Is Time Up for Recovery of Time Value?

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Abstract—This article looks at *Prudential Assurance*, the latest judgment in a long line of overpaid tax litigation cases. The Supreme Court, departing from the House of Lords decision in *Sempra Metals Ltd v IRC*, found that the claimants were not entitled to recover compound interest on taxes levied in breach of EU law. This article is critical of the reasoning of the Supreme Court, in particular, of the treatment of 'use value' of money and the narrowing of the 'at the expense of' requirement in unjust enrichment.

1. Introduction

In *Prudential Assurance v Revenue & Customs Commissioners* ('*Prudential*'),[1] Lords Reed, Hodge, and Mance handed down the judgment in the Supreme Court, holding that compound interest was not recoverable in that case.[2] The court held that there is no action in unjust enrichment to recover compound interest

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[1] [2018] UKSC 39, [2018] 3 WLR 652.

[2] ibid [79].

representing the loss of the use of money ('use value') which the claimant had paid to the defendant. [3] In order to reach this conclusion, the Court notably moved away from the landmark decision of the House of Lords in *Sempra Metals Ltd v IRC* ('*Sempra*'),[4] which had allowed claims in unjust enrichment for the recovery of the time value of money and, additionally, had held that the relevant restitutionary award can be calculated on the basis of compound interest. *Prudential* is significant for two reasons. First, the Supreme Court held that a previous decision of the House of Lords was no longer good law. Secondly, and more broadly, the Court held that the use value of money may not be a relevant enrichment under the law of unjust enrichment.

This article will first briefly discuss the background decisions of the House of Lords in *Sempra* and of the European Court of Justice ('ECJ') in *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* ('*FII Litigation*').[5] The article will then argue that the analysis of the Supreme Court in *Prudential* leaves much to be desired: the Court effected a significant change in the law of unjust enrichment on the basis of reasons which, once scrutinised, are largely unsound.

2. Background Decisions

A. Sempra

The claim in *Sempra* arose after the ECJ held that a tax regime allowing resident parent companies, but not non-resident companies, to make an election such that its subsidiaries did not have to account for advance corporation tax on dividends paid to it, was contrary to Article 52 of the European Community ('EC')

[3] Ibid.
[4] [2007] UKHL 34, [2008] AC 561.
[5] C-446/04.

Treaty, which guarantees the freedom of establishment.[6] In *Sempra*, the House of Lords was concerned with whether the calculation of the award required by Community law in the circumstances of this breach was to be on the basis of simple interest or compound interest.[7] The House of Lords held, inter alia, that a claim in unjust enrichment lies for the recovery of the time value of money,[8] in the form of an award of compound interest.

B. FII Litigation

Prudential concerned a test claim brought against HMRC, under a group litigation order made following the decision of the ECJ in *Test Claimants in the FII Group Litigation*. The issue in the *FII Litigation* proceedings arose due to the differential treatment under the UK tax regime of dividends received by parent companies resident in the UK. Under s. 208 of the Income and Corporation Taxes Act 1988, where a UK resident company received dividends from a UK resident subsidiary it was not liable to pay corporation tax in respect of these dividends. In addition to this, the parent company would receive credit equal to the amount of the corporation tax that the distributing subsidiary had paid in advance. On the other hand, UK resident companies, receiving dividends from subsidiaries resident outside the UK, received no such allowances. They were liable to pay corporation tax on the dividends received and, additionally, they received no

[6] *Metallgesellschaft Ltd v Inland Revenue Commissioners and Hoechst AG v Inland Revenue Commissioners* (Joined Cases C-397 and C-410/98) [2001] Ch 620.
[7] *Sempra* (n 4) [12]
[8] ibid [33]

tax credit. The ECJ held that this disparity in the treatment of dividends received fell afoul of Article 56 of the EC Treaty.[9]

3. Questions before the Court in Prudential

While there were several issues to be resolved before the Supreme Court as a result of the decision of the ECJ, this case-note will focus on the Supreme Court's treatment of the question of whether the claimant could claim compound interest in respect of the sum it had unlawfully paid to the Revenue, on the basis that the Revenue was unjustly enriched by the opportunity to use this sum. The Supreme Court held that the claimant could not recover compound interest. Furthermore, their Lordships departed from *Sempra* to the extent that it allowed a claim in unjust enrichment for the recovery of compound interest, representing the 'use value' of money.[10]

4. The Decision of the Supreme Court in Prudential

The Revenue argued that the opportunity to use money mistakenly paid is not a benefit obtained at the expense of the payor. The claimant opposed this, arguing that this line of argument should not be allowed as the Revenue had conceded that the claimant was entitled to recover compound interest on the basis of *Sempra*. The Supreme Court disagreed with the claimant, allowing the Revenue to proceed with their line of argument due to significant developments in the law of unjust

[9] Prohibiting restriction on the free movement of capital and payments between Member States and between Member States and third countries.
[10] *Prudential* (n 1) [79].

enrichment that had occurred since the trial at first instance.[11] The Court found that, in light of these developments, a critical analysis of the reasoning in *Sempra* was necessary. The Court provided 5 reasons that formed the basis of its decision to depart from *Sempra*. As will be explored below, except for the first two considerations of the court, namely, the development of the law since *Metallgesellschaft*, and an apparent omission by the House of Lords in *Sempra*, the majority of the justifications provided are unsound.

A. Development of the Jurisprudence of the CJEU since Metallgesellschaft

The Court of Justice of the EU ('CJEU') in *Metallgesellschaft* held that the tax regime in the UK, specifically s. 247 of the Income and Corporation Taxes Act 1988 ('ICTA'), was contrary to EU law.[12] The regime allowed UK-resident parent companies, but not Member State-resident parent companies, to elect when they paid corporation tax in relation to the dividend they received from their subsidiaries. Parent companies resident in Member States were deprived of this option of election and had no choice but to pay advance corporation tax. On the question of remedy, the CJEU in *Metallgesellschaft* held that the sum due under EU law, pursued under a claim in restitution, would be 'the amount of interest which would have been generated by the sum, use of which was lost as a result of the premature levy of the tax'.[13]

The Supreme Court stated that, since this pronouncement, the jurisprudence of the CJEU has developed. First, the CJEU has since stated in *Littlewoods* that it is for the internal legal order of Member States to determine the conditions

[11] ibid [40].
[12] *Metallgesellschaft* (n 6) [76].
[13] ibid [88].

under which such interest arises and the rate at which it is calculated.[14] Second, pursuant to this domestic procedural autonomy, the Supreme Court in *Littlewoods Limited v Commissioners for her Majesty's Revenue and Customs*[15] had held that where the claimant had lost the opportunity to use money, an award of simple interest is an adequate indemnity under EU law.

This justification of the Supreme Court cannot be faulted. It demonstrates that the Court was cognisant of the fact that recovery of compound interest in an action in unjust enrichment was not required by the principle of effectiveness under EU law.[16] This is in fact an important consideration because it means that, in deciding whether the claimant was entitled to recovery under unjust enrichment, the Court rightly held that it was not bound by EU law to provide interest on a compounded basis.

B. Conflict between Sempra and Prior Legislation

The Court questioned the decision of the House of Lords in *Sempra* on the basis of the majority's failure to have regard to provisions of prior legislation when it decided to award compound interest.[17] The legislative schemes noted by the court were ICTA and the Value Added Tax Act 1994 ('VATA'). S. 78 of VATA contains provisions for the payment of simple interest on overpaid tax. S. 826 of ICTA also provides for the payment of

[14] *Littlewoods Retail Ltd v Revenue and Customs Commissioners* (Case C-591/10) [27].
[15] [2017] UKSC 70, [2017] W.L.R. 1401.
[16] *Prudential* (n 1) [56].
[17] ibid [59].

simple interest in the case of overpaid taxes, covering advance corporation tax and mainstream corporation tax.

In allowing a common law claim for the recovery of interest on the basis of mistaken payments, the Supreme Court suggested that *Sempra* eroded the legislative schemes in place for the regulation of payment of interest on overpaid taxes.[18] Per the Supreme Court in *Prudential*, the fact that the court in *Sempra* did so without referring to the relevant legislative schemes diminished the persuasiveness of its reasoning.[19]

Once again, this is submitted to be a relevant consideration. The fact that the House of Lords in *Sempra* had effected a major change in the law without reference to the relevant background legislative schemes leaves the decision vulnerable to criticism. Not only did the court in *Sempra* fail 'to proceed in harmony with Parliament',[20] but in failing to refer to the legislative provisions, the court did not explain why it felt the need to render a judgment that was quite clearly at odds with the existent statutory regime. An omission as conspicuous as this can rightly be used to criticise *Sempra*, on the basis that the court's process of determination was not, or at the very least did not appear to be, as comprehensive as it ought to have been.

C. Legislation's failure to solve problems arising from Retrospective Effect of Kleinwort Benson

A third consideration for the Supreme Court was the impact of the decision of the House of Lords in *Kleinwort Benson v Lincoln City Council* ('*Kleinwort Benson*')[21] in conjunction with its decision in

[18] ibid [60].
[19] Ibid [59].
[20] *Johnson v Unisys Ltd* [2003] 1 AC 518 [37].
[21] [1999] 2 AC 349.

Sempra. In *Kleinwort Benson*, the House of Lords abolished the mistake of law bar, thereby enabling claims in unjust enrichment for recovery of money paid under mistakes of law. [22]

Kleinwort Benson concerned a dispute under the swaps agreement line of litigation in the 1990s. In *Hazell v Hammersmith & Fulham Borough Council*,[23] the House of Lords held that the interest rate swaps agreements entered into by local authorities were ultra vires and, as a result, such agreements were void. This resulted in a line of claims being brought for the restitution of sums paid under the void agreements. The claimant bank in *Kleinwort Benson* wished to ground its claim in restitution on mistake, as this would enable it to rely on s.32(1)(c) of the Limitation Act 1980, which stipulated that the period of limitation in the context of mistake claims does not begin to run until the claimant has discovered the mistake or until the time the claimant would reasonably have been expected to discover the mistake. Problematically however, prior to *Kleinwort Benson*, the law did not allow recovery of money paid under a mistake of law. The House of Lords, by a majority of 3-2, abolished the mistake of law bar. One of the differences between the majority and the minority was whether this decision should have the retrospective effect of rendering *Kleinwort Benson*'s payment, which was lawful *prior* to the decision in this case, mistaken. The majority held that the decision in *Kleinwort Benson* did have such a 'retrospective effect'.

The Supreme Court in *Prudential* noted that the effect of holding that the decision would have retrospective effect was to enable 'claims to be brought within six years of the mistake being discovered, no matter how long in the past the payment had been made'.[24] The House of Lords in *Sempra*, like the House of Lords in *Kleinwort Benson*, made drastic changes to the law, believing that

[22] ibid 373.
[23] [1992] 2 AC 1.
[24] *Prudential* (n 1) [61].

Parliament would enact legislation to prevent 'serious untoward consequences' for the Revenue.[25] The Supreme Court in *Prudential* noted however, that the legislature had been unsuccessful in addressing the problem arising from the retrospective nature of the decision in *Sempra*.[26] As such, the decision of the House in *Sempra* is questioned by the Supreme Court because it was premised on a belief that legislation would prevent adverse consequences resulting from the operation of s. 32(1)(c) – a belief which has not been substantiated by subsequent enactment of legislation.

The basis of this criticism of *Sempra* is faulty. The Supreme Court is correct in observing that the government has failed to exclude or restrict the operation of s. 32(1)(c) to its own detriment. However, contrary to what the Court seems to suggest initially, this failure of the legislator is not due to the fact that such exclusions or restrictions are impossible: the problems arising from the retrospective effect of decisions in *Kleinwort Benson* are not 'incapable of being fully addressed by legislation'. This is evidenced in the very judgment in *Prudential*, a few paragraphs down, when the Court contradicts itself by acknowledging that the legislator could address the issue by including 'a reasonable transitional period'.[27] It may be argued that this deficiency in the legislation forced the Supreme Court to stem litigation being brought against the Revenue for restitutionary awards in the order of billions of pounds. However, this justification cannot stand once we notice that the holding in *Prudential* does not apply solely to claims in unjust enrichment against the Revenue: the impact of this result-led decision-making entails ramifications in cases beyond the tax context. As I argue under the next sub-heading, what is unacceptable here is that in such cases, the blanket

[25] Ibid.
[26] ibid [62].
[27] ibid [64].

narrowing of the scope of claims in unjust enrichment may not be as desirable as it supposedly was in *Prudential*.

In any case, it is submitted that the Court's method of presenting the legislature's failure does not really acknowledge the fact that there are other remedies available to stem the claims being brought against the Revenue. This is problematic because one of the reasons the Court gives for departing from *Sempra* is the impossibility of addressing the flood of tax recovery litigation. But as the judgment itself acknowledges, there is no such impossibility; the legislature is capable of addressing the problem, it had simply failed to do so. One such failed attempt of enacting legislation[28] to this effect was struck down by the House of Lords in *Michael Fleming v Customs & Excise* for lacking the transition arrangements necessary under EU Law.[29] It follows that in the absence of such impossibility, it is reasonable to wonder whether the Court had sufficient reasons to justify its departure.

D. Disruption of Public Finances

The Court noted that the amount the Revenue would be liable to pay in the present case, if recovery of compound interest was allowed, would be in the order of £4-5 billion. In the same vein, the Court noted the sum in question in Littlewoods was £17 billion. These large sums in dispute were yet again the result of the applicable limitation period and the compounding of interest. Because the limitation period did not start running until the discovery of the mistake, claims in this area were capable of being backdated for several decades.[30] This was especially problematic where the principle amount was incurring not only simple interest, but compound interest over this extended period.

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[28] Value Added Tax Regulations 1995 reg.29.
[29] [2008] UKHL 2, [2008] 1 W.L.R. 195.
[30] *Prudential* (n 1) [65].

It is apparent that the enormity of previously successful claims, potential claims and their potential impact on public finances, was a strong consideration for this Court.

Taking into account the impact of allowing recovery on a particular basis on public finances is not problematic *per se*. This area of restitution is difficult precisely because of the fact that there are underlying policy considerations which pull in opposite directions. More specifically in cases of taxes exacted where they are not due, the constitutional principle that there is to be no taxation without Parliamentary authority seems to go against the protection of the Revenue and the prevention of fiscal chaos. This can be demonstrated with reference to the *Woolwich* ground of recovery for example, where it has been argued that the very nature of claims brought by private citizens against public authorities (such as HMRC) give rise to considerations of a public law nature, which courts hearing a private law claim in unjust enrichment should, nevertheless, pay heed to.[31] However, the problem with result-motivated decision-making is that quite often, the court is focussing on the implications ensuing from the factual matrix of the case in front of them. In turn, this often causes courts to overlook the fact that the law established in this specific case will have a knock-on effect on cases across the relevant area of law. Such is the case here, because the policy-motivated decisions in the Revenue cases do and will hold true across the law of unjust enrichment. While there may be justifications for restrictions on recovery where the financial consequence otherwise would be devastating for HMRC, it does not follow that such restrictions, as between two private parties, a mistaken payor and an unjustly enriched payee, are equally justified. Yet, the holding of *Prudential* has precisely this impact. So whilst narrowing the scope of recovery appears to be the

[31] Williams, *Enrichment and Public Law: A Comparative Study of England, France and the EU* (Hart Publishing, 2010).

desirable decision in the context of a claim against HMRC, effecting change in the law of unjust enrichment on this basis alone ignores that fact that this narrows the scope of recovery in all contexts and may yield undesirable results.

E. Development of 'at the expense of' element in ITC v Revenue

In order to make out a claim in unjust enrichment, a claimant must make out four elements.[32] First, that the defendant was enriched. Secondly, that the enrichment was at the expense of the claimant. Third, there must be an 'unjust factor'.[33] Finally, there must be no defence on which the defendant can depend. The previous considerations outlined above demonstrated that the Supreme Court was ready to effect change in the law of unjust enrichment. In this case, the Justices effected this desired change through the second element of an unjust enrichment claim: by holding that the Revenue had not been enriched at the expense of the Claimant.

First, the Court noted that in *Investment Trust Companies v Revenue and Customs Commissioners* ('*ITC*'),[34] the Supreme Court had narrowed the scope of the 'at the expense of' element of a claim and consequently, the scope of unjust enrichment. The facts of *ITC* are significant if one is to understand the Supreme Court's reasoning in the present case. In *ITC*, the claimant companies had paid VAT to managers for their provision of investment management services. The managers subsequently paid the VAT to HMRC. However, under EU law, the charging of the VAT in such cases was unlawful. The managers had a claim to recover the

[32] *Benedetti v Sawiris* [2014] AC 938 [10].
[33] For example, absence of consideration, lack of authority and want of consent etc.
[34] [2017] UKSC 29, [2017] 2 W.L.R. 1200.

VAT paid under s. 80 of the Value Added Tax Act 1994. However, claimant companies were dissatisfied with this for two reasons. First, the managers could only recover VAT paid within the three-year limitation period under s. 80. Secondly, the managers were entitled to, and they had, deducted VAT they paid to their own third-party suppliers from the VAT paid to HMRC. 'On the notional figures used by way of illustration in the case, the managers had deducted £25 from £100 VAT paid to them by the claimants and had therefore paid to HMRC, and recovered from HMRC, and passed on to the claimants, only £75'.[35] Proceeding under these notional figures, claimant companies brought a claim for the £25 paid during the three-year period. Additionally, claimant companies brought a claim for the sum paid that was time-barred under s. 80 of VATA. The Supreme Court held that HMRC had not been enriched by the notional £25. Further, the Court held that the VAT received was not enrichment at the expense of the claimant companies. The claimant had not transferred any value directly to HMRC, rather, the managers had. The Court held that 'at the expense of' required direct conferral of benefit, rather than a causality between defendant's gain and claimant's loss. The claimant's case failed on this ground.

The Supreme Court in *Prudential* applied this direct conferral requirement to the facts of the case and found it not to have been satisfied. The decision in *Sempra*, which held that in addition to the sum paid, the defendant was also enriched by the use of the money, was held to have 'questionable features'.[36] The Supreme Court's reasoning in criticising *Sempra* is worth quoting in full:

[35] Burrows, 'Narrowing the scope of unjust enrichment' (2017) 133 LQR 537.
[36] *Prudential* (n 1) [71].

> 'If on 1 April the claimant mistakenly pays the defendant £1,000, with the result that the defendant is on that date obliged to repay the claimant £1,000, the defendant's repayment of £1,000 on that date will effect complete restitution. Restitution of the amount mistakenly paid in itself restores to the claimant the opportunity to use the money: there is no additional amount due in restitution. That is because there has been only one direct transfer of value, namely the payment of the £1,000. The opportunity to use the money mistakenly paid can arise as a consequence of that transfer, but a causal link is not sufficient to constitute a further, independent, transfer of value. *Contrary to the analysis of Lord Nicholls in Sempra Metals [2008] AC 561, para 102, the recipient's possession of the money mistakenly paid to him, and his consequent opportunity to use it, is not a distinct and additional transfer of value.*'[37]

Unfortunately, the reasoning here does not stand up to scrutiny. The Court is correct in holding that on 1 April, where the defendant pays the claimant £1,000, this repayment in itself will amount to complete restitution. However, the fact that the £1,000 of itself restores the claimant with the opportunity to use money is not due to the fact that the use value of money is incapable of enriching the defendant as a distinct transfer of value. Rather, in this instance, the repayment is immediate, such that defendant has simply not been benefitted by the use value of the £1,000. To put it in a different way, because there has been no passage of time, there has been no opportunity to use the money, and so there is no use value. A conclusion that full repayment of the sum itself will always be the full measure of restitution does not follow from this example. Yet, this is precisely what the Court goes on to assert, transposing the first scenario of immediate repayment into the next scenario:

[37] ibid (emphasis added).

> 'The position is essentially the same if the £1,000 is repaid not on 1 April but on 1 May. There has been no transfer of value subsequent to 1 April, when the mistaken payment was made. The only transfer of value needing to be reversed remains the payment of the £1,000.'[38]

The position clearly is not the same in this scenario. A key distinction between the first scenario and the second scenario is the passage of time. In the first scenario, no time had passed between the claimant's payment and the defendant's repayment. As such, transfer of value, in the form of time value of money, could not have arisen. In the second scenario, this is not the case: a month has elapsed since the defendant received the money and, in that time, the defendant has been enriched by the opportunity to use the sum received. Not only is D enriched, but he is also enriched *at the expense of* C, who has lost the use of his money during this time, and consequently lost out on the revenue he could have gained with this money. According to the reasoning of the court in *Benedetti*,[39] this lost value should be calculated by reference to the price which a reasonable person in the defendant's position would have had to pay to borrow an equivalent sum of £1000 for a term equivalent to the period of D's retention.

In other words, the first scenario where no time elapses and the second scenario, where a month elapses, are similar because in both cases, the defendant received two things: the face value of the money and the use value of the money. The fact that no time elapses in the first scenario does not change the fact that the defendant received two things – it alters the valuation of the use value of the money received, as this valuation is contingent

[38] ibid [72].
[39] *Benedetti* (n 32).

on time. As such, it is incorrect to state that because in the first scenario, the total enrichment is the face value of money, it follows that in the second scenario, this will also be the case.

In the alternative, it is also possible to see this part of the judgment as holding that there has been a transfer of value in the form of the use value of money, but the law of unjust enrichment does not deem it to be a relevant transfer. In this case, we need to know what qualifies as a relevant transfer. Furthermore, if this benefit does not come from the claimant, then the question arises, where does the benefit come from? The judgment seems to suggest that the opportunity to use money arises from the defendant's failure to repay the debt.[40] If this is the case, then we face the problem of explaining how this accrual occurs.[41] It is submitted that the better view is to look at the benefit obtained by the defendant: it seems contrary to logic and common sense to suggest that benefit obtained from non-repayment of a debt (where non-repayment necessarily disadvantages a creditor) is not at the creditor's expense. It is when we look at it from this perspective that it becomes evident that the defendant's benefit would not have occurred but for the claimant's deprivation: namely, the face value and the use value of the money. It is submitted that the focus on transfer here merely leads to confusion and led the Supreme Court to an untenable conclusion.

As a final point, although the court extends the reasoning of *ITC* to the present case, specifically the directness requirement, it is important to note that on the facts, *ITC* was concerned with a wholly different scenario from the one in *Prudential*.[42] The issue in *ITC* was whether the claimant could bring a claim against HMRC, which was an indirect recipient (because claimant

[40] *Prudential* (n 1) [74].
[41] Mitchell, 'End of the Road for Overpaid Litigation' [2018] The UK Supreme Court Yearbook (forthcoming).
[42] Ibid.

companies had paid the money to the managers, who then paid the tax to HMRC). *ITC* was therefore concerned with claims in unjust enrichment being brought against remote recipients. This is different from the present case, because the direct conferral requirement stemmed from the desire to restrict recovery in cases where the defendant was enriched by a party which was itself enriched by the claimant. *Prudential*, on the other hand, was concerned with the recovery of the opportunity to use money. It seems odd that the directness requirement in a multi-party case, notwithstanding the lack of clarity of the directness requirement itself, is being used to reach and justify a finding in *Prudential*, where the latter case occurs under a wholly different factual matrix. Here, as between two parties, the term 'directness' cannot mean the same thing as it did in *ITC*, as there simply were no indirect recipients of money.

5. Conclusion

The Supreme Court in *Prudential* gave five reasons for departing from the decision in *Sempra*, in so far as it allowed the recovery of compound interest for claims in unjust enrichment for the loss of opportunity to use money. Of these five, two are tenable. The Court was correct to have regard to the fact that an award of simple interest is now sufficient compensation under EU law, where the claimant has lost the opportunity to the use of money that has been paid as tax under legislation which is contrary to EU Law. The Court was also correct to note that the decision in *Sempra* was open to criticism as it failed to acknowledge the inconsistency of its decision with the existent legislative framework.

The next three reasons are highly problematic. The Court is incorrect in suggesting that legislation is incapable of addressing the problem of overpaid tax recovery litigation: all that is required is the inclusion of a transition period. Further, in taking account

of the impact of such litigation on public finances, the court engages in result-led jurisprudence which narrows the law of unjust enrichment and will apply across the board in non-HMRC cases, possibly leading to undesirable results. Finally, the most untenable aspect of the judgment is the modification of the 'at the expense of' element of unjust enrichment, where the Court's reasoning is simply faulty. In light of this assessment, it is submitted that despite the accuracy of the first two considerations, the weakness of the latter three arguments renders the Court's decision in *Prudential* untenable.