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VAT overpayments and under-deductions

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STOP PRESS: *The Supreme Court is due to hear HMRC's appeal against the Court of Appeal's judgment in Littlewoods in July 2017. HMRC does not regard the Court of Appeal's judgment as having wider application and will continue to ask for a stay of other compound interest claims already lodged. It will also refuse new claims until the conclusion of the litigation.*

References:

[Littlewoods \[2015\] All ER \(D\) 225 \(May\)](#)

[HMRC Brief 9/2015—HMRC position following the Court of Appeal Judgment in Littlewoods Retail Ltd and others](#)

This Practice Note outlines what taxable persons should do when they have paid more VAT to HMRC than they were liable to pay, either as a result of paying too much output tax or recovering too little input tax.

For the application of the law of restitution in the context of VAT, see Practice Note: [VAT—restitution and interest](#).

Overpayments

The amount of VAT that a taxable person is liable to pay on a taxable supply is:

References:

[Council Directive 2006/112/EC, art 1](#)

- the amount of output tax chargeable on that supply, calculated on the price of the goods or services in question by reference to the VAT rate applicable to those goods or services, less
- the amount of input tax borne directly by the various cost components of that supply

The taxable person making the supply is not liable to pay, and HMRC is not entitled to collect, more than this amount.

Occasionally, after a taxable person has submitted a VAT return accounting for output tax on a supply, and without making any adjustments to the price for the supply:

- a court or tribunal may deliver a judgment or ruling
- a revision may be made to HMRC practice or published guidance
- an event may take place, or
- information may otherwise come to light

that indicates that they have overstated the amount of output tax, and thus the amount of VAT, properly due.

Such post-supply developments include (but are not limited to):

- realisation that an incorrect VAT treatment has been applied to the supply—for example:
 - it was treated as a supply made in the course or furtherance of a business when it was not
 - it was treated as a supply made in the UK when it was not
 - it was treated as in scope (ie ‘VATable’) when it should have been disregarded, or treated as neither a supply of goods nor a supply of services or otherwise outside the

- scope of VAT (for instance, because it should have been treated as a [transfer of a business as a going concern](#)), or
- it was treated as a taxable supply when it was exempt
- realisation that a higher rate has been applied to the supply than was applicable (eg it was treated as a standard-rated supply when it was zero-rated), and
- a court judgment that the UK law on the basis of which the VAT return was prepared was in breach of EU VAT law (see Practice Note: [VAT—European legal principles](#))

Any adjustment to the price of a taxable supply would also affect the amount of VAT payable on that supply. Such adjustments are discussed in [Price adjustments](#), below.

Where a taxable person has paid more VAT than was due from them, they are entitled to repayment of the excess from HMRC. This entitlement (sometimes referred to as *San Giorgio* rights) is a consequence of the rights conferred by EU law.

References:

San Giorgio, Case [C-199/82](#)

Under-deductions

Taxable persons may also on occasion understate the amount of input tax they are entitled to deduct.

They are not regarded as having overpaid VAT in such a scenario.

This is because what they hold is a right (to deduct recoverable input tax) and not an obligation.

References:

University of Sussex [\[2001\] STC 1495](#)

Where they fail to exercise this right, that in itself has no bearing on the amount of VAT due from them in respect of any prescribed accounting period or VAT return (which is why they will not have overpaid VAT).

References:

University of Sussex [\[2001\] STC 1495](#)

The right remains and can be exercised by way of a late claim to deduct input tax.

Such a late claim would be self-contained, and would stand or fall on its own merits rather than taking effect as a correction of an earlier VAT return. The claim would have no bearing on the amount of VAT due in respect of the prescribed accounting period or VAT return in which the deduction should have been made.

References:

University of Sussex [\[2001\] STC 1495](#)

Claiming overpaid VAT

A taxable person's right to recover overpaid VAT is set out in [section 80](#) of the Value Added Tax Act 1994 ([VATA 1994](#)). Section 80 only deals with 'overpaid VAT', ie the scenario where more VAT than was due has been paid as a result of overstated output tax (as described above, where more VAT than was due has been paid because of an under-declaration of input tax, that is not regarded as an overpayment of VAT for the purposes of s 80).

References:

[VATA 1994, ss 80\(1\), 80\(1A\), 80\(1B\)](#)

Claims under [VATA 1994, s 80](#) are subject to a limitation period of four years. This is often referred to as the 'four-year cap'.

References:

[VATA 1994, s 80\(4\)](#)

When the limitation period commences depends on the nature of the claim. In the case of a taxable person having overstated the amount of output tax due in a VAT return, the limitation period runs from the end of the prescribed accounting period to which that VAT return relates.

References:

[VATA 1994, s 80\(4ZA\)](#)

Any VAT, penalty, interest or surcharge a taxable person is liable to pay to HMRC may be set against the amount claimed under [VATA 1994, s 80](#).

References:

[VATA 1994, ss 80\(2A\), 81\(3\), 81\(3A\)](#)

[FA 2008, s 130](#)

Examples of amounts that may be set against the amount claimed under [VATA 1994, s 80](#) include:

- any unpaid VAT returns
- any unpaid VAT assessments
- the amount of any understated output tax, or any over-deduction of input tax, made or arising in the prescribed accounting period to which the claim relates
- the amount of any such output tax, or input tax, made or arising in any other prescribed accounting period the understatement, or over-deduction, of which was made on the same basis as underlies the claim, and
- any outstanding debts to HMRC in relation to any direct or other indirect taxes

Late claims to recover input tax

The rules on claiming deductions for recoverable input tax (including by way of a late claim) are set out in Value Added Tax Regulations 1995, [SI 1995/2518, reg 29](#).

The earliest opportunity for a taxable person to exercise their right to deduct recoverable input tax is in their VAT return (the 'earliest return') for the prescribed accounting period in which both of the following are true:

References:

[Value Added Tax Regulations 1995, SI 1995/2518, reg 29\(1\)](#)

- the input tax is (or has become) chargeable, and they have received the VAT invoice for the underlying supply (or other evidence to support the deduction)

HMRC may allow or direct the taxable person to make the claim at a later time.

References:

VAT Regs, SI 1995/2518, reg 29(1)

However, this later time must fall no more than four years after the date by which the taxable person is required to submit the earliest return.

References:

VAT Regs, SI 1995/2518, reg 29(1A)

Where, in relation to the same prescribed accounting period, a taxable person understates not only the amount of input tax they are entitled to deduct but the amount of output tax due from them as well, then when they make a late claim to deduct the input tax, they would (unless they have already accounted for and/or paid the amount of understated output tax) be entitled only to claim the excess of the understated input tax over the understated output tax.

Making a claim

Whether a claim is made under [VATA 1994, s 80](#) or is a late claim to input tax pursuant to VAT Regs, reg 29, it is made in the same way.

There are two ways in which the claim may be made. HMRC refers to these as Method 1 and Method 2.

References:

VAT Notice 700/45, para 4

Under Method 1, the taxable person would claim credit or repayment of the relevant amount in the VAT return for the prescribed accounting period in which the overpayment is discovered. The claim can include VAT that was overpaid in any previous prescribed accounting periods (subject to the four-year cap mentioned above).

References:

VAT Notice 700/45, para 4.3

Under Method 2, the taxable person would submit their claim on form VAT 652.

References:

Form VAT 652

A taxable person may use Method 1 where:

References:

VAT Regs, SI 1995/2518, reg 34

- the aggregate of output tax overstated, and recoverable input tax understated, in any VAT return for any prescribed accounting period ending within the previous four years ('over-declarations'), less
- the aggregate of output tax understated, and recoverable input tax overstated, in any such VAT return ('under-declarations')

falls within the prescribed range.

The excess of over-declarations over under-declarations falls within the prescribed range where it:

References:[VATA 1994, s 80\(6\)](#)[VAT Regs, SI 1995/2518, regs 34, 37](#)[VAT Notice 700/45, paras 4.3, 5](#)

- does not exceed £10,000, or
- does exceed £10,000 but does not exceed:
 - £50,000, or
 - 1% of the total value of sales and all other outputs (excluding VAT) that the taxable person is required to declare in the VAT return for the prescribed accounting period in which the overpayment of VAT is discovered

Method 2 is used where Method 1 cannot be used or where the taxable person chooses to use Method 2. In addition to stating the basis and amount of the claim, the taxable person should also mention the method by which the amount claimed was calculated (referring to any documentary evidence they hold in support of the claim).

References:[VATA 1994, s 80\(6\)](#)[VAT Regs, SI 1995/2518, reg 37](#)[VAT Notice 700/45, paras 4.4, 5](#)

After a claim has been made, amendments can be made in relation to the amount claimed or the method by which the amount claimed was calculated, but only if the fundamental character of the claim remains unchanged. In other words, the amended claim has to arise out of essentially the same facts or circumstances as the original claim.

A prime example of what constitutes such an amendment is the correction of a mistake, whether an arithmetical error or the omission of some supplies that were clearly intended to be included in the original claim. It is also permissible for the taxable person, when making a claim, to say they are not yet able to calculate the full figures and gather all the required documentation, but are in the course of doing so, and will provide such further details as soon as possible. Any such further submission would be regarded as falling within the scope of the original claim.

References:[Reed Employment \[2013\] UKUT 109 \(TCC\), \[2013\] STC 1286](#)[Vodafone Group Services \[2016\] UKUT 89 \(TCC\), \[2016\] STC 1064](#)**Unjust enrichment**

HMRC is entitled to raise the defence of unjust enrichment against a claim made under [VATA 1994, s 80](#).

References:[VATA 1994, s 80\(3\)](#)

This is the only exception to HMRC's obligation to repay VAT that has been collected in breach of EU law, and it applies where:

References:[Weber's Wine World, Case C-147/01](#)

- the overpaid VAT has been borne by someone other than the taxable person in question, and

- repayment of the overpaid VAT by HMRC to the taxable person would unjustly enrich the taxable person

Whether, and the extent to which, any unjust enrichment may arise in any given case requires a full economic analysis of the facts.

Although the cost of VAT is normally passed on, it cannot be assumed that it is actually passed on in every case. This will be a question of fact.

References:

Comateb, Case C-192/95

Even where the cost of the overpaid VAT has been passed on to another person, repayment to the taxable person may not necessarily result in unjust enrichment. For example, where the increase in price resulting from the inclusion of VAT has led to a decrease in sales, the taxable person may justly claim that they have suffered damage and that they would not be unjustly enriched by being repaid the overpaid VAT.

References:

Comateb, Case C-192/95

HMRC states that it would refuse any claim made under [VATA 1994, s 80](#) where taxable persons:

References:

[VAT Notice 700/45, para 9.1](#)

- have charged VAT that was not payable
- have passed the economic cost of the overcharge to their customers
- have suffered no loss or damage as a result of having passed the overcharge on, and
- are unable or unwilling to reimburse their customers with any VAT repaid to them by HMRC

Even where a taxable person accepts they would be unjustly enriched if the overpaid VAT in question were repaid to them, they could still claim repayment under [VATA 1994, s 80](#) provided they (very broadly):

References:

[VATA 1994, s 80A](#)

[VAT Regs, SI 1995/2518, regs 43A–43G](#)

[VAT Notice 700/45, para 9](#)

- put in place arrangements to reimburse the ‘consumers’ who have borne the cost of the overpaid VAT
- sign an undertaking in favour of HMRC in the form set out in [VAT Notice 700/45, para 10](#)
- make all reimbursements to consumers within 90 days of receiving the repayment
- pass any statutory interest received with the repayment to consumers, and
- repay any residual amount not reimbursed to consumers after the 90 days to HMRC within 14 days of the end of the 90-day period

Interest

Where a person is seeking recovery of overpaid tax pursuant to their so-called *San Giorgio* rights (see: [Overpayments](#), above), they are entitled to recover not only the tax levied in breach of EU law, but also any amounts paid to the relevant 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 person.

References:

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

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

References:

Littlewoods, Case C-591/10

Where the EU does not lay down detailed procedures to give effect to a right derived from EU law, these must be set by individual Member States. This means that it is for the Member State to set the rules on how such 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

These rules must comply with the principles of equivalence and effectiveness, and the principle of effectiveness requires that the rules must not be such as to deprive the taxpayer of an adequate indemnity for the loss in question.

References:

Littlewoods, Case C-591/10

In the UK, the relevant rules in the context of VAT are contained in [VATA 1994, s 78](#).

They provide that where a taxable person has overpaid VAT, or under-deducted input tax, due to an HMRC error (eg HMRC having published guidance or given advice in correspondence that was wrong in law), they would be entitled to claim interest on the overstated or understated amount at the applicable rate for the relevant period.

References:

[VATA 1994, s 78](#)

The applicable rate is provided for under [section 197](#) of the Finance Act 1996, which specifies a simple interest rate.

References:

[VATA 1994, s 78](#)

Air Passenger Duty and Other Indirect Taxes (Interest Rate) Regulations 1998, SI 1998/1461, reg 5

As a matter of domestic law, [VATA 1994, s 78](#) lays down an exclusive statutory scheme in relation to interest in respect of VAT overpaid due to an HMRC error. This means that taxpayers would be barred from bringing concurrent claims for interest under common law.

References:

Littlewoods [2015] All ER (D) 225 (May)

However, when EU law is taken into account (such as the taxable person's *San Giorgio* rights), there may be circumstances (such as those in the *Littlewoods* case) where [VATA 1994, s 78](#), in providing only for simple interest, would have the effect of depriving the taxpayer of an adequate indemnity for the loss in question (thus offending against the principle of effectiveness).

References:

Littlewoods [2015] All ER (D) 225 (May)

In such a case, s 78 would be disapplied, and the taxable person would seek to recover more than simple interest (ie compound interest) under common law; specifically, the law of restitution.

For European principles generally (including the principles of equivalence and effectiveness), and the disapplication of domestic legal provisions that are incompatible with applicable EU law, see Practice Note: [VAT—European legal principles](#).

For the application of the law of restitution in the context of VAT, see Practice Note: [VAT—restitution and interest](#).

Price adjustments

Occasionally, after a taxable person has submitted a VAT return accounting for VAT on a taxable supply, they may agree to the full or partial refund of, or other downward adjustment to, the consideration for that supply.

This includes where a prompt payment discount (PPD) is offered (for example, a discount of 5% of the full price if payment is made within 14 days of the date of the invoice).

References:

[VATA 1994, Sch 6, para 4](#)

Whether the taxable person needs to adjust the amount of VAT charged on that supply depends on whether the refund or downward adjustment extends to the VAT element of the consideration.

Where the recipient of the supply is entitled to deduct all the VAT they have incurred on the supply, they may agree with the taxable person not to adjust the VAT element of the consideration. In such a case the taxable person would not issue a VAT credit note in respect of the supply and they would not be required to adjust the amount of VAT charged.

Where the refund or downward adjustment does extend to the VAT element of the consideration, the taxable person is required to:

References:

[VAT Regs, SI 1995/2518, reg 38](#)

- issue a VAT credit note in respect of the supply (where it was a supply in respect of which they were required to issue a VAT invoice), and
- adjust the amount of VAT charged

This adjustment falls outside the regime outlined in [Making a claim](#), above.

References:

[VAT Regs, SI 1995/2518, reg 38\(7\)](#)

[VAT Notice 700/45, para 4.10](#)

Prompt payment discounts

Where a PPD is offered, and is taken up, the adjustment would normally extend to the VAT element of the consideration.

From 1 April 2015, the taxable person may choose not to issue a VAT credit note provided that the relevant tax invoice contains the following (in addition to the standard prescribed particulars):

References:

[HMRC Brief 49/2014, para 5\(f\)](#)

- the terms of the PPD (in particular, the time by which payment must be made in order to secure the discount), and

- a statement that the recipient of the supply is only entitled to deduct the amount of VAT actually paid to the taxable person

HMRC has suggested the following wording for this purpose:

References:

[HMRC Brief 49/2014, para 5\(h\)](#)

'A discount of X% of the full price applies if payment is made within Y days of the invoice date. No credit note will be issued. Following payment you must ensure you have only recovered the VAT actually paid.'

HMRC also suggests the inclusion of the following in the tax invoice:

References:

[HMRC Brief 49/2014, para 5\(f\)](#)

- the discounted price
- the VAT on the discounted price, and

- the total amount due if the PPD is taken up

Other VAT adjustments

A taxable person may also need to make VAT adjustments under other provisions that are outside the scope of this note. These include:

- retail schemes

References:

[VAT Regs, SI 1995/2518, Pt IX, regs 66–75](#)

[VAT Notice 727](#)

- the VAT—capital goods scheme

References:

[VAT Regs, SI 1995/2518, Pt XV, regs 112–116](#)

- an approved estimation procedure

References:

[VAT Regs, SI 1995/2518, reg 28](#)

[VAT Notice 700, para 21.2.3](#)

- VAT—partial exemption
- exports
- intra-EU supplies of goods (see Practice Notes: [Vat—buying goods in the EU](#) and [VAT—selling goods in the EU](#))
- bad debt relief

References:

[VATA 1994, s 36](#)

[VAT Regs, SI 1995/2518, Pt XIX, regs 165–172B](#)

[VAT Regs, SI 1995/2518, Pt XIXB, regs 172F–172J](#)

- pre-registration expenses

References:
[VAT Regs, SI 1995/2518, reg 111\(1\)](#)
[VAT Notice 700/1, para 5.2](#)

- post de-registration expenses, and

References:
[VAT Regs, SI 1995/2518, reg 111\(5\)](#)
[VAT Notice 700/11, section 9](#)
the [VAT Mini One Stop Shop](#)

In addition, taxable persons may be required to make adjustments to their VAT accounts; these too are outside the scope of this note.