

# Unjust Enrichment

**H**as there been a sea-change? In *HMRC v Baines & Ernst*<sup>1</sup> the Court of Appeal had one of its first opportunities to consider the VAT unjust enrichment defence. The Court told HMRC that it had adduced no evidence to prove 'passing on'. An experienced VAT Tribunal and the High Court had both concluded that the unjust enrichment defence had been proved by HMRC, for all, or part, of the claim period. That case, though I see no reason to regard it as a watershed, certainly provides an occasion to take stock of the unjust enrichment defence in VAT. It will provide a useful precedent for some, but not all, claimants faced with the defence. In terms of principle and practice in the English courts it affirms a pragmatic approach, which should ensure the defence is not an excessively difficult obstacle to repayment claims. However, there is still plenty of scope for HMRC to pursue the defence. Claimants should not be surprised to receive earlier and more comprehensive requests to produce relevant documents, especially those relating to pricing policy.

## Origins of the defence

The unjust enrichment defence can be invoked by HMRC when a taxable person makes a claim that he has accounted for an amount as output tax which was not due as output tax. The defence is statutory and was first introduced, as a defence to claims for repayments of amounts overpaid as VAT, in 1989 (at the same time as the specific statutory right/procedure for reclaiming overpaid VAT was brought into existence). The defence is now in VATA 1994, s 80(3) and (3A) to (3C). Since the substitution of the new s 80(1) and (1A), which apply to all claims made after 25 May 2005, it is clear that the statutory defence can apply to output-tax-based claims made by either 'payment' or 'repayment' traders.

*Peter Mantle, barrister, Monckton Chambers, who acted for HMRC in Baines & Ernst, reviews the defence of unjust enrichment in VAT*

## Unjust enrichment

HMRC has a defence if 'the crediting of an amount would unjustly enrich the claimant'. Unjust enrichment is not defined by UK courts and tribunals in VATA 94 but is a concept that is interpreted and applied in accordance with the jurisprudence of the ECJ.

The ability of Member States to apply an unjust enrichment defence to a claim for repayment of tax that had been levied in breach of Community Law was recognised by the ECJ in 1980 in Case 68/79 *Hans Just I/S v Danish Ministry for Fiscal Affairs*. As with most ECJ cases on unjust enrichment, it did not concern

law unjust enrichment defences. The ECJ may have occasion to resolve that debate in Case C-309/06 *Marks & Spencer v HMRC*, a reference that has just passed the stage of written observations. The Opinion of Advocate-General Jacobs and the Judgment in Case C-147/01, *Weber's Wine World*, involving the introduction with retrospective effect of an unjust enrichment defence into Austrian law, can only be explained, it is suggested, if the unjust enrichment defence is an inherent limit on the scope of the restitutionary right under EC law. At this point it is safe to say that there is an autonomous EC law concept of unjust enrichment that

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VAT. Under Danish domestic law, the 'criterion of unjust enrichment' was described as 'the cornerstone of the rules' relating to taxes paid but not owed. Thus unjust enrichment was introduced into the tax jurisprudence of the ECJ by reference to a concept embedded in the tax system of a particular Member State. This, and the formulation of the ECJ's approval of the application of the unjust enrichment defence in early cases, have fuelled debate as to whether there is an EC law principle that restitution of taxes levied contrary to EC law is not required if the result would be to unjustly enrich the claimant, or merely tolerance of acceptable national

operates in the field of restitution of overpaid tax.

The English Courts, including in the *Baines* litigation, have been ready to recognise that VAT has special features relevant to the application of the defence, especially that the intention and structure of the VAT system is that the tax should be borne by the final consumer.

## Passing on and consequential economic loss

The ECJ has identified two aspects to the unjust enrichment defence. The first is passing on. Unless the burden of the tax, or part of it, has been passed on to another

there can be no question of unjust enrichment. That burden-bearer has, in practice, invariably been the claimant's customer. However, proof of passing on does not necessarily establish unjust enrichment. The second aspect is whether loss was sustained by passing on, predictably often said to result from a fall in volume of sales.

As well as refusing to allow passing on to be considered in isolation from possible damage suffered by the claimant as a result of passing on, the ECJ has shown acute awareness that the defence could be used to make tax restitution claims excessively difficult, especially were the evidential burden to be placed on the claimant. For some this was associated with scepticism in the ECJ as to whether it could be shown that no economic loss resulted from passing on. However, recent ECJ judgments, especially *Weber's Wine World*, seem to have been less guarded. Perhaps the ECJ is now comfortable that its jurisprudence on evidential matters provides robust and sufficient protection to claimants. It even emphasised in *Weber's Wine World* that national courts are permitted to require co-operation on the part of the claimant when the defence is raised, so long as it does not make pursuing the claim excessively difficult.

### Key points from the cases

A number of points can be extracted from the ECJ's jurisprudence and its application by the English courts: (1) passing on and unjust enrichment are essentially matters of fact; (2) the burden of proving the defence is on HMRC; (3) there cannot be a presumption, or any rule that in effect operates as a presumption, that there has been unjust enrichment; (4) reasonable inferences can be drawn from the evidence; (5) reasonable disclosure can be required from the claimant; (6) the parties are entitled to adduce expert economic evidence but it cannot be assumed that every unjust enrichment case will require an economic analysis. (See *Baines* on this point. It was relatively unusual in that no expert economic evidence was called. The result may cause HMRC to be more conservative about dispensing with expert evidence.)

The principles as to burden of proof and presumptions apply both to passing on and to resultant economic loss, but, if passing on is proved, in the absence of any material giving rise to an issue that there had been resultant economic loss, there is no onus on HMRC to address economic loss and the defence will succeed. Warren J adopted an eminently well-reasoned and sensible



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approach to this in the *Baines* litigation, which is authoritative. Thus claimants who, in a Tribunal appeal, do not wish to rely solely on not having passed on the burden of the tax, should raise economic loss in their grounds of appeal, and produce evidence in support, or produce a justification of their inability to do so.

Importantly, the Court of Appeal (CA) ruled in *Baines* that the assessment of the defence must be 'made on all of the available evidence of any relevance and probative value'. Both parties will have a very free hand as to evidence in future cases, largely constrained only by what evidence is in practice available. However, the CA, whilst only deciding that evidence relating to events before as well as after the claim period was in principle admissible, was clearly wary of any attempt by HMRC to go back to a historic date and seek to draw inferences from periods significantly pre-dating the claim period, HMRC now having the benefit of a three-year limitation period.

### Baines & Ernst

And so to the result in *Baines*. The first point to note is that it involved a claim concerning exempt supplies of debt management services to consumers that had wrongly been treated as taxable. Complications caused by input tax deducted were central to CA's ultimate decision. Where a zero-rated supply is wrongly treated as standard-rated, changes to the right to deduct input tax simply cannot arise. It was in the context of zero-rated supplies that Moses J in *Marks & Spencer*<sup>3</sup> had commented that HMRC would not usually experience difficulty in showing that VAT had been

passed on. Further, it would seem perverse, with B2B supplies, for the supplier not to pass on VAT in full to a business that could deduct all that VAT as input tax. Thus *Baines* will be of most relevance where an exempt supply has been treated as taxable.

There might, in theory, be other ways of treating an argument that the claimant would have charged an amount equal to the gross price including VAT if the supply had been treated as exempt, but the CA has now firmly located such issues within 'passing on'.

Given oral evidence from Baines' financial director and some documentary evidence that clearly suggested some sort of policy of passing on VAT had been followed, the CA's verdict might have been considered as truly radical if it had been purely and simply that there was no evidence at all capable of supporting passing on. However, CA's approach was more painstaking. It was troubled that Baines had incurred large amounts of input tax, in the early part of the claim period in similar amounts to its output tax liability. This created a complication, particularly when judging the level at which prices would have been fixed in the hypothetical 'believed exempt' world. The CA (at paragraphs 67 and 69) seemed prepared to accept there was evidence to support the conclusion that Baines' price would have been below the actual gross price. However, it concluded that without more evidence to show what the precise price would have been the Tribunal's conclusion that the whole burden of the VAT had been passed on could not stand. It was wrong, absent a finding on likely price, to infer that the output tax less input tax had been passed on, nor had it been proved that any particular part of the burden had been passed on. Accordingly the defence failed. Clearly this will pose problems for HMRC on similar facts, unless there is other available evidence, for example records of a more sophisticated pricing policy evidencing passing on. Absent such evidence, where there is an issue on how inputs bearing VAT would have been paid for in a 'believed exempt' world, the apparent burden on HMRC to prove the exact price that was likely to have been charged in that hypothetical situation seems likely to make passing on significantly less easy to prove.

### Notes

<sup>1</sup> [2006] STC 1632.

<sup>2</sup> [2006] STC 653.

<sup>3</sup> [1999] STC 205.