

HARM Master Thesis – European and International Taxation
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ON WHY EU STAND ON THE PASSING ON DEFENCE EQUATES TO ENRICHING THE UNJUST

“Two old ladies are in a restaurant. One complains, ‘You know, the food here is just terrible.’ The other shakes her head and adds, ‘And such small portions.’ Woody Allen

“All is well that ends well.” Williams Shakespeare

“There's no egg in eggplant, no ham in hamburger, neither apple nor pine in pineapple.” Anonymous

“Consequences have consequences, and the consequences of the consequences have consequences, and so on. It gets very complicated... Extreme economic ignorance was displayed when various experts, including Ph D. economists, forecast the cost of the original Medicare law. They did simple extrapolations of past costs. Well the cost forecast was off by a factor of more than 1000%. How did it happen? Answer: They over simplified to get easy figures, like the rube rounding Pi to 3.2! They chose not to consider effects of effects on effects, and so on.” Charlie Munger

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LIST OF ABBREVIATIONS

EU – European Union Law.

ABSTRACT

European Union law recognizes the right to restitution as inherent in Community law. The foremost importance of this right makes sense among other reasons because it brings to life EU law and deters Member States from contravening it. However, EU law also allows Member States to deny refunds of taxes it illegally collected by arguing that the claimant taxpayer passed on the tax to the end consumers and would be unjustly enriched if he got a full refund. There is clearly plenty of room for restitution and this sort of unjust enrichment passing on defence to clash with each other. In this light, this essay asks whether the EU stand on the unjust enrichment passing on defence as permitted under EU law is sound. This essay holds that ideally the EU should close the door on the passing on defence on the basis of unjust enrichment. The passing on of taxes may not lead to unjust enrichment at all. Even if it did, the difficulty and cost of proving it are unsurpassable. This creates an unnecessary risk for Member States of denying restitution which would render EU law ineffective. Further, this defence rids the system of deterrence mechanism critical to a Union still in its forming stages. Furthermore, the legal and practical hurdles to a large number of consumers to file claim means that by large it is the State that is likely to enrich at the expense of the taxpayers. It is abuse of the State power to use the unjust enrichment doctrine to enrich itself.

1. INTRODUCTION

European Union law recognizes the right to restitution as inherent in Community law. The foremost importance of this right makes sense among other reasons because it brings to life EU law and deters Member States from contravening it. However, EU law also allows Member States to deny refunds of taxes it illegally collected by arguing that the claimant taxpayer passed on the tax to the end consumers and would be unjustly enriched if he got a full refund. There is clearly plenty of room for restitution and this sort of unjust enrichment passing on defence to clash with each other.¹ In this light, this essay asks whether the EU stand on the unjust enrichment passing on defence as permitted under EU law is sound. As the name suggests, the doctrine of unjust enrichment rests profoundly on the concept of justice. To this extent, at its broadest this essay asks whether there is justice, and thereby legitimacy, in permitting States to appeal to rely on the doctrine of unjust enrichment when it itself has contravened EU law.

EU tax controversies involving unjust enrichment and passing on disputes are not uncommon. The spectrum from which EU tax controversies can arise is broad. For instance, they may arise from VAT, Excise, or other duties fees. Likewise, they may arise from all fields, including cases dealing with excise on alcohol, duck duties, and VAT on chocolate teacakes and oil lubricants. They can arise, for instance, as follows. A restaurant at the Copenhagen airport implements a VAT as mandated by Danish tax authorities. Subsequently, this tax turns out to be in violation of EU Law. The clash arises if the restaurant requests a return of the overpaid VAT taxes, but the authorities refuse to give back the illegally raised taxes arguing that it is the restaurant's customers who paid the VAT -- the taxed was passed on. Therefore, according to the tax authorities, a denial of over paid taxes is warranted since it would unjustly enrich the restaurant.

As it concerns the unjust enrichment passing on defence the EU allows, this hypothetical gives rise to numerous vexing problems for a legal system to deal with. This essay focuses on addressing how EU law deals with the following controversial problems: Would the restaurant indeed be unjustly enriched if it gets a refund? How can it be proved that tax was passed on, and how much of it was passed on? If indeed the tax was passed on to the consumers, but the State does not refund the consumers, should the State be permitted to be unjustly enriched? To answer these questions, this essay analyzes EU public law dealing with the pass on defence and unjust enrichment, as well as the economic theory and scholars' views on the functioning of the unjust enrichment passing on defence.

EU stand on the passing on defence is shaped largely by the EU principles of autonomy, and effectiveness.² Under the auspices of the principle of autonomy, EU has opened the door to the passing on defence grounded on the unjust enrichment doctrine. It permits, but does

¹ A different way angle from which to interpret this clash is from the perspective of EU principles. Restitution is an integral element of the principle of effectiveness, whereas permitting Member States to apply the passing on defence springs from the principle of autonomy. Given the freedom to design recovery procedures, Member States are likely to protect their finances. Thus, it certainly should not come as a surprise that such a clash exists.

² Certainly, it is also shape by other principles; however, the focus of this essay is on the principle of effectiveness, which it considers to be the most critical one. Other which have come up in EU unjust enrichment principles include among others the principle of equality, neutrality, legal certainty, and fiscal certainty.

not require, the State to apply it. Under the auspices of the principle of effectiveness which protects restitution, EU law has limited the reach of the passing on defence by requiring the unjust enrichment passing on defence not be interpreted liberally. In practice this means, among other things, that EU holds that the State has the burden of proof and the unjust enrichment exception to restitution should be interpreted strictly.

An inquiry into the functioning of the passing on defence reveals that having opened the door to the passing on defence, the EU is acting wisely by narrowing its reach. The unjust enrichment passing on defence is afflicted with severe shortcomings. Not only the view that returning illegally collected taxes would unjustly enrich the tax payer rests on frail grounds, but it is unclear why of all parties it is the State contravening that law that should be unjustly enriched.

First, as regards the unjust enrichment of the taxpayer, maybe the taxpayer while expecting a refund did not pass on the taxes at all to its customers. Or, on the alternative, if the conditions holds for the tax to pass on, who is to say that the claimant would not passed on the refund to its customers by lower prices, albeit to future consumers. Further, the factual difficulties in proving the amount tax are unsurpassable. For instance, in the hypothetical above, if the menu only shows the total price per dish or drink, as is customary in the restaurant industry, the customers may only know that the restaurant was subject to a new tax rate until the time they have already eaten their food. Still, even if the taxpayer let the consumers know all along that their purchase was subject to tax, it is not proof that the tax was passed on. Indeed, if the claimant is able to raise prices in global economy full of substitutes and pass on the rise in prices to the consumers, it could certainly be the case that in the absence of the tax the claimant's profits would have been higher at the new price. For instance, if the restaurant, a profit maximizer, has such power as to pass on taxes by raising prices, then there was no point of waiting for the tax increase to raise prices, when it could have raised prices before and enjoyed higher profits. In other words, the tax authority argument seems to be that: "All is well that ends well, even if [in the absence of the illegal tax] it would have ended up being better." Such outcome does not fair.

Secondly, and along different lines, one can also point to faults in the defence even if the State can prove that the claimant would not be worse off in the absence of a refund. For once, it seems morally unjust to allow the party that has been contravening the law to claim the unjust enrichment doctrine against an innocent party. This scenario is likely to happen when the consumers who the State deems to carry the tax cannot recover from the State due to practical and legal reasons such as large number of consumers and the lack of standing. Furthermore, a fundamental purpose of restitution in EU law is deterrence. This is a critical importance to a Union still in the forming stages which the Court foregoes by limiting restitution. Indeed, rewarding the party that contravenes EU law amounts to giving the State license for a perfect crime. EU law walks the right line in once having opened the door to the passing on defence, limiting its reach. However, it would be wiser stand for the EU to close the door to the passing on defence all the way. If the food is bad, then no portion is better than small portions.

This essay is divided into five parts. The first part is the introduction. The second part describes EU stand on restitutions, and the passing on defence. The third part addresses the critical short comings of the passing on defence. Part IV evaluates how EU law deals with the shortcomings of the passing-on defence. Part V concludes.

2. RESTITUTION, AND THE PASSING-ON DEFENCE IN EU LAW

This part begins by providing a general overview of the concepts of restitutions, unjust enrichment, and the passing on defence in Section 2.1. Then, the stand of EU law on restitution is stated in Section 2.2. Finally, the stand of EU on the passing on defence is stated in Section 2.3.

2.1. Background

The concepts of restitution, unjust enrichment and the passing on defence are intertwined, ambiguous and adopt different dimensions in different legal systems. In general terms, of the three, restitution tends to be the broadest concept, the passing on defence the narrowest, and unjust enrichment stands some place in between both triggering restitution while at times also allying with the passing on defence to prevent restitution.

Commonly restitution refers to the concept of giving back to the rightful owner “something that has been taken away, lost, or surrendered.”³ Yet, in the academic circles there is debate as what the purpose of restitution should be. To some academics restitution should be about giving back what was wrongfully taken, while to others it should be about restoring the claimant of losses it may have suffered.⁴ This difference, as will become apparent later in the essay⁵, could be crucial in determining if recovery takes place.⁶

Meanwhile, the unjust enrichment doctrine tends to be more self explanatory. It refers to the principle that no person should be allowed to profit at another's expense without making restitution for the benefits that have been unfairly received and retained. It may trigger a cause of action or prevent it. Indeed, there is the view that justification is the underlying reason motive behind all tax related restitutions.⁷

Regarding the difference between unjust enrichment and restitution, Peter Birks, who is a leading scholar on the topic, explains that to some scholars the law of restitution and the law of unjust enrichment are the same, while to others “restitution is the law's response to a number of different causative events” one of causative event which could be unjust enrichment.⁸ Of these two views, the perspective that restitution and unjust enrichment are two distinct fields of laws not be used interchangeably is more prevalent nowadays.⁹

³ Thomson Gale. *West's Encyclopedia of American Law* (1998) For a discussion of its origin see e.g. W. Seavey & A. Scott, *Restitution*, 54 L. Q. R. 29, 31 (1938); Peter Birks, *A Letter to America*, *Global Jurist Frontier*. Chaim Saiman, *The Reemergence of Restitution: Theory and Practice in the Restatement (Third) of Restitution*, Villanova University School of Law. School of Law Working Paper Series. Year 2006 Paper 60.

⁴ Michael Rush, *The Defence of Passing* (2006) page 146. He notes that Birks, and Burrows are in the first camp, while Smith, McInnes, Grantham and Rickett are in the second.

⁵ It mainly discuss in part 4, but also in part 5, and touch upon in the description of EU law in part 3.

⁶ As will be discuss in more detail in the next section, Europe restitution is more about restoring losses, rather than giving back what was wrongfully taken. Otherwise, unjust enrichment could not be a defence to deny restitution.

⁷ Graham Virgo, *The law of taxation and unjust enrichment*, pp. 132-165, published in John Avery Jones, Peter Harris, David Oliver; *Comparative Perspectives on Revenue Law* (2008) Cambridge University Press.

⁸ Peter Birks, *Restitution and Unjust Enrichment: Unjust Enrichment and Wrongful Enrichment* (June, 2001) 79 *Tex. L. Rev.* 1767.

⁹ Graham Virgo, *The Principles of the Law of Restitution* (2006) New York: OUP. p. 11.

At last, the passing on defence, as the name implies, is always a defence.¹⁰ It refers to the idea that a claimant's loss may have been negated or has been reduced or negated by the claimant having passed on to his customer all, or some of, the overpayment. The passing on defence is the nemesis of restitution, and it stands next to and stands next to unjust enrichment. Firat Cengiz provides a general explanation of a distinction between the concept of unjust enrichment and the passing on defence. He explains that:

“Matters of unjust enrichment and passing on defence are essentially similar in terms of their underlying rationales. They both stem from the fairness consideration, though one deals with the question of whether an individual should be entitled to damages under conditions which do not fully justify such damage award, and the other with whether an individual should be entitled to damages he did not actually incur. The only practical difference is that analysis of passing-on proves much more complicated than that of unjust enrichment as it involves technical economic and econometric data.”¹¹

All said, the concepts and distinctions introduced here demonstrate the complexity of defining the discussed legal terms. Different scholars and different legal systems attach different meaning to each term to such an extent that they may even be used interchangeably. For instance, such since to be the case between restitution and unjust enrichment in some legal systems. This can create confusion, in particular for collaborators on the field addressing the topic on short essay which hope not to critic the use of terminology use by the Court but the substance of the doctrine. Fortunately, as will become apparent through this essay, in the EU the term unjust enrichment is understood to be quiet distinct from the term restitution.

However, in EU law, and in particular as it relates to tax and duty cases, it is the terms of unjust enrichment and the passing on defence that create confusion. Both are defences to restitution, which, by large are entangled.¹² I say by large because there are cases in which restitution is denied because of the taxpayer's ability to pass on taxes, but in which the main rationale for the denial according to the Court is not the taxpayers' unjust enrichment. Rather, it is to protect the State budget, or to prevent disruption of the tax system. These type of cases are also introduced in this essay, but are not the focus of this essay. As will be pointed out later in Part 4.2., the Court distinguishes those denials of restitution from the ones springing from the supposed taxpayer's unjust enrichment.

2.2. EU Stand on Restitution

The European Court has continuously restated that restitution is essential component of EU law.¹³ Indeed, repayment of charges ‘is a consequence of, and an adjunct to’ the

¹⁰ Note that while the defence of passing on is always a defence, the concept of passing can be used not only as a defence, but also as basis for a claim. In some legal systems it can give rise to claims for the entity to whom the tax was passed on. For more infor see: Magnus Strand, The Defence of Passing On. Comparing Reasons in the Commission White Paper with those presented by the United States Antitrust Modernization Commission, Uppsala University.

¹¹ Firat Cengiz, Passing-On Defence and Indirect Purchaser Standing in Actions for Damages against the Violations of Competition Law: what can the EC learn from the US? ESRC Centre for Competition Policy and School of Law, University of East Anglia. CCP Working Paper 07-21.

¹² While that is not the focus of this essay, there is criticism that EU Court is misusing the term unjust enrichment when it equates to the passing-on defence.

¹³ For instance see, Rebecca Williams, Unjust Enrichment and European Law (2001) Oxford Journal of Legal Studies. Vol. 21, No. 3, pp. 583-591

Community law right which invalidated the charge.”¹⁴ Certainly, the right to obtain a refund for VAT charges wrongly levied is inherent in EU law.¹⁵ Further, the right to restitution pertains to taxes collected by the state as well as those raised by public bodies.¹⁶ However, “a directive cannot of itself impose obligations on an individual and cannot therefore be relied upon as such against an individual.”¹⁷ This means that while directive can give rise vertical effect they cannot give rise to horizontal effect.

In accordance with settled case-law, restitution may take form under vertical effect either through the principle of direct effect or the principle of State Liability. EU case-law holds that a member state may be held liable for damages arising from failing to transpose a directive or transposing it ineffectively.¹⁸ Rights arise when the EU directive has direct effect -- it is clear, precise and unconditional.¹⁹ Along similar lines, even in the absence of direct effect, an individual may be able to claim damages under the State Liability principle. EU case has held that individuals have a right to reparation where three conditions are met: the rule of European Union law infringed must be intended to confer rights on the claimant; the breach of that rule must be sufficiently serious; and there must be a direct causal link between the breach and the loss or damage sustained by the claimant.²⁰ Still, the State liability presents a more difficult path to the claimant. For instance, there is uncertainty as to what it takes to overcome the sufficiently serious requisite. While, failure to implement a directive within the time limit automatically constitutes a sufficiently serious breach,²¹ by large it is up for the claimant to prove other failures are serious harm.²²

At last, as relevant to this essay, by large EU recovery procedures are shaped in particular by the three EU principles: autonomy, equivalence, and effectiveness.²³ The first means that it is the Member State and not the EU to implement the recovery procedure. For example, in *Comet* the court noted that “in the absence of any relevant Community rules, it is for the national legal order of each member state to designate the competent courts and to lay down the procedural rules for proceedings designed to ensure the protection of the rights which individuals acquire through the direct effect of Community law.”²⁴ The second principle means that EU rights should not be treated less favorably than national rights.²⁵ The third, and the one more relevant to this essay, is that Member States cannot implement recovery procedures that render EU law ineffective by making “it impossible in practice to

¹⁴ Case 199/82 *Amministrazione delle Finanze dello Stato v SpA San Giorgio* [1983] E.C.R. 3595, [1985] 2 C.M.L.R. 658 (E.C.J.) [hereinafter *San Giorgio*], paragraph 12. See also, *Comateb and Others* , paragraph 20; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 84.

¹⁵ See, e.g. Case C-46/93 *Brasserie du Pêcheur* [1996] ECR I-1029

¹⁶ Case C-242/95 *GT-Link v. DSB* [1997] ECR I-4449; Case C-188/89 *Foster v. British Gas* [1990] ECR I-3313, paragraph 20.

¹⁷ Case C-91/92 *Dori v. Recreb srl*, [1994] ECR I-3325), paragraph 20. See also Case 152/84 *Marshall v Southampton and South-West Hampshire Health Authority* [1986] ECR 723, paragraph 48.

¹⁸ Inter alia, Case 8/81 *Becker v Hauptzollamt Muenster-Innenstadt* [1982] ECR 53, paragraphs 23 to 25; Joined cases C-6/90 and C-9/90 *Francovich and Bonifaci v Republic of Italy* [1991] ECR I-5375

¹⁹ Inter alia, *Becker*. See also Case 26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1; [1970] CMLR 1

²⁰ Inter alia *Francovich*; *Brasserie*.

²¹ Cases C-178,179,188,189 and 190/94 *Dillenkofer and others v Federal Republic of Germany* [1996] ECR I-4845.

²² Case C-5/94 *R v Ministry of Agriculture, Fisheries and Food, ex parte Hedley Lomas (Ireland) Ltd* [1996] ECR I-2553

²³ As stated in an earlier footnote, it is of course shaped by numerous other principles, including the principle of equality (see *Mark & Spencer II*) and the principle of neutrality.

²⁴ *Comet*

²⁵ Case C-39/73 *Rewe-Zentralfinanz v Direktor der Landwirtschaftskammer Westfalen-Lippe* [1973] ECR 1039

exercise the rights which the national courts are bound to protect."²⁶ This means that national laws are inapplicable if it conflicts with individual rights.²⁷ Indeed, the Court has gone as far as to find that the procedural remedy offered must be adequate and must also have a deterrent effect.²⁸

2.3. EU Stand on the Passing on Defence

The EU stand on the passing on defence can be shortly summarized as follows. European case law does not required but does allow Member State to implement the passing on defence on the main rationale that it would lead to unjust enrichment. However, EU law supports the view that the unjust enrichment defence should not be applied liberally, on the basis that it could render EU law ineffective.²⁹ This means that, while member states are free to design their own recovery procedures, determining if there is passing is a factual matter to be decided by the National Court.³⁰ Further, it is must be the State and not the claimant that has the burden of proof.³¹ Furthermore, the State cannot establish such presumption as to render claimant's right ineffective.³² In addition, in case of partial passing on, the amount of refund denied cannot exceed the amount that was passed on.³³ In fact, the Court recognizes the intricacies into calculating the amount that may have passed on.³⁴

This section will proceed by discussing a survey of case law illustrating EU's view towards the defence. To make easier for the reader to follow, the cases are placed into three groups. The first group discusses the case opening the door to the passing on defence. The group discusses four cases narrowing the reach of the passing on defence. The third group discusses two cases addressing the situations when the State by granting refunds can be impoverished. This part of the Essay will limit itself to mentioning the existing law by discussing the relevant cases. In part IV of this essay, it will evaluate and critic the stage of EU existing law.

2.3.1. Opening the Door to the Passing on Defence -- Hans Just I/S

Hans Just I/S v. Danish Ministry for Fiscal Affairs³⁵ represents a landmark case on the topic of unjust enrichment. In this case, as a defence to a claim for the return of money unlawfully levied, the ECJ permitted the application of a Danish rule relating to the passing on of the expense. This case arose from a Danish alcohol producer and importer challenging excise tax provisions on the grounds that they taxed imported products at a higher rate than domestic products and violated the EU principle of non-discrimination. As it concerns the passing on defence, plaintiff Hans Just sought repayment of what it alleged to be overpayments of excise tax under the Danish scheme. A critical issue came to be whether plaintiff's showing that plaintiff had actually suffered a loss as a result of the tax provision was relevant.

²⁶ Case 61/79 Denkavit [1980] ECR 12

²⁷ Case 106/77 Amminiztrazione dello Stato v. Simmenthal Spa [1978] ECR 629.

²⁸ Case 14/83 Sabine von Colson and Elisabeth Kamann v Land Nordrhein-Westfalen [1984] 01891

²⁹ Case C-129/00 Commission of the European Communities -v- Italian Republic,

³⁰ San Giorgio. See also: C-331/85, 376/85 and 378/85 Bianco and Girard v. D Directeur General des Douanes des Droits Indirects, paragraph 17.

³¹ San Giorgio.

³² Joined Cases C-192/95 C-218/95 Comateb and Others [1997] ECR I-165.

³³ Comateb

³⁴ Case C-147/01 Weber's Wine World Handels-GmbH and others v Abgabenberufungskommission Wien [2003] ECR I-11365

³⁵ Case 68/79 Hans Just I/S v. Danish Ministry for Fiscal Affairs 1980 ECR 501

The Court agreed with plaintiff in finding a violation of the EU principle of non discrimination. However, the main legacy in this case is that the EU Court did not reject the Danish law of unjust enrichment permitting public authority to deny repayment of overpaid taxes if it was shown that the economic burden of the taxes in question had been passed on. The ECJ held that “Community law does not prevent the fact that the burden of the charges which have been unlawfully levied may have been passed on to other traders or to consumers from being taken into consideration.”³⁶ Indeed the Court noted that “the protection of rights guaranteed in the matter by Community law does not require an order for the recovery of charges improperly made to be granted in conditions which would involve the unjust enrichment of those entitled.”³⁷

2.3.2. Limits of the Passing on Defence

Having opened the door to the passing on defence, the Court has since limited its reach in a number of ways. This subsection discusses some of the cases which outcome has limited the reach of the passing on defence for breaches of EU law.

San Giorgio – The Burden of Proof Rests on the State

A critically important landmark case in the area of the passing on defence is San Giorgio.³⁸ In this case while the Court reiterated a Member State’s autonomy in designing recovery procedures, the Court prioritize the right to restitution of illegally raised taxes. This case arose because the Italian state had collected charges for health inspections contrary to EU law. The problem was that under Italian law there was no repayment of any illegal tax where the Italian state argued that the sums involved had been passed onto other persons through higher pricing. The plaintiff challenged this.

The Court was critical of the State. On one hand, it permitted the State the flexibility to determine when taxes had been passed on. On the other hand, the Court established that “the passing on defence was contrary to EC law in as much as it was subject to rules of evidence which render the exercise of that right virtually impossible.”³⁹ The court explained that:

“any requirement of proof which has the effect of making it virtually impossible or excessively difficult to secure the repayment of charges levied contrary to community law would be incompatible with Community law. That is so particularly in the case of presumptions or rules of evidence intended to place upon the taxpayer the burden of establishing that the charges unduly paid have not been passed on to other persons or of special limitations concerning the form of the evidence to be adduced, such as the exclusion of any kind of evidence other than documentary evidence.”⁴⁰

³⁶ Hans Just I/S

³⁷ Hans Just I/S, paragraph 26. See also: Amministrazione delle Finanze, 1983 E.C.R. 3595, paragraph 3, “Community law does not prevent a national legal system from disallowing the repayment of charges which have been unduly levied where to do so would entail unjust enrichment of the recipients”; Case C-343/96 Dilexport Srl v. Amministrazione delle Finanze dello Stato [1999] ECR I-579, “The Community legal order does not require the repayment of taxes, charges and duties levied in breach of Community law where it is established that the person required to pay such charges has actually passed them on to other persons.”

³⁸ San Giorgio.

³⁹ San Giorgio, paragraph 11. See also, Dilexport, paragraph 54, Bianco and Girard, Comateb; and Case C-441 and 442/98 Michailidis [2000] I-7145, paragraph 36-38

⁴⁰ San Giorgio , paragraph 14

Comateb: Repayment Compensation for Partial Loses

In subsequent years, the Court has by large followed the pattern set in *San Giorgio* of leaving the door open to the passing on defence but focusing on the issue of who and how to prove the unjust enrichment.⁴¹ For example, in *Comateb and Others*⁴² the Court held that total passing on cannot be assumed and when there is only partial passing on, Member States can only deny repayment for the part that has not been passed on.⁴³ This case concerned proceedings brought by 27 companies against the French Guadeloupe authorities for the repayment of dock dues. These dues had been found to be equivalent to Customs duties and therefore contrary to Community Law to the extent that they were levied on goods from other Member States. The defendant viewed that the claimant's legal obligation to incorporate the duty into the cost price in order to avoid a penalty was the proof of passing on. The Court rejected this view as making claimant's right ineffective. The Court highlighted that it is factual matter for the Court to decide, whether, and to what extent the passing has taken place. Further, the Court also introduced the notion that if the taxable person may suffer as a result of a fall in the volume of his sales and should be compensate for it.⁴⁴

Weber's Wine World Handels-GmbH: Limits Presumptions

Along similar lines, in *Weber's Wine World Handels-GmbH*⁴⁵, the Court noted that “the principle of effectiveness precludes national legislation or a national administrative practice which makes the exercise of the rights conferred by the Community legal order impossible in practice or excessively difficult.”⁴⁶ This case provides deep insights into EU stand on the Passing on defence.

This case arose, as relevant, due to an Austrian rule which fixed restrictive procedural rules for the repayment of duty collected on alcoholic beverages in violation of Community law. The rule, which came to exist to hinder a possible judgment of the Court holding that Community law prohibited the maintenance of a national duty, made recovery subject to the condition that the duty has not been passed on to third parties. The claimants⁴⁷ stated that the duty was not passed on to consumers. However, the tax authority rejected the claims for repayment of the duties already paid, since it took the view that the inquiry had revealed that they had been definitively passed on to the consumer.

As it was not for the European Court to resolve factual matter it did not reach a decision on whether passing on had taken place or whether the law was too restrictive. Nonetheless, the Court acted in manner favorable to the claimants finding the rule too restrictive since shifting of burden to the claimants was a factual matter for the National Court to decide. The Court explained that under the rule at issue the tax authority viewed as sufficient proof of passing-on that the prices invoiced to consumers included the duty. This, the court held, “might constitute a presumption that the duty has been passed on to third parties, and also of unjust enrichment of the taxable persons, of such a kind as to render

⁴¹ Damian Chalmers, Gareth Davies, Giorgio Monti. European Union Law. Text and Materials. 2nd Edition, CUP, 2010, page 278; referring to P. Wattel, National Procedural Autonomy and the Effectiveness of EC Law: Challenge the Charge, File for Restitution, Sue for Damages? (2008) 35(2) LIE 109.

⁴² *Comateb*, paragraphs, 27 and 28.

⁴³ *Michailidis*, paragraph 34

⁴⁴ *Comateb*, paragraph 29. See also *Michailidis*, paragraph 34

⁴⁵ *Weber's Wine World*

⁴⁶ *Weber's Wine World*, paragraph 118.

⁴⁷ *Weber's Wine World Handels* was a wine dealer and the other claimant operated restaurants.

repayment of the duty levied though not due impossible or at least excessively difficult, which is contrary to Community law.”⁴⁸

The Court went on to finding that repayment cannot be refused “without requiring that the degree of unjust enrichment that repayment of the charge would entail for the taxable person be established.”⁴⁹ The Court reasoned that “that the authority cannot merely establish that the charge was passed on to third parties and presume from that fact alone, or from the fact that the national legislation requires that the charge be incorporated in the selling price to consumers, that the economic burden which the charge represented for the taxable person is neutralized and that, consequently, repayment would automatically entail unjust enrichment of the trader.”⁵⁰ The Court went on to declare that it is necessary to engage in economic analysis accounting for all circumstances,⁵¹ as the extent of unjust enrichment to be avoided will also depend in a possible decline in volume of sales as a result of increase of the price to pass on.⁵² Indeed, the Court went as far as distancing itself from a prior decision that viewed the passing of consuming as probable,⁵³ when it concluded that “the numerous factors which determine commercial strategy vary from one case to another so that it is virtually impossible to determine how they each affect the passing on of the charge.”⁵⁴

However, the Court certainly does not conclude that the passing on defence is incompatible with EU law. The Opinion by A-G Jacobs, which by large was incorporated in the decision does a good job at summarizing the EU’s workings of the burden of proof.⁵⁵ He notes that:

Community law precludes any presumption of unjust enrichment to be refuted by the claimant; it does not preclude the possibility of drawing reasonable inferences from existing evidence. Without such a possibility, the balance might be tilted so far in favour of the claimant as to render the justified aim of preventing unjust enrichment in practice impossible to achieve. It must be possible for the deciding body to take all available relevant evidence into consideration and reach a fair decision taking full account of whatever likelihood there may be that the claimant bore any part of the burden of the tax or suffered any economic loss as a result of its imposition.⁵⁶

Communities v. Italian Republic: On a State laws shifting the burden to the Claimant

In the Commission of the European Communities v. Italian Republic illustrates another EU dispute within the realm of unjust enrichment. Shortly stated, this case concerns the legality of an Italian law providing recovery where a person has paid a tax due to a State, which has been subsequently declared incompatible with Community law. However, the issue was the legality of the law if it passed the burden of proof to a third party.

⁴⁸ Weber's Wine World, paragraph 113

⁴⁹ Weber's Wine World paragraph 118

⁵⁰ Weber's Wine World, paragraph 118; Marks & Spencer, paragraph 110.

⁵¹ paragraph 118, paragraph 100. See also, *Bianco and Girard*, paragraph 20.

⁵² Weber's Wine World. For a similar point see also C-309/06 Marks & Spencer v CCE [2008] ECR-I 2283.

⁵³ Bianco and Girard, paragraph 17

⁵⁴ Bianco and Girard, paragraph 97

⁵⁵ Opinion by AG Jacob in Weber v. Wine World

⁵⁶ Opinion by AG Jacob in Weber v. Wine World, paragraph 60

Danfoss and Sauer-Danfoss⁵⁷ -- Looking Forward.
On the issue of Whether the Party Bearing the Tax Can Make the Claim:

Danfoss and Sauer-Danfoss⁵⁸ while not yet decided, merits being discussed in this thesis since, as will be discussed in Part 4, its resolution could go prove critical to the functioning of restitution and motivations behind foregoing the passing on defence. The issues at stake in this cases are whether EU law precludes a Member State from rejecting a claim for repayment brought by the party bearing the tax on either of these two basis: 1. The party is no the taxable party; and/or 2. The party is not the directly injured party and there is no direct causal link between any loss and the conduct giving rise to liability.⁵⁹

The relevant facts of the case are as follow. Between 1992 and 1999, Denmark imposed a tax on lubrication oils and hydraulic oils in violation of EU law. The taxable parties in this case were Danish oil companies that paid lubrication tax to the Danish government. However, the twist in this case is that the Danish oil companies did not file a claim for a repayment of the excises wrongly paid. Instead, it its customers, Danfoss and Sauer-Danfoss, that file a claim against the Danish Tax Authority asking for a reimbursement of taxes levied in breach of EU law. This is because it is undisputed that the excise was passed on to Danfoss and Sauer-Danfoss. Futhermore, although the Danish government disputes this, Danfoss and Sauer-Danfoss claim that they did not pass their taxes on to their customers.

The AG opinion for his case has just come out. As to the first issue, the AG recommended the Court to find that it is for national law to determine if the party onto whom the illegally paid taxes has been passed on the taxed can recover directly from the State as law as the national procedure complies with the EU principles of effectiveness and equivalence. Therefore, the EU law does not preclude a Member State from rejecting a claim on the basis that the party is not the taxable person.

As to the second issue, the AG recommended the Court to find that the State may not, prima facie, be rejected based on the fact that there is no direct causal link between the levying of the tax and the loss of the customer.⁶⁰ He based this recommendation on an analysis of the requirement of persons suffering harm to file to be awarded damages. The three requirements in EU law: the rule of European Union law infringed must be intended to confer rights on them; the breach of that rule must be sufficiently serious; and there must be a direct causal link between the breach and the loss or damage sustained by the individuals. The AG reason that the Member State should not be allowed to add the requirement that the party filing an action be directly injured.

⁵⁷ Case C-94/10 Danfoss A/S and Sauer-Danfoss ApS v Skatteministeriet (2010/C 100/47)

⁵⁸ Case C-94/10 Danfoss A/S and Sauer-Danfoss ApS v Skatteministeriet (2010/C 100/47)

⁵⁹ Official Journal C 100 , 17/04/2010 P. 0032 – 0032. The Opinion is available in Spanish. But is not available in English.

⁶⁰Henkow/Terra/Kajus. Opinion of AG Kokott. Case C-94/10 Danfoss and Sauer-Danfoss. Repayment of taxes paid in breach of EU law – claim by the person carrying the economic burden – excise duties.

2.3.3 Preventing the State's Impoverishment a Priority in EU law

This subsection discusses the following cases: Weissgerber⁶¹., and Stadeco⁶².

Weissgerber When the State is not Unjustly Enriched

In Weissgerber the Court held that “a credit negotiator may rely on the tax exemption provision if he did not pass that tax on to the person receiving his services so as to entitle that person to deduct the input tax.”⁶³ This case arose when Germany failed to implement a directive on time exempting credit negotiators. Claimant Gerd Weissgerber, was an insurance agent and finance negotiator, who introduced clients seeking credit to three German banks. For this service the banks paid the claimant with commissions. Yet, the credit notes which the banks sent to Mr. Weissgerber’s bank account as payment did not show any amount of VAT.⁶⁴ The question the Court sought to answer was to what extent the right to deduct retroactively depended on the trader having “refrained from passing the tax on to persons following him in the chain of supply’.”⁶⁵

To answer this question, the Court explored the intrinsic nature of the VAT system. The Court noted that the intrinsic nature of the VAT system is such that an exemption claimed *a posteriori* can negatively disrupt taxpayers in a business relationship with the person exempted from the tax.⁶⁶ This results since in the directive on “one hand by availing themselves of an exemption persons entitled thereto necessarily waived the right to claim a deduction in respect of inputs and on the other hand, having been exempted from the tax, they were unable to pass on any charge whatsoever to the person following them in the chain.”⁶⁷

From this intrinsic nature of the VAT system, the Court reasoned which was the driving motivation in EU law, in requiring that the trader refrained from passing the tax on in order to recover. The motivation was “to prevent a claim for the exemption provided for by the directive made *a posteriori* by a trader from having adverse effects on other traders who have already deducted the amounts of VAT in question as input tax.”⁶⁸ In this light, the Court held that a right to deduct or to a refund could arise only if the tax was passed on and if the recipient of the services is himself subject to VAT.

Stadeco: The Risk of Preventing Loses as a Valid State Interest

In Stadeco the Court held that EU law did not preclude a refund being subject to conditions “if that taxable person has not completely eliminated in sufficient time the risk of

⁶¹ Case 207/87 Gerd Weissgerber v Finanzant Neustadt/Weinstrasse [1988] ECR 4433

⁶² C-566/07 Staatssecretaris van Financiën v Stadeco BV [] ECR

⁶³ Weissgerber, paragraph 16

⁶⁴ Weissgerber, paragraph 5

⁶⁵ Weissgerber, paragraph 10.

⁶⁶ Weissgerber, paragraph 12

⁶⁷ Weissgerber, paragraph 13

⁶⁸ Weissgerber, paragraph 51

the loss of tax revenue.”⁶⁹ This case arose when Stadeco, a Dutch supplier, charged a Dutch governmental body Dutch output VAT for services provided in exhibitions in Germany. Since the exhibition was not in Holland, the VAT was wrongly charged. Having realized their mistake, Stadeco requested a refund from the Dutch tax authorities. The Dutch tax authorities responded by providing the requested refund to Stadeco but under the condition that Stadeco would issue a credit note to its customer in Germany, the Dutch governmental body, so that it could in turn claim a refund from Stadeco. However, Stadeco never issued the credit note and did not pass on the refund to its customer in Germany. The Dutch tax authorities then assessed Stadeco for the VAT accounted for on the original invoices.

The relevant question to the Court was whether the Dutch Authorities could make the refund subject to the condition that the Claimant issued a corrected invoice to the customer to whom it wrongly charged VAT. The ECJ held that Member States can condition refunds on in cases where there is a risk of revenue loss if such a correction is not made. Such situations included cases where the supplier claims a refund of the incorrectly charged VAT but the customer has also claimed the same amount of VAT as input tax and makes no adjustment to that claim. The Court reasoned that identifying whether the supplier had eliminated all risk of tax loss and could justify not correcting the VAT documents could be complex, and that on balance, requiring the Claimant to issue the corrected documents was the best way for the supplier to eliminate that risk of loss. This power to condition a refund, the Court noted, is in addition to the power to deny a refund on the basis of the unjust enrichment defence.

3: SHORTCOMINGS OF THE PASSING ON DEFENCE

The purpose of this thesis is to evaluate whether EU’s stand on the passing on defence is appropriate. It is inherent in this task to inquire into the nature of the passing on defence. Michael Rush explains that the “the underlying purpose of the defence is to resolve a seemingly intractable dilemma. That is, between two undeserving parties engaged in legal dispute, should the defendant retain, or the claimant recover, the benefit in question?”⁷⁰

Unsurprisingly, given this ‘seemingly intractable dilemma,’ the passing on defence is plagued with vexing theoretical and empirical issues. This essay focuses on two vexing issues. The first issue is whether the passing on of taxes does indeed lead to unjust enrichment. Within this issue, lies the matter on how the passing on can be proved, and whom should have the burden to prove it. Since unjust enrichment is main justification for passing on defence, this issue is of foremost importance in this paper. The second issue is, if indeed the passing on of taxes would lead to unjust enrichment of the claimant, whether it should be the State or the claimant who should unjustly be enriched.

This part continues in Section A by first introducing the economic theory behind the passing on defence. Then in Section B it first explains the view arguing that the claimant does not unjustly be enriched when the State returns to claimant his overpaid taxes. After, it tackles with the view that even there was unjust enrichment it would be difficult to prove it. Finally, in Section C, it takes on the issue of which party’s unjust enrichment is preferable.

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⁷⁰ Michael Rush, *The Defence of Passing On* (2006), page 11.

3.1. Background: The Economics of the Passing on Defence

The passing on defence rests on the notion that those who actually paid the tax may not necessarily bear it. Indeed, the term tax incidence in the field of economic refers precisely to the actual division of a tax burden between buyers and sellers.⁷¹ The premise of this tax incidence begins with the idea that where the tax incidence falls does not depend on who has the formal legal obligation to pay the tax.⁷² For example, an employer might pay salary tax, but if some of the tax is offset with a lower salary, then the employee bears at the least a part of the tax burden. Likewise, a retailer that faces a VAT may bear the whole cost of the tax, bear part of the tax to the consumer, or have the consumer bear all of the tax by increasing the prices. In either case, the employer or the restaurant would have the formal obligation to pay the tax. Thereby, it is important to keep in mind that determining who actually bears the tax requires more than a formal look at the law.

The concept of tax incidence in economics falls under the public finance branch. Economic theory teaches that who actually bears the tax burden depends on price elasticity of supply and demand of what is being taxed.⁷³ It is intuitive that a higher price will lead to a lower demand and vice versa. Elasticity refers to by how much an increase (decrease) in price leads to a decrease (increase) in demand. When supply is more elastic than demand, the tax burden falls on the buyers.⁷⁴ If demand is more elastic than supply, producers will bear the cost of the tax. Indeed, there are even economic models that suggest that the bearing of tax can be 'passed up' as well as it can be passed on.⁷⁵ The thinking goes that a firm would not only try to shift the burden to its customers but also to its suppliers, bargaining for better prices.⁷⁶

As a matter of fact, there are many factors influencing the price. This makes computing the incidence of taxes one of the most difficult problems in economics.⁷⁷ The extent of the difficulty is illustrated by Zodrow right below. He explains that in addition to the factors commonly consider economic incidence of a tax is also affected by:

changes in asset prices that reflect the discounted present values of the economic effects of future tax and/or public expenditure changes. For example, an increase in property taxes, holding expenditures constant, might be capitalized into land or house values. The prices of these assets might fall by the present value of the projected increase in future taxes, whereas increases in expenditures, holding property taxes constant, might have offsetting effects... These capitalization effects should include the effects of other tax-induced price changes, such as changes in future housing or land rents.

⁷¹ See e.g. B. Rudden & W. Bishop, Gritz and Quellmehl: Pass It On (1981) 5 Euro. L. Rev. 243; M.H. Johnson, AAA Refunds: A Study in Tax Incidence (1937) 37 Colum. L. Rev. 910; O. von Mehring, The Shifting and Incidence of Taxation (Philadelphia: Blakiston, 1942) at 86, 87; and Michell (1995)

⁷² For example, while the law may place a tax on an employer, in practice it may be the employee who bears the tax. In such case the employer has the statutory incidence.

⁷³ For detail discussion on elasticity see inter alia: George Zodrow, Who Pays the Property Tax? Land Lines (April 2006) Vol 18, N. 2; H.A. Silverman, Taxation: Its Incidence and Effects (London: Macmillan, 1931).

⁷⁴ In economics elasticity means the ratio of the percent change in one variable to the percent change in another variable. For example, as price increases how much does demand change.

⁷⁵ Paul Michell, Restitution, 'Passing On,' and the Recovery of Unlawfully Demanded Taxes: Why Air Canada Doesn't Fly (1995) 53(1) U.T. Fac. L. Rev. 130, 160.

⁷⁶ Id.

⁷⁷ Zodrow (2001)

All said, a number of economic factors contribute to the likely scenario that the burden of a tax may be divided up between different parties, in different degrees, depending, among others, on the elasticity of what is being taxed and the structure of the market.

3.2. There is no Unjust Enrichment or It is Impossible to Calculate It

The less traditional perspective that there is not unjust enrichment even when a party is refunded is introduced first. Then the matter of how to prove unjust enrichment is discussed. The arguments presented here set the parameter under which EU stand on the passing on defence is evaluated in Part IV of this paper.

3.2.1. There is no Unjust Enrichment

At first the view that passing on defence seems pretty straight forward and basic. The VAT is meant to be a consumer tax,⁷⁸ to be passed on to the consumer, and when a taxpayer passes on the damages to others it suffers no damages.⁷⁹ Therefore, reimbursing the taxpayer in full would amount to a windfall for a tax payer.⁸⁰ On this rationale, in order to avoid unjust enrichment, the passing on defence has been widely embraced by numerous scholars, legislatures and countries.⁸¹ Scholars who favor this view among others include McInnes⁸², Grantham and Rickett,⁸³ and Palmer.⁸⁴ Palmer, for instance, reasons that in the absence of a mechanism permitting transferring to the party that actually bore the taxes, the taxpayer that merely had the formal duty to pay the taxes should not be reinstated.⁸⁵

However, an alternative understanding of the passing on of taxes shared by some scholars is that even in the absence of the passing on defence the claimant would not be unjustly enriched. For instance, Nussim⁸⁶ claims that the basic common understanding of the passing on defence as it related to taxes is misplaced. Nussim argues that since the taxpayer takes into account the likelihood that the tax might turn out to be illegal, the taxpayer only rarely actually passes on the full amount of the tax. He explains that the taxpayer only tries to pass on the expected burden of the tax, taking into account the possibility that the tax will be refunded. Nussim basically reasons: "If the refund is expected with certainty at the time that the tax is paid, however, the refund is passed on in the same manner as the tax, because it is the net-of-refund tax that affects production costs."⁸⁷ In other words, the relative burdens involved in imposing this possibly unlawful tax, should it prove to have been unlawful, will

⁷⁸ The idea being that taxpayer merely served as a middleperson through which taxes were transferred to the tax authority. See William J. Woodward Jr., "Passing-on" the Right to Restitution, 39 U. MIAMI L. Rev. 873, 885-909 (1985).

⁷⁹ Woodward (1985).

⁸⁰ *Id.*

⁸¹ For instance, the defence of passing on is available in competition law in, among others, Denmark, France and Italy; and in tax law in large number of countries.

⁸² M McInnes, *At the Plaintiff's Expense? Quantifying Restitutory Relief* (1998) 57 CLJ 472.

⁸³ M McInnes, R Grantham and C Rickett; *Disgorgement for Unjust Enrichment?* (2003) 62 (1) CLJ 159.

⁸⁴ Gareth H. Jones, Review of Palmer, *The Law of Restitution*, 38 Cambridge Law Journal 212 (1979).

⁸⁵ *Id.* ("Unless restitution for their benefit can be worked out, it seems preferable to leave the enrichment with the tax authority instead of putting the judicial machinery in motion for the purpose of shifting the same enrichment [of the state] to the taxpayer.");

⁸⁶ Jacob Nussim, *On a Pass on Pass on Defense: Unjust Enrichment and the Recovery of Overpaid Taxes* (November 2006). Bar Ilan University Public Law Working Paper No. 06-2.

⁸⁷ Nussim (2006)

depend upon whether taxpayers viewed their potential refund as limited by the passing on defence.

Indeed, Charlotte Crane,⁸⁸ who shares the same view, notes that “One cannot assess the burden of a tax simply by looking at what the law on the books says. The procedural aspects of collection and the refund process are important factors that must be taken into account in determining what the tax instrument put in play by the legislature actually is.”⁸⁹ Similarly, Benjamin Alarie, does a good job at explaining how taxes are passed. He explains: “It is only the expected value of the tax—and not more—that will be passed on to customers in the resale market at any given time. And dynamically, as the market adjusts its expectations regarding the validity of the tax, the price charged by A to B in the resale market will automatically adjust to take these varying expectations into account.”⁹⁰

All said, Nussim’s perspective is insightful and also in line with the more intuitive view that if the conditions hold for tax to be passed on to the consumers, so will they hold for a refund to be passed on to the consumer. Either, the refund will pass because the taxable entity expects to get the refund since it will challenge the illegal tax. Thus, they will not raise the prices and will not try to pass on the refund. Or, in the alternative, they will pass the refund on to future consumers. It follows, that either way, if the claimant gets a refund, the claimant is not unjustly enriched.

3.2.2. The Burden of Proof

The general onus is that those who assert a defence must prove it.⁹¹ However, equally important is defining how and what does it mean to prove it. Among the main criticism against the passing on defence is the difficulty in determining if there has been passing-on. For instance, Birks shares this view. He notes that “The defence is suspect because it raises almost insuperable factual difficulties. If I raise my prices to cover your unlawful levy, have I passed the levy?”⁹² To Birk, whether the plaintiff passed on some or all of the VAT is immaterial,⁹³ Birk the plaintiff should be reinstated, regardless of the exact loss the plaintiff may have suffered.⁹⁴

Birk does not stand alone in highlighting the factual difficulties of the defence. For instance, Alarie, while finding that in the real world passing on is likely to take place, rejects the defence because it is “apt to be unwieldy, expensive to operationalize, and not admit easily of proof in litigation.”⁹⁵ Similarly, Rush concludes that there is no place for such a defence in unjust enrichment largely due to the critiquing of the passing-on defence which includes the high litigation costs involved in implementing the defence, and the difficulty in determining

⁸⁸ Charlotte Crane, Who’s Left with the Money (July 28th, 2010) Jotwell. The Journal of Things we like (LOTS).

⁸⁹ Id.

⁹⁰ Benjamin Alarie, Kingstreet Investments: Taking a Pass on the Defence of Passing On (October 22, 2007). Canadian Business Law Journal, Vol. 46, No. 1, pp. 36-49, 2008.

⁹¹ Joel Nitikman, The Recovery of Overpaid Tax Through Unjust Enrichment (1998) Canadian Tax Journal. 1998, Volume 46, Issue Number 5. 992-1028, 1004.

⁹² Peter Birk, Restitution: the future, (1992) The Federation Press Pty Ltd.

⁹³ Id.

⁹⁴ Peter Birks, Unjust Enrichment, (2d ed. 2005). Birk goes far as to propose that the issues of improperly collected taxes be treated as a matter of automatic “constitutional right of restitutions. Graham Virgo, The Principles of the Law of Restitutions (1999) at 105-15, 736.

⁹⁵ Alarie, Benjamin. Kingstreet Investments: Taking a Pass on the Defence of Passing On (October 22, 2007) Canadian Business Law Journal, Vol. 46, No. 1, pp. 36-49, 2008. Mitchell was referring to the Supreme Court decision in *Kingstreet Investments*:35

the amount passed on.⁹⁶ Likewise, another leading scholar on the topic, Graham Virgo, also presents a similar criticism. Virgo, who has at times gone from supporting the defence to criticizing, also objects to the passing-on defence and argues that enrichment laws should only focus on prevent the unjust enrichment of the defendant.⁹⁷

A review of the AG Advisory opinions demonstrates that the Birk's chorus includes a number AGs -- albeit sharing Birk's views to different degrees. For instance, AG Mancini in San Giorgio's advisory opinion acknowledged the factual difficulties noting that:

it is usually impossible to isolate any portion of the price and link it causally to a particular cost. Moreover, in my opinion, that argument is irrefutable. And who indeed can say that, if the importer had been released from the burden of the unlawful charge, he would not have applied the same price and sold the same quantity of goods? Had that been the case, he would have obtained.⁹⁸

Along similar lines, the AG in Comateb went step farther finding that "it is impossible to show that the financial loss sustained by the party that has paid the unlawful charge has been offset by incorporating that charge in the price of the product in question."⁹⁹ The extent of his conviction is indicated in view that "it is plain, indeed abundantly plain in my view, that it can be positively established that the sum has been passed on to a third party only if supply is elastic and demand rigid, something that does not happen in the real economy."¹⁰⁰

3.3. On Which Party Should Keep the Over Paid Taxes

First, the view that it is ok for the State to keep the illegally collected tax are introduced. Then the view that the State should not keep the illegally collected are introduced.

3.3.1. Motivations Favoring the State

A vexing issue relating to the passing on defence is that it could result in the State keeping illegally collected taxes and could as well end up being unjustly enriched. As Rush notes, referring to situations where the State would be unjustly enriched, "while the persuasiveness of the windfall argument is apparent, courts which deny restitution on this basis must, according to the view adopted in this book, also explain why the defendant."

The justifications for the State to keep the illegally collected taxes can arise from different grounds. In situations where the State would be unjustly enriched by denying restitution, for instance, scholar Woodward leans in favor of the State keeping the illegally collected taxes. He notes that "The government is of course arguably different from other defendants because it disburses its income ... for the 'public welfare'."¹⁰¹ Along similar lines, scholar Virgo notes that "the best approach is to allow the Revenue a defence of passing-on and enable it to retain the tax and use it for the public benefit."¹⁰² Similarly, scholar McInnes notes that there is no reason why societal resources should be expended to re-distribute the

⁹⁶ Rush

⁹⁷ Graham Virgo, The Principles of the Law of Restitutions (1999) at 105-15, 736.

⁹⁸ AG Mancini in San Giorgio's advisory opinion

⁹⁹ AG Tesauro Comateb. Paragraph 21

¹⁰⁰ AG Tesauro Comateb. Paragraph 21

¹⁰¹ William J. Woodward Jr., Passing-on the Right to Restitution, 39 U. MIAMI L. Rev. 873, 885-909, at 901 1985.

¹⁰² Graham Virgo, The Law of Taxation Is Not an Island--Overpaid Taxes and the Law of Restitution. 1993 B.T.R. 442, 462.

surplus from the defendant to the plaintiff."¹⁰³ Indeed, scholar Jones reasons that the implementing of the passing-on defence can ultimately have the effect of encouraging the finding and restituting of the party that actually bore the tax burden,¹⁰⁴ while others see the fiscal certainty principle as a sufficient justification.

Furthermore, there is the view that the State may keep the illegally collected taxes to safeguard its finances. At its strongest expression, this view takes the argument as to which party should keep the funds away from the realm of unjust enrichment. This view holds that refunding the claimant disrupts the tax system and the State could be impoverished if it refunds illegally collected taxes. Both Weissgerber and Stadeco illustrate dispute within this realm. In both of those cases the court noted that due to the functioning of indirect taxes it is possible that the taxable party that passed on the tax also passed on the right to deduct. This could mean that refunding the claimant the overpaid taxes, when all parties along the chain have deducted the tax, and even the final end consumer did not pay taxes, would result in the States impoverishment.

Nonetheless, while this view springs from the possibility to pass on a tax, it is quite distinct from the defence of passing on resting on the doctrine of unjust enrichment. Indeed, both the AG opinions in Weissgerber and Stadeco are clear to distinguish between the unjust enrichment defence of passing on, and the motivation to protect the State finances resulting from taxes having passed on. For instance, the AG in Weissgerger, comparing the case at hand where the State could lose resources, with unjust enrichment cases, made the distinction. He noted: "the reservation now requiring interpretation is not to be understood in the sense of the observations made in the judgments in Cases 68/79 and 199/82 [the unjust enrichment cases of Hans Just I/S and San Giorgio]... [this reservation] arose from considerations relating solely to tax law and based on the scheme of the VAT directive."¹⁰⁵

3.3.2. Motivations Favoring the Claimant.

There are those who view restitution of the illegally collected taxes of foremost importance. For instance, scholars Birks, Burrows and Chambers side with this view.¹⁰⁶ Birk, for example, note that the passing-on cannot be justified by the need for plaintiff's loss and defendant's gain to correspond.¹⁰⁷ To Birk restitution is about giving back what was wrongfully taken.¹⁰⁸

Equally critical, Nussim emphasizes the high likelihood that the defence will lead to the unjust enrichment of the state. This could happen when neither of the taxpayers along the chain nor the consumers deemed to have bore the tax are refunded the taxes paid in excess. Nussim points out that this scenario is likely. He explains that the third parties which are often deemed to have bore the cost of the taxes either do not have standing to sue, or do not

¹⁰³ Mitchell McInnes, The Canadian Principle of Unjust Enrichment: Comparative Insights into the Law of Restitution, 37 ALTAL. REV. 1, 20-23 (1999)

¹⁰⁴ R. Goff & G. Jones, The Law of Restitution (6th ed. 2002); R.B. Grantham & C.E.F. Rickett, Enrichment & Restitution In New Zealand (2000)

¹⁰⁵ AG in Weissgerger, paragraph 23.

¹⁰⁶ Michael Rush, The Defence of Passing (2006) page 165.

¹⁰⁷ See Ross Grantham and Charles Rickett. A Normative Account of Defences to Restitutionary Liability. The Cambridge Law Journal. 67 (1) (2008) 92-125,118; P. Birks. Unjust Enrichment (2nd., Oxford 2005) 715; G Virgo, The Principles of Law of Restitution (2nd., Oxford 2006) 220. Virgo notes that if fiscal certainty was its underlying motive, then it should be recognized that this, and not unjust enrichment is the underlying policy.

¹⁰⁸ Rush, page 146.

have information that the tax was wrongly charged, or simply find it economically impracticable or prohibitive to file an action to obtain a tax refund due among other reasons to the large size of affected parties.¹⁰⁹ Then, Nussim, points out, it unfair that the government that broke the law, be the party unjustly enriched.

This view is not without support in the EU. For instance, AG Tesauro in Comateb stands on this side. AG Tesauro does not agree that: “that the State, which itself has actually obtained unjust enrichment by levying - for years, even - an unlawful charge, may then specifically rely on a principle of that kind to refuse to repay the sums unduly paid.”¹¹⁰ AG Tesauro goes on to explain that:

even if an individual trader may, on occasion, profit from the reimbursement of a charge that has been unduly paid, which he has passed on in part or in whole, we have also to consider whether in such circumstances it is reasonable to apply the concept of unjust enrichment. The answer is that it is not - simply in terms of the general theory of the law: I do not in fact believe it can be right to describe as unjust enrichment the profit derived by an individual from the reimbursement of a charge unduly required and levied by the authorities.¹¹¹

4. A CRITIC ON THE EU STAND ON THE PASSING ON DEFENCE

This part begins by first critiquing the EU’s tolerance towards the view that the unjust enrichment of a party can be calculated. Then it critic the stand on letting the State keep the illegally collected tax.

4.1. Factual Difficulties are Unsurpassable – EU Should Reject the Defence

In light of the review from Part 3 of the passing on defence shortcomings, this essay finds that the possible unjust enrichment of the taxpayer is not justification to deny restitution. In part, since the passing on of taxes may not lead to unjust enrichment at all, because, as Nussim explains,¹¹² what matters is the expected tax, not the actual tax. Thus, a tax may not pass at all, or, just like tax is passed on, so is a refund. But most importantly, since like Birk,¹¹³ this essay is suspicious of the ability to calculate the actual amount that could have been passed on. This factual difficulty inherent in the defence creates an unnecessary risk for Member States of denying restitution which would render EU law ineffective. Therefore, the ideal stand for EU would be to have not tolerance for the entanglement of the passing on concept and the unjust enrichment doctrine. Alternatively, if the door has been opened, EU law should go far in limiting its reach.

Since EU has opened the door to the passing on defence in Hans Just, and left it opened ever since, it follows that EU law fails short of the ideal stand: rejecting the defence. However, to the extent that the EU has placed the burden of prove on the State, EU law has

¹⁰⁹ Nussim correctly points out that it is typically impossible or prohibitively costly to do identify the consumers and In most cases, the individual consumer has no incentive to seek restitution of his part of an excessive tax as the restitution he could expect is typically very small in relation to the cost of bringing such a claim. .

¹¹⁰ AG Tesauro in his Comateb Opinion, paragraph 21.

¹¹¹ AG Tesauro in his Comateb Opinion, paragraph 21.

¹¹² Nussim (2006)

¹¹³ Birk (1992)

taken the right step. Some legal systems have not even come this far.¹¹⁴ Indeed, as has become obvious in the numerous disputes, in the absence of the limits sets by the EU, numerous Members States would likely place the onus of proof on the defendants. Certainly, as the EU has continuously reiterated would go against the principle of effectiveness by rendering “virtually impossible or excessively difficult for the plaintiff to secure payment.”¹¹⁵

However, placing the onus of proof on the right party is only the minimum step to protect EU rights from the inherent problems which the plague the passing on defence. The proof requirements to shift the burden to the plaintiff are equally important. Setting the threshold of proof as low as the mere legal incidence would be practically the same as placing the onus of proof on the plaintiff. This would certainly render EU ineffective. Thus, at the minimum to provide an appropriate protection to its citizens, a legal system must protect the EU rights to restitution by acknowledging the difficulties to prove if, and how much was passed on.

In this arena, EU stand which was at first troublesome, has become more satisfactory. For instance, in Bianco and Girard the Court noted the passing of consuming as probable.¹¹⁶ But fortunately, while not directly rejecting this view, subsequently the Court in Comateb established a distance from this view by concluding that “the numerous factors which determine commercial strategy vary from one case to another so that it is virtually impossible to determine how they each affect the passing on of the charge.”¹¹⁷

Indeed, EU case law has continuously reiterated an understanding that legal incidence and tax incidence is not the same thing -- That the mere legal obligation is not proof the tax was passed on.¹¹⁸ This is illustrated, among others, in the Weber's Wine World. The Court noted that presuming passing on simply because if claimant did not he would face a penalty, “might constitute a presumption that the duty has been passed on to third parties, and also of unjust enrichment of the taxable persons, of such a kind as to render repayment of the duty levied though not due impossible or at least excessively difficult, which is contrary to Community law.”¹¹⁹ Further, the Court in Comateb acknowledges that “because the increase in the price of the product brought about by passing on the charge has led to a decrease in sales.”¹²⁰ The Court goes even as far as to admit that “the numerous factors which determine commercial strategy vary from one case to another so that it is virtually impossible to determine how they each affect the passing on of the charge.”¹²¹

Still, it is unfortunate that the Court has not fully incorporated this acknowledgement in its Stand towards the defence that the factual difficulties are unsurpassable. The Court’s aim, as explained by AG Jacobs in his Weber's Wine World’s opinion, is not to render the passing on defence ineffective.¹²² Instead, EU law aims to allow the deciding court to make reasonable inferences from evidence and “reach a fair decision taking full account of whatever likelihood there may be that the claimant bore any part of the burden of the tax or

¹¹⁴ For instance Canada. See Joel Nitikman, The Recovery of Overpaid Tax Through Unjust Enrichment, (1998) Canadian Tax Journal. Volume 46, Issue Number 5. 992-1028, 1004.

¹¹⁵ See, among others, San Giorgio, paragraph 14. Also, Denkavit, noting that national procedures cannot make it impossible or excessively difficult for individuals to exercise their EU rights.

¹¹⁶ Bianco and Girard, paragraph 17.

¹¹⁷ Comateb, paragraph 97.

¹¹⁸ Comateb, Weber.

¹¹⁹ Weber's Wine World.

¹²⁰ Comateb, paragraph 31.

¹²¹ Comateb, paragraph 97

¹²² AG Jacob’s opinion in Weber's Wine World

suffered any economic loss as a result of its imposition.”¹²³ The Court’s language and view are idealistic.

In reality, the facts difficulties are unsurpassable and no reasonable inferences can ever be made. There are too many factors to consider, including some impossible to quantify, to calculate if there was a passing on. For example, there are alternative ways of maintaining the profit margin, such as increasing sales or cutting other expenses.¹²⁴ The cost of the tax may not be passed at all, or, just as they are be passed up consumers, they may be passed up by bargaining for lower prices for input costs up the latter, or maybe passed to employees by firing or paying lower salaries. Further, as Zodrow illustrates,¹²⁵ it also necessary to consider the dynamics of present values and the uncertainty brought about but the passing on defence.

The fact is that so much uncertainty surrounds the passing on defence that it is impossible to know, to draw reasonable inferences, if there is, or no unjust enrichment on the side of the claimant. As Rush points out, there are alternative ways of maintaining the profit margin, such as increasing sales or cutting other expenses.¹²⁶ It is a fact, as Charlie Munger’s quote at the cover page illustrates, that effects have effects, and economic calculations can be way off under such circumstances. For instance, even, if the claimant is able to raise prices in global economy full of substitutes and pass on the rise in prices to the consumers, it could certainly be the case that in the absence of the tax the claimant’s profits would have been higher at the new price. In such case, the State has robbed the taxable entity of the potential profits they would have made by raising taxes, under the auspices of a doctrine which meant to bring justice, not cause it. And, all is not well that ends well, when it could have ended better if there had not been illegally tax collected in the first place.

4.2. It is Abuse to Assert the Unjust Enrichment Doctrine to Enrich the Unjust

This essay aligns itself with the view that it is of foremost importance that the State does not unjustly enriched at the expense of the taxpayer. In part since deterrence is an important aspect of restitution and the State should not be giving a license to commit a perfect crime. But most importantly, EU law should not reward those that break the law at the expense of the innocent party, particularly asserting a doctrine that springs from justice. Indeed, if there are other reasons to deny restitutions, such as fiscal certainty or preventing the State impoverishment, then those should be clearly stated as the justifications and should not be mix with the unjust enrichment defence.

Given that the Union is still not fully formed, it is vital for the EU Court to provide the right incentives to deter Member States from contravening EU law. Rewarding the blame worthy party, not only rids the system of a valuable deterrence instruments, but sends the wrong signal to Member States. Indeed, the passing on defence on the basis of unjust enrichment itself amounts to a tax increase above and beyond the nominal tax that can be legally collected under the tax instrument in question.¹²⁷ This is because, in situations where the unjust enrichment of the government is favored over the taxpayers as a whole, the government gets to keep the taxes that it should not have collected in the first place. An

¹²³ AG Jacob’s opinion in *Weber's Wine World*, paragraph 60.

¹²⁴ Rush.

¹²⁵ Zodrow (2001)

¹²⁶ Rush (2006)

¹²⁷ (93) See, e.g., DAGAN, supra note 14, at 79-80; Rudden & Bishop, supra note 91, at 256; Woodward, supra note 27, at 927-30 (“Undeserved’ windfalls may be tolerable here as elsewhere in our system in the

amount of taxes greater than was authorized by law was collected, and governments constrained by law should not be permitted to engage in a scheme bordering expropriation.¹²⁸

Furthermore, EU law should not reward the party that contravenes the law at the expense of the innocent party on the basis of the unjust enrichment doctrines. Simply stated, a legal system that favors the blameworthy party lacks legitimacy and is inherently unjust. Truth be told, it seems inconsistent to apply the unjust enrichment doctrine, which as its language indicates derives its legitimacy from justice, in favor of a State that contravene the law in a dispute with an innocent party. As AG Tesauro in *Comateb* put it: “I do not believe that the State, which itself has actually obtained unjust enrichment by levying - for years, even - an unlawful charge, may then specifically rely on a principle of that kind to refuse to repay the sums unduly paid.”¹²⁹

Indeed, the sort of reasoning that EU law does not want see the enrichment of those who have benefited from illegal conduct, is reiterated throughout a number EU case law¹³⁰ For instance, it is thus the recipient of the illegal aid whom the national authorities must recover the money from. Likewise, in several cases the Court has noted that “it is necessary to prevent the State from taking advantage of its own failure to comply with Community law.”¹³¹ Certainly, those cases do not deal with the defence of passing on. But, parallels can be drawn with the reasoning in these cases to conclude that the Court does not wish to see the unjust enrichment of those who have benefited from illegal conduct, in this case the State.

The argument that leaving the money to the State seems would encourage finding the party that bore the tax, however noble, is weak and insufficient to justify the enrichment of the guilty party. For once, the legal option may never become available.¹³² Indeed, just like it can become available for the State, it can also become available for the consumers. For instance, the Court could allow horizontal action. It could even made the refund conditional on the claimant setting up a constructive fund for the consumers to claim it. Indeed, it can even condition a refund on the issuance of new invoice as it did in *Stadeco*. For another, it maybe impracticable for a large number of defendants with little to gain on an individual basis to file an action to collected from the State.¹³³ As AG Mancini in *San Giorgio*'s advisory opinion noted: “It is absurd to think of a mass of consumers who, in a system in which the class action is unknown, would bring an action against the State in order to recover minimal amounts.”¹³⁴

Indeed, even the upcoming *Danfoss* decision offers no relief on sight. According to AG Kokott, EU law does not preclude a Member State from denying access to the final consumer to whom the tax was passed on as long as it abides with the principle of equivalence. In other words, this means that the taxable party will not be able to claim from the State because supposedly it passed taxes on, and the party bearing the taxes will not be able to claim from

¹²⁸ Id.

¹²⁹ AG Tesauro in his *Comateb* Opinion, paragraph 21.

¹³⁰ Damian Chalmers, Gareth Davies, Giorgio Monti, *European Union Law. Text and Materials*, 2nd Edition, CUP, 2010, page 278; referring to Case C-39/94 SFEI [1996] ECR I-3547; Case C-71/04 Xunta de Galicia [2005] ECR I-7419.

¹³¹ *Sabine von Colson*, paragraph 17; Case C-152/84 *Marshall*, paragraph 49

¹³² Note that there are also alternatives schemes that are employed to avoid the enrichment of State. One alternative is for the State to give back the overpaid taxes to the claimant but have the claimant keep it on a constructive trust. Such schemes, however, are a problem in EU law, in particularly when the directive does not give rise to a horizontal cause of action.

¹³³ As mentioned earlier, the cost of recovery to cost of litigation may make prohibitive.

¹³⁴ AG Mancini in his *San Giorgi o*'s advisory opinion.

the State either. To the extent that AG Kokott recommends the principle of State Liability cannot be limited by the Member States, AG Kokott is still not resolving the difficulties impracticalities for the consumers in overcoming the hurdles in the State Liability where a consumer may appeal for reparations. For instance, the consumer still has to prove a serious breach, and it is unclear what a serious breach is.¹³⁵

It follows, that it would be appropriate for EU case law to close its doors to the passing on defence. The reasoning and conclusions from numerous AG opinions, like Comateb AG Teasuro's advisory opinion, should be followed. They have indicated that it is plain inconsistent to apply a doctrine which springs from the concept of justice, by a State that has been raising contrary to law for years. This is not to say that there are no policy considerations, for instance, fiscal certainty, which could restrict a taxpayer's right to recover even when the State has contravened EU law. For instance, in Stadeco, as in Weissgerber, the Court was concerned with the possibility of the State being impoverished from taxpayers passing on the right to a deduction. It is clear from both decisions as well as their corresponding AG opinions, that this defence to restitution is different from alleging that the taxpayer would be unjustly enriched. Indeed, in Stadeco, the Court noted that the power to condition a refund, while having the effect of preventing unjust enrichment, is different to the power to deny a refund on the basis of the unjust enrichment defence. As, the AG Opinion in Weissgerber notes, "it in no way means the generalization of a legal concept known to several legal systems and its incorporation into tax law... The said reservation arose from considerations relating solely to tax law and based on the scheme of the VAT directive."¹³⁶

In short, the point is that the driving policy behind refusing restitution is fiscal certainty or preventing disruption to the tax system, or the State impoverishment; it should not be masked under a doctrine which a State having violated the law has not legitimacy to apply against an innocent party, but rather be stated upfront. Otherwise, it may be more fitting and sincere for the EU to rename what it has so far called the unjust enrichment defence to the principle of enriching the unjust. And certainly that is a path the EU Court should not walk.

5. CONCLUSION

This essay holds that ideally the EU should close the door on the passing on defence on the basis of unjust enrichment. The passing on of taxes may not lead to unjust enrichment at all. Even if it did, the difficulty and cost of proving it are unsurpassable. This creates an unnecessary risk for Member States of denying restitution which would render EU law ineffective. Further, this defence rids the system of deterrence mechanism critical to a Union still in its forming stages. Furthermore, the legal and practical hurdles to a large number of consumers to file claim means that by large it is the State that is likely to enrich at the expense of the taxpayers. In such case, it is not appropriate to rely on a concept springing from justice, the unjust enrichment doctrine, to justify en the unjust enrichment of the State that broke the law. -- seems like giving the State license to a perfect crime. If, the State's goal in denying restitution is to prevent disrupting to the functioning of the tax system by posteriori claims which could impoverish it, then it should say so directly. But, it should not allege the unjust enrichment doctrine, when its end result would be to unjustly enrich the State at the expense of all taxpayers. It follows that the defence of passing justified by the unjust enrichment should be fully rejected. While making the portions of the terrible food small. It would be more ideal if good food is served.

¹³⁵ R v Ministry of Agriculture.

¹³⁶ Weissgerber, Paragraph 24.