

New tax rate for restitution interest

25/11/2015

Tax analysis: Why has the government introduced a 45% rate of corporation tax on restitution interest? Etienne Wong, barrister at 15 Old Square, explores the background to the change and anticipates a challenge under EU law.

Original news

Section 38 of the Finance (No 2) Act 2015 introduces a 45% rate of corporation tax on restitution interest paid by HMRC arising from a mistake of law in specific circumstances with effect from 21 October 2015. This is intended to reflect the historic rates of corporation tax over the period to which typical awards relate, as well as the effect of compound interest. HMRC will also withhold tax on payments of restitution interest from 26 October 2015.

What does this provision do and when does it come into effect?

Recovering overpaid tax is a complex area, particularly where the tax was levied in breach of EU law. An especially controversial aspect is whether interest payable by HMRC when repaying the overpaid tax should be on a simple or compound basis.

The new provision introduces and applies a special rate of corporation tax to such interest, but only where it is compound.

The special rate is 45% (compared with the current corporation tax rate of 20%).

The new provision applies where the following three conditions are satisfied:

- o the interest is payable pursuant to a claim in restitution (whether under the *Woolwich* head (unlawful collection) or the *Deutsche Morgan Grenfell* head (mistake of law))
- o the claim has been finally decided, or HMRC and the company have entered into a final settlement agreement, in the company's favour, and
- o more than simple interest is payable

The tax will be deducted at source. In other words, instead of paying the company the interest and then waiting for the company to submit its tax return and pay the tax then, HMRC will withhold the tax at the point of payment.

The new provision is retrospective, having taken effect from 21 October 2015 (or 26 October 2015 in relation to the power to withhold).

What is the case law background to the provision?

The new provision refers to unlawful collection and mistake of law, which are references to *Woolwich Equitable Building Society v IRC* [1993] AC 70, [1992] 3 All ER 737 and *Deutsche Morgan Grenfell Group plc v IRC* [2006] UKHL 49, [2007] 1 All ER 449 respectively--the two cases that extended restitution to tax.

Littlewoods Retail Ltd and others v Revenue and Customs Commissioners [2015] EWCA Civ 515, [2015] All ER (D) 225 (May) is also in point, being the lead case on whether interest payable by HMRC when repaying tax levied in breach of EU law should be simple or compound. The case has not been finally decided--it is currently on appeal to the Supreme Court. The amounts involved are astronomical, and with a number of other cases standing behind it, the (all too real) possibility of HMRC having to make substantial interest payments in the near future is clearly a driver for the new provision.

When does HMRC have to pay restitution interest?

Where EU law is not involved, UK law applies, and under the applicable provisions, HMRC is only required to pay simple interest when repaying overpaid tax to a taxpayer.

Where EU law is involved--eg where the overpaid tax was levied in breach of EU law--the amount of interest HMRC is required to pay must (under the EU principle of effectiveness) be such as to give the taxpayer adequate indemnity. This may be simple or compound, depending on the circumstances.

The new provision is aimed at situations where EU law is involved and compound interest is payable under the applicable principles.

Why do you think this measure was introduced to the Finance Bill at report stage, rather than being included in the Bill all along?

The government may have held the new provision back in case the First-tier Tribunal went against HMRC in *Coin-a-Drink Ltd v HMRC* [2015] UKFTT 495. The taxpayer's argument there was that restitution interest should not be subject to corporation tax at all. The Tribunal's decision in HMRC's favour was released on 6 October 2015, and the new provision was tabled about a fortnight later.

Does it raise any particular difficulties?

How interest is computed in any given case will be of crucial importance. If the entire amount is required to give adequate indemnity, it is difficult to see how only 55% of the same would suffice. On the other hand, if the amount is such that the after-tax balance is sufficient to give adequate indemnity, then query whether it has been 'grossed up' to take account of the tax, and, if so, whether the new provision achieves anything at all (if it does not in fact reduce what HMRC is required to pay).

The government claims that the new provision:

'Ensures that the rate of corporation tax applicable to payments of restitution interest made by HMRC reflects both the rates of corporation tax over the period to which typical awards relate, and the effect of compounding interest not taxed in the year to which it relates. This is a unique set of circumstances and this measure ensures that recipients of such restitution interest payments do not enjoy an unfair tax advantage at the expense of the public purse'.

The thinking is that if, in 1984, the company had not overpaid tax but put the funds on deposit instead, it would have paid corporation tax on the interest it would have earned at 45%, so levying tax at 45% now is only fair. Although, after 1984, the rate of corporation tax started falling, it was 52% before then, so setting the special rate at 45% is a reasonable compromise that achieves an equitable blend over an extended period.

This does not, however, address the position of a company that only overpaid tax in periods after 1984.

Do you think the provision is vulnerable to challenge under EU law?

A company that overpaid tax between 1990 and 2010 (for example) would not have paid corporation tax at 45% on the interest earned even if it had placed the relevant funds on deposit. In such a case, the imposition of the special rate may well deprive the taxpayer of an adequate indemnity. This would offend against the principle of effectiveness and expose the government to challenge under EU law.

Coin-a-Drink may be appealed. If the taxpayer prevails, the new provision may be found to offend against the principle of effectiveness.

The EU principle of equivalence requires that rules governing claims for repayment of overpaid tax made under EU law must not be less favourable than those governing claims made under UK law. Given that the new provision is in essence only aimed at situations where EU law is involved, and the special rate of 45% is clearly less favourable (from the taxpayer's perspective) than 20% (the current rate of corporation tax), a challenge that it offends against the principle of equivalence is likely.

Interviewed by Duncan Wood.

A full overview of the Autumn Statement 2015 can be found here: [Autumn Statement 2015: Overview of tax announcements](#), LNB News 25/11/2015 137.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor



CLICK HERE FOR
A FREE TRIAL OF
LEXIS®PSL

[About LexisNexis](#) | [Terms & Conditions](#) | [Privacy & Cookies Policy](#)
Copyright © 2015 LexisNexis. All rights reserved.