

NEWS BRIEF

Overpaid tax: claiming for compound interest

Following a long-awaited decision by the High Court, taxpayers can now, in certain circumstances, claim compound interest on tax overpaid by mistake (*Littlewoods Retail Limited and others v The Commissioners for Her Majesty's Revenue and Customs* [2014] EWHC 868 (Ch)). The court also held that, where compound interest is payable in connection with overpaid VAT, sections 78 and 80 of the Value Added Tax Act 1994 (VATA), which provide a statutory framework for the repayment of VAT with simple interest, must be disapplied.

Earlier proceedings

Littlewoods' claims, worth in excess of £1.2 billion, arose from overpayments of VAT made by various home shopping companies in the Littlewoods group between 1973 and 2004. These overpayments amounted to more than £200 million and arose from the incorrect VAT treatment of commission arrangements between Littlewoods and its network of agents, which sold goods to the general public.

Following the Court of Appeal's decision in *Customs and Excise Commissioners v Littlewoods Organisation Plc* and the House of Lords' decision in *Fleming (trading as Bodycraft) v HMRC*; *Condé Nast Publishing Ltd v HMRC*, HM Revenue & Customs' (HMRC) repaid the principal amounts to Littlewoods, plus simple interest (at the statutory rate prescribed by section 78 of VATA) of £268,159,135 ([2001] EWCA Civ 1542; [2008] UKHL 2, www.practicallaw.com/7-380-9439).

In 2007, Littlewoods brought proceedings to seek restitution of the benefit obtained by the government as a consequence of the overpayments. 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.

The first phase of the High Court trial took place in April 2010. The trial was then adjourned for a number of questions to be referred to the European Court of Justice (ECJ) ([2010] EWHC 1071 (Ch)). The ECJ held that where an EU member state has charged tax in breach of EU law, taxpayers are entitled to the repayment of that tax together 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 is for the national court to decide the conditions on which this interest would be paid, subject to the EU principles of effectiveness and equivalence.

The High Court trial then resumed, with the court considering whether simple interest, paid in accordance with section 78 of VATA, is an effective and equivalent remedy.

Key findings

The High Court held that Littlewoods' claims for compound interest should succeed in full, for the following reasons:

- It is for national law to determine, in compliance with the principles of effectiveness and equivalence, whether a taxpayer that has overpaid VAT contrary to the requirements of EU law has a right to the reimbursement of the principal sum, and to the payment of interest on that sum. However, EU law requires that national laws should not deprive the taxpayer of an adequate indemnity for the loss caused by the overpayment of VAT. The court held that an adequate indemnity requires the payment of an amount of interest that is broadly commensurate with the loss of use value of the overpaid tax.
- As a matter of English law, and in accordance with the principles set out in *Sempra Metals Ltd v HMRC* (where the House of Lords held that compound interest was recoverable in restitution to

reflect the time value of corporation tax that was mistakenly paid prematurely), an assessment of the objective use value of the overpaid tax must be made, which is properly reflected in an award of compound interest ([2007] UKHL 34).

- In calculating the objective use value of the overpaid tax, the actual benefit derived by the government as a result of holding the overpayments is irrelevant.
- Where the provision of an adequate indemnity for the loss suffered through overpaid tax requires the payment of compound interest, sections 78 and 80 of VATA must be disapplied accordingly.

Practical implications

It is understood that a number of claims stand behind Littlewoods' claim. Many of these claims appear to turn on similar facts and legal issues, although they will all need to be decided on their own merits.

Due to the nature of the cause of the overpayments of VAT relevant to these proceedings, and the effects of statutory limitation periods for claims of overpaid tax, any immediate implications for other taxpayers may be limited. For example, section 80(4) of VATA imposes a four-year limitation period on VAT overpayment claims. Taxpayers may, however, wish to revisit with their tax advisers situations where they have received repayments of mistakenly overpaid tax.

HMRC has indicated that it intends to appeal the decision.

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