

## **It's Not Just Enrichment... It's Unjust M&S Enrichment**

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The European Court of Justice has recently handed down judgment in the latest episode of the long running legal battle between Marks and Spencer plc ('Marks and Spencer') and the Commissioners for Her Majesty's Revenue and Customs. The ruling stems from proceedings brought by Marks and Spencer challenging the Commissioners' refusal to uphold a claim brought by the retailer for repayment of VAT which had been erroneously paid.

The Commissioners acknowledged that between April 1973 and October 1994, chocolate covered teacakes marketed by Marks and Spencer had wrongly been treated as biscuits (and not cakes), attracting the standard rate of VAT (rather than the zero rate). As a result, the retailer had been paying a tax which was not due. On the basis of this mistake, Marks and Spencer submitted a claim for repayment, 10% of which was accepted by the Commissioners. However, the Commissioners took the view that the remaining 90% had been passed on to customers and invoked the defence of unjust enrichment under section 80(3) of the VAT Act 1994. Three year limitation periods were also applied to the claim.<sup>1</sup>

Challenges to the decision of the Commissioners were unsuccessful before the VAT and Duties Tribunal, High Court and Court of Appeal.<sup>2</sup> The House of Lords however made a reference to the ECJ, although clearly favouring the Commissioners case.

The first question asked whether it is possible for a trader to derive as a matter of Community law, the right to be "taxed" at a zero rate, where that "rate", really an exemption, is the result of provision of national law. The Court noted that the actual original wording of Article 28(2) of the Sixth Directive was permissive of exemptions: there was no Community law requirement for Member States to maintain such exemptions. The Court therefore agreed with the submissions of the Commissioners, holding that Marks and Spencer did not have a directly enforceable Community-law right to have those supplies taxed at a zero rate for VAT, in reality to pay no output tax on those supplies.

<sup>1</sup> Pursuant to section 77 of the Value Added Tax Act 1994.

<sup>2</sup> However, the Court of Appeal made a reference to the ECJ on a separate aspect of the proceedings. In light of the ruling in Case C-62/00 *Marks and Spencer* [2002] ECR I-6325, the Commissioners accepted that the retailer's claim should not be time barred and repaid the full 10%, maintaining their unjust enrichment defence for the remaining 90%.

The second question concerned whether a right existed, deriving from the general principles of Community law, including the principle of fiscal neutrality, to a refund of VAT paid in error when the rate which should have been applied stems from national law. Answering in the affirmative, the Court observed that the maintenance of exemptions/reduced rates of VAT, lower than the minimum rate laid down by the Sixth Directive, is only permissible if it complies with the principle of fiscal neutrality. The Court therefore held that those principles governing the common system of VAT, including the principle of fiscal neutrality, apply even to Article 28(2) and could be invoked against a national provision failing to adhere to them.

The Court's reasoning here is interesting. From the point of view of a tax authority it might be thought to have a missing link. The right to a refund is acknowledged by the Court to be the consequence and the complement of *the rights conferred directly on individuals by Community law* (in para 35). Yet in this case it had just concluded there was no directly effective right to pay no output tax. The expected consequence and compliment of no direct right might be thought to be no right to a refund. However, the ECJ decided that "the refund" principle also applies to charges levied in breach of national legislation permitted under Article 28(2) of the Sixth Directive. This has all the appearance of a judicial policy decision. It appears at first sight to have consequences which equate to a conclusion that a directly effective right existed to pay VAT at no higher rate than that set in national law. The Court's conclusion was that if the UK maintained a zero rate for certain supplies under art 28(2) it had to permit refund of tax if a trader paid at a higher rate, subject to limitation and other defences, and that those defences had to be in accordance with the general principles of EU law. That may be thought a sound policy as it was obvious (as now affirmed by the ECJ) that the general principles, most notably fiscal neutrality, are relevant to whether any give zero rate can be maintained. However, it divorces the right to a refund from an identifiable directly effective right, in circumstances where there was no allegation that the maintenance of the zero-rate itself breached the general principles.

Marks and Spencer sought to argue that the application of the rule of unjust enrichment to 'payment traders' and not to 'repayment traders' constituted a breach of the principles of equal treatment and fiscal neutrality. The Court noted that the degree of any unjust enrichment can only be established following an economic analysis, taking into account all relevant circumstances. This would therefore be a matter for the national court to adjudicate upon.

However, the Court ruled that although the principles of equal treatment and fiscal neutrality applied in principle, there was no infringement merely because a refusal to make a repayment was based on the unjust enrichment of the taxable person concerned. Nevertheless, the Court held that the principle of fiscal neutrality did preclude the prohibition of unjust enrichment from being applied only to taxable persons such as 'payment traders' and not to other taxable persons such as 'repayment traders' if those taxable persons have marketed similar goods. In addition, the principle of equal treatment precludes discrimination which is not objectively justified, affecting traders who are not necessarily in competition with each other but are in a similar situation in other respects.

The Court held that their analysis would not be affected by evidence that the trader in question has not suffered any financial loss or disadvantage.

The Court drew upon settled case law for the proposition that in the absence of Community legislation, it is for each Member State to lay down procedural rules to fully safeguard Community law rights. However, the national court must in principle order the repayment of the entirety of the VAT payable to any trader who has suffered discrimination, unless there are other remedies available in respect of that infringement at national law. Any remedies must not be contrary to Community law, including the principle of equal treatment.

*Paul Lasok QC and Peter Mantle represented the Commissioners*

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