23 July 2021

PRESS SUMMARY

Test Claimants in the Franked Investment Income Group Litigation (Respondents) v Commissioners for Her Majesty's Revenue and Customs (Appellant)
[2021] UKSC 31
On appeals from [2010] EWCA Civ 103 and [2016] EWCA Civ 1180

JUSTICES: Lord Reed (President), Lord Hodge (Deputy President), Lord Briggs, Lord Sales, Lord Hamblen

BACKGROUND TO THE APPEALS

This appeal arises in the course of long-running proceedings known as the Franked Investment Income (**FII**) Group Litigation. The FII Group Litigation brings together many claims concerning the tax treatment of dividends received by UK-resident companies from non-resident subsidiaries, as compared with the treatment of dividends paid and received within wholly UK-resident groups of companies. The Respondents to this appeal are claimants within the FII Group Litigation (the **Claimants**) whose cases have been selected to proceed on certain common issues against the Appellant, the Commissioners for Her Majesty's Revenue and Customs (the **Revenue**).

These issues concern now repealed provisions of the Income and Corporation Taxes Act 1988 which provided for a system of advance corporation tax (**ACT**) and the taxation of dividend income from non-resident sources (the **DV provisions**). The Claimants' primary claim is that the differences between their tax treatment and that of wholly UK-resident groups of companies breached the EU treaty provisions which guarantee freedom of establishment and free movement of capital. They seek repayment by the Revenue of the tax wrongly paid, together with interest, dating back to the UK's entry to the EU in 1973.

There have been several other proceedings concerning the compatibility of the UK's previously in force tax regime with EU law, raising issues which also arise in the FII Group Litigation. These proceedings have collectively driven the development of both English law and EU law, giving rise to important judgments of the House of Lords and Supreme Court including the Court's decision in *Prudential Assurance Co Ltd v Revenue and Customs Comrs* [2018] UKSC 39.

The FII Group Litigation proceedings have been complex and extended. There have been two consecutive trials in the High Court, often labelled as the "liability trial" and "quantification trial" respectively, each of which resulted in an appeal to the Court of Appeal. The proceedings have also resulted in appeals to the Supreme Court, of which this is the third, and three references to the Court of Justice of the European Union (**CJEU**).

The outstanding issues for determination in these appeals are disparate, involving issues of principle and issues relating to the quantification of the Claimants' claims. The Supreme Court addresses these issues in its judgment as follows:

1. Is the Revenue barred from contesting an award of compound interest for tax paid prematurely by the Claimants? **[58-84]**
2. On what basis are the Claimants entitled to recover interest for tax paid prematurely? **[85-118]**

3. What is the nature of the remedy required by EU law in respect of the set off of double taxation relief? **[119-159]**
4. Was the Revenue enriched as a matter of English law given the interaction of ACT with shareholder credits? **[160-193]**
5. Does it make any difference that the UK group had a non-resident parent which received double taxation treaty credits? **[194-200]**
6. Are the DV provisions permitted by the standstill provision of Article 64(1) TFEU in light of the Eligible Unrelieved Foreign Tax Rules? **[201-222]**
7. When and to what extent should unlawfully charged ACT be regarded as "surrendered"? **[223-232]**

Certain other outstanding issues have been determined by agreement between the parties following the Supreme Court's decision in *Prudential* **[52-57]**.

JUDGMENT

The Supreme Court unanimously allows the Revenue's appeal on issues 1 and 2 above but dismisses their appeal on issue 4. The Supreme Court unanimously allows the Claimants' appeal on issues 3, 5 and 6 above but dismisses their appeal on issue 7. Lord Reed and Lord Hodge give the judgment with whom Lord Briggs, Lord Sales and Lord Hamblen agree.

REASONS FOR THE JUDGMENT

1. Is the Revenue barred from contesting an award of compound interest for tax paid prematurely by the Claimants?

The Claimants' case is that the Revenue are barred from challenging their entitlement to compound interest for the time value of money during periods when they paid tax prematurely (the **prematurity period**). They argue that the first phase of the litigation conclusively established the validity of their claims in restitution. They plead alternatively cause of action estoppel, issue estoppel, abuse of process and lack of jurisdiction, each of which is underpinned by the principle that there should be finality in litigation.

The Claimants' submissions on this issue are rejected. In respect of cause of action estoppel and issue estoppel, while the first phase of the litigation has often been described as the "liability phase", it was concerned with determining issues of principle at a high level of generality. During that first phase, the High Court and Court of Appeal had recognised only that the Claimants had a successful claim for the prematurity period. Neither court made any determination as to the appropriate measure of compensation, which was left over to the second phase **[65-67, 73]**. While the Revenue had conceded during the second phase that compound interest should be paid, the Supreme Court has allowed the Revenue to withdraw its concession in light of its judgment in *Prudential* **[68]**.

Further, the Revenue's challenge does not amount to an abuse of process. Given the complex and evolving legal backdrop to the FII Group Litigation and related proceedings, it is unsurprising that questions of central importance have only recently or are yet to be decided **[77-78]**. There is also no jurisdictional bar to the Supreme Court hearing the Revenue's challenge under section 54(4) of the Access to Justice Act 1999 **[80]**.

2. On what basis are the Claimants entitled to recover interest for tax paid prematurely?

The Revenue's case is that interest for the prematurity period should be calculated on a simple interest basis under section 85 of the Finance Act 2019 (the **2019 Act**). The Claimants argue that interest should instead be calculated on a simple interest basis under section 35A of the Senior Courts Act 1981 (the **1981 Act**). The importance of this issue lies in the fact that the 2019 Act imposes a six-year limitation period whereas the Claimants argue that claims to interest under the 1981 Act benefit from the extended limitation period available under section 32(1)(c) of the Limitation Act 1980.

The Revenue's appeal succeeds on this issue. Section 85 of the 2019 Act was introduced to provide a statutory basis for awarding interest in respect of the prematurity period **[97, 100]**. The Supreme Court rejects the numerous arguments advanced by the Claimants that they should not be confined to a remedy under section 85. The Court highlights, among other things, that although EU law confers a right to the payment of interest, it does not prescribe a period of limitation **[105]** and that, following *Prudential*, claims to interest are not restitutionary in nature **[107]**.

3. *What is the nature of the remedy required by EU law in respect of the set off of double taxation relief?*

This issue concerns the utilisation of various reliefs by the Claimants including double taxation relief (**DTR**) to reduce or eliminate their liability to pay unlawfully levied mainstream corporation tax (**MCT**). A consequence of the order in which the reliefs were applied was that DTR was not fully utilised. Under the DTR provisions, DTR could not be carried forward to reduce MCT in a future accounting period and was consequently lost. The Claimants seek a remedy, arguing that the inability to carry forward unused DTR breached EU law.

The Claimants' appeal succeeds on this issue. In light of the CJEU' s judgment in *Österreichische Salinen* (Case C-437/08) [2011] STC 917, it is clear that the DTR provisions, in preventing the carrying forward of unused DTR, gave rise to indirect economic double taxation and a difference in treatment as between domestic-source and foreign-source dividends in breach of EU law **[135-140]**. In terms of the appropriate remedy, the offending DTR provisions must be disapplied **[145]**. In respect of MCT already incurred as a result of the inability to carry forward DTR, a remedy is available in restitution to recover the MCT plus interest subject to the law of limitation **[155-156, 158]**.

4. *Was the Revenue enriched as a matter of English law given the interaction of ACT with shareholder credits?*

The Revenue's case is that although they received unlawfully levied ACT from the Claimants, those payments triggered a corresponding obligation on the Revenue to pay out shareholder tax credits. As a result, the Revenue argues it was not "enriched" as a matter of English law.

The Revenue's appeal fails on this issue. The obligation to pay ACT on the one hand and entitlement to shareholder tax credits on the other were set out in independent statutory provisions, neither of which was conditional on the other. The (unlawful) levy of ACT had no bearing on the shareholder's entitlement to the tax credit **[190]**. Further, a consequence of interpreting the ACT provisions in conformity with EU law is that the Revenue were obliged to pay the shareholder tax credits even without the payment of ACT **[191-192]**. The shareholder tax credits cannot therefore be deducted from the unlawful ACT in calculating the compensation due to the Claimants.

5. *Does it make any difference that the UK group had a non-resident parent which received double taxation treaty credits?*

This issue arises in respect of the Ford test claimant. FCE Bank plc (**FCE**) is a UK resident company, ultimately owned by the Ford Motor Company (**Ford US**). FCE was paid dividends by Ford's overseas subsidiaries and in turn paid dividends to Ford US, triggering payments of ACT. Ford US was entitled to a tax credit pursuant to a UK-US double taxation treaty. Again, it is accepted that the ACT paid was unlawfully levied and the question is whether in determining the Revenue's enrichment, account should be taken of the credit paid to Ford US.

The Claimants' appeal succeeds on this issue. As with issue 4 above, the payment of the tax credit was not conditional on FCE incurring a liability to pay ACT. The Revenue were obliged to pay the credit to Ford US regardless. The Revenue are not therefore entitled in calculating compensation due to FCE to deduct from the unlawful ACT, the tax credit paid to Ford US **[198]**.

6. *Are the DV provisions permitted by the standstill provision of Article 64(1) TFEU in light of the Eligible Unrelieved Foreign Tax Rules?*

Article 63 of the Treaty on the Functioning of the EU prohibits restrictions on the free movement of capital. It is subject to the "standstill provision" in Article 64(1) which provides for a derogation from the prohibition for restrictions existing on 31 December 1993. The unlawful levying of corporation tax on foreign-sourced dividends took place for many years prior to that date. The Claimants accept that the DV provisions would benefit from the standstill but for the introduction of the Eligible Unrelieved Foreign Tax Rules (**EUFT rules**) in 2001. They argue that the EUFT rules introduced a new approach, restricting the free movement of capital, which is not protected by the standstill provision.

The Claimants' appeal succeeds on this issue. Considering the case law of the CJEU on the application of the standstill provision, it is clear that the adoption of the EUFT rules altered the tax regime governing foreign source dividends. The rules introduced materially different procedures for the calculation of tax credits and did nothing to reduce the pre-existing restriction on the free movement of capital. As a result, the benefit of the standstill provision is lost **[220-221]**.

7. When and to what extent should unlawfully charged ACT be regarded as "surrendered"?

The ACT provisions provided for ACT paid by a company to be set off against its liability to MCT. Where a company had paid more ACT than its liability to MCT, it could, as well as carrying surplus ACT back or forward, "surrender" surplus ACT to a subsidiary, which could then set it off against its own MCT liability. This issue concerns the appropriate method for calculating compensation where a parent company has surrendered an undifferentiated pool of lawful and unlawful ACT to a subsidiary.

The Claimants' appeal fails on this issue. The Court rejects their argument that the reasoning in *Prudential* regarding the utilisation of ACT should apply also to the surrendering of ACT **[227-228]**. The ACT provisions deem the subsidiary to be the entity which has paid the surrendered ACT. They do not treat the parent company's ACT liability as if it belonged to the corporate group as a whole **[230]**. There is therefore no basis for treating a parent company's surplus ACT which was actually surrendered to a particular subsidiary other than as partly lawful and partly unlawful on a pro rata basis **[232]**.

References in square brackets are to paragraphs in the judgment

NOTE

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