TC01247

Appeal number: SC/3007/2009

TAX CREDIT – Foreign income dividends – Claim by Trustees of exempt approved pension scheme – FIDS received from UK resident companies – ICTA 1988 s.231

TAX CREDIT – Cross-border dividends – Claims for tax credits based on ECJ decision in Manninen (Case C-319/02) – ICTA 1988 s.231

LIMITATION – Tax credit claims – Whether out of time – TMA ss.28A(3) and 42 – Limitation Act 1970 s.32(1)(c)

FIRST-TIER TRIBUNAL

TAX

THE TRUSTEES OF THE BT PENSION SCHEME **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (Income Tax) **Respondents**

TRIBUNAL: SIR STEPHEN OLIVER QC
JULIAN GHOSH QC

Sitting in public on 14-18 December 2009 and on 4 May 2011

Peter Whiteman QC and Conrad McDonnell, counsel, instructed by McGrigors LLP, solicitors, for the Appellant

Rupert Baldry QC and James Rivett, counsel, instructed by the General Counsel to HM Revenue and Customs, for the Respondents

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DECISION

A. THE ISSUES

5 1. There are three issues in this appeal:-

(i) whether the Appellant, the trustees of the BT Pension Scheme ("BTPS") are entitled to a payment of a tax credit under the Income and Corporation Taxes Act 1988 ("TA 1988"), Section 231 for certain dividends elected to be "Foreign Income Dividends" ("FIDs") within 10 TA 1988, Section 246A, which BTPS received from UK resident companies between 1st July 1994 and 2nd July 1997: we refer to these claims made by BTPS as the "FIDs claims";

(ii) whether BTPS is entitled to a payment of a tax credit under TA 1988, Section 231, for dividends paid by non-UK resident companies 15 between 1st July 1990 and 2nd July 1997: we refer to these as "*Manninen* claims" since these claims arise from the case law of the European Court of Justice, concerning the application of the EC Treaty to cross-border dividends, which commenced with the European Court's judgment in *Manninen* (Case C-319/02); the Statement of 20 Facts agreed between the parties, which we reproduce below, refers to these particular claims as "Tax Credit Claims". Since the FIDs claims are also claims for tax credits, we use the terminology of "*Manninen* claims" for these claims in our Decision;

(iii) to the extent that the FIDs claims and the *Manninen* claims are good, in 25 principle, whether these claims have been made in time ("the limitation issue").

2. The FIDs claims relate to dividends paid by UK tax-resident companies to BTPS which are funded out of non-UK source income by the dividend-paying companies; that non-UK source income arises both from sources located within 30 the Community and from sources located in non-Member States ("third countries"), so far as the dividend-paying companies are concerned. The *Manninen* claims relate to dividends paid by companies tax-resident within both Member States and third countries.

3. It is agreed between the parties that quantum be left to be decided after the 35 determination of the questions of law.

4. Mr Whiteman QC presented the case for BTPS on the substantive issues in relation to the FIDs claims and the *Manninen* claims. Mr McDonnell presented the case for BTPS on the limitation issue. Mr Baldry QC presented the case for the Respondents ("HMRC") on all of the issues.

B. STATEMENT OF FACTS

5. There was a Statement of Facts agreed between the parties, which we reproduce here (omitting certain immaterial sections). The parties agreed that the Statement of Facts is an aid to assist the determination of the relevant questions of law in this appeal (and HMRC are not bound by the Statement of Facts as determinative of any issues arising as to quantum).

Background to BTPS and Hermes

6. The BT Pension Scheme (formerly known as the British Telecom Pension Scheme) (**"BTPS"**) was formed in the 1980s and is the largest defined benefit pension fund in the United Kingdom. BTPS was at all material times an exempt approved scheme.

7. BTPS was formed as a result of the separation of the Post Office Staff Superannuation Fund (**"POSSF"**) into the Post Office Staff Superannuation Scheme (**"POSSS"**) and the British Telecommunications Staff Superannuation Scheme (**"BTSSS"**) on 1 April 1983. BTSSS later merged with British Telecommunications plc New Pension Scheme (**"BTNPS"**) to form BTPS with effect from 1 January 1993. Accordingly, in respect of periods before 1 January 1993, the claims are maintained by the trustees of BTPS on behalf of the two funds, BTSSS and BTNPS, which now constitute BTPS.

8. Until 2006, the trustees of the BTPS were a group of nine individuals. Since 14 December 2006, BTPS has had a corporate trustee, BT Pension Scheme Trustees Limited (**"BTPSTL"**) and the individual trustees became directors of BTPSTL.

9. The investment fund management team of POSSS and BTPS, originally known as PosTel Investment Management Limited (**"PosTel"**), was formed in 1982 from the existing investment fund management team of POSSF. From that time until 1995, PosTel was jointly owned by the Trustees of POSSS and the Trustees of BTPS.

10. On 31 March 1995 the Trustees of the BT Pension Scheme acquired the 50% holding in PosTel owned by the POSSS, and PosTel's name was changed to Hermes Pensions Management Limited. In March 2008 its name was changed to Hermes Fund Managers Limited (**"HFML"**). HFML is now 100% owned by BTPS.

11. HFML is the parent company of a number of companies falling within the Hermes group, some of which are separately authorised and regulated by the Financial Services Authority.

12. Hermes Investment Management Ltd (**"HIML"**) (known from February 1990 to March 1995 as PosTel Financial Asset Management Limited) is a wholly owned subsidiary of HFML. HIML is an institutional fund manager which invests funds on behalf of approximately 209 clients including pension funds, insurance companies, government entities, financial institutions, charities and endowments. HIML is the principal manager of the BTPS and undertakes the day to day management of the pension fund's assets.

13. Hermes Administration Services Limited (**"HASL"**) is a wholly owned subsidiary of HFML. HASL provides administration services to BTPS and other clients.

14. The investments of BTPS are registered in the name of Britel Fund Trustees Limited and Britel Fund Nominees Limited (or in certain cases, another nominee such as Britel (MAM) Nominees Limited). These companies hold all such assets purely in their capacity as nominees on behalf of the Trustees of BTPS. For all tax purposes, the Trustees of BTPS are the relevant taxable entity and BTPS is the beneficial owner of the relevant assets.

15. **Investments of BTPS**

16. At all material times, approximately 70% to 75% of the investments of BTPS (by market value) were in the form of equities.

17. Of BTPS' holdings of equities, some were investments in companies resident in the United Kingdom ("**United Kingdom equities**"), and some were investments in companies resident in the EU and elsewhere ("**overseas equities**"). The proportion of overseas equities has varied over time. Between March 1990 and 31 December 1992, approximately 81% of the holdings (by market value) were United Kingdom equities and 19% were overseas equities. On 31 December 1993, 31 December 1994, 31 December 1995 and 31 December 1996, in each case approximately 73% of the holdings were United Kingdom equities and 27% were overseas equities. On 31 December 1997 and in subsequent years, approximately 67% of the holdings, or less, were United Kingdom equities, and 33% or more were overseas equities.

18. BTPS invests a very small proportion (approximately 3%) of its equities portfolio in selected smaller companies, in which it may take up to a 10% interest. These investments in small companies are not included in these claims.

19. The vast majority (at least 97%) of BTPS' equities portfolio was invested in large publicly quoted companies in the United Kingdom and overseas. These are the investments which are the subject of these claims. In each case, BTPS would

typically hold less than 2% of the company's share capital, and always less than 5%. BTPS' relationship with the investee companies was purely as shareholder.

20. **High Court Claims**

20.1 **FIDs claims**

5 20.1.1 On 31 January 2003, the Trustees of the BTPS (together with Britel Nominees Limited and Britel (MAM) Nominees Limited) brought a claim in the High Court of Justice against the Commissioners of Inland Revenue for payable tax credits in respect of Foreign Income Dividends (Claim Number HC03C00426) (the "**FIDs Claim**").

10 20.2 **Tax Credit claims**

20.2.1 On 1 April 2005 the Trustees of the BTPS (together with Britel Nominees Limited and Britel (MAM) Nominees Limited) brought a claim in the High Court of Justice against the Commissioners of Inland Revenue for tax credits in respect of overseas dividends received directly (Claim Number
15 HC05C00770) (the "**Tax Credit Claim**" which we refer to as the "*Manninen* claims" in the course of our Decision. However, in reproducing the parties' Statement of Facts we leave the terminology as used by the parties).

20.3 **Group Litigation Order**

20.3.1 The FIDs Claim brought by BTPS was one of several claims brought around
20 this time by trustees of various pension schemes.

20.3.2 On 13 May 2004 the solicitors acting for BTPS, McGrigors, issued an application in the High Court for an order that the Court grant a group litigation order under rules 19.10 and 19.11 of the Civil Procedure Rules.

20.3.3 The hearing of the application took place on 7 July 2004 before Chief Master
25 Winegarten and an agreed Order by Consent between BTPS and HMRC was sealed by the Court on 21 July 2004. It was held that BTPS would be appointed as Test Claimant in the group litigation. The application was therefore brought in the name of 'The Trustees of the BT Pension Scheme and the Claimants listed in Schedule 1 to this Order'. The Order provided that
30 claims in connection with the FIDs regime would constitute the 'FIDs Group Litigation' and provided that a group register of claims should be set up and maintained by McGrigors as lead solicitors.

20.3.4 A Case Management Conference took place on 4 October 2005. At this conference draft directions were agreed. In addition, The Honourable Mr. Justice Park ruled on whether certain questions of Community law should be referred to the ECJ. The Honourable Mr. Justice Park decided that the questions should not be referred to the ECJ at that stage.

20.3.5 A further Case Management Conference took place on 4 July 2007, where it was directed by The Honourable Mr. Justice Rimer that the High Court claims of BTPS as the test claimant be stayed pending the outcome of this appeal to the Special Commissioners. The parties agreed that:-

(a) the Special Commissioners should consider the FIDs claims and the Tax Credit claims (including those made outside the ordinary Taxes Management Act 1970 time limits); and

(b) if any tax return claims are rejected for being out of time, then the relevant claimants will be able to revert to the High Court route.

20.3.6 Following the Case Management Conference on 4 July 2007 the High Court claims have been stayed and the tax return claims are being pursued in the Special Commissioners.

21. **<u>Tax return claims</u>**

21.1 **FIDs claims**

21.1.1 On 4 February 2003, Mr D. W. Burrowes of HASL, on behalf of BTPS, wrote to Mrs E. Bowman of HM Inspector of Taxes, Glasgow Large Business Office, stating that BTPS had been advised that it had a case under EU law that section 246C of TA 1988 contravened EU law and in particular was contrary to the principle of free movement of capital enshrined in Article 56 of the EC Treaty; that Hermes were seeking, on behalf of BTPS, a payment of tax credits on all Foreign Income Dividends (FIDs) received on or after 1 July 1994; and that a claim had been filed in the High Court on 31 January 2003 for recovery of tax credits on FIDs received in respect of the years of assessment 1994/5, 1995/6, 1996/7 and 1997/8.

21.1.2 The High Court claim filed on 31 January 2003 was in the following amounts:

(a) 1994 – 95 £2,357,508.65;

(b) 1995 – 96 £3,481,698.50;

(c) 1996 – 97 £5,097,286.97; and

(d) 1997 – 98 £1,651,508.66.

21.1.3 On 28 October 2003, Mr D. W. Burrowes wrote to Mr. Pigott of HM Inspector of Taxes, Glasgow LBD (CT) on behalf of BTPS attaching a list of all the FIDs incorporated in the claim and providing lower claim numbers for 1996/1997 representing a claim for payable tax credits relating to the FIDs received by BTPS in the following amounts:

(a) 1994 – 95 £2,357,508.65;

(b) 1995 – 96 £3,481,698.50;

(c) 1996 – 97 £4,514,291.22; and

(d) 1997 – 98 £1,651,508.66.

21.1.4 On 23 January 2004, Mr D. W. Burrowes wrote to the Inland Revenue, Glasgow Large Business Office enclosing a further copy of the schedule representing a claim for payable tax credits relating to the FIDs received by BTPS in the 1997/1998 period and listing in detail the tax credits being claimed.

21.1.5 On 28 January 2005, BTPS wrote to Mr N. Gay, HM Inspector of Taxes, Glasgow Large Business Office, enlarging on the claim for payable tax credits in respect of FIDs received in the 1994/1995 and 1995/1996 periods of assessment.

21.2 **Tax Credit claims**

21.2.1 On 17 October 2005, BTPS wrote to HMRC, Audit & Pension Schemes Services notifying HMRC of its claim under section 231(3) of TA 1988 for a payment of excess tax credits totalling £90,617,473.06 in respect of non-United Kingdom dividends received in the 1990/1991 to 1995/1996 periods of assessment. The true amount of the claim was £90,917,015.88, after the correction of an error in calculation[1]. On the same date, BTPS wrote separately to HMRC, Audit & Pension Schemes Services notifying HMRC of

[1] The schedule in the 17 October 2005 letter contained a calculation error, in that for France, 1992-93, the wrong rate was used to calculate the tax credit on the dividend, resulting in the claim being understated by £299,542. That error was easily identifiable since the dividend amount itself was also given. The Statement of Agreed Facts used the corrected figure.

its claim under section 231(3) of TA 1988 for payment of excess tax credits totalling £32,952,214.67 in respect of non-United Kingdom dividends received in the 1996/1997 and 1997/1998 periods.

C. AGREED DESCRIPTION OF THE UK TAX SYSTEM

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22. The parties also produced a helpful summary of what they agreed to be an uncontroversial description of the relevant provisions of the UK Tax Code, accepting that this did not bind us in any way as to our analysis of the relevant provisions. The summary was based on the European Court of Justice's analysis
10 of the relevant UK provisions in *Test Claimants in the FII Group Litigation Order v Inland Revenue Commissioners* (Case C-446/04) ("*FII ECJ*")[2]:

23. **Introduction**

23.1 The case is concerned with the period from 1 July 1990 to 2 July 1997 and (unless otherwise stated) statutory references are references to the statutes in
15 force from time to time in that period. Apart from rate changes and the introduction of Self Assessment, a significant change during the period was the introduction of foreign income dividends ("**FIDs**") on 1 July 1994.

23.2 From 1973 onwards, the United Kingdom of Great Britain and Northern Ireland operated a system of taxation known as 'partial imputation', under
20 which, in order to avoid economic double taxation when a resident company distributed profits, part of the corporation tax paid by that company was imputed to its shareholders. Until 6 April 1999, the basis of that system was, on the one hand, advance payment of corporation tax by the company making the distribution, and, on the other hand, a tax credit granted to shareholders
25 who had received a dividend. In addition, a United Kingdom-resident company was exempt from corporation tax on dividends received from another United Kingdom-resident company. (*FII ECJ*, paragraph 7).

23.3 In respect of dividends paid by a company resident in the United Kingdom, prior to 2 July 1997, a pension scheme was entitled to tax credits under section
30 231(1) of TA 1988 and, where the amount of said credits exceeded its income tax liability for the year of assessment in which the dividend was received, it was entitled to claim under section 231(3) of TA 1988 to have the amount of such excess tax credits paid to it by HMRC.[3]

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2 Paragraph numbers refer to the paragraphs of the Judgment of the European Court of Justice.

3 References to HMRC also include reference to their predecessors, the Commissioners of Inland Revenue.

24. **ACT: ACT and Surplus ACT**

24.1 Under section 14 of TA 1988, a company resident in the United Kingdom which paid dividends to its shareholders was liable to pay advance corporation tax (“**ACT**”), calculated by reference to the amount or value of the distribution made (*FII ECJ*, paragraph 8).

24.2 A company had the right to set the ACT paid in respect of a distribution made during a particular accounting period against the amount of corporation tax for which it was liable in respect of that accounting period, subject to certain restrictions. If the liability of a company for corporation tax was insufficient to allow the ACT to be set off in full, the “Surplus ACT” could be carried back to a previous accounting period or carried forward to a later one, or surrendered to subsidiaries of that company, which could set it off against the amount for which they themselves were liable in respect of corporation tax. Surplus ACT could be surrendered only to United Kingdom resident subsidiaries. (*FII ECJ*, paragraph 9).

25. ACT: Dividends paid by United Kingdom resident companies to other United Kingdom resident companies

25.1 Under section 208 of TA 1988, where a United Kingdom resident company received a distribution from a company that was also United Kingdom resident, it was not liable to corporation tax in respect of that distribution. (*FII ECJ*, paragraph 11).

25.2 In addition, by virtue of section 231(1) of TA 1988, every payment of a distribution subject to ACT by a United Kingdom resident company to another United Kingdom resident company gave rise to a tax credit in favour of the latter company equal to the proportion of the distribution corresponding to the ACT paid (or which should have been paid) by the former company[4]. In terms of section 238(1) of TA 1988, the distribution received and the tax credit together constituted 'franked investment income' (**"FII"**) in the hands of the company receiving the distribution. (*FII ECJ*, paragraph 12), A United Kingdom resident company which received FII from another United Kingdom resident company could take account of the amount of the tax credit and deduct it from the amount of ACT which it itself had to pay when making a distribution to its own shareholders. (*FII ECJ*, paragraph 13).

25.3 Alternatively, under section 247 of TA 1988, United Kingdom resident companies, if they met certain conditions, could make a 'group income election'. The consequence was that no ACT was chargeable on distributions

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[4] Exceptionally, in the tax year 1993-94 the tax credit payable differed from the ACT rate, as set out in the table in Annex 1

paid by the United Kingdom resident subsidiary to its United Kingdom resident parent within the group, and consequently no franked investment income arose: instead, the parent company's distribution to its own shareholders was subject to ACT in the normal way (and again shareholders could claim tax credits).

26. **ACT: United Kingdom resident shareholders receiving dividends from United Kingdom resident companies**

26.1 Under Schedule F of TA 1988, individual shareholders who were resident in the United Kingdom were liable to income tax on distributions received from a company resident in the United Kingdom. Those shareholders were, however, entitled to a tax credit equal to the fraction of the distribution corresponding to ACT paid by that company. Under section 231(3) of TA 1988 the shareholder was entitled to have that tax credit set against the income tax chargeable on his income for the year of assessment in which the distribution was made and, when the amount of the tax credit exceeded such income tax, to have the excess paid to him. (*FII ECJ*, paragraph 14).

26.2 If the shareholder was a non-taxpayer, including a charity or a private individual whose income did not exceed the annual personal allowance or, as is relevant to this case, an exempt pension fund (which is essentially a fund which is exempt from tax on its investment income but not on its trading income), then there was no tax liability on the dividend income. In addition, pension funds normally did not have any significant income tax liabilities from other sources, so they routinely claimed payments of the full amount of the tax credits that accompanied dividends received from United Kingdom resident companies. The payment was usually claimed on a Form R63N. These forms were usually prepared on a regular basis and submitted to a pension scheme's local tax office. Repayment was usually made within a short time of the Form R63N being submitted. No other correspondence was involved. When the Self Assessment regime was introduced, this procedure remained but the amount of dividends and tax credits paid had to be included in the Self Assessment tax return. The tax return was supposed to include total credit payments due to the pension scheme less the amount reclaimed to the date of submission, with potentially an amount remaining payable. HMRC considered that the Form R63N repayment claims were "provisional" claims with the Self Assessment tax return forming the final total claim.

27. **ACT: United Kingdom resident corporate shareholders receiving dividends from non-United Kingdom resident companies**

27.1 When a United Kingdom-resident company received dividends from a company resident outside the United Kingdom, it was in principle liable to corporation tax on those dividends (see *FII ECJ*, paragraph 15). The charge

was under Schedule D Case V (income from possessions overseas) and the chargeable amount was (i) the gross amount of the foreign dividend, that is to say the amount of the dividend prior to the deduction of any withholding tax levied by the source country and — in a case where tax relief was given in the United Kingdom for the appropriate proportion of the foreign tax suffered on the profits out of which the dividend was paid — (ii) the amount of such "**foreign underlying tax**". Relief for such foreign underlying tax was given in cases where the United Kingdom resident company held at least a 10% interest in the company paying the dividend.

27.2 The United Kingdom resident company receiving those foreign dividends was not entitled to any tax credit against its own ACT liability (on an onward distribution) in respect of the foreign underlying tax or withholding tax suffered, and the dividends received did not qualify as franked investment income.

27.3 However, in terms of sections 788 and 790 of TA 1988, the United Kingdom resident company was entitled to relief against corporation tax for the withholding tax and foreign underlying tax. Such relief was granted either under the legislation in force in the United Kingdom or under a double taxation convention ("**DTC**") concluded by the United Kingdom with the other state. (*FII ECJ*, paragraph 16). In the case of credit for foreign underlying tax, the granting of relief was limited, pursuant to section 790 of TA 1988, to the situation where the United Kingdom resident company receiving the distribution either directly or indirectly controlled, or was a subsidiary of a company which directly or indirectly controlled, 10% or more of the voting rights in the company making the distribution. (The said restriction on the relief for foreign underlying tax to those cases where the United Kingdom resident company held at least a 10% interest in the company paying the dividend was held to be contrary to Community law in *FII ECJ*, paragraph 74, although the consequences are still the subject of ongoing litigation.)

27.4 Under the United Kingdom legislation, if the foreign tax rate on the underlying profits was less than the United Kingdom tax rate then relief against corporation tax was correspondingly limited. Equally, if the foreign tax rate exceeded the United Kingdom rate then relief was limited to claiming credit up to the United Kingdom rate. Thus, relief for the foreign underlying tax was available only on the amount due in the United Kingdom by way of corporation tax on the income concerned. (*FII ECJ*, paragraph 17).

28. **The FIDs regime**

28.1 Experience with the arrangements described above showed that companies receiving a significant proportion of their income from foreign dividends

generated Surplus ACT. This was because: (i) foreign dividends did not attract a tax credit and therefore did not create FII which could be used to reduce the companies' ACT liability on distributions made by them; and (ii) any credit given for foreign tax reduced the mainstream corporation tax ("MCT")[5] liability against which the ACT could be set off. To alleviate this Surplus ACT in relation to United Kingdom resident companies with foreign dividend income, an additional system ("the FIDs regime") was introduced in 1994. From 1 July 1994, a resident company receiving dividends from a non-resident company could elect that a dividend which it paid to its shareholders be treated as a FID. (*FII ECJ*, paragraph 23). Electing for a dividend to be treated as a FID was optional under section 246A(1) of TA 1988, in that qualifying companies could elect for a dividend or part of a dividend to be a FID. If they did not so elect, the dividend was treated under the pre-existing rules described above. So far as this appeal relates to FIDs, it is concerned only with cases where qualifying companies did elect for the FID treatment.

28.2 ACT was payable on the FID but, to the extent to which the FID matched the foreign dividends received, the resident company could set the ACT off against any part of that company's MCT liability, or, to the extent it was not able to be used in that way, could claim repayment of the Surplus ACT. (*FII ECJ*, paragraph 23).

28.3 A United Kingdom resident parent company could pay a dividend (a FID) to its own shareholders equal to the amount of the foreign dividend received by that company. Surplus ACT was thus avoided since the company was entitled (under section 246N of TA 1988) to use the ACT relating to the FID – the "notional foreign source ACT" – so far as it would otherwise have been Surplus ACT, as described above.

28.4 To an extent, a United Kingdom resident company could choose which foreign dividends to match with the FIDs under section 246J of TA 1988. It would be logical for the foreign dividends carrying foreign underlying tax at a rate at least equivalent to the MCT rate in the United Kingdom to be matched first.

28.5 In practice, United Kingdom resident parent companies with many foreign subsidiaries might be in a position where income of different foreign subsidiaries was subject to foreign tax at different rates, sometimes greater than and sometimes less than the MCT rate in the United Kingdom, or at times not corresponding with the financial year in the United Kingdom. Some United Kingdom resident parent companies in that situation chose to structure

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5 Note that mainstream corporation tax is not an expression used in the United Kingdom legislation, and also that the expression is sometimes used to mean only the corporation tax remaining to be paid after ACT set-off. In this Statement, as in the FII judgment, the expressions "mainstream corporation tax" or "MCT" will be used to refer to the full amount of the company's United Kingdom corporation tax liability prior to ACT set-off.

the group so that multiple foreign subsidiaries were held through an intermediate holding company resident overseas. The intermediate holding company was referred to as a "mixer company"; for example if it was resident in the Netherlands (a common choice) then it was called a "Dutch mixer company". The mixer company paid dividends to the United Kingdom resident parent company. Typically, in that situation, the average foreign underlying tax across all the foreign profits which were represented in the mixer company's dividend was, often by design, close to the rate of MCT in the United Kingdom, that is to say 33% (or 31%, from 1 April 1997).

29. FIDs: Shareholder receipts

29.1 When a FID was paid to an individual shareholder, the latter was not entitled to a tax credit, but was treated for income tax purposes as having received income which had borne tax at the lower rate. (*FII ECJ*, paragraph 25).

29.2 Tax-exempt shareholders, such as United Kingdom pension funds which received FIDs, were not entitled to a payable tax credit. (*FII ECJ*, paragraph 25).

29.3 Dividends were often enhanced by the FID paying company, but this was not universal, and nor was the enhancement always for the full amount of what would have been the tax credit on an ordinary dividend.

30. FIDs: overall rate of taxation (example calculations)

30.1 The example calculations below assume an MCT rate of 33% and an ACT rate of 20%, i.e. the situation in tax years 1994-95, 1995-96 and 1996-97. Full details of MCT and ACT rates during the periods from 1990 to 1998 are set out in Annex 1 below. In these example calculations, all references to "effective rates of tax" are by reference to the company's profits as calculated for tax purposes, and it is assumed that the company is not eligible for the small companies rate of corporation tax. (Note that in the case of typical companies, the profits calculated for tax purposes may be more than or less than the unadjusted accounting profits, for example due to the tax calculation taking into account capital allowances or other reliefs.) These example calculations are without prejudice to any quantum issues, and all timing issues are disregarded.

30.2 In the hands of a tax exempt pension fund, the corporate profits represented by a dividend paid by a company resident in the United Kingdom out of its United Kingdom-source profits (including distributed profits of United Kingdom-resident subsidiaries) were subject to an overall effective rate of tax of 16.25%. That is to say each £100 of profits were subject to corporation tax

at 33%, leaving £67 to be distributed. The distribution of £67 gave rise to a payable tax credit of £16.75 under the partial imputation system, so the pension fund ended up with £83.75 net.

30.3 Where (after 1 July 1994) a FID election was made in a case where the United Kingdom parent had greater than 10% voting control of the non-United Kingdom subsidiary, the corporate profits represented by the dividend paid by the non-United Kingdom subsidiary were subject to whatever tax and withholding tax was payable in the source country (subject to treaty exemption or local exemptions if any, noting in particular the EU Parent Subsidiary Directive and/or national participation exemptions which gave exemption from withholding tax in the case of a 25% holding). If that foreign tax was not at a rate of at least 33% then MCT was payable by the parent company in the United Kingdom, to top up the effective tax rate on the underlying profits giving rise to the dividend to 33% (more precisely, the MCT payable on the Schedule D Case V income in the United Kingdom was not fully relieved by double taxation relief). In this way source profits of £100 were subject to tax of at least 33% overall, leaving no more than £67 to be distributed to the ultimate shareholders (precise figures would depend on the source country corporation tax rate which was higher than 33% in some cases).

30.4 Where a FID election was made (after 1 July 1994) in a case where the United Kingdom company did not have greater than 10% voting control of the non-United Kingdom company paying the foreign dividend then the position was as follows. First, the underlying corporate profits represented by the foreign dividend would have been subject to whatever corporation tax and/or withholding tax was payable in the source country. Secondly, the foreign dividend (grossed up for the foreign withholding tax) was subject to MCT charged at a rate of 33% on the parent company in the United Kingdom, with credit relief given for the foreign withholding tax but not for foreign underlying tax. In this way foreign dividends were directly subject to tax of at least 33%, leaving 67% or less to be distributed to the ultimate shareholders.

31. United Kingdom resident pension funds receiving dividends from non-United Kingdom resident companies

31.1 In the periods 1 July 1990 to 1 July 1997, as a consequence of the condition in section 231(1) of TA 1988 which excluded tax credits in the case of distributions made by non-United Kingdom resident companies, dividends received by pension schemes from non-United Kingdom resident companies did not attract tax credits at all.

31.2 If a United Kingdom tax exempt pension fund, as an investor, held shares in a non-United Kingdom resident company, no United Kingdom tax was payable on the dividend income, since the pension fund was exempt from tax on its

investment income. However, in contrast to the position for investments in United Kingdom resident companies, no payable tax credit was available to the pension fund in the United Kingdom in respect of the dividend.

31.3 Finally, it should be noted that no United Kingdom unilateral tax relief for overseas withholding tax was available to pension funds under section 790 of TA 1988, since there was no United Kingdom income tax against which such tax relief could be given.

ANNEX 1

Tax Rates for years 1 April 1990 to 1 April 1998.

Financial Year Commencing 1 April	**Main Corporation Tax rate[6] (%)**	**Advanced rate on distributions[7]**	**Tax credit rate (%)**
1990	34	25/75	25
1991	33	25/75	25
1992	33	25/75	25
1993	33	9/31	20
1994	33	20/80	20
1995	33	20/80	20
1996	33	20/80	20
1997	31	20/80	20

[6] Applied to all taxable profits above the upper limit for small companies' relief.

[7] This is the ACT on a distribution expressed as a fraction of the grossed-up distribution.

1998	31	20/80	20

D. THE RELEVANT PROVISIONS OF THE UK TAX CODE

32. It is convenient to set out the provisions of the UK Tax Code which are the subject of the FIDs claims and the *Manninen* claims respectively:

TA 1988, section 231

231 Tax credits for certain recipients of qualifying distributions

(1) Subject to sections [231AA], [231AB] ... [, 247 and [469(2A)]], [section 171(2B) of the Finance Act 1993 and section 219(4B) of the Finance Act 1994,] where[, in any year of assessment for which income tax is charged] a company resident in the United Kingdom makes a qualifying distribution and the person receiving the distribution is another such company or a person resident in the United Kingdom, not being a company, the recipient of the distribution shall be entitled to a tax credit equal to such proportion of the amount or value of the distribution as corresponds to [the tax credit fraction in force when] the distribution is made.

[(1A) The tax credit is one-ninth.]

[(2) [Subject to sections 231A and Section 241(5)], a company resident in the United Kingdom which is entitled to a tax credit in respect of a distribution may claim to have the amount of the credit paid to it if -

(a) the company is wholly exempt from corporation tax or is only not exempt in respect of trading income; or

(b) the distribution is one in relation to which express exemption is given (otherwise than by section 208), whether specifically or by virtue of

a more general exemption from tax, under any provision of the Tax Acts.]

(3) *[Subject to section (3AA) below,] a person, not being a company resident in the United Kingdom, who is entitled to a tax credit in respect of a distribution may claim to have the credit set against the income tax chargeable on his income under section 3 or on his total income for the year of assessment in which the distribution is made [and [subject to subsections (3A) to (3D)below] where the credit exceeds that income tax, to have the excess paid to him.]*

[(3A) *Subject to subsection (3B) below, where ..., in any accounting period of a company at the end of which it is a close investment-holding company –*

(a) *arrangements relating to the distribution of the profits of the company exist or have existed the main purpose of which or one of the main purposes of which is to enable payments, or payments of a greater amount, to be made to any one or more individuals under subsection (3) above in respect of such an excess as is mentioned in that subsection, and*

(b) *by virtue of those arrangements, any eligible person -*

(i) *receives a qualifying distribution consisting of a payment made by the company on the redemption, repayment or purchase of its own shares, or*

(ii) *receives any other qualifying distribution in respect of shares in or securities of the company, where the amount or value of*

the distribution is greater than might in all the circumstances have been expected but for the arrangements,

the entitlement of the eligible person to have paid to him under subsection (3) above all or part of a tax credit in respect of any distribution made by the company in the period shall be restricted to such extent as [is] just and reasonable.

[(3B) Subsection (3A) does not apply in relation to a tax credit in respect of a dividend paid by a company in any accounting period in respect of its ordinary share capital if –

(a) throughout the period, the company's ordinary share capital consisted of only one class of shares, and

(b) no person waived his entitlement to any dividend which would have become payable by the company in the period or failed to receive any dividend which had become due and payable to him by the company in the period.]

[(3C) In subsection (3A) above –

"arrangements" means arrangements of any kind whether in writing or not,

"close investment-holding company" has the meaning given by section 13A, and

"eligible person", in relation to a qualifying distribution, means an individual resident in the United Kingdom who would (apart from subsection (3A) above) be entitled to have paid to him under subsection (3) above all or part of a tax credit in respect of the distribution.]

[(3D) In determining under subsection (3) above whether a person is entitled to have any excess of tax credit paid to him in a case where subsection (3A) above applies, tax

credits shall be set against income tax in the order that results in the greatest payment in respect of the excess.]

(4) Where a distribution mentioned in subsection (1) above is, or falls to be treated as, or under any provision of the Tax Acts is deemed to be, the income of a person other than the recipient, that person shall be treated for the purposes of this section as receiving the distribution (and accordingly the question whether he is entitled to a tax credit in respect of it shall be determined by reference to where he, and not the actual recipient, is resident); …

(5) …"

TA 1988, section 246A, section 246C

[246A Election by company paying dividend

(1) Where a company [resident in the United kingdom] pays a dividend, the dividend shall be treated as a foreign income dividend for the purposes of this Chapter if the company elects for it to be so treated in accordance with this section and section 246B.

(2) An election may not be made under this section as regards a dividend unless the dividend is paid, or to be paid, in cash.

[(2A) An election under this section cannot be made as regards a distribution which already falls to be treated as a foreign income dividend by virtue of paragraph 2(1) of Schedule 7 to the Finance Act 1997.]

(3) An election may not be made under this section as regards a dividend which is paid, or to be paid, to a person by virtue of his holding a share in respect of which there are arrangements for the holder to choose whether, or in what form, dividends are to be paid; and the arrangements may be for the holder to choose to be paid a dividend by a company other than the one which issued the share.

(4) Where at a given time -

(a) a company pays one dividend in respect of each of two or more shares of the same class, and

5 *(b) payment is on the same terms as respects all the shares involved,*

an election may not be made under this section as regards any of the dividends unless an election is made as regards each of the dividends.

(5) Where at a given time -

10 *(a) a company pays two or more dividends in respect of each of two or more shares of the same class, and*

(b) payment is on the same terms as respects all the shares involved,

15 *an election may not be made under this section as regards any one of the dividends in respect of a given share unless an election is also made as regards the corresponding dividend in respect of each of the other shares involved.*

20 *(6) Subject to subsection (7) below, a company which has more than one class of share capital may not make an election under this section as regards any dividend.*

(7) In a case where -

25 *(a) a company has more than one class of share capital,*

(b) at a given time the company pays a dividend in respect of each share of each such class, and

(c) all of those dividends are paid on the same terms,

the company may elect that each of those dividends is to be treated as a foreign income dividend.

(8) *For the purposes of subsection (7) above a dividend is paid on the same terms as another dividend if the relevant proportion in the case of each dividend is the same; and the relevant proportion, in relation to a dividend, is the proportion which the amount of the dividend bears to the nominal value of the share in respect of which the dividend is paid.*

(9) *For the purposes of subsections (6) and (7) above fixed-rate preference shares shall not be treated as constituting a class of share capital; and "fixed-rate preference shares" shall be construed in accordance with [paragraph 13(6) of Schedule 28B].*

(10) *Where an election is made under this section as regards a dividend in respect of which an election is in force under section 247(1) -*

(a) *the election under this section shall have effect as if it were also a notice to the collector under section 247(3) stating that the paying company does not wish the election under section 247(1) to have effect in relation to the dividend as regards which the election under this section is made;*

(b) *if the election under this section is revoked, the revocation shall have effect as if it were also a revocation of the notice deemed by paragraph (a) above;*

(c) *the notice deemed by paragraph (a) above may not be revoked otherwise than as mentioned in paragraph (b) above;*

(d) *if the notice deemed by paragraph (a) above is revoked it shall be treated as never having been made.]*

…

246C No tax credit for recipient

Section 231(1) shall not apply where the distribution there mentioned is a foreign income dividend."

The FID claims concern tax credits conferred by TA 1988, section 231(1), (3) and the disallowance of the tax credits by TA 1988, section 246C, for dividends elected by the paying company to be FIDs. BTPS claims that the disallowance effected by section 246C breaches its rights to the free movement of capital. The *Manninen* claims relate to the requirement that the tax credits conferred by section 231(1), (3) are restricted to dividends paid by UK tax resident companies (and that the non-availability of tax credits for dividends paid by non-UK tax resident companies also breaches the free capital movement rights).

We comment further on these respective provisions below.

E. THE RELEVANT EUROPEAN COMMUNITY LAW

33. Since all of the material events occur before the introduction of the Treaty of Lisbon we shall use pre-Lisbon terminology (in particular we shall refer to the "European Community", rather than the "European Union" and use the pre-Lisbon numbering in the EC Treaty).

Free movement of capital: Directive 88/361/EEC

34. Directive 88/361/EEC ("the Capital Directive") provided directly effective rights relating to the free movement of capital as between 1st July 1990 and 31st December 1993. The relevant provisions are as follows:

Article 1 provided:

> "*1. Without prejudice to the following provisions, Member States shall abolish restrictions on movement of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I ...*".

Article 6 provided:

> "*1. Member States shall take the measures necessary to comply with this Directive no later than 1st July*

1990. They shall forthwith inform the Commission thereof. They shall also make known, by the date of their entry into force at the latest, any new measure or any amendment made to the provisions governing the capital movements listed in Annex I."

Heading III of the Nomenclature in Annex I included the following in the various classifications of capital movements:

"*A – Transactions in securities on the capital market*

1. *Acquisition by non-residents of domestic securities dealt in on a stock exchange.*

2. *Acquisition by residents of foreign securities dealt in on a stock exchange.*

3. *Acquisition by non-residents of domestic securities not dealt in on a stock exchange.*

4. *Acquisition by residents of foreign securities not dealt in on a stock exchange.*"

The Capital Directive contained directly enforceable rights which secured the intra-Community free movement of capital. These rights did not (in contrast to Article 56 of the EC Treaty: see below) relate to capital movements between Member States and non-Member States ("third countries").

<u>EC Treaty, Article 56</u>

35. Article 56 of the EC Treaty (Free Movement of Capital) replaced the Capital Directive with direct effect, from 1st January 1994. Article 56 provides that:

"*1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited ...*"

Thus Article 56 extended the rights which guaranteed free capital movement to capital movements between Member States and third countries.

Article 58 provides:

"*1. The provisions of Article 56 shall be without prejudice to the right of Member States:*

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where the capital is invested;

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for the purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

2. The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56."

F. 1992 AGREEMENT ON THE EUROPEAN ECONOMIC AREA

36. In addition to receiving dividends from companies resident in other Member States of the European Community, which dividends are the subject of both the FIDs claims and the *Manninen* claims, BTPS received dividends from companies incorporated and tax resident in signatory-States of the 1992 Agreement on the European Economic Area ("the 1992 Agreement"). Article 40 of the 1992 Agreement provides:

> "*Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article.*"

37. No separate submissions were made by either BTPS or HMRC in relation to Article 40 of the 1992 Agreement. We take it to be common ground that both the submissions of the respective parties and our conclusions apply equally to the relevant European Community Law in relation to the Capital Directive and Article 56 of the EC Treaty on the one hand and Article 40 of the 1992 Agreement on the other. Our conclusions on the application of the relevant European Community Law should be taken to apply equally to the application of Article 40 of the 1992 Agreement.

G. THE CAPITAL DIRECTIVE AND ARTICLE 56 OF THE EC TREATY: THE ANALYTICAL FRAMEWORK

38. It is convenient to set out, at this stage, the analytical framework for the application of Community Law to the relevant domestic taxation provisions. We must consider the application of Article 56 of the EC Treaty to TA 1988, Section 231, Section 246A et seq (and Section 246C in particular), in relation to the FIDs claims and the application of the Capital Directive and Article 56 to TA 1988, Section 231 alone, in relation to the *Manninen* claims).

39. A preliminary point is this: although direct taxation does not as such (that is, expressly, or specifically) fall within the purview of the Community, the powers and jurisdiction of Member States must nevertheless be exercised consistently with Community Law. Domestic Tax provisions which breach Community Law give rise to directly enforceable rights for those who have had their Community rights breached: *Finanzamt-Köln-Alstadt v Schumacker* (Case C-279/93, paragraph 21).

Overview

40. The Capital Directive and Article 56 form part of the "fundamental freedoms" (free movement of goods: Articles 23-31, free movement of workers: Articles 39-42, free movement of persons: Articles 43-48 and the free movement of capital and payments: Articles 56-60, which, as we observe replaced the Capital Directive on 1 January 1994).

41. The "capital" whose free movement is protected by the Capital Directive (up to 1st January 1994) and Article 56 are the shares and securities in the dividend paying companies (UK resident in relation to the FIDs claims,[8] non-UK resident, in relation to the *Manninen* claims[9]), in respect of which BTPS claims investment (whether by subscription for new shares or the acquisition of existing shares) is made less attractive (hence restricting capital movement) by reason of discriminatory treatment of FIDs and cross border dividends respectively.[10]

42. All of the freedoms share a common legislative objective of the EC Treaty (the creation of an internal market: EC Treaty, Article 3.1.c) and are thus construed consistently (and are subject to the same limitations and subject to the same justifications for breach: see *Kraus* (Case C-19/92), paragraph 29, *Asscher* (Case C-107/94) paragraph 29, *Royal Bank of Scotland v Greece* (Case C-311/97) paragraph 20. The only caveat to this is that Article 56, in its application to third countries, may be subject to different justifications which might cure *prima facie* breach, than in relation to an intra-Community application: *FII ECJ* paragraph 171. Both the FIDs claims and the *Manninen* claims have a third country element. In relation to the FIDs claims the FIDs-paying companies financed the FIDs form income arising in both Community Member States and third countries. In relation to the *Manninen* claims, certain of the dividends received by BTPS were paid by companies resident in third countries.

43. Furthermore, the freedoms, including the Capital Directive and Article 56, only apply if there is a cross-border element which gives rise to a disadvantage based indirectly on neutrality. They do not apply to "wholly internal situations": *Werner* (Case C-112/91).

Application of Community Law to Member States' Domestic tax Provisions

44. Firstly a question of whether or not the relevant provisions have been breached must be considered. Secondly, if (and only if) there is *prima facie* breach, whether that breach is cured by a legitimate "justification", that is, the pursuit of an objective which is compatible with the EC Treaty, which licenses the Member State to breach the freedoms, must be ascertained. But even if a *prima facie* breach is potentially justified, the breach is only cured if the relevant domestic provision is "proportionate", in that it does not go beyond what is necessary to attain that other objective which is pursued: see, for example, *De Lasteyrie du Saillant v Ministère de l'Economie, des Finances et de l'Industrie* (Case C-9/02)

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[8] Listed and non listed securities: See the Capital Directive, Annex I, Nomenclature, A.1, 3.

[9] Listed and non listed non-UK securities: see the Capital Directive, Annex I, Nomenclature, A.2, 4.

[10] It is common ground that the Capital Directive remains of value for the construction of Article 56: see *Trummer and Meyer* (Case 222/97); *Van Hilten* (Case C-513/03, paragraph 39).

("*De Lasteyrie*") (paragraphs 38-48 regarding breach and paragraph 49 in relation to justification and proportionality).

Breach

45. In relation to the application of the freedoms to Member States' domestic tax systems, it is sufficient to constitute breach that a domestic tax provision has a "dissuasive effect" on a taxpayer wishing to exercise a Community right, or that the relevant provision is "likely to discourage" any person from effecting transactions in exercise of a Community right: *De Lasteyrie*, paragraphs 45, 46 and 48 of the Judgment of the European Court of Justice.[11] Such an impediment to the exercise of a Community right is *prima facie* breach "*even if of limited scope or minor importance*" (so that there is no *de minimis* protection for a Member State): *De Lasteyrie*, paragraph 43.

46. It is also clear that the test for breach is applied on the basis of *a priori* reasoning and inference and not as part of any fact-finding or consideration of evidence. So for example, the European Court of Justice expressly observed that "*any assessment of the facts in the case is a matter for the national court*" (*De Lasteyrie*, supra, paragraph 41) but nevertheless observed that a charge to tax on a taxpayer who wishes to change his residence from one Member State to another has "*... at the very least a dissuasive effect on the taxpayer sufficient to establish themselves in another Member State*" (paragraph 45) and is "*likely to discourage a taxpayer from carrying out [a transfer of tax residence from one Member State to another]*" (paragraph 46).

47. This test is, we think, uncontroversial and was not the subject of any dispute between the parties (although HMRC initially suggested that the potential

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[11] This "likely to discourage" test in fact amalgamates two distinct grounds for breach. Firstly breach occurs where there is discrimination, that is the less favourable treatment on the grounds of nationality. Breach arising from discrimination may be direct (where less favourable treatment by a domestic provision of a Member State is expressly predicated on the nationality of a particular Community national so as, typically, to treat nationals of that Member State more favourably than non-nationals, to the disadvantage of the non-national) or indirect (where the effect, albeit not the express terms of a domestic provision, is to confer such unfavourable treatment to the non-national). This may happen when domestic provisions (here tax provisions) either confer less favourable treatment because of the particular nationality of a Community national (say because he is not tax resident) (indirect breach since a non-resident is clearly more likely to be non-tax resident than a national). Or breach may occur because receipts payable by non-nationals, say dividends paid by non-tax resident companies, are taxed less favourably than receipts payable by national, tax resident companies. In either case discrimination only causes breach where the national and non-national persons or receipts are in objectively comparable circumstances. The second ground for breach is market access impediment, a "restrictions based" approach. In the present case, both the FIDS claims and the *Manninen* claims have been treated by both parties as a complaint of (potential) indirect discrimination by BTPS of the FIDs paid out of non-UK source income, as compared to dividends paid out of UK source income and, in relation to the *Manninen* claims, of the cross border dividends paid to BTPS by non-UK resident companies, as compared to dividends paid by UK resident companies (which are not FIDs).

dissuasive effects of the relevant UK tax provisions had to be tested by evidence, see paragraph 11 of HMRC's written reply to BTPS's supplementary skeleton argument, HMRC did not quarrel with the test as put here during the course of the oral hearing). Furthermore, we see nothing in principle (or in the case law of the European Court of Justice) to suggest that the test is different for the application of the Capital Directive as opposed to Article 56 (and neither party suggested otherwise).

Justification and Proportionality

48. That justification only cures *prima facie* breach if it pursues a Treaty-compatible objective is clear from paragraph 49 of *De Lasteyrie*. The test for proportionality (that the pursuit of a Treaty compatible objective which interferes with the fundamental freedoms, including the capital movement rights conferred by the Capital Directive and Article 56 must not so beyond what is necessary to achieve that other Treaty objective) may also be found at paragraph 49.

Remedies for Unjustified Breach of the Freedoms

49. It is common ground that the Capital Directive and Article 56 had direct effect at the material times. Orthodoxy requires taxpayers relying on the direct effect of Community rights to seek to have the national courts construe the relevant domestic legislation sympathetically so as to be Community-compliant. If sympathetic construction is not available, the taxpayers complaining of a breach of Community rights seek to have non-compliant provisions disapplied against them, failing which they must fall back onto either restitutionary remedies or a claim for damages (alleging non-contractual liability on the part of the offending member state).[12] For the reasons we give below, the appropriate remedy in relation to the FIDs claims is the disapplication of TA 1988, section 246C, while the appropriate remedy in relation to the *Manninen* claims is a sympathetic construction of section 231(1), so as to imply a statutory caveat in section 231(1) that the requirement of UK tax-residence for a dividend paying company to attract a tax credit for the recipient shareholder is treated as impliedly subject to and overridden by the Community Law rights of the shareholders, so that a tax credit is available to shareholders under section 231(1), (3), for dividends paid by non-UK tax-resident companies, if otherwise the shareholders' Community rights (here the rights to free movement of capital) are breached, without justification

H. THE FIDS CLAIMS

Appellant's Submissions

[12] This seems to be the order of remedial action as a matter of the approach of the Court of Justice: see *Faccini Dori* (Case C-91/92).

50. The essence of BTPS's submissions, presented by Mr Whiteman QC, in relation to the FIDs claims is relatively simple and may be summarised thus: Dividends paid by UK resident companies to BTPS would ordinarily attract a tax credit in BTPS's hands under TA 1988, Section 231(1), (3). Such dividends would ordinarily attract a charge to ACT in the hands of the paying company (see TA 1988, Section 14 and the summary of the UK Tax Code above). Dividends paid by UK resident companies, financed out of non-UK source income do not attract such a tax credit, where an election has been made by the paying company under TA 1988, Section 246A, for the dividend to be a FID (removing the burden of a charge to ACT, to alleviate the prospect of surplus ACT). The right to a credit under Section 231(1), (3) which is otherwise available is expressly denied by Section 246C. This results in FIDs paid by a UK tax-resident company out of non-UK source income being treated less favourably in the hands of UK tax resident shareholders (no tax credit) than dividends which are paid by a UK tax resident company out of UK source income (tax credit available). The comparatively unfavourable treatment of non-UK sourced FIDs and UK sourced dividends occurs in objectively comparable circumstances; there is no relevant distinction so far as the recipient shareholders are concerned between the dividends paid out of UK source income and the dividends paid out of non-UK source income.

51. Furthermore, Mr Whiteman submitted, the FIDS claims were not made in a wholly internal situation; HMRC could not plead, he said, that Article 56 was not engaged. This was implicit in the approach of the European Court in *FII ECJ*. In any event it was clear, after *FII ECJ* that the rights relating to both establishment and the free movement of capital of a UK resident company paying a FID were infringed by the FIDs regime and in particular the Community Law rights of the paying company were breached by the absence of a tax credit for the *shareholders* who received a FID (an election having been made) and thus were denied a tax credit on that FID. This disadvantage to the shareholders breached the Community Law rights of the dividend paying company since it meant that shares in companies financing dividends out of non-UK source income (elected to be FIDs) were less attractive to UK resident shareholders and made it more difficult for such companies to raise capital from putative shareholders who would not obtain tax credits on FIDs. That disadvantage to the shareholders (and therefore to the company) arose because the paying company that paid a dividend out of non-UK source income (otherwise the dividend could not be a FID) and made the relevant election under Section 246A. That was a cross-border circumstance (the funding of dividends out of non-UK source income) which informed the nature of a disadvantage (to the shareholders, as much as to the dividend paying company whose Community Law rights were breached by the absence of a tax credit). It cannot be, says Mr Whiteman, that the payment of a FID without a tax credit can be dismissed as a wholly internal circumstance, since if that were the case, the disadvantage expressly recognised by the European Court of Justice in FII ECJ which gave rise to a breach of the FID-paying company's Community rights (there, both to freedom of establishment and free movement of capital) would not have been relevant in ***FII ECJ***.

52. Mr Whiteman also put his case that the FIDs claims were not within a wholly internal circumstance another way. The recipient shareholders were disadvantaged by the absence of a tax credit on a FID by reason of a breach of the paying company's Community rights. The shareholders could rely on the infringement of the *paying company's* Community rights to obtain a remedy which removed that disadvantage: *Eurowings* (Case C-294/97), paragraph 34 (which made it clear that the consumers of services could rely on a breach of the right of service providers to provide cross border services to raise Community Law actions of their own against a Member State's offending domestic provisions; by analogy shareholders may rely on a breach of the Community law rights of a company in which they hold shares to raise a Community Law action of their own to counter a disadvantage arising to them by reason of the breach of the company's Community rights).

53. Furthermore, Mr Whiteman submitted, the prospect of a company paying a dividend funded out of non-UK source income to BTPS where there was no election under Section 246A (so that the dividend would bear ACT, and would not be a FID, which in turn would make a tax credit available to BTPS under TA 1988, Section 231(1), (3) since Section 246C would not apply) was irrelevant. A paying company in making an election under Section 246A to avoid generating surplus ACT was opting, in Mr Whiteman's words, for the "least worst solution". The alleviation of the paying company's ACT position by way of an election under Section 246C for dividends funded by non-UK source income was, however, at the expense of a tax credit to the recipient shareholder. This meant that the receipt of dividends funded by non-UK source income was less attractive than UK dividends financed out of UK source income (which carry a tax credit under Section 231(1)). This meant that UK resident recipient shareholders such as BTPS were discouraged ("dissuaded") from investing in UK tax resident companies (whether by subscription or by acquiring existing shares). This was a breach of Article 56 of the EC Treaty on the *De Lasteyrie* test.

54. In reply to a submission made by HMRC (see below) that tax credits were necessarily dependent on ACT having been paid by the dividend-paying company (which would not be the case for a FID since the point of an election was to effect a repayment of the ACT: see the Summary of the UK tax code above), either as a matter of principle or because the ACT was a surrogate for income tax paid by the recipient shareholder, Mr Whiteman submitted that FII ECJ made it clear that the availability of a tax credit in respect of a dividend was not dependent on ACT having been paid by the dividend paying company and in any event ACT is, on no view, a surrogate for income tax paid by the recipient shareholder (ACT, said Mr Whiteman, is corporation tax paid by the dividend paying company: nothing more).

55. And finally, said Mr Whiteman, the technique of FIDs-paying companies paying "enhanced dividends" (see paragraph 20.3 of the parties' summary of the UK Tax Code), where companies paid FIDs "grossed up" so that the amount received by

shareholders reflected the amount equal to what they would have received had a smaller dividend been paid and a tax credit received did not affect the position. After all, there was no tax credit on the actual (enhanced) dividend and the company's reserves were depleted by more than they would be if tax credits were available.

HMRC's Submissions

56. Mr Baldry QC made the following submissions on behalf of HMRC:-

(i) The terms of TA 1988, Section 246A and Section 246C were clear on their terms and did not admit of any tax credit for FIDs paid to BTPS.

(ii) Article 56 was not engaged at the material times so as to confer Community Law rights on BTPS. The FIDs claims arose in relation to dividends paid by UK resident companies to UK resident shareholders (here BTPS). There was no cross-border element. Rather this was a wholly internal situation which was outside the very scope of Article 56.

(iii) Furthermore the dividends which were the subject of the FIDs claims did not bear ACT (since the paying company had made an election under Section 246A(1)). The ACT otherwise payable by a company paying a dividend funds the ACT credit in the hands of the recipient shareholder. If there is no ACT payable by the paying company on a dividend, a tax credit paid to the recipient shareholder would not have been properly funded: Mr Baldry sought support from *Pirelli Cable Holding NV v IRC* [2006] UKHL 4 for the proposition that a tax credit is necessarily dependent on the dividend having borne ACT. Indeed, said Mr Baldry, the ACT was a surrogate for income tax paid by the recipient so it makes no sense to pay a tax credit under Section 231(1), and *a fortiori* to pay a sum equal to the ACT credit to a recipient shareholder under Section 231(3) where a dividend does not bear ACT. And, said Mr Baldry, ACT funds tax credits available to shareholders under section 231. So it is legitimate to withhold tax credits in circumstances in which no charge to ACT arose.

(iv) Finally, said Mr Baldry, the technique of paying "enhanced dividends" ensured that there was, in any case, no loss to recipient shareholders even if there was no tax credit available under Section 231(1), where an election had been made by the paying company under Section 246A.

57. Mr Baldry's submissions for the most part all relate to whether Article 56 is engaged and if so whether the Community rights it conferred were breached. Mr

Baldry did not plead that FIDs were paid in objectively different circumstances to dividends which were not FIDs. Were we to hold that Community rights were breached in relation to the FIDs claims, Mr Baldry pleaded the legitimate right of Member States to secure "effective fiscal supervision" as a potential justification for breach in relation to third countries, which submission we take HMRC to make in identical terms in relation to both the FIDs claims and the *Manninen* claims..

I. OBSERVATIONS ON THE RELEVANT PROVISIONS OF THE UK TAX CODE

58. Before we set out our decision on the FIDs claims, the *Manninen* claims and the limitation issues, we make the following observations on the relevant provisions of the UK tax code.

59. TA 1988, section 231(1) gives a tax credit to a shareholder who receives a "qualifying distribution" within section 14 from a UK resident company. Section 231(1) therefore on its terms imposes two conditions before a tax credit is conferred: firstly that the dividend be a "qualifying distribution" within section 14; secondly that the dividend be paid by a UK tax resident company.

60. We address BTPS's complaint as to the requirement of UK tax residence of a dividend paying company below. However we consider that it is important for us to make it clear that the credit conferred by TA 1988, section 231(1), (3) is not dependent on the dividend paying company suffering a charge to ACT.

61. At the material times, a "qualifying distribution" was a distribution within the meaning of TA 1988, section 209(2) (excluding section 209(2)(c)). Dividends were distributions within section 209(2)(a). Thus a credit was available under section 231(1) for dividends paid by UK resident companies within the UK corporation tax charge (since TA 1988, section 209 only applied for corporation tax purposes). It is certainly true that in the normal course of events a qualifying distribution (here a dividend) paid by a UK resident company attracted a liability under section 14 to ACT for the dividend paying company. Thus normally the tax credit conferred by section 231(1) will, on its terms, at the material times, be given in a circumstance where the dividend paying company is both UK tax-resident (indeed within the charge to corporation tax) and has suffered a charge to ACT. But the tax credit given by section 231(1) is not dependent on the dividend paying company having suffered a charge to ACT under section 14 (and still less having paid ACT). Rather the tax credit is dependent on the dividend being a "qualifying distribution" which simply, put short, means that it is a dividend within TA 1988, section 209(2)(a).

62. However, the tax credit conferred by section 231(1) on a dividend received by a shareholder is not on its terms any sort of repayment of tax suffered by the

dividend paying company, either in relation to tax paid on the profits out of which the dividend is paid ("underlying tax"), or of ACT.

63. And neither would we expected section 231(1) to describe the tax credit it confers as any sort of repayment of underlying tax or of ACT.

64. In respect of the relationship between a credit available under section 231(1) and underlying tax, the credit given by section 231(1) is an imputation credit which reduces the tax liability of the recipient shareholder of a dividend paid out of taxed profits. That imputation credit is based on an assumption that the paying company has borne tax on the profits used to pay the dividend (and avoids, to the extent of the quantum of the imputation credit, double economic taxation on the dividend). But section 231(1) does not require that company to have actually borne underlying tax. For example, a company may make profits of £100 in Year 1 and suffer a charge to tax of 30%. That company pay a dividend of £65 (being a qualifying distribution) of the balance of £70 it retains. In Year 2, the company makes a loss of £100 which it carries back to shelter the entirety of its profits of £100 of Year 1. Thus the company pays no underlying tax in respect of its Year 1 profits but the dividend remains a qualifying distribution and the shareholder retains the benefit of the imputation credit for the dividend in Year 1. This observation serves to show that the tax credit available under section 231(1) is in no sense a repayment of underlying tax paid by the dividend paying company. A more mundane example is where a company reduces capital, to increase distributable profits and pays a dividend out of those newly created reserves. Those new reserves would never have borne underlying tax but nevertheless the paying company, at the material times, would suffer a charge to ACT in the ordinary course of events and the recipient of the dividend would obtain a tax credit under section 231(1). This shows that the imputation mechanism in section 231(1) is a "broad axe" approach which assumes that dividends will be subject to double economic taxation and mitigates that prospect by way of a credit which reduces the tax charge of a shareholder who receives a dividend, without enquiring whether the dividend paying company has actually suffered underlying tax on its profits.

65. As to the relationship between a credit conferred by section 231 and ACT, the imputation credit cannot be described as a repayment of ACT either. ACT is simply a pre-payment of corporation tax by a dividend paying company. The ACT franks the paying company's mainstream corporation tax charge. It is unintelligible for the recipient of a dividend to be described as being "repaid" the ACT paid by the dividend paying company, when that ACT is "repaid" to the paying company by way of a franking of its mainstream corporation tax charge.

66. And ACT is in no sense a deduction of tax at source for the recipient shareholder. As we have observed (now several times) ACT is a pre-payment of a company's mainstream corporation tax charge. A withholding tax is imposed on a receipt to satisfy a tax liability of the recipient of that receipt. That ACT is not a

withholding tax has been recognised by the European Court of Justice: *Oce van der Grinten NV v IRC* (Case C-58/01). And if ACT is not a withholding tax suffered by the recipient shareholder (whether individual or corporate), ACT cannot, we consider, be a surrogate for tax paid by the shareholder who receives a dividend in respect of which the paying company has suffered ACT. The description of ACT as a surrogate for tax paid by the recipient of a dividend is simply another way of describing ACT as a withholding tax.[13]

67. In relation to section 231(3), the tax credit is conferred not by a reduction in a charge to tax but by way of a cash payment to a taxpayer whose tax liability is exhausted before the full value of an imputation credit conferred by section 231(1) can be utilised, as well as to fully exempt taxpayers (such as BTPS) who can never utilise a tax credit under section 231(1). But this payment in cash is no more a repayment of the dividend paying company's underlying tax or ACT that the imputation credit given by section 231(1), for exactly the same reasons we give above in relation to the credit given by section 231(1). We hope we do not weary the reader by pointing out again that the credit given by section 231(1) and the credit paid under section 231(3) is available whether the dividend paying company suffers actual underlying tax on the profits out of which the dividend is paid and that ACT is a liability to pre-pay corporation tax on the part of the paying company (not in any sense a liability to tax for the recipient of a dividend). That section 231(3) pays a cash amount to a partially or fully tax exempt recipient of a dividend of course recognises that to the extent that an imputation credit cannot benefit a tax exempt shareholder, that shareholder must be compensated in some other way, given the assumption that the dividend is paid out of taxed profits, even though those profits may not have actually borne tax. But again, what is clear is that the payment of a tax credit under section 231(3) is neither a repayment of tax suffered by the dividend paying company, nor the repayment of tax suffered by the recipient shareholder.[14]

68. It is clear from our observations that we do not agree with Mr Baldry's submission that a credit available under TA 1988, section 231(1), (3) is dependent on the dividend paying company having suffered underlying tax or ACT. And we do not agree with his submission that ACT is in any sense a surrogate for tax suffered on

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13 We observe, in parentheses, that a UK resident corporate shareholder can never be said to have suffered tax on a dividend paid to it by a UK resident company (and so it can never be said that ACT is a surrogate for tax paid by such a UK resident corporate recipient): such UK resident corporate shareholders are exempt from corporation tax on dividends paid by UK resident paying-companies: TA 1988, section 208. And since the liability to ACT under section 14 and the availability of a tax credit under section 231(1) are identical, at the material times, whether a dividend is paid to a UK resident corporate shareholder or an individual (or any other type of shareholder), it follows, we think, that ACT cannot be a surrogate for the payment of tax by the recipient of a dividend by any type of shareholder.

14 See *HMRC v UBS* [2007] EWCA Civ 119, paragraphs 48, 84, which makes it clear that the payment of a tax credit to a corporate shareholder is not a relief from (and so not a payment (or repayment of)) corporation tax.

a dividend by a recipient shareholder. We repeat this observation in our decision on the FIDs claims in principle.

69. As it happens, we also find ourselves wondering if Mr Baldry is correct in his submission that ACT paid by a dividend paying company funds the tax credit given to a shareholder under section 231(1), (3). The ACT franks the paying company's mainstream corporation tax charge. So HMRC loses the benefit of the ACT paid as a pre-payment of that mainstream corporation tax to the extent that the paying company has a mainstream corporation tax liability at the end of its accounting period. But the individual shareholder may take the benefit of a credit under section 231(1), (3) after that time and in any event, in the case of a credit paid in cash to a partially or fully tax exempt shareholder under section 231(3), this credit represents a real cost to HMRC on any view.

70. More fundamentally we cannot see the relevance of Mr Baldry's submission that ACT funds a credit given by section 231. Even if this were correct, all that this means is that there is a loss of revenue to the UK if tax credits are given to shareholders where the paying company does not suffer a charge to ACT. A loss of revenue is not a reason why breach of Community rights does not occur; nor does it cure breach.[15]

J. DECISION ON THE FIDs CLAIMS

Breach of Article 56

71. We apply the analytical framework we set out above to Section 246C as follows. As we have observed above, we apply the same approach to each of Article 56 and the 1992 Agreement.

72. Of course, Mr Baldry is correct that the terms of TA 1988, Section 246C are clear. No tax credit is available on its terms. It is their very clarity which presents the disadvantage of the absence of tax credits on FIDs which BTPS complains about.

73. Firstly, we consider that the absence of a tax credit on a FID is a disadvantage to the recipient shareholders (here BTPS) which is a breach of the free movement of capital provisions in Article 56. We have already observed that the test for breach ("likely to discourage", "liable to dissuade") is the same for both. We are presented with a case where if a UK tax resident company pays a dividend funded out of UK source profits, the recipient shareholder obtains a tax credit under section 231(1), (3). But if the dividend is paid out of non-UK source profits (and the paying company elects that it be a FID), there is, quite simply, no tax credit. That makes shares in companies which funds dividends out of non-UK source profits less attractive than shares in objectively comparable companies which fund

[15] This is trite Community law: see for example *Skandia* (Case C-422/10), paragraph 51.

dividends out of UK source profits and is (self-evidently) liable to dissuade investment in the former class of companies. To that extent potential shareholders who wish to invest indirectly in non-UK source profit sources out of which companies would pay FIDs are faced with an impediment in such indirect investment (the absence of a tax credit on the dividends which effectively on-pay those non-UK source profits).

74. Secondly, the absence of a tax credit by the application of Section 246C does not arise in a wholly internal situation within the meaning of *Werner* (supra). It is true that the FIDs regime applies to a dividend paid by a UK tax-resident company to UK resident shareholders. But Section 246C only removes the tax credit if the dividend is paid out of non-UK source income. Otherwise the dividend would not be a FID. A dividend paid out of non-UK source income, which is elected to be a FID and thus carries no tax credit is disadvantaged in the hands of a recipient shareholder by reason of the absence of the tax credit, as compared to a dividend paid by a company funded out of UK source income which carries a tax credit, by reason (only) that the FID is funded out of non-UK source profits. In other words the disadvantage of the absence of a tax credit on a FID is a direct result of the FID being funded out of non-UK source profits, rather than UK source profits. This makes shares in UK companies which fund dividends out of non-UK source profits less attractive than shares in UK companies which fund dividends out of UK source profits. That is not a wholly internal situation.

75. Separately, in relation to whether the FIDs claim is within a wholly internal situation which excludes the application of Article 56, *Eurowings* is good authority for the proposition that the shareholders of a company may rely on a breach of Community rights of the company in which they hold shares. As we have observed, the freedoms are to be construed, as far as possible, in a consistent manner (see *Kraus*, supra). The European Court of Justice, in *Eurowings*, supra, at paragraph 34, makes it clear that the consumers of a supply of services may rely on the breach of the Community Law rights of the supplier of cross border services. We see no reason in principle (and we were not shown any Community case law) why by analogy shareholders of a company whose Community law rights are breached cannot rely on such breach to found their own Community Law action.

76. Nor, we consider, does it make any difference that the absence of a tax credit is triggered by an election made by the paying company under Section 246C. The paying company makes an election in order to minimise its exposure to surplus ACT. That does not (at all) affect the disadvantage accruing to a taxpayer who would receive the benefit of a tax credit under Section 231(1), (3) for a dividend funded by UK source income, as compared to a taxpayer who does not receive such a tax credit where the dividend is funded by non-UK source income. Put another way, the ECJ has consistently held that a countervailing advantage is not a justification which can cure a breach: *EC v France ("avoir fiscal")* (Case C 270/83), paragraph 20. So even if BTPS relies on a breach of the FIDs paying

company's rights to found the FIDs claims BTPS makes, the countervailing advantage to the FIDs paying company (repayment of ACT on the dividend elected to be a FID) cannot cure breach of Article 56. *A fortiori* if the shareholders (here BTPS) have had, as we have found, their own Community law rights breached, a countervailing advantage afforded to a different person (the paying company which is repaid its ACT) cannot cure breach of Community Law either.

77. The technique of certain companies paying enhanced dividends elected to be FIDs (where dividends elected to be FIDs were inflated so that a tax-exempt recipient who was not entitled to a tax credit received an additional amount by way of dividend to compensate for the absence of the credit: see paragraph 29.3 in the Parties' summary of the UK Tax Code) does not affect our conclusion either. The fact that a dividend paying company must adopt a technique to seek to counter a disadvantage (by paying an increased dividend, to make up for the absence of a tax credit) merely highlights the existence of that disadvantage. It does not remove it.

78. Accordingly, we have no hesitation in finding that the absence of a tax credit, by reason of Section 246C, is "likely to dissuade" investment by shareholders, in investing in shares in companies which generate non-UK source income, with which to finance the payment of dividends and thus constitutes a *prima facie* breach of Article 56 of the EC Treaty.

79. We are reinforced in our conclusion by the terms of the decision of the European Court of Justice in *FII ECJ*. In *FII ECJ*, the European Court of Justice made observations, relevant to the FIDs claims, in reply to the question relating to the FIDs regime, referred by the English High Court. The question referred was as follows:

> "*[Question 4].*
>
> *Where the Member State has measures which in certain circumstances provide for resident companies, if they so elect, to recover the ACT paid on distributions to the shareholders to the extent that distributions are received by the resident companies from non-resident companies (including for this purpose companies resident in third countries) is it contrary to Article 43 [EC], [Article] 56 EC ... for those measures:*
>
> *(a) to oblige the resident companies to pay ACT and to reclaim it subsequently; and*

(b) *not to provide for the shareholders of the resident companies to receive a tax credit which they would have received on a dividend from a resident company which had not itself received dividends from non-resident companies?*"

80. Question 4.b thus refers (self-evidently) to whether the absence of tax credits on FIDs breach the free movement of capital rights of UK resident companies which pay FIDs.

81. The European Court of Justice replied as follows:

> "*[140]. By Question 4, the national court essentially asks whether Articles 43 EC and 56 EC ... preclude national legislation, such as the legislation at issue in the main proceedings, which, while allowing resident companies receiving foreign-sourced dividends to elect to recover ACT accounted for on a subsequent distribution to their own shareholders, first, obliges those companies to pay the ACT and to reclaim it subsequently and, secondly, does not provide any tax credit to their shareholders, whereas those shareholders would have received such a tax credit if the resident companies had made a distribution based on nationally-sourced dividends ...*
>
> *[148]. ... A shareholder receiving a payment of dividends from a resident company which has its origin in foreign-sourced dividends treated as FIDs, is not entitled to a tax credit, but is treated as having received income which has been taxed at the lower rate for the tax year in question. In the absence of a tax credit, such a shareholder has no right to any repayment of tax if he is not liable to income tax or where the income tax due is less than the tax on the dividend at the lower rate.*
>
> *[149]. As the claimants in the main proceedings contend, that means a company which has elected to be taxed under the FID regime must increase the amount of distributions if it wishes to guarantee its shareholders a return equivalent*

to that which would be achieved from a payment of nationally-sourced dividends …

[151]. As regards the obligation on a company which has elected to be taxed under the FID regime to account for ACT pending subsequent repayment, the United Kingdom Government repeats its argument that the situation of a company receiving foreign-sourced dividends is not comparable to that of a company receiving nationally-sourced dividends, in that the obligation on the former company to account for ACT on a subsequent payment of dividends is explained by the fact that, unlike the latter, it receives dividends on which no ACT has been accounted for. If, in that different context, a company receiving foreign-sourced dividend which elects to be taxed under the FID regime is entitled to reimbursement of the ACT accounted for, such treatment cannot constitute discrimination in any way …

[158]. As regards the fact that shareholders are not entitled to a tax credit under the FID regime, the United Kingdom Government argues that such a tax credit is granted to a shareholder receiving a distribution only where there is a economic double taxation of the profits distributed which must be prevented or mitigated. That does not apply to the FID regime in as much as, first, no ACT has been accounted for on foreign-sourced dividends and, secondly, the ACT which the resident company receiving those dividends must account for in making a distribution to its shareholders is subsequently repaid.

[159]. However, that argument is based on the same false premiss that a risk of economic double taxation arises only in the case of dividends paid by a resident company subject to an obligation to account for ACT on dividends distributed by it, whereas the true position is that such a risk also exists in the case of dividends paid by a non-resident company, the profits of which are also subject to corporation tax in the State in

which it is resident, at the rates and according to the rules applying there.

[160]. For the same reason, the United Kingdom Government cannot suggest that dividends received from a non-resident company are not less favourably treated by arguing that, because such a company is not obliged to account for ACT, it may pay higher dividends to its shareholders.

[161]. It is also necessary to reject the argument that the differences in treatment to which foreign-sourced dividends paid under the FID regime are subject do not constitute a restriction on the free movement of establishment because that scheme is merely optional.

[162]. As the claimants in the main proceedings point out, the fact that a national scheme which restricts freedoms of movement is optional does not mean that it is not incompatible with Community law. …

[173]. The answer to Question 4 must therefore be that Articles 43 and 56 EC preclude legislation of a Member State which, while exempting from advanced corporation tax resident companies paying dividends to their shareholders which have their origin in nationally-sourced dividends received by them, allows resident companies distributing dividends to the shareholders which have their origin in foreign-sourced dividends received by them to elect to be taxed under a regime which permits them to recover the advanced corporation tax, first, obliges those companies to pay that advanced corporation tax and subsequently to claim repayment and, secondly, does not provide a tax credit for their shareholders, whereas those shareholders which would have received such a tax credit in the case of a distribution made by a resident company which had its origin in nationally-sourced dividends."

82. The following points are clear from the observations of the European Court of Justice:-

(i) the free movement of capital rights of a UK resident company paying a FID are breached by the absence of a tax credit on a dividend which constitutes a FID, in the hands of a recipient shareholder;

(ii) the absence of ACT on a FID is irrelevant, provided (it seems, critically) that the dividend is paid out of taxed income (see paragraph 158-160);

(iii) that the fact that a dividend paid by the paying company out of non-UK source income is only a FID (and therefore does not carry a tax credit) because of an election made by the paying company is, quite simply, irrelevant (paragraph 161, 162);

(iv) furthermore, the European Court clearly had in mind that the recipient shareholders may be fully taxable, partially taxable or tax exempt (see the Court's observations on the FIDs regime at paragraph 148).

83. We have already concluded that Mr Baldry's submissions on the clarity of the terms of section 231(1), (3) and section 246C are not relevant to the question of whether or not BTPS's Community rights to free movement of capital are breached. And we have concluded that the absence of a credit by reason of section 246C is indeed liable to dissuade potential shareholders from investing in shares of companies which pay FIDs (at the material times). Further, we have concluded that this breach does not occur in a wholly internal situation. We have also concluded that Mr Baldry's submission that ACT paid by a dividend paying company is a surrogate for tax suffered by the recipient of the dividend (so that it is justifiable in a sense which prevents breach from occurring at all to refuse a tax credit for a dividend on which no charge to ACT arises) is not well founded and indeed *FII ECJ* makes it clear that the absence of a charge to ACT for a dividend paying company is irrelevant to the question of whether the absence of a credit for the shareholder under the FIDs regime breaches Community rights, as well as confirming that neither the elective nature of the FIDs regime, nor the prospect of "enhanced dividends" cures that breach.

84. The only question at large, in relation to the FIDs claims, is whether there is a reason why the breach of the paying company's rights by the absence of a tax credit on a FID does not also give rise to directly enforceable Community rights on the part of recipient shareholders (here BTPS). For the reasons given above, the short answer is "No".

85. Accordingly, we have no hesitation in finding that the absence of a tax credit, by reason of Section 246C, is "likely to dissuade" investment by shareholders, in investing in shares in companies which generate non-UK source income, with which to finance the payment of dividends and thus constitutes a *prima facie* breach of Article 56 of the EC Treaty.

Justification

86. Mr Baldry did not plead any justification for a breach of Article 56 in relation to FIDs funded out of income arising in Community Member States. Mr Baldry did, however, plead a potential justification for such breach in relation to both the FIDs claims and the *Manninen* claims, based on the notion of "effective fiscal supervision" discussed by the European Court in *Manninen*. We take Mr Baldry's submissions relating to the FIDs claims to apply to FIDs funded by income arising from third counties,

87. In *Manninen* the European Court of Justice observed that:

> "*[50]. The Finnish and United Kingdom Governments referred to various practical obstacles which, in their submission, preclude a shareholder fully taxable in Finland from being granted a tax credit corresponding to the corporation tax due from the company established in another Member State. They argued that the Treaty rules on the free movement of capital apply not only to movements of capital between Member States but also to movements of capital between Member States and non-Member countries. According to those Governments, bearing in mind the diversity of the tax systems in force, it is impossible in practice to determine exactly the amount of tax, by way of corporation tax, which has effected dividends paid by a company established in another Member State or in a non-Member country. They argue that such impossibility is due in particular to the fact that the basis of assessment for corporation tax varies from one country to another and that the rates may vary from one year to the next. They argue that dividends paid by a company do not necessarily arise from the profits of a given accounting year.*

[51]. In that respect, it should first be noted that the case in the main proceedings does not in any way concern the free movement of capital between Member States and non-Member countries. This case concerns the refusal by the tax authorities of a Member State to grant a tax advantage to a person fully taxable in that State where that person has received dividends from a company established in another Member State.

[52]. Moreover, the order for reference shows that, in Finland, the tax credit allowed to the shareholder is equal to ${}^{29}/_{71}{}^{ths}$ *of the dividends paid by the company established in that Member State. For the purposes of calculating the tax credit, the numerator of the fraction to be applied is thus equal to the rate of taxation of company profits subject to corporation tax, and the denominator is equal to the result obtained by deducting that same rate of taxation from the base of 100.*

[53]. Finally it should also be noted that in Finnish tax law, the tax credit always corresponds to the amount of tax actually paid by way of corporation tax by the company which distributes the dividends. Should the tax paid by way of corporation tax turn out to be less than the amount of the tax credit, the difference is charged to the company making the distribution by means of an additional tax.

[54]. In those circumstances, the calculation of a tax credit granted to a shareholder fully taxable in Finland, who has received dividends from a company established in Sweden, must take account of the tax actually paid by the company established in that other Member State, as such tax arises from the general rules on calculating the basis of assessment and from the rate of corporation tax in that latter Member State. Possible difficulties in determining the tax actually paid cannot, in any event, justify an obstacle to the free movement of capital such as that which arises from the legislation in issue in the main proceedings ...

[55]. In the light of the above considerations the answer to the questions referred must be that Articles 56 and 58 EC preclude legislation whereby the entitlement of a person fully taxable in one Member State to a tax credit in relation to dividends paid to him by limited companies is excluded where those companies are not established in that State."

88. We take the following propositions from the propositions we set out above:-

(i) the observations of the European Court of Justice make it clear that the basis on which the Court established breach of Article 56 and the basis on which the Court considered a possible justification to cure that breach ("*practical obstacles [which make it] ... impossible in practice to determine exactly the amount of tax ... which has affected dividends paid by a company [paying a cross-border dividend]*)" (paragraph 50) is predicated on the assumption that the paying company has suffered tax on the profits out of which it pays the dividends;

(ii) it follows that Article 56 (and the Capital Directive) is not engaged if the paying company has not suffered tax on the profits out of which it has paid cross-border dividends (here dividends to BTPS);

(iii) however, "possible difficulties" in establishing the tax actually paid (the reference to "actually paid" in paragraph 54 reinforces our conclusion that the paying company must have actually suffered tax in its own jurisdiction) cannot justify an obstacle to the free movement of capital (that is they cannot cure breach).

89. We observe a slight tension in the European Court of Justice's observations which, on the one hand, assume that there is only a breach of Article 56 in respect of a cross-border dividend where tax credits are denied, if the paying company has suffered tax in its own jurisdiction but on the other hand makes it clear that possible difficulties in establishing whether or not that company has suffered tax cannot cure breach.

90. Mr Baldry's submission as to a possible justification of a breach of Article 56 related exclusively to the right of Member States to secure "effective fiscal supervision" (that is the policing of tax compliance): see, for example, *Futura Participations SA* (Case C-250/95). Thus Mr Baldry does not, plead, as such, the possibility of "difficulties" in establishing whether or not income arising in third countries, which funded FIDs paid to BTPS have or have not suffered tax. Mr Baldry rather pleads that the United Kingdom is entitled to ascertain whether or not such third country income has indeed suffered such tax (without which Article

56 is not engaged, as respects third countries) and where the United Kingdom is unable to ascertain whether or not such third country profits have been taxed, no tax credit need be afforded to BTPS.

91. The whole question of whether there is a distinction between "effective fiscal supervision" in the context of ascertaining whether or not tax has been borne by companies paying cross-border dividends and the "possible difficulties" which do not cure breach is before the High Court in the *CFC and Dividends Group Litigation Order*. The issue will be explored, we are told, in detail there (as to the relevant legal issues in play, what evidence, if any, will need to be led, by HMRC in particular, and the application, if relevant, of the principle of proportionality). These are fundamental questions of principle. HMRC submitted that it would not be sensible to decide this issue in this Tribunal, when the High Court will decide it, although, in further submissions, BTPS suggested that we could decide the applicability of this justification on the FIDs claims in favour of BTPS (that is, this justification cannot cure a breach of Article 56 in relation to the FIDs claims). BTPS suggested that since any "fiscal supervision" must apply at the level of the UK resident FIDs-paying company, in relation to which HMRC has self-evidently conducted all necessary "fiscal supervision", the notion of "effective fiscal supervision" cannot apply to the FIDs claims to cure breach.

92. We have heard no submissions from HMRC on how the principles which govern how "effective fiscal supervision" should apply in relation to a breach of Article 56 in the context of the FIDs claims (or indeed the *Manninen* claims, in relation to which this justification may also be relevant, see below). (The hearing of the present appeal took place before the Court of Appeal released the decision in *Test Claimants in the FII Group Litigation v HMRC* [2010] EWCA Civ 103.)

93. In the absence of any positive reliance by HMRC on the "effective fiscal supervision" principle we find ourselves bound to determine the issue in favour of BPTS. But we recognise that this is a matter that would merit arguments in a higher court (should this case go on appeal) we understand BTPS to accept that HMRC would not be barred from presenting such an argument.

94. It is worth recording that in *Manninen* the Court rejected submissions made by Member States based on territoriality (see paragraphs 31-39) and the cohesion of the tax system (paragraphs 40-48). Mr Baldry did not plead either of those justifications before us. Mr Baldry's only response in relation to justification was that of "effective fiscal supervision".

Disposal of the FID claims

95. Having found that there is *prima facie* breach of Article 56, we must now turn to the remedy for such breach. So far as BTPS's remedy is concerned, once it is clear that Community rights have been engaged, the parties agreed that

disapplication is the relevant remedy (of Section 246C). In a case where there are directly enforceable rights (to the free movement of capital), sympathetic construction of Section 246C is out of the question. Section 246C could hardly be clearer that tax credits are not to be paid in the case of a FID. That leaves disapplication.

96. Accordingly we allow the appeal in principle in relation to the FIDs claims, subject, of course to the FIDs claims having been made in time and our decision on the limitation issue. Section 246C must be disapplied in relation to the FID claims, insofar as they have been made in time (as to which we conclude below).

97. In so far as we find any FIDs claims to have been made out of time, the appeals in relation to those out of time FIDs claims are dismissed (see below).

J. THE *MANNINEN* CLAIMS

The Appellant's submissions

98. Mr Whiteman's submissions in relation to the *Manninen* claims are equally as straightforward as his submissions on the FIDs claims. *Manninen*, says Mr Whiteman, held that it was a breach of Article 56 (as regards both shareholders who receive cross-border dividends and companies who pay such dividends) for the Member State which taxed those dividends, in the hands of the shareholder, to restrict tax credits to dividends paid by companies resident in the same Member State as the recipient shareholders. It follows that it is equally a breach of Article 56 to restrict a tax credit on cross-border dividends, in this case, paid by non-UK resident companies, on the basis that the paying company was not UK tax resident. The fact that the recipient shareholder utilised the tax credit by way of a payment from HMRC (because in this case BTPS is a tax exempt entity) is neither here nor there. *Manninen* is authority for the proposition that imputation credits which reduce the tax liability on a dividend in the hands of the recipient shareholders must be applied to cross-border dividends. The reasoning holds equally as good, says Mr Whiteman, for tax credits which result in a payment to the recipient shareholder (because of the shareholder's tax liability being exhausted or, as here, the shareholder being tax-exempt) results in the payment of an amount of cash. *Manninen* concerned a fully taxable shareholder but that was not part, according to Mr Whiteman, of the Court's reasoning as to why there was a breach of the Capital Directive (when applicable) and Article 56.

HMRC's submissions

99. Mr Baldry made the following submissions on behalf of HMRC:-

(i) *Manninen* concerned a breach of Article 56, in relation to fully taxable shareholder-recipients of dividends; *Manninen* had no application in a

case such as the present where the recipient shareholder was a tax-exempt entity who sought a payment of cash, rather than the reduction of a liability to tax (and sought to escape the full consequences of economic double taxation);

5 (ii) in any event, the treatment of a dividend from a UK company on the one hand and a non-UK resident company on the other, was identical in the case of a shareholder such as BTPS. The dividends were exempt in both cases: there was, accordingly, no breach of either the Capital Directive or Article 56;

10 (iii) furthermore, the payment of a tax credit would, said Mr Baldry, result in the UK effectively reimbursing a tax-exempt shareholder, such as BTPS, for the tax suffered by the paying company in its own jurisdiction: Mr Baldry referred to *Orange European Smallcap Fund NV* (Case C-194/06); thus there was no breach of the Capital Directive 15 or Article 56 by the United Kingdom failing to pay BTPS a tax credit to compensate for the underlying tax paid by the paying company in its own jurisdiction.

(iv) Finally, Mr Baldry submitted that even if there was prima facie breach of the Capital Directive and Article 56, that breach was cured (only in 20 relation to dividends paid by companies resident in third countries) by an appeal to "effective fiscal supervision", which was a justification for breach of the freedoms. For reasons which we make clear below, to the extent that this submission is relevant to disposing of the appeals in relation to the *Manninen* claims, we must wait for the decision of the 25 High Court in the *CFC and Dividends GLO*.

Decision on the *Manninen* claims

100. As with the FIDs claims, we apply the analytical framework we set out above to the lack of any tax credit for dividends paid to BTPS by non-UK-tax resident companies and consider whether, in the context of the *Manninen* claims, there is 30 prima facie breach of the Capital Directive and Article 56 and, if so, whether that breach is cured by an appeal to "effective fiscal supervision" as pleaded by Mr Baldry (albeit that this submission on effective fiscal supervision is restricted to dividends paid by companies tax resident in third countries).

Breach

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101. It is as well to recollect that the question referred to the European Court of Justice was whether the restriction of the availability of imputation credits in Finland to dividends paid by Finnish tax resident companies (so that dividends paid by Swedish tax resident companies did not carry an imputation credit for Finnish

resident recipients of the Swedish dividends) was precluded by Article 56. The European Court observed as follows:

> "*[18]. ... The national court is asking in essence whether Articles 56 EC and 58 EC preclude legislation, such as that at issue in the main proceedings, whereby the right of a fully-taxable person in a Member State to the benefit of a tax credit on dividends paid to him by limited companies is excluded where those companies are not established in that State ...*
>
> *[20]. As for whether tax legislation such as that at issue in the main proceedings involves a restriction on the free movement of capital within the meaning of Article 56 EC, it should be noted that the tax credit under Finnish tax legislation is designed to prevent the double taxation of company profits distributed to shareholders by setting off the corporation tax due from companies distributing dividends against the tax due from the shareholder by way of income tax on revenue from capital. The end result of such a system is that dividends are no longer taxed in the hands of the shareholder. Since the tax credit applies solely in favour of the dividends paid by companies established in Finland, that legislation disadvantages fully taxable persons in Finland who receive dividends from companies established in other Member States, who, for their part, are taxed at the rate of 29% by way of income tax on revenue from capital.*
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> *[21].* [The European Court of Justice observed at paragraph 21 that the economic double taxation is not cured by any relevant Double Tax Treaties].
>
> *[22]. It follows that the Finnish tax legislation has the effect of deterring fully taxable persons from investing their capital in companies established in another Member State.*

> [23]. *Such a provision also has a restrictive effect as regards companies established in other Member States, in that it constitutes an obstacle to their raising capital in Finland. Since revenue from capital of non-Finnish origin receives less favourable tax treatment than dividends distributed by companies established in Finland, the shares of companies established in other Member States are less attractive to investors residing in Finland than shares in companies which have their seat in that Member State …*
>
> [24]. *It follows from the above that legislation such as that at issue in the main proceedings constitutes a restriction on the free movement of capital which is, in principle, prohibited by Article 56 EC.*"

102. The observations of the European Court of Justice may be summarised thus:-

(i) a fully taxable shareholder who receives dividends from a company which pays that dividend out of taxed profits suffers economic double taxation;

(ii) the imputation credit alleviates that economic double taxation;

(iii) the confinement of a tax credit to dividends paid by companies which are tax resident in the same jurisdiction (Finland) who receive dividends from those companies makes it less attractive for those shareholders to invest in shares in non-Finnish resident companies (and also makes it more difficult for non-Finnish tax resident companies to raise capital in Finland);

(iv) it follows that the confinement of the availability of a tax credit to dividends paid by companies resident in the same State as the recipient shareholders is a restriction on the free movement of capital.

103. It is, of course, implicit in the Court's reasoning that the relevant dividends are paid out of profits which have been subject to tax in the hands of the paying company. Otherwise the reasoning of the Court, focusing, as it does, on economic double taxation would be unintelligible. This assumption, that tax credits should only be available in respect of dividends paid out of taxed profits is made express in the context of a potential justification to a *prima facie* breach of the Capital

Directive and Article 56, which we consider more fully below, when we consider "effective fiscal supervision" as a potential justification for breach.

104. The absence of a tax credit on cross-border dividends (by reason of the condition in TA 1988, Section 231(3) that a tax credit is only available on dividends paid by a UK tax resident company) is, to our mind, a clear breach of Article 56. Dividends paid by a UK tax resident company to tax exempt shareholders, such as BTPS, attract a tax credit. Cross-border dividends do not. That is, to use the Court's language, a restriction on the capital movement rights of both tax exempt shareholders and the paying companies since that less favourable treatment of cross-border dividends, as opposed to dividends paid by UK tax resident companies, makes them and therefore the shares on which those dividends are paid (self-evidently) less attractive to potential investors who are resident in the UK.

105. Of course Mr Baldry is correct to observe that the European Court of Justice, in *Manninen*, referred to "fully taxable persons". But that is because the particular facts of the case concerned a fully taxable person. Nowhere in the judgment of the European Court of Justice in *Manninen* does the Court suggest that its approach is restricted to fully taxable shareholders as a matter of principle. Section 231(1), (3) confers a tax credit which is an imputation credit, which alleviates double economic taxation (albeit based on certain assumptions) in the same manner as the Finnish imputation credit described in paragraph 20 of the Court's judgment but in the case of a shareholder who receives a dividend, whose tax liability is exhausted, or in the case of an entirely tax-exempt shareholder, affords relief for (albeit assumed) underlying tax by way of a payment of a cash amount, rather than a reduction of a tax charge (which is meaningless to an exempt taxpayer). Put shortly, we reject Mr Baldry's submission that the decision in *Manninen* is confined to fully taxable shareholders and that the European Court of Justice's approach cannot, as a matter of principle, be applied to cross border dividends (and the shares on which they are paid) paid to partially or fully exempt shareholders, such as BTPS.

106. As for Mr Baldry's submission that there is no discrimination as between dividends paid by UK resident companies and dividends paid by non UK tax resident companies, we consider this to be simply wrong. It is true that BTPS is tax-exempt as regards both types of dividend. But dividends paid by UK resident companies attract a tax credit. Dividends paid by non-UK resident companies do not. That is a disadvantage arising to a tax exempt shareholder such as BTPS in respect of those dividends received from non-UK resident companies which makes shares in those companies less attractive and thus is liable to dissuade investment in non-UK resident companies.

107. And for the reasons we have given above in relation to the absence of any dependence of the availability of a tax credit under section 231(1) or section 231(3), in our analysis of the relevant provisions of the UK tax code, on a prior

charge to tax on that shareholder, we do not accept that, in the case of a partially exempt or entirely exempt shareholder who receives a dividend, the payment of a tax credit in cash reimburses the recipient shareholder for either underlying tax suffered on the profits out of which the dividend is paid, in the hands of the paying company, or ACT. The tax credit is not a refund of tax suffered by the recipient of a dividend at source.

108. Of course no Member State has an obligation to refund or otherwise reimburse a taxpayer for tax suffered on receipts taxed in another Member State. So, as Mr Baldry points out, tax deducted at source (withholding tax) on a dividend in one Member State need not be reimbursed by another Member State, where the recipient shareholder is tax resident: *Orange European Smallcap*. But that is not this case. The dividend, as such, has not suffered tax (and will not suffer tax until it is received by a UK tax resident shareholder, who is fully or partially taxable). ACT is not, as is common ground between the parties, any form of withholding tax. So the absence of ACT on the dividend paid by a non-UK tax resident company to a UK resident (tax-exempt) entity, such as BTPS, is wholly irrelevant to the question of whether Article 56 has been breached or not (the same holds true for the Capital Directive). The European Court of Justice's reference to "economic double taxation" explains the rationale of tax credits in an imputation system. It does not impose a limitation on its reasoning which restricts its application to fully taxable recipients of dividends. We note that the tax credit in issue in the *Manninen* claims is the same tax credit (conferred by TA 1988, Section 231(1), (3)) as was in issue in *FII ECJ* where the European Court of Justice (having had partially and entirely tax-exempt shareholders in mind: see above) expressly observed that the absence of tax credits (albeit in the context of FIDs) breached Article 56. *A fortiori*, we consider, the absence of tax credits on cross-border dividends is a breach of Article 56.

Justification

109. Mr Baldry pleaded the same notion of "effective fiscal supervision" in relation to the *Manninen* claims, for dividends paid by companies established in third countries as a cure to a breach of the Capital Directive and Article 56, as he did in relation to the FIDs claims. We have set out the relevant passages in *Manninen* and our observations on those passages above. In relation to the *Manninen* claims, Mr Baldry pleads that the United Kingdom is entitled to ascertain whether or not the companies established in third countries which have paid dividends to BTPS, in respect of which BTPS wishes a payment of a tax credit, have indeed suffered a charge to tax (without which Article 56 is not engaged, as respects third countries) and where the United Kingdom is unable to ascertain whether or not the profits out of which third country dividends are paid have been taxed, no tax credit need be afforded to BTPS.

110. Since, for the reasons we give below, we find that all the Manninen claims are out of time and so those claims are dismissed in any event, it is not necessary for us to express any concluded view on this "effective fiscal supervision" point.

Disposal of the appeal in relation to the *Manninen* claims

5 111. It was common ground between the parties that should there be an unjustified breach of the Capital Directive and Article 56, in relation to the *Manninen* claims, we should hold that Section 231(3) should be applied as if the words "*resident in the United Kingdom*" were simply not there. In other words there would be a partial disapplication of Section 231(3). We assume this common ground to be 10 based on a notion of "sympathetic construction" where, rather than partially disapplying self-evidently fundamental parts of a particular offending provision (here that a company must be resident in the United Kingdom before a tax credit is to be paid under Section 231(3)), words are to be "read in" along the lines of "*unless Community rights are thereby breached*". Such a radical "reading in" of 15 words to preserve Community rights, under the guise of sympathetic construction, has been approved by the Court of Appeal as not "going against the grain"[16] of the relevant legislation: *HMRC v IDT Card Services Ireland Ltd* [2006] STC 1252, paragraphs 113, 114. The Court of Appeal's approach in *IDT* binds us and we accept that this technique has been held, as a matter of English law, to permit so- 20 called sympathetic construction of otherwise offending domestic provisions. Accordingly, subject to the limitation issue which we consider below, we apply *IDT* in the manner suggested by the parties. Section 231 must, subject to our decision on the limitation issue, be read as if the UK residence requirement of the dividend paying company, as a condition of the conferring of a tax credit under 25 section 231(1) or section 231(3), was subject to the caveat that the residence requirement was subject to statutorily implied qualification "*unless the requirement as to residence in the United Kingdom breaches Community Law rights*".

112. So far as dividends paid by companies established within the Community are 30 concerned, we decide that section 231(3) should be construed as we have set out above (although our decision as to whether this results in the payment of a tax credit is dependent upon our decision on the limitation issue: see below).

113. We express no conclusion in relation to third country dividends, since the *Manninen* claims are in anhy event out of time (see below.

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[16] *Ghaidan v Godin-Mendoza* [2004] 2 AC 557, paragraph 33, per Lord Nicholls, cross referring to Lord Roger (*Ghaidan* concerned sympathetic construction of UK legislation to make it compliant with the Human Rights Act 1998): the principles of sympathetic construction in relation to the Human Rights Act 1998 and Community legislation appear to be considered by the Court of Appeal in *IDT* to be the same for all practical purposes: see paragraph 92 per Arden LJ.

K. LIMITATION

114. As we observe below, it appears that the Court of Appeal's decision in Biggs v Somerset CC answers the limitation issue conclusively. We have set out our conclusions as to the limitation issue below. However, we were not addressed by either party on the application of *Biggs v Somerset CC* [1996] 2 All ER 734. Accordingly, we invited both parties to address us in further submissions on the application of this decision to the limitation issue. And since this appeal was first heard by us, the Upper Tier Tribunal has decided questions of the application of [now] European Union Law to national limitation periods in *HMRC v Marks & Spencer* [2010] UKUT 213, whose approach seems wholly consistent with *Biggs v Somerset CC*. We also (of course) invited further submissions by the parties on the Upper-Tier Tribunal's decision in *Marks & Spencer*.

115. We now turn to the limitation issue.

116. All of the FIDs claims and *Manninen* claims are "claims" governed by the Taxes Management Act 1970, section 42 and section 43, which we set out here in the form relating to pre-self assessment periods and post-self assessment periods respectively.

<u>Taxes Management Act 1970 ("TMA 1970")</u> : before 1996 Amendments to cover Self-Assessment periods

42 **Procedure for making claims etc**

(1) Where any provision of the Taxes Acts provides for relief to be given, or any other thing to be done, on the making of a claim, this section shall, unless otherwise provided, have effect in relation to the claim.

(2) Subject to any provision in the Taxes Acts for a claim to be made to the Board, every claim shall be made to an inspector.

(3) An appeal may be brought against the decision of the inspector or the Board on a claim by giving written notice to the inspector or the Board as the case may be within thirty ays of receipt of written notice of that decision.

…

(7) The inspector or the Board may give effect to any claim by discharge of tax or, on proof to the satisfaction of the inspector or the Board that any tax has been paid by the claimant by deduction or otherwise, by repayment of tax.

,,,

(9) On an appeal on a claim, the Commissioners may vary the decision appealed against whether or not the variation is to the advantage of the appellant

(10) Where it is necessary, in order to give effect to a claim, or as a result of allowing a claim to make

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any adjustment by way of an assessment on any person, the assessment shall not be out of time if it is made within one year of the final determination of the claim.

For the purposes of this subsection, a claims hall not be deemed to be finally determined until the amount recoverable under the claim can no longer be varied, whether by any Commissioners on appeal or by the order of any court.

Section 43

43 Time limit for making claims

(1) Subject to any provision of the Taxes Acts prescribing a longer or shorter period, no claim for relief under the Taxes Acts shall be allowed unless it is made within six years from the end of the chargeable period to which it relates.

(2) A claim (including a supplementary claim) which could not have been allowed but for the making of an assessment to income tax or capital gains tax after the year of assessment to which the claim relates may be made at any time before the end of the year of assessment following that in which the assessment was made.

Taxes Management Act 1970 ("TMA 1970") : after 1996 Amendments to cover Self-Assessment periods 43 Time limit for making claims

(1) Subject to any provision of the Taxes Acts prescribing a longer or shorter period, no claim for relief under the Taxes Acts shall be allowed unless it is made

(a) in the case of a claim with respect to income tax or capital gains tax, within five years from the 31st January next

following the year of assessment to which it relates; and

(b) *in the case of a claim with respect to corporation tax, within six years from the end of the accounting period to which it relates.*

(2) *A claim (including a supplementary claim) which could not have been allowed but for the making of an assessment to income tax or capital gains tax after the year of assessment to which the claim relates may be made at any time before the end of the year of assessment following that in which the assessment was made.*

Section 28A

117. For the reasons we record below, relating to one of Mr McDonnell's submissions on behalf of BTPS, TMA 1970, Section 28A is also relevant:

28A Amendment of self-assessment where enquiries made

(*1)* *This section applies where an officer of the Board gives notice under section 9A(1) or 11AB(1) of this Act to any person (the taxpayer) of his intention to enquire into -*

(a) *the return on the basis of which the taxpayer's self-assessment was made, or*

(b) *any amendment of that return on the basis of which an amendment (the taxpayer's amendment) of that assessment has been made by the taxpayer [or]*

(c) *any claim or election included in the return (by amendment or otherwise).*

(2) If, at any time before the officer's enquiries are completed, the officer is of opinion that -

(a) the tax contained in the taxpayer's self-assessment is insufficient and, in a case falling within [subsection (1)(b) or (c) above], the deficiency is attributable (wholly or partly) to the taxpayer's amendment, and

(b) unless the assessment is immediately so amended as to make good the deficiency or, as the case may be, so much of the deficiency as is so attributable, there is likely to be a loss of tax to the Crown,

he may by notice to the taxpayer amend the assessment accordingly.

(3) At any time in the period of 30 days beginning with the day on which the officer's enquiries are completed, the taxpayer may so amend his self-assessment -

(a) as to make good any deficiency or eliminate any excess which, on the basis of the conclusions stated in the officer's notice under subsection (5) below, is a deficiency or excess which could be made good or eliminated under subsection (4) below; or

(b) in a case falling within subsection (1)(a) above where the return was made before the end of the period of twelve months beginning with the filing date, as to give effect to any amendments to the return which he has notified to the officer.

(4) If, at any time in the period of 30 days beginning immediately after the period mentioned in subsection (3) above, the officer is of opinion that -

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(a) any amount set out in the return is insufficient or excessive, and

(b) in a case falling within subsection (1)(b) or (c) above, the deficiency or excess is attributable (wholly or partly) to the taxpayer's amendment,

he may by notice to the taxpayer so amend the assessment as to make good or eliminate the deficiency or excess or, where paragraph (b) above applies, so much of the deficiency or excess as is so attributable.

(4A) If –

(a) any claim or election is included in the return,

(b) the officer is of opinion that the claim or election should be disallowed in whole or in part but that its disallowance to the extent he thinks appropriate would not require any amendment of the taxpayer's self-assessment, and

(c) the claim or election, so far as the officer thinks it should be disallowed, is not, before the end of the period mentioned in subsection (3) above, amended to the officer's satisfaction or withdrawn,

the officer shall, before the end of the period mentioned in subsection (4) above, give notice to the taxpayer of the extent to which he is disallowing the claim or election.

(4B) Subsection (4A)(c) above is without prejudice to any provision by virtue of which any claim or election is irrevocable or unamendable.

(5) Subjection to subsection (6) below, the officer's enquiries shall be treated as completed at such time as he by notice -

(a) informs the taxpayer that he has completed his enquiries, and

(b) states his conclusions as to the amount of tax which should be contained in the taxpayer's self-assessment and as to any claims or elections into which he has enquired.

(6) At any time before a notice is given under subsection (5) above, the taxpayer may apply for a direction that the officer shall give such a notice within such period as may be specified in the direction.

(6A) Subject to subsection (7) below, an application under subsection (6) above shall be heard and determined in the same way as an appeal against an amendment of a self-assessment under subsection (2) or (4) above.

(7) The Commissioners hearing the application shall give the direction applied for unless they are satisfied that the officer has reasonable grounds for not giving the notice.

(7A) Where, in the case of any return made in respect of any chargeable period –

(a) alternative methods are allowed by the Tax Acts for bringing amounts into account in that return,

(b) the return is made or amended using one of those methods,

(c) a return could have been made in that case using an alternative method, and

(d) an officer of the Board determines which of the alternative methods is to be used by the Board in relation to the taxpayer for that period,

5 *any enquiry into that return or into an amendment of it shall be conducted, and this section shall have effect, as if the only method allowed for the purposes of the Tax Acts were the method determined by the officer.*

10 *(7B) For the purposes of subsection (7A) above the cases where the Tax Acts allow alternative methods for bringing amounts into account in a return are –*

(a) the case where those amounts may be
15 *brought into account either -*

(i) in making a computation for the purposes of Case I or II of Schedule D; or

(ii) in making a computation for the
20 *purposes of any of Cases III to V of that Schedule; and*

(b) the case where the computation in which amounts are brought into account may be either -

25 *(i) a computation for the purposes of Case I of schedule D; or*

(ii) a computation for the purpose of applying the basis (commonly called the I minus E basis) under which a company carrying on life
30 *assurance business or capital redemption business may be charged to tax on that business otherwise than under Case I of Schedule D.]*

(7C) In subsection (7B) above –

"life assurance business" includes annuity business within the meaning of Chapter I of Part XII of the principal Act; and

5 *"capital redemption business" means any capital redemption business, within the meaning of section 458 of that Act, which is business to which that section applies.]*

(8) In this section 'filing date' means the day mentioned in section 8(1A), section 8A(1A) or,
10 *as the case may be, section 11(4) of this Act.*

118. The FIDs claims run from 1994-1995 to 1997-1998. The *Manninen* claims run from 1990-1991 to 1997-1998.

119. It is common ground that the FIDs claim made for 1997-1998 was made in time.

120. HMRC say that all of the other claims (both the FIDs claims and *Manninen*
15 claims) are out of time.

<u>History of the FIDs claims and the Manninen claims</u>

121. Mr McDonnell, on behalf of BTPS, set out the history of the FIDs claims and the *Manninen* claims.

The FIDs claims

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122. A High Court claim was filed in relation to the FIDs claims on 31st January 2003. On 4th February 2003, the appellants wrote to an Inspector of Taxes at Glasgow Large Business Office stating that they were seeking a payment of tax credits on all FIDs received on or after 1st July 1994 and the claim had been filed in the High
25 Court on 31st January 2003. On 28th October 2003, a further letter was written to a different Inspector of Taxes in which the claim for the year 1996/97 was reduced. This was followed by a letter sent on 23rd January 2004, enclosing a copy of the Schedule detailing the claims. Another letter was sent on 28th January 2005, in which the claims for 1994/1995 and 1995/1996 were increased.

30 123. BTPS's submission is that the FID claims were made on one of the following alternative dates: 31st January 2003, 4th February 2003, 28th October 2003 or 23rd January 2004.

The Manninen claims

124. The High Court *Manninen* claims were brought on 1st April 2005. The claims which are now the subject of this appeal were made on 17th October 2005.

Categorisation of the FID and *Manninen* claims

125. Mr McDonnell divided the FIDs claims and the *Manninen* claims into six categories (Category A – Category C in relation to the FIDs claims and Category A - Category C in relation to the *Manninen* claims).

The FIDs claims

126. (i) Category A claims are for the years 1994/95 and 1995/96. These claims were made in 2003. BTPS accepts that they are outside the 6 year time limit if the time limit applies.

(ii) Category B is the claim for the year 1996/97. The enquiry into this year was open at the time that the claim was made and did not close until a Closure Notice was issued in 2008. Again, the claim was made outside the 6 year time limit but BTPS submits that it is relevant that the enquiry was open at the time that this claim was made. In addition, BTPS relies (in the alternative) on the High Court claim issued on 31st January 2003, which was made within the last day of the statutory 6 year time limit.

(iii) Category C is the claim for the year 1997/98. It is common ground between the parties that this claim was within time.

The Manninen claims

127. BTPS accepts that all of these claims are outside the statutory time limit if it applies. They were all made in 2005.

(i) Category A claims are the claims for the year 1993/94, 1994/95, 1995/96 and 1997/98. These claims are based on Article 56 of the Treaty.

(ii) Category B is again the claim for 1996/97, which was the open year.

(iii) Category C is the claim for the earliest years, 1990/91, 1991/92 and 1992/93, which rely on the Capital Directive.

The Appellant's submissions

128. In summary, Mr McDonnell's submissions amount to this:-

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(i) notwithstanding the express statutory time limits set out in Section 42 and section 43, the Community Law principles of equivalence, effectiveness and legal certainty require limitation periods to be extended so as to permit a "reasonable time" to be afforded to those with Community rights, to enforce those rights as from the point at which those rights have become certain;

(ii) the extension of limitation periods required, says BTPS, by Community Law from a time when previously uncertain Community rights became certain is analogous to, but distinct from applicable Community law principles in cases relating to actions for damages, where limitation periods are properly triggered by the time when a claimant becomes aware of the circumstances giving rise to loss;

(iii) the Community rights relating to free movement of capital were uncertain until, so far as the FIDs claims are concerned, the decision of the European Court of Justice in *FII ECJ*; indeed, says Mr McDonnell, prior to *FII ECJ*, which was well after the statutory time limits had expired for all of the years in question, the FIDs claims would inevitably have been rejected (we assume Mr McDonnell means properly rejected, even after a reference to the European Court of Justice); put another way, BTPS cannot be accused of not having prosecuted the FIDs claims with proper diligence;

(iv) similarly, the Community Law rights relating to the *Manninen* claims were uncertain until the European Court of Justice reached its decision in *Manninen* itself; Mr McDonnell repeated his submissions in relation to the FIDs claims in the context of the *Manninen* claims, that prior to the decision of the European Court of Justice in *Manninen,* well after all of the years had become time-barred, the *Manninen* claims would have inevitably been rejected by any UK judicial tribunal and thus BTPS cannot be criticised for failing to prosecute the *Manninen* claims within the statutory time limit;[17]

(v) it follows that the statutory time limits must, in satisfaction of the principles of effectiveness, equivalence and legal certainty, be extended so as to permit a "reasonable time" for BTPS to make its claims to enforce its Community rights relating to the free movement of capital for both the FIDs claims and the *Manninen* claims;

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[17] We appreciate that *Manninen* was decided well before *FII ECJ*; however, as we have consistently dealt with the FIDs claims prior to the *Manninen* claims we continue to deal with the respective claims in that order in dealing with the limitation issue.

(vi) that "reasonable time" is 6 years as from the decision in *FII ECJ* (in relation to the FIDs claims) and *Manninen* (in relation to the *Manninen* claims) respectively, based on the principle of equivalence, failing which BTPS and HMRC agree that should we find in favour of BTPS 5 that the express statutory time limits in TMA 1970 are to be extended, a period of 3 years from these respective decisions is "reasonable".

129. Mr McDonnell also made separate submissions in relation to:-

(i) the period up to 1st January 1994, for which BTPS relies upon the application of the Capital Directive, rather than Article 56;

10 (ii) TMA 1970, Section 28A(3) and its repeal by FA 2001, Section 88, and Schedule 8, paragraph 29;

(iii) the Closure Notice in respect of the year 1996/97, which he said was incorrect and wrong in law;

(iv) the FIDs claims, in relation to which Mr McDonnell submitted that the 15 High Court claim issued on 31st January 2003 (in respect of the open year 1996/97) was issued within the statutory time limit in Section 42 (in other words that the High Court claim operated as the making of a claim to enforce Community rights and a claim to tax credits by BTPS);

20 (v) further, and in the alternative, Mr McDonnell argued that if the statutory time limit in Section 42 operates against BTPS for 1996/97, it has a purely procedural effect of moving BTPS's claim to the High Court where it is in time, rather than the Tribunal, where it is not in time;

25 (vi) finally, Mr McDonnell made certain submissions on the Limitation Act 1990, Section 32(1)(c); for the reasons we set out below, we do not address these submissions.

The Appellant's submissions as to general propositions of Community Law and their application to limitation periods

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a) **Time limits extended for a "reasonable period" to allow previously uncertain Community rights to be enforced**

130. Mr McDonnell made a number of general submissions which amounted to the proposition that national limitation periods must be re-settled each and every time

Community rights become certain or clear for the first time, irrespective of how long, it seems, the limitation period has expired for and how fundamental a change in the law occurred which established Community rights for the first time. These submissions apply to all of the categories of BTPS's claims except Category C of the FIDs claim (which is within time on any view). In other words these general submissions apply to categories A and B of the FIDs claims and Categories A, B and C of the *Manninen* claims.

131. BTPS rely on *Autologic Holdings Plc & Others v IRC* [2005] UKHL 54, for the proposition that the normal statutory machinery governing claims and appeals, in particular limitation periods, require appropriate adaptation in the case of claims founded on Community Law rights: Mr McDonnell relied on observations made by Lord Nicholls at paragraph 30.

132. BTPS further contend that the requirement to adapt and extend a limitation period is based on the Community Law principles of equivalence, effectiveness and legal certainty: Mr McDonnell referred to *Hoechst AG & Another v IRC and Attorney General* and *Metallgesellschaft Limited v IRC and Attorney General* (Joined Cases C-397/98 and C-410/98), paragraph 85 and *Danske Slagterier v Bundesrepublik Deutschland* (Case C-445/06), paragraphs 31-35. Mr McDonnell also referred to *Fleming t/a Bodycraft v HMRC and Conde Nast Publications Limited v CEC* [2008] UKHL 2, paragraphs 78-90 (Lord Neuberger) in support of his proposition.

133. Mr McDonnell submitted that an examination of the relevant principles and the case-law of the European Court of Justice revealed that a limitation period cannot run against any claimant who had directly effective Community Law rights, because otherwise the limitation period is doing far more than achieving legal certainty, it is in effect, amounting to a bar of the ability to bring claims altogether. Mr McDonnell sought support for this proposition in Lord Walker's dissenting judgment in *Autologic* at paragraphs 91-95.

134. Mr McDonnell made a distinction between cases in which Community Law rights which were previously uncertain became certain (which requires limitation periods to be extended for a "reasonable period" after they become certain to permit their enforcement) and damages claims based on *Frankovich* principles, in which Mr McDonnell accepted that limitation runs from the time that a claimant is (on a reasonable basis) aware of the facts giving rise to the loss. This appeal, says Mr McDonnell, is clearly in the former category. Mr McDonnell relies on paragraphs 162 and 163 of the Advocate-General's Opinion in *Haahr Petroleum Limited v Abenra Havn* (Case C-90/94) to support his submission.

135. Having made these general observations, Mr McDonnell sought specific support for the proposition that limitation periods required to be extended to permit Community Law claims to be enforced, when otherwise the limitation period,

having expired, would act as an ultimate bar to the enforcement of Community rights from the Community Law principle of effectiveness and from observations made by Chadwick LJ in *Marks & Spencer v Halsey* [2008] STC 526, at paragraphs 51 and 54. The principle of effectiveness, says Mr McDonnell, permits BTPS to expect the national court, here the First-Tier Tribunal, to give effect to relevant Community legislation and Community case-law notwithstanding national procedural obstacles which would render the exercise of BTPS's Community rights practically impossible or excessively difficult. And Chadwick LJ in *Marks & Spencer* makes it clear, says Mr McDonnell, that, as a matter of principle, the national court is required to extend limitation periods to allow claims to be made within a "reasonable time" after the Community Law right is established, that is, says Mr McDonnell, when the rights are made clear or become certain. Further support for these propositions is to be found, according to Mr McDonnell, in *Condé Nast* (paragraphs 78, 84-90). Mr McDonnell accepted that *Condé Nast* concerned a different issue, namely whether the reduction of a limitation period required a transitional period for already-accrued Community Law rights to be enforced, which is different from the issue in the present case. However Mr McDonnell said that the same concepts which were relevant in *Condé Nast* were present in this appeal, namely, that of the reasonably well advised person and a time limit running out before such a person was aware of the existence of and the ability to make a Community Law claim. *Condé Nast*, says Mr McDonnell, makes it clear that legal certainty protects the ability of a claimant to make Community Law claims by adapting otherwise clear limitation periods, just as defendants or respondents are entitled to the application of legal certainty and the application of limitation periods to give finality to cases.

136. As to what that extended "reasonable period" might be, Mr McDonnell submitted that this should be 6 years (since this was the limitation period set out in TMA 1970, Section 42), running from the time at which the relevant Community Law rights became certain (in relation to the FIDs claims, the decision of the European Court of Justice in *FII ECJ* and in relation to the *Manninen* claims, the decision of the European Court of Justice in *Manninen*).

137. Mr McDonnell also made submissions on *FJ Chalke Limited v HMRC* [2010] EWCA Civ 313, where the Court of Appeal had held that there was no breach of the principle of effectiveness as a result of the national time limit for the same reasons given by Henderson J in the Court below, namely that the claimant could have brought its High Court claim for restitution before the expiry of the relevant time limit. BTPS distinguished their situation from that in *FJ Chalke* on the following grounds:

(a) BTPS's claim is not just for interest but also for principal amounts of overpaid tax and/or payable tax credits;

(b) the statutory limitation period expired at the latest on 31st January 2004 in relation to the 1997/98 claims and on earlier dates for the earlier claims;

(c) the Community Law right to recover tax credits had not yet been established or alternatively was not established until, at the earliest, 7th September 2004, which was the date of the judgment in *Manninen* (in relation to the *Manninen* claims) and 12th December 2006, in relation to the FIDs claims, which was the date of the judgment in *FII ECJ*; and

(d) this appeal, concerning BTPS, was the lead case for the recovery of tax credits (in relation to both the FIDs claims and the *Manninen* claims).

In other words, says Mr McDonnell, the statutory limitation period expired in respect of all the claims and before the earliest date when the right to bring these claims can be regarded as having been established, which situation was not considered by either Henderson J or the Court of Appeal in *FJ Chalke*.

138. Furthermore, Mr McDonnell relies on paragraphs 66 and 67 on Etherton LJ's judgment in *FJ Chalke* as supporting his argument that Community Law requires the national law time limit to be suspended or extended in respect of BTPS's claims. In paragraph 66, says Mr McDonnell, Etherton LJ considered whether the 3 year cap and other provisions of national law and practice made it excessively difficult for the claimant to have brought its High Court claims before the ECJ's decision in *Marks & Spencer*. Etherton LJ held that they did not do so because 12 months of the statutory limitation period remained after the ECJ's decision in which the claimant would have brought these claims. However, in the present case for all of the years concerning the FIDs claims and the *Manninen* claims, there is no unexpired limitation period because the limitation period had already expired before the relevant judgments of the ECJ in *FII ECJ* and *Manninen*. The strict application, according to Mr McDonnell, of the statutory limitation period would render the exercise of BTPS's Community Law rights impossible or excessively difficult.

<u>Date on which the Community Law rights in relation to the FIDs claims and the *Manninen* claims became certain</u>

139. Even if Mr McDonnell were correct that the principles of effectiveness, equivalence and legal certainty required an automatic re-triggering of limitation periods each and every time Community rights in a particular context became clear, or certain, that is not enough to get BTPS home. It is central to Mr McDonnell's submissions that, so far as the FIDs claims are concerned, the right to a tax credit, notwithstanding the application of TA 1988, Section 246C in the context of the FIDs regime did not become certain until the decision of the ECJ in *FII ECJ*. Similarly, in relation to the *Manninen* claims, the burden of Mr

McDonnell's submissions is that the 6 year time limit in TMA 1970 should only be extended if he can demonstrate that the right to the payment of tax credits on cross-border dividends only became certain after the decision was made in *Manninen* by the European Court of Justice.

5 140. As a general observation, Mr McDonnell submitted that European Community Law in the area of the application of the fundamental freedoms (including the free movement of capital provisions) to cross-border dividends developed incrementally over the period from approximately 2000 to 2006, starting with *Verkooijen* C-35/98 in June 2000, *Lenz C-315/02*, *EC Commission v France* and
10 *Manninen* in 2004 and *FII ECJ* in 2006. In other words, said Mr McDonnell, European Community rights relating to cross-border dividends, both for the paying company and recipient shareholders, were very uncertain from 2000 onwards until the European Court of Justice reached several decisions in (for present purposes) *Manninen* in 2004 and *FII ECJ* in 2006. The ECJ, over this
15 period, had interfered more and more with national taxation systems in a way that could not have been anticipated in 1999.

141. It was not, according to Mr McDonnell, until *Lenz* that it was clear that Community Law was relevant to the rates of taxation applicable to differently sourced dividends: see, in particular, paragraphs 20-22 of the Judgment. There
20 was, said Mr McDonnell, a lengthy discussion in paragraphs 23-49 on whether that restriction on the free movement of capital under national law was capable of being justified having regard to the provisions of the EC Treaty by reference to "general interest" considerations or the cohesion of a national tax system. It was only after *Lenz*, says Mr McDonnell, that it became clear that such reasons did not
25 justify restrictions on the free movement of capital.

142. Mr McDonnell summarised his propositions on *Lenz* in particular as this: the principle that different tax treatments of home-State dividends and cross-border dividends infringed the fundamental freedoms was only clearly recognised in 2003 or 2004. Before the European Court of Justice's decision in *Lenz*, the
30 exercise of the freedoms, in relation to cross-border dividends (in particular the free movement of capital provisions) was practically impossible because it was not clear that Community Law would interfere in this area at all. Even though there was a general prohibition on restrictions on the free movement of capital, Article 58 provided potential justification for such a restriction (which was
35 analysed by the European Court of Justice in *Lenz*). It is therefore only since *Verkooijen*, *Lenz* and *Manninen* in particular that restrictions of the free movement of capital could not be justified by an appeal to the cohesion of the national tax system, protection of the tax revenues etc. The European Court of Justice stated this, in terms, in *FII ECJ*, which confirmed, according to Mr
40 McDonnell, that the development of Community Law rights, in relation to cross-border dividends was uncertain and incremental as between *Verkooijen* and *FII ECJ*.

143. Mr McDonnell put his case that the relevant Community rights in relation to the FIDs claims and the *Manninen* claims did not become certain until *FII ECJ* and *Manninen* in relation to each class of claim in another way. Mr McDonnell said that prior to each relevant decision of the European Court of Justice, an attempt to enforce the relevant Community Law rights in relation to the FIDs claims or the *Manninen* claims would have been "practically impossible", in which case the limitation period had to be extended to permit enforcement of these newly acquired Community Law rights. Mr McDonnell relied on *Emmott v Minister for Social Welfare & Attorney General* (Case C-208/90), paragraphs 29 and 33 for this formulation of his case.

144. And the notion of the relevant Community Law rights only becoming certain at the time when the European Court of Justice reached its decisions in *FII ECJ* and *Manninen* could be put a yet different way, according to Mr McDonnell. If it is right, says Mr McDonnell, that, prior to these decisions, no "*reasonably diligent claimant*", or "*no claimant who is aware of the law at that time or is well advised as to the law*" could have made a claim which would have succeeded, this, according to Mr McDonnell, demonstrates that the relevant Community Law rights have not been established. Mr McDonnell relied on the European Court of Justice's judgment in *Grundig 2 C-255/00*, paragraph 40 (referred to in *Condé Nast* at page 346h), which referred to "*normally diligent taxpayers*". This is the phrase used by the Court to ensure that rights conferred by Community Law can be effectively exercised and that "*normally diligent taxpayers*", says Mr McDonnell, can familiarise themselves with the new regime and can prepare and commence proceedings in circumstances which do not comprise their chances of success. This concept can also be seen at *Walker-Fox v Secretary of State for Work and Pensions* [2005] EWCA Civ 144 ("Walker-Fox"), at paragraph 48, albeit it was held there that the claimant with knowledge of the law could have applied it within the limitation period. The notion of a "*reasonably diligent claimant*", says Mr McDonnell, is an objective test, rather than an examination of whether a particular claimant (here BTPS) had actual knowledge of the law.

145. Applying his general submissions to this case, Mr McDonnell submitted that Community Law had only gradually and incrementally developed in relation to the application of the fundamental freedoms to cross-border dividends (see above and *FII ECJ* at paragraphs 215, 216). The "normally diligent" claimant could not have made a claim in question until the European Court of Justice had made the relevant Community Law clear in *FII ECJ* (in relation to the FIDs claims) and *Manninen* (in relation to the *Manninen* claims). There was no opportunity for such a claimant to make a claim before these judgments but even if the Community rights for both the FIDs claims and the *Manninen* claims had become sufficiently clear that a normally diligent taxpayer could have anticipated success in making these claims after the European Court of Justice had delivered this judgment in *Verkooijen* on 6th June 2000, most of the statutory time limits had expired before then and all of them had expired before the judgment in *Manninen* in 2004. After all, said Mr McDonnell, the European Court of Justice had held in *Metallgesellschaft and Hoechst* (Joined Cases C-397/98 and C-410/98) (paragraph

107) that a taxpayer had not failed to show "reasonable diligence" in failing to make a claim at a time when on any view national law denied the taxpayer the ability to make an effective claim.

A "reasonable period" by which Section 42 should be extended is 6 years

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146. Mr McDonnell's primary submission was that the principle of equivalence demanded that the Section 42 time limits are triggered as from the date of *FII ECJ* (in relation to the FIDs claims) and *Manninen* (in relation to the *Manninen* claims). Mr McDonnell accepts that Chadwick LJ in *Marks & Spencer* did not specify a specific "reasonable period" in which a claim should be brought but in other cases, said Mr McDonnell, the ECJ had held that 3 years was a reasonable time limit.

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147. Mr McDonnell, in the alternative, submitted that if we did not consider that the principle of equivalence required the Section 42 time limits to be applied from the dates of the respective decisions in *FII ECJ* and *Manninen*, that a 3 year period was a "reasonable period".

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Further submissions

Period up to 1st January 1994: action based on the Capital Directive

20 148. This submission relates only to Category C of the *Manninen* claims (1990-1991, 1992-1993, 1993-1994), for the period up to 1st January 1994 when BTPS must rely on the Capital Directive, rather than Article 56.

149. For these periods during which the directly enforceable rights relating to the free movement of capital are founded on the Capital Directive, rather than Article 56 of the EC Treaty, BTPS relies on *Emmott*, paragraphs 1, 3-13 and 16-23. Mr McDonnell submits that *Emmott* establishes that the particular nature of directives indicates that time does not begin to run until the national law conforms to the directive. Mr McDonnell further submits that the relevant UK provisions (here TA 1988, Section 231(1) [since this period relates only to the *Manninen* claims]) have never in this respect conformed with the Capital Directive. In particular, the UK Tax Code, and Section 231(1), (3) has never at any stage conformed within the time limits set down under national law for making claims. The Capital Directive has never, said Mr McDonnell, properly (or at all) been transposed into national law in respect of these claims. The last of the years during which the Capital Directive was applied was 1992/93, so that the 6 year time limit under national law expired on 5th April 1999. As it did not in any way conform with what is now known to be the effect of the Capital Directive at that time, to bring the *Manninen* claims for the period up to 1st January 1994, under the Capital Directive, would have been impossible under national law.

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150. Furthermore, submits Mr McDonnell, *Emmott* confirms his more general submission, which we have recorded above, that it is not until Community Law rights become clear and the exercise of those rights is a practical possibility, that limitation periods should begin to run in national law, in order to comply with Community Law principles (in particular of effectiveness but also of equivalence and legal certainty). Mr McDonnell further submitted that *Danske Slagterier* at paragraphs 53-56 held that *Emmott* is still good law. Mr McDonnell also referred us to *Johnson v Chief Adjudication Officer (No 2)* (Case C-410/92) for the proposition that a time limit which prevents a claimant from bringing a claim altogether does not start to run until a directive on which the claimant relies is properly transposed.

151. Applying Mr McDonnell's submissions to the present case, for those periods before 1st January 1994 for which BTPS relies on the Capital Directive,, Mr McDonnell contends that in relation to the first 3 years of the *Manninen* claims, the national time limits contained in Section 42 of TMA 1970 are a complete bar to proceedings. The national time limits of 6 years ran out in 1997, 1998 and 1999. It was practically impossible for BTPS to have brought these claims at that time for the reasons Mr McDonnell gives above (that the relevant Community Law rights have not yet been established and HMRC and the national courts were bound to refuse the claim). If the time limits in Section 42 were given force now, BTPS would have no claim in relation to the Capital Directive and the time limits operate as a complete bar to proceedings, which is contrary to the approach of the European Court of Justice in *Emmott*. BTPS was not, says Mr McDonnell, in the same position as the claimants in *Johnson*, where the limitation period applied without breaching Community Law rights to restrict the claimant's remedy (because the limitation period reduced the number of years used to calculate the remedy available to the claimant). Mr McDonnell considers that the Capital Directive is similar to the directive which was in issue in *Emmott* because both directives required Member States to abolish restrictions or discriminations by a certain date.

152. Furthermore, Mr McDonnell did not accept that any limitation period for a complaint relating to the non-implementation of the Capital Directive began to run as from 1st January 1994, when the right to free movement of capital became directly effective on the introduction of Article 56. Mr McDonnell submitted the following reasons in support of this submission. First, there were changes in the law on the free movement of capital with effect from 1st January 1994, the most plain of which is that from that date onwards it also extended to third countries and EEA members who were not Member States. We take it that Mr McDonnell is making the point that Article 56 contained different substantive rights to that of the Capital Directive and the enactment of directly effective rights in Article 56 as from 1st January 1994 cannot, therefore, affect (and in particular trigger) any limitation period concerning the Capital Directive. It is for this reason that we assume that Mr McDonnell submitted that it cannot be said that a claim previously based on the Capital Directive for periods before 1st January 1994 somehow transmogrified into a claim based on Article 56 of the EC Treaty for those periods

(because Article 56 was simply not effective before 1st January 1994). Secondly, even though the Capital Directive, says Mr McDonnell, had no future application after 1st January 1994, it was still the case that it had not been implemented in the prior years and therefore BTPS did not have a right under national law to claim the tax credit for those prior years. It is only since (in relation to the *Manninen* claims) the decision of the European Court of Justice in *Manninen* that BTPS's rights in relation to tax credits for cross-border dividends became clear.

153. Mr McDonnell further contends in relation to this point that while after 1st January 1994, any future non-conformity or any continuing non-conformity of the national law with the freedom to move capital from that day forward would not be a matter covered by the Capital Directive (but rather Article 56), it does not follow either that the Capital Directive-based rights prior to 1st January 1994 fell away, or that the limitation period in relation to Capital Directive-based Community Law rights started to run from that point. Mr McDonnell submits that wherever a provision in a directive finds its way into the EC Treaty, or indeed some other directive (whether an old directive is repealed and replaced by a new directive), any action is, says Mr McDonnell (correctly) clearly based on the old directive. Thus says Mr McDonnell, it does not follow that the claim based on an old or repealed directive falls away because it has been replaced by a new legislative provision. Thus the replacement of the source of free movement of capital rights of the Capital Directive by Article 56 does not affect Community Law rights (or relevant limitation periods) based on the Capital Directive for the period between 1st July 1990 and 31st December 1993. BTPS's claim under the Capital Directive is a complaint about non-implementation because the Capital Directive required the UK to remove restrictions which, despite the terms of the Capital Directive, remained in place. However the precise Community Law rights on which BTPS relies in respect of the *Manninen* claims did not become clear until the European Court of Justice's decision in *Manninen* so the limitation period in respect of the Capital Directive rights cannot, says Mr McDonnell, start to run until the decision in *Manninen*.

Year 1996-1997: Repeal of TMA 1970, Section 28A(3) of itself a breach of Community Law rights in relation to the claims for that year

154. Mr McDonnell put forward an alternative argument in respect of 1996-1997 which related only to the FIDs claims and Manninen claims for 1996-1997 (that is Category B of each of the FIDs claims and the *Manninen* claims). 1996-1997 was an open year (that is, the income tax computation was not closed or finalised) for both the FIDs claims and the *Manninen* claims. Mr McDonnell's argument runs along these lines: BTPS are entitled to rely on TMA 1970, Section 28A(3) in the form it was in in 1996/97, which permitted a taxpayer to propose amendments to a self-assessment at any time when there was an open enquiry into the self-assessment and also permitted the taxpayer to effect amendments to his self-assessment within 30 days of the issue of a Closure Notice. This provision was repealed by FA 2001, Section 88 and Schedule 8, paragraph 29 with effect for existing enquiries as well as enquiries commencing after the passing of FA 2001.

There was no transitional provision. Mr McDonnell argues that this sudden imposition of a time bar has prevented BTPS from exercising relevant Community law rights in relation to the FIDs claims and *Manninen* claims. Mr McDonnell relies on the House of Lords decision in *Fleming* and *Condé Nast* to argue that in relation to procedural changes which would frustrate Community Law rights and which are made without adequate transitional provisions, to protect legitimate expectations of those whose Community Law rights are cut down by the procedural changes, the claimant (here BTPS) remains entitled to exercise its rights under the procedural conditions previously in effect (in this case BTPS should be entitled to make relevant amendments under Section 28A). In other words, says Mr McDonnell, BTPS is entitled to make amendments to its self-assessment tax return for 1996/97, to reflect the FIDs claims and *Manninen* claims without any reference to Section 42 of TMA 1970, since Section 28A previously had the effect of removing the 6 year limitation period in Section 43. HMRC, says Mr McDonnell, cannot rely on the repeal of Section 28A, which would otherwise have permitted BTPS to make the FIDs claims and *Manninen* claims for 1996-1997, when the repeal was made without adequate transitional provisions.

Year 1996-1997: Issue of Closure Notice for 1996-97 wrong in law: effect of High Court FIDs claim

155. This submission related only to Category B of the FIDs claims, that is, the FIDs claims for 1996-1997.

156. Mr McDonnell submitted that the issue of the Closure Notice in respect of 1996-1997 in respect of the FIDs claims was incorrect and wrong in law because the Inspector who issued it was aware that BTPS were claiming Community Law rights (for the FIDs claims and the *Manninen* claims) and the Closure Notice failed to give effect to those rights. In so far as this submission relates to TMA 1970, section 28A, we have already recorded Mr McDonnell's submissions above. However, Mr McDonnell also made further submissions on the effect of the High Court claim relating to the FIDs claims for 1996-1997 (Category B of the FIDs claims).

157. In relation to the FIDs claims, the High Court claim was issued on 31st January 2003 in respect of the open year 1996/97 and was therefore issued within the statutory time limit. Mr McDonnell relies on *Gallic Leasing Limited v Coburn* [1991] STC 699 to argue that the issuing of the claim form specifying the Community Law claim in relation to the FIDs claims was sufficient for holding that the claim was made within the statutory time limit, even if it was not actually served on HMRC until later. In the light of the rules regarding procedural obstacles, Mr McDonnell argues that to assert that the claim is out of time where the High Court claim was made within time and was notified to HMRC within 4 days, would be a procedural obstacle making it impossible for them to exercise their rights in respect of that period.

158. Furthermore, Mr McDonnell argues that if the statutory time limit operates against them for 1996/97, it has a purely procedural effect of moving their claim (for the FIDs claims) to the High Court where it is in time, rather than the Tribunal where it is not in time. In those circumstances, Lord Nicholls considered in *Autologic* (paragraph 30) that there would be a discretion to extend time that would allow the Special Commissioners/the Tribunal to decide the matter instead.

b) **Limitation Act 1970, Section 32(1)(c)**

159. Mr McDonnell made further submissions on the relationship between the Limitation Act 1970, Section 32(1)(c) and the limitation period of 6 years contained in TMA 1970, Section 42. In *Test Claimants in the FII Group Litigation v HMRC* [2008] EWHC 2893 (Ch) ("*FII Chancery") and Test Claimants in the Thin Cap Group Litigation v HMRC* [2009] EWHC 2908 (Ch) ("*Thin Cap")*, questions relating to Section 32(1)(c) in the context of Community Law have been left open to be resolved in the future (see *Thin Cap*, paragraphs 339 to 342, which cross-refers to *FII Chancery*). Put shortly, Mr McDonnell made it clear that he was not asking us to decide any issue in relation to Section 32(1)(c) and we record Mr McDonnell's observations for completeness only.

HMRC's Submissions

160. Mr Baldry, making HMRC's submissions on the limitation issue, noted that each of BTPS's claims fall within section 42 TMA 1970, as identified by Park J in his interlocutory judgment in the High Court proceedings (*In the matter of the Trustees of the BT Pension Scheme & Others v HM Revenue & Customs* [2005] EWHC 3088 (Ch) at para. 19). They therefore must have been brought within the time limit prescribed by s 43 TMA 1970 in order to be valid. HMRC accept that the FIDs claim for 1997/98 was brought in time but all the other claims were made outside the time limit in s 43. HMRC therefore contend that these claims must be disallowed on this basis alone if no other.

161. Mr Baldry denied that the statutory time limits imposed by the TMA are incompatible with Community law. Mr Baldry also rejected Mr McDonnell's general submission that national limitation periods are re-settled each and every time Community rights become certain or are made clear. Mr Baldry said that it is settled law that it is compatible with Community law for a Member State to lay down reasonable time-limits which are fixed in advance for bringing proceedings based upon Community rights (see *Aprile SRL (In liquidation) v Amministrazione delle finanze dello stato (No.2)* (Case C-228/96). The six-year time limit in national legislation in this case, in which a taxpayer can bring its claims is therefore not incompatible with Community law rights. *Marks & Spencer* and *Fleming* were concerned with a different point, namely where the time limit is shortened without giving taxpayers a reasonable time to put in the claims which they were entitled to put in before the new time bar came down.

162. Mr Baldry submitted that HMRC's argument on this point is supported by a long line of authority from the ECJ starting with *Rewe-Zentralfinanz v Landwirtschaftskammer Saarland* (Case C-33/76) to its recent judgment in *Danske Slagterier*. Such time limits are an application of the fundamental principle of legal certainty protecting both individuals and administrations (see *Rewe* at para. 5). Such time limits are not just consistent with the principle of legal certainty: by giving finality to the prospect of litigation limitation periods are, said Mr Baldry, part of the very principle of legal certainty.

163. A reasonable time limit in which everyone can make their claims means everyone knows their rights. That is no different, in fact it is of all the more force, where complicated areas of law are being developed by the ECJ. Case law develops and changes over time, so that the understanding of the status of rights under the UK's corporation tax system in 1970 and in 1980 and in 2009 is radically different. The operation of reasonable time limits ensures that every time the law does develop taxpayers cannot go back to 1970 to make claims they had not previously realised they could have made. Reasonable time limits ensure that there is legal certainty and that rights can be exercised for a reasonable period only.

164. All that Community law requires is that any such time limits are neither (1) less favourable than those relating to similar actions of a domestic nature (and therefore contrary to the principle of equivalence) nor (2) framed so as to render virtually impossible or excessively difficult the exercise of rights conferred by Community law (and therefore contrary to the principle of effectiveness): see *Danske*.

165. Mr Baldry therefore submitted that a reasonable time limit set in advance (here six years) does not offend the principles of equivalence and effectiveness. Neither does such a time limit offend legal certainty (quite the opposite: it establishes legal certainty). In addition to paragraph 48 of *Danske Slagterier*, Mr Baldry also relied on paragraph 48 of *Haahr Petroleum* and paragraph 48 of *Fantask* (Case C-188/95) to make good his submissions. Paragraph 48 of *Haahr Petroleum* deals with the meaning of "virtually impossible" by explaining that national rules must not be framed so as to render virtually impossible or excessively difficult the exercise of rights. If there is a reasonable time limit, the fact that the time limit operates so that people who did not bring their claim before the time limit expired cannot bring their claim any longer means that it is not reasonably possible but totally impossible. However, that is the precise point of a time limit and does not make the concept of a time limit contrary to Community law as long as it is fixed in advance and it is reasonable.

166. Mr Baldry thus submitted that in this case a six-year time limit set in advance is manifestly reasonable and Community Law-compliant. Mr Baldry said that this point has been settled by *Haahr Petroleum*, *Danske* and *Aprile*. In both *Aprile* and *Marks & Spencer v CEC* Case (C-62/00), the European Court of Justice held a three-year time limit to be reasonable. Applying the same process of reasoning,

Mr Baldry said that it is a*cte claire* that the national law time limit of six years in s 43 TMA 1970 contravenes neither the principle of equivalence nor the principle of effectiveness. While this time limit has to be applied subject to any enforceable Community law rights, in the absence of the Appellants having an enforceable Community law right which can be derived from the principles of these cases, s 42 should be applied.

167. Mr Baldry further argues that even if it were not settled law that a reasonable time limit such as that in TMA 1970 did not offend the principles of equivalence or effectiveness, the principle of equivalence does not require this time limit to be disregarded. This time limit applies equally to domestic law claims and claims founded upon the assertion of a Community law right. The logical consequence of BTPS's argument would not be to establish equivalence between the two types of claims but would rather be to provide taxpayers preferential rights in respect of Community law claims to those enjoyed by taxpayers with domestic law claims. In other words, BTPS's argument would lead to a twin-track time limit: a six-year time limit for domestic law claims and a different time limit for Community law claims where taxpayers would have six years or three years from the time they first realised they had a claim. There was no reason in principle, said Mr Baldry, to adopt such a dualist approach which put Community Law claims into a privileged class in relation to national limitation periods.

168. Mr Baldry submitted that it is almost impossible to think of a similar situation arising under domestic law. However, suppose, said Mr Baldry, the Supreme Court were to reach a decision which fundamentally alters the application of domestic law and there were people who had claims which were otherwise out of time by say, 10 years. Those people cannot now say that they had a right they did not previously realise they had, they should be able to bring their claim. Equivalent treatment demands a Community law claim be treated in the same way as a domestic law claim, not that Community Law claims be treated better than domestic law claims.

169. The principle of effectiveness does not require s 43 to be disregarded either. Contrary to BTPS's argument, there is nothing controversial in the proposition that a person who has a Community right but is not aware of it, or it has not been created yet because the ECJ has not developed the law in this way does not make any difference, regardless of whether or not he is well advised in relation to his rights. If there is a domestic time limit, which is a reasonable time, fixed in advance but the taxpayer has failed to assert his right because his tax advisers had not appreciated it, he will lose that right because that is the function of time limits.

170. Mr Baldry further submits that Mr McDonnell's reliance upon the dicta of Chadwick LJ in *Marks & Spencer v Halsey* is entirely misguided, as can be seen from paragraphs 51 to 55 of his judgment. First, the time limits in issue were different to those at issue in the present case because HMRC enjoyed a specific discretion to extend them (see paragraph 53 of the judgment). They were not

therefore time-limits that had been fixed in advance, the compatibility of which with Community law is *acte claire*.

171. Furthermore, said Mr Baldry, paragraph 51 of the judgment in *Marks & Spencer v Halsey* makes clear that the taxpayer was seeking in *Marks & Spencer*, as are BTPS in this case, essentially to apply the reasoning used in respect of a mistake-based claim under s 32(1)(c) of the Limitation Act 1980, as was applied in *Deutsche Morgan Grenfell v IRC & the Att-Gen* [2006] UKHL 49. In the context of a mistake claim, time starts running from when the claimant knew it had made a mistake or from when it was reasonable for it to become aware that it had done so. In the context of that type of provision, the House of Lords had said that time starts running against the claimant in a case like *DMG* when the ECJ gave its judgment in the relevant case. It is therefore in the context of s 32(1)(c) that it is relevant to look at the period in time when the law has changed in order to identify when time starts running. HMRC submit that this is irrelevant to a statutory claim under s 42 TMA 1970 and a fixed time limit.

172. Furthermore, Mr Baldry submitted, BTPS are wrong to submit that Chadwick LJ's dicta lay down a principle which is binding upon the Tribunal. These dicta were entirely *obiter* in that he expressly declined to make an order to the effect that the domestic limits should have been extended to enable *Marks & Spencer* to bring its claims and he had not looked at the relevant cases. One of his reasons for doing so was that the *Fleming* and *Conde Nast* appeals were on their way to the House of Lords. Lord Neuberger confirmed in *Conde Nast* that the starting point was that reasonable time limits fixed in advance were compatible with Community law (para. 79 of the judgment). The issue in that case was if a time limit was cut down, what kind of transitional provision should be given to allow claimants to bring claims they already had. It has nothing to do with this type of case.

173. Furthermore, there is no authority for the proposition that a person who had a s 42 or other statutory claim but was unaware of the true state of the law should be given a "reasonable" period, whether 6 years or 3 years, from the date on which that claim became "clear", in this case said to be the dates of the judgments in *Manninen* and *FII*, to bring his claims. All of BTPS's submissions to the contrary were based on a misreading of the relevant case law of the European court of Justice. Mr Baldry relied on *Aprile*, paragraph 8, *Fantask*, paragraph 52, *Haahr Petroleum,* paragraph 42, *Walker-Fox*, paragraphs 14, 20, 23-29 34 and 49 (per Ward LJ) and *Chalke*, paragraph 72 in support his submission.

174. Mr Baldry drew the following principles from the case law he cited in support of his submissions which rejected the notion of a re-setting of a limitation period whenever Community rights became certain or clear. A reasonable time limit fixed in advance does not create legal uncertainty but creates certainty. It does not make it impossible for the taxpayer to assert his rights because the rights being asserted here, i.e. a right to the payment of cash from HMRC in respect of both of these claims, has existed throughout in exactly the same way as any other

domestic law right. These rights exist in domestic law as a result of the European Communities Act 1972 and have always existed but it is necessary to see whether the claims in respect of them have been brought in time. It is therefore not for the Tribunal to re-mould a statutory time limit such as s 42 to say six years or such other time as might be reasonable, because there is absolutely no authority under Community law to say that the six-year time limit is incompatible with Community law. On the contrary, all the early authorities say that it is plainly compatible. Mr Baldry referred to *FII Chancery*, paragraph 220, 227 and 230-245.

<u>Period up to 1st January 1994: action based on the Capital Directive</u>

175. In relation to the further submissions made by BTPS, Mr Baldry addressed BTPS's submissions on the Capital Directive (in relation to Category C of the *Manninen* claims: 1990-1991, 1991-1992 and 1992-1993) contended that BTPS's submissions based on the Capital Directive were misconceived. To the extent that the United Kingdom has failed to transpose a directive properly, Mr Baldry said that time only begins to run from when it would be reasonable for a taxpayer to have become aware of this, so that a reasonable time to enforce Community rights should run from that time, for national law limitation periods to comply with the principle of effectiveness. The burden of Mr Baldry's submission , as we understand it, was that the United Kingdom did not breach its Community Law obligations by failing to implement the Capital Directive into national law, so a failure to implement the Capital Directive did not give rise to a cause of action at all (either before *FII ECJ* and *Manninen*, or thereafter, when the respective Community rights in relation to the FIDs claims and the *Manninen* claims, on BTPS's analysis, became clear for the first time) or, alternatively, that the direct effect of the Capital Directive was clear well before 1st January 1994, when the Capital Directive was replaced by Article 56. So the limitation period relating to any action based on a failure to implement the Capital Directive had expired on any view well before the making of the FIDs claims for 1990-1991 to 1992-1993 (the Category C *Manninen* claims). Furthermore, said Mr Baldry, any reliance by BTPS on Fleming was misconceived. *Fleming* concerned the reduction of a limitation period without adequate protection for accrued Community rights and legitimate expectation (because there was no transitional provision). This case concerned an adequate limitation period set in advance which had simply expired before BTPS has raised an action based on non implementation of the Capital Directive.

<u>Year 1996-1997: Repeal of TMA 1970, section 28A</u>

176. Mr Baldry rejected the argument forwarded by BTPS in relation to the Category B FIDs claim, that there was an open enquiry into their tax return for the year 1996-1997 which entitled claims to be brought and changes to the rules of those enquiries somehow took that entitlement away, so that this is similar to a *Marks & Spencer/Fleming* type breach of Community rights. Mr Baldry answered this

submission with an observation that an enquiry under s 28 TMA 1970 into a tax return does not disturb the application of the relevant time limits in section 42 and section 43 TMA 1970 which apply to each and every claim made under s 231(3) TA 1988, without express statutory authority (which was not present here and not suggested to be present by BTPS).

177. Even if, said Mr Baldry, BTPS could satisfy the Tribunal that they were entitled to rely upon s 28A TMA 1970 in the form it took in 1996-1997, which he disputes, there is nothing, says Mr Baldry, in section 28A or elsewhere in TMA 1970 which in the case of an enquiry into a tax return acts as a stay on section 42 or otherwise affects the basic rule in section 43 TMA 1970 that no claim for relief under the Taxes Acts shall be allowed unless it is made within 5 years from the 31st January next following the year of assessment to which it relates.

178. Further, and in any event, said Mr Baldry, the amendment of a tax return following the end of an enquiry under s 28A TMA 1970 was invalid as a means of claim under section 42 and Sch. 1A TMA 1970.

179. In relation to the Category B *Manninen* claim, i.e. the claim for the year 1996/97, in addressing BTPS's submission that the open enquiry into their tax return for this year entitled them to make this claim late, Mr Baldry, for the same reasons given in relation to the Category B FIDs claim, denied that the existence of an open enquiry meant that this claim was brought in time.

Issue of Closure Notice for 1996-1997 wrong in law: effect of High Court FIDs claim

180. Mr Baldry also addressed BTPS's submissions as to the effect of the High Court claim on Category B of the FIDs claims. Mr Baldry submitted that the High Court claim cannot be construed as a statutory claim for tax credits because it was the very opposite: it was an assertion by BTPS that they were denied a tax credit and a request to be compensated for the denial of that tax credit.

181. Even if it were appropriate to regard this claim as a claim not for compensation but a claim for a tax credit under section 42 TMA 1970, this claim was still out of time. On 31 January 2003, a claim form was issued in High Court. It does not satisfy the bare minimum of the prescribed statutory formalities for a claim under TA 1988, section 231(1) TA 1988 and TMA 1970, section 42(11since, contrary to schedule 1A, paragraph 2(1), of TMA 1970, it was not made to an officer of the Board of the Inland Revenue.

182. Furthermore, according to Mr Baldry, *Gallic Leasing* does not assist BTPS because there it was held that, in the absence of a particular type of form, it is still necessary to specify that the claim is being made for a particular relief. However,

the High Court claim is predicated on the basis that BTPS are not actually making a claim for tax credits. The bringing of a High Court common law action was not the prescribed form for claims under section 42 of TMA 1970 because by 2003, any claim for tax credits would have to be made via BTPS's tax return or by Form R63N. BTPS had traditionally made all their claims for tax credits using that Form. Therefore even if the High Court claim could be construed as a claim for tax credits, which it was not, it was not in the correct form.

183. Finally, even if the High Court claim were a claim for tax credits on FIDs, it was out of time. This claim was not in any event served on the HMRC before the due date because it was not served until 15 May 2003 at the earliest, which was after the expiry of the time limit in s 42 TMA 1970. HMRC deny that the letter they received on 4 February 2003 constituted a "claim" for the purposes of s 42 TMA 1970 but even if did do so, it was itself outside the relevant time-limit. It may well be the case that a simple claim form for a statutory tax credit could have been served on HMRC, but this High Court claim was actually a much more complex damages claim. The letters written on 4 February 2003 informing HMRC about the High Court claim or the service of this claim later on are therefore irrelevant.

184. Thus HMRC deny that the Category A FIDs claims are within time because they were made outside the 6 year limitation period and there is no principle, according to HMRC, which re-settles a limitation period each and every time a Community right becomes clear or certain. Category B of the FIDs claim fails for the same reason (and HMRC reject BTPS's arguments based on either TMA 1970, section 28A or the effect of the FIDs High Court claim). It is common ground that the Category C FIDs claim for the year 1997-1998 was made in time.

185. And HMRCs' position on the *Manninen* claims is this: Category A of the *Manninen* claims fail because they were brought out of time and there is no re-setting of limitation periods after *Manninen*. Category B of the *Manninen* claims fails because it was brought out of time and HMRC rejects BTPS's arguments based on section 28A of TMA 1970. And the Category C *Manninen* claims based on the Capital Directive fail because they were brought out of time and again HMRC reject any notion of a re-setting of national time limits.

Limitation Act 1970, section 32(1)(c)

186. Mr Baldry made it clear that BTPS's submissions in relation to Section 32(1) of the Limitation Act 1970 played no part in this appeal. This is an issue presently being argued elsewhere.

187. We are not, in this case, concerned with any arguments concerning Section 32(1)(2) of the Limitation Act. We record, as we have already observed, the submissions made by the parties for completeness but this is an issue to be decided elsewhere. We say no more about it.

188. We have already indicated why we have stayed our decision on the FIDs claims in so far as funded by income from third countries and in relation to the *Manninen* claims insofar as they relate to dividends paid by companies resident in third countries. Having stayed that part of our decision, we invited further submissions on the limitation issue, in particular on *Biggs v Somerset* which was not dealt with in the course of submissions by either party but which seems to address many of the salient arguments on the limitation issue directly. We give our decision on the limitation issue as it affects the FIDs claims and the *Mannine*n claims relating to dividends paid to BTPS by companies tax-resident in Member States.

<u>No re-setting of national limitation periods whenever Community rights become certain or clear</u>

189. We find no support in principle or authority for Mr McDonnell's submission that reasonable national limitation periods are re-settled each and every time Community rights become clear or certain for the first time.

190. As an initial observation, we assume that Mr McDonnell's submissions were confined to cases where Community rights became certain for the first time because of a decision by the European Court of Justice and was not to encompass Community rights in any form of Community legislation, even where the legislation codified previous case law and made particular Community rights clear for the first time. Otherwise Mr McDonnell's submissions would have us assume retrospective effect for such Community legislation which we cannot find any legislative intent for.

191. We should also say that we are unconvinced by Mr McDonnell's analogy with damages claims, where Mr McDonnell accepts that time starts to run when a claimant ought reasonably to know that he has suffered loss and claims where Community rights become clear at a particular time, when Mr McDonnell considers that it is only once that particular Community rights have become clear that time begins to run. We have already observed in setting out the analytical framework for the application of Community Law to domestic tax provisions and the remedies for breach of Community Law, that a claimant who asserts directly effective Community rights must seek sympathetic construction of the relevant domestic law provisions, failing which the disapplication of those provisions, failing which the claimant's rights are restricted to a claim for non contractual damages (which carries the defence for a Member State that the breach was not sufficiently serious to attract a liability for damages) or a so-called *San Giorgio* claim for restitution of wrongly paid tax. Since sympathetic construction and damages are remedies for the same breach of Community rights, it is contrary to principle for there to be separate limitation periods for damages cases and for cases when Community rights become clear for the first time, since breach of those rights attract the same remedies in each and every case.

192. Neither are we impressed with Mr McDonnell's distinction between time limits which merely restrict remedies for breach of Community rights (such as in *Johnson*) and cases where limitation periods act as a complete bar to the enforcement of Community rights. The whole point of limitation periods is to give finality to the prospect of litigation. Of course the principle of equivalence requires that Community rights be protected no less well than domestic rights. And the principle of effectiveness requires that Community rights be protected well enough that they are not practically impossible to enforce. But the 6 year time limit in TMA 1970 applies to both domestic claims and Community claims alike. And 6 years is a perfectly reasonable limitation period to set in advance. There is, quite simply, nothing to have prevented BTPS taking the same case as *FII ECJ* and *Manninen* when the respective litigants in those cases took their cases to the European Court of Justice. That limitation periods may result in a complete bar to an action being taken reflects a combination of the state of the law at a particular time which may discourage a particular action and an absence of willingness to litigate by the claimant who then finds himself out of time. But that is true for all legal actions everywhere.

193. Furthermore, we do not consider that *FII ECJ* and *Manninen* represents the emergence of new Community rights to the free movement of capital. We note that the European Court expressly observes that the rights to imputation credits were not clear until its own judgment in that case (paragraphs 215-217). But these rights represent the application of existing rights to the free movement of capital to a particular circumstance (cross border dividends paid to shareholders who are denied a tax credit because the paying company has elected the dividends into a particular statutory regime). This application of existing rights to new circumstances is precisely what, we consider, the Advocate-General had in mind in *Haahr Petroleum* when he said that such an application did not affect the running of national limitation periods (see paragraphs 162, 163 of his Opinion). And as for the incremental development of the application of Community law to intra-Community dividends, if not to cross border dividends paid to and by companies resident in third countries, this incremental development mirrors the development of many areas of domestic law, such as, to take but one example, the unwinding of a trustee's exercise of discretion based on a mistake and the development of the so-called "*Hastings-Bass*" principle.

194. These observations lead us to conclude that there is nothing in the 6 year time limit in TMA 1970 which offends any of the principles of equivalence, effectiveness, or legal certainty and certainly nothing which demands that this limit be re-set each and every time previously uncertain Community rights become clear by reason of a decision by either the European Court or a domestic court.

195. We conclude this as a matter of principle. Of course we should find to the contrary if authority so dictated. However we cannot find any support in either Community case law or in English case law for the proposition that limitation

periods are re-set whenever Community rights become clear for the first time. *Emmott* is a case with no application to this appeal. In *Emmott,* the Member State persuaded the claimant to forbear from prosecuting her claim until the limitation period had expired. That is simply not this case. All of the other Community cases cited to us accept that a reasonable limitation period (6 years is reasonable in the light of the European Court's approval in case law of lesser periods) set in advance does not offend the principle of effectiveness: see, for example, *Johnson*.

***Biggs v Somerset County Council* [1996] 2 All ER 734**

196. There is no English case law (binding or otherwise) which suggests (let alone compels) a contrary conclusion to the one we have reached in principle. Quite the opposite. As we observe above, *Biggs v Somerset CC* addresses many of the arguments put to us by the parties directly and seems to reach a conclusion (binding on us) that HMRCs' submissions on the limitation issue are correct.

197. In *Biggs v Somerset CC*, according to the headnote and the facts set out at pp. 737 to 740h, the appellant had worked for 14 hours a week as a part-time science teacher at a school under the control of the defendant council. She was dismissed in 1976. Under the statutory provisions at the time, an employee who worked for less than 21 hours a week had no right to make a claim to an industrial tribunal for unfair dismissal. In 1994, the House of Lords held in *Equal Opportunities Commission v Secretary of State for Employment* [1995] 1 AC 1 that the provisions of the Employee Protection (Consolidation) Act 1978 that disqualified employees who worked for fewer than 16 hours a week from claiming redundancy pay and compensation for unfair dismissal were contrary to Article 119 of the EC Treaty, Council Directive (EEC) 75/117 (the equal pay directive) and Council Directive (EEC) 76/207 (the equal treatment directive). The appellant lodged a claim with an industrial tribunal two months after the House of Lords decision. The equal treatment directive only came into force after the appellant's dismissal so she could only rely on Article 119 and the equal pay directive. The tribunal held that it had no jurisdiction to hear the claim because it had not been made within 3 months of the termination of the employment as required by s 67(2) of the 1978 Act. The Employment Appeal Tribunal dismissed her appeal and she appealed to the Court of Appeal.

198. The Court of Appeal dismissed the appeal for the following reasons:

(1) The appellant could have made her claim within the prescribed time limit of three months[18]. The tribunal had no jurisdiction to consider this

[18] S 62(7) stated that the three month time limit could be extended if it were reasonably practicable to do so. This is not relevant to the present appeal, suffice it to say that the subsequent House of Lords decision was held not to be a reason why it had not been reasonably practicable for the appeal to be brought earlier.

claim outside the prescribed time limit even after the House of Lords ruling in 1994. The appellant's mistake as to what her rights were was a mistake of law, not fact, and it would be contrary to the principle of legal certainty to allow past transactions to be reopened and limitation periods circumvented because the existing law had not yet been fully explained or had not been fully understood (pp 741 to 743e).

(2) The statutory time limit did not of itself offend Community law and was compatible with the principle of legal certainty. The appellant's failure to make a claim within the time limit was not the result of applying the time limit but of her ignorance of her right in 1976 to present a claim by invoking Community law and s 2 of the European Communities Act 1972 (pp 743f to 744h).

(3) Article 119 did not of itself provide any direct remedy for breach of the right not to be unfairly dismissed by reason of unfair discrimination. The only remedy was the statutory right to make a claim to an industrial tribunal for unfair dismissal and that remedy was only available subject to the statutory time limit (pp 744j to 746d and 746g to 747b).

199. The facts and arguments in *Biggs* are very similar to those in the present case. In particular, very similar arguments to some of those put forward by BTPS were rejected by the Court of Appeal in *Biggs*. These include the argument that if the appellant had brought her claim within the statutory time-limit, it would have been doomed to failure because of the statutory provisions which only allowed such claims to be brought by someone who was employed for more than 21 weeks and in 1976, Mrs Biggs could not reasonably have been expected to be aware of the existence of her directly effective rights under Article 119 or of her right to assert that the domestic provision be disapplied (p. 741a to b). Neill LJ acknowledged that in 1976, the impact and importance of s 2 of the European Communities Act 1972 were not widely known. Nevertheless, the House of Lords decision in 1994 was declaratory of what the law has always been since s 2 of the 1972 Act established the primacy of Community law. The appellant's claim implicitly relied on the 1994 decision being of retrospective effect. There was however no legal impediment preventing someone who claimed that he had been unfairly dismissed from presenting a claim and arguing that restricting claims by part-time workers was indirectly discriminatory (p. 742g to h). For the same reason, the existence of this time limit did not make it impossible or extremely difficult to present a claim. A time limit could not be relaxed to assist a claimant who was ignorant of the law, when the same time limit would have to be enforced against a claimant in a similar situation who was fully aware of his or her legal rights (p 744f to h).

200. We note that *Biggs* was effectively a damages claim because the appellant there was seeking damages for unfair dismissal which Mr McDonnell distinguished

from authorities concerning time limits remaining from when Community rights became clear. However, quite apart from our scepticism about the distinction Mr McDonnell made in this context, the judgment in *Biggs* is given on the basis that, based on the arguments put forward by the appellant in that case, it was actually a case in the second category identified by the Appellants, i.e. when the time limit only starts to run when the claimant's rights become sufficiently certain. In *Biggs*, this was after the House of Lords decision in 1994 and in the present case, it is after the ECJ's judgments in *Manninen* and *FII ECJ*. The argument that the normally diligent taxpayer would not have made a claim before the judgment in question did not assist Mrs Biggs. Nor did the fact that the application of the statutory time-limit meant there was an absolute bar to her now being able to assert her Community law rights.

201. *Biggs* therefore causes considerable difficulty for BTPS. On the other hand, this case provides support to several of the arguments put forward by HMRC. It supports HMRCs' contentions that reasonable time limits fixed in advance promote legal certainty especially in areas of law being developed by the European Court and such time limits are not in themselves incompatible with Community law even if they prevent some claimants from asserting their Community law rights. The HMRC submission that the time limit does not begin to run for the Appellants' claims from when rights become "clear" because these rights have always existed under domestic law by virtue of s 2 of the European Communities Act 1972 is identical to one of the reasons given by the Court for rejecting Mrs Biggs' appeal (see p742g to h of *Biggs*). This case provides further support to HMRC's arguments and it follows the same line as the other cases they have relied on but does not add anything further to them.

202. Furthermore, the decision of the Upper-Tier Tribunal in HMRC v Marks & Spencer [2010] UKUT 713 adopts an approach to the compatibility of a six year time limit with [now] European Union Law which is wholly consistent with Biggs v Somerset.

203. We do not consider that Biggs (or the Upper Tier Tribunal decision in Marks & Spencer) to be in any way inconsistent with *Fleming* or indeed the dicta of Chadwick LJ in *Marks & Spencer v Halsey* . *Fleming* concerned the reduction of a limitation period which, in the absence of transitional provisions, breached accrued Community rights which had relied on the older, longer limitation period. That is not this case, which concerns the expiry of a reasonable limitation period set in advance. And Chadwick LJ's comments in *Marks & Spencer v Halsey* must be seen in context. We should be very reluctant to depart from dicta of Chadwick LJ, even obiter, without being sure of being on very firm ground. But there is no need to depart from any of his dicta in *Marks & Spencer v Halsey*. *Marks & Spence v Halsey* concerned cross border group relief of losses where the Court of Appeal held that the Community right to give or take cross border group relief accrued at the time of the claim for group relief. And because the European Court of Justice had held that there was a Community right to such cross border

group relief of losses only where the losses being relieved were not relievable in the jurisdiction in which they arose (Case C-446/03) it follows, according to Chadwick LJ, that at the time of a group relief claim by a UK resident company in respect of the losses of a non-UK resident group company, the UK resident claimant company must be given some (reasonable) time to ascertain whether the non-UK company's losses are indeed relievable in its own jurisdiction or whether they are available for cross border group relief. None of those considerations apply here, whatever the status of Chadwick LJ's observation and whatever the ultimate conclusion is as to its correctness (as to which we offer no view). *Biggs v Somerset* binds us to reach the conclusion we would have reached in the absence of authority: there is no Community Law obligation on the United Kingdom to re-set the limitation period in TMA 1970 each and every time Community rights become clear for the first time and no such obligation in particular to re-set any time limit after *FII ECJ* in relation to the FIDs claims and after *Manninen* in relation to the *Manninen* claims.

204. As noted at paragraph 114 above, we invited the parties to make further written submissions on *Biggs v Somerset CC* and *HMRC v Marks & Spencer*. The Appellant filed written submissions dated 25 November 2010; HMRC filed written submissions in response dated 2 December 2010.

205. The Appellant prefaced its submissions on *Biggs* and *Marks & Spencer* with observations on the "way in which the ECJ develops Community law". It asserted that "Community law is different from the common law in that it is a young law, and still in a phase of rapid evolution." Whilst accepting that Community law incorporates the declaratory theory of law – that is to say, that a judgment of the ECJ interpreting a directive or provision of the Treaty has effect *ex tunc* – the Appellant submitted that, in certain circumstances, the ECJ can limit the temporal effects of its judgment so that they have effect *pro tunc*, whether from the date of the judgment itself, or the date of the order for reference in the given case, or (exceptionally) from some other past date. It was submitted that this power to limit the temporal effect of a judgment is, in effect, recognition of the fact that the ECJ has power to develop Community law in ways that could not reasonably have been anticipated at an earlier date. This aspect of the jurisprudence of the ECJ is reflected, the Appellant submitted, in the evolution of a given proposition of Community law from a state where there is "objective, significant, uncertainty regarding the implications of the Community provisions" to a state where it is *acte clair*.

206. In the light of these prefatory remarks, the Appellant accepted HMRC's argument that limitation periods are an aspect of legal certainty, but contended that legal certainty cannot be raised in order to defend the State from liability by reliance on time limits running during periods when the Community law itself was uncertain.

207. In relation to *Biggs* itself, the Appellant submitted that the Court of Appeal did not decide that the Community law argument – that is to say, the argument that

Community law required the industrial tribunal to disapply the national law time limits – was fundamentally invalid. Instead, it submitted, the Court of Appeal proceeded on the basis that the national law "must not be so framed as to make it virtually impossible or excessively difficult to obtain reparation" (which is a statement from *Francovich v Italy* Joined Cases C-6/90 and C-9/90 [1991] ECR I-5357 at 5416 that was quoted by Neill LJ in *Biggs* at 744d).

208. The Appellant submitted that, properly understood, the decision in *Biggs* was no more than a decision that, in the circumstances of that case, it would not have been excessively difficult to enforce a claimant's legal rights in 1976 (the year of Mrs Biggs' dismissal), including the right to rely on the principle in *Defrenne v Sabena* Case 43/75 [1976] ECR 455. In this regard, the Appellant drew attention to the following passage from the judgment of Neill LJ at page 742g-h (with emphasis added by the Appellant):

> *"Since 1 January 1973, and certainly since the decision of the Court of Justice in Defrenne v Sabena, there was* ***no legal impediment*** *preventing someone who claimed that he had been unfairly dismissed from presenting a claim and arguing that the restriction on claims by part-time workers was indirectly discriminatory."*

The Appellant submitted that this passage indicates that the Court of Appeal clearly regarded the date of the decision in *Defrenne v Sabena* (which was before Mrs Biggs' dismissal) as a significant clarification of the law such that there would have been a legal impediment to a person's bringing a claim before that date. This approach, it was submitted, supports the Appellant's contentions in the present appeal, in which (it says) the significant clarification of the law that removed the legal impediment on a tax-exempt pension fund bringing a claim for tax credits of this type was the judgment of the ECJ in *Manninen.*

209. By contrast, the Appellant submitted that the Court of Appeal in *Biggs* did not consider the decision of the House of Lords in *Equal Opportunities Commission v Secretary of State for Employment* as having any bearing on whether it was "excessively difficult" to bring a claim before 1994. This was because, in the Appellant's submission, the *EOC* decision merely explained the existing law. In this regard, the Appellant invited us to note that the House of Lords made no reference to the ECJ, which, as the national court of final appeal, it would have been bound to make if the law had been unclear.

210. In summary, the Appellant submitted that the Court of Appeal in *Biggs* was drawing a relevant distinction, in the context of time limits, between:

(1) decisions (such as that of the House of Lords in *EOC*) explaining the existing law, even if not fully explained or not fully understood previously; and

(2) decisions of the ECJ (such as *Defrenne v Sabena*) which, for practical purposes, establish a new "principle" and in that way give a claimant a new right to bring a claim which could not previously have been expressed.

5 In the present case, the Appellant submitted that the decision of the ECJ in *Manninen* fell into the second of those two categories.

211. In relation to *Marks & Spencer*, the Appellant submitted that the Upper Tribunal's reasoning was founded on the principle of legal certainty. But, in that case, the question of whether time limits should be extended as a result of the application of 10 the principle of effectiveness was framed by reference to the date when the "no possibilities test" was satisfied, not (as in the present appeal or in *Biggs*) the date when Community law becomes certain. The Appellant seeks, therefore, to distinguish *Marks & Spencer* on the grounds that it was not a case where there was significant uncertainty as to the Community law and the Community law was 15 clarified only after the national law time limit had expired.

212. In response, HMRC's written submissions endorsed and adopted our preliminary analysis of *Biggs* as set out in the draft of this judgment and as now appears at paragraphs 196*ff* above. HMRC submitted that there was nothing in the Appellant's submissions. The essence of HMRC's argument is, it seems to us, 20 encapsulated in the following passage from the written submissions:

> *"The consistent flaw in each of the new submissions advanced by the Appellant is that it has always been open to the Appellant itself to bring the challenge that was brought by the taxpayer in Case C-319/02 Manninen [2004] ECR I-7477."*

25 In other words, as HMRC puts it, the impediment to the Appellant's bringing the claim was not the existence of a domestic time limit that made it "impossible or excessively difficult" to bring a claim but rather its ignorance of the true state of its rights as a matter of Community law.

213. We are not persuaded by the Appellant's submissions in relation to either *Biggs* or 30 *Marks & Spencer*. Nothing in those submissions causes us to resile from the observations and conclusions set out above.

214. Regardless of the Appellant's submissions on the nature of Community law and the effective ability of the ECJ to establish "new" rights *pro tunc*, we can find nothing in the decision of the Court of Appeal in *Biggs* to support the distinction 35 that the Appellant seeks to draw between decisions explaining the existing law and decisions of the ECJ that, for practical purposes, establish a new "principle" and in that way give a claimant a new right to bring a claim that could not

previously have been expressed. Indeed, such an exercise of introducing a judicially-introduced "new substantive principle" of Community law would amount to impermissible judicial legislation as opposed to a judicial interpretation and application of existing Community provisions, albeit in new and developing contexts, which may lead to previously unforeseen conclusions in particular cases, which is the essence of the judicial function. In particular, we are not convinced that the passage from the judgment of Neill LJ quoted at paragraph 208 above – including the expression "and certainly since the decision of the Court of Justice in *Defrenne v Sabena*" – supports the contention that one must draw the distinction for which the Appellant contends. The Court of Appeal referred not to the clarity of the law but to the question of whether or not "as a matter of law" the claim in question could be advanced. In this regard, we note that the Appellant has not drawn our attention to any aspect of the decision in *Manninen* to the effect that the principle that it established was not effective, as a matter of law, retrospectively. In *Biggs*, Neill LJ pointed to the fact that section 2 of the 1972 Act and the principle of the primacy of Community law meant that persons in the position of Mrs Biggs had always been in a position to present a claim. Similarly, and notwithstanding the fact that *Manninen* might not have been decided by that stage, there was no legal impediment to a taxpayer such as the Appellant from arguing the points that ultimately found favour with the ECJ in *Manninen*. We do not consider, therefore, that the Appellant's claim was not "as a matter of law...capable of being enforced" prior to the decision in *Manninen.*

215. Furthermore, we do not consider that the Appellant's submissions on the decision in *Marks & Spencer* alters, or casts into doubt, the decision in *Biggs*, which remains binding upon us.

216. It follows that each of the categories of the FIDs and *Manninen* claims, other than the FIDs claim for the year 1997-1998 are made out of time and fail for that reason.

Claims based on the Capital Directive

217. We do not consider that the failure of the United Kingdom to implement the Capital Directive into national law assists BTPS. It is true that a failure to implement a directive within the specified time limit is automatically sufficiently serious breach[19] in a damages claim (*Dillenkoffer* (Joined Cases 178-179 and 189-190/94, paragraphs 21-23) but the question we are faced with does not relate to a damages claim but to whether the 6 year time limit in TMA 1970 should be re-set after the European Court of Justice's decision in *Manninen* in relation to a claim for the payment of tax credits for the *Manninen* claims. For the reasons we give above, the short answer is "no". Thus we do not consider Mr McDonnell's submission that the TMA 1970 time limits are to be re-set after *Manninen* for the

[19] Although in the case of a directly effective directive, a causal link between the breach and any loss may be difficult to establish: *Brasserie du Pecheur* (Case C-46 and 48/93), paragraph 51.

periods covered by Category C of the *Manninen* claims to be well founded. The Category C claims remain out of time and fail as a result.

1996-1997: TMA 1970, section 28A

218. In relation to BTPS's submissions on TMA 1970, section 28A, we conclude that nothing in section 28A permits an out of time claim to be made, notwithstanding the tax year is the subject of an open enquiry. Put short, nothing in section 28A extends the time limits specified elsewhere in TMA 1970. The repeal of section 28A does not reduce a limitation period in a sense analogous to *Fleming*. Thus section 28A does not assist BTPS in relation to Category B of either the FIDs claims or the *Manninen* claims. Thus Category B of each of the FIDs and *Manninen* claims remains out of time and are not saved by TMA 1970, section 28A.

1996-1997: Closure Notice: effect of FIDs High Court claim

219. The High Court FIDs claim for tax credits is in terms a claim for damages. It is not a claim for tax credits. We cannot construe it, either on its terms (Mr McDonnell did not rely on any specific terms to make good his submission that the High Court claim was a claim for tax credits), or by reference to its function, as such. The High Court claim arises on the basis that tax credits have not been conferred (and thus is inconsistent with its being a claim for tax credits). Thus the High Court claim cannot be treated as a claim made within time for the Category B FIDs claim.

220. Our conclusion as to the nature of the FIDs High Court claim also answers, we consider, Mr McDonnell's submission that our finding against BTPS on the limitation issue in relation to the Category B FIDs claim merely pushes this FIDs claim into the High Court. If what Mr McDonnell means by this is that BTPS's claim for tax credits for 1996-1997 having failed because it is out of time, so that BTPS are left only with an action for damages against the United Kingdom for damages, we agree. If Mr McDonnell's submission is that the prospect of this claim being out of time means, in turn, that we should exercise some form of discretion to extend the relevant TMA 1970 time limits to permit the FIDs claims to be made in time, we disagree with Mr McDonnell. We have already concluded that the prospect of the FIDs claims being wholly out of time because of the TMA 1970 limitation periods does not offend the principles of effectiveness, equivalence or legal certainty. We do not consider that we should exercise any discretion to extend the TMA 1970 time limits in this case.

221. Thus Category B of the FIDs claims is not saved by the effect of the High Court claims for tax credits on the FIDs for 1996-1997 and remains out of time.

Summary of Conclusions on Limitation Issue and decision on the FIDs claims and the *Manninen* claims

222. On the basis that we do not consider that the United Kingdom has any Community Law obligation at the material times to re-set the TMA 1970 time limits:

5 (i) The FIDs claims fail for being made out of time except Category C (1997-1998);

(ii) Category A (1994-1995 and 1995-1996) and Category B of the FIDs claims 1996-1997 fail (and the Category B FIDs claims are not saved by either TMA 1970 section 28A or by the effect of the FIDs High 10 Court claim);

(iii) Category A of the *Manninen* claims fail;

(iv) Category B of the *Manninen* claims (1996-1997) fails and is not saved by TMA 1970, section 28A;

(v) Category C of the *Manninen* claims (1990-1991, 1991-1992, 1992-15 1993) fail for having been made out of time and are not saved by the failure of the United Kingdom to implement the Capital Directive.

(vi) It follows that:-

a. We dismiss Category A and Category B of the FIDs claims as they were made out of time;

20 b. We allow the appeal for Category C of the FIDs claims (for 1997-1998);

c. We dismiss the appeal for Category A of the *Manninen* claims as they were made out of time.

d. We dismiss the appeal for Category B of the *Manninen* claims;

25 e. We dismiss the appeal for category C of the *Manninen* claims.

223.This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later

than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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10 **SIR STEPHEN OLIVER QC**

15 **JULIAN GHOSH QC**
TRIBUNAL JUDGES

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