

## ***A Customer's Right to Recover from HMRC VAT Wrongly Charged***

### **Frank Mitchell, Monckton Chambers**

On 12 February 2015 the Court of Appeal handed down his Judgment in *Investment Trust Companies (in liquidation) v HMRC* [2015] EWCA Civ 82. The Court delivered a unanimous judgment upholding the March 2012 decision of Henderson J in some respects and overturning it in others.

Broadly, the facts were as follows. For many years VAT was charged at the standard rate on investment management services provided to the Claimants being a number of closed-ended investment trusts (hereinafter "Claimants" or "Investment Trusts"). As a result of the ECJ Judgment in *JP Morgan Fleming Claverhouse v HMRC* [2008] STC 1180 ("*Claverhouse*") HMRC published Business Brief 65/07 wherein they accepted, for the first time, that the management services were exempt.

There were nine claimants in all and three of these were the subject of the lead appeals. As a result of the differing business carried out by the trusts some of them had an element of VAT recovery and others had no VAT recovery. To the extent that an entity had no VAT recovery its claim against HMRC was for 100% of the VAT it had paid to the service provider but which had not been refunded to it by the service provider. Where the company had an element of recovery, say 60%, its claim was for the irrecoverable portion, being 40%, of the VAT it had paid to the service provider but which had not been refunded to it. For the remainder of this article we will assume that we are dealing with entities which had no VAT recovery.

The analysis which the Court performed was based on a hypothetical supply which bore £100 VAT. The fund manager would charge £100 VAT to the Claimant. The fund manager had a hypothetical £25 input tax deduction and so it accounted for £100 output tax, and took a £25 input credit resulting in a net amount payable to HMRC of £75. The £25 input tax deduction would, of course, be matched by a £25 output tax liability by the entities supplying services to the fund manager.

The net effect of all of this was that the claimant would pay £100 VAT to the fund manager and would be entitled to recover none of it as input credit. In argument, HMRC attached great importance to the fact that the fund manager paid only £75 to HMRC but it was accepted that HMRC received the further £25 from the fund manager's own suppliers (who, it was assumed, had no input VAT credits of their own).

Without going into the details of the claims, in the wake of *Claverhouse* and then *Fleming v Revenue & Customs Commissioners* [2008] UKHL 2, [2008] 1 WLR 195

the fund managers, which were still in existence, reclaimed the overpaid VAT from HMRC and returned the amounts they recovered back to the investment trusts. Because of the timing of the claims the fund managers were not able to recover the VAT overpaid for the periods after 4 December 1996 and before the relevant dates in 2001 which were outside the three-year cap. This period of 1996 – c.2001 was referred to as “the dead period”.

There were two types of claim being made by the Claimants. First, a claim by all of the claimants in respect of VAT they had incurred during the dead period (as this was VAT which the fund managers had not recovered from HMRC and had not refunded to the Claimants); and, second, the £25 which the fund managers had not recovered from HMRC (represented by their own input tax entitlement) and which had not been repaid by the fund managers to the investment trusts.

In essence, the fund managers reclaimed everything they could from HMRC and paid it to the investment trusts. The investment trusts then sought to recover the balance from HMRC.

There were seven distinct issues of UK law and three of EU law, though they can be summarised as follows:

- i. whether the claimants had a remedy under the English law of restitution.
- ii. If so, whether this claim was excluded by section 80(7) VATA;
- iii. If the claimants did not have a claim in English law did they have an enforceable EU law right to reimbursement (applying Case C-35/05, *Reemtsma Cigarettenfabriken GmbH v Ministero delle Finanze* and Case C-94/10, *Sauer Danfoss ApS v Skatteministeriet*) and (if so) how should English law give effect to that right.

In the High Court, Henderson J held that even though the Claimants were not accountable persons with respect to VAT, they did have a restitutionary claim against HMRC for the full £100. The learned trial judge rejected the argument that HMRC could not have been enriched by more than the amount of tax (£75) which they actually received. Notwithstanding these findings the learned High Court Judge held that the domestic law claims were barred by s.80(7) which, on its proper construction, was not limited to restitutionary claims made by the person accountable for the tax but was intended to be a comprehensive restriction which extended to similar claims by end consumers who had borne the economic burden of the unlawful tax.

As to the position under EU law the High Court held that the claimants had

*San Giorgio* rights which could be given effect to by (a) disapplying s.80(7); (b) allowing the claimants to choose between a *Woolwich* cause of action (see *Woolwich Equitable Building Society v IRC* [1993] AC 70) or a claim based on the principles set out in *Deutsche Morgan Grenfell Group Plc v IRC* [2006] UKHL 49 (“DMG”) with its extended s.32(1)(c) limitation period; but (c) limiting those claims to a three year limitation period by analogy with s.80(4).

As a consequence of all of the foregoing only the claims of one of the claimants for the uncapped periods succeeded i.e. the £25 which the fund managers deducted by way of input tax during the uncapped periods and which they did not refund to the Claimants.

The Court of Appeal identified 10 separate issues which required consideration. This article cannot hope to provide anything other than the most basic summation of the key issues in this case, the complexity and intricacy of which is hard to overstate.

## **English Law**

The Court of Appeal held that the Claimants did have a restitutionary claim against HMRC but (contrary to Henderson J) held that it could only be for £75 since the court was required to decide whether HMRC had been unjustly enriched at the end of the process of accounting for output tax and deducting input tax.

However, HMRC had no obligation to allow deduction of input tax for the dead period and the Court of Appeal held that the claimants could have no better right than the managers to the recovery of the £25. Accordingly, although the claimants had been overcharged £100, they could only claim £75 from HMRC and would have to claim the remaining £25 directly from the Managers. So, the Court held that HMRC were enriched to the extent of £75.

The next question which arose is whether the Claimants could properly bring proceedings for the restitution of that enrichment even though they did not account for the tax to HMRC. This created a legal difficulty for the claimants because the law of restitution had historically applied a general rule that only the persons who were the direct victims of an unjust enrichment could bring a claim.

The Court of Appeal acknowledged the significant contribution made by academics to the evolution of this branch of the law but held it more appropriate to consider the evolving jurisprudence. The Court of Appeal has considered these issues in three judgments in the last three years and, based upon those judgments, the Court concluded that “indirect benefit can, in appropriate cases,

be sufficient to found a claim in restitution.” The Court agreed with Henderson J’s conclusion that in the context of VAT the final consumer who pays the tax has a sufficient economic connection with HMRC to be able to say that they have been enriched at his expense.

In light of the foregoing, the Appellants had a restitutionary claim against HMRC for £75 in respect of the dead period but could not recover the £25 from HMRC for any period. The question which then arose is whether the three year time limit provided by section 80(4) should apply to the Claimants’ restitutionary claim. The Court held:

*“We are not ... persuaded that it is possible to derive from the statutory background any legislative intent to restrict claims for the recovery of overpaid VAT to the machinery of what is now s.80 regardless of the identity of the claimant. The judge’s purposive approach was based on the assumption that Parliament would not have restricted taxpayers to s.80 claims within the s.80(4) time limit yet allowed restitutionary claims by the end consumers to remain enforceable subject only to s.32(1)(c) of the Limitation Act. But this supposes that Parliament ever had in mind that any such claims could be brought. The language and legislative history of s.80 point clearly, in our view, in the contrary direction.”*

Therefore, the Respondents succeeded in part in their appeal on the UK restitutionary basis, by limiting the Claimant’s right to recovery to £75 of the £100 and only in respect of the dead periods. The Appellants however succeeded in their argument that the claim to the £75 was not time-barred.

The question which then arose was whether the claimants could recover the £25 (for the dead periods or the uncapped periods) by relying on their EU law rights and, if so, whether such a claim would be subject to the three year cap by analogy with section 80(4).

## **EU Law**

Henderson J. in the High Court had held that the UK domestic restitutionary remedy was, in effect, time-barred pursuant to section 80(3) but held that a claim for the £25 could be maintained under EU law because the fund managers would have an ‘iron-clad’ change of position defence in respect of any proceedings against them for recovery of the £25. However, Henderson J’s judgment in this respect was premised upon the then state of the evidence to the effect that the managers would have passed on to the claimants the amount of their input tax in the form of higher prices had their output tax supplies been treated as exempt. However, shortly before the hearing at the High Court this evidence was changed and it was accepted that the managers would not have

sought to pass on the £25. Although the High Court Judge considered that this made no difference the Court of Appeal held that the manager's section 80 claim for the £75 reversed the tax treatment of the £25 and made their retention of that sum as against the Claimants impermissible. Accordingly, the Managers would not have a change of position defence and, therefore, the prospect of recovering the £25 from HMRC did not arise (that right arising only if recovery of the £25 otherwise proved impossible or excessively difficult).

Nonetheless, the Court considered the Judgments in *Reemtsma and Sauer Danfoss* for completeness but concluded that the same principles should govern the position under EU law as determine the extent of the unjust enrichment under domestic law. The Court held that it was appropriate in both cases to have regard to the position not only at the time when the tax was paid but also having regard to the consequences of reversing the tax position. On this basis the end consumer could have no greater right of recovery against HMRC than the accounting party itself. The £25 was therefore held to be recoverable against the Managers alone.

Notwithstanding the foregoing, the Court held that even if a broader view were to be taken of *San Giorgio* claims the right to repayment of VAT would be vindicated by a claim for the £75 against HMRC and a claim for £25 against the managers, the latter of whom, the court held, would have no change of position defence to any such claim.

The Court therefore allowed the appeal of HMNRC against the Judge's order for the payment of the £25 but allowed the Claimants' appeal against the construction of section 80(7) so that the Claimants were entitled to recover £75 from HMRC for the dead periods.

## **Conclusion**

Unless successfully appealed, this Judgment establishes definitively that customers can, in certain circumstances, recover VAT from HMRC which was wrongly charged to them. Moreover, that claim is subject to the time limits applicable to restitutionary claims and not the time limits prescribed by the VAT Act therefore it is possible that, as here, the customer can recover from HMRC VAT of which the supplier is out of time to seek repayment. However, in the case of tax overcharged as a result of the erroneous application of an exemption, that claim will be limited to the net amount of output tax for which the supplier has accounted i.e. after deduction of any input credit deduction to which the supplier was theretofore entitled. In those circumstances the prospect of separate proceedings against the supplier for the portion of the difference (the £25 in ITC) would need to be considered.

Legislation to regulate this area – so as to eliminate the mismatch between

time limits in the VAT Act and those subject to restitutionary remedies - must be considered a distinct possibility.

**Andrew Macnab and George Peretz (instructed by the Solicitor for HM Revenue & Customs) for the Commissioners**

*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.*

This case note was first featured in the April 2015 issue of De Voil.