

Court of Appeal confirms that compound interest is payable in respect of overpaid VAT

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Tax analysis: What are the implications of the Court of Appeal's landmark judgment in the Littlewoods case that HMRC must account to the taxpayer for compound interest in respect of VAT overpaid by mistake? Christopher Marks of Weil, Gotshal & Manges comments on the judgment of the Court of Appeal.

Original news

Littlewoods Retail Ltd and others v Revenue and Customs Commissioners [2015] EWCA Civ 515, [2015] All ER (D) 225 (May)

Over a 31-year period from 1973 to 2004 the taxpayer, Littlewoods mistakenly overpaid a total of approximately £204m in VAT to HMRC. HMRC repaid the principal sums together with simple interest at the rates provided for in the Value Added Tax Act 1994, s 78 (VATA 1994). Littlewoods brought a claim seeking to recover in restitution the time value of the sums which it mistakenly overpaid.

The Court of Appeal has confirmed that, in certain circumstances, a taxpayer can recover a sum equivalent to compound interest on overpaid VAT.

What is the brief background to this case?

The claims relate to overpayments of VAT mistakenly made by Littlewoods (and other companies in its group) between 1973 and 2004. The overpaid VAT was repaid by HMRC at various points between 2005 and 2008, together with simple interest at the statutory rate prescribed by VATA 1994, s 78. However, this simple interest equated to a fraction of the actual benefit which the government derived from retaining the overpaid VAT over a 31-year period. Therefore, Littlewoods made a restitutionary claim in the High Court, seeking a remedy which is commensurate with the benefit obtained by the government in unlawfully collecting the VAT.

The first phase of the High Court trial took place in April 2010 (see *Littlewoods Retail Ltd and others v Revenue and Customs Commissioners* [2010] EWHC 1071 (Ch), [2010] STC 2072). The trial was adjourned for a number of questions to be referred to the Court of Justice of the European Union (CJEU), which gave its judgment in July 2012 (*Littlewoods Retail Ltd v HMRC*: C-591/10 [2012] STC 1714). The High Court trial then resumed and concluded over three weeks in October and November 2013, with judgment handed down on 28 March 2014 (see *Littlewoods Retail Ltd and others v Revenue and Customs Commissioners* [2014] EWHC 868 (Ch), [2014] STC 1761). In that judgment, Mr Justice Henderson concluded that the EU law requirement for Littlewoods to receive an 'adequate indemnity' for the loss occasioned by its overpayments of VAT (as confirmed by the CJEU in these proceedings) necessitated an award of compound interest. HMRC appealed to the Court of Appeal.

What did the Court of Appeal decide?

The Court of Appeal upheld the judgment of the High Court in its entirety, finding that Mr Justice Henderson had not fallen 'into any error on any of the issues'. The judgment is a significant development in what is undoubtedly one of the most important tax-related cases of the modern era. It confirms that, in certain circumstances where VAT has been overpaid, taxpayers are entitled to claim compound interest. Lady Justice Arden delivers the judgment of the Court of Appeal to which Lord Justices Patten and Floyd had also contributed.

In broad terms, the Court of Appeal was called upon to consider four key issues.

Matter of English law

The court had to consider whether Littlewoods' claims could succeed solely as a matter of English law--specifically, whether VATA 1994, ss 78 and 80 exclude the possibility of bringing common law restitution claims in respect of overpaid

VAT. In upholding a declaration made by Mr Justice Vos (as he then was) in 2010, the court concluded that VATA 1994, ss 78 and 80 form a coherent code for compensating taxpayers for the time value of money, such that Littlewoods' restitution claims were excluded as a matter of English law (without reference to EU law).

Statutory exclusion and EU law

In light of its decision as to the effect of VATA 1994, ss 78 and 80, the court had to determine whether the statutory exclusion of Littlewoods' common law claims was contrary to EU law. Applying the decision of the CJEU in these proceedings, the court found that the adequate indemnity to which Littlewoods is entitled must amount to 'reimbursement of the losses constituted by the unavailability of sums of money as a result of tax being levied'. In the circumstances of this case, the court concluded that the statutory interest paid to Littlewoods pursuant to VATA 1994, s 78 did not constitute an adequate indemnity for its losses. It follows that the statutory exclusion of Littlewoods' common law claims violated the principle of effectiveness and, as such, was contrary to EU law.

Giving effect to EU law rights

Therefore, the court considered how to give effect to Littlewoods' EU law rights under English law. In this regard, the court upheld the conclusions of Mr Justice Henderson to the effect that:

- o VATA 1994, ss 78 and 80 cannot be construed in conformance with EU law, and
- o instead, those sections must be disapplied so as to permit Littlewoods to pursue its claims

The court held that this disapplication could not be carried out selectively, meaning that 'it is a matter of choice' for Littlewoods, and not the courts, as to which of the available English law remedies it pursues.

Calculating quantum

The court had to determine the correct basis for calculating the quantum of Littlewoods' claims. HMRC contended the quantum should be calculated by reference to the actual use made by the UK government of the overpaid VAT. Littlewoods argued it should be calculated by reference to the objective use value of the overpaid VAT.

The court found that, in principle, the actual benefit obtained by the government could be relevant to calculating the quantum of Littlewoods' claims. However, it ultimately concluded that the question of actual benefit could not be relevant in this case, principally because:

- o the government was free to use the overpaid tax as it saw fit, and
- o even if the government did spend the money on public projects, the court is 'entitled to take the view that it was well spent'--this is notwithstanding HMRC's contention that the government incurred a much lower level of actual benefit from such expenditure than the benefit which would have arisen (by way of saved interest) from using the overpayments to reduce government borrowing

Therefore, the court upheld Mr Justice Henderson's finding that Littlewoods' claims should be quantified by reference to the cost of government borrowing over the period for which the government retained the overpaid VAT.

In addition, the court upheld two previous findings of the High Court in the proceedings (of Mr Justice Henderson and Mr Justice Vos, respectively) that:

- o the compound interest payable to Littlewoods should continue to run after the date of the repayment of the principal amounts of overpaid tax on such amounts of accrued interest as remained outstanding, and
- o the overpayments of VAT received by the government went to reduce government borrowing in the year in which they were received

Does the judgment assist in the interpretation and application of the 'adequate indemnity' concept included in the CJEU's guidance?

Yes. Consistent with previous decisions of the CJEU, the court held:

'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.'

While it is for national courts to determine the method of calculation of this reimbursement, the court was clear in its conclusions that the statutory interest paid to Littlewoods did not constitute an adequate indemnity for its losses and that EU law does not merely require the provision of a remedy which meets the description 'interest'.

Therefore, although the precise interpretation of the 'adequate indemnity' test will, necessarily, turn on the facts of individual cases, this decision doubtless clarifies the approach of the English courts and makes clear that the payment of simple interest will not suffice in every instance.

How does this judgment impact on other claims awaiting the outcome of this case?

The judgment will likely be widely welcomed by taxpayers, especially those with claims stood behind Littlewoods. HMRC has, however, sought permission to appeal to the Supreme Court, so it is possible that there will be a further delay before the proceedings are finally resolved.

Following the decision of the High Court in March 2014, HMRC confirmed that it would continue to apply for any claims for compound interest to be stayed pending the final determination of the *Littlewoods* proceedings (see LNB News 06/05/2014 101). If HMRC obtain permission to appeal to the Supreme Court, it seems likely that they will continue to take the same approach in light of the Court of Appeal's judgment.

What are the possible wider ramifications for compound interest claims? What should lawyers do next?

The High Court judgment was one of the largest money judgments (if not the largest money judgment) ever handed down by the English courts and, together with the recent judgment of the Court of Appeal, certainly merits consideration by lawyers and tax practitioners alike. In particular, taxpayers may wish to revisit with their tax advisers situations where they have received repayments of mistakenly overpaid tax.

However, it will likely take some time for the full impact of the Court of Appeal's decision to be clear, especially in light of HMRC's intended appeal to the Supreme Court. It may therefore be necessary to wait a little while longer before taking any action in reliance on the judgment.

In any event, it is likely that this case will provide valuable clarity in relation to claimants' EU law rights to claim compound interest on overpaid tax, as well as reinforce the existing English law principles in relation to restitution, interest and quantification established in *Sempre Metals v IRC* [2007] UKHL 34, [2007] 4 All ER 657. It remains one to watch.

Weil, Gotshal & Manges has acted for Littlewoods in connection with the proceedings since 2009. The Weil Gotshal & Manges team was led by litigation partner Jamie Maples, assisted by tax counsel Oliver Walker, litigation associates Christopher Marks and Timothy Goldfarb and legal executive Christine Howard.

Weil Gotshal & Manges instructed Laurence Rabinowitz QC, Steven Elliott and Maximilian Schlote (all of One Essex Court) and Michael Jones (Gray's Inn Tax Chambers).

Interviewed by David Bowden.

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