**[2017] UKUT 211 (TCC)**

**Appeal number: UT/2015/0051**

***VAT — repayment of output tax accounted for but not properly due — repayment falling into recipient's profit — Shop Direct — whether profit so derived within scope of corporation tax — yes — appeal dismissed***

**UPPER TRIBUNAL**
**TAX AND CHANCERY CHAMBER**

**COIN-A-DRINK LIMITED** **Appellant**

**- and –**

**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS** **Respondents**

**Tribunal: Hon Mr Justice Mann**
**Judge Colin Bishopp**

**Sitting in public in London on 8 May 2017**

**David Southern QC and Denis Edwards, counsel, instructed by BDO LLP, for the Appellant**

**Rupert Baldry QC, Elizabeth Wilson and Nicholas Saunders, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

1. The appellant, Coin-a-Drink Limited ("CAD"), supplies food and drinks to retail customers by means of vending machines. Between 1973 and 1984, it accounted to the respondents, HMRC, or their predecessors for VAT at the standard rate on sales made in that manner. It was later recognised that the supplies should have been treated as zero-rated, and CAD made a claim for repayment of the output tax for which it had incorrectly accounted, amounting to £411,230. HMRC agreed that the claim was justified, and made the repayment in September 2009. In addition HMRC paid statutory interest, pursuant to s 78 of the Value Added Tax Act 1994 ("VATA"), amounting to £949,452.

2. CAD recognised the payments it had received in its profit and loss account for the period to 31 July 2010, describing each of the receipts as "other income" and showing them below operating profit. It treated both sums as non-taxable when it submitted its corporation tax return and computations for the period. HMRC opened an enquiry into the return and in January 2013 issued a closure notice amending the return by bringing both of the sums received into taxable profit.

3. In May 2013, having exhausted the review process, CAD appealed to the First-tier Tribunal ("the F-tT") against the conclusions of the closure notice. Its appeal was heard in November 2014 by Judge Poole and Ms Ruth Watts Davies, who released a decision in October 2015 by which they dismissed the appeal, finding that both payments were taxable. With the permission of Judge Poole CAD now appeals to this tribunal against the F-tT's finding that the repayment of VAT is subject to corporation tax; it does not seek to challenge the conclusion relating to the taxability of the interest.

4. The legislative provision pursuant to which the repayment claim was made (or, at least, the provision pursuant to which HMRC say it was made) was s 80 of VATA which, so far as material to this decision, and as it was in force at the relevant time, is as follows:

> "(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.…

> (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."

5. In *Shop Direct Group v Revenue and Customs Commissioners* [2016] UKSC 7, [2016] 1 WLR 733 the Supreme Court decided that a repayment of overpaid output tax ordinarily falls into taxable profit in the year of receipt. The circumstances of that case and this differ in several respects, but Mr David Southern QC, appearing before us with Mr Denis Edwards for CAD, did not argue that those differences enable us to distinguish *Shop Direct*. Rather, their argument is that the Supreme Court, and before it the Court of Appeal, this tribunal and the First-tier Tribunal, were not asked to consider the character of what was received. It was not, they say, a simple repayment within s 80, but represented the satisfaction of CAD's free-standing European law right to restitution in accordance with the principles set out by the European Court of Justice ("the ECJ") in Case 199/82 *Amministrazione delle Finanze dello Stato v SpA San Giorgio* [1983] ECR 3595. That principle was applied by the Court of Justice of the European Union ("the CJEU") in Case C-591/10 *Littlewoods Retail Ltd v Revenue and Customs Commissioners* [2102] STC 1714, in which the court decided that the state must repay, with interest, all sums levied in breach of European law rules, as the output tax in issue in this case was. It follows that the state cannot make a payment of restitution, and then take part of it back by means of taxation; a person in the position of CAD is entitled to receive and retain 100% of the amount paid. Anything less undermines the European law requirement of an effective remedy.

6. The F-tT fell into error, CAD says, in its conclusion at [46] that what CAD received was a straightforward repayment within the scope of s 80. It was misled by the comparison it drew between an output tax reclaim such as that made by CAD and the direct tax cases, in which there is no statutory scheme and a taxpayer seeking repayment is perforce driven to a restitutionary claim. That comparison led the F-tT to the wrong conclusion that, because in this case there was a statutory scheme, there was no place for a claim in restitution. Subsection (7), as Mr Southern accepts, provides that s 80 contains an exhaustive code governing the repayment of overpaid output tax, but, he says, that can only be the case so far as domestic law is concerned. It cannot operate to override or exclude a right conferred by European law; thus although s 80 may implement a European law right to a repayment, it cannot change the character of that right. The F-tT was, therefore, also wrong to reject, at [57], CAD's argument that the repayment was not one governed by s 80 and, with it, the argument that the conclusion in *Shop Direct* is of no application to this case.

7. The F-tT was also wrong, CAD argues, to take into account in its reasoning the fact, as it assumed, that if CAD had not paid the excess output tax to HMRC an equivalent amount would have fallen instead into taxable profit. The assumption was wrong: there was no evidence at all before the F-tT about what CAD would have done had it realised at the time that its supplies were zero-rated. It could not therefore be correct to say, as the F-tT did at [64], that HMRC "has finally obtained the corporation tax which would in any event have been accounted for at an earlier time if the original overpayment had never been made". European law affords a trader in CAD's position an absolute right to recover tax which it should not have been required to pay, and that right cannot be cut down by an assumption, based on nothing more than speculation, about what the position might have been if the payment had not been made. Both *San*

*Giorgio* and *Littlewoods* make it clear that if the excess payment was 100, the amount to be repaid is 100 (plus interest); a payment of 75, whether the reduction is effected by simple deduction or by taxation, does not satisfy that requirement.

8. In addition, as Lord Hope explained in *Sempra Metals Ltd v IRC* [2007] UKHL 34, [2007] STC 1559 at [28], where he drew with approval on the 1998 work of Professor Peter Birks in *Restitution, Past, Present and Future, Essays in Honour of Gareth Jones*, "… the remedy of restitution differs from that of damages. It is the gain that needs to be measured, not the loss to the claimant. The gain needs to be reversed if the claimant is to make good his remedy … in the context of unjust enrichment the everyday meaning of 'restitution' is stretched so that it reaches all givings up, with no hint of a restriction on giving back." What HMRC are trying to do here, CAD says, is to restrict the scale of the repayment by the back door, by imposing tax on it. The reason there was no evidence before the F-tT about what CAD would, or might, have done had it not been required to account to HMRC for the impugned output tax was that it was an irrelevant consideration; CAD was entitled to the repayment of the entire sum regardless of what its past actions might have been. Even s 80 is consistent with that proposition: HMRC are obliged to credit the taxpayer with the tax overpaid, not some part of it.

9. Mr Southern accepts that the repayment was made, in full, and that only later was a tax charge imposed but that sequence, he says, is immaterial because the taxation of the receipt has the same economic effect as the retention of a proportion of a repayment before it is handed over, when it is the state which is both paying and taxing. We asked Mr Southern in the course of argument what would be his position if it was, for example, a bank making a restitutionary payment and the state imposing tax on the resulting profit, and he agreed that the position would be different because of what was said by Lord Reed in *Investment Trust Companies v Revenue and Customs Commissioners* [2017] UKSC 29, [2017] 2 WLR 1200 at [71], to the effect that in a tripartite situation such as we postulated two transfers (of restitution and tax) cannot be collapsed into one.

10. We were a little surprised when Mr Edwards later submitted, by reference to an observation of the ECJ in Case C-271/91 *Marshall v Southampton and South West Hampshire Area Health Authority (No 2)* [1993] ECR I-4400, that European law would nevertheless prevent the state from taxing a restitutionary payment. The question in *Marshall* was whether a cap on awards of compensation for discrimination in employment, made by what were then the Industrial Tribunals, must be disapplied when the respondent to the claim was an organ of the state. In deciding that it must, the court observed, at [24],

> "… the objective is to arrive at real equality of opportunity and cannot therefore be attained in the absence of measures appropriate to restore such equality when it has not been observed. As the Court stated in paragraph 23 of the judgment in [Case 14/83 *Von Cohort and Kamann v Land Nordrhein-Westfalen* [1984] ECR 1891], those measures must be such as to guarantee real and effective judicial protection and have a real deterrent effect on the employer."

11. The relevance of that observation to this case, CAD argues, is that if HMRC were permitted to tax the repayment the judicial protection and real deterrent effect to which the court referred would be undermined, and a taxpayer in the position of CAD would be deprived of an effective remedy.

12. HMRC's response, which we take from the skeleton argument of Mr Rupert Baldry QC, leading Miss Elizabeth Wilson and Mr Nicholas Saunders, since we did not think it necessary to hear oral argument from them, is essentially very simple. It is that CAD has had its restitutionary payment, in full; such a payment, as the Supreme Court decided in *Shop Direct*, must be brought into profit as a trading receipt in the year of receipt; and there is no basis, in the law of restitution, in UK domestic law or in European law, on which it can be said that a profit so derived must be insulated from tax. CAD's *San Giorgio* right has been satisfied, with the consequence that profit of which it was deprived at the time the overpayments were made and on which it did not bear tax at the time has now been received and has been taxed, in accordance with the ordinary law, as the trading receipt the repayment is. In that context it makes no difference whether the repayment is received as the result of a s 80 claim or for some other reason.

13. There is no doubt, HMRC say, that CAD had a *San Giorgio* right to repayment of the overpaid output tax, and that it is entitled to interest in addition, as the CJEU decided in *Littlewoods*. In both of those cases the court made it clear that, in the absence of a European law mechanism for the making of repayments, and there is none, the payment must be made in accordance with national rules. In *San Giorgio*, at [12], the court observed 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", and there are remarks to similar effect in *Littlewoods* at [27]. The only limitation, as the court put it in *Littlewoods*, is that any conditions imposed by national law

> "must comply with the principles of equivalence and effectiveness; that is to say that they must not be less favourable than those concerning similar claims based on provisions of national law or arranged in such a way as to make the exercise of rights conferred by the EU legal order practically impossible."

14. Although CAD might have sought repayment by invoking other causes of action it did not need to do so because UK national law provides an adequate remedy in s 80. The requirement of s 80(7) that a claim for repayment of overpaid output tax must be made by that means cannot offend European law by making it "practically impossible" or, as it has been put in other cases, "excessively difficult" to pursue such a claim: CAD has done so, and it has received full repayment. It therefore had, and has exercised, an effective remedy, a remedy which also satisfies the principle of equivalence because it does not discriminate between claims based on European and domestic law. It is simply not possible to say that there is any conflict or inconsistency between the European law requirements and s 80, and correspondingly no reason why CAD's claim should be regarded as one made otherwise than in accordance with s 80. The F-tT's conclusion to that effect could not be faulted.

15. CAD's argument, HMRC say, is based on a false premise. There is no tax charge on the repayment, which CAD has received in full. What is subject to tax is the profit to which the receipt has given rise, but European law has nothing to say, relevant here, about the taxation of corporate profits, which is exclusively the province of national law. The imposition of tax on a profit which a company has recognised in its GAAP-compliant accounts is in complete accordance with UK law, and such tax cannot be characterised as a deduction from the repayment as CAD seeks to do. If CAD had brought the VAT into account at the time, rather than pay it to HMRC, it would have

represented a taxable profit. If CAD were right, and the repayment was not taxable, it would be placed in a better position, for which there is no discernible justification. It is no answer to say that, rather than increase its profit, CAD might instead have reduced its prices; not only is there no evidence of what it might have done, the relevant comparison is of like with like.

16. In our judgment HMRC's submissions are correct. We agree, in particular, that the primary flaw in CAD's argument is that it is attempting to treat tax on profits as if it was a deduction from the repayment. We do not consider that it is possible to do so. The profits, whatever their derivation, shown in CAD's accounts are taxable because they are profits. The accounts themselves recognised them as profits, again because that is what they were. There are special rules for certain sources of profits, such as those derived from loan relationships, but no special rule applies to the profit to which the repayment in this case led. It follows that the incidence of tax is determined by the ordinary corporation tax rules, and the fact that part of the profit taxed is derived from a VAT repayment is an equally ordinary consequence of the application of those rules. There is nothing in *San Giorgio*, *Littlewoods* or any of the other authorities to which Mr Southern and Mr Edwards took us which supports the proposition that the taxation rules must be disapplied when a restitutionary payment leads to a profit recognised in the recipient's trading accounts.

17. We are satisfied that the F-tT came to the correct answer for the correct reasons. The appeal is therefore dismissed.

**Hon Mr Justice Mann  Judge Colin Bishopp**

**Upper Tribunal Judges**
**Release date: 31 May 2017**