Neutral Citation Number: [2013] EWHC 3249 (Ch)

Case No: HC03C01346

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Rolls Building,
Royal Courts of Justice
Fetter Lane, London, EC4A 1NL

Date: 24/10/2013

Before :

MR JUSTICE HENDERSON

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Between :

(1) THE PRUDENTIAL ASSURANCE COMPANY LIMITED **(2) PRUDENTIAL HOLBORN LIFE LIMITED**	**Claimants**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Defendants**

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Mr Graham Aaronson QC and Mr Tom Beazley QC (instructed by **Joseph Hage Aaronson LLP**) for the **Claimants**
Mr David Ewart QC, Mr Rupert Baldry QC, Professor Andrew Burrows QC (Hon) and Ms Barbara Belgrano (instructed by **the General Counsel and Solicitor to HMRC**) for the **Defendants**

Hearing dates: 15, 16, 17, 18 and 19 July 2013

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Judgment

Mr Justice Henderson:

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I Introduction

1. On 15 to 19 July 2013 the resumed trial took place before me of the claims of two test claimants in the CFC and Dividend Group Litigation, namely the Prudential Assurance Company Limited ("Prudential") and Prudential Holborn Life Limited.

2. The initial trial of these claims had been adjourned by my order of 5 November 2010, following hearings on 18 to 19 November 2009 and 20 to 21 May 2010, for the reasons given in the judgment which I handed down on 5 November 2010. That judgment is reported as Test Claimants in the CFC and Dividend Group Litigation v Revenue and Customs Commissioners [2010] EWHC 2811 (Ch), [2011] STC 214. Since the CFC (*controlled foreign companies*) part of the CFC and Dividend Group Litigation is still dormant, for the reasons briefly stated in paragraph [6] of my earlier judgment, and since the Dividend part is in fact concerned with "portfolio" holdings of less than 10% of the shares of the relevant companies (see paragraphs [2] and [3]), I will for convenience refer to my earlier judgment as Portfolio Dividends (No. 1), and to the relevant part of the group litigation as the Portfolio Dividend Group Litigation, or the Portfolio Dividend GLO (*group litigation order*).

3. I will not, in general, repeat matters contained in my judgment in Portfolio Dividends (No. 1), and the present judgment should be read as a sequel to it. For consistency, I will continue to use the abbreviation "ECJ" to refer both to the Court of Justice of the European Union (as it has been since the entry into force of the Treaty of Lisbon on 1 December 2009) and to the Court of Justice of the European Communities (as it previously was). I will also continue to use most of the same abbreviations to refer to earlier domestic decisions in the FII (*franked investment income*) and other group litigation, although in the interests of clarity I now think it preferable to use the description "High Court" rather than "Chancery" to refer to decisions in the Chancery Division of the High Court. Thus I will use the label "FII (High Court)", rather than "FII (Chancery)", to refer to my judgment in Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners [2008] EWHC 2893 (Ch), [2009] STC 254. I will refer to the defendants as "HMRC" or "the Revenue".

4. There were two main procedural reasons why I decided to adjourn the trial in 2010. First, as a result of the decision of the Court of Appeal in FII (CA), which was handed down on 23 February 2010, it appeared that all of the claims for recovery of overpaid tax in the present proceedings were subject to a six year limitation period, whether those claims were pleaded as Woolwich claims (where it has always been common ground that the limitation period is six years from the date of the unlawful payment) or pleaded in mistake (where, according to the Court of Appeal, the extended limitation period conferred by section 32(1)(c) of the Limitation Act 1980 had been validly curtailed, even in relation to *San Giorgio* claims, first by section 320 of the Finance Act 2004 and then by section 107 of the Finance Act 2007: see Portfolio Dividends (No. 1) at paragraphs [48] to [50] and [56]). The claims which were thus time-barred included (subject to one possible exception, which I discussed in paragraphs [72] to [76]) all of the claims to recover advance corporation tax ("ACT"), because those claims had first been introduced by amendments made to the claim form in October 2009, but the payments in question had all been made in or before 1998. Secondly, the surviving claims relating to allegedly overpaid corporation tax, again according to the Court of Appeal in FII (CA), all fell within the scope of section 33 of the Taxes Management Act 1970 (or its corporate equivalent), and in many

cases were also capable of being raised in open appeals before the Tax Chamber of the First-tier Tribunal ("the FTT"), with the result (in either case) that the FTT had jurisdiction to deal with them and it would prima facie have been an abuse of process to pursue them in the High Court: see Portfolio Dividends (No. 1) at paragraphs [51] to [54] and [56].

5. Apart from those procedural reasons, the fundamental issue of the lawfulness of the Schedule D Case V charge to corporation tax on (non-portfolio) dividends paid by a subsidiary resident in an EU Member State to its UK-resident parent remained open, pending either a decision of the Supreme Court following the grant of permission to appeal or a further decision by the ECJ on a second reference for a preliminary ruling: see Portfolio Dividends (No. 1) at paragraphs [37] to [39]. More generally, I expressed the view (optimistically, as it turned out) at [68] that the existing appeals in the FII and Thin Cap group litigation, together with any further references to the ECJ that might be ordered in those appeals, would in due course probably resolve the great majority, if not all, of the issues which arise in the present case, or at any rate would in all likelihood point the way to a solution clearly enough for a further hearing to be unnecessary.

6. In the event, the Supreme Court refused both sides permission to appeal on the issues relating to the lawfulness of the Case V charge, and endorsed the decision of the Court of Appeal that there should be a second reference to the ECJ. In due course, as I shall explain in more detail later in this judgment, the second reference led to the decision of the ECJ on 13 November 2012 in Case C-35/11, Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue and the Commissioners for Her Majesty's Revenue & Customs, [2013] STC 612 (where the report includes the opinion of Advocate General Jääskinen), [2013] Ch 431 (where only the judgment of the Court is reported). I will refer to this judgment as "FII (ECJ) II", and to the judgment of the ECJ on the first reference in 2006 as "FII (ECJ) I" (Case C-446/04, [2006] ECR I-11753, [2007] STC 326, [2012] 2 AC 436).

7. The Supreme Court granted the parties permission to appeal from FII (CA) on a number of important issues relating to remedies, and after a six day hearing in February 2012 gave its judgment on 23 May 2012: see Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners [2012] UKSC 19, [2012] 2 AC 337. I will refer to this judgment as "FII (SC)". I will need to return to various aspects of the judgments in FII (SC), but at this stage the relevant point is that the Supreme Court overruled the Court of Appeal on the two procedural issues which had led me to adjourn the trial in 2010. First, the court held unanimously that section 107 of the Finance Act 2007 infringed the EU principle of protection of legitimate expectations in so far as it retrospectively excluded mistake-based claims which had been commenced before 8 September 2003, and which had been preserved when section 320 of the Finance Act 2004 was enacted. The claim of the first test claimant in the present case, Prudential, had been started by a claim form issued on 8 April 2003, so it has now been definitively held that this test claim, in common with all others begun before 8 September 2003, cannot be defeated by section 107 where the claimant seeks to rely on the extended limitation period for mistake claims. Secondly, the Supreme Court also held unanimously that section 33 of the Taxes Management Act 1970 was inapplicable to claims for recovery of tax which had been paid contrary

to EU law: see the judgments of Lord Walker of Gestingthorpe JSC at paragraphs [116] to [119] and Lord Sumption JSC at paragraphs [204] to [205].

8. In the light of these developments, it became clear that the supposed procedural obstacles to the prosecution of the present claims in the High Court had to a large extent disappeared. The test claimants therefore took steps to restore the matter, and at a case management conference on 20 December 2012 I ordered that the trial be resumed with a time estimate of 4 to 5 days. I also gave the parties permission to exchange any further witness statements of fact upon which they might wish to rely in relation to matters arising from the judgment of the ECJ in FII (ECJ) II, and directed the parties to agree a list of issues. This was duly done, and counsel used the list of issues as the framework for both their written and their oral submissions.

9. In broad terms, the issues which now fall for determination may be grouped under the following headings:

(1) How should the admitted invalidity under EU law of the Case V charge to corporation tax on portfolio dividends be remedied, whether by a conforming construction or disapplication of the offending domestic legislation?

(2) Did the ACT charge on the onward distribution in the UK of portfolio dividends received from abroad infringe Article 63 TFEU (free movement of capital), and (if so) how should the invalidity be remedied?

(3) Technical issues relating to the special taxation regime applicable to insurance companies, in the light of the answers to issues in categories (1) and (2) above.

(4) Issues relating to third country portfolio dividends, and the extent to which the test claimants can rely on Article 63 in relation to them.

(5) Remedies: in relation to each of the above categories, is there a valid Woolwich and/or mistake-based restitutionary claim, and if so in what amount? Are any restitutionary defences available to the Revenue, including in particular change of position, and (if so) are the requirements of any such defence satisfied, and to what extent?

(6) Interest: on what basis is interest payable on any sums the claimants are entitled to recover?

(7) Limitation: to what extent are the claims barred by a six year limitation period, and to what extend is the claim for recovery under a mistake of law barred by section 320 of the Finance Act 2004?

(8) Should any of the claims be stayed on Autologic principles, for example because they relate to open years, or years in which a claim for unilateral double taxation relief under section 790 of the Income and Corporation Taxes Act 1988 ("ICTA 1988") could have been made on the date when the pleadings were begun?

10. In practice, both sides have concentrated their main submissions on the issues in categories (1), (2), (5) and (6), which raise questions of general and potentially far

reaching significance, particularly in relation to the impact of directly effective principles of EU law on offending domestic legislation, and in relation to the English law of restitution. Neither side suggested that the answers to the technical questions on insurance company taxation turn on the intricacies of the relevant UK legislation, so it is fortunately unnecessary for me to provide more than a general guide to that notoriously complex subject. Nor have the issues relating to third country portfolio dividends loomed nearly as large as it appeared they might do three years ago, while the issues relating to limitation and the appropriate forum (the High Court or the FTT) have been greatly simplified by the decision of the Supreme Court in FII (SC).

11. On the issues relating to remedies and interest, I have had the benefit of full and stimulating submissions from Mr Tom Beazley QC, who is a newcomer to the test claimants' team and the Portfolio Dividend GLO, as well as from Mr Ewart QC and Professor Burrows QC on behalf of HMRC. The other issues were principally argued by Mr Aaronson QC for the claimants and Mr Ewart QC for the Revenue, both of whom are veterans of all the leading cases in the FII and related GLOs. I express my gratitude to them and their respective legal teams for the quality of the assistance I have received.

12. With this introduction, I will now deal with matters in the following order. I will begin with a broad overview of the relevant rules and legislation which at the material times governed the UK taxation of life assurance and pension business. I will then briefly review the history of the FII litigation, concentrating mainly on developments since my earlier judgment in Portfolio Dividends (No. 1). Before coming to the decision of the ECJ in FII (ECJ) II, I will examine two important previous decisions of the ECJ which have featured prominently in the argument on several of the issues before me. Those cases are Joined Cases C-436/08 and C-437/08, Haribo Lakritzen Hans Riegel BetriebsgmbH and Österreichische Salinen AG v Finanzamt Linz, [2011] ECR I-305, [2011] STC 917 ("Haribo" and "Salinen") and Case C-310/09, Ministre du Budget, des Comptes publics et de la Fonction publique v Accor SA, 15 September 2011, [2012] STC 438 ("Accor"). After reviewing those cases, and FII (ECJ) II, I will then deal with the agreed issues in the order set out above.

II The taxation of life assurance and pension business: an overview

13. This section of my judgment is based on the helpful summary contained in the claimants' skeleton argument, much of which I have reproduced verbatim. The rules for taxation of life assurance companies have undergone frequent and significant changes during the period covered by the claims, but the changes have not materially affected the substance of the issues which I have to determine. Statutory references given below should be taken as illustrative, since the provision in question may not have been in force throughout the whole period. It should also be noted that I refer to the provisions in the present tense, even though they may have been superseded.

14. Life insurance companies carry on various types of business, and specific tax rules apply to particular categories of business, such as life assurance and annuity business, overseas life assurance business, pension business and permanent health business.

15. Where a life assurance company carries on more than one of these categories of business, each category is treated separately for tax purposes, and detailed rules apply for the apportionment of investment income and gains or losses between the

categories. Income and gains or losses directly referable to any one category of business are attributed to that category. Income or gains or losses not directly referable to a specific category are apportioned between the categories under detailed rules set out in ICTA 1988 sections 432A, C, D and E.

16. One of the separate categories of business is "basic life assurance and general annuity business" ("BLAGAB"). It is a broad category that includes most types of life assurance, but specifically excludes pension business: see ICTA 1988 sections 431F and 431 EA.

17. Corporation tax on profits of life assurance companies referable to BLAGAB is in practice charged on the so-called "Income minus Expenses" ("I minus E") basis. The I minus E basis taxes the investment return accruing to policy holders from the investments of a life assurance company's long term fund under Schedule A and Cases III, V and VI of Schedule D, together with net chargeable gains. It allows deduction only of non-trading loan relationship deficits and the expenses of managing the business (which are dealt with under special rules contained in ICTA 1988 section 76). The objective of the I minus E basis is to ensure that the investment returns included in benefits paid to policy holders have been taxed in the hands of the insurance company at an appropriate rate. Holders of UK life assurance policies are not subject to basic or lower rate tax on the gains from their policies, and the tax collected from the insurance company under the I minus E system may be seen as a proxy for that tax.

18. On the assumption that the life assurance business is carried on for profit, and is not mutual business, the profit for shareholders is also included in the charge to tax under the I minus E basis rather than being separately taxed as the profits of a trade under Case I of Schedule D. However, different rates of corporation tax are charged on the respective policy holders' and shareholders' shares of the profits or gains taxed under the I minus E basis. The policy holders' share is taxed at only the basic, or lower, rate of tax, consistently with the objective referred to above, whereas the shareholders' share is taxed at the full rate of corporation tax. The detailed rules are contained in sections 88 and 89 of the Finance Act 1989.

19. Although there is no actual charge under Case I of Schedule D on BLAGAB profits, it is nevertheless necessary to carry out a "notional" Case I computation for at least two reasons. First, the computation is a necessary step in determining the respective policy holders' and shareholders' shares for the purposes of sections 88 and 89. Secondly, the notional calculation also serves to impose a minimum charge on taxable profits in cases where the I minus E basis produces a lower amount than the Case I computation. In such circumstances, the notional Case I computation is treated as the taxable profit. As a matter of mechanics, this is achieved by restricting the "E" in the I minus E calculation.

20. Under the I minus E basis, section 208 of ICTA 1988 applies in the normal way so as to exclude dividends received from a UK-resident company from the charge to corporation tax. Section 208 provides as follows:

> "Except as otherwise provided by the Corporation Tax Acts, corporation tax shall not be chargeable on dividends and other distributions of a company resident in the United Kingdom, nor

> shall any such dividends or distributions be taken into account in computing income for corporation tax."

21. By contrast, foreign-source dividends are charged to corporation tax in the I minus E computation as income within Case V of Schedule D ("tax in respect of income arising from possessions out of the United Kingdom"). Double tax relief is given, either under double tax arrangements with other countries or unilaterally under section 790(4) and (5) of ICTA 1988, for foreign withholding taxes paid on the dividends, but not (in the case of portfolio dividends) for the underlying corporation tax on the profits from which the dividends were paid.

22. Following the decision of the ECJ in FII (ECJ) I, HMRC accept that foreign portfolio dividends received as part of the test claimants' BLAGAB business were treated less favourably than domestic dividends, and (in the case of dividends received from companies resident in the EU) that this treatment was contrary to Article 63 TFEU (formerly Article 56 EC): see Portfolio Dividends (No. 1) paragraph [29], and paragraph 7 of the Revenue's skeleton argument for the hearing in November 2009.

23. I now turn to the rules relating to pension business. The relevant rules are those relating to distributions made on or before 1 July 1997. Under those rules, the actual income from investments held by life assurance companies for pension business was exempt from corporation tax under section 438(1) of ICTA 1988, which provided that:

> "Exemption from corporation tax shall be allowed in respect of income from, and chargeable gains in respect of, investments and deposits of so much of an insurance company's long term business fund, as is referable to pension business."

By virtue of section 438(2), however, this exemption did not "exclude any sums from being taken into account as receipts in computing profits or losses for any purpose of the Corporation Tax Acts". The profit earned for the company by carrying on the pension business was taxed under Case VI of Schedule D, but applying Case I principles, as profit from underwriting: see section 436(1). In this way the insurance company was taxed on its share of the pension income and gains, at the full rate of corporation tax, while the policy holders' share was exempt. The exemption for the policy holders' share reflected the fact that pension policy holders were taxed on receipt of their pensions, and unlike the holders of life assurance policies they did not receive the proceeds already taxed at the basic or lower rates.

24. Prima facie, by virtue of section 438(3), the general exemption of UK dividends from corporation tax in section 208 of ICTA 1988 did not apply to the FII of an insurance company when such income arose from pension business. The FII would therefore be included in the computation of pension business profits under section 436. However, the insurance company could make an election under section 438(6) that section 208 would apply to the share of FII received by its pension business, in which case the company would gain the advantage of exemption from corporation tax on the relevant portion of the FII but at the price of losing the benefit of the associated tax credit: see Portfolio Dividends (No. 1) at paragraph [12].

25. In view of the relevance of these provisions to one of the technical issues, I will quote the provisions of section 438(3) and (6) as they stood in 1994/95:

> "(3) Subject to subsection (6) below, the exclusion by section 208 from the charge to corporation tax of franked investment income shall not prevent such income being taken into account as part of the profits in computing under section 436 income from pension business.
>
> …
>
> (6) If for any accounting period there is, apart from this subsection, a profit arising to an insurance company from pension business and computed under section 436, and the company so elects as respects all or any part of its relevant franked investment income arising in that period, … subsections (3) to (5) above shall not apply to the franked investment income to which the election relates."

For the purposes of subsection (6), "relevant" FII meant the shareholders' share of FII referable to pension business, "shareholders' share" having the same meaning as for the purposes of section 89 of the Finance Act 1989.

26. Because the right to make an election under section 438(6) was confined to FII, and thus to dividends received from UK-resident companies, it followed that pension business dividends received from companies resident outside the UK were compulsorily included in the computation of the company's profit from its pension business. In the case of portfolio dividends, double taxation relief was again given only for withholding taxes, and not for underlying tax on the profits out of which the dividends were distributed.

27. For completeness, I should mention that the tax rules for general (as opposed to life) insurance companies were at all material times much simpler; and the complexities of insurance company taxation do not impinge at all on the claims of other participants in the Portfolio Dividends GLO who received portfolio investment income either as part of a fund management business or as trading income. In the case of general insurers, it is not disputed that as from 1 July 1997 they had the benefit of section 208 in exempting FII from the charge to corporation tax on their profits, whereas no such exemption was available in respect of their foreign dividends. In the case of non-insurance fund managers or traders, they were taxed on foreign dividend income under either Case I or Case V of Schedule D, while their domestic dividends were again exempt under section 208.

28. The Prudential test claimants have been selected because their claims are thought to encompass all of the issues which arise under the Portfolio Dividends GLO not only for insurance companies of all types, but also for other corporate recipients of portfolio investment income.

III The history of the FII litigation

29. I do not propose to deal in any detail with the history of the FII litigation, or of the present proceedings relating to portfolio dividends, down to and including the decision of the Court of Appeal in FII (CA). I have already covered most of this ground in Portfolio Dividends (No. 1) at paragraphs [7] to [54]. In general terms, and by way of recapitulation, it is enough to say that in its reasoned order in the present case the ECJ repeated and applied the principles which it had laid down in FII (ECJ) I, while also dealing specifically with the issues relating to the right of election under section 438(6) of ICTA 1988, and third country dividends, which had been raised in Questions 2 and 4 of the order for reference made by Park J on 18 March 2005. Meanwhile, on the domestic front, I heard and decided FII (High Court) in 2008, and in February 2010 the Court of Appeal delivered its judgment in FII (CA) on the appeals and cross-appeals from my decision. Five of the main areas in which the Court of Appeal disagreed with my conclusions are summarised in Portfolio Dividends (No. 1) at paragraphs [36] to [54].

30. In Portfolio Dividends (No. 1) I quoted the main parts of the ECJ's reasoned order dealing with portfolio dividends, and nothing would be gained by setting out the corresponding parts of the Court's earlier judgment in FII (ECJ) I on which they were based. I will, however, quote one passage from the discussion of non-portfolio dividends by the ECJ in FII (ECJ) I, because it forms the basis of important parts of the subsequent reasoning of the Court in Haribo, Accor and FII (ECJ) II. The passage comes in the context of the Court's statement of principle that a Member State which wishes to prevent or mitigate the imposition of a series of charges to tax on distributed profits may choose between a number of systems which will not necessarily have the same result (paragraph 43 of the judgment), provided however that, in structuring its tax system, a Member State must comply with the provisions of EU law, and especially those imposed by the Treaty provisions on free movement (paragraph 45). The passage then continues:

> "46. It is thus clear from case-law that, whatever the mechanism adopted for preventing or mitigating the imposition of a series of charges to tax or economic double taxation, the freedoms of movement guaranteed by the Treaty preclude a Member State from treating foreign-sourced dividends less favourably than nationally-sourced dividends, unless such a difference in treatment concerns situations which are not objectively comparable or is justified by overriding reasons in the general interest (see, to that effect, Case C-315/02 *Lenz* [2004] ECR I-7063, paragraphs 20 to 49, and Case C-319/02 *Manninen* [2004] ECR I-7477, paragraphs 20 to 55) …
>
> 47. As regards the question whether a Member State may operate an exemption system for nationally-sourced dividends when it applies an imputation system to foreign-sourced dividends, it must be stated that it is for each Member State to organise, in compliance with Community law, its system for taxing distributed profits and, in particular, to define the tax base and the tax rate which apply to the company making the

distribution and/or the shareholder receiving them, in so far as they are liable to tax in that Member State.

48. Thus, Community law does not, in principle, prohibit a Member State from avoiding the imposition of a series of charges to tax on dividends received by a resident company by applying rules which exempt those dividends from tax when they are paid by a resident company, while preventing, through an imputation system, those dividends from being liable to a series of charges to tax when they are paid by a non-resident company.

49. In order for the application of an imputation system to be compatible with Community law in such a situation, it is necessary, first of all, that the foreign-sourced dividends are not subject in that Member State to a higher rate of tax than the rate which applies to nationally-sourced dividends.

50. Next, that Member State must prevent foreign-sourced dividends from being liable to a series of charges to tax, by offsetting the amount of tax paid by the non-resident company making the distribution against the amount of tax for which the recipient company is liable, up to the limit of the latter amount.

51. Thus, when the profits underlying foreign-sourced dividends are subject in the Member State of the company making the distribution to a lower level of tax than the tax levied in the Member State of the recipient company, the latter Member State must grant an overall tax credit corresponding to the tax paid by the company making the distribution in the Member State in which it is resident.

52. Where, conversely, those profits are subject in the Member State of the company making the distribution to a higher level of tax than the tax levied by the Member State of the company receiving them, the latter Member State is obliged to grant a tax credit only up to the limit of the amount of corporation tax for which the company receiving the dividends is liable. It is not required to repay the difference, that is to say, the amount paid in the Member State of the company making the distribution which is greater than the amount of tax payable in the Member State of the company receiving it.

53. Against that background, the mere fact that, compared with an exemption system, an imputation system imposes additional administrative burdens on taxpayers, with evidence being required as to the amount of tax actually paid in the State in which the company making the distribution is resident, cannot be regarded as a difference in treatment which is contrary to freedom of establishment, since particular administrative burdens imposed on resident companies receiving foreign-

> sourced dividends are an intrinsic part of the operation of a tax credit system."

31. It can be seen that this passage formulates three important principles. First, whatever mechanism a Member State chooses to adopt in order to prevent or mitigate economic double taxation, the Treaty freedoms of movement prohibit treating foreign-sourced dividends less favourably than nationally-sourced dividends, unless the less favourable treatment either (a) concerns situations which are not objectively comparable, or (b) is justified by overriding reasons in the general interest.

32. Secondly, there is no reason in principle why a Member State should not operate a dual system (of exemption for national dividends and imputation for foreign dividends, as in the UK at the material time), provided that:

    (a) the Member State does not impose a higher rate of tax on foreign dividends than it does on national dividends; and

    (b) it gives a credit for the amount of tax paid by the foreign company, up to (but not in excess of) the amount of tax paid by the national company on the dividends.

33. Thirdly, the mere fact that an imputation system imposes additional administrative burdens on taxpayers, when compared with an exemption system, for example requiring evidence of the amount of tax actually paid in the foreign country, does not infringe Article 63, because such burdens "are an intrinsic part of the operation of a tax credit system".

34. Before I come on to the decisions of the ECJ in <u>Haribo</u> and <u>Accor</u>, I will first complete the history of the domestic FII litigation. On 8 November 2010 the Supreme Court ruled on the applications for permission to appeal by both parties from the decision of the Court of Appeal in <u>FII (CA)</u>. Permission to appeal was refused on the issues relating to the lawfulness of the Case V charge to corporation tax, and the "corporate tree" ACT issues, on which the Court of Appeal had decided there should be a further reference to the ECJ. The Supreme Court added two further questions to be referred to the ECJ, neither of which is directly relevant for present purposes. The time limit for making an application for permission to appeal on a number of the other issues was extended until after the further reference had been determined by the ECJ and its rulings had been applied. Permission to appeal was, however, given on four issues relating to remedies, to which a fifth was added shortly before the hearing of the appeal.

35. The appeal was heard by a court of seven justices, headed by Lord Hope of Craighead DPSC. Lord Hope delivered a most helpful introductory and co-ordinating judgment, in which he also briefly stated his own views on the issues. As he said, "very substantial judgments" had been prepared by each of Lord Walker of Gestingthorpe, Lord Reed and Lord Sumption JJSC. Shorter, but by no means insubstantial, judgments were also delivered by Lord Browne of Eaton-under-Heywood and Lord Clarke of Stone-cum-Ebony, while Lord Dyson JSC briefly stated where he stood on all the issues. In very broad terms, and without attempting a detailed analysis, there were a number of issues on which all members of the court were agreed; but on a critical issue of EU law, namely whether EU law protected the test claimants'

mistake-based claims, and the related question whether such claims had been validly curtailed by section 320 of the Finance Act 2004, the court was divided. A majority of five considered, for various reasons, that the mistake-based claims were protected by EU law; that the test claimants should enjoy the same freedom of choice between the Woolwich and mistake-based restitutionary causes of action as English law would afford in a purely domestic context; and that section 320 infringed at least the EU principle of effectiveness, with the result that it could not be relied on as a defence to the test claimants' *San Giorgio* claims. The minority, however, comprising Lord Sumption and Lord Browne, disagreed, taking the view that the protection afforded by EU law extended no further than the Woolwich cause of action, which by itself provided an effective remedy for recovery of the unlawfully levied ACT, and that the enactment of section 320 had therefore not infringed the EU principle of effectiveness. In view of the disagreement on this key question, all members of the court were agreed that it could not be regarded as *acte clair*, and that there would have to be a further (third) reference to the ECJ.

36. I have already referred to two issues on which the Supreme Court were unanimous, concerning section 107 of the Finance Act 2007 and section 33 of the Taxes Management Act 1970: see paragraph 7 above. The other issues which have now been definitively determined relate to the Woolwich remedy. The court has held that the Woolwich remedy does not require a "demand"; that it provided an effective remedy under EU law for recovery of the unlawfully levied ACT; and that it did not benefit from the extended limitation period under section 32(1)(c) of the Limitation Act 1980.

37. The position on the third reference to the ECJ is as follows. The reference was duly made, and the oral proceedings took place on 26 June 2013, some three weeks before the resumption of the present trial. The Advocate General (Wathelet) issued his Opinion on 5 September 2013. The judgment of the Court is awaited, probably towards the end of this year or early in 2014.

IV The decisions of the ECJ in Haribo and Accor

38. The decision of the Third Chamber of the ECJ in the conjoined cases of Haribo and Salinen is of particular relevance to the present case for at least two reasons. First, it considered the compatibility with Article 63 TFEU of a (rather complex) dual exemption and imputation system for national and foreign dividends, in the specific context of portfolio holdings. Secondly, it raised in an acute form the difficulties of compliance with the information requirements of the Austrian tax authorities, which in practice usually had the result of preventing taxpayers from claiming either the conditional exemption afforded to certain foreign portfolio dividends or a tax credit under the alternative imputation system, thereby leaving the portfolio dividends chargeable to Austrian corporation tax at the full national rate.

39. As Advocate General Kokott said by way of introduction to her Opinion delivered on 11 November 2010:

> "1. The present cases once again concern the taxation of foreign dividends. Austrian law on corporation tax contains rules which are intended to prevent the double imposition of corporation tax on corporate profits distributed in the form of dividends, once at the level of the company making the

> distribution and a second time at the level of the recipient company. In the case of national dividends such economic double taxation is prevented by the dividends being exempt from corporation tax at the level of the recipient company. In the case of foreign dividends, however, the question whether an exemption is granted, a credit is merely given for the foreign corporation tax, or neither, depends on the size of the holding, the previously paid tax and the origin.
>
> 2. In the case of portfolio dividends from other European Union ("EU") States, that is to say dividends from shareholdings of less than 10%, exemption and crediting appear to be frustrated, as a rule, because the recipient is not able to provide the necessary information on previously paid foreign corporation tax. In such cases, economic double taxation therefore occurs …"

40. In simplified terms, the scheme of the relevant Austrian corporation tax legislation, contained in paragraph 10 of the 1988 Law on corporation tax as amended with retrospective effect in 2009, was to provide:

(a) unconditional exemption for domestic dividends (broadly equivalent to the exemption in section 208 of ICTA 1988);

(b) exemption subject to fulfilment of various conditions for foreign portfolio dividends;

(c) unconditional exemption for foreign non-portfolio dividends (i.e. from holdings of more than 10%; before 2009 the threshold was 25%); and

(d) where exemption was not available under (b) or (c), a tax credit for foreign tax corresponding to Austrian corporation tax.

41. On 13 June 2008 the Federal Ministry of Finance published an extra-statutory notice ("the 2008 Notice") concerning paragraph 10(2) of the 1988 Law on corporation tax. The 2008 Notice, which applied retrospectively, provided that if dividends were distributed from holdings in foreign companies below the (then) 25% exemption threshold, both the corporation tax charged on the profits distributed in the state of residence of the distributing company and the withholding tax levied in that state were to be credited against the Austrian corporation tax due. The Notice went on to state that, in order to obtain a credit for the foreign tax, the taxpayer had to provide the following information (see paragraph 7 of the judgment of the ECJ; I have added lettering for ease of reference):

> "(a) the exact name of the company making the distribution in which the taxpayer has the holding;
>
> (b) a precise indication of the size of the holding;
>
> (c) a precise indication of the rate of corporation tax to which the company making the distribution is subject in the State in

> which it is established. If it is not subject to the normal tax regime of the State in which it is established (in that, for example, it has the benefit of a more favourable rate of tax, a personal tax exemption or significant tax exemptions or reductions), the rate of tax actually applicable must be given;
>
> (d) an indication of the amount of corporation tax charged on the taxpayer's holding in the light of the above parameters;
>
> (e) a precise indication of the rate of the withholding tax actually levied, restricted to the rate of withholding tax under the relevant double taxation convention;
>
> (f) a calculation of the tax creditable."

42. It can be seen, therefore, that the 2008 Notice required the company receiving the dividend to supply precise details of the rate of corporation tax (presumably the nominal or statutory rate) to which the distributing company was subject in its state of residence, together with details of "the rate of tax actually applicable" (which must, I think, in at least some cases mean the effective rate) if the company benefited from a more favourable tax regime, or from significant exemptions or reliefs. The referring tribunal in Haribo considered that the 2008 Notice remained applicable despite the legislative amendments to the corporation tax law in 2009. However, it also appears from paragraph 99 of the judgment of the ECJ that, in practice, the Austrian authorities were normally content for the credit to be computed by reference to the nominal rate of corporation tax in the distributing company's state of residence:

> "99. Furthermore, as the Austrian Government observes, the notice of 13 June 2008 has simplified the evidence necessary in order to receive a credit for the foreign tax in that, when calculating the tax paid abroad, account is taken of the following formula. The profit of the company distributing dividends must be multiplied by the nominal rate of corporation tax applicable in the State where that company is established and by the holding of the recipient company in the capital of the company distributing dividends. Such a calculation requires only limited co-operation on the part of the company distributing dividends or of the investment fund when the holding concerned is possessed through such a fund."

43. Against this background, I can now turn to the facts in the two cases, which were relatively straightforward. In the 2001 tax year, Haribo received income from a holding in an investment fund that included dividends paid by capital companies established both in Member States other than Austria and in third countries. Salinen received similar income in the 2002 tax year, and also suffered operating losses. Both companies applied for the dividends paid by foreign companies in which they held less than 25% of the shares to be exempt. The applications were refused, and the companies appealed to the independent finance tribunal in Linz, which allowed their appeals, holding that paragraph 10(2) of the 1988 Law infringed Article 63. Applying by analogy the exemption for domestic dividends in paragraph 10(1), the tribunal said that the foreign dividends in question should be treated as tax-exempt income.

44. On a further appeal to the higher administrative court (the Verwaltungsgerichtshof), that court affirmed the decision of the tribunal on liability, but disagreed with it on the appropriate remedy. It held that the right solution was not to exempt the relevant dividends, but rather to grant a credit for the foreign tax charged on the dividends. According to the administrative court, the imputation method corresponded more closely to the approach chosen by the Austrian legislature than the exemption method, particularly where the foreign tax was levied at a lower rate than the Austrian tax: see paragraph 16 of the judgment of the ECJ.

45. It was at this stage, and in response to the decision of the administrative court, that the Finance Ministry published the 2008 Notice. The cases were referred back to the Linz tribunal, which on 3 October 2008 made a reference to the ECJ on the question whether the exemption and imputation methods could be regarded as equivalent under EU law. Following the 2009 amendments to the relevant legislation, the tribunal was asked by the ECJ to clarify the effect of the amendments, and this led to a reformulation of the questions referred to the ECJ.

46. For present purposes, the most important of the questions referred is the second, which asked:

> "Is [*European Union*] law infringed if for foreign portfolio dividends from [*States of the European Union or States party to the EEA Agreement*] the imputation method is to be applied in so far as the requirements for the exemption method are not met, although both the proof of the requirements for the exemption method (comparable taxation, amount of the foreign tax rate, absence of personal or subject-based exemptions of the foreign corporation) and the data necessary for the crediting of foreign corporation tax cannot be provided by the shareholder, or can be provided only with great difficulty?"

Question 3 then asked whether EU law was infringed in the case of third country portfolio dividends, in circumstances where the legislation granted neither an exemption nor a tax credit. If Question 3 was answered in the affirmative, Question 4(a) asked whether EU law would still be infringed if, in order to remove discrimination against third country holdings, the imputation method were adopted, but proof of the foreign tax already paid could not be proved, or could be proved only with disproportionate effort.

47. A further issue, which arose only in Salinen, was whether the tax to be credited under the imputation system had to include withholding tax levied by the distributing company's state of residence, as well as the underlying corporation tax paid in that state: see paragraph 26 of the judgment of the ECJ.

48. It is worth noting that four members of the Third Chamber of the ECJ which heard the case, including the President and Juge Rapporteur (Judge Lenaerts), had also been members of the court which delivered the reasoned order in the present case. The Court dealt with Question 2 in paragraphs 76 to 104 of its judgment. The Court first held that the relevant legislation entailed a restriction on the movement of capital which was in principle prohibited by Article 63 (paragraphs 79 to 81). On the issue of justification, the Court relied on FII (ECJ) I for the basic propositions that the

situation of a corporate shareholder receiving foreign dividends is comparable to that of a corporate shareholder receiving national dividends, and where a Member State has a system for preventing economic double taxation in respect of national dividends it must accord equivalent treatment to foreign dividends (paragraphs 84 and 85). The court then repeated its previous learning about the conditions which must be satisfied if an imputation method is to provide equivalent treatment to an exemption for national dividends, referring to FII (ECJ) I at paragraphs 48, 51, 52 and 57, and paragraph 39 of the reasoned order in the present case.

49. The Court continued:

> "89. In those circumstances the imputation method enables dividends from non-resident companies to be accorded treatment equivalent to that accorded, by the exemption method, to dividends paid by resident companies. Application of the imputation method to dividends from non-resident companies makes it possible to ensure that foreign-sourced and nationally-sourced portfolio dividends bear the same tax burden, in particular where the State from which the dividends come applies, in the context of corporation tax, a lower tax rate than that applicable in the Member State where the company receiving the dividends is established. In such a case, exempting dividends from non-resident companies would give taxpayers that have invested in foreign holdings an advantage compared with those having invested in domestic holdings.
>
> 90. In light of the equivalence between the exemption and imputation methods, the difficulties that the taxpayer might encounter in order to prove that the conditions for the tax exemption of dividends received from non-resident companies are met are, in principle, irrelevant when determining whether Article 63 TFEU precludes legislation such as that at issue in the main proceedings. The only consequence that those difficulties, or even impossibility for the taxpayer to furnish the proof sought, will have is that the imputation method, which is equivalent to the exemption method, will be applied to the dividends which the taxpayer receives from non-resident companies.
>
> 91. As to the administrative burden imposed on the taxpayer in order to qualify for the imputation method, it has already been held that the mere fact that, compared with an exemption system, an imputation system imposes additional administrative burdens on taxpayers cannot be regarded as a difference in treatment which is contrary to the free movement of capital (see, to this effect, *Test Claimants in the FII Group Litigation*, paragraph 53).
>
> 92. According to the referring tribunal, the administrative burden thereby imposed on a company receiving portfolio

dividends by the national legislation at issue in the main proceedings could, however, prove excessive.

93. Haribo explains in this regard that, unlike portfolio dividends paid by resident companies, which are exempt, portfolio dividends paid in Austria by companies established in another Member State or in a non-Member State party to the EEA Agreement and received through an investment fund are normally subject, in Austria, to corporation tax of 25% because of the excessive administrative burden imposed on the taxpayer. According to Haribo, the exemption and imputation methods are equivalent only in cases where proof of the corporation tax paid abroad can in fact be adduced or can be without disproportionate effort.

94. On the other hand, the Austrian, German, Italian, Netherlands and United Kingdom Governments and the Commission contend that the administrative burden imposed on the company receiving portfolio dividends is not excessive. The Austrian Government stresses in this regard that the Notice of 13 June 2008 simplified significantly the evidence necessary in order to receive a credit for the foreign tax.

95. It must be born in mind that the tax authorities of a Member State are entitled to require the taxpayer to provide such proof as they may consider necessary in order to determine whether the conditions for a tax advantage provided for in the legislation at issue have been met and, consequently, whether to grant that advantage (see, to this effect, Case C-136/00 *Danner* [2002] ECR I-8147, paragraph 50; Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 43; and Case C-318/07 *Persche* [2009] ECR I-359, paragraph 54).

96. Admittedly, if it were to prove that, because of an excessive administrative burden, it is in fact impossible for companies receiving portfolio dividends from companies established in Member States other than the Republic of Austria and in non-Member States party to the EEA Agreement to benefit from the imputation method, the legislation would not enable the economic double taxation of such dividends to be prevented, or even to be mitigated. In circumstances of that kind, the imputation method and the exemption method, which does enable the imposition of a series of charges to tax on the dividends distributed to be avoided, cannot be considered to lead to equivalent results.

97. However, inasmuch as a Member State is, in principle, free, to avoid the imposition of a series of charges to tax on portfolio dividends received by a resident company by opting for the exemption method when the dividends are paid by a resident company and for the imputation method when they are paid by

a non-resident company …, additional administrative burdens which are imposed on the resident company, in particular the fact that the national tax authority demands information relating to the tax that has actually been charged on the profits of the company distributing dividends in the State in which the latter is resident, are an intrinsic part of the very operation of the imputation method and cannot be regarded as excessive (see, to this effect, *Test Claimants in the FII Group Litigation*, paragraphs 48 and 53). In the absence of such information, the tax authorities of the Member State where the company receiving foreign-sourced dividends is established are not, in principle, in a position to determine the amount of corporation tax paid in the State of the company making the distribution that must be credited against the amount of tax payable by the recipient company.

98. Whilst the company receiving dividends does not itself have all the information relating to the corporation tax that has been charged on the dividends distributed by a company established in another Member State or in a non-Member State party to the EEA Agreement, such information is known, in any event, to the latter company. Accordingly, any difficulty that the recipient company may have in providing the information required relating to the tax paid by the company distributing dividends is connected not to the inherent complexity of the information but to a possible lack of co-operation on the part of the company that has the information. As the Advocate General states in point 58 of her Opinion, the inadequate flow of information to the investor is not a problem for which the Member State concerned should have to answer."

50. It is worth noting at this point what Advocate General Kokott had said on this subject at paragraphs 55 to 58 of her Opinion:

"55. In the present cases, the problem actually resides purely in the realm of fact. Thus, Haribo claims that in the case of a portfolio holding in a foreign corporation through a domestic investment fund it is not even possible to ascertain the corporation from which the dividends originate.

56. In my opinion, these problems of proof cannot in themselves make it disproportionate to apply an only conditional exemption method with a possible switchover to the imputation method, as provided for in Austrian law for portfolio dividends from other EU/EEA States.

57. Such a provision does not require anything that is actually impossible. The necessary information is in fact available somewhere, namely from the respective companies which distributed the dividends and possibly also from the domestic investment funds through which the company shares eligible

> for dividends are held. If obtaining that information entails considerable, cost-intensive effort, the investor must consider which is more favourable for him: proving the previous foreign charge to tax or relinquishing the exemption or credit.
>
> 58. Even if such proof should ultimately not be possible because the shareholder is not in a position, *de facto* or *de jure*, to obtain that information, this must nevertheless be attributed to the shareholder's sphere. It is in the interest of both the foreign companies and the domestic investment fund to organise the portfolio investment as attractively as possible. This includes providing the shareholder with the necessary information so that he can benefit from the possibility of preventing or mitigating economic double taxation in his state of residence. The inadequate flow of information to the investor is not a problem for which the Member State should have to answer."

51. Reverting to the judgment of the Court, the ECJ then referred in paragraph 99 to the simplifications introduced by the 2008 Notice, and in paragraphs 100 to 103 made the point that the availability of various mutual assistance provisions did not place national tax authorities under any obligation to use them in order to obtain the necessary information. The Court then stated its answer to the second question in paragraph 104:

> "104. In light of the foregoing, the answer to the second question referred therefore is that Article 63 TFEU must be interpreted as not precluding legislation of a Member State under which portfolio dividends which a resident company receives from another resident company are exempt from corporation tax whilst portfolio dividends which a resident company receives from a company established in another Member State or in a non-Member State party to the EEA Agreement are subject to that tax, provided, however, that the tax paid in the State in which the last-mentioned company is resident is credited against the tax payable in the Member State of the recipient company and the administrative burden imposed on the recipient company in order to qualify for such a credit are not excessive. Information demanded by the national tax authority from the company receiving dividends that relates to the tax that has actually been charged on the profits of the company distributing dividends in the State in which the latter is resident is an intrinsic part of the very operation of the imputation method and cannot be regarded as an excessive administrative burden."

52. The crucial point which in my judgment emerges from the Court's discussion of Question 2 is its apparently unqualified endorsement of the principle that it is an intrinsic part of the operation of an imputation system to require the taxpayer to provide details of the foreign tax actually charged on the distributed profits, even in the case of portfolio dividends. This principle therefore cannot in itself be regarded as

imposing an excessive administrative burden on taxpayers. It follows, in my view, that any difficulty, or even practical impossibility, for a taxpayer in providing such information cannot be taken into account in determining whether an excessive administrative burden has been imposed on him. The justification for this austere doctrine is that the relevant information must be known to the company making the distribution; and any inadequacy in the provision of information to the investor "is not a problem for which the Member State concerned should have to answer" (paragraph 98). Furthermore, the Court reached this conclusion in the light of evidence before the referring tribunal that in practice it was usually impossible for investors to furnish the information required by the Austrian tax authorities, apparently even after the simplifications introduced in 2008.

53. It should be noted that the discussion by the ECJ of Question 2 was concerned only with portfolio dividends from other EU/EEA States. The reason for this was that the legislation provided neither exemption nor a tax credit for dividends from third countries. In its answer to Question 3, the ECJ held that this treatment infringed Article 63; while in its answer to question 4 it ruled, in effect, that the infringement could be remedied by adoption of an imputation system, subject to the same conditions as applied in relation to portfolio dividends from EU or EEA States. In particular, the Court made it clear that the same principles relating to the allegedly excessive administrative burden that this would place on taxpayers would apply: see paragraphs 144 and 147 of the judgment.

54. Finally, I should briefly mention the answer which the Court gave to the separate question in Salinen (see paragraph 47 above). The Court pointed out in paragraph 166 that the imposition of a withholding tax at source in the State of the company making the distribution "creates the conditions for juridical double taxation unless a credit is granted for it in the State where the Company receiving the dividends concerned is established". Nevertheless, in the absence of any general rules for the elimination of double taxation within the EU, and having regard to the corresponding freedom of Member States to define their tax base and exercise their fiscal competence, there was no requirement *of EU law* (my emphasis) to provide a credit for such withholding tax under an imputation system. The Court concluded:

> "171. Accordingly, Article 63 cannot be interpreted as obliging a Member State to provide, in its tax legislation, that a credit is to be granted for the withholding tax levied on dividends in another Member State in order to prevent the juridical double taxation – resulting from the parallel exercise by the Member States concerned of their respective powers of taxation – of the dividends received by a company established in the first Member State (see, to this effect, Case C-513/04 *Kerckhaert and Morres* [2006] ECR I-10967, paragraphs 22 to 24).
>
> 172. The same finding is called for *a fortiori* where the juridical double taxation results from the parallel exercise by a Member State and a non-Member State of their respective powers of taxation, as follows from paragraphs 119 and 120 of the present judgment."

55. I now turn to Accor. Under the French tax legislation in force at the relevant time (1998 to 2000), a French parent company was not subject to corporation tax on dividends it received from its subsidiaries, wherever the subsidiaries were established. Pursuant to Article 158 *bis* of the Code Général des Impôts ("CGI"), if the dividends were distributed to the parent by a subsidiary established in France, the parent company received a tax credit equal to half of the actual payments made by the subsidiary. The parent did not, however, receive any credit in respect of dividends originating from subsidiaries established outside France.

56. When the parent company redistributed the dividends to its shareholders, it was required to make an advance payment of tax by Article 223 *sexies* of the CGI, in an amount equal to the tax credit calculated under Article 158 *bis.* Where the parent company had received a credit in respect of the dividends, it could set off the amount of the credit against the amount of the advance payment, resulting in a nil liability. Where, however, the parent was not entitled to a tax credit, because the dividends originated outside France, the advance payment of tax had to be made in full, thereby reducing the amount of the redistributed dividends (unless the parent chose to use its cash reserves to increase them to their pre-tax level).

57. Accor received dividends in the tax years 1998 to 2000 from its subsidiaries established in Member States other than France, and when it re-dsitributed those dividends to its own shareholders it made an advance payment of tax in accordance with the relevant provisions of the CGI in respect of the years 1999 to 2001. Accor then sought reimbursement of the advance payment of tax on the ground that the relevant provisions of the CGI were incompatible with EU law. The sums involved were substantial, and according to paragraph 15 of the Opinion of Advocate General Mengozzi the amount at stake in this and analogous cases was approximately €3 billion. In due course the case reached the Conseil d'État, which made a reference to the ECJ for a preliminary ruling. By its first question, the Conseil d'État asked whether the system which I have briefly described infringed what are now Articles 49 and 63 TFEU. If the answer to that question was affirmative, and the French tax authorities were in principle required to reimburse the sums received in so far as they infringed EU law, the second question referred was whether reimbursement could be opposed on the ground that it would lead to the unjust enrichment of the parent company. In the light of the answers to questions one and two, the third and final question was whether the EU principles of equivalence and effectiveness prevented the reimbursement from being made subject to the condition

> "that the person liable for the tax furnishes evidence which is in its sole possession and relating with respect to each dividend concerned, in particular to the rate of taxation actually applied and the amount of tax actually paid on profits made by its subsidiaries established in the Member States … other than France, whereas, with respect to subsidiaries established in France that evidence, known to the administration, is not required?"

58. The First Chamber of the ECJ gave its judgment on 15 September 2011. Its answer to the first question was that the absence of a tax credit for dividends received from non-resident subsidiaries constituted less favourable treatment of those dividends, because the effect of the advance payment chargeable on redistribution of the dividends by the

parent reduced the amount of the dividends available for redistribution: see in particular paragraphs 47 to 50 of the judgment. Various justifications advanced by the French government were rejected, and the Court concluded in paragraph 69 that Articles 49 and 63 TFEU:

> "… preclude legislation of a Member State intended to eliminate economic double taxation of dividends, such as that at issue in the main proceedings, which allows a parent company to set off against the advance payment, for which it is liable when it redistributes to its shareholders dividends paid by its subsidiaries, the tax credit applied to the distribution of those dividends if they originate from a subsidiary established in that Member State, but does not offer that option if those dividends originate from a subsidiary established in another Member State, since, in that case, that legislation does not give entitlement to a tax credit applied to the distribution of those dividends by that subsidiary."

59. I will for the moment pass over the Court's answer to the second question, although I will need to return to it in the context of unjust enrichment. For now, it is enough to record that the question was answered in the negative.

60. The Court discussed the third question in paragraphs 77 to 102 of its judgment. In paragraph 81, it noted that the question had been framed on the implicit assumption that, if liability were established, it would be necessary to grant Accor the same tax credits for its foreign dividends as it had received for its French dividends. In support of this argument, Accor argued (see paragraph 83) that the tax credit system was based merely on the liability of the distributing subsidiary to corporation tax, since the tax credit was always equal to 50% of the dividends distributed. Accor therefore submitted that all it needed to establish in relation to subsidiaries outside France was that they were liable to corporation tax in their Member State of residence.

61. This argument was opposed by the French and UK governments, which argued that the correct way to remedy the discrimination was "to apply a tax credit of any amount that would offset the tax paid in the Member State in which the subsidiary is established and which should be calculated on the basis of the amount of the tax to which the profits underlying the dividends paid by the subsidiary were liable in that State" (paragraph 85). This argument was accepted by the ECJ, relying on principles established in <u>FII (ECJ) I</u> and <u>Haribo</u>: see paragraphs 86 to 91. As a result:

> "92. … a Member State must be in a position to determine the amount of the corporation tax paid in the State in which the distributing company is established that must be the subject of the tax credit granted to the recipient parent company. Therefore, contrary to what Accor maintains, it is not sufficient to provide evidence that the distributing company has been taxed, in the Member State in which it is established, on the profits underlying the dividends distributed, without providing information relating to the nature and rate of the tax actually charged on those profits."

62. The Court went on to say that the administrative burdens of providing the necessary information to the national tax authority could not be regarded as excessive, or as infringing the principles of equivalence and effectiveness.

63. The Court gave its reasons for holding that the principle of equivalence would not be infringed in paragraphs 94 to 98, repeating its observations in Haribo at paragraphs 98, 100 and 101. The Court then dealt with effectiveness, in an important passage upon which the claimants in the present case strongly rely:

> "99. As regards compliance with the principle of effectiveness, it should be noted, first, that the evidence required should enable the tax authorities of the Member State of taxation to ascertain, clearly and precisely, whether the conditions for obtaining a tax advantage are met, but it does not need to take any particular form and the assessment must not be conducted too formalistically (see, to that effect, *Meilicke and Others*, paragraph 46).
>
> 100. Secondly, it is for the national court to determine whether the evidence concerning the rate of taxation actually applied and the amount of tax actually paid on the profits underlying the distribution of the dividends will not prove virtually impossible or excessively difficult to obtain, in particular in the light of the legislation of the Member State in which the distributing company is established concerning the avoidance of double taxation, the registration of corporation tax to be paid, and the retention of administrative documents or accounts.
>
> 101. The request for production of that information should moreover be made within the statutory period for retention of administrative documents or accounts, as laid down by the law of the Member State in which the subsidiary is established. As Accor observes, in order for it to receive the tax credit it should not be required to provide documents covering a period significantly longer than the statutory period for retention of administrative documents and accounts."

64. The Court then gave its answer to the third question:

> "102. In the light of the foregoing, the answer to the third question is that the principles of equivalence and effectiveness do not preclude the reimbursement to a parent company of [*sums which ensure equality of treatment*], being subject to the condition that the person liable for the tax furnish evidence which is in its sole possession and relating, with respect to each dividend concerned, in particular to the rate of taxation actually applied and the amount of tax actually paid on profits made by subsidiaries established in other Member States, whereas, with respect to subsidiaries established in France, that evidence, known to the administration, is not required. Production of that

> evidence may however be required only if it does not prove virtually impossible or excessively difficult to furnish proof of payment of the tax by the subsidiaries established in the other Member States, in the light in particular of the provisions of the legislation of those Member States concerning the avoidance of double taxation, the recording of the corporation tax which must be paid and the retention of administrative documents. It is for the national court to determine whether those conditions are met in the case before the national court."

V The decision of the ECJ in FII (ECJ) II

65. The Grand Chamber of the ECJ delivered its judgment on the second FII reference on 13 November 2012. The Juge Rapporteur was, once again, Vice-President Lenaerts. The Court had the benefit of submissions by the German, Irish, French and Dutch governments, as well as the parties and the European Commission.

66. For present purposes, the most important part of the judgment concerns the lawfulness of the Case V charge on dividends paid by foreign subsidiaries to their UK parents. This was the subject of the first question referred to the Court, which asked whether the references to "tax rates" and "different levels of taxation" at paragraph 56 of the judgment of the ECJ in FII (ECJ) I, (a) referred solely to statutory or nominal rates of tax; or (b) referred to the effective rates of tax paid as well as the statutory or nominal rates of tax; or (c) had some other, and if so what, meaning. The Court's answer to this question is to be found in paragraphs 36 to 65 of the judgment. Departing from the view of the Advocate General (who had held that the reference was to statutory or nominal rates only), and adopting a solution which, so far as I am aware, had not been propounded by any of the parties, the Court held (in short) that in paragraph 56 of FII (ECJ) I the Court had intended to refer to both statutory and effective rates of tax, that the Case V charge was unlawful because it constituted a restriction on the freedoms of establishment and movement of capital under Articles 49 and 63 TFEU, and although it was prima facie justified by the need to ensure the cohesion of the national tax system, it nevertheless failed the test of proportionality.

67. The Court began its analysis of the first question by recalling three principles established by its existing jurisprudence. The first principle is that, in the context of the prevention or mitigation of economic double taxation of distributed profits, the position of a corporate shareholder receiving foreign dividends is comparable to the receipt of national dividends, because in each case the profits are in principle liable to be subject to a series of charges to tax (paragraph 37, referring to FII (ECJ) I at paragraph 62 and Haribo at paragraph 59). The second principle, which follows from the first, is that Articles 49 and 63 require a Member State which has a system for preventing economic double taxation in respect of national dividends paid to resident companies to accord equivalent treatment to foreign dividends (paragraph 38, referring to FII (ECJ) I at paragraph 72 and Haribo at paragraph 60). The third principle is that a Member State is free to adopt a dual exemption/imputation system for domestic and foreign dividends, and the two methods are in fact equivalent, so long as (a) the tax rate applied to foreign dividends is not higher than the rate applied to domestic dividends, and (b) the tax credit is at least equal to the amount paid in the State of the company making the distribution, up to the limit of the tax charged in the home State of the recipient (paragraph 39, referring to FII (ECJ) I at paragraphs 48

and 57, Haribo at paragraph 86, Accor at paragraph 88, and the reasoned order in the present case at paragraph 39).

68. The Court then noted the freedom of Member States, under EU law as it now stands, to organise its system for taxing distributed profits, provided that the system does not entail discrimination prohibited by the Treaty. As the Court observed (paragraph 40):

> "An obligation on the Member State where the company receiving dividends resides to exempt foreign-sourced dividends from corporation tax would affect the competence of the Member State concerned to tax, in compliance with the principle of non-discrimination, the profits thereby distributed at the rate prescribed by its own legislation."

69. Against this background, the Court then explained in what circumstances an imputation system for foreign dividends will *not* be equivalent with an exemption system for domestic dividends, and the nature of the test which it had intended to lay down in FII (ECJ) I:

> "43. It must in fact be held that the tax rate applied to foreign-sourced dividends will be higher than the rate applied to nationally-sourced dividends within the meaning of the case-law cited in paragraph 39 of the present judgment, and therefore that the equivalence of the exemption and imputation methods will be compromised, in the following circumstances.
>
> 44. First, if the resident company which pays dividends is subject to a nominal rate of tax below the nominal rate of tax to which the resident company that receives the dividends is subject, the exemption of the nationally-sourced dividends from tax in the hands of the latter company will give rise to lower taxation of the distributed profits than that which results from application of the imputation method to foreign-sourced dividends received by the same resident company, but this time from a non-resident company also subject to low taxation of its profits, inter alia because of a lower nominal rate of tax.
>
> 45. Application of the exemption method will give rise to taxation of the distributed nationally-sourced profits at the lower nominal rate of tax applicable to the company paying dividends, whilst application of the imputation method to foreign-sourced dividends will give rise to taxation of the distributed profits at the higher nominal rate of tax applicable to the company receiving dividends.
>
> 46. Second, exemption from tax of dividends paid by a resident company and application to dividends paid by a non-resident company of an imputation method which, like that laid down in the rules at issue in the main proceedings, takes account of the effective level of taxation of the profits in the State of origin also cease to be equivalent if the profits of the resident

> company which pays dividends are subject in the Member State of residence to an effective level of taxation lower than the nominal rate of tax which is applicable there.
>
> 47. The exemption of the nationally-sourced dividends from tax gives rise to no tax liability for the resident company which receives those dividends irrespective of the effective level of taxation to which the profits out of which the dividends have been paid were subject. By contrast, application of the imputation method to foreign-sourced dividends will lead to an additional tax liability so far as concerns the resident company receiving them if the effective level of taxation to which the profits of the company paying the dividends were subject falls short of the nominal rate of tax to which the profits of the resident company receiving the dividends are subject.
>
> 48. Unlike the exemption method, the imputation method therefore does not enable the benefit of the corporation tax reductions granted at an earlier stage to the company paying dividends to be passed on to the corporate shareholder.
>
> 49. Accordingly, the determination which the referring court was called upon to make by the Court, in paragraph 56 of its judgment in *Test Claimants in the FII Group Litigation*, relates both to the applicable nominal rates of tax and to the effective levels of taxation. The "tax rates" to which paragraph 56 refers relate to the nominal rate of tax and the "different levels of taxation … by reason of a change to the tax base" relate to the effective levels of taxation. The effective level of taxation may be lower than the nominal rate of tax by reason, in particular, of reliefs reducing the tax base."

70. The reasoning of the first part of this key passage is a little compressed and not entirely easy to follow. I will therefore explain my understanding of it. It is reasonably clear, to my mind, that in paragraphs 44 and 45 the Court is concentrating on nominal rates of tax, and (except at one point) is leaving out of account any possible difference between the nominal rate and the effective rate. The Court begins by hypothesising a situation (probably quite rare in practice) where a resident company paying dividends (which I will call P1) is subject to a lower rate of tax than the recipient resident company (R). Exemption of those dividends in the hands of R means that they are taxed overall at only the lower of the two nominal rates (say 20% instead of 30%). That situation is then contrasted with the receipt by R of dividends from a foreign company (which I will call P2) which are subject to the imputation system. It is again assumed that the nominal rate of tax applicable to the dividends in P2's state of residence is lower than the 30% rate applicable to R (see the concluding words of paragraph 44, although the words "inter alia" suggest that there may also be other reasons for the lower taxation of P2's profits). Let it be assumed, as in the case of P1, that the lower rate is 20%. This time, however, the overall result is that the dividends are taxed in R's hands at the full rate of 30%. The tax credit available to set against the charge on R will be only 20%, and in the absence of any exemption the overall

charge to tax on the dividends will be "topped up" to R's nominal rate. The contrast drawn in paragraph 44 is then lucidly summarised in paragraph 45.

71. The Court then considers the position where the lower rate of tax paid by P1 and P2 is not a lower *nominal* rate, but a lower *effective* rate. Suppose, for example, that in the states of residence of P1 and P2 the nominal rate applicable to the profits out of which the dividends were paid was 30% (the same as the nominal rate applicable to R), but P1 and P2 in fact paid tax on their profits at an effective rate of only 20%. In these circumstances, too, there is no equivalence between the exemption and the imputation systems, because the former results in an overall charge to tax of 20% whereas the latter results in an overall charge of 30%. As before, the difference is accounted for by the topping-up effect of the imputation system. These are the points which the Court is making in paragraphs 46 to 48.

72. The Court then concluded, in the light of my findings of fact in FII (High Court), that the rules in force in the UK failed to ensure equivalent treatment of foreign dividends, because although the UK applied the same nominal rate of tax to resident companies which paid and received dividends (P1 and R in my example), the effective rate of tax paid by the former (P1) was normally lower than the nominal rate, and not only in exceptional cases. Accordingly, the dual system operated by the UK constituted a restriction which was in principle prohibited by Articles 49 and 63 (paragraphs 50 to 54).

73. The Court then turned to the issue of justification, which had not been separately addressed in FII (ECJ) I. The Court concluded that the restriction was in principle justified by the need to preserve the cohesion of the UK tax system, because the necessary direct link existed between the tax advantage granted (whether in the form of the tax credit for foreign dividends or exemption for domestic dividends) and the tax to which the distributed profits had already been subject (paragraphs 56 to 59). The defence of justification failed, however, because cohesion of the national tax system did not require the difference in treatment which the UK had adopted. In other words, the test of proportionality was not satisfied.

74. I need to set out in full this part of the Court's analysis:

> "60. As to the proportionality of the restriction, whilst application of the imputation method to foreign-sourced dividends and of the exemption method to nationally-sourced dividends may be justified in order to avoid economic double taxation of distributed profits, it is not, however, necessary, in order to maintain the cohesion of the tax system in question, that account be taken, on the one hand, of the effective level of taxation to which the distributed profits have been subject to calculate the tax advantage when applying the imputation method and, on the other, of only the nominal rate of tax chargeable on the distributed profits when applying the exemption method.
>
> 61. The tax exemption to which a resident company receiving nationally-sourced dividends is entitled is granted irrespective of the effective level of taxation to which the profits out of

which the dividends have been paid were subject. That exemption, in so far as it is intended to avoid economic double taxation of distributed profits, is thus based on the assumption that those profits were taxed at the nominal rate of tax in the hands of the company paying dividends. It thus resembles a grant of a tax credit calculated by reference to that nominal rate of tax.

62. For the purpose of ensuring the cohesion of the tax system in question, national rules which took account in particular, also under the imputation method, of the nominal rate of tax to which the profits underlying the dividends paid have been subject would be appropriate for preventing the economic double taxation of the distributed profits and for ensuring the internal cohesion of the tax system while being less prejudicial to freedom of establishment and the free movement of capital.

63. It is to be observed in this connection that in *Haribo* …, paragraph 99, the Court, after pointing out that the Member States are, in principle, allowed to prevent the imposition of a series of charges to tax on dividends received by a resident company by applying the exemption method to nationally-sourced dividends and the imputation method to foreign-sourced dividends, noted that the national rules in question took account, for the purpose of calculating the amount of the tax credit under the imputation method, of the nominal rate of tax applicable in the State where the company paying dividends was established.

64. It is true that calculation, when applying the imputation method, of a tax credit on the basis of the nominal rate of tax to which the profits underlying the dividends paid have been subject may still lead to a less favourable tax treatment of foreign-sourced dividends, as a result in particular of the existence in the Member States of different rules relating to determination of the basis of assessment for corporation tax. However, it must be held that, when unfavourable treatment of that kind arises, it results from the exercise in parallel by different Member States of their fiscal sovereignty, which is compatible with the Treaty (see, to this effect, *Kerckhaert and Morres*, paragraph 20, and Case C-96/08 *CIBA* [2010] ECR I-2911, paragraph 25).

65. In light of the foregoing, the answer to the first question is that Articles 49 TFEU and 63 TFEU must be interpreted as precluding legislation of a member state which applies the exemption method to nationally-sourced dividends and the imputation method to foreign-sourced dividends if it is established, first, that the tax credit to which the company receiving the dividends is entitled under the imputation method is equivalent to the amount of tax actually paid on the profits

> underlying the distributed dividends and, second, that the effective level of taxation of company profits in the Member State concerned is generally lower than the prescribed nominal rate of tax."

75. A crucial aspect of this analysis is the principle, evidently accepted by the Court, that an exemption for national dividends (such as section 208 of ICTA 1988) is based on the assumption that the profits from which they are paid have been taxed at the (full) nominal rate of tax in the hands of the paying company. This assumption may seem highly unrealistic in the case of the UK, given the findings which I made in FII (High Court) and which the ECJ itself applied in paragraph 51 of its judgment. But the assumption had already been adumbrated in Haribo (see paragraph 33 of the opinion of Advocate General Kokott), and as an abstract proposition it may be thought to have a certain logical appeal. In any event, it appears that at this stage of its analysis the ECJ perceived the vice of the UK system to lie in the contrast between the (notional) full credit at the nominal rate afforded to national dividends, by virtue of their exemption, and the (actual) credit at the effective rate afforded to foreign dividends. (It needs to be remembered at this point that the FII litigation was concerned with non-portfolio dividends, in respect of which credit for underlying tax was available, but only for the amount of tax actually paid). Consistently with this approach, in paragraph 62 the Court took the view that cohesion could be restored by taking account under the imputation method of the nominal rate of tax to which the underlying profits had been subject. The Court then noted that in Haribo the national rules (in fact the extra-statutory 2008 Notice) had taken account of the nominal rate of tax in calculating the amount of the tax credit.

76. It seems, therefore, that the Court would in principle accept as compatible with Articles 49 and 63 a dual system which combined exemption for national dividends with the grant of a tax credit at the foreign nominal rate for foreign dividends.

77. It remains to consider the actual terms of the Court's answer to question 1 in paragraph 65. The answer is highly compressed, and needs to be read with the Court's reformulation of Question 1 in paragraph 36. I read the answer as picking up the two key points made in the foregoing analysis. According to the Court, a dual system such as that in force in the UK will infringe Articles 49 and 63 if (a) the tax credit on foreign dividends "is equivalent to the amount of tax actually paid on the profits underlying the distributed dividends", and (b) "the effective level of taxation of company profits in the Member State concerned is generally lower than the prescribed nominal rate of tax". Condition (a) picks up the discussion on justification, and in particular paragraphs 61 to 63; while condition (b) picks up the earlier discussion on equivalence, including in particular paragraph 51.

78. The second question considered by the ECJ raised the "corporate tree" issues relating to ACT. The Court answered them in favour of the test claimants. For present purposes, I need refer only to what the Court said in paragraphs 71 to 73:

> "71. It should be recalled for this purpose that a resident company receiving foreign-sourced dividends is, in relation to the objective of preventing economic double taxation pursued by the rules at issue in the main proceedings, in a situation comparable to that of a resident company receiving nationally-

> sourced dividends. In the light of that objective, it is apparent from the answers given to the second and fourth questions in the judgment in *Test Claimants in the FII Group Litigation* that Articles 49 TFEU and 63 TFEU preclude legislation of a Member State which, as regards foreign-sourced dividends alone, does not take account of corporation tax already paid on the distributed profits.
>
> 72. As is clear from paragraph 62 of the present judgment, the obligation imposed on a resident company by national rules, such as those at issue in the main proceedings, to pay ACT when profits from foreign-sourced dividends are distributed is, in fact, justified only in so far as that advance tax corresponds to the amount designed to make up for the lower nominal rate of tax to which the profits underlying the foreign-sourced dividends have been subject compared with the nominal rate of tax applicable to the profits of the resident company.
>
> 73. In this connection, it is of little account whether the non-resident company which pays dividends to its resident parent company is itself liable for corporation tax, provided, however, that the distributed profits have been subject to corporation tax."

79. At this stage, all I will say about this passage is that the ECJ has clearly laid down that ACT may be lawfully charged in respect of foreign dividends only if and to the extent that the charge makes up a difference in nominal corporation tax rates between the foreign rate and the national rate. This point was then repeated by the ECJ, in its answer to other questions, at paragraphs 86, 87 and 108.

VI <u>Issues concerning the corporation tax charge on portfolio dividends</u>

80. The first and second agreed issues are formulated as follows:

> "1. In light of [*the reasoned order and the decisions in <u>FII (ECJ) I</u> and <u>FII (ECJ) II</u>*] is it possible to give the domestic legislation a conforming construction? Specifically, should the legislation be interpreted so as to entitle the Claimant to a tax credit to set against D V tax charged on Portfolio Dividends and, if so, what is the appropriate amount of the tax credit?
>
> 2. Alternatively, should the domestic legislation be disapplied and, if so, how should that disapplication be given effect? "

81. By way of recapitulation, it will be recalled that under the I minus E basis of taxation applicable to life assurance business section 208 of ICTA 1988 applied in the usual way so as to exclude portfolio dividends received from a UK-resident company from the charge to corporation tax under Case V of Schedule D. By contrast, foreign-sourced dividends were taxed within the I minus E computation as income chargeable under Case V. Double tax relief was given, either under double tax arrangements with

other countries or unilaterally under section 790(4) and (5) of ICTA 1988, for foreign withholding taxes paid on the dividends, but not for any underlying tax.

82. Under section 88(1) of the Finance Act 1989, corporation tax was charged on the policy holders' share of profits at the basic (or, with effect from 6 April 2004, the lower) rate of income tax. The much smaller shareholders' share (representing the Case I profits of the business as computed under section 89) was taxable at the normal corporation tax rate.

83. The relevant provisions of section 790 of ICTA 1988 are as follows:

> "**790 Unilateral relief**
>
> (1) To the extent appearing from the following provisions of this section, relief from income tax and corporation tax in respect of income and chargeable gains shall be given in respect of tax payable under the law of any territory outside the United Kingdom by allowing that tax as a credit against income tax or corporation tax, notwithstanding that there are not for the time being in force any arrangements under section 788 providing for such relief.
>
> (2) Relief under subsection (1) above is referred to in this Part as "unilateral relief".
>
> …
>
> (4) Credit for tax paid under the law of the territory outside the United Kingdom and computed by reference to income arising or any chargeable gain accruing in that territory shall be allowed against any United Kingdom income tax or corporation tax computed by reference to that income or gain …
>
> (5) Subsection (4) above shall have effect subject to the following modifications, that is to say –
>
> …
>
> > (c) credit shall not be allowed by virtue of subsection (4) above for overseas tax on a dividend paid by a company resident in the territory unless –
> >
> > (i) the overseas tax is directly charged on the dividend, whether by charge to tax, deduction of tax at source or otherwise, and the whole of it represents tax which neither the company nor the recipient would have borne if the dividend had not been paid; or
> >
> > (ii) the dividend is paid to a company within subsection (6) below;
>
> …

> (6) Where a dividend paid by a company resident in the territory is paid to a company falling within subsection (6A) below which either directly or indirectly controls, or is a subsidiary of a company which directly or indirectly controls –
>
> > (a) not less than 10% of the voting power in the company paying the dividend;
>
> …
>
> and the company receiving the dividend shows that the conditions specified in subsection (7) below are satisfied;
>
> any tax in respect of its profits paid under the law of the territory by the company paying the dividends shall be taken into account in considering whether any, and if so what, credit is to be allowed in respect of the dividend.
>
> …
>
> (6A) A company falls within this subsection if –
>
> > (a) it is resident in the United Kingdom; or
> >
> > (b) it is resident outside the United Kingdom but the dividend mentioned in subsection (6) above forms part of the profits of a permanent establishment of the company's in the United Kingdom."

In the case of portfolio dividends, the credit for withholding tax (where it is not provided under double tax arrangements) is provided by sections 790(4) and (5)(c)(i), but a credit for underlying tax, although falling within the general wording of subsection (4), is excluded by subsections (5)(c)(ii), (6) and (6A).

84. It has already been established by the reasoned order that the Case V charge on portfolio dividends infringed the Article 63 rights of the test claimants in all cases where the dividend was paid by a company resident in the EU or EEA. Thus the basic question which I am now considering is how, as a matter of domestic English law, that infringement of EU law is to be remedied. It is common ground that the claims to recover the unlawfully levied tax are properly to be characterised as *San Giorgio* claims, and that the EU principle of effectiveness requires the UK to provide a remedy for those claims which does not make the test claimants' Article 63 rights either virtually impossible or excessively difficult to exercise.

85. In order to answer this question, it is first necessary to understand in precisely what relevant respects the UK legislation infringed Article 63. This enquiry has both a negative and a positive aspect. Negatively, what were the defects in the legislation? Positively, what would have been required to eliminate them? On the negative side, it is abundantly clear from the authorities which I have reviewed that the infringement lay, at least, in the failure of the UK system to provide a tax credit for the actual underlying tax paid on the distributed profits in the source state, when the UK had

chosen to counter economic double taxation of domestic dividends by the exemption in section 208. This is a recurrent theme from its first emergence in December 2006 in FII (ECJ) I (notably at paragraphs 50, 63-64 and 74) to its latest iteration in November 2012 in FII (ECJ) II (at paragraphs 37 to 39, citing FII (ECJ) I, Haribo, Accor, and the reasoned order).

86. According to the Revenue, that is the only defect in the UK legislation which needs to be remedied. The claimants disagree, however, and submit that it is apparent from the fuller and more sophisticated analysis of the problem by the Grand Chamber of the ECJ in FII (ECJ) II that there was a further defect in the domestic system. The nature of this defect is revealed, they say, by the focus in FII (ECJ) II on nominal (as well as effective) rates of tax, and the theory espoused by the Court that, in the context of relieving economic double taxation, the grant of an exemption from tax (as in section 208) is equivalent to the grant of a tax credit at the full nominal rate of tax applicable to the company paying the dividend: see in particular the discussion at paragraphs 43 to 49 and 60 to 65. Where domestic dividends are relieved from economic double taxation by exemption, the application of an imputation system to foreign dividends requires account to be taken of the *nominal* rate of tax to which the underlying profits have been subject in the source state. Not only is this explicitly stated in paragraph 62, submit the claimants, but the same paragraph makes it clear, positively, that national rules which satisfied this condition "would be appropriate for preventing the economic double taxation of the distributed profits and for ensuring the internal cohesion of the tax system".

87. According to the claimants, the right way in which to take account of the nominal rate of tax in the source state would be to grant a tax credit for such nominal rate of tax, in addition to a credit for the actual underlying tax paid in respect of the dividend, up to a ceiling (in each case) of the full amount of the actual charge to corporation tax under Case V. The credits for the nominal rate of tax and the actual underlying tax are cumulative, but in combination they cannot do more than extinguish the Case V charge (as reduced by any withholding tax for which relief is already provided either under double taxation arrangements or under section 790). Thus there is no question of any windfall for the claimants, because any excess of the credits over the actual charge would not generate any right to payment of the excess from HMRC. And if the end result in virtually every case will be to extinguish the charge, that is neither surprising nor a cause for concern. On the contrary, it will merely illustrate how the exemption and imputation methods of relieving economic double taxation are operating in an equivalent manner, that being the fundamental principle which underpins the ECJ's jurisprudence in this area.

88. The Revenue submit that these submissions are misguided and irrelevant, arguing (in short) that the discussion of nominal rates in FII (ECJ) II has nothing to do with portfolio dividends. They point out, correctly, that the FII litigation is concerned only with foreign dividends paid by subsidiaries to their UK-resident parent companies. The commercial and economic context in which such dividends are paid, within a single corporate group, is very different from the purely investment context in which portfolio dividends are paid. It cannot therefore be assumed that the reasoning of the ECJ in the former context will automatically translate into the latter. Furthermore, the Revenue advance two separate (but linked) reasons why the discussion of nominal rates in FII (ECJ) II cannot apply to portfolio dividends.

89. First, the ECJ has already ruled definitively in the reasoned order on the invalidity of the Case V charge in relation to the portfolio dividends which are in issue in the present proceedings. This ruling identifies the vitiating feature of the UK legislation as its failure to afford a credit for the underlying tax, and gives no hint of the existence of a second failure connected with the nominal rate of tax applicable to the foreign dividends.

90. Secondly, in the reasoned order the ECJ expressly considered and rejected a defence of justification advanced by the UK government on the basis of the need to ensure the cohesion of the tax system: see paragraphs 64 to 69 of the reasoned order. By contrast, in FII (ECJ) II the ECJ held that the defence of cohesion was in principle made out, and it was only on the issue of proportionality that the test claimants ultimately succeeded. There is no indication in FII (ECJ) II that the Court intended to depart from or qualify its previous ruling on the defence of cohesion in the reasoned order, so the only way to maintain consistency between the two judgments is to treat the discussion in FII (ECJ) II as confined to the dividends which were in issue in that case, namely non-portfolio dividends.

91. These submissions were presented by Mr Ewart in oral argument with his customary skill, but in the end I do not find them convincing. I begin with the obvious point that the reasoned order, by its very nature, was intended to do no more than apply principles which had previously been established by the ECJ, particularly in FII (ECJ) I. Thus the ground on which the Case V charge on portfolio dividends was held to infringe Article 63 (then Article 56 EU) was firmly based on the reasoning in FII (ECJ) I, where the position of portfolio dividends had of course been expressly considered. (It is worth noting, incidentally, that the reason why portfolio dividends were dealt with was the Court's uncertainty whether all of the shareholdings in issue in the FII GLO were indeed non-portfolio holdings: see the opinion of Advocate General Geelhoed at paragraph 31, and the judgment of the Court at paragraph 38). Thus I do not read the reasoned order as implicitly excluding the existence of further factors in the UK legislation which may have infringed Article 63, especially if such factors represented a logical extension or refinement of the reasoning of the Court in FII (ECJ) I.

92. It seems to me, in broad agreement with the submissions of the claimants, that this is essentially what has occurred. The request for clarification in the second FII reference has produced a fuller and more nuanced analysis by the Court of the problems associated with the Case V charge on foreign dividends. A crucial part of this analysis is the theoretical assumption that the exemption from tax of a dividend is to be regarded as equivalent to the grant of a tax credit at the nominal rate, and the concomitant principle that a state of residence which grants exemption to domestic dividends must, at least, grant credit for the nominal rate of tax paid in the source state, although it remains free to charge a higher nominal rate itself (and thus to top up the charge by the difference between the domestic and foreign nominal rates). This analysis, in my judgment, flows from and forms part of the Court's general elucidation of the overriding need to treat foreign and domestic dividends equivalently, and is as applicable to portfolio dividends as it is to non-portfolio dividends.

93. I find support for this view in the fact that the Court drew expressly on Haribo, which was concerned exclusively with portfolio dividends, when discussing the issue of

proportionality: see paragraph 63 of the judgment. Nor, to reverse the point made by the Revenue, can I find any indication that the Court did *not* intend its analysis to apply to non-portfolio dividends, even though it must have had them well in mind. It would, indeed, have been strange if any such distinction had been intended, given the general nature of the basic principle that EU law precludes a Member State from treating foreign dividends less favourably than national ones. Furthermore, in the case of portfolio and non-portfolio dividends alike, the comparison which has to be made is with the blanket exemption for domestic dividends conferred by section 208. In other words, as Mr Aaronson put it in his submissions in reply, the UK comparator is constant, whatever the size of the foreign dividend. Viewed in this way, the Case V charge in relation to portfolio dividends is invalid for all of the reasons which (as we now know) invalidate it in relation to non-portfolio dividends, but with the aggravating feature that no credit is allowed for the actual underlying tax.

94. For similar reasons, I am unable to accept the submission that the rejection of the defence of cohesion in the reasoned order means that the acceptance in principle of the defence in FII (ECJ) II cannot have been meant to apply to portfolio dividends. In my judgment the discussion of the subject in FII (ECJ) II must be taken to represent the latest and fully considered views of the ECJ on the subject, and to have superseded the very brief discussion in the reasoned order. I note, in any event, that the rejection of the defence in paragraphs 64 to 68 of the reasoned order seems to elide the question whether the defence was available in principle (which requires a direct link to be established between the tax advantage granted in the state of residence and the tax already suffered in the source state) and the issue of proportionality. Thus the Court said in paragraph 67 of the reasoned order:

> "While the tax legislation in question in the main proceedings rests on the basis of a link between the tax advantage and the corresponding levy by providing for a tax credit for dividends received from a non-resident company in which the resident parent company holds not less than 10% of the voting power, the need for such a direct link must in fact lead to the same tax advantage being granted to companies receiving dividends from non-resident companies, in which the resident parent company holds less than 10% of the voting power, since those companies are also obliged to pay corporation tax on distributed profits in the State in which they are resident (see, to that effect, *Test Claimants in the FII Group Litigation*, paragraph 93)."

It seems to me that in this passage the Court may well be saying that the necessary direct link did indeed exist, but the UK was nevertheless unable to rely on the defence because the failure to grant a credit for underlying tax to portfolio dividends was disproportionate. If that is right, the fuller discussion in FII (ECJ) II was making essentially the same point, but with greater analytical clarity and a focus on nominal as well as effective rates of tax.

95. At first sight, it may be thought that the claimants' analysis of the invalidity under EU law of the Case V charge is unduly complex, and also likely to produce too much in the way of credit. One may feel intuitively that credit for underlying tax actually paid and credit at the nominal foreign rate ought to be alternatives, and something must

have gone wrong if they are treated as cumulative. But the two types of credit are conceptually quite distinct; and the apparently excessive result of aggregating them can be simply remedied by treating them as alternatives, with credit to be granted for whichever amount is the higher (up to the limit of the Case V charge reduced by withholding tax). In the great majority of cases credit at the nominal foreign rate will be higher than a credit for the underlying tax actually paid, but Mr Aaronson was able to satisfy me that this will not invariably be the case, particularly bearing in mind the widely varying systems of corporate taxation throughout the EU.

96. I therefore conclude that the UK legislation would have been compliant with EU law if it had provided for the grant of such a "dual" credit for portfolio dividends. The grant of the further credit for withholding tax is not, in itself, a requirement of EU law, as the decision of the ECJ in Salinen makes clear: see paragraph 54 above. But there can be no doubt, in my judgment, that a credit for withholding tax must also be granted, as a matter of domestic law. I heard no detailed argument about the order in which the credits should be applied, and for the sake of simplicity (but without prejudice to the resolution of any issues which may emerge at a future date) I have treated the withholding tax as the first of the credits to be set against the Case V charge, thereby reducing (and placing a cap on) the amount of the charge available to be set off by the foreign tax credit.

97. Before moving on, I should note a further argument relating to portfolio dividends received by insurance companies which the Revenue articulated for the first time in an (undated) written note sent to me on 3 September 2013 (six weeks after the conclusion of the hearing), to which the claimants replied on 6 September. The argument is that the reasoning of the ECJ in FII (ECJ) II cannot apply to an insurance company such as Prudential, because such companies do not generally pay corporation tax at the normal UK nominal rate, but at a lower nominal rate equivalent to the basic or lower rate of income tax on the policy holders' share of profits calculated on the I minus E basis. Accordingly, it is said, when Prudential received portfolio dividends from UK-resident companies, it did not receive a notional tax credit at the nominal rate of the subsidiary, but only at the lower nominal rate which Prudential paid on the policy holders' share of its profits. The Revenue do not accept, and the claimants have not argued, that the effective rate of corporation tax paid by UK companies was generally less than the lower nominal rate of corporation tax paid by Prudential. Thus, say the Revenue, there is no reason to think that in obtaining exemption from tax on its UK dividends Prudential got relief for any more than its proper share of the actual tax paid by the companies in question. Accordingly, Prudential would be given equivalent treatment in respect of portfolio dividends which it received from non-UK resident companies if the only credit which it received were one for the proper share of the actual tax paid by those companies.

98. I am unable to accept this argument. In my judgment it follows from the ECJ's reasoning in FII (ECJ) II that the exemption of UK-source dividends is equivalent to taxing the dividends and giving credit at the relevant UK nominal tax rate. This principle applies to dividends received by an insurance company which are taxed on the I minus E basis and allocated to the policy holders' share of profits in the same way as it applies to dividends taxed at the full UK corporation tax rate, the only difference being that the assumed credit is correspondingly smaller because it is capped at the lower nominal rate. Equal treatment of foreign dividends can therefore

be achieved by granting a credit based on the foreign nominal rate but capped at the UK policy holder rate. So, for example, where the foreign nominal rate is 30% and the UK policy holder rate is 20%, the credit is limited to 20%. In principle, this is no different from the case where an ordinary UK company receives a dividend from a country whose nominal rate is higher than the normal UK corporation tax rate. In such cases the foreign nominal rate credit is again capped at the rate at which the dividends are taxed in the UK.

99. Nor is it relevant, in my view, if the effective rate of tax paid by UK companies is generally the same as, or higher than, the policy holders' share rate of corporation tax. I am in no position to judge whether that is in fact the case. But even assuming it were, it would not in my opinion detract from, or render inapplicable, the approach laid down by the ECJ in FII (ECJ) II, which is firmly based on a systemic lack of equivalence in the UK between the exemption and tax credit methods of relieving economic double taxation. It is true that the ECJ was, of necessity, proceeding on the basis of the findings of fact which I had made, with the benefit of expert evidence, in the FII litigation. But that evidence related to the position of UK companies generally: see FII (High Court) at paragraph [64]. In the light of that evidence, I do not think it credible to suppose that the ECJ would have regarded its reasoning as inapplicable to the special case of the policy holders' share of profits charged to tax at a lower nominal rate, especially when it is remembered that the shareholders' share of the profits remained taxable at the full UK rate. Furthermore, if the Revenue wished to run such an argument, it would in my judgment have been necessary for them both to plead it and to adduce evidence to substantiate the proposition that the effective rate of tax paid by UK companies is not generally lower than the policy holder rate.

100. Having now identified the respects in which the UK legislation infringed Article 63, and how it could have been rendered compliant, the next question is whether this result can be achieved by a process of conforming construction of the UK legislation, or whether the Case V charge must be disapplied. If I am right in my analysis so far, the answer to this question will be of little, if any, practical significance, because a conforming construction which required a dual credit to be granted would in practice probably always extinguish the Case V charge, as would the de facto exemption of portfolio dividends if the charge were to be disapplied in its entirety. But the question is conceptually important, so I will briefly deal with it.

101. There is no dispute about the principles which should be applied in considering whether a conforming interpretation of legislation which infringes EU law is possible. They are set out in paragraphs [37] and [38] of the judgment of Sir Andrew Morritt C in Vodafone 2 v Revenue & Customs Commissioners [2009] EWCA Civ 446, [2010] Ch 77. Sir Andrew's formulation has recently been restated in a single paragraph by Aikens LJ (with whom Etherton and Maurice Kay LJJ agreed) in Wilkinson v Fitzgerald [2012] EWCA Civ 1166, [2013] 1 WLR 1776, at paragraph [50], and it is in that form that I will cite it:

> "the obligation on the English courts to construe domestic legislation consistently with Community law obligations is both broad and far-reaching. In particular [the obligation]: [1] … is not [to be] constrained by conventional rules of construction (per Lord Oliver of Aylmerton in *Pickstone v Freemans Plc* [1989] AC 66, 126B); [2] … does not require ambiguity in the

legislative language (per Lord Oliver in the *Pickstone* case, at p126B and per Lord Nicholls of Birkenhead in *Ghaidan v Godin-Mendoza* [2004] 2 AC 557, para 32); [3] … is not an exercise in semantics or linguistics (per Lord Nicholls in *Ghaidan's* case, at paras 31 and 35; per Lord Steyn, at paras 48-49; per Lord Rodger of Earlsferry, at paras 110-115); [4] … permits departure from the strict and literal application of the words which the legislature has elected to use (per Lord Oliver in *Litster v Forth Dry Dock & Engineering Co Ltd* [1990] 1 AC 546, 577A; per Lord Nicholls in *Ghaidan's* case, at para 31); [5] … permits the implication of words necessary to comply with Community law obligations (per Lord Templeman in the *Pickstone* case, at pp 120H-121A; per Lord Oliver in the *Litster* case, at p 577A); [6] [accepts that] the precise form of the words to be implied does not matter (per Lord Keith of Kinkel in the *Pickstone* case, at p 112D; per Lord Rodger in *Ghaidan's* case, at para 122; per Arden LJ in *R (IDT Card Services Ireland Ltd) v Customs and Excise Comrs* [2006] STC 1252, para 114); [7] [is only constrained to the extent that] the meaning should "go with the grain of the legislation" and be compatible with the underlying thrust of the legislation being construed": see per Lord Nicholls in *Ghaidan v Godin-Mendoza* [2004] 2 AC 557, para 33; Dyson LJ in *Revenue and Customs Comrs v E B Central Services Ltd* [2008] STC 2209, para 81; [8] [must not lead to an interpretation being adopted] which is inconsistent with a fundamental or cardinal feature of the [national] legislation since this would cross the boundary between interpretation and amendment (see per Lord Nicholls, at para 33, Lord Rodger, at paras 110-113 in *Ghaidan's* case; per Arden LJ in *R (IDT Card Services Ireland Ltd) v Customs and Excise Comrs* [2006] STC 1252, paras 82 and 113) … [9] … cannot require the courts to make decisions for which they are not equipped or give rise to important practical repercussions which the court is not equipped to evaluate: see the *Ghaidan* case, per Lord Nicholls, at para 33; per Lord Rodger, at para 115; per Arden LJ in the *IDT Card Services* case, at para 113."

102. The principle of conforming construction is often referred to as the *Marleasing* principle, named after the ECJ case in which it was first clearly enunciated (Case C-106/89, Marleasing SA v La Comercial Internacional de Alimentación SA [1990] ECR I-4135). In FII (SC) Lord Sumption at paragraph [176] described the principle, as it has been applied in England, as "authority for a highly muscular approach to the construction of national legislation so as to bring it into conformity with the directly effective Treaty obligations of the United Kingdom". He added that, however strained a conforming construction may be, and however unlikely it is to have occurred to a reasonable person reading the statute at the time, "a later judicial decision to adopt a conforming construction will be deemed to declare the law retrospectively in the same way as any other judicial decision".

103. Applying these principles, I consider that it falls well within the scope of conforming interpretation to construe section 790 of ICTA 1988 as providing for the grant of a tax credit for foreign dividends to the extent necessary to secure compliance with EU law. Since section 790 already provides for the grant of tax credits, in the case of both portfolio and non-portfolio dividends, the grant of a further tax credit for portfolio dividends would not in my judgment go against the grain of the UK tax legislation. Nor would it require the court to make policy decisions for which it is not equipped, because the sole purpose of the tax credit would be to secure compliance with the judgments of the ECJ in which the UK tax system has been held to infringe Article 63.

104. In reaching this conclusion, I am accepting the Revenue's submission that a conforming interpretation is possible, and that it is therefore unnecessary for the Case V charge on portfolio dividends to be disapplied in cases where it infringes Article 63. The Revenue's submission was, of course, advanced on the basis that the additional credit would be confined to the actual underlying tax paid on the distributed profits in the source country. However, I can see no reason why the same principles should not apply if the credit is of the more complex dual nature which I have held to be appropriate. The underlying purpose is still exactly the same, and the machinery of the grant of a credit still goes with the grain of the legislation.

105. The primary submission of the claimants was that the Case V charge should be disapplied, because a conforming interpretation is not possible. In oral argument, however, Mr Aaronson displayed little enthusiasm for the argument, rightly recognising that I am bound by the "highly muscular" approach to conforming interpretation expounded by the Court of Appeal. His main point was that the grant of a credit for underlying tax in the case of portfolio dividends would be contrary to the express prohibition of the grant of such a credit in section 790, and therefore could not be said to go with the grain of the legislation. In my opinion there are two answers to this submission. The first is that it cannot be enough to say that grant of the proposed credit would breach a prohibition in the legislation, because the question of conforming interpretation only arises where there is prima facie such a breach. Secondly, as I have already explained, a credit for foreign underlying tax would in my view accord with the general structure and machinery of the section, particularly as it already confers such a credit for non-portfolio dividends.

106. I would only add that, even if I had been persuaded that a conforming interpretation was impossible, I would not have held that the Case V charge had to be disapplied in its entirety. It would only be necessary for the charge to be disapplied to the extent that it was unlawful under EU law. This would, in practice, produce the same result as a conforming interpretation of section 790, and would fulfil the same basic objective of removing the incompatibility with EU law which has been identified by the ECJ. To go back to basics, it is important not to forget the basic obligation imposed on domestic courts by section 2(4) of the European Communities Act 1972. This provides that "any enactment passed or to be passed … shall be construed and have effect subject to" the United Kingdom's Treaty obligations incorporated into UK law by section 2(1). Thus the entire UK statute book, past, present and future, was, as a matter of domestic law, subjected to the overriding effect of the UK's obligations under incorporated EU law. Whether this obligation is discharged by a process of conforming interpretation or disapplication ought in principle to make no difference.

107. I now move on to the factual issues associated with the grant of a credit for underlying tax in respect of the portfolio dividends received by the claimants. The potential scale of the problem facing the claimants should not be under-estimated. Indeed, it is formidable. Taking just the first test claimant, Prudential, its claims extend from 1990 to 2007, during which period it received several thousand dividends. I heard oral evidence from Prudential's taxation manager, Mr Simon Barker, who has been employed by the Prudential group for 33 years and has spent his whole career in the tax departments of companies in the group. It was put to him in re-examination by Mr Aaronson that the number of dividends received each year by Prudential was around 2,000. Mr Barker said he had never tried to add them up, but this would be a reasonable estimate and the number each year was "in the thousands".

108. I begin with the element of the credit which represents the nominal rate of tax. This must in my judgment mean the nominal rate of corporation tax applicable to the profits out of which the dividend was paid in the state of residence of the company which paid the dividend. This appears to me to be the comparison which the ECJ had in mind when in FII (ECJ) II it contrasted the absence of such a credit for foreign portfolio dividends with the (notional) credit at the full UK nominal rate which was implicit in the section 208 exemption for domestic dividends. If I am right that the nominal rate credit is additional to (or, perhaps more accurately, operates in parallel with) the credit for the actual underlying tax paid, I cannot imagine that the ECJ envisaged the enquiry into nominal rates extending beyond the state of residence of the source company. The enquiry should in principle be a simple one, which can normally be answered by looking at the published tax legislation of the source state. It is possible that in some cases there may be more than one potentially relevant nominal rate, for example where different types of profit are charged to tax at different rates, or where the company is established in an enterprise zone to which a preferential rate of tax applies. In the great majority of cases, however, there is likely to be a single nominal rate applicable to all of the profits from which the dividend is paid.

109. The efforts made by Prudential to ascertain the relevant foreign nominal tax rates are explained in the second witness statement of Nicola Hine, a trainee solicitor at Joseph Hage Aaronson LLP (the lead and test case solicitors for the Dividend GLO). She set out the results of her work in a number of tables. In her statement she describes the sources of information that she used (such as the OECD tax database for the 34 OECD member countries) and the assumptions that she made in order to deal with various minor problems (for example where tax years did not coincide with calendar years). Rather strangely, Ms Hine was in a few instances unable to find any information about nominal tax rates (for Ghana for 1994 to 2007, and for Bermuda, the Cayman Islands, Gibraltar and Guernsey for 1994 to 2005). Subject to those few exceptions, however, a nominal rate was, as I understand it, ascertained by her for each relevant country for each relevant year.

110. HMRC did not require Ms Hine to attend for cross-examination, but Mr Barker was briefly cross-examined by Mr Baldry. When questioned about Ms Hine's work, he accepted that there was no way of telling whether the particular companies from whom Prudential had received dividends were actually liable for tax at the nominal rate listed in her tables, for example because the company might have been subject to a special rate of tax, or some of the income which it received may have been exempt

from tax. Mr Barker agreed that the only way to be sure would be to ask the company concerned, though whether they would be willing to impart such information to an external portfolio investor was another matter.

111. I am satisfied on the evidence that Prudential has made reasonable efforts to obtain the necessary information, and in my view the figures in Ms Hine's tables should be adopted subject to any adjustments which may be agreed with the Revenue. Given the scale and historic nature of the enquiry, and the fact that the need to grant a credit based on nominal rates has only emerged as a result of FII (ECJ) II in 2012, I do not think it would be reasonable to expect perfect accuracy; and if there are any minor imperfections in the tables, it would in my judgment better accord with the EU principle of effectiveness to use the flawed figures rather than reject them entirely or insist on yet further investigations. For similar reasons, I think that if HMRC wished to challenge any of the rates for the kinds of reason instanced by Mr Baldry, it was incumbent on them to do so in particular instances, and not just to rely on the possibility that such cases might exist as a reason for discrediting the entire exercise.

112. I turn to the element of the tax credit which represents the underlying corporation tax actually paid in respect of the dividend in the source state. The main burden of the claimants' evidence on this subject, unsurprisingly, is that it would be completely unrealistic to require them to produce this information for many thousands of portfolio dividends received over a period of 18 years.

113. Unchallenged evidence to this effect is given in the second witness statement (dated 22 September 2009) of John McCullough, who was then a senior taxation manager at Prudential, having worked in the group's taxation department since 1980. He said that, even when dealing with a subsidiary company, it was a time-consuming process to obtain information to calculate underlying tax rates in relation to foreign shareholdings, perform the necessary calculations and agree them with HMRC. The procedures set out in HMRC's International Manual required all underlying tax rates claimed to be referred to the Underlying Tax Group (UTG) in Nottingham. Mr McCullough continued:

> "39. My understanding is that the information required to calculate an underlying tax rate can vary depending on the country from which it is received. However, the following information is typically required:
>
> - a notice of assessment to tax or copy of the self assessment as appropriate;
> - if the dividend resolution specifies the profits from which the dividend has been paid, a copy of the dividend resolution itself is required;
> - details of the percentage shareholding the UK company has in the company paying the dividend;
> - copies of the company's accounts for the relevant period giving, in particular, details of how the profits

have been appropriated and details of reserve transfers, etc;

- details of dividends received if underlying tax relief is claimed in respect of those dividends.

40. While this level of detail can be obtained from a company's overseas subsidiaries there must be some considerable doubt as to whether companies over which we have no influence at all would be prepared to provide this information to us. It seems fairly obvious to me that there would be a natural reluctance on the part of these companies to divulge details of their underlying (and usually confidential) tax calculations to a company in a different jurisdiction that has no connection with them at all other than owning a very small percentage of their shares.

41. Prudential's claims, which cover the years from 1990 to 2007, include several thousand dividends. Even on the assumption that the relevant companies would be prepared to provide the information in principle, there would be onerous administrative requirements in obtaining it due to the numbers of accounting periods of different foreign companies that would have to be considered, not to mention the language difficulties and associated expense and delay in having all the relevant documentation translated into English. These logistical problems would of course be exacerbated considerably in relation to older years. I am unsure of the record-keeping requirements in the various jurisdictions but it is not inconceivable that many of the relevant documents for the earlier years do not even exist any more.

42. There is of course then the need to perform the relevant calculations for each dividend and possibly enter into discussions with UTG on the results, again, thousands of times over. The extract from the International Manual quoted above indicates that the information requirements and calculations will vary from country to country and of course Prudential has a very diverse portfolio.

43. It is therefore, in my view, completely unrealistic for a company like ours to be required to undertake this task."

114. Mr Barker returned to this theme in his first statement dated 31 January 2013. He endorsed the points previously made by Mr McCullough and said that for the same reasons he had decided not to write to the distributing companies to ask if they would provide the necessary information, as it would be extremely time consuming and expensive to do so, and highly unlikely to produce any useful information. He decided, instead, to use information available publicly over the internet to collate such information as was available about the companies from whom the claimants had received portfolio dividends and their effective tax rates. He worked with the help of a

paralegal, Fay Cullen, whom he closely supervised, and who herself provided a statement explaining the work she had done. The first stage of the project, which took ten months, involved collating and checking Prudential's records of dividend income received and then researching the underlying effective tax rates of the foreign companies concerned. Fuller details are given by Miss Cullen, who explains that for the research on effective tax rates she decided to use a website called moneycentral.msn.com for the bulk of her research. It had a user-friendly search function and produced detailed historical information, although in most cases did not go back before 2002. Mr Barker then entered this information, together with details of the nominal rates provided by Ms Hine, in a series of spreadsheets adapted from records of dividends received which had been maintained by Prudential's fund managers, M & G Limited. Mr Barker gave a description of these spreadsheets in his written evidence, and helpfully amplified it orally when examined in chief by Mr Aaronson.

115. Under cross-examination, Mr Barker accepted that if the source company was a holding company, the effective tax rate obtained by Ms Cullen's researches was likely to be based on the consolidated accounts of the group, and would not necessarily show how much tax was actually paid by the holding company. Mr Barker said it was the best they could come up with, but the only way to produce an accurate calculation would be to request and obtain the necessary information from every company. He also agreed that the tax charge shown in consolidated accounts could be very unreliable as a guide to the position of the holding company. Mr Baldry instanced the case of a Dutch holding company which was subject to a participation exemption in Holland. Mr Baldry's cross-examination continued:

> "Q. In order to work out how much tax was actually paid by the company that paid you the dividend, you would need to ask the company in question?
>
> A. Correct.
>
> Q. And there's no reason to suppose that had you made such a request, and had the company been willing to tell you, there is no reason to suppose the company itself wouldn't have known how much tax it had actually paid?
>
> A. I would expect they should. We are talking about a very long time ago for some of these dividends."

116. In the light of this evidence, I do not think that Mr Barker's spreadsheets can be taken as providing even a broadly accurate indication of the underlying tax actually paid by the source companies. A question about effective rates of tax is, by its very nature, not the kind of question that can be answered solely by reference to material available on public websites or published accounts. As Mr Barker readily accepted, there is no substitute for actually going to the companies concerned and asking them; and even then there is no certainty that the company would be both able and willing to supply the necessary information, particularly for the earlier years. I also find that Prudential could not reasonably be expected to carry out such an exercise in support of its claim, for the reasons given by Mr McCullough and Mr Barker. I have not heard evidence in

relation to any other claimants in the Dividend GLO, but I would be surprised if the position were any different.

117. Where, then, does this leave the claim for a credit for the underlying tax actually paid? The rival submissions are starkly opposed. Relying on Haribo, the Revenue submit that the provision of such information is "an intrinsic part of the very operation of the imputation method and cannot be regarded as excessive" (paragraph 97 of the judgment). The information was known to the companies which paid the dividends, and it is not the UK's responsibility if portfolio shareholders were provided with inadequate information by the company to claim the credit: see the Opinion of Advocate General Kokott at paragraph 58, expressly endorsed by the Court at paragraph 98 of its judgment. Furthermore, Haribo is a strong case, because the Court reached these conclusions despite evidence from the referring tribunal that the Austrian tax authority's requirements were in practice virtually impossible to satisfy. The practical difficulties were squarely before the Court, and were included in the formulation of the second and fourth questions referred to it. Indeed, the Court's answer to the second question could hardly have been more explicit:

> "Information demanded by the national tax authority from the company receiving dividends that relates to the tax that has actually been charged on the profits of the company distributing dividends in the State in which the latter is resident is an intrinsic part of the very operation of the imputation method and cannot be regarded as an excessive administrative burden."

118. If Haribo was the last word of the ECJ jurisprudence on this topic, I do not think the claimants could seriously dispute the principles upon which the Revenue rely or their application to the present case. But, say the claimants, the subsequent decision of the ECJ in Accor makes all the difference. They rely on the Court's discussion of administrative burdens under the rubric of effectiveness in paragraphs 99 to 101 of the judgment, and on the Court's statement in the answer to the third question in paragraph 102 that:

> "Production of that evidence may however be required only if it does not prove virtually impossible or excessively difficult to furnish proof of payment of the tax by the subsidiaries established in the other Member States …"

The claimants point out that there was no discussion of effectiveness in Haribo, where the issue was rather whether the administrative burden imposed on the company receiving portfolio dividends was excessive and thus nullified the relief from economic double taxation prima facie provided by the imputation system. If this is right, the claimants go on to submit that the appropriate way to provide them with an effective remedy would be either to disapply the Case V charge or to grant a credit based on the nominal rate of tax.

119. I do not find this an easy question, but on balance I prefer the submissions of the Revenue on this part of the case. My reasons are briefly as follows.

120. First, the decision in Haribo is directly in point (it concerned portfolio dividends) and unequivocal in its reasoning, which was based firmly on the intrinsic nature of an imputation system and the proposition that the necessary information is in principle capable of ascertainment from the company paying the dividend, coupled with the proposition that the tax authorities of the recipient State are under no obligation to try to obtain the information themselves. The Court clearly faced, and was unmoved by, the plight of companies which in practice found themselves unable to obtain the information, and thus ended up without any relief at all.

121. Secondly, the Court in Accor was dealing not with portfolio dividends, but with dividends paid by subsidiaries. Moreover, there was no evidence that Accor would encounter any particular difficulty in providing information about the tax actually paid by its own subsidiaries established in other Member States. The focus was rather on the absence of any such requirement for dividends which Accor received from its French subsidiaries, and the question whether EU law required the grant of a tax credit for the foreign dividends at the same rate as that enjoyed by the French dividends. In this context, the key conclusion was that the tax credit for foreign dividends did not have to equate with the 50% credit for French dividends, and it was therefore necessary for information to be provided about the nature and rate of tax actually charged on the foreign profits (paragraph 92 of the judgment). It is only at this point that the Court discussed the administrative burdens of providing the information, holding that they could not be regarded as excessive or as infringing the principles of equivalence and effectiveness. In relation to equivalence, the Court relied on Haribo and (in paragraph 96 of the judgment) actually cited the statement in paragraph 98 of Haribo that "the inadequate flow of information to the parent company is not a problem for which the Member State concerned should have to answer". The discussion of effectiveness is comparatively brief, and there is no indication that it was intended to qualify, or still less negate, the principle derived from Haribo which the Court had just applied. In my judgment the discussion of effectiveness must be read as being subject to the principles established in Haribo, and was not intended to detract from them. So understood, there is no conflict between the two decisions, and there is still scope for operation of the principle of effectiveness in the taxpayer's favour. Mr Ewart instanced possible restrictions on the provision of information in the source State, for example based on secrecy laws or legislation about the period for which documents need to be retained. If information were to be required which would breach such restrictions in the source State, the principle of effectiveness would be infringed. That is very different, however, from saying that the principle is also infringed by the virtual impossibility or excessive difficulty of obtaining information which the paying company would in principle be able to supply.

122. Thirdly, where the problem is caused by the failure of foreign companies to provide adequate information to their investors, and where according to the ECJ the Member State cannot be held responsible for that failure, it simply makes no sense, in my judgment, to say that the Member State has nevertheless failed to provide the recipient with an effective remedy by requiring the information to be supplied. Consistently with the former principle, the lack of an effective remedy must be laid at the door of the company which has failed to provide the investor with the information it needs. That was the position in Haribo, and in my view it remains the position after Accor.

123. For these reasons, I conclude that:

> (a) the test claimants have failed on the facts to prove their entitlement to a tax credit for the underlying tax actually paid;
>
> (b) this failure involves no breach by the United Kingdom of the principle of effectiveness; and
>
> (c) there is therefore no reason either to disapply the requirement of proof, or to grant a tax credit at the nominal rate as a proxy.

In practice, however, these conclusions make little (if any) difference if I am right in my earlier conclusion that FII (ECJ) II required the UK to grant a credit at the nominal rate of corporation tax paid by the distributing company, quite separately from the credit for underlying tax actually paid. The only circumstances in which it might make a difference are the rare cases where the tax actually paid in a particular year exceeds tax at the nominal rate (for example as a result of balancing charges to match an earlier relief). I would also again emphasise that the credit granted is in any event capped at the UK nominal rate applicable to the dividend less withholding tax. The amount of credit needed to reach the cap and achieve de facto exemption for the dividend will therefore be no more than about 5 to 10% in cases where the dividend forms part of the policy holders' share under an I minus E calculation, and withholding tax is levied at a typical rate of 10 or 15%. In cases where the normal UK nominal rate of corporation tax applies, the gap to be bridged for complete relief would have been around 10% higher in most of the years in issue, but on the basis of the figures in Ms Hine's tables of nominal rates these conditions are again likely to have been satisfied in the great majority of instances.

VII Issues concerning the ACT charge on the onward payment of portfolio dividends

124. The agreed issues under this heading are as follows:

> "1. Is the ACT charge on the onward distribution of portfolio dividends received by the claimant from the EU/EEA and third countries contrary to Article 63 TFEU?
>
> 2. Is it possible to give the domestic legislation a conforming construction? Specifically, should the legislation be interpreted so as to entitle the Claimant to a tax credit to set against the ACT payable on the onward distribution of Portfolio Dividends and, if so, what is the appropriate tax credit?
>
> 3. Alternatively, should the domestic legislation be disapplied and, if so, how should that disapplication be given effect?
>
> 4. What is the effect of the amounts paid by way of ACT being purportedly set off against MCT [*mainstream corporation tax*] paid but not due?"

125. I will deal with these questions briefly, because it is common ground that the answers either follow on from my decision on the issues relating to the Case V charge or are covered by authority which is binding on me.

126. To place the issues in context, the following introduction (adapted from the Revenue's skeleton argument) may be helpful. Dividends received by a UK resident company from another UK resident company were known as franked investment income ("FII"). Dividends paid by a UK resident company were known as franked payments. A UK resident company which paid dividends had to account for ACT on the excess of its franked payments over its FII. Dividends which the company received from non-UK resident companies were not treated as FII. In FII (ECJ) I this difference in treatment was held to be an unlawful restriction on the EU freedoms of establishment and free movement of capital. The essential point is that there was an unjustified difference in treatment because the UK system took account of ACT paid on domestic dividends, by charging only the excess of a company's franked payments over its FII to ACT, but did not take account of foreign corporation tax paid by a foreign company when it paid dividends to its UK-resident parent. In FII (ECJ) II, it was further held (in answer to the "corporate tree" questions) that it did not matter how far down the corporate "roots" the corporation tax had been paid, so long as the distributed profits had been subject to corporation tax at some stage.

127. The precise extent of the unlawful restriction was clarified by the ECJ in paragraph 72 of its judgment in FII (ECJ) II:

> "72. As is clear from paragraph 62 of the present judgment, the obligation imposed on a resident company by national rules, such as those at issue in the main proceedings, to pay ACT when profits from foreign-sourced dividends are distributed is, in fact, justified only in so far as that advance tax corresponds to the amount designed to make up for the lower nominal rate of tax to which the profits underlying the foreign-sourced dividends have been subject compared with the nominal rate of tax applicable to the profits of the resident company."

It is interesting to note the express link between this passage and paragraph 62 of the judgment, which made essentially the same point in relation to nominal rates of corporation tax. This is entirely consistent with the ECJ's standard jurisprudence to the effect that ACT is no more than an advance payment of MCT.

128. The tax credit for FII was provided by section 231(1) of ICTA 1988:

> "(1) … where a company resident in the United Kingdom makes a qualifying distribution and the person receiving the distribution is another such company … the recipient of the distribution shall be entitled to a tax credit equal to such proportion of the amount or value of the distribution as corresponds to the rate of advance corporation tax in force for the financial year in which the distribution is made."

In the light of paragraph 72 of FII (ECJ) II, it appears to me that section 231(1) would have been compliant with EU law if it had also provided a credit in respect of dividends received from non-UK resident companies for (a) underlying tax to which the distributed profits had been subject, and (b) the nominal rate of corporation tax in the source State, but subject to an upper limit equal to the UK nominal rate of ACT. As before, I consider it clear that the foreign nominal rate referred to is that in force in the State of the company paying the dividend. It is equally clear that the credit must be capped at the level of the UK's nominal ACT rate (typically 25%). There could be no question of the UK ever charging ACT in respect of redistributed foreign dividends at any higher rate.

129. In accordance with my approach to conforming construction of section 790, I consider that section 231(1) should likewise be construed in such a way as to grant a limited credit for foreign-sourced portfolio dividends of the amount needed to secure compliance with EU law. No question of disapplication therefore arises. This approach also has the advantage of consistency with that adopted by the Court of Appeal in relation to non-portfolio dividends in FII (CA): see FII (CA) at paragraphs 107 and 108.

130. As to the fourth issue, it is common ground:

(a) that unlawful ACT set against unlawful MCT remains unutilised, and must be repaid; and

(b) that lawful ACT so utilised must also be repaid, because the Court of Appeal so held in FII (CA) at paragraph 151.

The only rider which I need to add is that the Court of Appeal's decision in paragraph 151 is subject to an application for permission to appeal to the Supreme Court which has yet to be determined.

VIII The technical life assurance taxation issues

(1) Attribution of profits under section 89 of the Finance Act 1989

131. I have already explained in general terms how section 89 of the Finance Act 1989 set out the rules for calculating the policy holders' share of the profits of life assurance business, which were chargeable to tax at the basic (or, from 1 April 2004, the lower) rate of income tax, while the shareholders' share, representing the profit derived from carrying on the business, was charged to tax at the full corporation tax rate.

132. In a little more detail, the policy holders' share was arrived at by deducting, from the "relevant profits" (as defined in section 88(3)) of a company carrying on life assurance business, the "Case I profits" (defined in section 89(7) as meaning profits computed in accordance with the provisions of ICTA 1988 applicable to Case I of Schedule D) of the company for the period in respect of the business, reduced in accordance with section 89(2). The reductions specified in section 89(2) comprised:

(a) the amount, so far as unrelieved, of any FII arising in the period as respects which the company had made an election under section 438(6) of ICTA 1988;

(b) the shareholders' share of any other unrelieved FII arising in the period from investments held in connection with the business; and

(c) the shareholders' share of any foreign income dividends so arising.

The effect of these deductions from the Case I profits was to increase by a corresponding amount the policy holders' share which was taxed at the lower rate.

133. The agreed issues under this heading are:

> "1. Does section 89 infringe the Claimant's Treaty rights?
>
> 2. Is the Claimant entitled to deduct the Portfolio Dividends from the Schedule D Case I profits in the calculation provided for by section 89(2) and, if so, to what extent?"

134. In my judgment the answer to the first question must be in the affirmative. The deduction afforded by section 89(2) for unrelieved FII and foreign income dividends brought a corresponding tax advantage by increasing the size of the policy holders' share, whereas no such advantage could be obtained in respect of foreign portfolio dividends. This difference in treatment was plainly discriminatory, and no justification for it has been advanced by the Revenue.

135. The question, therefore, is how the discrimination should be remedied. In my judgment the right solution, as the Revenue submit, is not to allow a further deduction for foreign portfolio dividends under section 89(2), which would be equivalent to treating them as exempt from corporation tax, but rather to leave them in the computation and grant a tax credit for the dividends on the same principles as I have already discussed in relation to the Case V charge. In practical terms, this will usually produce a result equivalent to exemption, but conceptually I think it is the preferable approach. Nor did I understand Mr Aaronson to dissent from it on any substantial grounds, in his brief oral submissions on the point, although his preferred solution would have been to treat the dividends as in practice exempt from tax, and therefore exclude them from the computation under section 89(2), except in the rare cases where grant of a tax credit would have left a small portion of the dividend still within the Case V charge, in which case no deduction should be allowed for that portion. The end result, unless I am mistaken, should in each case be the same, which no doubt explains why Mr Aaronson was content to deal with the point summarily.

(2) The increased claim for payment of tax credits under section 242 of ICTA 1988

136. The background to this issue is briefly as follows. The claim is not one for the repayment of tax unlawfully paid, but rather for the non-payment of certain tax credits to which the claimants say they should have been entitled. Section 242 of ICTA 1988, until it was repealed by the Finance (No. 2) Act 1997, allowed claims to be made for the set-off of various losses, including excess management expenses, against surplus FII. Upon the making of such a claim, the company could require the surplus to be treated as taxable income instead of being exempted under section 208. The result of making a claim to treat surplus FII as taxable income was that it could no longer be carried forward to frank future dividends, or be used for any other purpose. The company was, however, entitled to obtain payment of the tax credit comprised in the amount of FII by which the surplus was reduced. Such a claim would have been available to Prudential in 1991, 1992 and 1994 in respect of its industrial business.

The total amount claimed in respect of unpaid tax credits for those three years is approximately £11.3 million.

137. So far as material, section 242 provided as follows:

> "(1) Where a company has a surplus of franked investment income for any accounting period –
>
> (a) the company may, on making a claim for the purpose, require that the amount of the surplus shall for all or any of the purposes mentioned in subsection (2) below be treated as if it were a like amount of profits chargeable to corporation tax; and
>
> (b) subject to subsection (4) below, the provisions mentioned in subsection (2) below shall apply in accordance with this section to reduce the amount of the surplus …, and
>
> (c) the company shall be entitled to have paid to it the amount of the tax credit comprised in the amount of franked investment income by which the surplus is so reduced.
>
> (2) The purposes for which a claim may be made under subsection (1) above are those of –
>
> …
>
> (c) the deduction of expenses of management under section 75 or 76;
>
> …"

138. As Mr McCullough explained in his written evidence, the automatic effect of excluding foreign dividends from the charge to corporation tax under the I minus E calculation (i.e. if they were treated as exempt in the same way as domestic dividends) would have been to increase Prudential's excess management expenses, and would thus have enabled Prudential to make correspondingly larger section 242 claims. The agreed question under this heading is:

> "Can the Claimant claim an additional amount in respect of tax credits comprised in surplus UK FII under section 242(1)(c) to the extent that the setting aside or reduction of the D V charge on foreign source dividends under I minus E has the effect of increasing the claimant's excess management expenses?"

139. The Revenue do not deny that section 242 discriminated against foreign portfolio dividends by confining its scope to surplus FII, or that this infringed Article 63. They submit, however, that the claim for payment of the tax credits forgone is misconceived, for three separate reasons.

140. The first reason is that the claim is based on the mistaken assumption that conformity with EU law would lead to a reduction in the amount chargeable to tax on the I minus

E basis, rather than to the grant of an appropriate credit against the tax charged. This is in substance the same point that the Revenue make in relation to the calculation of the policy holders' share under section 89 of the Finance Act 1989, and for the same reasons I consider it to be well-founded. If that is right, the claim does not get off the ground, because the appropriate remedy for the infringement of Article 63 is the grant of a credit against the tax charged on the I minus E basis, not a reduction in the income which enters into the computation. If the figure for "I" remains unchanged, so must the amount of any surplus "E".

141. Even if that is wrong, the Revenue's second argument is that the absence of the ability to make a section 242 claim cannot found a claim in restitution, and any remedy would lie in damages, subject to a cast-iron limitation defence and the need for Prudential to establish a sufficiently serious breach. This argument, too, is in my judgment correct. The claim cannot be characterised as a *San Giorgio* claim to recover unlawfully levied tax, or the time value of prematurely levied tax. It is, rather, a consequential claim arising from the inability to make an advantageous election under section 242 which would in turn have led to the payment of a tax credit.

142. Linked with this is the Revenue's third point, which is that section 242 cannot be looked at in isolation. By virtue of section 244 of ICTA 1988, where tax credits have been claimed under section 242, the amount so claimed is deducted from the ACT which the company can set against corporation tax. In quantifying any damages claim, the possible operation of section 244 would have to be taken into account, as would the use which Prudential actually made of the surplus FII in respect of which it says it should have been able to make a section 242 claim.

143. For all these reasons, I agree with the Revenue that this claim is misconceived and must be dismissed.

(3) Issues concerning the absence of a section 438(6) election

144. The agreed question under this heading is:

> "Did the election regime under section 438(6) entail a less favourable treatment of Portfolio Dividends contrary to Article 63 TFEU and, if so, what was that less favourable treatment?"

145. I have already explained the general nature of the right to make an election under section 438(6) in Portfolio Dividends (No. 1) at paragraph [12] and in paragraphs 24 to 26 of this judgment. The question whether section 438(6) infringed Article 63 (then Article 56 EC) was considered by the ECJ in the reasoned order: see Portfolio Dividends (No. 1) at paragraphs [22] to [23], where paragraphs 55 to 58 of the reasoned order are set out. The first part of the question which I now have to consider is the question remitted to the national court, namely "whether, in light of the fact that the permitted election, as regards dividends of national origin, entailed the waiver of tax credits, a company receiving dividends of foreign origin, which could not exercise such an election, was treated less favourably because of that fact alone" (paragraph 56).

146. The question is essentially one of fact, and it was addressed by Mr McCullough in his second statement. He explains that the rate of corporation tax on pension business profits always exceeded the rate of tax applicable to the tax credit carried by FII, and it was therefore beneficial to make the election so long as it did not cause other reliefs claimed to be displaced due to an overall insufficiency of profits remaining in charge to tax. His unchallenged evidence, which I accept, is that:

> "Where we received dividends from UK resident companies we always made s438(6) elections where the election reduced the company's liability to tax. Had it been possible to make an election for foreign dividends, and the tax computations for the year indicated that it would be beneficial to do so, we would obviously have done so."

147. In the light of this evidence, I am in no doubt that the confinement of the ambit of section 438(6) to FII did involve less favourable treatment of foreign portfolio dividends in breach of Article 63, and that the question remitted by the ECJ should be answered in the affirmative. The next question is to identify the precise nature of the less favourable treatment accorded to such portfolio dividends (or, more accurately, the proportion of them allocated to the shareholders' share of pension business profits).

148. In the case of domestic dividends, the effect of the election is to reinstate the exemption from corporation tax in section 208. The calculations put forward by the claimants proceed on the assumption that, if the right to make an election is extended to foreign portfolio dividends, they should likewise be treated as exempt, with the result that any withholding tax which has been credited or recovered in respect of the dividends should be repaid. The Revenue submit, however, that this is the wrong approach, and that the dividends should be treated in the same way as for the purposes of the Case V charge and ACT, that is to say they should be accorded a tax credit of the amount needed to secure compliance with Article 63. In my view the Revenue's approach is correct in principle, because the grant of an exemption might go further than would be necessary to remedy the breach of EU law. In accordance with my earlier conclusions, however, the credit should include a credit for the nominal rate of tax in the source State, and since (on this approach) withholding tax will still be taken into account, the end result in nearly all cases will be equivalent to exemption.

149. I should also record that Mr Ewart expressly accepted in the course of his oral submissions that the net benefit which would have accrued to the claimants from making an election is recoverable by them as a restitutionary claim, and would not sound only in damages. This concession was in my view rightly made, because (on the Revenue's approach, which I have accepted) the claim is in substance one to recover unlawfully levied corporation tax in circumstances where the making of an election to unlock it would have been a matter of course, had the claimants appreciated that it was available to them. In the same way, the claims of the test claimants in the Hoechst case to recover the time value of prematurely levied ACT were restitutionary claims, and were recognised by the ECJ as falling within the *San Giorgio* principle, even though they would have depended upon the making of a group income election.

150. There is one other relatively minor matter which I need to deal with under this heading. In respect of the 1990 accounting period only, Prudential has a further claim for tax credits on UK FII in respect of which a section 438(6) election was made. As Mr McCullough explains in paragraph 21 of his second statement, in that year the ordinary branch business had a nil tax charge, before the section 438(6) claim was made. What is now said, in summary, is that a larger election was made under section 438(6) than would have been necessary had it been appreciated that foreign dividends, like domestic ones, would benefit from exemption from tax. The claim is for the tax credits forgone in respect of the FII which Prudential says it need not have included in the election. The amount claimed is approximately £642,000.

151. In my judgment this claim must fail, because it is based on the flawed assumption that the relevant portfolio dividends would have been exempt from corporation tax and could therefore be left out of account in the tax computation. As I have already explained, I consider the right analysis to be that the dividends should not be treated as exempt, but rather as carrying a tax credit to set against the Case V tax otherwise chargeable. On that basis, the dividends remain in the tax computation and the foundation for the claim disappears.

IX <u>Third country portfolio dividends</u>

152. The agreed issues in relation to third country portfolio dividends are these:

> "1. In respect of which third countries from which the Claimant received dividends is it entitled to rely on Article 63? More particularly:
>
> 2. Is the Claimant entitled to rely on Article 63 in relation to dividends from third countries in respect of which the UK had no entitlement to obtain information relevant for ascertaining the amount of tax paid on the foreign profits?
>
> 3. If not, to what extent does the Claimant's entitlement depend on the terms of the information exchange clause in the agreement concerned?"

153. The ECJ dealt with third country portfolio dividends when answering the fourth question referred to it in the present proceedings: see <u>Portfolio Dividends (No. 1)</u> at paragraphs [25] to [26], where paragraphs 92 to 97 of the reasoned order are quoted.

154. In my earlier judgment I expressed the tentative view that, if the Revenue had no contractual right to obtain from the tax authorities of the source country such information as was necessary to verify compliance with the conditions needed to obtain relief from double taxation, then the refusal to grant a credit for such tax would be justified: see paragraph [26]. On behalf of the claimants, Mr Aaronson now challenges that tentative conclusion. He submits that the ECJ's discussion was confined to cases where, as it is put in paragraph 95 of the reasoned order, "the legislation of a Member State makes the grant of a tax advantage dependant on satisfying requirements, compliance with which can be verified only by obtaining information from the competent authorities of a third country". In the present case, he submits, the UK legislation does not make the grant of double taxation relief for third

country dividends subject to any such requirement. On the contrary, it simply says that there is no entitlement to any relief for underlying tax on portfolio dividends, without exception. Moreover, even where the legislation does afford relief for underlying tax, that is to say for holdings of 10% or more, grant of the relief is based on evidence of the foreign tax provided by the taxpayer. It does not depend on the satisfaction of conditions which the Revenue could verify only by obtaining information from the tax authorities of the third country.

155. Mr Aaronson is obviously right that the refusal of relief for underlying tax in respect of portfolio dividends in section 790 of ICTA 1988 is absolute and unqualified. No direct analogy can therefore be drawn with the kind of case referred to by the ECJ in paragraphs 95 and 96 of the reasoned order (referring to Case C-101/05, Skatteverket v A, [2007] ECR I-11531). The ECJ was not, however, purporting to lay down an exhaustive rule, but rather giving an illustration of the kind of circumstances in which a Member State may be able to establish a justification for a restriction on the movement of capital within the ambit of Article 63. That is clear, in my judgment, from paragraph 93 of the reasoned order, and also from the answer to Question 4 in paragraph 97(where the words "in particular where" show that the test is not of an exhaustive nature). It seems to me that the question of justification has to be considered on a case by case basis and having regard to all the circumstances, including the terms of the relevant legislation, the nature and proportionality of the conditions which have to be satisfied, and any relevant guidance given by the ECJ. It also needs to be remembered that, although the reasoned order was made in the present case, it was delivered as long ago as 23 April 2008, before the subsequent decisions of the Court in Haribo, Accor and FII (ECJ) II.

156. On the basis of my conclusion that EU law requires the UK to grant a tax credit for foreign portfolio dividends which is based on the foreign nominal rate of tax, I can see no reason to exclude any third countries from the relief sought by the claimants. All that is needed to verify a claim for such a credit is a statement of the country from which the dividend was paid and the nominal rate of tax applicable in that country. It is incumbent on the taxpayer who makes the claim to provide this information, and I have already found that (in the exceptional circumstances of the present case) the information provided by the claimants is sufficient for the purpose. My answer to the first question under this heading is therefore "All third countries", and the second and third questions do not arise.

157. Since I have held that the claimants are also entitled to a credit for the underlying tax actually paid, I will briefly consider the position in case I am wrong in my conclusion that they are entitled to a credit based on the nominal rate. In those circumstances, the position would be on all fours with that recently considered by the Upper Tribunal (the Hon. Mr Justice Warren P and Judge Herrington) in The Trustees of the BT Pension Scheme v Revenue & Customs Commissioners [2013] UKUT 0105 (TCC) at paragraphs [233] to [253]. One of the three main issues which the Upper Tribunal had to decide in that case was whether the BT Pension Scheme was entitled to payment of a tax credit under section 231 of ICTA 1988 for portfolio dividends paid by non-UK resident companies between 1990 and 1997. These claims are referred to in the decision as "the *Manninen* claims". Having held that the pension scheme was so entitled, the Upper Tribunal went on to hold, as part of its conforming construction of section 231, (see paragraph 246):

> "that such entitlement will extend to claims in respect of dividends sourced from a third country where the claims can be verified by obtaining information from the competent authorities of third countries under rights conferred under the relevant double taxation convention."

158. It is important to note that no argument appears to have been addressed to the Upper Tribunal about entitlement to a credit based on the nominal rate of tax, probably because the hearing took place in July 2012, before the ECJ had delivered its judgment in FII (ECJ) II. After the judgment had been given on 13 November 2012, the Upper Tribunal invited written submissions from the parties on it (see paragraph 202), but there is no indication that those submissions raised the issue of a tax credit at the nominal rate. Accordingly, the case was decided on the footing that the only credit available was one for the actual underlying tax. On that basis, the Upper Tribunal accepted the Revenue's argument that it could rely on a justification of "effective fiscal supervision" in order to withhold relief except where it was able to verify the claims by obtaining information from the competent authorities of third countries.

159. The Upper Tribunal then held that this condition would be satisfied where, at the time when HMRC came to consider the claim, there was a double tax convention in force with the relevant country which provided for exchange of information for any purpose of the tax legislation of the contracting states, but not where the convention contained no information exchange provisions at all, or contained provisions only for the purposes of preventing fraud or tax avoidance: see paragraphs [248] to [252].

160. I was told that there is a pending appeal, for which permission has been granted, to the Court of Appeal in the BTPS case. Furthermore, although technically not binding on me, it is a decision of an appellate tribunal chaired by a High Court judge who has great experience and expertise in this area. In those circumstances, I think that I should simply follow the decision of the Upper Tribunal on this part of the case, unless I were convinced that it was wrong. I am not sure that I would have dealt with the issue in exactly the same way, but I am certainly not prepared to say that the decision of the Upper Tribunal was wrong, and I entirely agree with their analysis of the different types of double tax convention. I will therefore content myself with saying that, if the only credit to which the claimants were entitled was one for underlying tax actually paid, I would follow the reasoning and conclusion of the Upper Tribunal in the BTPS case.

161. Since, however, the claimants are in my opinion also entitled to a credit based on the nominal rate, and since no argument to that effect was addressed to the Upper Tribunal in BTPS, my answers to the questions under this heading are as indicated in paragraph 153 above.

X Remedies

(1) Introduction

162. The agreed issues relating to remedies are as follows:

> "1. For each of the categories of claim [*considered above*]:

(i) Was there any unlawfully exacted tax so as to found a claim under *Woolwich*? If so what is the measure of the unlawfully exacted tax?

(ii) Did the claimant pay tax by mistake so as to found a claim in mistake? If so, what is the measure of the restitution?

(iii) Is there a restitutionary defence available – e.g. defence of change of position, passing on, "fiscal chaos" and, if so, are the requirements of any such defence fulfilled and to what extent?

2. On what basis is interest payable?"

163. In the event, there is a large measure of common ground in relation to the claims where I have found that either corporation tax or ACT was unlawfully levied. The Revenue do not dispute that:

(a) such claims are to be characterised as *San Giorgio* claims under EU law;

(b) the overpaid tax (or its time value in the case of utilised ACT) is in principle recoverable by either a Woolwich claim or a mistake-based restitutionary claim, subject to defences and limitation; and

(c) the tax was in fact paid under an operative mistake, the mistake being that it was lawfully due and payable.

164. This common ground covers the claims to recover unlawful corporation tax which I have upheld in sections VI, VIII(3) and IX above. I have held that the claims to recover tax credits in respect of UK FII in section VIII(2) and (3) fail, so no question of remedies arises in relation to them; but, if it did, I would agree with the Revenue that these claims sound only in damages, not restitution. As to the ACT claims, it is agreed:

(a) that unlawful ACT which was utilised against lawful MCT is recoverable, on the same basis as in Hoechst;

(b) that unlawful ACT which was utilised against unlawful MCT is also recoverable, on the basis that the purported charge was a nullity; and

(c) lawful ACT which was utilised against unlawful MCT is recoverable because the Court of Appeal so held in FII (CA), but this is subject to the Revenue's pending application to the Supreme Court for permission to appeal against that conclusion.

165. The claimants' counsel have appended to their skeleton argument a number of worked examples showing the practical application of the principles for which they contend. The examples proceed on the assumption that the relevant foreign dividends should have been exempted from tax, in the same way as domestic dividends. As I have explained, I do not consider that contention to be correct, although for practical purposes it makes little difference if (as I have held) the claimants are also entitled to

a tax credit at the foreign nominal rate. The examples will therefore need to be reworked on the correct basis. I did not understand the Revenue to have any disagreements in principle with the examples, apart from the assumption that the foreign dividends were exempt. If any difficulties do emerge, and the parties are unable to resolve them by agreement, there will be an appropriate liberty to apply for their resolution in the order made after this judgment has been handed down.

166. Despite the terms of agreed issue 1(iii), the only restitutionary defence pleaded by the Revenue is change of position. Mr Ewart confirmed in oral argument that no reliance is placed, in the present case, on possible defences of passing on or fiscal chaos. Accordingly, the two major issues with which I still have to deal are:

(a) the change of position defence; and

(b) the basis on which interest should be payable.

(2) <u>Change of position</u>

167. The defence of change of position is pleaded as follows in paragraph 28 of the amended defence:

> "Further and/or alternatively, in so far as the Defendants were initially unjustly enriched, the Defendants have in good faith changed their position in consequence of the payments made by the Claimants and/or the equivalent payments made by other Claimants in the CFC and Dividend GLO such that it would now be inequitable and /or unconscionable to require the Defendants to make restitution of those sums. The sums in question formed part of the United Kingdom's tax revenue for the relevant year in which they were paid. Those sums have been irretrievably spent, in some cases many years ago."

168. I will begin my examination of this subject with the question whether, as a matter of EU law, it is open to the Revenue to rely on change of position as a defence to a *San Giorgio* claim for the repayment of unlawfully levied tax. If the answer to that question is no, and if the prohibition applies to both the <u>Woolwich</u> and the mistake-based claims advanced by the claimants, the defence must fail, regardless of any merit which it may have as a matter of English domestic law.

169. In <u>FII (High Court)</u> I pointed out that, while the case law of the ECJ accepts that reasonable limitation periods may be fixed for repayment claims in the interests of legal certainty, no substantive defence to *San Giorgio* claims had at that date been recognised apart from the defence of unjust enrichment where the unlawful charge has been passed on by the taxpayer to a customer: see paragraphs [306] to [308] of my judgment and the cases there cited, including in particular <u>Weber's Wine World</u> (Case C-147/01, ECR I-11365) at paragraphs 94 and 102.

170. It is important to note that in <u>FII (High Court)</u> the Revenue had conceded that the defence of change of position was not open to them in relation to <u>Woolwich</u> claims, which they argued were all the test claimants needed in order to vindicate their *San Giorgio* claims. I disagreed, holding that the mistake-based <u>DMG</u> cause of action was

also needed for that purpose, and that the EU principle of effectiveness applied to both causes of action alike. I therefore interpreted the Revenue's concession in relation to the Woolwich cause of action as extending to DMG claims for the recovery of unlawfully levied tax: see paragraph [304]. In those circumstances, the issue of change of position was in my view a live one only in relation to the few restitutionary claims which I had held should *not* be classified as *San Giorgio* claims, and it was only to that limited category of claims that my discussion of the Revenue's pleaded case of change of position in paragraphs [309] to [352] was directed. In the present case, by contrast, the Revenue maintain their concession in relation to Woolwich claims, but argue that mistake-based claims are different and there is no reason why change of position should not be available as a defence to them.

171. Before I consider the Revenue's arguments in favour of that submission, I must first refer to the latest relevant case law of the ECJ. Its effect, in my judgment, is to reaffirm in the clearest terms a principle of stark and uncompromising simplicity. The only substantive defence which EU law recognises to a *San Giorgio* claim is that of unjust enrichment of the taxpayer.

172. The case which establishes that proposition is Case C-398/09, Lady & Kid A/S and others v Skatteministeriet [2012] STC 854, in which the Grand Chamber delivered judgment on 6 September 2011. In 1987 Denmark had introduced a business tax known as the employment market contribution, or "AMBI". It was charged at a fixed rate of 2.5%, and calculated on the same basis as VAT. It was not, however, payable upon the import of goods into Denmark, but only upon their first sale in Denmark. In return for the introduction of the AMBI, a number of social security charges which had to be paid by Danish employers were abolished. The purpose of the combined package of measures was "to eliminate the link between the contributions to be paid and the number of employees, in order to stimulate growth and develop employment, while retaining neutrality as regards public finances" (paragraph 5 of the judgment of the Court). The AMBI was levied between 1988 and 1991, but its lawfulness was challenged and in 1992 the challenge was upheld by the ECJ: see Case C-200/90, Dansk Denkavit ApS and another v Skatteministeriet, [1992] ECR I-2217, [1994] STC 482. Following that judgment, Denmark implemented legislation laying down the arrangements for reimbursement of the AMBI which had been unlawfully levied, but various conditions had to be satisfied by claimants for reimbursement, including that they had suffered a net loss when the amount paid by way of the AMBI was set against the savings from the social charges which had been abolished. The four claimants in the national proceedings before the Copenhagen District Court were all retailers. Two of them, including Lady & Kid had made a net gain, in the sense that they had saved more in employer social security contributions than they had paid in AMBI; the other two, however, had made a net loss, and one of them (Direct Nyt) had no employees and had therefore made no saving at all. On appeal from the rejection by the District Court of all four claims, a number of questions were referred by the appellate court to the ECJ, seeking clarification of the EU law concept of "passing on", and asking whether an unlawful levy had to be reimbursed where the taxpayer had in fact made a net saving as a result of the abolition of other charges.

173. In his Opinion delivered on 7 December 2010, Advocate General Cruz Villalón held that passing on was not necessarily the only exception to the principle that unlawfully levied taxes had to be repaid, and proposed the adoption of an ad hoc solution which

would net off the benefit to the claimants from the abolished charges against the unlawful tax. Having referred to two earlier decisions of the Court where he found some support for this proposal, the Advocate General said at paragraph 67:

> "In my opinion, the two judgments referred to demonstrate that entitlement to repayment of sums unduly paid may be subject to exceptions, in particular circumstances other than passing on, resulting from other advantages that the person may have been granted by the authority for whose benefit the unlawful tax was levied. The ultimate conclusion is that the fact that the tax has been passed on does not constitute the only possible means of refusing repayment, which may be based on a possible unjust enrichment arising out of a parallel saving."

174. This proposal was not accepted by the Court. After referring to the *San Giorgio* principle (in paragraph 17), and the established passing on exception (in paragraphs 18 and 19), the Court continued:

> "20. None the less, since such a refusal of reimbursement of a tax levied on the sale of goods is a limitation of a subjective right derived from the legal order of the European Union, it must be interpreted narrowly. Accordingly, the direct passing on to the purchaser of the tax wrongly levied constitutes the sole exception to the right to reimbursement of tax levied in breach of European Union law.
>
> 21. The Court has also held that, even where it is established that the burden of the charge levied though not due has been passed on to third parties, repayment to the trader of the amount thus passed on does not necessarily entail his unjust enrichment, since even where the charge is wholly incorporated in the price, the taxable person may suffer as a result of a fall in the volume of his sales …
>
> 22. Similarly, the Member State may not reject an application for reimbursement of an unlawful tax on the ground that the amount of that tax has been set off by the abolition of a lawful levy of an equivalent amount.
>
> 23. Although reimbursement of an unlawful levy to a trader who has passed on the amount to his customers can, in the conditions set out above, lead to unjust enrichment, that is not so in the case of an alleged abolition of other taxes in relation to the introduction of a tax contrary to European Union law.
>
> 24. That abolition falls within the ambit of choices made by the State in the field of taxation which express its general policy in economic and social matters …
>
> 25. That conclusion cannot be called into question by the Court's judgments in Case 177/78 *McCarren* [1979] ECR 2161

> and Case 222/82 *Apple and Pear Development Council* [1983] ECR 4083. Even if, in paragraph 25 of the judgment in *McCarren* and paragraph 41 of the judgment in *Apple and Pear Development Council*, the Court did not rule out that the national court, applying its national law, could take into consideration possible methods of refusing reimbursement of an unlawful tax other than passing on, it must be noted that the Court, in paragraph 20 of the present judgment, states that the direct passing on of the tax wrongly levied to the purchaser constitutes the sole exception to the right to reimbursement of tax levied in breach of European Union law."

175. In the passage which I have quoted, the Grand Chamber went out of its way on two occasions (in paragraphs 20 and 25) to state that the direct passing on of the unlawfully levied tax is "the sole exception" to the general right to reimbursement of such tax conferred by EU law. The statement of principle gains added strength, in my view, from the fact that the Court was clearly rejecting the view of the Advocate General, and was doing so against a factual background where two of the claimants were net beneficiaries from the package of fiscal measures which had been introduced in 1987. The Court was not, of course, considering a defence remotely comparable to change of position by the Member State which had levied the unlawful tax. But on the face of it the words "the sole exception" must mean what they say. If there is only one exception, no others may be admitted, whatever their nature.

176. Furthermore, all the indications are that this is now the settled jurisprudence of the Court. Six days after the judgment in Lady & Kid, on 15 September 2011 the First Chamber of the ECJ delivered its judgment in Accor. As reformulated by the Court, the second question referred in Accor asked whether the French authorities were permitted by EU law to refuse reimbursement on the ground either that it would lead to the unjust enrichment of the French parent company, or that the sum paid by the parent company "does not constitute an accounting or tax charge for it but is set off against the total of the sums which may be redistributed to its shareholders" (paragraph 70 of the judgment). In other words, as I understand it, the point being made was that the economic burden of the unlawful tax charge was in fact borne by the company's shareholders, and not by the company itself. This argument was rejected by the Court, and the principles which had just been enunciated in Lady & Kid were applied. After referring to the established passing on exception, the Court said:

> "73. However, it is settled law that, since the disallowing of repayment in such circumstances entails placing a limitation on a subjective right derived from the EU legal order, that restriction must be narrowly construed (*Weber's Wine World and Others*, paragraph 95, and *Lady & Kid and Others*, paragraph 20).
>
> 74. Thus, it is apparent from paragraphs 20 and 25 of *Lady & Kid and Others* that the only exception to the right to repayment of taxes levied in breach of EU law is in a case in which a charge that was not due has been directly passed on by the taxable person to the purchaser."

177. Most recently, in his Opinion in FII (ECJ) III delivered on 5 September 2013, Advocate General Wathelet said at paragraph 74:

> "It is settled case-law that the right to a refund of taxes levied in a Member State in breach of EU law is the consequence and complement of the rights conferred on individuals by provisions of EU law prohibiting such taxes. There is only one exception to that obligation: where charges to tax have been passed on in their entirety to a third party and their reimbursement would bring about the unjust enrichment of the taxable person. That is not the position here."

178. The authorities cited by the Advocate General for the existence of the "one exception" included Weber's Wine World, but not (rather surprisingly) Lady & Kid or Accor. They could only have reinforced the proposition which he clearly considered to be well settled.

179. Mr Ewart relied on two main lines of argument in support of his submission that, despite Lady & Kid, change of position remains open to the Revenue as a defence to the claimants' *San Giorgio* claims.

180. The first argument is that only the Woolwich remedy is "protected" by EU law. Mr Ewart submits that, as restated by the Supreme Court in FII (SC), the remedy gives full effect in English law to the underlying policy that unlawfully levied tax must be repaid. It reflects an absolute right to recover tax unlawfully charged, subject only to a six year limitation period which is admittedly compliant with EU law. By contrast, says Mr Ewart, the mistake of law remedy is in important respects both narrower and broader than the Woolwich remedy. It is narrower, in that it depends on establishing that the tax was paid under an operative mistake of fact or law, and therefore does not cover all cases where tax which is not due has been received by the Revenue. Indeed, it applies to lawful and unlawful tax alike, provided only that it has been mistakenly paid. The remedy is broader, in that it applies generally in the law of restitution, and at the simplest level requires only the making of a mistake, however unreasonable or negligent the claimant may have been. This point was amplified by Professor Burrows, who argued that the "unjust factor" which underpins the Woolwich principle is policy-based, whereas mistake as an unjust factor does not rest on any policy that unlawful tax should not be retained, but simply on the claimant's impaired consent. As a matter of legal analysis, it is to be classified with other unjust factors in the law of unjust enrichment which are based on problems associated with the claimant's consent.

181. This argument is in substance a refinement of the one which found favour with the Court of Appeal in FII (CA), to the general effect that the Woolwich remedy (with appropriate modifications) is all that the EU principle of effectiveness requires the United Kingdom to make available for the satisfaction of *San Giorgio* claims. It is clear, however, that the majority in the Supreme Court took a different view, albeit provisionally because of the unanimous decision of the court to make a further reference to the ECJ. The view of the majority is perhaps most clearly stated by Lord Reed, who said at paragraph [212]:

> "Where an action for the recovery of taxes under domestic law can be based either on the ground of mistake or on the ground of unlawful demand (or, as in the present case, on both grounds), it follows from the principle of equivalence that both grounds of action should also be available in similar circumstances to enforce an analogous right under EU law. So long as they must both be available, they must also both be effective. *The principle of effectiveness therefore applies to both grounds of action* (my emphasis)."

182. Mr Ewart criticised the final sentence which I have italicised as a non-sequitur, but he accepted that all of the majority agreed with it. Nor do I accept the implausible suggestion that Lord Reed was guilty of a logical fallacy. It seems to me he was making the simple point that, where domestic law provides two remedies for the recovery of unlawfully levied tax, the EU law principle of effectiveness must apply to both of them alike. Given the existence of the Woolwich remedy, effectiveness does not require the ingredient of a mistake to be removed from the other remedy; but it does require claimants to be allowed to choose between them while they both remain in force.

183. Furthermore, Lord Reed's view has now been endorsed by Advocate General Wathelet in his Opinion on the third reference. After accepting that the principle of effectiveness does not require Member States to provide more than one legal remedy to enable individuals to safeguard their EU law rights (paragraph 45), the Advocate General said:

> "47. If, however, in application of the principle of procedural autonomy, a Member State makes a number of legal remedies available to individuals, the second subparagraph of Article 19(1) TEU requires that each of those remedies ensure effective legal protection, and a legal remedy cannot offer "effective" protection unless the conditions in accordance with which it may be used and achieved a positive outcome are known in advance.
>
> 48. Accordingly, as soon as taxpayers choose one of the national legal remedies available under national law (in the present case, the *Kleinwort Benson* remedy) or have recourse to the only national legal remedy available, they must come under the protection offered by the general principles of EU law."

To similar effect, he then said in paragraph 53:

> "… the guarantees attaching to the principle of effectiveness apply to every legal remedy which national law makes available to claimants for the reimbursement of taxes levied in breach of EU law."

184. It is, of course, still possible that the ECJ will depart from the views of their Advocate General and the majority of the Supreme Court; but, unless and until they do so, I am in no doubt that I should follow those views. For what it is worth, they also coincide

with my own understanding of the law: compare Portfolio Dividends (No. 1) at paragraphs [46] and [47]. I would therefore reject Mr Ewart's first line of argument.

185. His second line of argument is based on the way in which recognition of mistake of law as an unjust factor grounding a restitutionary claim has evolved in England. His general point is that recognition of the cause of action has been so closely bound up with the defence of change of position that the two cannot sensibly be separated, and if the EU principle of effectiveness requires the remedy to be made available, it can only do so subject to the concomitant defence. The passage which Mr Ewart mainly relied on in support of this submission is to be found in the celebrated speech of Lord Goff of Chieveley in Kleinwort Benson Limited v Lincoln City Council [1999] 2 AC 349 at 372-373:

> "*Rejection of the mistake of law rule in the common law world*
>
> It is perhaps easier for us now to see that the policy underlying the rule can best be achieved, consistently with justice, by the recognition of a right of recovery subject to specified defences to cater for the fears which formerly appeared to require a blanket exclusion of recovery. However, the blossoming of scholarly interest in the development of a coherent law of restitution did not occur in the common law world until the middle of the 20th century … There can be no doubt that it is this scholarly work which has provided the prime cause for the rejection of the mistake of law rule, either by legislation or by judicial decision, in countries throughout the common law world. This is due not only to specific criticism of the mistake of law rule as such, but still more to the combined effect of two fundamental changes in the law: first, recognition that there exists a coherent law of restitution founded upon the principle of unjust enrichment, and second, within that body of law, recognition of the defence of change of position. This is due essentially to the work of scholars. Once that work had been published and widely read it was, I believe, inevitable that in due course both doctrines would be recognised by the judges, the time of such acceptance depending very much on the accidents of litigation. In fact, in England both were accepted by this House in 1991, in the same case, *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548. Once both had been recognised it became, in my opinion, also inevitable that the mistake of law rule should be abrogated, or at least reformulated, so that there should be a general right of recovery of money paid under a mistake, whether of fact or law, subject to appropriate defences. This is because a blanket rule of non-recovery, irrespective of the justice of the case, cannot sensibly survive in a rubric of the law based on the principle of unjust enrichment; and because recognition of a defence of change of position demonstrates that this must be proved in fact if it is to justify retention, in whole or in part, of money which would

> otherwise be repayable on the ground that the payee was unjustly enriched by its receipt. The combined effect is not only that the mistake of law rule can no longer be allowed to survive, but also that the law must evolve appropriate defences which can, together with the defence of change of position, provide protection where appropriate for recipients of money paid under a mistake of law in those cases in which justice or policy does not require them to refund the money. It is this topic which lies at the centre of the present appeals. As the argument before the appellate committee has demonstrated, the identification of such defences is by no means easy and, whatever your lordships' house may decide, the topic is likely to continue to engage the attention of judges, scholars and law reformers for some years to come."

186. Lord Goff's conclusion on the first issue, at 375H, was as follows:

> "I would therefore conclude on issue (1) that the mistake of law rule should no longer be maintained as part of English law, and that English law should now recognise that there is a general right to recover money paid under a mistake, whether of fact or law, subject to the defences available in the law of restitution."

187. In my judgment Mr Ewart is right to this extent, that without recognition of the defence of change of position in <u>Lipkin Gorman</u> the mistake of law rule would not have been abrogated by the House of Lords in <u>Kleinwort Benson</u>; and he is also right to say that the evolution of appropriate defences (apart from change of position) must go hand in hand with the development of the law of restitution in this area. But I cannot derive from any of this a proposition in the strong form that a right to recover unlawfully levied tax on the ground of mistake of law (as finally recognised by the House of Lords in <u>DMG</u>) is so inextricably linked with the availability of a change of position defence that the two must be regarded as inseparable, so that the defence is an integral part (or qualification) of the right itself. Only a proposition in such a strong form could even arguably co-exist with the settled principle applied by the ECJ in <u>Lady & Kid</u> and other cases, on the assumption (as I have already held) that the mistake-based remedy for the recovery of overpaid tax is protected by EU law. And even then, I would regard it as highly questionable whether such a formulation of the right, with a built-in defence, did not in fact infringe the "sole exception" principle so clearly stated by the ECJ.

188. In addition, it seems to me that the argument may well break down at an earlier stage. Change of position is a defence of general application in the law of restitution, but its availability is highly fact-specific, and there are powerful policy arguments (eloquently advanced to me by Mr Beazley) for saying that the defence should not be recognised where a mistake-based claim is brought to recover unlawful tax. In short, the argument is that all the factors which lead to the admitted exclusion of change of position as a defence to a <u>Woolwich</u> claim apply with equal force, and should lead to the same conclusion, where the claim is founded on a mistake about the lawfulness of the overpaid tax. Whether or not that argument is correct, it seems to me clear, at least in cases of the present type, that the defence cannot properly be regarded as an automatic concomitant of the cause of action. Accordingly, the foundation of Mr

Ewart's argument disappears, and there is in my judgment no answer to the simple point that, as a matter of EU law, the defence is excluded by the Lady & Kid principle.

189. For these reasons, I conclude that the Revenue's change of position defence must, as a matter of EU law, fail in relation to all the claimants' *San Giorgio* claims.

190. Even if the defence were not precluded by EU law, the Revenue would in the present case have to overcome another formidable obstacle. It is common ground that the burden of establishing the defence lies on them, but apart from pleading it in the very general terms quoted in paragraph 164 above they have adduced no evidence, and given no disclosure, in relation to the issue. In their skeleton argument, counsel for the Revenue say that change of position "is to be approached as a matter of principle", and they are "not seeking, at this stage, a ruling to the effect that, on the detailed facts, change of position is established". That would be premature, they submit, when it is not known whether any claim to restitution will prima facie succeed, or what the quantum of any successful claims will be. Instead, they seek to establish that, as a matter of principle, they can rely on the defence in respect of the mistake-based restitutionary claims. Building on this foundation, they then ask the court to determine the following points of principle in their favour:

(a) the "wrongdoer" bar does not prevent the Revenue from here relying on the defence;

(b) there is no policy obstacle to the defence operating in respect of a mistake claim, although it cannot apply as a defence to a Woolwich claim;

(c) on the facts, the defence will succeed "if the sums have been spent on government projects/plans (or in reducing governmental borrowing) and cannot now be easily recouped"; and

(d) "at a high level of generality, restitution would here be inequitable in all the circumstances".

191. In my judgment this approach is seriously misconceived. In the first place, no directions have been given for a split trial in relation to the defence, with points of principle (specified or otherwise) to be determined first. On the contrary, this is the (adjourned) trial of the action, and the agreed issue relating to any restitutionary defence which may be available asks whether the requirements of any such defence are fulfilled, and to what extent: see paragraph 159 above. That is a question which can only be answered in the light of specific evidence, and it neither entails nor suggests the adoption of a two stage approach. Furthermore, it would in my view be both dangerous, and undesirable in principle, if I were to express any views on the so-called questions of principle identified by the Revenue in a factual vacuum. As the Court of Appeal observed in FII (CA) at paragraph [192], the defence is highly fact-sensitive, and its possible application to government spending raises important and difficult questions of law and policy. In general, such questions should be firmly grounded in a factual context before the court pronounces on them. The dangers of deciding questions of law in an abstract form not related to particular facts have often been adverted to by the courts. If I may venture to repeat what I said earlier this year,

in the context of a proposal, in another GLO case, to refer certain questions to the ECJ in an abstract form:

> "Experience shows that questions which look deceptively simple when posed in the abstract may become far more complex and difficult, and new angles and implications may emerge, once they are put in a detailed factual context. It is a truism to say that no question of law can be decided in a factual vacuum; and even a decision which is based on a short statement of agreed facts can often turn out to be a deceptive short cut."

See The Claimants in the Loss Relief Group Litigation Order v Revenue and Customs Commissioners [2013] EWHC 205 (Ch) at paragraph [48].

192. In propounding a two stage approach, the Revenue were no doubt encouraged by the history of the proceedings in FII (High Court), where (albeit only in relation to non-*San Giorgio* claims) I discussed the ingredients of the defence at some length and concluded that the Revenue would be likely to succeed in establishing it. In particular, I said in paragraph [344]:

> "To state the obvious, taxation is not imposed for its own sake, but in order to fund government expenditure. It is one of the two main ways in which public expenditure is funded, the other being public sector borrowing. One would expect government spending decisions, at a policy level, to be reached at least in part on the basis of the tax revenues which it has received in the past, and which it expects to receive in the future. Even if tax revenues are not spent immediately, common sense suggests that they will be used up over a fairly short period, and that it is probably safe to assume that tax receipts which predated the claims in the present case by more than six years, and therefore fell outside the scope of a *Woolwich* claim with its six-year limitation period, will have been exhausted well before the commencement of the action. As a matter of causation, no precise link can be demonstrated between particular receipts and particular items of government expenditure, but common sense again suggests that planned government expenditure would not have taken place at the level which it did but for the availability of the tax receipts which were taken into account in fixing departmental budgets. If all concerned, both the government and the taxpayers, proceeded on the footing that the tax was validly levied, I ask myself what is wrong with the argument that it would now be inequitable to require the Revenue to make restitution for the tax which was paid by mistake, because the money in question has long ago been spent in the public interest, and everybody assumed in good faith that it had been validly levied? I confess that, once the question is stated in these terms, the answer to it seems to me to be obvious. It would in my judgment be inequitable to require repayment in such circumstances, always bearing in mind that

> the claimants have a perfectly good separate *San Giorgio* claim for repayment of the unlawfully levied tax itself, free from any change of position defence."

It is important to emphasise, however, that the view which I there expressed was only a provisional one, and all I actually decided was that the Revenue could raise the defence at a subsequent stage: see FII (CA) at paragraph [190]. I must also acknowledge, with the benefit of hindsight, and academic commentary on the views which I then expressed, that I now think I was probably unwise to go as far as I did without more detailed evidence, and some points which seemed obvious to me in 2008 appear far less clear in 2013. Furthermore, whether my views were right or wrong, I did at least have the benefit of some relevant evidence from Mr David Ramsden, who was then the Treasury's chief economic adviser: see paragraphs [349] to [352].

193. At the trial in July counsel for the claimants invited me to rule that, in the absence of any evidence, the defence of change of position was not open to the Revenue. I declined to give an immediate ruling to that effect, partly because I wished to see how the Revenue would develop their argument in oral submissions, and partly because both sides had come prepared to deal with the issues raised by the Revenue within the five days allocated for the hearing. Nevertheless, having heard full argument, and having had time to reflect on the matter, I am firmly of the view that the claimants' submission should be accepted. I would therefore rule that it is not open to the Revenue, having adduced no evidence, to rely on the defence in the present proceedings, even if I am wrong in my conclusion that the defence is anyway precluded by EU law. In these circumstances, although I heard interesting argument on some of the issues, I think it would be inappropriate for me to say any more about them. Not only would anything I said be doubly obiter, but I would also be at risk of making unsubstantiated factual assumptions.

(3) On what basis is interest payable?

Introduction and background

194. The claimants seek compound interest in respect of each category of claim which has succeeded. They submit that the periods over which interest should be compounded are as follows:

(a) for unlawfully levied ACT which was subsequently set off against MCT, from the date of payment by the claimants to the date of utilisation;

(b) for all other unlawfully levied tax (including unlawfully levied ACT which was never utilised, and unlawful ACT utilised against unlawful MCT), from payment by the claimants to the date of repayment by the Revenue; and

(c) for the principal sum of the time value of utilised ACT (resulting from (a) above), from the date of set-off against MCT to the date of repayment by the Revenue.

The claimants say they would be content to accept the usual rates of compound interest awarded in the Commercial Court (namely Bank of England base rate plus 1%, compounded monthly). In oral argument, however, they proceeded on the more realistic basis that, if compound interest were to be awarded, it should be at conventional rates calculated by reference to the rates of interest and other terms applicable to borrowing by the Government in the market during the relevant period, that being the solution adopted by a majority of the House of Lords in Sempra Metals Limited v IRC [2007] UKHL 34, [2008] 1 AC 561 ("Sempra").

195. The Revenue accept that compound interest is payable in respect of the utilised ACT claims, because that is what the House of Lords decided in Sempra. In respect of all the other claims, however, that is to say those in categories (b) and (c) above, they submit that EU law does not require compound interest to be awarded, and that simple interest under section 35A of the Senior Courts Act 1981 would provide the claimants with an "adequate indemnity" in accordance with the guidance given by the ECJ in the Littlewoods case (Case C-591/10, Littlewoods Retail Ltd and Others v HMRC, [2012] STC 1714). The Grand Chamber of the ECJ delivered its judgment in that case, which I will call "Littlewoods (ECJ)", on 19 July 2012, on a reference for a preliminary ruling by the High Court in a case in which the claimants had been repaid by HMRC unlawfully levied VAT of approximately £205 million together with simple interest computed in accordance with section 78 of the Value Added Tax Act 1994. The critical issue, broadly stated, was whether the claimants were also entitled under EU law to receive compound interest, giving credit for the simple interest which had already been paid. This is, I believe, the first occasion on which it has fallen to the English Court to seek to apply the guidance given by the ECJ in Littlewoods (ECJ), although a further High Court hearing in the Littlewoods case itself is due to begin in late October 2013.

196. In view of the importance and difficulty of the issue, I propose to begin with a brief review of the development of the ECJ's jurisprudence in this field and earlier attempts by the English courts to apply that jurisprudence in the context of *San Giorgio* claims to recover unlawfully levied tax.

197. The same basic issue as in Littlewoods had earlier arisen, together with a number of other issues, in a GLO (the VAT Interest Cars Group Litigation) where the claimants were motor vehicle dealers who had overpaid VAT for periods of many years, dating back in some cases to the introduction of VAT in the United Kingdom in 1973. The overpayments related to the VAT treatment of demonstrator cars, in ways which subsequent decisions of the ECJ established to be unlawful. As in Littlewoods, the overpaid VAT was eventually repaid to the dealers in full together with simple interest pursuant to section 78 of VATA 1994. The dealers were not satisfied with this, however, and claimed that the EU law principles of effectiveness and equivalence required the tax to be repaid with compound interest. This was resisted by the Revenue, who argued that as a matter of domestic law the repayment scheme of VATA 1994 was intended to be exhaustive, and that there was nothing in the principles of EU law relating to the repayment of unlawfully levied tax which required the domestic regime to be overridden. Selected test claims were then heard by me in February 2009: see F J Chalke Limited and Another v Revenue and Customs Commissioners [2009] EWHC 952 (Ch), [2009] STC 2027 ("Chalke (High Court)").

198. In my judgment in Chalke (High Court), I held that the statutory scheme for the recovery of overpaid VAT and interest in VATA 1994 was indeed exhaustive, and that there was no room for a common law right to recover compound interest by way of restitution to co-exist with that scheme: see paragraph [74]. I then turned to what I

described as the second core question, namely whether EU law overrode the domestic statutory scheme and required an award of compound interest to be made. My analysis of the case law of the ECJ down to and including FII (ECJ) I may be found in paragraphs [78] to [108]. In summary, I thought that the decision of the ECJ in the latter case represented a significant development, in the context of *San Giorgio* claims, of the Court's frequently stated principle that questions relating to interest were ancillary matters for the national court to determine. In particular, the ECJ had said in paragraph 205 of its judgment in FII (ECJ) I:

> "It follows from that case law that, where a Member State has levied charges in breach of the rules of Community law, individuals are entitled to reimbursement not only of the tax unduly levied but also of the amounts paid to that State or retained by it which relate directly to that tax. As the court held in paras 87 and 88 of [*Hoechst*], that also includes losses constituted by the unavailability of sums of money as a result of a tax being levied prematurely."

In paragraph [107] I said that the ECJ had made it clear, to my mind:

> "… that the *San Giorgio* principle must now be regarded as entitling a claimant who has paid tax levied in breach of Community law not only to repayment of the tax itself, but also to reimbursement of all directly related benefits retained by the member state as a consequence of the unlawful charge. It is only in this way that the claimant can obtain an effective remedy for its loss, and effect can be given to the underlying principle that the member state should not profit from the imposition of the unlawful charge."

199. I then continued:

> "108. Certain important consequences seem to me to follow from this analysis. In the first place, if an effective remedy requires that the member state should not profit from the unlawful charge, the claimant should in principle be entitled not only to repayment of the tax itself but also to interest. Otherwise the claimant would effectively be compelled to make an interest-free loan to the member state for the period between the wrongful exaction of the tax and its repayment. Secondly, no sensible distinction can be drawn in relation to interest between cases where tax is levied prematurely (as in *Hoechst*) and cases where the tax itself has to be repaid. In each case, the claimant should recover by way of "interest" a sum which represents the loss of use of the money, or (perhaps more accurately) the benefit of the use of the money to the member state, over the relevant period. If anything, common sense suggests that this right should be stronger in cases where the tax itself has to be repaid than in cases where the tax was merely levied prematurely. Thirdly, the measure of such loss of use or benefit, in the context of a restitutionary claim brought in

> an English court, should normally be compound, not simple, interest, as the majority of the House of Lords … upholding Park J … and the Court of Appeal … recognised and held in *Sempra*: it is only by an award of compound interest that the commercial value of the use of the money over the time when it was retained can be properly reflected. Fourthly, such an award of interest can no longer be regarded as merely ancillary to the repayment of the tax, within the principle of *Société Roquette Frères* and *Express Dairy Foods* (restated in *Hoechst* … para 86 of the judgment of the ECJ) because it must now be seen as an integral part of the *San Giorgio* claim for the repayment of the tax and reimbursement of all directly related benefits retained by the member state."

200. I then discussed the domestic authorities, before concluding (in paragraph [124]) that the second core question should be answered in favour of the claimants. I nevertheless dismissed all the claims, because I held (for reasons which I need not go into) that the Revenue's secondary defence of limitation succeeded.

201. My decision in Chalke (High Court) was the subject of appeals and cross-appeals by both sides to the Court of Appeal. The Court (Mummery, Etherton and Patten LJJ) heard the appeals in January 2010, and handed down its judgment on 25 March 2010: see [2010] EWCA Civ 313, [2010] STC 1640 ("Chalke (CA)"). The only reasoned judgment was delivered by Etherton LJ, with whom Patten and Mummery LJJ agreed. The Court upheld my decision on the limitation issues, so the appeals were dismissed. However, the first, and logically prior, issue addressed by Etherton LJ was the Revenue's cross-appeal against my conclusion that, as a matter of EU law, the claimants were entitled in principle to compound interest on their overpayments of VAT: see paragraph [25]. After reciting the arguments on both sides, including "powerful submissions" advanced by Mr Jonathan Swift on behalf of the Revenue (summarised in paragraphs [38] and [39]), Etherton LJ said:

> "40. This issue is one of great importance carrying enormous financial consequences, not only for the United Kingdom but all member states. It is relevant to other cases pending or anticipated in the High Court and the Court of Appeal. I do not consider that the answer to the issue is clear. There is considerable cogency in the argument of the Commissioners and the analysis of the judge that, at least until *FII*, the settled jurisprudence of the ECJ in relation to *San Giorgio* claims was that, save in the [*Hoechst*] case of premature levying of tax, interest was an ancillary matter to be dealt with in accordance with national law, including whether there was a right to any interest at all and, if so, the rate and the time for which it was to be paid. It is also striking, as the Commissioners have forcefully submitted, that there is no clear statement by the ECJ, whether in *FII* or any subsequent case, that the former settled jurisprudence has been changed by the formulation of the *San Giorgio* principle in *FII* (see … para 205 of the ECJ's judgment), and that, in cases of overpayment as much as cases

> of premature payment, the *San Giorgio* principle requires the recipient to pay compensation for the time value of the wrongful retention of tax when it was not lawfully due. On the other hand, it is clear, as the judge found and as the claimants contend, that the formulation of the *San Giorgio* principle in para 205 of *FII* is, on one interpretation, broad enough to encompass the claimants' claims to payment for the time value of the overpayments of VAT while retained by the Commissioners. It is also difficult to see any logical basis for distinguishing in this respect between the premature levying and payment of tax and the overpayment of tax. In both cases, only compound interest will normally give a full and effective remedy. As Mr Conlon observed, it is possible to conceive examples in which VAT is exacted prematurely in breach of Community law, and it is difficult to see any principled reason for treating such cases differently from overpayments of VAT.
>
> 41. In view of those doubts and difficulties and the importance and financial implications of the issue, it seems plainly desirable that there should be a reference to the ECJ for a preliminary ruling on the issue. The judge himself (see [2009] STC 2027 at [125]) considered whether to refer the question to the ECJ for a further preliminary ruling. One of the reasons why he declined to do so was that it was open to the Commissioners to appeal his decision, in which case the question of a further reference could be more appropriately considered by this court. In the light of the decision of Henderson J that the restitutionary claims of the claimants for compound interest are time-barred and my conclusion (below) that he was right in that decision, it is not possible for the reference to be made in these proceedings since a reference is not necessary to enable judgment to be given: see art 267 TFEU … and paras 11 and 14 of the ECJ's *Information Note on references from national courts for a preliminary ruling* (OJ 2009/C 297/01). Other than to state that there should be a reference to the ECJ for a preliminary ruling when a proper opportunity arises, it is not necessary, and I do not consider it appropriate, to express any further view about the merits of this part of the appeal."

202. The "proper opportunity" envisaged by Etherton LJ came almost immediately. In April 2010 the trial took place before Vos J of all issues of liability in the Littlewoods case, where a total of 15 claimants within the Littlewoods group of companies were claiming compound interest amounting to approximately £1 billion on the overpayments of VAT made by them over more than 30 years between 1973 and 20 October 2004. The second of those issues was whether the claimants were entitled to compound interest, in addition to the simple interest under section 78 of VATA 1994 which they had already received. Vos J delivered his judgment on 19 May 2010: see [2010] EWHC 1071 (Ch), [2010] STC 2072 ("Littlewoods (High Court)"). Unsurprisingly, it was common ground that the issue should be referred to the ECJ,

once Vos J had decided on the first issue argued before him that, as a matter of domestic law, the claimants' restitutionary claims for interest were excluded by the statutory scheme for repayment of overpaid VAT with simple interest.

203. In view of the obvious need for a reference, the discussion of the second issue by Vos J in paragraphs [63] to [71] of his judgment was comparatively brief, but it repays careful reading and I will quote part of it:

> "66. Etherton LJ in *Chalke CA* said (see [2010] STC 1640 at [40]) that he found it difficult to see any logical basis for distinguishing between the premature levying and payment of tax and the overpayment of tax. But it seems to me that such a basis may exist in EU law if the governing principles are: first, that taxes shall be levied only in accordance with EU law; secondly, that, when they are levied in breach of EU law, they must be reimbursed; thirdly, that all questions affecting the payment of interest are indeed matters for national law; and fourthly, that the principle of effectiveness requires that national law shall not render practically impossible or excessively difficult the exercise of EU law rights.
>
> 67. On my analysis, it is the extent of the second and third of those four principles that are truly in doubt. Must the reimbursement include the use value of the money or not? And if so, what then is left for the national courts to determine? It is this latter point that has led me to incline towards the view that the ECJ may not have intended in *FII* to make the "significant advance" in jurisprudence that Henderson J referred to in *Chalke Chancery* (see [2010] STC 1640 at [107]). If EU law were to lay down that, in all cases, reimbursement of improperly levied taxes must include the use value of the money (including compound interest) it would be creating something that crosses previously established boundaries:
>
> (i) It would call into question the line of ECJ cases in which it has been made clear that all ancillary questions, beyond repayment itself, is for the national law to settle …
>
> (ii) It would be surprising if EU law was concerned with the detail of interest claims that should be available for tax repayment claims, but not other kinds of claims against member states.
>
> (iii) The ancillary matters that would be left to national courts would thereby be significantly attenuated. As the ECJ said in [*Hoechst*] (see … para 81):
>
> > "81. It must be stressed that it is not for the [ECJ] to assign a legal classification to the actions brought by the plaintiffs before the national court …"

But if the value of the use of the money had to be awarded in every case (even if that value might be differently assessed on a case-by-case basis), EU law would be delineating the precise way in which the EU right was to be vindicated in national law. On one analysis, this could be said to be over-stepping the mark between EU rights on the one hand, and the domestic causes of action by which they can be vindicated on the other.

(iv) The ECJ has already acknowledged exceptions to the need to repay VAT (and, therefore, presumably interest also), for example, in *Weber's Wine World* (see … para 94), where the taxpayer would itself be unjustly enriched by such an outcome, as where the trader has passed the burden of VAT on to third parties.

(v) It would be creating an EU right that would require much more detailed exposition in EU law than might perhaps be appropriate. EU law would need to explain how the loss of use value of the money was to be calculated – at what rates and with what rests: otherwise, the principle of effectiveness could not properly be implemented, because national courts would not know the precise extent and limits of the EU right.

68. This discussion leaves outstanding, of course, the question of whether there is, indeed, a logical distinction between claims in relation to prematurely paid, as opposed to overpaid, tax. To return to the four principles I set out at [66] above, if the second principle requires only reimbursement, with the third principle leaving interest to national law, then the repayment of the use value of an unlawfully levied ACT pre-payment could be regarded as the reimbursement itself. This seems to be the way it was viewed in [*Hoechst*] (… para 87) as the "very objective sought by the claimants' actions."

69. The parties have not been able to agree the questions that should be referred to the ECJ. In these circumstances, I have considered carefully the drafts provided by the parties and have determined that three questions along the following lines would most closely reflect the problem that I have described under this issue 2:

(i) Question 1: Where a taxable person has overpaid VAT contrary to the requirements of EU VAT legislation, does the remedy provided by a member state accord with EU law if that remedy allows for (a) reimbursement of the principal sums overpaid, and (b) simple interest on those sums, in accordance with national legislation, such as ss 80 and 78 of VATA 1994?

(ii) Question 2: If not, does EU law require that the remedy provided by a member state should allow for (a) reimbursement of the principal sums overpaid, and (b) the use value of the

> overpayment in the hands of the member state and/or the loss of the use value of the money in the hands of the taxpayer?
>
> (iii) Question 3: If the answer to both questions 1 and 2 is in the negative, what must the remedy that EU law requires the member state to provide include, in addition to reimbursement of the principal sums overpaid, in respect of the use value of the overpayment and/or interest?"

204. In the event, the first three questions in the order for reference were framed in virtually identical terms to those proposed by Vos J in his judgment. There was also a fourth question, designed to raise the issue whether, if the claimants were in principle entitled to compound interest, EU law permitted the claimants to choose between Woolwich and mistake-based restitutionary claims to enforce their *San Giorgio* right, or whether they should be confined to the former: see Littlewoods (High Court) at paragraphs [72] to [96] ,and the further judgment of Vos J on the precise form of the order at [2010] EWHC 2771 (Ch), [2011] STC 171 (Note). In the end, however, nothing turns on the detailed formulation of the questions, because the ECJ decided to examine them all together: see Littlewoods (ECJ) at paragraph 22.

The decision in Littlewoods (ECJ)

205. After referring to the *San Giorgio* principle, the Court in Littlewoods ECJ continued as follows:

> "25. The Court has also held that, where a Member State has levied charges in breach of the rules of Community law, individuals are entitled to reimbursement not only of the tax unduly levied but also of the amounts paid to that state or retained by it which relate directly to that tax. That also includes losses constituted by the unavailability of sums of money as a result of a tax being levied prematurely (*Metallgesellschaft*, paragraphs 87 to 89, and *Test Claimants in the FII Group Litigation*, paragraph 205).
>
> 26. It follows from that case law that the principle of the obligation of Member States to repay with interest amounts of tax levied in breach of EU law follows from that law.
>
> 27. In the absence of EU legislation, it is for the internal legal order of each Member State to lay down the conditions in which such interest must be paid, particularly the rate of that interest and its method of calculation (simple or "compound" interest). Those conditions must comply with the principles of equivalence and effectiveness; that is to say that they must not be less favourable than those concerning similar claims based on provisions of national law (or arranged in such a way as to make the exercise of rights conferred by the EU legal order practically impossible (see, to that effect, *San Giorgio*, paragraph 12; *Weber's Wine World*, paragraph 103; and Case C-291/03 *MyTravel* [2005] ECR I-8477, paragraph 17).

28. Thus, according to consistent case law, the principle of effectiveness prohibits a Member State from rendering the exercise of rights conferred by the EU legal order impossible in practice or excessively difficult …

29. In this case, that principle requires that the national rules referring in particular to the calculation of interest which may be due should not lead to depriving the taxpayer of an adequate indemnity for the loss occasioned through the undue payment of VAT.

30. It is for the referring court to determine whether that is so in the case at issue in the main proceedings, having regard to all the circumstances of the case. In that regard it should be noted that it is apparent from the order for reference that, under the provisions of section 78 of the VATA 1994, the Commissioners paid Littlewoods interest on the VAT levied in breach of EU law. Pursuant to those provisions, Littlewoods received payment of simple interest, in accordance with the said provisions, in an amount of £268,159,135, corresponding to interest due over about 30 years, which amount exceeds by more than 23% that of the principal sum, which amounts to £204,774,763.

31. As for verifying whether the principle of equivalence has been complied with in the case at issue in the main proceedings, it should be noted that compliance with that principle requires that the national rule in question apply without distinction to actions based on infringement of EU law and those based on infringement of national law having a similar purpose and cause of action. However, the principle of equivalence cannot be interpreted as requiring a Member State to extend its most favourable rules to all actions brought in a certain area of law. In order to ensure compliance with that principle, it is for the national court, which alone has direct knowledge of the procedural rules governing restitution actions against the State, to determine whether the procedural rules intended to ensure that the rights derived by individuals from EU law are safeguarded under domestic law comply with that principle and to consider both the purpose and the essential characteristics of allegedly similar domestic actions. For that purpose, the national court must consider whether the actions concerned are similar as regards their purpose, cause of action and essential characteristics (see, to that effect, Case C-63/08 *Pontin* [2009] ECR I-10467, paragraph 45 and case-law cited).

…

34. In the light of the foregoing, the answer to the questions referred is that EU law must be interpreted as requiring that a taxable person who has overpaid VAT which was collected by

> the Member State contrary to the requirements of EU VAT legislation has a right to reimbursement of the tax collected in breach of EU law and to the payment of interest on the amount of the latter. It is for national law to determine, in compliance with the principles of effectiveness and equivalence, whether the principal sum must bear "simple interest", "compound interest" or another type of interest."

Paragraph 34 was then repeated in the formal ruling of the Court at the end of the judgment.

206. Some important points of principle emerge with clarity from this judgment. In the first place, the ECJ has repeated (in paragraph 25) the principle which it stated in FII (ECJ) I at paragraph 205 that the right to reimbursement of unlawfully levied tax extends to amounts paid to, or retained by, the State which "relate directly" to that tax. Such amounts are said to *include* (and, I infer, are therefore not confined to) losses representing the time value of prematurely levied tax. The generality of the principle thus exemplified is then reinforced by paragraph 26, which says (twice over, for good measure) that the obligation to repay unlawful tax "with interest" follows from the case law recited in the two previous paragraphs. I therefore take it as now settled that EU law requires interest to be paid when unlawful tax is reimbursed. In such cases, the payment of interest is not merely an ancillary matter for national law to determine. On the contrary, it is a substantive part of the right to a refund recognised in the *San Giorgio* line of cases, whether it is regarded as an amount retained by the State which relates directly to the unlawfully levied tax, or as a loss sustained by the person who paid the tax through the non-availability of the money. Either way, it is essentially a claim for the time value of the money, although whether that value is to be ascertained (in terms of domestic law) by measuring the State's unjust enrichment, or by quantifying the loss to the claimant, is not stated, and must therefore be a matter which is left to national law to determine.

207. Secondly, the judgment lends no support at all to the notion that EU law draws a distinction between cases where tax is levied prematurely and cases where tax is overpaid. The possibility of the Court drawing such a distinction was expressly raised by Vos J in Littlewoods (High Court) at [68], but the ECJ has instead affirmed paragraph 205 of FII (ECJ) I and recognised the general principle that unlawfully levied tax must be repaid with interest. In so ruling, the Court was in substance following the views expressed by Advocate General Trstenjak in paragraphs 29 to 30 of her Opinion, where she said that it would be illogical to distinguish between the two types of case, and that the rights of a taxable person to repayment of the unlawful tax and interest "are based on the provisions of EU law prohibiting the taxes levied".

208. Thirdly, however, the Court declined to rule that the right to interest means a right to compound interest. Paragraph 27 states explicitly that it is for the internal legal order of each Member State to lay down the conditions for payment of interest, including whether it should be simple or compound. The only requirements of EU law are that the national conditions must comply with the familiar principles of equivalence and effectiveness. As the Court explained, this means in general terms that the conditions "must not be less favourable than those concerning similar claims based on provisions of national law", nor must they operate "in such a way as to make the exercise of rights conferred by the EU legal order practically impossible". It is in the context of

the requirement of effectiveness that the Court said, in paragraph 29, that the national rules on interest "should not lead to depriving the taxpayer of an adequate indemnity for the loss occasioned through the undue payment of VAT".

209. At this point, it must be said, the guidance given by the Court is somewhat opaque. The concept of an "adequate indemnity" is a new one which has no precursor in the case law of the ECJ in this area, but little is provided by way of elucidation. The reference to "the loss occasioned" perhaps suggests that the question is meant to be answered from the taxpayers' point of view rather than by reference to the subtractive principles of unjust enrichment. Paragraph 30 then says that the national court must determine whether Littlewoods have been deprived of such an indemnity "having regard to all the circumstances of the case", evidently including the fact that Littlewoods had already received a very substantial sum by way of simple interest. Since the dispute was whether Littlewoods should be entitled to compound interest, the relevance of the observation that they had received a large amount by way of simple interest is, at first sight, elusive. In the context of effectiveness, however, the Court may merely be making the point that simple interest is in certain circumstances capable of providing a taxpayer with an effective remedy. In the absence of any unqualified EU right to compound interest, a payment of simple interest will sometimes be all that EU law requires the national court to provide.

210. I do not propose to explore these difficulties any further in the present judgment, for two main reasons. First, as will become apparent, I consider that as a matter of English common law the claimants are entitled to compound interest on all their claims. If that conclusion is correct, it is obvious that the claimants will have received an "adequate indemnity" for their loss, whatever the precise shade of meaning of that enigmatic phrase may be. Secondly, I wish to trespass as little as possible on questions which may well be live when the Littlewoods case returns to the High Court, especially as I am now the designated judge who will hear the case following the promotion of Vos J to the Court of Appeal. In this connection, it may be relevant to note that in the present case, unlike Littlewoods and Chalke, there is no exhaustive statutory scheme which provides for the payment of simple interest when unlawfully levied ACT or MCT is reimbursed, and the only relevant statutory power to award interest is that contained in section 35A of the Senior Courts Act 1981.

211. So far as material, section 35A provides as follows:

> "(1) Subject to rules of court, in proceedings (whenever instituted) before the High Court for the recovery of a debt or damages there may be included in any sum for which judgment is given simple interest, at such rate as the court thinks fit or as rules of court may provide, on all or any part of the debt or damages in respect of which judgment is given, or payment is made before judgment, for all or any part of the period between the date when the cause of action arose and –
>
> (a) in the case of any sum paid before judgment, the date of the payment; and
>
> (b) in the case of the sum for which judgment is given, the date of the judgment.

> …
>
> (4) Interest in respect of a debt shall not be awarded under this section for a period during which, for whatever reason, interest on the debt already runs.
>
> …”

As the wording of subsection (1) makes clear, the power to award interest is a discretionary one, and it is confined to simple interest. Subject to those limitations, interest may be awarded for the whole or any part of the period between the time when the cause of action arose and the date of judgment or earlier payment. Subsection (4) shows that the power to award interest is a default one, which cannot be used to duplicate, or take priority over, interest which already runs on the debt for whatever reason.

The decision of the House of Lords in Sempra

212. In the light of Littlewoods (ECJ) both sides submit, and I agree, that the first step is to decide on what basis interest is due under English law in respect of the successful claims. This involves a careful consideration of the decision of the House of Lords in Sempra, where the issue was how to give effect in English law to the decision of the ECJ in the Hoechst case. As I explained in Chalke (High Court) at [109], the hearing in the House of Lords formed part of the same proceedings, Sempra Metals Ltd being the same company, under a new name, as Metallgesellschaft Ltd. In paragraphs [110] to [112] I summarised the decisions in the courts below, where both Park J and the Court of Appeal had held that the test claimants were entitled to recover compound interest in respect of the period for which ACT had been prematurely paid. Only thus, in their view, would the test claimants obtain full (rather than partial) restitution or compensation for their loss. All of the test claims were ones in which the ACT had been fully utilised, but both Park J and the Court of Appeal expressed the view (obiter) that the same principles should apply where the claim was one to recover unutilised ACT which had never been set against MCT.

213. The Revenue’s appeal to the House of Lords was dismissed. For varying reasons, the House held that the court had jurisdiction, either at common law or in equity, to award compound interest where a claimant was seeking restitution of money paid under a mistake, and (by a majority) that the appropriate measure of restitution was compound interest calculated on a conventional basis applicable to government borrowing. Although the actual decision is clear, the case is a difficult one to analyse because all five members of the court reached their conclusion by different routes, and on various key issues the House was split with differingly constituted three-two majorities.

214. By way of an overview, the following summary (largely drawn from the claimants’ skeleton argument, and not controverted by the Revenue) may be helpful:

> (1) By a majority (consisting of Lords Hope, Nicholls and Scott), the House held that the court had jurisdiction at common law to award compound interest where a claimant sought restitution of money paid under mistake; according to the minority on this issue (Lords Walker and Mance) the court could make such an award by an extension of the court’s discretionary equitable jurisdiction.

(2) A different majority (Lords Hope, Nicholls and Walker) held that, in the case of personal restitution, the money award reversing unjust enrichment had to take into account the value of use of the money over the time during which it had been retained by the defendant.

(3) As to the value of the use of that money over the period, Lords Hope and Nicholls said that it was prima facie the reasonable cost to the claimant of borrowing the same sum over the period, unless the defendant could show that he had in fact gained no benefit himself, while according to Lords Scott and Mance interest was only recoverable if it were proved that the money had actually earned interest in the hands of the defendant.

(4) Finally, the same majority as in (2) above held:

a) that the assumption that the Government had derived some benefit from the premature payment of the tax had not been displaced; but

b) the Government was in a different position to ordinary commercial borrowers, in that it could borrow at more favourable rates; and accordingly

c) the claims should be quantified on the conventional basis mentioned above.

215. For present purposes I will concentrate mainly on the speeches of Lords Hope, Nicholls and Walker, because (to anticipate) Mr Beazley has satisfied me that, taken together, they provide a solid basis for concluding that compound interest should be awarded on all the successful claims, and not just (as is common ground) on the claims for utilised ACT. This conclusion involves rejection of the Revenue's primary argument that, save in relation to utilised ACT, the position is governed by section 35A, because, put shortly, the overpaid tax is itself a principal sum within the ambit of that section.

(a) The judgment of Lord Hope

216. The leading judgment was delivered by Lord Hope of Craighead. In paragraph [2], he described "the important question of principle" arising on the appeal as being:

> "is the claimant who seeks a remedy on the ground of unjust enrichment entitled to an award for restitution of the value of money that is measured by compound interest?"

It is worth noting, at this early stage, that the question was framed by Lord Hope in general terms, although he had expressly recognised in paragraph [1] that in the instant case "interest is the measure of the principal sum itself".

217. In the next section of his judgment, headed "Interest: an introduction", Lord Hope reviewed the jurisdictional routes by which English law may make an award of interest. Having dealt briefly with statute (section 35A) and the equitable jurisdiction, Lord Hope commented that the common law jurisdictional route was more complicated. In relation to claims for restitution, he said this:

> "7. The claim that is made in this case, however, is for restitution. It is presented as a claim for the time value of money by which the defendant was enriched unjustly. The claimant submits that the common law requires that it be paid a sum which represents the value of the money over the period of that enrichment, and that this sum falls to be calculated by compounding interest over that period. It has been held that in an action for money had and received the net sum only can be recovered … But interest has been awarded at common law where restitution follows the reversal on appeal of a previously satisfied judgment … Various other exceptions have been recognised … Furthermore the claim in this case is not for more than what was had and received by the defendant. What was had and received was the enrichment. It is the enrichment itself that is to be valued, not anything more than that.
>
> 8. In *NEC Semi Conductors Ltd v Inland Revenue Comrs* [2006] STC 606, para 173, Mummery LJ said that the question how restitutionary relief of the kind that is sought in this case should be assessed was not settled by the *La Pintada* case [1985] AC 104, as the claim is not for an entitlement to interest, as creditors, on a debt or on damages by way of compensation for loss of the use of the money that was unjustly demanded and retained by the defendant. I respectfully agree with him, and I would approach the issue in this case from the same starting point. I would hold that it is open to your Lordships to examine this issue on the basis that the answer to it is to be found in the law of unjust enrichment. It is not foreclosed by the decisions of this House in the *Westdeutsche* case [1996] AC 669 and the *La Pintada* case [1985] AC 104, neither of which addressed the issues that arise in this case."

Here again I would comment that Lord Hope's approach to the problem is through a general examination of the law of unjust enrichment, and on the footing that it is "the enrichment itself that is to be valued".

218. Lord Hope then turned to the judgment of the ECJ and the issues. In paragraph [11] he reiterated that the interest was the principal sum claimed, and that the House was not concerned with the ancillary claim under section 35A for simple interest, in respect of which Sempra accepted that the section would apply once the principal sum had been identified. In paragraph [14] he said that the question how the interest should be calculated could not be answered without a clear understanding of the relevant causes of action in domestic law.

219. Lord Hope then discussed the causes of action, beginning with the common law claim for damages. On this part of the case, he expressed his general agreement with Lord Nicholls: see paragraphs [16] and [17]. He then turned to the restitutionary cause of action:

> "18. I wish to concentrate on the approach that should be taken to the restitutionary cause of action on which Sempra prefers

> and is entitled to rely, which is its claim that the money was paid under a mistake. The conclusion that the court has jurisdiction to award compound interest as damages at common law is, however, a valuable one. It provides us with a building block which was missing when the House rejected the use of compound interest as a possible solution in equity in *Westdeutsche* … Ancillary interest was sought on a sum for which the court was to give judgment in satisfaction of the local authority's restitutionary claim against the bank. It was common ground that there was no jurisdiction to award compound interest in such a case at common law or by statute: per Lord Goff of Chieveley at p690H."

220. Lord Hope then proceeded to discuss the restitutionary claim in paragraphs [19] to [26]. He pointed out that in the courts below, and in the judgment of the ECJ, it had apparently been assumed that the basis of the award would be the same irrespective of the choice of remedy (i.e. a damages claim, or a mistake-based restitutionary claim). The arguments before the House had shown, however, that this assumption was "no longer sustainable": paragraph [20]. Lord Hope continued:

> "21. There is no doubt that a compensatory remedy for breach of Community law would look to what the taxpaying company had lost by reason of having to pay the tax early. But that, from Sempra's point of view, is not the preferred remedy. If it is to escape from the six-year limitation period it must instead pursue the alternative argument that the payments were made under a mistake. This is a restitutionary remedy. So it is necessary to look more closely at the nature of this remedy, and at the basis on which a claim under it falls to be calculated. It is only when this question has been addressed and answered that it will be possible to answer with confidence the question how, if Sempra is to be provided with the restitutionary remedy to which it is entitled for its mistake as to its rights under Community law, the amount of the principal sum due must be calculated."

Lord Hope then referred to the development of a coherent law of restitution in the earlier decisions of the House in <u>Lipkin Gorman v Karpnale Ltd</u> [1991] 2 AC 548 and the <u>Kleinwort Benson</u> case, before concluding at the end of paragraph [22]:

> "I think that it can now be taken as settled that, under the *Kleinwort Benson* principle, a cause of action at common law is available for money paid under a mistake of law: *Deutsche Morgan Grenfell Group Plc v Inland Revenue Comrs* [2007] 1 AC 558, para 62. I also think that the time has come to recognise that the court has jurisdiction at common law to award compound interest where the claimant seeks a restitutionary remedy for the time value of money paid under a mistake."

221. The jurisdiction which Lord Hope here recognised was, in my view, clearly meant to extend to all cases where a claimant seeks a restitutionary remedy for the time value of money paid under a mistake. I am fortified in this view by the fact that Lord Hope then went on to discuss the limits that must be set to restitution as a common law remedy, concluding in paragraph [24] that "in principle, the right of recovery must be accompanied by appropriate defences to prevent unfairness". He then returned to the facts of the instant case:

> "25. There is no need to pursue these arguments any further in this case. The question whether there is an unjust factor has already been settled. As the [*ECJ*] has explained, there was no legal ground for the retention of the enrichment. The unjust enrichment principle supports the free-standing cause of action to recover interest, which is the measure of the enrichment. It has not been suggested that a restitutionary award by way of interest would give rise to injustice, so long as it was appropriately calculated.
>
> 26. … Recognition that the court has jurisdiction to award compound interest at common law is a short, but logical, step in the further development of the restitutionary remedy. It follows from the fact that the right to recover money paid under a mistake is available at common law. To treat the choice of remedy in unjust enrichment as discretionary would, in my opinion, be inconsistent with the common law right that gives rise to it."

The final sentence of this quotation introduces the important theme that there is nothing discretionary about an award of interest as a restitutionary remedy. It is part of the measure of the enrichment itself, and therefore part of the remedy to which the claimant is in principle entitled.

222. In the next section of his judgment (paragraphs [27] to [36]) Lord Hope discussed the basis on which the restitutionary award should be calculated. He pointed out how the remedy of restitution differs from that of damages, drawing in particular on the work of Professor Peter Birks. In paragraph [29] he referred again to the absence of any suggestion that the remedy for unjust enrichment was discretionary, and in paragraph [30] he quoted a passage from Professor Birks' work on <u>Unjust Enrichment</u> to the effect that "restitution" has a wider meaning than mere "giving back". He continued:

> "31. I would apply the reasoning in these passages to the claim for interest in this case. A remedy in unjust enrichment is not a claim of damages. Nor is it a contractual remedy, so there is no need to search for an express or an implied term as the basis for recovery. The old rules which inhibited awards of interest to ancillary interest on sums due on contractual debts or on claims for money had and received do not apply. The essence of the claim is that the revenue was unjustly enriched because Sempra paid the tax when it did in the mistaken belief that it was obliged to do so when in fact it was being levied prematurely. So the revenue must give back to Sempra the whole of the

> benefit of the enrichment which it obtained. The process is one of subtraction, not compensation."

223. After criticising Professor Birks' use of the word "disgorgement" as potentially misleading, Lord Hope continued:

> "32. … But, as in cases of property other than money where the claim includes restitution for the value of the use of the asset that was transferred, subtraction of the enrichment from the defendant includes more than the return of the money that was transferred and its nominal or face value. That value, in this case, has already been accounted for. The subject matter of Sempra's claim is the time value of the enrichment. This is the amount that has to be assessed.
>
> 33. In this case the enrichment consists, not of the payment of a sum of money as such, but of its payment prematurely. As Professor Birks pointed out, the availability of money to use is not unequivocally enriching in the same degree as the receipt of money: *Unjust Enrichment*, p53. But money has a value, and in my opinion the measure of the right to subtraction of the enrichment that resulted from its receipt does not depend on proof by Sempra of what the revenue actually did with it. It was the opportunity to turn the money to account during the period of the enrichment that passed from Sempra to the revenue. This is the benefit which the defendant is presumed to have derived from money in its hands, as Lord Walker puts it in para 180. The revenue accepts that the money it received prematurely had a value, but it says that the restitutionary award should take the form of simple interest. I do not think that such an award would be consistent with principle. 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 paras 47, 48) 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.
>
> 35. I recognise, of course, that in *Westdeutsche* … this House held that in a claim at common law for money had and received the claimant was entitled only to simple interest under section 35A of the Supreme Court Act 1981 and, by a majority, that it would not be appropriate for equity to award compound interest on the principal sum in aid of the bank's common law claim. As my noble and learned friend, Lord Mance, points out in his

> analysis of that case, the argument throughout was that there was no power at common law to award compound interest. But I agree with Lord Nicholls and with my noble and learned friend, Lord Scott of Foscote, that Sempra's restitutionary claim is available to it at common law. Once it is accepted that losses caused by late payment are recoverable under the restitutionary remedy at common law irrespective of the position in equity, the problem that was addressed in the *Westdeutsche* case disappears.
>
> 36. Furthermore, the interest in question in the present case is, as the Court of Justice stressed [2001] Ch 620, para 88 the principal sum itself. In my opinion the decision in the *Westdeutsche* case does not address this point. We were not asked to overrule that decision, because it is distinguishable on this ground. Furthermore, the basis of Sempra's claim, as the common law has now recognised, is unjust enrichment. I do not think that it is open to the common law, when it is providing a remedy in unjust enrichment, to decline to apply the principle on which that remedy is founded when the principal sum to be awarded is being calculated. As Lord Nicholls points out (see para 99), there is now ample authority to the effect that interest losses which are recoverable as damages should be calculated on a compound basis where the evidence shows that this is appropriate. The same rule should be applied to the restitutionary remedy at common law."

224. From this passage I would derive the following principles:

(a) an award of simple interest would not be an appropriate measure of the time value of the enrichment, because it is "an artificial construct" which has no relation to business reality;

(b) Sempra's restitutionary claim was available to it at common law;

(c) because that claim was based on the principle of unjust enrichment, it is not open to the common law, when providing a remedy, to decline to calculate the principal sum recoverable on a compound interest basis, where the evidence shows this to be appropriate; and

(d) nothing in <u>Westdeutsche</u> prevents the court from adopting such an approach.

225. After referring briefly to the treatment of compound interest elsewhere in the EU, and by the European Commission in unlawful aid cases, Lord Hope dealt with compound interest in domestic law. As he said in paragraph [41], it is "a necessary, and very familiar, fact of commercial life". After referring to discussions of the subject by the English and Scottish Law Commissions, he concluded:

> "Computation of the time value of the enrichment on the basis of simple interest will inevitably fall short of its true value. Such a result would conflict with the principle that applies in

> unjust enrichment cases, that the enrichee must give up to the claimant the enrichment with, as Professor Birks put it in *Unjust Enrichment*, p167, no hint of a restriction to giving back. In my opinion the compounding of interest is the basis on which the restitutionary award in this case should be calculated."

226. In the final main section of his judgment (paragraphs [42] to [49]), Lord Hope discussed the issue of measurement and gave his reasons for adopting a conventional rate of compound interest calculated by reference to the ability of the Government to borrow in the market.

(b) The judgment of Lord Nicholls

227. In an early section of his judgment, headed "Compound interest and Community law", Lord Nicholls said that in his view it was implicit in the decision of the ECJ in Hoechst that assessment of the amount of interest (including the question whether it should be simple or compound) was a matter for the Member State concerned, provided always that the Member State's rules satisfied the principles of equivalence and effectiveness: see paragraphs [66] to [68]. In essence, this view coincides with the more explicit guidance that the ECJ has now given in Littlewoods (ECJ). It is therefore worth noting that Lord Nicholls' whole approach to the subject was based on a correct understanding of the relationship between EU law and national law in this area. He went on to say that (as in the present case) there was no dispute that the domestic causes of action available to the claimants satisfied the EU law requirement of equivalence, but issue had been joined on the effectiveness of those remedies:

> "72. As already foreshadowed, the crux of the dispute on effectiveness concerns the availability of compound interest in respect of the wrongful levying of ACT. The Inland Revenue recognises that interest is payable in respect of the tax paid prematurely in the form of ACT. But it contends that under English law the courts do not have power to award compound interest save in cases of fraud and misapplication by a fiduciary. The revenue contends, further, that an award of simple interest would be an effective legal remedy for Sempra in the present case."

228. Lord Nicholls then discussed the provision made by English law for interest losses in a claim for damages, and the unsatisfactory state of the authorities, leading to his conclusion (in paragraph [94]) that the House "should now hold that, in principle, it is always open to a claimant to plead and prove his actual interest losses caused by late payment of a debt". Such losses would be recoverable , subject to the usual principles of contract law such as remoteness and failure to mitigate. In paragraphs [98] and [99], Lord Nicholls emphasised that this conclusion did not conflict with section 35A of the 1981 Act, or its underlying legislative policy, for two reasons. First, section 35A was not intended to be an exhaustive code, as subsection (4) makes clear. Secondly, the section is concerned with interest on debts and damages, but "says nothing about the principles to be applied by a court when assessing the amount of damages for which it gives judgment".

229. Lord Nicholls then went on to discuss interest benefits and restitution. This discussion, running from paragraphs [101] to [131], is the part of the judgment which is most material for present purposes. Lord Nicholls began his discussion by saying that Sempra's restitutionary claim was in principle "unanswerable":

> "102. … The benefits transferred by Sempra to the Inland Revenue comprised, in short, (1) the amounts of tax paid to the Inland Revenue and, consequentially, (2) the opportunity for the Inland Revenue, or the Government of which the Inland Revenue is a department, to use this money for the period of prematurity. The Inland Revenue was enriched by the latter head in addition to the former. The payment of ACT was the equivalent of a massive interest free loan. Restitution, if it is to be complete, must encompass both heads. Restitution by the revenue requires (1) repayment of the amounts of tax paid prematurely (this claim became spent once set off occurred) and (2) payment for having the use of the money for the period of prematurity.
>
> 103. In the ordinary course the value of having the use of money, sometimes called the "use value" or "time value" of money, is best measured in this restitutionary context by the reasonable cost the defendant would have incurred in borrowing the amount in question for the relevant period. That is the market value of the benefit the defendant acquired by having the use of the money. This means the relevant measure in the present case is the cost the United Kingdom Government would have incurred in borrowing the ACT for the period of prematurity. Like all borrowings in the money market, interest charges calculated in this way would inevitably be calculated on a compound basis."

230. Lord Nicholls went on to say, in paragraph [104], that the present state of English law did not accord with that analysis, because the court was thought to have no jurisdiction to make an award of compound interest on a personal claim for restitution of money paid by mistake or following an unlawful demand. He then discussed how "this divergence from reality" had come about and reviewed a number of authorities, before concluding in paragraph [111] that it was open to the House to re-examine the basic point of law conceded in Westdeutsche, namely whether interest may be awarded by the courts in exercise of their common law jurisdiction to grant personal restitutionary relief. He added that the House should undertake the task, and "the law of restitution should now have the opportunity to develop as a coherent body of principled law". He continued:

> "112. If the House takes this opportunity I venture to repeat there can only be one answer on this important question of law. Nobody has suggested a good reason why, in a case like the present, an award of compound interest should be denied to a claimant. An award of compound interest is necessary to achieve full restitution and, hence, a just result. I would hold that, in the exercise of its common law restitutionary

> jurisdiction, the court has power to make such an award … To that extent I would depart from the decision of the *Westdeutsche* appeal [1996] AC 669.
>
> 113. If this approach is adopted the unfortunate decision in the *London, Chatham and Dover Railway* case [1893] AC 429 will be effectually buried in relation to the payment of interest for non-payment of a debt and in relation to the payment of interest for having the use of money in personal restitution cases. The law will achieve a principled measure of consistency between contractual obligations and restitutionary obligations. The common law in Australia has developed in this way. The common law in England should do likewise.
>
> 114. I add that, as with awards of compound interest as damages for non-payment of a debt, so also with awards of compound interest as restitutionary relief in respect of a defendant's unjust enrichment: such awards do not conflict with section 35A of the Supreme Court Act 1981. As already noted, section 35A is concerned with interest on "a debt or damages". An amount of money recoverable as restitutionary relief falls within this phrase. Section 35A bites on that amount. But section 35A says nothing about the principles to be applied by the courts at the anterior stage when assessing the amount of money required to achieve full restitution."

231. I would comment that, although Lord Nicholls was careful to confine his actual decision to cases similar to those then before the House, his reasoning, and the principles on which it was based, seem to me equally applicable to a restitutionary claim for the recovery of overpaid tax. This was, of course, the view taken by both Park J and the Court of Appeal, and with the benefit of the sharper focus in the judgments of Lord Hope and Lord Nicholls on the restitutionary causes of action available to the claimants I can only say that the arguments of principle in favour of compound interest seem to me to be just as compelling in relation to claims for overpaid tax as Lord Nicholls found them to be in relation to claims arising from prematurely paid tax.

232. Lord Nicholls then discussed how the value of the use of money should be measured in cases of personal restitution, elaborating on the view he had already expressed that "the value of the use of money is prima facie the reasonable cost of borrowing the money in question": see paragraph [116]. He continued:

> "117. The time value of money, measured objectively in this way, is to be distinguished from the value of the benefits a defendant actually derived from the use of the money. The latter value is not in point in the present case. Sempra retained no proprietary interest in the money it paid to the Inland Revenue, and it has no interest in the "fruits" of that money. Sempra's claim is a personal claim against the Inland Revenue in respect of the benefits it transferred to the revenue. The value of those benefits should be measured as described above.

> 118. In the present case there can be nothing unjust in requiring the Inland Revenue to pay compound interest, by way of restitution, on the huge interest free loan constituted by Sempra's payment of ACT."

Lord Nicholls added that this would not always be so, and instanced a recipient of a payment made by mistake who made no actual use of the money, and then repaid it when the mistake came to light. I need not explore cases of that type, because the Revenue have advanced no argument, and adduced no evidence, to displace the prima facie assumption that the Exchequer has benefited from the tax overpaid, or prematurely paid, by the claimants.

233. In the next section of his judgment, running from paragraphs [120] to [125], Lord Nicholls dealt with an argument advanced by the Revenue that an award of compound interest would treat the claimants more favourably than taxpayers with claims based on domestic law. As he recorded in paragraph [120], "the general position under the United Kingdom tax regime, both for direct and indirect taxes, is that taxpayers who pay tax late are required to pay simple interest, and taxpayers who overpay tax are entitled to repayment together with an amount based on simple interest". Lord Nicholls then said:

> "121. The point is not without force. But this is now water under the bridge. In [*Woolwich*] a similar submission was made regarding the availability of interest under section 35A, as opposed to the statutory repayment supplements. The point was upheld by Lord Keith of Kinkel and Lord Jauncey of Tullichettle. The majority of the House, however, took a different view. A restitutionary cause of action arose, with the usual consequences regarding interest, when the building society made the tax payments required by the ultra vires regulations. This was so, even though in the result the building society received more favourable interest treatment than other overpaying taxpayers.
>
> 122. The *Woolwich* case concerned a claim to simple interest under section 35A. But on this point no sensible distinction can be drawn between an overpaying taxpayer's right to seek interest under section 35A and, as in the present case, an overpaying taxpayer's entitlement to an award of interest, simple or compound, as damages or as an element of substantive restitutionary relief.
>
> 123. The Inland Revenue also submitted that Sempra's restitutionary claim based on mistake stands apart from Sempra's other two causes of action. Sempra's claims for damages for breach of statutory duty and restitution in respect of tax paid pursuant to an unlawful demand are directly founded on the United Kingdom's breach of the Treaty. This is not so with the claim based on mistake. The claim based on mistake is founded on Sempra's own mistake. The fact that Sempra's mistake arose because of this country's breach of the

> Treaty is not part of Sempra's cause of action. This distinction, it was submitted, provides a principled justification for treating Sempra's mistake-based claim differently from its other claims so far as compound interest is concerned.
>
> 124. Here again this point has already been decided adversely to the Inland Revenue. The effect of the decisions of this House in [*Kleinwort Benson and DMG*] is that money paid by mistake can be recovered, whether the mistake is of fact or law. Money paid by way of tax does not stand on a different footing. In principle the restitutionary consequences are the same for tax payments made by mistake as they are for other payments made by mistake."

234. In paragraph [130] Lord Nicholls stated his final conclusion:

> "130. I can now state my conclusion on whether English law provides an effective remedy for the United Kingdom's breach of article 43 of the Treaty. In my view it plainly does. For the reasons given above, compound interest is available under English law when quantifying the extent of Sempra's losses and when quantifying the extent of the Inland Revenue's unjust enrichment."

He added in paragraph [131] that there would be no point in referring a further question to the ECJ, since English law provided for the award of compound interest when quantifying the remedies available to Sempra under all three causes of action which it asserted.

(c) The judgment of Lord Walker

235. I can deal more briefly with the judgment of Lord Walker, because he introduced it (in paragraph [154]) by saying that he was "essentially in agreement" with Lord Nicholls and Lord Hope, and that he too would dismiss the appeal "largely for the reasons which they give". Like Lord Nicholls, he correctly foresaw that, had the ECJ been expressly asked whether EU law required an award of compound interest, its answer "would surely have been that any choice between simple and compound interest was for the national court, subject always to the principles of equivalence and effectiveness": see paragraph [161]. He then said, in paragraph [163], that it was impossible to apply the principles of equivalence and effectiveness without first considering the present state of English law on the award of interest, either as interest on a principal sum, or as damages, or as a restitutionary remedy.

236. In paragraphs [166] and following, Lord Walker discussed the topic of interest in unjust enrichment. After reviewing the authorities, which he found to be in at least as confused a state as those relating to compensatory claims, he said at [178]:

> "The crucial insight in the speeches of Lord Nicholls and Lord Hope is, if I may respectfully say so, the recognition that what Lord Nicholls calls income benefits are more accurately characterised as an integral part of the overall benefit obtained

> by a defendant who is unjustly enriched. Full restitution requires the whole benefit to be recouped by the enriched party: otherwise "the unravelling would be partial only" … "

237. In paragraph [180] Lord Walker added some valuable observations on terminology, and the need for:

> "… a vocabulary, generally understood and accepted, to distinguish between (1) proprietary claims which may involve tracing in equity (as in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324); (2) personal claims for an account of profits (that is, for a sum equal to the profits actually made by the defendant); and (3) personal claims for interest which represents (in a more or less conventional way) the benefit which the defendant is presumed to have derived from money in his hands."

The claims which the House was considering in Sempra, and the claims which I am considering in the present case, are all of the third type.

238. After saying that he agreed with Lord Hope's analysis of the decision of the ECJ in Hoechst, Lord Walker then stated his conclusions:

> "183. The judgment of the Court of Justice is in my opinion a powerful encouragement for this House to reconsider the basis on which a monetary award reversing unjust enrichment can and should take account of the time value of money. In modern economic conditions simple interest does not provide full compensation in a case where unjust enrichment has lasted for a significant period (a fact which is now reflected, as Lord Hope points out, in the practice of the European Commission) …
>
> 184. Lord Nicholls and Lord Hope propose to cut through the thicket of problems by recognising a restitutionary remedy available as of right at common law, subject to the court's power to resort to "subjective devaluation" in order to avoid injustice in hard cases. This would be following a course which, in the *Westdeutsche* case [1996] AC 669, was not so much rejected as assumed not to be open. I must confess that my own inclination would be to take the course which this House came very close to taking, but ultimately drew back from taking, in the *Westdeutsche* case: that is to extend the court's equitable jurisdiction to award compound interest. Before your Lordships the law has been much more fully investigated, and in my opinion there are compelling reasons for departing from the *Westdeutsche* case and recognising the force of Lord Goff's and Lord Woolf's powerful dissenting speeches in that case.

> 185. Both Lord Goff [1996] AC 669, 695-697 and Lord Woolf, at pp 721-723, saw their preferred solution as an extension of equity's auxiliary jurisdiction in order to make good the inadequacy of a common law remedy. That would in my opinion be a principled development in the still-evolving relationship between equity and the common law …
>
> 186. In the *Westdeutsche* case [1996] AC 669 Lord Goff and Lord Woolf both considered, at pp 691 and 723 respectively, that on the facts of that case compound interest was required in order to achieve complete restitution and reverse unjust enrichment. Lord Woolf recognised, at p 722, that the exercise of the auxiliary jurisdiction would (as with all equitable remedies) be discretionary, and, at p 724, that compound interest should not be awarded if the facts were such that the defendant would not have earned compound interest. Awards of simple interest under section 35A of the Supreme Court Act 1981 are also discretionary, but the court's exercise of its discretion causes few difficulties in practice. In my opinion this is clearly a case in which compound interest should be awarded, since (i) it is a case where Community law requires full restitution; (ii) the defendant is economically powerful and sophisticated and must be supposed (as the agreed "conventional basis" seems to recognise) to have taken full advantage of its premature receipts of ACT; and (iii) it is not suggested that the claimant has been at fault or has been dilatory in making or pursuing its claim.
>
> 187. I feel some apprehension about the suggested conclusion that compound interest should be available as of right, subject only to an exception for "subjective devaluation", a concept normally applicable to benefits in kind … It is true that the time value of money (as opposed to money itself) may be regarded as a "non-money benefit", as Birks does in *Unjust Enrichment*, 2nd ed (2005), p 53. But it is a benefit which can readily be quantified in money terms; that has been, for many centuries, the function of interest. The discretionary nature of an equitable award of interest provides the necessary flexibility, though I would expect the principles for the exercise of the discretion to develop along familiar and predictable lines.
>
> 188. In this case either the common law route or the equitable route lead to the same conclusion. The appropriate exercise of discretion is to order the revenue to pay compound interest at a conventional rate calculated by reference to the average cost of Government borrowing during the relevant period. I would therefore dismiss the appeal and make the order proposed by Lord Hope."

239. It is clear from this passage that Lord Walker's personal preference would have been to make an award of compound interest as a matter of discretion, in exercise of an

extended version of the court's equitable jurisdiction. I do not, however, read either this preference, or the degree of apprehension expressed by Lord Walker in paragraph [187], as amounting to a positive dissent from the "as of right" solution propounded by Lords Hope and Nicholls, at any rate in relation to restitutionary claims against the Revenue. It seems to me that, in the type of case under consideration, Lord Walker saw either route as providing an acceptable route to a solution (compare the opening words of paragraph [188]), although his preference was for the equitable route. Had he intended to push his disagreement on this critical issue to the point of actual dissent, I think he would have said so explicitly, and would also have expressed his preferred solution in less tentative terms. In addition, he would not have said in paragraph [154] that he was "essentially in agreement" with Lord Hope and Lord Nicholls, or endorsed their "crucial insight" in the way he did in paragraph [178]. To summarise, I regard Lord Walker's observations in paragraphs [184] to [188] as being broadly supplemental in character, and not as intended to detract from his basic agreement with the reasoning and analysis of Lords Hope and Nicholls.

(d) The judgments of Lord Scott and Lord Mance

240. For completeness, I should briefly mention the different approaches taken by the minority on the first issue in Sempra. Lord Mance and Lord Scott both considered that a common law restitutionary remedy in respect of money had and received could not include an award of compound interest, and that the decision of the majority of the House in Westdeutsche on that issue should not be departed from. Lord Mance would, however, have extended the discretionary equitable jurisdiction to provide relief in appropriate circumstances in respect of any actual interest benefit received by the recipient of a principal sum paid by mistake: see paragraph [240]. He would therefore have remitted the case to the Chancery Division, for the judge to consider what actual award should be made against the Revenue to reflect any actual benefit which the Revenue might be found to have received: paragraph [241]. Lord Scott, for his part, agreed with Lord Mance that proof of actual benefit was necessary, but considered that if the common law did allow a restitutionary claim for such interest, it should be available as a matter of right (subject to change of position and other defences) and not as a matter of discretion: see paragraphs [150] to [153].

Conclusions

241. Having reviewed Sempra at considerable (but, in my view, unavoidable) length, I can now state my conclusions on the entitlement of the claimants to interest in respect of their restitutionary claims as a matter of English law.

242. In relation to the claims for utilised ACT, it is common ground (as I have said) that the position is governed by Sempra. Accordingly, compound interest is payable on the amount of the ACT prematurely paid, from the date of its payment until the date of setting-off against MCT, at conventional government rates. In their skeleton argument, counsel for the Revenue suggest that it is still open to HMRC to adduce evidence to show that the government was not enriched by receipt of the monies in question. I do not accept that submission. Whatever the theoretical position may be, this is the trial of the action, and no evidence in support of a lower rate of interest, or no interest at all, has been adduced. There are no grounds for allowing the Revenue a further opportunity to rectify this omission, even assuming such evidence to be available.

243. As to the claims for wrongly paid and unutilised ACT, I have already indicated that I can see no rational basis for distinguishing them from the claims for utilised ACT. I would hold accordingly, and I would reject that Revenue's submission that the claimants' only entitlement is to simple interest pursuant to section 35A. My reason for rejecting that submission is, as Lord Nicholls explained, that compound interest forms part of the principal sum that needs to be awarded in order to achieve full restitution. As he put it in paragraph [122], it is an element of the substantive restitutionary relief; see too paragraph [114].

244. I would also apply the same reasoning, and reach the same conclusion, in relation to the claimants' various claims for the recovery of unlawfully charged corporation tax. In my judgment no distinction can sensibly be drawn in this context between ACT and corporation tax. In each case the Revenue was enriched by the overpaid tax, and in each case full restitution requires an award of compound interest as part of the principal sum which the claimant is entitled to recover. As before, section 35A is inapplicable. The compound interest should run from the date when the corporation tax was paid until the date of its repayment.

245. That leaves the claim for compound interest in respect of the post-utilisation period for utilised ACT. In Sempra it was common ground that interest should run under section 35A in respect of the post-utilisation period, and no argument to the contrary was addressed to the court. Park J had decided that interest for the post-utilisation period fell to be calculated on a simple basis pursuant to section 35A, because it was a truly ancillary claim for interest on the primary loss: see [2004] EWHC 2387 (Ch), [2004] STC 1178 at paragraphs [45] and [46]. There was no appeal by the taxpayers against that part of Park J's decision. However, both Lord Nicholls and Lord Walker clearly considered that a challenge to the judge's conclusion on the point might have had some merit: see their judgments at paragraphs [129] and [156] respectively. Lord Mance, too, left the point open at paragraph [228].

246. Although I can fully understand why Park J concluded as he did, I now have the benefit of the judgments of the House of Lords in Sempra, and in my view the approach of the majority on the first issue should logically lead to the conclusion that compound interest is also available in respect of the post-utilisation period. The Revenue remain unjustly enriched until the date of actual repayment, and section 35A is again inapplicable because the interest forms part of the restitutionary claim itself. I would therefore so hold.

247. In the light of the conclusions which I have reached, it is not disputed that the award of compound interest computed on the conventional government basis would satisfy the requirement of effectiveness under EU law, and provide the claimants with an adequate indemnity within the meaning of paragraph 29 of Littlewoods (ECJ).

XI Limitation issues

248. The agreed issues under this heading are:

(1) To what extent is the claim statute barred by a six year limitation period?

(2) To what extent is the claim for recovery under a mistake of law barred by section 320 of the Finance Act 2004?

249. The questions fall to be answered in the light of the following procedural history:

(a) The original claim form was issued on 8 April 2003. The only claimant at that stage was Prudential. Corporation tax claims were made in respect of dividends received from portfolio holdings in other EU/EEA states for accounting periods from 1995 to 2002.

(b) By amendment dated 2 September 2003, claims in respect of portfolio dividends received from third countries were added in respect of the same accounting periods.

(c) By amendment dated 14 July 2004, two further claimants were added: Prudential Holborn Life Limited and Scottish Amicable Life Plc. Their claims were of a similar nature to those already made by Prudential.

(d) By amendment dated 24 November 2004, additional claims were made for accounting periods from 1990 to 1994 inclusive and 2004.

(e) By amendment dated 30 June 2005, a claim for damages for breach of statutory duty was added to the particulars of claim.

(f) By amendment dated 22 January 2008, the third claimant (Scottish Amicable Life Plc) was removed from the claim. Additional claims were also made for accounting periods from 2004 to 2006.

(g) By amendment dated 1 September 2008, additional claims were made for the 2007 accounting period.

(h) By amendment dated 17 July 2009, a claim for damages for breach of statutory duty was added to the claim form; and

(i) By amendment dated 19 October 2009, claims in respect of ACT were added ("the ACT claims").

250. Section 320 of the Finance Act 2004 was enacted on 24 June 2004. Its essential provisions are set out in several of the earlier cases, but for convenience I will repeat them:

> "*Exclusion of extended limitation period in England, Wales and Northern Ireland*
>
> (1) Section 32(1)(c) of the Limitation Act 1980 … (extended period for bringing an action in case of mistake) does not apply in relation to a mistake of law relating to a taxation matter under the care and management of the Commissioners of Inland Revenue. This subsection has effect in relation to actions brought on or after 8 September 2003.
>
> (2) For the purposes of – (a) section 35(5)(a) of the Limitation Act 1980 … (circumstances in which time-barred claim may be brought in course of existing action), and (b) rules of court … having effect for the purposes of those provisions, as they apply

> to claims in respect of mistakes of the kind mentioned in subsection (1), a new claim shall not be regarded as arising out of the same facts, or substantially the same facts, if it is brought in respect of a different payment, transaction, period or other matter. This subsection has effect in relation to claims made on or after 20 November 2003.
>
> …
>
> (6) The provisions of this section apply to any action or claim for relief from the consequences of a mistake of law, whether expressed to be brought on the ground of mistake or on some other ground (such as unlawful demand or ultra vires act).
>
> (7) This section shall be construed as one with the Limitation Act 1980 …"

251. I also need to mention a special provision relating to amendments which it has become standard practice to include in tax-related GLOs, including the CFC and Dividend GLO where it was introduced by an order made by Park J on 13 November 2003. The effect of the provision, in outline, is to grant permission to any claimant enrolled on the group register to amend its claim form or particulars of claim in relation to causes of action within the scope of the GLO by an informal procedure, and so that the amendments will relate back to the date of the original claim unless the court subsequently finds that they either (a) have the effect of adding new claims within the meaning of section 35 of the Limitation Act 1980, or (b) do not arise out of the same or substantially the same facts as a claim in respect of which the claimant has already claimed a remedy. (In fact the provision puts the matter the other way round, saying that the amendments will take effect from when they are made, unless the court subsequently finds that they do *not* add a new claim etc, in which case they relate back; but in practice the issue tends to arise only when the Revenue make it clear that they do not agree to the relation back of the amendments).

252. Against this background, two questions were briefly argued before me. The first question was the extent to which the corporation tax claims of the second claimant ("PHL") are confined to a six year limitation period. The second was whether the ACT claims of both claimants (which were first introduced by amendment in October 2009) arise out of the same or substantially the same facts as their corporation tax claims. Neither question was argued in detail or at any length, from which I infer that the answers are not perceived on either side as having much practical significance.

253. It is convenient to begin with section 320, if only to make the obvious point that its validity in cases of the present type (where the claimant seeks to recover tax levied in breach of EU law) remains to be determined by the ECJ on the third reference made by the Supreme Court in FII (SC). If the ECJ follows the lead of its Advocate General, and the view of the majority in the Supreme Court, it will hold the section to be invalid; but it cannot safely be predicted that this will be the case. I will therefore begin by considering the position on the assumption that the section is valid.

254. On that assumption, the section has no effect on Prudential's original claims, or on the amendments made on 2 September 2003, because the retrospective effect of

subsection (1) goes back only to 8 September 2003. On the other hand, the section would in my view apply to all the subsequent amendments, each of which would (by virtue of subsection (2)) be treated as introducing new claims which could not be related back to the date of the original claim form. The result would therefore be to confine Prudential, in respect of all its claims introduced by amendment after September 2003, to a six year limitation period, whether the claim is mistake-based or founded on the Woolwich cause of action. The section would also apply in the same way to the claims of PHL, which was added as a claimant only after section 320 had come into force.

255. If, however, the section is invalid, the question arises whether it is open to PHL to pursue any claims in respect of payments of tax made by it before 14 July 1998. In principle, it seems to me that the answer to this question is Yes, because there would then be nothing to prevent PHL from relying on the extended limitation period for mistake-based claims in section 32(1)(c) of the Limitation Act 1980. I do not understand the Revenue to argue that PHL could with reasonable diligence have discovered its mistake before 14 July 1998. In practice, therefore, I can see no obstacle to PHL pursuing its mistake-based claims for periods before July 1998, always assuming that section 320 is invalid.

256. The claimants also suggested that it would in any event be possible for the claims of PHL to be related back to the date of issue of the original claim form by Prudential. I have no hesitation in rejecting that submission. The claim by PHL cannot be regarded as a claim made by Prudential. It is a claim made by a different company, relating to different dividends paid at different times. Even if the claim could be said to arise out of substantially the same facts as Prudential's claim, that would not avail PHL, because it is a different party.

257. The second question, assuming section 320 to be invalid, is whether the ACT claims can be related back to the dates of the respective claim forms. The question is probably academic, since it seems to me that the claimants would probably be able to rely on section 32(1)(c) on the ground that they could not have been aware of the invalidity of the ACT provisions before, at the earliest, the decision in FII (ECJ) I in December 2006: compare FII (High Court) at paragraph [267]. In case it matters, however, I will briefly state my views on the question.

258. The issue is whether the ACT claims arise out of the same, or substantially the same, facts as the corporation tax claims previously advanced by Prudential and PHL respectively. Mr Ewart argued that they do not. He submitted that the previous claims were concerned with corporation tax in respect of dividends received, whereas the ACT claims concerned a different tax charged when the relevant foreign dividends were distributed onwards by Prudential and PHL to their shareholders. He emphasised that the payment on of the foreign dividends was not automatic, and would have depended on the making of appropriate resolutions by the two companies.

259. On the other hand, the essential arguments about the invalidity of the ACT charge are the same as those in relation to the Case V corporation tax charge. This reflects the settled jurisprudence of the ECJ, as mentioned above, and is also illustrated by the acceptance on both sides that the answers to the ACT issues follow almost automatically from the answers to the corporation tax issues. Furthermore, the ACT claims are concerned with the same foreign portfolio dividends as the corporation tax

claims, although it is their onward payment rather than their initial receipt which triggered the relevant tax charge. Taking these factors into account, I consider that the ACT claims may fairly be regarded as arising out of substantially the same facts as the original corporation tax claims, and I would hold accordingly. It follows that the ACT claims are deemed to have been commenced on the same date as the original claims, and (leaving aside section 32(1)(c)) they are not time barred if section 320 is invalid.

XII Claims under the Tax Acts and the Autologic principle

260. The first agreed issue under this heading asks whether claims which relate to open years, or years in which a claim for unilateral double taxation relief under section 790 of ICTA 1988 could have been made on the date when High Court proceedings were brought, should be stayed according to the principles laid down by the majority of the House of Lords in the Autologic case (Autologic Holdings Plc v Inland Revenue Commissioners [2005] UKHL 54, [2006] 1 AC 118). I will deal with this issue very briefly, because in the end there was no disagreement about it.

261. In their skeleton argument, counsel for the Revenue formally maintained their position that any such claims should be litigated through the tax appeal procedure rather than in the High Court, and that the corresponding parts of the High Court claims should be stayed. In oral argument, however, Mr Ewart adopted a more pragmatic stance. He agreed that there were some issues (notably the ACT claims) which had to be litigated in the High Court, because the Tax Acts provide no machinery for their resolution. He also accepted that many of the claims did not relate to open years. He made it clear that the Revenue wished me to hear and determine all of the agreed issues, and that it was only at the stage of working out the consequences of my decision (and any appeals from it) that it would be necessary to distinguish between claims which were still open and those which were not.

262. For their part, the claimants do not dispute that, when the issues of principle have been finally determined, they should where possible be given effect through the statutory appeal machinery. The issue therefore evaporated, and it is enough to say that nothing in the speeches of the majority in Autologic leads me to think that it is wrong for me sitting in the High Court to have adjudicated on any of the agreed issues which I have considered in this judgment. On any view, the ACT claims have to be determined by the High Court; and many of the corporation tax claims relate to periods which are now closed, or in respect of which it was too late to make a claim under the statutory machinery when High Court proceedings were begun. In the context of group litigation, where the individual circumstances of all the claimants enrolled in the GLO will vary enormously, the most pressing requirement is for the common issues of law to be determined as quickly and economically as possible. To that end, it is clearly desirable that I should rule on all the disputed issues in the same proceedings, unless there is a rigid jurisdictional bar which prevents me from doing so. As I have explained, I do not consider that any such bar exists. The Autologic principles will be fully respected if, in the working out of this judgment and any appeals from it, matters are resolved as far as possible (in the absence of agreement) through the statutory appeal machinery.

263. A second agreed issue under this heading asked whether the statutory claims procedure for unilateral relief under section 790 excludes the claimant's common law

claims. I need say no more about this, because Mr Ewart expressly confirmed that the issue is no longer pursued by the Revenue and has been abandoned (transcript, day 5, page 165).