Neutral Citation Number: [2015] EWCA Civ 82

Case No: A3/2013/2066
A3/2013/2070

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
Henderson J
[2012] EWHC 458 (Ch)
[2013] EWHC 665 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 12 February 2015

Before :

LORD JUSTICE MOORE-BICK
Vice President of the Court of Appeal, Civil Division
LORD JUSTICE PATTEN
and
LORD JUSTICE BEATSON

- -

Between :

2013/2066	**INVESTMENT TRUST COMPANIES (IN LIQUIDATION)**	**Claimants/ Respondents/**
	- and -	
	THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Defendants/ Appellants**
2013/2070	**INVESTMENT TRUST COMPANIES (IN LIQUIDATION)**	**Claimants/ Appellants**
	- and -	
	THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Defendants/ Respondents**

- -
- -

Laurence Rabinowitz QC, Andrew Hitchmough QC and **Michael Jones** (instructed by **PricewaterhouseCoopers Legal LLP**) for Investment Trust Companies (in Liquidation)
Andrew Macnab and **George Peretz** (instructed by the **Solicitor for HM Revenue & Customs**) for the Commissioners

Hearing dates : 21, 22 and 23 October 2014

- -

Approved Judgment

Lord Justice Patten :

Introduction

1. This is the judgment of the Court.

2. The claimants are all closed-end investment trusts who obtained investment management services under contracts with various management companies ("the Managers"). Closed-end investment trusts, as their name suggests, are fixed period investment vehicles. They are incorporated as limited companies subject to a term date when they are wound up and their assets distributed to the holders of the issued shares. This explains why the claimants are now in liquidation. Under the terms of the management agreements, the Managers were paid fees for the services they provided plus VAT "if applicable". The UK tax treatment of these services at the time when they were provided was that they were subject to VAT at the standard rate. Although from 1990 there had been an express exemption for investment management services supplied to authorised unit trust schemes and this was extended after 1997 to open-ended investment companies, the Value Added Tax Act 1994 ("VATA 1994") continued to treat the supplies of services to closed-end investment trusts as taxable and from 1990 onwards the Managers accounted for VAT on that basis.

3. On 28 June 2007, following a reference from the VAT and Duties Tribunal, the ECJ ruled in Case C-363/05 *J P Morgan Fleming Claverhouse Investment Trust Plc and another v HMRC*, [2007] ECR I-5517, [2008] STC 1180 ("*Claverhouse*") that the provisions of Article 13B(d)(6) of the Sixth VAT Directive, which included within the categories of services qualifying for exemption from VAT the "management of special investment funds", were capable of including closed-end investment funds and that in defining the funds in their territory which were to benefit from the exemption:

> "Member States must respect the objective pursued by that provision, which is to facilitate investment in securities for investors through investment undertakings, while guaranteeing the principle of fiscal neutrality from the point of view of the levying of VAT on the management of special investment funds which are in competition with other special investment funds such as funds falling within the scope of the UCITS Directive."

4. The ECJ in *Claverhouse* ruled that Article 13B(d)(6) had direct effect and HMRC correctly interpreted the ruling of the ECJ as indicating that in implementing the Directive it would be difficult to justify any distinction in treatment between closed-end investment trusts and other forms of special investment funds. On 7 November 2007 they announced (in Business Brief 65/07) that fund management services supplied to investment trust companies, like the claimants, would be treated as exempt supplies and with effect from 1 October 2008 Items 9 and 10 of Group 5 in Schedule 9 VATA 1994 were amended to include the management of a close-end collective investment undertaking.

5. It followed from this that between 1 January 1990 and 1 October 2008 the UK had failed properly to transpose Article 13B(d)(6) into national legislation and that the

Managers who had supplied the services and accounted for the output tax on them were entitled to make claims for repayment under s.80 VATA 1994.

6. Section 80 (as amended by the Finance (No. 2) Act 2005) then provided that:

> "(1) Where a person –
>
> (a) has accounted to the Commissioners for VAT for a prescribed accounting period (whenever ended), and
>
> (b) in doing so, has brought into account as output tax an amount that was not output tax due,
>
> the Commissioners shall be liable to credit the person with that amount.
>
> …
>
> (2) The Commissioners shall only be liable to credit or repay an amount under this section on a claim being made for the purpose.
>
> (2A) Where—
>
> (a) as a result of a claim under this section by virtue of subsection (1) or (1A) above an amount falls to be credited to a person, and
>
> (b) after setting any sums against it under or by virtue of this Act, some or all of that amount remains to his credit,
>
> the Commissioners shall be liable to pay (or repay) to him so much of that amount as so remains.
>
> (3) It shall be a defence, in relation to a claim under this section by virtue of subsection (1) or (1A) above, that the crediting of an amount would unjustly enrich the claimant.
>
> …
>
> (4) The Commissioners shall not be liable on a claim under this section—
>
> (a) to credit an amount to a person under subsection (1) or (1A) above, or
>
> (b) to repay an amount to a person under subsection (1B) above,
>
> if the claim is made more than 3 years after the relevant date.
>
> …

> (7) Except as provided by this section, the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them."

7. A claim for repayment had therefore to be made within three years of the relevant date which was the end of the prescribed accounting period referred to in s.80(1)(a). It was also subject to the important provisions of s.80(2A) which, in conjunction with s.81(3) and s.81(3A) VATA 1994, operate to limit the repayment to the net amount of overpaid tax which remains after deducting from the amount of output tax any deductions of input tax which the Managers had made when accounting for the tax on their supplies of services. HMRC were not therefore required to repay to the Managers more than the net amounts (after setting input tax deducted against that output tax) that they received in the relevant accounting periods.

8. Section 80(3) (as supplemented by regulations under VATA 1994) has the effect of avoiding the unjust enrichment of the taxpayer by making its claim for repayment conditional on it entering into arrangements to reimburse its customers who have paid the VAT on the taxable supplies of goods or services with the amount of the overpaid VAT which is recovered. For reasons which I will come to, this is not an issue in this case because the Managers have refunded to the claimants what they have recovered under s.80 from HMRC.

9. On these appeals we are concerned with the position of three out of the nine claimants in these proceedings. They are Kleinwort Overseas Investment Trust Plc ("Kleinwort Trust"), F & C Income Growth Investment Trust Plc ("F & C Trust") and M & G Recovery Investment Trust Plc ("M & G Trust") who were selected as lead claimants under a consent order made on 25 January 2010. Four of the claimants (including Kleinwort Trust) were registered in the UK for VAT for the relevant accounting periods. The remaining five (including F & C Trust and M & G Trust) were not. An investment trust which invests only in stocks, shares and other securities within the EU is exempt from VAT and makes no taxable supplies. It is not therefore required to be registered. But if (like Kleinwort Trust) it also invests outside the EU then it is entitled to recover UK input tax in respect of its non-EU activities which are not exempt but zero rated. The amount of input tax recoverable is calculated by reference to its non-EU investments as a proportion of its total portfolio expressed as a percentage known as its partial exemption rate. For Kleinwort Trust this was an average of 58.4% over the relevant accounting periods.

10. The trial judge (Henderson J) was presented with two diagrams which are appended to this judgment. The first illustrates the payment flows relevant to F & C Trust and M & G Trust which, for the reasons explained above, were not registered for VAT and were therefore unable to recover input tax. As a consequence, they bore the full cost of the VAT on the supply by the Managers of the services rendered to them. Diagram 2 illustrates the position of Kleinwort Trust which was able to recover on average 58.4% of any related input tax thereby reducing its economic loss to 41.6% of the VAT which it was charged in respect of management services.

11. Both diagrams are based on a notional VAT payment to the Managers of £100. In the case of F & C Trust and M & G Trust, the £100 VAT is received by and paid to the Managers who make a VAT return for the relevant accounting period declaring the

£100 as output tax but claiming a set-off of £25 (another notional figure) for the input tax which the Managers have paid on allowable supplies made to them in connection with their supply of management services. The £25 will not necessarily have been accounted for and paid to HMRC as the output tax of the supplier. The Managers' own right to deduct input tax is not conditional upon the Managers' supplier accounting for the £25 as output tax or upon HMRC receiving that sum from the supplier. HMRC will thus recover from the Managers the amount of the Managers' own output tax paid by the investment trust company less the £25 deduction for input tax. The Managers therefore retain £25 of the £100 paid to them by the investment trust company in satisfaction of their right to deduct input tax.

12. Diagram 2 differs from this only in that Kleinwort Trust was able to recover £58.40 of the £100 which it paid to the Managers as output tax by treating it as an input in relation to its zero rated non-EU business. Its net loss in respect of the output tax paid is therefore reduced to £41.60.

13. In early 2004 (after the *Claverhouse* litigation had been commenced), the Managers of F & C Trust and M & G Trust made claims for refunds of VAT for accounting periods from 2001 to 2004. No claim was made by or in respect of Kleinwort Trust which had gone into liquidation and had received no supplies of management services after 1998. Any claim which it might have therefore fell outside the three year limitation period under s.80(4). In 2007 (following the ruling of the ECJ in *Claverhouse*), the claims of the Managers of F & C Trust and M & G Trust were allowed and VAT refunds (with interest under s.78 VATA 1994) were made for the 2001-2004 period.

14. The reduction in the limitation period under s.80(4) from six years to three years had been effected by s.47 FA 1997 as from 18 July 1996. Prior to the change in the legislation, the six year time limit under s.80(4) did not apply to cases where the tax had been paid under a mistake. In such cases a claim could be made within six years of the date on which the claimant discovered his mistake or could with reasonable diligence have done so. This proviso in cases of mistake was removed by the amendment to s.80(4).

15. The amendments made to s.80(4) did not include any transitional provisions allowing for the recovery of overpaid tax in existing cases. They were also accompanied by a new regulation 29(1A) inserted by the Value Added Tax (Amendment) Regulations 1997 with effect from 1 May 1997 under which the Commissioners were not to allow claims for the deduction of input tax made more than three years from the date of the return for the relevant accounting period. Again, this contained no transitional relief.

16. The decisions of the ECJ in Case C-62/00 *Marks & Spencer plc v Customs and Excise Commissioners* [2003] QB 866 and the House of Lords in *Fleming v Revenue & Customs Commissioners* [2008] UKHL 2, [2008] 1 WLR 195 established that the introduction of a reduced claim period without appropriate transitional relief was incompatible with EU law and that the new three year time limit should be disapplied in respect of rights that had accrued at the date of the change. Section 121(1) FA 2008 (which came into force in March 2008) disapplied the three year cap in s.80(4) for periods ending before 4 December 1996 provided that the claim was made before 1 April 2009. This therefore allowed further claims for overpaid tax made before the deadline to go back at least as far as 1990.

17. As a result, the Managers of all of the three lead claimants made further claims in respect of accounting periods ending before 4 December 1996. The claims were paid with interest and the monies refunded by the Managers to the investment trust companies.

18. The effect of the changes to s.80(4) after taking into account the disapplication of the amended provisions for the accounting periods ending before 4 December 1996 is that no claims for refunds can be made by the Managers of any of the claimants for the accounting periods between 4 December 1996 and the date in 2001 that was three years before the first s.80 claims were made in 2004. This period is referred to by Henderson J as "the dead period". In relation to the three lead claimants, it ends on 20 March 1998 in the case of Kleinwort Trust; on 6 April 2001 in the case of F & C Trust, and on 1 April 2001 in the case of M & G Trust. The amount of VAT claimed by each claimant in respect of the dead period is substantial:

    (a) Kleinwort Trust £333,478;

    (b) F & C Trust £262,289;

    (c) M & G Trust £1,790,850.

19. The total amount of VAT overpaid by the other claimants in the dead period is estimated to be some £4,844,817.

20. On 28 August 2009 the claimant investment trust companies issued a claim form seeking restitution under English domestic law from HMRC of the amounts of overpaid VAT not recovered by the claims made under s.80 VATA 1994. HMRC are alleged to have been unjustly enriched at the claimants' expense by the amount of the overpaid tax. In the alternative, they seek to recover those sums under EU law which they say gives them a direct right of recovery on the *San Giorgio* principle (see [1983] ECR 3595, [1985] 2 CMLR 658) for charges levied in breach of EU law.

21. In this action, the claims of Kleinwort Trust and F & C Trust are limited to the amounts of VAT paid during the dead period. But in the case of M & G Trust, the claim also includes the input tax deductions made by its Manager in accounting periods from 1992 to 1996 and from the end of the dead period until 26 March 2002. In diagram 1 this is the £25 input tax deducted by the Manager as a set-off against the £100 output tax but not refunded by HMRC because of the application of s.80(2A).

22. In summary therefore if one takes the nominal figure of £100 used in the two diagrams to represent the amount of output tax on the Managers' services the claims of F & C Trust and M & G Trust are for £100 in the dead period and (by M & G Trust alone) for £25 in respect of the uncapped periods covered by the s.80 claims. It is agreed that the amount of VAT unrecovered by Kleinwort Trust during the dead period is £41.60. For the purposes of the hearing before Henderson J, the parties were able to agree a list of issues which have been broadly adhered to on this appeal. They were:

    "A. English Law Issues

1. Do the Investment Trusts (in principle) have mistake-based restitution claims/causes of action against [HMRC] for the Unrecovered VAT? This includes consideration of the following:

1.1. Were [HMRC] enriched as a result of the VAT Charges that were paid by the Investment Trusts to the Managers and accounted for by the Managers to [HMRC]?

1.2. If so, what is the extent of that enrichment?

1.3. Do [HMRC] remain enriched by the amounts of the Unrecovered VAT, taking into account the repayments made by [HMRC] under section 80 [VATA 1994]?

1.4. If [HMRC] were and remain so enriched, was and is that enrichment at the expense of the Investment Trusts?

1.5. If [HMRC] were and remain enriched at the expense of the Investment Trusts, was and is that enrichment unjust?

2. If the Investment Trusts have any mistake-based restitutionary claim/cause of action against [HMRC] as a matter of English law, is that cause of action excluded by statute, namely by section 80 [VATA 1994]?

B. EU Law Issues

3. If the Investment Trusts have no mistake-based restitutionary claim as a matter of English law (or they do but that claim is excluded by statute), does EU law require that the Investment Trusts should be able to claim the Unrecovered VAT from [HMRC] (by means of a directly effective right to reimbursement or otherwise)?

4. In the circumstances of this case, does the statutory scheme contained in [VATA 1994] (section 80, etc) provide a remedy that satisfies the principle of effectiveness as regards the protection of the Investment Trusts' EU law rights (if any)?

5. If EU law requires that the United Kingdom should provide the Investment Trusts with a claim for reimbursement against [HMRC], is the statutory exclusion (if any) of such claims to be disapplied to the extent necessary to allow the Claimants the mistake-based restitutionary cause of action they assert?

C. Referable Issues?

6. Is there any need for one or more questions to be referred to [the ECJ] in respect of any of the EU law issues that arise in this case?”

23. Under domestic law the two principal issues are (1) whether the Investment Trusts have any claims in restitution for the overpaid tax given that the Managers and not they were accountable for and paid the tax in question; and (2) if so, whether HMRC have been enriched to the extent of the full £100 charged to the Investment Trusts as VAT by the Managers under the management agreements or only to the extent of the £75 actually paid to HMRC after deduction by the Managers of input tax. If the correct sum is the £75 then M & G Trust has no claim for the uncapped periods and the claims for the dead period are reduced accordingly. But if HMRC have been unjustly enriched at the claimants' expense in respect of the dead period at least in respect of the £75 then the only defence to the claim for that period is s.80(7). There is no defence under s.80(4) which operates only to cap claims by the Managers under s.80. Nor is there an available defence under the Limitation Act 1980. It is common ground that the primary limitation period for the claims in restitution is six years and that this takes effect subject to s.32(1)(c) of the 1980 Act. It is not suggested that the Investment Trusts could have had any relevant knowledge of the overpayment until after the decision in *Claverhouse*.

24. Henderson J held that the claimants did have a restitutionary claim as pleaded for the full £100 even though they were not accountable to HMRC for the VAT. He said that as the ultimate consumers of the Managers' output services, they had (contractually) funded the tax paid which was sufficient to give them a cause of action for its recovery. He rejected the argument that HMRC could not have been enriched by more than the amount of tax (£75) which they actually received. The £25 of the output tax was, he held, retained by the Managers in satisfaction of the liability of HMRC to credit them with that sum under s.25(2) and s.26 VATA 1994. It had therefore been used to meet an obligation of HMRC. But he held that the domestic law claims were barred by s.80(7) which, on its proper construction, was not limited to restitutionary claims made by the person accountable for the tax but was intended to be a comprehensive restriction which extended to similar claims by end consumers who had borne the economic burden of the unlawful tax.

25. It was therefore necessary for the judge to go on to consider the position under EU law. As to this, he held that the claimants had *San Giorgio* rights which could be given effect to by (a) disapplying s.80(7); (b) allowing the claimants to choose between a *Woolwich* cause of action (see *Woolwich Equitable Building Society v IRC* [1993] AC 70) or a claim based on the principles set out in *Deutsche Morgan Grenfell Group Plc v IRC* [2006] UKHL 49 ("*DMG*") with its extended s.32(1)(c) limitation period; but (c) limiting those claims to a three year limitation period by analogy with s.80(4). As a consequence, only the M & G Trust claim for the uncapped periods could succeed.

English law

Were HMRC enriched?

26. Before the judge and on this appeal both sides accepted that the fundamental conditions for a successful claim for restitution are encapsulated in the four questions posed by Lord Steyn in *Banque Financière de la Cité v Parc (Battersea) Limited* [1999] 1 AC 221 at 227A-B. They are:

a) Has the defendant been benefited, in the sense of being enriched?

b) Was the enrichment at the claimant's expense?

c) Was the enrichment unjust?

d) Are there any defences?

27. The first of these questions raises the issue about the £25. Putting aside for the moment whether any enrichment was at the expense of the claimants as opposed to the Managers, there is really no issue about the £75 which is included in the claims for the dead period. VAT was not leviable on the Managers' services and HMRC have received and retained at least £75 of the output tax for that period. Nor is there any separate issue from point (b) about point (c). HMRC accept that if there was any enrichment at the expense of the claimants it was unjust if it resulted from a mistake. As to this, it was conceded before the judge that insofar as any VAT was paid by the claimants to the Managers when it was not properly chargeable and due as a matter of law, then it was paid by mistake. It is also accepted, as I have said, that the claimants could not, with reasonable diligence, have discovered their mistake before the decision of the ECJ in *Claverhouse*.

28. The argument before Henderson J on the first issue therefore concentrated on the £25 represented by the Managers' input tax. HMRC contended that they had not been enriched in respect of that sum because the £25 had never been paid to them and represented tax properly recoverable by them in any event: i.e. as output tax on the supplies made to the Managers. As such, it was unaffected by the decision in *Claverhouse*. That supply of services was always taxable. The claimants' mistake about the correct tax treatment of the supplies made by the Managers may have caused the payment of the £100 to the Managers but it was not causative even on a 'but for' test of the loss of the £25. But for the mistaken payment of £100, HMRC would not have obtained the £75. But they would, it is said, have benefited to the extent of the £25 at the expense of the Managers even if the £100 had never been paid. In economic terms, they cannot therefore be said to have been enriched by more than the £75 which was paid to them and cannot be required to repay the £25 input tax which was always due to them from the Managers' suppliers.

29. The judge rejected this argument on the basis that it was wrong to equate, in causative terms, HMRC's entitlement to the £25 as output tax from the Managers' suppliers with the Managers' right to deduct that same sum as input tax against their own VAT liabilities. The taxpayer had the right (even if not the obligation) to deduct allowable input tax from any output tax for which he was accountable and HMRC had a corresponding duty under s.25(2) and (3) VATA 1994 to give credit for the amount of the input tax and, where it exceeded the output tax, to refund the excess to the taxpayer. There was therefore enrichment in respect of the £25 because, although not paid to HMRC by the Managers, it was used to finance the credit which HMRC were, in the circumstances, obliged under s.25 to give to the Managers for the input tax which they had paid:

> "45. These provisions make it clear, in my judgment, that HMRC should indeed be regarded as enriched by the £25, because although the £25 was not paid to HMRC by the

> Managers, it was nevertheless used to give them a credit, at HMRC's expense, for the input tax attributable to their investment management services which was wrongly thought to be deductible on the footing that the services were not exempt from VAT. HMRC therefore ended up out of pocket to the extent of the input tax. It is simply irrelevant to this analysis that the input tax is in principle the same as tax for which the Managers' own suppliers were liable to account as output tax at the previous stage in the supply chain."

30. The use of a person's money to discharge a debt can undoubtedly constitute enrichment of the debtor: see *Gibb v Maidstone & Tunbridge Wells NHS Trust* [2010] EWCA Civ 678. But one of the difficulties about treating the £25 as part of the enrichment of HMRC in respect of VAT not due is that if the supply of services by the Managers was not taxable then there was no corresponding right to deduct or retain as input tax the VAT paid to the Managers' own suppliers. HMRC are now left in the position of having allowed deductions to be made which have resulted in the Managers retaining the £25 in satisfaction of an entitlement which never existed. In simple cash terms, they are not worse off than they would otherwise have been if, through the s.80 refunds or by way of restitution for the dead period, they are not required to pay back more than the £75 which they actually received. But if the judge is right they are worse off and indeed out of pocket because, by refunding £100 directly to the claimants, they lose the benefit of the £25 of output tax duly paid to them by the Managers' own suppliers and leave the Managers in receipt of the £25 they deducted in respect of that tax. Put another way, they are economically worse off unless in recovering the payment of the £100 VAT, the claimants must give credit for the £25 out of that sum which the Managers retained and which, under the terms of the management agreements, they were not entitled to charge.

31. HMRC have therefore expanded their submissions on this issue to include points which we are told were not canvassed before Henderson J. The argument based on causation has been largely sidelined. Their case is that, when viewed at the date of the claim, the judge was wrong to hold them liable to repay the £25 because they were never enriched by it. In order to qualify for the refunds under s.80, the Managers were required retrospectively to elect to treat its supplies of services to the claimants as exempt. As a consequence, they lost (again retrospectively) their right to deduct or retain the input tax under s.25 so that the VAT which they paid to their own suppliers became an irrecoverable part of the cost of their own business which, on the evidence, they chose not to pass on to the claimants. Since the basis of the Managers' s.80 claims was that they had no right to deduct input tax against an exempt supply, their retention of the £25 did not therefore satisfy any liability to them on the part of HMRC. The effect of s.80(2A) was simply to recognise that the position in respect of output tax cannot be adjusted retrospectively without at the same time making a corresponding adjustment to the input tax position. The s.80 refunds for the uncapped periods therefore restored to the Managers (and, through them, to the claimants) all the VAT that was wrongly paid to HMRC. The £25 of output tax paid to HMRC by the Managers' suppliers is, as stated earlier, unaffected by *Claverhouse* and relates to a taxable supply. Any claim for unjust enrichment in respect of the £25 therefore lies against the Managers who charged VAT on their supply of services; have retained

£25 of the £100 paid to them; and can be made to account for the £25 which they have caused to be paid.

32. The judge's reliance on an obligation of HMRC to refund the Managers' allowable input tax as a justification for treating the £25 retained by the Managers as an enrichment of HMRC has been criticised by Professor Charles Mitchell in the *All England Law Reports Annual Review* for 2012 on the grounds now adopted by HMRC. He makes the point which I will come to that the judge's view (expressed in [69] and [135]-[139] of his judgment) that the Managers would have a cast-iron change of position defence to any claim in restitution because they had retained no benefit from the £100 was wrong for the same reason. Their inability to deduct as input tax the VAT paid to their own suppliers meant that £25 of the £100 remained with them gratuitously and could not be treated as the recovery of the s.25 credit they would have been entitled to had the supplies to the claimants been taxable.

33. The claimants' response to these arguments is to take a point about timing. Mr Rabinowitz QC accepts that a taxable person may not seek to deduct input tax when the output supplies are exempt: see Case C-319/12 *Minister Finansów v MDDP sp z oo Akademia Biznesu, sp komandytowa* [2014] STC 699. But his primary submission is that at the time when the £100 was paid the English VAT legislation did require the Managers' supplies of services to be treated as taxable and therefore gave the Managers a right to deduct input tax. At that time HMRC were therefore under a legal obligation to credit or refund that tax. The mistake made by the claimants was not to realise that they could elect not to pay the VAT because Article 13B(d)(6) had not been properly implemented in the domestic legislation. For the purposes of the claim in restitution, the date of payment is the relevant date. At the disgorgement stage, the £25 is not refunded as part of the s.80 process and its retention by the Managers does not amount to a discharge of HMRC's liability to the claimants.

34. The direct effect of Article 13B(d)(6) and the other provisions of the Sixth Directive inevitably raises the issue of the legal status of any incompatible national provisions. The ECJ has resolved this conflict by requiring the primacy of EU law to be effected through the national courts which are required to disapply national legislation and to uphold claims for repayment of the unlawful charge: see Case 106/77 *Amministrazione delle finanze dello Stato v Simmenthal* [1978] ECR 629. But it has also made clear that this process does not involve the national court treating the incompatible domestic tax provision as a nullity: see Joined Cases C-10/97 to C-22/97 *Ministero delle Finanze v IN.CO.GE.'90 Srl & Others* [1998] ECR I-6307 ("IN.CO.GE").

35. The domestic provisions therefore remain effective to govern the legal relationship between the taxpayer and HMRC until disapplied through a challenge in the national courts preceded by the taxpayer's own reliance on his rights under EU law. In these circumstances, it is for the national courts to ensure that national law provides an effective remedy for the overpayment and for national law to provide the substantive means of achieving this:

> "26. Thus, the obligation on the national court to ensure that a domestic charge levied in breach of Community law is refunded must, subject to compliance with the two conditions laid down by the Court in its case-law, be discharged in

> accordance with the provisions of its national law. It follows that the detailed rules for repayment which are to apply and the classification, for that purpose, of the legal relationship established when that charge was levied between the tax authorities of a Member State and particular companies in that State are matters which fall to be determined under national law.
>
> 27. Furthermore, as the Court has recently held, Community law does not in principle preclude the legislation of a Member State from laying down, alongside a limitation period applicable under the ordinary law to actions between private individuals for the recovery of sums paid but not due, special detailed rules governing claims and legal proceedings to challenge the imposition of charges and other levies (Case C-231/96 *Edis v Ministero delle Finanze* [1998] ECR I-4951, paragraph 37, and Case C-260/96 *Ministero delle Finanze v Spac* [1998] ECR I-4997, paragraph 21).
>
> …
>
> 29. The answer to the question submitted must therefore be that the obligation on a national court to disapply national legislation introducing a charge contrary to Community law must lead that court, in principle, to uphold claims for repayment of that charge. Such repayment must be ensured in accordance with the provisions of its national law, on condition that those provisions are not less favourable than those governing similar domestic actions and do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law. Any reclassification of the legal relationship established between the tax authorities of a Member State and certain companies in that State when a domestic charge subsequently found to be contrary to Community law was levied is therefore a matter for national law."

(See IN.CO.GE).

36. Although therefore Mr Rabinowitz is strictly correct to submit that at the time of payment the VAT was, in domestic terms, due and payable, that argument is ultimately a sterile one because it chooses to ignore the necessarily subsequent process required under EU law to give effect to the provisions of the Sixth Directive. The enforcement of a taxpayer's directly enforceable rights operates in the first instance through the mechanisms provided under domestic legislation: in this case s.80 VATA 1994. Only if those are inadequate to provide a full and effective remedy under EU law must the court step in to provide restitution through the deployment of the civil law.

37. This means in our view that the focus of a claim for restitution of overpaid tax based on the principle of unjust enrichment has necessarily to recognise and respect the methodology adopted for the recovery of the charge and to assess the claim that HMRC

have been unjustly enriched in the light of that process. This requires the court to decide whether there has been unjust enrichment at the end of that process and not merely at the time of the original mistaken payment.

38. Since the Managers had, by common consent, a directly effective right to treat the services supplied to the claimants as exempt and were entitled to enforce that right retrospectively through the medium of s.80, it must follow that the making of those claims operated as an election to treat those supplies as exempt and the waiver of the right to deduct input tax: see Case 8/81 *Becker v Finanzamt Münster-Innenstadt* [1982] ECR 53 at p. 75.

39. Although s.80(4) prevented recovery of the tax beyond the three year time limit, the claims for the dead period do not on that account justify any different treatment. The Managers are to be placed into the position which they would have been in had the domestic legislation properly implemented the provisions of the Sixth Directive. This would have been that no output tax was payable in any of the accounting periods in question but that no recovery could be made in respect of the £25 input tax. The reversal of the tax position created by VATA 1994 has to be carried out on a global basis. Once the legality of the domestic tax treatment is challenged it has to be treated as disapplied in respect of each of the accounting periods in which it was operated. This means that even in respect of the dead period for which no direct recovery can be made using the machinery of s.80, the amount of the overcharged tax levied on the Managers was never more than £75. They must, as Lewison LJ has said, take the rough with the smooth: see *Birmingham Hippodrome Theatre Trust Ltd v Revenue & Customs* [2014] EWCA Civ 684 at [35].

40. Consistently with this, HMRC had no obligation to allow deduction of input tax for the dead period and the claimants have no better right than the Managers to the recovery of the £25. Although the claim in restitution is not a s.80 claim, it proceeds on the premise that the tax paid was never due and that HMRC were enriched to the extent of the full amount paid. The judge was wrong in our view to regard the £25 retained by the Managers as representing the discharge of any still subsisting obligation to refund that amount on the part of HMRC and, except upon that premise, they cannot have been enriched by more than the £75 for any of the accounting periods in question. Any domestic claim in restitution for the £25 therefore lies against the Managers alone.

<u>Was the enrichment at the expense of the claimants?</u>

41. The issue here is whether the claimants, who paid the VAT on the Managers' services to the Managers, have a claim in restitution to recover it even though they were not accountable for the tax to HMRC. In other words, does the fact that the claimants paid the Managers, and that HMRC received it from the Managers rather than directly from the claimants, mean that any enrichment of HMRC was not "at the expense of the claimants"?

42. The judge reviewed the wide divergence of academic opinion and the authorities, which (at [55]) he considered provided only limited guidance and sporadic illumination because none of the cases to which he was referred appeared to him at all close to the factual and legal position he had to consider. In the light of this, he held that there was no room in the law for a bright line rule which would exclude claims

against indirect recipients. Although as a general rule some form of direct enrichment should be required, there should be limited exceptions based on the underlying commercial and economic reality of the transaction.

43. He stated:

> "68. The real question, therefore, is whether claims of the present type should be treated as exceptions to the general rule. So far as I am aware, no exhaustive list of criteria for the recognition of exceptions has yet been put forward by proponents of the general rule, and I think it is safe to assume that the usual preference of English law for development in a pragmatic and step by step fashion will prevail. Nevertheless, in the search for principle a number of relevant considerations have been identified, including (in no particular order):
>
> a) the need for a close causal connection between the payment by the claimant and the enrichment of the indirect recipient;
>
> b) the need to avoid any risk of double recovery, often coupled with a suggested requirement that the claimant should first be required to exhaust his remedies against the direct recipient;
>
> c) the need to avoid any conflict with contracts between the parties, and in particular to prevent "leapfrogging" over an immediate contractual counterparty in a way which would undermine the contract; and
>
> d) the need to confine the remedy to disgorgement of undue enrichment, and not to allow it to encroach into the territory of compensation or damages.
>
> 69. Many of these considerations present no difficulty in the present case. There is no risk of double recovery, because the claimants have in effect exhausted their remedies against the Managers. The Managers have obtained the maximum repayments from HMRC available under the domestic statutory scheme, and have passed on those repayments in full to the claimants. I am also satisfied that no claim for breach of contract could lie against the Managers at the suit of the claimants. Although the possibility of such claims was mooted at various stages in the oral argument, I agree with Mr Rabinowitz that there has been no breach by the Managers of their contracts with the investment trusts, and that the terms in the investment management agreements which required payment of VAT "if applicable", or words to similar effect, did not impose any warranty or obligation to ensure that the VAT charged was in fact lawfully due. The only remedy of the investment trusts against the Managers in respect of the overpaid tax was therefore a restitutionary one, based on mistake. If, however, any such claim were now to be brought,

> the Managers would have a cast iron defence of change of position, having accounted to HMRC for the entirety of the tax as output tax, and having retained no benefit from it.
>
> 70. Similarly, it is not suggested that the present claims against HMRC would conflict in any way with the contractual arrangements between the investment trusts and the Managers; and the claims are limited to disgorgement of the unlawful tax by which HMRC have been enriched.
>
> 71. The requirement of causation, however, is more problematic. As I have already pointed out, there is no strict causal connection between the payment of the VAT element of the invoices submitted by the Managers to the claimants, and the payment of the VAT by the Managers to HMRC. The Managers were liable to account for the VAT to HMRC once they had supplied the relevant services, and the obligation of the claimants to pay the Managers was purely contractual: see paragraph 50 above. It cannot even be said that the VAT was paid or accounted for to HMRC out of the money paid by the claimants to the Managers, or that the VAT would not have been paid but for the payments by the claimants to the Managers.
>
> 72. On the other hand, the scheme of VAT, as explained by the ECJ in Elida Gibbs and echoed by Neuberger J in the Sussex University case, is to impose the burden of the tax on the final consumer, and to make the suppliers of the goods or services the collectors of the tax on behalf of the tax authorities. In other words, VAT is a tax on the consumer, collected by the supplier, and paid or accounted for to HMRC. Viewed in this way, the nexus between the consumer and HMRC could hardly be closer or stronger, and in economic terms the person at whose expense unlawful VAT is paid to HMRC is indubitably the consumer. I remind myself at this point that "at the expense of" is not a statutory requirement, and (as the subrogation cases show) it can be satisfied by reference to the underlying commercial reality of a transaction. To recognise that the test is satisfied in the present case would not, as Mr Swift submitted, be to dismiss the structure of the VAT legislation as mere formalism, but rather to give due weight to the economic reality which explains and underpins that structure."

44. VAT, as an indirect form of taxation, has created this dichotomy between the payment of the amount of the VAT by the ultimate consumer and the statutory duty to account for the tax which is imposed on the supplier of the goods or services. But the economic justification for repatriating any recovery of overpaid tax to the consumer is recognised in the machinery of s.80 which (in s.80(3)) contains provisions to prevent unjust enrichment by the taxpayer and which led in this case to the Managers undertaking to refund to the claimants the £75 for which they had accounted to HMRC. This is consistent with the reasoning of the ECJ in Case C-317/94 *Elida*

Gibbs Ltd v Customs and Excise Commissioners [1996] ECR I-5339 referred to by Henderson J in his judgment that the tax is one imposed on the ultimate consumer:

> "19. The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.
>
> 20. Thus, in Case 89/81 *Staatssecretaris van Financiën v Hong Kong Trade* [1982] ECR 1277, paragraph 6, the Court held that it was apparent from the First Directive … that one of the principles on which the VAT system was based was neutrality, in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain.
>
> 21. That basic principle clarifies the role and obligations of taxable persons within the machinery established for the collection of VAT.
>
> 22. It is not, in fact, the taxable persons who themselves bear the burden of VAT. The sole requirement imposed on them, when they take part in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved, is that, at each stage of the process, they collect the tax on behalf of the tax authorities and account for it to them."

45. The recognition of a restitutionary right on the part of the consumer to recover VAT which should not have been charged is not, however, without its difficulties. As the judge recognised, there is no strict causal connection between the payment of the VAT on the services and the Managers' duty to account. The latter provides the mechanism for the recovery of the tax and operates regardless of whether the VAT is due contractually between consumer and supplier or whether it is paid. Regardless of the operation of the provisions in s.80(3) to prevent unjust enrichment, the consumer also has a restitutionary claim against the Managers for the mistaken payment of VAT. The judge said in [69] that the Managers would have a change of position defence to any such claim based on their having accounted for the tax to HMRC. But, for the reasons set out earlier, this would not apply to the claim for the £25 which *ex hypothesi* was never deductible and paid to HMRC but was retained by the Managers.

46. There is also the bigger question of whether the correct legal approach is that there is a general requirement of direct enrichment and, if so, what are the limits (if any) on the possible exceptions to it. We have referred to the judge's review of the academic literature and the wide divergence of views in what is, by comparison with other branches of the law of obligations, a relatively new and undeveloped area of the law. The spectrum of scholarly views ranges from those, such as Professor Graham Virgo (*The Principles of the Law of Restitution*, 2nd edition 2005), who have advocated direct enrichment as an almost unqualified condition of recovery to those who,

following the late Professor Peter Birks (*Unjust Enrichment* 2nd edition 2005), have suggested that a causal link between the claimant's loss and the defendant's enrichment is in principle sufficient. Mitchell, Mitchell and Watterson, the editors of Goff and Jones (*The Law of Unjust Enrichment* 8th edition 2011, §6-25), consider that this last approach would on balance "be more conducive to the rational development and containment of claims in unjust enrichment". Professor Burrows (*The Law of Restitution* 3rd edition 2011) takes what the judge described as an intermediate position that a claim in restitution should, as a general rule, be limited to the direct provider of the benefit in question but subject to various exceptions.

47. The limited guidance in the authorities, and the clear statements by all three members of this court in the decision we discuss in the next two paragraphs led the judge to adopt Professor Burrows' intermediate position. From the publications of the first editions of *Goff and Jones* in 1966 and Birks' *Introduction* in 1985 scholars have had a decisive influence leading to the recognition of restitutionary claims based on unjust enrichment as a separate category of private law in *Lipkin Gorman (a firm) v Karpnale Ltd.* [1991] 2 AC 548. Since then others have also made significant contributions to its development. But, notwithstanding that influence and the analytical force of many of their arguments, it is the authorities which are the sources of the law, and for that reason, we consider that they, rather than the large number of publications put before us, must be our starting point.

48. For this purpose we can begin with the decision of this court in *Kleinwort Benson Ltd v Birmingham City Council* [1997] QB 380. The facts of the case were a long way from the transaction we have to consider. Kleinwort Benson had entered into an interest swap agreement which was *ultra vires* the council and sought restitution of the money it had paid. This was resisted on the ground that the bank had made good its loss on separate hedging contracts which it had entered into with other parties. This court affirmed the decision of the judge in that case in favour of the bank. It did so on the basis that the hedging arrangements were too remote to be taken into account as the passing on of the burden of the loss to a third party: a situation which, as explained earlier, did not occur in this case. The judgments are largely taken up with whether a defence of passing on which has been recognised in other jurisdictions in relation to overpaid tax has a more general application. The references to the unjust enrichment needing to have occurred "at the payer's expense" were made to emphasise that the plaintiff should not be disabled from recovering what he had paid under the void transaction merely because he had taken the precaution of hedging against his liability under the contract. There was no issue as such as to whether the bank was the relevant payer. The swap contract involved a direct payment between it and the council of the bank's own money.

49. In the *Kleinwort Benson* case Morritt LJ at p. 400F said:

> "… the words 'at the expense of the plaintiff' on which the authority placed such reliance do not appear in a statute and should not be construed or applied as if they did. In my view they do no more than point to the requirement that the immediate source of the unjust enrichment must be the plaintiff".

Evans and Saville LJJ made more nuanced statements to the same effect. Evans LJ stated (at p 393A) that "…'At his expense', … serves to identify the person by or on whose behalf the payment was made … [and who] having made the payment, is necessarily out of pocket…". Saville LJ (at 395A) stated "The expression 'at the payer's expense' is a convenient way of describing the need for the payer to show that his money was used to pay the payee". The judge was right in our view (at [59]) to treat Morritt LJ's reference to the plaintiff being the immediate source of the unjust enrichment and the other statements as not laying down any principle that no form of indirect enrichment will suffice. The point was not in issue.

50. The same can be said of the decision in *Filby v Mortgage Express (No. 2) Ltd* [2004] EWCA Civ 759 where the issue was whether Mortgage Express was entitled to be subrogated to the rights of the bank whose unsecured loan to Mrs Filby's husband had been paid off using the balance of a loan fraudulently obtained by Mr Filby from Mortgage Express. The only defence raised by Mrs Filby was that she had been enriched by her husband and not by Mortgage Express. Once it was decided that Mortgage Express remained the beneficial owner of the balance of the fraudulently obtained loan until its use to discharge the earlier loan, this point disappeared. The decision is of interest, even if not of authority on the point, because of the views expressed that even had Mr Filby become the beneficial owner of the money prior to its use to discharge the unsecured loan:

> "… the present claimants expected to obtain the security of a first legal charge and would not otherwise have made the advance. They would have no difficulty in establishing the reality that their money was used to reduce the joint Midland Bank loan account…." (*per* May LJ at [50]).

The judge (at [65]) read this as indicating that the court could take into account the underlying economic or commercial reality of the transaction regardless of the legal realities involved.

51. Of more relevance and interest are three more recent decisions of this Court, all of which were decided and reported after the decision of Henderson J under appeal. They are (chronologically) *Menelaou v Bank of Cyprus UK Ltd* [2013] EWCA Civ 1960 ("*Menelaou*"); *TFL Management Services Ltd v Lloyds TSB Bank plc* [2013] EWCA Civ 1415 ("*TFL*") and *Relfo Ltd v Varsani* [2014] EWCA Civ 360 ("*Relfo*").

52. *Menelaou* was another claim by a bank to be subrogated to the rights of a third party in order to recover a debt due from the defendant. In this case the bank sought to be subrogated to the unpaid vendor's lien which arose on the exchange of contracts for the sale and purchase of a house by the defendant who was the daughter of its customers. The purchase had been funded using the proceeds of sale of an existing property belonging to the defendant's parents which had been charged to the bank to secure loans made to them. The bank agreed to release that property from the charges on terms that part of the debt would be paid off and that it would be granted a charge over the new property belonging to the daughter. The charge which was granted was invalid because it had not been executed by her. The bank therefore sought to preserve its security by being subrogated to the lien.

53. The case is potentially relevant because the indebtedness which the new charge over the daughter's property was intended to secure remained that of her parents. The bank had not lent any money to the daughter. The new property had been bought by the parents using part of the proceeds of sale released from the earlier charges. The bank's claim to be subrogated to the unpaid vendor's lien was rejected by the judge at first instance because the monies used to purchase the property were not provided by and did not belong to the bank. His decision was reversed on appeal. Although the case centres on the equitable remedy of subrogation, its relevance to the principles of restitution is forged by the now well-established acceptance that subrogation operates to prevent unjust enrichment. In *Banque Financière de la Cité v Parc (Battersea) Limited* (supra) Lord Hoffmann (at p. 236) said:

> "It is important to remember that, as Millett LJ pointed out in *Boscawen v Bajwa* [1996] 1 WLR 328, 335, subrogation is not a right or a cause of action but an equitable remedy against a party who would otherwise be unjustly enriched. It is a means by which the court regulates the legal relationships between a plaintiff and a defendant or defendants in order to prevent unjust enrichment. When judges say the charge is "kept alive" for the benefit of the plaintiff, what they mean is that his legal relations with a defendant who would otherwise be unjustly enriched are regulated *as if* the benefit of the charge had been assigned to him."

54. The judge in *Menelaou* had (rightly) rejected the suggestion that the bank retained a beneficial interest in the proceeds of sale of the first property which were used to finance the second purchase. But he also held that the daughter had not been enriched at the bank's expense even though the monies used to provide the purchase price had, until their release, been secured by the original charges. There had, he said, to be something in the nature of a transfer of value from the bank to the claimant. The position was complicated by the fact that the bank did not release its existing charges over the first property until about a month after completion. The detriment therefore occurred after the new property had been acquired free of any effective charge.

55. The bank's case in the Court of Appeal was that, but for the release from the charge of the monies needed in order to purchase the daughter's house, the transaction could not have gone ahead. The economic reality was that the bank had provided the means of facilitating the purchase of the house that was transferred into her name. This was unaffected by the fact that the existing charges did not come to be released until after the transaction was completed. Although the bank had not made a loan to the daughter who was the contractual purchaser, the monies released from the charge provided the purchase price. There was therefore in a very real sense a transaction of value between the bank and the daughter even though its use to fund the purchase involved the interposition of her parents. The Court accepted this. Floyd LJ said:

> "When the Bank gave its undertaking to release its charges on Rush Green Hall, and thus release the purchase monies for the purchase of Great Oak Court, there was, as I have held, a transfer of value from the Bank to Melissa. Moreover, if one asks Peter Gibson LJ's question, namely whether it can properly be said that the Bank "is the provider of the money

> used to discharge the debt", the answer in the present case is that it is. Certainly that is true if one asks whether the Bank is the source of the monies used as a matter of economic reality. I therefore see no reason in principle or justice why the Bank should not be entitled to the remedy of subrogation."

56. The decision therefore involves an acceptance as part of the ratio that a transfer of value sufficient to give rise to a claim in restitution need not take the form of a direct payment between the claimant and defendant. But it is also significant because in the course of his judgment Floyd LJ referred to and approved the decision of Henderson J in the present case which he said contained "a thoughtful and valuable analysis of what is meant by the requirement that the enrichment be at the expense of the claimant".

57. In *TFL* the question of what was meant by "at the expense of the claimant" arose in another very different context. Proceedings brought by a company to recover a debt were dismissed on the basis that the debt was due to a bank not involved in the proceedings. The bank then sued and recovered the money. The claimant (as assignee of the company's cause of action) then brought a claim in restitution against the bank to recover the costs of the earlier proceedings on the ground that the bank had been unjustly enriched as a result of them. The claim raised interesting issues about whether any enrichment was unjust and whether the bank had any specific defences to the claim which was held to be triable and not appropriate for summary disposal. But in his judgment Floyd LJ returned to the question of indirect benefit and the decision of Henderson J in this case. Having quoted [67] and [68] of the judgment (see [43] above) he said:

> "[57] I agree with Henderson J that these are relevant considerations in deciding the question of whether an indirect benefit was conferred at the Claimant's expense. But the various factors to which he refers are not, and were not I think intended to be, rigid principles. Far less can it be said that if one or more of the factors can be said to be adverse to the claim, the claim is necessarily doomed to failure."

58. *Relfo* is a much commented-on case in relation to what Arden LJ has to say about tracing in the context of a claim based on the knowing receipt of trust property. But Sales J had held that the liquidator of Relfo was entitled to repayment of the sum in question both on the basis of knowing receipt and also unjust enrichment. On 5 May 2004 one of the directors of Relfo (a Mr Gorecia) caused the company to transfer £500,000 to a company called Mirren Limited at a time when Relfo owed £1.4m to HMRC. Relfo was left insolvent and subsequently went into creditors' voluntary liquidation. On the same day Intertrade Group LLC transferred the dollar equivalent of £500,000 to an account of Mr Varsani in Singapore. The money was credited to Mr Varsani's account on 10 May. It was funded by two payments made to Intertrade's account on 5 May. On 13 May $100,000 was paid out of the Singapore account to Mr and Mrs Gorecia. Mr Gorecia and Mr Varsani had close business links both before and throughout this period. After the transfer between Relfo and Mirren the £500,000 was dissipated but none of the withdrawals were paid to Intertrade.

59. The liquidator accepted that he could not identify specific transactions passing between the Mirren and the Intertrade accounts and Sales J held that there was no transfer out of Mirren's account in advance of the Intertrade payment to Mr Varsani which could have funded it. But he also held that Mr Gorecia arranged the payment to Mirren on the basis that his contacts in the Ukraine could ensure (by means to be devised) that the money would be paid to Mr Varsani.

60. Arden LJ held that the liquidator was entitled to pursue a tracing remedy:

> "62. I therefore accept Mr Shaw's submission that the fact that Mirren did not reimburse anyone for the Intertrade payment until after the Intertrade payment had been made does not matter. On the judge's findings, the Intertrade payment and the other payments made throughout the chain of substitutions was made on the faith of the arrangement that Mirren would provide reimbursement. By making that arrangement, Mirren exploited and used the value inherent in Relfo's money that had been paid into Mirren's account.
>
> 63. In my judgment, Mr Shaw is correct in his submission that *Agip* is authority for the proposition that monies held on trust can be traced into other assets even if those other assets are passed on before the trust monies are paid to the person transferring them, provided that that person acted on the basis that he would receive reimbursement for the monies he transferred out of the trust funds. The decision in *Agip* demonstrates that in order to trace money into substitutes it is not necessary that the payments should occur in any particular order, let alone chronological order. As Mr Shaw submits, a person may agree to provide a substitute for a sum of money even before he receives that sum of money. In those circumstances the receipt would postdate the provision of the substitute. What the court has to do is establish whether the likelihood is that monies could have been paid at any relevant point in the chain in exchange for such a promise. I see no reason in logic or principle why this particular way of proving a substitution should be limited to payments to or by correspondent banks."

61. But she then went on to consider the alternative claim for unjust enrichment which would have become relevant had there been no available tracing claim. Having referred to the division of academic opinion on whether direct enrichment was required, she said:

> "78. The ["Direct Providers Only Rule" ("DPR")] raises some immediate questions. Why should the law impose a rule that there can be no claim in unjust enrichment unless the defendant happens to receive the benefit directly from the claimant rather than from the claimant via a third party, and then allow a long list of what might be called ad hoc exceptions? The answer to this question is that DPR is a rule about limiting the

> substitution of new property or rights for the property which leaves the claimant's hands. It may be very unjust to allow the claimant to recover the new property or rights if he has no tracing claim, for example, where the immediate recipient made a gift to the defendant of an amount equal to what he had received from the claim and this transaction of gift was independent of his transaction with the claimant. The claimant may, moreover, end up being able to recover his property from a number of defendants at different stages in the chain.
>
> 79. On this basis, the "exceptions" represent the boundaries (thus far ascertained) of recoverability for indirect unjust enrichment. It is not enough for the claimant to show the defendant is better off by the amount by which the claimant is worse off. That does not even satisfy a "but for" test of causation. Some greater link is required to be shown.
>
> 80. Likewise the list of exceptions raises questions. The exceptions are a motley collection. Some of them are principles from other areas of law, such as trust law, and some of them are remedies, such as subrogation, which do not constitute a basis of liability. They are not, therefore, principles for imposing liability for unjust enrichment carved out of the DPR."

62. Having referred to Henderson J's judgment in this case and to *Menelaou*, she said:

> "92. I agree with Henderson J that the "reality" which May LJ was invoking was not confined to strictly legal reality, but could in appropriate circumstances include a broader underlying commercial or economic reality (judgment, [65]).
>
> 93. This court accepted in *Menelaou* that the bank had released the charge over the parents' house with a view to its obtaining security over the daughter's house. The majority relied on economic reality. Moses LJ, however, did not think it was necessary to rely on economic reality as such on the grounds that this test was uncertain and that a decision-maker might use this concept because he was unable to articulate his real reasoning.
>
> …
>
> 95. *Menelaou* is, of course, a case about subrogation and thus one only of the exceptions listed in section 8(2) of *the Restatement.* Nonetheless, particularly read with the passage from the speech of Lord Hoffmann in *Banque Financière* and the dictum of May LJ set out above, the decision strongly supports the view that the law is moving towards identification of a general principle. Overall the court must find that there is a sufficient link between the formation of the transaction whereby the claimant conferred a benefit on the direct recipient

> (or was entitled to receive a benefit) and the transaction under which the defendant obtained a benefit to make the enrichment unjust. I do not read the judgments of Gloster and Floyd LJJ as taking any different view on that point. Moreover, in deciding whether there is a sufficient link, the court will look at the substance and not the form.
>
> 96. Any principle for unjust enrichment against indirect recipients will have to be refined in later cases. For now, the criteria identified by Henderson J will no doubt be of assistance. They identify important policy considerations for the application of the law in this area. As I see it, they are consistent with there being some ultimate general principle."

63. Both Gloster and Floyd LJJ held that the appeal should be dismissed on the basis that the liquidator had a right to trace. They made express their reluctance to lay down any definitive guidance on whether and in what circumstances an indirect benefit sufficed to found a claim in restitution. As Professor Nolan has observed ((2015) 131 LQR 12), they "stuck closely to the fact that the arrangements in [that] case were in substance tantamount to a direct payment". Gloster LJ said:

> "103. However, for the reasons given by Floyd LJ in paragraphs 115 to 122 of his judgment, and despite my initial reluctance, I am nonetheless satisfied that we are able to conclude that the arrangement by which Mr Gorecia benefited and enriched Bhimji Varsani using Relfo's money was in the circumstances in reality equivalent to a direct payment and demonstrated a sufficient causal connection to support a remedy in unjust enrichment.
>
> 104. Like Floyd LJ I do not consider that this is a suitable case for the court to attempt to articulate general principles as to the circumstances in which a claim for unjust enrichment might lie, notwithstanding that that the defendant has not received his benefit directly from the claimant. It is clear from the cases to which Arden LJ has referred that the court has not limited the remedy to cases falling within what Professor Burrows in *The Restatement* refers to as "the direct providers only" rule and that there are exceptions to the rule. Again this is not a suitable case in which to explore the extent of those exceptions. What one can say is that on the basis of the evidence as found by the judge this was clearly a case which demonstrated the necessary causal link between the payment and the gain to justify an unjust enrichment claim."

64. Floyd LJ said:

> "113. The "direct transfers only" rule, for which there is also eminent academic support, represents the other extreme of the spectrum of possible tests to which I referred in paragraph 107 above. In fact, adherence to the direct transfers only rule makes

> it unnecessary to ask whether there is a sufficiently close causal connection, or, alternatively, if one does ask the question it will answer itself. A direct transfer from A to B must be sufficiently close - it could not be closer. However, as Arden LJ has amply demonstrated, the courts have not rigidly observed a direct transfers only rule, and exceptions have been recognised: see per Henderson J in *Investment Trust Companies (In liquidation) v Revenue & Customs Commissioners* [2012] EWHC 458 (Ch); [2012] STC 1150. This suggests, at the very least, that something less than the direct transfers only rule, by way of a general test of the necessary connection, may suffice.
>
> …
>
> 115. The present case is not one in which I would wish to attempt to lay down any general rule applicable to determine causation in unjust enrichment cases. In particular I would not wish to attempt, because it is not necessary, an analysis of precisely how much liberalisation of a direct transfers only rule, or how much tightening of a "but for" test, will ultimately prove to be appropriate. However, in my judgment, the factual findings made by the judge in the present case made his conclusion that there was a sufficiently close causal connection an inevitable one. Indeed, provided one focuses on substance and not on form, or as it is put in some of the cases, on economic reality, the facts in the present case showed that the arrangement by which Mr Gorecia benefited and enriched Bhimji Varsani using Relfo's money were equivalent to a direct payment. I would draw attention to some of those findings."

65. We have considered whether, despite the unwillingness of the majority in *Relfo* to provide some more comprehensive guidance about the approach to be adopted in cases of indirect benefit, this appeal should be taken as the opportunity to do so. We have reached the conclusion that this is not necessary and that it would be neither practicable nor wise.

66. First, it is, we consider, clear as a matter of authority at Court of Appeal level that indirect benefit can, in appropriate cases, be sufficient to found a claim in restitution. A direct transfers rule which admits of no exceptions would have negated the reasoning behind the decision in *Menelaou* and was expressly rejected by Floyd LJ in that case and (although *obiter*) in his judgment in *Relfo* with which Gloster LJ agreed. Although decided in the context of a strike-out, the same can be said about the judgments of Floyd and Beatson LJJ in *TFL.* In all three of these recent decisions the approach and conclusions of Henderson J on this question have been approved. A further endorsement can be found in the judgment of Beatson LJ in *R (Hemming) v Westminster City Council* [2013] EWCA Civ 591 at [129].

67. Therefore, although the Court in *Menelaou, TFL* and *Relfo* has disavowed any attempt to produce an exhaustive statement of what categories of indirect benefit satisfy the requirements for a claim based on unjust enrichment, they have recognised that the considerations suggested by Henderson J in his judgment are relevant ones in

assessing whether an indirect benefit was conferred "at the claimant's expense", and that he was right to conclude that in the case we are concerned with it was. It is enough to say that Henderson J was right to find that in the context of VAT the final consumer who pays the tax has a sufficient economic connection with HMRC to be able to say that they have been enriched at his expense when the tax ought never to have been imposed on the services which were supplied. We can see no purpose in embarking on a more wide ranging review of the law which, in the circumstances, would be entirely *obiter*.

68. Secondly, there are too few concrete examples to go beyond the considerations identified by Henderson J as in effect criteria for the recognition that an indirect receipt is "at the expense" of a claimant. Henderson J referred at [68] to "the search for principle", which is possibly a conscious echo of the title to Lord Goff of Chieveley's 1983 Maccabaean lecture "*The Search for Principle*" (1983) 69 Proc Brit Acad.169. Lord Goff stated (at 186) that the development of common law doctrine was kaleidoscopic "in the sense that it is in a constant state of change in minute particulars". He warned (*op cit.* at 174) against "the temptation of elegance" because "the law has to reflect life in all its untidy complexity". This is perhaps illustrated by the decision in *Anns v Merton LBC* [1978] AC 728, at 751, where a generalised principle of negligence liability was formulated some forty-five years after the decision in *Donoghue v Stevenson* [1932] AC 562. Although Lord Goff appeared to welcome this, it is instructive that the principle in *Anns* was qualified twelve years later in *Caparo Industries plc v Dickman* [1990] 2 AC 605 and *Anns* itself was overruled the following year in *Murphy v Brentwood DC* [1991] 1 AC 398. What happened is an example of the dangers of moving to a general principle prematurely and shifting the emphasis to the identification and more precise definition of exceptions to a broadly formulated principle of liability.

69. Before leaving this part of the case, we make one observation about the considerations so skilfully distilled from the authorities and the commentators by Henderson J which has a bearing on what might be called "the default position". In this case, the only consideration of those identified by Henderson J which might have been problematic for allowing the claim was the first one, a "close causal connection": see [71] – [72] set out at [43] above. Henderson J considered that the requirement of causation was met by having regard to the economic and commercial reality in considering whether, in the light of the VAT regime, the enrichment was in reality at the expense of the claimant. We agree with him that it is permissible to do this. Once one is satisfied that one can do this, the potential problem of satisfying the "close causal connection" requirement is overcome. But looking at "economic" or "commercial" reality carries the risk of paying insufficient attention to legal categorisation and the rules of other regimes. Henderson J reflected those matters in the third and fourth of his considerations; the need to avoid "conflict with contracts between the parties" or (in the characteristically vivid language of Professor Birks) "leapfrogging" over an immediate contractual counter party or a relevant third party in a way which would undermine the contract, and not allowing the remedy to encroach into the territory of compensation or damages. We consider that the correlative of taking a broad approach to the first consideration by taking account of "economic" or "commercial" reality is that it is important not to take a narrow view of what, under the third criterion, would conflict with contracts between the parties or with a relevant third party in a way which would undermine the contract.

Section 80(7) VATA 1994

70. It is common ground that s.80(7) is effective to prevent any claim by the Managers outside s.80. This therefore secured the imposition of the three year limitation period under s.80(4) and would exclude any common law claim by the Managers in restitution. But the judge ultimately held that s.80(7) was not, despite its express language, limited to a claim by the person who had accounted for and paid the VAT to HMRC. It should, he held, be given a purposive construction in order to recognise and ensure that s.80 (with the then three year limit on claims) provides an exhaustive and exclusive mechanism for the recovery of undue VAT.

71. We find this a surprising conclusion and, in our view, it is wrong.

72. The machinery of s.80 imposes on HMRC a liability to *credit* output tax that was not due to the person who has "*accounted to the Commissioners for VAT*": see s.80(1). Only the Managers satisfy this condition. The liability to "*credit or repay*" the VAT only arises "*on a claim being made for this purpose*": see s.80(2). Again, this limits the liability and the means of recovery to the accounting party. Section 80(4) is a limit on a "*claim under this section*".

73. Section 80(7) does not, in terms, exclude any claims which are not 'claims under this section'. Instead, it places a restriction on the Commissioners' liability "*to credit or repay any amount accounted for or paid to them*". This is precisely the same language as is used in s.80(1) and (2) and, in our view, must carry the same meaning. It therefore limits any claim for the recovery of the tax by the accounting party (the Managers in this case) to one under s.80. The Managers cannot therefore avoid the s.80(4) time limit by bringing a claim in restitution with the more generous limitation period that applies to such claims. It does not, however, extend to the claimants who were never accountable for the tax and did not pay it to the Commissioners.

74. HMRC accept that the claimants cannot, for these reasons, bring themselves within s.80(1). But they contend that s.80(7) should, despite its adoption of the same terminology, be given an extended meaning which is effective to exclude other classes of claimant like the investment trusts in this case who would otherwise have a means of recovering the tax through some other form of legal claim.

75. HMRC's primary submission on the meaning of s.80(7) is that it is not necessary to resort to a purposive construction of the words "*accounted for or paid to them by way of VAT*". Mr Macnab accepts that this phrase is descriptive of the only means by which the tax is paid. But the focus of s.80(7), he says, is on what the Commissioners are required to do in respect of undue VAT. The obligation on them to credit or repay it should not be read as co-extensive with the method by which they received the tax. "*Repay*" can properly describe the means of refunding the amount of the tax to whoever has a legal claim for its recovery. The judge accepted this:

> "103. My next point is that there is nothing in the wording of subsection (7) which expressly makes its ambit co-extensive with that of subsection (1). On the contrary, subsection (7) provides in apparently unqualified terms that, except as provided by section 80, HMRC shall not be liable "to credit or repay any amount accounted for or paid to them by way of

VAT that was not VAT due to them". It is true that these words are most naturally and easily read as referring to the taxable person who paid or accounted for the overpaid VAT in the first place; and this impression is strengthened by the references to crediting and repayment of undue tax earlier in the section. Nevertheless, I consider it at least possible to read the words "repay any amount" as including repayments by HMRC to somebody other than the taxable person himself. The first meaning of "repay" in the Oxford English Dictionary, second edition, is: "To pay back (money or its equivalent); to refund, return (a sum or amount owed); to give money or goods in discharge of (a debt or loan)." In my judgment, a payment made by HMRC to the claimants, in response to a common law restitutionary claim, of an amount equal to the undue tax received from or accounted for by the Managers, could be described without any abuse of language as a "repayment" by HMRC of the undue tax by which they had been directly or indirectly enriched. I agree with the submission of Mr Swift that enough force can be given to the notion of payment back inherent in the prefix "re" by looking at the matter from HMRC's point of view, without any need to insist that the recipient of the repayment should be the same person as the original payer. I also see no insuperable difficulty in treating the concept of repayment as extending to the full amount of the enrichment, even though the amount actually paid to HMRC was the £75, not the full £100. I therefore conclude that a construction of subsection (7) which would include within its ambit claims by end consumers such as the claimants in the present case is linguistically an available one, even if it is not the most natural way of reading the words.

104. At this point, purposive considerations appear to me to be decisive. The evident purpose of section 80, so far as taxable persons are concerned, is to provide exhaustive and exclusive machinery for the recovery of undue VAT, subject to a relatively strict time limit for the making of claims. It is thus common ground that the Managers could not make restitutionary claims against HMRC in respect of VAT overpaid by them during the dead period, although in the absence of section 80 there would be nothing to prevent them from advancing such claims, with the benefit of the usual six year limitation period and mistake-based extensions to it pursuant to section 32(1)(c) of the Limitation Act 1980. Given that Parliament has decided to enact this limited regime in relation to the taxable persons by whom the undue VAT was paid or accounted for to HMRC, it seems to me inconceivable that Parliament could have intended a more generous regime to be available to the end customers by whom the economic burden of the unlawful tax was actually borne. It would make no sense to limit recovery by the tax collector, but to expose the

> Exchequer at the same time to far more extensive claims by the "real" taxpayer. Furthermore, it could not plausibly be suggested that the position of end customers was somehow overlooked, because the section contains a defence of passing on, and (as I have already explained) regulations make elaborate provision for the benefit of repayments to suppliers to be passed on to their customers. It would be wholly inconsistent with this limited and carefully regulated scheme if claims by the end customers fell outside its scope."

76. Although the word "*repay*" taken in isolation is obviously capable of describing the satisfaction of any claim for the recovery of overpaid or undue tax, we consider that the natural meaning of the phrase "*credit or repay any amount accounted for or paid to them by way of VAT*" read in context is the refunding of the tax to the taxpayer. The use of "*repay*" merely reflects the provisions of s.80(2A) which were intended to extend to taxpayers who were repayment traders. Since the terminology of s.80(7) is explicable by and reflective of the earlier provisions of s.80, we are not persuaded that it should be given some wider and much less natural meaning. But if resort is to be made to a purposive approach to construction then that exercise has, we think, to involve a consideration of the legislative history. The judge undertook this exercise but thought it was unhelpful. We take a different view.

77. The precursor to s.80 was s.24 of the Finance Act 1989 which provided as follows:

> "24. (1) Where a person has paid an amount to the Commissioners by way of value added tax which was not tax due to them, they shall be liable to repay the amount to him.
>
> (2) The Commissioners shall only be liable to repay an amount under this section on a claim being made for the purpose.
>
> (3) It shall be a defence, in relation to a claim under this section, that repayment of an amount would unjustly enrich the claimant.
>
> (4) No amount may be claimed under this section after the expiry of 6 years from the date on which it was paid, except where subsection (5) below applies.
>
> (5) Where an amount has been paid to the Commissioners by reason of a mistake, a claim for the repayment of the amount under this section may be made at any time before the expiry of 6 years from the date on which the claimant discovered the mistake or could with reasonable diligence have discovered it.
>
> (6) A claim under this section shall be made in such form and manner and shall be supported by such documentary evidence as the Commissioners prescribe by regulations; and regulations under this subsection may make different provision for different cases.

> (7) Except as provided by this section, the Commissioners shall not be liable to repay an amount paid to them by way of value added tax by virtue of the fact that it was not tax due to them."

78. These provisions, which were framed in the language of repayment and contain the basic structure now evident in s.80, were enacted in response to the decision of the House of Lords in *CCE v Fine Art Developments Plc* [1989] 1 AC 914. This had confirmed that a taxpayer was entitled to set off against future payments of VAT the amount of tax overpaid in earlier accounting periods which resulted from an unlawful direction by the Commissioners about the price on which the VAT was to be charged. The Commissioners had refused to allow the deductions on the basis that the overpaid tax was irrecoverable as paid under a mistake of law. But the House of Lords held that regulations made under paragraph 2(4)(c) of Schedule 7 to VATA 1983 created a legal right for the taxpayer to make the deductions.

79. As a result, s.24 was enacted to provide, by way of primary legislation, a specific mechanism for the making of claims to recover overpaid tax including a time limit for the making of such claims in s.24(5). This was subsequently amended by s.47 of the Finance Act 1997 which introduced the three year period in what is now s.80(4). The section was also amended to correct the omission of the right to recover unclaimed input tax (exposed by the decision of Neuberger J in *University of Sussex v CCE* [2001] STC 1495) by providing for a credit in respect of the resulting overstated tax.

80. These latter changes did not result in any significant amendment to the scope of what is now s.80 which remained a means (as it had been in the original form of s.24) of refunding overpaid VAT to the taxpayer. It is also material to observe that at the time when s.24 was enacted money paid under a mistake of law remained irrecoverable. This continued to be the case until the decision of the House of Lords in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349.

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

82. It follows from this that, under domestic law, the claimants are entitled to recover the £75 paid in respect of the dead periods but the £25 is irrecoverable by any of the claimants either for the dead periods or the uncapped periods. In the case of Kleinwort Trust, the sum payable will be limited by the need to reflect its ability to recover 58.4% of the VAT it was charged. It is therefore necessary to consider whether the claimants can recover the £25 by relying on their rights under EC law and, if so, whether any such claims should be limited by analogy (as the judge held) to the period under s.80(4).

EU Law

83. The judge accepted that the investment trusts had a *San Giorgio* claim for the £25 as part of the £100 by which HMRC had been enriched. As explained earlier, this was based on the premise that the £25 had been used to meet the obligation of HMRC to give credit to the Managers for the input tax paid in respect of the services rendered by their own suppliers. The Managers had therefore accounted to HMRC for the full £100 and had a good change of position defence even in respect of the £25 which they retained out of the £100 paid to them by the claimants.

84. Henderson J therefore concluded that the EU principle of effectiveness required the claimants to be able to recover by direct action against the State the amount of the overpaid VAT which had not or could not be recovered by a combination of the statutory machinery of s.80 and a claim in restitution under domestic law. This amounts on our analysis to the £25.

85. HMRC's challenge to this conclusion proceeds at two levels. The first part of their case is that on *San Giorgio* principles there was no right to recover the £25 because it did not represent undue VAT in respect of which HMRC had been enriched. The *San Giorgio* claims to recover this sum therefore failed *in limine* for essentially the same reasons as the claim to recover the £25 as unjust enrichment under domestic law. In the alternative, they contend that on a correct application of the conditions for a *San Giorgio* claim there is no claim either because one of the relevant conditions is that there should be no net loss of tax to the State or because, in the case of a tax like VAT where the ultimate consumer bears the economic burden of the tax but is not the accountable party, the consumer has no direct cause of action against the State unless recovery of the amount of the tax from the taxable person would prove "impossible or excessively difficult": see Case C-94/10 *Danfoss A/S and Sauer-Danfoss ApS v Skatteministeriet* [2011] I-09963 ("*Danfoss*"). In this case the only barrier to a claim in restitution against the Managers was a change of position defence based on their having accounted for the whole £100 to HMRC. The judge's acceptance that there was a good defence on those grounds is based on his view that the £25 was retained in discharge of an outstanding obligation by HMRC to credit input tax which we have rejected for the reasons already stated.

86. *San Giorgio* (Case 199/82 *Amministrazione delle Finanze dello Stato -v- SpA San Giorgio* [1983] ECR 359) established the general principle:

> "that entitlement to the repayment of charges levied by a Member State contrary to the rules of Community law is a consequence of, and an adjunct to, the rights conferred on individuals by the Community provisions prohibiting charges having an effect equivalent to customs duties or, as the case may be, the discriminatory application of internal taxes. Whilst it is true that repayment may be sought only within the framework of the conditions as to both substance and form, laid down by the various national laws applicable thereto, the fact nevertheless remains, as the Court has consistently held, that those conditions may not be less favourable than those relating to similar claims regarding national charges and they may not

> be so framed as to render virtually impossible the exercise of rights conferred by Community law."

See paragraph 12 of the judgment.

87. So stated, the principle raises the obvious question of whether, in the context of VAT, the ultimate consumer who is directly affected by the imposition of the tax as a cost unit in the price he pays but is not the taxpayer has any directly enforceable right against the State for the recovery of the overpaid tax. Mr Rabinowitz suggested that this issue had been resolved by the decision of the ECJ in *Claverhouse* which recognised (at the suit of the claimant investment trusts) that Article 13B of the Sixth Directive was directly enforceable and could be relied on by the claimants as end consumers even though they were not accountable for the tax. The judgment in *Claverhouse* does not, however, grapple directly with the issue of recovery of the overpaid tax and, like the judge (see [129]-[130]), we think it is more productive to look at the two cases where the point was directly in issue. These are *Danfoss* and the earlier decision in *Reemtsma Cigarettenfabriken GmbH v Ministero delle Finanze*: Case C35/05: [2007] ECR 1-2425 ("*Reemtsma*").

88. *Reemtsma* was a VAT case. It concerned cross-border supplies of advertising and marketing services by an Italian company to Reemtsma, a cigarette manufacturer based in Germany. The Italian company invoiced Reemtsma for VAT on the supplies which was paid and accounted for by the supplier to the Italian tax authorities on the basis that the supply took place in Italy. VAT is not payable under the Sixth Directive on cross-border supplies. Instead, the receiving party must account in his home state for output tax on the supply of goods or services in that state and is entitled to deduct the VAT there as input tax.

89. Reemtsma in due course sought repayment of the VAT which it had paid and its Italian supplier had accounted for on the ground that the place of supply was Germany where Reemtsma was established and no VAT had therefore been payable in Italy by the supplier. The Eighth Directive contains detailed provisions for the refunding of VAT paid by a taxable person in one Member State on services provided in another. But reimbursement was refused in this case because the VAT had never been chargeable in Italy in respect of the relevant supplies. It was also the position under Italian law that only the supplier of the services and not a recipient established in another Member State was entitled to seek the reimbursement of the tax.

90. The Court of Cassation in Italy referred two questions to the ECJ: (1) whether the VAT paid in Italy on the services supplied was refundable at all under the provisions of the Eighth Directive and (2) whether, assuming an obligation to reimburse the tax existed, the domestic legislation limiting claims to the tax supplier in Italy was compatible with the principle of effectiveness or required to be supplemented by a direct right of action between the foreign taxable person and the Italian revenue authorities.

91. The answer given by the ECJ to the first question was that the VAT paid in Italy was not refundable under the Eighth Directive. But it went on to consider the second question which is the one relevant for our purposes. Reemtsma's argument was that a right to claim reimbursement of the tax vested in the taxpayer alone would not satisfy the principle of effectiveness because it would not cater, for example, with events

such as the intervening insolvency of the supplier. The Commission submitted to the ECJ that a procedure under which the tax was reclaimable by the supplier and then recovered from the supplier by the end consumer using his remedies under the civil law was an effective means of recovering the tax.

92. In its judgment the ECJ said:

> "37. It must be pointed out in that regard that, in the absence of Community rules on applications for the repayment of taxes, it is for the domestic legal system of each Member State to lay down the conditions under which such applications may be made; those conditions must observe the principles of equivalence and effectiveness, that is to say, they must not be less favourable than those relating to similar claims founded on provisions of domestic law or framed so as to render virtually impossible the exercise of rights conferred by the Community legal order (see, inter alia, Case C-30/02 *Recheio - Cash & Carry* [2004] ECR I-6051, paragraph 17, and Case C-291/03 *MyTravel* [2005] ECR I-8477, paragraph 17).
>
> 38. Also, the Sixth Directive does not contain any provisions relating to the adjustment by the issuer of the invoice of VAT which has been improperly invoiced. The Sixth Directive merely defines, in Article 20, the conditions which must be complied with in order that deduction of input taxes may be adjusted at the level of the person to whom goods or services have been provided. In those circumstances, it is for the Member States to lay down the conditions in which improperly invoiced VAT may be adjusted (*Schmeink & Cofreth and Strobel*, paragraphs 48 and 49).
>
> 39. In the light of the case-law cited in the two preceding paragraphs, it must be conceded that, in principle, a system such as the one at issue in the main proceedings in which, first, the supplier who has paid the VAT to the tax authorities in error may seek to be reimbursed and, second, the recipient of the services may bring a civil law action against that supplier for recovery of the sums paid but not due observes the principles of neutrality and effectiveness. Such a system enables the recipient who bore the tax invoiced in error to obtain reimbursement of the sums unduly paid.
>
> 40. It must also be borne in mind that, according to settled case-law, in the absence of relevant Community rules, the detailed procedural rules designed to ensure the protection of the rights which individuals acquire under Community law are a matter for the domestic legal order of each Member State, under the principle of the procedural autonomy of the Member States (see, inter alia, Case C-78/98 *Preston and Others* [2000] ECR I-3201, paragraph 31, and Joined Cases C-392/04 and C-422/04 i-21 *Germany and Arcor* [2006] ECR I-0000, paragraph 57).

> 41. In that regard, as rightly submitted by the Commission, if reimbursement of the VAT becomes impossible or excessively difficult, in particular in the case of the insolvency of the supplier, those principles may require that the recipient of the services to be able to address his application for reimbursement to the tax authorities directly. Thus, the Member States must provide for the instruments and the detailed procedural rules necessary to enable the recipient of the services to recover the unduly invoiced tax in order to respect the principle of effectiveness.
>
> 42. The answer to the second part of the second question must therefore be that the principles of neutrality, effectiveness and non-discrimination do not preclude national legislation, such as that at issue in the main proceedings, according to which only the supplier may seek reimbursement of the sums unduly paid as VAT to the tax authorities and the recipient of the services may bring a civil law action against that supplier for recovery of the sums paid but not due. However, where reimbursement of the VAT would become impossible or excessively difficult, the Member States must provide for the instruments necessary to enable that recipient to recover the unduly invoiced tax in order to respect the principle of effectiveness."

93. The decision in *Reemtsma* is sufficient in itself to dispose of one of HMRC's original arguments (pressed more before the judge than before us) that not being the taxable party the investment trusts have no *San Giorgio* rights sufficient to give them a direct claim against HMRC for the recovery of the overpaid tax. The decision recognises that the end consumer, although not the taxpayer, has a sufficient economic connection with the payment of the tax to qualify for reimbursement under the *San Giorgio* principle. Nor is there much scope for debate about what is procedurally necessary to ensure that the process of reimbursement is effective. The ECJ accepted that a two-stage process of recovery (as in the present case) was *San Giorgio* compliant and was to be regarded as the normal method of recovery unless, to use its words, reimbursement proved in the particular case to be impossible or excessively difficult. This is consistent with the well-established principle that remedial measures are matters for the individual Member State to prescribe. The claimants in this case have received the benefit of the refunds obtained by the Managers as a result of the s.80 claims and have pursued their own civil claims for restitution in respect of the dead period. The remedies available to them under national law have therefore respected and complied with the principle of effectiveness. The failure by the claimants through these processes to obtain reimbursement of the £25 in respect of any of the relevant accounting periods is not due to any defect or omission in the procedure. That part of the claim has failed on the substantive grounds explained earlier in this judgment. Reliance therefore by the investment trusts on their *San Giorgio* rights and, in particular, on the EU principle of effectiveness is not sufficient to establish a claim to the £25 unless the references in *Reemtsma* to reimbursement of the VAT becoming impossible or excessively difficult are not to be read as limited simply to procedural defects or barriers to recovery (such as the possible insolvency of the supplier) unrelated to the merits of the claim but embody a wider principle of

recovery than is available under a common law claim for restitution based on unjust enrichment. If the focus of *Reemtsma* is purely procedural then it cannot create a cause of action where none would otherwise exist.

94. In this context, Mr Macnab drew our attention to a passage in the opinion of Advocate General Sharpston in *Reemtsma* where she endorses the argument of the Commission that a two-stage process for recovery of the undue VAT is permissible provided that the supplier remained available to meet a civil claim:

> "The Commission recalls the court's rulings, in particular *Schmeink & Cofreth*, to the effect that Member States must provide for rectifying errors in invoicing VAT, including both rectifying the invoice and reimbursing the tax wrongly paid. It submits that that duty flows from the principle of neutrality and from the prohibition of unjust enrichment (here, on the part of the tax authorities). Member States may choose whatever procedure is suitable, provided that the principle of effectiveness is respected. A situation in which normally only the supplier, as person liable for the tax, may seek reimbursement from the tax authorities and the customer must seek reimbursement from the supplier, under civil law, appears in principle acceptable. However, provided that any risk of tax loss is wholly eliminated, the principle of effectiveness might require the customer to be able to claim against the tax authorities if recovery by the normal procedure proved "virtually impossible or excessively difficult" (for example, in Reemtsma's case, if its Italian supplier had ceased to exist). Finally, the principle of non-discrimination would require any Member State which allowed an action against the tax authorities for a customer established in its territory to allow the same right of action to a customer established in another Member State."

See paragraph 84 of her Opinion.

95. The reference to the need to ensure that any risk of a tax loss is wholly eliminated should, he says, be read as a condition for any direct *San Giorgio* claim by the end consumer. Read in context, the Commission appears to have been saying that if a direct right of action against the state must be superimposed on the existing two-stage machinery for reimbursement under which the supplier as the accounting party would claim and obtain the refund in the first instance, such a right of action should not lead to a change in what would otherwise be the original correct tax treatment of the transaction in question. In other words, that in adjudicating upon the claim the national court should determine the extent of enrichment by reference to what VAT the supplier was entitled to be refunded in order to reverse the overpayment of the tax. On this basis, HMRC would not be enriched by the £25 because, as explained earlier, the Managers were never entitled to deduct input tax on the supplies they made to the claimants and the £25 which they retained for that purpose enriched them rather than HMRC.

96. It is not clear whether this part of the Commission's argument, although accepted by the Advocate General, can be regarded as an established feature of the *San Giorgio* principle. There is certainly no express mention of it in the judgment of the ECJ in *Reemtsma* which confines itself to accepting that a two-stage process of recovery is compatible with the principle of effectiveness unless impossible or excessively difficult. We can therefore turn to the later decision of the ECJ in *Danfoss* which is the most recent word on these issues. The case concerned Danish excise duty on lubricating oil levied in purported compliance with EU Directive 92/81/EEC of 19 October 1992. The Directive contained an exemption for mineral oils used for purposes other than as motor fuels, heating, or as fuels for the purpose of air navigation other than private pleasure flying. The Danish legislation which implemented the Directive failed to include the exemption in reliance in Article 3(2) of the Directive which permitted the relevant products to be "subject to other indirect taxes for specific purposes". The ECJ eventually decided that Article 3(2) did not justify the omission of the exemption and the tax was abolished by the Danish tax authorities in 2002.

97. *Danfoss* was a claim by a company which purchased lubricating oil from Danish suppliers between 1995 and 2001 and paid duty on the supplies it received. The suppliers, as the taxable party, accounted for the duty to the Danish revenue authorities. After it had been established that the tax ought never to have been imposed on the supplies in question, Danfoss sought reimbursement of the duty and compensation directly from the State of Denmark. The claim was rejected on the basis that only the supplier as the taxable party could make a claim for reimbursement of the tax. The suppliers, who had passed the economic burden of the tax to Danfoss and their other customers, could have taken but did not take any steps to recover the tax for their benefit.

98. The question referred by the Danish court to the ECJ was:

> "1. Does Community law preclude a Member State from rejecting a claim for reimbursement brought by an undertaking to which excise duty imposed contrary to a directive has been passed on, where such rejection – in circumstances such as those of the present case – is on the ground that it is not the undertaking that paid the duty to the State?"

99. The Court answered that question as follows:

> "19. By its first question, the national court asks the Court of Justice, in essence, whether a Member State may oppose a claim for reimbursement brought by an operator to whom the amount of the duty unduly paid has been passed on, on the ground that he is not the person liable for payment of that duty and has therefore not paid out the corresponding amount to the tax authorities.
>
> 20. In order to answer that question, it should first be borne in mind that the right to a refund of charges levied in a Member State in breach of the rules of EU law is the consequence and complement of the rights conferred on individuals by the

provisions of EU law prohibiting such charges. The Member State is therefore required in principle to repay charges levied in breach of EU law (see Case 199/82 *San Giorgio* [1983] ECR 3595, paragraph 12; Case C-264/08 *Direct Parcel Distribution Belgium* [2010] ECR I-731, paragraph 45; and Case C-398/09 *Lady & Kid and Others*, [2011] ECR I-0000, paragraph 17).

21. However, by way of exception to the principle of the reimbursement of charges incompatible with EU law, the repayment of duties wrongly levied can be refused only where repayment would entail unjust enrichment of the persons concerned, that is to say, where it is established that the person required to pay such charges has actually passed them on to the purchaser directly (see, to that effect, *Lady & Kid and Others*, paragraphs 18 and 20).

22. In such circumstances, the burden of the charge levied but not due has been borne not by the taxable person, but by the purchaser to whom the cost has been passed on. Accordingly, to repay the taxable person the amount of the charge already collected from the purchaser would be tantamount to paying him twice over, which may be described as unjust enrichment, whilst in no way remedying the consequences for the purchaser of the illegality of the charge (Joined Cases C-192/95 to C-218/95 *Comateb and Others* [1997] ECR I-165, paragraph 22, and *Lady & Kid and Others*, paragraph 19).

23. It appears from this that the right to the recovery of sums unduly paid helps to offset the consequences of the duty's incompatibility with EU law by neutralising the economic burden which that duty has unduly imposed on the operator who, in the final analysis, has actually borne it.

24. That said, it should also be noted that, in accordance with settled case-law, in the absence of EU rules governing claims for the repayment of taxes, it is for the domestic legal system of each Member State to lay down the conditions under which those claims may be made; subject, nevertheless, to observance of the principles of equivalence and effectiveness (see Case C-291/03 *MyTravel* [2005] ECR I-8477, paragraph 17, and Case C-35/05 *Reemtsma Cigarettenfabriken* [2007] ECR I-2425, paragraph 37).

25. In that regard, given the purpose of the right to the recovery of sums unduly paid, as recalled in paragraph 23 above, observance of the principle of effectiveness requires that the conditions under which an action may be brought for recovery of sums unduly paid be fixed by the Member States, pursuant to the principle of procedural autonomy, in such a way that the economic burden of the duty unduly paid can be neutralised.

> 26. From that perspective, it has been held that, if the final consumer is able, on the basis of national law, to obtain reimbursement through the taxable person of the amount of the charge passed on to him, that taxable person must in turn be able to obtain reimbursement from the national authorities (see *Comateb and Others*, paragraph 24). In the same way, a national legal system which allows the supplier who has paid VAT to the tax authorities in error to seek reimbursement, and which allows the recipient of the services to bring a civil law action against that supplier for recovery of the sums paid but not due observes the principle of effectiveness, as that system enables the recipient who bore the tax invoiced in error to obtain reimbursement of the sums unduly paid (see *Reemtsma Cigarettenfabriken*, paragraph 39).
>
> 27. It follows that a Member State may, in principle, oppose a claim for the reimbursement of a duty unduly paid made by the final consumer to whom that duty has been passed on, on the ground that it is not that consumer who has paid the duty to the tax authorities, provided that the consumer – who, in the final analysis, bears the burden of that duty – is able, on the basis of national law, to bring a civil action against the taxable person for recovery of the sums unduly paid.
>
> 28. However, if reimbursement by the taxable person were to prove impossible or excessively difficult – in particular, in the case of the insolvency of that person – the principle of effectiveness requires that the purchaser be able to bring his claim for reimbursement against the tax authorities directly and that, to that end, the Member State must provide the necessary instruments and detailed procedural rules (see *Reemtsma Cigarettenfabriken*, paragraph 41).
>
> 29. Accordingly, the answer to Question 1 is that a Member State may oppose a claim for reimbursement of a duty unduly paid, brought by the purchaser to whom that duty has been passed on, on the ground that it is not the purchaser who has paid the duty to the tax authorities, provided that the purchaser is able, on the basis of national law, to bring a civil action against the taxable person for recovery of the sum unduly paid and provided that the reimbursement, by that taxable person, of the duty unduly paid is not virtually impossible or excessively difficult."

100. The importance of *Danfoss* lies in what the ECJ has said about the nature of the end consumer's rights to seek direct reimbursement of the overpaid tax and the scope of the *San Giorgio* principle. The claimants' case is that paragraph [20] of *Danfoss* makes it clear that the right to seek recovery of the tax should be co-extensive with the obligation of the Member State which is required in principle to repay charges unlawfully levied. The domestic remedies will be inadequate to achieve this unless they neutralise the economic burden of the duty paid: see paragraph [25]. The focus

of the principle of effectiveness is therefore upon the financial impact of the tax on the end consumer which, in the present case, is the £100 and not merely the £75 which the supplier accounted for to HMRC. Although the state's obligation to secure the repayment of the tax can be satisfied by a two-stage process as in *Reemtsma* under which any shortfall is recovered by a civil action against the suppliers, that, the claimants say, will only be an effective discharge of the repayment obligation if it can achieve recovery of the whole of the tax unduly paid.

101. The judge thought that the application of this guidance to the present case resulted in a claim under EU law for the whole of the £100:

> "134. As I have already indicated, I can see no good reason to confine the concept of impossibility or excessive difficulty to insolvency of the Managers, or to similar external causes which impact on their financial ability to meet otherwise valid claims against them. From the perspective of the claimants, the amount for which they are prima facie entitled to claim reimbursement is the full amount of the unlawful VAT which they paid to the Managers, i.e. the £100. The fact that the Managers may be able to recover only £75 from HMRC has no bearing on the fact that the amount actually paid by the claimants was the full £100. That is also the amount, as I have held, by which HMRC have been unjustly enriched at the claimants' expense. Thus, to the extent that the claimants are unable to recover the £100 from the Managers, it seems to me to follow that reimbursement of the claimants by the Managers has, as a matter of fact, proved impossible. I conclude, therefore, that the principle of effectiveness is at least potentially engaged in the claimants' favour."

102. Recovery of the £75 had been achieved for the uncapped periods through the s.80 recoveries which had been passed on to the investment trusts. But for the dead period these were defeated by the s.80(4) limitation period. That difficulty has been removed by the direct remedy in restitution available to the claimants against HMRC under domestic law. The more difficult question, as the judge recognised, was whether the principle of effectiveness as characterised in *Danfoss* enabled the claimants to recover the £25 which they had paid to the Managers but which had been retained by them in satisfaction of their claim to deduct input tax in respect of their own suppliers.

103. The original evidence before the judge was that the Managers would have passed on to the claimants the amount of their input tax in the form of higher prices had their own output supplies between treated as exempt. They would therefore have had a change of position defence to any claim in restitution against them by the investment trusts either because the £25 was deductible as input tax or because the Managers had (by reason of the failure properly to implement Article 13B(d)(b)) lost the opportunity of increasing the price of their supplies to compensate them for their inability to recover the input tax. Shortly before the hearing, this evidence changed to an acceptance that the Managers would not have sought to pass on the £25 to the claimants in the form of increased prices had their own supplies always been treated as exempt. But the judge held that this made no difference:

> "138. Mr Rabinowitz's answer to this submission was briefly as follows. He accepted that the claimants had a prima facie restitution claim against the Managers on the basis of mistake. He also accepted that Mr Swift's analysis might have force if the £25 had always stayed with the Managers, and if HMRC had never been enriched by the £25. But, he said, HMRC were in fact enriched by the full £100, for all of which the Managers had duly accounted to HMRC, even though the payments which they actually made were of the net amounts of £75. Accordingly, the Managers had a good change of position defence in relation to the full £100, and any attempt by the claimants to recover the £25 from the Managers would fail.
>
> 139. I accept the argument for the claimants on this point. It seems to me that the Managers changed their position in relation to the entirety of the £100 when they accounted for it as output tax in their quarterly VAT returns. The fact that they also received credit for the associated input tax does not in my judgment alter the position. The receipt of the credit was simply a consequence of the operation of the VAT rules which everybody was operating on the mistaken assumption that the investment management services were not exempt. Nor do I consider it relevant to enquire what the Managers would have done in the hypothetical situation where it was known to all concerned that the services were in fact exempt, not least because in that event there would have been no payment of £100 by the investment trusts in the first place, and the question of recovering it from the Managers would therefore not have arisen."

104. For the reasons explained earlier in this judgment, Henderson J was, we consider, wrong to treat HMRC as enriched by the entire £100 on the basis that the £25 retained by the Managers satisfied an outstanding and relevant obligation to give credit for input tax. Nor was he entitled to treat the Managers as having a realistic change of position defence. Their s.80 claim for the £75 reversed the tax treatment of the £25 and made their retention of that sum as against the investment trusts impermissible. Since the recent evidence before the judge removed the alternative way in which a change of position defence could have been asserted, the repayment by HMRC to the investment trusts of the full £100 would in a real sense unjustly enrich the Managers who would be relieved of their liability to account for the £25 to the claimants but would have no liability to account for the sum to HMRC.

105. In these circumstances, it is not necessary to decide whether the *San Giorgio* principle in its application to indirect taxes such as VAT imposes on the relevant authorities a liability to account for the full amount of the tax paid by the ultimate consumer regardless of how much of that sum is properly to be regarded as due to the revenue on the correct tax treatment of the relevant transaction. Our provisional view is that there is much to be said for the view that the same principles should govern the position under EU law as determine the extent of the unjust enrichment under domestic law. In both cases the Court should have regard to the position not only at

the time when the tax was paid but also having regard to the consequences of reversing the tax position. On this basis the end consumer can have no greater right of recovery against HMRC than the accounting party itself. The £25 is therefore recoverable against the Managers alone. This is consistent with the principle that the repayment of the overpaid tax is to be effected through the machinery provided by the Member State which must include its own application of the VAT rules. The point was not directly in issue in *Danfoss* but there is nothing in the judgment of the ECJ which in our view contradicts it.

106. In the end, however, one reaches the same conclusion even if the wider principle of recovery is the correct one to be applied. The *San Giorgio* claims of the investment trusts for the recovery of the full £100 are capable in this case of being satisfied by a combination of their successful claims against HMRC for the £75 and a domestic law claim against the Managers for the £25 to which they would have had no change of position defence on either of the grounds relied on before the judge. This method of neutralising the economic burden on the claimants of having paid the VAT cannot be regarded as either virtually impossible or excessively difficult which is the *Danfoss* test. The claim to recover the £25 for any of the relevant accounting periods therefore fails and it is unnecessary for us to consider either the correctness of the judge's exclusion of some of the claims by the imposition of a limitation period analogous to s.80(4) or the remedial issues discussed in his second judgment.

107. The appeal can therefore be resolved by the application of established EU law principles and there is no need for any reference of these questions to the ECJ.

Conclusion

108. We therefore allow the appeal of HMRC against the judge's order for the payment of the £25 but also allow the appeal of the claimants against the judge's construction of s.80(7). Subject to adjustment in the case of Kleinwort Trust, the result is that the claimants are entitled to recover the £75 for all of the accounting periods in question but the £25 for none of them.

Crown copyright©

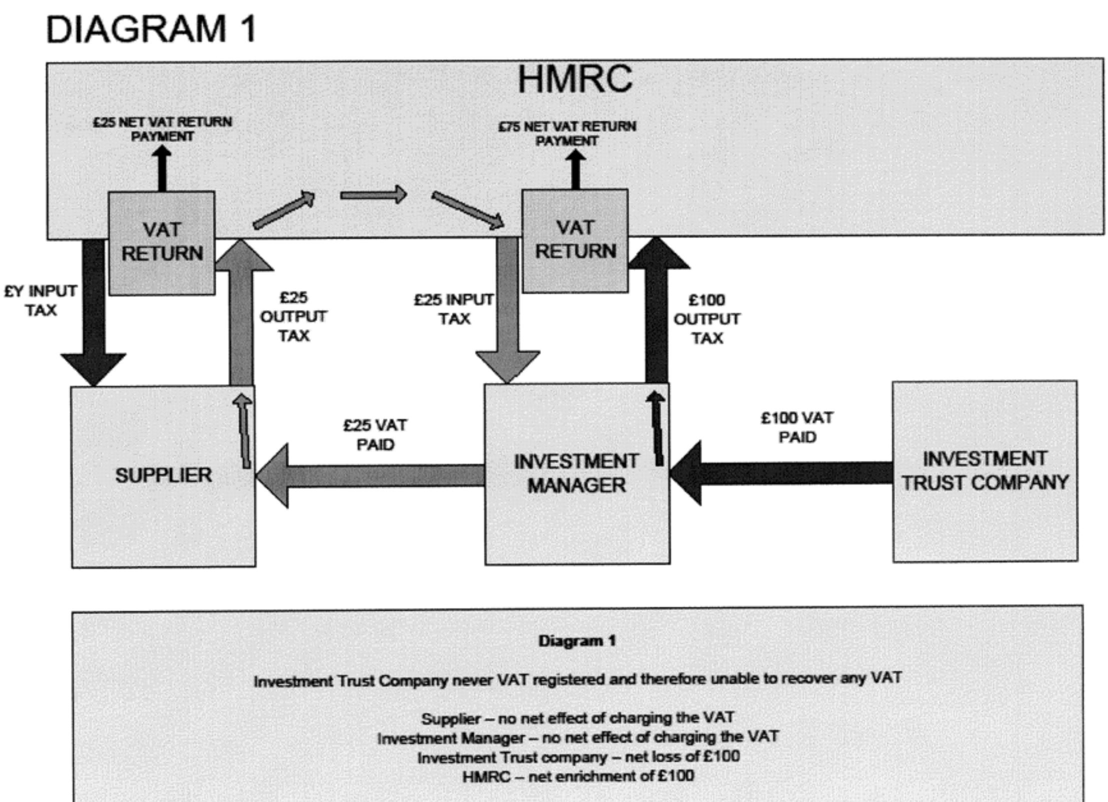
DIAGRAM 1
HMRC
£25 NET VAT RETURN PAYMENT
VAT RETURN
£75 NET VAT RETURN PAYMENT
VAT RETURN
£Y INPUT TAX
£25 OUTPUT TAX
£25 INPUT TAX
£100 OUTPUT TAX
SUPPLIER
£25 VAT PAID
INVESTMENT MANAGER
£100 VAT PAID
INVESTMENT TRUST COMPANY
Diagram 1
Investment Trust Company never VAT registered and therefore unable to recover any VAT
Supplier – no net effect of charging the VAT
Investment Manager – no net effect of charging the VAT
Investment Trust company – net loss of £100
HMRC – net enrichment of £100

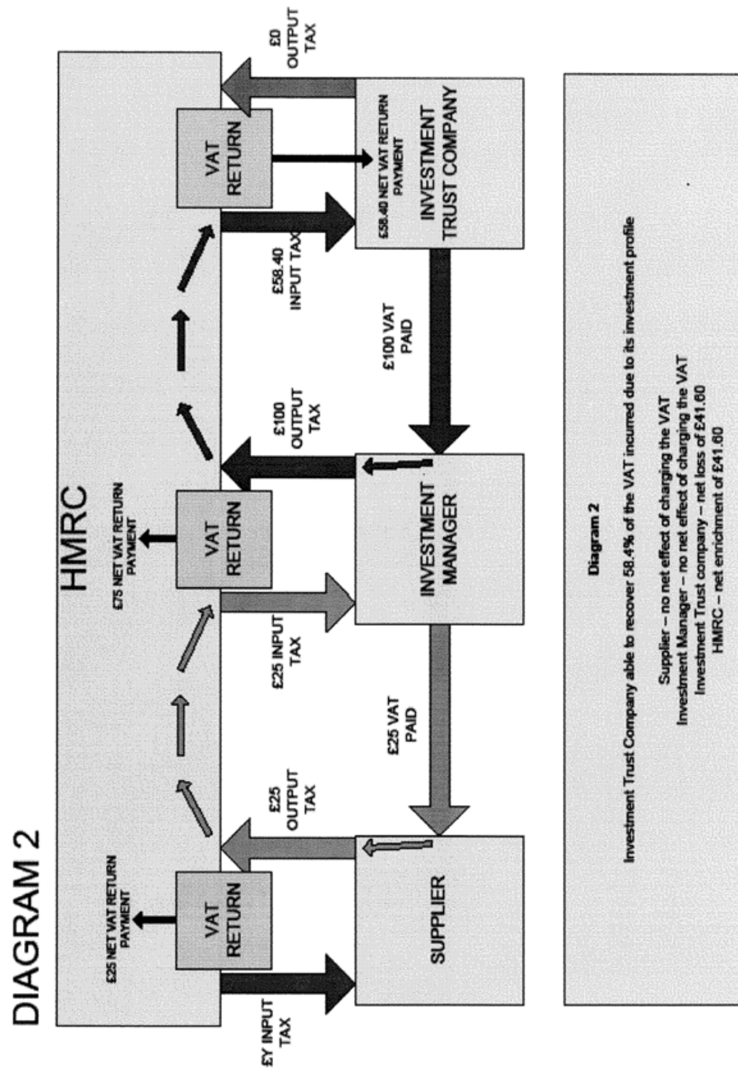
DIAGRAM 2
HMRC
£25 NET VAT RETURN PAYMENT
VAT RETURN
£75 NET VAT RETURN PAYMENT
VAT RETURN
VAT RETURN
£58.40 NET VAT RETURN PAYMENT
£Y INPUT TAX
£25 OUTPUT TAX
£25 INPUT TAX
£100 OUTPUT TAX
£58.40 INPUT TAX
£0 OUTPUT TAX
SUPPLIER
£25 VAT PAID
INVESTMENT MANAGER
£100 VAT PAID
INVESTMENT TRUST COMPANY
Diagram 2
Investment Trust Company able to recover 58.4% of the VAT incurred due to its investment profile
Supplier – no net effect of charging the VAT
Investment Manager – no net effect of charging the VAT
Investment Trust company – net loss of £41.60
HMRC – net enrichment of £41.60