Analysis

Jazztel: restitution and retrospectivity

Speed read

The High Court has partially allowed Jazztel's claim in unjust enrichment for restitution of unlawful SDRT payments paid under mistake of law. Claims for restitution of payments made prior to 8 September 2003 are exempt from FA 2004 s 320(1), which purported retrospectively to dis-apply s 32(1)(c) of the Limitation Act 1980. Section 32(1) provided that limitations periods for mistake claims only start to run when the claimant 'has discovered the … mistake … or could with reasonable diligence have discovered it'. However, the court held that s 320(1) is effective to disapply s 32(1)(c) and curtail mistake claims brought after 8 September 2003.

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In *Jazztel v HMRC* [2017] EWHC 677 (reported in *Tax Journal*, 21 April 2017), the High Court partially allowed claims brought by Jazztel Plc (Jazztel) for restitution of payments of stamp duty reserve tax (SDRT) it made to the HMRC under the SDRT tax regime, which was subsequently found to be unlawful under EU law. Perhaps most importantly, the case clarifies that the applicable limitation period for claims for restitution of tax based on mistaken payments made after 8 September 2003 is six years from the date of the mistaken payment. However, for mistaken payments made before that date, time for limitations purposes only start to run when the claimant 'has discovered the…mistake…or could with reasonable diligence have discovered it'. The judgment also contains an important discussion of the nature of 'mistake' in claims for restitution of tax paid under mistake of law, and addresses (in part) HMRC's argument that it is entitled to the change of position defence.

Background and overview

Jazztel had made 23 SDRT payments to HMRC on certain agreements to transfer chargeable securities over the period from 2000 to 2008. The SDRT was payable at 1.5% in respect of:

- the issue of shares to a clearance service (pursuant to FA 1986 s 96); and
- the issue of shares to a depositary receipts issuer (pursuant to FA 1986 s 93).

Subsequently, in HSBC *Holdings Plc v HMRC* (Case C-569/07) EU:C:2009:594 and *HSBC Holdings plc and Bank of New York Mellon v HMRC* [2012] UKFTT 163 (TC), it was held that the SDRT scheme was incompatible with Community law.

Jazztel brought a claim against HMRC for restitution based on the House of Lords decision in *Deutsche Morgan Grenfell Group Plc v IRC* [2006] UKHL 49 – a restitutionary claim for tax paid under a mistake of law. A claim for recovery of unlawful tax under the principle established in *Woolwich Equitable Building Society v IRC* [1993] AC 70 was not included because it was time-barred. In addition, the claimant had exhausted available remedies under a statutory restitution scheme set out in the Stamp Duty Reserve Tax Regulations, SI 1986/1711 (although it maintained a claim for compound interest in respect of those sums). A damages claim for compensation for breach of Community law was also pleaded, but was stayed.

HMRC denied that the claimant had made the payments mistakenly, and also raised a defence based on FA 2004 s 320(1), which purported retrospectively to disapply s 32(1)(c) of the Limitation Act 1980 in claims for restitution of tax commenced after 8 September 2003. Ordinarily, s 32(1)(c) postpones the commencement of the limitations period for a claim based on mistake until such time as 'the plaintiff has discovered the … mistake … or could with reasonable diligence have discovered it'.

The High Court ruled substantially in the claimant's favour, partially allowing the restitutionary claims. There are three noteworthy aspects to the decision, considered below.

Mistaken payments in taxation cases: legal advice and doubt

The first noteworthy point in the judgment is the elucidation of the doctrine of mistake as a ground of restitution, particularly in the context of uncertain points of tax law. A claimant must show that at the time the enrichment was conferred, the claimant was mistaken; and the mistake 'caused' the enrichment to be conferred (para 29). However, difficulties arise where the claimant has been advised (to whatever degree) that the tax is not lawful, or that there is some doubt that it is lawful. Can a claimant be said to be mistaken about a payment being due, if they have been advised that the tax is not (or may not be) payable as a matter of law?

HMRC argued that Jazztel had not made a mistake when it paid the SDRT, because it had received legal advice from its advisors (Linklaters) that there was at least an argument that SDRT was not payable. Marcus Smith J held that mistakes could co-exist with an element of doubt, provided 'the level of subjective doubt remains below the 50% threshold' (at paras 28-30 of the judgment, applying *Marine Trade SA v Pioneer Freight Futures Co Ltd BVI* [2009] EWHC 2656 (Comm)). In this case, Jazztel's subjective view had changed over time. At first, it held an unqualified belief that it was legally obliged to pay SDRT to the HMRC. In December 1999, Linklaters advised it of a potential challenge which, if successful, may have changed this obligation. However, while this advice 'must have injected an element of doubt into what was Jazztel's state of mind … the monolithic state of Jazztel's belief came to be qualified, but did not otherwise change or crumble' (para 68). It was only on 18 March 2009, with the delivery of the advocate general's opinion in *HSBC Holdings*, that Jazztel clearly doubted that the tax was legally due: but not before. All the disputed payments were made before that date, and so were all caused by mistake (para 68).

While Marcus Smith J's analysis of the facts of Jazztel's state of mind is comprehensive, it may seem somewhat surprising that the law of mistake in this context requires such detailed investigation into a claimant's subjective understanding of the legal advice it received. One might question why a claim for restitution on the grounds of mistake ought to be contingent on whether the claimant's legal advice was definitive, and whether that advice was in any event subjectively believed by the claimant. It might be argued that a taxpayer should be entitled to await a binding ruling on the point. The justification for this is perhaps that it is legitimate for states in the 'interests of legal certainty and administration', and maintaining stability in public finances, to impose time limits for bringing proceedings to recover unlawful tax (*Marks & Spencer Plc v C & E Commrs* (Case C-62/00) [2003] QB 866, paras 35 and 41). The role for the law of mistake in the context of restitution of unlawful tax claims however now seems diminished given that, as explained below, the limitations period for mistake now mirrors that of *Woolwich* claims (except for claims arising out of payments made prior to 8 September 2003).

'Retrospectivity' and effectiveness

The next issue relates to the incompatibility of FA 2004 s 320(1) with EU law. That provision, as already noted, disapplied s 32(1)(c) of the Limitation Act 1980, and in doing so, deprived claimants (such as Jazztel) of the 'postponed' limitations commencement date. However, it did so in two ways, as Marcus Smith J concluded that s 320 'infringes Community law both in its express retrospectivity and in its hidden retrospectivity' (para 96).

Section 320(1) was undoubtedly expressly retrospective: it is expressed on its face to be effective as at 8 September 2003, the date on which it was announced in Parliament, as opposed to the later date it received the royal assent and passed into law (22 July 2004).

> Perhaps most importantly, the case clarifies that the applicable limitation period for claims for restitution of tax based on mistaken payments

However, s 320(1) purported to disapply s 32(1)(c) in relation to tax related mistake claims brought after 8 September 2003. The effect was that persons who had mistakenly paid HMRC before 8 September 2003 would only have six years from the date of payment to bring a claim seeking restitution rather than six years from the date of 'discovery' of that mistake. The section's retrospective operation was 'hidden' in the sense that its effect was to deprive claimants of rights that would otherwise have been preserved by s 32(1)(c) and that stretched back years before s 320 came into effect on 8 September 2003. It did so without any express words to the effect that it had such retrospective operation.

Having identified the two types of retrospective operation, his Lordship then considered the requirement, expounded by the House of Lords in *Fleming (trading as Bodycraft) v HMRC* [2008] UKHL 2 to 'fashion the remedy necessary to avoid an infringement of Community law'. It followed that all payments made prior to 8 September 2003 were exempt from s 320(1), but all payments after that time were time-barred if the claim was brought more than six years after mistaken payment. As a result, the limitation period for claims for restitution on the grounds of mistake, and claims for *Woolwich* restitution of unlawful tax, are the same. Section 320(1) is thus effective in preventing claimants from using s 32(1)(a) to bring claims that would otherwise be time-barred.

The judgment focuses on the retrospective nature of s 320 – particularly '[t]he real mischief' of hidden retrospectivity (para 100(vi)). However, it is important to bear in mind that EU law does not prohibit retrospective law-making. As was stated *in Grundig Italiana SpA v. Ministerio Delle Finanze* (Case C-255/00) [2003] 1 CMLR 36, 'the question whether such rules may apply retroactively is equally a question of national law, provided that any such retroactive application does not contravene the principle of effectiveness'. The principle of effectiveness requires that any such retroactive rules must 'not render virtually impossible or excessively difficult the exercise of rights conferred by Community law' (*Marks & Spencer*, para 34).

The principle of effectiveness can be satisfied in the context of legislation aimed at reducing the period within which repayment of sums collected in breach of Community law may be sought, provided that 'the new legislation includes transitional arrangements allowing an adequate period after the enactment of the legislation for lodging the claims for repayment which persons were entitled to submit under the original legislation' (*Marks & Spencer*, para 38). The problem in Jazztel was that there were no transitional arrangements at all (see paragraphs 97-98).

Change of position defence

The change of position defence, first recognised in English law in the seminal case of *Lipkin Gorman (a Firm) v Karpnale Ltd* [1990] 1 AC 548, applies where the defendant can prove that it changed its position in good faith in reliance on the receipt. HMRC contended that there was a correlation between tax receipts and government expenditure budgets and that, consequentially, it was 'inequitable and/or unconscionable' for the Crown to be required to repay the amounts claimed (as to the use of this terminology, see *Unjust Enrichment* (Edelman and Bant), second edition 2016, page 506).

The application of the change of position defence to payments made to HMRC is controversial and, for the time being, unavailable to HMRC as a matter of law (as a result of *The Test Claimants in the Franked Investment Income Group Litigation v HMRC* [2016] EWCA Civ 1180 (*FII (CA) No. 2*). However, HMRC has sought permission to appeal *FII (CA) No. 2* to the Supreme Court. In those circumstances, somewhat surprisingly (and with some reluctance), Marcus Smith J permitted HMRC to maintain its position on change of position pending a change in the law (para 13).

The court limited itself to considering whether a correlation between tax receipts and central government expenditure existed, and did not consider whether HMRC in fact established the defence. Like Henderson J in *FII (CA) No. 2*, Marcus Smith J appeared to evidence a degree of scepticism of HMRC's change of position arguments.

Points for advisers

The claimant was a test claimant in the stamp taxes group litigation, and this decision will certainly be followed with interest by companies who paid taxes in connection with the issue of shares into clearance, and have thus far been unable to claim because of s 320. However, the decision confirms that s 320(1) is effective to prevent the use of s 32(1)(a) in the context of mistaken payment claims to get around the more restrictive limitations periods applicable to *Woolwich* claims. This is likely to increase the need for taxpayers, and their advisers, to consider challenging unlawful taxes in time, rather than wait for a court decision. ■

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▶ Cases: *Jazztel v HMRC* (18.4.17)