CASE C-591/10 *LITTLEWOODS AND OTHERS v COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS*

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In Littlewoods and Others v Commissioners for Her Majesty's Revenue and Customs (Case C-591/10), the European Court of Justice ("ECJ") has decided that each Member State must set the conditions in which interest on overpaid tax must be paid, including the rate of interest, subject to the principles of effectiveness and equivalence. The principle of effectiveness requires that the interest paid must give the taxpayer "adequate indemnity for the loss occasioned" through the overpayment of the tax. The judgment is less clear about the operation of the principle of equivalence. That principle requires national rules to be applied without distinction to actions based on an infringement of EU law and those based on infringements of national law, where those actions have a similar purpose and the cause of action is similar. It does not require Member States to extend their most favourable rules to interest claims for overpaid VAT.

The ECJ's judgment has opened up a new battleground for the domestic courts. In contrast to the ECJ's ruling in *Metallgesellschaft and Others* (Joined Cases C-397/98 and C-410/98) that breaches of what was, at the time, Article 52 of the EC Treaty required an "effective legal remedy", in Littlewoods the ECJ may have lowered the requirement: the remedy must be "adequate". A lowering of the bar could be inferred from the ECJ's observation that the simple interest awarded to Littlewoods amounted to 123 per cent of the principal sum repaid. Whether that is a steer to the domestic courts remains to be seen because the alternative interpretation of the judgment is that "adequate" is the same as "effective"; the ECJ was simply surprised at the extent of the exposure to paying interest. There appears to be a further steer

in the ECJ's final answer that "another type of interest" may give the adequate remedy. Those steers could pave the way for a solution to be developed along the lines of LJ Chadwick's observations in the Court of Appeal in *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners and another* - [2005] STC 687 (see paragraphs 44 and 45) that a suitable single rate could provide the requisite remedy rather than a simple or compound rate. Such a suitable rate would have to bridge the gap, in Littlewoods' case, between the GBP 268,159,135 simple interest awarded and the circa GBP 1 billion of compound interest claimed.

THE ECJ'S JUDGMENT

The ECJ reduced the four questions referred to the following:

> *"whether, ... it is in accordance with EU law for national law to provide for the payment of only 'simple' interest on that sum, or whether EU law requires national law to provide for payment of 'compound interest' as a counterpart for the value of the use of the overpaid sums and/or the loss of the value of the use of the latter or for another method of reparation which, in that latter case, the Court is asked to specify. Should the relevant national rule be incompatible with EU law, the national court asks what consequences it should draw from such incompatibility."*

The Court made a preliminary observation that Littlewoods' claim was not an action for the breach of EU law, but an action for repayment of VAT levied in breach of EU law. The significance of that observation is not entirely clear. Perhaps most obviously, it justified the ECJ in narrowing its citation of previous cases to those dealing with the refund of unlawfully levied charges. The case law on damages actions is not referred to. That should mean that difficulties of the kind which arose in the UK courts in the *Sempra* (previously Metallgesellschaft) litigation, essentially concerning differences between compensation and restitution claims, should not arise in VAT repayment claims. Such repayment claims are in their nature restitution.

The judgment puts beyond doubt that a Member State's obligation to pay amounts directly related to overpaid tax includes the obligation to pay interest on the amount of the overpayment. However, as stated at the outset, the rate at which such interest must be paid and the type of interest (simple, compound or "other") is left to each Member State subject to the principles of effectiveness and equivalence.

The court does not give any guidance on how a national court should determine that the indemnity in the form of interest is "adequate". Compound interest is not precluded from being the adequate remedy. Nor, strictly, is simple interest precluded from being the adequate indemnity. It may be that it is at this point that the principle of equivalence comes in: equivalent may provide the yardstick for what is "adequate" recovery.

THE TASK OF THE DOMESTIC COURTS

It seems that the first task of the UK courts will be to assess whether a given claim for repayment has a "similar purpose and cause of action" as a *Woolwich* or mistake based claim for restitution excluded by s80 Value Added Tax Act 1994 ("VATA 1994"). If so, a comparison of the interest awarded under s78 VATA 1994 would b required against the restitution, by way of interest, which would be due under such similar claim. A finding that simple interest yields a lower remedy than a similar claim for restitution would require the exclusion of the limit placed by s78 VATA 1994 on the interest that is recoverable. It is not clear whether or not that also requires the exclusion under s80 VATA 1994 to be disapplied.

The ECJ observed that

> *"As is apparent from consistent case-law when faced with a rule of law that is incompatible with directly applicable EU law, the national court is required to disapply the national rule"*

unless there is another provision which safeguards the individual rights conferred by EU law. It must follow that, if the provision for simple interest under s78 VATA 1994 is found to be wanting, that provision is to be disapplied. It does not follow (or does not necessarily follow) that the entire statutory regime in VATA 1994 is to be disapplied. If, however, the entire statutory regime in VAT were to be disapplied, taxpayers who have not made protective restitution claims in the High Court would be prejudiced. Those taxpayers could rely on the Court's references to ss78 and 80 VATA 1994 as authority for the proposition that the right to simple interest is displaced by the right to be awarded an adequate remedy. Accordingly, HMRC's obligation to pay interest when a claim for overpaid VAT is submitted to them is defined by directly effective EU law (including the principle of effectiveness), rather than by the wording of s78 VATA 1994 itself. Such taxpayers can argue that, in an appeal to the tribunal against an unfavourable decision of HMRC, the tribunal would have the power to award adequate interest as part of its power to determine the legality of HMRC's decisions under ss78 and 80 VATA 1994. Alternatively the restriction on the tribunals to award anything other

than simple interest by virtue of their limited vires would be called into question.

Lord Hope in the majority House of Lords' decision in *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners and another* - [2007] STC 1559 held that

> *"[33] ... Simple interest is an artificial construct which has no relation to the way money is obtained or turned to account in the real world. It is an imperfect way of measuring the time value of what was received prematurely. Restitution requires that the entirety of the time value of the money that was paid prematurely be transferred back to Sempra by the Revenue.*
>
> *[34] All this points to the conclusion, subject to what I say later about onus (see [47], [48], below) that, for restitution to be given for the time value of the money which was paid prematurely, the principal sum to be awarded in this case should be calculated on the basis of compound interest."*

The principle to be derived from the *Sempra* decision is that simple interest did not provide an 'effective' or "full" remedy in a restitution claim. Without reference to the details of the Sempra case, the interest in question was the principal remedy sought by the tax payer in that case. As mentioned, the ECJ in *Sempra* held that the remedy had to be effective, which was interpreted by the UK courts to be a "full" remedy. The task for the courts in *Littlewoods* and cases similar to it will be to determine what "adequate" means. It seems that the remedy must be 'sufficient' to put the taxpayer in the position it would have been in had it not been required to pay the unlawful tax. It must follow that simple interest is unlikely to provide an adequate remedy for a repayment claim which is restitutionary in its nature. An open question is what the UK courts will make of the steers' described above.

CONCLUSION

The ECJ's judgment in Littlewoods seems to provide fertile grounds for litigation on interest claims in the UK courts. It may be necessary to ask the ECJ for further guidance on the factors which must be taken into account in determining what amounts to an adequate indemnity for loss suffered as a result of overpaid tax. Much will turn on how the UK court in Littlewoods interprets the ECJ's judgment.

A final thought: where does this leave repayment supplement and the statutory exclusion of interest when there is a repayment supplement under s85A(5) VATA 1994? Unless the level of repayment supplement is "adequate", it would seem that interest must be paid.

Peter Mantle of Monckton Chambers acted for HMRC.

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