

SIMPLE INTEREST IS AN ADEQUATE REMEDY FOR OVERPAID VAT

Littlewoods Limited & others v Commissioners for Her Majesty's Revenue and Customs [2017] UKSC 70

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The Supreme Court has decisively and unanimously concluded that s78 Value Added Tax Act 1994 ("VATA 1994") provides complete and adequate compensation for being kept out of the money by providing for simple interest on overpaid VAT. The words "*if and to the extent that they would not be entitled to do so apart from this section*" in s78(1) did not preserve common law rights to compound interest alongside s78, otherwise s78 "would effectively become a dead letter". Those words only preserve other statutory rights to interest. Further, s78 does not violate EU law by denying taxpayers "an adequate indemnity". That expression

"51. ... bears a broader meaning than that which Henderson J and the Court of Appeal favoured, and suggests that the CJEU has given member state courts a discretion to provide reasonable redress in the form of interest in addition to the mandatory repayment of any wrongly levied tax, interest and penalties."

That "clear view" of the CJEU's judgment in Case C-591/10 ([2012] STC 1714) was supported by three reasons, namely:

1. the structure of the CJEU's judgment and its choice of words;
2. the practice of member states in awarding simple interest (subject to one exception) "suggests that the court was not being as radical as the courts below have held"; and
3. prior and subsequent case law of the CJEU is consistent with this interpretation.

Lord Reed and Lord Hodge's judgment, supported by Lord Neuberger, Lord Clarke and Lord Carnwath, can be seen as a master class in statutory construction on the first issue which concerned English law, and the interpretation of the CJEU's judgment on the issue of EU law.

Issue 1: the construction of sections 78 and 80 VATA 1994

The compound interest claims were based on common law rights to restitution for the government's unjust enrichment arising out of a mistake of law ¹ and in any event, the payment of undue tax ². It was argued that in addition to the repayment of the overpaid tax, the common law rights to restitution included restitution of the use value of money ³.

Vos J at first instance held that sections 78 and 80 did exclude the claims ⁴, but referred the question whether such exclusion was contrary to EU law to the CJEU. The CJEU held that EU law required the repayment of the overpaid tax, but it was for the member state to determine, in compliance with the principles of equivalence and effectiveness, whether simple interest, compound interest or another type of interest was payable ⁵.

Henderson J, when the case resumed in the High Court ⁶, held that Littlewoods' claims succeeded in full, and in particular that only an award of compound interest would satisfy its EU law rights. Henderson J held that the exclusion of common law claims by sections 78 and 80 was therefore incompatible with EU law such that those provisions had to be disapplied so as to allow Littlewoods to pursue their claims. The Court of Appeal upheld Henderson J on all issues ⁷.

Littlewoods' initial argument was based on common law, without reliance on EU law, which gave rise to the first issue whether Vos J and the Court of Appeal were right to hold that sections 78 and 80 excluded the common law claims. Littlewoods appealed on this point as it avoided the need to rely on EU law, although its EU law argument had been the winning argument below.

When Littlewoods brought its claims, s80(4) imposed a three year limitation period. However, as originally enacted, s80 contained a six year limitation period unless the overpaid tax had been paid by reason of mistake. In mistake cases, the six year limitation did not start to run until the mistake was discovered or could with reasonable diligence have been discovered. Littlewoods relied on the extended limitation period to claim the overpaid tax back to 1973. The three year limitation period had been introduced retrospectively without any transitional arrangements and had to be disapplied as it breached EU law ⁸. Section 80(4)

¹ *Kleinwort Benson Ltd v Lincoln County Council* [1999] 2 AC 349 and *Deutsche Morgan Grenfell Group plc v Inland Revenue Comrs* [2006] UKHL 49; [2007] 1 AC 558.

² *Woolwich Equitable Building Society v Inland Revenue Comrs* [1993] AC 70, this right being subject to a six year limitation unlike the right to restitution based on mistake of law.

³ *Sempra Metals Ltd v Inland Revenue Comrs* [2007] UKHL 34; [2008] AC 561.

⁴ [2010] EWHC 1071 (Ch.); [2010] STC 2072.

⁵ (Case C-591/10) [2012] STC 1714, para 22.

⁶ [2014] EWHC 868 (Ch.); [2014] STC 1761.

⁷ [2015] EWCA Civ 515; [2016] Ch. 373.

⁸ *Marks & Spencer plc v Customs and Excise Comrs* (Case C-62/00) [2003] QB 866; *Fleming (trading as Bodycraft) v Revenue and Customs Comrs* [2008] UKHL 2; [2008] 1 WLR 195.

had been introduced to deal with exposure of HMRC to pay claims going back as far as the introduction of VAT in 1973. Its

"21... evident aim is to protect public finances against the risk of liability to repay tax emerging more than three years after the tax was received. ... As this court put it in Investment Trust Companies v Revenue and Customs Comrs [2017] UKSC 29; [2017] 2 WLR 1200, para 88, the limitation period is designed to avoid the disruption of public finances."

Their Lordships then stated that Parliament has "created a specific remedy for taxpayers who have overpaid VAT, but has done so subject to limitations". Those limitations are principally the time within which claims can be brought and the unjust enrichment defence. There was no equivalent of those limitations for common law claims. Moreover, section 80(7) expressly provides that there is no liability to repay overpaid VAT "except as provided by this section". The will of Parliament would be defeated if common law claims for overpaid VAT were not excluded and "Parliament cannot have intended the special regime in section 80 to be capable of circumvention in that way." However, the Supreme Court concluded that it did not follow from s80 itself that there was no common law claim for interest on amounts of overpaid VAT.

Littlewoods did not contest that analysis of s80. In relation to the claim for compound interest, its argument centred on:

- the specific wording in s78(1), which provides for simple interest "*if and to the extent that they would not be liable to do so apart from this section*"; and
- the absence of an express exclusion of alternative remedies in s78 itself.

Littlewoods essentially relied on the contrasting drafting of sections 80 and 78 and argued that the ordinary meaning of the italicised words meant that *Sempra* based common law claims for restitution of the use value of money were preserved by s78 and must be given priority.

Their Lordships gave three reasons for why the drafting of s78 must have intended to exclude common law rights to interest on repayments.

- Firstly, s78(1) only provides for interest to be paid where repayments are "due to an error on the part of the Commissioners". "What would be the point of limiting interest under section 78 to cases of official error, if interest was generally available at common law regardless of whether any official error had been made?"
- Secondly, s78 specifically provides for the rate of interest that is to be applied and rates have been set for the whole lifetime of VAT back to 1973

and the rate is for simple rather than compound interest.

- Thirdly the limitation period in s78(11) must, like its equivalent in s80, be “... intended to protect public finances from disruption”.

The omission of a specific exclusion of alternative claims and the apparent preservation of other claims was dealt with as follows.

- Firstly, their Lordships observed that the basic task of giving effect to the true meaning of what Parliament has said is not confined to the literal interpretation of the relevant provision. It is ‘proper and necessary’ to have regard to the state of affairs existing at the time the provision was enacted. “It is a fair presumption that Parliament’s policy or intention is directed to that state of affairs.”⁹
- Secondly when s78 was enacted, the state of affairs was that interest was available under VAT legislation only in limited circumstances. Interest was also available under Senior Courts Act, s35A. Under Common law, the general rule was that the court had no power to award interest for late payment of a debt, the only exception being special damages within the contemplation of the parties under the second limb of *Hadley v Baxendale*. In the case of restitution actions for money had and received, only the net sum could be recovered. In that context “the statutory scheme established by section 78 was more generous than the common law, as then understood.”¹⁰
- Thirdly, the decision in *Sempra Metals*, allowing for the first time common law claims for the use value of money giving rise to unjust enrichment on potentially compound basis “was not contemplated by Parliament when it enacted sections 78 and 80, many years earlier”. Counsel for Littlewoods accepted that if *Sempra* claims were permitted under the specific wording in s78(1), they would be available in any case where amounts were paid under s80 and

“section 78 would effectively become a dead letter. It follows that the literal reading fatally compromises the statutory scheme created by Parliament. It cannot therefore be the construction of the critical words which Parliament intended”.

- The critical words in s78(1) relied on by Littlewoods can only have contemplated the preservation of statutory claims for interest under, for example, now sections 85 and 85A VATA and section 35A Senior Courts Act 1981.

⁹ Quoting Lord Wilberforce in *Royal College of Nursing of the United Kingdom v Department of Health and Social Security* [1981] AC 800, 822 at [35].

¹⁰ [36].

Their Lordships concluded that the scheme created by s78 was inconsistent with the concurrent availability of common law claims for interest, therefore such claims were impliedly excluded.

Issue 2: why s78 does not breach EU law

Having dealt with statutory construction, their Lordships turned to the interpretation of the CJEU's judgment in *Littlewoods*, the central question being "... whether the CJEU has ruled that HMRC must reimburse in full the use value of the money which over an exceptionally long period of time Littlewoods has paid by mistake."

The uncontentious starting point that member states must refund charges levied in breach of EU law ¹¹ has been supplemented by the CJEU having established that 'amounts directly related to the tax' must also be paid, and that includes 'losses constituted by the unavailability of sums of money as a result of tax having been levied prematurely' ¹². The obligation under EU law to pay interest on tax follows from the obligation to repay the overpaid tax. However, in the absence of EU legislation, it is for member states to make provision for the payment of interest subject to the principles of equivalence and effectiveness. The principle of effectiveness requires national rules on the calculation of interest "should not lead to depriving the taxpayer of an adequate indemnity for the loss occasioned through the undue payment of VAT." ¹³

Their Lordships noted that in accepting *Littlewoods*' argument that simple interest did not give them adequate indemnity or reimbursement, Henderson J (upheld by the Court of Appeal) interpreted the reference to "an adequate indemnity" as "a right to reimbursement of losses representing the time value of unlawfully levied tax which the member state retained." ¹⁴ Those losses were 'directly related to the tax'. Henderson J therefore had accepted that "the right to interest to make good those losses had been recognised as a right conferred by EU law", relying on two later judgments of the CJEU ¹⁵.

Littlewoods had not argued that EU law always required the payment of compound interest but that interest reflecting the use value of the money received should always be paid in order to satisfy the principle of effectiveness relying on the

¹¹ *Amministrazione delle Finanze dello Stato v SpA San Giorgio* (Case 199/82) [1983] ECR 3595, para 12 and *Metallgesellschaft Ltd v Inland Revenue Comrs* (Joined Cases C-397/98 and C-410/98) [2001] Ch. 620; [2001] ECR I-1727.

¹² Para 25 of the CJEU's judgment quoted in the context of paragraphs 24 to 30 of the CJEU's judgment at [43].

¹³ Paragraph 29 of the CJEU's judgment in *Littlewoods*. No question concerning the principle of equivalence arose in this case.

¹⁴ [45]

¹⁵ *Namely British Sugar plc v Rural Payments Agency* (Case C-147/10) heard with *Zuckerfabrik Jülich AG v Hauptzollamt Aache* (Case C-133/10) and *Société Tereos v Directeur général des douanes et droits indirects* (Case C-234/10) EU:C:2012:591 and *Irimie v Administratia Finantelor Publice Sibiu* (Case C-565/11) [2013] STC 1321.

CJEU's decision in *Marshall v Southampton and South West Hampshire Health Authority (Teaching) (No 2)* (Case C-271/91) [1994] QB 126; [1993] ECR I-4367. However, Littlewoods were claiming that they did have an EU law entitlement to compound interest, as only compound interest would be sufficient to satisfy their EU law rights. The *Marshall* case was the source of the concept of "adequate" compensation. The CJEU had held in that case that compensation for any loss suffered as a result of the breach of EU law had to be "full" to be adequate and an award of interest was an essential component of 'full compensation'. Henderson J concluded that the interest had to be "broadly commensurate with the loss suffered". The Court of Appeal rejected HMRC's argument that it only need to provide for 'interest in some recognisable form' and held that the applicable test meant a taxpayer was "entitled to reimbursement of losses constituted by the unavailability of sums of money as a result of tax being levied."

Their Lordship reached the opposite view to the lower courts by interpreting the CJEU's judgment in Littlewoods in the context of the wider judgment.

Firstly the **structure** of the judgment was analysed in the following three parts.

1. The case law cited by the CJEU at paras 24 to 26 gives a 'general entitlement to interest on tax levied in breach of EU law'. The courts below placed undue emphasis on the single word "reimbursement" considered in isolation. That word, when considered in the context of the whole judgment of the CJEU means "no more than recompense or compensation, which is achieved through the payment of some form of interest." Interest is a means of compensation for a person being kept out of his money. The CJUE does not specify the level of compensation payable in the form of interest.
2. The case law cited by the CJEU at paras 27 to 29 establishes that member states are given discretion as to the interest rate and method of calculation. That discretion is qualified by the principle of effectiveness. The principle of effectiveness gives context of phrase adequate indemnity. The phrase 'adequate indemnity' has a less definitive meaning than full reimbursement. The choice of words supports a range of meanings such as "adequate compensation" or "reasonable redress".
3. The principle of effectiveness "would be breached only if the interest rate were so low as to deprive the claim of substance". Para 30 of the CJEU's judgment suggests that the payment of a substantial amount of interest can constitute reasonable redress. Both the Advocate General and the Court referred to the fact that Littlewood had recovered the VAT and an amount exceeding 125% of the VAT. Although the Court was less categorical than the Advocate General that the payment of simple interest complied with the principle of effectiveness, by referring to the amounts paid, which were substantial, the Court was indicating that the interest could be adequate and rules providing for the payment of simple interest "do not render practically

impossible or excessively difficult the exercise of rights conferred by EU law". Their Lordships added that "this approach is readily understandable in a context in which the CJEU, in the interest of legal certainty, has upheld the validity of national limitation periods of relatively short duration which restrict the ability of taxpayers to recover unduly paid tax".

Secondly, the CJEU had before it submissions on 13 **member states' practice** showing that all but one paid simple interest. Their Lordships stated that "if the CJEU were seeking to outlaw this practice, we would have expected clear words to that effect. They are absent."

Thirdly, **pre and post Littlewoods case law** consistently states that the payment of interest is an "ancillary problem to be settled in national law, whether it concerned the date from which interest was payable, the rate of interest or the method of calculation". The CJEU did not refer to *Marshall* in its judgment although the case had been cited in argument. Their Lordships took the view that *Marshall* was distinguishable as it was concerned with ascertaining the principal sum due by way of compensation. In that context equating 'adequate' and 'full' made sense. Three reasons were given for why the same could not be said for the interest element of the compensation.

1. In *Marshall* the principle of effectiveness was applied in the context of defining content of the right to the principal element of the compensation.
2. The right to the interest component of compensation was addressed separately in *Marshall*. Although the interest component was required to make the compensation 'full', the award of interest was required to be made in accordance with national rules. Their Lordships held that "taking into account the diminution in value of a sum of money through the passage of time is not the same as compensation in full for the use value of money".
3. The Advocate General referred to the European Commission's 'support of the sufficiency of simple interest' as "adequate restitution of compensation". That is why the CJEU may have adopted the phrase "an adequate indemnity", as Henderson J recognized.

Finally, the subsequent case law did not alter the law as the 'CJEU formulates the law in substantially the same way as it did in the Littlewoods case'.

Littlewoods has recovered over 125% of the overpaid VAT in the form of interest.

"73 ...The size of that recovery reflects a combination of circumstances which could not have occurred in most of the other EU member states: the retroactive nature of a major development of the common law by the courts, so as to allow for the first time the recovery of money paid under a mistake in law, and the inability of the legislature to respond to that development, under

EU law, by retroactively altering the law of limitation so as to protect public finances. The resultant payment of interest cannot realistically be regarded as having deprived Littlewoods of an adequate indemnity, in the sense in which that expression should be interpreted.”

This decisive judgment appears to signal the **end of the road for claims for compound interest for almost all practical purposes**. Whether any particular set of circumstances may cause the reasoning to be tested remains to be seen. There is little, if any, doubt that the judgment is influenced by the sums involved, namely £1.25billion in Littlewoods’ own claim and an estimated £17 billion of circa 5000 claims stood behind this case. That is not to say that the judgment is driven by a desired outcome of protecting public finances. Rather, their Lordships’ reasoning shows that EU law leaves the content of the right to interest to member states, and member states are entitled to take account of the impact on public finances when formulating the content of the right.

Andrew Macnab and Peter Mantle of Monckton Chambers (led by Jonathan Swift QC of 11 King’s Bench Walk) represented HMRC.

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.