VAT focus

Berkshire Golf Club and the economics of unjust enrichment

Speed read

By the release of the judgment in *Berkshire Golf Club*, the First-tier Tribunal has given its first judgment on unjust enrichment since the 2003 judgment from the CJEU in *Weber's Wine World*, in which it was made clear that establishing unjust enrichment is an economic exercise. This case amply demonstrates that unjust enrichment is a complex and challenging (and expensive) defence for HMRC to cite. However where HMRC has been prepared to incur the substantial economic analysis investment that citing and proving unjust enrichment requires, the taxpayer may face a similar outlay in rebutting HMRC's assertions. So what does this mean for the future of this defence? In the writers' opinion, the case amply illustrates that the advocate general in *Commission v Italy* was right. The economics of unjust enrichment are fraught with difficulty.

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The FTT in *Berkshire Golf Club and others v HMRC* [2015] UKFTT 627 (reported in *Tax Journal*, 8 January 2016) has given its first judgment on unjust enrichment since the 2003 judgment of the CJEU in *Weber's Wine World Handels-GmbH v Abgabennerufungskommission Wein* (C-147/01) [2005] All ER 224, in which it was made clear that establishing unjust enrichment is an economic exercise. The legal landscape and challenges for HMRC in making good the case for unjust enrichment are evident from this latest ruling.

Background

Before *Berkshire Golf Club*, on 19 December 2013 the CJEU considered the liability of visitor green fees charged by non-profit making members' golf clubs in *Bridport and West Dorset Golf club* (C-495/12). The CJEU determined that an exemption should apply to these green fees, as they were a supply of sporting services by an eligible body for the benefit of an individual playing sport. The fact that the individual in question was not a member of the club had no bearing on the liability for the fee.

Following this decision, the UK changed the scope of the sporting services exemption to remove the membership condition, with effect from 1 January 2015. Many clubs had submitted claims for VAT overpaid from 1990 (the date from which the UK implemented the exemption provisions) on visitor green fees. Consistent with the judgment against them, HMRC paid Bridport's claim in full but then wanted to consider whether to invoke the unjust enrichment defence in respect of these other claims.

Unjust enrichment is a matter on which the relevant legal tests have only infrequently been tested in the UK courts. European case law establishes that member states are liable to repay taxes levied in breach of EU law, save to the extent that the member state can show that the taxpayer concerned has not borne the burden of the unlawful tax charge in whole or in part. A taxpayer may bear the burden of the tax charge where:

- he has been unable to pass the charge on;
- when the charge has been passed on, thereby increasing the price of the goods, he has suffered a loss of profits associated with the reduction in sales which results as a consequence of the higher price charged; or
- he has, in some other regard, suffered damage as a consequence of the unlawful tax.

Unlike the more normal position for a VAT tribunal case, the burden of proof lies with HMRC to establish the amount of a repayment claim that would unjustly enrich the taxpayer. EU case law is quite clear that it is impermissible for it to impose requirements on a taxpayer which effectively render it impossible or excessively difficult to make good their claim for repayment. The burden is on HMRC, by evidence, to show that the taxpayer would be unjustly enriched. In a domestic context and by reference to this principle, Moses J in *Marks and Spencer v C&E Commrs* [1999] STC 205 determined that: 'Lacunae in evidence should not be considered to the detriment to the trader.' This is particularly in circumstances in which evidence is not available as a consequence of the effluxion of time.

In the EU case of *Weber's Wine World*, the European court indicated that the extent of unjust enrichment could only be established following an economic analysis of all the relevant circumstances. In *Commission v Italy* [2003] ECR I-14637, the advocate general explained the exercise to be undertaken was:

'a thorough analysis of the market, taking into account a large number of variables such as structure of the market concerned (more or fewer providers) and the availability of possible substitutes for the product affected by the charge. Account must also be taken of the fact that market conditions are dynamic in nature and that prices fluctuate according to changes in supply and demand.'

Establishing unjust enrichment

The three appellant clubs, together with Bridport, were selected as being broadly representative of the different types of UK golf courses. HMRC instructed an expert economist and an economic consultancy to gather evidence from the four clubs, seeking to establish the economic circumstances for unjust enrichment.

On the basis of the work undertaken, HMRC concluded that clubs which charged £100 per round would be unjustly enriched by the order of 65% of their claim, with other clubs being unjustly enriched to the extent of 47% of their claim. The principal basis on which this conclusion was reached was that the market for green fees was, in an economic sense, a perfectly competitive market. HMRC's expert thereby

undertook a principally theoretical exercise of economic calculation to establish that the unlawful tax was substantially passed on to golfers (to the extent of 67% and 50%), with virtually no commensurate loss of profit or damage (limited to low single digit percentages).

By way of rebuttal, the clubs also appointed an economics expert. The clubs' expert was of the opinion that the facts and evidence available contradicted HMRC's conclusion that the market was perfectly competitive. The clubs argued that one of the critical assumptions underpinning a perfectly competitive market was manifestly not met. Perfect competition requires an assumption that the cost of supplying one more round of golf (marginal cost) exactly equals the price charged for it. Using the data provided to HMRC and the economic consultancy reports, the clubs' expert believed that it was evident that the marginal cost for green fee golf was very low. It was argued by the expert that, once it was established that the marginal cost did not equal the price use of alternative, economic models for the calculation of loss led to an answer that illustrated that at least 95% of the unlawful charge was borne by the clubs.

There were a number of other non-unjust enrichment-related issues also before the tribunal, but these are not the subject of this article.

What did the tribunal decide?

The tribunal had heard considerable argument as to precisely what HMRC had to establish in order to make out the defence (i.e. whether proving pass on was enough to shift the burden to the taxpayer to show loss). The tribunal did not provide an explicit answer to that issue. Rather it highlighted that the two experts both agreed that there was *some* unjust enrichment and proceeded to evaluate the opinions provided, in the relevant legal context and by reference to the evidence.

Consistent with the approach of the clubs' expert, the tribunal determined to focus on establishing, by reference to the factual and historic evidence, what the marginal cost of a round of golf was likely to have been. Interestingly, the tribunal specifically identifies that, in the factual evidence on marginal cost, there were lacunae from both sides' perspective.

However, the tribunal determined, consistently with the approach in *Marks and Spencer*, that those lacunae were to be resolved substantially in favour of the taxpayers. It highlighted that the clubs' expert had consistently placed great importance on the question of the composition and determination of marginal cost, but that the HMRC's expert had not chosen to fully address these issues either in his final report or in oral evidence. The tribunal determined that, on the evidence, marginal cost was not equal to price; and that accordingly the perfect competition model was not the appropriate one to reflect and synthesise a hypothetical world in which VAT had never been unlawfully levied on green fee golf by non-profit making clubs.

Without the foundation of the perfect competition model, HMRC had offered no alternative basis for determining the level of pass through and economic loss. The clubs' expert had, however, provided detailed analysis of the calculation of economic loss by reference to alternative determinations of marginal cost. This analysis was corroborated by the tribunal by reference to the financial accounts of the clubs. It concluded that a 10% restriction of the claims of all clubs, irrespective of price per green fee, was appropriate.

Why is the case important?

Clearly, if you are a non-profit making golf club with a claim for repayment lodged with HMRC, this case could be the final piece in the jigsaw facilitating claims to be paid. (We await HMRC's response to the judgment and whether it will appeal.)

However, the case is of potentially far greater import than for golf clubs alone. This case is the first domestic judgment following the direction from the CJEU in *Weber's Wine World* concerning the role of economic analysis in unjust enrichment.

The unjust enrichment aspects of this case were heard over five days, with HMRC instructing both an economic consultancy and a sports economist. The clubs too decided to appoint their own expert, who served a report with appendices running to hundreds of pages. It is clear that whatever refinement is put on the arguments of what precisely HMRC must prove in an economic context, vis-à-vis pass on and/or economic loss, HMRC failed to support a conclusion that there was more than 10% unjust enrichment in the present case.

However, the question remains as to whether the HMRC's expert's evidence alone failed to meet the required standard. Or was it because the clubs' expert had considered a broader spectrum of models and possibilities, which the detail of the factual material was capable of evidencing?

The tribunal states clearly that evidential lacunae will be resolved against HMRC. Where HMRC's expert had failed to adequately address matters raised in the clubs' expert's report, the tribunal were not prepared to allow HMRC a second opportunity to refine its analysis. However, the clubs' expert had presented illustrative analysis, showing how changes in marginal cost impacted the percentage of economic loss suffered. On the evidence, it had been claimed by the clubs that the costs of additional rounds were limited to green tickets, water for showers, laundry for towels, etc – which amounted to 'a matter of pence'. HMRC presented no substantial evidence to the contrary, maintaining that marginal cost must equal price. Yet despite this, though reasonably by reference to the annual accounts, the tribunal accepted a marginal cost of £5 per round. Could it be said that was a lacuna filled in HMRC's favour?

The CJEU case law is clear that a member state may not render it virtually impossible or excessively difficult for a taxpayer to secure repayment of tax levied in breach of EU law. But what does that really mean for a taxpayer when faced with a substantial investment by HMRC in economic analysis? Must a taxpayer facing an unjust enrichment challenge have pockets as deep as HMRC's in order to ensure that, in what is an enormously complex and intellectually challenging area, the taxpayer can effectively put HMRC to the test?

If so, what does that mean for the category allocation and associated costs regime for unjust enrichment cases? What size of case for either side justifies the unjust enrichment defence? And does all of this have an impact on whether in practice it becomes excessively difficult to secure repayment of unduly levied tax?

In the writers' opinion, the case amply illustrates that the advocate general in *Commission v Italy* was right. The economics of unjust enrichment are fraught with difficulty. ■

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