PRESS SUMMARY

Prudential Assurance Company Ltd (Respondent) v Commissioners for Her Majesty's Revenue and Customs (Appellant) [2018] UKSC 39
On appeal from: [2016] EWCA Civ 376

JUSTICES: Lord Mance, Lord Sumption, Lord Reed, Lord Carnwath, Lord Hodge

BACKGROUND TO THE APPEAL

Prudential Assurance Company ("**PAC**") is a test claimant in this litigation, which relates to periods running from 1990–2009 and concerns the tax treatment of UK-resident companies that received dividends from portfolio shareholdings (i.e. where the investor holds less than 10% of the voting power in the company) in overseas companies.

The key features of the tax system at the relevant time were as follows. On receiving dividends from a UK-resident company, a UK-resident recipient company was exempt from corporation tax under s.208 of the Income and Corporation Taxes Act 1988 ("**ICTA**"), and by s.231(1) ICTA, would receive a tax credit equal to the amount of advance corporation tax ("**ACT**") that the distributing company had paid on the distribution. By s.238(1) ICTA, the dividend received and the tax credit together constituted "franked investment income" ("**FII**") in the hands of the recipient company, which, by s.241 ICTA, could be used to eliminate or reduce its own liability to ACT on distributions ("**franked payments**") to its own shareholders. In contrast, a UK-resident company receiving dividends from an overseas company was subject to corporation tax under schedule D of ICTA ("DV tax"). Furthermore, it did not receive a tax credit on the dividends, which did not qualify as FII, although it could be entitled to some relief against double taxation under domestic rules, or conventions between the UK and other countries.

PAC brought a claim to recover corporation tax and ACT levied contrary to EU law. Before PAC's claim was heard, the Court of Justice of the European Union ("**CJEU**") concluded in two decisions that the UK's treatment of overseas dividends was contrary to EU law in that it treated dividends received from overseas companies less favourably than dividends from UK-resident companies.[1] Following these decisions, the first instance judge gave two judgments in favour of PAC. The Court of Appeal dismissed HMRC's appeal against the judge's conclusions on Issues I, II, III and IV below, and allowed in part their appeal on Issue V. It is common ground that PAC is entitled to an appropriate tax credit, and to repayment of any tax unlawfully charged. The current dispute concerns the amount to be awarded, which depends on issues of domestic and EU law.

JUDGMENT

The Supreme Court unanimously dismisses HMRC's appeal on Issue I, allows HMRC's appeal on Issues II and III, and allows PAC's cross-appeal on Issue V. Lord Mance, Lord Reed and Lord Hodge give a joint judgment, with which Lord Sumption and Lord Carnwath agree.

REASONS FOR THE JUDGMENT

<u>Issue I: does EU law require the tax credit to be set by reference to the overseas tax actually paid, as HMRC submit, or by reference to the foreign nominal tax rate ("**FNR**"), as PAC submits?</u>

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[1] See the decision in Case C-446/04 *Test Claimants in the FII Group Litigation* and the Reasoned Order in Case C-201/05 *Test Claimants in the CFC and Dividend Group Litigation v Revenue and Customs Comrs*

The Supreme Court dismisses HMRC's appeal on this issue. The CJEU jurisprudence, particularly Case C-35/11 "*FII ECJ II*", clearly establishes that the credit for foreign dividends should be by reference to the FNR, rather than by reference to the actual or effective tax incurred overseas. There is no suggestion in the CJEU case law that any distinction is to be drawn in this respect between portfolio and non-portfolio holdings **[17-18, 27-28]**. As a result of the Court's conclusion on Issue I, Issue IV (i.e. the construction of the domestic provisions if HMRC were to succeed on Issue I) does not arise **[34]**.

<u>Issue II: is PAC entitled to compound interest in respect of tax which was levied in breach of EU law, on the basis that HMRC were unjustly enriched by the opportunity to use the money in question?</u>
The Supreme Court allows HMRC's appeal on this issue. In *Sempra Metals Ltd v Inland Revenue Comrs* [2007] UKHL 34 a majority of the House of Lords held that a claim would lie in unjust enrichment for restitution of compound interest on money which was paid prematurely as the consequence of a mistake **[43-55]**. A number of developments since that decision indicate that it failed to have regard to tax legislation, created problems in the law of limitation, and caused disruption in public finances **[56-67]**. Furthermore, it is inconsistent with *Investment Trust Companies v Revenue and Customs Comrs* [2017] UKSC 29, which explained the requirement for a defective transfer of value by the claimant to the defendant. The recipient's possession of money mistakenly paid to him, and his consequent opportunity to use it, is not a distinct transfer of value, additional to the payment of the money. Accordingly, there is no right to interest on the basis of unjust enrichment **[68-74]**. The Supreme Court therefore departs from the reasoning in *Sempra Metals* on this issue and rejects PAC's claims to compound interest (except insofar as they were conceded by HMRC) **[80]**.

<u>Issue III: does a claim in restitution lie to recover lawful ACT which was set against unlawful mainstream corporation tax ("**MCT**")?</u>[2]
The Supreme Court allows HMRC's appeal on this issue, answering this question in the negative. When the lawful ACT was set against unlawful MCT, HMRC did not receive unlawfully levied tax, as required for a "*San Giorgio*" claim **[98]**.[3] If an apparent charge to MCT was unlawful, that charge was a nullity. The lawful ACT could not have been set against a nullity, but would remain available to be otherwise utilised **[101-102]**. Furthermore, the payment of the ACT did not entail a defective transfer of value which fell to be corrected, as required by *Investment Trust Companies* (above) **[103]**.

<u>Issue V(a): where ACT from a pool which includes unlawful and lawful ACT is utilised against an unlawful MCT liability, is the unlawful ACT regarded as a pre-payment of the unlawful MCT liability or is the ACT so utilised regarded as partly lawful and unlawful pro rata?</u>
The Supreme Court allows PAC's cross-appeal on this issue. Unlawful ACT is treated as set first against unlawful MCT. Further, because unlawful MCT is a nullity, the unlawful ACT is recoverable unless it has been set against a lawful MCT charge **[111]**.

<u>Issue V(b): where domestic FII was carried back to an earlier quarter, is it to be treated as having been applied to relieve the lawful and unlawful ACT pro rata, or only lawful ACT?</u>
The Supreme Court allows PAC's cross-appeal on this issue. Domestic FII which is carried back to an earlier quarter is to be regarded as having been applied to relieve only lawful ACT. HMRC's pro rata approach would deprive a company of the tax credit at the FNR required under EU law **[118-122]**.

References in square brackets are to paragraphs in the judgment

<u>**NOTE**</u>
This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at:
http://supremecourt.uk/decided-cases/index.html

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[2] Lawful ACT refers to the element within an ACT charge which did not represent unduly levied tax on overseas-sourced dividends. Unlawful MCT refers to the part of the MCT charge which is attributable to the failure to give the overseas dividends a tax credit at the FNR (pursuant to the Court's conclusion on Issue I) **[88]**.
[3] See Case C-199/82 *Amministrazione delle Finanze dello Stato v San Giorgio SpA*