Lexis®PSL **Tax**

Overpaid direct tax and restitution

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This Practice Note looks at the position where a person has overpaid tax (ie paid an amount by way of tax where tax was not due) and their rights to recover that amount under statute, common law and EU law.

This Practice Note only looks at overpaid direct tax.

For a taxable person's rights to recover overpaid VAT, see Practice Note: VAT overpayments and under-deductions.

For the application of the law of restitution in the context of VAT, see Practice Note: VAT—restitution and interest.

The statutory regime—overpayment relief

The current statutory regime (overpayment relief) governing the recovery of overpaid tax was introduced on 1 April 2010, and applies to claims for recovery made on or after that date.
References:
FA 2009, s 100(2)
Schedule 1AB to the Taxes Management Act 1970 (TMA 1970) applies where the overpaid tax is income tax or capital gains tax.

Schedule 18, Part VI to the Finance Act 1998 (FA 1998) applies where the overpaid tax is corporation tax.

Where either set of provisions applies, the taxpayer may make a claim for repayment or discharge of the relevant amount.
References:
TMA 1970, Sch 1AB, para 1(2)
FA 1998, Sch 18, para 51(2)
There are, however, prescribed circumstances (or Cases) in which HMRC is not liable to give effect to the claim.
References:
TMA 1970, Sch 1AB, para 2

FA 1998, Sch 18, para 51A

The statutory regime is intended to be exclusive, restricting relief for overpaid tax to:

References:

TMA 1970, Sch 1AB, para 1(6)

FA 1998, Sch 18, para 51(6)

- the statutory regime (ie the regime laid down by TMA 1970, Sch 1AB, and FA 1998, Sch 18), and
- any other provision providing for relief in:
  - the Income Tax Acts (in relation to income tax)
  - any enactment relating to the taxation of capital gains (in relation to capital gains tax), and
  - the Corporation Tax Acts (in relation to corporation tax)

A claim must be made no more than four years after the end of the 'relevant tax year' (in relation to income tax or capital gains tax) or the 'relevant accounting period' (in relation to corporation tax).

References:

TMA 1970, Sch 1AB, para 3

FA 1998, Sch 18, para 51B

For more information on overpayment relief generally, see the Self-Assessment Claims Manual, SACM12000.

Where a taxpayer has overpaid tax, and there is a European element to their rights to recover the overpaid tax (eg where the tax has been levied in breach of EU law), how overpayment relief gives effect to those rights, and whether any statutory restriction on the application of the relief (eg by reference to the prescribed Cases) is effective, would need to be assessed by reference to EU law.

EU law

Where a taxpayer resident in a Member State has paid an amount by way of tax that has been levied in breach of EU law (eg in breach of a fundamental freedom), the taxpayer has a general right under EU law to recover that amount. These rights, sometimes known as *San Giorgio* rights after the CJEU case of that name, are a consequence of, and an adjunct to, the rights conferred under EU law.

References:

San Giorgio, Case C-199/82

The taxpayer is entitled to recover not only the tax levied in breach of EU law, but also any amounts paid to the Member State or retained by the Member State that relate directly to the tax, including any losses constituted by the relevant sums not being available to the taxpayer.

References:

Metallgesellschaft, Case C-397/98 and C-410/98

It follows from this that the Member State in question would be obliged to pay interest on amounts collected in breach of EU law.

References:

Littlewoods, Case C-591/10

Where there are no EU rules on how the overpaid tax is to be repaid, it is for the Member State to:

References:

Metallgesellschaft, Case C-397/98 and C-410/98

- designate the courts and tribunals, and
- lay down the detailed procedural rules

that would safeguard the taxpayer's rights.

Such rules include rules on how interest is to be paid; in particular, the applicable rate and the method of calculation (eg whether simple or compound).

References:

Littlewoods, Case C-591/10

The Member State does not, however, have unfettered autonomy in this respect, and must ensure that the relevant rules (whether in relation to overpaid tax or interest) comply with the European principles of equivalence and effectiveness.

References:

Rewe, Case C-33/76

The principle of equivalence requires that the rules governing a claim based on EU law must not be less favourable than those governing a domestic claim of a similar nature.

References:

Marks & Spencer, Case C-62/00

The principle of effectiveness requires that the rules must not render the exercise of rights conferred by EU law practically impossible or excessively difficult.

References:

Marks & Spencer, Case C-62/00

In particular, it requires that the rules in relation to interest must not be such as to deprive the taxpayer of an adequate indemnity for the loss in question.

References:

Littlewoods, Case C-591/10

These principles apply not only in the context of direct taxation, but more widely, including in relation to time limits and VAT. Although a Member State retains its sovereign rights in relation to certain areas (such as direct taxation), it is nevertheless bound by the treaties that form the constitutional basis of the EU to which it is a

signatory. Pursuant to the principle of sincere co-operation, it is required to take appropriate measures to:

References:

TEU, art 4

- ensure fulfilment of the obligations arising out of the treaties, and
- facilitate the achievement of the EU's tasks

and refrain from any measure that could jeopardise the attainment of the EU's objectives.

The principles of equivalence and effectiveness flow from the principle of co-operation and ensure that Member States do not circumvent their obligation under the treaties to safeguard rights under EU law by means of national measures that discriminate against the exercise of such rights.

For more information on fundamental freedoms generally, see Practice Note: Interaction of EU law and direct tax.

Overpayment relief forms part of the rules in the UK that govern the recovery of overpaid tax. The following must, therefore, comply with the principles of equivalence and effectiveness where the right of recovery derives from EU law:

- how the relief gives effect to that right
- any restriction on the application of the relief, and
- the exclusion of claims under common law (ie the provisions in the statutory regime to the effect that overpayment relief is an exclusive remedy)

EU law—Finance Act 2013, s 231

The significance of EU law is expressly acknowledged by the amendments to overpayment relief made by section 231 of the Finance Act 2013 (FA 2013).

References:

TMA 1970, Sch 1AB, para 2

FA 1998, Sch 18, Part VI

Under the rules applying both before and after FA 2013, HMRC is not liable to give effect to a claim for overpayment relief if or to the extent that the claim falls within a prescribed Case.

References:

TMA 1970, Sch 1AB, para 2

FA 1998, Sch 18, para 51A

Case G refers to where the overpayment results from generally prevailing practice, ie a mistake in the calculation of the relevant tax where that calculation was carried out in accordance with the practice generally prevailing at the relevant time.

References:

TMA 1970, Sch 1AB, para 2(8)

FA 1998, Sch 18, para 51A(8)

Case H refers to a similar scenario but applies only to PAYE assessments and calculations (which are excluded from Case G).

References:

TMA 1970, Sch 1AB, para 2(9)

The reference to generally prevailing practice echoes a similar reference in TMA 1970, s 33(2A) (TMA 1970, s 33 being the predecessor to overpayment relief).

The Supreme Court confirmed in *FII Group Litigation* that legislation that barred a claim on the ground of generally prevailing practice was inconsistent with EU law where that claim derived from EU law.

References:

Fantask, Case C-188/95

Test Claimants in the Franked Investment Income Group Litigation v IRC [2012] All ER (D) 188 (May)

This led to FA 2013, s 231, which added a provision to the overpayment relief regime to the effect that Cases G and H do not apply where the overpaid tax has been charged in breach of EU law.

References:

TMA 1970, Sch 1AB, paras 2(9A), (9B)

FA 1998, Sch 18, paras 51A(9), (10)

Common law—restitution

A taxpayer's rights to recover overpaid tax under common law remain relevant not only in relation to outstanding claims and claims that are under appeal, but also where overpayment relief does not apply or where any restriction on its application is disapplied on account of incompatibility with EU law.

For more information on the interaction between EU law and national law (such as conforming interpretation and disapplication), see Practice Note: Interaction of EU law and direct tax.

The relevant area of law here is the law of restitution, which is still developing, with a number of questions yet to be authoritatively decided by the courts.

References:

Westdeutsche Landesbank Girozentrale v Islington London Borough Council [1996] 2 All ER 961

Where a person is enriched at the expense of another (eg where the first person receives money from the second by mistake), and the enrichment is unjust, the law of restitution may be engaged to reverse the unjust enrichment.

To establish whether a claimant is entitled to restitution, the four key questions are as follows:

References:
Banque Financière de la Cité v Parc (Battersea) [1998] 1 All ER 737

- whether the defendant was enriched
- whether the enrichment was at the claimant's expense
- whether the enrichment was unjust, and
- if the defendant was unjustly enriched at the claimant's expense, whether there are any applicable defences the defendant could raise

Circumstances in which a defendant's enrichment may be unjust include where the enrichment results from:

- a mistake of fact
- a mistake of law
- duress
- undue influence
- an ultra vires demand by a public authority (such as a tax authority)
- discharge of a debt owed by the defendant, and
- receipt by the defendant of property belonging to the claimant

Defences the defendant may invoke include:

- change of position

References:
Lipkin Gorman v Karpnale [1992] 4 All ER 512

- estoppel, and

References:
Avon County Council v Howlett [1983] 1 All ER 1073

- passing on

References:
Marks & Spencer v HMRC [2005] All ER (D) 442 (Jul)

Change of position refers to the situation where the position of the defendant has changed in such a way that it would be inequitable to require them to make restitution.

Estoppel applies where the claimant made a representation of fact that led the defendant to believe they were entitled to retain the benefit in question.

Passing on refers to the situation where the claimant manages to offset their loss by (for example) increasing the prices they charge to their customers.

The aim of restitution is to reverse the benefit derived from, or to pay to the claimant the value of, the enrichment, and not to compensate the claimant for their loss. It is not about damages. Just as there would be unjust enrichment if the defendant paid nothing to the claimant, it would be equally unjust to award the claimant more than the benefit conferred on the defendant.

The question is what is the value of the benefit to the defendant—whether it is its objective use value or whether it should be valued by reference to its actual use.
References:
Littlewoods v HMRC [2015] EWCA Civ 515
The starting point is normally objective use value, but it is open to a defendant, particularly one who was an involuntary recipient of the benefit, to show that they do not value the benefit at all or that they value it at less than its market value (by application of the principle of subjective devaluation).
References:
Littlewoods v HMRC [2015] EWCA Civ 515
For more information on restitution generally, see: Restitution and unjust enrichment—overview (subscription to Lexis®PSL Dispute Resolution required), which in turn links to more detailed Practice Notes on this topic.

Restitution and direct tax

Until the 1990s, it was quite difficult for a person who had paid an amount to the government (including an amount paid to (what was then) the Inland Revenue by way of tax) to recover that amount where it subsequently transpired that amount was not due.

Woolwich

In *Woolwich*, the House of Lords recognised a new cause of action under the law of restitution founded on money having been paid pursuant to an unlawful or ultra vires demand by a public authority, and held that a taxpayer who has paid an amount to the Inland Revenue by way of tax pursuant to such a demand was entitled to recover that amount as of right.
References:
Woolwich Equitable Building Society v IRC [1992] STC 657
Lord Goff of Chieveley explained the basis for recovery as follows: '… it is one of the most fundamental principles of English law … that taxes should not be levied without the authority of Parliament; and full effect can only be given to that principle if the return of taxes exacted under an unlawful demand can be enforced'.
References:

Woolwich Equitable Building Society v IRC [1992] STC 657

As originally formulated, a claim based on *Woolwich* refers to unlawful demand, and the question arises as to whether such a claim can only be made where there is a demand from HMRC.

In *FII Group Litigation*, the Supreme Court confirmed that the *Woolwich* cause of action was not limited to cases where there had been a formal demand, but extended to any case where tax had been unlawfully exacted from a taxpayer by virtue of a legislative requirement (eg under self-assessment).

References:

Test Claimants in the Franked Investment Income Group Litigation v IRC [2012] All ER (D) 188 (May)

Mistake

There is a second cause of action to recover unpaid tax under the law of restitution.

Until 1998, common law had only permitted recovery where the relevant payment had been made under a mistake of fact but not one of law.

In *Kleinwort Benson*, the House of Lords held that the rule of law that barred recovery where the relevant amount had been paid under a mistake of law could no longer be sustained. A right of recovery should arise where money has been paid under a mistake, whether that mistake was one of fact or law. As Lord Goff observed, '[money] paid under a mistake of law … will, *prima facie*, lead to [a defendant's] unjust enrichment, just as receipt of money paid under a mistake of fact will do so'.

References:

Kleinwort Benson v Lincoln City Council [1998] 4 All ER 513

However, his Lordship also observed that the cause of action did not apply to claims in relation to tax—at least not yet.

References:

Kleinwort Benson v Lincoln City Council [1998] 4 All ER 513

In *Deutsche Morgan Grenfell* (*DMG*), the House of Lords held that the general right (derived from *Kleinwort Benson*) to recover payments made under a mistake of law extended to taxes paid to the Inland Revenue on the mistaken belief that they were due and payable.

References:

Deutsche Morgan Grenfell Group v IRC [2007] STC 1

Following *DMG*, therefore, a taxpayer who has overpaid tax has two concurrent claims under common law (ie a *Woolwich* claim and a mistake-based claim) and (as Lord Walker of Gestingthorpe observed) 'English law generally permits a claimant to choose between concurrent causes of action and concurrent remedies as best suits his interests'.

References:

Deutsche Morgan Grenfell Group v IRC [2007] STC 1

Limitation periods

A *Woolwich* claim and a mistake-based restitution claim are subject to different limitation periods, and this is the key consideration for the taxpayer when choosing between the two.

The limitation period for a *Woolwich* claim falls within the section 5 of the Limitation Act 1980 (LA 1980) and is six years from when the cause of action arises—ie when the overpaid tax in question is paid.

References:

Commission v United Kingdom, Case C-640/13

The limitation period for a mistake-based claim is extended by LA 1980, s 32(1)(c) and runs from when the claimant discovers the mistake (or could with reasonable diligence have discovered it).

Following *DMG*, the government announced on 8 September 2003 that it would restrict how the extended limitation period would apply in relation to mistake-based claims that relate to tax.

This led to section 320 of the Finance Act 2004 (FA 2004), which provides that the extended limitation period does not apply, in relation to claims brought on or after 8 September 2003, where that claim is based on a mistake of law concerning a taxation matter under the Inland Revenue's care and management.

Section 107 of the Finance Act 2007 (FA 2007) takes the restriction even further by (retroactively) disapplying the extended limitation period in relation to any action brought before 8 September 2003 for relief from the consequences of a mistake of law concerning a taxation matter.

In *FII Group Litigation*, the Supreme Court unanimously held that FA 2007, s 107 was contrary to EU law.

References:

Test Claimants in the Franked Investment Income Group Litigation v IRC [2012] All ER (D) 188 (May)

Following this, and while the government was still working on amending the section, the CJEU ruled (on a referral from the EC) that FA 2007, s 107 was incompatible not only with the principle of effectiveness, but also with the principle of the protection of legitimate expectations.

References:

Commission v United Kingdom, Case C-640/13

This led eventually to section 299 of the Finance Act 2014, which provides that FA

2007, s 107 does not apply to any action (or cause of action) where the mistake of law in question results in the charging of tax in breach of EU law.

As for FA 2004, s 320, the CJEU confirmed that although it was permissible for a Member State to reduce the period in which claims to recover amounts overpaid in breach of EU law must be brought, this was conditional not only on the new limitation period being reasonable, but also on the new legislation including transitional arrangements that allow an adequate period (after its enactment) for the lodging of recovery claims that taxpayers resident in that Member State were entitled to make under the previous legislation.
References:
Test Claimants in the Franked Investment Income Group Litigation, Case C-362/12
Because the restriction imposed by FA 2004, s 320 was retroactive and applied without any transitional arrangements, it was held to be incompatible with the principles of effectiveness, legal certainty and the protection of legitimate expectations.
References:
Test Claimants in the Franked Investment Income Group Litigation, Case C-362/12
The UK government had argued that because, under domestic law:
References:
Test Claimants in the Franked Investment Income Group Litigation, Case C-362/12

- a taxpayer had a choice between two causes of action, and
- restricting the limitation period applicable to one of them (the mistake-based cause of action) did not in any way affect the limitation period applicable to the other (the *Woolwich* cause of action (which, in itself, complied with the principle of effectiveness))

this meant that FA 2004, s 320 was not contrary to EU law.

This was rejected by the CJEU.
References:
Test Claimants in the Franked Investment Income Group Litigation, Case C-362/12
No amendment has yet been made to FA 2004, s 320.

Damages

As mentioned in Common law—restitution, above, the law of restitution is not about compensating the claimant for their loss. It is not about damages.

However, in addition to their (so-called) *San Giorgio* rights, a taxpayer is also entitled to claim damages against the relevant Member State for loss resulting from breach by the Member State of its obligations under EU law.
References:

Francovich, Cases C-6/90 and C-9/90

This entitlement is inherent in the legal order imposed by the EU. The full effectiveness of EU law would be impaired, and the protection of the rights it confers would be weakened, if nationals of a Member State were unable to obtain redress when their rights are infringed by a breach of EU law for which that Member State is responsible.

References:

TEU, art 4(3)

Francovich, Cases C-6/90 and C-9/90

State liability is, therefore, guaranteed under EU law. However, the conditions under which that liability gives rise to a right to damages depend on the nature of the breach giving rise to the loss or damage, and may differ from case to case.

References:

Francovich, Cases C-6/90 and C-9/90

Where the breach in question is a breach of (what is now) TFEU, art 288 (ie the Member State's obligation to take all measures necessary to achieve the result provided for by a Directive) three conditions must be satisfied before the Member State would be required to make good the loss or damage:

References:

Francovich, Cases C-6/90 and C-9/90

- the EU law in question must confer rights on nationals
- those rights must be identifiable, and
- there must be a causal link between the breach and the loss or damage

Where the breach is in a field where the Member State has a wide discretion to make legislative choices, the conditions are that:

References:

TFEU, art 340

Factortame, Cases C-46/93 and C-48/93

- the EU law in question must be intended to confer rights on nationals
- the breach must be sufficiently serious, and
- there must be a direct causal link between the breach and the loss or damage

The decisive test for determining whether a breach is sufficiently serious depends on whether the Member State manifestly and gravely disregarded the limits on its discretion.

References:

Factortame, Cases C-46/93 and C-48/93

The factors that may be taken into consideration in this respect include:

References:

Factortame, Cases C-46/93 and C-48/93

- the clarity and precision of the EU law in question
- the measure of discretion left to the relevant authorities
- whether the breach or damage caused was intentional or involuntary
- whether any error of law was excusable
- the fact that the position taken by an EU institution may have contributed towards the breach, and
- the adoption or retention of national measures or practices that were contrary to EU law

The CJEU considers a breach of EU law to be sufficiently serious if the Member State has persisted despite:
References:
Factortame, Cases C-46/93 and C-48/93

- a judgment establishing the breach, or
- a preliminary ruling or settled case law on the matter from which it is clear that the conduct in question constituted a breach

As for how the national's rights against the Member State are to be enforced, if there are no EU rules on the subject, it would be for the Member State to:
References:
Francovich, Cases C-6/90 and C-9/90

- designate the courts and tribunals, and
- lay down the detailed procedural rules

that would safeguard the taxpayer's rights.

These rules must comply with the European principles of equivalence and effectiveness.
References:
Francovich, Cases C-6/90 and C-9/90
It is also for the Member State, in the absence of relevant EU rules, to set the criteria for determining the extent of compensation (which must be commensurate with the loss or damage). This, too, is subject to the European principles of equivalence and effectiveness.
References:
Francovich, Cases C-6/90 and C-9/90
When determining the loss or damage for which compensation may be granted, the national court may inquire whether the claimant exercised reasonable diligence to avoid the loss or damage or limit its extent, and whether, in particular, they availed in time of all the legal remedies available to them.
References:

Francovich, Cases C-6/90 and C-9/90
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