

Unjust enrichment

House of Lords Decision Marks & Spencer

The House of Lords has released its decision in the M&S 'teacakes' case. The case relates to overpaid output VAT on zero rated teacakes and looked at the taxpayer's rights under European Law to rely on domestic zero-rating and HMRC's unequal application of the unjust enrichment defence before May 2005.

Background

HMRC had always considered that M&S's chocolate covered teacakes were biscuits and not cakes and were therefore standard rated. In 1994, HMRC accepted they had made an error and that the teacakes were in fact zero rated. Following initial litigation, HMRC accepted the claim should not be time barred but continued to limit the £3.5 million repayment to just 10 percent of the claim on the grounds of 'unjust enrichment'.

After going through the domestic courts the House of Lords referred the case to the European Court of Justice (ECJ). The questions essentially asked whether a taxpayer has a direct Community right or rights under general Community principles to zero rate and, if so, whether the UK's unjust enrichment provisions at the time were contrary to the Directive. This difference in treatment was between payment and repayment traders prior to 26 May 2005. Before this date claims made under s80 VATA were subject to the defence of unjust enrichment only in respect of claims for 'repayment' of output VAT overpaid. A repayment trader making an output tax claim did not at that time come within the terms of the unjust enrichment provisions of section 80 as their claim would be for credit of output tax over-declared but not overpaid as repayment traders do not pay any VAT to HMRC. The ECJ responded that whilst there is no directly enforceable Community law right to zero rating as it is a derogation, such derogations do not extend to removing claims for VAT mistakenly accounted for on zero rated supplies entirely from the scope of the Directive, and the principle of fiscal neutrality provides a right for taxpayers to recover such sums mistakenly charged.

In terms of unjust enrichment the ECJ looked at two principles. Firstly the Court responded that, although unjust enrichment is a valid defence, it was contrary to the principle of fiscal neutrality to apply unjust enrichment to a payment trader but not a repayment trader, where they have marketed similar goods. With regards to the principle of equal treatment, which appeared to be broader in scope, this required that similar situations should not be treated differently unless differentiation is objectively justified. The Court indicated that the blanket difference in treatment between similar claims by payment and repayment traders was not objectively justified. The ECJ left it for the national court to determine whether these principles had been contravened.

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Held

Given the ECJ Judgment came out in April last year the return of the case to the House of Lords suggested we would see the national court's interpretation and views. However HMRC have decided not to pursue the case and have repaid the claim. The House therefore allowed M&S's appeal with minimal comment. It is not clear as to why HMRC waited so long to decide not to pursue the case. Certainly the decision indicates that they thought they would lose this case as soon as the ECJ had given its views.

Why is this important?

HMRC's withdrawal leaves us in the same position as we were post the ECJ decision in that HMRC may not be able to apply the defence of unjust enrichment to any claim for overpaid output VAT by a payment trader made before 26 May 2005. Consequently, where such a claim still remains open, HMRC should now repay the claim subject to verification. Where a claim was made, rejected, or settled in part, but not appealed, and is hence closed, taxpayers can still seek repayment on the basis that HMRC should be required to revisit the claim on the basis of the decision in M&S. UK legislation contains a valid three year time limit for claims thereby blocking fresh claims being submitted for periods over three years old. Also the discrimination point has been dealt with as regards to claims made after the 2005 law change, so our law is now EU compliant in this area. This would suggest that the potential for revisiting blocked claims is limited to those claims which have already been lodged with HMRC before May 2005 but if you are affected by this case please contact 4 Eyes Ltd to discuss your options.