

Scottish Law Commission

(Scot Law Com No 169)

# **Report on Unjustified Enrichment, Error of Law and Public Authority Receipts and Disbursements**

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The Scottish Law Commission was set up by section 2 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law of Scotland. The Commissioners are:

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# Scottish Law Commission

*Item 4 of our Fifth Programme of Law Reform*

## **Unjustified Enrichment, Error of Law and Public Authority Receipts and Disbursements**

To: The Right Hon the Lord Hardie, QC  
*Her Majesty's Advocate*

We have the Honour to submit our Report on Unjustified Enrichment, Error of Law and Public Authority Receipts and Disbursements.

(Signed) BRIAN GILL, *Chairman*  
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J G S MACLEAN, *Secretary*  
23 December 1998

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## ABBREVIATIONS

*Armour on Valuation and Rating*

C S Haddow and J R Docherty (eds), *Armour on Valuation and Rating* (5th edn; 1985; loose-leaf; updated to release No 10, published October 1998)

*Gloag and Henderson, The Law of Scotland*

W A Wilson, A Forte *et al* (eds), *Gloag and Henderson, The Law of Scotland* (10th edn; 1995)

Law Com No 227

Law Commission, *Report on Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments* (Law Com No 227) (1994)

Law Com CP No 120

Law Commission, *Consultation Paper No 120 on Restitution of Payments Made Under a Mistake of Law* (1991)

Macphail, *Sheriff Court Practice*

I D Macphail *et al*, *Sheriff Court Practice* (1988)

Scot Law Com DP No 95

Scottish Law Commission, *Discussion Paper No 95 on Recovery of Benefits Conferred Under Error of Law* (1993) (2 volumes)

Scot Law Com DP No 99

Scottish Law Commission, *Discussion Paper No 99 on Judicial Abolition of the Error of Law Rule and its Aftermath* (1996)

Scot Law Com DP No 100

Scottish Law Commission, *Discussion Paper No 100 on Recovery of Ultra Vires Public Authority Receipts and Disbursements* (1996).

### References to statutes in Part 3

"ADRE(S)A = Abolition of Domestic Rates Etc. (Scotland) Act 1987

"FA" = Finance Act;

"LGE(S)A 1994" = Local Government etc. (Scotland) Act 1994;

"LGFA 1992" = Local Government Finance Act 1992;

"LG(FP)(S)A 1963" = Local Government (Financial Provisions) (Scotland) Act 1963;

"LG(S)A" = Local Government (Scotland) Act;

"TMA 1970" = Taxes Management Act 1970;

"VATA 1994" = Value Added Tax Act 1994.

# Part 1 Introduction

## Purpose of Report

1.1 In this Report<sup>1</sup> we make recommendations on certain topics connected with the recent judicial abrogation of the rule precluding recovery of benefits conferred under error of law,<sup>2</sup> and with the recovery of *ultra vires* public authority receipts and disbursements.<sup>3</sup> We also give the results of consultation on the question whether this Commission should undertake a wider review of the law on unjustified enrichment.<sup>4</sup>

## The law reform background

1.2 Our work on the law of unjustified enrichment began with two developments in the early 1990s. The first was the English Law Commission's project to abolish the rule precluding the recovery of payments made under error of law.<sup>5</sup> The second was the *Woolwich* decision,<sup>6</sup> which changed the English common law rule on the recovery of overpaid taxes, together with the English Law Commission's project of harmonising the *Woolwich* rule and the statutory provisions on the recovery of overpaid taxes.<sup>7</sup> These were matters which we could not ignore. As anticipated in our last *Annual Report*,<sup>8</sup> we deferred completion and submission of the present report until the judgment of the House of Lords in the recent English case of *Kleinwort Benson Ltd v Lincoln City Council* became available.<sup>9</sup> The significance of that decision is explained below.<sup>10</sup>

## Recommendations following judicial abrogation of error of law rule

1.3 In our Discussion Paper No 95 on *Recovery of Benefits Conferred Under Error of Law*, we sought views on provisional proposals that the rule precluding recovery of benefits conferred under error of law should be abrogated by statute.<sup>11</sup> This proposals was then superseded by the case of *Morgan Guaranty Trust Company of New York v Lothian Regional Council*.<sup>12</sup> In that case an Inner House Bench of Five Judges of the Court of Session, relying

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<sup>1</sup> This Report is issued under our *Fifth Programme of Law Reform* (1997) Scot Law Com No 159, Item No 4, the reform of the law of obligations: see *ibid*, paras 2.24-2.29. See also *ibid*, Item No 2, Codification and para 2.16.

<sup>2</sup> Part 2, Section A, below.

<sup>3</sup> Part 2, Section B and Parts 3 and 4 below.

<sup>4</sup> Part 5 below.

<sup>5</sup> Law Commission, Consultation Paper No 120 on *Restitution of Payments Made Under a Mistake of Law* (1991) Part II; Law Commission, Report on *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments* (1994) Law Com No 227, Section B.

<sup>6</sup> *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL affg CA), revg [1989] 1 WLR 137.

<sup>7</sup> Law Commission, Consultation Paper No 120 on *Restitution of Payments Made Under a Mistake of Law* (1991) Part III; Law Commission, Report on *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments* (1994) Law Com No 227, Section C.

<sup>8</sup> *Thirty-Third Annual Report 1997-98* (Scot Law Com No 167) para 2.24.

<sup>9</sup> [1998] 4 All E R 513 (HL); [1998] 3 WLR 1095 (HL). Judgment was issued on 29 October 1998.

<sup>10</sup> See para 1.4.

<sup>11</sup> Scot Law Com DP No 95 (1993), vol 1, Proposition 1 (para 2.95).

<sup>12</sup> 1995 SC 151, 1995 SLT 299 (Court of Five Judges) reversing the Lord Ordinary whose judgment is set out in 1995 SLT pp 301-308; noted G T Laurie 1995 JR 244; N Andrews [1995] CLJ 246; G T Laurie (1995) 111 LQR 379; M Hogg, (1997) 1 ELR 381; and see R Evans-Jones and P Hellwege, "Swaps, Error of Law and Unjustified Enrichment" (1995) 1 SLPQ 1.

inter alia on research and arguments in our Discussion Paper No 95, in effect abolished that rule, and restored the old law as it had existed in the Institutional period. Our work was not wasted, however, because the court was assisted by the research and the discussion set out in that Paper. Certain issues consequential on the judicial abolition of the error of law rule are considered in Part 2 below.<sup>13</sup>

**1.4 No statutory safeguard against reopening payment transactions.** There remained the second main provisional proposal in Discussion Paper No 95, namely, a statutory safeguard which would prevent persons who had paid a purported debt in accordance with a common understanding, or settled view, of the law later overturned by a judicial decision from recovering lest a wide circle of closed transactions be opened up whenever such a decision was made.<sup>14</sup> In our Discussion Paper No 99,<sup>15</sup> we provisionally resiled from that proposal and pointed to the difficulties it created. The House of Lords in the English case of *Kleinwort Benson v Lincoln City Council*<sup>16</sup> (which abolished the mistake of law rule in English law) affirmed that judicial decisions changing a settled view of the law have retrospective effect so as to reopen closed payment transactions but criticised the proposed safeguard, approved of our cautious approach to the safeguard in Discussion Paper No 99, and refused to introduce the safeguard at common law in England and Wales. In Part 2, Section A below, following that decision and the earlier comments of consultees on Discussion Paper No 99, we recommend against the introduction of the safeguard by statute in common law claims for repayment.

**1.5 No statutory introduction of "the *Woolwich* rule".** In *Woolwich Equitable Building Society v IRC*,<sup>17</sup> the House of Lords introduced in English law a new ground of restitution to the effect that a citizen who makes an undue payment of tax or other levy to a public authority pursuant to an *ultra vires* demand has a prima facie right to repayment ("the *Woolwich* rule"). In Section B of Part 2 below, we recommend against the introduction in Scotland of "the *Woolwich* rule".<sup>18</sup> We think that the Scottish courts would reach broadly the same result at common law and could do so by reliance on broader principles of recovery not restricted to *ultra vires* public authority receipts.

**1.6 Amendment of statutory provisions on recovery of local government non-domestic rates.** In our Discussion Paper No 100, we reviewed among other things the statutory provisions for the recover of local government council tax and rates. We sought views on proposals to harmonise some of the provisions on rates with the *Woolwich* rule.<sup>19</sup> In the light of consultation, we make recommendations in Part 3 below,<sup>20</sup> for amendment of the distinctive statutory provisions relating to the refund of overpaid non-domestic rates, which relate only to Scotland. In Appendix A to this report we also set out a clause which could be incorporated in a suitable statutory vehicle such as a Bill on local government finance or

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<sup>13</sup> These issues were explored in our Discussion Paper No 99 on *Judicial Abolition of the Error of Law Rule and its Aftermath* (1996), Part II.

<sup>14</sup> Discussion Paper No 95, vol 1, Proposition 3(para 2.125).

<sup>15</sup> *Judicial Abolition of the Error of Law Rule and its Aftermath* (1996), Proposition 1 (para 3.51).

<sup>16</sup> [1998] 3 WLR 1095 (HL).

<sup>17</sup> [1993] AC 70 (HL affg CA), revg [1989] 1 WLR 137.

<sup>18</sup> See recommendation 2 (para 2.65).

<sup>19</sup> See Part IV.

<sup>20</sup> Part 3, Section B (paras 3.8-3.65).

rating. We do not however propose any change to the provisions for refund of overpaid council tax which are already liberal and fair to the council tax payer.<sup>21</sup>

1.7 **No recommendation to amend statutory provisions on recovery of central government taxes and council tax.** In our Discussion Paper No 100, we also reviewed the statutory provisions for the recovery of the principal central government taxes and charges.<sup>22</sup> We sought views on proposals to harmonise some of these provisions with the *Woolwich* rule.<sup>23</sup>

1.8 Apart from rates, these proposals related to United Kingdom or Great Britain enactments and, save for minor modifications of detail, were the same as (and based on) the English Law Commission's recommendations in their Report on *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments*.<sup>24</sup> In the light of consultation and subsequent developments, we depart from these earlier proposals for reasons explained in Part 3<sup>25</sup> and recommend against amending these enactments.<sup>26</sup>

1.9 **Refund of *ultra vires* disbursements from Consolidated Fund: the "*Auckland Harbour Board*" rule.** While the *Auckland Harbour Board* rule<sup>27</sup> - whose status in Scots law is unclear - is in some respects defective, we recommend that it should not be reformed by legislation separate from a general codification of the Scots law on unjustified enrichment.<sup>28</sup> In this respect we make the same recommendation as the Law Commission.<sup>29</sup>

## Consultation on possible review of the general law on unjustified enrichment

1.10 Our research for Discussion Papers Nos 95, 99 and 100 revealed much that is wrong with the present law on unjustified enrichment. In our Discussion Paper 99 we sought views on whether a new type of approach based on broader and more liberal grounds of recovery than the existing grounds should be examined as part of a general review of the law of unjustified enrichment.<sup>30</sup> Further in our *Fifth Programme of Law Reform*,<sup>31</sup> we observed that the law on unjustified enrichment may be a suitable topic as a long term project for more comprehensive statutory reform, possibly including an exercise in codification. In Part 5 below we give the results of our consultation.

## Constitutionality

1.11 In Part 3 below, we recommend legislation on refund of non-domestic rates. The Scotland Act 1998 expressly mentions obligations arising from unjustified enrichment as one of the branches of Scots private law over which the Scottish Parliament will have legislative

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<sup>21</sup> Part 3, Section F (paras 3.107-3.109).

<sup>22</sup> Discussion Paper No 100 on *Recovery of Ultra Vires Public Authority Receipts and Disbursements* (1996).

<sup>23</sup> See *ibid*, Part IV.

<sup>24</sup> (1994) Law Com No 227.

<sup>25</sup> Part 3, Section C (paras 3.66-3.84) and Section D (paras 3.85-3.103).

<sup>26</sup> Paras 3.84 and 3.103.

<sup>27</sup> *Auckland Harbour Board v The King* [1924] AC 318 (PC) under which *ultra vires* disbursements by central government from the Consolidated Fund, and possibly other *ultra vires* disbursements by public authorities from other public funds, are always recoverable.

<sup>28</sup> Recommendation 7 (para 4.11).

<sup>29</sup> Law Com No 227, Section D.

<sup>30</sup> Discussion Paper No 100, Proposition 1 (para 3.124).

<sup>31</sup> (1997) Scot Law Com No 159, paras 2.27-2.29.

competence.<sup>32</sup> "Taxes and excise duties" are matters reserved to the United Kingdom Parliament but "local taxes to fund local authority expenditure (for example, council tax and non-domestic rates)" are excepted from this reservation.<sup>33</sup> The 1998 Act, Schedule 4, sub-paragraph 2(1) provides that an Act of the Scottish Parliament cannot modify, or confer power by subordinate legislation to modify, the law on reserved matters. Sub-paragraph 2(3) however provides among other things that sub-paragraph 2(1) applies in relation to a rule of Scots private law only to the extent that the rule in question is "special to a reserved matter" or the subject matter of the rule is "interest on sums due in respect of taxes or excise duties and refunds of such taxes or duties". While the issue is not entirely free from doubt, it seems most unlikely that sub-paragraph 2(1) was intended to reserve to the United Kingdom Parliament legislative competence over the statutory procedures in purely Scottish local government legislation for refunds of non-domestic rates, given that the law on unjustified enrichment and the law on non-domestic rates are both matters within the legislative competence of the Scottish Parliament.

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<sup>32</sup> Section 126(4)(c) as read with section 29(4)(b) and Schedule 4, sub-para 2(3).

<sup>33</sup> Scotland Act, 1998, Schedule 5, Part II, Section A1.

## Part 2 Possible Amendments of Common Law Consequential on *Morgan Guaranty* and *Woolwich* Cases

2.1 In this Part, we consider in Section A whether a statutory safeguard should be introduced barring common law claims reopening payment transactions completed on the faith of a settled view of the law subsequently changed by judicial decision. Section B considers whether the "Woolwich rule"<sup>1</sup> should be introduced in Scots law by statute.

### A. NO STATUTORY SAFEGUARD AGAINST COMMON LAW CLAIMS REOPENING SETTLED TRANSACTIONS

#### (1) Main proposal in Discussion Paper No 95 superseded by *Morgan Guaranty* case

2.2 The decision of the Inner House in *Morgan Guaranty Company Trust of New York v Lothian Regional Council*<sup>2</sup> in effect implemented the main proposal in our Discussion Paper No 95, namely that the common law rule under which money paid under an error of law is *prima facie* not recoverable should be abolished.<sup>3</sup> This proposal had been generally supported by consultees<sup>4</sup> and, so far as we can judge, the decision in *Morgan Guaranty* abrogating the error of law rule has likewise been widely welcomed.

2.3 The *Morgan Guaranty* case involved an action for repayment of sums paid under an "interest rate swap transaction" between a bank and a local authority<sup>5</sup> of a type subsequently held<sup>6</sup> to be void as *ultra vires* the local authority. Payments made under a purported obligation in a void swap agreement in the mistaken belief that such an agreement was valid were held to be recoverable though the mistake was an error of law.

2.4 The recent English case of *Kleinwort Benson Ltd v Lincoln City Council*<sup>7</sup> also involved the recovery of undue payments made under a void swap agreement in the mistaken belief that it was valid. In that case, the House of Lords abrogated the mistake of law rule in

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<sup>1</sup> Ie the rule laid down in *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL affg CA) giving a taxpayer a *prima facie* right under English law to recover undue payments of tax and similar levies paid to a public authority pursuant to an *ultra vires* demand.

<sup>2</sup> 1995 SC 151 (Court of Five Judges) reversing Lord Ordinary 1995 SLT 299 (OH) at pp 301-308.

<sup>3</sup> Scot Law Com DP No 95, vol. 1, Proposition 1 (para 2.95).

<sup>4</sup> Including the Building Societies Association; the Court of Session Judges; the Committee of Scottish Clearing Bankers; the Faculty of Advocates; the Faculty of Law, University of Aberdeen; Professor W M Gordon; the Law Society of Scotland; the Royal Faculty of Procurators in Glasgow; Scottish Chambers of Commerce; the Sheriffs' Association; and the Association of Sheriffs Principal. Only one commentator expressed doubts.

<sup>5</sup> An "interest rate swap" is an agreement between two parties by which each agrees to pay the other on specified dates amounts calculated by reference to the interest which would have accrued over a given period on the same notional sum assuming that different rates of interest are payable to each party.

<sup>6</sup> *Hazell v Hammersmith and Fulham London Borough Council* [1992] 2 AC 1 (HL) followed in *Morgan Guaranty Trust Company of New York v Lothian Regional Council* 1995 SLT 299 (OH) per Lord Penrose varied on another point 1995 SC 151. Cross-border differences in the relevant local government legislation were minor and immaterial on this point.

<sup>7</sup> [1998] 4 All E R 513 (HL).

English law. The House further held that, under English law, payments made in accordance with a settled view or general understanding of the law which is subsequently overturned by judicial decision are recoverable in restitution on the ground of mistake of law.<sup>8</sup> The main interest of the speeches for present purposes lies in this second issue for reasons which we now explain.

**(2) Change by judicial decision in the "settled view" of the law: statutory safeguard against reopening settled transactions?**

**Background**

2.5 In our Discussion Paper No 95 on *Recovery of Benefits conferred under Error of Law*,<sup>9</sup> on the assumption that the error of law rule should be abolished by statute, we provisionally proposed that it should be provided that where there has been a change:

- (a) in the law; or
- (b) in the common understanding of the law,

effected by a judicial decision in civil proceedings, and a payment was previously made in accordance with the law, or the understanding of the law, before that change, the payment should not be recoverable by reason only of that change.<sup>10</sup> This proposal was based on legislation in New Zealand and Western Australia.<sup>11</sup> Its purpose was to protect the security of receipts and the finality of closed payment transactions. We argued that the safeguard was too important to be left to the uncertainties of judicial decisions.<sup>12</sup>

2.6 Commenting on Discussion Paper No 95, the Court of Session judges pointed to the oddity of providing that a payment is not to be recoverable by reason of a "change" in the law. If a judicial decision does indeed effect a change in the law, a payment made on the faith of the law as it stood before the change would not have been made under error of law and therefore would not be recoverable on the ground of error in law. In our Discussion Paper 99, therefore, we accepted that any provision introducing the safeguard should not refer to "a change" in the law. If the courts do change the law, the reference is unnecessary; if they do not (because of the declaratory theory), it would be inappropriate for statute to state that they do.

2.7 As the judges recognised, however, there remains the question whether, where a judicial decision overturns a "common understanding", or (to use the Law Commission's terminology<sup>13</sup>) "settled view", of the law, recovery of past undue payments made in accordance with the overturned view should be barred. While most consultees responded to Discussion Paper No 95 approved a statutory safeguard barring recovery, some criticised the details of the proposals, some reserved their opinion and some opposed the idea of exceptions to any statutory safeguard.

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<sup>8</sup> *Idem*.

<sup>9</sup> (1993) Vol 1, paras 2.84-2.125.

<sup>10</sup> *Ibid*, vol 1, Proposition 3(4) (para 2.125).

<sup>11</sup> Judicature Act 1908, s 94A(2), inserted by the Judicature Amendment Act 1958, s 2 (New Zealand); Law Reform (Property, Perpetuities and Succession) Act 1962, s 23 (Western Australia) re-enacted in the Property Law Act 1969 (Western Australia), s 124(2).

<sup>12</sup> Scot Law Com DP No 95, vol 1, para 2.123.

<sup>13</sup> Law Com No 227, paras 5.2 to 5.13; recommendation (5) (para 5.13).

2.8 **The *Morgan Guaranty* case and "the floodgates argument".** It could not be assumed that those consultees who approved a statutory safeguard would necessarily adhere to that view in the new situation created by the decision in *Morgan Guaranty*.<sup>14</sup> In that case, the court had not only abrogated the error of law rule and held out the promise of incremental development of the common law, but also cast doubt on the floodgates argument, that is to say, the argument that abolition of the error of law rule would lead to the unjustifiable reopening of a large number of settled payment transactions between other parties. Lord President Hope disapproved the introduction into the structure of enrichment law of a rule based on expediency, explicitly rejected the floodgates argument as a reason for retaining the error of law rule and generally minimising the importance of that argument.<sup>15</sup>

2.9 Lord Clyde considered that the floodgates argument had less force then (1995) that at the time when the error of law rule was affirmed by the *Glasgow Corporation* case in 1959.<sup>16</sup> First, "[a]t a technical level the change in the law of prescription and limitation may well reduce the scale of the alleged dangers..."<sup>17</sup> Second, Lord Clyde referred in this context to the *Woolwich* case<sup>18</sup> which in his view afforded evidence of changed views of public policy:

"I do not believe that it can be so confidently affirmed today that the public interest in the finality of settlement transactions should outweigh the interest of private individuals in recovering money which, in a proper understanding of the law, they were never due to pay".<sup>19</sup>

Third, it was not obvious why error in the construction of a standard form contract which might affect very many individuals should enable repetition<sup>20</sup> while error in construing public legislation would not.<sup>21</sup>

2.10 **The Law Commission.** Meantime in England and Wales, the Law Commission recommended statutory safeguards against opening the floodgates to, first, private law actions of repayment brought by third parties where a judicial decision changes "a settled view" as to liability under private law<sup>22</sup> and, second, statutory claims by third parties where a decision of a court or tribunal changes a settled view as to tax liability.<sup>23</sup>

2.11 **New consultation.** In our Discussion Paper No 99<sup>24</sup> therefore we consulted afresh on the question whether statute should supplement the abolition of the error of law rule by introducing a safeguard<sup>25</sup> against reopening payment transactions which have been

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<sup>14</sup> 1995 SC 151.

<sup>15</sup> *Ibid* at p 165.

<sup>16</sup> *Glasgow Corporation v Lord Advocate* 1959 SC 203.

<sup>17</sup> 1995 SC 151 at p 172C. The Prescription and Limitation (Scotland) Act 1973, s 6 and Sch 1, para (b), introduced a 5 year period of negative prescription of obligations based on redress of unjustified enrichment.

<sup>18</sup> *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL aggf CA).

<sup>19</sup> 1995 SC 151 at p 172C, D.

<sup>20</sup> It is under the private rights exception to the error of law rule introduced in *Baird's Trustees v Baird and Co* (1877) 4 R 1005.

<sup>21</sup> 1995 SC 151 at p 172E.

<sup>22</sup> Law Com No 227, paras 5.2 to 5.13; recommendation (5) para 5.13.

<sup>23</sup> Law Com No 227, paras 10.10-10.20, recommendation (12) (para 10.20). There is a not dissimilar statutory rule at present under which refund of overpaid tax is denied if it was paid in accordance with the generally prevailing practice when the return was made: Taxes Management Act 1970, s. 33(2), proviso.

<sup>24</sup> (1996) Part III.

<sup>25</sup> As regards terminology, in *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL), Lord Goff (at pp 538-539a) and (expressly correcting our loose usage) Lord Lloyd (at p 547e-h) said that the effect of the proposed "settled view of the law" rule was not to provide the payee with "a defence" properly so called. But rather rested on the theory that a payment made on that basis is not made under a mistake at all. However that

completed in accordance with a settled view or common understanding of the law subsequently changed by judicial decision.<sup>26</sup> This question is closely connected with fundamental principles governing the theory and practice of judicial law-making.

**(a) The "declaratory" and "settled view" theories**

2.12 The English Law Commission pointed out that where the law is changed by **legislation**, a payment made complying with the pre-existing law is irrecoverable because legislation (unless it provides for retrospection) does not have retrospective effect.<sup>27</sup> On the other hand, where a "general understanding" or "settled view" of the law is later changed by a **judicial decision**, the position is unclear because of the clash of two competing theories as to the effect of judicial decisions.

2.13 **The declaratory theory.** On one theory, the judges do not "change" the law but merely "declare" what the law is and always has been. In other words a judicial decision declaring the law operates retrospectively. So where a payment is made before a judicial decision declaring the law to be different from a previous settled view thereof, and the payment had been made on the faith of, or in accordance with, that settled view, then the payment is, on this "declaratory theory", mistaken and recoverable.

2.14 In our Discussion Paper No 95<sup>28</sup> we had agreed with the Law Commission's observation<sup>29</sup> that the declaratory theory is "a mere fiction and should not be allowed to affect substantive rights". On consultation, however, Lord Coulsfield remarked to us that the declaratory theory could not be dismissed as easily. In his view, "[i]t is, really, no theory, but a fundamental working assumption or basis for the legal system". This view was accepted by us in Discussion Paper No 99<sup>30</sup> and was later referred to with approval in *Kleinwort Benson v Lincoln City Council*.<sup>31</sup>

2.15 **The "settled view" theory.** The English Law Commission took the view that it should not matter whether a change occurs through legislation or judicial decision: the payment should not be recoverable because in their view in substance there has been no mistake.<sup>32</sup> They cited English cases suggesting that where the courts change a settled view of the law there is no mistake (the "settled view" theory).<sup>33</sup> We have not traced comparable Scots cases. While the Law Commission did not expressly attach the declaratory theory, their argument emphasised the "settled view" theory in the context of claims to recover mistaken payments. They thought it "unlikely that the declaratory theory of the common

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theory was rejected. Therefore such a payment is made under error. Therefore an action for its recovery and the "settled view" rule does operate as a defence. While Lord Lloyd (*idem*) preferred the term "safeguard" (another term used in our discussion papers), Lord Hope used the term "defence". We have used both of the terms "safeguard" and "defence" in this report.

<sup>26</sup> In England, there is an analogy in the *Woolwich* case where the House of Lords left it to the Law Commission to suggest defences to a claim for refund of tax overpaid pursuant to an *ultra vires* demand in order to protect public finances from undue disruption: [1993] AC 70 at pp 176-177 per Lord Goff.

<sup>27</sup> Law Com No 227, para 5.2; Law Com CP No 120, para 2.57.

<sup>28</sup> Vol 1, para 2.116.

<sup>29</sup> Law Com CP No 120, para 2.58.

<sup>30</sup> Paras 3.14 and 3.15.

<sup>31</sup> [1998] 4 All E R 513 (HL) at p 535j per Lord Goff.

<sup>32</sup> Law Com No 227, para 5.3; Law Com CP No 120, para 2.58.

<sup>33</sup> *Henderson v Folkestone Waterworks Co* (1885) 1 T L R 329 at p 329 per Lord Coleridge: "at the time the money was paid... the law was in favour of the company"; applied in *Julian v Mayor of Auckland* [1927] NZLR 453; see also *Derrick v Williams* [1939] 2 All E R 559 at p 565. Such cases were distinguished in the *Kleinwort Benson* case [1998] 4 All ER 513 (HL) at pp 536, 537 per Lord Goff.

law would lead the courts to permit recovery where there has been an obvious judicial change in the law" but concluded that the matter could not be safely left to the common law.<sup>34</sup> They therefore recommended:

"that a restitutionary claim in respect of any payment, service or benefit that has been made, rendered or conferred under a mistake of law should not be permitted merely because it was done in accordance with a settled view of the law at the time, which was later departed from by a subsequent judicial decision".<sup>35</sup>

### **"Settled view" theory inconsistent with declaratory theory of judicial law-making**

2.16 We found it difficult to reconcile the "settled view" theory with the declaratory theory of judicial law-making. To say that "where the court changes a settled view of the law there has been in substance no error" seemed to us to presuppose, contrary to the declaratory theory, that the courts do change the law. How far the declaratory theory was correct or false, and whether it applied in the law of unjustified enrichment to open up past transactions, was a difficult and controversial question which this Commission could not resolve. In our Discussion Paper No 99, we remarked that it would be fallacious to say that the judges never change the law: as Lord Reid has observed, that is a fairy-tale.<sup>36</sup> It was equally fallacious to say that the courts never declare the law. In between these two extremes, there were many gradations and many ways of describing what the courts do.<sup>37</sup> The issues were complex. In that paper, differing in emphasis from the Law Commission,<sup>38</sup> we said that there is a real and substantial risk that the courts might hold that a decision changing the settled view of the law had retrospective effect.

### **Rejection of the "settled view" theory by the *Kleinwort Benson* case**

2.17 The question has now been answered by the English case of *Kleinwort Benson Ltd v Lincoln City Council*<sup>39</sup> where the House of Lords, by a majority of three to two, disapproved of the "settled view" theory on the ground that it is inconsistent with the declaratory theory of judicial law-making under which judicial decisions declare what the law is and always has been and so operate retrospectively. They held that a person who pays in accordance with a settled view of the law later overturned by the court has made an error and can recover. As a decision of the House of Lords dealing with a matter of general jurisprudence, it can be taken to apply in Scots law. The speeches also throw much light on the question whether a safeguard should be introduced by statute.

### **The arguments of the minority judges**

2.18 The minority (Lord Browne-Wilkinson<sup>40</sup> and Lord Lloyd<sup>41</sup>) agreed in principle with the majority that the mistake of law rule should be abolished in English law. Differing in principle from the majority, but agreeing with the English Law Commission, they

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<sup>34</sup> Law Com No 227, para 5.7.

<sup>35</sup> Law Com No 227, Recommendation (5) (para 5.13).

<sup>36</sup> Lord Reid, "The Judge as Law-Maker" (1972-73) 12 JSPTL 22 at p 22. See also Lord Mackay of Clashfern, "Can Judges Change the Law?" (1987) 73 *Proceedings of the British Academy* 285.

<sup>37</sup> Eg correcting previous mistaken judicial decisions, clarifying the law, resolving differences between contradictory lines of authority, filling gaps in the law and so on.

<sup>38</sup> Law Com No 227, paras 5.2-5.16.

<sup>39</sup> [1998] 4 All E R 513 (HL).

<sup>40</sup> *Ibid* at pp 517-523.

<sup>41</sup> *Ibid* at pp 545-552.

considered that if at the time of payment the law had been settled by a judicial decision, a payment in accordance with that law was not (on the "settled view" theory) made under a mistake of law, even if the law was subsequently changed by a later judicial decision. They thought it dangerous and "quite wrong" to overturn the English mistake of law rule without holding that closed transactions cannot be reopened.<sup>42</sup> They concluded that the House of Lords should indicate that an alternation of the law is desirable but leave it to the English Law commission and Parliament to produce a statute simultaneously introducing a new cause of Action for mistake of law and properly regulating the limitation period applicable to it.

2.19 This adoption of the "settled view" theory was supported by two policy reasons. First, the prospect of transactions being reopened many years after the event by a subsequent judicial decision should not be favoured by the law, especially in the field of commerce. The defendant would not always be able to rely on a defence of change of position. Certainty and finality were twin policy objectives of the highest order in formulating legal principles.<sup>43</sup> In our view, however, the "settled view" safeguard would create its own uncertainties, and there is a better way of attaining finality through the negative prescription. Second, Lord Lloyd further observed that if the payer and payee both believed at the time of payment that the law accorded with a settled understanding, no moral obligation rested on the payee to repay when the law was subsequently changed by a judicial decision. For if the payee's conscience was affected in such a case, it ought also to be affected if the law was subsequently changed by legislation. Yet nobody suggested that a subsequent change in the law by legislation could ground a claim in restitution.<sup>44</sup> The judges of the majority however considered that the analogy of an Act of Parliament was unhelpful in dealing with a change of law by judicial decision since Parliament can legislate for retrospective effect while judges can only use the common law to remedy injustice.<sup>45</sup>

### **The arguments of the majority judges**

2.20 In giving the leading judgment for the majority,<sup>46</sup> Lord Goff gave a profound analysis of the way in which the common law has been and is developed by the judges. He then observed:

"the law which the judge then states to be applicable to the case before him is the law which, as so developed, is perceived by him as applying not only to the case before him, but to all other comparable cases, as a congruent part of the body of the law. Moreover when he states the applicable principles of law, the judge is declaring these as constituting the law relevant to his decision. Subject to consideration by appellate tribunals, and (within limits) by judges of equal jurisdiction, what he states to be the law will, generally speaking, be applicable not only to the case before him but, as part of the common law, to other comparable cases which come before the courts, whenever the events which are the subject of those cases in fact occurred".<sup>47</sup>

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<sup>42</sup> In this respect, both Lords of Appeal were influenced by the terms of the English Limitation Act 1980, s 32(1)(c) which can only be changed by statute. See para 2.30 below.

<sup>43</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL) at p 549e,f per Lord Lloyd.

<sup>44</sup> *Ibid* at p 549f-h per Lord Lloyd.

<sup>45</sup> *Ibid* at pp 537f-j (Lord Goff); 554c-f (Lord Hoffmann).

<sup>46</sup> *Ibid* at pp 523-540; as to the "settled view: safeguard, see pp 533-540.

<sup>47</sup> *Ibid* at p 535d-f.

2.21 Lord Goff concluded that the declaratory theory was not an aberration of the common law, that it does not presume the existence of an ideal system of the common law revealed by judges, but that it does mean that their decisions have retrospective effect.<sup>48</sup> To hold that the payer made no mistake would be inconsistent with the declaratory theory of judicial law-making. He regarded it as a remarkable feature of the "settled view" principle that "the longer ago the payment was made, the less likely is it to have been made under a settled understanding of the law. An appropriately drawn limitation statute would surely produce a more just result".<sup>49</sup> We revert to this below.<sup>50</sup>

2.22 Lord Hoffmann said that the "settled view" theory looks at the question of what counts as a mistake in too abstract a way, divorced from its setting in the law of unjust (or unjustified) enrichment.<sup>51</sup>

"The problem arises because (1) the law requires that a mistake should have been as to some *existing* fact or ...the then *existing* state of the law but (2) a judicial statement of the law operates retrospectively. So the question is whether the retrospectivity of the law-making process enables one to say that holding a contrary view of the law at an earlier stage was a mistake. This question cannot be answered simply by taking a robust, commonsense definition of a mistake and saying that one does not believe in fairy stories ... The commonsense notion of a mistake as to an existing state of affairs is that one has got it wrong when, if one had been better informed, one could have got it right. But common sense does not easily accommodate the concept of retrospectivity. This is a legal notion.... The lawyer would ...start by considering why, in principle, a person who had paid because he held some mistaken belief should be entitled to recover. The answer is that it is *prima facie* unjust for the recipient to retain the money when, if the payer had known the true state of affairs, he would not have paid."<sup>52</sup>

Under English law since *Kelly v Solari*,<sup>53</sup> in the case of a mistake of fact, the mistaken payer can recover even if he could have discovered the true state of affairs. (The same has been true of Scots law since the *Morgan Guaranty* case in 1995 which abrogated the requirement that an error of fact or law must be excusable for an action of repetition to lie based on error.)<sup>54</sup> In Lord Hoffmann's view the distinction between mistakes of fact and law turned upon the point that in principle the truth or falsity of any proposition of existing fact could have been ascertained at the time, whereas the law, as subsequently declared by the court, could not. He did not think that this should make a difference to a claim in unjust enrichment. In both cases the state of affairs was not what the payer thought: in mistake of fact, because things were actually not what he believed them to have been and, in mistake of law, because of the retrospectivity of the court's decision. In his view, in order to avoid unacceptable anomalies, this retrospectivity required that a payer claiming restitution should be treated as making a mistake of law.<sup>55</sup>

"Imagine a client who has paid under what he thought to be a legal obligation. He had not consulted a lawyer at the time, but seeks advice after a case in the House of Lords which decides that the obligation was void. The lawyer tells him that

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<sup>48</sup> *Ibid* at p 535,g.

<sup>49</sup> *Ibid* at p 539c.

<sup>50</sup> See paras 2.29-2.33.

<sup>51</sup> [1998] 4 All E R 513 (HL) at p 552g,h.

<sup>52</sup> *Ibid* at pp 552h-533c.

<sup>53</sup> (1841) 9 M & W 54.

<sup>54</sup> *Morgan Guaranty Trust Company of New York v Lothian Regional Council* 1995 SC 151.

<sup>55</sup> [1998] 4 All E R 513 (HL) at pp 553d-f.

according to the House of Lords, he need not have paid. He asks whether he can recover his money on the grounds of mistake. On the 'settled view' theory, the lawyer has to say: 'No, because if you had consulted me at the time, I would have told you that you were certainly right to pay. Therefore you made no mistake.' The client asks: 'Does that mean that the obligation was actually valid? If so, what has made it invalid?' The lawyer has to answer 'No, the House of Lords has told us that it was always void. Nevertheless, you made no mistake. On the other hand, if lawyers had regarded it as a doubtful point, or if any lawyer would have told you then that the obligation was void, so that it would have been extremely foolish of you not to have sought advice, then you would have been able to recover.'

"My Lords, it seems to me that the imaginary client would have great difficulty in understanding how these distinctions can arise out of a rule giving a remedy for unjust enrichment. In each case he thought that the obligation was valid and it has subsequently turned out that it was not. In principle, the question should not turn upon what other people might have thought was the law but upon what he thought was the law. And this has turned out to have been wrong, however many lawyers might have agreed with him at the time. So there ought to be a remedy in all cases or none."<sup>56</sup>

2.23 Lord Hope's approach was slightly different. He thought it preferable to avoid being drawn into any discussion as to whether a particular judicial decision changed the law or was merely declaratory.<sup>57</sup> He observed however that it was necessary:

"to face up to the fact that every decision as to the law by a judge operates retrospectively, and to concentrate instead on the question - which I would regard as the critical question - whether the payer would have made the payment if he had known what he is now being told was the law. It is the state of the law at the time of the payment which will determine whether or not the payment was or was not legally due to be paid, and it is the state of mind of the payer at the time of payment which will determine whether he paid under a mistake. But there seems to me to be no reason in principle why the law of unjust enrichment should insist that that mistake must be capable of being demonstrated at the same time as the time when the payment was made. A mistake of fact may take some time to discover. If there is a dispute about this, the question whether there was a mistake may remain in doubt until the issue has been resolved by a judge. Why should this not be so where the mistake is one of law?"<sup>58</sup>

Remarking that the "settled view" safeguard was incapable of precise definition, caused unpredictable absurdities and was lacking in principle, Lord Hope concluded that this Commission's work had shown a need for caution which was fully justified.<sup>59</sup>

### **Introduction of statutory safeguard a question of policy not principle**

2.24 Two consequences of the *Kleinwort Benson* case may be noted. First, the case for statutory reform may now be argued against a stable common law background. We now know that, under the declaratory theory of judicial law-making, a judicial decision is given retrospective effect in the law of unjustified enrichment so as to permit recovery of past payments made, or other benefits conferred, in accordance with a settled view of the law overturned by a later judicial decision.

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<sup>56</sup> *Ibid* at pp 553g-554a.

<sup>57</sup> *Ibid* at p 563e,f.

<sup>58</sup> *Ibid* at p 563f-j.

<sup>59</sup> *Ibid*, pp 566h-567a.

2.25 Second, the decision, confirming the impression given by the *Morgan Guaranty* case, makes it virtually certain that the Scottish courts will not introduce a "settled view" safeguard at common law (except possibly in tax cases thought that possibility seems remote).<sup>60</sup> Lord Hoffman for example observed that the adoption of the "settled view" safeguard "would be a legislative act in a sense in which the abrogation of the mistake of law rule would not" and "would be founded purely upon policy; upon a utilitarian assessment of the advantages of preserving the security of transactions against the inevitable anomalies, injustices and difficulties of interpretation which such a rule would create".<sup>61</sup> Such decisions on legislative policy were regarded as being for Parliament, not the courts.

2.26 It is still arguable that a statutory safeguard may be needed following abolition of the error of law rule to protect the finality of closed transactions and the security of receipts.<sup>62</sup> On the one hand, referring to the division of opinion among law reform bodies, Lord Goff remarked:

"That this whole topic is one of great difficulty can perhaps best be seen in the Scottish Law Commission's *Judicial Abolition of the Error of Law Rule and its Aftermath* (Scot Law Com Discussion Paper no 99) (1996) in which the rival arguments for and against legislative reform are rehearsed in some detail, and the difficulties exposed. This division of opinion does not encourage statutory adoption of a provision in these or comparable terms, still less its recognition as part of the common law of this country".<sup>63</sup>

On the other hand, as we have seen, the need for a statutory safeguard was left open by Lord Hoffman and supported by Lord Browne-Wilkinson and Lord Lloyd. It is necessary therefore to examine the statutory options in the light of our consultation on Discussion Papers Nos 95 and 99.

### **(3) Possible statutory safeguards**

2.27 We have identified four possible options in the formulation of statutory safeguards against reopening settled payment transactions following on a judicial decision changing a settled view of the law. These are:

- (i) prospective overruling;
- (ii) shortening the five year period of negative prescription;
- (iii) introducing a statutory safeguard barring recovery of all payments made before the decision without exceptions; and
- (iv) introducing such a statutory safeguard subject to exceptions.

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<sup>60</sup> On tax cases, see para 2.46 below.

<sup>61</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 at pp 554j-555a.

<sup>62</sup> This is generally reckoned to be the main policy underlying the Judicature Act 1908, s 94A(2) (New Zealand): see Law Reform Commission of British Columbia, Report No 51 on *Benefits Conferred under a Mistake of Law* (1981), p 72: "Section 94A(2) is aimed at closing the 'floodgates of litigation' which might be opened if every overruling of a case or change in jurisprudence gave rise to restitutionary claims"; New South Wales Law Reform Commission Report No 53 on *Restitution of Benefits Conferred Under Mistake of Law* (1987), paras 5.20 and 5.21; New Zealand Law Commission, *Contract Statutes Review, Report No 25*, (1993) para 4.29.

<sup>63</sup> [1998] 4 All E R 513 (HL) at p 540a,b.

We consider these options in that sequence.

**(4) First possible option: prospective overruling**

2.28 In Scot Law Com DP No 95, we rejected the possibility that a safeguard against opening settled transactions might take the form of a statute enabling the court to declare that a judicial precedent is overruled only prospectively.<sup>64</sup> This was accepted by consultees. The Court of Session judges observed that the concept of prospective overruling raises broad issues of principle, and should not be introduced as a mere mechanism or protective adjunct in the present context. This conclusion is fortified by dicta in the *Kleinwort Benson* case.<sup>65</sup>

**(5) Second possible option: shortening the period of the short negative prescription?**

2.29 Although we have not consulted on it, another possible way of protecting the security of receipts would be to amend the Prescription and Limitation (Scotland) Act 1973<sup>66</sup> so as to shorten the period of the short (quinquennial) negative prescription of obligations for the redress of unjustified enrichment (whether by receipt of money, property or the product of services) conferred under error of law or possibly error of fact or law.

2.30 **English law: limitation period runs from time of judicial overruling.** In the *Kleinwort Benson* case,<sup>67</sup> several judges thought that the abrogation of the mistake of law rule would require to be followed by an amendment of the English Limitation Act 1980, s 32(1)(c) which lays down a six year period of limitation of actions which does not begin to run until the "mistake" is discovered.<sup>68</sup> A subsequent overruling of a Court of Appeal decision by the House of Lords could occur many decades after payments have been made on the faith of the Court of Appeal decision. In such a case, "the mistake" would not be discovered until the later overruling.<sup>69</sup> The consequence would be that all payments made pursuant to the Court of Appeal decision would be recoverable subject only to the possible defence of change of position.

2.31 **Scots law: prescriptive period runs from date of payment.** By contrast, in Scots law, under the 1973 Act, the five year period of the negative prescription of an obligation of repetition of an undue payment begins to run on the date when the recipient is enriched<sup>70</sup> which, in the case of an enrichment by receipt of an undue payment, normally means the date when the payment was received.<sup>71</sup> The period may be extended only where the creditor was induced to refrain from making a claim by fraud, or by error induced by the debtor's words or conduct, or was under a legal disability.<sup>72</sup> So the problem of unduly long time limits does not arise in Scotland.<sup>73</sup>

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<sup>64</sup> Vol 1, Proposition 3(3) (para 2.125).

<sup>65</sup> [1998] 4 All E R 513 (HL) at p 536a per Lord Goff: "a system of prospective overruling ...although it has occasionally been adopted elsewhere with, I understand, somewhat controversial results, has no place in our legal system".

<sup>66</sup> Section 6 and Sch 1, para 1.

<sup>67</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL).

<sup>68</sup> *In re Diplock* [1948] Ch 465 (CA) at p 515.

<sup>69</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL) at p 523d per Lord Browne-Wilkinson.

<sup>70</sup> *NV Devos Gebroeder v Sunderland Sportswear Ltd* 1990 SC 291.

<sup>71</sup> Cf *Royal Bank of Scotland v Watt* 1991 SC 48 at pp 58; 62; and 65.

<sup>72</sup> 1973 Act, s 6(4).

<sup>73</sup> See *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 at p 569e,f per Lord Hope.

2.32 The result is that a statutory or common law safeguard against reopening settled payment transactions is much less necessary in Scotland than it is in England.

2.33 We do not think that the case has been made out for shortening the five year period of negative prescription of obligations to repay undue payments made under error of law. It would be wrong to reintroduce in an important context the anomalous and sometimes unworkable distinction between errors of fact and errors of law which the *Morgan Guaranty* case abolished. In that case, Lord Clyde said that the five year prescriptive period gave adequate protection against reopening transactions.<sup>74</sup> Moreover in the *Kleinwort Benson* case, Lord Hope thought that even against the background of the longer limitation period in English law, the risk of widespread injustice remains to be demonstrated.<sup>75</sup> The defence of change of position would be available and difficulties of proof are likely to increase with the passage of time.<sup>76</sup> The English Law Commission have provisionally proposed a uniform long-stop period of limitation of actions of ten years from the date of the defendant's act or omission giving rise to the claim<sup>77</sup> which they provisionally consider should apply to restitutionary claims.<sup>78</sup> Against this background, the present Scottish five year period seems reasonable.

#### **(6) Third possible option: statutory "settled view" safeguard without exceptions**

2.34 In our Discussion Paper No 99, we said that a "settled view" safeguard against reopening closed transactions is not based on principle or equity but rather on the policy of protecting security of receipts.<sup>79</sup> It cannot be based on equity because a commonly held mistake of law is more likely to be excusable than a mistake of law by one person.<sup>80</sup> An analogy may be drawn with the law on negative prescription which is also a policy-led device for cutting off just claims for redress of unjustified enrichment with a view to attaining finality and protecting the security of receipts.

2.35 Several commentators on our earlier Discussion Paper No 95 have misgivings about the concept of "common understanding". The Court of Session judges, for example, remarked that there may be a common understanding of the law which has been identified by legal advisers as a misunderstanding and argued that the concept of "common understanding" does not provide the appropriate criterion, departure from which may be taken as in some sense an error. In separate comments, Lord Coulsfield remarked:

"At any given time, there are some areas of the law which can be regarded as reasonably fixed and others which cannot be so regarded, and the degree of uncertainty in the latter areas varies infinitely. How would the paper's proposed solution apply to a case in which 60% of lawyers if consulted would have given an opinion one way and 40% the other? Or if the proportions were 70%/30%? If you are not careful, you may end up with a solution which makes the possibility of recovery depend on the quality of advice available to the person affected, either at the time of the transaction or the time when the possible error is noticed.... If some basis of this kind were to be taken, it seems to me that it would be better to say "a

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<sup>74</sup> 1995 SC 151 at p 172C,D.

<sup>75</sup> [1998] 4 All E R 513 at p 569d,e.

<sup>76</sup> *Idem*.

<sup>77</sup> Law Commission, Consultation Paper No 151 on *Limitation of Actions* (1998) proposals 15.16-15.18

<sup>78</sup> *Ibid*, proposal 15.48 (para 13.83).

<sup>79</sup> Scot Law Com DP No 99, para 3.29.

<sup>80</sup> *Idem*; *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 at p 566j,567a per Lord Hope.

view of the law reasonably held at the time", but that would be not more than a minor improvement."

2.36 The Faculty of Advocates drew attention to certain practical difficulties. They observed that in practice, the payee would presumably have to establish that solicitors and counsel advising clients at the time of payment had had a common understanding. If the state of the law had been an open or controversial question then the defence would fail. The Faculty and another commentator remarked that "landmark" decisions changing the law<sup>81</sup> are commonly preceded, not by a common understanding which was controverted by the decision, but by a vigorous debate within the profession as to the true state of the law. In such cases, the defence would not be available. So probably the defence would be difficult to establish and apply only in a restricted number of cases. The Unjustified Enrichment Working Part of the Law Society of Scotland initially agreed that a statutory bar to recovery was necessary but had reservations about the formulation of the proposal and observed that they would wish to examine any draft Bill closely in this respect.

**(7) Fourth option: statutory "settled view" safeguard subject to exceptions**

2.37 It is possible that a "settled view" safeguard against reopening closed transactions would be more acceptable if appropriate exceptions were made to it. For example, arguably, a person who makes a payment on the faith of a settled view of the law and subsequently raises a successful action overturning the settled view (the payer-challenger) has a specially strong claim to be allowed to recover for three reasons. First, otherwise in many cases persons making payments under error of law would have no incentive to challenge the mistaken settled view of the law.<sup>82</sup> Second, it would seem very unjust if his success in challenging the settled view benefited others but did not benefit him. The payer-challenger should enjoy the fruits of his efforts and expense and should be rewarded for risking the uncertainties of litigation. As Professor D M Walker remarked: "No doubt past transactions cannot be opened but surely the man who makes the challenge should not be barred".<sup>83</sup> Third, if the bar to recovery should rest on the policy of not opening a wide circle of payment transactions, the challenger-payer may nevertheless recover. One case, that of the challenger, is not a wide circle; if only his case is to let in, no floodgates are opened.

2.38 For these reasons, in our Discussion Paper No 95, we sought views on a provisional proposal that the payer-challenger should recover.<sup>84</sup> It emerged on consultation however that drawing a line between the payer-challenger and others would create anomalies. Lord Coulsfield argued that there is no equity in a distinction between those affected by the statutory safeguard who cannot recover and those falling within the exceptions who can.

"The person who challenges the mistake may simply be the person who has the funds to take a risk which others cannot afford to take, or the person who happens to consult a legal adviser who is prepared 'to have a go' as opposed to the adviser who may reasonably be regarded as more prudent".

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<sup>81</sup> The Faculty referred to *R H M Bakeries (Scotland) Ltd v Strathclyde Regional Council* 1985 SC (HL) 17; *Armout v Thyssen Edelstahlwerk A G* 1990 SLT 891 (HL) as examples.

<sup>82</sup> Cf Pannam, "Recovery of Unconstitutional Taxes" (1964) 42 Texas Law Review 777 at pp 802, 803, fn 97; cited in Scot Law Com No 95, vol 1, para 2.114.

<sup>83</sup> Case-note, 1959 J R 218.

<sup>84</sup> Scot Law Com DP No 95, vol 1, para 2.124 and Proposition 3(4) (para 2.125).

He argued that if there were to be a remedy for error of law, the approach of the British Columbia Commission<sup>85</sup> was the correct one so that everyone affected by the error should recover if the error were excusable.<sup>86</sup>

2.39 Moreover, it would sometimes be difficult in practice to confine the exception to the payer-challenger. Although Scottish court procedure does not as yet allow "class" or "multi-party" actions,<sup>87</sup> parties acting in concert may raise actions at the same time and seek to have their actions joined.

2.40 In our Discussion Paper No 95, we also sought views on a second possible exception allowing recovery by any other person who had made a payment under the same error and claimed repayment in an action commenced before the date of the judicial decision in the payer-challenger's action.<sup>88</sup> The *Blaizot* case,<sup>89</sup> in which the European Court assumed a power of prospective overruling, affords a precedent for such a rule. If several sue and one is picked out as a test case, it would bear hard on the allows to disallow recovery.

2.41 On the other hand, since the policy underlying the safeguard is finality in a wider circle of payment transactions, the safeguard would only work well if the exceptions did not apply to such a circle. Cases falling within the exceptions should not be so numerous as to render the safeguard ineffective. On consultation, the Convention of Scottish Local Authorities (COSLA) and the Society of Directors of Administration in Scotland (SODAT) commented that the exceptions to the bar to recovery could be open to exploitation or abuse. Thus SODAT observed that where a test case was being taken it would be relatively easy for the person promoting the test case to advise persons in a similar position to start proceedings prior to the decision in the test case. They referred to a case where the Police Federation and the Fire Fighters Union advised their members to lodge claims with industrial tribunals in advance of the decision of the European Court in the *Coloroll* case.<sup>90</sup> In the United Kingdom, it is estimated that 140,000 claims were lodged.<sup>91</sup> We think that these fears are well founded.

2.42 If however the safeguard were to be enacted without the exceptions, the scope of the abolition of the error of law rule would be very narrow. The only payers who would be entitled to recover would be those whose error was not linked to a subsequent change in a settled view of the law. While such cases do occur,<sup>92</sup> there are as many (if not more) cases in which an action of repetition is raised because a judicial decision has overturned the settled view of the law under which the payment was made.<sup>93</sup> Yet a payment based on a settled

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<sup>85</sup> Law Reform Commission of British Columbia, Report No 51 on *Benefits Conferred under a Mistake of Law* (1981), p 72, quoted in Scot Law Com DP No 95, vol 1, para 2.111.

<sup>86</sup> Lord Coulsfield's conclusion that there is no equitable way of restricting the ambit of recovery reinforced his doubts about abolition of the error of law rule itself.

<sup>87</sup> See our Discussion Paper No 98 on *Multi-Party Actions: Court Proceedings and Funding* (1994); see also *Multi-Party Actions: Report by Working Party set up by Scottish Law Commission* (1994).

<sup>88</sup> Scot Law Com DP No 95, vol 1, para 2.124 and Proposition 3(4) (para 2.125).

<sup>89</sup> Case 24/86 *Blaizot v University of Liège* [1989] 1 CMLR 57, discussed in Scot Law Com DP No 95, vol 1, para 2.113.

<sup>90</sup> *Coloroll Pension Trustees Ltd v Russell* C 200/91; [1995] 2 CMLR 357.

<sup>91</sup> Other cases of co-ordinated action include actions arising out of sudden disasters (eg Piper Alpha) or "creeping disasters" (eg Thalidomide deformities), or financial disasters arising from fraud (eg BCCI, the Mirror Pension Fund) or other fault (Lloyds of London).

<sup>92</sup> Eg *Bremner v Taylor* (1866) 3 SL Rep 24 (OH); *McNair v Arrol* 1952 SLT (Sh Ct) 41; *Taylor v Wilson's Trs* 1975 SC 146; *Ali v Wright* 1989 GWD 11-456.

<sup>93</sup> Eg *Oliver v Scott*, Bell, *Illustrations* vol 1, p 328; *Meiklejohn v Erskine* 31 January 1815 FC; *Dixon v Monkland Canal Co* (1831) 5 W and S 630; *Hogath v Dewar and Webb* (1897) 13 Sh Ct Repts 314; *Manclark v Thomson's Trs*, 1958 SC

view of the law is more likely to be excusable than a payment under an error of law entertained by only one payer.<sup>94</sup>

## (8) Consultation

2.43 In Discussion Paper No 99 we suggested that the case for a statutory safeguard, with or without exceptions, (the third and fourth options respectively) was not sufficiently strong to justify the intervention of statute. On consultation on that paper, most of those who commented agreed with this view.<sup>95</sup> The Sheriffs Association suggested that a statutory safeguard was unnecessary because "[t]he *condictio indebiti* would remain an equitable remedy and Courts would, no doubt, take an equitable approach in determining whether or not a transaction should be re-opened". The Faculty of Advocates said that the case for a statutory safeguard, with or without exceptions, was not sufficiently strong to justify statutory intervention, that the tenor of the judgments in *Morgan Guaranty* was against such a bar, and that there was much to be said for the view that, after abolition of the error of law rule, all payers affected by such an error should recover, subject to the courts taking an equitable approach in determining whether or not a transaction should be re-opened. Professor MacQueen said that in principle it would seem wrong that the likeliest defender to be protected by such a bar - the State in some manifestation or other - should be able to retain payments made to it under a wrong view of the law. In his view the floodgates argument is unimpressive when the State has machinery to effect repayment which it has used in the past eg in refunding sports clubs overpayments of VAT. He thought that further reform is best left to the judges either developing ideas of equity or the excusability of the error which are referred to in *Morgan Guaranty*.

2.44 Aberdeen University considered that the quinquennial negative prescription<sup>96</sup> would be an adequate safeguard. Dr J E du Plessis and Professor D P Visser also opposed a statutory safeguard pointing out that the "floodgates" situation has proved - at least in South Africa where the error of law rule was abandoned in 1992<sup>97</sup> - not to be a real threat, although they conceded that taxes might be different. They accepted that the "settled view of the law" defence was more principled than a "general practice" defence, but urged us to reconsider building such an important piece of legislation round an essentially contested concept such as "settled view of the law", which was likely to be unacceptably uncertain.<sup>98</sup>

2.45 A few consultees did not agree with our suggested approach. The University of Glasgow supported a statutory safeguard without exceptions (the third option). They

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147; *Glasgow Corporation v Lord Advocate* 1959 SC 203. See also *Haggarty v Scottish TGWU* 1955 SC 109, where repetition was allowed.

<sup>94</sup> In saying this, we do not overlook the fact that the excusability requirement has been abolished. It is still relevant to the making of legislative policy.

<sup>95</sup> University of Aberdeen, Faculty of Advocates, Dr J E du Plessis and Professor D P Visser (joint comments), Mr G Jamieson, Law Society of Scotland, Professor H L MacQueen, Mr A J M Steven.

<sup>96</sup> Prescription and Limitation (Scotland) Act 1973, s 6.

<sup>97</sup> *Willis Faber Enthoven (Pty) Ltd v Receiver of Revenue* 1992 (4) SA 202 (A).

<sup>98</sup> They argued that the uncertainty admittedly present in the "prevailing practice" defence is manageable in that an actual practice in a particular government office has to be established. The variables that would be introduced by adopting the "settled view" defence are so numerous that it will almost certainly create greater uncertainty and increase litigation. They referred to two other devices - short time limits and deferment of payment - as possible safeguards for governmental bodies refunding overpaid taxes.

favoured finality, pointed to the difficulties of a "settled view" principle,<sup>99</sup> and argued that exceptions would inspire litigation.

### **Are fiscal debts special?**

2.46 The Inland Revenue opposed major changes in relation to taxes administered by them, expressly opposed abolition of the "general practice" defence in statutory claims for refunds<sup>100</sup> and seemed by implication to favour a statutory safeguard in common law actions of repetition of undue tax paid under error of law. The possibility of a special safeguard in tax cases was referred to by Lord Goff in the *Kleinwort Benson* case.<sup>101</sup> He observed that:<sup>102</sup>

"in cases concerned with overpaid taxes, a case can be made in favour of a principle that payments made in accordance with a prevailing practice, or indeed under a settled understanding of the law, should be irrecoverable. If such a situation should arise with regard to overpayment of tax, it is possible that a large number of taxpayers may be affected; there is an element of public interest which may mitigate against repayment of tax paid in such circumstances; and, since ex hypothesis all citizens will have been treated alike, exclusion of recovery on public policy grounds may be more readily justifiable". (emphasis added)

This was against the background of the existence in English law of a separate and distinct restitutionary regime for taxes and other similar charges which when exacted *ultra vires*, are recoverable as of right at common law under the principle in the *Woolwich* case<sup>103</sup> as well as statutory regimes on refunds.<sup>104</sup> By contrast, as we have seen, the court in *Morgan Guaranty* though the *Woolwich* case showed that the public interest in finality of transactions should not outweigh the interest of private individuals in recovering undue payments.<sup>105</sup> So far as common law claims are concerned, consultation did not reveal widespread support for giving public authorities a special defence not available to private citizens and bodies.

### **(9) Conclusions and recommendation**

2.47 To put our views on the settled view safeguard in context, we summarise our general conclusions on safeguards against reopening settled payment transactions as follows.

(a) Since in legal theory the courts declare what the law is and always was and do not change the law, undue payments made on the faith of, or in accordance with, a settled view of the law later changed by a judicial decision will be treated as made under error and therefore are in principle recoverable under the law of unjustified enrichment subject to the normal defences to a claim based on redress of unjustified enrichment including change of position.<sup>106</sup> In Scotland there is authority to the effect

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<sup>99</sup> "At what point in time would a settled view of the law be deemed to lose its settled character? As the need for 'change' became more obvious, how reasonable would it be to cling to the older settled view?"

<sup>100</sup> Taxes Management Act 1970, s 33(2).

<sup>101</sup> [1998] 4 All E R 513 at pp 537j-538f.

<sup>102</sup> *Ibid* at p 538e,f.

<sup>103</sup> *Idem*.

<sup>104</sup> At paras 3.51-3.58 below, we consider whether a statutory "settled view" safeguard might be introduced as a defence to claims under statute for the refund of overpaid central and local government taxes and rates.

<sup>105</sup> 1995 SC 151 at p 172C,D per Lord Clyde quoted at para 2.9 above.

<sup>106</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL).

that the specific ground is error<sup>107</sup> though the claim may possibly be based on a broader ground.<sup>108</sup>

(b) The decisions and dicta in the *Morgan Guaranty* and *Kleinwort Benson* cases make it extremely unlikely that the Scottish courts would introduce at common law a safeguard against reopening payment transactions following a judicial decision overturning a settled view of the law because such a safeguard could not be founded upon principle and equity but only on policy considerations.<sup>109</sup>

(c) Therefore such a safeguard could only be introduced by statute.

(d) There is no support for a safeguard in the form of prospective overruling (the first option).<sup>110</sup>

(e) The five year period of negative prescription provides a reasonable safeguard against the reopening of long settled payment transactions and need not be shortened (the second option).<sup>111</sup> Since the period of negative prescription begins to run on the date of the payment or enrichment itself rather than (as in England) on the later date of the judicial decision changing the law, no amendment of the Prescription and Limitation (Scotland) Act 1973 comparable to that suggested for the English Limitation Act 1980 is necessary.<sup>112</sup>

2.48 In summary, a statutory "settled view" safeguard with or without exceptions (the third and fourth options) should not be introduced in common law claims for the following reasons.

(i) Such a safeguard would create anomalous distinctions barely intelligible to most laymen who would not understand how they could arise out of principles of unjustified enrichment.<sup>113</sup> In particular a layman would find it very difficult to understand why if an obligation to pay had always been invalid, he was nevertheless under no error in assuming it to be valid when making the payment (with the result that he could not recover it).

(ii) In principle, the right of a payer to recover on the ground of error should not turn upon what other people might have thought was the law at the time of his payment but upon what he thought was the law at that time. If his view of the law is overturned by judicial decision, it has turned out to have been wrong, however many lawyers might have agreed with him at the time. So there ought to be a remedy in all cases or none.<sup>114</sup>

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<sup>107</sup> *Morgan Guaranty Trust Company of New York v Lothian Regional Council* 1995 SC 151 at p 165D,E per Lord President Hope.

<sup>108</sup> See eg R Evans-Jones and P Hellwege, "Swaps, Errors of Law and Unjustified Enrichment" (1995) 1 SLPQ 1.

<sup>109</sup> See para 2.25 above.

<sup>110</sup> See para 2.28 above.

<sup>111</sup> See para 2.29 above.

<sup>112</sup> See paras 2.30-2.33 above.

<sup>113</sup> See para 2.22 above.

<sup>114</sup> *Idem*.

(iii) A payment based on a "settled view of the law" is more likely to be excusable than a payment under an error of law entertained by only one payer. It would be highly anomalous if the former error barred recovery which the latter error did not.<sup>115</sup>

(iv) Following abolition of the error of law rule there is no equitable way of restricting the ambit of recovery to a particular payer or classes of payer. Thus as a minimum the payer-challenger should recover since it would be most unjust if his success in challenging the settled view benefited others but did not benefit him. Yet he may simply be the person who has the funds to take a risk which others cannot afford to take, or the person who happens to consult a legal adviser who is prepared 'to have a go' as opposed to the adviser who may reasonably be regarded as more prudent.<sup>116</sup> A further exception allowing recovery by persons commencing proceedings before the decision in the payer-challenger's action would mean that organisations with multiple debtors could be faced with co-ordinated action exploiting or abusing any exceptions to the safeguard.<sup>117</sup>

(v) Since the provisions of the 1973 Act on the short (five years) negative prescription are satisfactory, a statutory or common law safeguard against reopening settled payment transactions is less necessary in Scotland than it is in England.

(vi) It is an anomalous feature of the "settled view" safeguard that the longer ago the payment was made, the less likely is it to have been made under a settled understanding of the law. The negative prescription produces a more just result than would a "settled view" safeguard.<sup>118</sup>

(vii) The concept of a "settled view of the law" is likely to be unacceptably uncertain, causing difficulties of proof and expensive litigation with an unpredictable outcome. In this respect it compares unfavourably with the relative clarity and certainty of the rules on negative prescription.

(viii) In other legal systems where the error of law rule has been abolished by judicial decision,<sup>119</sup> no "settled view" safeguard has as yet proved necessary.

For reasons such as these, the "settled view" safeguard has been rightly described as incapable of precise definition, lacking in principle and productive of unacceptable anomalies and unpredictable absurdities.<sup>120</sup>

2.49 We recommend:

**Where payments are made on the faith of a settled view of the law to the effect that the payments are due, and that view is later changed by a subsequent judicial decision, recovery of the payments should not be barred by statute but should continue to be regulated by the common law (under which the payments will be**

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<sup>115</sup> See paras 2.34 and 2.42 above.

<sup>116</sup> See paras 2.37, 2.38.

<sup>117</sup> See paras 2.40, 2.41.

<sup>118</sup> See paras 2.21, 2.29-2.33.

<sup>119</sup> Ie Australia, Canada, and South Africa.

<sup>120</sup> See para 2.23 above.

recoverable unless the court finds that it would be inequitable to order repayment).

(Recommendation 1)

## B. SHOULD THE *WOOLWICH* RULE BE INTRODUCED INTO SCOTS LAW BY STATUTE?

2.50 In the English case of *Woolwich Equitable Building Society v IRC*,<sup>121</sup> the House of Lords held that a citizen who makes an undue payment of tax or similar levy to a public authority pursuant to an *ultra vires* demand has a prima facie right to repayment, subject to the general restitutionary defences such as change of position. This decision introduced in English law a new ground of restitution (sometimes referred to as "the *Woolwich* rule") which permits restitution of *ultra vires* public authority receipts without the need to establish the normal restitutionary grounds such as error or improper compulsion. The decision proceeded on an analysis of the pre-existing law of England. The only Scottish authorities cited, namely the *Glasgow Corporation* and *British Oxygen Company* cases,<sup>122</sup> had been decided largely on the basis of English authority. What however was the Scots law prior to the *Woolwich* case?

### The constitutional principle of automatic recovery

2.51 **The constitutional principle against taxation without Parliamentary authority.** Where a citizen in Scotland pays the Crown undue tax in response to an *ultra vires* demand, and the Crown refuses repayment, there is technically no breach of the letter of the provisions of the Claim of Right 1689 concerning taxation,<sup>123</sup> since those provisions merely prevent the Crown from granting revenue-raising powers to third parties without Parliamentary consent.<sup>124</sup> Those provisions therefore do not in terms apply to a case where the demand is made, and the payment is retained, by or on behalf of the Crown itself.

2.52 Though the Bill of Rights 1689 was not among the pre-Union English Acts applied by the Treaty of Union to Scotland, there is of course no doubt that the principle of no taxation by the Crown or others without Parliamentary consent, enshrined in the Bill of Rights<sup>125</sup> (and relied on in the *Woolwich* case<sup>126</sup>), applies in Scots law as in other parts of the

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<sup>121</sup> [1993] AC 70 (HL affg CA), revg [1989] 1 WLR 137.

<sup>122</sup> *Glasgow Corporation v Lord Advocate* 1959 SC 203; *British Oxygen Co v South of Scotland Electricity Board* 1959 SC (HL) 17; affg 1958 SC 53.

<sup>123</sup> "The Declaration of the Estates of the Kingdom of Scotland containing the Claim of Right and the offer of the Crowne to the King and Queen of England"; APS 1689, c 28. This enacts: "the give gifts or grants for raising of money without the Consent of Parliament or Convention of Estates is Contrary to law".

<sup>124</sup> The reason for the difference between the taxation provisions of the Claim of Right and of the Bill of Rights probably lies in the different relations between the Crown and the two legislatures in the seventeenth century. The Crown in Scotland was expected to live off its own revenues but "extraordinary taxation", agreed by the Scottish Parliament, had become regular. See G Donaldson *Scotland: James V to James VII* (1965) p 302; D Stevenson *The Scottish Revolution: 1637-44* (1973) p 42. It seems likely that the abuse struck at by the Scottish provisions was the King's alienation to the subject of the power to raise revenues, eg the gift for 16 years by Charles I to the Marquis of Hamilton of the impost on wines, the largest single source of Crown revenues. See D Stevenson "The King's Scottish Revenues and the Covenanters, 1625-1641" (1974) 17 *Historical Journal* 17 at pp 21, 22. Such grants were thought to make resort to extraordinary Parliamentary taxation necessary.

<sup>125</sup> 1 W & M, c. 36, Article 4 provides: "That levying money for or to the use of the Crowne by pretence of prerogative without grant of Parlyament for longer time or in other manner than the same is or shall be granted is illegal."

<sup>126</sup> [1993] AC 70 (HL) at p 172E per Lord Goff; (CA) at p 97E per Glidewell LJ.

United Kingdom,<sup>127</sup> and may be implicit in the Claim of Right if it is construed liberally and in its historical context.

**2.53 Scots precursors of the *Woolwich* case.** The *Woolwich* case has few precursors in Scots law. There are two older Scots cases which could be explained as based on the constitutional principle of no taxation without Parliamentary consent, and an implied right of repetition derived therefrom. In neither was the opinion of the judges reported.<sup>128</sup> It would have been possible to construe the *Magistrates of Dunbar* case<sup>129</sup> as based on fundamental constitutional principles, and in particular on an automatic constitutional right to repayment of authorised taxes unwarrantably exacted.<sup>130</sup> The constitutional potential of the case was not fully realised and developed perhaps because the grounds of judgment were not reported. With one or two very doubtful exceptions, none of the reported modern Scots cases decided before *Glasgow Corporation v Lord Advocate*<sup>131</sup> on claims for repayment of central government taxes lend any support to the existence of a general automatic common law right to repayment.<sup>132</sup> In one case duty paid apparently in error of law was recoverable by set-off in circumstances where, because of the (now abolished) error or law rule, repetition could not have been claimed.<sup>133</sup> There may therefore have been an anomalous difference between the grounds of the remedy of direct repetition of payments made in response to unlawful demands and the grounds of the remedy of giving credit for such a payment in adjusting accounts. In *Glasgow Corporation v Lord Advocate*<sup>134</sup> the First Division held that a taxpayer does not have an automatic right based on Article 4 of the Bill of Rights to recover from the Crown undue tax paid in error.

**2.54 The *Woolwich* case.** The decision in the *Glasgow Corporation* case, however, based as it was largely on English authority,<sup>135</sup> has been undermined by the decision of the House of Lords in *Woolwich Equitable Building Society v IRC*<sup>136</sup> conferring on a tax payer a prima facie right of recovery of undue payments of tax based on the mere facts that the payment was undue and that the public authority's demand for payment was *ultra vires*.

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<sup>127</sup> See eg *Boog v Magistrates of Burntisland* (1775) Mor 1991; *Glasgow Corporation v Lord Advocate* 1959 SC 203.

<sup>128</sup> *Murray v Thomson* (1826) 5 S 183 (repetition ordered of over-charges of sheriff-clerks' fees not sanctioned by the relevant act of sederunt); *Magistrates of Dunbar v Kelly* (1829) 8 S (repetition of customs dues on exports of fish levied by burgh *ultra vires* purportedly under statute; defence of *bona fide* consumption repelled). Distinguished in *Bell v Thomson* (1867) 6 M 64 where Lord Cowan at p 69 wrongly assumed that the magistrates retained the money. Applied in *Unigate Foods Ltd v Scottish Milk Marketing Board* 1975 S C (HL) 75 at p 90 per Lord President Emslie (obiter).

<sup>129</sup> (1829) 8 S 128.

<sup>130</sup> The Session Papers disclosed that no direct reference was made to broad constitutional principle of the Claim of Right or Bill of Rights. However the sheriff (8 S at p 129) cited *Boog v Magistrates of Burntisland* (1775) Mor 1991 in which constitutional principle was relied on and in which *Campbell v Hall* (1774) 1 Cowp 204; 20 State Trials 239 was cited, though the case did not involve repetition.

<sup>131</sup> 1959 SC 203.

<sup>132</sup> *Galletly's Trs v Lord Advocate* (1880) 8 R 74; *Lord Advocate v Marquis of Ailsa* (1881) 9 R 40; *Russell v North of Scotland Bank* (1891) 18R 543; *National Bank of Scotland v Lord Advocate* (1892) 30 SL Rep 579; *Alston's Trs v Lord Advocate* (1895) 33 SL Rep 278; *Watherston's Trs v Lord Advocate* (1901) 3 F 429; *Sprot's Trs v Lord Advocate* (1903) 10 SLT 452. Perhaps the only case which could be construed as favouring such a right is *Lord Advocate v Marquis of Ailsa* but that related to recovery by set-off.

<sup>133</sup> In *Lord Advocate v Marquis of Ailsa* (1881) 9 R 40, it was held that where a person paid succession-duty on woodlands which was not due, he was entitled, in an accounting under statute for the duty payable on sale of timber in the future, to credit for the previous undue payments.

<sup>134</sup> 1959 SC 203.

<sup>135</sup> The Crown relied on *National Pari-Mutuel Association Ltd v The King* (1930) 47 TLR 110 (CA); *William Whiteley Ltd v The King* (1909) 101 LT 741; and contended that *Attorney-General v Wilts United Dairies Ltd* (1921) 37 TLR 884 was not in point.

<sup>136</sup> [1993] AC 70 (HL affg CA), revg [1989] 1 WLR 137.

2.55 **Scottish cases subsequent to the *Woolwich* case.** Subsequently in the Scottish *Morgan Guaranty* case, Lord President Hope said that the Inner House's decision in that case achieved the same result as the decision in *Woolwich* but "by reference to the principles of Scots law".<sup>137</sup> This view is not without its difficulties.<sup>138</sup> In *Morgan Guaranty* neither the problem of payments of *ultra vires* levies to public authorities nor the constitutional argument based on the Bill of Rights 1689, article 4, were addressed simply because neither issue was relevant. The decision in the *Morgan Guaranty* case removed the error of law bar to an action of repetition on the ground of error. Its precise *ratio decidendi* appears therefore to be limited to a claim based on an erroneous belief on the part of the payer that the payment was due and does not apply to the facts in the *Woolwich* case. That case concerned not a payment in error but a payment made under reservation of rights of recovery by the building society plaintiff which at all material times had denied that the payment was due, and was under no error as to the relevant law. The building society had paid the undue tax for a motive quite different from error, namely in order to avoid any adverse publicity which might arise from delay in payment. The Court's decision in *Morgan Guaranty* removed the error of law rule or defence will enable actions of repetition based on error to succeed, but does not by itself add a new ground of repetition equivalent to the *Woolwich* ground applying in cases in which (like *Woolwich* itself) the payment was not made in error.

2.56 The Lord President's dictum does however strongly suggest that the *Woolwich* rule as such does not apply in Scotland, and that the Scottish courts would reach that result in his words "by reference to the principles of Scots law". As his Lordship said, "it would be inequitable that a remedy which is now available in England in this important field of transactions between the citizen and a public authority should be denied here on the ground that it was not permitted by our law".<sup>139</sup> We have little doubt that the Scottish courts would give the taxpayer a remedy at common law to recover an overpayment of tax made in response to an *ultra vires* demand. In an authoritative chapter on this topic in a leading textbook, the claim is subsumed under the *condictio sine causa*<sup>140</sup> though it has also been argued that the claim is a *conditio indebiti*.<sup>141</sup> The emphasis in recent cases on the general principle underlying a claim of repetition also leads to the conclusion that a remedy for the redress of public authority's unjustified enrichment at the taxpayer's expense would lie. In *Morgan Guaranty*, for example, the court deduced the error requirement from the need in a repetition claim to negative an intention of donation on the part of the payer at the time of payment.<sup>142</sup> A payment by way of undue tax pursuant to an *ultra vires* demand likewise negatives an intention of donation. In the *Dollar Land* case, Lord Cullen observed:

"A person may be said to have received unjustified enrichment at another's expense when he has obtained a benefit from his actings or expenditure, without there being a legal ground which would justify him in retaining that benefit, and it is in accordance with equity that he should account for that enrichment".<sup>143</sup>

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<sup>137</sup> 1995 SC 151 at 165B,C.

<sup>138</sup> See our Discussion Paper No 99, paras 4.41-4.47.

<sup>139</sup> 1995 SC 151 at p 165C.

<sup>140</sup> W A Wilson and A Forte (eds), *Gloag and Henderson, The Law of Scotland* (10th edn; 1995) para 29.7, p 476, fn 49 citing the *Woolwich* case as persuasive authority, together with *British Oxygen Co Ltd v South West Scotland Electricity Board* 1959 SC (HL) 17 and *British Railways Board v Glasgow Corporation* 1976 SC 224.

<sup>141</sup> See eg R Evans-Jones, "Some Reflections on the Conditio Indebiti in a Mixed System" (1994) 111 SALJ 759; R Evans-Jones and P Hellwege, "Swaps, Error of Law and Unjustified Enrichment" (1995-96) 1 SLPQ 1.

<sup>142</sup> 1995 SC 151 at p 165E per Lord President Hope; at p 175 F,G per Lord Cullen.

<sup>143</sup> *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1996 SC 330, at pp 348, 349 approved in *Shilliday v Smith* 1998 SC 725 at p 727C per Lord President Rodger.

Again in *Shilliday v Smith*,<sup>144</sup> Lord Caplan remarked:

"The simple equitable formulation of the rules arising from unjust enrichment would perhaps be: 'Is it right that a person should be entitled to retain a valuable benefit in circumstances where the person who conferred it had no intention that he should keep it?'"

### **New ground of repetition limited to public sector debts or bodies?**

2.57 We believe that, as a matter of principle and policy, there is a virtually unanswerable case for giving the citizen a remedy on the *Woolwich* facts. To that extent, the decision of the House of Lords in the *Woolwich* case is to be welcomed. The difficulty we have however lies in accepting that the introduction of a new ground of repetition limited to public sector debts or bodies (however defined) provides the best path to reform.

2.58 In the *Woolwich* case, Lord Goff said that one objection to this decision:

"is to be found in the structure of our law of restitution, as it developed during the 19th and early 20th centuries. That law might have developed so as to recognise a *condictio indebiti* - an action for the recovery of money on the ground that it was not due. But it did not do so. Instead, ...there developed common law actions for the recovery of money paid under a mistake of fact, and under certain forms of compulsion. What is now being sought is, in a sense, a reversal of that development *in a particular type of case; ...*"<sup>145</sup> (emphasis added)

The last words are important since they, together with other dicta,<sup>146</sup> show that English law is still committed to a system of very specific grounds of restitution.

2.59 The *Woolwich* case gave little guidance as to the type of public debts to which the new ground of recovery should apply and there is considerable uncertainty as to what the criterion of scope should be.<sup>147</sup> In principle the scope of the *Woolwich* rule should be governed by the justifications of legal principle or legal policy which the rule is designed to promote.

2.60 This however is exceedingly difficult to accomplish. At least nine justifications were mentioned in the *Woolwich* case itself<sup>148</sup> and at least eight other jurisdictions<sup>149</sup> have been

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<sup>144</sup> 1998 SC 725 at p 734E.

<sup>145</sup> [1993] 1 A C 70 at p 172 C,D.

<sup>146</sup> *Ibid* at p 165C per Lord Goff: "I would not think it right, especially bearing in mind the development of the concept of economic duress, to regard the categories of compulsion for present purposes as closed".

<sup>147</sup> See eg Burrows, *The Law of Restitution* (1993) p 354 arguing that if the payment demand falls within the public law doctrine of *ultra vires* and hence is susceptible to judicial review, the *Woolwich* rule applies: otherwise not. Contrast J Beatson "Restitution of Taxes, Levies and Other Imposts: Defining the Extent of the Woolwich Principle" (1993) 109 L Q R 401 arguing (especially at pp 417, 418) that the *Woolwich* principle applies to taxes, duties and imposts levied *ultra vires* (ie unlawfully) by three categories of payee, namely (1) governmental bodies; (2) other public bodies whose authority to charge is subject to public law principles; and (3) other bodies whose authority to charge is solely the product of statute and thus limited. Professor Birks at one time tentatively argued that the ground of recovery was "transactional inequality": see - P Birks, "The English recognition of unjust enrichment" [1991] LIMCLQ 473 at p 498; P Birks "Restitution from the Executive - A Tercentenary Footnote to the Bill of Rights" in: P D Finn (ed), *Essays on Restitution* (1990), 164 at pp 175,176. Later he argued that it rested on the need to confine public authorities within their powers ie the public law principle of legality: P Birks, "When Money is Paid in Pursuance of Void Authority ...' - A Duty to Repay?" [1992] Public Law 580 at p 587.

<sup>148</sup> (i) The "simple call of justice"; (ii) the Bill of Rights, article 4 (the constitutional principle of no taxation without Parliamentary consent); (iii) the intrinsically coercive powers of the State; (iv) the public law principle of legality; (v) penalising the good player; (vi) the example of European Community Law; (vii) the imbalance

identified in other cases and influential academic commentaries.<sup>150</sup> These justifications would tend to confuse the law by pointing to different boundaries for the *Woolwich* rule.

2.61 First, many of the justifications could be invoked as a reason for introducing a rule of automatic recovery applying to *private* sector debts as well as to public sector debts.<sup>151</sup>

2.62 Second, there are other justifications which apply well enough to powerful governmental bodies such as the defendant in *Woolwich* (the Inland Revenue, the epitome of government power in its relations with citizens) but which seem inapt or unconvincing when applied to less powerful public or semi-public bodies (such as privatised trust ports) and appear especially inapt and even absurd when applied to a small private trader (such as a statutorily licensed taxi-cab operator with one cab).<sup>152</sup>

2.63 Third, the only remaining justification is the public law principle of legality.<sup>153</sup> But this is a formal justification which, unlike the *Woolwich* case, has nothing to do with the relative strength of the parties, and seems to create an arbitrary and uncertain boundary. The distinction between private and public law, and (especially in this era of privatisation) between private and public bodies, is very ill-defined. The introduction of the private/public dichotomy into the Scots law of unjustified enrichment would give rise to great uncertainty and invidious distinctions which are best avoided.

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created by the Government's absolute right to recover *ultra vires* payments made out of the Consolidated Fund; (viii) want of consideration; and (ix) the unjustified enrichment principle. For a detailed description, see our Discussion Paper No 100, paras 3.53-3.85.

<sup>149</sup> (x) Increasing public confidence in the fairness of government; (xi) higher standards of fairness expected of public authorities; (xii) superior ability of governmental bodies to make refunds; (xiii) inadequacy of improper compulsion as a ground of repetition; (xiv) inadequacy of *condictio indebiti*; (xv) discrimination against poorer and less well-advised citizens; (xvi) discouragement of *ultra vires* demands; and (xvii) encouragement of prompt payment of debts. For a detailed description, see our Discussion Paper No 100, paras 3.86-3.110.

<sup>150</sup> Particularly influential were P Birks, "Restitution from the Executive: A Tercentenary Footnote to the Bill of Rights" Fn 147 above) and W R Cornish, "'Colour of Office': Restitutionary Redress Against Public Authority" (1987) 14 *Journal of Malaysian and Comparative Law* 41. Both were cited in the *Woolwich* case. Other sources are cited in Birks [1992] *Public Law* 580 at p 591, fn 75.

<sup>151</sup> These include the justifications specified at fn 148, heads (i), (v), (vi), (viii) and (ix), and at fn 149, heads (xiii)-(xvii).

<sup>152</sup> These include the justifications specified at fn 148, heads (ii), (iii), (vii); and at fn 149, heads (x)-(xii).

<sup>153</sup> Fn 148 above, head (iv).

2.64 In our Discussion Paper No 100, Part IV, we sought views on whether the *Woolwich* rule should be introduced in Scots law by statute. The general reaction was against statutory intervention on this matter. We concur in that view.

2.65 We therefore recommend:

**It is unnecessary to introduce the *Woolwich* rule (under which a citizen who makes an undue payment of tax or similar levy to a public authority pursuant to an *ultra vires* demand has a prima facie right to repayment) into Scotland by statute since in comparable circumstances the Scottish courts would give a citizen a remedy by reference to the principles of Scots law.**

(Recommendation 2)

# Part 3 The Statutory Provisions for Refund of Overpaid Tax or Rates

## A. INTRODUCTORY

3.1 In our Discussion Paper No 100, we sought the views of Scottish consultees on provisional proposals for Scotland parallel to the recommendations made by the Law Commission in Parts IX to XV of their Report on *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments* (1994) Law Com No 227, which, at that time, we generally supported. The stated aim of the recommendations in these Parts was to incorporate "the *Woolwich* rule"<sup>1</sup> into the statutory provisions dealing with recovery of overpaid central and local government taxes while at the same time establishing limitations or defences to its exercise.<sup>2</sup>

### 1. Types of tax and levy covered by the Law Commission's recommendations

3.2 In Law Com No 227, the Law Commission considered the following types of tax or levy:-

- \* Taxes administered by the Inland Revenue (Income Tax; Inheritance Tax; Stamp Duties);
- \* Indirect Taxes (Value Added Tax; Charges governed by European Law; Excise Duties and Car Tax; Insurance Premium Tax);
- \* National Insurance Contributions;
- \* Local Authority Council Tax.

From the standpoint of Scots law, it is necessary to add:

- \* Local Authority Non-domestic Rates and Water Rates due under statutes applying only in Scotland.

## Abbreviations

3.3 In this Part the following abbreviations are used:-

"ADRE(S)A" = Abolition of Domestic Rates Etc. (Scotland) Act 1987;

"FA" = Finance Act;

"LGE(S)A 1994" = Local Government etc. (Scotland) Act 1994;

"LGFA 1992" = Local Government Finance Act 1992;

"LG(FP)(S)A 1963" = Local Government (Financial Provisions) (Scotland) Act 1963;

"LG(S)A" = Local Government (Scotland) Act;

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<sup>1</sup> Is the rule laid down in *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL affg CA) giving a tax-payer a prima facie right under English law to recover undue payments of tax and similar levies paid to a public authority pursuant to an *ultra vires* demand.

<sup>2</sup> Law Com No 227, para 8.20.

"TMA 1970" = Taxes Management Act 1970;

"VATA 1994" = Value Added Tax Act 1994.

## Overview

**3.4 Recommendations in Law Com No 227.** In respect of *ultra vires* receipts by public authorities, the English Law Commission stated that there should be a series of specific amendments to the provisions for refund of overpaid tax in legislation governing the principal central and local government taxes, to reflect the emergence of the *Woolwich* principle, the proposed abolition of the mistake of law bar<sup>3</sup> and the need for defences against the exercise of both rights.<sup>4</sup> In pursuit of this aim, the Law Commission made important recommendations for amendment of the statutory provisions on refund of Inland Revenue taxes. In particular they recommended that TMA 1970, s 33 (which applies to refund of taxes paid under mistake of fact or law), should be replaced by a right on the part of all taxpayers charged to tax, whether under an assessment or otherwise, to recover tax paid but not due irrespective of the presence or absence of any mistake on the part of the taxpayer.<sup>5</sup> On the other hand, the Commission recommended against any amendment of the statutory provisions for refund of VAT (which are not restricted to payments in error)<sup>6</sup> and recommended only one minor amendment of the statutory schemes for refund of social security contributions<sup>7</sup> and local authority council tax.<sup>8</sup>

**3.5 Developments since 1996.** Since our Discussion Paper No 100 was issued in 1996, several significant events have occurred which alter the balance of the argument. First, FA 1997 has strengthened the defences available to the Board of Customs and Excise against claims for refunds of VAT. Among other things, FA 1997, s 47, abolished the "due diligence" formula regulating the commencement of the limitation period for claims for refunds for VAT<sup>9</sup> and shortened that period from six to three years.<sup>10</sup> Second, as we have seen, the House of Lords, in refusing to introduce in the English common law a defence (or safeguard) of "payment in accordance with a settled view of the law", subjected that defence to very strong criticism.<sup>11</sup> Third, a new system of self-assessment to income tax has been introduced.<sup>12</sup> Further, the Inland Revenue have opposed the replacement of TMA 1970, section 33 by a new provision containing untried concepts such as the "due diligence" formula (now rejected for VAT) and the "settled view of the law" defence (now trenchantly criticised by the House of Lords). The Inland Revenue contend that it is the statutory machinery for appeals, not the application for refund under TMA, 1970, section 33, which forms the main safeguard for taxpayers against overpayments of tax. In their view, severe criticism of section 33 is unjustified if that section is considered in its context as a closely defined exception to the finality of tax assessments in cases of mistake.

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<sup>3</sup> Now achieved by *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL).

<sup>4</sup> Law Com No 227, p 191.

<sup>5</sup> Law Com No 227, recommendation (11) (para 9.25).

<sup>6</sup> Law Com No 227, recommendation (34) (paras 14.14-14.19).

<sup>7</sup> Law Com No 227, recommendation (37) (para 15.12).

<sup>8</sup> Law Com No 227, recommendation (38) (para 15.26).

<sup>9</sup> Is the formula under which the limitation period runs from the date when the VAT payer discovered the mistake or could by reasonable diligence have discovered it. Under FA 1997, s 47, the limitation period runs from the date of the mistaken payment: see para 3.94 below.

<sup>10</sup> See para 3.94 below.

<sup>11</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL) discussed in Part 2, Section A above.

<sup>12</sup> See paras 3.73-3.81 below.

3.6 **Refund of rates under LG(FP)(S)A 1963, s 20(1).** The only type of tax discussed in this Part which differs in its machinery of collection and refund from the English law is non-domestic rates.<sup>13</sup> The main provision to be considered is LG(FP)(S)A 1963, s 20(1) which provides for a refund of an undue payment of rates made under error of fact (on application within six years from the year for which the rates were paid).<sup>14</sup> An obvious reform is that the undue payment should also be refunded if the error was of law or mixed fact and law.

3.7 More difficult is the question whether it is reasonable to regard the statutory machinery for appeals against valuation notices and demand notes for rates, rather than the application for refund under the LG(FP)(S)A 1963, s 20(1), as the main safeguard for ratepayers against overpayments of rates. It would be pointless for legislation to provide time limits for appeals if these time limits can simply be ignored by a ratepayer and application made by him instead for a refund under the 1963 Act, s 20(1). So the main question is what is the proper role of the 1963 Act, s 20(1)? There is a choice. Should it be considered (following Law Com No 227 and our Discussion Paper No 100) as equivalent to the *Woolwich* rule with the result that it should provide for refund of an undue payment made pursuant to an *ultra vires* demand irrespective of any error of fact or law on the part of the ratepayer? Or should it be regarded rather in its statutory context as a longstop provision making a closely defined exception to the principle of the finality of the valuation and assessment rolls and so applying only where the undue payment was made under error of fact or law and not otherwise? We turn now to consider the provision in its statutory context.

## **B. NON-DOMESTIC RATES**

### **1. The existing law**

#### **(1) The statutory scheme for fixing liability to non-domestic rates**

3.8 **Valuation and assessment rolls.** The system of valuation and rating<sup>15</sup> is based on a valuation roll and an assessment roll.<sup>16</sup> The valuation roll<sup>17</sup> shows the yearly rent or value of the rateable lands and heritages in each valuation area.<sup>18</sup> The assessment roll is made up and maintained by a rating authority on the basis of the valuation roll and contains the information required for collecting the rates levied by the authority.<sup>19</sup>

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<sup>13</sup> Some provisions of the LGFA 1992 and subordinate legislation thereunder on the recovery of council tax and water charges make or reflect cross-border differences.

<sup>14</sup> See para 3.17 below.

<sup>15</sup> See *Armour on Valuation and Rating* (5th edn) Chapter 1; *Stair Memorial Encyclopaedia* vol 14, sv "Local Government", paras 834 *et seq*.

<sup>16</sup> The valuation roll is primarily regulated by LG(S)A 1975, Part I. The assessment roll and the recovery and refund of rates are primarily regulated by provisions in LG(S)A 1947. Both of these Acts have been much amended by statutes reflecting the far-reaching changes in local authority finance and organisation.

<sup>17</sup> Made up and kept by the local assessor under the LG(S)A 1975, Part I. Sections 1 and 37 provide for quinquennial revaluations. The roll is a "running roll" ie a roll made up for a revaluation year remains in force till the next quinquennial revaluation.

<sup>18</sup> As to the form and content of the roll, see Valuation Roll and Valuation Notice (Scotland) Order 1989 (SI 1989/2385); *Armour on Valuation for Rating* (5th edn) para 2-12.

<sup>19</sup> LG(S)A 1947, s 233(1) substituted by LG(S)A 1975, s 11.

## (a) Valuation roll

3.9 **The valuation roll and the limitation of rating to non-domestic subjects.** The Local Government (Scotland) Act 1975, section 7 provides that every rate levied by a rating authority<sup>20</sup> for any year shall be levied in respect of all lands and heritages within the area of the rating authority<sup>21</sup> according to their rateable value as appearing in the valuation roll in force at the beginning of that year.

3.10 Under the 1975 Act as originally enacted, domestic dwellings were included among the subjects entered in the valuation roll, since their occupiers were assessed for rates. The Abolition of Domestic Rates Etc. (Scotland) Act 1987 introduced the community charge and (as its name implies) abolished domestic rates with effect from 1 April 1989.<sup>22</sup> The old system of rates was preserved but confined to non-domestic subjects.<sup>23</sup>

3.11 The 1987 Act was repealed by the LGFA 1992, which replaced the community charge with the council tax.<sup>24</sup> Dwellings chargeable to council tax are entered into a "valuation list" distinct from the valuation roll.<sup>25</sup> The 1992 Act retained with modifications the system of non-domestic rates levied on non-domestic subjects.<sup>26</sup> It amended the 1975 Act<sup>27</sup> so as to provide that rates are levied by rating authorities in respect of lands and heritages in their area in accordance with section 7 of that Act, or in certain cases in accordance with regulations.<sup>28</sup>

3.12 **Statutory applications and appeals concerning entries in valuation roll.** Statutory provisions lay down special procedures for dealing with appeals or complaints concerning entries in the valuation roll, namely, application to the assessor for redress;<sup>29</sup> appeal or complaint to the valuation appeal committee,<sup>30</sup> or to the Lands Tribunal for Scotland,<sup>31</sup> and a further appeal to the Lands Valuation Appeal Court,<sup>32</sup> the jurisdiction of which is limited to questions of value.<sup>33</sup> Time limits are imposed on the period for making appeals or complaints.<sup>34</sup>

3.13 **Finality of valuation roll.** As a general rule, the valuation roll, when completed by the assessor and placed in the hands of the rating authority as the basis for levying assessments,<sup>35</sup> is final and conclusive so far as matters of valuation are concerned.<sup>36</sup> There

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<sup>20</sup> Ie since 1st April 1996, the new unitary local authorities: see LGE(S)A 1994, s 30.

<sup>21</sup> LG(S)A 1975, s 7B(3) inserted by LGFA 1992, s 110(2).

<sup>22</sup> Section 1. However section 5 provides for the continuation of the system of valuation for the limited purpose of construing references to rateable values in statutes and other documents.

<sup>23</sup> ADRE(S)A 1987, s 3.

<sup>24</sup> 1992 Act, Part II.

<sup>25</sup> LGFA 1992, s 73(1) provides that dwellings shall not be entered in the valuation roll in respect of the financial year 1993-94 or any subsequent financial year. Dwellings on the roll immediately before 1 April 1993 were deleted with effect from that date.

<sup>26</sup> LGFA 1992, s 110 inserting a new section 7A and a section 7B in the LG(S)A 1975.

<sup>27</sup> See section 7B inserted by LGFA 1992, s 110(2) and amended by the LGE(S)A 1994, Sch 13, para 100(4).

<sup>28</sup> Made under LGE(S)A 1994, s 153.

<sup>29</sup> LG(S)A 1975, s 3(2).

<sup>30</sup> LG(S)A 1975, ss 3(2) and (4); 4; Lands Valuation (Scotland) Act 1854, s 13.

<sup>31</sup> Lands Tribunal Act 1949, s 1(3A).

<sup>32</sup> Valuation of Lands (Scotland) Amendment Act 1879, s 7; LG(S)A 1966, s 23.

<sup>33</sup> See eg *British Linen Co v Assessor for Aberdeen* (1906) 8 F 508; *Assessor for Glasgow v Glasgow Corporation* 1929 SC 291; or questions necessary to determine value *Ferguson v Assessor for Inverness-shire* 1912 SC 768.

<sup>34</sup> See eg Valuation Timetable (Scotland) Order 1995, Schedule (SI 1995/164) as amended by the Valuation Timetable (Scotland) Amendment Order 1997 (SI 1997/1781); Valuation Timetable (Scotland) Amendment Order 1995 (SI 1995/2455).

<sup>35</sup> LG(S)A 1975, s 1(4).

are some exceptions to this rule. (i) The principle of the finality of the valuation roll only applies to matters of valuation. Where an entry in the valuation roll is erroneous for a reason other than an error in valuation,<sup>37</sup> it may be challenged in an appeal against the rates demand note<sup>38</sup> or in an action in the ordinary courts for a common law remedy.<sup>39</sup> (ii) Once the valuation roll has come into force, it can only be altered by the assessor in any of the nine cases specified in the Local Government (Scotland) Act 1975, section 2(1), paragraphs (a) to (h) or to give effect to any change in proprietorship, tenancy or occupancy.<sup>40</sup> (iii) Correction of error is one of only two grounds upon which a proprietor, tenant or occupier of lands on the valuation roll may appeal at any time against the relevant entry.<sup>41</sup> (iv) There is a statutory right to recover rates paid under error of fact.<sup>42</sup>

## (b) Assessment roll

**3.14 Finality of assessment roll.** Liability for rates is directly determined not by the valuation roll but by the assessment roll,<sup>43</sup> which is made up by the rating authority<sup>44</sup> on the basis of the rateable value in the valuation roll.<sup>45</sup> The assessment roll is conclusive in the sense that a person is not liable for rates unless his name appears on the assessment roll.<sup>46</sup> It does not follow that a person whose name appears on the assessment roll has, because it appears there, no remedy.<sup>47</sup> But such a person can generally challenge an entry in the assessment roll only through the statutory avenue of appeal and can invoke common law remedies only in very exceptional circumstances.<sup>48</sup>

**3.15** There are two statutory qualifications to the conclusiveness of the assessment roll. (i) Within a year after the end of the year of assessment, the rating authority may amend the assessment roll by striking out a person's name on an assessor's certificate or by correcting the amount of any value or rate which may have been inaccurately entered.<sup>49</sup> It is provided, however, that any such amendment does not vitiate the rate or render it less operative.<sup>50</sup> So presumably if a rates demand note has become final by expiry of the appeal days, the person

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<sup>36</sup> *Armour on Valuation and Rating* (5th edn) para 2.26; Lands Valuation (Scotland) Act 1854, s 33; LG(S)A 1975, s 7(1): "every rate...shall be levied...according to the rateable value...as appearing in the valuation roll in force at the beginning of the year" (emphasis added).

<sup>37</sup> Eg because it duplicates one already there, or the wrong person is entered as owner or the subjects are not in the assessing area.

<sup>38</sup> LG(S)A 1947, s 237.

<sup>39</sup> Such as interdict (*Sharp v Latheron Parochial Board* (1883) 10 R 1163 and Lord Kinneir's opinion therein, reported in footnote in 1916 SC at p 371; *Distillers Co v Fife C C* 1924 SC 499; 1925 SC (HL) 15); or declarator (*Hope v Edinburgh Corporation* (1897) 5 SLT 195(OH)); *Abercromby v Badenoch* (1909) 2 SLT 114(OH)); or reduction (*Moss' Empires v Assessor for Glasgow* 1917 SC (HL) 1).

<sup>40</sup> Words added by Rating and Valuation (Amendment) (Scotland) Act 1984, Sch 2, para 13.

<sup>41</sup> LG(S)A 1975, s 3(4).

<sup>42</sup> We consider (iv) at para 3.20 below.

<sup>43</sup> *Dante v Assessor for Ayr* 1922 SC 109; *Distillers Co v Fife County Council* 1925 SC (HL) 15 at p 19. The law on this matter goes back to the Poor Law Amendment (Scotland) Act 1845, s 40, which provided that the assessment roll "shall be the rule for levying the assessment for the year or half-year then next ensuing".

<sup>44</sup> LG(S)A 1947, s 233(1) as substituted by LG(S)A 1975, s 11.

<sup>45</sup> LG(S)A 1975, s 7(1).

<sup>46</sup> *Bell v Thomson* (1867) 6 M 64 at p 70 per Lord Neaves (obiter): "An Assessment-roll has at least a certain degree of finality. If a man's name has been omitted in one year, posterior commissioners could not call on him in a subsequent year for bygone assessments"; approved in *Lanarkshire C C v Miller* 1917 SC 35 at p 41 per Lord Dundas and p 44 per Lord Salvesen.

<sup>47</sup> *Commercial Bank of Scotland v Glasgow Corporation* 1925 SLT (Sh Ct) 142 at p 144.

<sup>48</sup> See paras 3.59 - 3.62 below.

<sup>49</sup> LG(S)A 1947, s 233(3) as substituted by LG(S)A 1975, s 11; formerly s 233(4) of the 1947 Act as originally enacted.

<sup>50</sup> *Idem*.

concerned will remain liable for the current year's rates. (ii) There is a statutory right to recover rates paid under error of fact.<sup>51</sup>

**3.16 Demand note for rates and appeals to rating authority.** Every rating authority has a duty "as soon as practicable" to issue demand notes, for payment of rates payable to the authority, to every person liable.<sup>52</sup> A person receiving a demand note may appeal to the rating authority within a period specified in the notice.<sup>53</sup> The appeal rests on the ground that he is improperly charged,<sup>54</sup> but cannot be used to challenge the rateable value since, as already indicated,<sup>55</sup> the valuation roll is fixed on that point at that stage.<sup>56</sup>

## (2) General statutory right of recovery under LG(FP)(S)A 1963, section 20(1)

3.17 The Local Government (Financial Provisions) (Scotland) Act 1963, section 20(1) provides:

*"Where, notwithstanding section 2(2)(d) of the Local Government (Scotland) Act 1975 or any entry in a valuation roll which is no longer in force,<sup>57</sup> it is shown to the satisfaction of a rating authority that any amount has been paid to them in respect of rates by reason of an error of fact, and the amount is not recoverable apart from this section, the authority shall repay the amount to the person from whom they received it or to any other person appearing to them to be entitled to that person's interest:*

*Provided that no repayment under this subsection shall be made after the end of the sixth year after that in respect of which the amount was paid, unless application therefor was [made] before that time."* (italics added)

The provision will prevail over the 1975 Act, section 2(2)(d), in a conflict between them. This means that if an erroneous entry made in year 1 is not discovered till year 8, the ratepayer may recover under the 1963 Act, section 20, overpayments made in the last 6 years whereas the assessor under the 1975 Act, section 2(2)(d), can only correct the error with effect from the beginning of year 8.

**3.18 The aim of LG(FP)(S)A 1963, section 20(1).** Light is cast on the aim of the section by the Notes on Clauses.<sup>58</sup> It was designed to fill the gap left by the fact that there is:

*"no general provision in the Local Government Acts for the repayment of rates overpaid over a period of years. Once the Valuation Roll has been closed and appeals against entries disposed of, it is not possible to re-open it; and as far as the Assessment Roll is concerned, that is, the roll from which the rates are levied, there is*

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<sup>51</sup> See para 3.17 below.

<sup>52</sup> LG(S)A 1947, s 237(1).

<sup>53</sup> LG(S)A 1947, s 238 (1) and (2) as amended by the Rating and Valuation Amendment (Scotland) Act 1984, Sch 2, para 6.

<sup>54</sup> *Ibid*, s 238(1).

<sup>55</sup> See para 3.13 above.

<sup>56</sup> *Magistrates of Glasgow v Hall* (1887) 14 R 319.

<sup>57</sup> Italicised words inserted by Local Government (Miscellaneous Provisions) (Scotland) Act 1981, Sch 3, para 5. They complement the saving of the 1963 Act, s 20, inserted in LG(S)A 1975, s 2(2)(d) by the 1981 Act, Sch 3, para 32.

<sup>58</sup> Made available by the Scottish Office. Notes on Clauses are internal, unpublished papers prepared by civil servants to assist Ministers in piloting Bills through Parliament. In this case, the Note on clause (later section) 20 is uniquely valuable since *Hansard* is silent on its aim and provenance. It was not debated: cf *Parl Deb (HC)*, *Scottish Standing Committee* (1962-63), vol IV, col 608. We are grateful to the Scottish Office for permission to quote from the Notes on Clauses.

no power to remit rates except in the current and immediately succeeding financial year.<sup>59</sup>

3.19 The 6-year time-limit derived by analogy from the Income Tax Acts and the corresponding English rates provision, now repealed.<sup>60</sup> The section presents several difficulties as respects both the ground of claim and the availability of defences.

3.20 **The scope and meaning of "error" in LG(FP)(S)A 1963, section 20(1).** The main defect in section 20(1) is that it only applies to error of fact, not at all to error of law. But there are other difficulties. Section 20(1) makes it clear that the error must have caused the payment.<sup>61</sup> The most common form of error will be an erroneous assumption that rates are due to be paid by the payer when in fact they are not due, - a "liability error" as it is sometimes called. This in turn raises the fundamental question of when rates are due or not due for this purpose. Does "error" in s 20(1) refer only to an error of fact arising after the demand note has become final (eg inadvertent double payment)? Or does it include also an error in the relevant entries in the valuation roll or assessment roll?

3.21 In principle, it might be thought that the first approach would be followed because the *British Railways Board* case<sup>62</sup> establishes that after the expiry of the days for appealing against the rates demand note, generally the law cannot look behind the note but must treat its contents as correct. Two factors may suggest however that the second approach was that intended.

3.22 First, the 1963 Act, section 20, allows recovery of the amount overpaid only if it "is not recoverable apart from this section", eg at common law. In a common law action for repetition of an overpayment caused by an error in the valuation roll or assessment roll, generally the amount will not be recoverable (because of the local authority's defence of failure to exhaust statutory remedies).<sup>63</sup>

3.23 Second, the Notes on Clauses indicate that the section was intended to cover cases where (a) a person had paid someone else's rates, eg where a man paid his neighbour's rates as well as his own; or (b) the rate levied was not in accordance with the valuation roll; or (c) it emerged on a subsequent revaluation that a particular house had obviously been incorrectly valued by a considerable amount.<sup>64</sup> It does seem therefore that the intention was to give relief in respect of payments arising from errors in the valuation and assessment rolls in breach of the principle of the finality and conclusiveness of those rolls and indeed because of a perceived need to derogate from that principle.

3.24 It is possible that section 20 may also have been intended to apply to an overpayment caused by an error of fact arising after the demand note has become final (eg inadvertent double payment) but such an overpayment would normally be recoverable apart from the section by common law action.

3.25 **Defences.** The 1963 Act, section 20(1) provides no defences other than the six-year limitation period. The requirement that the amount claimed be "not recoverable apart from

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<sup>59</sup> Citing LG(S)A 1947, s 233(4) as originally enacted; see now *ibid*, s 233(3) as substituted by LG(S)A 1975, s 11.

<sup>60</sup> Rating and Valuation Act 1961, s 17; consolidated as the General Rate Act 1967, s 9, repealed by the Local Government Finance Act 1988, s 117(1); s 149 and Sch 13.

<sup>61</sup> See the words "paid ... by reason of an error of fact".

<sup>62</sup> 1976 SC 224.

<sup>63</sup> On this defence, see paras 3.59 - 3.62.

<sup>64</sup> Apparently a case of the last type in Edinburgh had provided much of the impetus for LG(FP)(S)A 1963, s 20.

this section" means that common law defences can be elided by recourse to the section. This is no doubt justifiable in some cases<sup>65</sup> but not in others eg if an attempt were made to use section 20(1) to evade a compromise. Some clarification appears desirable.

## 2. Recommendations for reform

### (1) Reform of ground of claim

3.26 Since the rating authority's duty to repay under section 20(1) of the 1963 Act arises only where the reason for the ratepayer's payment was an error of fact, it is clearly now out-of-date having regard (i) to the abolition of the old common law error of law rule by the *Morgan Guaranty* case,<sup>66</sup> and (ii) the *obiter dicta* in the same case stating that in principle money paid in the same circumstances as in the *Woolwich* case<sup>67</sup> (ie pursuant to an *ultra vires* demand) would be recoverable in Scots law though the precise ground of recovery is not clear.<sup>68</sup> In our Discussion Paper No 100, we provisionally proposed that the ground of claiming a refund should be extended beyond "undue payments in error of fact" to cover all undue payments,<sup>69</sup> whether made under error of fact or law, or under compulsion, or pursuant to an *ultra vires* demand or otherwise.

3.27 This provisional proposal was generally approved by those consultees who commented, with the very important exception of the Convention of Scottish Local Authorities who said that, in the view of experienced practitioners, the existing system functions well and does not need to be changed.

3.28 Our proposal accorded with the general policy in Discussion Paper 100 of widening the grounds of the statutory provisions on refunds beyond error to all undue payments, whether made under compulsion, or pursuant to an *ultra vires* demand or otherwise. The underlying belief was that the main statutory provisions on refunds (notably TMA 1970, s 33; VATA 1994, s 80; and LG(FP)(S)A 1963, s 20(1)) should include all undue payments so as to be as wide as the post-*Woolwich* and post-*Morgan Guaranty* common law grounds of recovery.

3.29 As we indicate below<sup>70</sup> the Inland Revenue contend that TMA 1970, section 33 should be considered in its context as a closely defined exception to finality in cases of error or mistake. If one views the refund provision in LG(FP)(S)A 1963, section 20(1) in the same light, then the need for assimilation of that provision to the wide grounds of recovery at common law disappears. On this view, the equivalent to the wide claim at common law is the machinery for appeals against demand notes for rates,<sup>71</sup> not the refund provision which should be treated as a long-stop only for error cases. If the refund provision were to extend beyond payments in error, the extension might undermine the principle of the finality of appeals.<sup>72</sup> On the analogy of TMA 1970, section 33 we think that that the refund provision

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<sup>65</sup> Eg the type of defence raised in *Bell v Thomson* (1867) 6 M 64.

<sup>66</sup> *Morgan Guaranty Trust Co of New York v Lothian Regional Council* 1995 SC 151.

<sup>67</sup> *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL).

<sup>68</sup> See Part 2, Section B above.

<sup>69</sup> It is thought that for this purpose a payment which would not have been due if the valuation roll, assessment roll and demand note had been properly made up, should be treated as "undue" notwithstanding that it arises from an error in any of these documents. Whether such an undue payment should be recoverable would then depend on whether the defence of non-exhaustion of statutory remedies is to be available under the legislation.

<sup>70</sup> See para 3.80 below.

<sup>71</sup> LG(S)A 1947, s 238(1) and (2) as amended: see para 3.16 above.

<sup>72</sup> *British Railways Board v Glasgow Corporation* 1976 SC 224.

should apply to error of law as well as error of fact but should not apply beyond error to compulsion or *ultra vires* demands.

3.30 On consultation the Law Society of Scotland commented that an error of law may not be unusual in rates cases.<sup>73</sup> Moreover errors of law tend to be more widespread when they do occur. On the other hand it has been said of the valuation roll that "The vast majority of cases of error will probably, in practice, be found to be errors in relation to matters of fact".<sup>74</sup>

3.31 We recommend:

**The ground of a claim for a refund of overpaid rates under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 (which currently applies only to undue payments made under error of fact) should be extended to cover also undue payments made under error of law, or error of mixed fact and law, but should not be extended to cover payments made without error but under compulsion, or pursuant to an *ultra vires* demand or otherwise.**

(Recommendation 3; Draft clause)

## (2) Introduction or amendment of "defences"

3.32 The extension of the ground of claims under the 1963 Act, section 20(1) to refund of rates paid under error of law would increase the importance of defences to such claims. We consider that the widening of the ground should be matched by the introduction of appropriate defences.

### (a) Retention of six-years time-limit on application for refund

3.33 Under the proviso to section 20(1) of the 1963 Act, no statutory refund may be made after the end of the sixth year after that in respect of which the amount was paid, unless application therefor was made before that time. We sought views on three possible modifications of this time limit.<sup>75</sup>

3.34 **Limitation rather than prescription.** The first was whether the period should be one of negative prescription or a simple statutory limitation period. There is a technical reason for preferring a limitation period. A period of negative prescription may be extended by interruption of the prescriptive period.<sup>76</sup> By contrast a limitation period on the lines envisaged would have a fixed and definite beginning and end. For that reason on balance a limitation period is preferable to prescription in the present context.

3.35 **Duration of limitation period.** Secondly, as regards the length of the period, the six years limitation period was introduced in 1963 long before the introduction of the five-year negative prescription in 1973. The time limit on claims for refund of overpaid income tax

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<sup>73</sup> They cited *Greenock Corporation v Arbuckle Smith and Co Ltd* 1960 SC(HL) 49 (whether the making of alterations to premises constituted "actual occupation" for rating purposes). See also eg *Glasgow Corporation v Perrydale Ltd* 1963 SC 512 (whether tenant not in occupation liable for rates); *McKillop, Petitioner* 1995 SLT 216(OH) (whether receiver under floating charge personally liable for rates); and cases on rating relief for premises used for charitable purposes such as *Belhaven-Westbourne Church Congregational Board v Glasgow Corporation* 1965 SC(HL) 1; *Dollar Academy Boarding Houses Association v Magistrates of Dollar* 1966 SLT 179 (OH); and *Scottish Burial Reform and Cremation Society v Glasgow Corporation* 1967 SC(HL) 116.

<sup>74</sup> *Armour on Valuation for Rating* (5th edn) para 3-35.

<sup>75</sup> Discussion Paper No 100, paras 4.184 and 4.185 (Proposition 24).

<sup>76</sup> Prescription and Limitation (Scotland) Act 1973, ss 6-10.

and capital gains tax under TMA 1970, section 33 is now five years after 31st January next following the year of assessment to which the return relates.<sup>77</sup> On consultation,<sup>78</sup> however, there was unanimous support by all consultees, including COSLA, for retention of the existing period of six years, which is within the period for which councils' financial records are retained. We therefore propose retention of the six years period.

3.36 It is true that COSLA agreed to the retention of the six years time limit against the background of our provisional proposal that a defence of payment in accordance with a "settled view" of the law would be available to a rating authority in a claim under the 1963 Act, s 20(1) and that we do not now recommend the introduction of that defence.<sup>79</sup> COSLA observed that a local authority is not in the same position as central government when obliged to make substantial refunds to tax payers as a result of a judicial decision. In that situation central government can recoup losses through increased taxation. COSLA pointed out that a local authority does not have the same scope for such action. We agree with that comment. On the other hand, central government and Parliament are likely to change the law at least prospectively if the need arises. Indeed, there is even a precedent in England and Wales for Parliament enacting a "general understanding" defence with retrospective (and temporary) effect in order to protect local authorities from claims for refunds of overpaid rates.<sup>80</sup> It is also true the Inland Revenue may rely on a defence of "payment in accordance with a generally prevailing practice" which is not available to local authorities, and the Customs and Excise may rely on a three year limitation period instead of the six years for claims against local authorities. On the other hand there is no comparable provision in respect of council tax.

3.37 Assessing this very difficult topic as best we can, we think that six years is a reasonable period. We state below<sup>81</sup> that if (contrary to our recommendations) it is considered that a further safeguard for local authorities is necessary, a shorter time limit would be preferable to a "settled view of the law" defence. It may be that in the light of experience a shorter limitation period will indeed prove necessary or expedient. That is possible but it cannot be said to be probable or still less certain. We think it preferable to maintain the existing period and shorten it later if the need arises rather than to shorten the period now when the case for it has not, or not yet, been made out.

3.38 **Commencement of limitation period.** Thirdly, under the present law, the six year period begins to run at the end of the year in respect of which the amount of rates in question was paid. In our Discussion Paper we suggested that in a claim based on error, time should not begin to run against the ratepayer until he discovers the error or could with reasonable diligence have discovered it.<sup>82</sup> This proposal met with a mixed reaction. While most consultees agreed, COSLA strongly disagreed stating that they were totally opposed to extending the current statutory time limit. The recent experience with VAT shows<sup>83</sup> that the foregoing formula could let in claims going back many years beyond the six years, and

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<sup>77</sup> TMA 1970, s 33(1) as amended by FA 1994, Sch 19, para 8(1)(b).

<sup>78</sup> See Discussion Paper No 100, Proposition 24(2) (para 4.185).

<sup>79</sup> See paras 3.53 - 3.58 below.

<sup>80</sup> In England and Wales the Local Government Finance Act 1988, (which repealed the General Rate Act 1967) by s 120 amended s 9(2) of that Act (so far as outstanding pre-repeal arrears were concerned) by retrospectively introducing a defence barring a refund of overpaid rates "if the amount paid was charged in accordance with the understanding generally prevailing at the time when the payment was demanded about the application of the relevant statutory provisions".

<sup>81</sup> See para 3.57.

<sup>82</sup> Discussion Paper No 100, Proposition 24(3) (para 4.185).

<sup>83</sup> See paras 3.91 - 3.94.

indeed (if not struck at by the 20 year long negative prescription) could extend back at least to 1963 when the refund provision was introduced. Such an open-ended provision is therefore dangerous and this fully justifies COSLA's opposition. We propose therefore that the existing rule on the commencement of the six year period should not be changed.

3.39 We recommend:

**The rule laid down by the proviso to section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 (under which no refund under that section may be made after the end of the sixth year after that in respect of which the amount was paid, unless application therefor was made before that time) should be retained.**

(Recommendation 4; Draft clause)

**(b) *Res judicata* and compromises**

3.40 The 1963 Act, section 20(1) makes no reference to the defences of *res judicata* and compromise. These defences are respectively designed to promote the public interest in the finality of litigation and in agreements freely entered into to avoid litigation. They both depend on the principle that a person should not be vexed twice for the same cause. Section 20(1) provides that the amount claimed must be "not recoverable apart from this section", for reasons which are not clear. Since these defences would make the amount not recoverable in a common law action, it appears that they would not prevent a section 20(1) claim. This seems contrary to principle and unreasonable.

3.41 *Res judicata*. The defence of *res judicata* is available where the question in an action has already been decided between the parties.<sup>84</sup> If (as we recommend below) *res judicata* were made available as a defence to a section 20 claim, five requirements would have to be satisfied.<sup>85</sup> (1) There would have to be a prior decision by a competent court or tribunal on the rating authority's liability to make a refund. (2) The earlier court decree would require to have been pronounced after defences have been lodged (ie "*in foro*") in the action without fraud eg a decree of *absolutor* absolving the rating authority from liability to make a refund. A decree in absence<sup>86</sup> or of dismissal<sup>87</sup> would not suffice.<sup>88</sup> As between the original court action and the later section 20 claim for refund, there would have also to be (3) identity of the subject matter viz that the earlier action concerned the fact that rates were paid when they were not due. (4) There must be identity of the grounds of the earlier action and of the section 20 claim. In other words the specific point raised in the claim (that the undue payment of rates is repayable because it had been paid under error) must have been decided in the earlier action. But if the

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<sup>84</sup> Or between other parties but binding the pursuer.

<sup>85</sup> See *Stair Memorial Encyclopaedia* vol 17 (1989) s v "Procedure", para 1102; Macphail, *Sheriff Court Practice* paras. 2-103 to 2-108.

<sup>86</sup> A decree in absence is granted where the defender fails to enter appearance in an action against him, despite the fact that the summons or initial writ served on him cited him to appear and certified that he would be liable if he failed.

<sup>87</sup> A decree of dismissal is granted where the defender has entered appearance in the action but the action has been disposed of on the basis of a preliminary plea (eg no title to sue; no jurisdiction; action incompetent in form) rather than on the merits. The action as laid is dismissed but the pursuer may bring a new action on the same ground.

<sup>88</sup> A decree of dismissal is not *res judicata* because such a decree merely upholds the defender's plea as to the competency or relevancy of the pursuer's action but not the substantive question of the local authority's liability to refund. The fact that an action is found to be incompetent or irrelevant does not, and should not, prevent the pursuer from raising an action which is competent and relevant. A decree in absence is not *res judicata* because where the defender does not appear, he cannot be said to have referred his cause to the decision of the court.

action had decided that there was (say) no double payment, a section 20 claim based on error of law (eg alleging that by law the payment was not due at all) could be made. (5) There must be identity of the parties' interests (ie that the claimant was the payer and the rating authority the recipient of the overpayment).

3.42 **Compromise.** The 1975 Act provides that where at any time before an appeal or complaint against an entry in the valuation roll is determined by a valuation appeal committee or the Lands Tribunal for Scotland, the parties reach agreement as to what should be done about the entry, the assessor may alter the roll to give effect to the agreement.<sup>89</sup> Such an alteration is not appealable.<sup>90</sup> A compromise is not however a defence to a claim under the 1963 Act, s 20(1).

3.43 A compromise relating to a disputed debt has the effect of discharging that debt and of creating a new independent obligation of payment which replaces that debt.<sup>91</sup> It follows that where the original disputed debt is superseded by a compromise, no action of repetition of that debt lies on the ground that it was in truth not due.<sup>92</sup> A compromise is strictly defined: to qualify as a compromise, an agreement must (1) be concerned with matters doubtful or debateable which have arisen between the parties; (2) be entered into for the deliberate avoidance of the hazard of litigation or diligence; and (3) give effect to a mutual surrender (quittance or abatement) of rights.<sup>93</sup> There must be give and take on both sides; an agreement which is all give on the one side and all take on the other, is not a compromise.<sup>94</sup> A compromise is very difficult to challenge successfully. It cannot be set aside except on the ground of fraudulent misrepresentation or fraudulent concealment, or something equivalent.<sup>95</sup>

3.44 **Recommendation.** In our Discussion Paper No 100, we suggested that the defences of *res judicata* and compromise should be expressly recognised by statute as available to a local rating authority in a claim under section 20(1).<sup>96</sup> This suggestion was unanimously approved and we adhere to it.

3.45 We recommend:

**A statutory claim under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 for recovery of an undue payment of rates should not lie where:**

**(a) a claim for the rates in question had been contractually compromised;  
or**

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<sup>89</sup> LG(S)A 1975, s 2(3). The agreement does not bind a person who subsequently becomes proprietor, tenant or occupier: *ibid*, s 3(2B).

<sup>90</sup> LG(S)A 1975, s 3(2).

<sup>91</sup> Erskine, *Institute* III,3,54; Bell, *Principles* s. 535; Gloag, *Contract* (2d edn) p 456. For a fuller analysis, see Scot Law Com DP No 95, vol 2, paras 2.79 - 2.82.

<sup>92</sup> See Scot Law Com DP No 95, vol 2, para 2.79, p 88 n 5.

<sup>93</sup> *Ibid*, para 2.79 citing (at p 89 n 1) *Evennoon Ltd v Jackel & Co Ltd* 1982 SLT 83 at p 86 per Lord President Emslie.

<sup>94</sup> *Hunter v Bradford Property Trust Ltd* 1970 SLT 173 (HL).

<sup>95</sup> Scot Law Com DP No 95, vol 2, para 2.81, p 90, n 3.

<sup>96</sup> Discussion Paper No 100, Proposition 25 (para 4.187).

(b) the payment was made in response to a court action by the rating authority against the ratepayer in circumstances which would raise a plea of *res judicata* against the ratepayer in an action by him against the authority for repetition.

(Recommendation 5; Draft clause)

(c) **Unjust enrichment of claimant or "passing on"**

3.46 The Law Commission recommended that it should be a defence to claims for the repayment of taxes overpaid as a result of mistake that repayment would unjustly enrich the claimant.<sup>97</sup> Such a defence would arise:

"where the burden of a charge has effectively been 'passed on' to other parties by the charge payer through an increase in the price of goods or services to take account of the higher cost to the payer arising from the payment of the charge."<sup>98</sup>

A defence of "passing on" is one form of a defence that the payer would be "unjustly enriched" by repayment.<sup>99</sup>

3.47 **Existing law.** A leading Scottish text-book suggests that in considering whether to grant repetition of an undue payment of money at common law, the court may consider whether the pursuer has passed on the payment in charges to his customers<sup>100</sup> but we have not traced any Scottish case. At present the defence is only available in a claim under section 80 of the VATA 1994,<sup>101</sup> which provides for repayment of overpaid VAT. Subsection (3) enacts that it is a defence to any claim under the section that repayment "would unjustly enrich" the claimant.<sup>102</sup>

3.48 **English law, Commonwealth and European Union.** In common law actions of restitution, the defence has been rejected in Australia<sup>103</sup> and, following this precedent, in *Kleinwort Benson v Birmingham City Council*,<sup>104</sup> the Court of Appeal, held that a general defence of "passing on" is not available under English law. In Canada, the issue provoked conflicting *obiter dicta* in the *Air Canada* case.<sup>105</sup> In the European Union, the national law of a member State may provide for a defence of passing on in an action for repayment of a tax, charge or duty levied in breach of Community law.<sup>106</sup> In the *San Giorgio* case (1982), the Advocate-General observed that, "with the exception of Denmark, passing on is alien to the legal

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<sup>97</sup> Law Com No 227, recommendations 20 (para 10.46) and 21 (para 10.48).

<sup>98</sup> Law Com CP No 120, para 3.81.

<sup>99</sup> Here the words "unjust" or "unjustly" do not denote the common law concept of absence of legal justification but have their ordinary meaning.

<sup>100</sup> *Gloag and Henderson, The Law of Scotland* (10th edn) para 29.7. Since equitable defences can probably not be relied on in an action of repetition based on improper compulsion, "passing on" would not be a defence in such an action.

<sup>101</sup> Formerly section 24 of the FA 1989.

<sup>102</sup> We revert to this provision at para 3.95 below.

<sup>103</sup> *Mason v New South Wales* (1959) 102 CLR 108; *Commissioner of State Revenue v Royal Insurance Australia Ltd* (1995)

69 ALJR 51, noted J Beatson, "Restitution of Overpaid Tax, Discretion and Passing-on" (1995) 111 LQR 375.

<sup>104</sup> [1996] 3 WLR 1139 (CA).

<sup>105</sup> *Air Canada v British Columbia* (1989) 59 DLR (4th) 161.

<sup>106</sup> Case 68/79 *Hans Just I/S v Danish Ministry for Fiscal Affairs* [1981] 2 CMLR 714; *Commission of the European Communities v Italian Republic* (Case 104/86) [1989] 3 CMLR 3.

experience of the member States",<sup>107</sup> and that in Danish law a defence of "passing on" had been permitted only within strict limits.<sup>108</sup>

**3.49 Assessment of defence.** Several objections may be made to a defence of "passing on".<sup>109</sup> First, it would be difficult to determine the precise extent to which the charge has in fact been passed on.<sup>110</sup> Second, "the increase in price may have lead to a decrease in demand so as to negate any 'windfall' element".<sup>111</sup> This may occur in the usual case where demand is elastic and prices are fixed by the market. Third, the defence is likely to be uncertain in its operation. For example, to illustrate the utility of the defence in minimising recovery in unmeritorious circumstances, the Law Commission remarked: "if a taxpayer company went into liquidation owing substantial amounts to the Inland Revenue, it would seem to us to be unjust if an absolute entitlement to a refund based on an earlier mistake could be maintained by the liquidator, who then proceeded to apply the sum recovered to other debts."<sup>112</sup> On the other hand, when a similar set of facts arose in the *McMaster Stores* case, the First Division held that there was no "unjust enrichment" within the section.<sup>113</sup> As we note below,<sup>114</sup> there have been difficulties in applying the defence in the context of statutory claims for refund of overpaid VAT and the law had to be amended by the Finance Act 1997, s 47.

**3.50 Consultation and conclusion.** In our Discussion Paper No 100, we considered this defence in the context of claims for overpaid income tax and rates.<sup>115</sup> We indicated<sup>116</sup> that, but for the Law Commission's support for the defence, we would have been inclined to reject it as a general defence to a claim for overpaid income tax or rates. On consultation, there was general agreement among those consultees who responded (including the Faculty of Advocates, the Law Society of Scotland and the Inland Revenue) that the claimant's unjust enrichment should not be introduced as a defence to a statutory claim for recovery of overpaid income tax or rates. Professor MacQueen suggested that the defence as it currently exists seems specially connected to the particular form of VAT. The defence has caused difficult problems in connection with VAT,<sup>117</sup> and we are not aware of any plans that it should apply to claims for refund of overpayments of direct taxes administered by the Inland Revenue. Our suggestion that the defence should not be available in claims for refund of rates<sup>118</sup> was generally approved on consultation and we adhere to it.

**(d) Payment in accordance with a "settled view" of the law or "prevailing practice"**

**3.51 Defence of "payment in accordance with settled view of the law".** The extension of section 20(1) of the LG(FP)(S)A 1963 to require the refund of payments of rates made under

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<sup>107</sup> [1985] 2 CMLR 658 at p 679 per Advocate-General Mancini: viz Belgium, France, Germany, Italy, Netherlands, United Kingdom: *ibid* at pp 678, 679.

<sup>108</sup> It has been said that "passing on" has a well-established pedigree as a public authority's defence in civil law systems. The *San Giorgio* and *St Just* cases, however, do not support that proposition.

<sup>109</sup> For a fuller analysis see our Discussion Paper No 100, paras 4.65 - 4.82.

<sup>110</sup> Law Com CP No 120, para 3.84.

<sup>111</sup> *Idem*. See also Burrows, "Public Authorities, Ultra Vires and Restitution" in Burrows (ed) *Essays on the Law of Restitution* (1991) 39 at p 59: "to pass on one's loss does not necessarily mean that one recoups that loss. For example, the charging of higher prices ought in theory to reduce the number of customers".

<sup>112</sup> Law Com No 227, para 10.45.

<sup>113</sup> *Commissioners of Customs and Excise v McMaster Stores (Scotland) Ltd (in receivership)* 1996 SLT 935 approving *Landec Ltd* MAN/90/1018.

<sup>114</sup> See paras 3.95 - 3.100 below.

<sup>115</sup> Discussion Paper No 100, paras 4.65 - 4.82 (income tax); 4.188 - 4.189 (rates).

<sup>116</sup> See *ibid* para 4.81.

<sup>117</sup> See paras 3.95 - 3.100 below.

<sup>118</sup> Discussion Paper No 100, Proposition 26 (para 4.189).

error of law raises sharply the question whether it should be a defence to such a claim that the payment had been made by the ratepayer in accordance with a "settled view of the law that the payment was due", and a later judicial decision has overturned that view. This matter was fully discussed in Part 2 above in connection with the formulation of defences or safeguards against common law actions of repetition following on a judicial decision changing a settled view of the law.<sup>119</sup> We sought views on this issue in Discussion Paper No 100.<sup>120</sup>

3.52 **"Generally prevailing practice".** In the case of income tax, Parliament has already recognised that public finances should be protected against opening floodgates by enacting the "generally prevailing practice" defence in TMA 1970, section 33(2),<sup>121</sup> which resembles the "settled view of the law" defence in its effect. Again in England, at one time no claim for refunds of overpaid rates lay "if the amount paid was charged on the basis, or in accordance with the practice, generally prevailing at the time when the payment was demanded".<sup>122</sup> Since the matter is one of policy, however, there can be different answers for different classes of taxes.

3.53 **Consultation.** On consultation, there were mixed views on whether "payment in accordance with a settled view of the law" should form a defence or exception to an application for refund of overpaid rates.<sup>123</sup> The CBI said that judicial decisions should not operate retrospectively. COSLA thought that a rating authority ought to be able to defend a claim where payments have been made previously on the understanding that the law was settled. They pointed out that a local authority is not in the same position as central government when it is obliged to make substantial refunds to taxpayers as a result of a judicial decision. In that situation, whereas central government can recoup such losses by increasing taxation, a local authority normally does not have that option. The Faculty of Advocates supported the defence upon the view that it would apply in refund of overpaid tax cases and there was no significant reason to differentiate between the rating system and taxation system.<sup>124</sup>

3.54 On the other hand, the Royal Institute of Chartered Surveyors in Scotland said that an overpayment of rates under error of law should be recoverable provided that back dating was restricted to the start date of the relevant quinquennial revaluation cycle. The Scottish Chamber of Commerce took a similar view. The Law Society of Scotland sounded a note of caution. They considered that in practice the distinction between a change in the settled view of the law and an error of law may be difficult to draw. They thought that the point required further clarification.

3.55 **Policy considerations.** In the light of consultation, we were inclined at first to recommend the introduction of the "settled view" defence in claims under the 1963 Act, s 20(1). However, the criticisms made of the proposed "settled view" defence or safeguard by the majority of the judges in the House of Lords in the *Kleinwort Benson* case<sup>125</sup> have made us change our mind. It is true that Lord Goff left open the possibility of a special "settled view" safeguard in tax cases on the basis that a large number of taxpayers exist all of whom

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<sup>119</sup> See Part 2, Section A.

<sup>120</sup> Paras 4.190 and 4.191 (Proposition 27); also *ibid*, paras 4.30 - 4.36 in the context of income tax.

<sup>121</sup> Quoted at para 3.66 below.

<sup>122</sup> General Rate Act 1967, s 9(2)(b) (repealed by Local Government Finance Act 1988, ss 117(1); 149, Sch 13).

<sup>123</sup> Discussion Paper No 100, Proposition 27 (para 4.191).

<sup>124</sup> In fact a similar (but not identical) "payment in accordance with general practice" defence will continue to apply under TMA 1970, s 33.

<sup>125</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1998] 4 All E R 513 (HL).

are treated alike and public policy grounds might make it more readily justifiable.<sup>126</sup> Overall, however, the criticisms made by the House of Lords<sup>127</sup> - which lead to the conclusion that the "settled view" safeguard is incapable of precise definition, lacking in principle and productive of unacceptable anomalies and unpredictable absurdities<sup>128</sup> - are so severe and compelling that it seems most unlikely that any government would adopt it in legislation.

3.56 **"Generally prevailing practice" defence.** A "generally prevailing practice" defence<sup>129</sup> would also suffer from disadvantages. First, ascertaining what is a "generally prevailing practice" would probably be easier than ascertaining a "settled view of the law". Nevertheless it is a question of fact which, if disputed, could only be decided by leading evidence. The procedure in section 20(1) claims is administrative not judicial and is not well suited to proof of disputed facts. Second, it would often be difficult for a ratepayer, especially if he cannot afford to pay for expert advice, to know and to prove or to disprove what is a generally prevailing practice. Third, whereas there is one Inland Revenue "prevailing practice" applying uniformly throughout the whole United Kingdom, there might be different "prevailing practices" in different local rating authorities. There is no clear answer to the question whether the word "generally" does, or should, mean "generally throughout Scotland"? Fourth, a "prevailing practice" will be established by the local rating authorities. It may be argued that in principle local authorities should not be entitled to rely on their own practice to override the correct interpretation of the law.

3.57 If (contrary to our recommendations) it is considered that a further defence or safeguard against opening the floodgates to too many section 20(1) claims is required, a shortening of the six year time limit for claims based on error of law, or mixed error of fact and law, would in our view be preferable to the introduction of either a "settled view of the law" defence or a "generally prevailing practice" defence.<sup>130</sup>

3.58 To sum up, we make no recommendation to introduce the following defences to a claim under the 1963 Act, section 20(1), namely that the payment by way of rates was (a) made by the ratepayer in accordance with a settled view of the law that the payment was due, and a later judicial decision has overturned that view, or (b) charged in accordance with the practice generally prevailing at the time when the payment was demanded.

**(e) Non-exhaustion of statutory remedies**

3.59 **The existing law on the defence of non-exhaustion of statutory remedies.** Where a ratepayer challenges an entry in the valuation roll, his failure to use or insist in the statutory avenue of appeal against an assessor's acts amending the valuation roll will bar a common law remedy<sup>131</sup> whether sought in an ordinary action or an application for judicial review.<sup>132</sup>

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<sup>126</sup> [1998] 4 All E R 513 at pp 537j - 538f, quoted at para 2.46 above.

<sup>127</sup> See para 2.48 above.

<sup>128</sup> See *idem* and para 2.23 above referring to dicta of Lord Hope.

<sup>129</sup> Cf TMA 1970, section 33(2).

<sup>130</sup> See para 2.48, heads (vii) and (viii).

<sup>131</sup> *Dante v Assessor for Ayr* 1922 SC 109 (declarator that the pursuer is not a tenant or occupier in the sense of the Valuation Acts of particular lands and so is not liable to be rated or assessed in respect thereof held incompetent because of his failure to utilise the statutory right of appeal to the Valuation Committee against the entry of his name as tenant and occupier on the valuation roll).

<sup>132</sup> *Tarmac Econowaste Ltd v Assessor for Lothian Region* 1991 SLT 77(OH).

3.60 As regards a ratepayer's challenge against rating, it used to be thought<sup>133</sup> that any person whose name has been wrongly inserted in the assessment roll by the rating authority may dispute liability by defending an action by the rating authority for payment,<sup>134</sup> or by raising an action of declarator that he is not liable.<sup>135</sup> This view was disapproved in the leading case of *British Railways Board v Glasgow Corporation*.<sup>136</sup> In that case it was observed<sup>137</sup> that with two exceptions,<sup>138</sup> the cases on which that view had rested were decided before the introduction in 1892 of statutory rights of appeal against rating demand notes in burghs.<sup>139</sup> One was a sheriff court case irreconcilable with the *Dante* case. The authority of the other, the Outer House case of *Hope*,<sup>140</sup> had been undermined by two circumstances. First, it could be distinguished on the basis that, since the subjects were outwith the city boundary, the magistrates had *ex hypothesi* no jurisdiction and accordingly the pursuer had no statutory remedy to exhaust.<sup>141</sup> Second, the apparent ratio of the *Hope* case was that strictly speaking the so-called "appeal" against a demand note for rates was not truly an appeal because the appellate authority were also the rating authority and therefore would be judges in their own cause, which would be "contrary to the fundamental doctrines of justice".<sup>142</sup> It was held in the *British Railways Board* case however that this proposition cannot stand because the same could be said of all valuation appeals prior to the reorganisation of valuation appeal committees by the Valuation and Rating (Scotland) Act 1956.<sup>143</sup> Moreover, however axiomatic the proposition:

"may appear as a general statement, when Parliament has enacted that there is to be a right of appeal and designates the body which will hear that appeal, no matter who or what the body is, then it is a statutory appeal".<sup>144</sup>

Accordingly it did not matter that the statutory avenue of appeal was to the rating authority which was also the authority which had made the allegedly *ultra vires* demand and received the payment.

3.61 It is not for us to recommend changes to appeals against rating. We cannot however completely ignore the fact that a local authority entertaining an appeal against a rates demand note are indeed judges in their own cause<sup>145</sup> and that this *prima facie* infringes

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<sup>133</sup> See W Hutton, *The Local Government (Scotland) Act 1947* (1949) p 324; J Muirhead, *Municipal and Police Government in Burghs in Scotland* (3d edn) vol 2, p 728.

<sup>134</sup> *McTavish v Commissioners of Caledonian Canal* (1876) 3 R 412; or by suspending summary warrant diligence. See also *Greenock Corporation v Arbuckle Smith & Co Ltd* 1958 SC 615, and the remarks thereon in *British Railways Board v Glasgow Corporation* 1976 SC 224 at p 229 per Lord McDonald.

<sup>135</sup> *Edinburgh and Glasgow Ry Co v Meek* (1850) 12 D 153.

<sup>136</sup> 1976 SC 224.

<sup>137</sup> 1976 SC 224 at 243 per Lord Kissen; cf at p 239 per Lord Justice-Clerk Wheatley.

<sup>138</sup> *Viz Hope v Edinburgh Corporation* (1897) 5 SLT 195 (OH); *Cupar Town Council v Hitt* (1915) 31 Sh Ct Rep 266.

<sup>139</sup> The Burgh Police (Scotland) Act 1892, s 340 (repealed), the precursor of LG(S)A 1947, s 238: see *British Railways Board v Glasgow Corporation* 1976 SC 224 at p 234. It may be noted that LG(S)A 1889, s 62(2) and (3) (repealed) provided for appeals to county councils against rates demand notes in the counties.

<sup>140</sup> *Hope v Edinburgh Corporation* (1897) 5 SLT 195 (OH).

<sup>141</sup> See *British Railways Board v Glasgow Corporation* 1976 SC 224 at p 229 per Lord McDonald (Ordinary), approved at p 243 per Lord Kissen.

<sup>142</sup> *Hope v Edinburgh Corporation* (1897) 5 SLT 195 (OH) at p 195.

<sup>143</sup> *British Railways Board v Glasgow Corporation* 1976 SC 224 at p 229 per Lord McDonald (Ordinary), approved at p 243 per Lord Kissen.

<sup>144</sup> *British Railways Board v Glasgow Corporation* 1976 SC 224 at pp 238,239 per Lord Justice-Clerk Wheatley.

<sup>145</sup> LG(S)A 1947, s 238.

elementary standards of natural justice.<sup>146</sup> We proceed on the assumption that this matter will be considered, and if need be reformed, by the competent authorities.

3.62 In the *British Railways Board* case,<sup>147</sup> the ratepayer pursuers argued that their failure to appeal to the rating authority against a demand note for rates, should not bar (1) an action of declarator that they were, as a nationalised industry, exempt under statute from liability for rates in respect of offices on "operational land", and (2) an action for repayment of rates paid under reservation. The Second Division held that assuming that the issue of liability turned on a question of rating rather than valuation, the pursuer's failure to appeal to the rating authority against the demand note for rates barred the actions for declarator and repayment. The case stands for the proposition:

"that recourse to common law proceedings in the Court of Session is not competent if the complainer has not availed himself of his statutory right of review, unless the failure was due to ignorance owing to some irregularity of procedure on the part of the assessor or rating authority, to the fact that resort to the statutory remedy would in the particular circumstances be otiose or to some other special reason".<sup>148</sup>

3.63 **Proposal in DP 100 to introduce defence.** However the defence of non-exhaustion of statutory remedies is not available to a rating authority in a claim under the 1963 Act, section 20(1) for refund of overpaid rates. That provision allows a claim for refund long after the time-limits have expired for exercising statutory rights of appeal.<sup>149</sup> Under our original provisional proposals in Discussion Paper No 100, error would no longer have been a requirement of refund. So a ratepayer, who lay back and deliberately failed to use the statutory avenues of appeal against a valuation notice or rating notice, could have recovered an undue payment. Time-limits on appeals against such notices could have been ignored with impunity. The finality of the valuation and assessment rolls, and hence their accuracy and reliability, would have been put at risk. On consultation there was general agreement with our proposal that non-exhaustion of statutory appeals should be a defence to a claim for refund of rates.<sup>150</sup>

3.64 **Defence of non-exhaustion unnecessary if error ground of refund.** We now recommend however that error of some kind should remain an essential requirement of obtaining a refund of overpaid rates under the 1963 Act, section 20(1), albeit the error could be of law or fact.<sup>151</sup> A ratepayer who pays in error of fact or law is very unlikely deliberately to fail to use the statutory avenue of appeal. Allowing him to recover his erroneous payment would not tend to undermine the finality of the valuation and assessment rolls. Moreover, we have seen that the intention underlying the 1963 Act, section 20(1), was to give relief in respect of payments arising from errors in the valuation and assessment rolls in breach of the principle of their finality.<sup>152</sup> In this respect there is an analogy with TMA 1970, section 33, which likewise is confined to error (of fact or law) and does not provide a defence of failure to exhaust statutory remedies. We conclude that if (as we recommend above) the ground of a statutory claim for refund of overpaid rates is confined to error (whether of fact

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<sup>146</sup> At a meeting with COSLA representatives, some support was expressed informally for these criticisms.

<sup>147</sup> *British Railways Board v Glasgow Corporation* 1976 SC 224.

<sup>148</sup> 1976 SC 224 at p 230.

<sup>149</sup> By virtue of the Prescription and Limitation (Scotland) Act 1973, s 12(1), the special six-year limitation would take precedence over the five-year negative prescription: see *Lord Advocate v Hepburn* 1990 SLT 530(OH) at p 532 per Lord Dervaird.

<sup>150</sup> Proposition 28 (para 4.198).

<sup>151</sup> See recommendation 3 (para 3.31) above.

<sup>152</sup> See para 3.23 above.

or law), a defence of non-exhaustion of statutory appeals against valuation or rating notices should not be available to the rating authority. The existing section 20(1) provides that the amount claimed must be "not recoverable apart from this section". We think that these words should be repealed. There is no reason to prevent a ratepayer from claiming under the statute a refund of an undue amount paid in error (eg where the rates were paid twice by inadvertence) even though he could recover the amount apart from the section by a common law action. We doubt whether these quoted words accord with the actual practice of rating authorities and they seem inconsistent with the policy of section 20. Moreover the reformed section 20 should state what "defences" may be relied on by a rating authority in a claim under its provisions and it should not be necessary to examine the possibly difficult question of whether a claim would have succeeded at common law.

**Recommendation: certain defences not to be introduced**

3.65 We recommend:

**In a claim for refund of overpaid rates under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963, it should not be a defence:**

- (a) that the refund would unjustly enrich the claimant;
- (b) that the undue payment of rates was made in accordance with
  - (i) a settled view of the law that the payment was due; or
  - (ii) with a generally prevailing practice,and a later judicial decision has overturned that view or practice; or
- (c) that the claimant has not exhausted his statutory remedies, including appeals against valuation or rating notices.

(Recommendation 6)

**C. TAXES ADMINISTERED BY THE INLAND REVENUE**

**1. Income Tax, Corporation Tax, Capital Gains Tax and Petroleum Revenue Tax**

**(1) The Law Commission's recommendations**

3.66 In the domain of income tax and certain other direct taxes administered by the Inland Revenue, the main statutory provision for refund of overpaid tax is TMA 1970, section 33 which provides:

"33.-(1) If any person who has paid tax charged under an assessment alleges that the assessment was excessive by reason of some error or mistake in a return, he may by notice in writing at any time not later than six years after the end of the year of assessment (or, if the assessment is to corporation tax, the end of the accounting period) in which the assessment was made, make a claim to the Board for relief.

(2) On receiving the claim the Board shall inquire into the matter and shall, subject to the provisions of this section, give by way of repayment such relief in respect of the error or mistake as is reasonable and just: provided that no relief shall be given under this section in respect of an error or mistake as to the basis on which the liability of the

claimant ought to have been computed where the return was in fact made on the basis of or in accordance with the practice generally prevailing at the time when the return was made."

3.67 The Law Commission criticised TMA 1970, section 33, mainly because its scope is narrower than the *Woolwich* rule. They observed that "there are situations where a taxpayer would have a right under the *Woolwich* principle to repayment of tax demanded *ultra vires* which would be denied under section 33."<sup>153</sup> These were "for the most part likely to be cases which might currently fall within the 'general practice' defence, insofar as such cases do not constitute cases of compromise or submission at common law, and cases where the taxpayer would be denied a remedy because of the possible consequential avoidance of a charge to tax on other income."<sup>154</sup> Further, it was in their view "illogical for the Taxes Acts to contain a provision for recovery of overpaid tax which is significantly narrower than that allowed at common law."<sup>155</sup> They remarked:

"There are situations where the section 33 right applies, but relief would be denied under the section whereas it would be permitted under the *Woolwich* principle. The House of Lords in *Woolwich* indicated that where a taxpayer had a statutory right of recovery, this should be pursued and was exhaustive of his rights. However, we believe it to be unfair to the taxpayer that he should have narrower rights where statute has addressed the issue than in those cases where it has not, unless there is a good reason for this difference."<sup>156</sup>

3.68 The Law Commission therefore recommended:

"a repeal of TMA 1970, section 33 and replacement by a right on the part of all taxpayers charged to tax, whether under an assessment or otherwise, to recover tax paid but not due irrespective of the presence or absence of any mistake on the part of the taxpayer".<sup>157</sup>

3.69 The Law Commission further recommended that the right to repayment should be subject to the following defences:<sup>158</sup> (i) change in "settled view" of the law; (ii) compromise and "submission to an honest claim"; (iii) time limit of 6 years; (iv) non-exhaustion of statutory remedies; and (v) unjust enrichment of the taxpayer.<sup>159</sup>

## (2) Our Discussion Paper and consultation

3.70 In our Discussion Paper No 100, we invited views, primarily from Scottish interests, on the Law Commission's recommendations.<sup>160</sup> We supported these recommendations subject to minor modifications to the recommended defences. First, we doubted whether it should be a defence to a statutory claim for recovery of overpaid taxes that recovery would "unjustly enrich" the taxpayer.<sup>161</sup>

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<sup>153</sup> Law Com No 227, para 9.23.

<sup>154</sup> *Idem*.

<sup>155</sup> *Ibid* para 9.24.

<sup>156</sup> *Idem*.

<sup>157</sup> Law Com No 227, recommendation 11 (para 9.25).

<sup>158</sup> Law Com No 227, Part X.

<sup>159</sup> We reviewed these in our Discussion Paper No 100, paras 4.29 *et seq*.

<sup>160</sup> Discussion Paper No 100, paras 4.5 - 4.113.

<sup>161</sup> Discussion Paper No 100, paras 4.65 - 4.82; Proposition 9 (para 4.82).

3.71 Secondly, while we agreed with the Law Commission that it should be a defence to a statutory claim for recovery of an overpayment of tax that a claim for the tax in question was contractually compromised,<sup>162</sup> we did not think that the English common law defence of "submission to an honest claim"<sup>163</sup> should apply in statutory claims and preferred the Scots law on *res judicata*.<sup>164</sup>

3.72 On consultation, though our provisional proposals met with general acceptance, the Inland Revenue made fundamental criticisms which have led us to depart from those proposals.

### (3) The self-assessment system

3.73 The Law Commission's arguments were primarily directed towards the system of assessment in force before the taxation year 1996-1997 and were then extended to self-assessment,<sup>165</sup> an approach followed in our Discussion Paper No 100.<sup>166</sup> The Inland Revenue however emphasised that the proposals should be considered afresh by reference to the system of self-assessment now in force.<sup>167</sup>

3.74 Under that system, it is the taxpayers themselves who create the legal charge to tax by making a self-assessment of their liability to income tax and capital gains tax for any year. The return which taxpayers are required to complete is a return of all the information needed to calculate their total taxable income from all sources and any chargeable gains for the period covered by the return. The responsibility for creating the correct legal charge is therefore on the taxpayer who can either calculate the tax due on the return form or leave the arithmetical calculation to the Inland Revenue. In either case the assessment is a self-assessment and is not open to appeal. If the taxpayer fails to file a return an Inland Revenue officer may make a determination of the tax due by the taxpayer.<sup>168</sup> Such a determination is treated as a self-assessment and there is therefore no right of appeal against it but if the taxpayer files an actual self-assessment that will automatically replace the determination.

3.75 **"Repair" or amendment of return.** On receipt of a return the Revenue's initial processing involves only the calculation of the tax due using the figures in the return (where that has not been done by the taxpayer) and the correction of any obvious errors. This is "repair" of a return and involves replacing an incorrect calculation based on the information provided by the taxpayer with a correct calculation based on that same information. Where a taxpayer disagrees with a "repair" he can amend the return back to its original state (unless it is under enquiry). In such a case the Revenue's only recourse is to open a formal enquiry into the return.

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<sup>162</sup> Discussion Paper No 100, Proposition 6(1)(a) (para 4.54). We also agreed it should not be a defence to such a claim that the payment was made in response to a mere threat to litigate, unless that payment would also qualify as a contractual compromise: *ibid*, Proposition 6(1)(b).

<sup>163</sup> See Discussion Paper 100, paras 4.45 - 4.51.

<sup>164</sup> At *ibid* para 4.52, we observed that it is not for us to suggest the extension to England of the Scottish solution which depends on technical concepts of court procedure and remedies (such as a decree *in foro*) which may have no exact English counterpart. If the Scots solution cannot be adopted in England, we suggest that this is one small corner of Revenue law where a cross-border difference should be permitted reflecting the different background common law rules.

<sup>165</sup> Law Com No 227, recommendation 31 (para 12.17).

<sup>166</sup> Cf paras 4.111 - 4.113; Proposition 14.

<sup>167</sup> The description of the self-assessment system in paras 3.74 - 3.81 below is based on comments made to us by the Inland Revenue.

<sup>168</sup> TMA 1970, s 28(1).

3.76 **Claim for refund under TMA 1970, s 33.** The Inland Revenue has nine months from the delivery of a return in which to "repair" it and a taxpayer has twelve months from the filing date in which he may amend his self-assessment.<sup>169</sup> Where an error is discovered by a taxpayer after the time limit<sup>170</sup> has passed, a claim to "error or mistake" relief may be made under section 33(1) of TMA 1970 within five years of the filing date for the year concerned. The ground may be error of fact or law.<sup>171</sup> Our Discussion Paper No 100 referred to a claim under section 33 being available "only on narrow grounds (eg error in a return)".<sup>172</sup> The Inland Revenue observed that all assessments under self-assessment will be based on a return (other than discovery assessments) so unless there is an error in the return the assessment will be correct.<sup>173</sup>

3.77 **Processing of taxpayer's return.** The normal processing of a taxpayer's return goes forward on the basis that the information provided in the return is accurate. It is, however, open to the Inland Revenue to enquire into any return provided it does so within the statutory time limit.<sup>174</sup> When an enquiry is completed, the Revenue officer who has conducted the enquiry will advise the taxpayer of his conclusion as to the amount of tax which should be included in the taxpayer's self-assessment.<sup>175</sup> The taxpayer may then amend his self-assessment in light of these conclusions.<sup>176</sup> The Inland Revenue too, has powers to amend a taxpayer's self-assessment.<sup>177</sup> The taxpayer has the right of appeal against any amendment made by the Revenue and the normal procedures for appeals apply.

3.78 The only assessments which are issued by the Revenue in self-assessment cases are "discovery" assessments<sup>178</sup> but the Revenue's rights to make such an assessment are strictly limited where the taxpayer has made a return.<sup>179</sup> The Revenue cannot make a "discovery" assessment if the information "discovered" was already in its possession when the self-assessment became final unless there was fraud or negligence on the part of the taxpayer. Thus a taxpayer who has made full disclosure in his return will have absolute finality twelve months after the filing date even if his return is incorrect, provided it was not incorrect because of fraudulent or negligent conduct.<sup>180</sup> The Revenue will not be able to make a discovery assessment because of a change in its practice.<sup>181</sup> This parallels the "general practice" defence to section 33 claims.

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<sup>169</sup> TMA 1970, s 9(4).

<sup>170</sup> In TMA 1970, s 9(4)(b).

<sup>171</sup> The statement in our Discussion Paper No 100, para 4.16, to the effect that "Section 33 applies only to error of fact, not error of law" was and is incorrect.

<sup>172</sup> Para 4.13.

<sup>173</sup> The former system whereby the Revenue issued estimated assessments in the absence of a return no longer applies from 1996/97 onwards.

<sup>174</sup> TMA 1970, s 9A(2).

<sup>175</sup> TMA 1970, s 28A(5).

<sup>176</sup> TMA 1970 s 28(A)(3).

<sup>177</sup> TMA 1970, s 28(A)(2) and (4).

<sup>178</sup> Made under TMA 1970, s 29.

<sup>179</sup> TMA 1970, s 29(3).

<sup>180</sup> Our Discussion Paper No 100 para 4.17 endorsed the view of the Law Commission that "since the Revenue can raise further assessments on discovery of errors, it is only fair that taxpayers should be entitled to claim refunds in similar circumstances". And at para 4.11 the Paper referred to the Revenue's power to raise additional assessments as being "exercisable even where the taxpayer has furnished correct information and the Revenue alone were responsible for the mistake". The Revenue pointed out that these statements do not accurately reflect the position under self-assessment as the Revenue cannot, outwith the twelve months time limit, assess a taxpayer simply because an error is discovered in the return.

<sup>181</sup> TMA 1970, s 29(2).

3.79 **Safeguards for taxpayer against erroneous levies of tax.** In summary, the Inland Revenue pointed to four safeguards under the self-assessment system against erroneous levies of tax. First, he will be assessed on the basis of the information which he himself has provided and, if he so chooses, in the amount which he himself has calculated as being correct. Second, if he has made an error in his return and an overpayment has resulted he may amend it within twelve months of the filing date. Refund of the overpayment will then be made automatically. Third, if he discovers outwith that period that he has made an error in his return he may make a claim under TMA 1970, section 33, whether the error made by him was one of fact or law and he has a right to appeal against the Inland Revenue's decision on his claim to the Special Commissioners and, in specific circumstances, to the courts.<sup>182</sup> Finally, should his self-assessment be amended by the Inland Revenue, or should a "discovery" assessment be made on him, he may appeal to the General or Special Commissioners and from them on a point of law to the courts.

3.80 The Revenue conclude that present statutory appeal machinery provides a fair and effective means of finally determining a taxpayer's liability. It is that machinery, and not section 33, which constitutes the primary safeguard against overpaying tax. Severe criticism of TMA 1970, section 33 is unjustified if that section is considered in its context as a closely defined exception to finality in cases of error or mistake.

3.81 The Revenue further contend that this is not an area of the law which, following the *Woolwich* case,<sup>183</sup> is causing significant problems in the field of direct taxes, and that there is no apparent evidence of injustice or major loss which would justify a change in the law. In contrast, they argue that the changes recommended by the Law Commission create a number of concepts, such as "due diligence"<sup>184</sup> and "settled view of the law",<sup>185</sup> which are untested and uncertain, and could provide a source for substantial litigation. The Revenue opposed replacing familiar legislation which is causing no significant difficulties with new legislation which could give rise to considerable operational problems. The "due diligence" concept appears in a provision on limitation derived from legislation on refunds of VAT which, as we note below,<sup>186</sup> created in effect an open-ended time-limit for refunds of indirect taxes and an unacceptable drain on the public purse. Relying on their recent experience with indirect taxes,<sup>187</sup> the Commissioners of Customs and Excise expressly represented to us that the Inland Revenue's fears of an open-ended time-limit for refunds of direct taxes were well founded.<sup>188</sup>

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<sup>182</sup> The Special Commissioners - who are, of course, entirely independent of the Inland Revenue - are to determine appeals against refusals of claims in accordance with the principles to be followed by the Board and can thus order such repayment as they consider to be reasonable and just.

<sup>183</sup> *Woolwich Equitable Building Society v IRC* [1993] AC 70 (HL, affg CA).

<sup>184</sup> The Commission recommended that it should be a defence to a claim for payment of tax claimed but not due that the applicant either knew of the ground of claim, or should by the exercise of due diligence have known of the ground, within the time limit for appeal against an assessment and did not raise it in that manner: see Law Com No 227, recommendation 19, para 10.45, and in Appendix B, draft clause A inserting new section 33AA(3) in TMA 1970.

<sup>185</sup> The Commission recommended that overpayments of tax should not be regarded as paid under a mistake of law on the part of the taxpayer merely because the taxpayer paid in accordance with a settled view of the law that the payment was due, and later judicial decisions have departed from that view: Law Com No 227, recommendation 12 para 10.20, and in Appendix B, draft clause A, inserting new section 33AA(6) in TMA 1970.

<sup>186</sup> See paras 3.91 - 3.94.

<sup>187</sup> See generally paras 3.85 - 3.103 below.

<sup>188</sup> Obtaining refunds of VAT became "an industry".

#### (4) Our recommendation

3.82 In view of these representations by the Inland Revenue, we believe that it would be unrealistic for us to press for legislation on the lines recommended by the Law Commission, for several reasons. First, since Parliament has recently introduced the new self-assessment system by legislation designed to balance the rights of the State and the taxpayer, it would be unrealistic for us to recommend, over the protests of the Inland Revenue, legislative changes significantly altering that balance. Second, there is no separate Scottish dimension. Third, since the Law Commission abandoned their original proposal for imposing uniformity on recovery rights in all the different statutory tax régimes, there is no statutory template with which recovery of Inland Revenue taxes must comply. Fourth, unlike the legislation on recovery of rates in Scotland,<sup>189</sup> TMA 1970, section 33 provides for recovery of income tax paid under error of law as well as error of fact, a fact which we overlooked in our Discussion Paper. Fifth, we are impressed by the Inland Revenue's argument that it is the statutory appeals procedure not section 33 which forms the main safeguard for taxpayers, and that severe criticism of section 33 is unjustified if that section is considered in its context as a closely defined exception to finality in cases of error or mistake.

#### 2. Inheritance Tax<sup>190</sup> and Stamp Duty<sup>191</sup>

3.83 The Law Commission recommended that the legislative scheme developed in relation to income tax should apply also to two other Inland Revenue taxes namely inheritance tax<sup>192</sup> and stamp duty.<sup>193</sup> If that scheme does not apply to income tax, however, it is not worth applying only to these two taxes.

#### 3. Conclusion

3.84 We make no proposal for amendment of the Taxes Management Act 1970, section 33 (which applies to income tax, corporation tax, capital gains tax and petroleum revenue tax) nor for its extension (with or without amendment) to inheritance tax or stamp duty.

#### D. INDIRECT TAXES ADMINISTERED BY HM CUSTOMS AND EXCISE<sup>194</sup>

##### (1) General

3.85 The system of collection of value added tax (VAT)<sup>195</sup> (which is administered by the Commissioners of Customs and Excise) and of the taxpayer's rights to a refund of overpaid tax,<sup>196</sup> was described by the Law Commission in 1994 and by our Discussion Paper No 100 in 1996.<sup>197</sup> Important changes to taxpayers' rights to such refunds, however, were made by the Finance Act 1997, s 47.<sup>198</sup>

3.86 **Recovery rights.** Section 80(1) of the Value Added Tax Act 1994 (formerly section 24(1) of the Finance Act 1989) provides that where a person has paid an amount to

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<sup>189</sup> See para 3.17 above.

<sup>190</sup> See Law Com No 227, paras 13.1 - 13.11.

<sup>191</sup> Law Com No 227, paras 13.12 - 13.23.

<sup>192</sup> Law Com No 227 recommendation 32, para 13.11.

<sup>193</sup> Law Com No 227 recommendation 33, para 13.23.

<sup>194</sup> Law Com No 227 Part XIV pp 155 - 164.

<sup>195</sup> *Ibid*, paras 14.8 - 14.13.

<sup>196</sup> *Ibid*, paras 14.14 - 14.19.

<sup>197</sup> Paras 4.126 - 4.131.

<sup>198</sup> See para 3.94 below.

the Customs and Excise Commissioners by way of VAT which was not tax due to them, they shall be liable to repay the amount to him<sup>199</sup> on a claim being made for the purpose.<sup>200</sup> This provision gives a general right to recover a tax not due which does not depend on the circumstances of payment: it is irrelevant, for example, whether the payment was made under a mistake.

**3.87 Law Commission's recommendations.** In Law Com No 227, the English Law Commission recommended no change to the recovery rights under VATA 1994, section 80 for two reasons. First, UK national law has to conform to EC law which recognises only two limits on the right to recovery, namely, the defence of "unjust enrichment" and reasonable limitation periods. Second, the Commissioners of Customs and Excise were satisfied with the operation of VATA 1994, section 80, and they confirmed that the defences recommended for direct Inland Revenue taxes were not needed.<sup>201</sup>

**3.88 Discussion Paper No 100.** In our Discussion Paper No 100, we sought views on the Law Commission's recommendation (with which we concurred) that the scheme for recovery of overpaid VAT in the VATA 1994, section 80, should not be altered.<sup>202</sup>

**3.89 Excise duty.** The Law Commission also recommended that overpaid excise duties should be subject to the same recovery régime as overpaid VAT.<sup>203</sup> This recommendation was implemented in 1995.<sup>204</sup>

## **(2) Recent legislation amending VATA 1994**

**3.90 Difficulties with VATA.** On consultation, Customs and Excise explained to us that it was only after they had lost some high profile court cases that it became clear that VATA 1994, section 80, was unsatisfactory, from the Government's point of view, in two respects, namely the unduly long limitation period for refund claims in mistake cases,<sup>205</sup> and the ineffectiveness of the defence of unjust enrichment.<sup>206</sup>

### **(a) Reduction of limitation period**

**3.91 Unduly long limitation period in mistake cases.** Under section 80 of VATA 1994 as originally enacted, no claim for refund could be made more than six years after the date on which the over-payment of VAT was made,<sup>207</sup> except that where the over-payment was made by reason of mistake, a claim could be made at any time within six years from the time the claimant discovered the mistake, or could with reasonable diligence have discovered it.<sup>208</sup>

**3.92** As Customs and Excise explained to us, the latter provision meant that once the mistake had been discovered, the taxpayer could make a claim dating back to the beginning of the time when they first began paying the money. In some cases this meant back to 1973,

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<sup>199</sup> The procedures are set out in SI 1989/2248, reg 6.

<sup>200</sup> VATA 1994, s 80(2).

<sup>201</sup> Viz change in the settled view of the law; non-exhaustion of statutory remedies; a bar against recovery by payer-challengers; *res judicata* and (in England) "submission to an honest claim": see Discussion Paper No 100, paras 4.30 - 4.54.

<sup>202</sup> Discussion Paper No 100, Proposition 17 (para 4.134).

<sup>203</sup> Law Com No 227, recommendation 35 (para 14.23).

<sup>204</sup> Customs and Excise Management Act 1979, s 137A, inserted by Finance Act 1995, s 20.

<sup>205</sup> See paras 3.91 - 3.94 below.

<sup>206</sup> See paras 3.95 - 3.101 below.

<sup>207</sup> *Ibid*, s 80(4).

<sup>208</sup> *Ibid*, s 80(5). An appeal lies to a VAT Tribunal: *ibid*, s 83(t).

when VAT was introduced. This could result in unforeseeable and unquantifiable burdens on the public purse. The Government could, and did, suddenly find itself liable to make very large refunds for which it had not budgeted. As a result, the general body of taxpayers may have to foot a greater tax bill than the Government intended to enable the exchequer to make repayments to businesses.

3.93 Customs and Excise informed us that some of the Government's identified liabilities to make refunds have been very large<sup>209</sup> and that even larger potential claims - indeed claims which are colossal by any standard - are possible.<sup>210</sup> An important source of repayment claims is judgments by British courts, or by the European Court of Justice, overturning a settled view of the law.

3.94 **Finance Act 1997, s 47.** To meet this criticism, section 80 of VATA 1994 was amended by section 47 of FA 1997 which provides that the Customs and Excise are not liable, on a claim under section 80 for refund of overpaid VAT, to repay any amount paid to them more than three years before the making of the claim.<sup>211</sup> This provision makes two changes to the time limit for claims. First, the period of the time limit is reduced from six to three years. Second, the time limit is not extended in cases of payment under mistake; in other words the three year period runs from the date of the mistaken payment, not from date when the claimant discovered the mistake or could with reasonable diligence have discovered it.<sup>212</sup>

**(b) Unjust enrichment of taxpayer or "passing on"**<sup>213</sup>

3.95 As indicated above,<sup>214</sup> section 80(3) of VATA 1994<sup>215</sup> provides that it is a defence to any claim under the section that repayment "would unjustly enrich" the claimant. This defence was designed to preclude recovery when the payee has "passed on" the amount of the tax, for example to purchasers of his goods or services. The common law principles of unjustified enrichment are not in point when construing the statutory expression "unjustly enrich".<sup>216</sup>

3.96 **European Community law.** The defence of unjust enrichment stems from European Community law, under which the national law of a member State may provide for a defence of "unjust enrichment" in an action for repayment of a tax, charge or duty levied in breach of Community law.<sup>217</sup> In the *San Giorgio* case,<sup>218</sup> however, it was held that any requirement of proof which makes it excessively difficult to secure the repayment of charges levied contrary

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<sup>209</sup> Eg £200 million paid to sports clubs and associations; £270 million to opticians; and about £10 million on hot pies.

<sup>210</sup> Eg up to £700 million on interest free credit; up to £25 billion on cars; up to £200 million on foreign exchange.

<sup>211</sup> After 18 July 1996, Customs and Excise deferred payment of claims for refunds exceeding 3 years. This decision, which affected agreements with opticians' professional bodies, was held to be an unconstitutional assumption of a power to suspend laws which infringed the Bill of Rights 1689: *R v Customs and Excise Commissioners ex p Kay & Co and Ors*, (QBD); [1996] STC 1500. See M Cornwall-Kelly, "The Stuarts live on" [1996] *Tax Journal* 384 9-10. Now however, under FA 1997, s 47(2), the 3 year time limit is deemed to have come into force on 18 July 1996, subject to certain exceptions in s 47(3) and (4).

<sup>212</sup> FA 1997, s 47 also provides for a claw back of excessive refunds, and a three year time limit on assessments of penalties and undeclared VAT.

<sup>213</sup> Law Com No 227, paras 10.44 - 10.48.

<sup>214</sup> See para 3.46.

<sup>215</sup> Formerly section 24 of the FA 1989.

<sup>216</sup> *Commissioners of Customs and Excise v McMaster Stores (Scotland) Ltd (in receivership)* 1996 SLT 935.

<sup>217</sup> Case 68/79 *Hans Just I/S v Danish Ministry for Fiscal Affairs* [1981] 2 CMLR 714.

<sup>218</sup> Case 199/82 *Amministrazione delle Finanze dello Stato v San Giorgio SpA* [1985] 2 CMLR 658.

to Community law<sup>219</sup> is incompatible with Community law. In that case the Advocate General took the view that "extinction of the right to repayment as a result of the passing on of charges is permissible only marginally and almost never in those cases where the price is determined by market forces".<sup>220</sup> In *Société Comateb & Ors. v Directeur Général des Douanes et Droits Indirects*,<sup>221</sup> the European Court held that a Member state may resist repayment of a charge levied in breach of Community law only where it is established that the charge has been borne in its entirety by a third party and that reimbursement of the trader would constitute unjust enrichment. It is for the national courts to determine, in the light of the facts in each case, whether the requirements of the defence of unjust enrichment are satisfied. If the burden of the charge has been passed on only in part, it is for the national authorities to reimburse the trader the amount not passed on.<sup>222</sup>

3.97 **Taxpayer's "unjust enrichment" cancelled out by his loss of profit.** As we indicated in Discussion Paper No 100,<sup>223</sup> the successful claimant's "unjust enrichment" by obtaining a refund of VAT which his customers have paid may be cancelled out by his loss of profit: "the increase in price may have led to a decrease in demand so as to negate any 'windfall' element".<sup>224</sup> This may occur in the usual case where demand is elastic and prices are fixed by the market.<sup>225</sup> This was recently recognised in the *Comateb* case<sup>226</sup> which held that although a charge levied on a trader in breach of EC law has been passed on by him in whole or in part to the ultimate consumer, repayment to the trader of the amount passed on does not necessarily entail his unjust enrichment. Indeed the trader may suffer damage as a result of the very fact that he has passed on the charge because the increase in price can lead to a decrease in sales. In the *Comateb* case, the European Court held that where domestic law permits the trader to claim that the illegal levying of the charge has caused him damage which excludes, in whole or in part, any unjust enrichment, it is for the national court to give such effect to the claim as may be appropriate.<sup>227</sup>

3.98 **Consultation.** In our Discussion Paper No 100 we observed that since apparently the defence works well in VAT and excise duty cases, we did not propose its abolition there.<sup>228</sup> On consultation, however, the Board of Customs and Excise pointed to dissatisfaction with the defence from their standpoint which has led to remedial legislation.

3.99 The defence of unjust enrichment only achieves justice if the trader has passed on the illegal VAT to his customer, the ultimate consumer, and his gain thereby acquired is not offset by lost business. For a time traders argued that they rather than their customers bore

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<sup>219</sup> Eg a restriction to documentary evidence, or a presumption of passing on which the claimant for repayment must rebut.

<sup>220</sup> *Ibid* at p 677.

<sup>221</sup> Joined Cases C-192/95 to C128/95 Judgment of ECJ 14.1.97; [1997] 2 CMLR 649.

<sup>222</sup> The fact that there is a statutory obligation to incorporate the charge in the cost price does not mean that there is a presumption that the entire charge has been passed on, even where failure to comply with that obligation carries a penalty.

<sup>223</sup> Para 4.74.

<sup>224</sup> *Idem*. See also A Burrows, "Public authorities, Ultra Vires and Restitution" in: A Burrows (ed), *Essays on the Law of Restitution* (1991) 39 at p 59: "to pass on one's loss does not necessarily mean that one recoups that loss. For example, the charging of higher prices ought in theory to reduce the number of customers".

<sup>225</sup> Moreover, if the loss is passed on, it may not be possible for the court to assess the longer term effect on sales of the increase in prices, since these effects may not be felt till after the time of action, depending on market conditions. This can be unjust to the payer especially if there is a very short limitation period.

<sup>226</sup> *Société Comateb & Ors. v Directeur Général des Douanes et Droits Indirects* Joined Cases C-192/95 to C128/95 Judgment of ECJ 14.1.97; [1997] 2 CMLR 649.

<sup>227</sup> [1997] 2 CMLR 649 at pp 669,670.

<sup>228</sup> Paras 4.81; 4.132 - 4.134. On the other hand, we observed that but for the Law Commission's support for the defence, we would have been inclined to reject it as a general defence: para 4.81.

the VAT because their prices were dictated by competitive market forces rather than by the effect of the VAT. So the overpayment of VAT was financed by cutting into profits rather than by charging increased prices to customers.<sup>229</sup> It appears that VAT Tribunals had formerly taken the view that the onus lay on Customs and Excise to prove (a) that the claimant had passed on the VAT to his customers by charging higher prices, and (b) that the claimant did not lose profit as a result of having to charge those higher prices. Because of *inter alia* the difficulty of proving a negative, it was almost impossible for Customs to prove the latter.<sup>230</sup> The Customs and Excise told us that traders, knowing these difficulties of proof experienced by Customs, learned to say that due to market forces they could not pass on VAT. The result was that, in the view of Customs, large numbers of traders<sup>231</sup> were getting windfall profits.<sup>232</sup>

**3.100 Finance Act 1997, section 46.** To remedy this mischief, the Finance Act 1997, section 46<sup>233</sup> provides in effect that where the terms of a transaction suggest that the whole or part of the cost of paying VAT has, for practical purposes, been borne by someone other than the taxpayer (eg his customer), then in determining whether he is unjustly enriched, loss or damage incurred by the taxpayer as a result of mistaken assumptions about VAT provisions is to be disregarded except to the extent of "the quantified amount"<sup>234</sup> ie the sum shown by the taxpayer to be the amount which would appropriately compensate him for loss or damage shown by him to have resulted from making the mistaken assumptions.<sup>235</sup> The effect of this provision is that the onus initially lies on the taxpayer to make a *prima facie* case quantifying and substantiating the appropriate amount of compensation. If such a *prima facie* case is made out, the onus then lies on the Customs and Excise to rebut it if they can.

## Conclusion

3.101 Our provisional proposal supporting the Law Commission's recommendation against amending the Value Added Tax Act 1994, section 80, was based on the agreement to that effect which then obtained as between the Law Commission and HM Customs and Excise. That proposal has been overtaken by events, notably the drain on the public purse arising from the operation of section 80 as originally enacted and the consequential amendments of section 80 made by the Finance Act 1997. There is here no separate Scottish private law dimension, nor even any separate Scottish dimension. It is not for us to recommend changes to new provisions so recently passed by Parliament.

## Other indirect taxes

3.102 The above changes apply equally to the other indirect taxes administered by Customs ie excise duties and taxes, including air passenger duty, insurance premium tax

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<sup>229</sup> See eg A R Barr, "Tax Matters" (1997) 42 JLSS 70 at p 71.

<sup>230</sup> We were informed that even where VAT was clearly shown on an invoice, or the invoice said VAT inclusive, VAT Tribunals did not accept this as conclusive evidence that tax had been passed on.

<sup>231</sup> Eg opticians obtaining refunds in connection with the supply of spectacles.

<sup>232</sup> In the *Comateb* case [1997] 2 CMLR 649 the European Court held that even though indirect taxes are designed to be passed on to the final consumer and even if in commerce they are normally passed on, it may not be assumed that there is a presumption that indirect taxes have been passed on and that the onus is on the taxpayer to rebut such a presumption.

<sup>233</sup> The provisions of this section take account of the *Comateb* case: Joined cases C-192/95 - C128/95: see above.

<sup>234</sup> VATA 1994, s 80(3A) and (3B) inserted by FA 1997, s 46(1).

<sup>235</sup> VATA 1994, s 80(3C) inserted by FA 1997, s 46(1).

and landfill tax.<sup>236</sup> Car tax has been abolished.<sup>237</sup> As in the case of VAT and for similar reasons, our provisional proposals on these taxes<sup>238</sup> are likewise superseded.

### Conclusion on indirect taxes

3.103 In these circumstances we make no recommendation for amending the scheme for recovery of overpaid VAT in the Value Added Tax Act 1994, section 80, as amended by the Finance Act 1997.

## E. SOCIAL SECURITY CONTRIBUTIONS

3.104 There is a provision in the Social Security (Contributions) Regulations 1979<sup>239</sup> which gives a right to the recovery of National Insurance Contributions paid in error.<sup>240</sup> This provision applies whether the mistake is one of fact or law.<sup>241</sup> The application must be made within 6 years from the end of the year in which the contribution was paid.<sup>242</sup> No provision is made as to interest. Under recent legislation intended to take effect in April 1999, the right of recovery of contributions will be limited in some cases.<sup>243</sup>

3.105 In our Discussion Paper No 100,<sup>244</sup> we sought views on the Law Commission's recommendation<sup>245</sup> (with which we concurred) that the existing scheme for the recovery of social security contributions paid in error should be unaltered except for the inclusion, by the amendment of the Contribution Regulations, of payments made under *ultra vires* secondary legislation.

3.106 We understand that there are no present plans to make the amendment recommended by the Law Commission. However we draw the attention of the competent authorities to the fact that the Law Commission's recommendation was approved by Scottish consultees (without specific comment).

## F. COUNCIL TAX<sup>246</sup>

3.107 The Local Government Finance Act 1992<sup>247</sup> replaced the community charge<sup>248</sup> (which was a flat-rate, capitation tax) with the council tax<sup>249</sup> in which the main unit of charge is the taxpayer's dwelling.<sup>250</sup> The primary legislation on council tax is cross-border and the separate Scottish subordinate legislation closely resembles its English counterpart.

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<sup>236</sup> See Finance Act 1997, s 50 and Sch 5. Air passenger duty is a duty of excise, Finance Act 1994, s 40.

<sup>237</sup> Car Tax (Abolition) Act 1992. Car tax is not chargeable after 13 November 1992, but the Car Tax Act 1983 is not repealed.

<sup>238</sup> Discussion Paper No 100, Proposition 18 (para 4.137) on excise duties; Proposition 19 (para 4.138) on insurance premium tax; Proposition 20 (para 4.142) on car tax.

<sup>239</sup> SI 1979/591 as amended.

<sup>240</sup> *Ibid*, reg 32; and see also reg 34 on voluntary contributions where recovery is not stated to depend on the existence of any error.

<sup>241</sup> *Morecombe v Secretary of State*, "The Times", December 12 1987.

<sup>242</sup> SI 1979/591, reg 32(5).

<sup>243</sup> Social Security Contributions and Benefits Act 1992, s 19A inserted by Social Security Act 1998, s 54.

<sup>244</sup> Proposition 21 (para 4.144).

<sup>245</sup> Law Com No 227, recommendation 37 (para 15.12).

<sup>246</sup> Law Com No 227, paras 15.13 - 15.26 describe the council tax system as it operates in England and Wales.

<sup>247</sup> Part II (ss 70 - 99) applies to Scotland.

<sup>248</sup> Which had been introduced by ADRE(S)A 1987.

<sup>249</sup> LGFA 1992, s 70 as amended by LGE(S)A 1994, Sch 13, para 176.

<sup>250</sup> LGFA 1992, s 72; as amended by SI 1992/1334; SI 1992/2955; SI 1993/526.

Regulations<sup>251</sup> make provision for the adjustment (repayment or crediting of overpayments) of council tax where payment is by instalments<sup>252</sup> or lump sum.<sup>253</sup> A final adjustment is made as soon as practicable after the end of the financial year.<sup>254</sup> Any overpayment, to the extent that it exceeds the person's other outstanding liability, must be repaid to him if he so requires or, in any other case, credited against any subsequent liability of his to pay council tax.<sup>255</sup>

3.108 As regards claims for refund of overpaid council tax, there is a difference between limitation in England and Wales and negative prescription in Scotland. In England and Wales, a six-year time limit from the date the cause of action accrued is imposed by the general law on recovery under statutes.<sup>256</sup> In Scots law, there is a question whether the 5-year or 20-year period of negative prescription applies. Since the short (5-year) period of negative prescription can apply to public law obligations,<sup>257</sup> the council tax provisions may possibly be construed as creating an obligation of repetition, or other obligation of redress of unjustified enrichment, which both prescribe in 5 years.<sup>258</sup>

In our Discussion Paper No 100, we concurred with the Law Commission's general recommendation<sup>259</sup> that the existing scheme for the recovery of undue council tax should not be altered. We further agreed with the Law Commission that overpayments demanded *ultra vires* should be recoverable but did not think it necessary to amend the regulations to

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<sup>251</sup> Council Tax (Administration and Enforcement) (Scotland) Regulations 1992 (SI 1992/1332). LGFA 1992, Sch 2, para 2 (5)(b) enables regulations to be made providing: "that any amount paid by the liable person in excess of his liability (whether the excess arises because an estimate turns out to be wrong or otherwise) must be repaid or credited against any subsequent liability".

<sup>252</sup> Reg 23 (payments: adjustments).

<sup>253</sup> Reg 24 (lump sum payments).

<sup>254</sup> Reg 27 (final adjustment of sums payable).

<sup>255</sup> Reg 27(4).

<sup>256</sup> Limitation Act 1980, s 9; Law Com No 227, para 15.25.

<sup>257</sup> *Lord Advocate v Butt* 1991 SLT 248 (OH) at pp 252K-253A per Lord Prosser; reversed on another point, 1992 SC 140 (2d Div).

<sup>258</sup> Prescription and Limitation (Scotland) Act 1973, s 6, and Sch. 1, para 1(b). Where however the obligation to repay is imposed by "an order of a tribunal or authority exercising jurisdiction under any enactment", the period is 20 years: 1973 Act, Sch 1, para 2 (c).

<sup>259</sup> Law Com No 227, recommendation 38 (para 15.26).

achieve that result.<sup>260</sup> Since these views were generally approved on consultation, we make no proposal for reform of the scheme for the recovery of undue council tax.

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<sup>260</sup> Discussion Paper 100, Proposition 22 (para 4.151).

## Part 4 Recovery by Public Authorities of *Ultra Vires* Disbursements

### Preliminary

4.1 In this Part, we consider the recovery by public authorities of *ultra vires* disbursements. Since the topic was considered by the English Law Commission in their Consultation Paper and Report, and relates to the fundamental constitutional principle of the authorisation by Parliament of payments out of the Consolidated Fund, it was necessary to ensure that the law on each side of the border is substantially the same.<sup>1</sup>

### The existing law

4.2 **Scots cases.** There are remarkably few reported cases of actions by "public authorities" for repetition of *ultra vires* or undue payments made by them. Most of the cases relate to actions for repayment of parochial relief paid unduly to a pauper under the old poor law.<sup>2</sup> In general, the Scottish courts have applied the ordinary common law rules on repetition to the recovery of *ultra vires* disbursements.<sup>3</sup> Exceptionally, one defence, that of *bona fide* consumption, is available to a private citizen defending an action by the Crown<sup>4</sup>, though it is probably not available to the Crown in an action by a private citizen, at any rate where the amounts are small.<sup>5</sup>

4.3 ***Ultra vires* payments out of the Consolidated Fund: the *Auckland Harbour Board* rule.** In the leading case of *Auckland Harbour Board v The King*,<sup>6</sup> Viscount Haldane observed:

"For it has been a principle of the British Constitution now for more than two centuries, a principle which their Lordships understand to have been inherited in the Constitution of New Zealand with the same stringency, that no money can be taken out of the Consolidated Fund into which the revenues of the State have been paid, excepting under a distinct authorization from Parliament itself. The days are long gone by in which the Crown, or its servants, apart from Parliament, could give such

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<sup>1</sup> Law Com No 227, Section D (Part XVII), "Claims by Public Bodies"; Law Com C P No 120, Part IV. See also Law Reform Commission of British Columbia, Report on *The Recovery of Unauthorized Disbursements of Public Funds*, LRC 48 (1980).

<sup>2</sup> Where relief was given for destitution, the poor law authority could generally not claim repetition from the pauper unless he had obtained the money by false pretences, as by concealing means sufficient for his support: *Henderson v Alexander* (1857) 29 Sc Jur 559; *Kilmartin Inspector of Poor v Macfarlane* (1885) 12 R 713; *Forfar Parish Council v Davidson* (1898) 1F 238; *Glasgow Parish Council v Rae* (1901) 17 Sh Ct Repts 117; *Prudential Assurance Co Ltd v Dalziel Parish Council* (1914) 24 Poor Law Magazine 203; *Rutherglen Parish v Tolmie* 1922 SLT (Sh Ct) 72.

<sup>3</sup> *Bremner v Taylor* (1866) 3 S L Rep 24 (OH); *Inverness County Council v Macdonald* 1949 SLT (Sh Ct) 79.

<sup>4</sup> *Lord Advocate v Drysdale* (1872) 10 M 499, affd (1874) 1 R (HL) 27. This was not an action of repetition of a payment, but an action by the Crown for arrears of teinds in circumstances where the defender had consumed the rents out of which the teinds were payable.

<sup>5</sup> *Earl of Cawdor v Lord Advocate* (1878) 5 R 710.

<sup>6</sup> [1924] AC 318 (PC). The Crown paid under statute to the Harbour Board money in consideration of the Board granting a lease to a third party. The statute authorised the payment only if the lease was entered into. The Harbour Board was ready to grant the lease on the Crown's request but the Crown never made the request, resumed title to the land, and set off the money against other sums due by the Harbour Board to the Crown. The Harbour Board's action of repayment failed.

an authorization or ratify an improper payment. Any payment out of the Consolidated Fund made without Parliamentary authority is simply illegal and ultra vires, and may be recovered by the Government if it can, as here, be traced".<sup>7</sup>

As a principle of the British Constitution, it must presumably apply in Scots law, unless possibly broadly the same result is achieved by reference to wider principles of Scots law. No Scots reported case referring to the principle has been traced.<sup>8</sup>

4.4 In Scots law, on one approach, the *Auckland Harbour Board* rule could be subsumed within the *condictio sine causa*.<sup>9</sup> Alternatively, the undue payment might be recoverable under the *condictio indebiti* if the wide theory as to its scope<sup>10</sup> came to be accepted. On the other hand, it may be treated as a separate and special ground of repetition based on constitutional law.

### Arguments for reform

4.5 The Law Reform Commission of British Columbia<sup>11</sup> advanced several arguments for reform of the *Auckland Harbour Board* rule, namely, (1) that the rule is not an effective means of enhancing legislative authority; (2) that there are more direct means of enhancing legislative control of public money; and (3) that Parliament does not exercise specific control over the expenditure of funds.<sup>12</sup> Another argument is the uncertainty surrounding the scope of the rule.

### The Law Commission's recommendation against reform

4.6 These considerations might suggest that the *Auckland Harbour Board* rule is in some need of reform. In their consultation paper, the Law Commission identified two main options<sup>13</sup> viz: (a) retention of the *Auckland Harbour Board* rule (on the assumption that appropriate restitutionary defences are available)<sup>14</sup>; and (b) abolition of the *Auckland Harbour Board* rule and application of the ordinary private law rules as reformed by abolition of the error of law rule.<sup>15</sup>

4.7 In their final Report however the Law Commission recommended against reform<sup>16</sup> for the following reasons. First, too few consultees supported reform for their support to carry

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<sup>7</sup> *Ibid* at pp 326-327 (delivering the judgment of the Board). By "traced" is probably meant ascertaining the recipient, not "tracing" in the sense of English Equity law: *Commonwealth of Australia v Burns* [1971] VR 525 at p 528 per Newton J.

<sup>8</sup> This is scarcely surprising because in English law, according to Law Com No 227, para 17.19: "there appear to have been only two reported cases on this topic in almost 400 years" See *Doddington's Case* (1596) Cro. Eliz. 545: cited in argument in [1924] AC 318 (PC) at p 320. There have been a few Commonwealth cases: eg *Commonwealth v Burns* [1971] V R 825 (Supreme Court of Victoria); *Attorney-General v Gray* [1977] 1 NSWLR 406 (CA).

<sup>9</sup> This is the approach adopted by *Gloag and Henderson, The Law of Scotland* (10th edn) para 29.7, notes 49 and 50.

<sup>10</sup> Eg to permit recovery of undue payments made to discharge an obligation without legal ground: Evans-Jones, "Reflections on the Condictio Indebiti in a Mixed System" (1994) 111 SALJ 759; R Evans-Jones, "From 'Undue Transfer' to 'Retention without a Legal Basis' (The *Condictio Indebiti* and *Condictio ob Turpem vel Iniustam Causam*)" in: R Evans-Jones (ed), *The Civil Law Tradition in Scotland* (1995) 213.

<sup>11</sup> Report No 48 on *The Recovery of Unauthorized Disbursements of Public Funds*, LRC 48 (1980), p 12.

<sup>12</sup> Another argument (*ibid* p 13) was that to allow a defence to the recipient of funds would put him on an equal footing with the Crown.

<sup>13</sup> Law Com No 227, para 17.9.

<sup>14</sup> This is the approach recommended by the Law Reform Commission of British Columbia, Report No 48 on *The Recovery of Unauthorized Disbursements of Public Funds*, LRC 48 (1980) pp 14, 15.

<sup>15</sup> A third option - replacement of the *Auckland Harbour Board* rule by a new statutory rule allowing recovery only in very limited circumstances - Law Com No 227, para 17.10 received no support from their consultees.

<sup>16</sup> Law Com No 227, recommendation 40 (para 17.21). The recommendation was made on the footing that the common law defences of change of position and submission or compromise would apply: para 17.21.

much weight.<sup>17</sup> Second, the practical area of application of the rule is limited<sup>18</sup> because of the legislation on welfare benefits, the area where disputes are most likely to arise.<sup>19</sup> Third, legislative reform has a tendency to generate litigation: "the present rule, as is the nature of absolute rules, tends towards certainty and the avoidance of case law."<sup>20</sup> Fourth, the arguments of principle did not suffice.<sup>21</sup>

### Should there be separate reform in Scots law?

4.8 In our discussion paper<sup>22</sup> we suggested that the present law is to some extent unsatisfactory. To the vagueness and uncertainty of the *Auckland Harbour Board* rule in England must be added the further uncertainty of how far the equivalent Scots rule corresponds, especially in relation to defences.<sup>23</sup> We questioned whether a separate rule is necessary or desirable to protect the Consolidated Fund. We agreed with other law reform bodies<sup>24</sup>, that a defence of "change of position" should be available.

4.9 On the other hand, we also acknowledged in our discussion paper<sup>25</sup> that the present Scots law of repetition, being in a state of transition, does not form a very secure basis for abolishing a rule of automatic recovery. The need for particular grounds of repetition like error is being questioned and the *Auckland Harbour Board* rule may accord with the direction in which the general law is moving. Furthermore, since the Law Commission have rejected legislation, it would be unrealistic for us to recommend for Scotland alone legislation to amend the *Auckland Harbour Board* rule eg by enacting defences. We therefore favoured no change in the law, at least in the short term.

4.10 This view was supported on consultation by the few who commented.<sup>26</sup> The Lord President (Lord Rodger of Earlsferry) emphasised the need to give proper weight to the fundamental principle underlying the *Auckland Harbour Board* rule and remarked:

"The control of payments from the Consolidated Fund is control of supply and that is the basis upon which our system of Parliamentary government depends. It is for this reason that the Privy Council pronounced such an apparently absolute rule - though like everyone else, I suspect that the usual restitution defences apply. Subject to that qualification, I do not believe that one can or should downgrade the importance of the principle that moneys cannot be paid out of the Consolidated Fund without authority and that, if they are, they can be recovered. Nor do I think that Parliament would pass such a measure even if it were asked to".

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<sup>17</sup> Law Com No 227, para 17.13.

<sup>18</sup> Law Com No 227, para 17.17: perhaps only "payments of salaries, grants and awards ultra vires and payments under ultra vires contracts": *ibid.*

<sup>19</sup> Law Com No 227, para 17.19.

<sup>20</sup> *Idem.*

<sup>21</sup> *Idem.*

<sup>22</sup> Discussion Paper No 100, paras 5.33 *et seq.*

<sup>23</sup> Eg we are not convinced that the apparently absolute nature of the *Auckland Harbour Board* rule leaves room for developing defences at common law. But, if there is room for such defences it seems unlikely, for example, that "submission to an honest claim" would or should ever be recognised as a defence to the Scottish version of the rule having regard to the different Scottish principles on finality of litigation.

<sup>24</sup> Law Reform Commission of British Columbia, Report No 48 on *The Recovery of Unauthorized Disbursements of Public Funds*, LRC 48, p 12; Law Reform Committee of South Australia, Report on *The Irrecoverability of Benefits Obtained by Reason of Mistake of Law* (84th Report, 1984) pp 32,33; and Law Com No 227, para 17.20.

<sup>25</sup> Discussion Paper No 100, paras 5.36 *et seq.*

<sup>26</sup> Including the Faculty of Advocates, Mr G Jamieson, the Law Society of Scotland (Obligations Committee) and the Lord President (Lord Rodger of Earlsferry).

Our consultation revealed that, as in England and Wales, there is insufficiently strong support in Scotland for statutory measures amending the *Auckland Harbour Board* rule.

4.11 In the light of these considerations we recommend:

**The *Auckland Harbour Board* rule (under which *ultra vires* disbursements by central government from the Consolidated Fund, and possibly other *ultra vires* disbursements by public authorities from other public funds, are always recoverable) should not be reformed by legislation at the present time.**

(Recommendation 7)

## Part 5 Future Development of the Law of Unjustified Enrichment

5.1 The Commission has a statutory duty under section 3(1) of the Law Commissions Act 1965 to keep under review the law with a view to its systematic development and reform including its simplification and modernisation. At least until recently, most commentators agreed that the present state of the law of Scotland on unjustified enrichment was unsatisfactory. The law was complex and in some cases obscure. It lacked a concerted jurisprudential theory and drew its principles from a number of disparate sources. Throughout the 1990s we have had in view the possibility of a comprehensive reform of the law of unjustified enrichment.

5.2 In Discussion Paper No 95<sup>1</sup> we made a provisional proposal for statutory reform of the rule that precluded the recovery of benefits conferred under error of law. Shortly after the publication of that discussion paper, the matter came before a bench of five judges of the Court of Session in *Morgan Guaranty Trust Company of New York v Lothian Regional Council*.<sup>2</sup> The effect of the decision in that case was to abolish the rule. The decision therefore overtook the work that we had done in Discussion Paper No 95 and there was no need for us to follow that work up with a formal report. We were pleased that in reaching that decision the court was assisted by the research and the discussion which we had set out in our Paper.

5.3 There remained the second main provisional proposal in Discussion Paper No 95, namely that there should be a statutory safeguard to prevent persons who had paid a purported debt in accordance with a settled view of the law later overturned by a judicial decision from recovering their payment, lest a wide circle of closed transactions be opened up whenever such a decision was made.<sup>3</sup> In our Discussion Paper No 99,<sup>4</sup> we provisionally resiled from that proposal and pointed to the difficulties that it created. In *Kleinwort Benson Ltd v Lincoln City Council*<sup>5</sup> the House of Lords approved of our cautious approach in Discussion Paper No 99 and refused to introduce such a safeguard in England at common law. In the light of Part 2 of this Report we recommend against the introduction of that safeguard by statute.

5.4 In Discussion Paper No 100<sup>6</sup> we reviewed the common law rules and the statutory provisions for recovery of undue payments of various taxes and charges imposed by both central and local government bodies and on *ultra vires* disbursements by such bodies. Our recommendations following that discussion paper are set out in Parts 2 to 4 of this Report.

5.5 Our work in these areas was done in parallel with that of the Law Commission in their Consultation Paper No 120<sup>7</sup> and Report (Law Com No 227).<sup>8</sup>

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<sup>1</sup> *Recovery of Benefits Conferred Under Error of Law*.

<sup>2</sup> 1995 SC 151.

<sup>3</sup> Discussion Paper No 95, Vol 1, Proposition 3 (para 2.125); see para 2.5 above.

<sup>4</sup> *Judicial Abolition of the Error of Law Rules and its Aftermath*.

<sup>5</sup> [1998] 4 All ER 513 (HL).

<sup>6</sup> *Recovery of Ultra Vires Public Authority Receipts and Disbursements*.

<sup>7</sup> *Restitution of Payments Made Under a Mistake of Law*.

5.6 At that time we were proceeding in terms of our *Fourth Programme of Law Reform*.<sup>9</sup> At about the same time we were preparing a draft of our *Fifth Programme of Law Reform*. One of the matters for our consideration was whether that programme should include some comprehensive and systematic review of the law of unjustified enrichment.

5.7 In the event we included the subject in our *Fifth Programme* with the approval of the Lord Advocate in the following terms:

"2.27 We also think, as a result of our extensive work to date on obligations for the redress of unjustified enrichment, that the topic may be suitable for more comprehensive reform. We propose to undertake this as a long-term project.

2.28 In our Discussion Paper No 95 on *Recovery of Benefits Conferred Under Error of Law*, we sought views on provisional proposals that the rule precluding recovery of benefits conferred under error of law should be abrogated by statute. This proposal has been superseded by a recent case in which the Court of Session in effect abolished that rule. The decision of the Court made very significant advances in developing the Scots law of unjustified enrichment, but also shows how difficult it is for the courts to reform the deep-rooted structural faults in the present law. There is uncertainty and undue complexity at every level, for example as to the differences between the main obligations or remedies of repetition, restitution and recompense; as to the scope and requirements of the forms of action or claim (*condictiones* and innominate actions) subsumed under repetition and restitution; and as to the specific grounds which have to be proved to establish a claim.

2.29 These defects remain. In a recent discussion paper, therefore, we invited comments on a proposal to publish a further discussion paper setting out a "non-binding" statement (or "restatement") of the existing law on unjustified enrichment and seeking views on whether comprehensive statutory codification or further piecemeal statutory reforms are desirable. In an appendix, we also published *Draft Rules on Unjustified Enrichment and Commentary* which had been prepared by Dr E M Clive to test the feasibility of codification. While opinion was divided, there was considerable support for such a discussion paper - hence our present proposal to undertake a further long-term project on the topic, possibly including an exercise in codification."<sup>10</sup>

5.8 In our *Thirty-Second Annual Report (1996-97)*<sup>11</sup> we referred to the matter in the following terms:

"2.28 We have encountered unexpected complexities in finalising the report on diligence on the dependence and admiralty arrestments. Consequently, we have had to concentrate resources on that project. We now intend to publish during 1998 a short report on unjustified enrichment, proposing certain limited reforms. On completion of our work on diligence, we will reassess the need for comprehensive reform of the law of unjustified enrichment in the light of the then state of the law and the pressure, if any, for reform."

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<sup>8</sup> *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments*.

<sup>9</sup> Scot Law Com No 126.

<sup>10</sup> Scot Law Com No 159. The *Fifth Programme* was approved by the Lord Advocate in February 1997.

<sup>11</sup> Scot Law Com No 161.

5.9 In this Report we have confined ourselves to a brief review of limited aspects of unjustified enrichment and to one short but important recommendation for amendment of the law relating to the repayment of overpaid non-domestic rates. We have not attempted a more general review of the subject for the following reasons.

5.10 In the consultation responses to our Discussion Papers Nos 95 and 99 there emerged a strong divergence of view from senior and experienced members of the profession on the questions (a) whether we ought to embark on proposals for a systematic reform of the law on the subject and (b) if we were to do so, in what direction such reform should lie. It became apparent to us that while most commentators recognised that the law might benefit from a systematic overhaul and that it was undesirable that it should remain in its present state, views were nonetheless far from unanimous on the desirability of any particular reform.

5.11 A few consultees favoured codification or comprehensive and systematic legislative reform. One commentator said that the first priority must be to obtain a clear and workable set of rules and that the only real hope of achieving this within a reasonable timescale would be by legislation. Another thought that codification would be a natural development in the civilian tradition of our law.

5.12 On the other hand the majority of commentators opposed codification. Some considered that such a project would be over-ambitious and might create as many problems as it solved.<sup>12</sup> There was a strongly held view among certain senior members of the profession, including some of the judges, that a period of judicial development would be preferable before the question of systematic reform was again considered.

5.13 There was more support for a non-binding re-statement. Two commentators observed that the various approaches to unjustified enrichment in current Scottish legal thinking need to be pitted against each other in order that a broad-based consensus may emerge. On the other hand, another consultee said that while the Commission's discussion papers had influenced the development of our law (eg in the *Morgan Guaranty*<sup>13</sup> case), he doubted whether the Commission should set out deliberately to achieve this through some conscious attempt at sub-legislative reform. The re-statement would be bound to come down on one side or the other on various controversial points and this might stifle discussion or create deeper doubts as to what the law is.

5.14 We have re-assessed the question of the future development of the law on unjustified enrichment and our involvement in it. In doing so we have taken into account our limited resources and our other priorities.

5.15 We have also taken into account the important decisions of the Inner House of the Court of Session in *Shilliday v Smith*<sup>14</sup> and of the House of Lords in *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd*.<sup>15</sup> These decisions have restructured the law on unjustified enrichment. The old structure which we criticised in our Fifth Programme has gone. The law is no longer based on actions for repetition, restitution or recompense. These are now seen as merely remedies which reflect the particular way in which an enrichment has

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<sup>12</sup> Lord Prosser, who is of this view, remarked in response to Discussion Paper No 95 (*supra*) that "old organic growths are likely to be recognisably defective. New and purportedly exhaustive statutory replacements are likely to be unrecognisably defective. A change from the former to the latter has no evident advantage".

<sup>13</sup> *Supra*.

<sup>14</sup> 1998 SC 725.

<sup>15</sup> 1998 SLT 992.

occurred. The law is based on a unifying principle or rule to the effect that an enrichment of one person at the expense of another falls to be redressed if there is no legal justification or ground for the retention of the enrichment. This development seems to us to be an excellent basis for further judicial or statutory refinement of the Scottish law on this subject.

5.16 In the light of these judicial developments we are of the view that our own involvement in this topic should now come to an end, at least for the time being. We have worked extensively on it over the last few years. We have considered options for minor reforms and more radical restructuring. We are pleased that some of our work has already been found useful. Our resources are now needed for other topics.

## Part 6 Summary of Recommendations

### POSSIBLE AMENDMENTS OF COMMON LAW CONSEQUENTIAL ON *MORGAN GUARANTY* AND *WOOLWICH* CASES (PART 2)

#### Common law claims reopening settled transactions

1. Where payments are made on the faith of a settled view of the law to the effect that the payments are due, and that view is later changed by a subsequent judicial decision, recovery of the payments should not be barred by statute but should continue to be regulated by the common law (under which the payments will be recoverable unless the court finds that it would be inequitable to order repayment).

(Paragraph 2.49)

#### The *Woolwich* rule not to be introduced into Scots law by statute

2. It is unnecessary to introduce the *Woolwich* rule (under which a citizen who makes an undue payment of tax or similar levy to a public authority pursuant to an *ultra vires* demand has a prima facie right to repayment) into Scotland by statute since in comparable circumstances the Scottish courts would give a citizen a remedy by reference to the principles of Scots law.

(Paragraph 2.65)

### STATUTORY PROVISIONS FOR REFUND OF OVERPAID RATES (PART 3)

#### (a) Ground of claim for refund

3. The ground of a claim for a refund of overpaid rates under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 (which currently applies only to undue payments made under error of fact) should be extended to cover also undue payments made under error of law, or error of mixed fact and law, but should not be extended to cover payments made without error but under compulsion, or pursuant to an *ultra vires* demand or otherwise.

(Paragraph 3.31; Draft clause)

#### (b) Introduction or amendment of "defences"

##### Time-limit on application for refund

4. The rule laid down by the proviso to section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 (under which no refund under that section may be made after the end of the sixth year after that in respect of which the amount was paid, unless application therefor was made before that time) should be retained.

(Paragraph 3.39)

### ***Res judicata* or compromise**

5. A statutory claim under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963 for recovery of an undue payment of rates should not lie where:
- (a) a claim for the rates in question had been contractually compromised; or
  - (b) the payment was made in response to a court action by the rating authority against the ratepayer in circumstances which would raise a plea of *res judicata* against the ratepayer in an action by him against the authority for repetition.

(Paragraph 3.45; Draft clause)

### **Certain defences not to be introduced**

6. In a claim for refund of overpaid rates under section 20(1) of the Local Government (Financial Provisions) (Scotland) Act 1963, it should not be a defence:
- (a) that the refund would unjustly enrich the claimant;
  - (b) that the undue payment of rates was made in accordance with
    - (i) a settled view of the law that the payment was due; or
    - (ii) with a generally prevailing practice,and a later judicial decision has overturned that view or practice; or
  - (c) that the claimant has not exhausted his statutory remedies, including appeals against valuation or rating notices.

(Paragraph 3.65)

### **RECOVERY BY PUBLIC AUTHORITIES OF *ULTRA VIRES* DISBURSEMENTS (PART 4)**

7. The *Auckland Harbour Board* rule (under which *ultra vires* disbursements by central government from the Consolidated Fund, and possibly other *ultra vires* disbursements by public authorities from other public funds, are always recoverable) should not be reformed by legislation at the present time.

(Paragraph 4.11)

# Appendix A

## Draft Clause

### Repayment of rates paid in error.

(1) For section 20 of the Local<sup>1</sup> Government (Financial Provisions) (Scotland) Act 1963 there shall be substituted-

#### **"Repayment of rates paid in error.**

20.-(1) Where, notwithstanding-

(a) section 2(2)(d) of the Local<sup>2</sup> Government (Scotland) Act 1975 (which relates to the date from which corrections of certain kinds of errors in a valuation roll are to have effect); or

(b) any entry in a valuation roll which is no longer in force, it is shown to the satisfaction of a rating authority, on an application to them in that regard, that an amount has been paid to them in respect of rates by reason of an error, the authority shall, subject to subsection (2) below, repay the amount to the person from whom they received it or to any other person appearing to them to be entitled to that person's interest.

(2) Repayment shall not be made under subsection (1) above if-

(a) in any action for repetition as respects the amount a plea-

(i) of res judicata; or

(ii) that any claim for repetition has been discharged by an agreement of compromise,

would be available to the rating authority; or

(b) the application for repayment is made later than the end of the sixth year after that in respect of which the amount was paid."

(2) Subsection (1) above does not affect the application of Part II of the said Act of 1963 in respect of any application for repayment which is made, in pursuance of that section, before such day as the Secretary of State may by order appoint.

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<sup>1</sup> 1963 c.12.

<sup>2</sup> 1975 c.30.

### *Explanatory Notes*

This *clause* replaces the existing provisions of section 20 of the 1963 Act. The existing provisions are quoted at para 3.17 of this report. Their aim was to give a citizen a right to a refund of an amount paid by way of rates due to an error of fact. They allow a claim for a refund notwithstanding that the time limits have expired for statutory rights of appeal against entries in the valuation roll or the rates demand notice. For example a claim may be made under section 20 where the rate levied was not in accordance with the valuation roll or a subsequent re-valuation shows that the property had clearly been considerably over-valued.

*Subsection (1)* of the *clause* re-enacts section 20 with amendments.

First, the *new section 20(1)* refers to "error" rather than "error of fact". So a claim for a refund may be made where the error is one of law, or of mixed fact and law, or of fact, whereas under section 20 as originally enacted the error had to be one of fact. This amendment implements recommendation 3 (para 3.31) of the report.

Second, *new section 20(2)* makes it clear that a ratepayer cannot claim a refund under its provisions if a court action for repayment would fail because the rating authority could rely either on a defence of "*res judicata*" (ie the matter had already been finally decided in a previous court action) or on a defence that the claim has already been the subject of a compromise. This amendment implements recommendation 5 (para 3.45) of the report. The defence of *res judicata* is explained at para 3.41 and the defence of compromise at paras 3.42 and 3.43.

Third, the existing section 20(1) provides that the amount claimed must be "not recoverable apart from this section". These words are repealed and not re-enacted in *new section 20*. There is no reason to prevent a ratepayer from claiming under the statute a refund of an undue amount paid in error (eg where the rates were paid twice by inadvertence) even though he could recover the amount by a common law action.

In *new section 20(1)*, paragraphs (a) and (b), reproduce the opening words of the existing section 20(1). For an explanation of these words, see para 3.17 of the report.

*Subsection (2) of the clause* is a transitional provision. Claims made before the appointed day are to be dealt with under the existing provisions of section 20. Claims made thereafter will proceed under *new section 20*.

# Appendix B

## List of those who submitted written comments on one or more of Discussion Papers Nos 95, 99 and 100

Professor John W G Blackie, University of Strathclyde  
Building Societies Association  
Mr Kenneth Campbell, Advocate  
Professor David L Carey Miller, University of Aberdeen  
Committee of Scottish Clearing Bankers  
Confederation of British Industry (Scotland)  
Convention of Scottish Local Authorities  
The Hon Lord Coulsfield  
Court of Session Judges  
Faculty of Advocates  
Professor William M Gordon, University of Glasgow  
HM Customs and Excise  
Inland Revenue  
Mr George Jamieson, Messrs Walker Laird, Solicitors  
Professor David Johnston, Christ's College, Cambridge  
Law Society of Scotland  
Professor Hector L MacQueen, University of Edinburgh  
Dr Jacques E du Plessis, University of Stellenbosch and  
Professor Daniel P Visser, University of Cape Town  
Registers of Scotland  
The Right Hon the Lord Rodger of Earlsferry, Lord President  
Royal Institution of Chartered Surveyors in Scotland  
Royal Faculty of Procurators in Glasgow  
Scottish Chambers of Commerce  
Sheriffs' Association  
Sheriffs Principal  
Society of Directors of Administration in Scotland  
Dr Andrew J M Steven, Edinburgh  
University of Aberdeen, Faculty of Law  
University of Glasgow, Centre for Research into Law Reform  
WS Society (a view of two members)