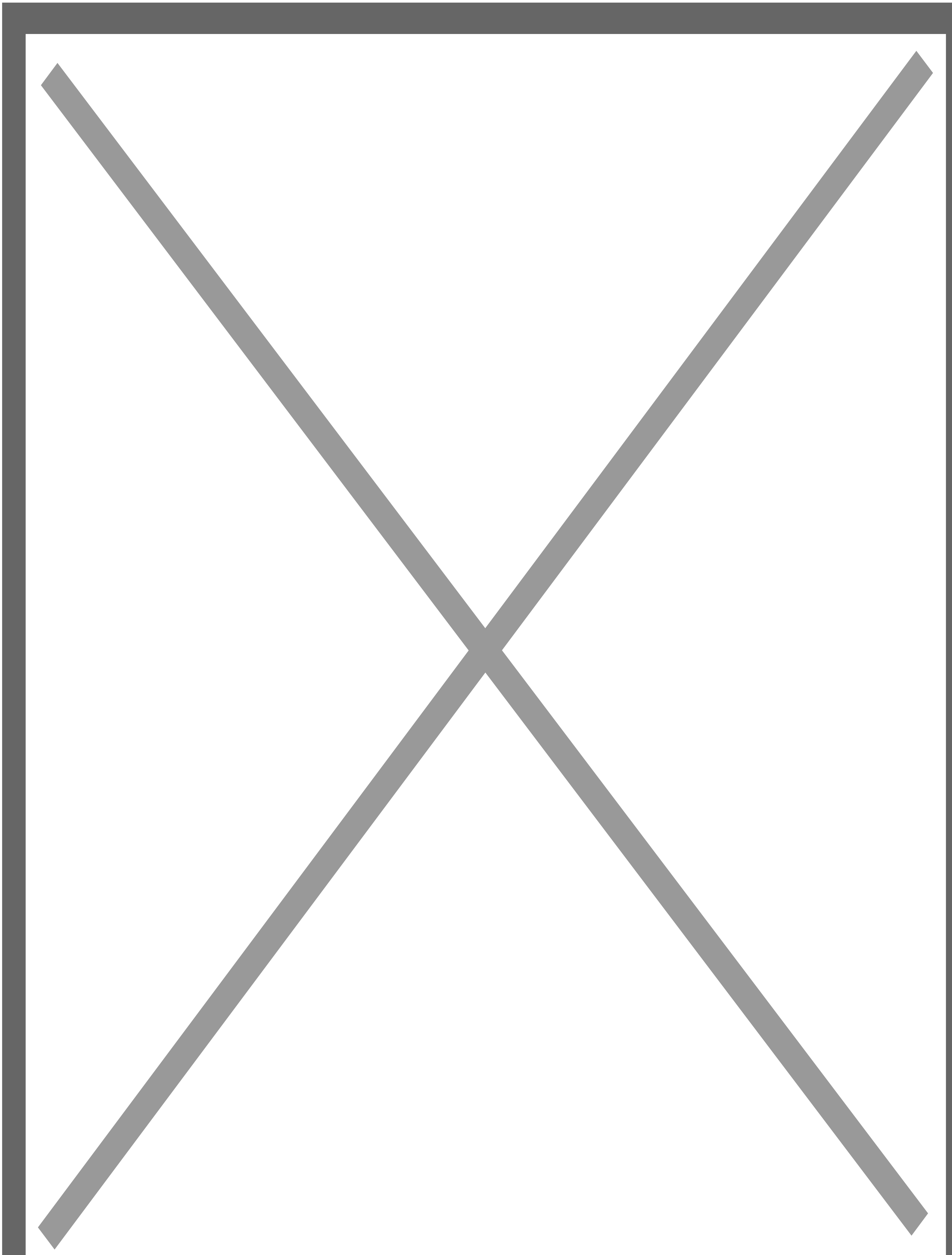
# The irritation game

International Tax | Management of taxes



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Keith Gordon reviews a decision by the CJEU where the legality of the UK's legislation was being challenged

lthough it is generally considered that the UK's parliament in Westminster is supreme (in that it can enact whatever provision it so wishes), there are in practice some limits on its powers. (For constitutional purists, these limits can be justified on the ground that they were imposed by parliament itself and can always be removed by parliament when no longer needed.) Among the contemporary restraints are where powers have been devolved, or where parliament has chosen to subject UK statutes to the jurisprudence of other legal jurisdictions under the Human Rights Act 1998 or the European Communities Act 1972 (as amended), for example.

This article considers the consequences of the European Communities Act 1972 and the fact that, where rights and freedoms conferred under EU law are in point, these can override any incompatible domestic statutes. It is often possible for British citizens and other taxpayers to obtain the benefits of EU law through the domestic legal system, without taking a case to the Court of Justice of the European Union (CJEU, formerly, the European Court of Justice) in Luxembourg. But the UK courts can refer cases to the CJEU when a point of European law is unclear.

However, there are occasions where a citizen or taxpayer need not start their own action. The European Commission itself can bring proceedings in the CJEU if it considers that a member state is acting in breach of its EU obligations. That is precisely what happened in the case (*European Commission v UK*, case C-640/13).

## Facts of the case C-640/13

As this was a referral by the Commission, the court did not consider a particular set of facts involving the parties. Instead, the court considered the legality of the UK's tax code in a more abstract sense. Nevertheless, a factual background is relevant.

The court noted that the common law doctrine of restitution, as it applies in England and Wales, provides a remedy for tax paid under an error of law. In other words, if it was thought that tax was payable and was paid, but it is later found that the law did not in fact require the tax to be paid, the payer is entitled to recover the overpayment.

Initially, the time limit governing claims for repayment was covered by the Limitation Act 1980 (LA 1980) s 32(1)(c). Section 32(1)(c) applies for all claims based on mistake, not just those in the tax field. It allows a claim to be made at any time up to six years after the claimant 'could with reasonable diligence have discovered' the mistake.

As readers might recall, over the past 20 or so years there has been a significant number of cases taken by taxpayers in which certain provisions of the UK's tax code have been held to breach one of the fundamental freedoms of the European Treaty. Because the developing case law meant that other taxpayers would learn for the first time that the tax they had historically paid might not have been due (given the incompatibility of the UK law with the UK's treaty obligations), the UK government feared that each new decision, either of the ECJ, as it then was, or the domestic courts, could open the floodgates with further claims for repayments. Some of these cases could date to 1973 when the UK joined the EEC, as it was then known.

To prevent this possible leakage, the UK government announced on 8 September 2003 that new claims made on or after that date would not be entitled to use the time limit set out in LA 1980 s 32(1)(c). This was later enacted as FA 2004 s 320. In effect, s 320 restricted claims for repayment to the previous six-year time limit for what used to be known as ‘error and mistake’ claims. These are now subject to a four-year cap under TMA 1970 Sch 1AB.

Although s 320 had the effect of restricting future claims, it is clear that the government became afraid that pre-September 2003 claims (as yet still unresolved) could prove expensive to the exchequer. So FA 2007 s 107 was enacted to extend the rule in s 320 to claims made before 8 September 2003. In other words, for claims already being litigated, s 107 sought to remove the right to recover tax through a retroactive change in the law.

The European Commission was not impressed and wrote to the UK authorities in 2009 expressing its view that s 107 breached European law. Six months later, the UK replied that it considered the provision to be lawful. In October 2010, the Commission sent the UK a detailed analysis stating why it was considered that the section was not compatible with the UK’s treaty obligations, formally seeking remedial measures within two months.

The UK’s response was to repeat its assertion that s 107 was compatible with European law. Eighteen months later, however, the Supreme Court concluded in Test Claimants in the *Franked Investment Income Group Litigation v Inland Revenue* [2012] UKSC 19 that s 107 indeed did infringe EU law. Seven months later, the UK pointed this out to the European Commission (although it presumably knew of the point by then) and added that it would disapply s 107 on a case-by-case basis. The clear implication is that every potential claimant would be required to rehearse the arguments that had already found favour with the Supreme Court and that HMRC would continue to appeal against such decisions until either the taxpayer gave up or the courts prevented the case proceeding further.

The Commission was not content with the UK’s response and started proceedings in the CJEU. In the court, the Commission explained why it considered s 107 to be unlawful. The UK accepted this point but argued that parliament was going to rectify the position (which it duly did in FA 2014).

## The court’s decision

The judgment is not particularly long. However, it emphasises certain key principles, in particular that of effectiveness, which allows citizens to exercise their rights under EU law. It is breached if those rights are removed retroactively without notice or with insufficient transitional measures put in place. Second, the court held that s 107 breached taxpayers’ legitimate expectations because their pre-existing claims for repayment would have become inadmissible by the retroactive change in the law.

The court noted the UK government’s defence that s 107 was about to be amended. However, the court held that the changes would be too late because it was required to consider the legal landscape at the end of the period given by the Commission for remedial action: that expired in December 2010.

As a result, the European Commission’s complaint was upheld and the UK government was ordered to pay costs.

## Commentary

It is now 10 years since HMRC was created. Throughout its life, we have heard repeated complaints from their spokespersons that certain taxpayers are acting unfairly and how the cost of this unfairness is being borne by ‘innocent’ taxpayers. Of course, some aspects of this unfairness relate to taxpayers who are acting wholly in accordance with the law (where there are understandably different views as to the legitimacy of a taxpayer’s actions); there are also cases of taxpayers deliberately refusing to comply with the law (and where fewer people would dispute that those taxpayers are acting unfairly). One of HMRC's complaints is that taxpayers are hanging on to money that will inevitably turn out to be payable to HMRC, taking hopeless procedural points in order to delay the inevitable.

However, fairness surely works two ways. In fact, there is Court of Appeal authority which suggests that governments and their tax departments:

'are required to act in a high-principled way, on occasions being subject to a stricter duty of fairness than would apply as between private citizens' (per Lord Justice Simon Brown in *R v Inland Revenue ex parte Unilever plc* [1996] STC 681).

In any event, how can it be fair for a government department to act in a way that it either knows to be wrong or at least should know to be wrong? In addition, why did HMRC refuse to accept the Supreme Court's decision in 2012 and put taxpayers to the trouble and expense of proceedings just to establish what the Supreme Court had already established? Further, by continuing to defend the indefensible at the CJEU, the government chose to waste taxpayers' money, by fighting this case and paying the Commission's legal costs, rather than accept the inevitable. From my perspective, the government's course of action leaves a lot to be desired.

It should be noted, of course, that the judgment applies only to claims based on EU law, as did the slight backtracking introduced by FA 2014. The government's decision to pull the rug under existing claims, therefore, continues to have effect in relation to any other types of claim. Of course, that still sounds rather unfair (on the assumption that HMRC are supposed to act fairly), but taxpayers might still be able to challenge s 107 on the basis that it breaches their human rights. Although retroactive legislation can sometimes be enacted without breaching a taxpayer's human rights, I consider that to be very much the exception. See also my article 'Hard cases' (Tax Adviser, October 2011) for one such exception, and indeed one where, contrary to the view taken by the Court of Appeal, I consider that the taxpayers' human rights were in fact infringed.

It is almost certainly the case that some taxpayers treat the tax system like a game. Rightly or wrongly, HMRC have publicly criticised that behaviour. However, they are not innocent of such tactics themselves. For taxpayers who are doing no more than trying to stay within the law (and, in many cases, taxpayers who are trying to stay within HMRC's interpretation of the law), HMRC's conduct is a source of irritation.