METALLGESELLSCHAFT / HOECHST FOLLOW UP: UK HIGH COURT RULES THAT TAX PAID UNDER A MISTAKE OF LAW CAN BE RECOVERED BY DEUTSCHE MORGAN GRENFELL (DMG)

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A judgment of the UK High Court delivered by Mr. Justice Park on the 18th July 2003 could have interesting repercussions for Danish companies with subsidiaries in the UK. The message is — you still have time to make a claim.

The case — *Deutsche Morgan Grenfell Group plc v Inland Revenue Commissioners and another* — one of a number of test cases arising out of the *Metallgesellschaft / Hoechst* ECJ decision — revolved around the payments of Advance Corporation Tax (ACT) made by DMG's UK subsidiaries to the UK Inland Revenue when they paid dividends to their German parent. The High Court held that English law recognised the right to recover money paid under a mistake of law (including taxes paid to the Revenue authorities) and the limitation period specified in the UK's domestic legislation (6 years) did not start to run until the mistake was discovered. Park J. found that this was the date of the ECJ decision in the Metallgesellschaft/Hoechst decision and consequently, DMG's claims for restitution was not time-barred.

BACKGROUND

Prior to the Metallgesellschaft / Hoechst ECJ decision, UK domestic law provided that where subsidiaries paid dividends to their qualifying

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parents, 'group income' elections could be made. These allowed the dividends to be paid without ACT being paid to the Inland Revenue. However, only UK resident companies could qualify for this tax treatment. The election could not be made if the group included a non-UK resident parent such as DMG. This was the established thinking prior to the time of the ECJ decision in Metallgesellschaft / Hoechst.

The ECJ decided in Metallgesellschaft / Hoechst that such tax treatment was incompatible with Community law and that Community law gave the affected companies a right to compensation or restitution.

A series of test cases were brought and the DMG case concerned questions concerning limitation of actions arising. In particular, some of DMG's ACT payments had been made more than 6 years before it commenced its action.

The Inland Revenue therefore argued that such claims were time-barred by the UK domestic legislation. The claimants' contentions were two-fold:

1. That English law recognised an action for restitution of money paid under a 'mistake of law'; and
2. That the UK domestic legislation relating to 'limitation periods' (in particular, section 32(1)(c) Limitation Act, 1980) started the limitation period only from the date the claimant discovered the mistake or could 'with reasonable diligence' have discovered it.

Basically, DMG argued that the ACT payments were made under a mistake of law and that it only discovered its mistake when the ECJ gave its decision in the Metallgesellschaft / Hoechst case. Consequently, time started to run only from that date which was 8 March 2001.

The High Court examined three principle questions:

(i) 'Does a claim for restitution of a payment made under a mistake of law apply in the case of a payment of tax to a Revenue authority?
(ii) Did DMG make the ACT payments under a mistake of law?
(iii) Under section 32(1)(c) of the Limitation Act 1980, did the limitation period begin to run only when the ECJ gave its decision or did it begin to run earlier (such as when DMG found out that Metallgesellschaft was challenging the ACT regime under Community law)?

Mr. Justice Park answered 'yes' to (i) and (ii), and that time only began to run from the date of the ECJ decision in answer to (iii). Consequently, he allowed DMG's claims.

ANALYSIS OF THE JUDGMENT

The House of Lords in *Kleinworth Benson* (KB) had previously held that English law recognises a claim in restitution to recover money under a mistake of law. In that case a bank (KB) had made payments to a local authority under swap agreements, which the bank though were legally enforceable. However, an intervening decision of the House of Lords (*Hazell*) showed that the bank and everyone else were mistaken about the law — the swap agreements were not legally enforceable. KB sued to recover the payments, which it had made and although it had limitation problems, it relied on its right to recover under section 32 of the Limitation Act 1980. By majority, the House of Lords held that KB was entitled to succeed; money paid under a mistake of law was recoverable and the limitation period was postponed until the time when the mistake was discovered or discoverable with reasonable diligence.

Mr. Justice Park cites a key part of Lord Goff's speech in *Kleinworth Benson*:

> 'The payer believed, when he paid the money, that he was bound in law to pay it. He is now told that, on the law as held to be applicable at the date of the payment, he was not bound to pay it. Plainly, therefore, he paid the money under a mistake of law, and accordingly, subject to any applicable defences, he is entitled to recover it.'

Park J. notes the significance of a payment of tax under a mistake of law or a payment made under an ordinary private transaction but, in principle, he dismisses the difference and holds that the tax payments paid under a mistake of law can be recovered.

The House of Lords in 1993 had rendered a judgment in which it held at common law taxes exacted ultra vires were recoverable as of right, without the need to invoke a mistake of law doctrine. (*Woolwich Equitable Building Society*).

In *Kleinworth Benson,* Lord Goff refers to this case and also comments that

> 'in cases concerned with overpaid taxes, a case can be made in favour of a principle that payments made in accordance with a prevailing practice, or indeed under a settled understanding of the law, should be irrecoverable. If such a situation should arise …it is possible that a large number of taxpayers may be affected; there is an element of public interest which may militate against repayment of tax in such circumstances… and exclusion of recovery on public policy grounds may be more readily justifiable.'

Park J. interpreted Lord Goff as leaving this matter open for a more appropriate case, as *Kleinworth Benson* did not concern an overpayment of taxes. It is this public interest argument, which might be advanced more vehemently in the event of an appeal.

The High Court clarifies that the mistake of law which DMG made was not that it paid ACT which was not payable — rather that it did not realise that its UK subsidiaries could have made group income elections with the DMG parent company, which would have had the effect of preventing the ACT from being payable. The Revenue argued that if DMG paid the ACT at a time when it knew that UK domestic law was being challenged under Community law, it could not say that ACT payments made after this time were paid under a mistake. The Court refuses to accept this submission reasoning that it was only after the ECJ had delivered its Metallgesellschaft / Hoechst decision that DMG knew what the law was in relation to group income elections. If the true state of the law had been known earlier, then the appropriate group elections would have been made and the ACT would not have been paid. Consequently, the Court finds that the mistake was only discovered on the date that the ECJ decision was released. Park J. did not accept that the mistake was known from the date that the Advocate General rendered his opinion, simply because it was 'not inevitable that the ECJ would take the same view as the Advocate General.'

In concluding, Mr. Justice Park holds for the DMG but again cites Lord Goff in *Kleinworth Benson*

> 'I recognise that the effect of section 32(1)(c) is that the cause of action in a case such as the present may be extended for an indefinite

> period of time… [T]he recognition of the right at common law to recover money on the ground that it was paid under a mistake of law may call for legislative reform to provide for some time limit to the right to recover in such cases.'

No legislation amending section 32 of the Limitation Act 1980 has been implemented to date and it appears that both the High Court in *DMG,* and the House of Lords in *Kleinworth Benson,* were saying this is a matter for the legislature to deal with.

Outcome

DMG were not entitled to return of the ACT as this was a pre-payment of their MCT (Mainstream Corporation Tax). What they are entitled to is interest on the ACT payments paid under a mistake of law from the relevant dates that the payments were made until the date of the MCT was payable.

COMMENT

As the decision involves a significant amount of revenue, and as this is a test case, it is highly likely that this case will eventually make it to the House of Lords. Whilst the judgment of the High Court appears on its face to be solid and in line with precedent, the potential 'public interest' defence alluded to by Lord Goff in *Kleinworth Benson* may come into play. As the *Kleinworth Benson* case was won 3-2, the House of Lords will be fully aware that cases of this type will appear more and more in the future with the impact of Community law decisions of the ECJ on the UK's domestic rules, which are found to be incompatible. In certain situations — involving a huge number of taxpayers, perhaps going back many years — it is not always going to be appropriate that tax returns (perhaps, closed for many years) will have to be re-opened for such a lengthy period. Clearly, the possibility remains that some form of public interest defence may be required to stem the potential floodgates. Whether this can be interpreted by the Courts or remains solely a matter for the UK legislature is an open question.

What is certain is that the date of the ECJ decision in Metallgesellschaft / Hoechst (8 March 2001) has taken on increased significance for com-

panies with subsidiaries in the UK who failed to make group income elections prior to that date. As the 6-year limitation period has been held to start from that date, there is still time to make claims!

Case References:

Deutsche Morgan Grenfell Group plc v Inland Revenue Commissioners and another [2003] All ER (D) 321. (18 July 2003).

Kleinworth Benson v Lincoln City Council [1998] 4 All ER 513.

Hazell v Hammersmith and Fulham LBC [1992] 2 AC 1.

Woolwich Equitable Building Society v Inland Revenue Commissioners [1993] AC 70.

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