

Restitution of Tax Which Has Been Paid Under Mistake of Law

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ABSTRACT

The court in the UK in 1802 applied the legal maxim ignorantia juris non excusat (which means 'ignorance of law is no excuse') in Bilbie v Lumley case which was involved in recovery of indemnity mistakenly paid by an insurance company to the insured. In this case the court held that insurance indemnity paid to the insured under mistake of law is not refundable because of the above maxim. In later cases courts in England also applied the above legal maxim in tax cases barring taxpayers from recovering tax paid under mistake of law. So, the above legal maxim became the English common law rule in almost every later case involving payment made under mistake of law. It is to be noted that the above legal maxim was originally developed to be applied in criminal cases. It seems that the above maxim of law was misapplied by the court in the Bilbie case in indemnity refund claim and other courts also misapplied the maxim in tax restitution cases. That maxim is acceptable in criminal cases but it is not applicable or desirable in recovery of money or tax paid under mistake of law. Hence, the House of Lords after almost two hundred years has overruled the Bilbie decision in Kleinwort Benson Ltd v Lincoln City Council, decided in 1998.

Keywords: *ignorantia juris non excusat, insurance indemnity, mistake of law, tax restitution.*

ABSTRAK

Dalam tahun 1802, mahkamah di UK mengaplikasikan maksim undang-undang ignorantia juris non excusat (yang bermaksud 'kejahilan terhadap undang-undang tidak boleh dimaafkan') dalam kes Bilbie v Lumley yang melibatkan usaha mendapatkan kembali indemniti yang tersilap dibayar oleh syarikat insurans kepada pengambil insurans. Dalam kes ini, mahkamah memutuskan bahawa indemniti insurans yang dibayar kepada pengambil insurans di bawah khilaf undang-undang tidak boleh dipulangkan berdasarkan kepada maksim tersebut. Kes-kes yang diputuskan oleh mahkamah di England selepas itu turut mengaplikasikan maksim berkenaan dalam kes-kes percukaian dengan menghalang pembayar cukai untuk menuntut wang cukai yang dibayar kerana khilaf undang-undang. Dengan itu maksim ini telah menjadi kaedah common law Inggeris dalam hampir kesemua kes yang terkemudian yang melibatkan pembayaran

kerana khilaf undang-undang. Perlu diberi perhatian bahawa maksim berkenaan pada asalnya diperkembangkan untuk digunakan dalam kes-kes jenayah. Kelihatan maksim ini telah disalahgunakan oleh mahkamah dalam kes *Bilbie* bagi tuntutan mendapatkan kembali indemniti dan mahkamah lain dalam kes restitusi percukaian. Maksim ini boleh diterima dalam kes-kes jenayah tetapi ia tidak boleh diaplikasikan atau tidak sesuai bagi mendapatkan kembali wang atau cukai yang dibayar kerana khilaf undang-undang. Dengan demikian, House of Lords selepas hampir 200 tahun telah mengakas keputusan kes *Bilbie* dalam *Kleinwort Benson Ltd. v Lincoln City Council* yang diputuskan dalam tahun 1998.

Kata kunci: *ignorantia juris non excusat*, indemniti insurans, khilaf undang-undang, restitusi percukaian.

INTRODUCTION

If a taxpayer paid tax to the tax department under mistake of law he was not entitled to recover it under English common law. Mistake of law means misunderstanding or misinterpreting any provision of any statute¹ and acting upon it. This common law principle was established based on the decision of Lord Ellenborough in *Bilbie v Lumley*.² This principle has been applied by the court in many cases in the past two centuries. In this case Lord Ellenborough based his decision on the maxim '*ignorantia juris non excusat*' which means that 'ignorance of law is no excuse'. Hence, according to him when tax paid under ignorance of law cannot be recoverable because of the above maxim.

The 'ignorance of law' principle has caused substantial injustice to innocent and law-abiding taxpayers. A taxpayer sometimes pay tax thinking that he might be liable to pay tax under a specific tax statute but later finds that he was not liable to pay tax under that statute. The finding was due to later decision of court on the matter. Sometimes, tax officers demand tax unlawfully from taxpayers and taxpayers pay tax under protest with the condition that if the court decides otherwise they will be given the right of restitution of the tax paid. In these circumstances justice and fairness demand that taxpayers should be given the *prima facie* right of restitution of tax paid under mistake of law.

The 'ignorance of law' principle is applicable in criminal cases and sometimes in civil cases for violating obligations: for example, not paying tax

¹ Law made by Parliament is known as statute.

² (1802) 2 East 469; [1775-1802] All E.R. 425. See also *Werrin v The Commonwealth* (1938) 59 CLR 150, at 159; Lord Goff in *Woolwich Building Society v Inland Revenue Commissioner* [1992] 3 All ER 737, 753.

to the government due to ignorance of law. In such cases the court will not accept the defence of ignorance of law and will order the taxpayer to pay the tax due plus a fine for late payment. The tax department may also sue him for concealing the income.

This principle is necessary in criminal law cases so that people are careful not to violate specific law and commit crimes. This is known as strict liability for committing crimes. Hence, to enforce a criminal penalty with an intention to deter people from committing crimes, the ignorance of law principle is applicable in relevant criminal cases where it can be said that the 'ignorance of the law is no excuse'. This principle is also desirable to ensure that offenders do not escape penalty under the excuse of ignorance of law. However, there is doubt whether this principle is applicable in tax restitution cases where tax was paid under mistake of law by a taxpayer.

This article presents arguments that the 'ignorance of law' principle, while applicable in criminal cases for wrongdoing, is not suitable and desirable in restitution cases. Tax or money paid under mistake of law should be recoverable as of right by the taxpayer. The 'ignorance of law' principle cannot be a good reason to deny the restitutionary right of a taxpayer who paid tax under mistake of law. As the common law decision in the *Bilbie* case caused substantial injustice to taxpayers who paid tax under mistake of law, the House of Lords in 1998 finally overruled the decision in *Kleinwort Benson Ltd. v Lincoln City Council*,³ by putting an end to the common law rule that money or tax paid under mistake of law is not recoverable.

In *Kleinwort Benson Ltd. v Lincoln City Council*⁴ the House of Lords held that tax paid under mistake of law is recoverable as a general right by the taxpayer. In this case the House of Lords abrogated the common law rule provided in *Bilbie v Lumley* case after almost two hundred years. Actually, taxpayers, lawyers and legal scholars had long wanted the House of Lords to stand up to overrule it, as it causes substantial injustice to innocent taxpayers.

IS IGNORANCE OF LAW NO EXCUSE IN RESTITUTION?

'Ignorance of law is no excuse' may be acceptable in criminal cases because if 'ignorance of law' is considered as an excuse it may encourage other criminals to commit crimes. Hence, to deter people from committing crimes a strict liability principle has been developed in criminal law to punish criminals and their defence of ignorance of law is not taken into consideration. However, this

³ [1999] 2 AC 349.

⁴ [1992] 2 AC 349.

strict principle of criminal law rule cannot be imported in civil law: for example, where an innocent and good taxpayer pays tax under mistake of law thinking that he is liable to pay the tax under a specific tax statute but later finds that in fact he was not liable. In such a situation the taxpayer must have the right to recover the tax paid under mistake of law.

WHAT IS IGNORANCE OF LAW?

Government makes laws to be followed by every person living in the country. To maintain peace and order in the country the government prohibits certain criminal acts by making laws and providing penalty provisions for neglecting and violating these laws. It is desired and presumed that everybody must be aware of and observe criminal law principles. If someone commits a criminal act and says 'I am sorry I do not know the law', such an excuse of 'ignorance of law' is not accepted.

If 'ignorance of law' in criminal offences is accepted to excuse punishment, then it would be difficult for the law enforcing agency to enforce the criminal law. People will commit offences and will demand excuse from penalty by raising the defence of 'ignorance of law'. Ultimately it would be seen that the law was failing to stop criminal offences and as a result the peace, order and security of people have been endangered. Hence, the principle of 'ignorance of law is no excuse' became English common law principle and still applied by the UK and other common law countries in criminal cases.

'IGNORANCE OF LAW' PRINCIPLE AND CRIMINAL CASES

The common law rule that money or tax paid under mistake of law is not recoverable first emerged in *Lowry v Bourdieu*,⁵ where Buller J. held that money paid under mistake of law is not recoverable. Before the decision in the *Lowry* case, courts in the UK did not classify mistake as 'mistake of fact' and 'mistake of law' in a suit for restitution.⁶ At that time restitution was possible under 'mistake of fact' and law. After the decision in the *Lowry* case restitution was possible under 'mistake of fact' but not under 'mistake of law'. The question is why should a taxpayer not be entitled to have recovery of tax under 'mistake of law', while he is entitled to recover tax under 'mistake of fact'? The maxim '*ignorantia juris non excusat*' propagates the principle of strict liability which

⁵ (1780) 2 Doug. 468, at p 471.

⁶ Lord Goff in *Kleinwort Benson Ltd. v Lincoln C.C.* [1999] 2 AC 349, at p 368.

is applicable in criminal law. The principle of 'ignorance of law is no excuse' is applied in criminal cases strictly and the offender is punished accordingly. His defence of the ignorance of the particular law is not accepted by the court. This is to ensure that criminal acts are stopped permanently and peace, order and security of people are maintained in society. However, this principle might not be applicable in tax restitutionary cases as it may cause injustice to taxpayers.

This maxim is only desirable and suitable in criminal law litigation and certainly not applicable in restitutionary claim in civil litigation, specially in taxation cases. Because, if this principle of law is sustained and applied in tax cases, it will cause much injustice to taxpayers. Justice demands that a taxpayer should have a right of restitution when he pays tax under 'mistake of law'.

The tax paid under mistake of law should not be regarded as the wealth of the government. If the tax department retains the tax paid under mistake of law it will be liable for unjust enrichment. Unjust enrichment in law arises when someone retains money or property belonging to another without any lawful justification. Money paid due to mistake to tax department should be kept in the tax department and when claimed should be refunded to the taxpayer, because in this situation a resulting trust is created in favour of the taxpayer. The tax department should hold the money for the use of the taxpayer as the money had and received.

ANALYSIS OF *BILBIE v LUMLEY* CASE

The suggestion that a mistake of law is not grounds for recovery of money or tax paid under mistake appears to have emerged first time in an *obiter dictum* of Buller J. in *Lowry v Bourdieu*.⁷ Previous decisions of courts showed no distinction between 'mistake of fact' and 'mistake of law'.⁸ At that time 'mistake' was considered as a mistake without classifying it into two types of mistake as mentioned above. In the *Lowry* case Buller J. relied on the maxim '*ignorantia juris non excusat*' to observe that money paid under 'mistake of law' was not recoverable.

In *Bilbie v Lumley*,⁹ the defendants took an insurance policy which was underwritten by the plaintiff. When the policy was taken the defendants did not disclose certain material facts. After some time, the defendants made a claim under the insurance policy. As they did not disclose certain material facts the plaintiff underwriter could refuse to settle the indemnity claim under the principle of utmost good faith in insurance contract. However, the plaintiff did

⁷ (1780) 2 Doug. 468, at p 471.

⁸ As per Lord Goff of Chieveley in *Kleinwort* case, at p 368.

⁹ (1802) 2 East 469; [1775-1802] All ER 425.

not know that it was entitled to refuse the claim and indemnified the defendants under mistake.

Therefore, in this case the plaintiff (insurer) made a mistake of law. Later when he discovered his mistake he sued the defendants to recover the indemnity paid under mistake of law. He argued that as he paid the money to the defendants under mistake of law he was entitled to recover it and at the trial court Rooke J. accepted this argument. However, at the Court of King's Bench, Lord Ellenborough CJ held that the plaintiff could not recover the money as he paid the money voluntarily under mistake of law with full knowledge or means of knowledge of the circumstances. In a tersely reported judgment, he pointed out that:

Every man must be taken to be cognisant of the law; otherwise there is no saying to what extent the excuse of ignorance might not be carried. It would be urged in almost every case.¹⁰

It is said that this decision of Lord Ellenborough later established the common law principle that all payments made under mistake of law are irrecoverable.¹¹ Later cases also applied this principle where money or tax was paid under mistake of law.

In *Brisbane v Dacres*,¹² Gibbs J. held that money paid with full knowledge of the facts could not be recoverable on the ground of mistake of law. Similarly, in *Kelly v Solari*,¹³ Parke B. said that "money paid with full knowledge of the facts cannot be recovered back by reason of its having been paid in ignorance of the law."

During the 18th century it was widely understood that no distinction should be drawn between 'mistake of fact' and 'mistake of law' in an action for recovery of money paid under mistake. However, towards the end of the 18th century the view was emerging that a mistake of law should not be a ground for recovery¹⁴.

It is to be noted that in some cases courts in the UK have held that money paid under 'mistake of law' is not recoverable whereas in some other cases courts have granted recovery of tax or money paid under 'mistake of law'.¹⁵ So, there are two streams of court decisions on the point of mistake of law.

¹⁰ (1802) 2 East 469, at p 472.

¹¹ Lord Goff and G. Jones, *The Law of Restitution*, Sweet & Maxwell, London, 1986, at p 117.

¹² (1813) 5 Taunt. 43, p 155-157.

¹³ (1841) 9 M. & W. 54, p 55.

¹⁴ Lord Goff in *Kleinwort* case, at p 369.

¹⁵ See *Blackpool* case [1910] 1 KB 592; *Customs and Excise Commissioners v Fine Arts* [1989] AC 914; *R. v Special Commissioners of Income Tax* [1988] 21 QB 31.

ARGUMENTS FOR RESTITUTION OF TAX

It is very rational that tax paid under 'mistake of law' should be refunded to the taxpayer, because the government is not entitled to impose and collect tax on citizens without the authority of law and therefore it cannot retain the tax which was not legally due. It is the cardinal principle of tax law that government cannot impose and collect tax without the sanction of law. The common law principle that tax paid under 'mistake of law' is not refundable also goes against the constitutional right of the citizens that every citizen shall have the right to own his property and shall not be deprived of it save by due process of law.¹⁶ Due process of law or rule of law requires that taxes paid under 'mistake of law' should be refunded. Because it is the property of taxpayers and it cannot be taken by the government without warrant of law.

This principle of law has been severely criticised by many legal scholars. This principle of law that tax paid under 'mistake of law' would be irrecoverable is manifestly unfair and unjust. Therefore, it was necessary to reformulate this principle of common law to prevent manifest injustice caused to taxpayers. There is no rationale why the tax paid under 'mistake of law' would not be recoverable. This principle of law has paved the way for unjust enrichment and has caused dissatisfaction to taxpayers. Therefore, it is desirable that this principle should not be applied in restitutionary litigations where one party takes improper advantage over the other.

Professor W.R. Cornish disagreed and criticised the approach adopted by Lord Ellenborough in *Bilbie v Lumley*.¹⁷ He said:

While that proposition may be a highly desirable foundation of criminal responsibility, it is not self evident that it must apply equally to civil obligation in respect of money paid.¹⁸

We may fully agree with the argument of Professor Cornish. The maxim '*ignorantia juris non excusat*' applied by Lord Ellenborough was basically derived and developed for application in cases of criminal liability and it is not desirable in cases of restitution of money or tax mistakenly paid. The above maxim is applicable in criminal liability for propagating strict liability as a person cannot defend himself after committing a crime saying that he was not aware of the relevant law which made the act a crime.

¹⁶ Article 13 of The Federal Constitution of Malaysia.

¹⁷ Article 13 of The Federal Constitution of Malaysia.

¹⁸ W.R. Cornish, 'Color of office: Restitutionary redress against public authority' [1987]

In 1802 Sir William Evan strongly supported the opinion of Vennius that money paid by mistake is recoverable, whether the mistake is one of fact or law. He also criticised the opinion of Pothier who refused recovery of money paid under mistake where the mistake is one of law.¹⁹ Sir William in his writing stated that money paid under a mistake of law was generally recoverable on that ground.

The opinion that money paid under mistake of law was not recoverable was widely applied by courts in the UK in the 19th and 20th century. However, this principle was applied only by courts of first instance and on occasion by the Court of Appeal in the UK. The matter was never heard by the House of Lords until 1998 in the *Kleinwort Benson*²⁰ case. In this regard Lord Goff states in the *Kleinwort* case that:

At all events the existence of the mistake of law rule became well established in the course of the 19th century and in the 20th century it was regularly applied by courts of first instance and on occasion by the Court of Appeal. It has however never fallen for consideration by your Lordship's House before the present appeals, which are now being heard after many years of criticism of the rule by scholars specialising in the law of restitution and after the rule itself has been discarded in a number of major common law jurisdictions.

From the above discussion on the opinion of legal scholars and Lord Goff on 'mistake of law', we can say that the distinction between 'mistake of fact' and 'mistake of law' is wrong in a suit for restitution of money or tax paid under mistake. The court cannot simply apply the mistake of law principle and say that money paid under 'mistake of law' is not recoverable. Money or tax paid under mistake no matter whether the mistake is of fact or law, must be recoverable as of right by the payer unless there is a justifiable defence for the defendant refusing the repayment, for example change of position defence. When tax or money paid under 'mistake of act' is recoverable, why is not it recoverable under 'mistake of law'? Mistake of law cannot be an unrecoverable ground in a suit for restitution. There is no justification for a decision that money or tax paid under 'mistake of law' is not recoverable unless there are acceptable defences to the payee.

¹⁹ Sir William Evans, *An essay on the action for money had and received*, (republished) [1998] RLR 1.

²⁰ [1999] 2 AC 349.

PRINCIPLE OF UNJUST ENRICHMENT AND RESTITUTION

When a person receives some money from another person without any legal justification, he should keep the money as a trustee until it is reclaimed by the real owner. In this situation a resulting trust originates where the person receives the money becomes a trustee and the person who wrongly pays the money becomes the beneficiary. In resulting trust it is the duty of the trustee to refund the money received to its real owner (the beneficiary). Equity, law and justice demand that such money must be returned to its real owner when claimed. Principles of honesty and good conscience dictate that the money must be returned to its real owner who paid the tax mistakenly.²¹ Principles of honesty, good conscience and piety emphasize that such tax must be refunded even if the taxpayer does not claim back the money.

If the person who is holding the money as a trustee under resulting trust refuses to repay to the real owner of the money, he will be liable for unjust enrichment. It is unjust enrichment because the trustee cannot retain the money on any justifiable grounds in law. Therefore, he will be enriched with the money and it is unjust enrichment. Unjust enrichment is not accepted in equity, law and justice. Hence, the person who is unjustly enriched must return the money to the real owner of the money. This is because he is unjustly enriched at the expense of another person.

Similarly, unjust enrichment may happen in taxation when a taxpayer pays tax to the tax department in response to the *ultra vires* demand of tax officers. Later it is declared in judicial proceedings that the taxpayer was not legally bound to pay the tax. In this case, the taxpayer is not legally bound to pay tax to the tax department but he has paid mistakenly due to the *ultra vires* and unlawful demand of tax department. Hence, in such a situation the tax department becomes unduly enriched. Another example of tax department's undue enrichment is: a taxpayer pays tax thinking that he is liable to pay tax under a specific tax statute but later it is understood that he was not so liable to pay tax and he has paid the tax mistakenly. In such a situation, it is the duty of the tax department to refund the tax. If not, the tax department will be unduly enriched.

When a taxpayer pays tax wrongly to the tax department, he has a *prima facie* or general right to get refund of the tax paid. The tax department has no

²¹ Gerald McMeel, *The Modern Law of Restitution*, Blackstone Press Ltd., Great Britain, 2000, p 3; See also al-Quran, Surah Nisa (4): 58. This verse states that 'verily Allah doth command you to render back your trust to those to whom they are due.' This verse of the Holy Quran clearly states that when someone entrusts us with something, it is our ethical and legal duty to return the things when the owner of the goods wants it back.

right to retain the tax mistakenly paid because it is not due by any tax statute. Hence, the tax department has no justifiable reasons to retain the tax mistakenly paid by a taxpayer. In such a situation, if the tax department refuses to refund the tax paid wrongly, it will be liable for unjust enrichment at the expense of the taxpayer. Equity, good conscience, law and justice dictate that the tax department must refund the tax. It cannot keep it legally as government property.

Restitution is of two types: restitution for autonomous unjust enrichment and restitution for wrongs.²² In a restitution suit for autonomous unjust enrichment, the defendant receives wealth from the claimant and the claimant disputes the defendant's entitlement to that wealth. In cases of restitution for autonomous unjust enrichment it is not necessary to demonstrate any breach of primary legal obligation such as breach of duty.²³ Here, enrichment arises automatically without having to breach any primary obligation.

In restitution for wrongs, the defendant obtains a benefit as a result of a breach of duty owed to the claimant. In this case it is necessary to show the breach of primary legal obligation such as breach of duty, breach of contract, conversion etc. So, we can say that restitution for autonomous unjust enrichment is not a fault-based remedy.²⁴

Unjust enrichment is itself a ground for restitution. In *Lipkin Gorman v Karpnale Ltd.*,²⁵ the House of Lords recognised the principle of unjust enrichment as the foundation of claims in restitution. According to Lord Steyn four questions²⁶ arise in a suit for restitution for unjust enrichment such as:

- i) Has the defendant benefited or been enriched?
- ii) Was the enrichment at the expense of the claimant?
- iii) Was the enrichment unjust?
- iv) Are there any defences for the defendant?

If the first three questions are proved in a suit for restitution on the ground of unjust enrichment, the claimant may succeed in the suit to recover the money or property transferred to the defendant. However, if there are justifiable defences for the defendant, for example change of position, the claimant may not win in the suit to recover the money or property paid.²⁷

²² Gerald McMeel, *The Modern Law of Restitution*, p 4.

²³ Gerald McMeel, 2000, p 4.

²⁴ As per Lord Steyn in *Banque Financiere de la Cite v Parach (Battersea) Ltd.* [1999] 1 AC 221 at p 227.

²⁵ [1991] 2 AC 548.

²⁶ *Banque Financiere de la Cite v Parach (Battersea) Ltd.* [1999] 1 AC 221, 227.

²⁷ P. Birks, *Unjust Enrichment*, Clarendon, Oxford, 2005, p 7.

RESTITUTION IS ALLOWED FOR TAX PAID UNDER MISTAKE OF
LAW IN RELEVANT TAX STATUTES IN SOME COMMON LAW
COUNTRIES IN SOUTH ASIA

Some of the common law countries have already abandoned the common law principle against restitution of taxes paid under 'mistake of law' by enacting laws in the Parliament as well as by the court's decision.²⁸ Malaysia, India, Bangladesh and some other common law countries do not follow the English common law principle in the *Bilbie* case as it manifestly causes injustice and anxiety to taxpayers.

Section 111 of the Income Tax Act 1967 (Malaysia) provides that:

... Where it is provided to the satisfaction of the Director-General Income Tax that any person has paid tax for any year of assessment in excess of the amount payable under this Act, that person shall be entitled to have the excess refunded by the Government and where that person is dissatisfied with the amount to be refunded to him, he may within thirty days of being notified of that amount, appeal to the Special Commissioners as if the notification were a notice of assessment...²⁹

The above section of the Income Tax Act 1967 clearly states that if any taxpayer pays tax in excess of tax legally due, he will be entitled to have the excess refunded no matter whether that payment in excess was under 'mistake of law' or for some other reasons. This section has removed the injustice and unfairness caused by the English common law principle ruled in the *Bilbie* case.

In *SGS Singapore (Pte.) Ltd. v Director General of Inland Revenue*,³⁰ the tax department collected tax from the appellant company which was not legally due and the High Court at Kuala Lumpur, Malaysia ordered the tax department to refund the tax to the taxpayer company. The Income Tax Act 1967 (Malaysia) has specific provision in section 111 mentioned above allowing refund of overpaid tax no matter whether the tax was paid by mistake or due to *ultra vires* demand of tax authority.

²⁸ Lord Goff in *Woolwich Equitable Building Society v Inland Revenue Commissioner* [1992] 3 All ER 753.

²⁹ There are similar provisions in 16 of the Customs Act 1967 (Malaysia) and 53 of the *Zakat and Fitrah* Enactment 1993 (Sabah, Malaysia).

³⁰ [2000] 2 AMR 1896.

Similarly, section 131 of the Income Tax Act 1967 (Malaysia) provides that:

(1) If any person who has paid tax for any year of assessment alleges that an assessment relating to that year is excessive by reason of some error or mistake in a return or statement made by him for the purposes of this Act and furnished by him to the Director General prior to the assessment becoming final and conclusive, he may within six years after the end of the year of assessment within which the assessment was made make an application in writing to the Director General for relief. (2) On receiving an application under subsection (1) the Director General shall inquire into the matter and, subject to this section and section 128 (5), shall give by way of repayment of tax such relief in respect of the alleged error or mistake as appears to him to be just and reasonable.

The above section in Income Tax Act (Malaysia) clearly mentions that if a taxpayer pays tax under mistake he has a right to recover it. This section will apply equally to tax paid under 'mistake of law' and 'mistake of fact'. Because this section does not specifically say that the taxpayers is entitled to refund of taxes paid only under 'mistake of fact' and not under 'mistake of law'.

In India if a taxpayer pays tax under mistake of law or fact he is entitled to recover it as of right. Section 72 of the Contracts Act (India) provides: A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it.

The word "mistake" in the above section includes 'mistake of law' as well as 'mistake of fact'. Because, that section does not expressly contain any qualification or limitation that the mistake will only mean 'mistake of fact'. In *Shiva Prasad Sing v. Srish Chandra Nandi*,³¹ Lord Reid in the Privy Council pointed out that money paid under mistake or coercion would be recoverable under section 72 of the Contract Act (India) and the right to relief under section 72 would be extended to money paid under 'mistake of law', i.e., "mistake in thinking that the money paid was due when in fact it was not due."³²

In the *State of Kerala v Aluminium Industries Ltd.*,³³ the Supreme Court of India held that money paid under 'mistake of law' is recoverable under section 72 of the Contracts Act (India). It is to be noted that section 72 of the Contracts Act (India) has abandoned the common law rule that "money paid under mistake of law is not recoverable". This section has paved the way for the courts to abandon the so-called common law principle of non-recovery of money or tax

³¹ AIR 1949 PC 297. This case was referred to the Privy Council in the UK as an appeal from the decision of the Supreme Court of India.

³² See also *Sales Tax Officer v Kanhailal Mukundlal Saraf*, AIR 1959 SC 135 at 141-142.

³³ (1965) 16 STC 689 (SC).

paid under 'mistake of law'. Until the Privy Council decision in *Shiva Prasad Singh* case, the Indian courts continued to follow the old common law principle provided in *Bilbie* case and denied the recovery of tax or charges paid under 'mistake of law'. Therefore, the decision of Lord Reid in the *Shiva Prasad* case is a significant case in the history of India, where the Privy Council showed their creativity to get rid of the observation of Lord Elinborough in *Bilbie v Lumby*.

In *Caltex (India) Ltd. v Assist. Commissioner of Sales Tax*,³⁴ the appellant (taxpayer company) paid sales tax under 'mistake of law'. The tax was paid under Rule 8 of the M. P. Sales Tax Rules 1957 which was held by the M.P. High Court in India in another case to be *ultra vires* to section 13(1)(d) of Central Sales Tax Act 1956 (India) and therefore was invalid.³⁵ When the decision of the M. P. High Court came to the knowledge of the appellant, it applied to recover the tax paid under 'mistake of law'. Bhargava J. in M. P. High Court in the present case held that the appellant was entitled to recover the tax paid under 'mistake of law' under section 72 of the Contracts Act (India).

Section 237 of the Income Tax Act 1961 (India) provides that if any person satisfies the assessing officer that the amount of tax paid by him or on his behalf for any assessment year exceeds the amount with which he is properly chargeable under this Act for that year, he shall be entitled to a refund of the excess. This section allows refund of excess tax even if the excess was due to 'mistake of law'. We have seen that in India the English common law principle of restitution under 'mistake of law' has been abandoned in section 72 of the Contracts Act and section 237 of Income Tax Act. Under these sections a taxpayer who pays tax under 'mistake of law', is entitled to recover it. Section 73 of the Contracts Act 1950 (Malaysia) embodies a provision which is in *pari materia* with section 72 of the Contracts Act (India). Section 73 of the Contracts Act (Malaysia) provides that:

A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return.

Chapter XVIII of the Income Tax Ordinance 1984 (ITO) (Bangladesh) provides provisions and procedure for refund of overpaid income tax. Section 146(1) of ITO 1984 provides that a person who satisfies the Deputy Commissioner of Income Tax that the amount of tax paid by him or on his behalf for any year exceeds the amount with which he is properly chargeable under this Ordinance

³⁴ AIR 1971 MP 162. See also The Supreme Court decision in *State of Madras v R. Nandlal and Co.*, AIR 1967 SC 1758.

³⁵ *Commissioner of Sales Tax (M.P.) v Girja Prasad Sunderal of Satna*, (1968) 21 STC 360. (MP).

for that year, shall be entitled to a refund of any such excess. The above section does not say about the reason for excess payment of tax. Whatever might be the reasons for the excess payment of income tax, the important point to be considered for refund is that the payment of tax was in excess of the amount due under the ITO 1984. Hence, under ITO 1984 (Bangladesh) excess tax paid to tax department is refundable to the taxpayer under 'mistake of law'.

Section 147 of ITO (Bangladesh) allows the legal representative or guardian of a deceased taxpayer to claim and receive the refund of the excess tax. Section 151 of the Act provides that the excess tax must be refunded within two months of the date of claim for refund. If it is not, then 7.5% annual interest should be paid to the taxpayer for late refund of the excess tax. So, the ITO 1984 (Bangladesh) has also abandoned the UK common law principle in *Bilbie* case. Hence, from the analysis of parliamentary statutes in Malaysia, India and Bangladesh we may say that overpaid tax should be refunded to the taxpayer as of right even if it was paid due to 'mistake of law'. This is because justice and equity require that excess tax must be refunded even if it was paid under 'mistake of law'. We cannot expect all taxpayers must to be well-versed in tax law and it is simply not possible. Even many tax officers misinterpret law and collect less or more tax than due by the relevant tax statute. So, 'mistake of law' cannot be a ground for refusal of refund of excess tax paid by the taxpayer.

STATUTES IN THE UK ALLOWS REFUND OF TAX PAID UNDER MISTAKE OF LAW

The Income and Corporate Tax Act 1988 (UK) provides no provision for refund of overpaid tax. However, section 33(2) of the Taxes Management Act 1970 (UK) provides provision for refund of tax paid under 'mistake of law'. Section 33(2) of the Taxes Management Act 1970 (UK) provides that if tax is overpaid by the taxpayer to the Revenue, which has been charged under an assessment which was excessive by reason of some error or mistake in the return or statement made by him for the purposes of the assessment is recoverable.³⁶ This overpayment may be set off against the tax payable in the subsequent years.³⁷ Section 33(2) of the Taxes Management Act 1970 (UK) uses the words "mistake" or "error" which include 'mistake of law'. If we critically analyze section 33(2) of the Taxes Management Act 1970 (UK), we can say that this section has modified the English common law rule in *Bilbie v Lumley*.³⁸ Under

³⁶ See 33(2) of Taxes Management Act 1970 (UK).

³⁷ See 33(2) of Taxes Management Act 1970 (UK).

³⁸ [1775-1802] All ER 425.

this section tax overpaid by the taxpayer due to 'mistake of law' is recoverable as of right in the UK.

Similarly, section 80 of the Value Added Tax Act 1994 (UK) (VATA 1994) and regulation 29 of the Value Added Tax Regulations 1995 (VATR 1995) provide provisions for refund of overpaid tax. Section 80 of VATA 1994 allows refund of overpaid output tax and previously unclaimed deduction of input tax under 'mistake of law'. Initially section 80 provided that an amount of tax paid by way of VAT which was not due to the Tax Commissioners could be claimed within six years from the date on which it was paid unless an amount had been paid by reason of a mistake, in which event a claim could be made at any time within six years from the date on which the claimant discovered the mistake or could with reasonable diligence have discovered it. Later an amendment was made to section 80(4) of VATA 1994 by section 47 of the Finance Act 1997 (UK) with effect from 18 July 1996. This amendment reduced the six year time limit for the recovery of overpaid tax to three years and removed the exception in relation to cases of mistake.³⁹ So, overpaid VAT paid under 'mistake of law' is recoverable under section 80 of the VATA on the ground that the VAT was not legally due to Tax Commissioners.

In *Fleming and Conde Nast Publications Ltd. v Her Majesty's Revenue and Customs*,⁴⁰ the House of Lords observed that overpaid output tax can be recovered by the taxpayer under section 80 of the Value Added Tax Act 1994 and Regulation 29 of the Value Added Tax Regulations 1995 on the ground of 'mistake of law'. Therefore, it is settled law under section 80(4) of the VATA 1994 and regulation 29 of VATR 1995 that overpaid value added tax (VAT) is recoverable by the taxpayer as of right under mistake of law. The consideration will be that VAT was overpaid and it was not due to the Tax Commissioners.

The General Rate Act 1967 (UK) also provides provisions for refund of excess tax paid under mistake of law on the ground that the rate in the valuation list was excessive and the ratepayer was not liable to make that payment. Section 9(1) of the General Rate Act 1967 (UK) provides:

Where it is shown to the satisfaction of a rating authority that any amount paid in respect of rates, and not recoverable apart from this section, could properly be refunded on the ground that - (a) the amount of any entry in the valuation list was excessive; or (b) a rate was levied otherwise than in accordance with the valuation list; or (c) any exemption or relief to which a person was entitled was not allowed; or (d) the hereditament was unoccupied during any period; or (e) the person who

³⁹ See also the decision of House of Lords in *Fleming and Conde Nast Publications Ltd. v Her Majesty's Revenue and Customs* [2008] UKHL 2.

⁴⁰ [2008] UKHL 2.

made a payment in respect of rates was not liable to make that payment, the rating authority may refund that amount or a part thereof.

In *Regina v Tower Hamlets London Borough Council, Ex p. Chetnik*,⁴¹ the applicants (ratepayers) paid rates under 'mistake of law' and for this reason the rating authority refused to refund the rates paid under 'mistake of law'. In the House of Lords it was held that although the rates were paid under 'mistake of law', the rating authority had no right in equity to keep those rates with them. Both the Court of Appeal and House of Lords held that the rating authority's decision not to refund the rates overpaid by the applicants was made in disregard of the legislative purpose of section 9 of the *General Rate Act 1967* (UK).

It is to be noted that section 9(1) of the *General Rate Act 1967* (UK) has made refund provision for rates paid by a person who was not liable to make that payment. In other words the rate was not payable under the Act but it was paid due to some reason such as mistake or unlawful demand of the rating authority. Whatever may be the reason of payment of the rate, the issue to be considered is whether it was due under law or not. If it was not due under law, it must be refunded by the rating authority as per section 9 of the *General Rate Act*.

In the *Tower Hamlets London Borough Council* case discussed above Lord Bridge of Harwich observed in the House of Lords that:

I in no way dissent from this reasoning, but I should myself have been content to derive the same conclusion from broader consideration that Parliament must have intended rating authorities to act in the same high principled way expected by the court of its own officers and not to retain rates paid under a mistake of law, or in paragraph (a) upon an erroneous valuation, unless there were, as Parliament must have contemplated there might be in some cases, special circumstances in which a particular overpayment was made such as to justify retention of the whole or part of the amount overpaid.⁴²

Lord Bridge did not deny the possible defences of the rating authority to refuse refund of rate paid under 'mistake of law' in special circumstances that justify retention of the whole or part of the amount of rate overpaid. In this case Lord Goff of Chieveley pointed out that section 9 of the *General Rate Act* (UK) allowed restitution of rates paid in the circumstances specified by the section

⁴¹ [1988] AC 858.

⁴² *Regina v Tower Hamlets London Borough Council, Ex p. Chetnik*, at 877. See also *Ex Parte James* [1874] LR 9 Ch. App. 609, at p 614 (as per James L.J.); *Ex parte Simmonds* [1885] 16 QBD 308, at p 312 (as per Lord Esher M.R.); *In Re Tyler* [1907] 1 KB 865, at p 869 (as per Vaughan Williams L.J.).

including rate paid under 'mistake of law'. His Lordship stated that section 9 was intended to prevent unjust enrichment of the rating authority. Lord Goff of Chieveley in his decision rightly stated that:

Section 9 confers on rating authorities a statutory power to refund an amount paid in respect of rates, Effectively therefore, the section creates a statutory remedy of restitution, in the circumstances specified by the section, to prevent the unjust enrichment of the rating authority at the expense of the ratepayer.⁴³

Lord Goff observed in the above quotation that rate overpaid under mistake of law or for some other reasons must be refunded to prevent unjust enrichment of the rating authority at the expense of the ratepayer. So, unjust enrichment is a good ground to demand refund of rate, tax or money paid under 'mistake of law'.

RESTITUTION OF TAX UNDER WOOLWICH PRINCIPLE (1992)

In *Woolwich Building Society v Inland Revenue Commissioner*,⁴⁴ Lord Goff at the House of Lords reformulated the English common law principle on restitution of overpaid tax. He observed that if tax paid to tax department due to unlawful or *ultra vires* demand of tax department, the taxpayer has *prima facie* right to recover it even if the tax paid was due to mistake or any other reasons. In this regard Lord Goff observed:

In the end, logic appears to demand that the right of recovery should require neither mistake nor compulsion, and the simple fact that the tax was exacted unlawfully should *prima facie* be enough to require its repayment.

In the above case the taxpayer (a corporation) paid a large amount of income tax to the tax department under the Income Tax (Building Societies) Regulations 1986. The taxpayer reserved the right to restitution of the tax in the event of a successful challenge to the validity of the Regulations by way of judicial review proceedings. Subsequently this regulation was challenged and the court held that the regulations were *ultra vires*. The company then applied to recover the taxes paid and also claimed interest on it.

During the hearing of the appeal, in the House of Lords the question was whether money exacted as taxes from a taxpayer by the tax department by way of an *ultra vires* demand was recoverable by the taxpayer as of right and if yes,

⁴³ *Regina v Tower Hamlets London Borough Council, Ex p. Chetnik*, at 877.

⁴⁴ [1992] 3 All ER 737.

whether the taxpayer company would be entitled to interest on the sums repaid to it by the tax department, running from the dates when those sums were paid to the tax department. In the House of Lords by the majority judgment (3 to 2 judgment) it was held that tax paid by a taxpayer to the tax authority or other levies paid pursuant to an *ultra vires* or unlawful demand by the tax authority is *prima facie* recoverable by the taxpayer as of right. In this case Lord Goff observed:

I do not consider that the principle of recovery should be inapplicable simply because the citizen has paid the money under a mistake of law.⁴⁵

The House of Lords in the above case ruled that the taxpayer has the right to recover tax paid even under 'mistake of law' although the court decided the case on the ground of *ultra vires* demand of tax by the tax department. This case is regarded as a historical and an epoch-making case in the legal history of the UK and common law countries. From the above observation of Lord Goff at the House of Lords we can say that even if tax is paid under 'mistake of law,' the taxpayer is entitled to recover the tax paid if he can prove that the tax was exacted unlawfully. However, Lord Goff in his statement at the House of Lords in 1992 indicated a signal that he is ready to held in future cases that money or tax paid under mistake of law is recoverable as of right. This he actually did in his judgment in *Kleinwort Benson* case (1998) stating that the payer of money or tax under mistake of law has a general right to recover it subject to certain justifiable defences of the payee.

PRINCIPLES OF EQUITY AND RESTITUTION

Tax paid under 'mistake of law' is recoverable in equity rules. In this respect we may refer to *Blackpool and Fleetwood Tramroad Co. v Bispham with Norbreck Urban District Council*.⁴⁶ In this case the Divisional Court in the UK held that equity demands that rates overpaid under 'mistake of law' should be refunded to the ratepayer. In this case the ratepayers disputed the liability of the payment of certain rates which were demanded by the rating authority. In another similar case, the ratepayers disputed and eventually paid the rates to another rating authority and the issue was pending in the court for a decision whether the ratepayers were legally bound to pay the rates or not. In the instant case, the ratepayers also agreed to pay the rates demanded provided that if the other litigation with

⁴⁵ *Woolwich Building Society v Inland Revenue Commissioner*, at 764.

⁴⁶ [1910] 1 KB 592; see also *Customs and Excise Commissioners v Fine Arts* [1989] AC 914; *R. v Special Commissioners of Income Tax* [1888] 21 QB 313.

a different rating authority was resolved in favour of the ratepayers (where the disputes were on the same legal issues) the rating authority should refund the rates paid under mistake of law. The disputes were turned on 'mistake of law' as in both of cases the ratepayers were not sure whether they were liable to pay the demanded rates under the law or not. The ratepayers succeeded in the other litigation where the court held that the ratepayers were not legally bound to pay the rates demanded by the rating authority.

Upon the decision of the court, the ratepayers claimed to set off the overpaid rates against the further rates due from them but the rating authority refused the claim as the rates were paid under 'mistake of law' which according to them could not be refunded. The rating authority also applied for distress warrant against the ratepayers in respect of the further rates due from them. The justices issued the distress warrant asked for and the ratepayers appealed against the decision. The Divisional Court reversed the decision of the justices and held that the rating authority was bound in equity to allow set off the overpaid rates under 'mistake of law' against the subsequent rates due. Lord Alverstone CJ in the Divisional Court observed:

If this had been a case in which the appellants had been attempting to set off disputed items, or to raise a claim in damages, against the rate in question, I should have doubted whether that would have been sufficient cause for a refusal by the justices to order payment; but in my opinion, apart from any question as to the undertaking given by the respondents when it is the fact that a rating authority has in hand money of a ratepayer which has admittedly been overpaid in respect of previous rates, and which money the rating authority ought not in equity to be allowed to keep, but which ought to be applied in payment of the debt due from the ratepayer for a subsequent rate, that is a sufficient cause for the justices to refuse to make an order for payment of that later rate.

Bray J. in the above case also approved the claim by the ratepayers to set off the overpaid rates and said:

Then the justices have found as a fact that the respondents have been overpaid by the appellants £460 8s., that is, an amount exceeding that claimed in respect of the 1908 rate. In my opinion the respondents were bound in equity to apply that sum; which they had been overpaid, in payment of the 1908 rate...⁴⁷

⁴⁷ *Blackpool and Fleetwood Tramroad Co. v Bispham with Norbreck Urban District Council*, at 599.

From the above discussion it is clear that tax paid under 'mistake of law' is recoverable under the law of equity. Because, equity or fairness demands that tax paid to the government under 'mistake of law' should be refunded. Tax paid under 'mistake of law' is also recoverable under the principle of constructive or resulting trust. When taxpayers pay tax under 'mistake of law' or fact to the tax department, the tax department holds the tax under resulting trust and the tax department should refund the tax whenever taxpayers claim the tax.⁴⁸

RESTITUTION OF TAX UNDER ISLAMIC LAW

Tax paid under 'mistake of law' is recoverable under Islamic law in accordance with the principle of trust law in Islam. Islamic law strongly very much emphasizes morality and ethics in the daily activities of people. It requires people to be completely honest and to render back the trust to whom it belongs. If a person does not return the trust, he will be liable under Islamic law to return it to whom it is due. There is also punishment from the God in the hereafter for misappropriation of the trust. In this regard the Quran provides:

Allah doth command you to render back your trusts to those to whom they are due and when ye judge between people, judge with justice. Verily how excellent is the teaching which He giveth you! Allah is He who heareth and seeth all things.⁴⁹

In this verse Allah (s.w.t.) clearly orders people to be trustworthy and to render back the trust that is kept with someone. So, the person keeping something as trustee must return the thing to its real owner when demanded. The verse also requires a judge to do justice on the parties in a suit. Therefore, when a trustee refuses to return the goods entrusted, the judge must make an order requiring him to return the goods to its real owner. When a tax department retains tax which is not due under tax law, it will amount to unjust enrichment of the tax department. Under Islamic law unjust enrichment is not justified and accepted. Hence, tax paid under 'mistake of law' is recoverable as of right under Islamic law.

Under Islamic law if someone deposits something with someone else, the later holds the thing as trustee for the real owner. The trustee has a moral and legal duty to render back the trust to the real owner when claimed. In this respect al-Quran states that: "If one of you deposits a thing on trust with another, let the trustee discharge his trust faithfully and let him fear his Lord."⁵⁰ If the person

⁴⁸ William Swadling, 'A New Role for Restituting Trusts?' [1996] 16 *Legal Studies* 110-131.

⁴⁹ Al-Quran, Surah 4, Verse 58.

⁵⁰ Al-Quran, Surah 2, Verse 283. See also Al-Quran, Surah 3, Verse 75.

misappropriates the trust, he will be liable to compensate under Islamic law and he will also be punished in the hereafter for committing sin.⁵¹

The above two verses of al-Quran (2:283 and 3:161) also clearly mention that when someone is entrusted with something, the trustee must discharge his trust faithfully. It means the trustee must keep and look after the things properly and sincerely so that no loss or damage happens to the things and the trustee has to return the things when demanded by the owner. From the above references of Islamic law principles on trust and unjust enrichment we may say that when tax is paid to the tax department under 'mistake of law', it is an honest duty of tax officers to refund the tax to the taxpayer. Of course, tax officers and the taxpayer have to follow the prescribed procedure for restoration of the tax provided in the tax statute or in any other procedural enactment.

JUSTICE – ALL SOULS REPORT (1988)

The Justice -- All Souls Report on administrative justice in England proposed that a right to restitution for voluntary payment and payment under 'mistake of law' ought to be introduced by legislation. Paragraph 11.88 of the report says:

Cases can arise where in consequence of an invalid regulation a trader has made payments to a statutory body. In principle, he should be allowed to recover these together with interest. But the law says that some payments are 'voluntary' or made under 'mistake of law' and so are not recoverable. We intend that the legislation we are proposing should provide a general right to recover payments in such circumstances.⁵²

Paragraph 11.88 of the above report was very important to do justice on taxpayer who paid tax under 'mistake of law'. Such payment might be due to an invalid regulation made by the authority. The report vehemently suggests that legislation should be made in the UK offering a general right to taxpayers to demand refund of tax paid voluntarily or under mistake of law. This report together with other reports of the UK Law Commission⁵³ encouraged the House of Lords in 1992⁵⁴ to hold that when tax is paid due to unlawful and *ultra vires* demand of tax department, the taxpayer should have a *prima facie* right to recover the tax and in 1998⁵⁵ to hold that the payer of money should have a general right to recover the money paid under 'mistake of law'.

⁵¹ Al-Quran, Surah 3, Verse 161.

⁵² *Justice -- All Souls: Administrative Justice: Some Necessary Reforms* (1988), p 363.

⁵³ Important aspects of the Law Commission Reports have been discussed in the next rubric.

⁵⁴ *Woolwich's case*,

⁵⁵ *Kleinwort's case*,

In restitution law, tax paid voluntarily (in the sense that there was no duress) is recoverable on the ground of tax paid under unlawful demand by the tax department which was decided in 1992 by the House of Lords in the *Woolwich* case.⁵⁶ Lord Goff in *Woolwich* case also proposed that tax paid under 'mistake of law' also recoverable by the taxpayer as of right if it can be proved that the tax department exacted the tax unlawfully. He observed:

In the end, logic appears to demand that the right of recovery should require neither mistake nor compulsion, and that the simple fact that the tax was exacted unlawfully should *prima facie* be enough to require its repayment.

Following the recommendation of the Justice -- All Souls Report, common law countries may amend their tax statutes and include provision to the effect that if taxpayers pay tax under 'mistake of law' they should have a *prima facie* right to recover the overpaid tax (if such provision has not been inserted yet). It is highly appreciable that in many common law countries the law of restitution has been modified to the effect that tax paid under mistake of law and fact is *prima facie* recoverable.

LAW COMMISSION (UK) REPORT 1991 and 1994 ON RESTITUTION

The Law Commission (UK) consultation paper entitled "Restitution of Payments Made under Mistake of Law"⁵⁷ published in 1991 seriously criticised the existing common law principle of non-recovery of tax paid under 'mistake of law' and forwarded a proposal for its abolition. The Law Commission did an excellent job in forwarding the proposal against the common law principle which no doubt influenced the House of Lords, especially Lord Goff in 1992, when the House of Lords abandoned the English common law principle in *Woolwich Equitable Building Society* case and held that if tax is paid under *ultra vires* and unlawful demand of the tax authority the tax is *prima facie* recoverable as of right. By applying Lord Goff's *ultra vires* demand principle we may say that where a taxpayer paid tax under mistake of law but he can prove that it was paid due to the unlawful demand of tax authority, he would be entitled to recover the tax paid under 'mistake of law'.

The UK Law Commission's Report 1994 on "Restitution: Mistake of Law and *Ultra Vires* Public authority Receipts and Payments" has again recommended that the 'mistake of law' rule in English law should be abrogated.⁵⁸ In this

⁵⁶ The facts and decision of *Woolwich* case have been discussed earlier in this paper.

⁵⁷ The Consultation Paper (Law Com no 120) was published in 1991.

⁵⁸ The UK Law Commission Report 1994 (Law Com. No. 227), paragraph 3.1 *et seq.* and clause 2 of the draft Bill appended to the report.

1994 report the UK Law Commission recommended that the abrogation of the 'mistake of law' rule should be introduced by legislation.⁵⁹

No doubt the report of the Law Commission would serve as a guiding force for courts in the common law countries especially in the UK to enact laws allowing restitution of money or tax paid under 'mistake of law' in the near future. Section 80 of Value Added Tax Act 1994 (UK) has already enacted such provision allowing recovery of overpaid tax either it was paid by mistake or due to unlawful demand of tax authority. VATA 1994 has proved a landmark development in the law of restitution of value added tax.

In tax law, if tax is refunded to the taxpayer by tax department under mistake of law, the tax department has a *prima facie* right to recover the tax wrongly returned to the taxpayer. Here, we may argue that if the tax department is entitled to recover tax refunded under mistake of law, then why should taxpayers not also be entitled to recover tax paid under 'mistake of law'? There should not be two sets of law of restitution applicable to government and taxpayers. This principle of law is discriminatory in the sense that it gives privilege to the government at the prejudice of the innocent taxpayers. It is to be noted that no civil law countries apply such a discriminatory principle that money paid under 'mistake of law' is not recoverable.

RESTITUTION UNDER *KLEINWORT BENSON* CASE (1998)

In 1998 House of Lords made a ground breaking decision by abolishing the common law rule in *Bilbie* case that money paid under 'mistake of law' is not recoverable as of right. The common law rule was applied by the courts of first instance and on occasion by the Court of Appeal for almost last two hundred years. But the matter was never referred to the House of Lords for its opinion and decision.⁶⁰ Luckily in 1998 the House of Lords had a chance to review the validity of the two hundred years celebrated common law rule on restitution under 'mistake of law' in *Kleinwort Benson Ltd. v Lincoln City Council*.⁶¹

In this case the plaintiff bank entered into interest rate swap agreements with four local authorities separately such as Lincoln City Council, Birmingham City Council, Southwark London Borough Council and Kensington and Chelsea Royal London Borough Council. Each of the transactions was fully performed by both parties according to its terms and resulted in the bank paying to the local authorities sums totalling £811,208. In 1991 the House of Lords decided in a case that such interest rate swap contracts were *ultra vires* the local authority.

⁵⁹ Paragraph 3.8 to 3.12 of UK Law Commission Report 1994.

⁶⁰ Judgment of Lord Goff in *Kleinwort Benson* case [1999] 2 AC 349, at p 370.

⁶¹ [1999] 2 AC 349.

After the decision the bank commenced proceedings in the Commercial Court against the four local authorities claiming restitution of the sums paid to them under 'mistake of law'. The bank claimed that such payments had been made by it in the mistaken belief that they were being made pursuant to a binding contract but in fact it was not following the decision of the House of Lords in 1991 in another case.

After reviewing the history of common law on restitution under 'mistake of law' and referring to the criticism of legal scholars against the application of the common law rule, the House of Lords was satisfied to hold that the 'mistake of law' rule that applied by the courts in the UK for a long period of time in restitutionary claims, no longer forms part of English law and it should no longer be maintained as part of English law. Instead the payer will have a general right of restitution of money paid under 'mistake of law'. Lord Goff at the House of Lords observed:

I would therefore conclude that the mistake of law rule should no longer be maintained as part of English law, and that English law should now recognise that there is a general right to recover money paid under a mistake, whether of fact or law, subject to the defences available in the law of restitution.⁶²

This was one of the epoch-making decisions by the House of Lords in the history of the English legal system. It was long desired by taxpayers, lawyers, legal scholars, the UK Law Commission that this defective common law rule should no longer be sustained in English legal system and it should be abrogated by both judicial decision and by making legislation at the Parliament. However, it could not be done so probably because the parties in dispute did not appeal to the House of Lords or it was not referred to the House of Lords for its opinion as a 'leap-frog' appeal.

It is to be noted that Lord Goff in the above decision of the House of Lords discarded the distinction between 'mistake of law' and 'mistake of fact' and said that the payer will have a general right to recover money paid under mistake whether it is 'mistake of law, or 'mistake of fact'. Before the decision of House of Lords in this case, the courts in the UK maintained that the payer who paid money under 'mistake of fact' can recover but if he paid under mistake of law, he cannot recover. Such dichotomy of mistake is absurd and it was long criticized by legal scholars and finally the House of Lords abandoned the dichotomy in 1998 in this case.

Another important point we find from the decision of the House of Lords in this case is that the court recognised justifiable exceptions to the general rule that money paid under 'mistake of law' is recoverable as of right. However,

⁶² *Kleinwort Benson Ltd. v Lincoln City Council*, p 375.

the House of Lords recognised that there might have exceptions to the general rule of restitution under 'mistake of law' in special circumstances justifying its retention or where justice or policy does not require the payee to refund the money.⁶³ In this regard Lord Goff observed:

The combined effect is not only that the mistake of law rule can no longer be allowed to survive, but also that the law must evolve appropriate defences which can, together with the defence of change of position, provide protection where appropriate for recipients of money paid under a mistake of law in those cases in which justice or policy does not require them to refund the money.⁶⁴

The House of Lords did a good job by abolishing the defective common law rule on 'mistake of law' and providing a general right of restitution of money paid under 'mistake of law' including tax. In certain special circumstances or on policy grounds it might be necessary for the court to withdraw the general right of restitution under 'mistake of law' for example where the insurer paid indemnity to the insured under 'mistake of law' (where the insured did not disclose a material fact in the insurance application form as it was filled up by an insurance agent who did not ask him about the fact or he failed to pay premium at the time when the loss arose for financial constraint). It is to be mentioned here that following the decision of House of Lords in *Kleinwort Benson* case (1998), later House of Lords also decided in *Deutsche Morgan Grenfell Group Plc v Inland Revenue Commissioners*⁶⁵ that the taxpayer has general right of restitution of tax paid under mistake of law.

CONCLUSION

There was a long dissatisfaction among people in the UK and common law countries against the application of the common law rule on restitution under 'mistake of law'. This was because the rule was defective and caused substantial injustice to parties including taxpayers. Legal scholars and the UK Law Commission criticised the rule in many occasions and recommended its abolition. Therefore, it was long desirable that this defective rule should be abrogated at least by judicial decision. Section 33(2) of Taxes Management Act 1970, *Tower Hamlets* case, *Woolwich* case, *Blackpool and Fleetwood Tramroad*

⁶³ See Lord Goff's observation at p 372 and 373.

⁶⁴ See Lord Goff's observation at p 372 and 373.

⁶⁵ [2006] UKHL 49. This case was decided by the House of Lords on appeal from [2005] EWCA civ 78.

case, section 80 of Value Added Tax Act 1994 and the observation of legal scholars, UK Law Commission Reports 1991, 1994 etc. have paved the way for the House of Lords in 1998 to finally overrule the long standing *Bilbie v. Lumley* decision in *Kleinwort Benson Ltd. v Lincoln City Council*.⁶⁶

The decision of the House of Lords in *Kleinwort Benson* case was a ground breaking decision in the history of the UK legal system. It has reduced tension and anxiety among people including taxpayers because the rule precluded restitutionary right when the payment was made under 'mistake of law'. It is natural for taxpayers to pay tax under 'mistake of law' when he is not legally liable to pay under a relevant tax statute or taxpayers pay tax due to *ultra vires* demand of tax officers which comes under 'mistake of law'. It is important that the existing law should be reviewed from time to time in common law countries by courts to determine its suitability at that time. If an old law is proved to be defective and unjustifiable, courts have to declare it unjustifiable and recommend its abolition or reformulation by making law in the Parliament. By updating old laws, we can have updated, suitable and justifiable laws that suit the present aspirations of people.

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⁶⁶ [1999] AC 349.