

NEWS BRIEF

Overpaid tax: another win for compound interest

Dismissing in its entirety an appeal brought by HM Revenue & Customs (HMRC), the Court of Appeal has confirmed that, in certain circumstances, EU law entitles taxpayers to claim compound interest on tax overpaid by mistake (*Littlewoods Limited and others v The Commissioners for Her Majesty's Revenue and Customs* [2015] EWCA Civ 515). In the context of compound interest payable in connection with overpaid VAT, sections 78 and 80 of the Value Added Tax Act 1994 (sections 78 and 80) must be disapplied accordingly.

While many taxpayers will welcome this decision, the court's judgment was carefully expressed as applying to the particular circumstances of the case. In addition, HMRC is continuing to fight its corner and has sought permission to appeal to the Supreme Court. So while this battle has been won, the war may not be over yet.

The dispute

Between 1973 and 2004, Littlewoods and other companies in its group mistakenly overpaid approximately £204 million of VAT. The overpayments arose from the incorrect VAT treatment of the commission arrangements between Littlewoods and its network of agents.

HMRC repaid the overpaid VAT following the Court of Appeal's decision in *Customs and Excise Commissioners v Littlewoods Organisation Plc* and the House of Lords' decision in *Fleming v Customs and Excise Commissioners* ([2001] EWCA Civ 1542; [2008] UKHL 2, www.practicallaw.com/7-380-9439). However, HMRC only paid simple interest, at the statutory rate prescribed by section 78, which amounted to approximately £268 million.

In 2007, Littlewoods commenced a restitutionary claim in the High Court, arguing that as a matter of English law or EU law, or both, it was entitled to a remedy equal to the benefit that the government had obtained by unlawfully collecting the VAT. Littlewoods argued that the government's benefit should be calculated by applying compound interest at a conventional rate, calculated by reference to the average cost of government borrowing during the period when the government held the overpayments.

Although the High Court trial started in April 2010, it was adjourned so that a number of questions could be referred to the European Court of Justice (ECJ). The ECJ held that where an EU member state has charged tax in breach of EU law, taxpayers are entitled to be repaid with interest (*Littlewoods Retail Ltd v HMRC C-591/10*; see *News brief "Compound interest and VAT: where are we now?"*, www.practicallaw.com/8-521-0777). However, the ECJ said that it was for national courts to decide on how the interest should be repaid, subject to the principle of effectiveness, which the ECJ confirmed required national laws to provide taxpayers with an "adequate indemnity" for their losses occasioned through the undue payment of VAT.

The High Court trial then resumed, and the court concluded that the EU law requirement for Littlewoods to receive an adequate indemnity for the loss occasioned by its overpayments of VAT necessitated an award of compound interest ([2014] EWHC 868; see *News brief "Overpaid tax: claiming for compound interest"*, www.practicallaw.com/8-565-4627). HMRC appealed to the Court of Appeal.

Key findings

The Court of Appeal upheld the High Court's decision in full, finding that it had not fallen into any error on any of the issues. In particular, the court found that, as a matter of English law, Littlewoods' claims were excluded by sections 78 and 80. However, Littlewoods' EU law right to an adequate indemnity meant that Littlewoods was entitled to be reimbursed for the losses that it suffered due to money being unavailable to it because tax had been unlawfully levied. On the facts of the case, this meant that an award of compound interest was necessary.

The court also found that the statutory exclusion of Littlewoods' claims by sections 78 and 80 was contrary to EU law, as it breached the principle of effectiveness by depriving Littlewoods of the right to an adequate indemnity. Therefore, sections 78 and 80 must be disapplied. There was no basis on which those sections could be disapplied selectively by the court, so Littlewoods was

free to choose the cause or causes of action that it wished to pursue before the English courts.

In calculating the quantum of Littlewoods' restitutionary claims, the court had to consider the objective use value of the overpayments received by the government. Here, that use value equated to the cost of government borrowing over the relevant period, including compound interest calculated to the date of the High Court's judgment.

Practical implications

In a brief issued shortly after the High Court's decision, 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 (www.gov.uk/government/publications/revenue-and-customs-brief-20-2014-high-court-judgment-on-interest-payments-for-littlewoods-retail-ltd). If HMRC obtains permission to appeal to the Supreme Court, it seems likely that it will take the same approach in light of the Court of Appeal's judgment.

A number of claims stand behind *Littlewoods*. It is understood that many of these claims ostensibly turn on similar facts and legal issues, although they will all need to be decided on their own merits. However, the conclusions in the Court of Appeal's judgment, especially in respect of the interpretation of EU law, are expressed to be "those which apply in the circumstances of this case". So HMRC may not accept the judgment as a general authority that compound interest is payable in respect of overpaid VAT.

Taxpayers may, however, wish to revisit with their tax advisers situations where they have received repayments of mistakenly overpaid tax. Potential claimants will also need to consider limitation issues before attempting to bring a claim.

Oliver Walker is counsel, and Christopher Marks is an associate, at Weil, Gotshal & Manges, which is acting for Littlewoods in the proceedings.
