commissioners* [2010] EWHC 1071 (Ch); [2010] STC 2072

3. *FII Test Claimants v Revenue and Customs Commissioners* [2012] UKSC 19; [2012] 2 AC 337; Case C-362/12 *Test Claimants in the Franked Investment Income Group Litigation v Revenue and Customs Commissioners* [2014] AC 1161

> *to available remedies. But consistently with that, it does not give to the national court any power of selection which it does not have under domestic law. The national court is left to apply its ordinary domestic rules in the form of the causes of action which are available to a taxpayer seeking to enforce its EU claims. The difficulty with HMRC's argument on this point is that it seeks to attribute to or invest the national court as a function of the principle of effectiveness with the power to select which remedies the claimant should be permitted to pursue when the object of the principle of effectiveness as explained in Littlewoods (ECJ) is to ensure that the taxpayer's* San Giorgio *rights are enforced. The ECJ in [33] and the earlier cases there referred to has made it clear that the choice and availability of remedies is exclusively a matter of domestic law subject only to their being effective remedies for the purpose of enforcing the EU rights in question. We consider that there is no support in these cases for what Henderson J described as this minimalist approach to disapplication and that such a rule would be contrary to principle. Once it is clear that the domestic law rules for the recovery of overpaid tax are incapable of providing recovery in accordance with the* San Giorgio *principle, they fall to be disapplied in favour of the claimant's EU rights. The national court has no power in our view to disapply the domestic bar to the enforcement of those rights on a selective basis. The procedural autonomy it is granted under EU law simply requires it to make available to the claimant the remedies which domestic law would give him had the claim for overpayment been a purely domestic one. Once therefore section 78(1) falls to be disapplied in order to give effect to Littlewoods' San Giorgio-based claims the English court has no further control over the causes of action available to the claimant. Its only power is to adjudicate and enforce those claims in accordance with the law."*

QUANTUM

Littlewoods had claimed amounts that represented the benefit derived by the Government from their overpayments rather than the loss to them from not having use of the money. Their claim was for interest saved by the Government calculated at the cost of borrowing at government rates. The Government essentially claimed that the actual benefit to them was lower and that is all it should have to pay.

Henderson J had decided that the rate of interest should be determined objectively and that it should be the rate at which the Government could borrow at the relevant time. Henderson J also took the view that the role of actual use value was very limited. On this aspect, the Court of Appeal disagreed with Henderson J, relying on two Supreme Court decisions in *Sempra* and

Benedetti[4].

The Court of Appeal agreed that the starting point is the objective use value. In restitution claims, the thing to be valued is the benefit to the defendant ("D"), in this case HMRC. Say that the objective use value is 10. If the D can show that the actual use value to D is, say 4, Lord Nicholls in *Sempra* had said that *"the law of restitution is sufficiently flexible to achieve a just result"* ([119] quoted at [157] in the Court of Appeal's decision). Henderson J had also referred to the concept of "subjective devaluation", but concluded that the law on that was at an early stage of development. That expression had been introduced by Lord Nicholls in *Sempra* where the principle of subjective devaluation was established. The concept was further developed in *Benedetti.*

Sempra, being a case of overpaid tax was of greater relevance to Littlewoods. *Benedetti* was concerned with the valuation of services which had been provided outside a contract. The essentially issue there was what the recipient of the services should pay for them, so they had to be valued. The majority in *Benedetti* agreed that it was open to D to prove that the value of services to D was less than their market value [171]. That principle is based on a *"based on the fundamental need to protect a defendant's autonomy. It is important to note that subjective devaluation is not about the defendant's intentions or expectations but is an ex post facto analysis of the subjective value of the services to the defendant at the relevant time."* (Lord Clarke in Benedetti quoted at [171]).

The principle of subjective devaluation may engage in particular where D essentially receives something involuntarily. Its relevance in Littlewoods was that there was no evidence that HMRC knew anything about the overpaid tax for many years. Also, Henderson J had been satisfied that the actual benefit HMRC obtained from Littlewoods' overpayment was less than the market value of the time value of that money, so actual use value could be relevant (see [187]). However, the Court held:

> *"...we do not consider that HMRC should be treated as if it were an involuntary recipient of overpayments of tax. Taxpayers have to pay tax even though they may not have received any assessment from HMRC. In this case there were also assessments. Even if HMRC had no idea at the time that Littlewoods was making overpayments of tax, it still cannot in our judgment be said to be in the position of the an involuntary recipient of a benefit. It is obvious that, under a system of self-assessment, tax will from time to time be paid in error and that that tax will have to be repaid. That*

4. *Sempra Metals Limited v Inland Revenue Commissioners* [2007] UKHL 34; [2008] 1 AC 561; *Benedetti v Sawiris and others* [2013] UKSC 50 [2013] 4 All ER 253.

is an inherent risk of a system of self-assessment. Statistically a certain percentage of tax receipts will have to be repaid, and we consider that government should not be able to discharge its obligations in restitution to the taxpayer by choosing to take a course which would dilute its repayment obligations."

Accordingly, the Court concluded that objective use value applied to value the time value of the overpayments made. The Court also upheld Henderson J's judgment that the compound interest payable should continue to run after the date of the repayments of the principal amounts of overpaid VAT until the date of judgment.

WHERE DOES THIS LEAVE US?

On the facts, Littlewoods succeeded in its claims. The Court of Appeal, like Henderson J, has given a strong indication that in many cases, especially where overpaid tax runs over relatively short periods of time, the payment of simple interest is likely to constitute adequate indemnity. Where, however, a taxpayer can show that simple interest is not broadly commensurate with the loss of use value of the overpaid tax, it is open to taxpayers to claim compound interest. The most obvious example is the many *Fleming* claims for overpaid tax extending over long periods, a number of which, like Littlewoods' claim, go back to 1973.

The Court of Appeal's findings with regard to the nature and scope of the EU law right and how it is given effect, namely through whatever cause of action a taxpayer chooses (whether it be *Woolwich* or a mistake based claim rather than s78 VATA), makes it uncertain whether a taxpayer is effectively obliged to start a High Court action or may claim through tribunal proceedings.

The Court of Appeal points out that the section 80 regime imposes on HMRC a statutory duty to repay overpaid tax, which normally carries interest (see [31], [42] and [43]). HMRC's duty is to comply with the law, which includes EU law. It follows that an HMRC decision, on a section 80 claim derived from EU law, which does not include an award of interest giving the claimant an adequate indemnity for being kept out of his money, is an unlawful decision under EU law.

The same applies to late payment of input tax, where interest is not paid[5].

The tribunal has jurisdiction over claims that HMRC decisions are unlawful and, more particularly, has jurisdiction to decide that HMRC decisions are unlawful under EU law.

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5. *Emblaze Mobility Solutions v HMRC* [2014] UKFTT 679 (TC).

Therefore, tribunal proceedings appear to be among the options that the Court of Appeal considers a taxpayer may select from. In tribunal proceedings, there need be no disapplication of section 80. Disapplication applies only in relation to section 78 and, where relevant, section 85A: HMRC cannot seek to sustain the legality of their decision before the tribunal by relying on statutory provisions that have to be disapplied under EU law.

We have another long and detailed judgment dealing with complex points of law. Unsurprisingly, it appears from recent press reports that HMRC have decided to seek permission to appeal to the Supreme Court.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

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