

Back to basics

When can you rely on HMRC statements?

SPEED READ Taxpayers increasingly need to rely on statements made by HMRC which do not have the force of law, such as HMRC clearances given to a specific taxpayer, or HMRC guidance to taxpayers generally. The doctrine of legitimate expectation provides a basis for that reliance, subject to the conditions set out in case law being met. In particular, a taxpayer needs to 'put all his cards face upwards on the table' when applying for clearance, and the clearance given (or guidance being relied upon) needs to be 'clear, unambiguous and devoid of relevant qualification'.



Christopher Harrison is a partner at Allen & Overy LLP. He advises on securitisations, capital markets transactions and corporate M&A. Email: christopher.harrison@allenoverly.com; tel: 020 3088 3638.



David Stainer is a senior professional support lawyer in the UK tax practice at Allen & Overy LLP. He specialises in the corporate tax aspects of financing transactions. Email: david.stainer@allenoverly.com; tel: 020 3088 2272.

The need for taxpayers to rely with confidence on statements made by HMRC is increasingly common. New tax legislation emerges every year, and it is not always possible for the statutory draftsman to deal with every single issue that emerges during consultation. Many such issues will fall to be dealt with in HMRC guidance lacking the force of law. This trend for taxpayers to be 'taxed by statute and untaxed by concession', as Walton J put it in *IRC v Vestey* [1977] STC 414, is generally considered undesirable, but it is nonetheless an inescapable aspect of modern taxation.

Sometimes, questions will arise that are not dealt with clearly either in legislation or published guidance. In such cases, a taxpayer or his advisers will often need to write to HMRC to seek a confirmation of the position. Additionally, a taxpayer may sometimes need to obtain HMRC clearance where there is no legal uncertainty (e.g. under a statutory clearance procedure).

In all such cases, it will be essential for the taxpayer to be able to place a high degree of reliance on the statements made by HMRC.

This back to basics article looks at the principles which govern a taxpayer's ability to rely on written statements by HMRC, focusing in particular on the public law doctrine of legitimate expectation. It does not focus on questions of forum, on the taxpayer's ability to rely on non-written confirmations by HMRC (e.g. by telephone), or on HMRC's conduct.

The doctrine of legitimate expectation

The doctrine of legitimate expectation emanates from public law, and applies to the behaviour of

a public authority in the tax field as it applies to behaviour by public authorities in any other field.

Essentially, the doctrine provides that where a public authority has made representations about how it will exercise its powers, and a person has formed a legitimate expectation of the authority's likely behaviour on the basis of those representations, then the authority's scope to act inconsistently with those representations will be very limited.

The key case on how the doctrine applies in the tax context is the case of *Inland Revenue ex parte MFK Underwriting Agencies Ltd* [1989] STC 873, which concerned the question of whether Lloyd's underwriting agencies and syndicates could rely on statements made by HMRC officials in meetings. In that case, Bingham LJ noted that, prima facie, a taxpayer's only legitimate expectation is to be taxed according to statute, and not according to concession or a wrong view of the law. Statements such as clearances or rulings would ordinarily bind HMRC only if two conditions are fulfilled:

- the taxpayer has to, as Bingham LJ put it, 'put all his cards face upwards on the table' in applying for the clearance or ruling; and
- the ruling has to be 'clear, unambiguous and devoid of relevant qualification'.

Bingham LJ said that the first of these requirements means that a taxpayer has to: give full details of the specific transaction on which a ruling is sought; make clear to HMRC the nature of the ruling sought (i.e. where HMRC is being asked to forgo tax, that must be made explicit); make clear that 'a fully considered ruling is sought'; and make clear what use the taxpayer intends to make of the ruling.

How legitimate expectation applies to HMRC clearances

The nature of disclosing full details of a transaction was expanded on by the House of Lords in *R v IRC ex parte Matrix Securities Ltd* [1994] STC 272. In that case, HMRC was found not to have been bound by a clearance it had given in relation to enterprise zone property unit trusts.

Rather than spell out the full facts in explicit detail, the taxpayer had merely provided enough information to enable HMRC to infer the full facts, which the House of Lords found was insufficient. Moreover, the taxpayer had not clearly spelt out the legal issues on which clearance was sought. And, finally, the taxpayer had knowingly not applied to the correct level of authority within HMRC, applying to its local inspector even though it knew that HMRC's financial institutions division was dealing with queries in the relevant area. Moreover, the taxpayer's request that HMRC should consider complex material and give a clearance within a day was found to be unreasonable.

Putting the *MFK* and *Matrix* decisions together, a practical checklist of points to be considered in applying for a clearance might be:

- the application needs to set out all material (and possibly material) facts about the transaction involved – and if the facts change after a

- clearance has been given, HMRC should be told about that and asked to reconfirm the clearance;
- the application needs to be clear about what is being asked for – if HMRC is being asked to forgo tax, that needs to be made explicit;
 - the application needs to set out the taxpayer's intended analysis in full, including the weaker aspects – if counterarguments have occurred to the taxpayer, they should arguably be set out so that HMRC can take a view;
 - the taxpayer needs to apply to the appropriate HMRC recipient, following any relevant guidance in that respect – sending the matter to a local inspector only may not be sufficient;
 - if a deadline is essential, it needs to be sensible and reasonable; and
 - when the clearance is given, if anything suggests that HMRC has given it based on a misunderstanding of any kind, it would be wisest to query that with HMRC.

It is important to note that these requirements are suggested with a well-advised and well-resourced taxpayer in mind. For a smaller taxpayer, some requirements (e.g. the requirement to set out the intended legal analysis and possible counterarguments) may be relaxed.

HMRC's views on reliance on clearances

While much of HMRC's guidance follows directly from the case law, an additional point is that HMRC will not provide a clearance where an application 'is about treatment of transactions which, in HMRC's view, are for the purposes of avoiding tax'. Of course, if arrangements were tax motivated, then making that clear would be part of putting an applicant's cards face up on the table, in any case.

It is worth noting that the HMRC guidance (on its website and available via www.bit.ly/10QisQr) says that where a court or tribunal judgment changes the prevailing interpretation of case law on which a HMRC clearance has been based, and the taxpayer's liability to tax for that period has not yet been finalised (e.g. because a return can still be amended), HMRC may, 'subject to the principle of legitimate expectation', be required to collect the correct amount of tax required by the new interpretation of the law. Likewise, a retrospective statutory change will vitiate confirmations previously given.

While on first glance this looks questionable, on deeper reflection it is arguably fair that clearances given prior to a change of law can be withdrawn, potentially even retrospectively, because otherwise taxpayers who obtained a clearance would enjoy an advantage over those who did not.

HMRC's guidance says that even where HMRC gives advice that is incorrect in law, it will be bound by the advice if:

- the advice is 'clear, unequivocal and explicit'; and
- the taxpayer can demonstrate that it reasonably relied on the advice, made full disclosure of all the relevant facts, and application of the statute would result in financial detriment to the taxpayer.

However, less encouragingly, it goes on to say that HMRC's 'primary duty will remain to collect the correct amount of tax as required by the law' and that 'there will be some circumstances' where HMRC is not bound by the advice it has given.

This advice does not read that consistently and it is unclear whether meeting the two requirements set out at the bullet points immediately above is, in HMRC's view, sufficient to found a legitimate expectation. However, it does not change the point that the checklist above is a sensible starting point for ensuring that HMRC is bound by a clearance given.

The case law enables taxpayers to place a reasonable degree of reliance on statements by HMRC, provided that the detailed requirements set out in those cases are met

How legitimate expectation applies to HMRC guidance

HMRC guidance can, in broad terms, be divided into two categories.

First, there are communications directed at taxpayers in general. These come under an array of different names: HMRC briefs, guidance notes, technical notes, FAQs and so on. The old categorisations of Extra-Statutory Concessions, Statements of Practice, and Revenue Interpretations are nowadays mainly historic, but many remain in force. In the VAT context, HMRC issues much guidance as VAT Notices. It should be noted that some VAT Notices (and some parts of other VAT Notices) are expressly stated to have the force of law – this article is not relevant to guidance having the force of law.

Secondly, there are HMRC's manuals. The HMRC manuals are, at least in theory, stated to be 'prepared for HMRC staff' and published 'for taxpayers and their advisors in accordance with the Freedom of Information Act 2000' (see www.bit.ly/1y715IO). Because of this distinction, slightly different questions arise when considering the extent to which statements in the manuals bind HMRC.

Looking at the first type of guidance, Bingham LJ was fairly clear in *MFK* that such guidance is capable of giving rise to legitimate expectation on the part of taxpayers. As he put it: 'No doubt a statement formally published by [HMRC] to the world might safely be regarded as binding, subject to its terms, in any case falling within them.'

Lord Wilson in the Supreme Court decision in *Gaines-Cooper* [2011] STC 2249 explicitly confirmed that the principles in *MFK* applied to published guidance as well as HMRC clearances, and accordingly found that guidance is capable of binding HMRC in relation to a taxpayer falling

within it if the guidance is clear, unambiguous and devoid of relevant qualification. In *Gaines-Cooper*, the ultimate result was that the Supreme Court found that the taxpayer fell outside the terms of the relevant guidance, but found *obiter* that had this not been the case, the guidance would not have founded a legitimate expectation because it fell short of the necessary degree of clarity.

When applying for clearances, the taxpayer needs to be as helpful and open as it can be with HMRC

It is instructive to compare the clear indication from *Gaines-Cooper* that HMRC can be bound by guidance with HMRC's own views. Minutes of a February 2013 meeting between HMRC, the Chartered Institute of Taxation (CIOT) and other parties about reliance on guidance are significantly more cagey in tone than the case law suggests is merited (see www.bit.ly/1qipBOc).

Those minutes indicate a reluctance on HMRC's part to be bound by guidance which turns out to be wrong in law. As discussed above, this is arguably fair where there has been a relevant court or tribunal decision or retrospective legislative change, but it seems unreasonable where HMRC simply changes its mind. The 2013 minutes say HMRC will seek to collect tax 'unless there is an overwhelming reason not to'. It follows: 'HMRC cannot ever say definitively that there will be specific circumstances where it will accept that guidance provides a legitimate expectation such that it is bound by the guidance and cannot pursue additional tax due as a result of that guidance being correct'. This statement is very difficult to square with relevant cases.

Turning to HMRC's manuals, the question of reliance is arguably more difficult than for other types of HMRC guidance, largely because of the introductory 'health warning' that prefaces the manuals. In addition to stating that the guidance has been prepared for HMRC staff (see above), the health warning states that: it should not be assumed that the manuals are comprehensive or provide a definitive answer in every case; the manuals are based on the law as it stands at the date of publication (and will be amended or supplemented if the law or HMRC's interpretation of it changes); and the manuals will not bind HMRC if it considers that there is, or may have been, avoidance of tax.

Given the health warning, the question arises whether HMRC's manuals can ever found a legitimate expectation, given the requirement in *MFK* (applied by *Gaines-Cooper*) that HMRC guidance be 'devoid of relevant qualification'. An unhelpful First-tier Tribunal decision, *Hanover Company Services v HMRC* [2010] STFD 1047, suggested *obiter* that one of HMRC's VAT

manuals was incapable of founding a legitimate expectation on this basis. It is questionable whether a generic health warning of the kind attached to HMRC's manual could really amount to a relevant qualification of the kind envisaged in *MFK*. It seems more likely that Bingham LJ would have had in mind provisos embedded in or related to specific statements or representations by HMRC, rather than very general prefatory wording. And nothing was made of this point by HMRC in *Gaines-Cooper*, where the guidance contained a similar health warning. Overall, it is strongly arguable that *Hanover* was wrongly decided, although it was never appealed and therefore remains available to make life difficult for taxpayers.

Overall, a taxpayer looking to rely on HMRC guidance should first satisfy itself that the guidance is 'clear and unambiguous'. If this is not the case, the taxpayer may need to consider obtaining a clearance from HMRC, rather than to risk relying on guidance which could fail the test in *MFK*. If the guidance is clear and unambiguous, the taxpayer would then need to review the terms of the guidance to determine whether or not it falls within its terms. This process involves (inter alia) determining whether any qualifications to the guidance are relevant to the taxpayer – the third criterion in *MFK*. A residual risk here is that a generalised health warning serves as a relevant qualification, per *Hanover*, but the taxpayer may feel able to get comfortable about that on the basis of *Gaines-Cooper*.

Conclusions

Despite the negative tone of some of HMRC's public pronouncements on the issues, the case law in this area enables taxpayers to place a reasonable degree of reliance on statements by HMRC, provided that the detailed requirements set out in those cases are met.

In particular, when applying for clearances, the taxpayer needs to be as helpful and open as it can be with HMRC, taking pains to draw HMRC's attention to any possibly material fact, and (at least for more sophisticated taxpayers) the intended legal analysis and potential weak points in the analysis. The relevant person at HMRC needs to be contacted, and given enough time to engage properly with the issues. If these steps are taken, the taxpayer's position in terms of relying on the clearance given is likely to be relatively strong.

When it comes to relying on published HMRC guidance, the taxpayer first needs to make sure that the guidance is clear and unambiguous. If that is not the case, applying for a clearance may need to be considered. If that is the case, the taxpayer then needs to consider carefully whether it is within the detailed terms of the guidance, including consideration of any relevant qualifications. That the case law provides a reasonable basis for taxpayers to rely on guidance is crucial, given the increasing use of guidance by HMRC to supplement legislation. ■

 For related reading, visit www.taxjournal.com

What can you legitimately expect?
(Jolyon Maugham, 8.3.12)

***Gaines-Cooper*: the decision** (Bill Dodwell & Patricia Mock, 27.10.11)

***GSTS Pathology LLP*: When do legitimate expectations end?**
(Kevin Smith & Richard Doran, 12.7.13)