

HOUSE OF LORDS

**OPINIONS OF THE LORDS OF APPEAL FOR JUDGMENT
IN THE CAUSE**

**Marks and Spencer plc (Appellants) v. Her Majesty's
Commissioners of Customs and Excise (Respondents)**

[2005] UKHL 53

LORD NICHOLLS OF BIRKENHEAD

1. I have had the advantage of reading in draft the speeches of my noble and learned friends Lord Hoffmann and Lord Walker of Gestingthorpe. For the reasons they give I agree your Lordships' House should refer questions to the Court of Justice of the European Communities on the points mentioned by Lord Walker of Gestingthorpe. Given the tortuous history of this matter I reach this conclusion with reluctance, but in the circumstances this outcome is inescapable.

LORD STEYN

My Lords,

2. I have read the opinions of my noble and learned friends, Lord Hoffmann and Lord Walker of Gestingthorpe. I am in full agreement with their opinions. For the reasons which Lord Hoffmann and Lord Walker so carefully explained I too regard it as inevitable that the House should refer questions to the European Court of Justice on the points mentioned.

LORD HOFFMANN

My Lords,

1. The supply of food is in general zero-rated for VAT: see section 30 and Schedule 8, Part II, Group 1, item 1 of the Value Added Tax Act 1994. But there are exceptions. One exception is confectionery: see

item 2 of the Excepted Items. But there is an exception to that exception: cakes or biscuits are in general also zero-rated. There is however an exception to that exception to the exception, namely biscuits wholly or partly covered with chocolate. They are standard-rated.

2. For many years, starting with the introduction of VAT in 1973, the Commissioners of Customs and Excise took the view that Marks & Spencer teacakes, which are covered with chocolate, were biscuits and therefore standard-rated. Marks & Spencer accounted for VAT on that basis. But in September 1994 they admitted they had been wrong. They were actually cakes and should have been zero-rated. Marks & Spencer claimed repayment of all the VAT for which they had wrongly accounted over the years, totalling £3.5 million.

3. Section 80 of the 1994 Act gives a limited right to repayment:

“(1) Where a person has (whether before or after the commencement of this Act) paid an amount to the Commissioners by way of VAT which was not VAT due to them, they shall be liable to repay the amount to him.

(2) The Commissioners shall only be liable to pay an amount under this section on a claim being made for the purpose.

(3) It shall be a defence, in relation to a claim under this section, that repayment of an amount would unjustly enrich the claimant.”

4. The Commissioners invoked the defence under subsection (3). They said that Marks & Spencer had passed on 90% of the VAT to their customers. After hearing expert evidence about the market for teacakes, the VAT Tribunal accepted this submission and held that Marks & Spencer were entitled to only 10% of their claim. Marks & Spencer no longer dispute that as a matter of domestic law this finding was correct. Instead, they claim that they have a right to repayment not only under section 80 but also as a matter of community law and that it would be contrary to principles of community law for that right to be restricted by the defence of unjust enrichment.

5. The main question in this appeal is therefore whether Marks & Spencer have a right to repayment under Community law. There is no doubt that if a Member State charges VAT in breach of the rules of

community law, a community right to repayment will be implied: see *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* (Case C-62/93) [1995] STC 805. Whether such a right would, in the circumstances of this case, be incompatible with the unjust enrichment defence is a matter in dispute. But what seems clear is that for such a right to arise in the first place, the charge to VAT must have been in breach of the rules of community law.

6. Does community law give Marks & Spencer a right to be zero-rated on the sale of teacakes? Article 12(3) of the Sixth Directive lays down the general rule that VAT must be charged at the standard rate. But, by way of exception, Article 28(2)(a) says that Member States “may” maintain “exemptions with refund of the tax paid at the preceding stage” (that is to say, zero-rating) which were in force in 1991. This continues an exception which has existed since VAT was first introduced.

7. The United Kingdom has chosen, as a matter of domestic law, to exercise this power. But does that mean that Marks & Spencer has a *community* right to be zero-rated? I should have thought not. Community law imposes no duty upon the United Kingdom to refrain from charging the standard rate of VAT on tea cakes. Marks & Spencer say that although there is no duty to legislate for a zero rate, article 12.1 of the Directive says that “the rate applicable to taxable transactions shall be that in force at the time of the chargeable event”. If, therefore, the rate in force at the time the tea cakes were sold was zero, there was a community right to be charged that rate and no more.

8. I do not accept this submission. Article 12.1 is concerned with timing, not with the rate which may be charged. In any case, article 12.1 can have no application to transactions on which no tax is imposed, whether they are exempt in the narrower UK sense or zero-rated, that is to say, exempt with refund of tax previously paid.

9. This view appears to me to be supported by the reasoning of the Court of Justice in *Idéal Tourisme SA v Belgian State* (Case C-36/99) [2001] STC 1386. Ideal Tourisme complained that the services they provided to coach passengers were charged VAT at 6% while competing air transport was exempt. They said that such discrimination was in breach of the community principle of equal treatment. The Belgian government said that they had a right to exempt air travel under article

28(3)(b) of the Directive but no such right in respect of coach travel. The Court said, in paragraph 38 of its judgment:

“As the Belgian State stated at the hearing, the harmonisation envisaged has not yet been achieved, insofar as the Sixth Directive, by virtue of art 28(3)(b), unreservedly authorises the member states to retain certain provisions of their national legislation predating the Sixth Directive which would, without that authorisation, be incompatible with that directive. Consequently, insofar as a member state retains such provisions, it does not transpose the Sixth Directive and thus does not infringe either that directive or the general community principles which member states must...comply with when implementing community legislation.”

10. Similarly, as it seems to me, the United Kingdom, by zero-rating cakes, was not transposing the Sixth Directive and its failure to apply that “rate” to Marks & Spencer teacakes was therefore not a breach of the Directive or any other principle of community law.

11. If that is correct, then the claim by Marks & Spencer to avoid the unjust enrichment defence must fail at the first hurdle. Speaking for myself, I think that it is correct. But we have been shown two contrary opinions which must be entitled to respect. The first is in the submissions of the Commission on a reference at an earlier stage of these proceedings which was concerned with the recovery of VAT on gift vouchers. There was no doubt that, in the light of the decision of the Court of Justice in *Argos Distributors Ltd v Commissioners of Customs and Excise* (Case C-288/94) [1996] STC 1359, VAT on the vouchers had been charged on a basis inconsistent with Community law. The reference raised no question about whether the same could be said about teacakes. Nevertheless, the Commission, in its Written Observations, said:

“There is only one difference between the early vouchers claim and the [late vouchers and teacakes] claims; as regards the early vouchers claim, the national legislation itself contravened the Directive, whereas with respect to the other two claims that legislation was unimpeachable in itself but was misapplied. Yet the end result in the two

instances was precisely the same: the Directive was breached...”

12. Likewise, the Advocate General (Geelhoed) said at para 44:

“It is manifestly clear from the documents before the court that, in regard to both teacakes and gift vouchers after August 1992, the commissioners applied national tax legislation in a manner inconsistent with the directive.”

13. There is no explanation of why the treatment of tea cakes was inconsistent with the directive. Nevertheless, in the light of these two observations, I find it impossible to say that the view which I would otherwise have formed is *acte clair*. I therefore agree with my noble and learned friend Lord Walker of Gestingthorpe that there should be a reference to the European Court and I concur in the order which he proposes.

LORD SCOTT OF FOSCOTE

My Lords,

14. Having had the advantage of reading in advance the opinion prepared by my noble and learned friend Lord Walker of Gestingthorpe I am in admiring agreement with his analysis of the issues raised by this appeal and agree with his conclusion that there should be the reference to the European Court of Justice on the points he has identified.

LORD WALKER OF GESTINGTHORPE

My Lords,

Introduction

15. The appellant Marks & Spencer Plc (“M & S”) is a very well-known high-street retailer. Its turnover comes mostly from the sale of clothing, but it also sells a limited range of foodstuffs, including ready-made meals and other own-brand products. Its own-brand products have for many years included chocolate-covered marshmallow teacakes, manufactured by the McVities division of United Biscuits. No other retailer sells identical teacakes. Another manufacturer, Thomas Tunnock Ltd, did, in the 1990s, make comparable teacakes which were sold both under the Tunnock brand name and (as an own-brand line) by Tesco Plc (“Tesco”).

16. Most foodstuffs are zero-rated for the purposes of value added tax (“VAT”): see section 30 of and, Part II, Group 1 of Schedule 8 to the Value Added Tax Act 1994 (“VATA 1994”). Clothing and footwear, by contrast, is zero-rated only if designed for young children (and not suitable for other persons) or if within limited categories of protective clothing and footwear: VATA 1994 Schedule 8 Part II, Group 16. Other sales of clothing attract VAT at the standard rate (currently 17.5%). A trader making supplies which are wholly or largely zero-rated is entitled to repayment of an amount equal to its surplus input tax as a VAT credit under VATA 1994 section 25(3). Such traders are sometimes referred to as “repayment traders”. Tesco was during the period relevant to this appeal a repayment trader. M & S, by contrast, was (with the exception of a single quarter during 1993) a “payment trader”, since the output tax on the bulk of its turnover (adults’ clothing) exceeded the input tax attributable to all its trading activities.

17. Although most foodstuffs are zero-rated, there are exceptions, listed in several paragraphs of excepted items in Group 1. The list of exceptions (which can be traced back to the days of purchase tax, so that its retention no doubt eased the transition to VAT on 1 April 1973) includes (para 2),

“Confectionery, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some product similar in taste and appearance.”

So a cake covered in chocolate is zero-rated, but a biscuit covered in chocolate (or chocolate substitute) is within an exception to an exception to an exception, and attracts standard-rate VAT. The complex litigation leading to this appeal originated in the fact that in 1994 the Commissioners of Customs & Excise, now the respondents the Commissioners of Revenue and Customs & Excise (“the Commissioners”) changed their view as to the correct classification of the teacakes sold by M & S. From 1973 to 1994 they regarded them as biscuits covered in chocolate, and so attracting standard-rate VAT. In 1994 they accepted that they were (and always had been) cakes covered in chocolate, and so entitled to zero-rating.

18. This is an appeal by M & S from an order of the Court of Appeal (“the second Court of Appeal”) made on 21 October 2003 following a reference to the Court of Justice of the European Communities (“the ECJ”) made on 14 December 1999 by a differently constituted Court of Appeal (“the first Court of Appeal”). The judgments of the first Court of Appeal are reported at [2000] STC 16; the opinion of the Advocate-General and the judgment of the ECJ at [2002] STC 1036; and the judgments of the second Court of Appeal at [2004] STC 1. The judgment of Auld LJ in the second Court of Appeal gives (paras 17 to 32) a full and accurate account of the complex and protracted course of the litigation. But since the House is (as I understand it) minded to make a further reference to the ECJ it is appropriate to set out a self-contained summary of the litigation, including some issues which are no longer live issues. A full explanation of the background is needed in order to explain the difficulties leading to the need for a further reference.

The main issues of EC law

19. Before attempting a summary of the course of the litigation, however, and in the hope of providing some signposts on the way, I shall try to identify the main issues of EC law which have arisen (some but not all of which are directly relevant to this appeal as it comes before your Lordships’ House). These are (1) directly enforceable rights under EC law (in the language of section 2(1) of the European Communities Act 1972, “enforceable Community right[s]”), especially in connection

with the transposition into national law of EC directives; (2) transitional provisions of the Sixth Directive on VAT (77/388/EEC), especially as regards zero-rating; (3) repayment of overpaid tax and the passing-on defence; and (4) general principles of EC law and when and how they give rise to enforceable Community rights. These are briefly considered in the following paragraphs.

20. *Enforceable Community rights*: It is very well established that an individual may assert a directly enforceable right in his national court where (1) a member state has failed to transpose, or has failed to make a correct transposition of, a directive into national law; and (2) the relevant provision of the directive is unconditional and sufficiently precise. In such circumstances the member state is estopped from relying on its own failure to make a correct transposition. These two conditions are sometimes called the first and second *Becker* conditions (after the seminal case of *Becker v Finanzamt Münster-Innenstadt* (Case 8/81) [1982] ECR 53, paras 24 and 25).

21. What if a member state's legislature correctly transposes a directive, but its executive branch of government (or another emanation of the state) systematically errs in its interpretation and application of the transposed measure? One view, based on some general observations by the ECJ in *Kampelmann v Landschaftsverband Westfalen-Lippe* (Joined Cases C-253/96 to C-258/96) [1997] ECR I-6907, para 42, was that that did not give rise to a directly enforceable right, and that any right to redress which the individual had before his national court was a matter for national law. The other view, tentatively expressed in the Court of Appeal in *Three Rivers District Council v Governors and Company of the Bank of England (No 3)* [2003] 2 AC 1, 71, was that an administrative failure to interpret and apply the transposed measure correctly could give rise to a directly enforceable right. This issue has assumed great importance in the present litigation, and led to a drastic revision by the ECJ of the question of EC law referred to it by the first Court of Appeal.

22. *Zero rating*: The long-term aspiration of those who shape EC strategy is that VAT should become a fully harmonised tax. But the process of harmonisation is still far from complete. In the meantime member states have been given limited powers to maintain, for a transitional period which has turned out to be protracted, reduced rates of VAT, exemptions from VAT and other special provisions of their own tax systems. The provision most relevant to this appeal, in article 28(2) of the Sixth Directive in its original form, was as follows:

“Reduced rates and exemptions with refund of the tax paid at the preceding stage which are in force on 31 December 1975, and which satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967, may be maintained until a date which shall be fixed by the Council, acting unanimously on a proposal from the Commission, but which shall not be later than that on which the charging of tax on imports and the remission of tax on exports in trade between the Member States are abolished . . .

On the basis of a report from the Commission, the Council shall review the above-mentioned reduced rates and exemptions every five years and, acting unanimously on a proposal from the Commission, shall where appropriate, adopt the measures required to ensure the progressive abolition thereof.”

Article 28(2) has continued in force, subject to amendments made by Council Directive 92/77/EEC, operative as from 31 December 1992. Article 28(2) as amended, and so far as relevant, provides as follows:

“(a) Exemptions with refund of the tax paid at the preceding stage and reduced rates lower than the minimum rate laid down in Article 12(3) in respect of the reduced rates, which were in force on 1 January 1991 and which are in accordance with Community law, and satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967, may be maintained.”

So the express requirement that the measures should be in accordance with Community law was introduced by the amendment.

23. M & S’s right to have sales of its teacakes zero-rated depends, therefore, on a choice made by the United Kingdom Parliament, but within the framework of powers conferred by the Sixth Directive. Your Lordships, like the courts below, have heard extended argument, deploying various metaphors, as to whether this right should be regarded as an enforceable Community right, or alternatively as one which fails to satisfy one or both of the *Becker* conditions.

24. *Repayment of repaid tax and the passing-on defence*: The Sixth Directive does not confer any express right to repayment of tax unlawfully exacted by a member state. But such a right is “the consequence and compl[e]ment” of a directly enforceable Community right. The taxpayer’s right of recovery must be exercised in “the framework of the substantive and procedural conditions laid down by the various relevant national laws,” but those conditions must comply with the general principles of equivalence and effectiveness: see *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* [1995] ECR I-1883, paras 40 and 41.

25. Passing-on is recognised (although not without some controversy: see for instance Burrows, *The Law of Restitution*, second edition (2002) pp591-596) as a possible defence to any restitutionary claim. It is in no sense peculiar to EC law (see for instance the decision of the High Court of Australia in *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516). But the ECJ has recognised that it is consistent with EC law for a national system of law to restrict the right of recovery of overpaid tax in circumstances where it is established that the burden of the tax has actually been passed on by the trader to others (normally his customers), so that reimbursement would amount to double recovery by, and unjust enrichment of, the trader. The ECJ first recognised this defence in *Hans Just I/S v Danish Ministry for Fiscal Affairs* (Case 68/79) [1980] ECR 501, and the line of authority continues down to *Weber’s Wine World Handels-GmbH v Abgabenberufungskommission Wien* [2003] ECR I-11365 (see the opinion of Advocate-General Jacobs at paras 45 ff, and the judgment of the ECJ at paras 93 ff). The defence is now very familiar to the ECJ, but it remains a matter for national law so long as there is no infringement of the principles of equivalence or effectiveness.

26. *General principles of EC law*: EC law recognises several general principles of law, including the principles of equivalence and effectiveness to which I have just referred. Other general principles include its disinclination to countenance discrimination, retrospectivity or expropriation of property. In this litigation the main area of controversy has been, not as to the general principles themselves, but as to whether and how far they can be invoked in the absence of a directly enforceable Community right.

The course of the litigation: up to the ECJ reference

27. With that brief introduction to the legal issues I turn to the course of the litigation. M & S sold teacakes long before the introduction of VAT. When VAT was introduced in 1973, M & S accounted for VAT at the standard rate (initially 10%, then 15% and latterly 17.5%) on its sales of teacakes, in accordance with guidance published by the Commissioners. But by a letter to McVities dated 30 September 1994 the Commissioners acknowledged that the teacakes should have been designated as cakes, and should have been zero-rated. M & S had therefore overpaid VAT from 1973 until 1994.

28. Section 80 of VATA 1994 provides as follows:

“(1) Where a person has (whether before or after the commencement of this Act) paid an amount to the Commissioners by way of VAT which was not VAT due to them, they shall be liable to repay the amount to him.

(2) The Commissioners shall only be liable to repay an amount under this section on a claim being made for the purpose.

(3) It shall be a defence, in relation to a claim under this section, that repayment of an amount would unjustly enrich the claimant.”

In March 1995 M & S made a claim for repayment of £3.5m in respect of the overpaid tax. In July 1995 the Commissioners refused the claim, relying on the passing-on defence in section 80(3). On 17 August 1995 M & S gave notice of appeal to the VAT and Duties Tribunal (“the Tribunal”). The Commissioners’ considered position on the appeal was that 90% of the overpaid tax had been passed on, and so was not recoverable.

29. While the appeal to the Tribunal was pending the Paymaster-General made a statement in the House of Commons on 18 July 1996, announcing the Government’s intention to ask Parliament to amend section 80, with retrospective effect to the date of the announcement, so as to impose a 3-year time limit on claims under section 80. This was effected by section 47 of the Finance Act 1997, enacted on 19 March 1997, which substituted a new section 80(4):

“The Commissioners shall not be liable, on a claim made under this section, to repay any amount paid to them more than three years before the making of the claim.”

This provision was deemed to have come into force on 18 July 1996, even in relation to claims made before that date (subject to limited exceptions provided for in section 47(3) and (4) of the 1997 Act).

30. M & S’s appeal was heard by the Tribunal during October 1996. The hearing occupied seven days, with a good deal of oral evidence (from M & S’s merchandising manager on its behalf, and from a professor of retailing at Manchester Business School on behalf of the Commissioners) on the passing-on issue. By a written decision dated 30 January 1997 (reported at [1997] V&DR 85) the Tribunal dismissed M & S’s appeal and confirmed that the amount repayable was £350,000.

31. In the meantime M & S had put forward another, separate repayment claim. It is not directly relevant to this appeal but it needs to be explained because it played an important part in the proceedings before the ECJ. This claim related to gift vouchers. From May 1991 M & S had sold gift vouchers in different denominations. Many were sold in bulk to employers, at a discount from their face value, with a view to the employers distributing them as incentives to their employees. Until the end of October 1996 M & S (in compliance with guidance from the Commissioners) charged VAT on the full face value of a discounted voucher (for instance a £10 voucher might be sold for £9 but the VAT accounted for was £1.75).

32. Throughout this period from May 1991 to October 1996 the Sixth Directive required that price discounts of this sort should not be included in the taxable amount (Article 11 (A) (1) (3)). This requirement had however been incorrectly transposed into national law (by section 10(3) of the Value Added Tax Act 1983). This provision was amended so as to accord with the Sixth Directive by the Finance (No. 2) Act 1992 with effect from 1 August 1992. Vouchers sold during the pre-amendment period (ending on 31 July 1992) have been referred to in the litigation as the early vouchers, and the vouchers sold during the second period (1 August 1992 to the end of October 1996) have been referred to as the later vouchers.

33. Despite the amendment of section 10(3) of the Value Added Tax Act 1983 the Commissioners continued to apply the national legislation in a manner contrary to the Sixth Directive. This continued until 24 October 1996, when the ECJ gave judgment in an important voucher case which had been referred to it by the Tribunal, *Argos Distributors Ltd v Customs and Excise Commissioners* (Case C-288/94) [1997] QB 499. M & S had no doubt been waiting for the ECJ's decision in *Argos*, since within a very few days M & S made a repayment claim for about £2.8m VAT overpaid on both the early vouchers and the later vouchers. In December 1996 the Commissioners agreed to repay about £1.9m, disallowing the rest of the claim because of the impending retrospective three-year cap.

34. At this stage the two claims began to converge and flow in the same channel of litigation. On 10 March 1997 the Commissioners told M & S that its teacakes claim, already reduced to 10% by the passing-on defence, would also be subject to the three-year cap (reducing it from £350,000 to about £88,000) and reiterated that the vouchers claim would be capped. M & S appealed to the Tribunal against these decisions. The Tribunal heard a preliminary issue as to jurisdiction and determined it (largely in favour of M & S) on 22 December 1997 ([1997] V&DR 344).

35. M & S's appeals to the Tribunal against the capping decisions were heard together over three days in March 1998. On 22 April 1998 the Tribunal gave a written decision dismissing both appeals ([1998] V&DR 235).

36. M & S appealed to the High Court against the dismissal of these appeals. It had already appealed against the Tribunal's dismissal of its appeal against the upholding of the passing-on defence. These appeals, together with a judicial review application arising out of the preliminary issue as to jurisdiction, came before Moses J at a five-day hearing in October 1998. Moses J gave judgment on 21 December 1998 dismissing the appeals, the judicial review issue having for practical purposes fallen away ([1999] STC 205). As to the passing-on defence Moses J reviewed the law and the evidence and held that the Tribunal was entitled to reach the conclusions which it did reach. That aspect of the matter has ceased to be a live issue. As to the capping appeals Moses J decided as follows (although this brief summary does scant justice to his detailed reasoning):

(1) (page 225):

“In relation to the teacakes claim Community law principles do not apply. The imposition of a zero rate in respect of teacakes was a purely domestic matter. The right to recover overpayments under section 80 arose because of a breach of domestic law. It did not arise as a result of a breach of Community law and thus no Community right to repayment arises.”

(2) As regards the early vouchers, the United Kingdom Government’s failure to transpose the Sixth Directive correctly did potentially give M & S directly enforceable rights, but M&S had failed to establish any breach of the principle of effectiveness (p 231) or any other general principle of EC law (pp 231-236).

(3) As regards the later vouchers (p 227), “the Commissioners’ misconstruction of section 10(3) is not a Community law right and, thus, does not engage Community law principles.”

So all three appeals failed, but (in the judge’s view) for quite different reasons.

37. M & S appealed to the Court of Appeal. On 14 December 1999, in a judgment given by Schiemann LJ (with whom Stuart-Smith and Ward LJJ agreed) the first Court of Appeal disposed of the appeal as follows: ([2000] STC 16):

(1) The teacakes passing-on appeal failed because the Tribunal had been entitled to reach the conclusions which it did reach (pp 42-43). That was the end of the appeal process as regards the factual evaluation of the passing-on defence.

(2) The teacakes capping appeal failed (a) because (pp 26-31) it satisfied neither of the *Becker* conditions; and (b) because (pp 31-32) general principles of Community law could not be relied on in the absence of some directly enforceable right.

(3) The later vouchers capping appeal failed (a) because (pp 27-32) it did not satisfy the first *Becker* condition, the Commissioners’ failure to interpret and apply national legislation which correctly transposed the Sixth Directive not being equivalent to incorrect

transposition; and (b) because (pp 31-32) general principles of Community law could not be relied on in the absence of some directly enforceable right.

(4) As regards the early vouchers capping appeal the first Court of Appeal decided to make a reference to the ECJ. In a part of his judgment (pp 39-42) which referred only to the early vouchers (see at p 39e) Schiemann LJ concluded that there was no evidence of any unfair discrimination of which M & S could complain.

38. When the order of the first Court of Appeal was drawn up the question to be referred to the ECJ was formulated as follows:

“In the circumstances in which a member State has failed to implement properly in its domestic legislation Article 11A of Council Directive 77/388, is it compatible with the principle of the effectiveness of the rights that a taxable person derives from Article 11A, or with the principle of the protection of legitimate expectations, to enforce legislation which removes with retrospective effect a right under national law to reclaim sums paid, by way of VAT, more than three years before the claim is made?”

The course of the litigation: the ECJ reference and subsequently

39. It is clear that the first Court of Appeal decided to make a reference to the ECJ only because of a perceived problem about the early vouchers. But both the Advocate-General and the ECJ ([2002] STC 1036) felt it necessary to extend the scope of the question so as to cover (in addition) the later vouchers and (debatably) the teacakes. It is for that reason necessary to look at the proceedings in Luxembourg in some detail, even though the vouchers (whether early or later) are no longer a live issue.

40. Advocate-General Geelhoed delivered his opinion on 24 January 2001. In successive sections of his opinion he covered the legal framework, the facts, and the question submitted to the ECJ. He then (paras 26-28) identified the three elements in the litigation in the national courts, and observed that the question submitted for a preliminary ruling concerned only overpaid tax in respect of the early vouchers and that the referring court was

“making a distinction between the case where the directive is said not to have been transposed or not to have been correctly transposed and the other two cases in which the directive was correctly transposed into national law but incorrectly applied.”

This was, the Advocate-General stated (para 29), manifestly apparent in the case of the gift vouchers.

41. Then the Advocate-General stated, in a paragraph which has caused the House some perplexity (para 30):

“The order for reference does not mention the claim for repayment of VAT erroneously paid in respect of teacakes. Nonetheless, a similar problem arises in the case of teacakes. In that connection, too, the question arises as to whether individuals have rights under Community law where a directive has in itself been correctly transposed into national law but that law is applied in a manner clearly inconsistent with the scope of the directive.”

42. In the proceedings in Luxembourg both M & S and the European Commission had urged the ECJ to take a broader view. The Commission had stated in its written observations dated 30 May 2000 (para 1):

“The parties also appear to be at one in their view that, as regards the teacakes and late vouchers claims, the relevant United Kingdom legislation, though in itself compatible with the Sixth VAT directive, was applied by Customs & Excise in a manner repugnant to that directive.”

Mr Lasok QC (for the Commissioners) says that that was a complete misunderstanding. The Commission pointed out the implications of the first Court of Appeal’s view (para 5):

“Indeed, if the view accepted by the Court of Appeal were correct, then a Member State could escape the

consequences of a directive simply by implementing it correctly and then proceeding to misapply it.”

The Advocate-General, although well aware of the ECJ’s disinclination to depart from the terms of the questions put to it, evidently recognised the force of this point (para 31) and expressed a view clearly contrary to that of the first Court of Appeal, concluding (para 44):

“It is manifestly clear from the documents before the Court that, in regard to both teacakes and gift vouchers after August 1992, the Commissioners applied national tax legislation in a manner inconsistent with the directive. It is also clear that the referring court is not permitting M&S to rely on the directive against that incorrect administrative practice. It follows therefrom, in my view, that in that case both the tax authorities and the competent courts are acting in breach of Community law. Thus, the United Kingdom is failing correctly to implement the relevant part of the Sixth Directive.”

43. The Advocate-General then addressed the questions as posed by the first Court of Appeal, discussing at length some well-known decisions of the ECJ on the principle of effectiveness. He concluded with the recommendation (para 78) that the question should be answered (by reference to the principle of effectiveness and the principle of legitimate expectations) in substantially the same terms as were adopted in the judgment of the ECJ.

44. In its judgment delivered on 11 July 2002 the ECJ emphatically endorsed the Advocate-General’s views on the transposition of Directives (paras 27 and 28):

“Consequently, the adoption of national measures correctly implementing a directive does not exhaust the effects of the directive. Member States remain bound actually to ensure full application of the directive even after the adoption of those measures. Individuals are therefore entitled to rely before national courts, against the State, on the provisions of a directive which appear, so far as their subject matter is concerned, to be unconditional and sufficiently precise whenever the full application of

the directive is not in fact secured, that is to say, not only where the directive has not been implemented or has been implemented incorrectly, but also where the national measures correctly implementing the directive are not being applied in such a way as to achieve the result sought by it.

As the Advocate-General noted in para 40 of his opinion, it would be inconsistent with the Community legal order for individuals to be able to rely on a directive where it has been implemented incorrectly but not to be able to do so where the national authorities apply the national measures implementing the directive in a manner incompatible with it.”

However the ECJ made no reference to teacakes, or to zero-rating, either in this context or elsewhere in the judgment. It expressed neither agreement nor disagreement with the Advocate-General’s views on this point.

45. The judgment went on to consider the principle of effectiveness (paras 34-42) and the principle of legitimate expectations (paras 43-47) and concluded by answering the question referred by the first Court of Appeal as follows:

“National legislation retroactively curtailing the period within which repayment may be sought of sums paid by way of VAT collected in breach of provisions with direct effect of the Sixth Directive, such as those in Article 11A (1), is incompatible with the principles of effectiveness and of the protection of legitimate expectations.”

46. The matter then came before the second Court of Appeal, where it was heard with another appeal (in which the Commissioners were appellants and the University of Sussex was the respondent). Judgment was given on 21 October 2003 by Auld LJ, with whom Chadwick LJ and Newman J agreed ([2004] STC 1). The second Court of Appeal was faced with an unusual situation, in that the ECJ had dealt with the first Court of Appeal’s reference in broader terms than those in which the questions were formulated. The ECJ’s answers showed that parts of the first Court of Appeal’s judgment were based on misapprehensions as to EC law. The second Court of Appeal felt bound to reopen parts of the

first Court of Appeal's judgment (relying so far as necessary on the principle in *Taylor v Lawrence* [2003] QB 528).

47. The situation was unusual in another respect also. As recorded in para 34 of Auld LJ's judgment, shortly before the opening of the resumed appeal, the Commissioners accepted that, in the light of the ECJ's judgment, the retrospective element of the three-year time limit (introduced by the amendment of section 80 of VATA 1994) could not be invoked against a directly enforceable provision of the Sixth Directive. Therefore they conceded both parts of the vouchers claim. They also conceded the capping point in relation to the teacakes claim, but described that as an extra-statutory concession. Auld LJ nevertheless considered the later vouchers claim at some length, in paras 36 to 50 of his judgment, concluding that the order of the first Court of Appeal should be varied and the appeal on the later vouchers claim allowed.

48. Auld LJ then considered the effect, if any, of the ECJ's judgment on the teacakes claim. In the first Court of Appeal, Schiemann LJ had considered and rejected the argument that M & S's claimed right for its teacakes not to be taxed otherwise than by zero-rating was not a directly enforceable right ([2000] STC16, 31):

“[M&S] cannot rely upon Art.12(1) because that provision does not define the content of any right that [M&S] has under Community law. Art. 12(1) defines no right to any particular rate of tax because the fixing of the rate is entirely within the discretion of the United Kingdom under Art. 28(2)(a). Insofar as it is legitimate to describe zero as being the rate applicable to the sale of teacakes that rate is not attributable to Community legislation but rather to United Kingdom legislation which is consistent with our obligations under the EC Treaty.”

Having quoted this passage Auld LJ set out at length the passages from the written observations of the European Commission, and the opinion of the Advocate-General, which appeared to contradict this conclusion. But he also noted (para 58) that in its judgment the ECJ said nothing about teacakes, or (in the context of zero-rating) about the second *Becker* condition. He summarised (paras 63-65) the two sides' submissions about the decision of the ECJ in *Idéal Tourisme SA v Belgium* (Case C-36/99) [2000] ECR I-6049.

49. Auld LJ concluded (paras 68-70) that as regards the first *Becker* condition the ECJ's wide reformulation of the principle put the teacakes claim on the same footing as the later vouchers claim. But it did not engage the second *Becker* condition, and the reasoning of the first Court of Appeal held good (para 69):

“As a matter of logic, and in the light of the Court of Justice's reasoning in *Idéal Tourisme*, a member state's breach of its own domestic law maintained consistently with, but not as a requirement of Community law, is not a breach of a Community law requirement to charge only a rate fixed by law within the meaning of Arts. 10(1)(a) and (b) and 12(1).”

This conclusion was reinforced by the fact that zero-rating (“exemption with refund of the tax paid at the preceding stage”) was not really a rate of tax, but its antonym. The ECJ had said nothing which bore on that conclusion.

50. In case he were wrong on his main conclusion Auld LJ went on to consider M & S's submissions on the passing on (or unjust enrichment) defence, and its reliance on discrimination as between payment traders and repayment traders. His conclusions were adverse to M & S on both points (paras 84 and 85 on the first point, and—rather more tentatively expressed—para 103 on the second point).

Discussion

51. This appeal has therefore reached your Lordships' House by a long and winding road, almost ten years after M & S first gave notice of appeal in respect of its teacakes claim. Your Lordships have heard argument on three main issues:

- (1) Did M & S, under article 28 of the Sixth Directive (both before and after its amendment in 1992) have a directly enforceable right not to be required to account for the tax on its teacakes otherwise than in accordance with the zero-rating provisions properly applicable under UK national law?

- (2) Even if article 28 did not give M & S a directly enforceable right of that type, was the United Kingdom (in giving effect to its discretion under that article) required by the principle of fiscal neutrality to avoid discrimination between different types of traders, so as to give M & S a directly enforceable right to complain of the discrimination?
- (3) If so, does EC law require or permit the remedy granted by the national court to depend on proof of financial loss, and on the absence of unjust enrichment?

52. On the first of these issues, it is not in dispute that article 28 is a transitional provision which does not form part of the harmonised system of VAT. It confers on member states a discretion, exerciseable within the ambit of what is permitted by article 28 (including, after the amendment in 1992, the requirement for measures to be “in accordance with Community law”). If the member state exercises its discretion within the permitted limits, it is acting consistently with EC law, and within a framework provided by EC law, but the measures which it continues in force are essentially national measures.

53. The decision of the ECJ in *Idéal Tourisme SA v Belgium* [2000] ECR I-6049 provides guidance on this type of situation. The claimant company complained that its international passenger coach operations were subject to VAT at 6%, whereas international air transport was exempt (under Belgian legislation ante-dating the Sixth Directive). The claim failed. The ECJ observed (para 38):

“The harmonisation envisaged has not yet been achieved, insofar as the Sixth Directive, by virtue of Art. 28(3)(b), unreservedly authorises the member states to retain certain provisions of their national legislation predating the Sixth Directive which would, without that authorisation, be incompatible with that directive. Consequently, insofar as a member state retains such provisions, it does not transpose the Sixth Directive and thus does not infringe either that directive or the general Community principles which member states must, according to *Klensch* [1986] ECR 3477, comply with when implementing Community legislation.”

There are some similar observations in the opinion of Advocate-General Cosmas at para 30 of his opinion.

54. It is true that in *Idéal Tourisme* the Belgian state had not misunderstood or misapplied its own domestic legislation. But that seems immaterial in the context of whether there is a breach of EC law. But for the observations of the European Commission and of Advocate-General Geelhoed on the reference in this case, I would have little or no hesitation in concluding, in common with all the United Kingdom tribunals and courts which have so far considered the matter, that M & S had no directly enforceable right under EC law.

55. Mr Lasok QC (for the Commissioners) has submitted that the observations of the European Commission were based on a misunderstanding, which the Advocate-General followed. There is, he submitted, no reasoning to explain the conclusions which the Advocate-General seems to have reached. Mr Lasok also emphasised that the ECJ did not comment on this aspect of the matter. It may be that the ECJ did not agree with the Advocate-General's observations, but refrained from making any comment on them because they were not strictly relevant to the reference. However, for my part I find it impossible to be sure about that. The reference from the first Court of Appeal had got into something of a muddle, which led the ECJ to take the unusual course of departing from the questions referred to it. The ECJ must have been anxious to obviate any further confusion. Auld LJ (at para 68 of his judgment, already noted) evidently thought that the general principle enunciated by the ECJ was relevant to the teacakes claim so far as concerned the first *Becker* question.

56. In a case which has already gone on for ten years I am naturally very reluctant (in common, no doubt, with all your Lordships) to see further delay and expense occasioned by a second reference to the ECJ. But the Advocate-General has in this case (in para 44 of his opinion) criticised the national courts for acting in breach of EC law. Having studied his opinion and the judgment of the ECJ I consider that there is still real doubt as to the relevant principles of EC law, and that this House, as the national court of last resort, really has no alternative but to make another reference.

57. If a reference is to be made I would also refer the questions of EC law underlying the second and third issues argued before your Lordships. On the second issue M & S have relied on *Goldsmiths*

(Jewellers) Ltd v Commissioners of Customs & Excise (Case C-330/95) [1997] ECR I-3801 and the case about reimbursable medicinal products, *EC Commission v France* (Case C-481/98) [2001] ECR I-3369. These cases appear to give M & S some support, but the Commissioners have argued that they are distinguishable. On the third issue (which has been loosely described as levelling up or levelling down) M&S has relied on *Cotter & McDermott v Minister for Social Welfare* (Case C-377/89) [1991] ECR I-1155, but the Commissioners have countered with *Italy v Council of the European Union* (Case C-340/98) [2002] ECR I-2663. These issues are also open to doubt.

58. In the appellant's printed case (paras 35, 46 and 68) Mr Milne QC (for M & S) proposed three questions for a possible reference to the ECJ. These broadly correspond to the three issues which I have identified, but Mr Milne's questions were not agreed by the Commissioners, and he indicated that he would himself wish to make some revisions in the way in which the questions are formulated.

59. If your Lordships agree that a further reference to the ECJ is necessary, the parties should agree the draft questions to be referred in accordance with your Lordships' opinions.