

HMRC loses unjust enrichment case

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In a case which is important to all taxpayers seeking to recover VAT overpaid to HM Revenue & Customs (HMRC), the Court of Appeal has found against HMRC and held that the taxpayer would not be unjustly enriched by repayment of output tax it had paid on supplies that should have been exempt from VAT.

The judgment makes it clear that there is a substantial burden of proof on HMRC before an unjust enrichment defence will be upheld. This decision is good news for taxpayers as it limits the extent to which HMRC can defend claims submitted by taxpayers for the repayment of overpaid output tax, for example three-year cap claims, on the grounds of unjust enrichment. This decision will also be of interest to taxpayers who have made claims that have been rejected by HMRC on the grounds of unjust enrichment in the past.

Background

The taxpayer submitted a claim to recover output tax of £5.8 million that it had charged on debt management services that were subsequently found to be exempt. Customs & Excise (as they then were) rejected the entire claim on the grounds that to repay the claim would unjustly enrich the taxpayer.

The High Court, overturning the decision of the Tribunal, held that repayment would not unjustly enrich the taxpayer but agreed to remit certain aspects of the case back to the Tribunal. The Court of Appeal has now held in favour of the taxpayer and refused to remit the case back to the Tribunal for its further consideration.

Case analysis

In reaching its conclusion, the Court relied on prior European Court of Justice case law findings that:

- Member States may not make it impossible or excessively difficult for taxpayers to recover taxes unduly levied;
- while the defence of unjust enrichment is permitted by EU law, the burden of proof to show that a taxpayer is unjustly enriched lies with the tax authorities;
- the mere fact that a taxpayer has ‘passed on’ a charge to a consumer is not
- sufficient to show that he would be unjustly enriched by repayment of any tax passed on; and
- it was necessary to undertake a proper economic analysis of the facts to show that any repayment would unjustly enrich the taxpayer.

The Court concluded that HMRC could not succeed in its case because it had not adduced sufficient evidence to show that the tax was in fact passed on in whole or in part by the taxpayer to its customers.

Key implications

The case will be of interest to taxpayers who:

- have not lodged a claim because they assumed unjust enrichment would apply;
- have had claims rejected in the past because of unjust enrichment;
- are in the process of lodging claims for overpaid output tax, for example a claim made on the basis that the three-year cap is invalid; or
- are lodging claims following recent ECJ case law, e.g the finding that fund management is exempt for VAT purposes.

The Court of Appeal judgment makes it clear that HMRC has a double burden of proof. First, it must prove that any tax has been passed on and, if so, the extent to which it has been passed on. Second, it must prove that repayment would unjustly enrich the taxpayer. Further, HMRC must also adduce evidence to prove both.

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What should you do now?

Taxpayers who have paid tax unduly and had claims rejected by HMRC in the past on the grounds of unjust enrichment need to consider whether HMRC had evidence to show that they would have been unjustly enriched. It may be possible for these taxpayers to seek recovery of the tax paid by making a claim to HMRC or lodging an appeal out of time. It should be noted that the determination of whether such an appeal is allowed is at the discretion of the Tribunal.

Taxpayers who have not lodged a claim for overpaid output tax because they assumed the defence of unjust enrichment will apply should consider lodging a claim with HMRC. Taxpayers may have decided not to make a claim for repayment of VAT because the effect of the provisions of VATA 1994, s.80 would have been to require the taxpayer to make arrangements to reimburse customers. This case suggests that such arrangements may not be valid and a claim might therefore be possible, subject to time limits.

For the future, taxpayers seeking recovery of any tax should remember that in order to defend such a claim HMRC must prove that the taxpayer would be unjustly enriched. Arguably, proof must be obtained by HMRC before a claim is refused as a claim should not be rejected, and the rejection then justified, by evidence adduced in retrospect.

In addition, it should be noted that the defence of unjust enrichment can be raised by HMRC in relation to other indirect taxes e.g. insurance premium tax and landfill tax.

Further issues

HMRC might raise the defence of unjust enrichment if the Courts eventually reject the validity of the three-year cap and the validity of the self-imposed transitional period. This decision will therefore be of relevance to all parties presently involved in related three-year cap litigation with HMRC.

HMRC have been refused leave to appeal this decision to the House of Lords and that the taxpayer's claim for compound interest on the sum to be repaid is to be considered by the Court.